Otsuka Corporation

ANNUAL REPORT 2001

For the fiscal year ended December 31, 2001

January—December 2001

Even since the foundation of the company, we at OTSUKA CORPORATION have focused on providing the most suitable proposals and responding quickly to customer needs. Currently, we receive continuous patronage from approximately 250,000 customers.

Now, we are expected to combine new technology with our experience and expertise cultivated over many years, considering our environment from the customers' point of view, and demonstrating even more advanced "Problem-Solving Power."

We will continue to respond to the trust that our customers have placed in us, and make steady progress with all our customers.

Since its founding, OTSUKA CORPORATION has offered customers a range of solutions through its two principal businesses of system integration and service and support, based upon its corporate principle of “Pursuit of Customer Satisfaction.”

In August 2001, OTSUKA CORPORATION’s new president, Yuji Otsuka, took the helm as the Company celebrated the 40th anniversary of its founding. Based upon the new organization created by President Otsuka, who succeeded former company President Minoru Otsuka, OTSUKA CORPORATION is adhering to its founding principles as it undertakes reforms and focuses on further development of the OTSUKA Group.

OTSUKA CORPORATION utilizes the strengths of independent, related firms to continually test and introduce state-of-the-art technology, which we offer as optimal systems to meet customers’ needs. We also supply a complete range of services to ensure that customers can realize the maximum potential from the systems that we provide, from consulting prior to system construction to operational support and training in system use after a system is in place, as well as equipment disposal and recycling when system components are no longer needed.

The coming of the full-fledged Web era will lead to new businesses in the future based upon practical IT applications, and will create networking needs, not only at large corporations but at middle-market firms and small and medium-sized companies as well. To meet the needs of this new era, OTSUKA CORPORATION will continue to develop its new solutions business model, offering fully integrated capabilities where face-to-face real businesses are merged with Internet-based Web business.

Contents

OTSUKA CORPORATION AR Statement of Exemption from Responsibility

The forecasts, plans and outlooks concerning future operating results that are described in this Annual Report are judgments believed to be reasonable by the Company’s management, based upon the information available to OTSUKA CORPORATION and member companies of the OTSUKA Group at the time such future projections were created. Various factors that form the basis of these forward-looking statements may differ from the OTSUKA Group’s assumptions, and actual results may differ significantly from those presented here.

Such factors include changes to the economic situation in principal markets and to product demand, and changes in various domestic and international regulations, accounting standards and customary business practices.

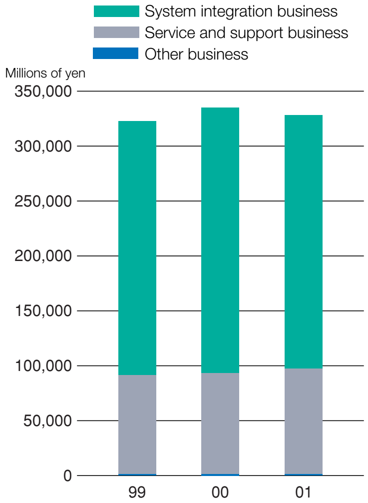
CONSOLIDATED FINANCIAL HIGHLIGHTS

OTSUKA CORPORATION and Its Consolidated Subsidiaries
Years ended December 31, 2000 and 2001

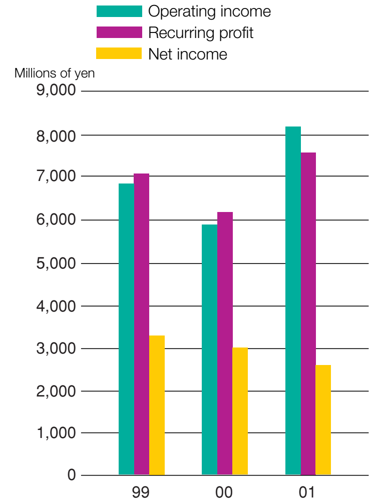
	Millions of yen		Thousands of U.S. dollars	%
	2000	**2001**	**2001**	**Change**
Results of Operations				
Net sales	¥334,911	**¥328,151**	**$2,496,014**	–2.0%
System integration business	241,904	**230,561**	**1,753,716**	–4.7
Service and support business	91,603	**96,338**	**732,775**	5.2
Other business	1,404	**1,252**	**9,523**	–10.8
Operating income	5,922	**8,178**	**62,204**	38.1
Recurring profit*	6,206	**7,665**	**58,302**	23.5
Income before income taxes and minority interests	5,708	**4,859**	**36,959**	–14.9
Net income	2,997	**2,531**	**19,252**	–15.5
Financial Position				
Total assets	167,761	**148,111**	**1,126,576**	–11.7
Total interest-bearing debt	46,549	**36,983**	**281,304**	–20.6
Total shareholders' equity	51,196	**41,131**	**312,855**	–19.7
Per-share indicators (Yen and U.S. dollars)				
Net income per share (EPS)	¥ 99.67	**¥ 79.94**	**$0.61**	–19.8
Dividends per share of common stock	25.00	**25.00**	**0.19**	0.0
Cash flow per share	316.42	**496.55**	**3.78**	56.9

Note:
U.S. dollar amounts are computed using the December 31, 2001 exchange rate of ¥131.47=US$1.
The profit ratio is calculated using the average shareholders' equity during the fiscal year.
* Recurring profit = Operating income – (Non-operating income – Non-operating expenses)

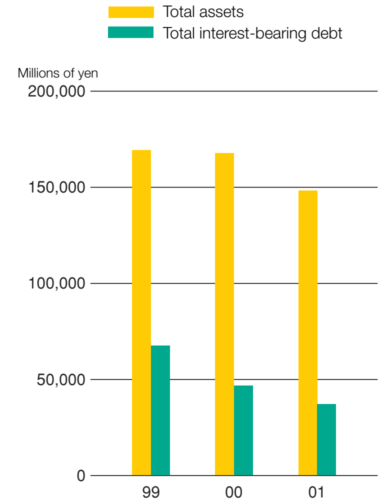
Net sales



Operating income/ Recurring profit/ Net income



Total assets/ Total interest-bearing debt



Note:
The amounts shown in this Annual Report have been rounded to the nearest whole number.

TO OUR SHAREHOLDERS AND INVESTORS

A Close and Confidential Business Partner Supporting Companies' Applications of IT

Thank you for your support of OTSUKA CORPORATION.

In fiscal 2001, OTSUKA CORPORATION celebrated the 40th anniversary of its founding. The year marked a turning point for our Company, one in which I assumed my duties as the Company's new president and all of our employees devoted themselves to the further development of the OTSUKA Group. Although consolidated sales of the OTSUKA Group for fiscal 2001 (January-December 2001) fell 2.0% from the prior year level to ¥328.1 billion, operating income increased 38.1% to ¥8.1 billion and recurring profit rose 23.5% to ¥7.6 billion, the highest levels in the Company's history. This strong operating performance was the result of efforts to increase operating efficiency through the continual improvement of in-house systems and strengthen the Company's financial position.

Although OTSUKA CORPORATION achieved the highest level of recurring profit in its history even as Japan weathered a prolonged economic recession, our sales declined and we cannot be overly optimistic about the future outlook. Nevertheless, by utilizing an appropriate business approach for the coming full-fledged Web era, based on customer assets and the integrated capabilities OTSUKA CORPORATION has built over many years, We are firmly convinced the OTSUKA Group will increase its profitability. The OTSUKA Group will release information on its business strategy and specific management policies to achieve this goal, as well as its actual operating results, in as timely and detailed a manner as possible.

OTSUKA CORPORATION regards the full disclosure of information to investors as an important issue from the standpoint of management. As the manager responsible for this year's operating results, with this Annual Report we will answer questions and requests from our investors concerning the analysis and assessment of our operating results and future business strategy as frankly as possible.

In the future, we will remain true to the founding spirit of our company as we pursue further reform and improvement. We sincerely hope you will continue to offer the OTSUKA Group your unwavering support.

March 2002

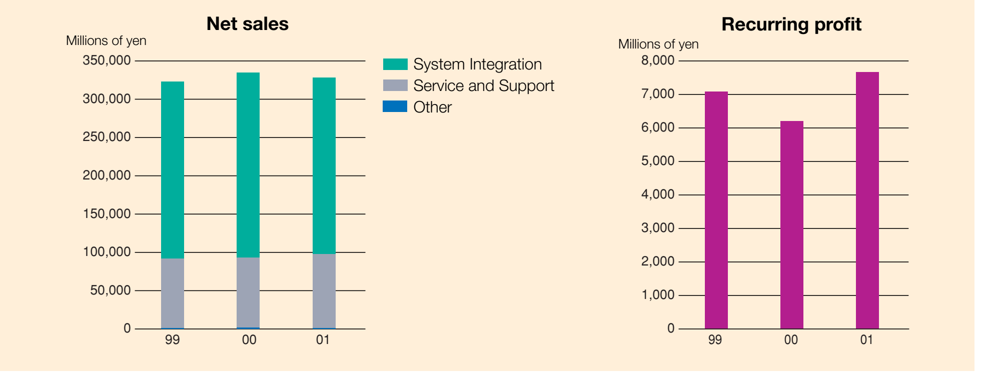
Yuji Otsuka

Yuji Otsuka
President

Q1

What were the main factors that allowed OTSUKA CORPORATION to achieve record recurring profit?

The primary factor we can cite that enabled us to achieve a record level of recurring profit despite a 2.0% drop in net sales was the fact that we were able to improve our sales cost ratio by 1.3 percentage points to 76.6%, by focusing on our highly profitable Service and Support (S&S) Business. Although net sales at our System Integration (SI) Business declined 4.7% from the prior fiscal year's level, our Sales and Support Business achieved net sales growth of 5.2%, raising its share of the Company's total net sales by 2.0 percentage points to 29.4%. Another reason for our improved performance was the growth of highly profitable businesses such as equipment installation and network construction when introducing systems, even in our SI Business, which helped increase our gross profit margin. Finally, we would note our use of information systems and the progress we made in centralized processing of various business operations, which enabled us to improve efficiency and control selling and administrative expenses.

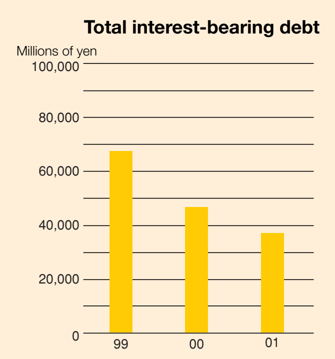


Q2

What management indicators do you focus on?

Among our various management indicators, we focus the most attention on our recurring profit margin. From the standpoint of emphasis on shareholder value, the most commonly emphasized indicators are those that highlight the profitability of corporate capital, such as return on equity (ROE). Because our accounting system continues to undergo large changes such as the introduction of retirement benefit accounting and market-value accounting, however, and our shareholders' equity changed substantially when we listed the Company's stock in July 2000, at this stage we continue to use these kinds of indicators as reference indexes. At this time, the recurring profit margin is the one indicator that we can compare to prior years, and we believe it is a good indicator which shows the Company's overall profitability including our product strength, sales capabilities and financial position. Moreover, the Company was able to reduce total interest-bearing debt, which is one of the Company's financial issues, by approximately ¥9.5 billion from the prior fiscal year's level to ¥36.9 billion, improving its interest-bearing debt ratio by 2.8 percentage points to 25.0%. On a non-consolidated basis as well, we slashed interest-bearing debt from ¥89.2 billion at the end of fiscal 1995 to ¥33.3 billion at the end of the period under review, 37.4% of its peak level at the end of fiscal 1995. This was the result of a continual reduction in trade notes and accounts receivable and inventory assets, which reflected efforts to promote centralization of various operations, the expansion of our leasing transactions, and enhanced credit management capabilities. As a result, we were able to satisfactorily increase cash flow from operations for the fiscal year to ¥15.7 billion, which we used as a source of funds to further reduce interest-bearing debt.

In the future, we will also direct more attention to indicators that appeal to OTSUKA CORPORATION's strong points, such as our operating cash flow per share.



Q3

Many of your competitors, including manufacturers, are concentrating on the IT service business. What were the reasons that OTSUKA CORPORATION was able to expand its S&S Business during the most recent fiscal year?

Since its establishment, we have declared "Pursuit of Customer Satisfaction" our management philosophy, and have made substantial efforts to create programs that put our philosophy into action. The cumulative results have become the source of our strength not only in the S&S Business but for the entire company today.

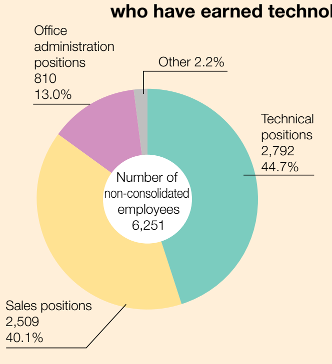
For example, to satisfy our customers' diverse needs our response is consistent, from consulting before we construct a system to supply support after we provide a product or service. In addition, we offer a multi-field approach by handling all of the software and devices such as computers, CAD systems, copiers, facsimiles and business phones that are necessary for today's office. Yet we also have an overwhelming multi-vendor response capability. This type of integrated capability, which only we possess, is a strength we've developed by continually responding to our customers' needs on every occasion. It has become the key factor differentiating us from other competitors.

Another unique characteristic of our company is our rapid response, based on a sales and support system that has close ties with local communities and each customer. We've established sales and support offices near to our customers, and our sales teams and engineers respond immediately whenever necessary. Such an organization is not something a company can construct in a short period of time, and we don't think other companies will be able to overtake us easily in this area.

In addition, OTSUKA CORPORATION is working to have each employee acquire a broad range of the most advanced skills so that we can respond to every possible customer issue. This is the reason we've built an in-house Web-learning environment and prepared a training environment that doesn't restrict learning by time or location, even as it controls costs, and why we encourage our employees to improve their skills in various ways such as obtaining public certifications and manufacturer authorized qualifications.

We'll also note that in addition to the approach we've just described, we are always working to develop a new menu of services such as security-related services. So we think that our ability to steadily grow our S&S Business is a result of the positive evaluation our customers have made of these interconnected efforts.

