

B. Capitalization and indebtedness

Not applicable.

C. Reasons for the offer and use of proceeds

Not applicable.

D. Risk factors

Canon is one of the world's leading manufacturers of plain paper copying machines, laser beam printers, bubble jet printers, cameras, steppers and aligners.

Primarily because of the business areas and geographical areas where Canon operates and the highly competitive nature of the industry to which it belongs, Canon is exposed to a variety of risks and uncertainties in carrying out its businesses, including, but not limited to, the following:

Risks Related to Canon's Industries

Canon has invested heavily in next-generation technologies. If the market for these technologies does not develop as Canon expects or if its competitors produce these or competing technologies more timely and effectively, Canon's operating results could be materially adversely affected.

Canon has made and will continue to make investments in next-generation technology research and development initiatives. Canon's competitors may achieve research and development breakthroughs in these technologies more quickly than Canon, or may achieve advances in competing technologies that render products under development by Canon uncompetitive.

The digital copier and camera business in which Canon operates is highly competitive.

Presently, the analog copying machines and conventional film camera segments of the market are mature with anticipated declining industry revenues as the market transitions to digital technology. Some of Canon's new digital products replace or compete with its traditional analog products. Changes in the mix of products from analog to digital, and the pace of that change as well as competitive developments could cause actual results to vary from those expected.

The recent trend of rapid digitalization has lowered the entry barriers in the digital camera segment, resulting in the entry of new competitors such as electronics manufacturers and an overall increase in the number of competitors to Canon's business. Although Canon believes that it has successfully kept pace with this trend toward digitalization, it may not be able to compete successfully in the future if it does not continue to invest in R&D activities, implement cost-cutting measures and introduce attractive and high value-added products to the market on a continuous basis.

Canon's camera and printer business depends upon seasonal consumer spending.

Sales of Canon's camera and printer products, particularly in the U.S., European and Japanese consumer markets, may be subject to seasonality. As a result, product sales may be impacted by seasonal purchasing patterns with higher sales generally occurring in the second half of the calendar year.

Because the semiconductor industry is highly cyclical, Canon may be adversely affected by any downturn in the industry.

The semiconductor industry is characterized by up and down business cycles, the timing, length and volatility of which are difficult to predict and has experienced recurring periods of oversupply of integrated circuits, resulting in significantly reduced demand for capital equipment, including the steppers and aligners Canon produces. Despite this cyclicality, Canon must maintain significant levels of research and development expenditures in order to maintain its competitive position. Canon's business and operating results could be materially adversely affected by any continued or future downturns in the semiconductor industry and related fluctuations in the demand for capital equipment in general, and particularly by DRAM manufacturers.

Downturns in the semiconductor industry have caused Canon's customers to change their operational strategies, which in turn may affect Canon's business.

Many device manufacturers have changed their business models to focus on designing of semiconductors, while consigning the production of semiconductors to lower cost foundries. Canon cannot accurately predict the future effect of these trends on its business. However, as manufacturing and sales activities shift to countries outside of Japan in response to these trends, especially to the Republic of China, unexpected developments, such as adverse regulatory or legal changes, may adversely affect Canon business operations.

The semiconductor equipment industry is characterized by rapid technological change. If Canon does not constantly develop new products to keep pace with technological change and meet its customers requirements, Canon will lose customers and its business will suffer.

Canon's steppers and mask aligners are affected by rapid technological change and can quickly become obsolete. Canon believes its future success in the steppers and aligners business depends on its ability to continue to enhance its existing products and by developing new products through incorporation of new and more advanced technologies. In particular, as semiconductor pattern sizes continue to decrease, the demand for more technologically advanced steppers is likely to increase.

Canon's stepper and mask aligner products could become obsolete sooner than anticipated because of faster than anticipated changes in one or more of the technologies related to Canon's products or in the market demand for products based on a particular technology. Any failure by Canon to develop the advanced technologies required by its customers at progressively lower costs and supply sufficient quantities to a worldwide customer base could adversely affect Canon's net sales and profitability.

Risks Related to Canon's Business

Canon derives a significant percentage of its revenues from Hewlett-Packard.

Canon depends on Hewlett-Packard for a significant part of its business. For the fiscal year ended December 31, 2002, approximately 21% of Canon's net sales were to Hewlett-Packard. As a result, its business, results of operations and financial condition may be affected by the policies, business, results of operations and financial condition of Hewlett-Packard. Although Canon believes that the merger between Hewlett-Packard and Compaq Corporation in 2002 will not affect Canon's business with Hewlett-Packard, any decision by Hewlett-Packard management to limit or reduce the scope of its relationship with Canon could adversely affect Canon's results of operations.

Canon depends on a limited number of suppliers of certain key components.

