

MORGAN STANLEY  
Form FWP  
December 06, 2018

December 2018

Preliminary Terms No. 1,300

Registration Statement Nos. 333-221595; 333-221595-01

Dated December 6, 2018

Filed pursuant to Rule 433

Morgan Stanley Finance LLC

Structured Investments

Opportunities in U.S. and International Equities

Buffered PLUS Based on the Value of a Basket Consisting of Two Indices due June 17, 2021

**Buffered Performance Leveraged Upside Securities<sup>SM</sup>**

**Fully and Unconditionally Guaranteed by Morgan Stanley**

**Principal at Risk Securities**

The Buffered PLUS offered are unsecured obligations of Morgan Stanley Finance LLC (“MSFL”) and are fully and unconditionally guaranteed by Morgan Stanley. The Buffered PLUS will pay no interest, provide a minimum payment at maturity of only 15% of the stated principal amount and have the terms described in the accompanying product supplement for PLUS, index supplement and prospectus, as supplemented or modified by this document. At maturity, if the basket has appreciated in value, investors will receive the stated principal amount of their investment plus leveraged upside performance of the basket. If the basket has depreciated in value, but the basket has not declined by more than the specified buffer amount, the Buffered PLUS will redeem for par. However, if the basket has declined by more than the buffer amount, investors will lose 1% for every 1% decline beyond the specified buffer amount, subject to the minimum payment at maturity of 15% of the stated principal amount. Investors may lose up to 85% of the stated principal amount of the Buffered PLUS. The Buffered PLUS are for investors who seek an equity-based return and who are willing to risk their principal and forgo current income in exchange for the leverage and buffer features that in each case apply to a limited range of performance of the basket. The Buffered PLUS are notes issued as part of MSFL’s Series A Global Medium-Term Notes program.

**All payments are subject to our credit risk. If we default on our obligations, you could lose some or all of your investment. These Buffered PLUS are not secured obligations, and you will not have any security interest in, or otherwise have any access to, any underlying reference asset or assets.**

**SUMMARY TERMS**

Issuer:	Morgan Stanley Finance LLC
Guarantor:	Morgan Stanley
Maturity date:	June 17, 2021
Original issue price:	\$1,000 per Buffered PLUS

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Stated principal amount: \$1,000 per Buffered PLUS  
 Pricing date: December 14, 2018  
 Original issue date: December 19, 2018 (3 business days after the pricing date)  
 Aggregate principal amount: \$  
 Interest: None

Basket:	Basket component	Bloomberg ticker symbol	Basket component weighting	Initial basket component value	Multiplier
	Russell 2000® Index (the “RTY Index”)	RTY	80%		
	EURO STOXX 50® Index (the “SX5E Index”)	SX5E	20%		

We refer to each of the RTY Index and the SX5E Index as an underlying index and, together, as the basket components.

Payment at maturity (per Buffered PLUS):

§ If the final basket value is *greater than* the initial basket value: \$1,000 + the leveraged upside payment

§ If the final basket value is *less than or equal to* the initial basket value but has decreased from the initial basket value by an amount *less than or equal to* the buffer amount of 15%: \$1,000

§ If the final basket value is *less than* the initial basket value and has decreased from the initial basket value by an amount *greater than* the buffer amount of 15%:

$$(\$1,000 \times \text{basket performance factor}) + \$150$$

*Under these circumstances, the payment at maturity will be less than the stated principal amount of \$1,000. However, under no circumstances will the Buffered PLUS pay less than \$150 per Buffered PLUS at maturity.*

Leveraged upside payment:  $\$1,000 \times \text{leverage factor} \times \text{basket percent change}$

Leverage factor: At least 108%. The actual leverage factor will be determined on the pricing date.

Basket percent change:  $(\text{final basket value} - \text{initial basket value}) / \text{initial basket value}$

Buffer amount: 15%

Minimum payment at maturity: \$150 per Buffered PLUS (15% of the stated principal amount)

Basket performance factor: Final basket value / initial basket value

Initial basket value: 100, which will be equal to the sum of the products of the initial basket component values of each of the basket components, as set forth under “Basket—Initial basket component value” above, and the applicable multiplier for each of the basket components, each of which will be determined on the pricing date.

Final basket value: The basket closing value on the valuation date.

Valuation date: June 14, 2021, subject to postponement for non-index business days and certain market disruption events.

Basket closing value: The basket closing value on any day is the sum of the products of (i) the basket component closing value of each of the basket components and (ii) the applicable multiplier for such basket component on such date.

Basket component closing value: In the case of each underlying index, the index closing value of such underlying index.

Multiplier: The multiplier will be set on the pricing date based on each basket component’s respective initial basket component value so that each basket component will represent its applicable basket component weighting in the predetermined initial basket value. Each multiplier will remain constant for the term of the Buffered PLUS. See “Basket—Multiplier” above.

Listing: The Buffered PLUS will not be listed on any securities exchange.

CUSIP / ISIN: 61768DTU9 / US61768DTU99

Agent: Morgan Stanley & Co. LLC (“MS & Co.”), an affiliate of MSFL and a wholly owned subsidiary of Morgan Stanley. See “Supplemental information regarding plan of distribution; conflicts of interest.”

Estimated value on the pricing date: Approximately \$985.20 per Buffered PLUS, or within \$10.00 of that estimate. See “Investment Overview” on page 2.

Commissions and issue price:	Price to public	Agent’s commission <sup>(1)</sup>	Proceeds to us <sup>(2)</sup>
Per Buffered PLUS	\$1,000	\$	\$
Total	\$	\$	\$

Selected dealers and their financial advisors will collectively receive from the agent, MS & Co., a fixed sales commission of \$ for each Buffered PLUS they sell. See “Supplemental information regarding plan of distribution; conflicts of interest.” For additional information, see “Plan of Distribution (Conflicts of Interest)” in the accompanying product supplement for PLUS.

(1) See “Use of proceeds and hedging” on page 15.

**The Buffered PLUS involve risks not associated with an investment in ordinary debt securities. See “Risk Factors” beginning on page 5.**

**The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities, or determined if this document or the accompanying product supplement, index supplement and prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

**The Buffered PLUS are not deposits or savings accounts and are not insured by the Federal Deposit Insurance Corporation or any other governmental agency or instrumentality, nor are they obligations of, or guaranteed by, a bank.**

**You should read this document together with the related product supplement, index supplement and prospectus, each of which can be accessed via the hyperlinks below. Please also see “Additional Terms of the Buffered PLUS” and “Additional Information About the Buffered PLUS” at the end of this document.**

References to “we,” “us” and “our” refer to Morgan Stanley or MSFL, or Morgan Stanley and MSFL collectively, as the context requires.