Composition of employees and number of employees who have earned technological qualifications



IT engineers
(Year ended December 31, 2001)

- Data processing specialists, personal computer engineers, etc.
  3,372
- Manufacturer-certified engineers
  Microsoft and Oracle engineers, Lotus, R/3, etc.
  5,487
- Individuals in charge of equipment installation
  1,620

Q4

What will you do to maintain these strengths of OTSUKA CORPORATION in the future?

Basically, we will make the maximum use of the integrated capabilities we already possess. However, at the same time, we'll also want to focus on building new relationships with our customers that are appropriate to the Internet era. Specifically we will continue to meet every customer need with a face-to-face response. At the same time, we'll combine this with new services that utilize the Internet. This will enable us to improve the level of customer satisfaction while pursuing greater management efficiency at OTSUKA CORPORATION.

For example, it is not always necessary for us to have an employee respond in order to provide the latest product information and technology intelligence or confirmation of the status of a transaction. Moreover, in situations such as gathering problem-solving indicators that will be useful for troubleshooting, there are times when it's preferable for the customer to train individuals so the company itself can solve problems anytime, anywhere. Recently, we have also been increasing new services that use the Internet, of which Web learning is one example. Thus by responding to the diverse, highly individualistic requests of our major customers, while simultaneously moving to further meet the needs of our small and medium-sized customers including requests for low-cost management and solutions to manpower shortages, and by organically combining real-world responses where employees meet customer needs with Web-based responses that utilize the Internet, we will make OTSUKA CORPORATION's competitive advantages even stronger.

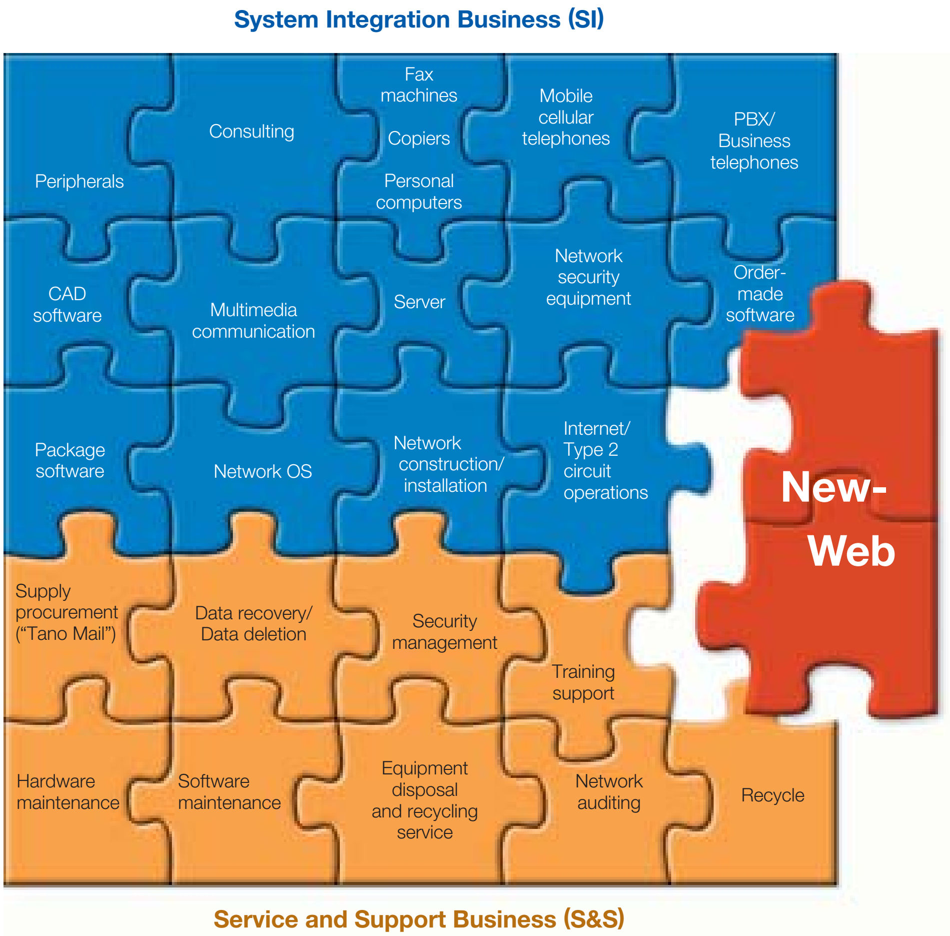
Q5

What kind of strategy is the “New-Web Strategy” that you’ve recently initiated?

Our “New-Web strategy” is a strategy to prepare for the arrival of a true Web era by further solidifying our relationship with our customers, which is OTSUKA CORPORATION’s greatest asset.

During the 1970s, we achieved terrific success with customers who were already using our products such as copiers, for example, by offering solutions involving products other than copiers that customers still weren’t using, such as office computers or facsimile machines. We followed up by expanding the types of products we handled, and then building our relationships with existing customers in our S&S Business by responding very attentively to our customers’ needs. So today, as IT continues to be applied to every aspect of every business from large corporations to middle-market firms and small and medium-sized businesses, the spread of IT is being accompanied by gradually increasing interest among our customers in the Internet. Based on this situation, our “New-Web strategy” is to wed the face-to-face real businesses that we’ve offered until now through our SI and S&S businesses with new, Web business channels that utilize the Internet, in order to provide solutions that meet our customers’ diversified needs.

Take our education and training activities as an example. In addition to the personal computer classrooms we’ve conducted, we are engaged in the full-scale development of Web learning using the Internet. Specifically, in situations where we can use the Web to offer preparatory and review lessons before and after customers come to our classrooms, we are providing services that link and merge real and virtual education. This enables us to respond to a broad range of customer needs, and build an even deeper customer service relationship.



Constructing a database containing information such as our customers' attributes (firm size, industry, location, departments with which we do business) and needs is indispensable for pursuing this strategy further. We believe that once this database is in place, it will enable us to understand overall market trends or individual customers' situations, and make it possible to offer appropriate customer proposals that are based on objective data rather than individuals' intuition or experience. The "New-Web Strategy" is a strategy only OTSUKA CORPORATION can create because we have a relationship of trust with customers that we've created over 40 years. We are firmly convinced this approach will be linked to further improvements in customer service and the strengthening of our competitive edge.

Q6

Please comment on the outlook for OTSUKA CORPORATION's market environment and how you intend to respond in the future.

Over the short term, the government's efforts to revitalize Japan's economy by promoting structural reforms and addressing bank's nonperforming loans will be accompanied by the pain of greater corporate bankruptcies and a jump in the number of unemployed. So we expect a severe economic environment to continue for the time being. Nevertheless, with the coming of a full-fledged Web era, responding to new changes in the business environment—including the electronic tender system that will be introduced based upon the e-Japan concept and the new business environments using the Internet that will be formed in each industry—will continue to be an unavoidable issue for corporate managers. Numerous firms already exist that will aggressively use IT to differentiate themselves from other companies and pursue low-cost management. Furthermore, the expansion of the telecommunications network is finally beginning to pay off, which will eliminate the biggest bottleneck to Internet use. Under these circumstances, the IT investment by domestic firms that until now has mainly been carried out by large corporations should steadily expand to include investment by small and medium-sized firms as well.

Based on the changes in the environment surrounding such firms, OTSUKA CORPORATION has formed the "New-Web strategy" we described earlier to accurately address our customers' needs. To implement this strategy, we must enhance our information systems to accumulate and apply data concerning our customers' needs, their system environments and our track record of meeting their needs. We must further strengthen our Group's consulting abilities, to recommend the optimal system configurations. And we must strive to take maximum advantage of both "real-world" responses and virtual environments to develop attractive products and service and support menus.

BUSINESS DEVELOPMENT

At a Glance

The one-stop solution provider, from installation

Through our two main businesses, System Integration Business for installation of the system and Service and Support Business for post-installation, we provide customers with a range of one-stop

System Integration (SI) Business

In the System Integration Business, we handle a wide range of products, such as IT related-equipment, OA equipment, VC (Voice & Visual Communication) equipment, and software (computer, network, peripheral devices, commercial software, copiers, facsimiles, business phones, and digital electronic switchboards). Custom-made/order-made software is also available as a service.

This business has two strong points. The first is an established multi-vendor system (including computer, peripheral devices, and commercial software). We are proud of being able to service multi-field environment by offering a broad spectrum of products.

The second is continuous research and examination of trends of new products and technologies. By effectively utilizing our rich resource of system evaluation experience, we can propose and provide the most suited system for our customers.

By nurturing these strengths, we will continue to provide the most efficient system for our customers with services ranging from consulting to system design/installation and network construction.

Service and Support (S&S) Business

In the Service and Support Business, we provide supplies (paper and toner), software management/operational instruction, and IT schools. We also have a structure in place to quickly respond to post-installation problems. We provide services such as responding to telephone calls to the Support Center, perform on-site repair work for any troubles with the system, handle system management requests, and data recovery service at the time of accidents.

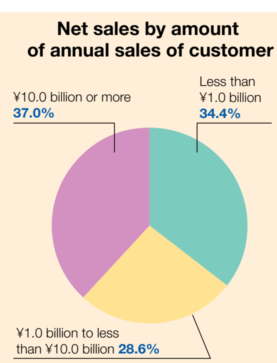
With the largest support center in the nation, and from 280 national service locations, engineers are ready to supply on-site support to each customer.

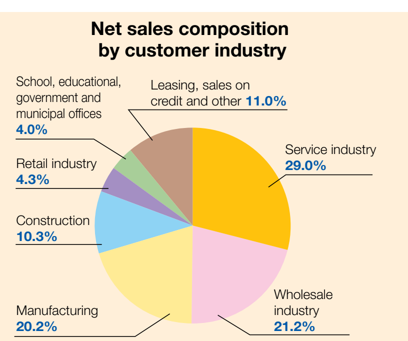
Working on the Web Era

We will offer high-quality systems/services with higher useability that can support the business expansion of our customers by combining and unifying virtual business for the new Internet generation. This business will be built upon the existing foundation of long-standing relationships of trust through face-to-face interaction with our customers.

A solid customer base

The history of OTSUKA CORPORATION has always unfolded in tandem with the development of Japan's domestic OA industry and IT-related industries. By responding to customers' needs and offering a diverse range of products and services, OTSUKA CORPORATION has been able to grow into an enterprise without precedent anywhere in the world, conducting business with 250,000 companies each month.

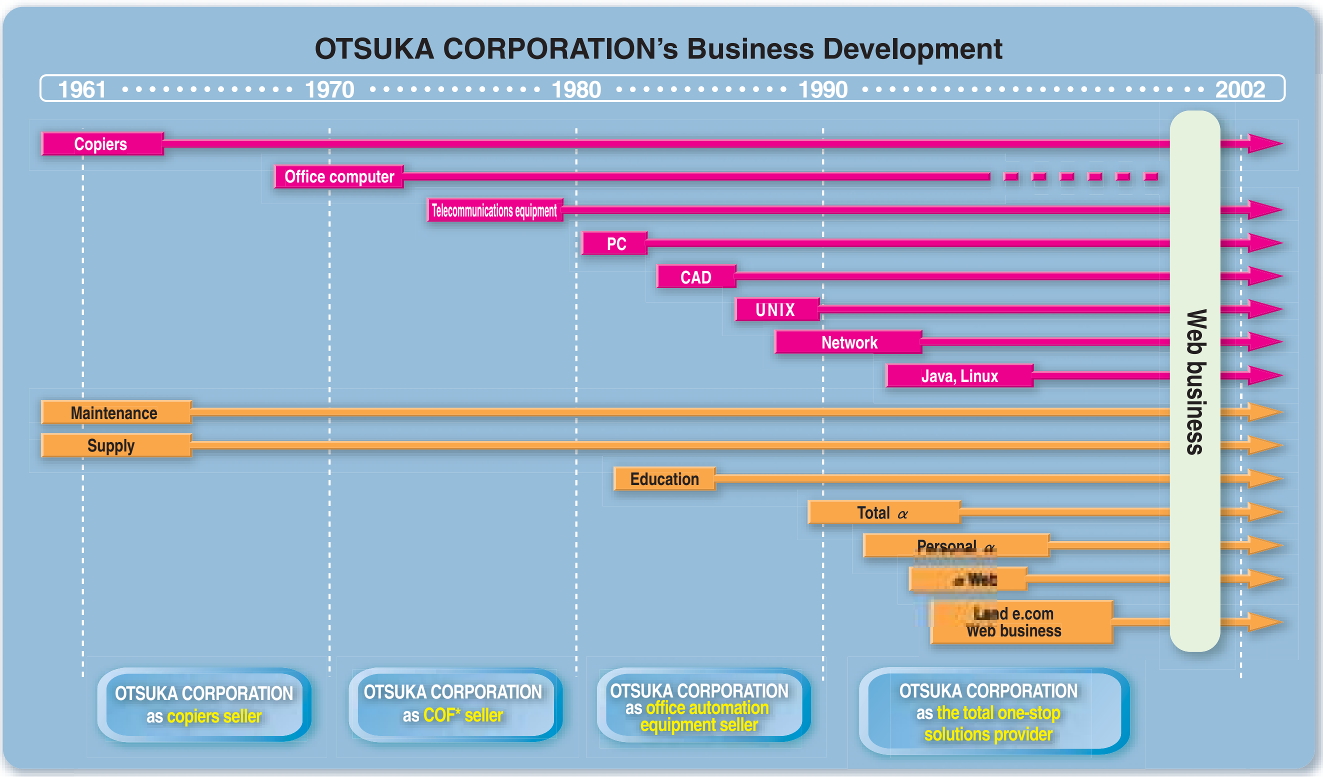




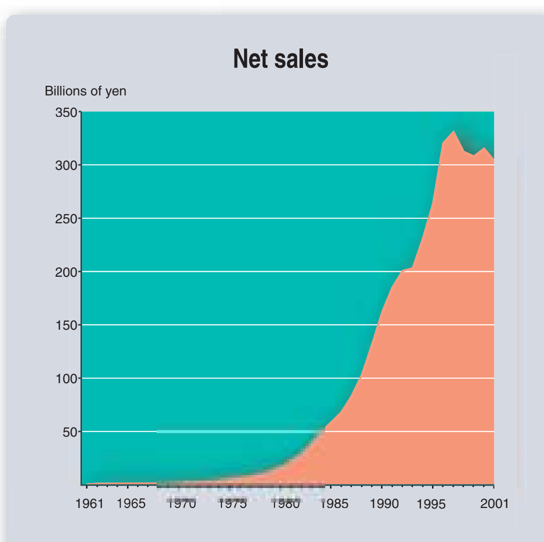
(As of December 31, 2001)

to post-installation of the system

solutions to solve their diversified problems and help them efficiently utilize the systems.



