

CANON INC
Form 6-K
August 10, 2016

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**, **2016**

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 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

[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 10, 2016**

By /s/ Eiji Shimizu
(Signature)*

Eiji Shimizu
General Manager
Consolidated Accounting Div.
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, 2016

[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, 2016

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 currency exchange rate fluctuations; the uncertainty of Canon's ability to implement its plans to localize production and other measures to reduce the impact of foreign currency exchange rate fluctuations; uncertainty as to economic conditions in Canon's major markets; uncertainty of continued demand for Canon's high-value-added products; Canon's ability to continue to develop products and to market products that incorporate new technology on a timely basis, are competitively priced, and achieve market acceptance; the possibility of losses resulting from foreign currency transactions designed to reduce financial risks from changes in foreign currency exchange rates; disasters, outages or similar events; and inventory risk due to disruptions in supply chains and shifts in market demand.

I. Corporate Information**(1) Consolidated Financial Summary**

	Millions of yen (except per share amounts)				
	Six months ended	Six months ended	Three months ended	Three months ended	Year ended December 31,
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015	2015
Net sales	1,657,476	1,831,851	860,246	974,406	3,800,271
Income before income taxes	126,753	164,516	80,992	103,235	347,438
Net income attributable to Canon Inc.	81,439	102,125	53,448	68,195	220,209
Comprehensive income (loss)	(186,071)	127,004	(123,306)	142,900	174,081
Canon Inc. shareholders' equity	-	-	2,703,453	3,005,227	2,966,415
Total equity	-	-	2,909,042	3,221,782	3,184,463
Total assets	-	-	4,614,823	4,548,076	4,427,773
Net income attributable to Canon Inc. shareholders per share:					
Basic (yen)	74.57	93.52	48.94	62.45	201.65
Diluted (yen)	74.57	93.52	48.94	62.44	201.65
Canon Inc. shareholders' equity to total assets (%)	-	-	58.6	66.1	67.0
Cash flows from operating activities	241,207	224,712	-	-	474,724
Cash flows from investing activities	(776,092)	(306,006)	-	-	(453,619)
Cash flows from financing activities	519,883	(123,565)	-	-	(210,202)
Cash and cash equivalents at end of period	-	-	569,180	626,965	633,613

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). Financial information presented in sections II. The Business is also in conformity with U.S.GAAP.

The Canon Group (consisting of the Company, 327 consolidated subsidiaries, and 5 affiliates accounted for using the equity method, as of June 30, 2016, collectively, the Group) is engaged in development, manufacturing, sales, and servicing activities in areas such as office, imaging systems, and industrial equipment. No material change in Canon s business has occurred during the six months ended June 30, 2016.

No additions or removals of significant group entities have occurred during the six months ended June 30, 2016.

II. The Business

(1) Risk Factors

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.

(2) Significant Business Contracts Entered into in the Second Quarter of Fiscal 2016

No material contracts were entered into during the three months ended June 30, 2016.

(3) Operating Results

Looking back at the global economy in the first half of 2016, the U.S. economy continued recovering smoothly as consumer spending and employment conditions improved. In Europe, the economy recovered moderately centered on Germany. In contrast, the Chinese economy continued its deceleration and the economies of emerging countries, including those of Southeast Asia and Russia, remained stagnant owing to the depreciation of local currencies. In Japan, corporate capital investments showed signs of recovery and employment conditions continued to improve. As a result, the global economy overall continued to realize moderate growth.

As for the markets in which Canon operates amid these conditions, demand for office multifunction devices (MFDs) remained at around the same level as for the previous year, while the market for laser printers shrunk mainly in emerging countries. As for cameras, although demand for interchangeable-lens digital cameras continued to gradually recover in developed countries, sales volumes of digital compact cameras declined in all regions due to the increasing popularity of smartphones. Additionally, demand for inkjet printers continued to decline in all regions. Within the Industry and Others sector, however, demand for lithography equipment used in the production of flat panel displays (FPDs) and manufacturing equipment for organic LED (OLED) displays enjoyed strong growth thanks to active capital investment by panel manufacturers.

The average value of the yen during the second quarter was ¥108.08 against the U.S. dollar, a year-on-year appreciation of approximately ¥13, and ¥121.94 against the euro, a year-on-year appreciation of approximately ¥13, which had a negative impact on net sales of ¥75.8 billion and on operating profit of ¥30.2 billion. As for the first half of the year, the average value of the yen was ¥111.28 against the U.S. dollar, a year-on-year appreciation of approximately ¥9, and ¥124.33 against the euro, a year-on-year appreciation of approximately ¥10, which had a negative impact on net sales of ¥106.8 billion and on operating profit of ¥43.5 billion.

[Second-quarter results]

During the second quarter, although office MFDs enjoyed solid demand, mainly for color models, total sales volume of laser printers declined due to the contraction of the market. Demand for interchangeable-lens digital cameras remained firm in the U.S. and Western European nations with unit sales remaining essentially unchanged from the same period of the previous year. As for digital compact cameras, unit sales declined in all regions compared with the previous year. Looking at inkjet printers, despite the shrinking market, sales volume remained at approximately the same level as for the previous year thanks to such factors as expanded sales of models equipped with large-capacity ink tanks for emerging countries. Also, sales of industrial equipment increased, particularly systems used in the production of FPDs and OLED displays. Consequently, along with the negative impact of the appreciation of the yen, second-quarter net sales decreased 11.7% year on year to ¥860.2 billion. The gross profit ratio decreased by 1.4 points year on year to 50.3% due to the negative effect of the yen's appreciation. Despite a reduction in operating expenses of

8.8% year on year thanks to Group-wide efforts to reduce spending, second-quarter operating profit decreased by 34.5% to ¥68.6 billion.

(3) Operating Results (continued)

Other income (deductions) increased by ¥13.9 billion due to foreign currency exchange gains while income before income taxes decreased by 21.5% year on year to ¥81.0 billion and net income attributable to Canon Inc. decreased by 21.6% to ¥53.4 billion.

Basic net income attributable to Canon Inc. shareholders per share was ¥48.94 for the second quarter, a year-on-year decrease of ¥13.51.

[First-half results]

During the first half, although office MFDs enjoyed solid demand, mainly for color models, total sales volume of laser printers declined due to the contraction of the market. Demand for interchangeable-lens digital cameras remained firm with unit sales remaining essentially unchanged from the same period of the previous year, although unit sales of digital compact cameras declined compared with the previous year. Looking at inkjet printers, despite the shrinking market, sales volume remained at approximately the same level as for the previous year thanks to such factors as expanded sales of models equipped with large-capacity ink tanks for emerging countries. Also, sales of industrial equipment increased, particularly systems used in the production of FPDs and OLED displays. Consequently, along with the negative impact of the appreciation of the yen, first-half net sales decreased 9.5% year on year to ¥1,657.5 billion. The gross profit ratio decreased by 0.9 points year on year to 50.5% due to the negative effect of the yen appreciation. Despite a reduction in operating expenses of 5.6% year on year thanks to Group-wide efforts to reduce spending, first-half operating profit decreased by 36.4% to ¥108.7 billion. Other income (deductions) increased by ¥24.5 billion due to foreign currency exchange gains while income before income taxes decreased by 23.0% year on year to ¥126.8 billion and net income attributable to Canon Inc. decreased by 20.3% to ¥81.4 billion.