**[Product Supplement for PLUS dated November 16, 2017](#) [Index Supplement dated November 16, 2017](#)  
[Prospectus dated November 16, 2017](#)**

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Investment Summary

Buffered Performance Leveraged Upside Securities

The Buffered PLUS Based on the Value of a Basket Consisting of Two Indices due June 17, 2021 (the “Buffered PLUS”) can be used:

§ As an alternative to direct exposure to the basket that enhances returns for any potential positive performance of the basket

§ To enhance returns and potentially outperform the basket in a bullish scenario

§ To achieve similar levels of upside exposure to the basket as a direct investment while using fewer dollars by taking advantage of the leverage factor

§ To obtain a buffer against a specified level of negative performance in the basket

Maturity:	Approximately 2.5 years
Leverage factor:	At least 108%. The actual leverage factor will be determined on the pricing date.
Buffer amount:	15%
Minimum payment at maturity:	\$150 per Buffered PLUS (15% of the stated principal amount). Investors may lose up to 85% of the stated principal amount of the Buffered PLUS.
Basket weightings:	80% for the RTY Index and 20% for the SX5E Index
Interest:	None

The original issue price of each Buffered PLUS is \$1,000. This price includes costs associated with issuing, selling, structuring and hedging the Buffered PLUS, which are borne by you, and, consequently, the estimated value of the Buffered PLUS on the pricing date will be less than \$1,000. We estimate that the value of each Buffered PLUS on the pricing date will be approximately \$985.20, or within \$10.00 of that estimate. Our estimate of the value of the

Buffered PLUS as determined on the pricing date will be set forth in the final pricing supplement.

*What goes into the estimated value on the pricing date?*

In valuing the Buffered PLUS on the pricing date, we take into account that the Buffered PLUS comprise both a debt component and a performance-based component linked to the basket components. The estimated value of the Buffered PLUS is determined using our own pricing and valuation models, market inputs and assumptions relating to the basket components, instruments based on the basket components, volatility and other factors including current and expected interest rates, as well as an interest rate related to our secondary market credit spread, which is the implied interest rate at which our conventional fixed rate debt trades in the secondary market.

*What determines the economic terms of the Buffered PLUS?*

In determining the economic terms of the Buffered PLUS, including the leverage factor, the buffer amount and the minimum payment at maturity, we use an internal funding rate, which is likely to be lower than our secondary market credit spreads and therefore advantageous to us. If the issuing, selling, structuring and hedging costs borne by you were lower or if the internal funding rate were higher, one or more of the economic terms of the Buffered PLUS would be more favorable to you.

*What is the relationship between the estimated value on the pricing date and the secondary market price of the Buffered PLUS?*

The price at which MS & Co. purchases the Buffered PLUS in the secondary market, absent changes in market conditions, including those related to the basket components, may vary from, and be lower than, the estimated value on the pricing date, because the secondary market price takes into account our secondary market credit spread as well as the bid-offer spread that MS & Co. would charge in a secondary market transaction of this type and other factors. However, because the costs associated with issuing, selling, structuring and hedging the Buffered PLUS are not fully deducted upon issuance, for a period of up to 6 months following the issue date, to the extent that MS & Co. may buy or sell the Buffered PLUS in the secondary market, absent changes in market conditions, including those related to the basket components, and to our secondary market credit spreads, it would do so based on values higher than the estimated value. We expect that those higher values will also be reflected in your brokerage account statements.

MS & Co. may, but is not obligated to, make a market in the Buffered PLUS and, if it once chooses to make a market, may cease doing so at any time.



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Key Investment Rationale

The Buffered PLUS offer leveraged upside exposure to any positive performance of the basket while providing limited protection against negative performance of the basket. Once the basket has decreased in value by more than the specified buffer amount, investors are exposed to the negative performance of the basket, subject to the minimum payment at maturity. At maturity, if the basket has appreciated, investors will receive the stated principal amount of their investment plus leveraged upside performance of the underlying basket. At maturity, if the basket has depreciated and (i) if the closing value of the basket has not declined by more than the specified buffer amount, the Buffered PLUS will redeem for par, or (ii) if the closing value of the basket has declined by more than the buffer amount, the investor will lose 1% for every 1% decline beyond the specified buffer amount. **Investors may lose up to 85% of the stated principal amount of the Buffered PLUS.**

Leveraged Performance	The Buffered PLUS offer investors an opportunity to capture enhanced returns for any positive performance relative to a direct investment in the basket.
Upside Scenario	The basket increases in value, and, at maturity, the Buffered PLUS redeem for the stated principal amount of \$1,000 plus at least 108% of the basket percent change. The actual leverage factor will be determined on the pricing date.
Par Scenario	The basket declines in value by no more than 15%, and, at maturity, the Buffered PLUS redeem for the stated principal amount of \$1,000.
Downside Scenario	The basket declines in value by more than 15%, and, at maturity, the Buffered PLUS redeem for less than the stated principal amount by an amount that is proportionate to the percentage decrease of the basket in excess of the buffer amount of 15%. (Example: if the basket decreases in value by 35%, the Buffered PLUS will redeem for \$800 or 80% of the stated principal amount.) The minimum payment at maturity is \$150 per Buffered PLUS.

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How the Buffered PLUS Work

Payoff Diagram

The payoff diagram below illustrates the payment at maturity on the Buffered PLUS based on the following terms:

Stated principal amount:	\$1,000 per Buffered PLUS
Hypothetical leverage factor:	108%
Buffer amount:	15%
Minimum payment at maturity:	\$150 per Buffered PLUS

#### Buffered PLUS Payoff Diagram

How it works

**Upside Scenario.** If the final basket value is greater than the initial basket value, investors will receive the \$1,000 stated principal amount plus 108% of the appreciation of the basket over the term of the Buffered PLUS (assuming a hypothetical leverage factor of 108%). The actual leverage factor will be determined on the pricing date.

Given the leverage factor of 108%, if the basket appreciates 20%, the investor would receive \$1,216.00 per Buffered PLUS, or 121.60% of the stated principal amount.

**Par Scenario.** If the final basket value is less than or equal to the initial basket value but has decreased from the initial basket value by an amount less than or equal to the buffer amount of 15%, investors will receive the stated principal amount of \$1,000 per Buffered PLUS.



§ If the basket depreciates 5%, investors would receive the \$1,000 stated principal amount.

**Downside Scenario.** If the final basket value is less than the initial basket value and has decreased from the initial basket value by an amount greater than the buffer amount of 15%, investors will receive an amount that is less than the stated principal amount by an amount that is proportionate to the percentage decrease of the basket in excess of the buffer amount of 15%. The minimum payment at maturity is \$150 per Buffered PLUS.

§ For example, if the basket depreciates 60%, investors will lose 45% of their principal and receive only \$550 per Buffered PLUS at maturity, or 55% of the stated principal amount.

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Risk Factors

The following is a non-exhaustive list of certain key risk factors for investors in the Buffered PLUS. For further discussion of these and other risks, you should read the section entitled “Risk Factors” in the accompanying product supplement for PLUS, index supplement and prospectus. You should also consult with your investment, legal, tax, accounting and other advisers in connection with your investment in the Buffered PLUS.