* COF stands for copiers, office computers and facsimile machines.



Case Study 1

Embody Networks Corporation

Providing strong supports with OTSUKA's application development technology and iDC (internet Data Center) to achieve a unique, novel business model sending 3D characters to websites.

Embody Networks is engaged in the development of digital contents plans and the creation, management and operation of databases. Currently, the firm is developing a business to dispatch 3D CG characters, such as navigators and companions that are designed to transmit compartmentalized information (contents) rapidly so that it is easy to understand.

Constructing an efficient system with support from OTSUKA CORPORATION

Embody Networks, a joint venture established by Pioneer Corporation and the advertising agency Asatsu DK Inc., is engaged in the development of digital contents plans and the creation of databases. As its first major project, the company is working on the construction of "DO! Character.com," an epoch-making website system to dispatch Web-based "3D motion characters" capable of realistic movements and expressions via the Internet.

To support the construction of this character dispatch system, OTSUKA CORPORATION broadly designed and revised functions based on its "WebShopping" Web shop construction tool and supplied these to Embody Networks. OTSUKA is providing consistent support for all of Embody Networks' efforts, from application development to system operation.

OTSUKA CORPORATION's involvement from development to operations was the result of its comprehensive proposal details at the competition stage. "We judged the development flexibility and details of OTSUKA's proposal to be the most appropriate for our needs," says Souichi Tanigaki of the Information Systems Section of the General Affairs Division at Pioneer's Omori office.

Marketing 3D motion characters, a new form of digital contents never before available, will demand various creative alternatives that cannot be addressed using the functions available for traditional Web-based shopping.

Short-term creation of a new paradigm business model

Moreover, although OTSUKA CORPORATION was responsible for construction of both the front-end and back-end of this system and required frequent program corrections at the test stage, OTSUKA succeeded in building the system in a short development period of just four and a half months. The key factor that made possible the realization of a business model which had never been attempted was a trailblazing spirit and an approach that united Pioneer and OTSUKA CORPORATION as business partners.

Furthermore, by effectively using OTSUKA's iDC system, this approach also made it possible to unify all processes from development to operation and forcefully promote a comfortable system operation that includes security.

"DO! Character.com" has been providing Internet-based services since July 2001.

http://www.do-chara.com/

Case Study 2

Sakaguchi Co., Ltd.

Sakaguchi created a B-to-B system and a B-to-C business based on OTSUKA's original package software "SMILE α," utilizing OTSUKA's integrated capabilities from consulting to system development, introduction and support.

Sakaguchi Co., Ltd. built a B-to-B system and a B-to-C system to shift its business away from importing and wholesaling foreign brands through its own sales channels to e-business.

Back-up assistance for firms moving into e-business

Faced with changes in Japan's distribution system, Sakaguchi, an import wholesaler that imports and sells European brands and markets its own house brand, plans to move beyond its previous business. Sakaguchi has started an Internet website for consumers and created a genuine e-business aimed at developing a new customer bracket and increasing sales. To launch its B-to-C business, the company worked for over a year to build its B-to-B activities.

To accomplish its transition from B-to-B to B-to-C, Sakaguchi first established a system to provide each employee with a PC and introduced groupware. The company followed up with a process of integrating information-related key systems operations, using OTSUKA CORPORATION's "SMILE α" sales management software, then constructed its B-to-B system.

A necessary precondition for starting its B-to-C business in the final phase was improving the PC skills of its employees. Sakaguchi took active advantage of OTSUKA CORPORATION's support capabilities, including seminars and training sessions at OTSUKA's training facilities. As a result, each of Sakaguchi's employees acquired skills sufficient to work as an instructor. Today, the company's employees can make frequent updates of the company's website pages and use the Internet to send information.

Uses of OTSUKA's housing service to handle problems

Unlike a real store, Sakaguchi's shop on the Internet is open for business 24 hours a day, 365 days a year. OTSUKA CORPORATION therefore proposed that Sakaguchi set up a server for B-to-C use in OTSUKA's 24-hour iDC support system, to enable Sakaguchi to respond immediately to unanticipated trouble. With OTSUKA's housing service, Sakaguchi can conduct its new business activity with a sense of security.

Site for businesses: http://www.e-trading.co.jp/
Site for consumers: http://www.i-lovebrand.com/

Case Study 3

Matsushita Seiko Co., Ltd.

A strong support system has become decisive, and Matsushita Seiko has rapidly deployed "SolidWorks." This software has contributed to dramatic reductions of product development time and cost through effective application of three-dimensional CAD data.

As a member of the Matsushita Group, Matsushita Seiko is primarily engaged in the development, manufacture and sale of air conditioning and air purification equipment.

OTSUKA CORPORATION selected as partner based on evaluation of support capabilities

Matsushita Seiko's history of CAD system introductions began in 1982 with "Regular CADAM." In 2000, the company introduced 3D CAD from OTSUKA CORPORATION as an effective tool to implement a plan for large-scale improvement for Matsushita Seiko's development processes. The company introduced "SolidWorks" because, compared with prior CAD software, "SolidWorks" adequately reflects users' opinions. Matsushita Seiko also rated the software as the easiest to use and simplest to remember, and appreciated the fact that "SolidWorks" is supported by users around the world.

The decisive factors for Matsushita Seiko when it selected a vendor were "SolidWorks" support facilities located near its offices, the fact that "SolidWorks" has established a friendly support system that "responds at the first sign of difficulty," and OTSUKA CORPORATION's ability to provide solutions.

Large-scale reductions in development time and cost through effective application of 3D data

Because the procedure for using OTSUKA's "SolidWorks" 3D CAD software is easy to remember, since its introduction "SolidWorks" has proved extremely useful for on-site development teams that must adapt continually to product development tasks without the benefit of sufficient training periods. Because "We were unable to begin development quickly in the case of high-end CAD systems that took time to master," says Yoshikazu Koma, Team Chief Manager at Matsushita Seiko's Osaka office, the company has succeeded in greatly shortening development times as a result of introducing "SolidWorks."

Through effective application of 3D data, Matsushita Seiko has obtained substantial results particularly with respect to prototypes and metal mold. For prototypes, an employee's manual efforts were previously very time-consuming. Since it introduced optical molding equipment that enables employees to create prototypes automatically using 3D data, however, Matsushita Seiko has greatly shortened delivery periods and slashed experimental costs in half. For purposes such as digital prototype production and metal mold as well, this 3D data application expertise has been broadly reduced to its essential components and widely applied.

For customers for whom the introduction of 3D CAD "SolidWorks" is a serious issue to achieve substantial reductions in development time and cost and improve development processes, "SolidWorks" provides powerful capabilities for pursuing management reform.

Cooperating to improve the skills of CAD design engineers as well

Along with its introduction of "SolidWorks," Matsushita Seiko is also addressing the task of improving its CAD design engineers' skills. Beginning in 2001, the company holds in-house competitions and is aggressively developing engineer training. Matsushita Seiko has entrusted the preparation of test problems and evaluations for these competitions to OTSUKA CORPORATION, which will help OTSUKA contribute to improving engineers' skills as well.

http://www.msc.panasonic.co.jp/

Case Study 4

NARITA AIRPORT AUTHORITY

NARITA AIRPORT AUTHORITY actively uses OTSUKA's educational system Web Learning, with OTSUKA's participation from the content preparation stage. The software has contributed to successful improvement of the busy staff's skills and smooth transfer of operations.

NARITA Airport Authority manages and operates Narita Airport, Japan's gateway to the skies. The corporation practices information sharing by using a large-scale Intranet and *Lotus Notes/Domino*.

■ Web Learning eliminates the time and effort of group training

Over four years ago, NARITA AIRPORT AUTHORITY set up an in-house personal computer (PC) network with one computer for each individual, and achieved information sharing using *Lotus Notes/Domino* groupware. In addition to employee work time management and a settlement system used for decision making, the corporation's network converts resources such as various internal airport information and users' requests into a database, which enables the staff to use the information at any time. When it planned replacement of all PC software with *Windows® 2000* and *Lotus Notes/Domino* upgrade in 2001, the corporation also requested a training system that would enable employees to conduct operations smoothly under the new environment while enabling it to use its existing Intranet.

NARITA AIRPORT AUTHORITY adopted Web Learning as its educational contents. MAKIO OKADA, Director of Communication Service Division in Communication Service Department at Business Headquarters, says the reason for selecting Web Learning was that "although we conducted group training in the past, with a staff of 900 people we needed one and a half months using that approach until all of our staff completed their training. And given the time and effort required to bring everyone together in the classroom, group training was very difficult because of 24-hour schedule management forthe shift employees and busy times when the runways were open. Web Learning was the most appropriate system for solving such time and effort problems."

■ Rapid preparation of teaching materials appropriate to each employee's level

Rather than use existing packaged teaching materials, OTSUKA CORPORATION proposed the creation of new training content that utilizes Web Learning and developed new, easy-to-understand teaching materials that respond to each employee's level. After completing the new material one month before the PC replacement period, OTSUKA used the client's Intranet and set up a server within NARITA AIRPORT AUTHORITY. As a result, the corporation's employees are not constrained by time or place and enjoy an environment where each individual can study at any time using his or her own PC. The corporation also achieved a smooth transfer and operation of its activities.

http://www.narita-airport.or.jp/airport/

In the United States and other countries, Windows® 2000 is a registered trademark or trademark of Microsoft Corporation.

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FINANCIAL SECTION

Three-Year Financial Data

OTSUKA CORPORATION and Its Consolidated Subsidiaries
Years ended December 31, 1999, 2000 and 2001

	Millions of yen			Thousands of U.S. dollars
	1999	2000	**2001**	**2001**
Net sales	¥322,816	¥334,911	**¥328,151**	**$2,496,014**
System Integration Business	231,262	241,904	**230,561**	**1,753,716**
Service and Support Business	90,427	91,603	**96,338**	**732,775**
Other Business	1,127	1,404	**1,252**	**9,523**
Operating income	6,878	5,922	**8,178**	**62,204**
Recurring profit	7,081	6,206	**7,665**	**58,302**
Income before income taxes and minority interests	8,205	5,708	**4,859**	**36,959**
Net income	3,219	2,997	**2,531**	**19,252**
Total assets	169,222	167,761	**148,111**	**1,126,576**
Total interest-bearing debt	67,503	46,549	**36,983**	**281,304**
Total shareholders' equity	28,074	51,196	**41,131**	**312,855**
Net income per share (EPS) (Yen and U.S. dollars)	¥114.06	¥ 99.67	**¥ 79.94**	**$0.61**
Dividends per share of common stock (Yen and U.S. dollars)	10.00	25.00	**25.00**	**0.19**
Cash flows from operating activities per share (Yen and U.S. dollars)	—	316.42	**496.55**	**3.78**
Operating income to net sales ratio (%)	2.13%	1.77%	**2.49%**	**—**
Net income to net sales ratio (%)	1.00	0.89	**0.77**	**—**
Total interest-bearing debt ratio (%)	39.89	27.75	**24.97**	**—**
Shareholders' equity ratio (%)	16.59	30.52	**27.77**	**—**
Return on equity (ROE)	12.23	7.56	**5.48**	**—**

* The profit ratios are calculated using the year-end value of shareholders' equity for fiscal 1998 and the average shareholders' equity for fiscal 1999 and 2000. U.S. dollar amounts are computed using the December 31, 2001 exchange rate of ¥131.47=US$1.
Parentheses indicate a negative numerical value.

Contents

Management's Analysis of Operating Results and Financial Position

Summary

During the consolidated fiscal year, Japan's economy was negatively affected by growing concerns over the future outlook for the world economy that were prompted by the economic slowdown in the United States. These concerns were exacerbated by a slump in exports and weak conditions in the IT sector following the collapse of the Internet bubble in the United States, as well as by lackluster demand for products such as semiconductors and electronic parts. In Japan, the unemployment rate increased as a result of corporate restructuring and industry reorganizations beginning with financial institutions, and overall Japan's recessionary gloom and deflationary trend grew increasingly stronger.

In this economic environment, the conditions in IT-related industries also created difficult conditions for hardware manufacturers, who faced a worldwide drop in demand in the markets for personal computers (PCs) and cellular telephone devices brought about by the IT recession. In information-related services, on the other hand, some sectors beginning with outsourcing showed comparatively bullish sentiments. As a result, the polarization tendency in the IT sector became more apparent.

It was under such conditions that OTSUKA CORPORATION welcomed its new president and marked the 40th anniversary of its founding. During the year, the Company looked ahead to further development of the OTSUKA Group under the Group's new organization. By following its management philosophy of "Pursuit of Customer Satisfaction," which was its starting point when the Company was established, OTSUKA CORPORATION has made it a corporate policy to place overriding priority on the provision of optimal solutions that meet customers' diversified needs, including consulting on the introduction of company systems, system configuration, support after a system has been provided and equipment recycling and disposal services. During the year, the OTSUKA Group also sought to strengthen its ability to respond based upon close local ties and industry-specific sales strategies, by taking advantage of the Group's integrated capabilities based on multi-field responses covering a wide range of products including computers, copiers, CAD systems and telecommunications equipments. The OTSUKA Group also concentrated on Web-businesses and Web-solution Internet-related activities, which will form the central pillar of its future business.

Income and Expenses

	Millions of yen			
	2000	2001	Amount of change, year on year	% change, year on year
Net sales	¥334,911	¥328,151	-6,760	-2.0%
System Integration Business	241,904	230,561	-11,343	-4.7
Service and Support Business	91,603	96,338	+4,735	+5.2
Other Business	1,404	1,252	-152	-10.8

Summary of Sales and Profits

During the fiscal year, although consolidated net sales enjoyed a boost as the result of the merger with Group enterprise Net World, INC. in October 2000, consolidated net sales for the full year decreased 2.0% to ¥328,151 million. In addition to the lack of unit sales growth and unit price declines in the PC market, which affected corporate demand, revenues were influenced by the Company's review of business condition changes at "α Land" (store-based sales), which resulted in a reduction in the number of outlets from 12 stores to five stores.

