CANON INC
Form 6-K
August 06, 2010

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Report of Foreign Issuer
Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

For the month of .....**August**... , **2010**

CANON INC.
(Translation of registrant s name into English)
30-2, Shimomaruko 3-Chome, Ohta-ku, Tokyo 146-8501, Japan

(Address of principal executive offices)

[Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F **X** Form 40-F

[Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes No **X**

[If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b):82-.....................

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CANON INC.
(Registrant)

Date....**August 5, 2010**.....

By...../s/...... Masashiro Kobayashi
....
(Signature)*

Masashiro Kobayashi
General Manager
Global Finance Management Center
Canon Inc.

*Print the name and title of the signing officer under his signature.
The following materials are included.
1. Quarterly Report filed with the Japanese government pursuant to the Financial Instruments and Exchange Law of Japan For the second quarter ended June 30, 2010

[English summary with full translation of consolidated financial information]

Quarterly Report filed with the Japanese government
pursuant to
the Financial Instruments and Exchange Law of Japan
For the second quarter ended
June 30, 2010
CANON INC.
Tokyo, Japan

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Disclaimer Regarding Forward-Looking Statements

This quarterly report includes forward-looking statements (within the meaning of Section 27A of the U.S. Securities Act of 1933 and Section 21E of the U.S. Securities Exchange Act of 1934) concerning Canon Inc. (the Company) and its subsidiaries (collectively Canon). To the extent that statements in this quarterly report do not relate to historical or current facts, they constitute forward-looking statements. These forward-looking statements are based on the current assumptions and beliefs of Canon in light of the information currently available to them, and involve known and unknown risks, uncertainties and other factors. Such risks, uncertainties and other factors may cause Canon s actual results, performance, achievements or financial position to be materially different from any future results, performance, achievements or financial position expressed or implied by these forward-looking statements. Canon undertakes no obligation to publicly update any forward-looking statements after the date of this quarterly report. Investors are advised to consult any further disclosures by Canon in its subsequent filings with the U.S. Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934 and its other filings.

The risks, uncertainties and other factors referred to above include, but are not limited to, foreign 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 exchange rate fluctuations; uncertainty of economic conditions in Canon s major markets; uncertainty about continued demand for Canon s high-value-added products; uncertainty about the recovery of computer and related markets; uncertainty about the recovery in demand for Canon s semiconductor production equipment; Canon s ability to continue to develop and 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 exchange rates; and inventory risk due to shifts in market demand.

I . Corporate Information

(1) <u>Consolidated Financial Summary</u>

	Millions of yen (except per share amounts)				
	Six months ended June 30, 2010	Six months ended June 30, 2009	Three months ended June 30, 2010	Three months ended June 30, 2009	Year ended December 31, 2009
Net sales	1,725,884	1,480,819	970,358	793,785	3,209,201
Income before income taxes	201,503	57,886	112,651	35,492	219,355
Net income attributable to Canon Inc.	124,449	33,349	67,638	15,605	131,647
Canon Inc. stockholders equity	-	-	2,699,378	2,683,183	2,688,109
Total equity	-	-	2,876,283	2,871,761	2,879,400
Total assets	-	-	4,016,902	3,744,669	3,847,557
Canon Inc. stockholders equity per share (yen)	-	-	2,176.72	2,173.53	2,177.53
Net income attributable to Canon Inc. Stockholders per share:					
Basic (yen)	100.68	27.01	54.67	12.64	106.64
Diluted (yen)	100.68	27.01	54.66	12.64	106.64
Canon Inc. stockholders equity to total assets (%)	-	-	67.2	71.7	69.9
Cash flows from operating activities	348,575	188,701	-	-	611,235
Cash flows from investing activities	(176,982)	(218,332)	-	-	(370,244)
Cash flows from financing activities	(150,605)	(71,360)	-	-	(142,379)
Cash and cash equivalents at end of period	-	-	771,697	603,565	795,034
Number of employees	-	-	193,804	165,318	168,879

Notes:

1. Canon s consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles.

2. Consumption tax is excluded from the stated amount of net sales.

(2) Description of Business

Canon prepares quarterly consolidated financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP). The conformity to U.S. GAAP is also applied to sections II. The Business and III. Property, Plant and Equipment .

Canon (consisting of the Company, 308 consolidated subsidiaries and 15 affiliates accounted for using the equity method, collectively, the Group) is engaged in the development, manufacture, sale and service primarily in the fields of office, consumer, industry and others. No material change in Canon s business has occurred during the three months ended June 30, 2010.

No additions or removals of principal group entities have occurred during the three months ended June 30, 2010.

(3) Group Entities

No additions or removals of significant group entities have occurred during the three months ended June 30, 2010.

(4) Number of Employees

Canon s number of employees is summarized as follows:

	As of June 30, 2010
Consolidated	193,804
Parent-alone	26,123

Note:

The total number of employees includes seasonal workers and others who do not work full time.

II. The Business

(1) <u>Production and Sales</u>

Production

Canon s production by segment group are summarized as follows:

	Millions of yen Three months ended June 30, 2010 Production	Change from June 30, 2009(%)
Office	486,779	+84.9
Consumer	404,127	+18.5
Industry and Others	72,709	+76.3
Total	963,615	+49.3

Notes:

1. Amount of production is calculated by sales price.

2. Consumption tax is excluded from the stated amount of production.

Sales

Canon s sales by segment group are summarized as follows:

	Millions of yen Three months ended June 30, 2010 Sales	Change from June 30, 2009(%)
Office	521,943	+31.3
Consumer	364,027	+9.8
Industry and Others	108,930	+27.5
Eliminations	(24,542)	-
Total	970,358	+22.2

Notes:

1. Consumption tax is excluded from the stated amount of net sales.

2. Canon s sales to its significant customer are summarized as follows:

Millions of yen	
Three months ended June 30, 2010	Three months ended June 30, 2009

	Sales	Proportion (%)	Sales	Proportion (%)
Hewlett-Packard Company	193,743	20.0	141,161	17.8

(2) Risk Factors

No additional risks related to Canon s business have arisen during the three months ended June 30, 2010. Furthermore, no material changes are recognized pursuant to the risk factors of Canon s business indicated in the Annual Securities Report (Yukashoken houkokusho) of the previous fiscal year.

(3) Significant Business Contracts Entered into in the Second Quarter of 2010

Share Exchange Agreement Canon Machinery Inc.

On June 28, 2010, the Boards of Directors of Canon Inc. (the Company) approved a share exchange under which the Company would make Canon Machinery Inc. (Canon Machinery) its wholly owned subsidiary, and the Company has entered into a share exchange agreement with Canon Machinery on the same date.

1. Strategic Rationale

The Company aims to facilitate the organic integration of management resources between the Company and Canon Machinery, further enhance the synergies throughout the Canon Group, and promote the flexibility and speed of its management, through the share exchange with Canon Machinery.

2. Method and Procedures

In accordance with the share exchange agreement reached on June 28, 2010, the Company allotted 0.61 share of the Company for one share of Canon Machinery to the shareholders of Canon Machinery (excluding itself), who will hold the shares of Canon Machinery just before the planned acquisition date of all the outstanding shares (excluding shares already held by the Company).

The Company executed the share exchange without obtaining the approval at the shareholders meeting of Canon Inc., pursuant to the provision of Article 796 Paragraph 3 stated in the Corporation Law, which specifies the simplified share exchange procedure. The Company did not issue new shares for this transaction, and allotted its treasury stocks instead.

3. Share Exchange Ratio

0.61 share of common stock of the Company was allotted and delivered for one share of common stock of Canon Machinery. As for the 5,208,900 shares of Canon Machinery held by the Company, no shares were allotted.

4. Basis for Calculation of the Terms of Allotment in Connection with the Share Exchange

In order to secure the fairness of the share exchange ratio under the share exchange, the Company and Canon Machinery determined that each company would separately request an independent third-party appraisal agency to calculate the share exchange ratio, and designated Nomura Securities Co., Ltd. (Nomura Securities) and Daiwa Securities Capital Markets Co., Ltd. (Daiwa Securities CM), respectively, as the third-party appraisal agencies to calculate the share exchange ratio.

Nomura Securities calculated the share exchange ratio by performing the average market price analysis for the Company, and the average market price analysis, comparable companies analysis and discounted cash flow analysis (DCF analysis) for Canon Machinery.

Daiwa Securities CM calculated the share exchange ratio by performing the market price analysis for the Company, and the market price analysis, comparable companies analysis and discounted cash flow analysis (DCF analysis) for Canon Machinery.

The Company and Canon Machinery diligently examined the results of professional analysis and advice on the calculation of the proposed share exchange ratios submitted by the above-mentioned third-party appraisal agencies designated by each company, and the Boards of Directors of the Company and Canon Machinery determined the share exchange ratio under the share exchange.