Basic net income attributable to Canon Inc. shareholders per share was ¥74.57 for the first half, a year-on-year decrease of ¥18.95.

Looking at Canon's first-half performance by business unit, beginning with the Office Business Unit, unit sales for office MFDs overall increased from the same period of the previous year thanks to strong sales of color models led by small-office/home-office color A3 (12 x18) imageRUNNER ADVANCE C3300-series models that were launched in the previous year, and the imagePRESS C10000VP series, which targets the production market. Among high-speed continuous-feed printers and wide-format printers, the Océ-produced VarioPrint i300, a high-speed sheet-fed color inkjet press, has been steadily receiving orders. As for laser printers, although sales continued to decrease significantly due to the impact of economic stagnation in emerging countries, in order to ensure profitability, Canon shifted its sales strategy from a focus on expanding sales volume of low-end models to expanding sales of high-added-value models mainly in developed countries. These factors, coupled with the negative effect of unfavorable currency exchange rates, resulted in total sales for the business unit of ¥910.7 billion, a year-on-year decrease of 14.6%, while operating profit totaled ¥92.3 billion, a year-on-year decrease of 38.9%.

Within the Imaging System Business Unit, unit sales of interchangeable-lens digital cameras remained at around the same level as the previous year owing to healthy demand for the professional-model EOS-1D X Mark II and advanced-amateur-model EOS 80D digital SLR cameras, which were launched this year, and an increase in sales volume in Japan and other Asian markets of the EOS M3 and M10 compact-system cameras, which were released the previous year. As for digital compact cameras, although sales volume declined amid the ongoing contraction of the market, high-added-value models that deliver high image quality, such as PowerShot G-series cameras, enjoyed solid demand. As for inkjet printers, unit sales remained at approximately the same level thanks to strong demand for models equipped with large-capacity ink tanks targeting emerging countries, which were launched in the previous year, and for the new imagePROGRAF PRO-1000 professional-model A2 photo printer.

(3) Operating Results (continued)

As a result of these factors, along with the negative effect of unfavorable currency exchange rates, sales for the business unit decreased by 12.2% to ¥522.4 billion, while operating profit totaled ¥62.8 billion, a year-on-year decline of 21.1%.

In the Industry and Others Business Unit, although unit sales of semiconductor lithography equipment decreased from the same period of the previous year, orders continued to hold firm. As for FPD lithography equipment, unit sales increased amid sales growth for systems used in the fabrication of large-size panels. Also, sales of manufacturing equipment for OLED displays, which is sold by Canon Tokki, increased amid brisk capital investment by panel manufacturers. As for network cameras, Axis, which was newly consolidated in the second quarter of the previous year, posted healthy sales growth. Consequently, sales for the business unit increased 22.1% year on year to ¥268.1 billion. As for operating profit, despite an improvement of ¥10.8 billion compared with the previous year, the business unit was in the red by ¥0.1 billion owing to upfront investment in next-generation technologies and new businesses.

Cash Flows

During the first half of 2016, cash flow from operating activities totaled ¥241.2 billion, an increase of ¥16.5 billion compared with the previous year owing to improvements in working capital, such as trade receivables. Cash flow from investing activities increased ¥470.1 billion year on year to ¥776.1 billion due to the payment for the right to acquire all of the ordinary shares of Toshiba Medical Systems Corporation (TMSC). Accordingly, free cash flow totaled negative ¥534.9 billion, a decrease of ¥453.6 billion compared with the corresponding year-ago period.

Cash flow from financing activities recorded proceeds of ¥519.9 billion, mainly owing to a provisional bank borrowing related to TMSC.

Owing to these factors, as well as the negative impact from foreign currency translation adjustments, cash and cash equivalents decreased by ¥64.4 billion to ¥569.2 billion from the end of the previous year.

Non-GAAP Financial Measures

We have reported our financial results in accordance with U.S. generally accepted accounting principles (U.S. GAAP). In addition, we have discussed our results using free cash flow, which is a non-GAAP measure.

We believe this measure, which takes into consideration the Company's operating and investing activities, is beneficial to an investor's understanding of Canon's current liquidity and the alternatives of use in financing activities.

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

(3) Operating Results (continued)

	Billions of yen Six months ended June 30, 2016
Net cash provided by operating activities	241.2
Net cash used in investing activities	(776.1)
Free cash flow	(534.9)

Management Issues to be Addressed

No material changes or issues with respect to business operations and finances have occurred during the six months ended June 30, 2016.

Research and Development Expenditures

Canon's research and development expenditures for the six months ended June 30, 2016 totaled ¥155.4 billion.

Property, Plant and Equipment**(1) Major Property, Plant and Equipment**

There were no significant changes to the status of existing major property, plant and equipment during the first half of 2016.

(2) Prospect of Capital Investment in the First Half of Fiscal 2016

The new construction of property, plant and equipment, which had been in progress as of December 31, 2015 and was completed during the first half of 2016, is as follows:

Name and location	Principal activities and products manufactured	Date of completion
Canon Inc.		
Toride Plant Ibaraki, Japan	Manufacturing Training Center	February 2016

There were no significant changes in the plans relevant to the retirement of property, plant and equipment during the first half of 2016. Moreover, there were no significant additional plans for new construction or retirement of property, plant and equipment during the first half of 2016.

III. Company Information**(1) Shares**

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

	As of June 30, 2016
Total number of issued shares	1,333,763,464

Stock Acquisition Rights

Not applicable.

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

Not applicable.

Rights Plan

Not applicable.

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

	Change during this term	As of June 30, 2016
Issued Shares (Number of shares)	-	1,333,763,464
Common Stock (millions of yen)	-	174,762
Additional Paid-in Capital (millions of yen)	-	306,288

Major Shareholders

	As of June 30, 2016	
	Number of shares owned (Number of shares)	Number of shares owned / Number of shares issued
The Master Trust Bank of Japan, Ltd. (Trust Account)	63,726,500	4.78%
Japan Trustee Services Bank, Ltd. (Trust Account)	51,313,300	3.85%
The Dai-Ichi Life Insurance Company, Limited	37,416,380	2.81%
Barclays Securities Japan Limited	30,000,000	2.25%
Mizuho Bank, Ltd.	22,558,173	1.69%
Moxley and Co. LLC	21,767,197	1.63%
State Street Bank West Client Treaty 505234	17,466,334	1.31%
Sompo Japan Nipponkoa Insurance Inc.	17,439,987	1.31%
OBAYASHI CORPORATION	16,527,607	1.24%

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Japan Trustee Services Bank, Ltd. (Trust Account 9)	15,509,100	1.16%
Total	293,724,578	22.03%

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: Apart from the above shares, Mizuho Bank, Ltd., held 9,057,000 shares contributed to a trust fund for its retirement and severance plans.

