CANON ANNUAL REPORT 2016

Fiscal Year Ended December 31, 2016

Canon

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Cover Photo:
The photographer in the cover photo (in the background on the left) is using an ultra-high-sensitivity Canon ME20F-SH multi-purpose camera to shoot this scene (see the thumbnail photo on the bottom left). The aurora borealis cover was photographed with a Canon EOS 5D Mark III.

Multi-purpose cameras that feature Canon ultra-high-sensitivity sensors enable the capture of vivid colors even in direly lit scenes where it would be difficult to see with the naked eye.

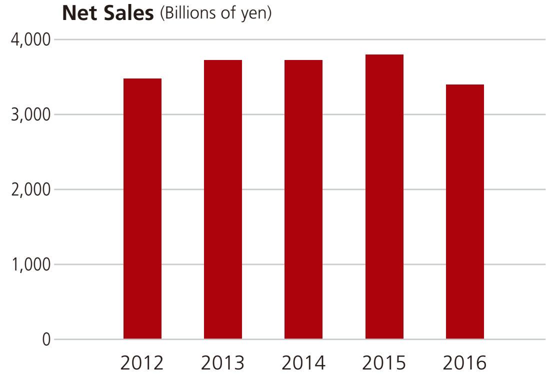
The still frame in the thumbnail photo was actually pulled from video shot with the ME20F-SH.

FINANCIAL HIGHLIGHTS

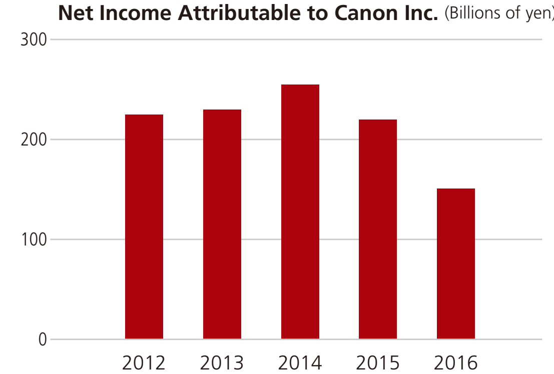
	Millions of yen (except per share amounts)			Thousands of U.S. dollars (except per share amounts)
	2016	2015	**Change (%)**	**2016**
Net sales	**¥3,401,487**	¥3,800,271	**-10.5**	**$29,323,164**
Operating profit	**228,866**	355,210	**-35.6**	**1,972,983**
Income before income taxes	**244,651**	347,438	**-29.6**	**2,109,060**
Net income attributable to Canon Inc.	**150,650**	220,209	**-31.6**	**1,298,707**
Net income attributable to Canon Inc. shareholders per share:				
—Basic	**¥ 137.95**	¥ 201.65	**-31.6**	**$ 1.19**
—Diluted	**137.95**	201.65	**-31.6**	**1.19**
Total assets	**¥5,138,529**	¥4,427,773	**+16.1**	**$44,297,664**
Canon Inc. shareholders' equity	**¥2,783,129**	¥2,966,415	**-6.2**	**$23,992,491**

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 JPY116=U.S.$1, the approximate exchange rate on the Tokyo Foreign Exchange Market as of December 30, 2016, solely for the convenience of the reader.

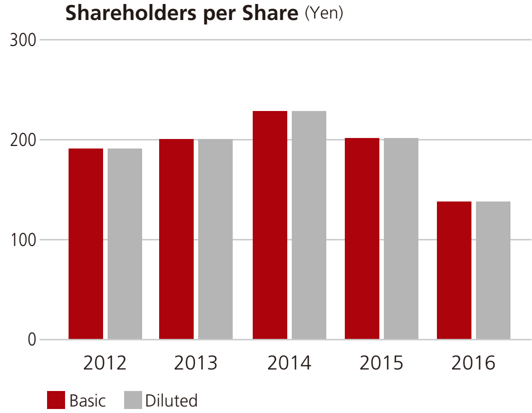
Net Sales (Billions of yen)



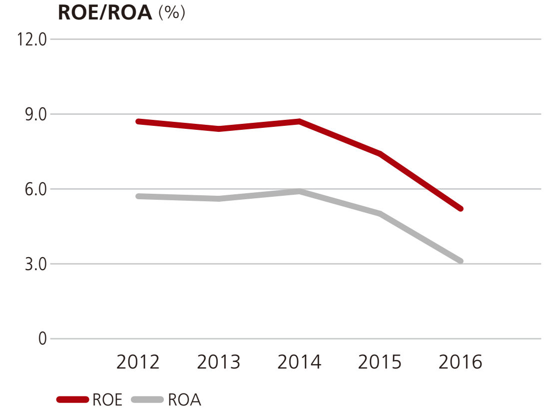
Net Income Attributable to Canon Inc. (Billions of yen)



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



ROE/ROA (%)



TO OUR SHAREHOLDERS

FUJIO MITARAI
Chairman & CEO
Canon Inc.

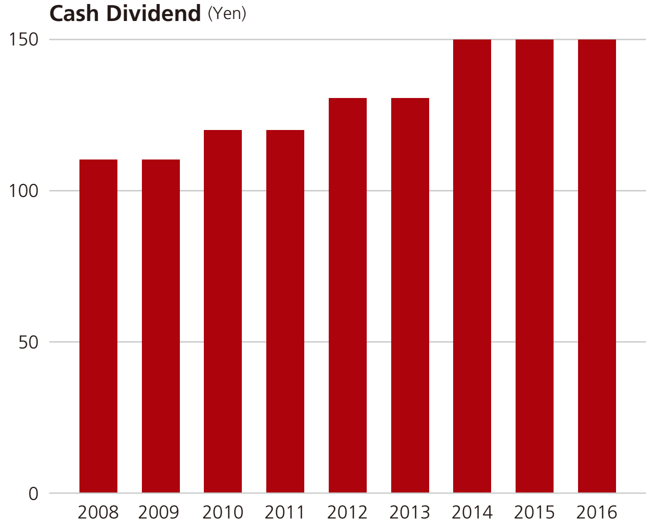
Canon will further promote a grand strategic transformation by accelerating reforms.

Performance in 2016

Looking back at the global economy in 2016, recovery in the United States and Europe slowed down, while growth in China continued to decelerate. As for the Japanese economy, the pickup in both corporate earnings and capital investment showed signs of stalling. With regard to currency exchange rates, the yen appreciated considerably throughout the year, and conditions for Canon's performance were extremely challenging.

Looking at each of our main products, sales were strong for color office multifunction devices and digital production printing systems, while sales of laser printers remained low due to such factors as sluggish economic conditions in emerging countries. New products for interchangeable lens digital cameras were well received in the market. As for digital compact cameras, sales volume declined due to difficulties in procuring components caused by the 2016 Kumamoto Earthquake, along with an ongoing contraction of the market. Meanwhile, sales of organic LED (OLED) panel manufacturing equipment grew significantly against a backdrop of increasing OLED use, primarily in smartphones.

Cash Dividend (Yen)



Consequently, along with the negative impact of yen appreciation, consolidated net sales for 2016 decreased 10.5% year on year to ¥3,401.5 billion, and the gross profit ratio was 49.2%. Despite a reduction in operating expenses of 8.5% year on year, which was partly due to Group-wide efforts to reduce spending, operating profit decreased by 35.6% to ¥228.9 billion, and net income attributable to Canon Inc. decreased by 31.6% to ¥150.7 billion. Seeking to actively provide a stable return to shareholders, we decided to distribute a full-year dividend of ¥150.00 per share, which is the same as the record-high dividend we paid in the previous year.

In 2016, we embarked on Phase V, our new five-year initiative within the Excellent Global Corporation Plan, which is guided by the basic policy of "Embracing the challenge of new growth through a grand strategic transformation." A significant event in the first year of Phase V was welcoming Toshiba Medical Systems Corporation (Toshiba Medical) into the Canon Group. Toshiba Medical has the broadest product portfolio in the diagnostic imaging equipment field and is the undisputed leader in Japan in sales of medical X-ray computed tomography (CT) systems. Furthermore, with the aim of achieving new growth, we have laid a foundation for our new businesses focused in the areas of commercial printing, network cameras, healthcare and industrial equipment, where future market expansion is expected.

Excellent Global Corporation Plan

Phase I 1996–2000	Phase II 2001–2005	Phase III 2006–2010	Phase IV 2011–2015	Phase V 2016–2020
To strengthen its financial structure, Canon transformed its mindset to a focus on total optimization and profitability. The company introduced various business innovations, including the selection and consolidation of business areas, and reform activities in such areas as production and development.	Aiming to become No. 1 in all major business areas, Canon focused on strengthening product competitiveness along with the changing times, stepping up efforts to digitize its products. The company also conducted structural reforms across all Canon Group companies around the world.	Canon moved ahead with such growth strategies as enhancing existing businesses and expanding into new areas while also thoroughly implementing supply chain management and IT reforms.	Responding to weakness in the global economy, Canon revised its management policy from a strategy targeting expansion of scale to a strategy aimed at further strengthening its financial structure. While actively pursuing M&A activities, the company restructured its business at a foundational level to introduce new growth engines for future expansion.	

From Phase I to Phase IV (1996–2015)

Canon launched the Excellent Global Corporation Plan in 1996, and has strengthened its management base through each of the plan's five-year initiatives, from Phase I to Phase IV.

During Phase I, we stressed thorough cash-flow management and significantly boosted productivity through the introduction of our cell production system, along with other measures. In Phase II, we stepped up efforts to digitalize our copying machines and camera offerings, while building the foundation for a robust financial structure. During Phase III, we actively carried out M&A activities, and welcomed Océ to the Group in 2010, clearing the way for a move into the high-growth-potential commercial printing market.

As the markets for our core businesses—such as cameras and office equipment—were maturing, during Phase IV, which began in 2011, we promoted diversification via the lateral expansion of our existing businesses—such as the Cinema EOS System and commercial photo printers—while also accelerating our M&A strategy. In this manner, we set a clear direction for shifting our focus for growth from B2C to B2B. We subsequently reinforced and expanded our rapidly growing network camera business by making Milestone Systems a subsidiary in 2014, followed by Axis in 2015. Additionally, Canon Nanotechnologies, formally Molecular Imprints, became a subsidiary in 2014, and we are accelerating the development of next-generation semiconductor manufacturing equipment that uses nanoimprint lithography, which will make it possible to achieve both miniaturization and cost reductions for semiconductor devices.

As a manufacturer, Canon strives unceasingly to achieve production reforms and thorough cost reductions. At the same time, we stay on top of opportunities to add excellent companies to the Group, in order to shift our focus towards changing growth markets, with the aim of unlocking new growth potential.

Finally, in the first year of Phase V, Toshiba Medical became a subsidiary. This completed our lineup of new businesses—namely commercial printing, network cameras, healthcare and industrial equipment—that we have been establishing in preparation for future growth. These businesses are now beginning to produce results.

Phase V (2016–2020)

Key Strategies

1. Establish a new production system to achieve a cost-to-sales ratio of 45%
2. Reinforce and expand new businesses while creating future businesses
3. Restructure the global sales network in accordance with market changes
4. Enhance R&D capabilities through open innovation
5. Complete the Three Regional Headquarters management system capturing world dynamism

2020 Management Targets

Net sales	¥5 trillion
*Cost-to-sales ratio	45% or less
Operating profit ratio	15% or more
Net income ratio	10% or more
Shareholders' equity ratio	70% or more

(Based on exchange rates: US$1 = ¥125 and €1 = ¥135)

*Cost-to-sales ratio refers to the cost of goods sold as a ratio of consolidated sales.

The year 2016 marked the start of Phase V, our latest five-year initiative within the Excellent Global Corporation Plan. As for the economic conditions on which Phase V is based, in 2016, the global economy experienced its lowest level of overall growth since the financial crisis precipitated by the Lehman shock. Growth is expected to remain only moderate in the coming fiscal year, even with the U.S. economy acting as a driving force. Meanwhile, we believe that two emerging trends will bring about significant changes to future industry structure, the economy and society.

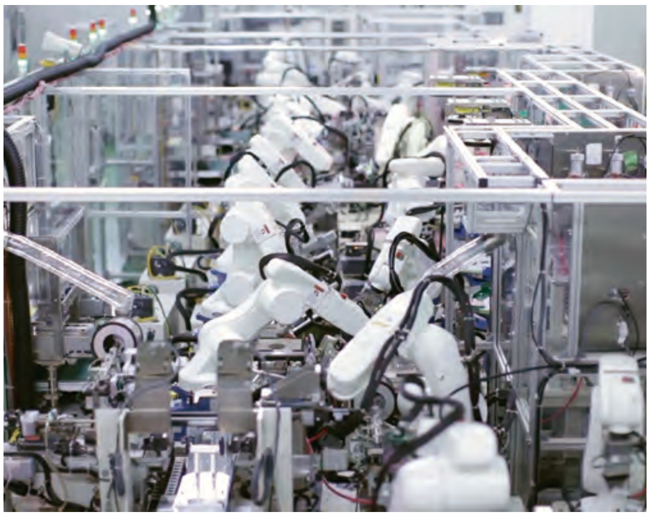
One of these trends is the Internet of Things (IoT), which creates new value through the interconnectedness of a diverse range of "things" via the Internet, from appliances and automobiles to factory equipment. Responding to this change means that, even as a manufacturer, we must stop thinking in terms of individual items and discard the notion that we will have no troubles with sales as long as we develop excellent products. Rather, we need to transform our business model to combine hardware, software and services, and consider the value offered by the system as a whole.

The other trend involves the rise of emerging economies. With advances in the digitalization and modularization of products, many companies in emerging countries are entering the market and further accelerating the product commoditization process, which is expected to result in even more intense competition.

Amid forecasts of such changes in the business environment, Canon launched Phase V, guided by the basic policy of "Embracing the challenge of new growth through a grand strategic transformation." During Phase V, we are seeking to further expand the reforms that we promoted in Phase IV, and aim to achieve net sales of ¥5 trillion, a cost-to-sales ratio of 45% or less, an operating profit ratio of 15% or more, a net income ratio of 10% or more, and a shareholders' equity ratio of 70% or more (based on exchange rates of US$1 = ¥125 and €1 = ¥135) in 2020, the final year of Phase V.

Concrete explanations regarding the progress of these strategies thus far, as well as our future course of action, are presented as follows.

Strategy 1 Establish a new production system to achieve a cost-to-sales ratio of 45%



We are enhancing productivity via automated toner cartridge production.

The most important activity that will allow our grand transformation to succeed is reinforcing existing businesses, and the most important target towards achieving this is a cost-to-sales ratio of 45%. We see two aspects to achieving this: developing and expanding the market shares of "Dantotsu Products" and thoroughly reducing manufacturing costs.

"Dantotsu Products" refer to breakthrough products that overturn conventional thinking. Through technological innovation, we will create products, services and solutions that not only offer superior price, functionality and performance, but that also cannot be imitated by other companies, thereby securing high profitability.

The Techno Wing at Oita Canon, a new R&D facility for automation equipment, was completed in 2016 as an initiative to reduce manufacturing costs. We will strengthen the robot assembly processes even further in the future, as we move toward complete automation. We will continue to produce our own key parts and components, and will proactively increase in-house production of such manufacturing equipment. We will also pursue productivity improvements by enhancing the functions of our mother plants in Japan while continuing production at optimal locations worldwide.

Strategy 2 Reinforce and expand new businesses while creating future businesses

Canon network cameras are keeping children safe (Singapore International School, Hong Kong).

As a measure to shift our business focus to fields where greater growth is anticipated, Canon has accelerated the lateral expansion of existing businesses and developed a number of derivative businesses, including the Cinema EOS System, professional-use video and broadcast equipment for the age of 4K and 8K and the DreamLabo. We will continue to reinforce and expand our four promising new businesses—commercial printing, network cameras, healthcare and industrial equipment.

In commercial printing, we are stepping up the development of products that combine the technologies of Canon and Océ, with the aim of full-scale entry into the rapidly growing markets of package printing (e.g., for product packaging) and high-image-quality color commercial printing for catalogues and other items.

In network cameras, Canon welcomed Milestone Systems to the Group in 2014, followed by Axis in 2015, and in 2016, we released the first product jointly developed by Canon and Axis. Going forward, we will work to enhance image quality through 4K and 8K video, and strengthen camera intelligence by leveraging Canon's image-processing and image-analysis technologies to

CEO Fujio Mitarai (right) and COO Masaya Maeda (left) visit Toshiba Medical Systems Corporation.

develop market-specific solutions for such areas as urban surveillance, airports, and stadiums.

In healthcare, we will provide innovative products and services worldwide, by combining the product lineup and development capabilities of Toshiba Medical, which joined the Group in 2016, with Canon's medical and production technologies. Furthermore, we will also expand into new fields, including healthcare IT and such biomedical fields as genetic diagnostics.

With regard to industrial equipment, strong growth is expected to continue for Canon Tokki's organic LED (OLED) panel manufacturing equipment, thanks to a tailwind from advances in IT equipment. Next-generation semiconductor manufacturing equipment that uses nanoimprint lithography is also expected to contribute to our business performance, as our mass production system is almost in order. In addition, we will work toward the growth of new businesses, mainly in the B2B domain, including machine vision, industrial cameras, CMOS sensors and Canon Electronics' aerospace business.

Strategy 3 Restructure the global sales network in accordance with market changes

Our e-commerce site where customers can purchase products online wherever they are at all hours has gained traction.

Canon is currently executing a major shift to B2B and B2G, which targets governments and agencies. This requires the ability to devise and implement solutions in response to customer demands. To that end, we are strengthening our overseas network functions, including connections with local governments, and enhancing coordination between companies. We are concentrating our efforts to establish a structure that is capable of detailed responses to customer requests at any time—including after-sales maintenance and service—by training highly-skilled sales engineers who are fully equipped with technical knowledge of both hardware and software.

Additionally, purchasing behavior is diversifying with the spread of the Internet and smartphones, and e-commerce sales are expanding rapidly, especially in China and the United States. In order to respond to these changes, we are actively pursuing omni-channel marketing, which integrates brick-and-mortar and online sales routes.

Strategy 4
Enhance R&D capabilities through open innovation

Strategy 5
Complete the Three Regional Headquarters management system capturing world dynamism

Medical research collaboration with a Harvard-affiliated medical institution (Healthcare Optics Research Lab., Canon U.S.A., United States).

Canon Americas pursues genotyping systems R&D with the aim of commercialization (Canon BioMedical, United States).

Research and development has always been a priority for Canon, resulting in a stream of excellent new products, such as digital cameras, that have formed the foundation of our growth. Recently, markets have undergone structural changes in the industries in which Canon operates, including cameras and office equipment. In this context, we will promote the selection and concentration of future research themes, and carry out well-modulated R&D investment, bearing in mind the urgency and gravity of the situation. At the same time, as innovation continues to accelerate in a highly uncertain environment, we will actively promote R&D by making use of external expertise, when pursuing research themes that would require enormous amounts of time and expense if developed independently.

Furthermore, we will actively implement the training and development of software engineers, in light of the growing demand for personnel in this area due to the advance of IoT and AI technologies.

In Phase IV, we made significant progress toward realizing our Three Regional Headquarters management system. In Phase V, we will further accelerate this diversification that leverages the unique features of each region, with the aim of completing a system capable of capturing the world dynamism of businesses in Japan, the United States and Europe.

To give an example of a specific initiative, we are carrying out R&D for genotyping solutions at Canon BioMedical, which we established in the United States in 2015. Canon BioMedical launched the research-use-only Novallele genotyping assays, which are being used in cancer and hereditary disease research, and will continue to make further contributions to medical progress in the future. Additionally, the Healthcare Optics Research Laboratory is steadily advancing research on ultra-miniature endoscopes and medical robotics. In Europe, we are also reinforcing printing solutions research centered on Océ.

Key Challenges for 2017

In 2017, the second year of our grand strategic transformation, we will take on the challenge of expanding our four new businesses of commercial printing, network cameras, healthcare and industrial equipment and produce results. So our theme for 2017 is "Further promoting a grand strategic transformation by accelerating reforms," as we work on the following five key challenges.

The first of these is to thoroughly bolster our existing businesses with the aim of achieving a cost-to-sales ratio of 45% by seeking even greater cost reductions and developing "Dantotsu Products" that realize high profitability.

The second is to strengthen and grow our new businesses and create future businesses. We will accelerate growth by focusing on commercial printing, network cameras, healthcare and industrial equipment.

Our third challenge is to restructure our global sales network. We will focus our efforts on establishing a structure to expand sales in new B2B businesses through such measures as training highly-skilled sales engineers. We will also formulate global e-commerce strategies to make the most of the potential for development and expansion of e-commerce.

The fourth is to strengthen R&D through open innovation. In addition to enhancing R&D efficiency for our existing businesses and prioritizing investment in promising future fields, we will carry out strategic R&D by actively pursuing cooperation with external partners.

The fifth is to cultivate global human resources and reinvigorate the Canon spirit. To this end, we will work to re-instill Canon's enterprising spirit and the *San-ji* (Three Selfs)* Spirit, while promoting the development of human resources that can exert leadership in a global setting.

* *San-ji*, or the "Three Selfs," refers to self-motivation (taking initiative and being proactive in all things), self-management (conducting oneself with responsibility and accountability) and self-awareness (understanding one's situation and role in all situations).

In Conclusion

2016 was indeed a year befitting the inaugural year of this five-year initiative that aims to achieve a grand transformation of our business. While this grand transformation is not something that can be accomplished overnight, all of Canon's divisions will make steady progress toward this goal.

Moving forward, 2017 is a major milestone for Canon, our 80th anniversary. While a moderate recovery is expected in the global economy, uncertainty is increasing and the economic situation does not allow for optimism. Nevertheless, we will accelerate our growth by steadily executing the initiatives laid out in Phase V to make this a fitting year for our 80th anniversary.

We look forward to your continued understanding and support.

Fujio Mitarai
Chairman & CEO
Canon Inc.

GROWTH STRATEGY

A. Toshiba Medical Systems Corporation's computed tomography is highly regarded around the world for their high image quality and advanced technologies and have high market shares. **B.** The Customer Experience Center TOKYO (Canon Inc. Shimomaruko Headquarters, Japan), the first one built in Asia, is a facility for demo training and data verification using Canon products, in addition to displaying our large commercial printing equipment. **C.** Canon network cameras installed at a soccer practice field at the Jockey Club Kitchee Centre in Hong Kong.

Accelerating growth in commercial printing, network cameras, health care and industrial equipment as key drivers of Canon's next-generation business.

"Reinforcement and expansion of new businesses while creating future businesses" is one of the strategies set out by Canon in Phase V of our Excellent Global Corporation Plan. Here we explain our growth strategies in the following four new businesses: commercial printing, network cameras, the health care business, and the industrial equipment business.

Commercial Printing

Canon welcomed Océ to the Group in 2010. We became the world's top printing company both in name and substance with an extensive product lineup ranging from compact printers to large commercial printing equipment. In recent years, the borders that had kept the printing market compartmentalized according to technologies and products have been disappearing. In response to these changes in the business environment, we decided to make a full-fledged entry into the fields of commercial and industrial printing where high growth is anticipated. Particularly promising are the markets for package printing, such as on folding carton, corrugated and labels as well as color printing with high image quality for catalogs and other items. Our plan is to nurture commercial printing as a major pillar of the next-generation printing business through efforts including building an organization that will support our partnership with Océ, in order to establish a solid position in these growth markets.

Network Cameras

Axis, with its network camera development capabilities and unrivalled sales network, Milestone, which holds the world's top share in video management software, and Canon, with its precision optics and sensor technologies for cameras, are each harnessing their strengths in full. In 2016, Canon and Axis released an interchangeable-lens network camera as our first jointly developed product. Furthermore, with the aim of becoming the No. 1 provider in the market for network image solutions, we are focusing development initiatives on high-performance network cameras and actively developing video analysis software.

Health Care

Major progress was seen in the health care field in 2016, when Toshiba Medical, a leader in the medical equipment industry, became a Canon subsidiary. Toshiba Medical has a broad product portfolio that spans diagnostic X-ray systems, computed tomography (CT), magnetic resonance imaging, diagnostic ultrasound systems and diagnostic nuclear medicine systems. In CT systems, Toshiba Medical is the dominant market share leader in Japan and has been steadily increasing its global market share. It also offers cutting-edge medical imaging solutions and in-vitro diagnostics. By maximizing the combined management resources of both companies, Canon aims to solidify its business foundation for health care that can contribute to the world.