**The Buffered PLUS do not pay interest and provide a minimum payment at maturity of only 15% of your principal.** The terms of the Buffered PLUS differ from those of ordinary debt securities in that the Buffered PLUS do not pay interest and provide a minimum payment at maturity of only 15% of the stated principal amount of the Buffered PLUS. If the final basket value is less than 85% of the initial basket value, you will receive for each § Buffered PLUS that you hold a payment at maturity that is less than the stated principal amount of each Buffered PLUS by an amount proportionate to the decline in the value of the basket from the initial basket value, plus \$150 per Buffered PLUS. **Accordingly, investors may lose up to 85% of the stated principal amount of the Buffered PLUS.**

**The market price will be influenced by many unpredictable factors.** Several factors, many of which are beyond our control, will influence the value of the Buffered PLUS in the secondary market and the price at which MS & Co. may be willing to purchase or sell the Buffered PLUS in the secondary market, including: the value, volatility and § dividend yield of the basket components, interest and yield rates in the market, time remaining to maturity, geopolitical conditions and economic, financial, political and regulatory or judicial events and any actual or anticipated changes in our credit ratings or credit spreads. You may receive less, and possibly significantly less, than the stated principal amount per Buffered PLUS if you try to sell your Buffered PLUS prior to maturity.

**The Buffered PLUS are linked to the Russell 2000<sup>®</sup> Index and are subject to risks associated with small-capitalization companies.** As the Russell 2000<sup>®</sup> Index is one of the basket components, and the Russell 2000<sup>®</sup> Index consists of stocks issued by companies with relatively small market capitalization, the Buffered PLUS are linked to the value of small-capitalization companies. These companies often have greater stock price volatility, lower trading volume and less liquidity than large-capitalization companies and therefore the Russell 2000<sup>®</sup> Index may be more volatile than indices that consist of stocks issued by large-capitalization companies. Stock prices of § small-capitalization companies are also more vulnerable than those of large-capitalization companies to adverse business and economic developments, and the stocks of small-capitalization companies may be thinly traded. In addition, small capitalization companies are typically less well-established and less stable financially than large-capitalization companies and may depend on a small number of key personnel, making them more vulnerable to loss of personnel. Such companies tend to have smaller revenues, less diverse product lines, smaller shares of their product or service markets, fewer financial resources and less competitive strengths than large-capitalization companies and are more susceptible to adverse developments related to their products.

**There are risks associated with investments in securities, such as the Buffered PLUS, linked to the value of foreign equity securities.** As the EURO STOXX 50<sup>®</sup> Index is one of the basket components, the Buffered PLUS are linked to the value of foreign equity securities. Investments in securities linked to the value of foreign equity securities involve risks associated with the securities markets in those countries, including risks of volatility in those markets, governmental intervention in those markets and cross-shareholdings in companies in certain countries. Also, there is generally less publicly available information about foreign companies than about U.S. companies that are subject to the reporting requirements of the United States Securities and Exchange Commission, and foreign § companies are subject to accounting, auditing and financial reporting standards and requirements different from those applicable to U.S. reporting companies. The prices of securities issued in foreign markets may be affected by political, economic, financial and social factors in those countries, or global regions, including changes in government, economic and fiscal policies and currency exchange laws. Local securities markets may trade a small number of securities and may be unable to respond effectively to increases in trading volume, potentially making prompt liquidation of holdings difficult or impossible at times. Moreover, the economies in such countries may differ favorably or unfavorably from the economy in the United States in such respects as growth of gross national product, rate of inflation, capital reinvestment, resources, self-sufficiency and balance of payment positions.

**The Buffered PLUS are subject to our credit risk, and any actual or anticipated changes to our credit ratings or credit spreads may adversely affect the market value of the Buffered PLUS.** You are dependent on our ability to pay all amounts due on the Buffered PLUS at maturity and therefore you are subject to our credit risk. The Buffered PLUS are not guaranteed by any other entity. If we default on our obligations under the Buffered PLUS, § your investment would be at risk and you could lose some or all of your investment. As a result, the market value of the Buffered PLUS prior to maturity will be affected by changes in the market's view of our creditworthiness. Any actual or anticipated decline in our credit ratings or increase in the credit spreads charged by the market for taking our credit risk is likely to adversely affect the market value of the Buffered PLUS.

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**As a finance subsidiary, MSFL has no independent operations and will have no independent assets.** As a finance subsidiary, MSFL has no independent operations beyond the issuance and administration of its securities and will have no independent assets available for distributions to holders of MSFL securities if they make claims in respect of such securities in a bankruptcy, resolution or similar proceeding. Accordingly, any recoveries by such holders will be limited to those available under the related guarantee by Morgan Stanley and that guarantee will rank § *pari passu* with all other unsecured, unsubordinated obligations of Morgan Stanley. Holders will have recourse only to a single claim against Morgan Stanley and its assets under the guarantee. Holders of securities issued by MSFL should accordingly assume that in any such proceedings they would not have any priority over and should be treated *pari passu* with the claims of other unsecured, unsubordinated creditors of Morgan Stanley, including holders of Morgan Stanley-issued securities.

**Changes in the values of the basket components may offset each other.** Value movements in the basket components may not correlate with each other. At a time when the value of one basket component increases, the § value of the other basket component may not increase as much, or may even decline. Therefore, in calculating the basket components' performance on the valuation date, an increase in the value of one basket component may be moderated, or wholly offset, by a lesser increase or a decline in the value of the other basket component.

**The basket components are not equally weighted.** The Buffered PLUS are linked to a basket of two basket components, and the basket components have significantly different weights in determining the value of the basket. The same percentage change in each of the two basket components could therefore have different effects on the § basket closing value because of the unequal weighting. For example, if the weighting of one basket component is greater than the weighting of the other basket component, a 5% decrease in the value of the basket component with the greater weighting will have a greater impact on the basket closing value than a 5% increase in the value of the basket component with the lesser weighting.

**Adjustments to the basket components could adversely affect the value of the Buffered PLUS.** The publisher of each underlying index can add, delete or substitute the stocks underlying such index, and can make other methodological changes that could change the value of such underlying index. Any of these actions could adversely affect the value of the Buffered PLUS. In addition, an index publisher may discontinue or suspend calculation or publication of the relevant underlying index at any time. In these circumstances, MS & Co., as the calculation agent, § will have the sole discretion to substitute a successor index for such index that is comparable to the discontinued index and is permitted to consider indices that are calculated and published by MS & Co. or any of its affiliates. If MS & Co. determines that there is no appropriate successor index for such index, the payment at maturity on the Buffered PLUS will be an amount based on the closing prices on the valuation date of the securities constituting such underlying index at the time of such discontinuance, without rebalancing or substitution, computed by the calculation agent in accordance with the formula for calculating such underlying index last in effect prior to discontinuance of such index.

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**Investing in the Buffered PLUS is not equivalent to investing in the basket components.** Investing in the Buffered PLUS is not equivalent to investing directly in the basket components or any of the component stocks of the Russell 2000<sup>®</sup> Index or the EURO STOXX 50<sup>®</sup> Index. Investors in the Buffered PLUS will not have voting rights or rights to receive dividends or other distributions or any other rights with respect to any of the component stocks of the Russell 2000<sup>®</sup> Index or the EURO STOXX 50<sup>®</sup> Index.