3: Moxley and Co. LLC is a nominee of JPMorgan Chase Bank, which is the depository of Canon's ADRs (American Depositary Receipts).

4: Apart from the above shares, the Company owns 241,692,769 shares (18.12% of total issued shares) of treasury stock.

(1) Shares (continued)Voting Rights

Classification	As of June 30, 2016	
	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) 241,692,700	-
Shares with full voting rights (Others)	1,090,545,400	10,905,454
Fractional unit shares (Note)	1,525,364	-
Total number of issued shares	1,333,763,464	-
Total voting rights held by all shareholders	-	10,905,454

Note:

In Fractional unit shares under Number of shares, 69 shares of treasury stock are included.

Treasury Stock, etc.

	Number of shares owned (Number of shares)	Number of shares owned / Number of shares issued
Canon Inc.	241,692,700	18.12%
Total	241,692,700	18.12%

(2) Directors and Executive Officers

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, 2015 and the end of this quarter.

Change in functions of director is below:

Toshizo Tanaka (Executive Vice President & CFO: Group Executive of Human Resources Management & Organization HQ)

There were no changes in members of executive officers between the filing date of the Annual Securities Report (Yukashoken Houkokusho) for the fiscal year ended December 31, 2015 and the end of this quarter.

Changes in functions of executive officers are below:

Toshio Homma	(Executive Vice President: Chief Executive of Office Imaging Products Operations)
Aitake Wakiya	(Managing Executive Officer: Group Executive of Finance & Accounting HQ)
Akiyoshi Kimura	(Managing Executive Officer: Group Executive of Corporate Planning Development HQ)
Masaaki Nakamura	(Managing Executive Officer: Deputy Group Executive of Human Resources Management & Organization HQ, Group Executive of Facilities Management HQ)
Soichi Hiramatsu	(Executive Officer: Group Executive of Procurement HQ)
Takanobu Nakamasu	(Executive Officer: Executive Vice President of Canon Europe Ltd.)
Hisahiro Minokawa	(Executive Officer: Senior General Manager of Human Resources Management & Organization Center)
Noriko Gunji	(Executive Officer: Executive Vice President of Canon Singapore Pte. Ltd.)

The Number of Directors and Executive Officers by Gender

Males: 46, Females: 2 (Females account for 4.2% of the total.)

Based on the number of Directors and Executive Officers as of June 30, 2016.

IV . Financial Statements (Unaudited)

(1) Consolidated Financial Statements

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CANON INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	Millions of yen	
	June 30, 2016	December 31, 2015
<u>Assets</u>		
Current assets:		
Cash and cash equivalents (Note 15)	569,180	633,613
Short-term investments (Note 2)	22,387	20,651
Trade receivables, net (Note 3)	468,200	588,001
Inventories (Note 4)	479,262	501,895
Prepaid expenses and other current assets (Notes 11 and 15)	233,595	313,019
Total current assets	1,772,624	2,057,179
Noncurrent receivables (Note 12)	27,419	29,476
Investments (Note 2)	719,675	67,862
Property, plant and equipment, net (Note 5)	1,158,529	1,219,652
Intangible assets, net	208,270	241,208
Goodwill	420,648	478,943
Other assets (Note 15)	307,658	333,453
Total assets	4,614,823	4,427,773

CANON INC. AND SUBSIDIARIES

Consolidated Balance Sheets (continued)

	Millions of yen	
	June 30, 2016	December 31, 2015
<u>Liabilities and equity</u>		
Current liabilities:		
Short-term loans and current portion of long-term debt (Note 6)	610,566	688
Trade payables (Note 7)	285,259	278,255
Accrued income taxes	33,423	47,431
Accrued expenses (Note 12)	264,751	317,653
Other current liabilities (Note 11)	167,411	171,302
Total current liabilities	1,361,410	815,329
Long-term debt, excluding current installments	710	881
Accrued pension and severance cost	266,165	296,262
Other noncurrent liabilities	77,496	130,838
Total liabilities	1,705,781	1,243,310
Commitments and contingent liabilities (Note 12)		
Equity:		
Canon Inc. shareholders' 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	401,385	401,358
Legal reserve	66,021	65,289
Retained earnings	3,363,960	3,365,158
Accumulated other comprehensive income (loss) (Note 9)	(292,259)	(29,742)
Treasury stock, at cost	(1,010,416)	(1,010,410)
(Number of shares)	(241,692,769)	(241,690,840)
Total Canon Inc. shareholders' equity	2,703,453	2,966,415
Noncontrolling interests (Note 8)	205,589	218,048
Total equity (Note 8)	2,909,042	3,184,463
Total liabilities and equity	4,614,823	4,427,773

CANON INC. AND SUBSIDIARIES

Consolidated Statements of Income and Consolidated Statements of Comprehensive Income

Consolidated Statements of Income

	Millions of yen	
	Six months ended June 30, 2016	Six months ended June 30, 2015
Net sales	1,657,476	1,831,851
Cost of sales	820,362	889,494
Gross profit	837,114	942,357
Operating expenses:		
Selling, general and administrative expenses (Note 15)	572,997	608,516
Research and development expenses	155,434	162,932
	728,431	771,448
Operating profit	108,683	170,909
Other income (deductions):		
Interest and dividend income	2,532	3,273
Interest expense	(521)	(361)
Other, net (Notes 11 and 15)	16,059	(9,305)
	18,070	(6,393)
Income before income taxes	126,753	164,516
Income taxes	41,457	58,784
Consolidated net income	85,296	105,732
Less: Net income attributable to noncontrolling interests	3,857	3,607
Net income attributable to Canon Inc.	81,439	102,125
	Yen	Yen
Net income attributable to Canon Inc. shareholders per share (Note 10):		
Basic	74.57	93.52
Diluted	74.57	93.52
Cash dividends per share	75.00	75.00

