Financial Section

Three-Year Financial Data

OTSUKA CORPORATION and Its Consolidated Subsidiaries
Years ended December 31, 2003, 2004 and 2005

	Millions of yen			Thousands of U.S. dollars
	2003	2004	**2005**	**2005**
Net sales	¥344,377	¥372,481	**¥409,413**	**$3,467,551**
System Integration Business	225,842	238,729	**258,275**	**2,187,479**
Service and Support Business	116,665	130,959	**149,100**	**1,262,815**
Other Business	1,869	2,792	**2,037**	**17,256**
Operating income	9,221	17,009	**21,911**	**185,576**
Recurring profit	9,055	17,036	**22,210**	**188,116**
Income before income taxes and minority interests	4,619	18,548	**20,552**	**174,074**
Net income	2,457	11,247	**11,747**	**99,494**
Total assets	162,144	167,228	**173,927**	**1,473,084**
Total interest-bearing debt	36,858	21,337	**11,695**	**99,059**
Total shareholders' equity	43,978	54,667	**58,920**	**499,030**
Net income per share (EPS) (Yen and U.S. dollars)	77.67	355.88	**371.72**	**3.15**
Dividends per share of common stock (Yen and U.S. dollars)	20.00	55.00	**75.00**	**0.64**
Cash flows from operating activities per share (Yen and U.S. dollars)	497.87	743.43	**710.97**	**6.02**
Operating income to net sales ratio (%)	2.68	4.57	**5.35**	—
Net income to net sales ratio (%)	0.71	3.02	**2.87**	—
Total interest-bearing debt ratio (%)	22.73	12.76	**6.72**	—
Shareholders' equity ratio (%)	27.12	32.69	**33.88**	—
Return on equity (ROE) (%)	5.69	22.80	**20.68**	—

Note:
Figures for ROE are calculated using average shareholders' equity.
U.S. dollar amounts are computed using the December 31, 2005 exchange rate of ¥118.07=US$1.

Management's Analysis of Operating Results & Financial Position

Summary of Sales and Profits

			Millions of yen	
	2004	**2005**	Difference to Last Year	% Change to Last Year
Net sales	¥372,481	**¥409,413**	+36,932	+9.9%
System Integration Business	238,729	**258,275**	+19,546	+8.2
Service & Support Business	130,959	**149,100**	+18,140	+13.9
Other Business	2,792	**2,037**	-755	-27.0
Cost of sales	285,655	**314,142**	+28,486	+10.0
Gross profit	86,825	**95,271**	+8,445	+9.7
Selling, general and administrative expenses	69,815	**73,360**	+3,544	+5.1
Operating income	17,009	**21,911**	+4,901	+28.8
Recurring profit	17,036	**22,210**	+5,174	+30.4
Income before income taxes and minority interests	18,548	**20,552**	+2,004	+10.8
Income taxes*	7,077	**8,575**	+1,498	+21.2
Net income	11,247	**11,747**	+500	+4.4

* Including adjustment amount for corporate and other taxes

Sales Summary

In the term under review, the System Integration Business and Service & Support Business both recorded robust sales, and overall, consolidated subsidiaries also did well. As a result, consolidated net sales rose 9.9%, to a record ¥409,413 million.

System Integration Business

The System Integration Business provides optimized system services ranging from consulting to system design and development, transport, installation, and network construction. By focusing resources on the innovative "ODS21" knowledge management system and the "SMILE series" of integrated mission-critical operational system, sales of personal computers, servers and information security-related products remained brisk, resulting in an increase of 8.2% in net sales, to ¥258,275 million.

Service & Support Business

The Service & Support Business follows up system installation by providing total support that includes the provision of supplies, hardware and software maintenance, telephone support, and IT education.

Website and catalog sales by the "tanomail" office supply mail-order service business continued to do well, and OA supplies again posted strong growth. A solid performance was also turned in by the maintenance business, which includes information security-related services. As a result, net sales grew 13.9%, to ¥149,100 million.

Other Business

In Other Business, net sales decreased 27.0%, to ¥2,037 million.

Summary of Income and Expenses

Although cost of sales rose 10.0%, to ¥314,142 million, gross profit increased 9.7%, to ¥95,271 million, a rise attributable to the increase in net sales.