Industrial Equipment

Sales of products such as semiconductor lithography equipment and panel manufacturing equipment are growing, on the tailwind of growth of mobile devices such as smartphones and increase of demand for IoT devices. In particular, organic LED (OLED) panel manufacturing equipment made by Canon Tokki is expected to continue showing strong growth. Furthermore, with regard to semiconductor manufacturing equipment that uses nanoimprint lithography to achieve both miniaturization and cost reductions for next-generation semiconductor devices, Molecular Imprints (now named Canon Nanotechnologies), which became a subsidiary in 2014, is pushing ahead with technological development and is expected to contribute significantly to results.

AT A GLANCE

Business Units	Main Products

OFFICE BUSINESS UNIT


Office Multifunction Devices (MFDs)


Digital Production Printing Systems


Laser Multifunction Printers (MFPs)


High Speed Continuous Feed Printers

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

IMAGING SYSTEM BUSINESS UNIT


Interchangeable Lens Digital Cameras


Digital Cinema Cameras


Inkjet Printers


Multimedia Projectors

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

INDUSTRY AND OTHERS BUSINESS UNIT


Semiconductor Lithography Equipment


Digital Radiography Systems

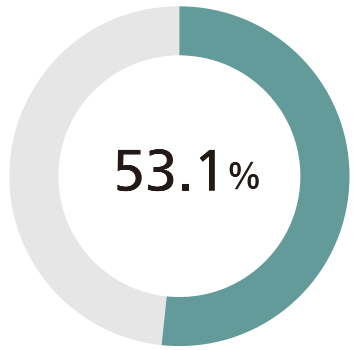

FPD (Flat panel display) Lithography Equipment

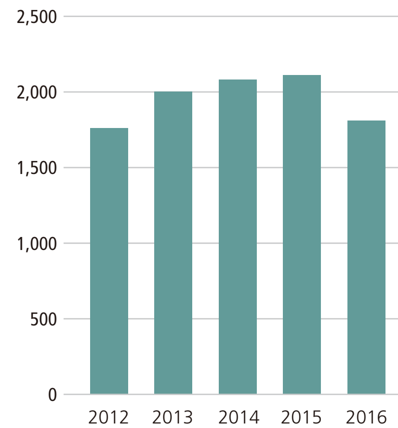

Network Cameras

- Semiconductor Lithography Equipment
- FPD (Flat panel display) Lithography Equipment
- Digital Radiography Systems
- Diagnostic X-ray Systems
- Computed Tomography
- Magnetic Resonance Imaging
- Diagnostic Ultrasound Systems
- Clinical Chemistry Analyzers
- Ophthalmic Equipment
- Vacuum Thin-film Deposition Equipment
- Organic LED (OLED) Panel Manufacturing Equipment
- Die Bonders
- Micromotors
- Network Cameras
- Handy Terminals
- Document Scanners

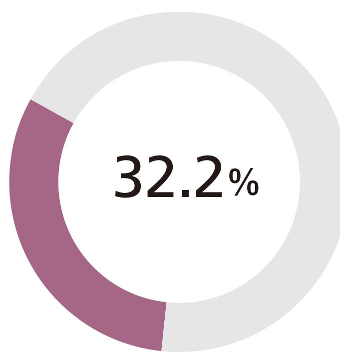
Outline | **Composition of Sales** (%) | **Net Sales** (Billions of yen)

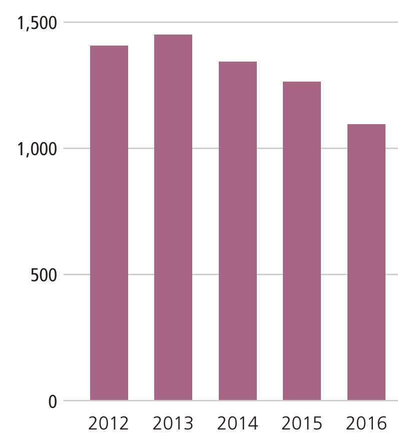
In this segment, Canon offers an extensive range of products with high image quality, high resolution, and high speed, ranging from compact printers to large-scale commercial printing equipment. Leveraging these products, Canon works in close collaboration with various Group companies and alliance partners to deliver optimal solutions tailored to match the customer's business operations. These include various document solutions, such as office document management and the output of records. At the same time, the Company provides top quality services and support in a swift and reliable manner.



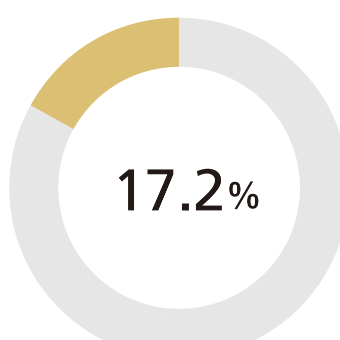


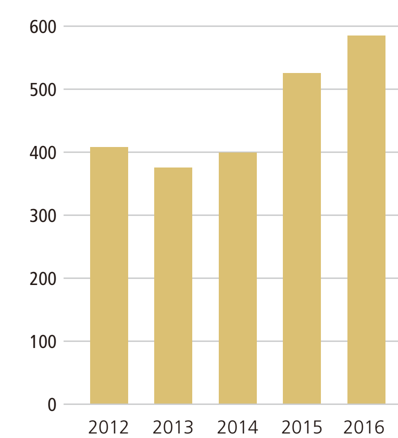
Canon's offerings in this segment include digital cameras, digital camcorders, digital cinema cameras, interchangeable lenses, multimedia projectors, and inkjet printers. Canon's digital cameras, digital camcorders and digital cinema cameras, designed to deliver unparalleled image quality, have earned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





Applying optical technologies and image-processing technologies amassed over many years, Canon provides high-value-added products to a wide range of industries. The Company is already prominent globally as a manufacturer of semiconductor lithography equipment and FPD (flat panel display) lithography equipment. Moreover, working closely with Group companies, Canon is focusing on healthcare fields harnessing such products as computed tomography and network cameras.





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

Widely used in commercial printing and central reprographic departments, Canon digital production printing systems are capable of handling diverse print content in a variety of paper types and sizes, and of providing quick turnaround of small-lot print jobs.

2016 Review

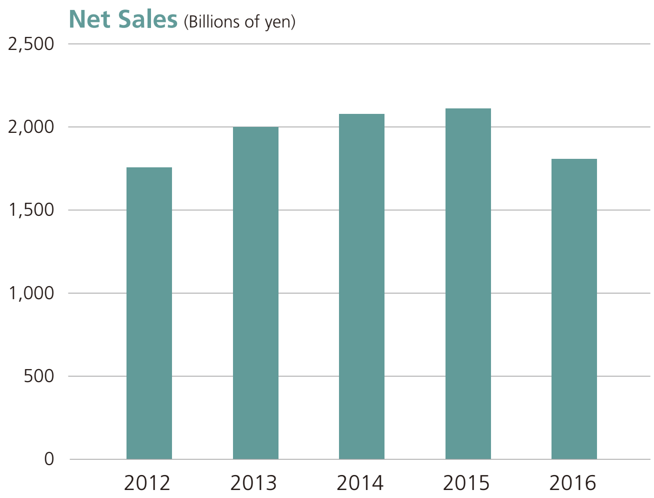
Canon worked on increasing the profitability of office multifunction devices (MFDs) amid intensifying competition by focusing on winning customers who can be expected to produce high print volume. Sales of monochrome models remained weak, particularly in Japan, as demand continued to shift toward color models. On the other hand, sales of the color models were relatively strong. Notably, the new imageRUNNER ADVANCE C5500 series of A3 medium- to high-speed color machines featuring significantly improved operability, productivity and image quality was well received. The imageRUNNER ADVANCE C3300 series launched in the previous year also performed favorably, mainly in China.

Digital production printing systems saw a growth in sales of the imageRUNNER ADVANCE 8500 series, despite the shrinking monochrome market, and the imagePRESS C10000VP series of color models performed strongly.

In addition, laser multifunction printers (MFPs) and laser printers saw drops in both sales volume and revenue, due to a contraction of emerging markets mainly in Central and South America, which led to a sharp decline especially in monochrome models.

The Océ VarioPrint i300 sheet-fed inkjet press, a high-speed commercial printer, posted healthy sales.

These factors, coupled with the negative effect of unfavorable currency exchange rates, resulted in consolidated net



Digital Production Printing System
imagePRESS C10000VP

Office Multifunction Device
imageRUNNER ADVANCE C5560F

Digital Production Printing System Océ VarioPrint i300

sales for the business unit of ¥1,807.8 billion, a year-on-year decline of 14.4%.

2017 Initiatives

Demand for color models in the office MFD market is expected to make up for lower demand for monochrome models and remain in line with that of the previous year overall. In this context, Canon will pursue even greater sales expansion by further enhancing its lineup of color models that realize high image quality with vivid color and improved expression, while also offering lower maintenance costs.

The market for laser printers is also expected to remain at the same level as that of the previous year. Even so, a growing number of people are using color models and MFPs as shared printers, owing to the establishment of network environments, and the number of users is predicted to continue rising. On the other hand, we will rigorously prioritize the profitability of low-end models, rather than only pursuing sales volume.

In the commercial printing market, steady demand for small-lot printing and central reprographic departments is expected to continue. Canon will further increase sales of light-production models and high-speed printers.

We are also improving Océ's high-speed sheet-fed inkjet press to handle various types of paper, aiming for substantial sales growth in this area.

Delivering exceptional image quality and superior mobility, the Cinema EOS System is a prominent presence in the motion picture production industry. Through even higher resolution and more expressive color gamut, Canon is developing 8K cameras and lenses that can create images so vivid they seem to come alive on screen.

2016 Review

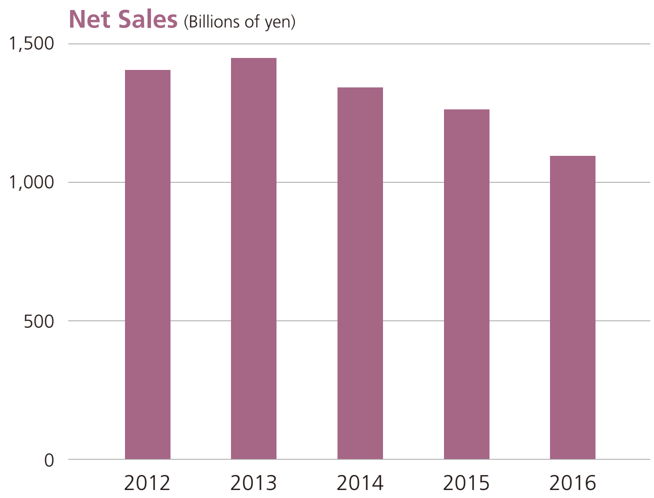
Sales volume for interchangeable lens digital cameras grew after the rollout of new products, including the flagship SLR model EOS-1D X Mark II, updated for the first time in four years; the EOS 5D Mark IV full-size camera for advanced amateurs; and the mirrorless model, the EOS M5, which features a built-in EVF (electronic viewfinder). Strong sales of these models contributed to the maintenance of Canon's top share of the global market.

Sales volume of digital compact cameras declined due to difficulties in procuring components caused by the 2016 Kumamoto Earthquake, along with an ongoing contraction of the market.

The Cinema EOS System, which is targeted at the motion picture production industry, bolstered its capacity to handle a wide range of professional needs with the launch of the EOS C700, its top-of-the-line digital cinema camera.

As for broadcasting equipment, demand was strong for models for sports coverage and for HD lenses in China and other countries. Inquiries picked up in Europe and Asia for zoom lenses for 4K broadcast cameras employing 2/3-inch sensors, and the COMPACT-SERVO lens for large-sensor cameras received favorable reviews worldwide.

As for inkjet printers, sales in emerging countries, mainly in Asia, were strong for refillable ink tank models for high volume printing. Newly designed models for home use also per-



Interchangeable Lens Digital Camera
EOS-1DX Mark II

Inkjet Printer
imagePROGRAF PRO-4000

Digital Cinema Camera EOS C700

formed well, mainly in Japan. However, overall sales volume declined due to a shrinking market for consumer products.

In large-format inkjet printers, the new imagePROGRAF PRO series models, which target the professional photo and graphic art market, saw robust sales.

As a result of these factors, along with the negative effect of unfavorable currency exchange rates, consolidated sales for the business unit decreased 13.3% year on year to ¥1,095.3 billion.

2017 Initiatives

Although demand for interchangeable lens digital cameras is waning, mainly in developed countries, the situation is improving gradually. In these circumstances, Canon seeks to capture a new user segment, using mirrorless cameras as a driver. We will also stimulate demand by further enhancing AF and video functions aimed at advanced amateurs.

Meanwhile, the digital compact camera market is expected to take a while longer to bottom out. Canon will continue to focus on cost reductions and sales of high added-value models with a view to improving profitability.

As for inkjet printers, we will concentrate on increasing sales in emerging countries of refillable ink tank models for high volume printing. As for the B2B field, we will conduct sales promotions for the MAXIFY series business models, and the imagePROGRAF PRO series, which target the professional photo and graphic art market.

Canon has accelerated development of next-generation semiconductor equipment using nanoimprint lithography that delivers high-resolution processes at a lower cost. With the aim of a commercial launch soon, Canon seeks to solidify its position in the field of semiconductor lithography equipment.

2016 Review

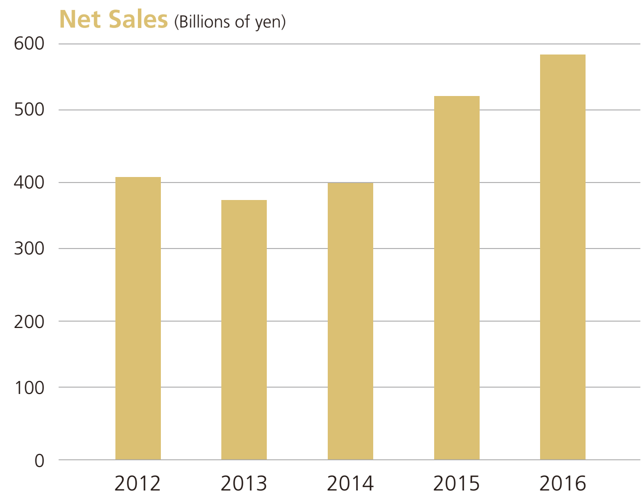
In semiconductor lithography equipment, Canon focused on sales of products such as the FPA-5550iZ i-line steppers, whose stable quality and operating rate have made them best sellers for a long period, and the FPA-6300ES6a KrF scanners that boast the industry's highest overlay accuracy and high productivity. However, unit sales decreased from the previous year amid the postponement of some capital investments by customers.

Meanwhile, in FPD (Flat panel display) Lithography Equipment, unit sales of lithography systems employed in the fabrication of small-to-mid sized panels, such as the MPAsp-E810 series, increased in response to growing demand for high-definition organic LED (OLED) displays used in mobile devices.

Also, sales of OLED panel manufacturing equipment sold by Canon Tokki increased significantly due to brisk capital investment by panel manufacturers for smartphones.

Sales of network cameras also grew, owing to our efforts to boost sales and broaden the product lineup to reflect increasing needs for enhancing marketing and efficiency at production sites, in addition to disaster-monitoring and crime-prevention functions. Moreover, we launched two software products leveraging original Canon technology in video content analysis.

With respect to medical equipment, sales of Canon's mainstay digital radiography systems expanded for manufacturers of X-ray system equipment in China. However, global unit sales remained flat year on year due to intensifying competition and other factors.



FPD (Flat panel display) Lithography Equipment MPAsp-E810

Network Cameras VB-M50B

Organic LED (OLED) Panel Manufacturing Equipment

As a result of these factors, consolidated net sales for the business unit increased 11.4% year on year to ¥584.7 billion.

2017 Initiatives

Unit sales of semiconductor lithography equipment are expected to remain at the same level as the previous year, underpinned by IoT demand. Meanwhile, Canon plans to increase unit sales of FPD lithography equipment to at least double the level of the previous year, as the stable quality of high-definition equipment for small-to-mid sized panels has become recognized in the market.

Canon, responding to strong demand, is also establishing a structure to expand production of Canon Tokki's OLED panel production equipment, which will sequentially allow it to significantly grow sales.

In the area of network cameras, in addition to the launch of an interchangeable-lens network camera suited for high-resolution surveillance that was jointly developed by Canon and Axis, Canon aims to reinforce its lineup by working to enhance its software offering. Canon will also focus efforts on camera intelligence, leveraging Canon's image-processing and image-analysis technologies to develop market-specific solutions.

In medical equipment, Toshiba Medical became a subsidiary of Canon at the end of last year. Based on a new growth strategy that centers on Toshiba Medical, Canon aims to exert the Group's comprehensive strengths to provide innovative products and high-quality services.

CORPORATE GOVERNANCE

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

Directors and Audit & Supervisory Board Members (as of April 1, 2017)

Representative Director
Chairman & CEO

Fujio Mitarai

Representative Director
President & COO

Masaya Maeda

Representative Director
Executive Vice President & CFO

Toshizo Tanaka
Group Executive of Human Resources Management & Organization HQ
Group Executive of Facilities Management HQ

Representative Director
Executive Vice President
In charge of Office Business

Toshio Homma
Chief Executive of Office Imaging Products Operations

Representative Director
Executive Vice President & CTO

Shigeyuki Matsumoto
Group Executive of R&D HQ

Directors

Kunitaro Saida *(Outside)*
Attorney

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

Audit & Supervisory Board Members

Makoto Araki

Kazuto Ono

Tadashi Ohe *(Outside)*

Hiroshi Yoshida *(Outside)*

Kuniyoshi Kitamura *(Outside)*

Note: Although this annual report is for FY2016, the above list of Directors and Audit & Supervisory Board members is as of April 1, 2017.

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

Fundamental Policy Concerning Corporate Governance

In order to establish a sound corporate governance structure and continuously raise corporate value, Canon believes that it is essential to improve management transparency and strengthen management supervising functions. At the same time, a sense of ethics and mission held by each executive and employee of Canon is very important in order to achieve continuous corporate growth and development.

Basic Guidelines on Corporate Governance

The Company is globally expanding its businesses in various business fields, including office equipment, consumer products, and industrial equipment, and aims to aggressively expand new business fields in the future. In order to make prompt decisions in each business field, and make important decisions for the entire Canon Group or matters that straddle several business fields from a company-wide perspective and at the same time secure appropriate decision making and execution of operation, the Company judges the corporate governance structure below to be effective.

Board of Directors

While the focus of the organizational structure of the Board of Directors is on Representative Directors that oversee company-wide business strategies or execution such as the CEO, COO, CFO, CTO, and Representative Directors or Executive Directors that oversee multiple business fields or headquarters functions, in order to secure sound management, two or more Independent Outside Directors are appointed. The Board of Directors, in accordance with laws and regulations, makes important decisions and supervises the execution of duties by officers.

Except for the above, the CEO and other Representative Directors are active in decision making and execution, and under the command and supervision of the Representative Directors, Executive Officers that are elected through resolution of the Board of Directors make decisions and execute operations of each business field or function.

Currently, the Board of Directors consists of seven members, five Representative Directors from inside Canon and two Outside Directors that qualify as Independent Directors*. As of April 1, 2017, there will be 38 Executive Officers, including two females and two non-Japanese.

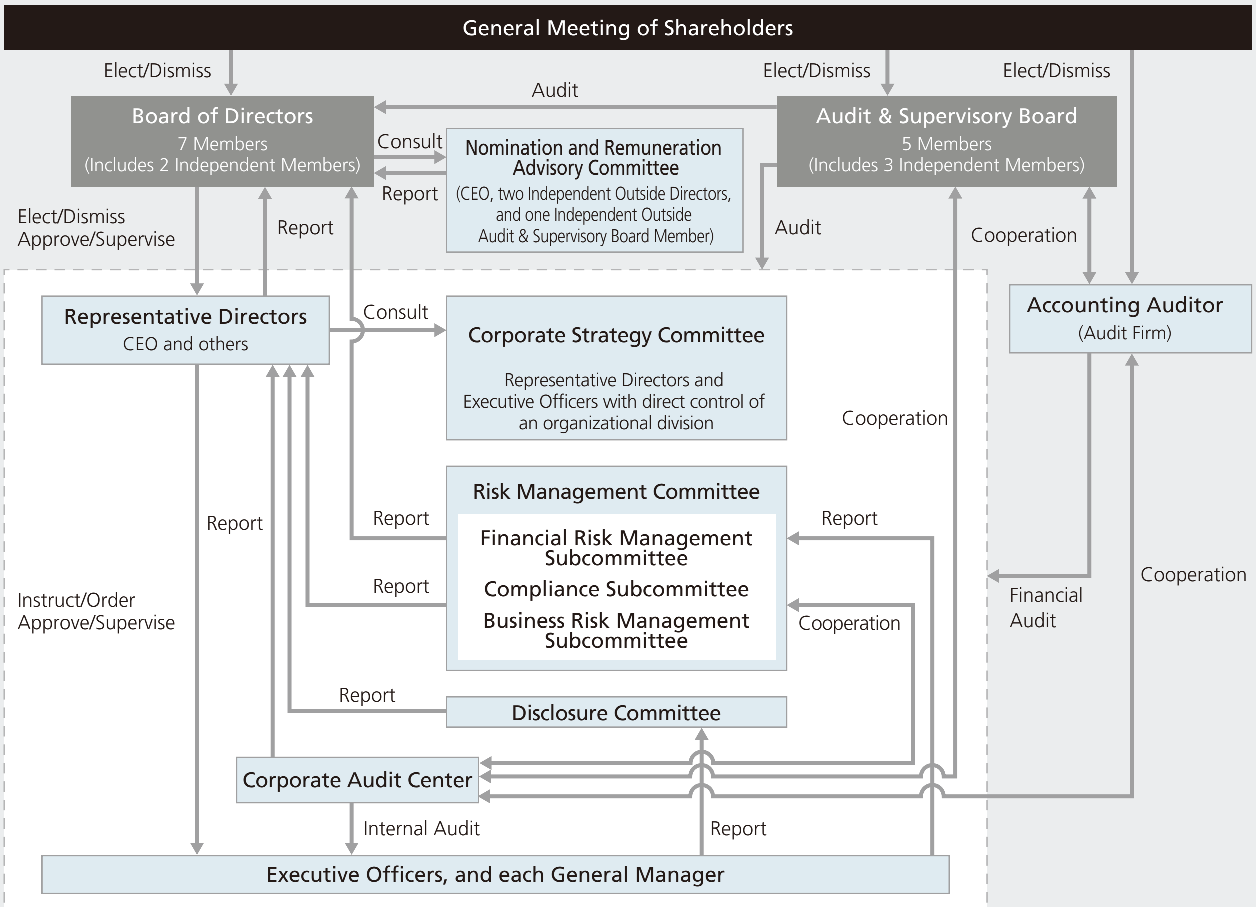
*Independent directors: Stock exchanges in Japan require listed companies to appoint outside directors and/or outside Audit & Supervisory Board members and to report their name. Outside directors and Audit & Supervisory Board members should have no possible conflict of interests with regular shareholders.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

Audit & Supervisory Board

As a body which is in charge of the audit of operations, under the principles of autonomy, which is independent from the Board of Directors, the Company has full-time Audit & Supervisory Board Members that are familiar with the Company's businesses or its management structure, and Independent Outside Audit & Supervisory Board Members that have extensive knowledge in specialized areas such as law, finance and accounting. The Audit & Supervisory Board, which is composed of these individuals, cooperates with the Company's accounting auditors and internal audit division, oversees the status of duty execution of operations and corporate assets to secure the soundness of management.

Currently, the Audit & Supervisory Board consists of five individuals, three of which are Independent Outside Audit & Supervisory Board Members. In accordance with auditing policies and plans decided at Audit & Supervisory Board meetings, the Audit & Supervisory Board Members attend

Governance Structure (as of March 30, 2017)



Board of Directors' meetings, Corporate Strategy Committee meetings, etc., receive reports from directors and employees, review documents related to important decisions, and conducting audits by investigating etc. the situation of businesses and property of the Company and its subsidiaries. In this way, the Audit & Supervisory Board plays a role in conducting strict audits of directors' execution of duty, including the status of development of the internal control system.

Procedures in the Nomination of Directors etc.

The Company established the "Nomination and Remuneration Advisory Committee," a non-statutory committee, which consists of the CEO, two Independent Outside Directors, and one Independent Outside Audit & Supervisory Board Member. At the time Director and Audit & Supervisory Board Member candidates are nominated and Executive Officers are selected (includes the selection of the successor of chief executive officer), the CEO recommends candidates thereof from among individuals that have been recognized as having met the prescribed requirements, and the Committee checks the fairness and validity of such recommendation prior to submission to and deliberation by the Board of Directors. Additionally, as for the Audit & Supervisory Board Member candidate, prior to deliberation of the Board of Directors, consent of the Audit & Supervisory Board shall be acquired.