**The rate we are willing to pay for securities of this type, maturity and issuance size is likely to be lower than the rate implied by our secondary market credit spreads and advantageous to us. Both the lower rate and the inclusion of costs associated with issuing, selling, structuring and hedging the Buffered PLUS in the original issue price reduce the economic terms of the Buffered PLUS, cause the estimated value of the Buffered PLUS to be less than the original issue price and will adversely affect secondary market prices.** Assuming no change § in market conditions or any other relevant factors, the prices, if any, at which dealers, including MS & Co., may be willing to purchase the Buffered PLUS in secondary market transactions will likely be significantly lower than the original issue price, because secondary market prices will exclude the issuing, selling, structuring and hedging-related costs that are included in the original issue price and borne by you and because the secondary market prices will reflect our secondary market credit spreads and the bid-offer spread that any dealer would charge in a secondary market transaction of this type as well as other factors.

The inclusion of the costs of issuing, selling, structuring and hedging the Buffered PLUS in the original issue price and the lower rate we are willing to pay as issuer make the economic terms of the Buffered PLUS less favorable to you than they otherwise would be.

However, because the costs associated with issuing, selling, structuring and hedging the Buffered PLUS are not fully deducted upon issuance, for a period of up to 6 months following the issue date, to the extent that MS & Co. may buy or sell the Buffered PLUS in the secondary market, absent changes in market conditions, including those related to the

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basket components, and to our secondary market credit spreads, it would do so based on values higher than the estimated value, and we expect that those higher values will also be reflected in your brokerage account statements.

**The estimated value of the Buffered PLUS is determined by reference to our pricing and valuation models, which may differ from those of other dealers and is not a maximum or minimum secondary market price.**

These pricing and valuation models are proprietary and rely in part on subjective views of certain market inputs and certain assumptions about future events, which may prove to be incorrect. As a result, because there is no market-standard way to value these types of securities, our models may yield a higher estimated value of the § Buffered PLUS than those generated by others, including other dealers in the market, if they attempted to value the Buffered PLUS. In addition, the estimated value on the pricing date does not represent a minimum or maximum price at which dealers, including MS & Co., would be willing to purchase your Buffered PLUS in the secondary market (if any exists) at any time. The value of your Buffered PLUS at any time after the date of this document will vary based on many factors that cannot be predicted with accuracy, including our creditworthiness and changes in market conditions. See also “The market price will be influenced by many unpredictable factors” above.

**The Buffered PLUS will not be listed on any securities exchange and secondary trading may be limited.** The Buffered PLUS will not be listed on any securities exchange. Therefore, there may be little or no secondary market for the Buffered PLUS. MS & Co. may, but is not obligated to, make a market in the Buffered PLUS. Even if there is a secondary market, it may not provide enough liquidity to allow you to trade or sell the Buffered PLUS easily.

§ Because we do not expect that other broker dealers will participate significantly in the secondary market for the Buffered PLUS, the price at which you may be able to trade your Buffered PLUS is likely to depend on the price, if any, at which MS & Co. is willing to transact. If, at any time, MS & Co. were not to make a market in the Buffered PLUS, it is likely that there would be no secondary market for the Buffered PLUS. Accordingly, you should be willing to hold your Buffered PLUS to maturity.

**The calculation agent, which is a subsidiary of Morgan Stanley and an affiliate of MSFL, will make determinations with respect to the Buffered PLUS.** As calculation agent, MS & Co. will determine the initial basket component values, the multipliers and the final basket value, and will calculate the basket percent change or basket performance factor, as applicable, and the amount of cash you will receive at maturity. Moreover, certain determinations made by MS & Co., in its capacity as calculation agent, may require it to exercise discretion and make subjective judgments, such as with § respect to the occurrence or non-occurrence of market disruption events and the selection of a successor index or calculation of the basket component closing value in the event of a market disruption event or discontinuance of an underlying index. These potentially subjective determinations may adversely affect the payout to you at maturity. For further information regarding these types of determinations, see “Description of PLUS—Postponement of Valuation Date(s)” and “—Calculation Agent and Calculations” in the accompanying product supplement. In addition, MS & Co. has determined the estimated value of the Buffered PLUS on the pricing date.

**Hedging and trading activity by our affiliates could potentially adversely affect the value of the Buffered PLUS.** One or more of our affiliates and/or third-party dealers expect to carry out hedging activities related to the Buffered PLUS (and possibly to other instruments linked to the basket components or component stocks of the Russell 2000® Index or the EURO STOXX 50® Index), including trading in the stocks that constitute the Russell 2000® Index or the EURO STOXX 50® Index as well as in other instruments related to the basket components. As a result, these entities may be unwinding or adjusting hedge positions during the term of the Buffered PLUS, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the valuation date § approaches. Some of our affiliates also trade the stocks that constitute the Russell 2000® Index or the EURO STOXX 50® Index and other financial instruments related to the basket components on a regular basis as part of their general broker-dealer and other businesses. Any of these hedging or trading activities on or prior to the pricing date could potentially increase the initial basket component values of the basket components, and, therefore, could increase the values at or above which the basket components must close on the valuation date so that investors do not suffer a loss on their initial investment in the Buffered PLUS. Additionally, such hedging or trading activities during the term of the Buffered PLUS, including on the valuation date, could adversely affect the closing values of the basket components on the valuation date, and, accordingly, the amount of cash an investor will receive at maturity.

**The U.S. federal income tax consequences of an investment in the Buffered PLUS are uncertain.** Please read the discussion under “Additional Information—Tax considerations” in this document and the discussion under “United States Federal Taxation” in the accompanying product supplement for PLUS (together, the “Tax Disclosure Sections”) concerning the U.S. federal income tax consequences of an investment in the Buffered PLUS. If the Internal § Revenue Service (the “IRS”) were successful in asserting an alternative treatment, the timing and character of income on the Buffered PLUS might differ significantly from the tax treatment described in the Tax Disclosure Sections. For example, under one possible treatment, the IRS could seek to recharacterize the Buffered PLUS as debt instruments. In that event, U.S. Holders would be required to accrue into income original issue discount on the Buffered PLUS every year at a

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“comparable yield” determined at the time of issuance and recognize all income and gain in respect of the Buffered PLUS as ordinary income. Additionally, as discussed under “United States Federal Taxation—FATCA” in the accompanying product supplement for PLUS, the withholding rules commonly referred to as “FATCA” would apply to the Buffered PLUS if they were recharacterized as debt instruments. The risk that financial instruments providing for buffers, triggers or similar downside protection features, such as the Buffered PLUS, would be recharacterized as debt is greater than the risk of recharacterization for comparable financial instruments that do not have such features. We do not plan to request a ruling from the IRS regarding the tax treatment of the Buffered PLUS, and the IRS or a court may not agree with the tax treatment described in the Tax Disclosure Sections.