Operating income rose 28.8%, to ¥21,911 million, against the backdrop of the increase in gross profit and an 0.8 percentage point decline in SG&A expenses to net sales, to 17.9%. As a result, the ratio of operating income to net sales improved 0.8 percentage point.

Recurring profit reached a record high for the fifth-straight fiscal year, rising 30.4%, to ¥22,210 million, following a decrease in other expenses brought about by lower interest expenses.

Although there was ¥1,668 million in amortization of the transition amount arising from the adoption of new accounting standards for retirement benefits, income before income taxes and minority interests increased 10.8%, to ¥20,552 million owing to the rise in recurring profit.

In aggregate, the Company absorbed the effect of the preceding term's extraordinary income of ¥5,481 million associated with the gain from the exemption from the obligation under the substitutional portion of the social welfare pension fund, and posted an increase of 4.4% in net income, to ¥11,747 million. Net income per share was ¥371.72, up from ¥355.88 in the preceding fiscal year.

Financial Position

Millions of yen

	2004	**2005**	Difference to Last Year	% Change to Last Year
Assets:	¥167,228	**¥173,927**	+6,698	+4.0%
Current assets	87,984	**100,396**	+12,411	+14.1
Fixed assets	79,244	**73,530**	-5,713	-7.2
Liabilities:	111,463	**113,647**	+2,183	+2.0
Current liabilities	100,409	**99,655**	-753	-0.8
Long-term liabilities	11,054	**13,991**	+2,937	+26.6
Minority interests	1,098	**1,359**	+261	+23.8
Shareholders' equity	54,667	**58,920**	+4,253	+7.8

Assets

Total assets increased ¥6,698 million, to ¥173,927 million. Current assets rose ¥12,411 million, to ¥100,396 million, as the good results achieved by the Company were reflected by increases in cash, time deposits and other cash equivalents and accounts and notes receivable. Fixed assets decreased ¥5,713 million to ¥73,530 million, due in part to the liquidation of deferred tax assets on revaluation of land.

Liabilities

Total liabilities rose ¥2,183 million, to ¥113,647 million. Current liabilities declined ¥753 million, to ¥99,655 million. This is attributable to the fact that while there were increases in notes and trade payables, income taxes payable and other items, there was also a decrease in short-term bank loans. Long-term liabilities increased ¥2,937 million to ¥13,991 million.

Shareholders' Equity

Shareholders' equity grew ¥4,253 million, to ¥58,920 million. This growth occurred despite a decrease in excess of land revaluation after tax-effect accounting following the liquidation of deferred tax assets on revaluation of land, and is mainly attributable to an increase in retained earnings. As a result, the shareholders' equity ratio rose 1.2 percentage points, to 33.9%.

The interest coverage ratio was 129.08 times; the interest-bearing debt ratio was 6.72%; return on assets (ROA) was 12.88%; and return on equity (ROE) was 20.68%.

	2004	**2005**
Interest coverage ratio (times)	48.94	**129.08**
Interest-bearing debt ratio (%)	12.76	**6.72**
ROA* (%)	10.36	**12.88**
ROE (%)	22.80	**20.68**

* ROA = Business profit/total assets (average during the year)
Business profit = Operating income + interest received + dividends received

Cash flows

	Millions of yen	
	2004	**2005**
Cash flows from operating activities	¥23,494	**¥22,468**
Cash flows from investing activities	-3,245	**-4,986**
Cash flows from financing activities	-15,617	**-11,338**
Cash and cash equivalents at end of year	7,717	**13,891**

Cash Flows from Operating Activities

Cash provided by operating activities decreased ¥1,026 million (4.4%) to ¥22,468 million. This happened even though income before income taxes and minority interests increased, and is mainly attributable to a rise in accounts and notes receivable.

Cash Flows from Investing Activities

Cash used in investing activities increased ¥1,740 million (53.6%), to ¥4,986 million, due mainly to proceeds from the sale of property, plant and equipment in the preceding term.

Cash Flows from Financing Activities

Cash used in financing activities decreased ¥4,279 million (27.4%) to ¥11,338 million. This is attributable mainly to expenditures made to redeem corporate bonds in the preceding term.