Corporate Strategy Committee, Risk Management Committee, and Disclosure Committee

The Company established the Corporate Strategy Committee, consisting of Representative Directors and some Executive Officers. Among items to be decided by the CEO, the Committee undertakes prior deliberations on important matters pertaining to Canon Group strategies. Outside Directors and Audit & Supervisory Board members attend Corporate Strategy Committee meetings and are able to express their own opinions.

Based on a resolution passed by the Board of Directors, Canon set up the Risk Management Committee, which formulates policy and action proposals regarding improvement of the Canon Group risk management system. The Risk Management Committee consists of three entities: the Financial Risk Subcommittee, which is tasked with improving systems to ensure reliability of financial reporting; the Compliance Sub-committee, which is tasked with promoting corporate ethics and improving legal compliance systems; and the Business Risk Management Sub-committee, which is charged with improving systems to management overall business risks, including risks related to product quality and information leak. The Risk Management Committee verifies the risk management system and reports the status to the CEO and the Board of Directors. In addition, the Disclosure Committee was established to undertake deliberations pertaining to information disclosure, including content and timing, to ensure important corporate information will be disclosed in a timely and accurate manner.

Internal Audit Division

The Corporate Audit Center, the Company's internal auditing arm, as an independent and specialized organization and in accordance with internal audit rules, conducts audits of particular themes and evaluations and provides guidance on such matters as compliance with laws and the internal control system. Furthermore, audits such as quality, the environment, and information security, are conducted by the Corporate Audit Center in cooperation with each division in charge. Additionally, based on top management policy, for all work processes, audits must be conducted from a specialized view point and there are plans to increase the number of members from the current 70 to strengthen auditing functions.

Accounting Auditor

The Company has an auditing service contract with Ernst & Young ShinNihon LLC to audit its financial statements.

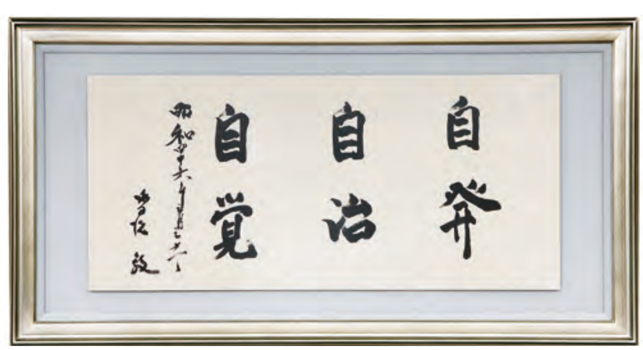
The names and other details of the certified public accountants that carried out accounting audit work for the Company are listed below.

Certified Public Accountant		Accounting Firm
Designated Partner, Engagement Partner	Yoshihiko Nakatani	Ernst & Young ShinNihon LLC
	Ryo Kayama	
	Kiyoto Tanaka	

Notes: 1. Since all partners have fewer than seven years of consecutive audits, the number of years of consecutive audits has been omitted.
2. The above audit firm reinforces self-imposed regulations, employing more stringent rotation rules than those of various regulations stipulated by law etc., regarding audit engagements with respect to listed companies.

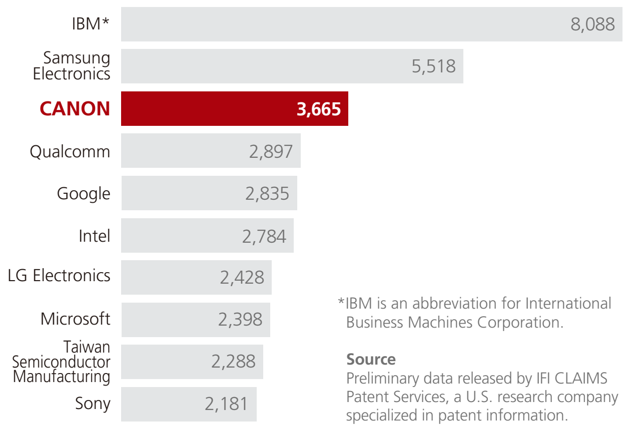
Auditing assistants that carried out audit work for the Company: (Certified Public Accountants: 27; Others*: 53)

*Note: Includes individuals that have passed the certified public accountant exam and persons in charge of auditing systems.



San-ji, or the Three Selfs, are: self-motivation (taking the initiative and being proactive in all things), self-management (conducting oneself with responsibility and accountability), and self-awareness (understanding one's situation and role in all situations). (calligraphy by Canon's first president, Takeshi Mitarai)

2016 Top Ten U.S. Patent Holders by Company



*IBM is an abbreviation for International Business Machines Corporation.

Source
Preliminary data released by IFI CLAIMS Patent Services, a U.S. research company specialized in patent information.

A. Canon continues clinical research at the Kyoto University Hospital to apply photoacoustic tomography to breast cancer screening and diagnosis.
B. Canon's ultra-high-resolution CMOS sensor captures images where the lettering on an aircraft fuselage about 18 kilometers away is legible.

Canon is engaged in efforts to discover new technologies that will help create future businesses.

Strengthening Our Global R&D Structure

Canon is pursuing globalized diversification of its operations in the field of R&D. The Company has established the foundation of the Three Regional Headquarters management system that leads to new businesses emerging from Japan, the United States, and Europe. We are leveraging the unique characteristics and capabilities of each region in activities that range from basic research to applied research.

For example, in the United States, Canon BioMedical is making steady progress in genotyping systems, while Healthcare Optics Research Laboratory is steadily advancing research on ultra-miniature endoscopes and medical robotics. In Europe, we are reinforcing R&D in business fields mainly in printing solutions centered on Océ, as well as making further use of existing R&D centers to advance R&D in new fields.

R&D Expenses and Patents

Canon is bolstering R&D activities to enable the ongoing development of innovative products and services. In the year under review, R&D expenses amounted to ¥302.4 billion, down 8.0%, or ¥26.1 billion, from the previous year. The ratio of R&D expenses to net sales was 8.9%. This focus on R&D activities has cemented Canon's high status in the field of intellectual property. In 2016, Canon was granted 3,665 patents in the United States, ranking it third in the world and the top ranked Japanese company for a twelfth consecutive year.

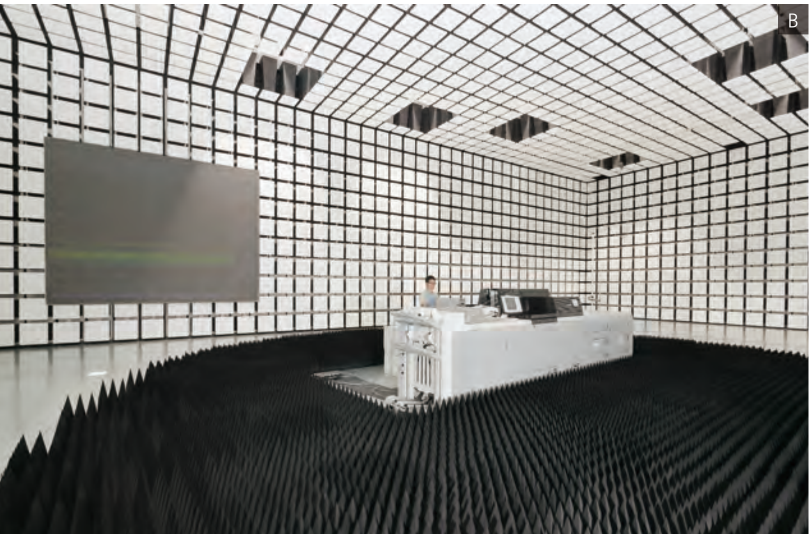
Initiatives to Establish New Businesses

Canon has a long-term perspective as it concentrates its efforts on discovering new technologies for the future. At the same time, the Company is continually bolstering R&D activities centered on key parts and key devices. With regard to CMOS sensors employed in interchangeable lens digital cameras and other devices, we are conducting in-house development and production of ultra-high-resolution sensors that make it possible to capture images of the lettering printed on the body of an aircraft roughly 18 kilometers away and ultra-high-sensitivity sensors capable of capturing vivid images in color even with minimal subject illumination, conditions under which subjects would be difficult to discern with the naked eye. We will explore applications in such fields as astronomical and nature observation, medical research, aviation, and surveillance and security.

In the medical field, Canon participates in the Impulsing Paradigm Change through Disruptive Technologies (ImPACT) Program organized by the Cabinet Office of Japan. We are working on research in photoacoustic tomography that enables 3-D imaging of blood vessels using laser illumination and ultrasonic sensors.

Moreover, Canon is combining its material appearance image-processing technology with Océ's elevated printing technology of UV-curable printers. The aim is to use a printer to faithfully reproduce material appearance characteristics of the original object, such as glossiness, surface contours, and transparency. In line with these activities, we carried out initiatives to create reproductions of rare manuscripts from the collection of the Vatican Apostolic Library in 2016.

PRODUCTION



A. Digital production printing system assembly: We are bolstering the functions of our domestic mother factories, raising the domestic production ratio of high-end models with high value added. (Toride Plant, Japan) **B**. We installed one of the largest semi-anechoic chambers in Japan in 2015, and now conduct verification testing in-house of large products. (Tamagawa Office, Japan) **C.** With the completion of Oita Canon's Techno Wing R&D facility, an R&D base for production automation equipment, we aim to fully automate camera production. (Oita Canon, Japan)

Canon aims to establish a new production system capable of generating higher profits while seeking improved quality based on the manufacturing capabilities.

Establishing a New Production System to Achieve a Cost-of-sales Ratio of 45%

Canon has always endeavored to innovate production and development operations to maximize profitability. These efforts include a thorough re-examination of production processes at our factories worldwide. As a key initiative in this effort, we are bringing production back to Japan. We are promoting a higher ratio of production in the country by strengthening domestic mother factories through the integration of design, procurement, production-engineering, and manufacturing-technology operations.

Canon will further improve productivity by enhancing its production engineering technology through initiatives such as in-house production, where Canon develops and produces its own parts and materials as well as manufacturing equipment; and automation of product assembly using technologies such as the Canon-developed Super Machine Vision. The Techno Wing R&D facility for automation equipment was completed in Japan at Oita Canon in 2016. We aim to fully automate camera production by 2018. In addition to advanced automation technologies, we will make use of leading-edge technologies such as IoT, big data, and artificial intelligence.

Meanwhile, we are moving ahead with functional specialization between Japan and Asia, allocating mass production of mid-range and low-priced products to our Asian production sites in China, Thailand, the Philippines and other countries. In the Americas and Europe, Canon is making use of automated production systems to implement localized production mainly of consumables such as toner cartridges.

Through these initiatives, Canon aims to achieve a cost-of-sales ratio of 45%, establishing a new production system capable of generating higher profits.

Developing Human Resource for Manufacturing

At Canon, we carry out global human resource training to prepare tomorrow's leaders for success at production sites around the world. In Japan, honing the skills of employees has resulted in such achievements as the seven prizes in four categories, including the Silver Award at Japan's National Skills Competition in 2016.

Environmental Friendly Manufacturing; Enhanced Product Quality

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

The Quality Management Headquarters, which was previously spread across multiple sites, was consolidated into the Tamagawa Office as a way to improve quality. We have introduced cutting-edge facilities and facilities to handle large products, and we have put into place a strong quality system that can swiftly respond to quality standards and certifications of various countries around the world.

SALES & MARKETING

A. Canon EXPO 2016 Shanghai, a traveling exhibition that displays new products and future technologies under the concept of "Closer & Connect," drew about 44,000 visitors in its tour of nineteen countries and regions across Asia. **B.** Canon BioMedical, founded in 2015 by Canon Americas, has launched its first products, genotyping tests, for genetic research*. *For research use only. Not for use in diagnostic procedures. **C.** Canon Europe attended a highly successful drupa 2016, where Canon's end to end production print solutions were demonstrated and well received, and helped contribute to increased sales in this area.

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

Japan

Sales in Japan amounted to ¥707.0 billion, or 20.8% of consolidated net sales.

The market for consumer products proved challenging due to a slump in personal consumption and the impact of the Kumamoto Earthquake, among other factors. Canon saw a year-over-year decline in shipments of products for consumers owing to the sluggish market. Although hardware sales stagnated in the B2B field, performance was strong in the consumables business. In addition, many companies increased their investments in security, resulting in an increase in sales in this area for products such as software, peripherals and surveillance cameras.

The Americas

Sales in the Americas amounted to ¥963.5 billion, or 28.3% of consolidated net sales.

In activities for the office business market, we expanded collaboration with our business solutions companies and commenced business negotiations for a large procurement with a major chain supplier for print-for-pay and business services. The imaging system business unit received positive feedback for our technological knowhow and strong support from photographers and broadcast industry professionals at sports festivals hosted in Latin America. In the health care field, we aim for further growth in the wake of our equity investment of T2 Biosystems, a developer of medical diagnostic products.

Europe (Europe, Middle East, Africa)

Sales in Europe amounted to ¥913.5 billion, or 26.9% of consolidated net sales.

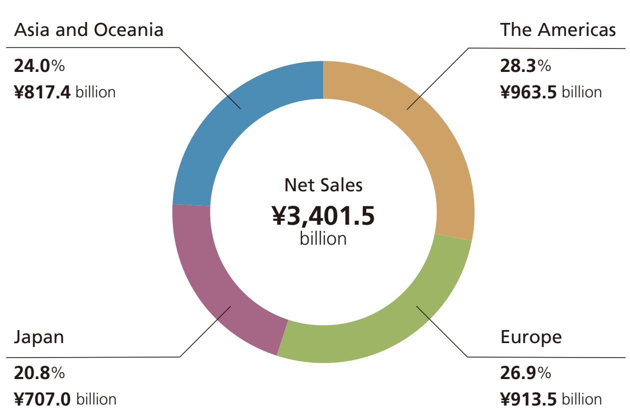
Canon in EMEA saw encouraging growth in areas of the businesses including Pro Print and Solutions & Services and strong market share in DSLR. Strategic investments were made to further strengthen our sales channels across EMEA and increase our solutions portfolio. To expand operations in emerging markets and be closer to our customers, new locations were established, including showrooms in Morocco and Qatar and an office in Nigeria. There was also a focus on transformation across the organization, with functional changes implemented to reflect a more customer-centric approach.

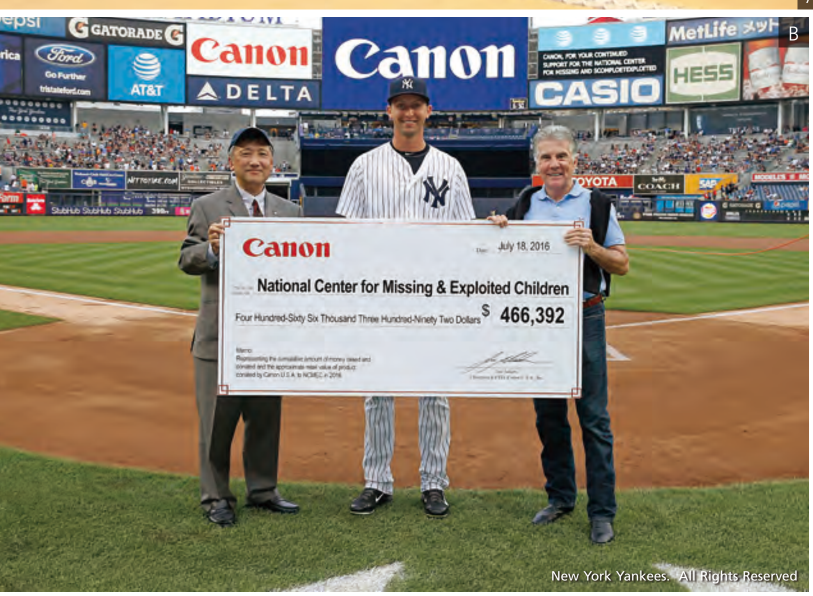
Asia and Oceania

Sales in Asia and Oceania amounted to ¥817.4 billion, or 24.0% of consolidated net sales.

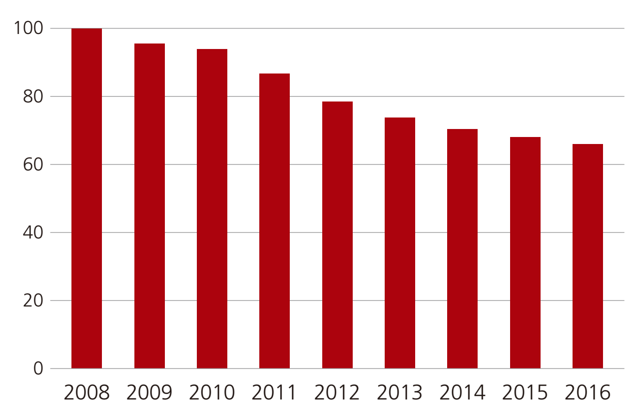
In China, Canon outlined its plan and vision at Canon EXPO 2016 Shanghai. Canon Singapore acquired three companies at the end of 2015, including Canon MailCom Malaysia. (formerly Efficient Mailcom.), a leader of transaction printing service provider in Malaysia, with the aim of expanding the B2B business in the South Asia and Southeast Asian markets. In Australia, IT solutions company Harbour IT and BPO business Converga, which have been added to the Canon Group, contributed to a significant increase in overall sales.

Composition of Sales by Region





Lifecycle CO_2 Emissions Improvement Index per Product



*2008 results set as 100

A. For the Tsuzuri Project, we donated high-resolution facsimiles of sliding door paintings completed over five years to Tenkyuin Temple, concluding in 2016 the reproduction of 56 paintings in total. **B.** Canon U.S.A. donated $466,392 as support for the activities of the National Center for Missing & Exploited Children (NCMEC) on Canon Promotional Night, a social contribution event held at Yankee Stadium.

Canon is promoting CSR activities with the aim of becoming a truly excellent corporation that is admired and respected the world over.

Canon's Basic Approach to CSR

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

Environmental Activities

Reducing Lifecycle CO_2 Emissions per Product

Canon sets a target of reducing lifecycle CO_2 emissions per product by 3% per year to address the issue of climate change. This effort falls under its environmental vision Action for Green, established in 2008. Canon has been actively pursuing initiatives to reduce CO_2 emissions at all product life cycle stages, from raw materials procurement to production, logistics, product use, and recycling. As a result, lifecycle CO_2 emissions per product were reduced by more than 30% from 2008 to 2016, or 5.5% per year. These efforts earned Canon inclusion on the "Climate A List" in 2016 for the first time. The ranking is the highest given by CDP, an international non-profit organization.

Social Contribution Activities

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

Canon Foundation Announces Seventh Grant Program Recipients

The Canon Foundation aims to contribute to the ongoing prosperity and well-being of mankind. It has offered two research grant programs, known as the Creation of Industrial Infrastructure grant and Pursuit of Ideals grant. For the latter, the foundation sought proposals from the public on issues for research concerning food. In 2016, 17 projects were selected for the seventh research grant program.

The Tsuzuri Project

Canon and the non-profit organization Kyoto Culture Association jointly promote a project called the "Tsuzuri Project" (Official title: Cultural Heritage Inheritance Project). The aim of the project is to preserve original cultural assets while making effective use of high-resolution facsimiles of cultural assets. These facsimiles are created by blending Canon's latest digital technology and traditional Japanese crafts, such as gold leaf craftwork. As a result of the project, original cultural assets can be kept in the more favorable environment of museums while facsimiles can be used for educational purposes and public exhibits. Since the program began in 2007, the cumulative total of reproduced and donated items has reached 34 (as of March 2017).

Helping to Bring Home Missing Children in the U.S.

Since 1997, Canon U.S.A. has supported the activities of the National Center for Missing & Exploited Children (NCMEC), a non-profit organization that works to prevent child kidnapping and to quickly find and recover missing children. Canon U.S.A. has provided police and investigative agencies with over 2,200 pieces of equipment such as digital cameras, scanners, and printers that are essential for distributing photographs and other information about missing children. Canon raised and donated $466,392 to NCMEC in 2016, including contributions from Canon U.S.A. employees.

Assistance for Typhoon-Stricken Areas in Vietnam

Canon Vietnam and Canon Marketing Vietnam provided assistance to areas hit by flooding as a result of Typhoon Aere in October 2016. Volunteers from Canon Vietnam, Canon Marketing Vietnam and other Japanese companies visited six communes of Ha Tinh Province and Quang Binh Province in Vietnam. They delivered supplies and financial aid to 600 households. The Canon Group also donated a total of $13,298, including donations from employees, to the affected areas.

Creative Skills and Storytelling Development for Young People in EMEA

Canon in EMEA offers programs for young people to spark their interest in creative and storytelling activities with a view to realizing a sustainable society. Canon Europe's various programs include workshops and exhibitions aimed at empowering young people, nurturing their creativity and focusing on areas such as photography, video and graphic art that are closely related to Canon's businesses. In 2016, we offered such programs in 12 countries, including Finland, Turkey and the UK. From 2017 Canon Europe will link the program to the UN Sustainable Development Goals.

Addressing the Issue of Conflict Minerals

Seeking to ensure that customers can use Canon products with peace of mind, the Canon Group addresses the issue of conflict minerals.

Canon has been conducting full-scale inquiries targeting products produced at manufacturing bases across the entire Canon Group. As of February 2017, within the scope of the responses collected, no specific parts or materials have been found to have contributed to funding armed groups in conflict regions as defined by U.S. legislation.

Canon Inc., a U.S. listed company, files a report at the end of May every year regarding the Company's status on this issue with the U.S. Securities and Exchange Commission. For the reporting year 2015, an independent assurance report made by an independent auditor was included with the Company's conflict minerals report, which confirmed that the Canon Group's activities were compliant with certain international standards. The report is also made available on Canon's website. Canon is a member of the Conflict-Free Sourcing Initiative (CFSI), that plays the leading role in response to the conflict minerals.

Cultivating Diverse Human Resources

Canon is committed to diversity of human resources. We welcome people of all types—irrespective of race, gender, age, customs, and value perceptions—and deploy such differences to foster our growth as an organization. Since 2012, we have engaged in in-house projects fostering diversity. In 2016, Canon held meetings with Group company presidents at 23 Group companies in Japan organized by the VIVID diversity promotion program, where they promoted activities to enable more active roles for women in the workplace Group-wide.

C. As part of our young people program, a photography workshop for young people called "All ages are beautiful" was held at Canon Finland.
D. Canon Vietnam and Canon Marketing Vietnam sent relief supplies and money to areas where Typhoon Aere in October 2016 caused flooding and damage.

FINANCIAL SECTION

TABLE OF CONTENTS

FINANCIAL OVERVIEW

GENERAL

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

OVERVIEW

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

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

Economic environment

Looking back at the global economy in 2016, the trend of recovery in the U.S. economy became stronger as employment conditions and consumer spending progressively improved from the latter half of the year. In Europe, although the economy grew moderately, centered on Germany, the outlook for the region's economy has grown increasingly uncertain due to concerns over the UK's decision to exit the EU and the political unrest in Syria. The Chinese economy continued its deceleration trend while the economies of emerging countries such as Russia and Brazil remained stagnant. In Japan, the economy remained weak due to weak consumer spending. Looking at the global economy as a whole, although higher growth than the previous year was expected at the beginning of the year, the global economy overall experienced its lowest level of growth since the financial crisis precipitated by Lehman Brothers' bankruptcy.

Market environment

As for the markets in which Canon operates amid these conditions, regarding the demand for office MFDs and laser printers, the demand for color models enjoyed strong growth due to the trend of shifting from monochrome to color machines, while the demand for monochrome shrunk due to the continued economic slowdown in emerging countries. As for cameras, along with the ongoing contraction of the market, especially for digital compact cameras, the market suffered from a shortage of components arising from the earthquake in Kumamoto earlier in the year. Additionally, demand for inkjet printers continued to decline. Within the Industry and Other sector, demand for lithography equipment used in the production of flat panel displays ("FPDs") and manufacturing equipment for organic LED ("OLED") displays enjoyed strong growth thanks to active capital investment by panel manufacturers.

The average value of the yen during the year was ¥108.58 against the U.S. dollar, a year-on-year appreciation of approximately ¥13, and ¥120.25 against the euro, a year-on-year appreciation of approximately ¥14.