5. Date of the Share Exchange (effective date)
Friday, October 1, 2010
6. Outline of the Parties to the Share Exchange
Wholly owning parent company resulting from the Share Exchange

(1) Trade Name: Canon Inc.
(2) Business Operation: Development, Manufacture and sale of office equipment, consumer products, and industrial and other equipment
(3) Common Stock: ¥174,762 million (As of June 30, 2010)

Share Exchange Agreement Tokki corporation

On June 28, 2010, the Boards of Directors of Canon Inc. (the Company) approved a share exchange under which the Company would make Tokki corporation (Tokki) its wholly owned subsidiary, and the Company has entered into a share exchange agreement with Tokki on the same date.

1. Strategic Rationale

The Company aims to facilitate the organic integration of management resources between the Company and Tokki, further enhance the synergies throughout the Canon Group, and promote the flexibility and speed of its management, through the share exchange with Tokki.

2. Method and Procedures

In accordance with the share exchange agreement reached on June 28, 2010, the Company allotted 0.12 share of the Company for one share of Tokki to the shareholders of Tokki (excluding itself), who will hold the shares of Tokki just before the planned acquisition date of all the outstanding shares (excluding shares already held by the Company).

The Company executed the share exchange without obtaining the approval at the shareholders meeting of Canon Inc., pursuant to the provision of Article 796 Paragraph 3 stated in the Corporation Law, which specifies the simplified share exchange procedure. The Company did not issue new shares for this transaction, and allotted its treasury stocks instead.

3. Share Exchange Ratio

0.12 share of common stock of the Company was allotted and delivered for one share of common stock of Tokki. As for the 22,301,620 shares of Tokki held by the Company, no shares were allotted.

4. Basis for Calculation of the Terms of Allotment in Connection with the Share Exchange

In order to secure the fairness of the share exchange ratio under the share exchange, the Company and Tokki determined that each company would separately request an independent third-party appraisal agency to calculate the share exchange ratio, and designated Nomura Securities Co., Ltd. (Nomura Securities) and Mitsubishi UFJ Morgan Stanley Securities Co., Ltd. (Mitsubishi UFJ Morgan Stanley Securities), respectively, as the third-party appraisal agencies to calculate the share exchange ratio.

Nomura Securities calculated the share exchange ratio by performing the average market price analysis for the Company, and the average market price analysis, comparable companies analysis and discounted cash flow analysis (DCF analysis) for Tokki.

Mitsubishi UFJ Morgan Stanley Securities calculated the share exchange ratio by performing the market price analysis for the Company, and the market price analysis, comparable companies analysis and discounted cash flow analysis (DCF analysis) for Tokki.

The Company and Tokki diligently examined the results of professional analysis and advice on the calculation of the proposed share exchange ratios submitted by the above-mentioned third-party appraisal agencies designated by each company, and the Boards of Directors of the Company and Tokki determined the share exchange ratio under the share exchange.

5. Date of the Share Exchange (effective date)

Friday, October 1, 2010

6. Outline of the Parties to the Share Exchange

Wholly owning parent company resulting from the Share Exchange

(1) Trade Name: Canon Inc.

(2) Business Operation: Development, Manufacture and sale of office equipment, consumer products, and industrial and other equipment

(3) Common Stock: ¥174,762 million (As of June 30, 2010)

(4) Operating Results

Looking back at the global economy in the second quarter of 2010, economic conditions continued improving broadly amid the recovery trend from the second half of 2009. Although the pace of economic recovery in Europe has remained decidedly modest largely due to sluggish consumer spending triggered by the financial concerns of Greece and other Southern European nations, along with deteriorating unemployment conditions, the United States continued to record a recovery in consumer spending along with steady export growth, while Japan saw a rapid increase in exports, mainly to Asian countries. The Asian economies, such as those of China and India, along with other emerging countries, continued to display solid growth.

As for the markets in which Canon operates amid these conditions, within the office equipment market, as had occurred earlier with color-model network digital multifunction devices (MFDs), demand for monochrome models also finally headed toward recovery. Additionally, the market for laser printers achieved a turnaround compared with the previous year. As for the consumer products market, demand for digital single-lens reflex (SLR) cameras displayed healthy growth throughout most all global markets, while demand for compact digital cameras recovered in developed countries and grew steadily in emerging markets, such as those in Asia. With regard to inkjet printers, demand indicates a steady recovery trend with the market size expanding compared with the year-ago period. In the industry and others market, market conditions for semiconductor lithography equipment and liquid crystal display (LCD) lithography equipment were marked by an upturn in order placements, owing to improved sentiment within the semiconductor-device and LCD-panel markets. The average values of the yen during the second quarter and first half of the year were ¥91.96 and ¥91.35 to the U.S. dollar, respectively, year-on-year appreciations of approximately ¥5 and ¥4, and ¥116.34 and ¥120.20 to the euro, year-on-year appreciations of approximately ¥17 and ¥7.

Amid the effects of the strong yen, net sales for the quarter totaled ¥970.4 billion, an increase of 22.2% from the year-ago period, and ¥1,725.9 billion for the first six months, a jump of 16.5%, owing to strong sales of such consumer products as digital SLR cameras, a strong recovery in sales of laser printers among office products, the turnaround within the industry and others market, and the impact of consolidation arising from corporate acquisitions, such as that of Océ N.V. Although the appreciation of the yen had a significant impact, the quarterly gross profit ratio rose 5.5 points year on year to 49.0%, and improved 5.4 points to 48.9% for the first half, mainly reflecting the launch of new products and ongoing cost-cutting efforts, along with heightened production turnover accompanying ramped up production. As a result, gross profit rose by 37.6% to ¥475.4 billion for the second quarter and increased by 31.0% to ¥843.9 billion for the six months ended June 30, 2010. Despite the impact of consolidation, Group-wide efforts to thoroughly cut spending contributed to an improvement in the operating expenses to sales ratio of 0.5 points to 37.3% for the quarter, and of 1.8 points to 37.3% for the first half of the year. Consequently, operating profit climbed approximately 2.5-fold to ¥113.4 billion for the quarter, and approximately 3.1 fold to ¥200.3 billion for the combined six-month period. Other income (deductions) recorded an increase due to an improvement in foreign currency exchange losses and earnings on investments in affiliates, leading to income before income taxes for the second quarter of ¥112.7 billion, an approximately 3.2-fold increase year on year, and ¥201.5 billion for the six months ended June 30, 2010, an approximately 3.5-fold leap from the corresponding period of the previous year. Net income attributable to Canon Inc. surged approximately 4.3-fold to ¥67.6 billion for the quarter, and 3.7 fold to ¥124.4 billion for the first half.

Basic net income attributable to Canon Inc. stockholders per share for the quarter was ¥54.67, an increase of ¥42.03 compared with the corresponding quarter of the previous year, and ¥100.68 for the first half of 2010, a year-on-year increase of ¥73.67.

Canon s second-quarter results by business unit are summarized as follows:

Looking at Canon s quarterly performance by business sector, within the Office Business Unit, while sales volume of color network digital MFDs increased by 39% boosted by the recovery in demand for office equipment along with the introduction of new image RUNNER ADVANCE-series products, sales volume for monochrome models increased by 21% reflecting the recovering market conditions. Laser printers, which suffered sluggish sales in the corresponding quarter of the previous year largely due to an adjustment of inventory levels, realized a significant increase in sales volume of 103%, almost double that of the previous year. Consequently, despite the significant effects of the strong yen, second-quarter sales for the segment totaled ¥521.9 billion, growing 31.3% year on year, and ¥931.1 billion for the six months ended June 30, 2010, an increase of 19.9%. Operating profit increased 98.0% to ¥83.8 billion for the second quarter, and 72.8% to ¥155.9 billion for the combined six months of the year, mainly as a result of expanded sales and the sharp rise in the gross profit ratio.

Within the Consumer Business Unit, sales volumes of such new digital SLR cameras as the competitively priced EOS Digital Rebel T1i (EOS 500D) and the new EOS Digital Rebel T2i (EOS 550D), along with the EOS 5D Mark II and EOS 7D advanced-amateur models, sustained healthy growth. As for compact digital cameras, the Company launched four new ELPH (IXUS)-series models and five new PowerShot-series models, boosting sales volumes particularly in emerging markets. Consequently, sales volume for digital cameras recorded a year-on-year increase of 9%. With respect to inkjet printers, sales displayed solid growth, particularly in Asia, amid the market recovery, contributing to an increase in sales volume of 4%. Although the appreciation of the yen had a strong impact, sales for the segment rose 9.8% year on year to ¥364.0 billion, and 14.0% to ¥654.3 billion for the six-month period. Operating profit increased by 71.6% to ¥66.9 billion for the quarter, and 101.3% to ¥114.3 billion for the first half, largely reflecting increased sales and the rise in the gross profit ratio.

In the Industry and Others Business Unit, independent business-related sales of Group subsidiaries increased in line with the turnaround in business conditions while sales volume of LCD lithography equipment grew appreciably, stimulated by the revival of the market. Sales volume of semiconductor lithography equipment, while remaining at a low level, also gained modestly. As a result, sales for the segment grew 27.5% to ¥108.9 billion for the quarter and 11.6% to ¥191.3 billion for the combined six months. Operating loss improved by ¥2.7 billion to ¥5.4 billion for the quarter and totaled ¥8.4 billion for the six-month period, a turnaround of ¥15.4 billion year on year owing to expanded sales combined with a reduction in expenses.