Consolidated Statements of Comprehensive Income

	Millions of yen	
	Six months ended	
	June 30, 2016	Six months ended June 30, 2015
Consolidated net income	85,296	105,732
Other comprehensive income (loss), net of tax (Note 9):		
Foreign currency translation adjustments	(270,258)	16,118
Net unrealized gains and losses on securities	(6,334)	4,587
Net gains and losses on derivative instruments	2,372	1,225
Pension liability adjustments	2,853	(658)
	(271,367)	21,272
Comprehensive income (loss) (Note 8)	(186,071)	127,004
Less: Comprehensive income (loss) attributable to noncontrolling interests	(4,735)	7,956
Comprehensive income (loss) attributable to Canon Inc.	(181,336)	119,048

CANON INC. AND SUBSIDIARIES

Consolidated Statements of Income and Consolidated Statements of Comprehensive Income

Consolidated Statements of Income

	Millions of yen	
	Three months ended June 30, 2016	Three months ended June 30, 2015
Net sales	860,246	974,406
Cost of sales	427,878	470,613
Gross profit	432,368	503,793
Operating expenses:		
Selling, general and administrative expenses (Note 15)	287,208	315,388
Research and development expenses	76,564	83,693
	363,772	399,081
Operating profit	68,596	104,712
Other income (deductions):		
Interest and dividend income	1,425	1,686
Interest expense	(341)	(260)
Other, net (Notes 11 and 15)	11,312	(2,903)
	12,396	(1,477)
Income before income taxes	80,992	103,235
Income taxes	24,912	32,355
Consolidated net income	56,080	70,880
Less: Net income attributable to noncontrolling interests	2,632	2,685
Net income attributable to Canon Inc.	53,448	68,195
	Yen	Yen
Net income attributable to Canon Inc. shareholders per share (Note 10):		
Basic	48.94	62.45
Diluted	48.94	62.44
Cash dividends per share	75.00	75.00

Consolidated Statements of Comprehensive Income

	Millions of yen	
	Three months ended June 30, 2016	Three months ended June 30, 2015
Consolidated net income	56,080	70,880
Other comprehensive income (loss), net of tax (Note 9):		
Foreign currency translation adjustments	(178,795)	70,246
Net unrealized gains and losses on securities	(1,492)	4,115
Net gains and losses on derivative instruments	860	(1,988)
Pension liability adjustments	41	(353)
	(179,386)	72,020
Comprehensive income (loss) (Note 8)	(123,306)	142,900
Less: Comprehensive income (loss) attributable to noncontrolling interests	(3,923)	7,216
Comprehensive income (loss) attributable to Canon Inc.	(119,383)	135,684

CANON INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Millions of yen	
	Six months ended June 30, 2016	Six months ended June 30, 2015
Cash flows from operating activities:		
Consolidated net income	85,296	105,732
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Depreciation and amortization	122,372	131,977
Loss on disposal of fixed assets	3,163	2,396
Deferred income taxes	(2,982)	(1,740)
Decrease in trade receivables	67,738	60,974
Increase in inventories	(31,050)	(56,480)
Increase in trade payables	26,305	16,687
Decrease in accrued income taxes	(12,178)	(7,177)
Decrease in accrued expenses	(24,148)	(28,223)
Increase in accrued (prepaid) pension and severance cost	3,824	3,690
Other, net	2,867	(3,124)
Net cash provided by operating activities	241,207	224,712
Cash flows from investing activities:		
Purchases of fixed assets (Note 5)	(100,700)	(117,501)
Proceeds from sale of fixed assets (Note 5)	2,095	2,103
Purchases of available-for-sale securities	(8)	(98)
Proceeds from sale and maturity of available-for-sale securities	407	183
(Increase) decrease in time deposits, net	(4,057)	51,936
Acquisitions of businesses, net of cash acquired	(9,226)	(241,386)
Purchases of other investments (Note 2)	(665,676)	(965)
Other, net	1,073	(278)
Net cash used in investing activities	(776,092)	(306,006)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	238	435
Repayments of long-term debt	(473)	(712)
Increase in short-term loans, net (Note 6)	610,000	-
Purchases of noncontrolling interests	(4,993)	(28,750)
Dividends paid	(81,905)	(92,806)
Repurchases and reissuance of treasury stock	(6)	803
Other, net	(2,978)	(2,535)

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Net cash provided by (used in) financing activities	519,883	(123,565)
Effect of exchange rate changes on cash and cash equivalents	(49,431)	(12,756)
Net change in cash and cash equivalents	(64,433)	(217,615)
Cash and cash equivalents at beginning of period	633,613	844,580
Cash and cash equivalents at end of period	569,180	626,965
Supplemental disclosure for cash flow information:		
Cash paid during the period for:		
Interest	385	377
Income taxes	42,724	59,554

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 quarterly 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 by the equity method as of June 30, 2016 and December 31, 2015 are summarized as follows:

	June 30, 2016	December 31, 2015
Consolidated subsidiaries	327	317
Affiliated companies	5	5
Total	332	322

(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.

(c) Recent Accounting Pronouncements

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

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

operations and financial condition.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

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

In May 2014, the FASB issued a new accounting standard related to revenue from contracts with customers. This standard requires an entity to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This standard was originally planned to be effective for annual reporting periods beginning after December 15, 2016, however, in August 2015, the FASB issued an accounting standard update for a one-year deferral of the effective date. Early adoption as of the original effective date is permitted. This standard may be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying this standard recognized at the date of initial application, although Canon has not selected a transition method. In March 2016, the FASB issued an accounting standard update which clarifies the implementation guidance for principal versus agent considerations. In April 2016, the FASB issued an accounting standard update which clarifies guidance related to identifying performance obligations and licensing implementation guidance. In May 2016, the FASB issued an accounting standard update which amends guidance in the new standard on transition, collectibility, noncash consideration and the presentation of sales and other similar taxes. These standard updates have the same effective date as the original standard. Canon is currently evaluating the adoption date and the effect that the adoption of this standard and these standard updates will have on its consolidated results of operations and financial condition.

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

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

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(2) Investments

On March 17, 2016, Canon acquired a right to acquire all the ordinary shares of Toshiba Medical Systems Corporation (TMSC), which is exercisable upon the clearance of necessary competition regulatory authorities, for ¥665,498 million. The clearance process by necessary competition regulatory authorities is still ongoing in some countries and regions outside Japan as of June 30, 2016. TMSC, in connection with our rights acquisition, is considered a variable interest entity under ASC 810. Canon does have certain protective rights including a right to refuse significant changes in capital structure of TMSC. However, under the terms of the right and related agreements, Canon does not have any ability to exercise any power to direct the activities of or to execute significant influence over TMSC pending clearance of competition regulatory authorities. Accordingly, we have accounted for this investment on a cost basis as of June 30, 2016, and it is included in investments in the accompanying consolidated balance sheet. The maximum exposure to loss associated with the right acquired at June 30, 2016 is limited to the acquisition cost. The fair value of this investment approximates its cost at June 30, 2016.