Summary of operations

During 2016, color-model office MFDs achieved higher growth than the market average, making up for the continued decline of monochrome models, which led to the same level of unit sales as the previous year overall. Although the unit sales of laser printers were below level compared with the same period of the previous year until the third quarter, due to the sluggish economic conditions in the emerging countries, signs of bottoming out started to appear in the fourth quarter. Looking at the interchangeable-lens digital cameras, sales volume for the year exceeded that of the previous year, supported by sales of new products, while sales volume for digital compact cameras declined compared with the previous year amid the ongoing contraction of the market. Sales volume for inkjet printers declined for consumer products, while sales volume of wide format inkjet printers for business use exceeded the previous year. In contrast, sales of FPD lithography equipment and OLED panel manufacturing equipment increased, boosted by increased capital investment by panel manufacturers. Consequently, along with the negative impact of the appreciation of the yen, net sales for the year decreased 10.5% year on year to ¥3,401,487 million. The gross profit ratio decreased by 1.7 points year on year to 49.2% mainly due to the negative effect of yen's appreciation. Despite a reduction in operating expenses of 8.5% year on year, partly due to Group-wide efforts to reduce spending, operating profit decreased by 35.6% to ¥228,866 million. Other income (deductions) increased by ¥23,557 million due to foreign currency exchange gains while income before income taxes decreased by 29.6% year on year to ¥244,651 million and net income attributable to Canon Inc. decreased by 31.6% to ¥150,650 million.

Key performance indicators

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

Revenues

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

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

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

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

Cash flow management

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

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

The debt to total assets ratio is also one of the KPIs. For a manufacturing company like Canon, it generally takes considerable time to realize profit from a business due to lead times required for R&D, manufacturing and sales has to be followed for success. Therefore, management believes that it is important to have sufficient financial strength. Canon will continue to reduce its dependency on external funds for capital investments in favor of generating the necessary funds from its own operations.

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

KEY PERFORMANCE INDICATORS

	2016	2015	2014	2013	2012
Net sales (Millions of yen)	**3,401,487**	3,800,271	3,727,252	3,731,380	3,479,788
Gross profit to net sales ratio	**49.2%**	50.9%	49.9%	48.2%	47.4%
R&D expense to net sales ratio	**8.9%**	8.6%	8.3%	8.2%	8.5%
Operating profit to net sales ratio	**6.7%**	9.3%	9.8%	9.0%	9.3%
Inventory turnover measured in days	**59 days**	47 days	50 days	52 days	57 days
Debt to total assets ratio	**11.9%**	0.0%	0.0%	0.1%	0.1%
Canon Inc. shareholders' equity to total assets ratio	**54.2%**	67.0%	66.8%	68.6%	65.7%

Note: Inventory turnover measured in days is determined by: Inventory divided by net sales for the previous six months, multiplied by 182.5. The increase of inventory turnover in 2016 was primarily due to the acquisition of Toshiba Medical Systems Corporation ("TMSC") on December 19, 2016. If this factor were excluded, the inventory turnover would show 50 days.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

Revenue recognition

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

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

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

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

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

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

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

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

Allowance for doubtful receivables

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

Valuation of inventories

Inventories are stated at the lower of cost or net realizable value. Cost is determined by the average method for domestic inventories and principally the first-in, first-out method for overseas inventories. Net realizable 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 net realizable value of its inventories, Canon considers the age of the inventories and the likelihood of spoilage or changes in market demand for its inventories.

Impairment of long-lived assets

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

Property, plant and equipment

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

Business combinations

The acquisition is accounted for using the acquisition method of accounting. The acquisition method of accounting requires the identification and measurement of all acquired tangible and intangible assets and assumed liabilities at their respective fair values, as of the acquisition date. The determination of the fair value of net assets acquired involves significant judgment and estimates, such as future cash flow projections, appropriate discount and capitalization rates and other estimates based on available market information. Estimates of future cash flows are based on a number of factors including operating results, known and anticipated trends, as well as market and economic conditions. With regard to acquisition of Toshiba Medical Systems Corporation ("TMSC"), the identification and measurement of acquired tangible and intangible assets are still preliminary and subject to change within the measurement period. For further information, please refer to Note 7 of the Notes to Consolidated Financial Statements.

Goodwill and other intangible assets

Goodwill and other intangible assets with indefinite useful lives are not amortized, but are instead tested for impairment annually in the fourth quarter of each year, or more frequently if indicators of potential impairment exist. Canon performs its impairment test of goodwill using the two-step approach at the reporting unit level, which is one level below the operating segment level. All goodwill is assigned to the reporting unit or units that benefit from the synergies arising from each business combination. If the carrying amount assigned to the reporting unit exceeds the fair value of the reporting unit, Canon performs the second step to measure an impairment charge in the amount by which the carrying amount of a reporting unit's goodwill exceeds its implied fair value. Fair value of a reporting unit is determined primarily based on the discounted cash flow analysis which involves estimates of projected future cash flows and discount rates. Estimates of projected future cash flows are primarily based on Canon's forecast of future growth rates. Estimates of discount rates are determined based on the weighted average cost of capital, which considers primarily market and industry data as well as specific risk factors. Canon has completed its impairment test in the fourth quarter of 2016 and determined that there were no reporting units that were at risk of failing the impairment test as the fair value of each reporting unit exceeded its respective carrying amount. Intangible assets with finite useful lives consist primarily of software, trademarks, patents and developed technology, license fees and customer relationships, which are amortized using the straight-line method. The estimated useful lives of software are from 3 years to 5 years, trademarks are 15 years, patents and developed technology are from 7 years to 17 years, license fees are 7 years, and customer relationships are from 11 years to 20 years, respectively.

Income tax uncertainties

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

Valuation of deferred tax assets

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

Employee retirement and severance benefit plans

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

In preparing its financial statements for 2016, Canon estimated a weighted-average discount rate used to determine benefit obligations of 0.7% for Japanese plans and 2.2% for foreign plans and a weighted-average expected long-term rate of return on plan assets of 3.1% for Japanese plans and 4.4% for foreign plans. In estimating the discount rate, Canon uses available information about rates of return on high-quality fixed-income government and corporate bonds currently available and expected to be available during the period to the maturity of the pension benefits. Canon establishes the expected long-term rate of return on plan assets based on management's expectations of the long-term return of the various plan asset categories in which it invests. Management develops expectations with respect to each plan asset category based on actual historical returns and its current expectations for future returns.

Decreases in discount rates lead to increases in actuarial pension benefit obligations which, in turn, could lead to an increase in service cost and amortization cost through amortization of actuarial gain or loss, a decrease in interest cost, and vice versa. For 2016, a decrease of 50 basis points in the discount rate increases the projected benefit obligation by approximately ¥99,379 million. The net effect of changes in the discount rate, as well as the net effect of other changes in actuarial assumptions and experience, is deferred until subsequent periods.

Decreases in expected returns on plan assets may increase net periodic benefit cost by decreasing the expected return amounts, while differences between expected value and actual fair value of those assets could affect pension expense in the following years, and vice versa. For 2016, a change of 50 basis points in the expected long-term rate of return on plan assets would cause a change of approximately ¥4,462 million in net periodic benefit cost. Canon multiplies management's expected long-term rate of return on plan assets by the value of its plan assets to arrive at the expected return on plan assets that is included in pension expense. Canon defers recognition of the difference between this expected return on plan assets and the actual return on plan assets. The net deferral affects future pension expense.

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

CONSOLIDATED RESULTS OF OPERATIONS

SUMMARY OF OPERATIONS

	Millions of yen				
	2016	change	2015	change	2014
Net sales	**3,401,487**	**-10.5%**	3,800,271	+2.0%	3,727,252
Operating profit	**228,866**	**-35.6%**	355,210	-2.3%	363,489
Income before income taxes	**244,651**	**-29.6%**	347,438	-9.3%	383,239
Net income attributable to Canon Inc.	**150,650**	**-31.6%**	220,209	-13.6%	254,797

Sales

In the current business term, the world economy as a whole experienced only a moderate recovery due to, among others, the slowdown in emerging economies. In such an environment, despite efforts to promote sales of highly-competitive products, due to the effect of significant appreciation of the yen, Canon's consolidated net sales in 2016 totaled ¥3,401,487 million, a decrease of 10.5% from the previous year.

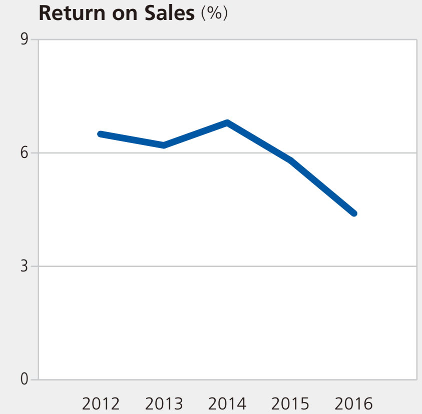
Overseas operations are significant to Canon's operating results and generated 79.2% of total net sales in 2016. Such sales are denominated in the applicable local currency and are subject to fluctuations in the value of the yen relative to those currencies. Despite efforts to reduce the impact of currency fluctuations on operating results, including localization of manufacturing in some regions along with procuring parts and materials from overseas suppliers, Canon believes such fluctuations have had and will continue to have a significant effect on its results of operations.

The average value of the yen during the year was ¥108.58 against the U.S. dollar, a year-on-year appreciation of approximately ¥13, and ¥120.25 against the euro, a year-on-year appreciation of approximately ¥14. The effects of foreign exchange rate fluctuations negatively affected net sales by approximately ¥280,434 million in 2016. This unfavorable impact consisted of approximately ¥144,206 million of unfavorable impact for the U.S. dollar denominated sales and unfavorable impact of ¥90,308 million for the euro denominated sales, and ¥45,920 million for other foreign currency denominated sales.

Cost of sales

Cost of sales principally reflects the cost of raw materials, parts and labor used by Canon in the manufacture of its products. A portion of the raw materials used by Canon is imported or includes imported materials. Many of these raw materials are subject to fluctuations in world market prices accompanied by fluctuations in foreign exchange rates that may affect Canon's cost of sales. Other components of cost of sales include depreciation expenses, maintenance expenses, light and fuel expenses, and rent expenses. The ratio of cost of sales to net sales for 2016 and 2015 was 50.8% and 49.1%, respectively.

Return on Sales (%)



Gross profit

Canon's gross profit in 2016 decreased by 13.5% to ¥1,673,833 million from 2015. The gross profit ratio also decreased by 1.7 points year on year to 49.2%. The decrease in the gross profit ratio primarily reflects the negative effect of appreciation of the yen against other foreign currencies such as the U.S. dollar and the euro.

Operating expenses

The major components of operating expenses are payroll, R&D, advertising expenses and other marketing expenses. Operating expenses decreased 8.5% year on year to ¥1,444,967 million owing to such factors as the decrease in foreign-currency-denominated operating expenses after conversion into yen due to the appreciation of the yen, and a decrease in advertising and other marketing expenses and R&D expenses.

Operating profit

Operating profit in 2016 decreased 35.6% from 2015 to a total of ¥228,866 million. The ratio of operating profit to net sales decreased 2.6 points to 6.7% from 2015.

Other income (deductions)

Other income (deductions) for 2016 was ¥15,785 million, an increase of ¥23,557 million from 2015 mainly due to a decrease in foreign currency exchange loss.

Income before income taxes

Income before income taxes in 2016 was ¥244,651 million, a decrease of 29.6% from 2015, and constituted 7.2% of net sales.

Income taxes

Provision for income taxes in 2016 decreased by ¥33,424 million from 2015. The effective tax rate for 2016 was 33.8%, which was higher than the statutory tax rate in Japan. This was mainly due to the effect of reversal of deferred tax assets derived from changes in tax laws and Japanese tax rates that took effect in 2016.

Net income attributable to Canon Inc.

As a result, net income attributable to Canon Inc. in 2016 decreased by 31.6% to ¥150,650 million, which represents 4.4% of net sales.

Segment information

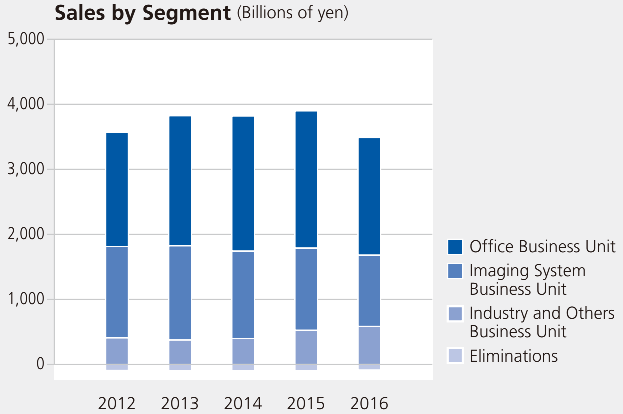
Canon divides its businesses into three segments: the Office Business Unit, the Imaging System Business Unit and the Industry and Others Business Unit.

The Office Business Unit mainly includes Office multifunction devices ("MFDs") / Laser multifunction printers ("MFPs") / Laser printers / Digital production printing systems / High speed continuous feed printers / Wide-format printers / Document solutions

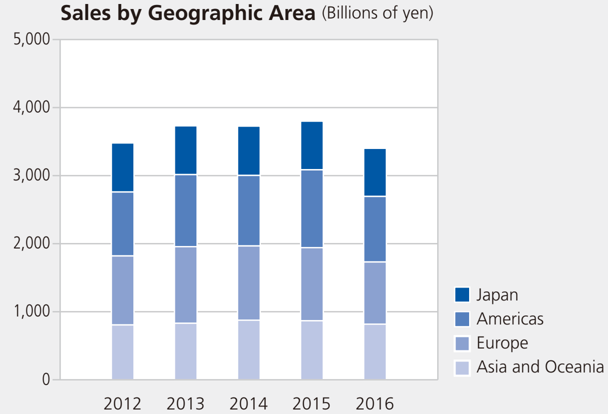
The Imaging System Business Unit mainly includes Interchangeable lens digital cameras / Digital compact cameras / Digital camcorders / Digital cinema cameras / Interchangeable lenses / Compact photo printers / Inkjet printers / Large-format inkjet printers / Commercial photo printers / Image scanners / Multimedia projectors / Broadcast equipment / calculators

The Industry and Others Business Unit mainly includes Semiconductor lithography equipment / FPD (Flat panel display) lithography equipment / Digital radiography systems / Diagnostic X-ray systems / Computed tomography / Magnetic resonance imaging / Diagnostic ultrasound systems / Clinical chemistry analyzers / Ophthalmic equipment / Vacuum thin-film deposition equipment / Organic LED ("OLED") panel manufacturing equipment / Die bonders / Micromotors / Network cameras / Handy terminals / Document scanners

Sales by Segment (Billions of yen)



Sales by Geographic Area (Billions of yen)



Sales by segment

Within the Office Business Unit, unit sales of office MFDs increased overall from the previous year thanks to strong sales of color models, even with the continued decrease in sales of monochrome models. This growth was supported by steady sales of the color A3 (12”x18”) imageRUNNER ADVANCE C5500-series models, which were released this year, and the small-office/home-office color A3 (12”x18”) imageRUNNER C3300-series models, which were launched in the previous year, along with expanded sales of imagePRESS C10000VP-series models, which target the production printing market. Among high-speed continuous-feed printers, unit sales of the Océ-produced VarioPrint i300, a high-speed sheet-fed color inkjet press, increased year on year. Although the unit sales of laser printers had been below level against the same period of the previous year until the third quarter, due to the sluggish economic conditions in the emerging countries, unit sales exceeded the same period of the year at fourth quarter along with a smooth transition to new models as planned. These factors, coupled with the negative effect of unfavorable currency exchange rates, resulted in total sales for the business unit of ¥1,807,819 million, a year-on-year decline of 14.4%, while operating profit totaled ¥169,486 million, a year-on-year decline of 41.7%.

Within the Imaging System Business Unit, sales volume for interchangeable-lens digital cameras grew compared with the previous year owing to healthy demand for the EOS-1D X mark II and the EOS 5D mark IV, which were launched this year, and the launch of a new addition to the Company’s strengthening compact-system camera lineup, the EOS M5, which features a built-in EVF. As for digital compact cameras, along with the ongoing contraction of the market, sales volume declined amid difficulties in procuring components due to the earthquake in Kumamoto earlier in the year, with much of the profitability generated by sales of high-added-value models that deliver high image quality and zoom capabilities. As for inkjet printers, although sales volume declined compared with the previous year due to a shrinking market for consumer products, sales of models equipped with large-capacity ink tanks that were launched in the fourth quarter of 2015 experienced healthy demand mainly in emerging countries, while demand was high mainly in Japan for newly designed models for home use that were launched in 2016. Additionally, wide format inkjet printers, new imagePROGRAF PRO-series models, which target the professional photo and graphic art market, saw an increase in unit sales. As a result of these factors, along with the negative effect of unfavorable currency exchange rates, sales for the business unit decreased by 13.3% to ¥1,095,289 million while operating profit totaled ¥144,413 million, a year-on-year decline of 21.3%.

In the Industry and Others Business Unit, unit sales of semiconductor lithography equipment decreased from the previous year amid the postponement of some capital investments by customers. As for FPD lithography equipment, unit sales of lithography systems employed in the fabrication of mid- and small-size panels increased in response to growing demand for high-definition OLED displays used in mobile devices. Also, sales of manufacturing equipment for OLED displays, which is sold by Canon Tokki, increased amid brisk capital investment by panel manufacturers. In addition, sales of network cameras increased compared with the previous year thanks to efforts to strengthen the product lineup. Consequently, sales for the business unit increased 11.4% year-on-year to ¥584,660 million while operating profit grew by ¥20,527 million to ¥7,448 million.

Intersegment sales of ¥86,281 million, representing 2.5% of total sales, are eliminated from total sales for the three segments, and are described as “Eliminations.”

SALES BY SEGMENT

	Millions of yen				
	2016	change	2015	change	2014
Office	**1,807,819**	**-14.4%**	2,110,816	+1.5%	2,078,732
Imaging System	**1,095,289**	**-13.3%**	1,263,835	-5.9%	1,343,194
Industry and Others	**584,660**	**+11.4%**	524,651	+31.6%	398,765
Eliminations	**(86,281)**	**—**	(99,031)	—	(93,439)
Total	**3,401,487**	**-10.5%**	3,800,271	+2.0%	3,727,252

SALES BY REGION

	Millions of yen				
	2016	change	2015	change	2014
Japan	**706,979**	**-1.0%**	714,280	-1.4%	724,317
Americas	**963,544**	**-15.8%**	1,144,422	+10.4%	1,036,500
Europe	**913,523**	**-15.0%**	1,074,366	-1.5%	1,090,484
Asia and Oceania	**817,441**	**-5.7%**	867,203	-1.0%	875,951
Total	**3,401,487**	**-10.5%**	3,800,271	+2.0%	3,727,252

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

Sales by geographic area

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

In Japan, net sales decreased 1.0% from the previous year due to the ongoing contraction of the digital camera market, especially for digital compact cameras, which reflected a slow recovery in consumer spending.

In the Americas, net sales decreased 15.8% from the previous year owing to the negative effect of the yen's appreciation and the decline in sales of laser printers, interchangeable-lens digital cameras and digital compact cameras.

In Europe, net sales decreased 15.0% from the previous year owing to the negative effect of the yen's appreciation and the decline in sales of laser printers.

In Asia and Oceania, despite strong sales of manufacturing equipment for OLED displays which is sold by Canon Tokki, net sales decreased by 5.7% from the previous year mainly due to the negative effect of the yen's appreciation.

Operating profit by segment

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

Operating profit for the Office Business Unit in 2016 decreased by 41.7% from the previous year to ¥169,486 million, owing to the negative effect of the yen's appreciation along with the decrease in sales of laser printers.

Operating profit for the Imaging System Business Unit in 2016 decreased by 21.3% from the previous year to ¥144,413 million, owing to the negative effect of the yen's appreciation along with the decrease in sales of compact digital cameras.

Operating profit for the Industry and Others Business Unit in 2016 grew by ¥20,527 million to ¥7,448 million thanks to strong sales of manufacturing equipment for OLED displays and network cameras, despite the negative impact of the yen's appreciation.

FOREIGN OPERATIONS AND FOREIGN CURRENCY TRANSACTIONS

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

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

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents decreased by ¥3,420 million to ¥630,193 million in fiscal 2016 compared to the previous year. Canon's cash and cash equivalents are primarily denominated in Japanese yen and in U.S. dollars, with the remainder denominated in other currencies.

Net cash provided by operating activities increased by ¥25,559 million to ¥500,283 million in fiscal 2016 compared to the previous year thanks to the decrease in working capital. The major component of Canon's cash inflow is cash received from customers, and the major components of Canon's cash outflow are payments for parts and materials, selling, general and administrative expenses, R&D expenses and income taxes.

For fiscal 2016, cash inflow from cash received from customers decreased due to sales deterioration. There were no significant changes in Canon's collection rates. Cash outflow for payments for parts and materials decreased due to efforts to reduce inventory level. Cash outflow for payments for selling, general and administrative expenses decreased thanks to Group-wide efforts to reduce spending those expenses.

Net cash used in investing activities increased by ¥383,506 million to ¥837,125 million in fiscal 2016. This mainly reflects the acquisition of Toshiba Medical Systems Corporation ("TMSC") to solidify Canon's business foundation for its health care business within the realm of "safety and security."

Canon defines "free cash flow" as cash flows from operating activities less cash flows from investing activities. For fiscal 2016, free cash flow decreased by ¥357,947 million to negative ¥336,842 million as compared with ¥21,105 million for fiscal 2015.

Note: "Free cash flow" is non-GAAP measure. Refer to "Non-GAAP Financial Measures" section for the explanation and the reconciliation to the reported GAAP measure.

Canon's management places importance on cash flow management and frequently monitors this indicator. 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 and believes that such indicator is beneficial to an investor's understanding. 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 provided in financing activities totaled ¥355,692 million in fiscal 2016, mainly resulting from the long-term bank borrowing of ¥610,000 million related to the acquisition of TMSC, the dividend payout and the repayment for short-term loans. The Company paid dividends in fiscal 2016 of ¥150.00 per share.

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

Short-term loans (including the current portion of long-term debt) amounted to ¥1,850 million at December 31, 2016 compared with ¥688 million at December 31, 2015. Long-term debt (excluding the current portion) amounted to ¥611,289 million at December 31, 2016 compared with ¥881 million at December 31, 2015.

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

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

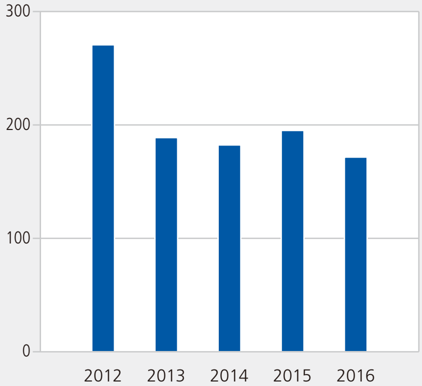
As of March 10, 2017, Canon's debt ratings are: Moody's: Aa3 (long-term); S&P: AA- (long-term), A-1+ (short-term); and R&I: AA+ (long-term). Canon does not have any rating downgrade triggers that would accelerate the maturity of a material amount of its debt. A downgrade in Canon's credit ratings or outlook could, however, increase the cost of its borrowings.

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

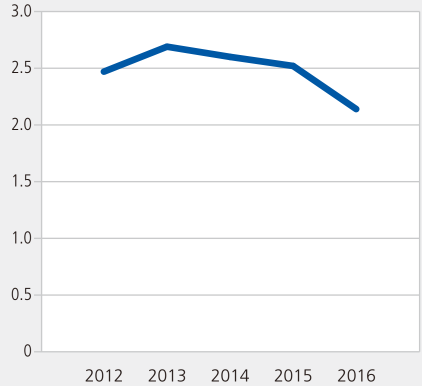
Reflecting the foregoing circumstances, Canon's total inventory turnover ratios were 59, 47, and 50 days at the end of the fiscal years 2016, 2015, and 2014, respectively. The increase of inventory turnover in 2016 was primarily due to the acquisition of TMSC on December 19, 2016. If this factor were excluded, the inventory turnover would show 50 days.

Increase in property, plant and equipment on an accrual basis in 2016 amounted to ¥171,597 million compared with ¥195,120 million in 2015 and ¥182,343 million in 2014. For 2017, Canon projects its increase in property, plant and equipment will be approximately ¥195,000 million.