In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of “prepaid forward contracts” and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; the degree, if any, to which income (including any mandated accruals) realized by non-U.S. investors should be subject to withholding tax; and whether these instruments are or should be subject to the “constructive ownership” rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the Buffered PLUS, possibly with retroactive effect. Both U.S. and Non-U.S. Holders should consult their tax advisers regarding the U.S. federal income tax consequences of an investment in the Buffered PLUS, including possible alternative treatments, the issues presented by this notice and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

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Morgan Stanley Finance LLC

Buffered PLUS Based on the Value of a Basket Consisting of Two Indices due June 17, 2021

Buffered Performance Leveraged Upside Securities<sup>SM</sup>

Principal at Risk Securities

Basket Overview

The basket consists of the Russell 2000<sup>®</sup> Index (the “RTY Index”) and the EURO STOXX 50<sup>®</sup> Index (the “SX5E Index”) and offers exposure to price movements in U.S. and international equity markets.

**Russell 2000<sup>®</sup> Index.** The Russell 2000<sup>®</sup> Index is an index calculated, published and disseminated by FTSE Russell, and measures the composite price performance of stocks of 2,000 companies incorporated in the U.S. and its territories. All 2,000 stocks are traded on a major U.S. exchange and are the 2,000 smallest securities that form the Russell 3000<sup>®</sup> Index. The Russell 3000<sup>®</sup> Index is composed of the 3,000 largest U.S. companies as determined by market capitalization and represents approximately 98% of the U.S. equity market. The Russell 2000<sup>®</sup> Index consists of the smallest 2,000 companies included in the Russell 3000<sup>®</sup> Index and represents a small portion of the total market capitalization of the Russell 3000<sup>®</sup> Index. The Russell 2000<sup>®</sup> Index is designed to track the performance of the small capitalization segment of the U.S. equity market. For additional information about the Russell 2000<sup>®</sup> Index, see the information set forth under “Russell 2000<sup>®</sup> Index” in the accompanying index supplement.

**EURO STOXX 50<sup>®</sup> Index.** The EURO STOXX 50<sup>®</sup> Index was created by STOXX Limited, which is owned by Deutsche Börse AG and SIX Group AG. Publication of the EURO STOXX 50<sup>®</sup> Index began on February 26, 1998, based on an initial index value of 1,000 at December 31, 1991. The EURO STOXX 50<sup>®</sup> Index is composed of 50 component stocks of market sector leaders from within the STOXX 600 Supersector Indices, which includes stocks selected from the Eurozone. The component stocks have a high degree of liquidity and represent the largest companies across all market sectors. For additional information about the EURO STOXX 50<sup>®</sup> Index, see the information set forth under “EURO STOXX 50<sup>®</sup> Index” in the accompanying index supplement.

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Information as of market close on December 3, 2018:

Basket Component Information as of December 3, 2018

	Bloomberg Ticker Symbol	Current Basket Component Level	52 Weeks Ago	52-Week High (on 8/31/2018): 1,740.753	52-Week Low (on 2/8/2018): 1,463.793
RTY Index	RTY	1,548.957	1,537.021	(on 1/23/2018): 3,672.29	(on 11/20/2018): 3,116.07
SX5E Index	SX5E	3,214.99	3,527.55		

The following graph is calculated based on an initial basket value of 100 on January 1, 2013 (assuming that each basket component is weighted as described in “Basket” on the cover page) and illustrates the effect of the offset and/or correlation among the basket components during the indicated period. The graph does not take into account the terms of the Buffered PLUS, nor does it attempt to show your expected return on an investment in the Buffered PLUS. The historical performance of the basket should not be taken as an indication of its future performance.

Basket Historical Performance

January 1, 2013 to December 3, 2018

The following graphs set forth the daily closing values of each of the basket components for the period from January 1, 2013 through December 3, 2018. The related tables set forth the published high and low closing values, as well as end-of-quarter closing values, for each of the basket components for each quarter in the same period. The closing values for each of the basket components on December 3, 2018 were: (i) in the case of the RTY Index, 1,548.957, and (ii) in the case of the SX5E Index, 3,214.99. We obtained the information in the tables and graphs below from Bloomberg Financial Markets, without independent verification. The historical values of the basket components should not be taken as an indication of their future performance, and no assurance can be given as to the basket closing value on the valuation date.

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Principal at Risk Securities

Russell 2000® Index  
Daily Index Closing Values  
January 1, 2013 to December 3, 2018

Russell 2000® Index	High	Low	Period End
2013			
First Quarter	953.068	849.350	951.542
Second Quarter	999.985	901.513	977.475
Third Quarter	1,078.409	989.535	1,073.786
Fourth Quarter	1,163.637	1,043.459	1,163.637
2014			
First Quarter	1,208.651	1,093.594	1,173.038
Second Quarter	1,192.964	1,095.986	1,192.964
Third Quarter	1,208.150	1,101.676	1,101.676
Fourth Quarter	1,219.109	1,049.303	1,204.696
2015			
First Quarter	1,266.373	1,154.709	1,252.772
Second Quarter	1,295.799	1,215.417	1,253.947
Third Quarter	1,273.328	1,083.907	1,100.688
Fourth Quarter	1,204.159	1,097.552	1,135.889
2016			
First Quarter	1,135.889	953.715	1,114.028
Second Quarter	1,188.954	1,089.646	1,151.923
Third Quarter	1,263.438	1,139.453	1,251.646
Fourth Quarter	1,388.073	1,156.885	1,357.130
2017			
First Quarter	1,413.635	1,345.598	1,385.920
Second Quarter	1,425.985	1,345.244	1,415.359
Third Quarter	1,490.861	1,356.905	1,490.861
Fourth Quarter	1,548.926	1,464.095	1,535.511
2018			
First Quarter	1,610.706	1,463.793	1,529.427
Second Quarter	1,706.985	1,492.531	1,643.069
Third Quarter	1,740.753	1,643.069	1,696.571
Fourth Quarter (through December 3, 2018)	1,672.992	1,468.698	1,548.957

The "Russell 2000® Index" is a trademark of FTSE Russell. For more information, see "Russell 2000 Index" in the accompanying index supplement.