Canon relies on a limited number of outside vendors which meet Canon's strict criteria for quality, efficiency and environmental friendliness for certain critical components used in its products. Canon's reliance on a limited number of suppliers involves several risks, including a potential inability to obtain an adequate supply of required components and the risk of untimely delivery of these subassemblies and components.

A portion of Canon's net sales consists of post-sale revenues.

A portion of our net sales consists of sales of supplies and the provision of services occurring after the initial equipment placement. As these supplies and services become more commoditized, the number of competitors in these markets has increased. Our success in maintaining these post-placement sales will depend on our ability to compete successfully with these competitors, some of which may offer lower-priced products or services.

Canon's sales cycle makes planning and inventory management difficult and future financial results less predictable.

Canon generally experiences seasonal trends in the sale of its consumer oriented products. The resulting uneven sales pattern makes it difficult to predict near-term demand and places pressure on Canon's inventory management and logistics systems. If predicted demand is substantially greater than orders, there will be excess inventory. Alternatively, if orders substantially exceed predicted demand, Canon's ability to fulfill orders may be limited, which could adversely affect net sales and increase the risk of unanticipated variations in its results of operations and financial condition. Many of the factors that create and affect seasonal trends are beyond Canon's control.

If Canon fails to successfully introduce new products or to achieve efficiencies following the introduction of new products, then its gross profits may be adversely affected.

The unit cost of Canon's products has historically been the highest when they are newly introduced into production and have at times had a negative impact on its gross profit, operating results and cash flow. Cost reductions and enhancements typically come over time through:

- engineering improvements;
- economies of scale;
- improvements in manufacturing processes; and
- improved serviceability of products.

Initial shipments of Canon's new products adversely affect its profit or cash flow, and Canon may be unable thereafter to improve its gross profit, operating results and cash flow.

Canon is subject to increasing financial and reputational risks due to product quality and liability issues.

Although Canon has recently established a Quality Risk Management Division to coordinate its efforts to minimize any risks that may arise from product quality and liability issues, there can be no assurance that Canon will be able to eliminate or mitigate occurrences of these issues and consequent damages. If such factors adversely affect Canon's operating activities, generate expenses such as those for product recalls, service, and compensation, or hurt its brand image, its financial results and condition or reputation for quality products may be adversely affected.

Canon's success depends on the value of its brand name, and if the value of the brand name were to diminish, its revenues, operating results and prospects would be adversely affected.

Canon's success in its markets depends in part on Canon's brand name and its value. In addition, as a manufacturer and distributor of consumer products, Canon's operating results are susceptible to adverse publicity regarding the quality or safety of its products. There can be no assurance that such adverse publicity will not occur or that such claims will not be made in the future. Furthermore, Canon cannot predict the impact of such adverse publicity on its business, financial condition and results of operations.

Canon depends on the attraction and retention of key personnel and highly qualified professionals.

Canon's future operating results depend in significant part upon the continued contributions of its engineers and key employees. In addition, Canon's future operating results depend in part on its ability to attract, train and retain other qualified management, technical, sales and support personnel for Canon's operations. The competition for these people in the high-tech industries in which Canon competes has become increasingly intense in recent years. Moreover, due to the accelerating pace of technological change, it has become increasingly difficult to train new personnel in time to meet product research and development requirements. The loss of key employees or Canon's inability to attract, retain, train motivate qualified personnel could adversely affect Canon's business, financial condition and results of operations.

Canon's physical facilities, information systems and information security systems are subject to damage as a result of disasters, outages or similar events.

Canon's headquarters functions, its information systems and its research and development centers are located in or near Tokyo, Japan, where the possibility of disaster or damage from earthquake is generally higher than in other parts of the world. In addition, Canon's facilities or offices, including those for research and development, material procurement, manufacturing, logistics, sales, and services are located throughout the world and subject to the possibility of disaster or outage or similar disruption as a result of any of a number of events, including natural disasters or computer virus and terrorist attacks. Although Canon is working to establish appropriate backup structures for its facilities and information systems, there is no assurance that Canon will be able to completely prevent or mitigate the effect of such issues as the aforementioned disasters, outflows of harmful substances, shutdowns of information systems, and leakage, falsifications, and disappearances of internal databases. If such factors adversely affect Canon's operating activities, generate expenses relating to physical or personal damage, or hurt Canon's brand image, its consolidated financial results and condition may be adversely affected.

Canon is subject to the risks of international operations.

A substantial portion of Canon's business activity is conducted outside Japan, including in developing and emerging markets in Asia. There are a number of risks inherent in doing business in those markets, including the following:

- less developed technological infrastructure, which can affect production or other activities or result in lower customer acceptance of Canon's services;
- difficulties in recruiting and retaining personnel;
- potentially adverse tax consequences;
- longer payment cycles;
- unfavorable political or economic factors; and
- unexpected legal or regulatory changes.