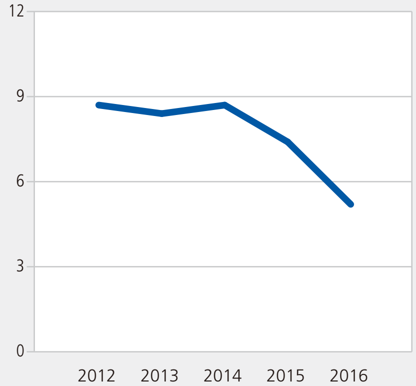
Increase in Property, Plant and Equipment (Billions of yen)



Working Capital Ratio



Return on Canon Inc. Shareholders' Equity (%)



Employer contributions to Canon's worldwide defined benefit pension plans were ¥14,575 million in 2016, ¥19,565 million in 2015 and ¥22,146 million in 2014. Employer contributions to Canon's worldwide defined contribution pension plans were ¥17,603 million in 2016, ¥17,277 million in 2015, and ¥15,077 million in 2014. In addition, employer contributions to the multiemployer pension plan of certain subsidiaries were ¥3,482 million in 2016, ¥3,864 million in 2015 and ¥2,815 million in 2014.

Working capital in 2016 decreased by ¥125,471 million to ¥1,116,379 million, compared with ¥1,241,850 million in 2015 and ¥1,470,554 million in 2014. 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 2016 was 2.14 compared to 2.52 for 2015 and to 2.60 for 2014.

Return on assets (net income attributable to Canon Inc. divided by the average of total assets) was 3.1% in 2016, compared to 5.0% in 2015 and 5.9% in 2014.

Return on Canon Inc. shareholders' equity (net income attributable to Canon Inc. divided by the average of total Canon Inc. shareholders' equity) was 5.2% in 2016 compared with 7.4% in 2015 and 8.7% in 2014.

The debt to total assets ratio was 11.9%, 0.0% and 0.0% as of December 31, 2016, 2015 and 2014, respectively. Canon had short-term loans and long-term debt of ¥613,139 million as of December 31, 2016, ¥1,569 million as of December 31, 2015 and ¥2,166 million as of December 31, 2014.

Non-GAAP Financial Measures

We have reported our financial results in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). In addition, we have discussed our results using the combination of two GAAP cash flow measures, Net cash provided by operating activities and Net cash used for investing activities, which we refer to as "Free Cash Flow" which is non-GAAP measure. We believe this measure is beneficial to an investor's understanding on Canon's current liquidity and the alternatives of use in financing activities because it takes into consideration its operating and investing activities.

A reconciliation of these non-GAAP financial measures and the most directly comparable measures calculated and presented in accordance with GAAP are set forth on the following table.

FREE CASH FLOW

	Millions of yen	
	2016	2015
Net cash provided by operating activities	**500,283**	474,724
Net cash used in investing activities	**(837,125)**	(453,619)
Free cash flow	**(336,842)**	21,105

OFF-BALANCE SHEET ARRANGEMENTS

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

Canon provides guarantees for bank loans of its employees, affiliates and other companies. Canon will have to perform under a guarantee if the borrower defaults on a payment within the contract periods of 1 year to 30 years in the case of employees with housing loans, and 1 year to 5 years in the case of affiliates and other companies. The maximum amount of undiscounted payments Canon would have had to make in the event of default by all borrowers was ¥6,056 million at December 31, 2016. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2016 were insignificant.

CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following summarizes Canon's contractual obligations at December 31, 2016.

		Payments due by period			
Millions of yen	**Total**	Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual obiligations:					
Long-term debt:					
Loan from a bank	**610,000**	—	—	610,000	—
Capital lease obligations and others	**2,538**	1,249	1,141	148	—
Operating lease obligations	**84,945**	26,380	31,816	14,955	11,794
Purchase commitments for:					
Property, plant and equipment	**36,578**	36,578	—	—	—
Parts and raw materials	**119,395**	119,395	—	—	—
Other long-term liabilities:					
Contribution to defined benefit pension plans	**22,382**	22,382	—	—	—
Total	**875,838**	205,984	32,957	625,103	11,794

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

Canon provides warranties of generally less than one year against defects in materials and workmanship on most of its consumer products. Estimated product warranty related costs are established at the time revenue are recognized and are included in selling, general and administrative expenses. Estimates for accrued product warranty costs are primarily based on historical experience, and are affected by ongoing product failure rates, specific product class failures outside of the baseline experience, material usage and service delivery costs incurred in correcting a product failure. As of December 31, 2016, accrued product warranty costs amounted to ¥13,168 million.

At December 31, 2016, commitments outstanding for the purchase of property, plant and equipment were approximately ¥36,578 million, and commitments outstanding for the purchase of parts and raw materials were approximately ¥119,395 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 2017, Canon expects to contribute ¥14,179 million to its Japanese defined benefit pension plans and ¥8,203 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

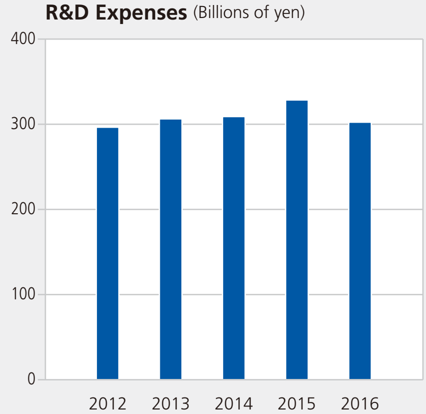
Canon has started its 5-year management plan, the Excellent Global Corporation Plan Phase V ("Phase V") from the year 2016. In Phase V, our slogan is "Embrace the challenge of new growth through a grand strategic transformation" and there are three key strategies related to R&D:

- Establish a new production system to achieve a cost-of-sales ratio of 45%;
- Reinforce and expand new businesses while creating future businesses; and
- Enhance R&D capabilities through open innovation.

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

- Establish a new production system to achieve a cost-of-sales ratio of 45%: Strengthen domestic mother factories by integrating design, procurement, production engineering and manufacturing technology operations while pursuing total cost reduction by advancing production engineering capabilities with more sophisticated robots and next-generation technologies such as the IoT, big data and artificial intelligence.
- Reinforce and expand new businesses while creating future businesses: Create and expand new businesses by accelerating the horizontal expansion of existing business with the exploration of new application possibility of Canon's technologies into new fields. Also, invest intensively on the R&D of promising businesses areas such as commercial printing, network cameras and life sciences while actively taking advantage of M&A to accelerate the early expansion of these businesses.
- Enhance R&D capabilities through open innovation: Construct a more open R&D system that proactively leverages external technologies and knowledge to accelerate and improve efficiency of the R&D. Especially in our fundamental research and development, Canon is promoting joint and contract research with various partners including universities, research institutes, and startups around the world.

R&D Expenses (Billions of yen)



In the "ImPACT" (Impulsing Paradigm Change through Disruptive Technologies) program led by the Japanese government, Canon's "Innovative Visualization Technology to Lead to Creation of a New Growth Industry" was selected as one of the R&D programs in the year 2014, and we are aiming to develop medical inspection equipment with the physically-noninvasive and -nondestructive imaging technology. Additionally, Canon is currently working on collaborative research with Massachusetts General Hospital ("MGH") and Brigham and Women's Hospital ("BWH") to develop biomedical optical imaging and medical robotics technologies at the Healthcare Optics Research Laboratory in Cambridge, Massachusetts, founded in 2013.

Canon has developed a comprehensive imaging simulation system covering all image formation processes including optics, mechanics, sensor, and image processing, ahead of its competitors. With the simulation system, Canon has succeeded in further reducing the need for prototypes, lowering costs and shortening product development lead times.

Canon's consolidated R&D expenses were ¥302,376 million in 2016, ¥328,500 million in 2015 and ¥308,979 million in 2014. The ratios of R&D expenses to the consolidated total net sales for 2016, 2015 and 2014 were 8.9%, 8.6% and 8.3%, respectively.

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

Canon obtained the third greatest number of private sector patents in 2016, according to the United States patent annual list, released by IFI CLAIMS® Patent Services.

MARKET RISK EXPOSURES

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

Equity price risk

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

Maturities and fair values of such marketable securities and investments with original maturities of more than three months, all of which were classified as available-for-sale securities, were as follows at December 31, 2016.

	Millions of yen	
Available-for-sale securities	Cost	Fair value
Debt securities		
Due after five years	320	498
Fund trusts	85	86
Equity securities	19,026	42,444
	19,431	43,028

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, 2016. All of the foreign exchange contracts described in the following table have a contractual maturity date in 2017.

Millions of yen	U.S.$	Euro	Others	Total
Forwards to sell foreign currencies:				
Contract amounts	213,018	131,440	27,186	371,644
Estimated fair value	(4,599)	(3,803)	(1,074)	(9,476)
Forwards to buy foreign currencies:				
Contract amounts	38,392	979	7,370	46,741
Estimated fair value	612	(16)	74	670

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

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

The amount of the hedging ineffectiveness was not material for the years ended December 31, 2016, 2015 and 2014. The amounts of net losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) was ¥311 million, ¥131 million and ¥145 million for the years ended December 31, 2016, 2015 and 2014, respectively.

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

LOOKING FORWARD

Although the IMF is projecting a modest pickup in the global economy in 2017, political and economic circumstances are expected to remain highly uncertain.

In the businesses in which Canon is involved, among office MFDs, demand for color models makes up for the market contraction of monochrome models and demand is expected to remain in line with that of the previous year overall. Although demand for laser printers is expected to remain at the same level as that for the previous year, demand for color models and laser multifunction models with high potential consumable sales is expected to increase. As for interchangeable-lens digital cameras, although demand is waning mainly in developed countries, the sluggish demand condition is improving gradually, which is expected to bottom out. Projections for digital compact cameras indicate continued market contraction, centered mainly on low-priced models. With regard to inkjet printers, demand is expected to continue declining mainly for consumer models. Looking at industrial equipment, within the semiconductor lithography equipment segment, the market is expected to remain at the same level as the previous year while the outlook for FPD lithography equipment and OLED display manufacturing equipment points to continued active capital investment by panel manufacturers. The network camera market is also expected to grow in response to increasing marketing and production site efficiency-enhancing needs, in addition to disaster monitoring and crime prevention functions.

Amid these conditions, 2017 marks not only the second year of Phase V of the Excellent Global Corporation Plan, but also Canon's 80th anniversary. To ensure that 2017 is a year befitting this milestone, Canon is addressing the following key challenges under the theme "Further promoting grand strategic transformation by accelerating reforms."

Thoroughly bolster existing business

In order to successfully transform its business structure, Canon will work to improve profitability by reinforcing the existing businesses that will support this transformation. Specifically, Canon will accelerate the development of "Dantotsu Products," which are products with unique appeal and strengths that realize high profitability thanks to their difficulty to imitate. At the same time, Canon will advance such initiatives as automation, in-house production, and procurement reform, in order to achieve a cost-of-sales ratio of 45%. Additionally, Canon will expand its business domains, developing new business models in response to the internet of things ("IoT") and cloud environments.

Strengthen and grow new businesses and create future businesses

For commercial printing, with the aim of becoming a comprehensive printing company, Canon will accelerate product development in order to make a full-scale entry into the fast-growing package printing market. Regarding network cameras, Canon will work to strengthen camera intelligence, by not only improving image quality, but leveraging the image-processing and image-analytics technologies at its disposal in order to create market-specific solutions. As for healthcare, Canon will formulate new growth strategies, built around TMSC, and will exert the Group's comprehensive strength to provide innovative products and high-quality services on a global scale. For industrial equipment, such as IC lithography equipment that utilizes nanoimprint lithography, Canon will formulate new business strategies to pioneer a "fourth industrial revolution" driven by artificial intelligence and IoT.

Restructure the global sales network

In the B2B sphere, success or failure is determined by the capacity to devise and implement solutions. In addition to training highly skilled sales engineers with a breadth of technical knowledge spanning both hardware and software, Canon will establish a sales structure with networks that expand to corporations and governments. Additionally, Canon will formulate global sales strategies that take full advantage of the expansion and development of e-commerce.

Strengthen R&D through open innovation

Canon will enhance R&D efficiency in existing business fields and be selective in investment in promising new fields. On top of this, aiming to establish and expand service businesses, Canon will train software engineers, develop systems and accelerate the establishment of an external cooperation system.

Cultivate global human resources and reinvigorate the Canon spirit

An enterprising spirit and the San-ji (Three Selfs) Spirit of self-motivation, self-management, and self-awareness, have been basic components of Canon's corporate DNA since its foundation. Canon is now working to re-instill these values as we promote the development of human resources that are able to exert leadership in a global environment.

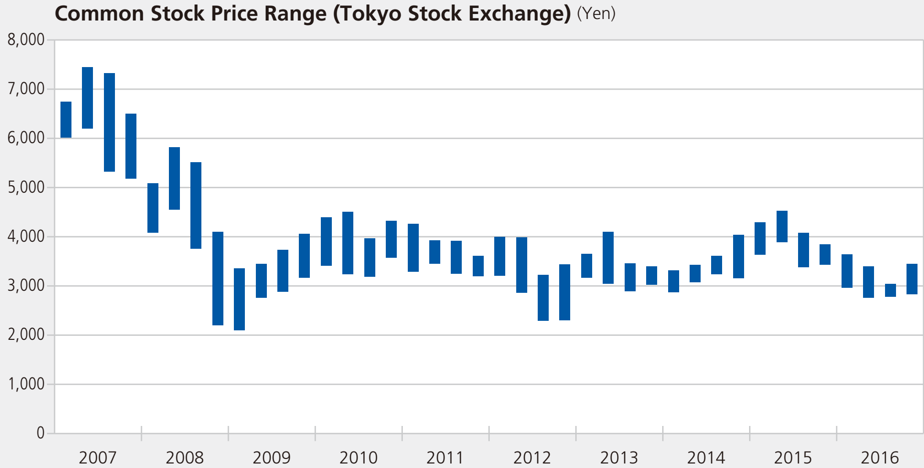
Forward looking statements

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

TEN-YEAR FINANCIAL SUMMARY

	Millions of yen (except per share amounts)			
	2016	2015	2014	2013
Net sales:				
Domestic	**706,979**	714,280	724,317	715,863
Overseas	**2,694,508**	3,085,991	3,002,935	3,015,517
Total	**3,401,487**	3,800,271	3,727,252	3,731,380
Percentage of previous year	**89.5%**	102.0%	99.9%	107.2%
Net income attributable to Canon Inc.	**150,650**	220,209	254,797	230,483
Percentage of sales	**4.4%**	5.8%	6.8%	6.2%
Advertising	**58,707**	80,907	79,765	86,398
Research and development expenses	**302,376**	328,500	308,979	306,324
Depreciation of property, plant and equipment	**199,133**	223,759	213,739	223,158
Increase in property, plant and equipment	**171,597**	195,120	182,343	188,826
Long-term debt, excluding current installments	**611,289**	881	1,148	1,448
Canon Inc. shareholders' equity	**2,783,129**	2,966,415	2,978,184	2,910,262
Total assets	**5,138,529**	4,427,773	4,460,618	4,242,710
Per share data:				
Net income attributable to Canon Inc. shareholders per share:				
Basic	**137.95**	201.65	229.03	200.78
Diluted	**137.95**	201.65	229.03	200.78
Dividend per share	**150.00**	150.00	150.00	130.00
Stock price:				
High	**3,656**	4,539	4,045	4,115
Low	**2,780**	3,402	2,889	2,913
Average number of common shares in thousands	**1,092,071**	1,092,018	1,112,510	1,147,934
Number of employees	**197,673**	189,571	191,889	194,151

Common Stock Price Range (Tokyo Stock Exchange) (Yen)



2012	2011	2010	2009	2008	2007	Thousands of U.S. dollars (except per share amounts) **2016**
720,286	694,450	695,749	702,344	868,280	947,587	**$ 6,094,647**
2,759,502	2,862,983	3,011,152	2,506,857	3,225,881	3,533,759	**23,228,517**
3,479,788	3,557,433	3,706,901	3,209,201	4,094,161	4,481,346	**29,323,164**
97.8%	96.0%	115.5%	78.4%	91.4%	107.8%	**89.5%**
224,564	248,630	246,603	131,647	309,148	488,332	**1,298,707**
6.5%	7.0%	6.7%	4.1%	7.6%	10.9%	**4.4%**
83,134	81,232	94,794	78,009	112,810	132,429	**506,095**
296,464	307,800	315,817	304,600	374,025	368,261	**2,606,690**
211,973	210,179	232,327	277,399	304,622	309,815	**1,716,664**
270,457	226,869	158,976	216,128	361,988	428,549	**1,479,284**
2,117	3,368	4,131	4,912	8,423	8,680	**$ 5,269,733**
2,598,026	2,551,132	2,645,782	2,688,109	2,659,792	2,922,336	**23,992,491**
3,955,503	3,930,727	3,983,820	3,847,557	3,969,934	4,512,625	**44,297,664**
191.34	204.49	199.71	106.64	246.21	377.59	**$ 1.19**
191.34	204.48	199.70	106.64	246.20	377.53	**1.19**
130.00	120.00	120.00	110.00	110.00	110.00	**1.29**
4,015	4,280	4,520	4,070	5,820	7,450	**31.52**
2,308	3,220	3,205	2,115	2,215	5,190	**23.97**
1,173,648	1,215,832	1,234,817	1,234,482	1,255,626	1,293,296	
196,968	198,307	197,386	168,879	166,980	131,352	

Note: U.S. dollar amounts are translated from yen at the rate of U.S.$1 = JPY116, the approximate exchange rate on the Tokyo Foreign Exchange Market as of December 30, 2016.

CONSOLIDATED BALANCE SHEETS

Canon Inc. and Subsidiaries
December 31, 2016 and 2015

	Millions of yen	
ASSETS	**2016**	2015
Current assets:		
Cash and cash equivalents (Note 1)	**630,193**	633,613
Short-term investments (Note 2)	**3,206**	20,651
Trade receivables, net (Note 3)	**641,458**	588,001
Inventories (Note 4)	**560,736**	501,895
Prepaid expenses and other current assets (Notes 6, 12 and 17)	**264,155**	313,019
Total current assets	**2,099,748**	2,057,179
Noncurrent receivables (Note 18)	**29,297**	29,476
Investments (Note 2)	**73,680**	67,862
Property, plant and equipment, net (Notes 5 and 6)	**1,194,976**	1,219,652
Intangible assets, net (Notes 7 and 8)	**446,268**	241,208
Goodwill (Notes 7 and 8)	**936,424**	478,943
Other assets (Notes 6, 11 and 12)	**358,136**	333,453
Total assets	**5,138,529**	4,427,773

LIABILITIES AND EQUITY		
Current liabilities:		
Short-term loans and current portion of long-term debt (Note 9)	**1,850**	688
Trade payables (Note 10)	**372,269**	278,255
Accrued income taxes (Note 12)	**30,514**	47,431
Accrued expenses (Notes 11 and 18)	**304,901**	317,653
Other current liabilities (Notes 1, 5, 12 and 17)	**273,835**	171,302
Total current liabilities	**983,369**	815,329
Long-term debt, excluding current installments (Notes 9 and 19)	**611,289**	881
Accrued pension and severance cost (Note 11)	**407,200**	296,262
Other noncurrent liabilities (Notes 7 and 12)	**142,049**	130,838
Total liabilities	**2,143,907**	1,243,310
Commitments and contingent liabilities (Note 18)		
Equity:		
Canon Inc. shareholders' equity:		
Common stock		
Authorized 3,000,000,000 shares; issued 1,333,763,464 shares in 2016 and 2015	**174,762**	174,762
Additional paid-in capital	**401,385**	401,358
Legal reserve (Note 13)	**66,558**	65,289
Retained earnings (Note 13)	**3,350,728**	3,365,158
Accumulated other comprehensive income (loss) (Note 14)	**(199,881)**	(29,742)
Treasury stock, at cost; 241,695,310 shares in 2016 and 241,690,840 shares in 2015	**(1,010,423)**	(1,010,410)
Total Canon Inc. shareholders' equity	**2,783,129**	2,966,415
Noncontrolling interests	**211,493**	218,048
Total equity	**2,994,622**	3,184,463
Total liabilities and equity	**5,138,529**	4,427,773

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF INCOME

Canon Inc. and Subsidiaries
Years ended December 31, 2016, 2015 and 2014

	Millions of yen		
	2016	2015	2014
Net sales	**3,401,487**	3,800,271	3,727,252
Cost of sales (Notes 5, 8, 11 and 18)	**1,727,654**	1,865,887	1,865,780
Gross profit	**1,673,833**	1,934,384	1,861,472
Operating expenses (Notes 1, 5, 8, 11 and 18):			
Selling, general and administrative expenses	**1,142,591**	1,250,674	1,189,004
Research and development expenses	**302,376**	328,500	308,979
	1,444,967	1,579,174	1,497,983
Operating profit	**228,866**	355,210	363,489
Other income (deductions):			
Interest and dividend income	**4,762**	5,501	7,906
Interest expense	**(1,061)**	(584)	(500)
Other, net (Notes 1, 2 and 17)	**12,084**	(12,689)	12,344
	15,785	(7,772)	19,750
Income before income taxes	**244,651**	347,438	383,239
Income taxes (Note 12)	**82,681**	116,105	118,000
Consolidated net income	**161,970**	231,333	265,239
Less: Net income attributable to noncontrolling interests	**11,320**	11,124	10,442
Net income attributable to Canon Inc.	**150,650**	220,209	254,797
	Yen		
Net income attributable to Canon Inc. shareholders per share (Note 16):			
Basic	**137.95**	201.65	229.03
Diluted	**137.95**	201.65	229.03
Cash dividends per share	**150.00**	150.00	150.00

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Canon Inc. and Subsidiaries
Years ended December 31, 2016, 2015 and 2014

	Millions of yen		
	2016	2015	2014
Consolidated net income	**161,970**	231,333	265,239
Other comprehensive income (loss), net of tax (Note 14):			
Foreign currency translation adjustments	**(107,666)**	(55,504)	143,834
Net unrealized gains and losses on securities	**997**	2,010	2,524
Net gains and losses on derivative instruments	**(2,948)**	2,785	(195)
Pension liability adjustments	**(70,355)**	(6,543)	(37,985)
	(179,972)	(57,252)	108,178
Comprehensive income (loss)	**(18,002)**	174,081	373,417
Less: Comprehensive income attributable to noncontrolling interests	**1,745**	11,973	9,666
Comprehensive income (loss) attributable to Canon Inc.	**(19,747)**	162,108	363,751

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF EQUITY

Canon Inc. and Subsidiaries
Years ended December 31, 2016, 2015 and 2014

	Millions of yen								
	Common stock	Additional paid-in capital	Legal reserve	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total Canon Inc. shareholders' equity	Noncontrolling interests	Total equity
Balance at December 31, 2013	174,762	402,029	63,091	3,212,692	(80,646)	(861,666)	2,910,262	156,515	3,066,777
Equity transactions with noncontrolling interests and other		(420)		216	(22)		(226)	(658)	(884)
Dividends to Canon Inc. shareholders				(145,790)			(145,790)		(145,790)
Dividends to noncontrolling interests								(2,949)	(2,949)
Transfer to legal reserve			1,508	(1,508)			—		—
Comprehensive income:									
Net income				254,797			254,797	10,442	265,239
Other comprehensive income (loss), net of tax (Note 14):									
Foreign currency translation adjustments					142,813		142,813	1,021	143,834
Net unrealized gains and losses on securities					2,301		2,301	223	2,524
Net gains and losses on derivative instruments					(195)		(195)	—	(195)
Pension liability adjustments					(35,965)		(35,965)	(2,020)	(37,985)
Total comprehensive income							363,751	9,666	373,417
Repurchases and reissuance of treasury stock		(46)		(15)		(149,752)	(149,813)		(149,813)
Balance at December 31, 2014	174,762	401,563	64,599	3,320,392	28,286	(1,011,418)	2,978,184	162,574	3,140,758
Equity transactions with noncontrolling interests and other		(29)			73		44	(29,627)	(29,583)
Dividends to Canon Inc. shareholders				(174,711)			(174,711)		(174,711)
Dividends to noncontrolling interests								(3,958)	(3,958)
Acquisition of subsidiaries								77,086	77,086
Transfer to legal reserve			690	(690)			—		—
Comprehensive income:									
Net income				220,209			220,209	11,124	231,333
Other comprehensive income (loss), net of tax (Note 14):									
Foreign currency translation adjustments					(57,592)		(57,592)	2,088	(55,504)
Net unrealized gains and losses on securities					1,509		1,509	501	2,010
Net gains and losses on derivative instruments					2,785		2,785	—	2,785
Pension liability adjustments					(4,803)		(4,803)	(1,740)	(6,543)
Total comprehensive income							162,108	11,973	174,081
Repurchases and reissuance of treasury stock		(176)		(42)		1,008	790		790
Balance at December 31, 2015	174,762	401,358	65,289	3,365,158	(29,742)	(1,010,410)	2,966,415	218,048	3,184,463
Equity transactions with noncontrolling interests and other		**27**			**258**		**285**	**(5,270)**	**(4,985)**
Dividends to Canon Inc. shareholders				**(163,810)**			**(163,810)**		**(163,810)**
Dividends to noncontrolling interests								**(4,077)**	**(4,077)**
Acquisition of subsidiaries								**1,047**	**1,047**
Transfer to legal reserve			**1,269**	**(1,269)**			**—**		**—**
Comprehensive income:									
Net income				**150,650**			**150,650**	**11,320**	**161,970**
Other comprehensive income (loss), net of tax (Note 14):									
Foreign currency translation adjustments					**(101,257)**		**(101,257)**	**(6,409)**	**(107,666)**
Net unrealized gains and losses on securities					**1,196**		**1,196**	**(199)**	**997**
Net gains and losses on derivative instruments					**(2,924)**		**(2,924)**	**(24)**	**(2,948)**
Pension liability adjustments					**(67,412)**		**(67,412)**	**(2,943)**	**(70,355)**
Total comprehensive income (loss)							**(19,747)**	**1,745**	**(18,002)**
Repurchases and reissuance of treasury stock				**(1)**		**(13)**	**(14)**		**(14)**
Balance at December 31, 2016	**174,762**	**401,385**	**66,558**	**3,350,728**	**(199,881)**	**(1,010,423)**	**2,783,129**	**211,493**	**2,994,622**