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Principal at Risk Securities

EURO STOXX 50<sup>®</sup> Index  
Daily Index Closing Values  
January 1, 2013 to December 3, 2018

EURO STOXX 50 <sup>®</sup> Index	High	Low	Period End
<b>2013</b>			
First Quarter	2,749.27	2,570.52	2,624.02
Second Quarter	2,835.87	2,511.83	2,602.59
Third Quarter	2,936.20	2,570.76	2,893.15
Fourth Quarter	3,111.37	2,902.12	3,109.00
<b>2014</b>			
First Quarter	3,172.43	2,962.49	3,161.60
Second Quarter	3,314.80	3,091.52	3,228.24
Third Quarter	3,289.75	3,006.83	3,225.93
Fourth Quarter	3,277.38	2,874.65	3,146.43
<b>2015</b>			
First Quarter	3,731.35	3,007.91	3,697.38
Second Quarter	3,828.78	3,424.30	3,424.30
Third Quarter	3,686.58	3,019.34	3,100.67
Fourth Quarter	3,506.45	3,069.05	3,267.52
<b>2016</b>			
First Quarter	3,267.52	2,680.35	3,004.93
Second Quarter	3,151.69	2,697.44	2,864.74
Third Quarter	3,091.66	2,761.37	3,002.24
Fourth Quarter	3,290.52	2,954.53	3,290.52
<b>2017</b>			
First Quarter	3,500.93	3,230.68	3,500.93
Second Quarter	3,658.79	3,409.78	3,441.88
Third Quarter	3,594.85	3,388.22	3,594.85
Fourth Quarter	3,697.40	3,503.96	3,503.96
<b>2018</b>			
First Quarter	3,672.29	3,278.72	3,361.50
Second Quarter	3,592.18	3,340.35	3,395.60
Third Quarter	3,527.18	3,293.36	3,399.20
Fourth Quarter (through December 3, 2018)	3,414.16	3,116.07	3,214.99

“EURO STOXX 50<sup>®</sup>” and “STOXX<sup>®</sup>” are registered trademarks of STOXX Limited. For more information, see “EURO STOXX 50<sup>®</sup> Index” in the accompanying index supplement.



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Additional Terms of the Buffered PLUS

Please read this information in conjunction with the summary terms on the front cover of this document.

Additional Terms:

If the terms described herein are inconsistent with those described in the accompanying product supplement, index supplement or prospectus, the terms described herein shall control.

**Underlying index publishers:** With respect to the RTY Index, FTSE Russell  
With respect to the SX5E Index, STOXX Limited

**Interest:** None

**Bull market or bear market Buffered PLUS:** Bull Market Buffered PLUS

**Index closing value:** With respect to the RTY Index, index closing value on any index business day shall be determined by the calculation agent and shall equal the closing value of such underlying index or any successor index reported by Bloomberg Financial Services, or any successor reporting service the calculation agent may select, on such index business day. In certain circumstances, the index closing value for the RTY Index will be based on the alternate calculation of such underlying index as described under “Discontinuance of Any Underlying Index or Basket Index; Alteration of Method of Calculation” in the accompanying product supplement. The closing value of the RTY Index reported by Bloomberg Financial Services may be lower or higher than the official closing value of the RTY Index published by the underlying index publisher for such underlying index.

With respect to the SX5E Index, index closing value on any index business day shall be determined by the calculation agent and shall equal the official closing value of such underlying index, or any successor index as defined under “Discontinuance of Any Underlying Index or Basket Index; Alteration of Method of Calculation” in the accompanying product supplement, published at the regular official weekday close of trading on such index business day by the underlying index publisher for the SX5E Index, as determined by the

calculation agent. In certain circumstances, the index closing value for the SX5E Index will be based on the alternate calculation of such underlying index as described under “Discontinuance of Any Underlying Index or Basket Index; Alteration of Method of Calculation” in the accompanying product supplement.

Postponement of maturity date: If the valuation date for any basket component is postponed so that it falls less than two business days prior to the scheduled maturity date, the maturity date will be postponed to the second business day following such valuation date as postponed.

**Denominations:** \$1,000 per Buffered PLUS and integral multiples thereof

Trustee: The Bank of New York Mellon

Calculation agent: Morgan Stanley & Co. LLC (“MS & Co.”)

**Issuer notice to registered security holders, the trustee and the depositary:** In the event that the maturity date is postponed due to postponement of the valuation date, the issuer shall give notice of such postponement and, once it has been determined, of the date to which the maturity date has been rescheduled (i) to each registered holder of the Buffered PLUS by mailing notice of such postponement by first class mail, postage prepaid, to such registered holder’s last address as it shall appear upon the registry books, (ii) to the trustee by facsimile confirmed by mailing such notice to the trustee by first class mail, postage prepaid, at its New York office and (iii) to The Depository Trust Company (the “depository”) by telephone or facsimile, confirmed by mailing such notice to the depository by first class mail, postage prepaid. Any notice that is mailed to a registered holder of the Buffered PLUS in the manner herein provided shall be conclusively presumed to have been duly given to such registered holder, whether or not such registered holder receives the notice. The issuer shall give such notice as promptly as possible, and in no case later than (i) with respect to notice of postponement of the maturity date, the business day immediately preceding the scheduled maturity date and (ii) with respect to notice of the date to which the maturity date has been rescheduled, the business day immediately following the actual valuation date.

The issuer shall, or shall cause the calculation agent to, (i) provide written notice to the trustee and to the depository of the amount of cash to be delivered with respect to each stated principal amount of the Buffered PLUS, on or prior to 10:30 a.m. (New York City time) on the business day preceding the maturity date, and (ii) deliver the aggregate cash amount due with respect to the Buffered PLUS to the trustee for delivery to the depository, as holder of the Buffered PLUS, on the maturity date.



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Additional Information About the Buffered PLUS

Additional  
Information:

Minimum  
ticketing size: \$1,000 / 1 Buffered PLUS

Tax  
considerations:

Although there is uncertainty regarding the U.S. federal income tax consequences of an investment in the Buffered PLUS due to the lack of governing authority, in the opinion of our counsel, Davis Polk & Wardwell LLP, under current law, and based on current market conditions, a Buffered PLUS should be treated as a single financial contract that is an “open transaction” for U.S. federal income tax purposes.

Assuming this treatment of the Buffered PLUS is respected and subject to the discussion in “United States Federal Taxation” in the accompanying product supplement for PLUS, the following U.S. federal income tax consequences should result based on current law:

§ A U.S. Holder should not be required to recognize taxable income over the term of the Buffered PLUS prior to settlement, other than pursuant to a sale or exchange.

§ Upon sale, exchange or settlement of the Buffered PLUS, a U.S. Holder should recognize gain or loss equal to the difference between the amount realized and the U.S. Holder’s tax basis in the Buffered PLUS. Such gain or loss should be long-term capital gain or loss if the investor has held the Buffered PLUS for more than one year, and short-term capital gain or loss otherwise.

In 2007, the U.S. Treasury Department and the Internal Revenue Service (the “IRS”) released a notice requesting comments on the U.S. federal income tax treatment of “prepaid forward contracts” and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; the degree, if any, to which income (including any mandated accruals) realized by non-U.S. investors should be subject to withholding tax; and whether these instruments are or should be subject to the “constructive ownership” rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the Buffered PLUS, possibly with retroactive effect.

As discussed in the accompanying product supplement for PLUS, Section 871(m) of the Internal Revenue Code of 1986, as amended, and Treasury regulations promulgated thereunder (“Section 871(m)”) generally impose a 30% (or a lower applicable treaty rate) withholding tax on dividend equivalents paid or deemed paid to Non-U.S. Holders with respect to certain financial instruments linked to U.S. equities or indices that include U.S. equities (each, an “Underlying Security”). Subject to certain exceptions, Section 871(m) generally applies to securities that substantially replicate the economic performance of one or more Underlying Securities, as determined based on tests set forth in the applicable Treasury regulations (a “Specified Security”). However, pursuant to an IRS notice, Section 871(m) will not apply to securities issued before January 1, 2021 that do not have a delta of one with respect to any Underlying Security. Based on our determination that the Buffered PLUS do not have a delta of one with respect to any Underlying Security, our counsel is of the opinion that the Buffered PLUS should not be Specified Securities and, therefore, should not be subject to Section 871(m).