Free cash flows that are the sum of cash provided by operating activities and cash used in investing activities, decreased ¥2,766 million, to ¥17,482 million.

Outlook

Consolidated projections for the current fiscal year ending December 31, 2006, are as follows: a 5.0% increase in net sales, to ¥430 billion, an 8.6% rise in operating income, to ¥23.8 billion, an 8.1% increase in recurring profit, to ¥24 billion, and a 12.4% rise in net income, to ¥13.2 billion.

Consolidated Balance Sheets

OTSUKA CORPORATION and Its Consolidated Subsidiaries
December 31, 2004 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2004	**2005**	**2005**
ASSETS			
Current assets			
Cash, time deposits and other cash equivalents (Notes 11 and 15)	¥ 9,043	**¥ 14,507**	**$ 122,869**
Accounts and notes receivable:			
Trade	54,415	**60,515**	**512,541**
Unconsolidated subsidiaries and affiliates	11	**2**	**25**
Other	3,383	**2,763**	**23,401**
	57,810	**63,281**	**535,968**
Less: Allowance for bad debts	(299)	**(283)**	**(2,404)**
	57,511	**62,997**	**533,564**
Inventories (Note 6)	16,277	**16,652**	**141,036**
Deferred tax assets (Note 10)	1,794	**2,151**	**18,224**
Other current assets	3,357	**4,086**	**34,614**
Total current assets	87,984	**100,396**	**850,309**
Investments and advances			
Investments in securities (Note 4)	2,943	**4,568**	**38,693**
Investments in unconsolidated subsidiaries and affiliates	379	**408**	**3,458**
Guarantee deposits	2,699	**2,763**	**23,406**
Deferred tax assets non-current (Note 10)	2,437	**2,579**	**21,850**
Deferred tax assets on revaluation of land	6,228	**—**	**—**
Other investments	4,960	**5,132**	**43,466**
Less: Allowance for bad debts	(786)	**(830)**	**(7,037)**
	18,862	**14,621**	**123,838**
Property, plant and equipment (Notes 14 and 15)			
Land	17,592	**17,592**	**148,999**
Buildings and structures	65,111	**65,841**	**557,645**
Construction in progress	—	**63**	**536**
Others	11,218	**12,242**	**103,691**
	93,923	**95,739**	**810,872**
Less: Accumulated depreciation	(39,325)	**(42,094)**	**(356,520)**
Net property, plant and equipment	54,598	**53,645**	**454,352**
Intangibles and deferred charges			
Software	5,197	**4,830**	**40,909**
Others	586	**433**	**3,674**
	5,783	**5,264**	**44,584**
Total assets	¥167,228	**¥173,927**	**$1,473,084**

The accompanying notes are an integral part of these statements.

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2004	**2005**	**2005**
LIABILITIES, MINORITY INTERESTS AND SHAREHOLDERS' EQUITY			
Current liabilities			
Short-term bank loans (Note 7)	¥ 13,850	**¥ 7,600**	**$ 64,368**
Current maturities of long-term debts (Note 7)	6,208	**891**	**7,553**
Accounts and notes payable:			
Trade	42,918	**46,932**	**397,497**
Unconsolidated subsidiaries and affiliates	232	**146**	**1,242**
Other	20,531	**22,251**	**188,461**
	63,682	**69,330**	**587,201**
Income taxes payable (Note 10)	3,112	**7,447**	**63,073**
Other current liabilities	13,555	**14,385**	**121,839**
Total current liabilities	100,409	**99,655**	**844,036**
Long-term liabilities			
Long-term debt (Note 7)	1,279	**3,204**	**27,137**
Reserve for retirement benefits (Note 8)	9,572	**10,277**	**87,049**
Deferred tax liabilities non-current (Note 10)	26	**29**	**248**
Deferred tax liabilities on revaluation of land	—	**267**	**2,269**
Other long-term liabilities	176	**212**	**1,799**
	11,054	**13,991**	**118,503**
Minority interests in consolidated subsidiaries	1,098	**1,359**	**11,513**
Contingent liabilities (Note 9)			
Shareholders' equity			
Common stock:			
Authorized: 112,860,000 shares			
Outstanding: December 31, 2004 31,667,020 shares			
December 31, 2005 31,667,020 shares	10,374	**10,374**	**87,870**
Capital surplus	16,254	**16,254**	**137,670**
Retained earnings	36,932	**46,941**	**397,575**
Excess of land revaluation after tax-effect accounting (Note14)	(9,075)	**(15,572)**	**(131,893)**
Unrealized gain on investment securities after tax-effect accounting	413	**1,109**	**9,397**
Foreign currency translation adjustment	(122)	**(74)**	**(626)**
Less: Treasury stock			
December 31, 2004 63,990 shares			
December 31, 2005 64,431 shares	(109)	**(113)**	**(963)**
Total shareholders' equity	54,667	**58,920**	**499,030**
Total liabilities, minority interests and shareholders' equity	¥167,228	**¥173,927**	**$1,473,084**