Second-quarter results by major geographic area are summarized as follows:

Japan

Net sales in Japan for the second quarter recorded an increase of 18.8% from the year-ago period to ¥733.6 billion, and a growth of 19.5% to ¥1,357.1 billion for the six months ended June 30, 2010 mainly owing to the rise in production turnover accompanying an increase in production, along with a significant recovery in sales. Operating profit generated in Japan surged 137.8% year on year to ¥115.1 billion for the quarter, and 160.5% to ¥210.2 billion for the six-month period.

Amid the effects of the strong yen, net sales outside Japan recorded growth compared with the corresponding quarter and six months of the previous year, thanks to the healthy sales expansion of products such as digital SLR cameras, coupled with the sales rebound for laser printers.

Americas

Despite the sharp appreciation of the yen, second-quarter sales totaled ¥266.4 billion, an increase of 20.9% from the year-ago period, and ¥467.8 billion for the combined six months of the year, an increase of 19.3%, largely due to solid sales of digital SLR cameras, recovery of sales for laser printers and the impact of consolidation. Operating profit for the second quarter totaled ¥7.6 billion, an approximately 4.0-fold increase year on year, and ¥11.5 billion for the six months ended June 30, 2010, an approximately 6.5-fold leap from the corresponding period of the previous year.

Europe

Although the appreciation of the yen had a strong impact, sales for the quarter recorded ¥310.4 billion, an increase of 29.7% from the same period of the previous year, and ¥540.5 billion an increase of 20.5% compared with the first half of the previous year, primarily due to the significant recovery of laser-printer-sales, combined with the effects of new consolidation. Operating profit for the second quarter totaled ¥13.1 billion, an approximately 2.5-fold increase year on year, and ¥20.0 billion for the six months ended June 30, 2010, a jump of 48.0%.

Asia and others

Sales for the second quarter rose by 45.5% from the year-ago period to ¥364.2 billion, and increased by 50.3% to ¥652.2 billion for the six months ended June 30, 2010 mainly owing to expanded sales of digital SLR cameras and LCD lithography equipment. Operating profit generated in the region surged 50.5% year on year to ¥14.1 billion for the quarter, and 85.1% to ¥25.0 billion for the six-month period.

Cash Flows

In the second quarter of 2010, cash flows from operating activities totaled ¥186.9 billion, an increase of ¥50.7 billion year on year, mainly due to the significant increase in profit. As capital investment was focused on items relevant to introducing new products, cash flows from investing activities decreased ¥50.4 billion to a total of ¥65.9 billion. Accordingly, free cash flows totaled positive ¥121.0 billion, an increase of ¥101.1 billion from the corresponding year-ago period.

Cash flows from financing activities recorded an outlay of ¥26.3 billion, mainly arising from the partial repayment of certain borrowings of Océ N.V., classified as short-term loans. Cash and cash equivalents increased by ¥56.2 billion to ¥771.7 billion from the end of the previous quarter.

Management Issues to be Addressed

No material changes or issues with respect to business operations and finance have occurred during the three months ended June 30, 2010.

Research and Development Expenditures

Canon s research and development expenditures for the three months ended June 30, 2010 totaled ¥81.9 billion.

III . Property, Plant and Equipment

(1) <u>Major Property, Plant and Equipment</u>

There were no significant changes to the status of existing major property, plant and equipment during the second quarter of 2010.

(2) <u>Prospect of Capital Investment in the Second Quarter of Fiscal 2010</u>

There were no significant changes in the plans relevant to the retirement of property, plant and equipment during the second quarter of 2010. Moreover, there were no significant additional plans for new construction or retirement of property, plant and equipment during the second quarter of 2010.

IV . Company Information

(1) <u>Shares</u>

Total number of authorized shares is 3,000,000,000 shares. The common stock of Canon is listed on the Tokyo, Osaka, Nagoya, Fukuoka, Sapporo and New York Stock Exchanges. Total issued shares are as follows:

	As of June 30, 2010
Total number of issued shares	1,333,763,464

<u>Stock Acquisition Rights</u>

The descriptions of the stock option plans as of June 30, 2010 are below.

The Stock Option Plan Approved on March 28, 2008

1. Number of share options

The number of share options that the Board of Directors are authorized to issue is 5,680.

2. Number of shares acquired upon exercise of a share option

The number of shares acquired upon exercise of one share option (the Allotted Number of Shares) is 100 common shares, and the total number of shares to be delivered due to the exercise of share options is 568,000 common shares.

3. Cash payment for share options (yen)

The cash payment required for each share option is ¥5,502.

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

Exercise Price after Adjustment

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

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

Exercise Price after Adjustment = Exercise Price before Adjustment ×
Number of Newly Issued Shares × Payment amount per Share
Number of Issued and Outstanding Shares +
Market Price
Number of Issued and Outstanding Shares + Number of Newly Issued Shares

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

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

4. Period during which share options are exercisable

From May 1, 2010 to April 30, 2014.

5. Exercise price and amount of increased stated capital (yen)

The exercise price and amount of increased stated capital per share is ¥5,502 and ¥2,751, respectively.

6. Other Conditions for Exercise of Share Options

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

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

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

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

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

7. Restriction on Acquisition of Share Options by Transfer

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

The Stock Option Plan Approved on March 27, 2009

1. Number of share options

The number of share options that the Board of Directors are authorized to issue is 7,820.

2. Number of shares acquired upon exercise of a share option

The number of shares acquired upon exercise of one share option (the Allotted Number of Shares) is 100 common shares, and the total number of shares to be delivered due to the exercise of share options is 782,000 common shares.

3. Cash payment for share options (yen)

The cash payment required for each share option is ¥3,287.

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

Exercise Price after Adjustment

1

=Exercise Price before adjustment ×	Ratio of Share Split or Share Consolidation

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

Exercise Price after Adjustment = Exercise Price before Adjustment ×

Number of Newly Issued Shares × Payment amount per Share

Number of Issued and Outstanding Shares +

Market Price

Number of Issued and Outstanding Shares + Number of Newly Issued Shares

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

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

4. Period during which share options are exercisable

From May 1, 2011 to April 30, 2015.

5. Exercise price and amount of increased stated capital (yen)

The exercise price and amount of increased stated capital per share is ¥3,287 and ¥1,644, respectively.

6. Other Conditions for Exercise of Share Options

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

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

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

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

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

7. Restriction on Acquisition of Share Options by Transfer

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

The Stock Option Plan Approved on March 30, 2010

1. Number of share options

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

2. Number of shares acquired upon exercise of a share option

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

3. Cash payment for share options (yen)

The cash payment required for each share option is ¥4,573.

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

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

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

$$\text{Exercise Price after Adjustment} = \text{Exercise Price before Adjustment} \times \frac{\text{Number of Issued and Outstanding Shares} + \dfrac{\text{Number of Newly Issued Shares} \times \text{Payment amount per Share}}{\text{Market Price}}}{\text{Number of Issued and Outstanding Shares} + \text{Number of Newly Issued Shares}}$$

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

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

4. Period during which share options are exercisable

From May 1, 2012 to April 30, 2016.

5. Exercise price and amount of increased stated capital (yen)

The exercise price and amount of increased stated capital per share is ¥4,573 and ¥2,287, respectively.

6. Other Conditions for Exercise of Share Options

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

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

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

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

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

7. Restriction on Acquisition of Share Options by Transfer

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

Exercise status of bonds with share subscription rights containing an adjustable exercise price clause

Not applicable.

Rights Plan

Not applicable

Change in Issued Shares, Capital Stock and Additional Paid in Capital

	Change during this term	As of June 30, 2010
Issued Shares (share)	-	1,333,763,464
Capital Stock (millions of yen)	-	174,762
Additional Paid-in Capital (millions of yen)	-	306,288

Major Shareholders

	As of June 30, 2010 Number of shares owned (Number of shares)	Number of shares owned / Number of shares issued
The Dai-ichi Life Insurance Company, Limited	74,832,380	5.61%
Japan Trustee Services Bank, Ltd. (Trust Account)	64,792,200	4.86%
The Master Trust Bank of Japan, Ltd. (Trust Account)	60,714,200	4.55%
Moxley & Co.	46,472,318	3.48%
JPMorgan Chase & Co. 380055	45,175,827	3.39%
State Street Bank and Trust Company	28,852,664	2.16%
State Street Bank and Trust Company 505223	20,412,863	1.53%
Sompo Japan Insurance Inc.	19,439,987	1.46%
State Street Bank and Trust Company 505225	19,154,948	1.44%
Melon bank. N.A. as agent for its client melon omnibus US pension	17,330,398	1.30%
total	397,177,785	29.78%

Notes:

1. Apart from the above shares, The Dai-Ichi Life Insurance Company, Limited held 6,180,000 shares contributed to a trust fund for its retirement and severance plans.

2. Moxley & Co. is a nominee of JPMorgan Chase Bank, which is the depositary of Canon s ADRs (American Depositary Receipts.)

