

3. Canon adopted ASU No. 2017-07 from the quarter beginning January 1, 2018. The adoption of the new presentation requirement of the service cost component and the other components of net benefit cost resulted in reclassification from cost of sales, and selling, general and administrative expenses, and research and development expenses into other income (deductions) for the years ended December 31, 2017, 2016, and 2015 respectively.

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 office multifunction devices ("MFDs"), plain paper copying machines, laser printers, cameras, inkjet printers, diagnostic equipment and lithography equipment.

Primarily because of the nature of the business and geographic areas in which Canon operates and the highly competitive nature of the industries to which it belongs, Canon is subject to a variety of risks and uncertainties, including, but not limited to, the following:

Risks Related to Economic Environment

Economic trends in Canon's major markets may adversely affect its operating results.

Canon's business activities are deployed globally in Japan, the United States, Europe, Asia, and in other regions. Declines in consumption and restrained investment due to economic downturn in these major markets may affect Canon's operating results. The operating results for products such as office, diagnostic equipment and industrial equipment are affected by the financial results of its corporate customers or medical institutions, and deterioration of their financial results has caused and may continue to cause customers to limit capital investments. Demand for Canon's consumer products, such as cameras and inkjet printers, is discretionary. Rapid price declines owing to intensifying competition and declines in levels of consumer spending and corporate investment could adversely affect Canon's operating results and financial position.

Canon's operating and financing activities expose it to foreign currency exchange and interest rate risks that may adversely affect its revenues and profitability.

Canon derives a significant portion of its revenue from its international operations. As a result, Canon's operating results and financial position have been and may continue to be significantly affected by changes in the value of the yen versus foreign currencies. Sales of Canon's products denominated in foreign currencies have been and may continue to be adversely affected by the strength of the yen against foreign currencies. Conversely, a strengthening of foreign currencies against the yen will generally be favorable to Canon's foreign currency sales. Canon's consolidated financial statements are presented in yen. As such, the yen value of Canon's assets and liabilities arising from foreign currency transactions have fluctuated and may continue to fluctuate. Unpredictable fluctuations may have certain effects on Canon's consolidated financial statements. Although Canon strives to mitigate the effects of foreign currency fluctuations arising from its international business activities, Canon's consolidated financial statements have been and may continue to be affected by currency translations from the financial statements of Canon's foreign subsidiaries and affiliates, which are denominated in various foreign currencies. Canon is also exposed to the risk of interest rate fluctuations, which may affect the value of Canon's financial assets and liabilities.

Canon may be adversely affected by fluctuations in the stock and bond markets.

Canon's assets include investments in publicly traded securities. As a result, Canon's operating results and general financial position may be affected by price fluctuations in the stock and bond markets. Volatility in financial markets and overall economic uncertainty create the risk that the actual amounts realized in the future on Canon's investments could differ significantly from the fair values currently assigned to them.

High prices of raw materials could negatively impact Canon's profitability.

Increases in prices for raw materials that Canon uses in manufacturing such as steel, non-ferrous metals and petrochemical products may lead to higher production costs and Canon may not be able to pass these increased production costs onto the sales prices of its products. Such increases in prices for raw materials could adversely affect Canon's operating results.

Risks Related to Canon's Industries and Business Operations

A substantial portion of Canon's business activity is conducted outside Japan, exposing Canon to the risks in international markets.

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

- unfavorable political, diplomatic or economic conditions;
- sharp fluctuations in foreign currency exchange rates;
- unexpected political, legal or regulatory changes;
- inadequate systems of intellectual property protection;
- difficulties in recruiting and retaining qualified personnel; and
- less developed production infrastructure.

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

Canon has invested and will continue to invest actively in next-generation technologies. If the markets for these technologies do not develop as Canon expects, or if its competitors produce these or competing technologies in a more timely or effective manner, Canon's operating results may 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. For several years, Canon has continued its investments in development and manufacturing in order to keep pace with technological evolution. If Canon's business strategies diverge from market demands, Canon may not recover some or all of its investments, or may lose business opportunities, or both, which may have a material adverse effect on Canon's operating results.

In addition, Canon has sought to develop production technology and equipment to accelerate the automation of its manufacturing processes and in-house production of key devices. If Canon cannot effectively implement these techniques, it may fail to realize cost advantages or product differentiation, which may adversely affect Canon's operating results. While differentiation in technology and product development is an important part of Canon's strategy, Canon must also accurately assess the demand for and commercial acceptance of new technologies and products that it develops. If Canon pursues technologies or develops products that are not well received by the market, its operating results could be adversely affected.