The cost, gross unrealized holding gains, gross unrealized holding losses and fair value for available-for-sale securities included in investments by major security type at June 30, 2016 and December 31, 2015 were as follows:

	Cost	Millions of yen June 30, 2016		Fair value
		Gross unrealized holding gains	Gross unrealized holding losses	
Noncurrent:				
Government bonds	258	-	9	249
Corporate bonds	42	167	6	203
Fund trusts	92	1	-	93
Equity securities	19,023	12,554	87	31,490
	19,415	12,722	102	32,035

Cost	Millions of yen December 31, 2015		Fair value
	Gross unrealized	Gross unrealized	

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		holding	holding	
		gains	losses	
Noncurrent:				
Government bonds	298	-	11	287
Corporate bonds	6	195	-	201
Fund trusts	63	1	-	64
Equity securities	20,461	23,482	1,094	42,849
	20,828	23,678	1,105	43,401

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(2) Investments (continued)

Maturities of available-for-sale debt securities included in investments in the accompanying consolidated balance sheets were as follows at June 30, 2016:

	Millions of yen	
	Cost	Fair value
Due after five years	263	421
	263	421

Realized gains and losses are determined using the average cost method and are reflected in earnings. The gross realized gains were nil and ¥133 million for the six months ended June 30, 2016 and 2015, respectively. The gross realized losses, including write-downs for impairments that were other than temporary, were ¥1,032 million and nil for the six months ended June 30, 2016 and 2015, respectively. The gross realized gains were nil and ¥133 million for the three months ended June 30, 2016 and 2015, respectively. The gross realized losses, including write-downs for impairments that were other than temporary, were ¥584 million and nil for the three months ended June 30, 2016 and 2015, respectively.

At June 30, 2016, substantially all of the available-for-sale securities with unrealized losses had been in a continuous unrealized loss position for less than twelve months.

Time deposits with original maturities of more than three months are ¥22,387 million and ¥20,651 million at June 30, 2016 and December 31, 2015, respectively, and are included in short-term investments in the accompanying consolidated balance sheets.

Aggregate cost of non-marketable equity securities accounted for under the cost method totaled ¥668,016 million and ¥2,570 million at June 30, 2016 and December 31, 2015, respectively. The increase in 2016 is primarily related to a right to acquire the ordinary shares of TMSC as described above. These investments were not evaluated for impairment at June 30, 2016 and December 31, 2015, respectively, because (a) Canon did not estimate the fair value of those investments as it was not practicable to estimate the fair value of the investments and (b) Canon did not identify any events or changes in circumstances that might have had significant adverse effects on the fair value of those investments.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(3) Trade Receivables

Trade receivables are summarized as follows:

	Millions of yen	
	June 30, 2016	December 31, 2015
Notes	17,358	17,614
Accounts	460,960	582,464
Less allowance for doubtful receivables	(10,118)	(12,077)
	468,200	588,001

(4) Inventories

Inventories are summarized as follows:

	Millions of yen	
	June 30, 2016	December 31, 2015
Finished goods	327,613	357,115
Work in process	138,030	130,258
Raw materials	13,619	14,522
	479,262	501,895

(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, 2016	December 31, 2015
Land	275,396	282,786
Buildings	1,590,945	1,632,604
Machinery and equipment	1,715,412	1,813,116
Construction in progress	58,411	61,952
	3,640,164	3,790,458
Less accumulated depreciation	(2,481,635)	(2,570,806)
	1,158,529	1,219,652

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

(6) Short-Term Loans

Short-term loans consisting of bank borrowings were ¥610,030 million and ¥26 million at June 30, 2016 and December 31, 2015, respectively.

The increase in 2016 was due to the provisional borrowing without collateral, related to a right to acquire the ordinary shares of TMSC. The interest rate on this borrowing was 0.13% as of June 30, 2016.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(7) Trade Payables

Trade payables are summarized as follows:

	Millions of yen	
	June 30, 2016	December 31, 2015
Notes	24,610	16,706
Accounts	260,649	261,549
	285,259	278,255

(8) Equity

The change in the carrying amount of total equity, equity attributable to Canon Inc. shareholders and equity attributable to noncontrolling interests in the consolidated balance sheets for the six months ended June 30, 2016 and 2015 are as follows:

	Millions of yen		
	Canon Inc. shareholders equity	Noncontrolling interests	Total equity
Balance at December 31, 2015	2,966,415	218,048	3,184,463
Dividends to Canon Inc. shareholders	(81,905)	-	(81,905)
Dividends to noncontrolling interests	-	(2,448)	(2,448)
Equity transactions with noncontrolling interests and other	285	(5,276)	(4,991)
Comprehensive income:			
Net income	81,439	3,857	85,296
Other comprehensive income (loss), net of tax			
Foreign currency translation adjustments	(261,083)	(9,175)	(270,258)
Net unrealized gains and losses on securities	(6,030)	(304)	(6,334)
Net gains and losses on derivative instruments	2,389	(17)	2,372
Pension liability adjustments	1,949	904	2,853
Total comprehensive income (loss)	(181,336)	(4,735)	(186,071)

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Repurchases and reissuance of treasury stock	(6)	-	(6)
Balance at June 30, 2016	2,703,453	205,589	2,909,042

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(8) Equity (continued)

Balance at December 31, 2014	2,978,184	162,574	3,140,758
Dividends to Canon Inc. shareholders	(92,806)	-	(92,806)
Dividends to noncontrolling interests	-	(2,231)	(2,231)
Acquisition of subsidiaries	-	77,086	77,086
Equity transactions with noncontrolling interests and other	(2)	(28,830)	(28,832)
Comprehensive income:			
Net income	102,125	3,607	105,732
Other comprehensive income (loss), net of tax			
Foreign currency translation adjustments	12,230	3,888	16,118
Net unrealized gains and losses on securities	4,117	470	4,587
Net gains and losses on derivative instruments	1,223	2	1,225
Pension liability adjustments	(647)	(11)	(658)
Total comprehensive income	119,048	7,956	127,004
Repurchases and reissuance of treasury stock	803	-	803
Balance at June 30, 2015	3,005,227	216,555	3,221,782

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(9) Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) for the six months ended June 30, 2016 and 2015 are as follows:

	Millions of yen				
	Foreign currency translation adjustments	Unrealized gains and losses on securities	Gains and losses on derivative instruments	Pension liability adjustments	Total
Balance at December 31, 2015	87,038	14,055	182	(131,017)	(29,742)
Equity transactions with noncontrolling interests and other	259	-	-	(1)	258
Other comprehensive income (loss) before reclassifications	(261,083)	(6,718)	4,239	1,832	(261,730)
Amounts reclassified from accumulated other comprehensive income (loss)	-	688	(1,850)	117	(1,045)
Net change during the period	(260,824)	(6,030)	2,389	1,948	(262,517)
Balance at June 30, 2016	(173,786)	8,025	2,571	(129,069)	(292,259)