3. Apart from the above shares, the Company owns 93,650,553 shares (7.02% of total issued shares) of treasury stock.

4. Mizuho Corporate Bank, Ltd. and its four affiliated companies listed below submitted a report on large share holdings to the Kanto Local Finance Bureau on July 7, 2010 in their joint names and reported that they owned 67,096,536 shares (5.03%) of the Company as of June 30, 2010 in total as detailed below. However, the Company has not confirmed the status of these holdings as of June 30, 2010.

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	Number of shares held	Number of shares held / Number of shares issued
Mizuho Corporate Bank, Ltd.	20,123,736	1.51%
Mizuho Bank, Ltd.	11,491,437	0.86%
Mizuho Securities Co., Ltd.	6,701,197	0.50%
Mizuho Trust & Banking Co., Ltd.	26,620,366	2.00%
Mizuho Asset Management Co., Ltd.	2,159,800	0.16%
total	67,096,536	5.03%

Voting Rights

As of June 30, 2010

Classification	Number of shares (shares)	Number of voting rights (units)
Shares without voting rights	-	-
Shares with restricted voting rights (Treasury stock, etc.)	-	-
Shares with restricted voting rights (Others)	-	-
Shares with full voting rights (Treasury stock, etc.)	(treasury stock) 93,650,500 (cross shareholding) 3,700	-
Shares with full voting rights (Others)	1,238,126,200	12,381,262
Fractional unit shares	1,983,064	-
Total number of issued shares	1,333,763,464	-
Total voting rights held by all shareholders	-	12,381,262

Note:

In Fractional unit shares under Number of shares, 53 shares of treasury stock and 50 shares of cross shareholding are included.

Treasury Stock

	Number of shares owned (Number of shares)	Number of shares owned / Number of shares issued

Canon Inc.	93,650,500	7.02%
Horie Mfg. Co., Ltd.	3,700	0.00%
Total	93,654,200	7.02%

(2) Stock Price Transition

The following table sets forth the monthly reported high and low market prices of the Company s common stock on the First Section of Tokyo Stock Exchange for the six months of fiscal 2010:

(Yen)

	January	February	March	April	May	June
High	4,040	3,865	4,400	4,520	4,240	3,905
Low	3,525	3,425	3,685	4,165	3,530	3,260

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(3) <u>Directors and Executive Officers</u>

There were no changes in members of directors between the filing date of the Annual Securities Report (Yukashoken Houkokusho) for the fiscal year ended December 31, 2009 and the filing date of this Quarterly Securities Report (Shihanki Houkokusho).

Changes in functions of directors are below:

Toshizo Tanaka	(Executive Vice President & CFO)
Masahiro Osawa	(Managing Director: Group Executive of Global Procurement HQ, Group Executive of General Affairs HQ)
Haruhisa Honda	(Managing Director: Group Executive of Manufacturing HQ)

The change in members of executive officers between the filing date of the Annual Securities Report (Yukashoken Houkokusho) for the fiscal year ended December 31, 2009 and the filing date of this Quarterly Securities Report (Shihanki Houkokusho) is below.

Changes in functions of executive officers are below:

Masahiro Haga	(Executive Officer: Group Executive of Finance & Accounting HQ)
Kengo Uramoto	(Executive Officer: Group Executive of Human Resources Management & Organization HQ)
Kenichi Nagasawa	(Executive Officer: Group Executive of Corporate Intellectual Property & Legal HQ)
Shigeyuki Uzawa	(Executive Officer: Deputy Chief Executive of Optical Products HQ)

V . Financial Statements (Unaudited)

(1) Consolidated Financial Statements

Index of Consolidated Financial Statements of Canon Inc. and Subsidiaries:

CANON INC. AND SUBSIDIARIES
Consolidated Balance Sheets

	Millions of yen	
	June 30, 2010	December 31, 2009
Assets		
Current assets:		
Cash and cash equivalents (Note 14)	771,697	795,034
Short-term investments (Note 2)	35,264	19,089
Trade receivables, net (Note 3)	547,961	556,572
Inventories (Note 4)	427,767	373,241
Prepaid expenses and other current assets (Note 10)	295,678	273,843
Total current assets	2,078,367	2,017,779
Noncurrent receivables (Note11)	15,789	14,936
Investments (Note 2)	86,426	114,066
Property, plant and equipment, net (Note 5)	1,263,422	1,269,785
Intangible assets, net	170,158	117,396
Other assets (Note 10)	402,740	313,595
Total assets	4,016,902	3,847,557

CANON INC. AND SUBSIDIARIES
Consolidated Balance Sheets (continued)

	Millions of yen	
	June 30, 2010	December 31, 2009
Liabilities and equity		
Current liabilities:		
Short-term loans and current portion of long-term debt	6,834	4,869
Trade payables (Note 6)	385,682	339,113
Accrued income taxes	66,818	50,105
Accrued expenses (Note 11)	280,191	274,300
Other current liabilities (Note 10)	137,368	115,303
Total current liabilities	876,893	783,690
Long-term debt, excluding current installments	5,444	4,912
Accrued pension and severance cost	177,412	115,904
Other noncurrent liabilities	80,870	63,651
Total liabilities	1,140,619	968,157
Commitments and contingent liabilities (Note 11)		
Equity:		
Canon Inc. stockholders equity (Note 8):		
Common stock	174,762	174,762
(Number of authorized shares)	(3,000,000,000)	(3,000,000,000)
(Number of issued shares)	(1,333,763,464)	(1,333,763,464)
Additional paid-in capital	407,031	404,293
Legal reserve	55,291	54,687
Retained earnings	2,918,817	2,871,437
Accumulated other comprehensive income (loss)	(333,405)	(260,818)
Treasury stock, at cost	(523,118)	(556,252)
(Number of shares)	(93,650,553)	(99,288,001)
Total Canon Inc. stockholders equity	2,699,378	2,688,109
Noncontrolling interests (Note 8)	176,905	191,291
Total equity (Note 8)	2,876,283	2,879,400
Total liabilities and equity	4,016,902	3,847,557

CANON INC. AND SUBSIDIARIES
Consolidated Statements of Income

	Millions of yen	
	Six months ended June 30, 2010	Six months ended June 30, 2009
Net sales	1,725,884	1,480,819
Cost of sales	881,953	836,540
Gross profit	843,931	644,279
Operating expenses:		
Selling, general and administrative expenses (Note 14)	490,825	425,735
Research and development expenses	152,825	153,606
	643,650	579,341
Operating profit	200,281	64,938
Other income (deductions):		
Interest and dividend income	2,743	2,791
Interest expense	(953)	(221)
Other, net (Notes 10, 13 and 14)	(568)	(9,622)
	1,222	(7,052)
Income before income taxes	201,503	57,886
Income taxes	73,975	24,105
Consolidated net income	127,528	33,781
Less: Net income attributable to noncontrolling interests	3,079	432
Net income attributable to Canon Inc.	124,449	33,349

	Yen	Yen
Net income attributable to Canon Inc. stockholders per share (Note 9):		
Basic	100.68	27.01
Diluted	100.68	27.01
Cash dividends per share	55.00	55.00

CANON INC. AND SUBSIDIARIES
Consolidated Statements of Income

	Millions of yen	
	Three months ended June 30, 2010	Three months ended June 30, 2009
Net sales	970,358	793,785
Cost of sales	494,995	448,320
Gross profit	475,363	345,465
Operating expenses:		
Selling, general and administrative expenses (Note 14)	280,033	219,742
Research and development expenses	81,892	80,817
	361,925	300,559
Operating profit	113,438	44,906
Other income (deductions):		
Interest and dividend income	1,722	1,357
Interest expense	(867)	(137)
Other, net (Notes 10, 13 and 14)	(1,642)	(10,634)
	(787)	(9,414)
Income before income taxes	112,651	35,492
Income taxes	43,858	17,346
Consolidated net income	68,793	18,146
Less: Net income attributable to noncontrolling interests	1,155	2,541
Net income attributable to Canon Inc.	67,638	15,605

	Yen	Yen
Net income attributable to Canon Inc. stockholders per share (Note 9):		
Basic	54.67	12.64
Diluted	54.66	12.64
Cash dividends per share	55.00	55.00

CANON INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows

	Millions of yen	
	Six months ended June 30, 2010	Six months ended June 30, 2009
Cash flows from operating activities:		
Consolidated net income	127,528	33,781
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	125,968	155,003
(Gain) loss on disposal of property, plant and equipment	4,597	(2,977)
Deferred income taxes	4,911	11,367
Decrease in trade receivables	15,598	101,401
(Increase) decrease in inventories	(49,876)	98,766
Increase (decrease) in trade payables	87,995	(146,775)
Increase (decrease) in accrued income taxes	19,734	(52,879)
Decrease in accrued expenses	(24,228)	(40,676)
Increase in accrued (prepaid) pension and severance cost	2,605	824
Other, net	33,743	30,866
Net cash provided by operating activities	348,575	188,701
Cash flows from investing activities:		
Purchases of fixed assets (Note 5)	(96,783)	(195,449)
Proceeds from sale of fixed assets (Note 5)	1,306	8,450
Purchases of available-for-sale securities	(9,028)	(50)
Proceeds from sale and maturity of available-for-sale securities	24	241
Decrease in time deposits, net	(16,840)	(20,153)
Acquisitions of subsidiaries, net of cash acquired	(55,533)	(2,979)
Purchases of other investments	(505)	(10,133)
Other, net	377	1,741
Net cash used in investing activities	(176,982)	(218,332)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	3,107	2,228
Repayments of long-term debt	(2,751)	(3,232)
Decrease in short-term loans, net (Note 7)	(76,661)	(204)
Dividends paid	(67,897)	(67,897)
Repurchases of treasury stock, net	(5,022)	(18)
Other, net	(1,381)	(2,237)
Net cash used in financing activities	(150,605)	(71,360)
Effect of exchange rate changes on cash and cash equivalents	(44,325)	25,360