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, 2004 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2004	**2005**	**2005**
Net sales (Note 18)	¥372,481	**¥409,413**	**$3,467,551**
Cost of sales (Notes 17 and 18)	285,655	**314,142**	**2,660,646**
Gross profit	86,825	**95,271**	**806,904**
Selling, general and administrative expenses (Notes 17 and 18)	69,815	**73,360**	**621,327**
Operating income	17,009	**21,911**	**185,576**
Other income (expenses)			
Interest and dividend income	54	**61**	**519**
Interest expenses	(348)	**(170)**	**(1,441)**
Gain on sale of investments in securities	9	**—**	**—**
Gain on sale of investments in subsidiaries and affiliates	456	**86**	**732**
Transfer from allowance for bad debts	93	**16**	**136**
Gain from the exemption from the obligation under the substitutional portion of social welfare pension fund	5,481	**—**	**—**
Dilution gain from change in equity interest	248	**13**	**114**
Loss on sale / disposal of property, plant and equipment	(808)	**(99)**	**(844)**
Impairment losses(Notes 2(16), 16)	(1,491)	**—**	**—**
Loss on sale of investments in securities	—	**(4)**	**(42)**
Loss on revaluation of investments in securities	(253)	**—**	**—**
Loss on sale of investments in subsidiaries and affiliates	(26)	**—**	**—**
Loss on revaluation of membership	(23)	**(1)**	**(12)**
Amortization of transition amount arising from adopting new accounting standard for retirement benefits	(1,724)	**(1,668)**	**(14,127)**
Losses on the settlement of the retirement benefits plan	(448)	**—**	**—**
Other, net	321	**408**	**3,462**
	1,538	**(1,358)**	**(11,502)**
Income before income taxes and minority interests	18,548	**20,552**	**174,074**
Income taxes (Note 10)			
Current	5,040	**9,569**	**81,052**
Deferred	2,036	**(994)**	**(8,420)**
	7,077	**8,575**	**72,632**
Minority interests in net gains of consolidated subsidiaries	224	**229**	**1,946**
Net income	¥ 11,247	**¥ 11,747**	**$ 99,494**

	yen		U.S. dollars (Note 3)
Net income and dividends per share (Note 2(14))			
Net income	¥355.88	**¥371.72**	**$3.15**
Cash dividends	55.00	**75.00**	**0.64**

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, 2004 and 2005

	Number of shares of common stock	Common stock	Capital surplus	Retained earnings	Excess of land revaluation	Unrealized gain on investment securities	Foreign currency translation adjustment	Treasury stock
		Millions of yen						
Balance at December 31, 2003	31,667,020	¥10,374	¥16,254	¥29,485	¥(12,219)	¥ 325	¥(133)	¥(108)
Sale of land	—	—	—	(3,143)	3,143	—	—	—
Retirement of treasury stocks relating to merger	—	—	—	(24)	—	—	—	—
Unrealized gain on investment securities	—	—	—	—	—	88	—	—
Foreign currency translation adjustment	—	—	—	—	—	—	11	—
Net income for the year	—	—	—	11,247	—	—	—	—
Cash dividends paid	—	—	—	(632)	—	—	—	—
Purchase of treasury stock	—	—	—	—	—	—	—	(0)
Balance at December 31, 2004	31,667,020	¥10,374	¥16,254	¥36,932	¥ (9,075)	¥ 413	¥(122)	¥(109)
Excess of land revaluation	**—**	**—**	**—**	**—**	**(6,496)**	**—**	**—**	**—**
Unrealized gain on investment securities	**—**	**—**	**—**	**—**	**—**	**696**	**—**	**—**
Foreign currency translation adjustment	**—**	**—**	**—**	**—**	**—**	**—**	**48**	**—**
Net income for the year	**—**	**—**	**—**	**11,747**	**—**	**—**	**—**	**—**
Cash dividends paid	**—**	**—**	**—**	**(1,738)**	**—**	**—**	**—**	**—**
Purchase of treasury stock	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**(3)**
Balance at December 31, 2005	**31,667,020**	**¥10,374**	**¥16,254**	**¥46,941**	**¥(15,572)**	**¥1,109**	**¥ (74)**	**¥(113)**