Canon's inability to manage successfully the risks inherent in its international activities could adversely affect its business, financial condition and operating results.

In order to produce Canon's products competitively and to reduce costs, Canon has established new production facilities in the People's Republic of China ("China"). Canon is also putting emphasis on strengthening its sales activity in China as well. However, with China's entry into the WTO, the basic structure and conditions within China are in the process of changing. Under these conditions, unexpected events, including political/legal change, labor shortage or strikes or changes in economic conditions may occur.

In addition, the recent outbreak of severe acute respiratory syndrome (SARS) in China and concerns over its spread in Asia and elsewhere could have a negative effect on business activity. Given the importance of Canon's Asian sales, production facilities and supply relationships, especially in China, Canon's business may be more exposed to this risk than the global economy generally.

All of the above factors regarding international operations could have an adverse impact on Canon's business results and financial condition.

Failure to adequately protect the intellectual property rights upon which Canon depends could harm its business.

Because of the emphasis on product innovation in the markets for Canon's products, many of which are subject to frequent technological innovations, patents and other intellectual property are an important competitive factor. Canon relies primarily on technology it has developed, and Canon seeks to protect such technology through a combination of patents, trademarks and other intellectual property rights.

Canon faces the risks that:

- competitors will be able to develop similar technology independently;
- Canon's pending patent applications may not be issued;
- the steps Canon takes to prevent misappropriation or infringement of its intellectual property may not be successful; and
- intellectual property laws may not adequately protect Canon's intellectual property, particularly in some countries outside Japan.

While Canon is not aware of any actual or potential significant impairment of, or adverse claim to, its rights in such technologies, any interference in Canon's rights to use such technologies could adversely affect its financial condition and operating results.

In addition, Canon may need to litigate in order to enforce its patents, copyrights or other intellectual property rights, to protect its trade secrets, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement, which can be expensive and time-consuming. In the event any government agency or third party were adjudicated to have a valid claim against Canon, it could be required to:

- refrain from selling the affected product in certain markets;
- make royalty payments or pay monetary damages;
- seek to develop non-infringing technologies, which may not be feasible; or
- seek to acquire licenses to the infringed technology, which may not be available on commercially reasonable terms, if at all.

Canon may also face disputes in the future involving employee inventions for which the intellectual property rights have been transferred to Canon. Although Canon believes that adequate payments have been made to employee inventors for such transfers based on fair and objective criteria, current or former employees may in the future demand increased payments from Canon, which could harm Canon's brand image as well as its business.

Canon's business as well as its company image could be adversely affected by any of these developments.

Canon's business is subject to environmental laws and regulations.

Canon is subject to certain Japanese and foreign environmental requirements in areas such as energy resource conservation, reduction of hazardous substances, recycling, clean air, water protection and waste disposal. Canon believes that it has taken adequate precautions to comply with these regulations in the course of its ordinary business operations. Furthermore, Canon does not believe that any environmental laws or regulations currently in effect will have an adverse effect on its operating results or financial condition. However, Canon cannot predict whether any pending or future legislation will be adopted or what the effect such legislation would have on it.

Environmental clean-up and remediation costs of its sites and associated litigation could decrease Canon's net cash flow, adversely affect its results of operations and impair its financial condition.

Canon is subject to liability for the investigation and clean-up of environmental contamination at each of the properties that it owns or operates, at certain properties Canon formerly owned or operated and at off-site locations where Canon arranged for the disposal of hazardous substances. If Canon were to be held responsible for damages in any future litigation or proceedings, such costs may not be covered by insurance and may be material.

In addition, Canon may face liability for alleged personal injury or property damage due to exposure to chemicals or other hazardous substances at or from its facilities. Canon may also face liability for personal injury, property damage, natural resource damage or for clean-up costs for the alleged migration of contamination or other hazardous substances from our facilities. A significant increase in the number or success of these claims and costs could adversely affect our results of operations or financial condition.

Economic trends in our major markets may adversely affect our net sale.

Economic downturns and declines in consumption in our major markets, including Japan, the United States and Europe may affect the levels of both corporate and consumer sales. Purchases of Canon's consumer products, such as cameras and printers, are to a very significant degree discretionary. A decline in the level of consumption caused by the worsening of general economic conditions could adversely affect Canon's results of operations.

Canon's operating results are also affected by the level of business activity of its customers, which in turn is affected by the level of economic activity in the industries and markets that they serve. A decline in the level of business activity of Canon's customers caused by the worsening of the global economy could adversely affect Canon's results of operations.