Net change in cash and cash equivalents	(23,337)	(75,631)
Cash and cash equivalents at beginning of period	795,034	679,196
Cash and cash equivalents at end of period	771,697	603,565
Supplemental disclosure for cash flow information:		
Cash paid during the period for:		
Interest	609	227
Income taxes	49,842	62,361

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(1) Basis of Presentation and Significant Accounting Policies

(a) Basis of Presentation

The Company issued convertible debentures in the United States in May 1969 and established a program in which its American Depositary Receipts (ADRs) were traded in the U.S. over-the-counter market. Since then, under the U.S. Securities Act of 1933 and the U.S. Securities Exchange Act of 1934, the Company has prepared its annual consolidated financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and filed them with the U.S. Securities and Exchange Commission on Form 20-F. The Company s ADRs were listed on the NYSE in September 2000 after being quoted on NASDAQ from February 1972 to September 2000.

Canon s consolidated financial statements are prepared in accordance with the recognition and measurement criteria of accounting principles generally accepted in the United States. Certain disclosures have been omitted.

The number of consolidated subsidiaries and affiliated companies that were accounted for on the equity method basis as of June 30, 2010 and December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Consolidated subsidiaries	308	241
Affiliated companies	15	15
Total	323	256

(b) 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.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(1) Basis of Presentation and Significant Accounting Policies (continued)

(c) Recently Issued Accounting Guidance

In October 2009, the FASB issued new accounting guidance for revenue recognition under multiple-deliverable arrangements. This guidance modifies the criteria for separating consideration under multiple-deliverable arrangements and requires allocation of the overall consideration to each deliverable using the estimated selling price in the absence of vendor-specific objective evidence or third-party evidence of selling price for deliverables. As a result, the residual method of allocating arrangement consideration will no longer be permitted. The guidance also requires additional disclosures about how a vendor allocates revenue in its arrangements and about the significant judgments made and their impact on revenue recognition. This guidance is effective for fiscal years beginning on or after June 15, 2010 and is required to be adopted by Canon no later than the first quarter beginning January 1, 2011 (with early adoption permitted). The provisions are effective prospectively for revenue arrangements entered into or materially modified after the effective date, or retrospectively for all prior periods. Canon is currently evaluating the effect of the adoption of this guidance, but does not expect the adoption of this guidance to have a material impact on Canon s consolidated financial statements.

In October 2009, the FASB issued new accounting guidance for software revenue recognition. This guidance modifies the scope of the software revenue recognition guidance to exclude from its requirements non-software components of tangible products and software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product s essential functionality. This guidance is effective for fiscal years beginning on or after June 15, 2010 and is required to be adopted by Canon no later than the first quarter beginning January 1, 2011 (with early adoption permitted) using the same effective date and the same transition method used to adopt the guidance for revenue recognition under multiple-deliverable arrangements. Canon is currently evaluating the of the adoption of this guidance, but does not expect the adoption of this guidance to have a material impact on Canon s consolidated financial statements.

CANON INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(2) Investments

The cost, gross unrealized holding gains, gross unrealized holding losses and fair value for available-for-sale securities by major security types are as follows:

	Millions of yen June 30, 2010			
	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Current:				
Government bonds	222	-	-	222
Corporate bonds	1,000	-	-	1,000
	1,222	-	-	1,222
Noncurrent:				
Government bonds	295	-	17	278
Corporate bonds	268	26	55	239
Fund trusts	3,114	160	1	3,273
Equity securities	20,150	6,222	2,656	23,716
	23,827	6,408	2,729	27,506

	Millions of yen December 31, 2009			
	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Current:				
Government bonds	222	-	-	222
Noncurrent:				
Government bonds	225	-	21	204
Corporate bonds	1,397	27	55	1,369
Fund trusts	2,275	300	7	2,568
Equity securities	11,932	7,295	1,501	17,726
	15,829	7,622	1,584	21,867

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(2) Investments (continued)

Maturities of available-for-sale debt securities and fund trusts included in short-term investments and investments in the accompanying consolidated balance sheets were as follows at June 30, 2010:

	Millions of yen	
	Cost	Fair value
Due within one year	1,222	1,222
Due after one year through five years	2,272	2,432
Due after five years through ten years	1,405	1,358
	4,899	5,012

Realized gains and losses are determined using the average cost method and are reflected in earnings. The gross realized losses, including write-downs for impairments that were other than temporary, were not significant for the six and three months ended June 30, 2010 and ¥1,884 million and 1,369 million for the six and three months ended June 30, 2009 respectively. The gross realized gains were not significant for the six and three months ended June 30, 2010 and 2009.

At June 30, 2010, substantially all of the available-for-sale securities with unrealized losses had been in a continuous unrealized loss position for less than 12 months.

Time deposits with original maturities of more than three months are ¥33,983 million and ¥18,852 million at June 30, 2010 and December 31, 2009, respectively, and are included in short-term investments in the accompanying consolidated balance sheets.

The aggregate cost of non-marketable equity securities accounted for under the cost method totaled ¥25,912 million and ¥28,567 million at June 30, 2010 and December 31, 2009, respectively. Investments with an aggregate cost of ¥23,490 million were not evaluated for impairment as of June 30, 2010, because (a) Canon did not estimate the fair value of those investments as it was not practicable to estimate the fair value of such 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.

Reclassifications from accumulated other comprehensive loss for gains and losses realized in net income was not significant for the six and three months ended June 30, 2010, and ¥1,494 million and ¥1,114 million for the six and three months ended June 30, 2009, respectively.

CANON INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(3) Trade Receivables

Trade receivables are summarized as follows:

	Millions of yen	
	June 30, 2010	December 31, 2009
Notes	37,613	13,037
Accounts	526,598	554,878
Less allowance for doubtful receivables	(16,250)	(11,343)
	547,961	556,572

(4) Inventories

Inventories are summarized as follows:

	Millions of yen	
	June 30, 2010	December 31, 2009
Finished goods	249,308	228,161
Work in process	143,232	129,824
Raw materials	35,227	15,256
	427,767	373,241

(5) Property, Plant and Equipment

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

	Millions of yen	
	June 30, 2010	December 31, 2009
Land	268,317	258,824
Buildings	1,310,157	1,299,154
Machinery and equipment	1,459,279	1,422,076
Construction in progress	87,390	105,713
	3,125,143	3,085,767
Less accumulated depreciation	(1,861,721)	(1,815,982)
	1,263,422	1,269,785

Fixed assets presented in the consolidated statement of cash flows includes property, plant and equipment and intangible assets.

(6) Trade Payables

Trade payables are summarized as follows:

	Millions of yen	
	June 30, 2010	December 31, 2009
Notes	11,463	7,608
Accounts	374,219	331,505
	385,682	339,113

CANON INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(7) Acquisition

In March 2010, Canon acquired 45.2 % of the total outstanding shares of Océ N.V. (Océ), which is listed on NYSE Euronext Amsterdam, for consideration of ¥ 50,374 million, in addition to the 22.9% interest Canon held before the public cash tender offer. In addition, Canon acquired Océ s convertible cumulative financing preference shares representing 19.1% of the total outstanding shares of Océ for consideration of ¥ 8,027 million. As a result, Canon s aggregate interest represents 87.2 % of the total outstanding shares of Océ. The fair value of the 12.8% noncontrolling interest in Océ of ¥ 18,245 million was measured mainly based on Océ s common stock price on the acquisition date.

The acquisition was accounted for using the acquisition method. Prior to the March 2010 acquisition date, Canon accounted for its 22.9% interest in Océ using the equity method. The acquisition-date fair value of the previous equity interest of ¥ 25,508 million was remeasured using the quoted price of Océ s common stock on the acquisition date and included in the measurement of the total acquisition consideration. In connection with the acquisition, Canon repaid ¥ 55,378 million of Océ s existing bank debt and ¥ 22,936 million of Océ s existing United States Private Placements notes, which are included in decrease in short-term loans in the consolidated statement of cash flows.

Océ is engaged in research and development, manufacture and sale of document management systems, printing systems for professionals and high-speed, wide format digital printing systems. Canon and Océ have complementary technologies and products and would benefit from this strong business relationship. Amid the increasingly competitive printing industry, Canon is further strengthening its business foundation in order to solidify its position as one of the global leaders. Canon aims to provide diversified solutions to its customers in the printing industry by making Océ a consolidated subsidiary.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at acquisition date. Although Canon is allocating the amount paid for acquisition to the acquired assets and assumed liabilities, such allocation is incomplete as of the issuance date of the consolidated financial statements.