	Millions of yen				
	Foreign currency translation adjustments	Unrealized gains and losses on securities	Gains and losses on derivative instruments	Pension liability adjustments	Total
Balance at December 31, 2014	144,557	12,546	(2,603)	(126,214)	28,286
Equity transactions with noncontrolling interests and other	-	-	-	-	-
Other comprehensive income (loss) before reclassifications	12,230	4,203	(345)	(688)	15,400
Amounts reclassified from accumulated other comprehensive income (loss)	-	(86)	1,568	41	1,523
Net change during the period	12,230	4,117	1,223	(647)	16,923
Balance at June 30, 2015	156,787	16,663	(1,380)	(126,861)	45,209

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(9) Other Comprehensive Income (Loss) (continued)

Reclassifications out of accumulated other comprehensive income (loss) for the six months ended June 30, 2016 and 2015 are as follows:

	Amount reclassified from accumulated other comprehensive income (loss) *1		Affected line items in consolidated statements of income
	Six months ended June 30, 2016	Six months ended June 30, 2015	
Unrealized gains and losses on securities	1,032	(133)	Other, net
	(340)	47	Income taxes
	692	(86)	Consolidated net income
	(4)	-	Net income attributable to noncontrolling interests
	688	(86)	Net income attributable to Canon Inc.
Gains and losses on derivative instruments	(2,842)	2,144	Other, net
	996	(574)	Income taxes
	(1,846)	1,570	Consolidated net income
	(4)	(2)	Net income attributable to noncontrolling interests
	(1,850)	1,568	Net income attributable to Canon Inc.
Pension liability adjustments	41	(132)	*2
	92	161	Income taxes
	133	29	Consolidated net income
	(16)	12	Net income attributable to noncontrolling interests
	117	41	Net income attributable to Canon Inc.
	(1,045)	1,523	

Total amount reclassified, net of
tax and noncontrolling interests

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

*2 This accumulated other comprehensive income (loss) component is included in the computation of net periodic pension cost.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(9) Other Comprehensive Income (Loss) (continued)

Reclassifications out of accumulated other comprehensive income (loss) for the three months ended June 30, 2016 and 2015 are as follows:

	Millions of yen		
	Amount reclassified from accumulated other comprehensive income (loss) *1		Affected line items in consolidated statements of income
	Three months ended June 30, 2016	Three months ended June 30, 2015	
Unrealized gains and losses on securities	584 (192)	(133) 47	Other, net Income taxes
	392	(86)	Consolidated net income
	(3)	-	Net income attributable to noncontrolling interests
	389	(86)	Net income attributable to Canon Inc.
Gains and losses on derivative instruments	(2,767) 923	(840) 413	Other, net Income taxes
	(1,844)	(427)	Consolidated net income
	(4)	(2)	Net income attributable to noncontrolling interests
	(1,848)	(429)	Net income attributable to Canon Inc.
Pension liability adjustments	12 48	(79) 84	*2 Income taxes
	60	5	Consolidated net income
	(8)	6	Net income attributable to noncontrolling interests
	52	11	Net income attributable to Canon Inc.
	(1,407)	(504)	

Total amount reclassified, net of
tax and noncontrolling interests

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

*2 This accumulated other comprehensive income (loss) component is included in the computation of net periodic pension cost.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

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

A reconciliation of the numerators and denominators of basic and diluted net income attributable to Canon Inc. shareholders per share computations for the six months ended June 30, 2016 and 2015 is as follows:

	Millions of yen	
	Six months ended June 30, 2016	Six months ended June 30, 2015
Net income attributable to Canon Inc.	81,439	102,125

	Number of shares	
	Six months ended June 30, 2016	Six months ended June 30, 2015
Average common shares outstanding	1,092,071,582	1,091,969,763
Effect of dilutive securities:		
Stock options	-	69,862
Diluted common shares outstanding	1,092,071,582	1,092,039,625

	Yen	
	Six months ended June 30, 2016	Six months ended June 30, 2015
Net income attributable to Canon Inc. shareholders per share:		
Basic	74.57	93.52
Diluted	74.57	93.52

A reconciliation of the numerators and denominators of basic and diluted net income attributable to Canon Inc. shareholders per share computations for the three months ended June 30, 2016 and 2015 is as follows:

	Millions of yen	
	Three months ended June 30, 2016	Three months ended June 30, 2015
Net income attributable to Canon Inc.	53,448	68,195

	Number of shares	
	Three months ended June 30, 2016	Three months ended June 30, 2015
Average common shares outstanding	1,092,071,180	1,092,042,189
Effect of dilutive securities:		

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Stock options	-	78,861
Diluted common shares outstanding	1,092,071,180	1,092,121,050

	Three months ended June 30, 2016	Yen Three months ended June 30, 2015
Net income attributable to Canon Inc. shareholders per share:		
Basic	48.94	62.45
Diluted	48.94	62.44

The computation of diluted net income attributable to Canon Inc. shareholders per share for the six and three months ended June 30, 2016 and 2015 excludes certain outstanding stock options because the effect would be anti-dilutive.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(11) 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, 2016 are expected to be recognized in earnings over the next twelve months. Canon excludes the time value component from the assessment of hedge effectiveness. Changes in the fair value of a foreign exchange contract for the period between the date that the forecasted intercompany sales occur and its maturity date are recognized in earnings and not considered hedge ineffectiveness.

Derivatives not designated as hedges

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

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(11) Derivatives and Hedging Activities (continued)

Contract amounts of foreign exchange contracts at June 30, 2016 and December 31, 2015 are set forth below:

	Millions of yen	
	June 30, 2016	December 31, 2015
To sell foreign currencies	253,623	228,053
To buy foreign currencies	25,322	37,540
<i>Fair value of derivative instruments in the consolidated balance sheets</i>		

The following tables present Canon's derivative instruments measured at gross fair value as reflected in the consolidated balance sheets at June 30, 2016 and December 31, 2015.

Derivatives designated as hedging instruments

		Millions of yen	
	Balance sheet location	June 30, 2016	Fair value December 31, 2015
Assets:			
Foreign exchange contracts	Prepaid expenses and other current assets	2,476	373
Liabilities:			
Foreign exchange contracts	Other current liabilities	287	534

Derivatives not designated as hedging instruments

		Millions of yen	
	Balance sheet location	June 30, 2016	Fair value December 31, 2015
Assets:			
Foreign exchange contracts	Prepaid expenses and other current assets	9,160	1,112
Liabilities:			
Foreign exchange contracts	Other current liabilities	138	90

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(11) Derivatives and Hedging Activities (continued)*Effect of derivative instruments in the consolidated statements of income*

The following tables present the effect of Canon's derivative instruments in the consolidated statements of income for the six and three months ended June 30, 2016 and 2015.