	Number of shares of common stock	Common stock	Capital surplus	Retained earnings	Excess of land revaluation	Unrealized gain on investment securities	Foreign currency translation adjustment	Treasury stock
		Thousands of U.S. dollars (Note 3)						
Balance at December 31, 2004	31,667,020	$87,870	$137,670	$312,802	$ (76,866)	$3,499	$(1,040)	$ (929)
Excess of land revaluation	**—**	**—**	**—**	**—**	**(55,026)**	**—**	**—**	**—**
Unrealized gain on investment securities	**—**	**—**	**—**	**—**	**—**	**5,897**	**—**	**—**
Foreign currency translation adjustment	**—**	**—**	**—**	**—**	**—**	**—**	**413**	**—**
Net income for the year	**—**	**—**	**—**	**99,494**	**—**	**—**	**—**	**—**
Cash dividends paid	**—**	**—**	**—**	**(14,721)**	**—**	**—**	**—**	**—**
Purchase of treasury stock	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**(33)**
Balance at December 31, 2005	**31,667,020**	**$87,870**	**$137,670**	**$397,575**	**$(131,893)**	**$9,397**	**$ (626)**	**$ (963)**

The accompanying notes are an integral part of these statements.

Consolidated Statements of Cash Flows

OTSUKA CORPORATION and Its Consolidated Subsidiaries
December 31, 2004 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2004	**2005**	**2005**
Cash flows from operating activities:			
Income before income taxes and minority interests	¥18,548	**¥20,552**	**$174,074**
Depreciation and amortization	6,162	**6,066**	**51,379**
Amortization of difference between cost of investment and equity in net assets of consolidated subsidiaries	37	**20**	**169**
Increase(decrease) in reserve for retirement benefits	(4,531)	**1,100**	**9,322**
Increase(decrease) in allowance for bad debts	(179)	**28**	**242**
Interest and dividend income	(54)	**(61)**	**(519)**
Interest expenses	348	**170**	**1,441**
Loss on sale / disposal of property, plant and equipment	808	**99**	**844**
Impairment losses	1,491	**—**	**—**
Gain on sale of investments in subsidiaries and affiliates	(456)	**(86)**	**(732)**
Loss on sale of investments in securities	—	**4**	**42**
Loss on revaluation of investments in securities	253	**—**	**—**
Loss on revaluation of membership	23	**1**	**12**
Dilution gain from change in equity interest	(248)	**(13)**	**(114)**
Increase in accounts and notes receivable	(2,995)	**(5,249)**	**(44,458)**
Decrease (increase) in inventories	292	**(367)**	**(3,109)**
Increase in accounts and notes payable	7,544	**4,178**	**35,387**
Other	1,087	**1,764**	**14,940**
Subtotal	28,132	**28,209**	**238,922**
Interest and dividend income received	55	**61**	**522**
Interest expenses paid	(351)	**(169)**	**(1,438)**
Income taxes paid	(4,341)	**(5,632)**	**(47,708)**
Net cash provided by operating activities	23,494	**22,468**	**190,298**
Cash flows from investing activities:			
Payments for purchase of property, plant and equipment	(3,081)	**(2,561)**	**(21,693)**
Proceeds from sale of property, plant and equipment	1,482	**11**	**95**
Payments for software developed	(1,877)	**(2,166)**	**(18,353)**
Payments for purchase of investments in securities	(367)	**(357)**	**(3,030)**
Proceeds from sale of investments in securities	79	**144**	**1,221**
Proceeds from sale of investments in consolidated subsidiaries(Note 11(3))	449	**—**	**—**
Payments for long-term loans receivable	(5)	**(6)**	**(56)**
Proceeds from long-term loans receivable	28	**4**	**41**
Other	45	**(53)**	**(453)**
Net cash used in investing activities	(3,245)	**(4,986)**	**(42,230)**
Cash flows from financing activities:			
Decrease in short-term bank loans, net	(8,910)	**(6,250)**	**(52,934)**
Proceeds from long-term debts	1,800	**2,900**	**24,561**
Repayments for long-term debts	(8,378)	**(6,291)**	**(53,285)**
Proceeds from issue of new shares	520	**63**	**538**
Cash dividends paid	(633)	**(1,737)**	**(14,718)**
Other	(15)	**(22)**	**(190)**
Net cash used in financing activities	(15,617)	**(11,338)**	**(96,028)**
Effect of exchange rate changes on cash and cash equivalents	3	**29**	**253**
Net Increase in cash and cash equivalents	4,635	**6,174**	**52,292**
Cash and cash equivalents at beginning of year	3,020	**7,717**	**65,359**
Increase in cash and cash equivalents due to merger (Note 11(2))	60	**—**	**—**
Cash and cash equivalents at end of year (Note 11(1))	¥ 7,717	**¥13,891**	**$117,652**