	Millions of yen
Current assets	123,572
Goodwill and other intangible assets	140,839
Other noncurrent assets	91,650
Non-current assets	232,489
Total acquired assets	356,061
Total assumed liabilities	253,907
Net assets acquired	102,154

The amounts of net sales of Océ included in the Canon s consolidated statements of income from the acquisition date to the period ended June 30, 2010 were ¥ 71,874 million.

The unaudited pro forma net sales as if Océ had been included in Canon s consolidated results of operations from the beginning of fiscal 2010 and 2009 were ¥ 1,810,372 million and ¥ 1,650,759 million, respectively.

Pro forma information related to net income was not disclosed because the impact on the Canon s consolidated results of operation was not material.

CANON INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(8) Equity

The change in the carrying amount of total equity, equity attributable to Canon Inc. stockholders and equity attributable to noncontrolling interests in the consolidated balance sheets for the six months ended June 30, 2010 and 2009 are as follows:

	Millions of yen		
	Canon Inc. stockholders equity	Noncontrolling interests	Total equity
Balance at December 31, 2009	2,688,109	191,291	2,879,400
Dividends paid to stockholders of Canon Inc.	(67,897)	-	(67,897)
Dividends paid to noncontrolling interests	-	(1,381)	(1,381)
Acquisition of subsidiaries	-	19,168	19,168
Capital transactions with noncontrolling interests and other	32,326	(33,058)	(732)
Comprehensive income (loss):			
Net income	124,449	3,079	127,528
Other comprehensive income (loss), net of tax			
Foreign currency translation adjustments	(72,743)	(2,300)	(75,043)
Net unrealized gains and losses on securities	(1,585)	96	(1,489)
Net gains and losses on derivative instruments	1,962	(29)	1,933
Pension liability adjustments	(221)	39	(182)
Total comprehensive income	51,862	885	52,747
Repurchase of treasury stock, net	(5,022)	-	(5,022)
Balance at June 30, 2010	2,699,378	176,905	2,876,283

Balance at December 31, 2008	2,659,792	191,190	2,850,982
Dividends paid to stockholders of Canon Inc.	(67,897)	-	(67,897)
Dividends paid to noncontrolling interests	-	(2,223)	(2,223)
	118	(492)	(374)

Capital transactions by consolidated subsidiaries and affiliated companies and other			
Comprehensive income (loss):			
Net income (loss)	33,349	432	33,781
Other comprehensive income (loss), net of tax			
Foreign currency translation adjustments	58,981	(898)	58,083
Net unrealized gains and losses on securities	1,612	221	1,833
Net gains and losses on derivative instruments	(1,676)	8	(1,668)
Pension liability adjustments	(1,096)	340	(756)
Total comprehensive income (loss)	91,170	103	91,273
Balance at June 30, 2009	2,683,183	188,578	2,871,761

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

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

A reconciliation of basic and diluted net income per share computations for the six months ended June 30, 2010 and 2009 is as follows:

	Millions of yen	
	Six months ended June 30, 2010	Six months ended June 30, 2009
Net income attributable to Canon Inc.	124,449	33,349

	Number of shares	
	six months ended June 30, 2010	Six months ended June 30, 2009
Average common shares outstanding	1,236,091,586	1,234,484,960
Effect of dilutive securities:		
Stock options	43,270	-
Diluted common shares outstanding	1,236,134,856	1,234,484,960

	Yen	
	Six months ended June 30, 2010	Six months ended June 30, 2009
Net income attributable to Canon Inc. stockholders per share:		
Basic	100.68	27.01
Diluted	100.68	27.01

A reconciliation of basic and diluted net income per share computations for the three months ended June 30, 2010 and 2009 is as follows:

	Millions of yen	
	Three months ended June 30, 2010	Three months ended June 30, 2009
Net income attributable to Canon Inc.	67,638	15,605

	Number of shares	
	Three months ended June 30, 2010	Three months ended June 30, 2009
Average common shares outstanding	1,237,304,166	1,234,483,059

Effect of dilutive securities:		
Stock options	70,353	-
Diluted common shares outstanding	1,237,374,519	1,234,483,059

	Yen	
	Three months ended June 30, 2010	Three months ended June 30, 2009
Net income attributable to Canon Inc. stockholders per share:		
Basic	54.67	12.64
Diluted	54.66	12.64

The computation of diluted net income per share for the six months ended June 30, 2009 and the three months ended June 30, 2009 excludes outstanding stock options because the effect would be anti-dilutive. The computation of diluted net income per share for the six months ended June 30, 2010 and the three months ended June 30, 2010 excludes certain outstanding stock options because the effect would be anti-dilutive.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(10) 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) as of June 30, 2010 are expected to be recognized in earnings over the next 12 months. Canon excludes the time value component from the assessment of hedge effectiveness. Changes in the fair value of a foreign exchange contract for the period between the date that the forecasted intercompany sales occur and its maturity date are recognized in earnings and not considered to be an ineffective hedge.

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 the foreign exchange contracts as of June 30, 2010 and December 31, 2009 are set forth below:

	Millions of yen	
	June 30, 2010	December 31, 2009
To sell foreign currencies	441,851	494,314
To buy foreign currencies	58,808	30,978

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CANON INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(10) Derivatives and Hedging Activities (continued)

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 as of June 30, 2010 and December 31, 2009.

Derivatives designated as hedging instruments

	Balance sheet classification	Millions of yen Fair value June 30, 2010	December 31, 2009
Assets:			
Foreign exchange contracts	Prepaid expenses and other current assets	3,289	-
Liabilities:			
Foreign exchange contracts	Other current liabilities	1,773	644

Derivatives not designated as hedging instruments

	Balance sheet classification	Millions of yen Fair value June 30, 2010	December 31, 2009
Assets:			
Foreign exchange contracts	Prepaid expenses and other current assets	19,032	752
Liabilities:			
Foreign exchange contracts	Other current liabilities	518	6,566

CANON INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(10) Derivatives and Hedging Activities (continued)

Effect of derivative instruments on the consolidated statements of income

The following tables present the effect of Canon s derivative instruments on the consolidated statements of income for the six and three months ended June 30, 2010 and 2009.

Derivatives in cash flow hedging relationships

	Millions of yen				
Six months ended June 30, 2010	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)	
	Amount	Classification	Amount	Classification	Amount
Foreign exchange contracts	3,284	Other, net	3,337	Other, net	(72)

	Millions of yen				
Six months ended June 30, 2009	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)	
	Amount	Classification	Amount	Classification	Amount
Foreign exchange contracts	(2,793)	Other, net	(1,447)	Other, net	(299)

	Millions of yen				
Three months ended June 30, 2010	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)	
	Amount	Classification	Amount	Classification	Amount
Foreign exchange contracts	2,849	Other, net	1,937	Other, net	(17)

	Millions of yen		
Three months ended	Gain (loss)		Gain (loss) recognized in

June 30, 2009	recognized in OCI (effective portion	Gain (loss) reclassified from accumulated OCI into income (effective portion)		income (ineffective portion and amount excluded from effectiveness testing)	
	Amount	Classification	Amount	Classification	Amount
Foreign exchange contracts	5,143	Other, net	(4,681)	Other, net	(148)

CANON INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(10) Derivatives and Hedging Activities (continued)
Effect of derivative instruments on the consolidated statements of income (continued)

Derivatives not designated as hedging instruments

Six months ended June 30, 2010	Millions of yen Gain (loss) recognized in income on derivative	
	Classification	Amount
Foreign exchange contracts	Other, net	35,070

Six months ended June 30, 2009	Millions of yen Gain (loss) recognized in income on derivative	
	Classification	Amount
Foreign exchange contracts	Other, net	(14,004)

Three months ended June 30, 2010	Millions of yen Gain (loss) recognized in income on derivative	
	Classification	Amount
Foreign exchange contracts	Other, net	28,953

Three months ended June 30, 2009	Millions of yen Gain (loss) recognized in income on derivative	
	Classification	Amount
Foreign exchange contracts	Other, net	(2,673)

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(11) Commitments and Contingent Liabilities

Commitments

As of June 30, 2010, commitments outstanding for the purchase of property, plant and equipment approximated ¥17,119 million, and commitments outstanding for the purchase of parts and raw materials approximated ¥64,397 million.

Canon occupies sales offices and other facilities under lease arrangements accounted for as operating leases. Deposits made under such arrangements aggregated ¥14,168 million and ¥14,210 million at June 30, 2010 and December 31, 2009, respectively, and are included in noncurrent receivables in the accompanying consolidated balance sheets.

Future minimum lease payments required under noncancelable operating leases are ¥14,430 million (within one year) and ¥34,960 million (after one year), at June 30, 2010.