Our determination is not binding on the IRS, and the IRS may disagree with this determination. Section 871(m) is complex and its application may depend on your particular circumstances, including whether you enter into other transactions with respect to an Underlying Security. If withholding is required, we will not be required to pay any additional amounts with respect to the amounts so withheld. You should consult your tax adviser regarding the potential application of Section 871(m) to the Buffered PLUS.

**Both U.S. and non-U.S. investors considering an investment in the Buffered PLUS should read the discussion under “Risk Factors” in this document and the discussion under “United States Federal Taxation” in the accompanying product supplement for PLUS and consult their tax advisers regarding all aspects of the U.S. federal income tax consequences of an investment in the Buffered PLUS, including possible alternative treatments, the issues presented by the aforementioned notice and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.**

**The discussion in the preceding paragraphs under “Tax considerations” and the discussion**

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**contained in the section entitled “United States Federal Taxation” in the accompanying product supplement for PLUS, insofar as they purport to describe provisions of U.S. federal income tax laws or legal conclusions with respect thereto, constitute the full opinion of Davis Polk & Wardwell LLP regarding the material U.S. federal tax consequences of an investment in the Buffered PLUS.**

The proceeds from the sale of the Buffered PLUS will be used by us for general corporate purposes. We will receive, in aggregate, \$1,000 per Buffered PLUS issued, because, when we enter into hedging transactions in order to meet our obligations under the Buffered PLUS, our hedging counterparty will reimburse the cost of the agent’s commissions. The costs of the Buffered PLUS borne by you and described on page 2 above comprise the agent’s commissions and the cost of issuing, structuring and hedging the Buffered PLUS.

Use of proceeds  
and hedging:

On or prior to the pricing date, we expect to hedge our anticipated exposure in connection with the Buffered PLUS by entering into hedging transactions with our affiliates and/or third party dealers. We expect our hedging counterparties to take positions in the basket components, in futures and/or options contracts on the basket components or component stocks of the Russell 2000<sup>®</sup> Index and the EURO STOXX 50<sup>®</sup> Index listed on major securities markets or positions in any other available securities or instruments that they may wish to use in connection with such hedging. Such purchase activity could potentially increase the initial basket component values of the basket components, and, therefore, could increase the values at or above which the basket components must close on the valuation date so that investors do not suffer a loss on their initial investment in the Buffered PLUS. In addition, through our affiliates, we are likely to modify our hedge position throughout the term of the Buffered PLUS, including on the valuation date, by purchasing and selling the stocks constituting the Russell 2000<sup>®</sup> Index and the EURO STOXX 50<sup>®</sup> Index, futures and/or options contracts on the basket components or component stocks of the Russell 2000<sup>®</sup> Index and the EURO STOXX 50<sup>®</sup> Index or positions in any other available securities or instruments that we may wish to use in connection with such hedging activities. As a result, these entities may be unwinding or adjusting hedge positions during the term of the Buffered PLUS, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the valuation date approaches. We cannot give any assurance that our hedging activities will not affect the values of the basket components, and, therefore, adversely affect the value of the Buffered PLUS or the payment you will receive at maturity. For further information on our use of proceeds and hedging, see “Use of Proceeds and Hedging” in the accompanying product supplement for PLUS.

Benefit plan  
investor  
considerations:

Each fiduciary of a pension, profit-sharing or other employee benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) (a “Plan”), should consider the fiduciary standards of ERISA in the context of the Plan’s particular circumstances before authorizing an investment in the Buffered PLUS. Accordingly, among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification

requirements of ERISA and would be consistent with the documents and instruments governing the Plan.

In addition, we and certain of our affiliates, including MS & Co., may each be considered a “party in interest” within the meaning of ERISA, or a “disqualified person” within the meaning of the Internal Revenue Code of 1986, as amended (the “Code”), with respect to many Plans, as well as many individual retirement accounts and Keogh plans (such accounts and plans, together with other plans, accounts and arrangements subject to Section 4975 of the Code, also “Plans”). ERISA Section 406 and Code Section 4975 generally prohibit transactions between Plans and parties in interest or disqualified persons. Prohibited transactions within the meaning of ERISA or the Code would likely arise, for example, if the Buffered PLUS are acquired by or with the assets of a Plan with respect to which MS & Co. or any of its affiliates is a service provider or other party in interest, unless the Buffered PLUS are acquired pursuant to an exemption from the “prohibited transaction” rules. A violation of these “prohibited transaction” rules could result in an excise tax or other liabilities under ERISA and/or Section 4975 of the Code for those persons, unless exemptive relief is available under an applicable statutory or administrative exemption.

The U.S. Department of Labor has issued five prohibited transaction class exemptions (“PTCEs”) that may provide exemptive relief for direct or indirect prohibited transactions resulting from the purchase or holding of the Buffered PLUS. Those class exemptions are PTCE 96-23 (for certain transactions determined by in-house asset managers), PTCE 95-60 (for certain transactions involving insurance company general accounts), PTCE 91-38 (for certain transactions involving bank collective investment funds), PTCE 90-1 (for certain transactions involving insurance company separate accounts) and PTCE 84-14 (for certain transactions determined by independent qualified professional asset managers). In addition, ERISA Section 408(b)(17) and Section 4975(d)(20) of the Code provide an exemption for the purchase and sale of securities and the related lending transactions, provided that neither the issuer of the securities nor any of its affiliates has or exercises any discretionary authority or control or renders any investment advice with respect to the assets of the Plan involved in the transaction and provided further that the Plan pays no more, and receives no less, than “adequate consideration” in connection with the transaction (the so-called “service provider” exemption). There can be no assurance that any of these class or statutory exemptions will be available with respect to

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transactions involving the Buffered PLUS.

Because we may be considered a party in interest with respect to many Plans, the Buffered PLUS may not be purchased, held or disposed of by any Plan, any entity whose underlying assets include “plan assets” by reason of any Plan’s investment in the entity (a “Plan Asset Entity”) or any person investing “plan assets” of any Plan, unless such purchase, holding or disposition is eligible for exemptive relief, including relief available under PTCEs 96-23, 95-60, 91-38, 90-1, 84-14 or the service provider exemption or such purchase, holding or disposition is otherwise not prohibited. Any purchaser, including any fiduciary purchasing on behalf of a Plan, transferee or holder of the Buffered PLUS will be deemed to have represented, in its corporate and its fiduciary capacity, by its purchase and holding of the Buffered PLUS that either (a) it is not a Plan or a Plan Asset Entity and is not purchasing such Buffered PLUS on behalf of or with “plan assets” of any Plan or with any assets of a governmental, non-U.S. or church plan that is subject to any federal, state, local or non-U.S. law that is substantially similar to the provisions of Section 406 of ERISA or Section 4975 of the Code (“Similar Law”) or (b) its purchase, holding and disposition of these Buffered PLUS will not constitute or result in a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or violate any Similar Law.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is particularly important that fiduciaries or other persons considering purchasing the Buffered PLUS on behalf of or with “plan assets” of any Plan consult with their counsel regarding the availability of exemptive relief.