Derivatives in cash flow hedging relationships

Six months ended June 30, 2016	Gain (loss) recognized in OCI (effective portion) Amount	Millions of yen		Gain (loss) recognized in income (ineffective portion and amount excluded from effectiveness testing)	
		Gain (loss) reclassified from accumulated OCI into income (effective portion) Location	Amount	Location	Amount
Foreign exchange contracts	6,349	Other, net	2,842	Other, net	(128)

Six months ended June 30, 2015	Gain (loss) recognized in OCI (effective portion) Amount	Millions of yen		Gain (loss) recognized in income (ineffective portion and amount excluded from effectiveness testing)	
		Gain (loss) reclassified from accumulated OCI into income (effective portion) Location	Amount	Location	Amount
Foreign exchange contracts	(250)	Other, net	(2,144)	Other, net	(60)

Three months ended June 30, 2016	Gain (loss) recognized in OCI (effective	Millions of yen		Gain (loss) recognized in income (ineffective portion and amount excluded from effectiveness testing)	
		Gain (loss) reclassified from accumulated OCI into income (effective portion)			

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	portion) Amount	Location	Amount	Location	Amount
Foreign exchange contracts	4,074	Other, net	2,767	Other, net	(65)

Millions of yen

Three months ended June 30, 2015	Gain (loss) recognized in OCI (effective portion) Amount	Gain (loss) reclassified from accumulated OCI into income (effective portion) Location	Amount	Gain (loss) recognized in income (ineffective portion and amount excluded from effectiveness testing) Location	Amount
Foreign exchange contracts	(2,303)	Other, net	840	Other, net	(31)

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(11) Derivatives and Hedging Activities (continued)*Effect of derivative instruments in the consolidated statements of income (continued)*Derivatives not designated as hedging instruments

		Millions of yen
Six months ended June 30, 2016		Gain (loss) recognized in income on derivative
	Location	
		Amount
Foreign exchange contracts	Other, net	23,175
		Millions of yen
Six months ended June 30, 2015		Gain (loss) recognized in income on derivative
	Location	
		Amount
Foreign exchange contracts	Other, net	(3,390)
		Millions of yen
Three months ended June 30, 2016		Gain (loss) recognized in income on derivative
	Location	
		Amount
Foreign exchange contracts	Other, net	17,741
		Millions of yen
Three months ended June 30, 2015		Gain (loss) recognized in income on derivative
	Location	
		Amount
Foreign exchange contracts	Other, net	(11,894)

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(12) Commitments and Contingent Liabilities**Commitments**

As of June 30, 2016, commitments outstanding for the purchase of property, plant and equipment approximated ¥36,520 million, and commitments outstanding for the purchase of parts and raw materials approximated ¥75,616 million.

Canon occupies sales offices and other facilities under lease arrangements accounted for as operating leases. Deposits made under such arrangements aggregated ¥12,287 million and ¥13,561 million at June 30, 2016 and December 31, 2015, respectively, and are included in noncurrent receivables in the accompanying consolidated balance sheets.

Future minimum lease payments required under noncancelable operating leases are ¥20,994 million (within one year) and ¥49,346 million (after one year), at June 30, 2016.

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 5 years, in the case of affiliates and other companies. The maximum amount of undiscounted payments Canon would have had to make in the event of default is ¥6,440 million at June 30, 2016. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at June 30, 2016 were not significant.

Canon also issues contractual product warranties under which it generally guarantees the performance of products delivered and services rendered for a certain period or term. 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, 2016 and 2015 is summarized as follows:

Six months ended June 30, 2016

	Millions of yen
Balance at December 31, 2015	14,014
Addition	9,052
Utilization	(8,064)
Other	(3,153)
Balance at June 30, 2016	11,849

Six months ended June 30, 2015

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	Millions of yen
Balance at December 31, 2014	11,564
Addition	11,420
Utilization	(7,144)
Other	(2,363)
Balance at June 30, 2015	13,477

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(12) Commitments and Contingent Liabilities (continued)

Legal proceedings

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

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(13) Disclosures about the Fair Value of Financial Instruments and Concentrations of Credit Risk***Fair value of financial instruments***

The estimated fair values of Canon's financial instruments at June 30, 2016 and December 31, 2015 are set forth below. The following summary excludes cash and cash equivalents, trade receivables, finance receivables, noncurrent receivables, short-term loans, trade payables and accrued expenses for which fair values approximate their carrying amounts. The summary also excludes investments and derivative instruments which are disclosed in Note 2 and Note 11, respectively.

	Millions of yen			
	June 30, 2016		December 31, 2015	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Long-term debt, including current installments	(1,247)	(1,224)	(1,543)	(1,507)

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

Long-term debt

Canon's long-term debt instruments are classified as Level 2 instruments and valued based on the present value of future cash flows associated with each instrument discounted using current market borrowing rates for similar debt instruments of comparable maturity. The levels are more fully described in Note 14.

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, 2016 and December 31, 2015, one customer accounted for approximately 14% and 15% of consolidated trade receivables, respectively. Although Canon does not expect that the customer will fail to meet its obligations, Canon is potentially exposed to concentrations of credit risk if the customer failed to perform according to the terms of the contracts.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(14) Fair Value Measurements

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

Level 1 - Inputs are quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs are quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable, and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 - Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable, which reflect the reporting entity's own assumptions about the assumptions that market participants would use in establishing a price.

Assets and liabilities measured at fair value on a recurring basis

The following tables present Canon's assets and liabilities that are measured at fair value on a recurring basis consistent with the fair value hierarchy at June 30, 2016 and December 31, 2015.

	Millions of yen June 30, 2016			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	-	35,000	-	35,000
Available-for-sale (noncurrent):				
Government bonds	249	-	-	249
Corporate bonds	-	203	-	203
Fund trusts	12	81	-	93
Equity securities	31,490	-	-	31,490
Derivatives	-	11,636	-	11,636
Total assets	31,751	46,920	-	78,671
Liabilities:				
Derivatives	-	425	-	425
Total liabilities	-	425	-	425

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(14) Fair Value Measurements (continued)

	Millions of yen December 31, 2015			Total
	Level 1	Level 2	Level 3	
Assets:				
Cash and cash equivalents	-	80,870	-	80,870
Available-for-sale (noncurrent):				
Government bonds	287	-	-	287
Corporate bonds	-	201	-	201
Fund trusts	12	52	-	64
Equity securities	42,849	-	-	42,849
Derivatives	-	1,485	-	1,485
Total assets	43,148	82,608	-	125,756
Liabilities:				
Derivatives	-	624	-	624
Total liabilities	-	624	-	624

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

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

The following table presents the changes in Level 3 assets measured on a recurring basis, consisting primarily of corporate bonds, for the six months ended June 30, 2015. There are no changes in Level 3 assets measured on a recurring basis for the six months ended June 30, 2016.