Guarantees

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

For each guarantee provided, Canon would have to perform under a guarantee if the borrower defaults on a payment within the contract periods of 1 year to 30 years, in the case of employees with housing loans, and of 1 year to 10 years, in the case of affiliates and other companies. The maximum amount of undiscounted payments Canon would have had to make in the event of default is ¥17,223 million at June 30, 2010. The carrying amounts of the liabilities recognized for Canon s obligations as a guarantor under those guarantees at June 30, 2010 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. 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. Changes in accrued product warranty cost for the six months ended June 30, 2010 and 2009 is summarized as follows:

Six months ended June 30, 2010

	Millions of yen
Balance at December 31, 2009	13,944
Addition	9,832
Utilization	(7,855)
Other	(2,915)
Balance at June 30, 2010	13,006

Six months ended June 30, 2009

Millions of yen

Balance at December 31, 2008	17,372
Addition	9,558
Utilization	(9,168)
Other	(3,547)
Balance at June 30, 2009	14,215

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(11) Commitments and Contingent Liabilities (continued)

Legal proceedings

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

In Germany, Verwertungsgesellschaft Wort (VG Wort), a collecting agency representing certain copyright holders, has filed a series of lawsuits seeking to impose copyright levies upon digital products such as PCs and printers, that allegedly enable the reproduction of copyrighted materials, against the companies importing and distributing these digital products. VG Wort filed a lawsuit in January 2006 against Canon seeking payment of copyright levies on single-function printers, and the court of first instance in Düsseldorf ruled in favor of the claim by VG Wort in November 2006. Canon lodged an appeal against such decision in December 2006 before the court of appeals in Düsseldorf. Following a decision by the same court of appeals in Düsseldorf on January 23, 2007 in relation to a similar court case seeking copyright levies on single-function printers of Epson Deutschland GmbH, Xerox GmbH and Kyocera Mita Deutschland GmbH, whereby the court rejected such alleged levies, in its judgment of November 13, 2007, the court of appeals rejected VG Wort s claim against Canon. VG Wort appealed further against said decision of the court of appeals before the Federal Supreme Court. In December 2007, for a similar Hewlett-Packard GmbH case relating to single-function printers, the Federal Supreme Court delivered its judgment in favor of Hewlett-Packard GmbH and dismissed VG Wort s claim. VG Wort has already filed a constitutional complaint with the Federal Constitutional Court against said judgment of the Federal Supreme Court. Likewise, after rejection by the Federal Supreme Court of an appeal by VG Wort in relation to Canon s single-function printers case in September 2008, VG Wort lodged a claim before the Federal Constitutional Court. Canon received a brief from the Federal Constitutional Court in September 2009 to enable the Court to decide on whether to accept the claim, and Canon responded to it in November 2009. In 2007, an amendment of German copyright law was carried out, and a new law has been effective from January 1, 2008 for both multi-function printers and single-function printers. The new law sets forth that the scope and tariff of copyright levies will be agreed between industry and the collecting society. Industry and the collecting society, based on the requirement under the new law, reached an agreement in December 2008. This agreement is applicable retroactively from January 1, 2008 and will remain effective through end of 2010. However, in Canon s assessment, the final outcome of the court case regarding the single-function printers sold in Germany before January 1, 2008 remains uncertain.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(11) Commitments and Contingent Liabilities (continued)

Legal proceedings (continued)

Canon is involved in various claims and legal actions, including those noted above, 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, Canon believes that any damage amounts claimed in the specific matters discussed above are not a meaningful indicator of Canon s potential liability. In the opinion of management, the ultimate disposition of the above mentioned matters would not have a material adverse effect on Canon s consolidated financial position, results of operations, or cash flows. However, litigation is inherently unpredictable. While Canon believes that it has valid defenses with respect to legal matters pending against it, it is possible that Canon s consolidated financial position, results of operations, or cash flows could be materially affected in any particular period by the unfavorable resolution of one or more of these matters.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(12) 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 as of June 30, 2010 and December 31, 2009 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 disclosed in Note 2.

	Millions of yen			
	June 30, 2010		December 31, 2009	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Long-term debt, including current portion	(10,532)	(10,529)	(9,781)	(9,777)
Foreign exchange contracts:				
Assets	22,321	22,321	752	752
Liabilities	(2,291)	(2,291)	(7,210)	(7,210)

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

Long-term debt

The fair values of Canon s long-term debt instruments are based on the present value of future cash flows associated with each instrument discounted using current market borrowing rates for similar debt instruments of comparable maturity.

Foreign exchange contracts

The fair values of foreign exchange contracts are measured based on the market price obtained from financial institutions.

Limitations of fair value estimates

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

Concentrations of credit risk

At June 30, 2010 and December 31, 2009, one customer accounted for approximately 19% and 22% 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.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(13) Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The three-level fair value hierarchy that prioritizes the inputs used to measure fair value is described 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 June 30, 2010 and December 31, 2009.

	Millions of yen June 30, 2010			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents		205,585		205,585
Available-for-sale (current):				
Government bonds	222			222
Corporate bonds			1,000	1,000
Available-for-sale (noncurrent):				
Government bonds	278			278
Corporate bonds		28	211	239
Fund trusts	1,475	1,798		3,273
Equity securities	23,716			23,716
Derivatives		22,321		22,321
Total assets	25,691	229,732	1,211	256,634
Liabilities:				
Derivatives		2,291		2,291
Total liabilities		2,291		2,291

CANON INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(13) Fair Value Measurements (continued)

	Millions of yen December 31, 2009			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents		184,856		184,856
Available-for-sale (current):				
Government bonds	222			222
Available-for-sale (noncurrent):				
Government bonds	204			204
Corporate bonds		29	1,340	1,369
Fund trusts	1,589	979		2,568
Equity securities	17,726			17,726
Derivatives		752		752
Total assets	19,741	186,616	1,340	207,697
Liabilities:				
Derivatives		7,210		7,210
Total liabilities		7,210		7,210

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 comprised mainly 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 six months ended June 30, 2010 and 2009.

Six months ended June 30, 2010

	Millions of yen
Balance at December 31, 2009	1,340
Total gains or losses (realized or unrealized):	
Included in earnings	(60)
Included in other comprehensive income (loss)	(20)
Purchases, issuances, and settlements	(49)
Balance at June 30, 2010	1,211

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CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(13) Fair Value Measurements (continued)

Six months ended June 30, 2009

	Millions of yen
Balance at December 31, 2008	1,516
Total gains or losses (realized or unrealized):	
Included in earnings	(144)
Included in other comprehensive income (loss)	(3)
Purchases, issuances, and settlements	34
Balance at June 30, 2009	1,403

The following table presents the changes in Level 3 assets measured on a recurring basis, consisting primarily of corporate bonds, for the three months ended June 30, 2010 and 2009.

Three months ended June 30, 2010

	Millions of yen
Balance at March 31, 2010	1,250
Total gains or losses (realized or unrealized):	
Included in earnings	4
Included in other comprehensive income (loss)	(21)
Purchases, issuances, and settlements	(22)
Balance at June 30, 2010	1,211

Three months ended June 30, 2009

	Millions of yen
Balance at March 31, 2009	1,464
Total gains or losses (realized or unrealized):	
Included in earnings	(50)
Included in other comprehensive income (loss)	
Purchases, issuances, and settlements	(11)
Balance at June 30, 2009	1,403

Gains and losses included in earnings are mainly related to corporate bonds still held at June 30, 2010 and 2009, and are reported in Other, net in the consolidated statements of income.

CANON INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(13) Fair Value Measurements (continued)

Assets and liabilities measured at fair value on a nonrecurring basis

Non-marketable equity securities with a carrying amount of ¥5,000 million were written down to their fair value of ¥2,422 million and equity securities accounted for by the equity method with a carrying amount of ¥33,984 million were written down to their fair value of ¥15,164 million, resulting in an other-than-temporary impairment charge totaling ¥21,398 million, which was included in earnings for the six and three months ended June 30, 2010. Non-marketable equity securities were classified as Level 2 instruments, as Canon uses observable inputs to value these investments. Equity securities accounted for by the equity method were classified as Level 3 instruments, as Canon uses unobservable inputs to value these investments.

Non-marketable equity securities with a carrying amount of ¥1,463 million were written down to their fair value of ¥478 million, resulting in an other-than-temporary impairment charge of ¥985 million, which was included in earnings for the six and three months ended June 30, 2009. All impaired non-marketable equity securities were classified as Level 3 instruments, as Canon uses unobservable inputs to value these investments.

(14) Supplemental Information

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, net were ¥2,195 million gains and ¥1,953 million losses, for the six months ended June 30, 2010, and 2009, respectively, and were ¥551 million losses and ¥5,708 million losses, for the three months ended June 30, 2010, and 2009, respectively.

Advertising costs are expensed as incurred. Advertising expenses were ¥39,739 million and ¥33,366 million for the six months ended June 30, 2010 and 2009, respectively, and were ¥25,687 million and ¥21,369 million for the three months ended June 30, 2010 and 2009, respectively.

Shipping and handling costs totaled ¥26,188 million and ¥22,042 million for the six months ended June 30, 2010 and 2009, respectively and ¥14,740 million and ¥11,357 million for the three months ended Jun 30, 2010 and 2009, respectively, and are included in selling, general and administrative expenses in the consolidated statements of income.