The Buffered PLUS are contractual financial instruments. The financial exposure provided by the Buffered PLUS is not a substitute or proxy for, and is not intended as a substitute or proxy for, individualized investment management or advice for the benefit of any purchaser or holder of the Buffered PLUS. The Buffered PLUS have not been designed and will not be administered in a manner intended to reflect the individualized needs and objectives of any purchaser or holder of the Buffered PLUS.

Each purchaser or holder of any Buffered PLUS acknowledges and agrees that:

(i) the purchaser or holder or its fiduciary has made and shall make all investment decisions for the purchaser or holder and the purchaser or holder has not relied and shall not rely in any way upon us or our affiliates to act as a fiduciary or adviser of the purchaser or holder with respect to (A) the design and terms of the Buffered PLUS, (B) the purchaser or holder's investment in the Buffered PLUS, or (C) the exercise of or failure to exercise any rights we have under or with respect to the Buffered PLUS;

(ii) we and our affiliates have acted and will act solely for our own account in connection with (A) all transactions relating to the Buffered PLUS and (B) all hedging transactions in connection with our obligations under the Buffered PLUS;

(iii) any and all assets and positions relating to hedging transactions by us or our affiliates are assets and positions of those entities and are not assets and positions held for the benefit of the purchaser or holder;

(iv) our interests are adverse to the interests of the purchaser or holder; and

(v) neither we nor any of our affiliates is a fiduciary or adviser of the purchaser or holder in connection with any such assets, positions or transactions, and any information that we or any of our affiliates may provide is not intended to be impartial investment advice.

Each purchaser and holder of the Buffered PLUS has exclusive responsibility for ensuring that its purchase, holding and disposition of the Buffered PLUS do not violate the prohibited transaction rules of ERISA or the Code or any Similar Law. The sale of any Buffered PLUS to any Plan or plan subject to Similar Law is in no respect a representation by us or any of our affiliates or representatives that such an investment meets all relevant legal requirements with respect to investments by plans generally or any particular plan, or that such an investment is appropriate for plans generally or any particular plan. In this regard, neither this discussion nor anything provided in this document is or is intended to be investment advice directed at any potential Plan purchaser or at Plan purchasers generally and such purchasers of the Buffered PLUS should consult and rely on their own counsel and advisers as to whether an investment in the Buffered PLUS is suitable.

However, individual retirement accounts, individual retirement annuities and Keogh plans, as well as employee benefit plans that permit participants to direct the investment of their accounts, will not be permitted to purchase or hold the Buffered PLUS if the account, plan or annuity is for the benefit of an employee of Morgan Stanley or Morgan Stanley Wealth Management or a family member and the employee receives any compensation (such as, for example, an addition

to bonus) based on the purchase of the Buffered PLUS by the account, plan or annuity.

**Additional  
considerations:**

Client accounts over which Morgan Stanley, Morgan Stanley Wealth Management or any of their respective subsidiaries have investment discretion are **not** permitted to purchase the Buffered PLUS,

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either directly or indirectly.

Selected dealers, which may include our affiliates, and their financial advisors will collectively receive from the agent a fixed sales commission of \$ for each Buffered PLUS they sell.

Supplemental information regarding plan of distribution; conflicts of interest:

MS & Co. is an affiliate of MSFL and a wholly owned subsidiary of Morgan Stanley, and it and other affiliates of ours expect to make a profit by selling, structuring and, when applicable, hedging the Buffered PLUS. When MS & Co. prices this offering of Buffered PLUS, it will determine the economic terms of the Buffered PLUS, including the leverage factor, such that for each Buffered PLUS the estimated value on the pricing date will be no lower than the minimum level described in “Investment Summary” on page 2.

MS & Co. will conduct this offering in compliance with the requirements of FINRA Rule 5121 of the Financial Industry Regulatory Authority, Inc., which is commonly referred to as FINRA, regarding a FINRA member firm’s distribution of the securities of an affiliate and related conflicts of interest. MS & Co. or any of our other affiliates may not make sales in this offering to any discretionary account. See “Plan of Distribution (Conflicts of Interest)” and “Use of Proceeds and Hedging” in the accompanying product supplement for PLUS.

Contact:

Morgan Stanley Wealth Management clients may contact their local Morgan Stanley branch office or our principal executive offices at 1585 Broadway, New York, New York 10036 (telephone number (866) 477-4776). All other clients may contact their local brokerage representative. Third-party distributors may contact Morgan Stanley Structured Investment Sales at (800) 233-1087.

Where you can find more information:

MSFL and Morgan Stanley have filed a registration statement (including a prospectus, as supplemented by the product supplement for PLUS and the index supplement) with the Securities and Exchange Commission, or SEC, for the offering to which this communication relates. You should read the prospectus in that registration statement, the product supplement for PLUS, the index supplement and any other documents relating to this offering that MSFL and Morgan Stanley have filed with the SEC for more complete information about MSFL, Morgan Stanley and this offering. You may get these documents without cost by visiting EDGAR on the SEC web site at [www.sec.gov](http://www.sec.gov). Alternatively, MSFL and/or Morgan Stanley will arrange to send you the product supplement for PLUS, index supplement and prospectus if you so request by calling toll-free 800-584-6837.

You may access these documents on the SEC web site at [www.sec.gov](http://www.sec.gov) as follows:



**Product Supplement for PLUS dated November 16, 2017**

**Index Supplement dated November 16, 2017**

**Prospectus dated November 16, 2017**

Terms used but not defined in this document are defined in the product supplement for PLUS, in the index supplement or in the prospectus.

“Performance Leveraged Upside Securities<sup>SM</sup>” and “PLUS<sup>SM</sup>” are our service marks.

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## 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.

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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:

	Millions of yen		
	Amount reclassified from accumulated other comprehensive income (loss) *1		
	Six months ended June 30, 2016	Six months ended June 30, 2015	Affected line items in consolidated statements of income
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.



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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
<b><i>Fair value of derivative instruments in the consolidated balance sheets</i></b>		

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

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

	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
<b>Assets:</b>				
Cash and cash equivalents	-	35,000	-	35,000
<b>Available-for-sale (noncurrent):</b>				
Government bonds	249	-	-	249
Corporate bonds	-	203	-	203
Fund trusts	12	81	-	93
Equity securities	31,490	-	-	31,490
Derivatives	-	11,636	-	11,636
<b>Total assets</b>	<b>31,751</b>	<b>46,920</b>	<b>-</b>	<b>78,671</b>
<b>Liabilities:</b>				
Derivatives	-	425	-	425
<b>Total liabilities</b>	<b>-</b>	<b>425</b>	<b>-</b>	<b>425</b>



## 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.