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Canon Inc. and Subsidiaries
Years ended December 31, 2016, 2015 and 2014

	Millions of yen		
	2016	2015	2014
Cash flows from operating activities:			
Consolidated net income	**161,970**	231,333	265,239
Adjustments to reconcile consolidated net income to net cash provided by operating activities:			
Depreciation and amortization	**250,096**	273,327	263,480
Loss on disposal of fixed assets	**5,203**	7,975	12,429
Equity in earnings of affiliated companies	**(890)**	(447)	(478)
Deferred income taxes	**7,188**	4,672	8,929
(Increase) decrease in trade receivables	**(4,155)**	22,720	9,323
Decrease in inventories	**6,156**	14,249	59,004
Increase (decrease) in trade payables	**56,844**	(17,288)	(24,620)
Increase (decrease) in accrued income taxes	**(16,456)**	(8,731)	3,586
Increase (decrease) in accrued expenses	**(5,256)**	(25,529)	11,124
Increase (decrease) in accrued (prepaid) pension and severance cost	**5,489**	4,622	(6,305)
Other, net	**34,094**	(32,179)	(17,784)
Net cash provided by operating activities	**500,283**	474,724	583,927
Cash flows from investing activities:			
Purchases of fixed assets (Note 5)	**(206,971)**	(252,948)	(218,362)
Proceeds from sale of fixed assets (Note 5)	**6,177**	3,824	3,994
Purchases of available-for-sale securities	**(84)**	(98)	(311)
Proceeds from sale and maturity of available-for-sale securities	**1,181**	804	2,606
(Increase) decrease in time deposits, net	**15,414**	47,665	(14,223)
Acquisitions of businesses, net of cash acquired (Note 7)	**(649,570)**	(251,534)	(54,772)
Purchases of other investments	**(4,460)**	(1,220)	—
Other, net	**1,188**	(112)	11,770
Net cash used in investing activities	**(837,125)**	(453,619)	(269,298)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt (Note 9)	**610,552**	717	1,377
Repayments of long-term debt (Note 9)	**(856)**	(1,350)	(2,152)
Decrease in short-term loans, net (Note 9)	**(80,580)**	—	(54)
Purchases of noncontrolling interests	**(4,993)**	(29,570)	—
Dividends paid	**(163,810)**	(174,711)	(145,790)
Repurchases and reissuance of treasury stock	**(14)**	790	(149,813)
Other, net	**(4,607)**	(6,078)	(4,454)
Net cash provided by (used in) financing activities	**355,692**	(210,202)	(300,886)
Effect of exchange rate changes on cash and cash equivalents	**(22,270)**	(21,870)	41,928
Net change in cash and cash equivalents	**(3,420)**	(210,967)	55,671
Cash and cash equivalents at beginning of year	**633,613**	844,580	788,909
Cash and cash equivalents at end of year	**630,193**	633,613	844,580
Supplemental disclosure for cash flow information:			
Cash paid during the year for:			
Interest	**738**	653	462
Income taxes	**76,714**	117,643	111,819

See accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Canon Inc. and Subsidiaries

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

(a) Description of Business

Canon Inc. (the "Company") and subsidiaries (collectively "Canon") is one of the world's leading manufacturers in such fields as office products, imaging system products and industry and other products. Office products consist mainly of office multifunction devices ("MFDs"), laser multifunction printers ("MFPs"), laser printers, digital production printing systems, high speed continuous feed printers, wide-format printers and document solutions. Imaging system products consist mainly of interchangeable lens digital cameras, digital compact cameras, digital camcorders, digital cinema cameras, interchangeable lenses, compact photo printers, inkjet printers, large-format inkjet printers, commercial photo printers, image scanners, multimedia projectors, broadcast equipment and calculators. Industry and other products consist mainly of semiconductor lithography equipment, FPD (Flat panel display) lithography equipment, digital radiography systems, diagnostic X-ray systems, computed tomography, magnetic resonance imaging, diagnostic ultrasound systems, clinical chemistry analyzers, ophthalmic equipment, vacuum thin-film deposition equipment, organic LED ("OLED") panel manufacturing equipment, die bonders, micromotors, network cameras, handy terminals and document scanners. Canon's consolidated net sales for the years ended December 31, 2016, 2015 and 2014 were distributed as follows: the Office Business Unit 53.1%, 55.5% and 55.8%, the Imaging System Business Unit 32.2%, 33.3% and 36.0%, the Industry and Others Business Unit 17.2%, 13.8% and 10.7%, and elimination between segments 2.5%, 2.6% and 2.5%, respectively. These percentages were computed by dividing segment net sales, including intersegment sales, by consolidated net sales, based on the segment operating results described in Note 21.

Sales are made principally under the Canon brand name, almost entirely through sales subsidiaries. These subsidiaries are responsible for marketing and distribution, and primarily sell to retail dealers in their geographic area. 79.2%, 81.2% and 80.6% of consolidated net sales for the years ended December 31, 2016, 2015 and 2014 were generated outside Japan, with 28.3%, 30.1% and 27.8% in the Americas, 26.9%, 28.3% and 29.3% in Europe, and 24.0%, 22.8% and 23.5% in Asia and Oceania, respectively.

Canon sells laser printers on an OEM basis to HP Inc.; such sales constituted 14.8%, 17.8% and 17.4% of consolidated net sales for the years ended December 31, 2016, 2015 and 2014, respectively, and are included in the Office Business Unit.

Canon's manufacturing operations are conducted primarily at 30 plants in Japan and 18 overseas plants which are located in countries or regions such as the United States, Germany, France, the Netherlands, Taiwan, China, Malaysia, Thailand, Vietnam and Philippines.

On December 19, 2016, Canon acquired all the ordinary shares of Toshiba Medical Systems Corporation ("TMSC"), one of the leading global companies in the medical equipment industry, and consolidated TMSC. Further information is described in Note 7.

(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 ("U.S. GAAP"). These adjustments were not recorded in the statutory books of account.

(c) Principles of Consolidation

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

(d) Use of Estimates

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

(e) Translation of Foreign Currencies

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

Gains and losses resulting from foreign currency transactions, including foreign exchange contracts, and translation of assets and liabilities denominated in foreign currencies are included in other income (deductions) in the consolidated statements of income. Foreign currency exchange gains and losses were net losses of ¥2 million and ¥22,149 million for the years ended December 31, 2016 and 2015, respectively, and a net gain of ¥2,628 million for the year ended December 31, 2014.

(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 ¥30,500 million and ¥80,870 million at December 31, 2016 and 2015, respectively, are included in cash and cash equivalents in the consolidated balance sheets.

(g) Investments

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

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

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

Canon does not hold any held-to-maturity securities.

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

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

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

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

(h) Allowance for Doubtful Receivables

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

(i) Inventories

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

(j) Impairment of Long-Lived Assets

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

(k) Property, Plant and Equipment

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

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

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

(l) Goodwill and Other Intangible Assets

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

Intangible assets with finite useful lives consist primarily of software, trademarks, patents and developed technology, license fees and customer relationships, which are amortized using the straight-line method. The estimated useful lives of software are from 3 years to 5 years, trademarks are 15 years, patents and developed technology are from 7 years to 17 years, license fees are 7 years, and customer relationships are from 11 years to 20 years, respectively. Certain costs incurred in connection with developing or obtaining internal-use software are capitalized. These costs consist primarily of payments made to third parties and the salaries of employees working on such software development. Costs incurred in connection with developing internal-use software are capitalized at the application development stage. In addition, Canon develops or obtains certain software to be sold where related costs are capitalized after establishment of technological feasibility.

(m) Environmental Liabilities

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

(n) Income Taxes

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

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

(o) Stock-Based Compensation

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

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

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

(q) Revenue Recognition

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

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

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

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

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

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

Canon records amounts received in advance from customers in excess of revenue recognized primarily for sales of optical equipment and product maintenance contracts as deferred revenue until the revenue recognition criteria are satisfied. Deferred revenue were ¥102,298 million and ¥51,390 million at December 31, 2016 and 2015, respectively, and are included in other current liabilities in the accompanying consolidated balance sheets.

Canon records estimated reductions to sales at the time of sale for sales incentive programs including product discounts, customer promotions and volume-based rebates. Estimated reductions to sales are based upon historical trends and other known factors at the time of sale. Canon regularly adjusts its estimates each period in the ordinary course of establishing sales incentive program accruals based on current information. Canon also provides price protection to certain resellers of its products, and records reductions to sales for the estimated impact of price protection obligations when announced.

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

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

(r) Research and Development Costs

Research and development costs are expensed as incurred.

(s) Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses were ¥58,707 million, ¥80,907 million and ¥79,765 million for the years ended December 31, 2016, 2015 and 2014, respectively.

(t) Shipping and Handling Costs

Shipping and handling costs totaled ¥44,296 million, ¥52,504 million and ¥49,576 million for the years ended December 31, 2016, 2015 and 2014, respectively, and are included in selling, general and administrative expenses in the consolidated statements of income.

(u) Derivative Financial Instruments

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

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

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

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

(v) Guarantees

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

(w) Recently Issued Accounting Guidance

In November 2015, the Financial Accounting Standards Board ("FASB") issued an amendment which requires deferred tax assets and liabilities be classified as noncurrent in the consolidated balance sheets. Canon early adopted this amended guidance from the quarter beginning January 1, 2016, on a prospective basis, and prior periods were not retrospectively adjusted. Canon's current deferred tax assets were ¥55,108 million and current deferred tax liabilities were ¥2,682 million as of December 31, 2015.

In July 2015, the FASB issued an amendment which requires an entity to measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Canon early adopted this amended guidance from the quarter beginning April 1, 2016. This adoption did not have a material impact on its consolidated results of operations and financial condition.

In May 2014, the FASB issued a new accounting standard related to revenue from contracts with customers. This standard requires an entity to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This standard was originally planned to be effective for annual reporting periods beginning after December 15, 2016, however, in August 2015, the FASB issued an accounting standard update for a one-year deferral of the effective date. Early adoption as of the original effective date is permitted. This standard may be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying this standard recognized at the date of initial application. In March 2016, the FASB issued an accounting standard update which clarifies the implementation guidance for principal versus agent considerations. In April 2016, the FASB issued an accounting standard update which clarifies guidance related to identifying performance obligations and licensing implementation guidance. In May 2016, the FASB issued an accounting standard update which amends guidance in the new standard on transition, collectibility, noncash consideration and the presentation of sales and other similar taxes. In December 2016, the FASB issued an accounting standard update which amends guidance in the new standard on disclosure of performance obligations, provisions for losses on certain types of contracts, scoping, and other areas. These standard updates have the same effective date as the original standard. Canon currently plans to apply the modified retrospective method of adoption from the quarter beginning January 1, 2018. While Canon currently does not expect the adoption of this standard to have a material impact on the timing of revenue recognition, the adoption of this standard is expected to result in change in allocation of revenue between goods and services in Office Business Unit and Industry and Others Business Unit on its consolidated statements of income. From consolidated balance sheets perspective, the reclassification between receivable and refund liability for variable consideration in Office Business Unit and Imaging System Business Unit may results in the increase of total assets and total liabilities. However, evaluation is still ongoing and it could result in additional impacts on its consolidated results of operations and financial condition.

In January 2016, the FASB issued an amendment which addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. This guidance includes the requirement that equity investments be measured at fair value with changes in the fair value recognized in net income. This guidance is effective for annual reporting periods beginning after December 15, 2017, and early adoption is permitted for certain provisions. Canon is currently evaluating the adoption date and the effect that the adoption of this guidance will have on its consolidated results of operations and financial condition.

In February 2016, the FASB issued an amendment which requires lessees to recognize most leases on their balance sheets but recognize expenses on their income statements in a manner similar to current guidance. For lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. This guidance is effective for annual reporting periods beginning after December 15, 2018, and early adoption is permitted. Canon is currently evaluating the adoption date and the effect that the adoption of this guidance will have on its consolidated results of operations and financial condition.

In October 2016, the FASB issued an amendment which requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Consequently, the amendments in this guidance eliminate the exception for an intra-entity transfer of an asset other than inventory. Two common examples of assets included in the scope of this guidance are intellectual property and property, plant, and equipment. This guidance is effective for annual reporting periods beginning after December 15, 2017, and early adoption is permitted. The amendments in this guidance should be applied on a modified retrospective basis through a cumulative effect adjustment directly to retained earnings as of the beginning of the period of adoption. Canon is currently evaluating the adoption date and the effect that the adoption of this guidance will have on its consolidated results of operations and financial condition.

2. INVESTMENTS

The cost, gross unrealized holding gains, gross unrealized holding losses and fair value for available-for-sale securities included in investments by major security type at December 31, 2016 and 2015 are as follows:

December 31 Millions of yen	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
2016: Noncurrent:				
Government bonds	**277**	**—**	**8**	**269**
Corporate bonds	**43**	**188**	**2**	**229**
Fund trusts	**85**	**1**	**—**	**86**
Equity securities	**19,026**	**23,439**	**21**	**42,444**
	19,431	**23,628**	**31**	**43,028**

Millions of yen	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
2015: Noncurrent:				
Government bonds	298	—	11	287
Corporate bonds	6	195	—	201
Fund trusts	63	1	—	64
Equity securities	20,461	23,482	1,094	42,849
	20,828	23,678	1,105	43,401

Maturities of available-for-sale debt securities included in investments in the accompanying consolidated balance sheets are as follows at December 31, 2016:

	Millions of yen	
	Cost	Fair value
Due after five years	**320**	**498**
	320	**498**

Gross realized gains were ¥750 million, ¥329 million and ¥2,540 million for the years ended December 31, 2016, 2015 and 2014, respectively. Gross realized losses, including write-downs for impairments that were other-than-temporary, were ¥1,032 million, ¥31 million and ¥31 million for the years ended December 31, 2016, 2015 and 2014, respectively.

At December 31, 2016, substantially all of the available-for-sale securities with unrealized losses had been in a continuous unrealized loss position for less than twelve months.

Time deposits with original maturities of more than three months were ¥3,206 million and ¥20,651 million at December 31, 2016 and 2015, respectively, and were 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 ¥7,800 million and ¥2,570 million at December 31, 2016 and 2015, respectively. These investments were not evaluated for impairment at December 31, 2016 and 2015, respectively, because (a) Canon did not estimate the fair value of those investments as it was not practicable to estimate the fair value of the investments and (b) Canon did not identify any events or changes in circumstances that might have had significant adverse effects on the fair value of those investments.

Investments in affiliated companies accounted for by the equity method amounted to ¥21,514 million and ¥20,415 million at December 31, 2016 and 2015, respectively. Canon's share of the net earnings in affiliated companies accounted for by the equity method, included in other income (deductions), were earnings of ¥890 million, ¥447 million and ¥478 million for the years ended December 31, 2016, 2015 and 2014 respectively.

3. TRADE RECEIVABLES

Trade receivables are summarized as follows:

December 31	Millions of yen	
	2016	2015
Notes	**28,811**	17,614
Accounts	**623,722**	582,464
	652,533	600,078
Less allowance for doubtful receivables	**(11,075)**	(12,077)
	641,458	588,001

4. INVENTORIES

Inventories are summarized as follows:

December 31	Millions of yen	
	2016	2015
Finished goods	**373,337**	357,115
Work in process	**143,298**	130,258
Raw materials	**44,101**	14,522
	560,736	501,895

5. PROPERTY, PLANT AND EQUIPMENT

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

December 31	Millions of yen	
	2016	2015
Land	**283,893**	282,786
Buildings	**1,656,087**	1,632,604
Machinery and equipment	**1,778,552**	1,813,116
Construction in progress	**54,786**	61,952
	3,773,318	3,790,458
Less accumulated depreciation	**(2,578,342)**	(2,570,806)
	1,194,976	1,219,652

Depreciation expenses for the years ended December 31, 2016, 2015 and 2014 were ¥199,133 million, ¥223,759 million and ¥213,739 million, respectively.

Amounts due for purchases of property, plant and equipment were ¥31,318 million and ¥30,789 million at December 31, 2016 and 2015, respectively, and are included in other current liabilities in the accompanying consolidated balance sheets. Fixed assets presented in the consolidated statements of cash flows include property, plant and equipment and intangible assets.

6. FINANCE RECEIVABLES AND OPERATING LEASES

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

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

December 31	Millions of yen	
	2016	2015
Total minimum lease payments receivable	**306,766**	318,066
Unguaranteed residual values	**14,776**	14,271
Executory costs	**(34)**	(888)
Unearned income	**(30,288)**	(31,920)
	291,220	299,529
Less allowance for credit losses	**(2,325)**	(2,878)
	288,895	296,651
Less current portion	**(105,308)**	(109,220)
	183,587	187,431

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

Years ended December 31	Millions of yen	
	2016	2015
Balance at beginning of year	**2,878**	6,276
Charge-offs	**(978)**	(1,343)
Provision	**398**	55
Translation adjustments and other	**27**	(2,110)
Balance at end of year	**2,325**	2,878

Canon has policies in place to ensure that its products are sold to customers with an appropriate credit history, and continuously monitors its customers' credit quality based on information including length of period in arrears, macroeconomic conditions, initiation of legal proceedings against customers and bankruptcy filings. The allowance for credit losses of finance receivables are evaluated collectively based on historical experience of credit losses. An additional reserve for individual accounts is recorded when Canon becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings. Finance receivables which are past due or individually evaluated for impairment at December 31, 2016 and 2015 are not significant.

The cost of equipment leased to customers under operating leases included in property, plant and equipment, net at December 31, 2016 and 2015 was ¥97,890 million and ¥108,746 million, respectively. Accumulated depreciation on equipment under operating leases at December 31, 2016 and 2015 was ¥75,997 million and ¥82,916 million, respectively.

The following is a schedule by year of the future minimum lease payments to be received under financing leases and noncancelable operating leases at December 31, 2016.

Year ending December 31:	Millions of yen	
	Financing leases	Operating leases
2017	117,728	7,226
2018	87,627	3,894
2019	58,364	2,185
2020	31,422	994
2021	10,986	409
Thereafter	639	41
	306,766	14,749

7. ACQUISITIONS

On March 17, 2016, Canon entered into a Shares and Other Securities Transfer Agreement with Toshiba Corporation and acquired the share options for consideration of cash to acquire all the ordinary shares of Toshiba Medical Systems Corporation ("TMSC"), which is exercisable upon the clearances of necessary competition regulatory authorities. As such clearances were obtained, Canon exercised the share options and acquired all the ordinary shares of TMSC on December 19, 2016. The acquisition date was December 19, 2016 and the purchase price was ¥665,498 million, which approximates the fair value at that date.

The acquisition was accounted for using the acquisition method of accounting. Acquisition-related costs were expensed as incurred and were not material.

Under Phase V of the Excellent Global Corporation Plan, a five-year initiative that Canon has been implementing since 2016, "embracing the challenge of new growth through a grand strategic transformation" has been set as a basic policy. With regard to "strengthening and growing new businesses, and creating future businesses," a particularly important strategy, Canon intends to develop a health care business within the realm of "safety and security," as a next-generation pillar of growth.

TMSC is one of the leading global companies in the medical equipment industry. Within the field of medical X-ray computed tomography ("CT") systems in particular, TMSC is the overwhelming market share leader in Japan and has been steadily increasing its global market share. By maximizing the combination of both companies' management resources, Canon aims to solidify its business foundation for health care that can contribute to the world.

The following table summarizes the preliminary purchase price allocation which was based on estimated fair values of the assets acquired and liabilities assumed at acquisition date. Since the acquisition date of TMSC was near the balance sheet date, and TMSC is composed of various entities located around the world, the purchase price allocation is still preliminary. The estimates and assumptions are subject to change as Canon obtains additional information for the estimates within the measurement period. The primary areas of the preliminary allocation of the fair value of consideration transferred that are not yet finalized relate to the fair values of certain tangible and intangible assets acquired and the residual goodwill. Specifically, certain underlying analyses for customer relationships, and patents and developed technology were based on overall estimates rather than detail information for each of the individual operations.

	Millions of yen
Cash and cash equivalents	25,301
Other current assets	169,545
Intangible assets	227,500
Other noncurrent assets	42,975
Total assets acquired	465,321
Current liabilities	199,223
Noncurrent liabilities	92,231
Total liabilities assumed	291,454
Noncontrolling interest	1,047
Net identifiable assets acquired	172,820
Goodwill	492,678
Net assets acquired	665,498

Intangible assets acquired, which are subject to amortization, consist of customer relationships of ¥155,200 million, and patents and developed technology of ¥72,300 million. Canon has preliminarily estimated the amortization period for the customer relationships, and patents and developed technology to be 15 - 20 years and 10 years, respectively. The weighted average amortization period for all intangible assets is approximately 15 years.

Goodwill recorded is attributable primarily to expected synergies from combining operations of TMSC and Canon, such as accelerating entry into new fields, further improvement in quality through shared production technology and expanding business domains through the enhancement of R&D capabilities. None of the goodwill is expected to be deductible for tax purposes.

The amounts of net sales of TMSC since the acquisition date included in the Canon's consolidated statement of income for the year ended December 31, 2016 were ¥13,582 million. The amounts of net income of TMSC included in the Canon's consolidated statement of income were not material.

The unaudited pro forma net sales for the years ended December 31, 2016 and 2015 as if TMSC had been included in Canon's consolidated statements of income from the beginning of the year ended December 31, 2015 were ¥3,806,667 million and ¥4,224,181 million, respectively. Pro forma net income was not disclosed because the impact on Canon's consolidated statements of income was not material.

Canon acquired businesses other than that described above during the year ended December 31, 2016 that were not material to its consolidated financial statements.

On April 15, 2015, the Company acquired 76.1% of the issued shares of Axis AB ("Axis"), a Sweden-based company listed on Nasdaq Stockholm, a global leader in the network video solution industry, primarily through a public cash tender offer for consideration of ¥244,725 million. In addition, the Company acquired 9.0% of the issued shares of Axis from noncontrolling shareholders primarily through an additional public cash tender offer. As a result, the Company's aggregate interest represents 85.1% of the issued shares of Axis. The fair value of the 23.9% noncontrolling interest in Axis of ¥77,086 million was measured based on Axis's common stock price on the acquisition date.

The acquisition was accounted for using the acquisition method of accounting. Acquisition-related costs were expensed as incurred and were not material.

The Company views its network surveillance camera business as a promising new business area for Canon. Canon aims to provide advanced and high-performance network solutions to its customers and improve its product competitiveness through the acquisition.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at acquisition date.

	Millions of yen
Current assets	31,365
Intangible assets	60,992
Goodwill	259,863
Other noncurrent assets	2,053
Non-current assets	322,908
Total assets acquired	354,273
Total liabilities assumed	32,462
Net assets acquired	321,811

Intangible assets acquired, which are subject to amortization, consist of trademarks of ¥42,880 million, patents and developed technology of ¥17,823 million and software of ¥289 million. Canon has estimated the amortization period for the trademarks, patents and developed technology, and software to be 15 years, 7 years and 5 years, respectively. The weighted average amortization period for all intangible assets is approximately 13 years.

Goodwill recorded is attributable primarily to expected synergies from combining operations of Axis and Canon. None of the goodwill is expected to be deductible for tax purposes. The goodwill is assigned primarily to the Industry and Others Business Unit for impairment testing.