Consolidated comprehensive income for the six months ended June 30, 2010 and 2009 was ¥52,747 million (increase) and ¥91,273 million (increase), respectively, and for the three months ended June 30, 2010 and 2009 was ¥5,095 million (decrease) and ¥37,400 million (increase), respectively

Certain debt securities with original maturities of less than three months classified as available-for-sale securities of ¥205,585 million and ¥184,856 million at June 30, 2010 and December 31, 2009, respectively, are included in cash and cash equivalents in the consolidated balance sheets. Additionally, certain debt securities with original maturities of less than three months classified as held-to-maturity securities of ¥999 million and ¥999 million at June 30, 2010 and December 31, 2009, respectively, are also included in cash and cash equivalents. Fair value for these securities approximates their cost.

CANON INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(15) Segment Information

Certain foreign private issuers, including Canon, have been exempted from the segment disclosure requirements of U.S. GAAP in filings with the SEC under the Securities Exchange Act of 1934.

However, in September 2008, the SEC issued its Foreign Issuer Reporting Enhancements (FIRE) rule, and Canon adopted the guidance for segment reporting under U.S. GAAP in the year ended December 31, 2009. For the interim period information, Canon discloses segment information under U.S. GAAP for all periods presented. Accordingly, prior period segment information has been adjusted to conform to this guidance under U.S. GAAP.

Segment information

Canon operates its business in three segments: the Office Business Unit, the Consumer 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 network digital MFDs, Color network digital MFDs, Personal-use network digital MFDs, Office copying machines, Full-color copying machines, Personal-use copying machines, Laser printers, and Large format inkjet printers

Consumer Business Unit: Digital SLR cameras, Compact digital cameras, Interchangeable lenses, Digital video camcorders, Inkjet multifunction peripherals, Single function inkjet printers, Image scanners, and Broadcasting equipment

Industry and Others Business Unit: Semiconductor lithography equipment, LCD lithography equipment, Medical image recording equipment, Magnetic heads, Micromotors, Computers, Handy terminals, Document scanners, and Calculators

The accounting policies of the segments are substantially the same as the accounting policies used in consolidated financial statements of Canon Inc. and Subsidiaries. Canon evaluates performance of, and allocates resources to, each segment based on operating profit.

Océ, which was acquired in the business combination concluded in March 2010 (see Note 7), is included in the Office Business Unit.

CANON INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(15) Segment Information (continued)

Segment information (continued)

Information about operating results for each segment for the six months ended June 30, 2010 and 2009 is as follows:

	Office	Consumer	Industry and Others	Corporate and eliminations	Consolidated
			(Millions of yen)		
2010:					
Net sales:					
External customers	**¥ 926,577**	**¥ 653,291**	**¥ 146,016**	**¥**	**¥ 1,725,884**
Intersegment	**4,500**	**1,023**	**45,242**	**(50,765)**	
Total	**931,077**	**654,314**	**191,258**	**(50,765)**	**1,725,884**
Operating cost and expenses	**775,206**	**540,048**	**199,637**	**10,712**	**1,525,603**
Operating profit (loss)	**¥ 155,871**	**¥ 114,266**	**¥ (8,379)**	**¥ (61,477)**	**¥ 200,281**
2009:					
Net sales:					
External customers	¥ 771,647	¥ 573,041	¥ 136,131	¥	¥ 1,480,819
Intersegment	4,653	893	35,187	(40,733)	
Total	776,300	573,934	171,318	(40,733)	1,480,819
Operating cost and expenses	686,089	517,164	195,117	17,511	1,415,881
Operating profit (loss)	¥ 90,211	¥ 56,770	¥ (23,799)	¥ (58,244)	¥ 64,938

Information about operating results for each segment for the three months ended June 30, 2010 and 2009 is as follows:

	Office	Consumer	Industry and Others	Corporate and eliminations	Consolidated
			(Millions of yen)		
2010:					
Net sales:					
External customers	**¥ 521,061**	**¥ 363,562**	**¥ 85,735**	**¥**	**¥ 970,358**
Intersegment	**882**	**465**	**23,195**	**(24,542)**	
Total	**521,943**	**364,027**	**108,930**	**(24,542)**	**970,358**
Operating cost and expenses	**438,159**	**297,094**	**114,354**	**7,313**	**856,920**

Operating profit (loss)	**¥ 83,784**	**¥ 66,933**	**¥ (5,424)**	**¥ (31,855)**	**¥ 113,438**
2009:					
Net sales:					
External customers	¥ 395,485	¥ 331,148	¥ 67,152	¥	¥ 793,785
Intersegment	2,145	394	18,312	(20,851)	
Total	397,630	331,542	85,464	(20,851)	793,785
Operating cost and expenses	355,321	292,526	93,622	7,410	748,879
Operating profit (loss)	¥ 42,309	¥ 39,016	¥ (8,158)	¥ (28,261)	¥ 44,906

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.

CANON INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(15) Segment Information (continued)

Geographic information

Information by major geographic area for the six months ended June 30, 2010 and 2009 is as follows:

	Japan	Americas	Europe	Other areas	Total
			(Millions of yen)		
2010:					
Net sales:	**¥ 337,661**	**¥ 474,494**	**¥ 541,647**	**¥ 372,082**	**¥ 1,725,884**
2009:					
Net sales:	¥ 342,882	¥ 401,860	¥ 449,175	¥ 286,902	¥ 1,480,819

Information by major geographic area for the three months ended June 30, 2010 and 2009 is as follows:

	Japan	Americas	Europe	Other areas	Total
			(Millions of yen)		
2010:					
Net sales:	**¥ 170,145**	**¥ 269,939**	**¥ 310,969**	**¥ 219,305**	**¥ 970,358**
2009:					
Net sales:	¥ 173,378	¥ 225,529	¥ 239,108	¥ 155,770	¥ 793,785

Net sales are attributed to areas based on the location where the product is shipped to the customers.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(15) Segment Information (continued)

Geographic information (continued)

The following information is based on the location of the Company and its subsidiaries for the six months ended June 30, 2010 and 2009. In addition to the disclosure requirements under U.S. GAAP, Canon discloses this information as supplemental information based on the disclosure requirements of the Japanese Financial Instruments and Exchange Law.

	Japan	Americas	Europe	Other areas	Corporate and eliminations	Consolidated
			(Millions of yen)			
2010:						
Net sales:						
External customers	**¥ 404,462**	**¥ 466,654**	**¥ 538,336**	**¥ 316,432**	**¥**	**¥ 1,725,884**
Intersegment	**952,682**	**1,112**	**2,188**	**335,783**	**(1,291,765)**	
Total	**1,357,144**	**467,766**	**540,524**	**652,215**	**(1,291,765)**	**1,725,884**
Operating cost and expenses	**1,146,939**	**456,262**	**520,566**	**627,262**	**(1,225,426)**	**1,525,603**
Operating profit	**¥ 210,205**	**¥ 11,504**	**¥ 19,958**	**¥ 24,953**	**¥ (66,339)**	**¥ 200,281**
2009:						
Net sales:						
External customers	¥ 416,201	¥ 391,236	¥ 447,612	¥ 225,770	¥	¥ 1,480,819
Intersegment	719,475	965	937	208,295	(929,672)	
Total	1,135,676	392,201	448,549	434,065	(929,672)	1,480,819
Operating cost and expenses	1,054,986	390,432	435,064	420,583	(885,184)	1,415,881
Operating profit	¥ 80,690	¥ 1,769	¥ 13,485	¥ 13,482	¥ (44,488)	¥ 64,938

Information by the location of the Company and its subsidiaries for the three months ended June 30, 2010 and 2009.

	Japan	Americas	Europe	Other areas	Corporate and eliminations	Consolidated
			(Millions of yen)			
2010:						
Net sales:						
External customers	**¥ 215,079**	**¥ 265,607**	**¥ 309,486**	**¥ 180,186**	**¥**	**¥ 970,358**

Intersegment	**518,487**	**788**	**932**	**184,022**	**(704,229)**	
Total	**733,566**	**266,395**	**310,418**	**364,208**	**(704,229)**	**970,358**
Operating cost and expenses	**618,506**	**258,837**	**297,294**	**350,070**	**(667,787)**	**856,920**
Operating profit	**¥ 115,060**	**¥ 7,558**	**¥ 13,124**	**¥ 14,138**	**¥ (36,442)**	**¥ 113,438**
2009:						
Net sales:						
External customers	¥ 202,506	¥ 220,095	¥ 238,750	¥ 132,434	¥	¥ 793,785
Intersegment	415,184	187	502	117,943	(533,816)	
Total	617,690	220,282	239,252	250,377	(533,816)	793,785
Operating cost and expenses	569,314	218,374	234,078	240,985	(513,872)	748,879
Operating profit	¥ 48,376	¥ 1,908	¥ 5,174	¥ 9,392	¥ (19,944)	¥ 44,906

CANON INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(2) <u>Other Information</u>

The Board of Directors approved an interim cash dividend at the meeting held on July 27, 2010 as below:

1. Total amount of interim cash dividends:
   68,206 million yen

2. Amount of an interim cash dividend per share:
   55 yen

3. Payment date:
   August 27, 2010

Note:
Interim dividend is paid to the shareholders registered on June 30, 2010.