With regard to profitability, OTSUKA CORPORATION achieved both record operating income of ¥8,178 million (up 38.1% compared to the prior year) and record recurring profit of ¥7,665 million (up 23.5%). Both achievements were the result of efforts to reduce the cost of sales. Because the Company will amortize over five years the difference that arose as the result of the change in accounting standards when the Company adopted retirement benefit accounting, however, the OTSUKA Group incurred an additional expense of ¥2,134 million as a new expense. This reduced net income for the period to ¥2,531 million, a decrease of 15.5% compared to the prior year. As a result, net income per share was ¥79.94 (compared with ¥99.67 the prior year). Furthermore, at the consolidated fiscal year-end, the OTSUKA Group implemented a revaluation of land owned for business purposes, and added a negative revaluation excess of ¥12,134 million to equity capital as a "provision for loss on revaluation of assets" equal to the net amount of the revaluation difference excluding related deferred taxes assets.

System Integration Business

During the year, the OTSUKA Group's System Integration Business, which provides optimal system introduction services ranging from consulting to system development, system installation and configuration and network construction, enhanced and expanded the functions of its original ERP "SMILE α" and "SMILE ie" software. For its "Document Solutions System ODS2000," which is designed to promote the construction of "knowledge management offices," the System Integration Business released "ODS21" (OTSUKA Documents Solutions 21 for open knowledge office) as the software development version. Personal computer price reductions, customers' efforts to control IT-related investment and lower unit sales of personal computers and copiers because of the reduction of the number of OTSUKA CORPORATION's "α Land" stores greatly affected System Integration Business net sales, however, which declined 4.7% from the prior year to ¥230,561 million.

Service and Support Business

The Company's Service and Support Business was able to increase sales by focusing on the software maintenance and network maintenance and support business. The Service and Support Business also achieved strong growth in its education-related business with Web Learning correspondence courses using PC classrooms and the Internet to offer a broad selection of manufacturer authorized courses. "Tano Mail," the Company's office supply sales program using catalogs and the Web, also enjoyed solid growth as a result of continuous improvements to strengthen sales and distribution through enhancement of its product line-up aimed at large companies and small and medium-sized firms. These results, together with the strong growth in OTSUKA CORPORATION's Web and security-related businesses such as "α-Mail" service providing firms with domain services, resulted in net sales of ¥96,338 million, up 5.2% compared to the previous year.

Other Business (Construction Business, etc.)

In its Other Business, the OTSUKA Group also engages in the design, construction and supervision of construction work and the maintenance and management of condominiums. Overall, the construction industry continues to face a harsh business situation. Other Business net sales for the fiscal year were ¥1,252 million, 10.8% lower than the prior year.

Cost of Sales and Other Income

	Millions of yen			
	2000	2001	Amount of change, year on year	% change, year on year
Cost of sales	¥260,959	¥251,483	-9,476	-3.6%
Gross profit	73,952	76,668	+2,716	+3.7
Selling, general and administrative expenses	68,030	68,490	+460	+0.7
Operating income	5,922	8,178	+2,256	+38.1
Non-operating profit and loss	284	-513	-797	—
Recurring profit	6,206	7,665	+1,459	+23.5
Extraordinary profit and loss	-498	-2,805	-2,307	—
Income before income taxes and minority interests	5,708	4,859	-849	-14.9
Income taxes*	2,759	2,344	-415	-15.0
Net income	2,997	2,531	-466	-15.5

* Including adjustment amount for corporation and other taxes

Cost of sales fell ¥9,476 million from the same period one year earlier to ¥251,483 million. As a result, the Company's gross profit margin improved 1.3 percentage points from 22.1% in the prior fiscal year to 23.4%.

Selling, general and administrative expenses rose ¥460 million to ¥68,490 million, rising slightly as a percentage of sales from 20.3% in the prior fiscal year to 20.9% because of an increase in personnel expenses and business consignment fees. As a result, operating income advanced ¥2,256 million over the prior fiscal year to ¥8,178 million, and the operating margin improved 0.7 percentage point from 1.8% in the prior fiscal year to 2.5%.

Non-operating income (expenses) yielded a net expense of ¥513 million, compared with net non-operating income of ¥284 million in the previous fiscal year. These payments were accounted for as purchasing discounts and included in non-operating income, to actual circumstances. These payments were accounted for as a ¥696 million purchasing deduction item included in cost of sales. As a result of the above items, recurring profit increased ¥1,459 million from the prior year to ¥7,665 million, the highest level in the Company's history.

Behind this improvement is the "OTSUKA Strategy Project," a business reform effort we have pursued since the collapse of Japan's bubble economy. This project is an effort to improve our financial position by closing business centers and renovating information systems, which has enabled us to reduce the number of employees by 370 from their peak level on a non-consolidated basis, slash product inventory in half and reduce interest-bearing debt by 63%.

During the fiscal year, the Company began application of retirement benefit accounting. This resulted in a one-time retirement benefit expense of ¥2,134 million, which increased extraordinary losses to ¥2,805 million for the period under review. As a result, income before income taxes and minority interests was ¥4,859 million, ¥849 million less than in the prior fiscal year.

Corporation income taxes, residence taxes and business taxes were ¥2,344 million, down from ¥2,759 million in the prior fiscal year. These amounts represented 48.3% and 48.2%, respectively, of income before income taxes and minority interests. Minority interests in net losses of consolidated subsidiaries amounted to ¥16 million (down 66.3% from the prior fiscal year).

As a result of the aforementioned factors, net income for the period under review decreased ¥466 million from ¥2,997 million to ¥2,531 million. The net profit margin declined from 0.9% to 0.8%.

Financial Position

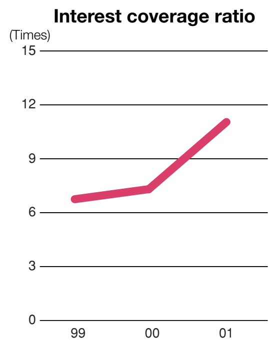
	Millions of yen			
	2000	2001	Amount of change, year on year	% change, year on year
Assets	**¥167,761**	**¥148,111**	**-19,650**	**-11.7%**
Current assets	79,335	75,286	-4,049	-5.1
Fixed assets	88,324	72,825	-15,499	-17.5
Currency translation adjustment	102	0	-102	—
Liabilities	**116,130**	**106,559**	**-9,570**	**-8.2**
Current liabilities	102,865	91,221	-11,644	-11.3
Long-term liabilities	13,265	15,338	+2,073	+15.6
Minority interests	**435**	**421**	**-14**	**-3.2**
Shareholders' equity	**51,196**	**41,131**	**-10,065**	**-19.7**

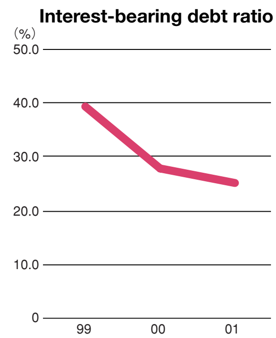
On the assets side of the balance sheet, total current assets decreased ¥4,049 million, a 5.1% reduction from the end of the prior fiscal year, to ¥75,286 million. The most significant reductions were a decline in sales credits because of lower sales for the reasons described above, and a drop in inventory assets because of adjustments such as further closings of the Company's "α Land" stores.

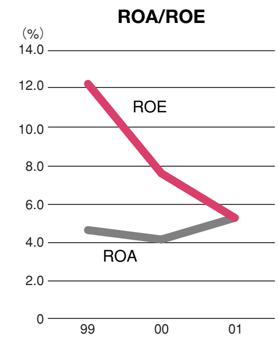
Tangible fixed assets were reduced sharply from the level at the end of the prior fiscal year, falling 36.0% to ¥40,605 million. The principal reason for the decline was a revaluation loss of ¥20,957 million generated as a result of the reappraisal of the value of land owned for business uses at the end of the period under review, which the Company deducted from the book value of land owned. The Company also added deferred tax assets of ¥8,822 million related to the revaluation in question to investments. As a result of the above changes, total fixed assets decreased ¥15,499 million to ¥72,825 million, a decline of 17.5% compared to the prior fiscal year-end, and total assets declined ¥19,650 million, an 11.7% drop compared to prior fiscal year-end.

Total current liabilities were ¥91,221 million, down 11.3% compared with the prior fiscal year, while long-term liabilities rose by 15.6% to ¥15,338 million. Total liabilities were ¥106,559 million. The Company used cash flow provided by operating activities and other sources to reduce interest-bearing debt by a net amount of ¥9,566 million to ¥36,983 million. As a result, the Group's total liabilities decreased ¥9,570 million, 8.2% lower than the balance at the prior fiscal year-end, and the interest coverage ratio improved from 7.3 times in the prior fiscal year to 11.0 times.

Total shareholders' equity fell ¥10,065 million to ¥41,131 million, a 19.7% decline from the prior fiscal year-end. This reflected the negative addition of ¥12,134 million to equity for the revaluation of land held for business purposes, as stipulated by the accounting method used for the revaluation, as well as a valuation gain of ¥558 million resulting from the market valuation of other marketable securities in accordance with the accounting standard for financial products that was applied during the period under review, which was added to equity. As a result, the equity ratio decreased 2.7 percentage points to 27.8%. Because the decline in net income for the period under review was greater than the decrease in shareholders' equity, return on equity (ROE) declined 2.1 percentage points to 5.5%. Return on assets (ROA) was 5.2%, 1.1 percentage points higher than in the prior fiscal year, an improvement that reflected the increase in operating income and the decrease in shareholders' equity.







* Return on assets (ROA) = Business profit/Average total assets
Business profit = Operating income
\+ Interest and dividend income + Purchase discounts

Cash Flows

	Millions of yen			
	2000	2001	Amount of change, year on year	% change, year on year
Cash flows from operating activities	¥9,514	¥15,724	+6,210	+65.3%
Cash flows from investing activities	(8,699)	(4,837)	-3,862	-44.4
Cash flows from financing activities	(1,977)	(10,442)	+8,465	+428.2
Cash and cash equivalents at end of year	4,445	4,963	+518	+11.7

Cash provided by operating activities was ¥15,724 million (up 65.3% from the prior fiscal year). Inflows consisted mainly of ¥4,859 million in income before income taxes and minority interests, and non-cash depreciation expense of ¥6,266 million. The total reduction of ¥1,883 million in trade receivables and inventory also served to boost cash provided by operating activities.

Cash used in investing activities totaled ¥4,837 million (down 44.4%). The primary items were the investment of ¥1,291 million for the purchase of tangible fixed assets and ¥3,159 million for software development.

Cash used in financing activities totaled ¥10,442 million (up 428.2% from the prior fiscal year). The primary financing activities were ¥9,652 million in decrease of short-term loans and long-term debts, net, and ¥791 million for dividend payments.

As a result of the above changes, cash and cash equivalents at the end of the period under review increased ¥518 million (up 11.7%) to ¥4,963 million.

Future Outlook

Although Japan's government is expected to implement structural reforms and take measures to dispose of financial institutions' nonperforming loans to revitalize Japan's economy, over the next fiscal period these steps are expected to be accompanied by increases in corporate bankruptcies and the unemployment rate, and the severe economic environment is expected to continue unchanged.

Nevertheless, with the coming of the full-fledged Web era, the issue of how to respond to new environmental changes—such as the electronic tender system that will be introduced based upon the government's e-Japan concept and the Internet environment-based business protocols that will be formed in each industry—will continue to be an unavoidable concern for corporate managers. Numerous firms can now be found that will decide to aggressively introduce IT to differentiate themselves from other companies and achieve low-cost management. As a result of these trends, the OTSUKA Group projects that IT investment at Japanese firms, which until now has occurred mainly in the form of early investment by major corporations, will spread steadily in the future to small and medium-sized companies.

Based on such changes in business environment and management issues, and to accurately meet our customers' needs, beginning in fiscal 2002 the OTSUKA Group will introduce its "New-Web Strategy." Through the collaboration and unification of our traditional real businesses with virtual businesses utilizing the Internet, and by taking greater advantage of its integrated capabilities, the Group will offer solutions that are truly effective for its customers. As measures to promote our "New-Web Strategy," we will build databases concerning each customer's attributes and needs and enhance our consulting capabilities for providing optimal solution proposals based upon this data. The OTSUKA Group will also seek to develop attractive products and service and support menus that make the best use of its real response and virtual environments.

Based on the above plan, for fiscal 2002 OTSUKA CORPORATION projects net sales of ¥340,900 million (up 3.9% from the prior fiscal year), recurring profit of ¥8,240 million (up 7.5%) and net income of ¥2,730 million (up 7.8%).

Consolidated Balance Sheets

OTSUKA CORPORATION and Its Consolidated Subsidiaries
Years ended December 31, 2000 and 2001

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2000	**2001**	**2001**
ASSETS			
Current assets:			
Cash, time deposits and other cash equivalents (Notes 6 and 10)	¥ 5,927	**¥ 6,431**	**$ 48,916**
Accounts and notes receivable:			
Trade	47,547	**45,935**	**349,395**
Unconsolidated subsidiaries and affiliates	787	**25**	**190**
Other	4,122	**3,802**	**28,919**
	52,456	**49,762**	**378,504**
Less: Allowance for bad debts	(413)	**(337)**	**(2,563)**
	52,043	**49,425**	**375,941**
Inventories (Note 5)	19,279	**16,120**	**122,614**
Deferred taxes assets (Note 9)	477	**861**	**6,549**
Other current assets	1,609	**2,449**	**18,628**
Total current assets	79,335	**75,286**	**572,648**
Investments and advances:			
Investments in securities (Note 4)	2,784	**4,086**	**31,079**
Investments in unconsolidated subsidiaries and affiliates	1,326	**955**	**7,264**
Guarantee deposits	8,860	**7,629**	**58,028**
Deferred taxes assets non-current (Note 9)	758	**756**	**5,750**
Deferred taxes assets regarding revaluation for land	—	**8,823**	**67,110**
Other investments	2,481	**1,441**	**10,961**
	16,209	**23,690**	**180,192**
Property, plant and equipment (Notes 6 and 13)**:**			
Land	29,676	**8,654**	**65,825**
Buildings and structures	56,084	**56,254**	**427,885**
Construction in progress	1,119	**1,057**	**8,040**
Others	9,642	**9,573**	**72,815**
	96,521	**75,538**	**574,565**
Less: Accumulated depreciation	(33,042)	**(34,933)**	**(265,711)**
Net property, plant and equipment	63,479	**40,605**	**308,854**
Intangibles and deferred charges:			
Software	8,152	**7,940**	**60,394**
Others	484	**590**	**4,488**
	8,636	**8,530**	**64,882**
Foreign currency translation adjustment	102	**—**	**—**
Total assets	¥167,761	**¥148,111**	**$1,126,576**

The accompanying notes are an integral part of these statements.