Entering new business areas through the development of next-generation technologies is a focal point of Canon's corporate strategy. To the extent that Canon enters into such new business areas, Canon may not be able to establish a successful business model or may face severe competition with new competitors. If such events occur, Canon's operating results may be adversely affected.

If Canon does not effectively manage transitions in its products and services, its operating results may decline.

Many of the business areas in which Canon competes are characterized by rapid technological advances in hardware performance, software functionality and product features; frequent introduction of new products; short product life cycles; and continued qualitative improvements to current products at stable price levels. Canon has sought to invest substantial resources into introducing appealing, innovative and cost-competitive new products. There are several risks inherent in introduction of new products and services, such as delays in development or manufacturing, unsuitable product quality during the introductory period, variations in manufacturing costs, negative impact on sales of current products, uncertainty in predicting customer demand and difficulty in effectively managing inventory levels. Moreover, if Canon is unable to respond quickly to technological innovations with respect to information systems and networks, Canon's revenue may be significantly affected as a result of delays associated with the incorporation into its products of such new information technologies.

Canon's revenues and gross margins also may suffer adverse effects because of the timing of product or service introductions by its competitors. This risk is exacerbated when a competitor introduces a new product immediately prior to Canon's introduction of a similar product. If any of these risks materialize, future demand for Canon's products and services could be reduced, and its operating results could decline.

Changes in the print environment may affect Canon's business.

In the business machines market for such products as office MFDs, copying machines and printers, customers are increasingly looking for ways to cut costs while protecting the environment. From this perspective, Managed Print Services ("MPS"), which aim to optimize printing efficiencies in the office, have become popular in recent years. This trend could lead to a decrease in business machine print volumes.

In addition, the digitalization of workflow in office could also lead to a decrease in customer print opportunities. If Canon is unable to supply products and services that respond to these types of market trends, its operating results may be adversely affected.

Canon's digital camera business operates in a highly competitive environment.

As the market for digital cameras has been shrinking, competition in price and performance specifications is intensifying. Moreover, along with the significant improvements in the shooting capabilities of other digital devices, including smartphones, consumer preferences for shooting activities have changed and diversified. If Canon is unable to introduce new products that appeal to the needs of consumers and maintain its superiority over other digital device competitors, or provide new services for enjoying images, Canon could suffer from an erosion of the digital camera market, with a resulting adverse effect on operating results.

Canon may not be able to adequately anticipate developments related to its medical device business, including changes to the market environment and developments related to medical device approvals, certifications and health insurance coverage.

Regarding the market for Canon's medical equipment sold to medical institutions, mainly in the area of diagnostic imaging, it takes a long time to design, research, develop and commercialize products, because it is necessary to prove the clinical effectiveness of new technologies and new products, and obtain regulatory approvals and certifications prior to sale in individual countries. The global market for medical devices is

expanding due to developing medical infrastructure in emerging countries, but in developed countries issues such as aging populations, rising health insurance costs and pressure to cut medical device costs may adversely affect Canon's medical device business.

Canon invests in research and development of new medical device technologies based on detailed analysis of the potential technical and business prospects for such technologies. However, despite these investments, Canon may become less competitive if it cannot anticipate whether new technologies will have the expected clinical effects or developments in the market or regulatory environment for such technologies. Canon may need to significantly modify its business plans in response to these challenges and it may not be able to generate the expected returns on its investments in research and development of medical devices.

Because the semiconductor lithography equipment and flat-panel-display ("FPD") industry is highly cyclical, Canon may be adversely affected by any downturn in demand for semiconductor devices and FPD panels.

The semiconductor lithography equipment and FPD lithography equipment industry is characterized by fluctuating business cycles, the timing, length and volatility of which are difficult to predict. Recurring periods of oversupply of semiconductor devices and panels have at times led to significantly reduced demand for capital equipment, including the semiconductor lithography equipment and FPD lithography equipment that Canon produces. Despite this cyclical nature, Canon must maintain significant levels of research and development expenditures to remain competitive. A future cyclical downturn in the lithography equipment industry and related fluctuations in the demand for capital equipment could cause cash flow from sales to fall below the level necessary to offset Canon's expenditures, including those arising from research and development, and could consequently have a material adverse effect on Canon's operating results and financial condition.