The amounts of net sales of Axis since the acquisition date included in the Canon's consolidated statement of income for the year ended December 31, 2015 were ¥72,602 million. The amounts of net income of Axis included in the Canon's consolidated statement of income were not material.

Pro forma results of operations were not disclosed because the effect on the Canon's consolidated statement of income was not material.

Canon acquired businesses other than that described above during the year ended December 31, 2015 that were not material to its consolidated financial statements.

8. GOODWILL AND OTHER INTANGIBLE ASSETS

Intangible assets subject to amortization acquired during the year ended December 31, 2016, including those recorded from businesses acquired, totaled ¥266,325 million, which primarily consist of customer relationships of ¥155,997 million, patents and developed technology of ¥73,451 million and software of ¥36,054 million. The weighted average amortization periods for intangible assets in total acquired during the year ended December 31, 2016 are approximately 14 years. The weighted average amortization periods for customer relationships, patents and developed technology and software acquired during the year ended December 31, 2016 are approximately 15 - 20 years, 10 years and 5 years, respectively.

Intangible assets subject to amortization acquired during the year ended December 31, 2015, including those recorded from businesses acquired, totaled ¥113,216 million, which primarily consist of trademarks of ¥42,949 million, software of ¥39,817 million, and patents and developed technology of ¥18,083 million. The weighted average amortization periods for intangible assets in total acquired during the year ended December 31, 2015 are approximately 9 years. The weighted average amortization periods for trademarks, software, and patents and developed technology acquired during the year ended December 31, 2015 are approximately 15 years, 5 years and 7 years, respectively.

The components of intangible assets subject to amortization at December 31, 2016 and 2015 were as follows:

December 31	**2016**		2015	
Millions of yen	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization
Software	**313,599**	**193,785**	308,348	181,972
Customer relationships	**172,234**	**11,146**	17,159	10,173
Patents and developed technology	**106,250**	**16,272**	39,685	16,123
Trademarks	**44,704**	**5,610**	49,861	2,952
License fees	**15,561**	**6,756**	15,669	5,617
Other	**17,713**	**8,250**	17,070	7,690
	670,061	**241,819**	447,792	224,527

Aggregate amortization expense for the years ended December 31, 2016, 2015 and 2014 was ¥50,963 million, ¥49,568 million and ¥49,741 million, respectively. Estimated amortization expense for intangible assets currently held for the next five years ending December 31 is ¥60,474 million in 2017, ¥53,031 million in 2018, ¥42,624 million in 2019, ¥34,079 million in 2020, and ¥28,817 million in 2021.

Intangible assets not subject to amortization other than goodwill at December 31, 2016 and 2015 were ¥18,026 million and ¥17,943 million, respectively, which primarily consist of in-process research and development recorded from businesses acquired.

For management reporting purposes, goodwill is not allocated to the segments. Goodwill has been allocated to its respective segment for impairment testing.

The changes in the carrying amount of goodwill by segment for the years ended December 31, 2016 and 2015 were as follows:

Years ended December 31 Millions of yen	Office	Imaging System	Industry and Others	Unallocated*1	Total
2016: Balance at beginning of year	**142,551**	**53,474**	**282,918**	**—**	**478,943**
Goodwill acquired during the year	**863**	**—**	**4,589**	**492,678**	**498,130**
Translation adjustments and other	**(7,158)**	**(4,440)**	**(29,051)**	**—**	**(40,649)**
Balance at end of year	**136,256**	**49,034**	**258,456**	**492,678**	**936,424**

Millions of yen	Office	Imaging System	Industry and Others	Unallocated	Total
2015: Balance at beginning of year	145,335	21,780	44,221	—	211,336
Goodwill acquired during the year	10,373	31,367	228,827	—	270,567
Translation adjustments and other	(13,157)	327	9,870	—	(2,960)
Balance at end of year	142,551	53,474	282,918	—	478,943

*1 Canon has not completed the allocation of goodwill to the segments for impairment testing which is attributable to the acquisition of TMSC as of December 31, 2016.

9. SHORT-TERM LOANS AND LONG-TERM DEBT

Short-term loans consisting of bank borrowings at December 31, 2016 and 2015 were ¥601 million and ¥26 million, respectively.

Long-term debt consisted of the following:

December 31	Millions of yen	
	2016	2015
Loan from a bank; bearing interest of 0.13% at December 31, 2016*1	**610,000**	—
Capital lease obligations and others	**2,538**	1,543
	612,538	1,543
Less current portion	**(1,249)**	(662)
	611,289	881

*1 On March 15, 2016, Canon entered into a provisional borrowing agreement with a bank which matures in 2017 for acquiring TMSC. On January 31, 2017, Canon refinanced this borrowing to the unsecured loans by credit facilities expiring in December 2021. The loans under the credit facilities are ¥610,000 million at a floating interest (0.04% as of January 31, 2017). As a result, this borrowing was classified as long-term debt in the accompanying Consolidated Balance Sheet as of December 31, 2016.

The aggregate annual maturities of long-term debt outstanding at December 31, 2016 were as follows:

Year ending December 31:	Millions of yen
2017	1,249
2018	736
2019	405
2020	125
2021	610,023
Thereafter	—
	612,538

Both short-term and long-term bank loans are primarily made under general agreements which provide that security and guarantees for present and future indebtedness will be given upon request of the bank, and that the bank shall have the right to offset cash deposits against obligations that have become due or, in the event of default, against all obligations due to the bank.

10. TRADE PAYABLES

Trade payables are summarized as follows:

December 31	Millions of yen	
	2016	2015
Notes	**38,073**	16,706
Accounts	**334,196**	261,549
	372,269	278,255

11. EMPLOYEE RETIREMENT AND SEVERANCE BENEFITS

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

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

The following tables include the provisional financial impact related to the acquisition of TMSC, which was acquired during the year ended December 31, 2016. TMSC participates in Toshiba Corporate Pension Fund and the establishment of the new pension plan is currently in progress. The Company calculated the projected benefit obligations based on the current benefit level of Toshiba Corporate Pension Fund and included proportional share of the plan assets of TMSC in the following tables. These obligations and plan assets are expected to be reasonable estimates of the impact of creating the new plan.

Obligations and funded status

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

December 31	Japanese plans		Foreign plans	
	Millions of yen		Millions of yen	
	2016	2015	**2016**	2015
Change in benefit obligations:				
Projected benefit obligations at beginning of year	**781,350**	760,331	**349,680**	364,662
Service cost	**29,367**	30,009	**6,816**	7,760
Interest cost	**8,238**	8,008	**8,792**	10,572
Plan participants' contributions	**—**	—	**1,594**	1,830
Actuarial (gain) loss	**45,778**	7,481	**55,629**	(5,534)
Benefits paid	**(25,032)**	(24,479)	**(6,268)**	(6,795)
Acquisition	**71,040**	—	**21,285**	—
Plan amendments	**(4,734)**	—	**—**	(2,655)
Foreign currency exchange rate changes	**—**	—	**(45,442)**	(20,160)
Projected benefit obligations at end of year	**906,007**	781,350	**392,086**	349,680
Change in plan assets:				
Fair value of plan assets at beginning of year	**626,575**	622,121	**217,870**	221,421
Actual return on plan assets	**12,145**	17,541	**18,276**	21
Employer contributions	**7,304**	8,701	**7,271**	10,864
Plan participants' contributions	**—**	—	**1,594**	1,830
Benefits paid	**(21,782)**	(21,788)	**(6,268)**	(6,795)
Acquisition	**43,194**	—	**14,972**	—
Foreign currency exchange rate changes	**—**	—	**(28,776)**	(9,471)
Fair value of plan assets at end of year	**667,436**	626,575	**224,939**	217,870
Funded status at end of year	**(238,571)**	(154,775)	**(167,147)**	(131,810)

Amounts recognized in the consolidated balance sheets at December 31, 2016 and 2015 are as follows:

December 31	Japanese plans		Foreign plans	
	Millions of yen		Millions of yen	
	2016	2015	**2016**	2015
Other assets	**976**	814	**1,346**	9,986
Accrued expenses	**—**	—	**(840)**	(1,123)
Accrued pension and severance cost	**(239,547)**	(155,589)	**(167,653)**	(140,673)
	(238,571)	(154,775)	**(167,147)**	(131,810)

Amounts recognized in accumulated other comprehensive income (loss) at December 31, 2016 and 2015 before the effect of income taxes are as follows:

December 31	Japanese plans		Foreign plans	
	Millions of yen		Millions of yen	
	2016	2015	**2016**	2015
Actuarial loss	**251,078**	208,946	**116,930**	71,750
Prior service credit	**(71,439)**	(79,935)	**(2,652)**	(2,567)
	179,639	129,011	**114,278**	69,183

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

December 31	Japanese plans		Foreign plans	
	Millions of yen		Millions of yen	
	2016	2015	**2016**	2015
Accumulated benefit obligation	**869,355**	740,545	**377,004**	338,160

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

December 31	Japanese plans		Foreign plans	
	Millions of yen		Millions of yen	
	2016	2015	**2016**	2015
Plans with projected benefit obligations in excess of plan assets:				
Projected benefit obligations	**905,975**	777,458	**390,942**	346,749
Fair value of plan assets	**666,428**	621,869	**222,449**	204,953
Plans with accumulated benefit obligations in excess of plan assets:				
Accumulated benefit obligations	**867,706**	731,537	**375,860**	331,351
Fair value of plan assets	**664,586**	615,963	**222,449**	200,891

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, 2016, 2015 and 2014 consisted of the following components:

Years ended December 31	Japanese plans			Foreign plans		
	Millions of yen			Millions of yen		
	2016	2015	2014	**2016**	2015	2014
Service cost	**29,367**	30,009	26,445	**6,816**	7,760	6,801
Interest cost	**8,238**	8,008	10,772	**8,792**	10,572	10,654
Expected return on plan assets	**(19,443)**	(19,579)	(18,018)	**(10,012)**	(11,857)	(10,637)
Amortization of prior service credit	**(13,230)**	(12,592)	(12,800)	**85**	(145)	(61)
Amortization of actuarial loss	**10,944**	10,402	10,023	**2,185**	3,839	1,698
(Gain) loss on curtailments and settlements	**—**	—	—	**—**	—	(9,370)
	15,876	16,248	16,422	**7,866**	10,169	(915)

Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss) for the years ended December 31, 2016, 2015 and 2014 are summarized as follows:

Years ended December 31	Japanese plans			Foreign plans		
	Millions of yen			Millions of yen		
	2016	2015	2014	**2016**	2015	2014
Current year actuarial (gain) loss	**53,076**	9,519	33,800	**47,365**	6,302	37,366
Current year prior service credit	**(4,734)**	—	—	**—**	(2,655)	—
Amortization of actuarial loss	**(10,944)**	(10,402)	(10,023)	**(2,185)**	(3,839)	(1,698)
Amortization of prior service credit	**13,230**	12,592	12,800	**(85)**	145	61
Curtailments and settlements	**—**	—	—	**—**	—	(16,725)
	50,628	11,709	36,577	**45,095**	(47)	19,004

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

	Japanese plans	Foreign plans
	Millions of yen	Millions of yen
Prior service credit	(13,163)	43
Actuarial loss	13,852	5,765

Assumptions

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

December 31	Japanese plans		Foreign plans	
	2016	2015	**2016**	2015
Discount rate	**0.7%**	1.1%	**2.2%**	3.0%
Assumed rate of increase in future compensation levels	**2.6%**	3.0%	**2.1%**	2.0%

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

Years ended December 31	Japanese plans			Foreign plans		
	2016	2015	2014	**2016**	2015	2014
Discount rate	**1.1%**	1.1%	1.6%	**3.0%**	2.9%	3.9%
Assumed rate of increase in future compensation levels	**3.0%**	3.0%	3.0%	**2.0%**	2.0%	2.3%
Expected long-term rate of return on plan assets	**3.1%**	3.1%	3.1%	**4.4%**	5.6%	4.9%

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

Plan assets

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

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

Outside Japan, investment policies vary by country, but the long-term investment objectives and strategies remain consistent. Canon's model portfolio for foreign plans has been developed as follows: approximately 40% is invested in equity securities, approximately 30% is invested in debt securities, and approximately 30% is invested in other investment vehicles, primarily consisting of investments in real estate assets.

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

The three levels of input used to measure fair value are more fully described in Note 20. The fair values of Canon's pension plan assets at December 31, 2016 and 2015, by asset category, are as follows:

December 31, 2016	Millions of yen							
	Japanese plans				Foreign plans			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Equity securities:								
Japanese companies (a)	46,630	—	—	46,630	—	—	—	—
Foreign companies	7,902	—	—	7,902	22,680	—	—	22,680
Pooled funds (b)	—	133,023	—	133,023	—	62,641	—	62,641
Debt securities:								
Government bonds (c)	99,157	—	—	99,157	11,558	—	—	11,558
Municipal bonds	—	1,317	—	1,317	—	2,577	—	2,577
Corporate bonds	—	14,298	—	14,298	—	19,989	—	19,989
Pooled funds (d)	—	121,066	—	121,066	—	22,296	—	22,296
Mortgage backed securities (and other asset backed securities)	—	13,612	—	13,612	—	—	—	—
Life insurance company general accounts	—	128,220	—	128,220	—	6,898	—	6,898
Other assets	—	102,127	84	102,211	—	76,276	24	76,300
	153,689	513,663	84	667,436	34,238	190,677	24	224,939

December 31, 2015	Millions of yen							
	Japanese plans				Foreign plans			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Equity securities:								
Japanese companies (e)	49,847	—	—	49,847	—	—	—	—
Foreign companies	3,287	—	—	3,287	18,661	—	—	18,661
Pooled funds (f)	—	125,850	—	125,850	—	66,296	—	66,296
Debt securities:								
Government bonds (g)	142,015	—	—	142,015	48	—	—	48
Municipal bonds	—	1,248	—	1,248	—	2,587	—	2,587
Corporate bonds	—	13,532	—	13,532	—	21,009	—	21,009
Pooled funds (h)	—	120,364	—	120,364	—	34,564	—	34,564
Mortgage backed securities (and other asset backed securities)	—	10,462	—	10,462	—	137	—	137
Life insurance company general accounts	—	125,759	—	125,759	—	6,190	—	6,190
Other assets	—	33,432	779	34,211	—	68,378	—	68,378
	195,149	430,647	779	626,575	18,709	199,161	—	217,870

(a) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥187 million.
(b) These funds invest in listed equity securities consisting of approximately 25% Japanese companies and 75% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
(c) This class includes approximately 85% Japanese government bonds and 15% foreign government bonds for Japanese plans, and mainly foreign government bonds for foreign plans.
(d) These funds invest in approximately 25% Japanese government bonds, 50% foreign government bonds, 5% Japanese municipal bonds, and 20% corporate bonds for Japanese plans. These funds invest in approximately 70% foreign government bonds and 30% corporate bonds for foreign plans.
(e) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥325 million.
(f) These funds invest in listed equity securities consisting of approximately 25% Japanese companies and 75% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
(g) This class includes approximately 85% Japanese government bonds and 15% foreign government bonds for Japanese plans, and mainly foreign government bonds for foreign plans.
(h) These funds invest in approximately 25% Japanese government bonds, 50% foreign government bonds, 5% Japanese municipal bonds, and 20% corporate bonds for Japanese plans. These funds invest in approximately 75% foreign government bonds and 25% corporate bonds for foreign plans.

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

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

The fair value of Level 3 assets, consisting of hedge funds, was ¥108 million and ¥779 million at December 31, 2016 and 2015, respectively. Amounts of actual returns on, and purchases and sales of, these assets during the years ended December 31, 2016 and 2015 were not significant.

The fair values of plan assets by each asset category of TMSC are calculated based on a pro-rata basis of total plan assets of Toshiba Corporate Pension Fund.

Contributions

Canon expects to contribute ¥14,179 million to its Japanese defined benefit pension plans and ¥8,203 million to its foreign defined benefit pension plans for the year ending December 31, 2017.

Estimated future benefit payments

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

Year ending December 31:	Japanese plans	Foreign plans
	Millions of yen	Millions of yen
2017	30,021	9,549
2018	32,431	9,920
2019	33,936	10,070
2020	34,833	10,460
2021	36,715	10,905
2022–2026	203,010	61,681

Multiemployer pension plans

The amounts of cost recognized for the multiemployer pension plans primarily in the Netherlands for the years ended December 31, 2016, 2015 and 2014 were ¥3,482 million, ¥3,864 million and ¥2,815 million, respectively. The multiemployer pension plan in which the subsidiaries in the Netherlands participated was 96% funded as of December 31, 2015. The collective bargaining agreements have no expiration date. Canon is not liable for other participating employers' obligations under the terms and conditions of the agreements.

Defined contribution plans

The amounts of cost recognized for the defined contribution pension plans of the Company and certain of its subsidiaries for the years ended December 31, 2016, 2015 and 2014 were ¥17,603 million, ¥17,277 million and ¥15,077 million, respectively.

12. INCOME TAXES

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

Years ended December 31	Millions of yen		
	Japanese	Foreign	Total
2016: Income before income taxes	**135,131**	**109,520**	**244,651**
Income taxes:			
Current	**47,687**	**27,806**	**75,493**
Deferred	**4,126**	**3,062**	**7,188**
	51,813	**30,868**	**82,681**
2015: Income before income taxes	228,871	118,567	347,438
Income taxes:			
Current	80,020	31,413	111,433
Deferred	3,414	1,258	4,672
	83,434	32,671	116,105
2014: Income before income taxes	277,041	106,198	383,239
Income taxes:			
Current	83,221	25,850	109,071
Deferred	6,796	2,133	8,929
	90,017	27,983	118,000

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 33%, 35% and 38% for the years ended December 31, 2016, 2015 and 2014, respectively.

The statutory income tax rate utilized for deferred tax assets and liabilities which are expected to be settled or realized in the periods from January 1, 2017 is approximately 31%. The adjustments of deferred tax assets and liabilities for amendments to the Japanese tax regulations which have been reflected in income taxes in the consolidated statements of income for the years ended December 31, 2016 and 2015 were ¥3,498 million and ¥6,456 million, respectively.

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

Years ended December 31	**2016**	2015	2014
Japanese statutory income tax rate	**33.0%**	35.0%	38.0%
Increase (reduction) in income taxes resulting from:			
Expenses not deductible for tax purposes	**0.8**	0.8	0.7
Income of foreign subsidiaries taxed at lower than Japanese statutory tax rate	**(3.0)**	(2.9)	(3.7)
Tax credit for research and development expenses	**(3.0)**	(4.8)	(5.0)
Change in valuation allowance	**(0.8)**	(0.4)	(0.5)
Effect of enacted changes in tax laws and rates on Japanese tax	**1.4**	1.9	0.8
Other	**5.4**	3.8	0.5
Effective income tax rate	**33.8%**	33.4%	30.8%

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

December 31	Millions of yen	
	2016	2015
Prepaid expenses and other current assets	**—**	55,108
Other assets	**149,866**	113,687
Other current liabilities	**—**	(2,682)
Other noncurrent liabilities	**(108,429)**	(96,243)
	41,437	69,870

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities at December 31, 2016 and 2015 are presented below:

December 31	Millions of yen	
	2016	2015
Deferred tax assets:		
Inventories	**15,387**	15,298
Accrued business tax	**1,835**	3,293
Accrued pension and severance cost	**108,781**	77,420
Research and development—costs capitalized for tax purposes	**5,998**	6,906
Property, plant and equipment	**26,519**	24,281
Accrued expenses	**31,316**	39,881
Net operating losses carried forward	**29,167**	33,526
Other	**33,782**	33,808
	252,785	234,413
Less valuation allowance	**(26,687)**	(32,931)
Total deferred tax assets	**226,098**	201,482
Deferred tax liabilities:		
Undistributed earnings of foreign subsidiaries	**(9,450)**	(10,400)
Net unrealized gains on securities	**(7,321)**	(7,354)
Tax deductible reserve	**(4,449)**	(4,974)
Financing lease revenue	**(47,802)**	(54,280)
Prepaid pension and severance cost	**—**	(1,104)
Intangible assets	**(85,888)**	(21,106)
Other	**(29,751)**	(32,394)
Total deferred tax liabilities	**(184,661)**	(131,612)
Net deferred tax assets	**41,437**	69,870

The net changes in the total valuation allowance were a decrease of ¥6,244 million and ¥4,567 million for the years ended December 31, 2016 and 2015, respectively, and an increase of ¥2,443 million for the year ended December 31, 2014.

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, 2016.

At December 31, 2016, Canon had net operating losses which can be carried forward for income tax purposes of ¥175,404 million to reduce future taxable income. Periods available to reduce future taxable income vary in each tax jurisdiction and generally range from one year to an indefinite period as follows:

	Millions of yen
Within one year	2,150
After one year through five years	22,314
After five years through ten years	57,302
After ten years through twenty years	56,547
Indefinite period	37,091
Total	175,404

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 ¥26,474 million for a portion of undistributed earnings of foreign subsidiaries that arose for the year ended December 31, 2016 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, 2016, such undistributed earnings of these subsidiaries were ¥935,913 million.

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

Years ended December 31	Millions of yen		
	2016	2015	2014
Balance at beginning of year	**6,056**	6,431	6,201
Additions for tax positions of the current year	**2,741**	2,174	1,649
Additions for tax positions of prior years	**—**	165	216
Reductions for tax positions of prior years	**(665)**	(1,180)	(114)
Settlements with tax authorities	**(370)**	(505)	(1,808)
Other	**(444)**	(1,029)	287
Balance at end of year	**7,318**	6,056	6,431

The total amounts of unrecognized tax benefits that would reduce the effective tax rate, if recognized, were ¥7,318 million and ¥6,056 million at December 31, 2016 and 2015, respectively.

Although Canon believes its estimates and assumptions of unrecognized tax benefits are reasonable, uncertainty regarding the final determination of tax audit settlements and any related litigation could affect the effective tax rate in a future period. Based on each of the items of which Canon is aware at December 31, 2016, 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, 2016 and 2015, and interest and penalties included in income taxes for the years ended December 31, 2016, 2015 and 2014 were not significant.

Canon files income tax returns in Japan and various foreign tax jurisdictions. In Japan, Canon is no longer subject to regular income tax examinations by the tax authority for years before 2015. Canon is also no longer subject to a transfer pricing examination by the tax authority for years before 2015. In other major foreign tax jurisdictions, including the United States and the Netherlands, Canon is no longer subject to income tax examinations by tax authorities for years before 2007 with few exceptions. The tax authorities are currently conducting income tax examinations of Canon's income tax returns for years after 2006 in major foreign tax jurisdictions.

13. LEGAL RESERVE AND RETAINED EARNINGS

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

Cash dividends and appropriations to the legal reserve charged to retained earnings for the years ended December 31, 2016, 2015 and 2014 represent dividends paid out during those years and the related appropriations to the legal reserve. Retained earnings at December 31, 2016 did not reflect current year-end dividends in the amount of ¥81,905 million which were approved by the shareholders in March 2017.

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 ¥940,000 million at December 31, 2016.

Retained earnings at December 31, 2016 included Canon's equity in undistributed earnings of affiliated companies accounted for by the equity method in the amount of ¥17,804 million.