	Millions of yen 2000	2001	Thousands of U.S. dollars (Note 3) 2001
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Short-term bank loans (Note 6)	¥ 30,498	**¥ 23,952**	**$ 182,186**
Current maturities of long-term debt (Note 6)	7,027	**3,728**	**28,356**
Accounts and notes payable:			
Trade	51,862	**49,664**	**377,759**
Unconsolidated subsidiaries and affiliates	949	**414**	**3,149**
Other	2,670	**2,885**	**21,944**
	55,481	**52,963**	**402,852**
Income taxes payable (Note 9)	782	**1,648**	**12,535**
Other current liabilities	9,077	**8,930**	**67,925**
Total current liabilities	102,865	**91,221**	**693,854**
Long-term debt (Note 6)	9,024	**9,303**	**70,761**
Reserve for retirement benefits (Note 7)	3,824	**5,575**	**42,405**
Deferred tax liabilities, non-current (Note 9)	307	**359**	**2,731**
Other long-term liabilities	110	**101**	**768**
Minority interests in consolidated subsidiaries	435	**421**	**3,202**
Contingent liabilities (Note 8)			
Shareholders' equity:			
Common stock:			
Authorized: 112,860,000 shares			
Outstanding:			
December 31, 2000 31,667,020 shares			
December 31, 2001 31,667,020 shares	10,375	**10,375**	**78,915**
Additional paid-in capital	16,255	**16,255**	**123,640**
Excess of land revaluation after tax-effect	—	**(12,134)**	**(92,294)**
Retained earnings	24,566	**26,122**	**198,692**
Less: Treasury stock	(0)	**(0)**	**(0)**
Unrealized gain of investment securities after tax-effect	—	**558**	**4,244**
Foreign currency translation adjustment	—	**(45)**	**(342)**
Total shareholders' equity	51,196	**41,131**	**312,855**
Total liabilities and shareholders' equity	¥167,761	**¥148,111**	**$1,126,576**

The accompanying notes are an integral part of these statements.

Consolidated Statements of Income

OTSUKA CORPORATION and Its Consolidated Subsidiaries
For the years ended December 31, 2000 and 2001

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2000	**2001**	**2001**
Net sales (Note 14)	¥334,911	**¥328,151**	**$2,496,014**
Cost of sales (Note 14)	260,959	**251,483**	**1,912,855**
Gross profit	73,952	**76,668**	**583,159**
Selling, general and administrative expenses (Note 14)	68,030	**68,490**	**520,955**
Operating income	5,922	**8,178**	**62,204**
Other income (expenses):			
Interest and dividend income	107	**104**	**791**
Interest expenses	(945)	**(749)**	**(5,697)**
Purchase discounts	894	**—**	**—**
Gain on sale of investments in affiliates	296	**—**	**—**
Gain on cancellation of stock transfer contract	1,500	**—**	**—**
Stock listing expenses of OTSUKA CORPORATION	(118)	**—**	**—**
Loss on sale/disposal of property, plant and equipment	(738)	**(409)**	**(3,111)**
Loss on evaluation/sale of membership	(1,406)	**(73)**	**(555)**
Equity in earnings of the affiliates	—	**(149)**	**(1,133)**
Amortization of transition amount arising from adopting new accounting standard for retirement benefit	—	**(2,135)**	**(16,239)**
Other, net	196	**92**	**699**
	(214)	**(3,319)**	**(25,245)**
Income before income taxes and minority interests	5,708	**4,859**	**36,959**
Income taxes (Note 9)**:**			
Current	3,098	**3,072**	**23,366**
Deferred	(339)	**(728)**	**(5,537)**
	2,759	**2,344**	**17,829**
Minority interests in net losses of consolidated subsidiaries	48	**16**	**122**
Net income	¥ 2,997	**¥ 2,531**	**$ 19,252**

	Yen		U.S. dollars (Note 3)
Net income and dividends per share (Note 2(15))**:**			
Net income	¥99.67	**¥79.94**	**$0.61**
Cash dividends	25.00	**25.00**	**0.19**

The accompanying notes are an integral part of these statements.

Consolidated Statements of Shareholders' Equity

OTSUKA CORPORATION and Its Consolidated Subsidiaries
For the years ended December 31, 2000 and 2001

	Number of shares of common stock	Millions of yen						
		Common stock	Additional paid-in capital	Excess of land revaluation	Retained earnings	Unrealized gain on investment securities	Foreign currency translation adjustment	Treasury stock
Balance at December 31, 1999	28,667,020	¥ 4,000	¥ 2,785	¥ —	¥21,289	¥ —	¥ —	¥—
Cumulative effect of adopting deferred tax accounting	—	—	—	—	562	—	—	—
Income for the year	—	—	—	—	2,997	—	—	—
Cash dividends paid	—	—	—	—	(282)	—	—	—
New shares issued in public offering	3,000,000	6,375	13,470	—	—	—	—	—
Purchase of treasury stock	—	—	—	—	—	—	—	(0)
Balance at December 31, 2000	31,667,020	10,375	16,255	—	24,566	—	—	(0)
Increase due to inclusion of an affiliate for equity method	**—**	**—**	**—**	**—**	**8**	**—**	**—**	**—**
Decrease due to inclusion of subsidiaries in the consolidation	**—**	**—**	**—**	**—**	**(192)**	**—**	**—**	**—**
Land revaluation	**—**	**—**	**—**	**(12,134)**	**—**	**—**	**—**	**—**
Unrealized gain on investment securities	**—**	**—**	**—**	**—**	**—**	**558**	**—**	**—**
Foreign currency translation adjustment	**—**	**—**	**—**	**—**	**—**	**—**	**(45)**	**—**
Net income for the year	**—**	**—**	**—**	**—**	**2,531**	**—**	**—**	**—**
Cash dividends paid	**—**	**—**	**—**	**—**	**(791)**	**—**	**—**	**—**
Balance at December 31, 2001	**31,667,020**	**¥10,375**	**¥16,255**	**¥(12,134)**	**¥26,122**	**¥558**	**¥(45)**	**¥ (0)**

	Number of shares of common stock	Thousands of U.S. dollars (Note 3)						
		Common stock	Additional paid-in capital	Excess of land revaluation	Retained earnings	Unrealized gain on investment securities	Foreign currency translation adjustment	Treasury stock
Balance at December 31, 2000	31,667,020	$78,915	$123,640	$ —	$186,856	$ —	$ —	$ (0)
Increase due to inclusion of an affiliate for equity method	**—**	**—**	**—**	**—**	**61**	**—**	**—**	**—**
Decrease due to inclusion of subsidiaries in the consolidation	**—**	**—**	**—**	**—**	**(1,460)**	**—**	**—**	**—**
Land revaluation	**—**	**—**	**—**	**(92,294)**	**—**	**—**	**—**	**—**
Unrealized gain on investment securities	**—**	**—**	**—**	**—**	**—**	**4,244**	**—**	**—**
Foreign currency translation adjustment	**—**	**—**	**—**	**—**	**—**	**—**	**(342)**	**—**
Net income for the year	**—**	**—**	**—**	**—**	**19,252**	**—**	**—**	**—**
Cash dividends paid	**—**	**—**	**—**	**—**	**(6,017)**	**—**	**—**	**—**
Balance at December 31, 2001	**31,667,020**	**$78,915**	**$123,640**	**$(92,294)**	**$198,692**	**$4,244**	**$(342)**	**$ (0)**

The accompanying notes are an integral part of these statements.

Consolidated Statements of Cash Flows

OTSUKA CORPORATION and Its Consolidated Subsidiaries
For the years ended December 31, 2000 and 2001

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2000	**2001**	**2001**
Cash flows from operating activities:			
Income before income taxes and minority interests	¥ 5,708	**¥ 4,859**	**$ 36,959**
Depreciation and amortization	6,450	**6,266**	**47,661**
Amortization of difference between cost of investment and equity in net assets of consolidated subsidiaries	49	**51**	**388**
Provision for retirement benefits	210	**1,714**	**13,037**
Provision for allowance for bad debts	568	**218**	**1,658**
Interest and dividend income	(107)	**(104)**	**(791)**
Interest expenses	945	**749**	**5,697**
Equity in earnings of the affiliates	—	**149**	**1,133**
Loss on sale/disposal of property, plant and equipment	738	**409**	**3,111**
Gain on sale of investment in securities	(296)	**—**	**—**
Gain on cancellation of stock transfer contract	(1,500)	**—**	**—**
Loss on evaluation of investments in securities	157	**189**	**1,438**
Loss on evaluation/sale of membership	1,406	**73**	**555**
Decrease in notes and accounts receivable	1,738	**2,260**	**17,190**
Decrease in inventories	1,805	**3,166**	**24,082**
Decrease in notes and accounts payable	(1,932)	**(2,759)**	**(20,986)**
Other	1,146	**1,356**	**10,314**
Sub-total	17,085	**18,596**	**141,446**
Interest and dividend income received	108	**101**	**768**
Interest expenses paid	(982)	**(795)**	**(6,046)**
Income taxes paid	(6,697)	**(2,178)**	**(16,567)**
Net cash provided by operating activities	9,514	**15,724**	**119,601**
Cash flows from investing activities:			
Payments for purchase of property, plant and equipment	(3,606)	**(1,291)**	**(9,819)**
Payments for software developed	(3,127)	**(3,159)**	**(24,028)**
Payments for purchase of investments in securities	(2,177)	**(686)**	**(5,218)**
Proceeds from sale of investments in securities	426	**61**	**464**
Increase in long-term loans receivable	(498)	**(89)**	**(677)**
Other	283	**327**	**2,487**
Net cash used in investing activities	(8,699)	**(4,837)**	**(36,791)**
Cash flows from financing activities:			
Decrease in short-term bank loans, net	(17,059)	**(6,545)**	**(49,783)**
Proceeds from long-term debts	623	**4,520**	**34,380**
Repayments of long-term debts	(5,118)	**(7,627)**	**(58,013)**
Proceeds from issue of new shares	19,845	**—**	**—**
Cash dividends paid	(282)	**(791)**	**(6,017)**
Other	14	**1**	**8**
Net cash used in financing activities	(1,977)	**(10,442)**	**(79,425)**
Effect of exchange rate changes on cash and cash equivalents	(2)	**7**	**53**
Net increase (decrease) in cash and cash equivalents	(1,164)	**452**	**3,438**
Cash and cash equivalents at beginning of year	5,433	**4,445**	**33,810**
Increase in cash and cash equivalents for newly consolidated subsidiaries	—	**66**	**502**
Increase in cash and cash equivalents due to merger	176	**—**	**—**
Cash and cash equivalents at end of year (Note 10)	¥ 4,445	**¥ 4,963**	**$ 37,750**

The accompanying notes are an integral part of this statement.

1. Basis of Presenting the Consolidated Financial Statements

Accounting principles

The accompanying consolidated financial statements have been prepared from the accounts maintained by OTSUKA CORPORATION (the "Company") and its consolidated subsidiaries in accordance with the provisions set forth in the Japanese Commercial Code and the Securities and Exchange Law, and in conformity with accounting principles and practices generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Accounting Standards.

Certain items presented in the consolidated financial statements submitted to the Director of the Kanto Finance Bureau in Japan have been reclassified for the convenience of readers outside Japan.

The consolidated financial statements are not intended to present the consolidated financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

2. Summary of Significant Accounting Policies

(1) Scope of consolidation

The Company had 22 subsidiaries (majority-owned companies) and 22 subsidiaries as at December 31, 2000 and 2001, respectively. The consolidated financial statements include the accounts of the Company and 9 subsidiaries and 10 subsidiaries for the years ended December 31, 2000 and 2001, respectively.

The 10 subsidiaries, which were consolidated in the year ended December 31, 2001, are listed below:

	Equity ownership percentage
OSK Co., LTD.	100.0%
Netplan Co., LTD.	100.0%
Alpha Techno Co., LTD.	100.0%
Fujimi Construction Co., LTD.	100.0%
Alpha System Co., LTD.	100.0%
Alpha Net Inc.	100.0%
JPSS Co., LTD. (*1)	92.4%
10art-ni Corporation	79.3%
Net World, INC.	68.4%
AURORA-OTSUKA CORP.	65.0%

(*1) Newly consolidated with effect from the year ended December 31, 2001

The Company and its consolidated subsidiaries are hereinafter referred to as the "Companies."

Companies that are owned more than 50% are generally classified as subsidiaries and companies that are owned more than 20% are classified as affiliates. However, due to the amendments of regulation for preparation of consolidated financial statements, companies that are owned more than 40% to 50% may also be classified as subsidiaries and companies that are owned 15% to 20% may also be classified as affiliates, if the Company substantially controls the investees' management or has significant influence and relationship with the investees.

The above-shown consolidated subsidiaries use a fiscal year ending on December 31 of each year, which is the same as that of the Company.

The accounts of the remaining 13 and 12 unconsolidated subsidiaries as at December 31, 2000 and 2001, respectively, had insignificant amounts in terms of total assets, net sales and, net income and, therefore, have been excluded from consolidation.

(2) Elimination of intercompany accounts

For the purposes of preparing the consolidated financial statements, all significant intercompany transactions, account balances and unrealized profits among the Companies have been entirely eliminated, and the portion attributable to minority interests is charged/credited to minority interests.

For the elimination of investments in common stock of consolidated subsidiaries, together with the equity in net assets of such subsidiaries, any difference between such investment costs and the amount of underlying equity in net assets of the subsidiary is deferred and amortized to income over five years on a straight-line basis.