Canon's business is subject to changes in the sales environment.

Disruptions of relationships with large Canon distributors or acquisitions of those distributors by competitors could adversely affect Canon's ability to meet its sales targets. In addition, the rapid proliferation of Internet-based businesses may render conventional distribution channels obsolete. These, and other changes in Canon's sales environment, could adversely affect Canon's operating results.

In addition, Canon depends on HP Inc. for a significant part of its business. As a result, Canon's business and operating results may be affected by the policies, business and operating results of HP Inc. Any decision by HP Inc. management to limit or reduce the scope of its relationship with Canon would adversely affect Canon's business and operating results.

Canon depends on specific outside suppliers for certain key components.

Canon relies on specific outside suppliers that meet Canon's strict criteria for quality, efficiency and environmental friendliness for critical components and special materials used in its products. In some cases, Canon may be forced to discontinue production of some or all of its products if the specific outside suppliers that supply key components and special materials across Canon's product lines experience unforeseen difficulties, or if such parts and special materials suffer from quality problems or are in short supply. Further, the prices of components and special materials purchased from specific outside suppliers may rise, triggered by the imbalance of supply and demand along with other factors. If such events occur as an outcome of the dependency on outside vendors, Canon's operating results may be adversely affected.

Canon may be subject to antitrust-related lawsuits, investigations or proceedings, which may adversely affect its operating results or reputation.

A portion of Canon's net sales consists of sales of supplies and the provision of services after the initial equipment placement. As these supplies and services have become more commoditized, the number of

competitors in these markets has increased. Canon's success in maintaining these post-placement sales will depend on its ability to compete successfully with these competitors, some of which may offer lower-priced products or services. Despite the increase in competitors, Canon currently maintains a high market share in the market for supplies. Accordingly, Canon may be subject to lawsuits, investigations or proceedings under relevant antitrust laws and regulations. Any such lawsuits, investigations or proceedings may lead to substantial costs and have an adverse effect on Canon's operating results or reputation.

Cyclical patterns in sales of Canon's products make planning and inventory management difficult and future financial results less predictable.

Canon generally experiences seasonal trends in the sales of its consumer-oriented products. Canon has little control over the various factors that produce these seasonal trends. Accordingly, it is difficult to predict short-term demand, placing pressure on Canon's inventory management and logistics systems. If product supply from Canon exceeds actual demand, excess inventory will put downward pressure on selling prices and raise inefficiency in cash management, potentially reducing Canon's revenue. Alternatively, if actual demand exceeds the supply of products, Canon's ability to fulfill orders may be limited, which could adversely affect market share and net sales and increase the risk of unanticipated variations in its operating results.

Canon's cooperation and alliances with, strategic investments in, and acquisitions of, third parties may not produce the anticipated improvements to its financial results.

Canon makes strategic acquisitions of other companies for the purpose of business expansion and Canon is also engaged in alliances, joint ventures, and strategic investments with other companies. These activities can help Canon to grow its business. However, weak business trends or disappointing performance by partners or acquired companies may adversely affect the success of such activities. The success of such activities may be adversely affected by the inability of Canon and its partners or acquired companies to successfully define and reach common objectives. Even if Canon and its partners or acquired companies succeed in designing a structure that allows for the definition and achievement of common objectives, synergies may not be created between the businesses of Canon and its partners or acquired companies. In addition, integration of operations may take more time than expected. In connection with its acquisitions, Canon recognizes goodwill and other intangible fixed assets on its consolidated balance sheet, and the amounts recognized may be impaired if there is a decline of future cash flow. An unexpected cancellation of a major business alliance may disrupt Canon's overall business plans and may also result in a delayed return on, or reduced recoverability of, the investment, adversely affecting Canon's operating results and financial position.

Canon depends on efficient logistics services to distribute its products worldwide.

Canon depends on efficient logistics services to distribute its products worldwide. Problems with Canon's computerized logistics systems, an outbreak of war or strife within Canon's operating regions or regional labor disputes, such as a dockworkers' strike, could lead to a disruption of Canon's operations and result not only in increased logistical costs, but also in the loss of sales opportunities owing to delays in delivery. Moreover, because demand for Canon's consumer products may fluctuate throughout the year, transportation means, such as cargo vessels or air freight, and warehouse space must be appropriately managed to take such fluctuations into account. Failure to do so could result in either a loss of sales opportunities or the incurrence of unnecessary costs.