14. OTHER COMPREHENSIVE INCOME (LOSS)

Changes in accumulated other comprehensive income (loss) for the years ended December 31, 2016, 2015 and 2014 are as follows:

Millions of yen	Foreign currency translation adjustments	Unrealized gains and losses on securities	Gains and losses on derivative instruments	Pension liability adjustments	Total
Balance at December 31, 2013	1,734	10,242	(2,408)	(90,214)	(80,646)
Equity transactions with noncontrolling interests and other	10	3	—	(35)	(22)
Other comprehensive income (loss) before reclassifications	142,813	3,933	(2,204)	(47,840)	96,702
Amounts reclassified from accumulated other comprehensive income (loss)	—	(1,632)	2,009	11,875	12,252
Net change during the year	142,823	2,304	(195)	(36,000)	108,932
Balance at December 31, 2014	144,557	12,546	(2,603)	(126,214)	28,286
Equity transactions with noncontrolling interests and other	73	—	—	—	73
Other comprehensive income (loss) before reclassifications	(57,592)	1,691	(256)	(6,155)	(62,312)
Amounts reclassified from accumulated other comprehensive income (loss)	—	(182)	3,041	1,352	4,211
Net change during the year	(57,519)	1,509	2,785	(4,803)	(58,028)
Balance at December 31, 2015	**87,038**	**14,055**	**182**	**(131,017)**	**(29,742)**
Equity transactions with noncontrolling interests and other	**259**	**—**	**—**	**(1)**	**258**
Other comprehensive income (loss) before reclassifications	**(101,350)**	**814**	**938**	**(67,511)**	**(167,109)**
Amounts reclassified from accumulated other comprehensive income (loss)	**93**	**382**	**(3,862)**	**99**	**(3,288)**
Net change during the year	**(100,998)**	**1,196**	**(2,924)**	**(67,413)**	**(170,139)**
Balance at December 31, 2016	**(13,960)**	**15,251**	**(2,742)**	**(198,430)**	**(199,881)**

Reclassifications out of accumulated other comprehensive income (loss) for the years ended December 31, 2016, 2015 and 2014 are as follows:

Years ended December 31	Amount reclassified from accumulated other comprehensive income (loss)*1 Millions of yen			Affected line items in consolidated statements of income
	2016	2015	2014	
Foreign currency translation adjustments	**139**	—	—	Other, net
	(46)	—	—	Income taxes
	93	—	—	Consolidated net income
	—	—	—	Net income attributable to noncontrolling interests
	93	—	—	Net income attributable to Canon Inc.
Unrealized gains and losses on securities	**282**	(298)	(2,509)	Other, net
	(94)	104	879	Income taxes
	188	(194)	(1,630)	Consolidated net income
	194	12	(2)	Net income attributable to noncontrolling interests
	382	(182)	(1,632)	Net income attributable to Canon Inc.
Gains and losses on derivative instruments	**(5,890)**	4,217	3,260	Other, net
	2,049	(1,180)	(1,248)	Income taxes
	(3,841)	3,037	2,012	Consolidated net income
	(21)	4	(3)	Net income attributable to noncontrolling interests
	(3,862)	3,041	2,009	Net income attributable to Canon Inc.
Pension liability adjustments	**(16)**	1,504	15,585	See Note 11
	164	(175)	(3,710)	Income taxes
	148	1,329	11,875	Consolidated net income
	(49)	23	—	Net income attributable to noncontrolling interests
	99	1,352	11,875	Net income attributable to Canon Inc.
Total amount reclassified, net of tax and noncontrolling interests	**(3,288)**	4,211	12,252	

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

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

Years ended December 31	Millions of yen		
	Before-tax amount	Tax (expense) or benefit	Net-of-tax amount
2016:			
Foreign currency translation adjustments:			
Amount arising during the year	**(108,280)**	**521**	**(107,759)**
Reclassification adjustments for gains and losses realized in net income	**139**	**(46)**	**93**
Net change during the year	**(108,141)**	**475**	**(107,666)**
Net unrealized gains and losses on securities:			
Amount arising during the year	**1,184**	**(375)**	**809**
Reclassification adjustments for gains and losses realized in net income	**282**	**(94)**	**188**
Net change during the year	**1,466**	**(469)**	**997**
Net gains and losses on derivative instruments:			
Amount arising during the year	**1,619**	**(726)**	**893**
Reclassification adjustments for gains and losses realized in net income	**(5,890)**	**2,049**	**(3,841)**
Net change during the year	**(4,271)**	**1,323**	**(2,948)**
Pension liability adjustments:			
Amount arising during the year	**(95,707)**	**25,204**	**(70,503)**
Reclassification adjustments for gains and losses realized in net income	**(16)**	**164**	**148**
Net change during the year	**(95,723)**	**25,368**	**(70,355)**
Other comprehensive income (loss)	**(206,669)**	**26,697**	**(179,972)**
2015:			
Foreign currency translation adjustments	(56,054)	550	(55,504)
Net unrealized gains and losses on securities:			
Amount arising during the year	3,249	(1,045)	2,204
Reclassification adjustments for gains and losses realized in net income	(298)	104	(194)
Net change during the year	2,951	(941)	2,010
Net gains and losses on derivative instruments:			
Amount arising during the year	52	(304)	(252)
Reclassification adjustments for gains and losses realized in net income	4,217	(1,180)	3,037
Net change during the year	4,269	(1,484)	2,785
Pension liability adjustments:			
Amount arising during the year	(13,166)	5,294	(7,872)
Reclassification adjustments for gains and losses realized in net income	1,504	(175)	1,329
Net change during the year	(11,662)	5,119	(6,543)
Other comprehensive income (loss)	(60,496)	3,244	(57,252)
2014:			
Foreign currency translation adjustments	144,826	(992)	143,834
Net unrealized gains and losses on securities:			
Amount arising during the year	6,379	(2,225)	4,154
Reclassification adjustments for gains and losses realized in net income	(2,509)	879	(1,630)
Net change during the year	3,870	(1,346)	2,524
Net gains and losses on derivative instruments:			
Amount arising during the year	(3,309)	1,102	(2,207)
Reclassification adjustments for gains and losses realized in net income	3,260	(1,248)	2,012
Net change during the year	(49)	(146)	(195)
Pension liability adjustments:			
Amount arising during the year	(71,166)	21,306	(49,860)
Reclassification adjustments for gains and losses realized in net income	15,585	(3,710)	11,875
Net change during the year	(55,581)	17,596	(37,985)
Other comprehensive income (loss)	93,066	15,112	108,178

15. STOCK-BASED COMPENSATION

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

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

The compensation cost recognized for these stock options for the years ended December 31, 2016, 2015 and 2014 was nil.

A summary of option activity under the stock option plans as of and for the years ended December 31, 2016, 2015 and 2014 is presented below:

	Shares	Weighted-average exercise price	Weighted-average remaining contractual term	Aggregate intrinsic value
		Yen	Year	Millions of yen
Outstanding at January 1, 2014	2,657,400	4,245	1.0	28
Exercised	(67,200)	3,287		
Forfeited/Expired	(728,400)	4,869		
Outstanding at December 31, 2014	1,861,800	4,036	0.7	248
Exercised	(249,600)	3,311		
Forfeited/Expired	(316,200)	3,678		
Outstanding at December 31, 2015	1,296,000	4,263	0.4	—
Exercised	**—**	**—**		
Forfeited/Expired	**(693,000)**	**4,500**		
Outstanding at December 31, 2016	**603,000**	**3,990**	**0.2**	**—**
Exercisable at December 31, 2016	**603,000**	**3,990**	**0.2**	**—**

At December 31, 2016, all outstanding option awards were vested.

The total fair value of shares vested during the years ended December 31, 2016, 2015 and 2014 was nil. Cash received from the exercise of stock options for the years ended December 31, 2016, 2015 and 2014 was nil, ¥826 million and ¥221 million, respectively.

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

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

Years ended December 31	Millions of yen		
	2016	2015	2014
Net income attributable to Canon Inc.	**150,650**	220,209	254,797
	Number of shares		
Average common shares outstanding	**1,092,070,680**	1,092,017,955	1,112,509,931
Effect of dilutive securities:			
Stock options	**—**	34,931	4,393
Diluted common shares outstanding	**1,092,070,680**	1,092,052,886	1,112,514,324
	Yen		
Net income attributable to Canon Inc. shareholders per share:			
Basic	**137.95**	201.65	229.03
Diluted	**137.95**	201.65	229.03

The computation of diluted net income attributable to Canon Inc. shareholders per share for the year ended December 31, 2016 excludes outstanding stock options because the effect would be anti-dilutive. The computation of diluted net income attributable to Canon Inc. shareholders per share for the years ended December 31, 2015 and 2014 excludes certain outstanding stock options because the effect would be anti-dilutive.

17. DERIVATIVES AND HEDGING ACTIVITIES

Risk management policy

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

Foreign currency exchange rate risk management

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

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

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

Contract amounts of foreign exchange contracts at December 31, 2016 and 2015 are set forth below:

December 31	Millions of yen	
	2016	2015
To sell foreign currencies	**371,644**	228,053
To buy foreign currencies	**46,741**	37,540

Fair value of derivative instruments in the consolidated balance sheets

The following tables present Canon's derivative instruments measured at gross fair value as reflected in the consolidated balance sheets at December 31, 2016 and 2015.

Derivatives designated as hedging instruments

December 31		Fair value	
		Millions of yen	
	Balance sheet location	**2016**	2015
Assets:			
Foreign exchange contracts	Prepaid expenses and other current assets	**19**	373
Liabilities:			
Foreign exchange contracts	Other current liabilities	**1,913**	534

Derivatives not designated as hedging instruments

December 31		Fair value	
		Millions of yen	
	Balance sheet location	**2016**	2015
Assets:			
Foreign exchange contracts	Prepaid expenses and other current assets	**567**	1,112
Liabilities:			
Foreign exchange contracts	Other current liabilities	**7,479**	90

Effect of derivative instruments in the consolidated statements of income

The following tables present the effect of Canon's derivative instruments in the consolidated statements of income for the years ended December 31, 2016, 2015 and 2014.

Derivatives in cash flow hedging relationships

Years ended December 31	Gain (loss) recognized in OCI (effective portion)	Gain (loss) reclassified from accumulated OCI into income (effective portion)		Gain (loss) recognized in income (ineffective portion and amount excluded from effectiveness testing)	
Millions of yen	Amount	Location	Amount	Location	Amount
2016: Foreign exchange contracts	**1,619**	Other, net	**5,890**	Other, net	**(311)**
2015: Foreign exchange contracts	52	Other, net	(4,217)	Other, net	(131)
2014: Foreign exchange contracts	(3,309)	Other, net	(3,260)	Other, net	(145)

Derivatives not designated as hedging instruments

Years ended December 31		Gain (loss) recognized in income on derivative		
		Millions of yen		
	Location	**2016**	2015	2014
Foreign exchange contracts	Other, net	**7,018**	1,099	(21,728)

18. COMMITMENTS AND CONTINGENT LIABILITIES

Commitments

At December 31, 2016, commitments outstanding for the purchase of property, plant and equipment approximated ¥36,578 million, and commitments outstanding for the purchase of parts and raw materials approximated ¥119,395 million.

Canon occupies sales offices and other facilities under lease arrangements accounted for as operating leases. Deposits made under such arrangements aggregated ¥13,128 million and ¥13,561 million at December 31, 2016 and 2015, respectively, and are included in noncurrent receivables in the accompanying consolidated balance sheets. Rental expenses under such operating lease arrangements amounted to ¥42,714 million, ¥46,483 million and ¥43,215 million for the years ended December 31, 2016, 2015 and 2014, 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, 2016 are as follows:

Year ending December 31:	Millions of yen
2017	26,380
2018	18,273
2019	13,543
2020	8,544
2021	6,411
Thereafter	11,794
Total future minimum lease payments	84,945

Guarantees

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

For each guarantee provided, Canon would have to perform under a guarantee if the borrower defaults on a payment within the contract periods of 1 year to 30 years, in the case of employees with housing loans, and 1 year to 5 years, in the case of affiliates and other companies. The maximum amount of undiscounted payments Canon would have had to make in the event of default is ¥6,056 million at December 31, 2016. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2016 were not significant.

Canon also issues contractual product warranties under which it generally guarantees the performance of products delivered and services rendered for a certain period or term. Changes in accrued product warranty costs for the years ended December 31, 2016 and 2015 are summarized as follows:

Years ended December 31	Millions of yen	
	2016	2015
Balance at beginning of year	**14,014**	11,564
Additions	**15,403**	18,942
Utilization	**(12,759)**	(12,404)
Other	**(3,490)**	(4,088)
Balance at end of year	**13,168**	14,014

Legal proceedings

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

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

Fair value of financial instruments

The estimated fair values of Canon's financial instruments at December 31, 2016 and 2015 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 and derivative instruments which are disclosed in Note 2 and Note 17, respectively.

December 31	Millions of yen			
	2016		2015	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Long-term debt, including current installments	**(612,538)**	**(612,668)**	(1,543)	(1,507)

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

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

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

Concentrations of credit risk
At December 31, 2016 and 2015, one customer accounted for approximately 12% and 15% of consolidated trade receivables, respectively. Although Canon does not expect that the customer will fail to meet its obligations, Canon is potentially exposed to concentrations of credit risk if the customer failed to perform according to the terms of the contracts.

20. FAIR VALUE MEASUREMENTS

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

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

Assets and liabilities measured at fair value on a recurring basis
The following tables present Canon's assets and liabilities that are measured at fair value on a recurring basis consistent with the fair value hierarchy at December 31, 2016 and 2015.

December 31 Millions of yen	Level 1	Level 2	Level 3	Total
2016: Assets:				
Cash and cash equivalents	—	30,500	—	30,500
Available-for-sale (noncurrent):				
Government bonds	269	—	—	269
Corporate bonds	—	229	—	229
Fund trusts	12	74	—	86
Equity securities	42,444	—	—	42,444
Derivatives	—	586	—	586
Total assets	42,725	31,389	—	74,114
Liabilities:				
Derivatives	—	9,392	—	9,392
Total liabilities	—	9,392	—	9,392

Millions of yen	Level 1	Level 2	Level 3	Total
2015: Assets:				
Cash and cash equivalents	—	80,870	—	80,870
Available-for-sale (noncurrent):				
Government bonds	287	—	—	287
Corporate bonds	—	201	—	201
Fund trusts	12	52	—	64
Equity securities	42,849	—	—	42,849
Derivatives	—	1,485	—	1,485
Total assets	43,148	82,608	—	125,756
Liabilities:				
Derivatives	—	624	—	624
Total liabilities	—	624	—	624

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

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

The following table presents the changes in Level 3 assets measured on a recurring basis, consisting primarily of corporate bonds, for the year ended December 31, 2015. There are no changes in Level 3 assets measured on a recurring basis for the year ended December 31, 2016.

Years ended December 31	Millions of yen
	2015
Balance at beginning of year	474
Total gains or losses (realized or unrealized):	
Included in earnings	—
Included in other comprehensive income (loss)	22
Purchases, issuances, and settlements	(496)
Balance at end of year	—

Assets and liabilities measured at fair value on a nonrecurring basis

During the years ended December 31, 2016 and 2015, there were no circumstances that required any significant assets or liabilities to be measured at fair value on a nonrecurring basis.

21. SEGMENT INFORMATION

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

The primary products included in each segment are as follows:

Office Business Unit:

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

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

Industry and Others Business Unit:
Semiconductor lithography equipment / FPD (Flat panel display) lithography equipment / Digital radiography systems / Diagnostic X-ray Systems / Computed Tomography / Magnetic Resonance Imaging / Diagnostic Ultrasound Systems / Clinical Chemistry Analyzers / Ophthalmic equipment / Vacuum thin-film deposition equipment / Organic LED (OLED) panel manufacturing equipment / Die bonders / Micromotors / Network cameras / Handy terminals / Document scanners

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

Information about operating results and assets for each segment as of and for the years ended December 31, 2016, 2015 and 2014 is as follows:

Millions of yen	Office	Imaging System	Industry and Others	Corporate and eliminations	Consolidated
2016: Net sales:					
External customers	**1,804,862**	**1,094,291**	**502,334**	**—**	**3,401,487**
Intersegment	**2,957**	**998**	**82,326**	**(86,281)**	**—**
Total	**1,807,819**	**1,095,289**	**584,660**	**(86,281)**	**3,401,487**
Operating cost and expenses	**1,638,333**	**950,876**	**577,212**	**6,200**	**3,172,621**
Operating profit	**169,486**	**144,413**	**7,448**	**(92,481)**	**228,866**
Total assets	**961,749**	**391,661**	**545,210**	**3,239,909**	**5,138,529**
Depreciation and amortization	**78,319**	**47,386**	**41,053**	**83,338**	**250,096**
Capital expenditures	**72,189**	**25,564**	**29,346**	**81,280**	**208,379**
2015: Net sales:					
External customers	2,108,246	1,262,667	429,358	—	3,800,271
Intersegment	2,570	1,168	95,293	(99,031)	—
Total	2,110,816	1,263,835	524,651	(99,031)	3,800,271
Operating cost and expenses	1,820,230	1,080,396	537,730	6,705	3,445,061
Operating profit	290,586	183,439	(13,079)	(105,736)	355,210
Total assets	1,020,758	452,283	332,252	2,622,480	4,427,773
Depreciation and amortization	86,206	52,070	45,064	89,987	273,327
Capital expenditures	73,819	38,337	24,241	106,733	243,130
2014: Net sales:					
External customers	2,075,788	1,342,501	308,963	—	3,727,252
Intersegment	2,944	693	89,802	(93,439)	—
Total	2,078,732	1,343,194	398,765	(93,439)	3,727,252
Operating cost and expenses	1,786,675	1,148,593	420,566	7,929	3,363,763
Operating profit	292,057	194,601	(21,801)	(101,368)	363,489
Total assets	1,025,499	517,524	342,695	2,574,900	4,460,618
Depreciation and amortization	87,058	53,912	37,544	84,966	263,480
Capital expenditures	69,704	31,124	15,976	107,956	224,760

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

Operating results of TMSC for the year ended December 31, 2016 and assets of TMSC other than corporate assets at December 31, 2016 are included in Industry and Others Business Unit based on preliminary assessment.

Information about product sales to external customers by business unit for the years ended December 31, 2016, 2015 and 2014 is as follows:

Years ended December 31	Millions of yen		
	2016	2015	2014
Office			
Monochrome copiers	**289,532**	328,061	322,398
Color copiers	**386,193**	421,209	401,447
Printers	**664,846**	857,369	862,000
Others	**464,291**	501,607	489,943
Total	**1,804,862**	2,108,246	2,075,788
Imaging System			
Cameras	**666,868**	782,623	861,196
Inkjet printers	**329,066**	362,663	366,946
Others	**98,357**	117,381	114,359
Total	**1,094,291**	1,262,667	1,342,501
Industry and Others			
Lithography equipment	**121,090**	123,887	90,395
Others	**381,244**	305,471	218,568
Total	**502,334**	429,358	308,963
Consolidated	**3,401,487**	3,800,271	3,727,252

Information by major geographic area as of and for the years ended December 31, 2016, 2015 and 2014 is as follows:

	Millions of yen		
	2016	2015	2014
Net sales:			
Japan	**706,979**	714,280	724,317
Americas	**963,544**	1,144,422	1,036,500
Europe	**913,523**	1,074,366	1,090,484
Asia and Oceania	**817,441**	867,203	875,951
Total	**3,401,487**	3,800,271	3,727,252
Long-lived assets:			
Japan	**1,163,374**	937,716	950,719
Americas	**147,129**	150,105	157,748
Europe	**166,734**	183,451	127,700
Asia and Oceania	**164,007**	189,588	210,650
Total	**1,641,244**	1,460,860	1,446,817

Net sales are attributed to areas based on the location where the product is shipped to the customers. Other than in Japan and the United States, Canon does not conduct business in any individual country in which its sales in that country exceed 10% of consolidated net sales. Net sales in the United States were ¥884,083 million, ¥1,047,838 million and ¥938,411 million for the years ended December 31, 2016, 2015 and 2014, respectively.

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

In addition to the disclosure requirements under Topic 280, Canon has disclosed the segment information based on the location of Canon Inc. and its subsidiaries. Results from a survey of a representative sample of financial statement users, however, indicated that they consider the latter to be less useful than sales information based on the location where the product is shipped to customers, which is disclosed separately. For this reason, Canon decided to discontinue the disclosure of geographical segment information based on the location of Canon Inc. and its subsidiaries from this year, in order to avoid the risk of confusing users due to disclosing two similar types of geographical information and make disclosure more concise and transparent.

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

Years ended December 31 Millions of yen	Balance at beginning of period	Addition-charged to income	Deduction bad debts written off	Translation adjustments and other	Balance at end of period
2016: Allowance for doubtful receivables					
Trade receivables	**12,077**	**1,460**	**(1,824)**	**(638)**	**11,075**
Finance receivables	**2,878**	**398**	**(978)**	**27**	**2,325**
2015: Allowance for doubtful receivables					
Trade receivables	12,122	2,180	(1,745)	(480)	12,077
Finance receivables	6,276	55	(1,343)	(2,110)	2,878
2014: Allowance for doubtful receivables					
Trade receivables	12,730	878	(2,236)	750	12,122
Finance receivables	7,323	154	(1,171)	(30)	6,276

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 excluded from its assessment of the effectiveness of Canon's internal control over financial reporting as of December 31, 2016, an assessment of internal control over financial reporting of Toshiba Medical Systems Corporation ("TMSC"), which became a wholly-owned subsidiary of Canon on December 19, 2016. TMSC had total assets of 251.4 billion yen and net sales of 13.6 billion yen for the period from December 19, 2016 to December 31, 2016 that were reflected in Canon's consolidated financial statements as of and for the fiscal year ended December 31, 2016.

Canon's management assessed the effectiveness of internal control over financial reporting as of December 31, 2016. In making this assessment, management used the criteria established in internal Control –Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the "COSO criteria").

Based on its assessment, management concluded that, as of December 31, 2016, Canon's internal control over financial reporting was effective based on the COSO criteria.

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

Fujio Mitarai
Chairman & CEO

Toshizo Tanaka
Executive Vice President & CFO

March 30, 2017

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Building a better working world

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The Board of Directors and Shareholders of
Canon Inc.

We have audited the accompanying consolidated balance sheets of Canon Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2016. Our audits also included the schedule of valuation and qualifying accounts (the "schedule"). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Canon Inc. and subsidiaries at December 31, 2016 and 2015, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Canon Inc. and subsidiaries' internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 30, 2017 expressed an unqualified opinion thereon.

Ernst & Young ShinNihon LLC

March 30, 2017

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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The Board of Directors and Shareholders of
Canon Inc.

We have audited Canon Inc. and subsidiaries' internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Canon Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

As indicated in the accompanying Management's Report on Internal Control over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Toshiba Medical Systems Corporation, which is included in the 2016 consolidated financial statements of Canon Inc. and subsidiaries and constituted 251.4 billion yen of total assets as of December 31, 2016 and 13.6 billion yen of net sales for the year then ended. Our audit of internal control over financial reporting of Canon Inc. and subsidiaries also did not include an evaluation of the internal control over financial reporting of Toshiba Medical Systems Corporation.

In our opinion, Canon Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Canon Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2016, and our report dated March 30, 2017 expressed an unqualified opinion thereon.

Ernst & Young ShinNihon LLC

March 30, 2017

TRANSFER AND REGISTRAR'S OFFICE

Canon Inc.

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

Manager of the Register of Shareholders

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

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

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

SHAREHOLDER INFORMATION

Stock Exchange Listings:

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

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

Ordinary General Meeting of Shareholders:

March 30, 2017, in Tokyo

Further Information:

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

MAJOR CONSOLIDATED SUBSIDIARIES

(As of December 31, 2016)

Manufacturing

Canon Precision Inc.
Fukushima Canon Inc.
TOSHIBA MEDICAL SYSTEMS CORPORATION
TOSHIBA ELECTRON TUBES & DEVICES CO., LTD.
Canon Chemicals Inc.
Canon Components, Inc.
Canon Electronics Inc.
Canon Finetech Inc.
Nisca Corporation
Canon Tokki Corporation
Canon ANELVA Corporation
Nagahama Canon Inc.
Canon Machinery Inc.
Oita Canon Materials Inc.
Oita Canon Inc.
Nagasaki Canon Inc.
Canon Virginia, Inc.
Canon Bretagne S.A.S.
Axis Communications AB
Océ-Technologies B.V.
Océ Printing Systems G.m.b.H.
Canon Dalian Business Machines, Inc.
Canon (Suzhou) Inc.
Canon Zhongshan Business Machines Co., Ltd.
Canon Zhuhai, Inc.
Canon Inc., Taiwan
Canon Vietnam Co., Ltd.
Canon Hi-Tech (Thailand) Ltd.
Canon Prachinburi (Thailand) Ltd.
Canon Business Machines (Philippines), Inc.
Canon Opto (Malaysia) Sdn. Bhd.

Research & Development

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

Marketing & Other

Canon Marketing Japan Inc.
Canon System and Support Inc.
Canon Software Inc.
Canon IT Solutions Inc.
TOSHIBA AMERICA MEDICAL SYSTEMS, INC.
Canon U.S.A., Inc.
Canon Canada Inc.
Canon Solutions America, Inc.
Canon Financial Services, Inc.
TOSHIBA MEDICAL SYSTEMS EUROPE B.V.
Canon Europa N.V.
Canon Europe Ltd.
Canon Ru LLC
Canon (UK) Ltd.
Canon Deutschland GmbH
Canon (Schweiz) AG
Canon Nederland N.V.
Canon France S.A.S.
Canon Middle East FZ-LLC
Canon Italia S.p.A.
Canon (China) Co., Ltd.
Canon Hongkong Co., Ltd.
Canon Singapore Pte. Ltd.
Canon India Pvt. Ltd.
Canon Australia Pty. Ltd.

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