(3) Investments in unconsolidated subsidiaries and affiliates

The Company had 13 unconsolidated subsidiaries and 17 affiliates at December 31, 2000 and 12 unconsolidated subsidiaries and 13 affiliates at December 31, 2001.

The investments in 2 major affiliates were accounted for by the equity method. Investments in unconsolidated subsidiaries and affiliates not accounted for by the equity method were carried at cost or less, since they did not have a material effect on consolidated net income in the consolidated financial statements.

(4) Translation of foreign currency

Effective from the year ended December 31, 2001, the Company and its subsidiaries adopted the new Japanese accounting standard for foreign currency translation, which is effective for periods beginning on or after January 1, 2001. Under the new standard, all monetary assets and liabilities denominated in foreign currencies, whether long-term or short-term, are translated into Japanese yen at the exchange rates prevailing at the balance sheet date. Resulting gains and losses are included in net profit or loss for the period. The adoption of the new method had immaterial impact on the accompanying consolidated financial statements.

The new standard also amended the method of translating foreign currency financial statements of foreign subsidiaries and affiliates into Japanese yen. Under the new standard, assets and liabilities of the foreign subsidiaries and affiliates are translated into Japanese yen at the exchange rates prevailing at the balance sheet date. The shareholders' equity at the beginning of the year is translated into Japanese yen at the historical rates. Profit and loss accounts for the year are translated into Japanese yen using the average exchange rate during the year. Differences in yen amounts arising from the use of different rates are presented as "foreign currency translation adjustments" in the shareholders' equity. The effect of adopting the new accounting standard on the accompanying consolidated financial statements was immaterial.

(5) Cash and cash equivalents

Cash and cash equivalents in the consolidated statements of cash flows are composed of cash on hand, bank deposits which can be withdrawn on demand and short-term investments with an original maturity of three months or less and which represent a minor risk of fluctuation in value.

(6) Inventories

Inventories are valued by the methods according to the category of inventories as follows:

Merchandise and maintenance parts	Cost mainly determined by the moving-average method
Work-in-process	Cost determined by the individual cost method
Supplies	Cost determined by the last purchase prices

(7) Financial instruments

(a) Securities

Securities held by the Company and its subsidiaries are, under the new standard, classified into two categories:

- Equity investment in subsidiaries and affiliates

  Investments of the Company in equity securities issued by unconsolidated subsidiaries and affiliates are accounted for by the equity method. Exceptionally, investments in certain unconsolidated subsidiaries and affiliates are stated at cost, mainly by the moving-average method, because the effect of application of the equity method would be immaterial.

- Other securities

  With a market quotation; stated at fair value, valued at market prices at balance sheet date. (Amount of the unrealized gains/losses from valuation of marketable securities are charged directly to shareholders' equity at a net-of-tax amount, while cost for sale is determined mainly by the moving-average method.)

  Without a market quotation; stated at cost, mainly by the moving-average method.

(b) Derivatives

Under the new standard, all derivatives are stated at fair value, with changes in fair value included in net profit or loss for the period in which they arise, except for derivatives that are designated as “hedging instruments.”

(c) Hedge accounting

Gains or losses arising from changes in fair value of the derivatives designated as “hedging instruments” are deferred as an asset or liability and included in net profit or loss in the same period during which the gains and losses on the hedged items or transactions are recognized.

The derivatives designated as hedging instruments by the Companies are principally interest swaps and forward exchange contracts. The related hedged items are trade accounts payable and bank loans.

The Companies have a policy to utilize the above hedging instruments in order to reduce the Companies’ exposure to the risk of interest and foreign exchange rate fluctuation. Thus, the Companies’ purchases of the hedging instruments are limited to, at maximum, the amounts of the hedged items.

The Company evaluates effectiveness of its hedging activities by reference to the accumulated gains or losses on the hedging instruments and the related hedged items from the commencement of the hedges.

(d) Additional information

Effective from the year ended December 31, 2001, the Company and its subsidiaries adopted the new Japanese accounting standard for financial instruments, which is effective for periods beginning on or after April 1, 2000. As a result of adoption of the new standard, income before income taxes for the year ended December 31, 2001 has increased by ¥109 million, as compared with the amount, which would have been reported if the previous standard had been applied consistently.

(8) Property, plant and equipment

Depreciation is mainly computed using the declining-balance method, at rates based on the estimated useful lives of assets, which are prescribed by the Japanese income tax laws. Depreciation of buildings newly acquired after April 1, 1998 has been provided based on the straight-line method in conformity with Japanese tax laws.

Normal repairs and maintenance, including minor renewals and improvements, are charged to income as incurred.

(9) Accounting for leases

Finance leases, other than those which are deemed to transfer the ownership of the leased assets to lessees, are accounted for by a method similar to that applicable to ordinary operating leases.

(10) Amortization

The amortization of costs of software developed for external sales are computed at an amount based on sales quantity during the year to the total estimated sales quantity. However, these costs should not be lower than the amount computed on the straight-line basis over the remaining period, which is three years.

Software developed for internal use is amortized on the straight-line basis over the estimated useful life, which is five years.

(11) Deferred charges

Bond expenses are charged to expenses as incurred.

(12) Accounting for income taxes

Income taxes of the Company and its domestic subsidiaries consist of corporate income taxes, local taxes and enterprise taxes.

The Company and its subsidiaries adopted the deferred tax accounting method. Income taxes were determined using the asset and liability approach, whereby deferred tax assets and liabilities were recognized in respect of temporary differences between the tax basis of assets and liabilities and those as reported in the consolidated financial statements.

(13) Allowance for bad debts

Allowance for bad debts is provided at an amount of possible losses from uncollectable receivables based on the actual rate of losses from bad debt for ordinary receivables, and on estimated recoverability for specific doubtful receivables.

(14) Reserve for retirement benefits

(a) Retirement benefits for employees

Effective from the year ended December 31, 2001, the Company and its subsidiaries adopted the new Japanese accounting standard for retirement benefits, which is effective for periods beginning on or after January 1, 2001. In accordance with the new standard, the reserve for retirement benefits as of December 31, 2001 represents the estimated present value of projected benefit obligations in excess of the fair value of the plan assets except that, as permitted under the new standard, the unrecognized transition amount arising from adopting the new standard of ¥10,654 million at January 1, 2001 (the beginning of the year) is amortized on a straight-line basis over 5 years, and the and unrecognized actuarial differences are amortized on a straight-line basis over the period of 12 years from the next year in which they arise.

As a result of adopting the new standard, net pension expense for the year ended December 31, 2001 has increased by ¥2,209 million and income before income taxes has decreased by ¥2,209 million as compared with the amounts which would have been reported if the previous standard had been applied consistently.

(b) Retirement benefits for directors

The Company has provided for the accrued retirement benefits to directors at an amount equivalent to 100% of such benefits the Company would be required to pay, had all eligible directors retired at the balance sheet date.

(15) Net income and dividends per share

Net income per common share is based upon the weighted average number of common shares outstanding during each year. Cash dividends per share shown for each year in the consolidated statements of income represent dividends declared as applicable to the respective year.

(16) Accounting for the consumption tax

The Japanese Consumption Tax Law imposes generally a consumption tax at a flat rate on all domestic consumption of goods and services. The consumption tax withheld upon sale is not included in the amount of "Net sales" in the accompanying consolidated statements of income but is recorded as a liability. Consumption tax, which is paid by the Company and domestic subsidiaries on purchases of goods and services is not included in the amounts of costs/expenses in the consolidated statements of income either, but is offset against the balance withheld, and the net balance is included in "Other current liabilities" in the consolidated balance sheets.

(17) Change of accounting policy (accounting for the purchase incentive)

During fiscal 2001, the Company changed the income statement classification of the purchase incentive from non-operating income to cost of sales as a purchase rebate. This reclassification was to achieve a better disclosure of cost of sales from the viewpoint of substantial nature of the purchase incentive. The reclassification resulted in an increase in gross profit and operating income of ¥696 million for 2001, respectively, and income before taxes of ¥38 million for 2001, as compared with the amounts which would have been reported if the previous policy had been applied consistently.

3. U.S. Dollar Amounts

Amounts in U.S. dollars are included solely for the convenience of readers outside Japan. The rate of ¥131.47=US$1, the rate of exchange on December 31, 2001, has been used in translation. The inclusion of such amounts is not intended to imply that Japanese yen have been or could be readily converted, realized or settled in U.S. dollars at this or any other rate.

4. Investments in Securities

At December 31, 2001, investments in securities were as follows:

(1) Other securities with fair value

	Millions of yen			Thousands of U.S. dollars		
	2001			2001		
	Cost	Carrying amount	Differences	Cost	Carrying amount	Differences
Fair value greater than carrying amount						
Stocks	¥679	¥1,737	¥1,058	$5,165	$13,212	$8,047
Bonds	—	—	—			
Other securities	—	—	—			
	¥679	¥1,737	¥1,058	$5,165	$13,212	$8,047
Fair value less than or equal to carrying amount						
Stocks	¥180	¥ 123	¥ (57)	$1,369	$ 935	$ (434)
Bonds	—	—	—			
Other securities	90	50	(40)	685	380	(305)
	¥270	¥ 173	¥ (97)	$2,054	$ 1,315	$ (739)
Total	¥949	¥1,910	¥ 961	$7,219	$14,527	$7,302

(2) Other securities sold in 2001 (for the year ended December 31, 2001)

Millions of yen 2001			Thousands of U.S. dollars 2001		
Amount for sale	Total gains on sale	Total losses on sale	Amount for sale	Total gains on sale	Total losses on sale
¥62	¥0	¥1	$472	$0	$8

(3) Securities not stated at fair value

	Millions of yen	Thousands of U.S. dollars
	2001	2001
	Stated amount on consolidated balance sheets	Stated amount on consolidated balance sheets
Held-to-maturity securities	¥ —	$ —
Other securities		
Unlisted stocks (excluding stocks traded over the counter)	2,137	16,255
Non-public issue convertible bonds	30	288
Discount bonds (IBJ)	5	38
Mid-term government bonds fund	2	15

(4) Prospected amount for redemption of other securities with maturity date and held-to maturity securities subsequent to the consolidated balance sheet date

	Millions of yen		Thousands of U.S. dollars	
	2001		2001	
	Within one year	More than one year	Within one year	More than one year
Bonds				
Government bonds and municipal bonds	¥—	¥—	$ —	$—
Corporate bonds	30	—	228	—
Others	5	—	38	—
Others	—	—	—	—
Total	¥35	¥—	$266	$—

5. Inventories

Inventories at December 31, 2000 and 2001 comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2000	**2001**	**2001**
Merchandise and maintenance parts	¥18,458	**¥15,465**	**$117,632**
Work-in-process	647	**496**	**3,773**
Supplies	174	**159**	**1,209**
	¥19,279	**¥16,120**	**$122,614**

6. Short-term Bank Loans and Long-term Debt

The annual average interest rates applicable to short-term bank loans at December 31, 2000 and 2001 were 1.18% and 0.92%, respectively.

Long-term debt at December 31, 2000 and 2001 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2000	**2001**	**2001**
Long-term borrowings from banks with annual interest rates from 1.18% to 2.99%	¥10,251	**¥ 6,631**	**$50,436**
2.66% secured Japanese yen bonds due November 2003	2,300	**2,300**	**17,494**
2.45% secured Japanese yen bonds due December 2001	1,400	**—**	**—**
2.75% secured Japanese yen bonds due December 2002	1,100	**1,100**	**8,367**
3.04% secured Japanese yen bonds due February 2003	1,000	**1,000**	**7,607**
0.75% secured Japanese yen bonds due March 2004	—	**2,000**	**15,213**
	16,051	**13,031**	**99,117**
Less: Current maturities of long-term debts	(7,027)	**(3,728)**	**(28,356)**
	¥ 9,024	**¥ 9,303**	**$70,761**

Aggregate annual maturities of long-term debt subsequent to December 31, 2001 are as follows:

Year ending December 31	Millions of yen	Thousands of U.S. dollars
2002	¥ 3,728	$28,356
2003	6,775	51,533
2004	2,496	18,985
2005	27	205
2006 and thereafter	5	38
	¥13,031	$99,117

At December 31, 2000 and 2001, assets pledged as collateral for short-term loans and long-term debt, including the current portion of long-term debt, were as follows:

	Millions of yen		Thousands of U.S. dollars
	2000	**2001**	**2001**
Land	¥22,298	**¥3,417**	**$25,991**
Buildings	15,347	**6,264**	**47,646**
Investment in securities	86	**—**	**—**
Time deposits	11	**11**	**83**
	¥37,742	**¥9,692**	**$73,720**

7. Reserve for Retirement Benefits

(1) Retirement benefit plan

The Company and its subsidiaries, except some companies, adopt a qualified pension plan, a welfare pension plan and termination allowance plan, as defined-benefit pension plans.

(2) The reserve for retirement benefits as of December 31, 2001 is analyzed as follows:

	Millions of yen	Thousands of U.S. dollars
	2001	2001
Projected benefit obligations	¥(48,263)	$(367,102)
Plan assets	28,688	218,209
	(19,575)	(148,893)
Unrecognized transition amount	8,512	64,745
Unrecognized prior service cost	—	—
Unrecognized actuarial differences	6,192	47,098
	(4,871)	(37,050)
Prepaid pension cost	—	—
Reserve for retirement benefits	¥ (4,871)	$ (37,050)

The above table includes the amounts related to the portion subject to the Japanese Welfare Pension Insurance Law. The balance of reserve for retirement benefits in the accompanying consolidated balance sheets at December 31, 2001 included retirement benefits for directors in an amount of ¥704 million ($5,355 thousand).

(3) Pension expense related to the retirement benefits for the year ended December 31, 2001 was as follows:

	Millions of yen	Thousands of U.S. dollars
	2001	2001
Service cost	¥3,363	$25,580
Interest cost	1,214	9,234
Expected return on plan assets	(1,489)	(11,326)
Amortization of transition amount	2,135	16,239
Additional benefits for employees' early retirement	41	312
Net pension expense	¥5,264	$40,039

Service cost includes pension costs of subsidiaries under simplified method.