In addition, the increasing levels of precision required of semiconductor lithography equipment and FPD lithography equipment and the resulting increase in the value and size of such equipment in recent years have resulted in a concurrent increase in the need for sensitive handling and transportation of these products. Because of their precise nature, even a minor shock during the handling and transportation process can potentially cause irreparable damage to such products. If unforeseen accidents during the handling and transportation process render a significant portion of Canon's high-end precision products unmarketable, costs will increase, and Canon may lose sales opportunities and customer confidence.

Substantially higher crude oil prices and the supply-and-demand balance of transportation means could lead to increases in the cost of freight, which could adversely affect Canon's operating results.

Other Risks

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

Canon's headquarters functions, information systems and research and development centers are located in or near Tokyo, Japan, where the possibility of damage from earthquakes is generally higher than in other parts of the world. In addition, Canon's facilities or offices, including those for research and development, materials procurement, manufacturing, logistics, sales and services are located throughout the world and subject to the possibility of outage or similar disruption as a result of a variety of events, including natural disasters such as earthquakes or floods, as well as terrorist attacks. Although Canon continues to establish appropriate backup structures for its facilities and information systems, there can be no assurance that Canon will be able to prevent or mitigate the effect of disruptive events or developments such as the leakage of harmful substances and shutdowns of information systems. Although Canon has implemented backup plans to permit the manufacture of its products at multiple production facilities, such plans do not cover all product models. In addition, such backup arrangements may not be adequate to maintain production quantity at sufficient levels. Such factors may adversely affect Canon's operating activities, generate expenses relating to physical or personal damage, or hurt Canon's brand image, and its operating results may consequently be adversely affected.

In addition, the global spread of the coronavirus disease ("COVID-19") has had disruptive effects on the supply chain and operations of manufacturers, particularly in Asia. As a result, Canon temporarily suspended operations in certain of Canon's factories and has experienced reduced production in some of Canon's factories. Although Canon expects the negative impact of COVID-19 on global economic and market conditions will adversely affect Canon's business, the duration and extent of the further spread of COVID-19 remain uncertain at this time, and therefore the impact on results of operations remains unknown.

Canon's success depends in part on the value of its brand name, and if the value of the brand is diminished, Canon's operating results and prospects will be adversely affected.

Canon's success depends in part on maintenance and development of the value of its brand name. The main factors which could damage its brand value are defective product quality, circulation of counterfeit and failures of its compliance regime. Although Canon works to minimize risks that may arise from product quality and liability issues, such as those triggered by the individual functionality and also from the combination of hardware and software that make up Canon's products, there can be no assurance that Canon will be able to eliminate or limit these issues and the resulting damages. If such factors adversely affect Canon's operating activities, generate additional expenses such as those related to product recalls, service and compensation, or otherwise hurt its brand image, Canon's operating results or reputation for quality may be adversely affected. Canon has been implementing measures to halt the spread of counterfeit products. However, the continued manufacture and sale of such products could adversely affect Canon's brand image as well as its operating results.

If Canon fails to maintain its overall compliance regime, especially legal and regulatory compliance, this also could result in damage to Canon's credibility and brand value.

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

Canon is subject to certain Japanese and foreign environmental laws and regulations in areas such as mitigation of climate change, resource conservation including product recycling, reduction of hazardous substances, clean air, clean water and waste disposal. Due to the laws and regulations, Canon may face liability for additional costs and alleged damages. Such costs and damages could adversely affect Canon's business and operating results.

Canon is subject to potential liability for the investigation and cleanup of environmental contamination at each of the properties that it owns or operates and at certain properties Canon formerly owned or operated. If Canon is held responsible for such costs in any future litigation or proceedings, such costs may not be covered by insurance and may be material.

Canon is subject to risks relating to legal proceedings.

Canon is involved in various claims and legal actions arising in the ordinary course of its business. Results of actual and potential litigation are inherently uncertain. An unfavorable result in a legal proceeding could adversely affect Canon's reputation, financial condition and operating results.

Canon may be subject to intellectual property litigation and infringement claims, which could cause it to incur significant expenses or prevent it from selling its products.

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 internally developed technology, and seeks to protect such technology through a combination of patents, trademarks and other intellectual property rights.

In relation to protection of its technologies, Canon faces 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 be unsuccessful; and intellectual property laws may not adequately protect Canon's intellectual property, particularly in certain emerging markets.