Six months ended June 30, 2015

	Millions of yen
Balance at December 31, 2014	474
Total gains or losses (realized or unrealized):	
Included in earnings	-
Included in other comprehensive income (loss)	22
Purchases, issuances and settlements	(496)

Balance at June 30, 2015

-

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(14) Fair Value Measurements (continued)

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, 2015. There are no changes in Level 3 assets measured on a recurring basis for the three months ended June 30, 2016.

Three months ended June 30, 2015

	Millions of yen
Balance at March 31, 2015	647
Total gains or losses (realized or unrealized):	
Included in earnings	-
Included in other comprehensive income (loss)	(151)
Purchases, issuances and settlements	(496)
Balance at June 30, 2015	-

Assets and liabilities measured at fair value on a nonrecurring basis

During the six and three months ended June 30, 2016 and 2015, there were no circumstances that required any significant assets or liabilities to be measured at fair value on a nonrecurring basis.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(15) 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 were a net gain of ¥10,680 million and a net loss of ¥15,526 million for the six months ended June 30, 2016 and 2015, respectively, and were a net gain of ¥7,622 million and a net loss of 7,600 million, for the three months ended June 30, 2016, and 2015, respectively.

Advertising costs are expensed as incurred. Advertising expenses were ¥28,314 million and ¥33,180 million for the six months ended June 30, 2016 and 2015, respectively, and were ¥16,549 million and ¥21,230 million for the three months ended June 30, 2016 and 2015, respectively.

Shipping and handling costs totaled ¥22,087 million and ¥26,578 million for the six months ended June 30, 2016 and 2015, respectively, and ¥10,870 million and ¥13,603 million for the three months ended June 30, 2016 and 2015, respectively, and are included in selling, general and administrative expenses in the consolidated statements of income.

Certain debt securities with original maturities of less than three months classified as available-for-sale securities of ¥35,000 million and ¥80,870 million at June 30, 2016 and December 31, 2015, respectively, are included in cash and cash equivalents in the consolidated balance sheets. Fair value for these securities approximates their cost.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(15) Supplemental Information (continued)

Finance receivables represent financing leases which consist of sales-type leases and direct-financing leases resulting from the sales of Canon's and complementary third-party products primarily in foreign countries. These receivables typically have terms ranging from 1 year to 6 years. Finance receivables are ¥256,116 million and ¥296,767 million at June 30, 2016 and 2015, respectively. Finance receivables which are individually evaluated for impairment at June 30, 2016 and 2015 are not significant.

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

Six months ended June 30, 2016

	Millions of yen
Balance at December 31, 2015	2,878
Charge-offs	(460)
Provision	231
Other	(323)
Balance at June 30, 2016	2,326

Six months ended June 30, 2015

	Millions of yen
Balance at December 31, 2014	6,276
Charge-offs	(656)
Provision	29
Other	(2,588)
Balance at June 30, 2015	3,061

Canon has policies in place to ensure that its products are sold to customers with an appropriate credit history, and continuously monitors its customers' credit quality based on information including length of period in arrears, macroeconomic conditions, initiation of legal proceedings against customers and bankruptcy filings. The allowance for credit losses of finance receivables are evaluated collectively based on historical experience of credit losses. An additional reserve for individual accounts is recorded when Canon becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings. Finance receivables which are past due at June 30,

2016 and December 31, 2015 are not significant.

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(16) Segment Information

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

The primary products included in each segment are as follows:

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

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

Industry and Others Business Unit: Semiconductor lithography equipment / FPD (Flat panel display) lithography equipment / Digital radiography systems / Ophthalmic equipment / Vacuum thin-film deposition equipment / Organic LED (OLED) panel manufacturing equipment / Die bonders / Micromotors / Network cameras / Handy terminals / Document scanners

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

CANON INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(16) Segment Information (continued)

Information about operating results for each segment for the six months ended June 30, 2016 and 2015 is as follows:

	Office	Imaging System	Industry and Others <i>(Millions of yen)</i>	Corporate and eliminations	Consolidated
2016:					
Net sales:					
External customers	909,498	521,870	226,108		1,657,476
Intersegment	1,250	489	42,034	(43,773)	
Total	910,748	522,359	268,142	(43,773)	1,657,476
Operating cost and expenses	818,439	459,518	268,265	2,571	1,548,793
Operating profit	92,309	62,841	(123)	(46,344)	108,683
2015:					
Net sales:					
External customers	1,064,781	594,557	172,513		1,831,851
Intersegment	1,304	635	47,157	(49,096)	
Total	1,066,085	595,192	219,670	(49,096)	1,831,851
Operating cost and expenses	914,986	515,585	230,586	(215)	1,660,942
Operating profit	151,099	79,607	(10,916)	(48,881)	170,909

Information about operating results for each segment for the three months ended June 30, 2016 and 2015 is as follows:

	Office	Imaging System	Industry and Others <i>(Millions of yen)</i>	Corporate and eliminations	Consolidated
2016:					
Net sales:					
External customers	455,858	287,303	117,085		860,246

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Intersegment	538	240	20,886	(21,664)	
Total	456,396	287,543	137,971	(21,664)	860,246
Operating cost and expenses	408,791	244,320	137,472	1,067	791,650
Operating profit	47,605	43,223	499	(22,731)	68,596
2015:					
Net sales:					
External customers	536,282	332,208	105,916		974,406
Intersegment	672	326	24,451	(25,449)	
Total	536,954	332,534	130,367	(25,449)	974,406
Operating cost and expenses	457,571	282,045	133,444	(3,366)	869,694
Operating profit	79,383	50,489	(3,077)	(22,083)	104,712

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)

(16) Segment Information (continued)

Information by major geographic area for the six months ended June 30, 2016 and 2015 is as follows:

	Japan	Americas	Europe (Millions of yen)	Asia and Oceania	Total
2016:					
Net sales:	337,076	471,320	456,659	392,421	1,657,476
2015:					
Net sales:	340,680	541,799	523,156	426,216	1,831,851

Information by major geographic area for the three months ended June 30, 2016 and 2015 is as follows:

	Japan	Americas	Europe (Millions of yen)	Asia and Oceania	Total
2016:					
Net sales:	168,535	247,072	236,774	207,865	860,246
2015:					
Net sales:	175,537	292,824	277,197	228,848	974,406

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

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

(2) Other Information

The Board of Directors approved an interim cash dividend at the meeting held on July 26, 2016 as below:

1. Total amount of interim cash dividends:

81,905 million yen

2. Amount of an interim cash dividend per share:

75 yen

3. Payment date:

August 26, 2016

Note:

The interim dividend is paid to registered shareholders as of June 30, 2016.