(4) Computation basis of pension liabilities

As of December 31, 2001

Discount rate .... 2.5% (beginning of period: 3.0%)
Expected rate of return on plan assets.......... 4.5% (beginning of period: 5.5%)
Periodic allocation principle
for projected benefit obligations.......... Standard of fixed-amount-for-period
Amortization of unrecognized prior service cost .... —
Amortization of transition amount.......... 5 years
Amortization of unrecognized actuarial differences .... 12 years from the next fiscal year of occurrence

8. Contingent Liabilities

The Company was contingently liable for guarantees of loans at December 31, 2000 and 2001 as follows:

	Millions of yen		Thousands of U.S. dollars
	2000	**2001**	**2001**
Loans borrowed by:			
NACOS COMPUTER SYSTEMS CORP.	¥120	**¥ 87**	**$ 662**
EMT Software, Inc.	34	**32**	**243**
Sofix Inc.	60	**47**	**357**
	¥214	**¥166**	**$1,262**

9. Income Taxes

The statutory tax rate used for calculating deferred tax assets and liabilities at December 31, 2001 was 42.1%.

At December 31, 2001, the reconciliation of the statutory tax rate to the effective income tax rate was as follows:

Statutory tax rate:	42.1%
Entertainment expenses	2.2
Inhabitants' tax per capita	2.5
Valuation allowance	1.2
Others	0.2
Effective tax rate	48.2%

At December 31, 2000 and 2001, significant components of the deferred tax assets and liabilities were as follows:

	Millions of yen		Thousands of U.S. dollars
	2000	2001	2001
Deferred tax assets:			
Allowance for bad debts	¥ 252	**¥ 191**	**$ 1,452**
Enterprise taxes	137	**201**	**1,529**
Accrued bonuses	230	**326**	**2,480**
Retirement benefits for employees	534	**1,040**	**7,911**
Retirement benefits for directors	—	**304**	**2,312**
Membership	508	**306**	**2,328**
Software cost	226	**309**	**2,350**
Operating loss carryforwards	583	**659**	**5,013**
Eliminated unrealized profits	558	**540**	**4,107**
Other	139	**283**	**2,152**
Total gross deferred tax assets	3,167	**4,159**	**31,634**
Less: Valuation allowance	(372)	**(472)**	**(3,590)**
Net deferred tax assets	2,795	**3,687**	**28,044**
Deferred tax liabilities:			
Reserve for computer program	1,842	**2,001**	**15,220**
Unrealized gain on investment securities	—	**407**	**3,096**
Other	25	**21**	**160**
Total gross deferred tax liabilities	1,867	**2,429**	**18,476**
Net deferred tax assets	¥ 928	**¥1,258**	**$ 9,568**

10. Supplementary Cash Flow Information

Cash and cash equivalents consisted of:

	Millions of yen		Thousands of U.S. dollars
	2000	2001	2001
Cash, time deposits and other cash equivalents	¥5,927	**¥6,431**	**$48,916**
Time deposits with deposit term of more than three months	(1,482)	**(1,468)**	**(11,166)**
Cash and cash equivalents at end of year	¥4,445	**¥4,963**	**$37,750**

11. Subsequent Event

The following appropriation of the Company's retained earnings in respect of the year ended December 31, 2001 was as proposed by the Board of Directors and approved by the shareholders at the annual general meeting held on March 28, 2002:

Appropriation	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥25.0 per share)	¥791	$6,017

12. Lease Transactions

Acquisition cost, accumulated depreciation and net book value at December 31, 2000 and 2001 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2000	**2001**	**2001**
Acquisition cost	¥12,360	**¥7,117**	**$54,134**
Accumulated depreciation	(8,839)	**(3,683)**	**(28,014)**
Net book value	¥ 3,521	**¥3,434**	**$26,120**

Future minimum lease payments under finance leases at December 31, 2000 and 2001 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2000	**2001**	**2001**
Due within one year	¥1,301	**¥1,379**	**$10,489**
Due after one year	2,276	**2,124**	**16,156**
	¥3,577	**¥3,503**	**$26,645**

Lease rental expenses, depreciation and interest expenses for the year ended December 31, 2000 and 2001 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2000	**2001**	**2001**
Lease rental expenses	¥2,054	**¥1,603**	**$12,193**
Depreciation	1,916	**1,505**	**11,447**
Interest expenses	114	**118**	**898**

Depreciation expense is calculated using the straight-line method, with the lease period as useful life and zero as the residual value.

The amounts of future lease payments on operating leases at December 31, 2000 and 2001 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2000	**2001**	**2001**
Due within one year	¥103	**¥179**	**$1,362**
Due after one year	236	**172**	**1,308**
	¥339	**¥351**	**$2,670**

13. Land Revaluation

Pursuant to the Law Concerning Land Revaluation, the Company revalued land used for business activities on December 31, 2001. The excess of the revalued carrying amount over the book value before valuation was recorded as "Excess of land revaluation after tax-effect" in shareholders' equity in the accompanying consolidated balance sheets. The land prices used for the revaluation were determined based on the prices in the official notice published by the Commissioner of the National Tax Agency in accordance with Article 2, Paragraphs 3 and 4 of the Enforcement Ordinance Concerning Land Revaluation, after making reasonable adjustments. Revaluation is permitted only on time.

The carrying book value before revaluation and the value assessed at the time revaluation as at December 31, 2001 were as follows.

	Millions of yen	Thousands of U.S. dollars
	2001	2001
Book value before revaluation	¥28,660	$217,998
Carrying amount after revaluation	7,706	58,617

14. Segment Information

Business segment information

The business segment information of the Company and its consolidated subsidiaries for the years ended December 31, 2000 and 2001 is summarized as follows:

	Millions of yen					
	2000					
	System integration	Service & support	Other	Total	Elimination	Consolidated total
Net sales to:						
Outside customers	¥241,904	¥91,603	¥1,404	¥334,911	¥ —	¥334,911
Intersegment sales/transfers	8	18	990	1,016	(1,016)	—
	241,912	91,621	2,394	335,927	(1,016)	334,911
Operating expenses	238,120	84,966	2,299	325,385	3,604	328,989
Operating income	¥ 3,792	¥ 6,655	¥ 95	¥ 10,542	¥ (4,620)	¥ 5,922
Assets, depreciation and capital expenditures:						
Assets	¥ 97,305	¥58,880	¥1,347	¥157,532	¥10,229	¥167,761
Depreciation and amortization	3,486	2,728	13	6,227	223	6,450
Capital expenditures	4,615	2,016	29	6,660	156	6,816

	Millions of yen					
	2001					
	System integration	Service & support	Other	Total	Elimination	Consolidated total
Net sales to:						
Outside customers	**¥230,561**	**¥96,338**	**¥1,252**	**¥328,151**	**¥ —**	**¥328,151**
Intersegment sales/transfers	**12**	**24**	**951**	**987**	**(987)**	**—**
	230,573	**96,362**	**2,203**	**329,138**	**(987)**	**328,151**
Operating expenses	**225,510**	**88,721**	**2,148**	**316,379**	**3,594**	**319,973**
Operating income	**¥ 5,063**	**¥ 7,641**	**¥ 55**	**¥ 12,759**	**¥ (4,581)**	**¥ 8,178**
Assets depreciation and capital expenditures:						
Assets	**¥ 79,633**	**¥48,854**	**¥1,340**	**¥129,827**	**¥18,284**	**¥148,111**
Depreciation and amortization	**3,417**	**2,619**	**9**	**6,045**	**221**	**6,266**
Capital expenditures	**2,453**	**1,784**	**82**	**4,319**	**209**	**4,528**

	Thousands of U.S. dollars					
	2001					
	System integration	Service & support	Other	Total	Elimination	Consolidated total
Net sales to:						
Outside customers	**$1,753,716**	**$732,775**	**$ 9,523**	**$2,496,014**	**$ —**	**$2,496,014**
Intersegment sales/transfers	**91**	**183**	**7,234**	**7,508**	**(7,508)**	**—**
	1,753,807	**732,958**	**16,757**	**2,503,522**	**(7,508)**	**2,496,014**
Operating expenses	**1,715,296**	**674,838**	**16,339**	**2,406,473**	**27,337**	**2,433,810**
Operating income	**$ 38,511**	**$ 58,120**	**$ 418**	**$ 97,049**	**$ (34,845)**	**$ 62,204**
Assets, depreciation and capital expenditures:						
Assets	**$ 605,712**	**$371,598**	**$10,192**	**$ 987,502**	**$139,074**	**$1,126,576**
Depreciation and amortization	**25,991**	**19,921**	**68**	**45,980**	**1,681**	**47,661**
Capital expenditures	**18,658**	**13,570**	**624**	**32,852**	**1,589**	**34,441**

Report of Independent Certified Public Accountants

The Board of Directors
OTSUKA CORPORATION

We have audited the accompanying consolidated balance sheets of OTSUKA CORPORATION and its consolidated subsidiaries as of December 31, 2000 and 2001, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. Our audits were made in accordance with auditing standards, procedures and practices generally accepted and applied in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the consolidated financial position of OTSUKA CORPORATION and its consolidated subsidiaries as of December 31, 2000 and 2001, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles and practices generally accepted in Japan (see Note 1) applied on a consistent basis, except for the change, with which we concur, made as of December 31, 2001 in accounting for the purchase incentive, as described in Note 2(17).

As described in Note 2, effective for the year ended December 31, 2001, OTSUKA CORPORATION and its consolidated subsidiaries have adopted new Japanese accounting standards for preparation of consolidated financial statements, accounting for financial instruments, retirement benefits, and foreign currency translation.

The amounts expressed in U.S. dollars, provided solely for the convenience of the reader, have been translated on the basis set forth in Note 3 to the accompanying consolidated financial statements.

ChuoAoyama Audit Corporation

ChuoAoyama Audit Corporation

Tokyo, Japan
March 28, 2002

GLOSSARY OF TERMS

Term	Formal Name/Origin	Definition
Tano Mail	**Tano Mail**	One of OTSUKA CORPORATION's catalog mail-order services and Internet mail-order services, offers approximately 12,000 and 30,000 products respectively centering on OA supplies and including stationery, office supplies, lifestyle products.
Total α Support 21	**Total Alpha Support 21**	First service of its kind in the industry, service menu of service & support (S&S) for businesses; about 200 services in five categories focused on consulting, system construction, operation support, education support, and the provision of information; choice of yearly or "spot" contract.
Business Partner	**—**	Here in our sales and service division we are not only concerned with increasing the sales of computers and computer equipment. We have invested a lot of energy in "solution business" by developing ERP software, "SMILE α," and the maintenance package, "Total α Support 21."
Multi-field	**—**	Multi-field term to describe the wide range of OA equipment, which includes not only such IT-related equipment as computers and CAD systems, but copiers, facsimiles, PBX, and business phones; combined with its multi-vendor solutions, OTSUKA CORPORATION's multi-field solutions differentiate it from other companies.
ASP	**Application Service Provider**	Server business that offers applications and corresponding services through a contract-based rental system; OTSUKA CORPORATION's ASP business carries out Web hosting service α-Mail and other services.
CRM	**Customer Relationship Management**	The status of all communications and business transactions with our customers is consolidated for more efficient customer service. In order to provide products and services that meet each customer's particular needs and to have more effective marketing, we use IT to improve and maintain client relations.
CTI	**Computer Telephony Integration**	Realization of high-performance processing by combining a computer's data processing function with a PBX or business phone's transmission function.
CTO	**Configuration to Order**	Configuration-to-order (CTO) production and sales that respond to customer specification requirements; differs from built-to-order (BTO) in that BTO results in products built to meet specified standards or products to which only simple changes can be made, compared with CTO' s ability to incorporate a range of client demands.
EC	**Electronic Commerce**	Commerce conducted from terminals connected to communications lines or that uses some kind of electronic method; transactions may include orders only or extend to payment; business between companies is called B-to-B, and business between companies and individuals is called B-to-C.
ERP	**Enterprise Resource Planning**	System that provides integrated management of information regarding accounting, sales management, production management purchasing management, inventory management, and other mission-critical tasks; integrated mission-critical business system.
LA	**Large Account Sales Department**	The Large Account Sales Department looks after the needs of major corporations with annual earnings that exceed ¥100 billion or companies listed on the stock exchange. Our clientele are presented with ideas for computer systems which have an advanced information infrastructure.

Term	Formal Name/Origin	Definition
MRO	**Maintenance, Repair and Operations**	The MRO Department handles the sales of all types of office supplies such as paper and toner.
ODS21	**OTSUKA Document Solutions 21 for Open Knowledge Office**	System package software or a system that incorporates such software, that enables use and for open knowledge office management of knowledge database of business documents; by combining PCs, servers, copiers, scanners, printers, and networks, it provides solutions revolving around documents relating to such areas as product registration, history management, security management, retrieving, and outputting documents, etc.
PBX	**Private Branch Exchange**	Independent equipment for businesses that converts sound signals into a corresponding digital signal when analog and digital lines coexist.
S&D	**Shop and Direct Marketing**	Retail outlet and online sales of computers are handled by the Shop and Direct Sales Department. While acting as head office for our retail chain "α Land" this department also operates the "Land-e.com"web store.
SMILE α	**SMILE Alpha**	OTSUKA CORPORATION's original ERP package software for Japanese businesses; released in September 1979 as package software for office computers; has achieved sales of 76,000 packages over more than 20 years (as of December 2001); basic packages include financial management, compensation management, sales management, and client management; can be customized to individual users' needs; modules for industries ranging from distribution, retail/food service, and service to construction and manufacturing.
Web Learning	**—**	Internet education system, one part of OTSUKA CORPORATION's education business; regardless of time or place, if users have Internet access, they can study; Web Learning has an advantage over group lessons in that it responds to the user's level, and can be used for both class preparation and review.
α–Mail	**Alpha Mail**	Hosting service of OTSUKA CORPORATION's ASP business; low start-up expenses and usage fees, enables registration of independent domain names, 50 basic mail addresses, 10MB server disk capacity, and special support center responses.
α–Web	**Alpha Web**	Registered name for OTSUKA CORPORATION's ISP, which uses Internet connection service to offer dial-up connection services and virtual domain services to create homepages without having a server.
α Land	**Alpha Land**	Our retail outlets are the Alpha Land stores. As of March 31, 2002 we had three stores nationwide, including our Yaesu Store in central Tokyo.