In relation to third party intellectual property rights, if any third party is adjudicated to have a valid infringement claim against Canon, Canon could be required to: refrain from selling the relevant product in certain markets; pay monetary damages; pursue development of non-infringing technologies, or attempt to acquire licenses to the infringed technology and to make royalty payments, which may not be available on commercially reasonable terms, if at all.

Canon may need to litigate in order to enforce its intellectual property rights or in order to defend against claims of infringement, which can be expensive and time-consuming.

Canon also licenses its patents to third parties in exchange for payment or licensing. The terms and conditions of such licensing or changes in the renewal conditions of such licenses could affect Canon's business.

With respect to employee inventions, Canon maintains company rules and an evaluation system and has been making adequate payments to employees for the invention rights based on these rules. However, there can be no assurance that disputes will not arise with respect to the amount of these payments to employees.

Canon's businesses, brand image and operating results could be adversely affected by any of these developments.

Canon must attract and retain highly qualified professionals.

Canon's future operating results depend in significant part upon the continued contributions of its employees. In addition, Canon's future operating results depend in part on its ability to attract, train and retain qualified personnel in development, production, sales and management. The competition for human resources in the high-tech industries in which Canon operates has intensified in recent years. Moreover, owing to the accelerating pace of technological change, the importance of training new personnel in a timely manner to meet product research and development requirements will increase. Failure by Canon to recruit and train qualified personnel or the loss of key employees could delay development or slow production and could increase the risks of outflow of technologies and know-how. These factors may adversely affect Canon's business and operating results.

Maintaining a high level of expertise in Canon's manufacturing technology is critical to Canon's business. However, it is difficult to secure the requisite expertise for specialized skill areas, such as lens processing, in a short time period. While Canon engages in advance planning to obtain the expertise needed for each skill area, Canon cannot guarantee that such expertise will be acquired in a timely manner and retained, and failure to do so may adversely affect Canon's business and operating results.

Canon is subject to risks arising from dependency on electronic data.

Canon possesses confidential electronic data relating to manufacturing, research and development, procurement, and production, as well as sensitive information obtained from its customers relating to the customers and to other individuals and parties. This electronic data is used by Canon and third party managed systems and networks. Electronic data is also used for the information service functions in various products.

There are some risks inherent in the use of the electronic data, including vulnerability to hacking, computer viruses, and cyber attacks, service failures and leakage of personal information due to infrastructure issues and issues arising from damage caused by natural disasters. Although Canon continues to make administrative and managerial improvements in order to alleviate these risks, such events may occur despite Canon's best efforts.

The materialization of such risks could result in interruptions to essential work, leaks of confidential data and damage to the information service functions in products. The occurrence of any of these events has the potential to cause Canon to be subject to claims from affected individuals and parties and to negatively influence Canon's brand image, the social trust it has developed, and its operations and financial conditions.

Canon's financial results may be adversely affected if its deferred tax assets are not recoverable or if it is subject to international double taxation.

Canon currently has deferred tax assets, which are subject to periodic recoverability assessments based on projected future taxable income. The changes of future profitability due to future market conditions and tax reforms including changes in tax rates may require possible recognition of significant valuation allowances to reduce the net carrying value of deferred tax asset balances. When Canon determines that certain deferred tax assets may not be recoverable, the amounts which may not be realized are charged to income tax expense and will adversely affect net income.

In addition, recently, international corporate tax avoidance has developed into a political issue with a focus on aggressive tax planning strategies of certain multinational corporations. The OECD established the BEPS (Base Erosion and Profit Shifting) project for the purpose of increasing cooperation among countries and implementing harmonization of taxation. The BEPS action plan was published in July 2013; the OECD then conducted further study based on that plan and published its final report in October 2015. Each country has been revising or amending its domestic taxation system and tax treaties based on the final report.

Canon believes that liability of taxation is a basic and significant responsibility as a corporate citizen and that the revision or amendment will not significantly affect Canon. It is, however, possible that there will be differences in opinion between Canon and tax authorities based on new transfer pricing documentation requirements.

Canon's retirement and severance benefit obligations are subject to certain accounting assumptions.

Canon has significant employee retirement and severance benefit obligations that are recognized based on actuarial valuations. Inherent in these valuations are key assumptions, including discount rates, expected return on plan assets, assumed rate of increase in compensation level and mortality rate. Actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore any such differences would be expected to be linked to increases in actual costs, which may adversely affect net income.