HISTORY

Year	Topics	Operational Development
1961	Establishment and incorporation	
1962	Establishment of Omori Branch	
1965	Establishment of Osaka Branch, penetration of Kansai region	
1968	Relocation to new head office in Chiyoda Ward, Tokyo	Commencement of trade with Ricoh Co., Ltd.
1970		Commencement of computer business
1976		Commencement of trade with NEC Corporation
1978	Launches Business System Fair (the current Practical Solutions Fair)	
1979		Launch of original business & industry package software, "SMILE"
1981		Commencement of PC business
1982		Commencement of education business
1984	Establishment of subsidiary OTSUKA System Engineering (the current OSK)	Commencement of CAD business
1987		Commencement of network business
1988	Opening of Ichikawa distribution center in Ichikawa City, Chiba Prefecture	
1990	Certification as system integrator by the Ministry of International Trade and Industry (the current Ministry of Economy, Trade and Industry) Establishment of Nagoya Branch (Chubu regional office) Opening of Telephone Support Center	Commencement of "Total Alpha Service" (the current "Total α Support 21")
1993	Establishment of Utsunomiya Branch	Commencement of over-the-counter sales ("α Land") development Commencement of trade with IBM Japan, Ltd. Commencement of trade with Compaq Computer K.K.
1995	Opening of Alpha Learning Center	Commencement of catalog sales of OA supplies Commencement of Web business with business Internet connection service "α-Web"
1997	Opening of Keihinjima Distribution Center and Tokyo CTO Center	
1998	Attainment of ISO 19002 certification by Tokyo CTO Center	Commencement of security business
1999	Opening of Solution Garden with demonstrations of latest products and proposal equipment in Chiyoda Ward, Tokyo	Rapid expansion of Web business
2000	Listing on the First Section of the Tokyo Stock Exchange Opening of Internet Data Center (iDC) Attainment of ISO 14001 certification at 15 business sites	Reinforcement of web business including ASP, housing and hosting
2001	40th anniversary Replacement of president	Rapid expansion of "Tano Mail" through strengthening MRO business

BUSINESS STRUCTURE (As of April 1, 2002)

- General Meeting
  - Statutory Auditors Office
- Board of Directors
- Chairman
  - Office of Corporate Audit
- President
  - Office of President
  - Office of Environmental Management
  - Corporate Management Headquarters
    - Corporate Planning Division
    - General Affairs & Human Resources Division
    - Finance and Accounting Division
    - Management Accounting Division
    - MIS (Management Information System) Division
    - Sales Administration Division
    - Customer Relations Division
  - Sales Management Headquarters
    - Metropolitan Office
      - Chuo Sales Group 1
      - Chuo Sales Group 2
      - Josai Sales Group
      - Johoku Sales Group
      - Tama Sales Group
      - Keiyo Sales Group
      - Kanagawa Sales Group
      - Saitama Sales Group
    - Kansai Office
      - Osaka Northern Sales Group
      - Osaka Southern Sales Group
      - Kyoto Branch
      - Kobe Branch
      - Hiroshima Branch
      - Kansai Administration Division
    - Chubu Office
      - Nagoya Branch
      - Mikawa Branch
    - Sapporo Branch
    - Sendai Branch
    - Utsunomiya Branch
    - Fukuoka Branch
    - Large Account Sales Department
      - Metropolitan Sales Group
      - Kansai Sales Group
      - Local Branch Group
      - Large Account Sales Support Group
    - Business Alliance Department
      - Metropolitan Group
      - Kansai Group
      - Local Branch Group
    - MRO (Maintenance Repair & Operation) Department
      - MRO Sales Group
      - Merchandise Selection Group
      - System Planning Group
    - S&D (Shop & Direct) Sales Department
      - α Land Group
      - Sales Promotion Group
    - Hotel Business Department
      - (4 Hotels)
    - Area System Sales Group
    - Large Account CAD Sales Group
    - Corporate Telecommunications System Sales Group
    - Merchandising Group
    - Logistics Group
  - Marketing Planning Headquarters
    - Area Sales Promotion Group
    - Area System Sales Promotion Group
    - Telecommunications System Sales Promotion Group
    - Otsuka Document Solutions Promotion Group
    - Vertical Industry Sales Promotion Group
    - Sales Planning Group
    - CAD Sales Promotion Group
    - Technical Sales Promotion Group
    - Apple Promotion Group
    - Application Solution Center
    - Technical Solution Center
    - Customer Service Promotion Group
    - System Support Group
    - Web Business Promotion Group
    - Education Business Promotion Group
    - Kansai Computer Sales Promotion Group
    - Osaka Customer Service Promotion Group

Notes:

LA: Department responsible for computer sales to large, listed companies
Business Alliance: Department responsible for sales of computer-related products and services focusing on PCs
MRO: Department responsible for sales of all types of office supplies focusing on such consumables as paper and toner
S&D: Department responsible for both over-the-counter and Web sales
α Land: Store name with over-the-counter sales

CORPORATE DATA (As of March 31, 2002)

Name: OTSUKA CORPORATION

Date of Foundation: July 17, 1961 (Date of Establishment: December 13, 1961)

Paid-in Capital: ¥10,374,851,000

Number of Employees: 6,251 (Male 5,129/Female 1,122)

Business: **System Integration Business:** Sales of computers, copiers, communication equipments and software, and software development of consigned software.

Service and Support Business: Supplies, maintenance and educational support.

Head Office: 12-1, Misaki-cho 2-chome, Chiyoda-ku, Tokyo 101-8373, Japan
Phone: +81-3-3264-7111

Branches:
Metropolitan Office
Kansai Office
Chubu Office

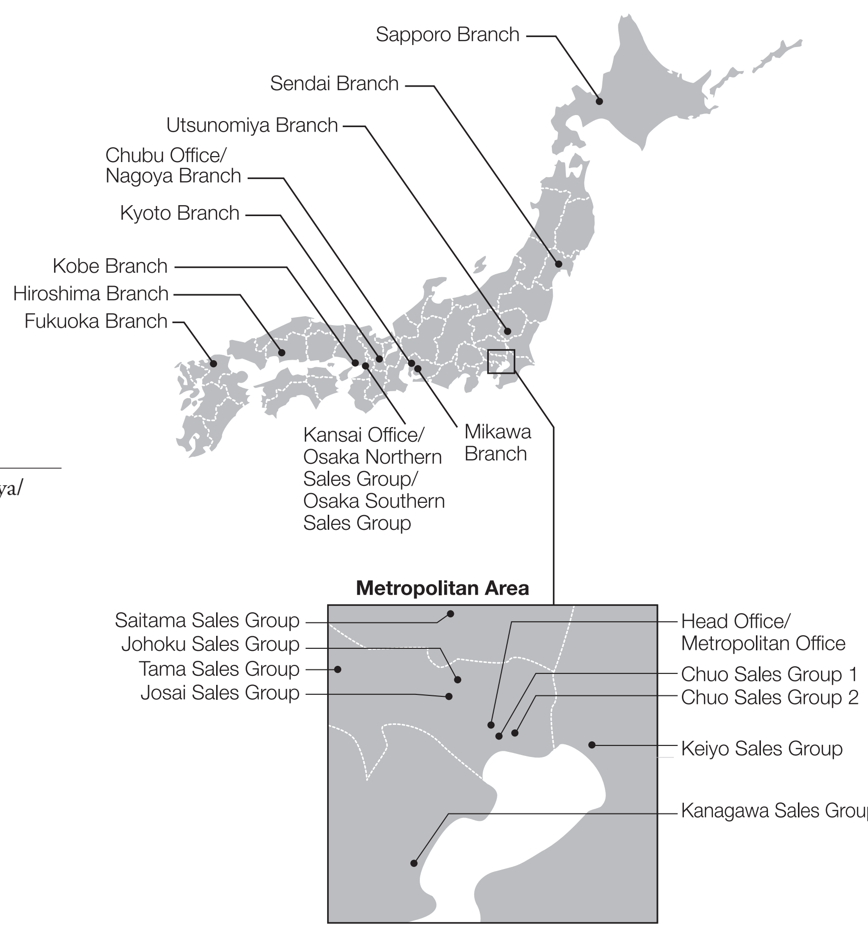
Department:
Large Account Sales Department
Business Alliance Department
MRO (Maintenance Repair & Operation) Department
S&D (Shop & Direct) Sales Department
Hotel Business Department

Offices:
Chuo Sales Group 1
Chuo Sales Group 2
Josai Sales Group
Johoku Sales Group
Tama Sales Group
Keiyo Sales Group
Kanagawa Sales Group
Saitama Sales Group
Osaka Northern Sales Group
Osaka Southern Sales Group

Local Branches:
Sapporo Branch
Sendai Branch
Utsunomiya Branch
Nagoya Branch
Mikawa Branch
Kyoto Branch
Kobe Branch
Hiroshima Branch
Fukuoka Branch

α Land: α Land Yaesu/α Land Utsunomiya/
α Land Midosuji

Overseas: Otsuka U.S.A. Inc.



PRINCIPAL GROUP COMPANIES (As of December 31, 2001)

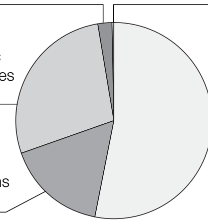
The OTSUKA Group (OTSUKA CORPORATION and its subsidiaries) consists of 22 subsidiaries, including 10 consolidated subsidiaries as well as 13 affiliated companies that carry out System Integration, Service and Support, and Other Business (construction, etc.). The 10 consolidated subsidiaries are listed below.

Company name	Date of establishment	Controlling share	Scope of business
System Integration (SI)			
OSK Co., LTD.	July 1984	100.0%	• Development, design, sale, and consulting for software • Education, guidance for IT-related systems
Netplan Co., LTD.	January 1987	100.0%	• Electronic communications construction and internal construction, sales of fixtures, etc.
Alpha System Co., LTD.	December 1967	100.0%	• Business and industry software development
10art-ni Corporation	May 1997	79.3%	• Integration using Linux-based systems • Java-based software development
Net World, INC.	August 1990	68.4%	• Sales and consulting for network peripheral equipment
AURORA-OTSUKA CORP.	August 1997	65.0%	• Sales and support of computer software, hardware, and network equipment
Service and Support (S&S)			
Alpha Net Inc.	October 1977	100.0%	• Total service and support for network systems • System engineering outsourcing
Alpha Techno Co., LTD.	February 1996	100.0%	• Emergency repair of PCs and peripheral equipment, data recovery, and elimination services
JPSS Co., LTD.	September 1996	92.4%	• Planning, development and provision of IT support and service
Other			
Fujimi Construction Co., LTD.	April 1964	100.0%	• Construction planning, execution, and oversight; maintenance of buildings and condominiums

INVESTOR INFORMATION (As of December 31, 2001)

Authorized Common Stock	112,860,000 shares
Issued Common Stock	31,667,020 shares
Number of Shares of Unit Stock	100 shares
Independent Auditor	Chuo-Aoyama Audit Corporation
Transfer Agent	The Chuo Mitsui Trust and Banking Co., Ltd. 33-1, Shiba 3-chome, Minato-ku, Tokyo 105-8574, Japan
Listing	The Tokyo Stock Exchange, First Section (Code: 4768)
Number of Shareholders	12,116

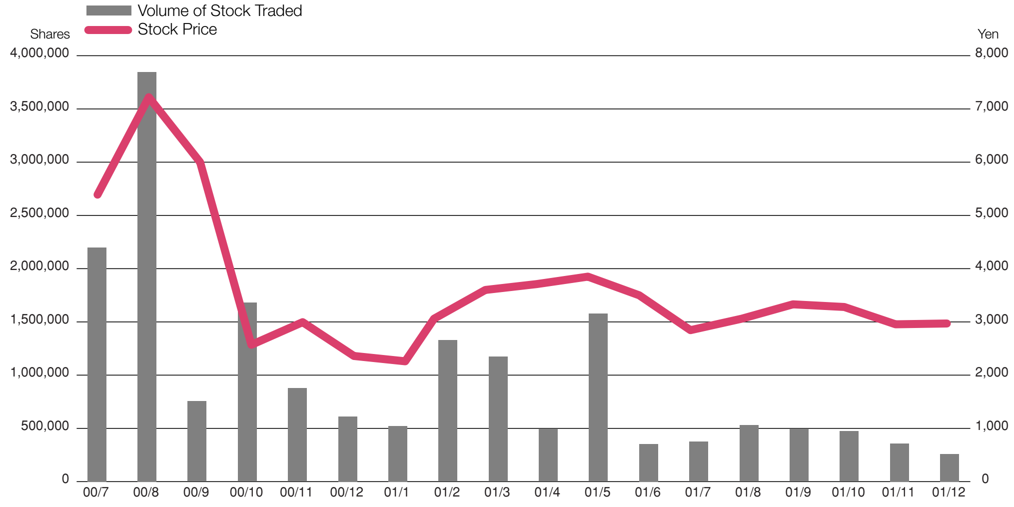
Breakdown of Shareholders



Major Shareholders

Name	Investment in OTSUKA CORPORATION		Investment in Major Shareholders by OTSUKA CORPORATION	
	Number of Shares Held	Equity Ownership (%)	Number of Shares Held	Equity Ownership (%)
Otsuka Sobi Co., Ltd.	8,112,730	25.61	—	—
Minoru Otsuka	2,765,490	8.73	—	—
Yuji Otsuka	2,622,580	8.28	—	—
OTSUKA CORPORATION Employee Stock-Sharing Plan	2,595,320	8.19	—	—
The Toyo Trust and Banking Company, Limited, Trust Account (A)	1,412,100	4.45	—	—
The Bank of Yokohama, Ltd.	720,840	2.27	382,204	0.03
Terue Otsuka	645,500	2.03	—	—
Atsushi Otsuka	485,550	1.53	—	—
Japan Trustee Services Bank, Ltd. Trust Account	352,900	1.11	—	—
The Bank of Tokyo-Mitsubishi, Ltd.	339,100	1.07	—	—

Stock Performance of OTSUKA CORPORATION



OTSUKA CORPORATION ANNUAL REPORT 2001

■ OTSUKA CORPORATION site	http://www.otsuka-shokai.co.jp
■ Office supplies purchasing site	http://www.tanomail.com/
■ Information provision services site for "Total α"	http://www.t-alpha.otsuka-shokai.co.jp/

Otsuka Corporation

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