The accompanying notes are an integral part of these statements.

1. Basis of Presenting the Consolidated Financial Statements

Accounting Principles

The accompanying consolidated financial statements of OTSUKA CORPORATION (the "Company") and its subsidiaries are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements from International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company as required by the Securities and Exchange Law of Japan.

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 16 subsidiaries (majority-owned companies) and 15 subsidiaries as at December 31, 2004 and 2005, respectively. The consolidated financial statements include the accounts of the Company and 11 subsidiaries and 11 subsidiaries for the years ended December 31, 2004 and 2005, respectively.

The 11 subsidiaries which were consolidated in the year ended December 31, 2005 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 Co., LTD.	100.0%
Otsuka Information Technology Corp.	100.0%
Otsuka Auto Service Co., LTD	100.0%
Net World Corporation	68.4%
Otsuka Business Service Co., LTD.	65.0%
10art-ni Corporation	52.8%

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

Generally, Companies that are owned more than 50 % are classified as subsidiaries and companies that are owned more than 20 % are classified as affiliates. However, companies that are owned between 40 % and 50 % may also be classified as subsidiaries and companies that are owned between 15 % and 20 % may also be classified as affiliates, if the Company substantially controls the investees' management or has significant influence and relationships with the investees, respectively.

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

The accounts of the remaining 5 and 4 unconsolidated subsidiaries as at December 31, 2004 and 2005, respectively, consisted of insignificant amounts in terms of total assets, net sales, net income and retained earnings, and have, therefore, been excluded from consolidation.

(Fiscal year 2004)
JPSS Co., LTD. were excluded from consolidation from this fiscal year due to the sale of ownership.

(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 eliminated in full, 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 the net assets of such subsidiaries, any difference between such investment costs and the amount of underlying equity in the 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 5 unconsolidated subsidiaries and 6 affiliates at December 31, 2004 and 4 unconsolidated subsidiaries and 10 affiliates at December 31, 2005.

No investments in affiliates for the years ended December 31, 2004 and 2005, 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 impact on consolidated net income and retained earnings in the consolidated financial statements.

(4)Translation of foreign currency

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.

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 adjustment” in shareholders' equity.

(5) Cash and cash equivalents

Cash and cash equivalents in the consolidated statements of cash flows are composed of cash in 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 methods according to the category of inventories as follows:

Merchandise and maintenance parts:	Merchandise and maintenance parts are stated at cost mainly determined by the moving-average method
Work-in-process:	Work-in-process is stated at cost determined by the individual cost method
Supplies:	Supplies are stated at cost determined by the latest purchase price

(7)Financial instruments

(a) Securities

Securities held by the Company and its subsidiaries are 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.In exceptional cases, investments in certain unconsolidated subsidiaries and affiliates are stated at cost, determined by the moving-average method, because the effect of application of the equity method would be immaterial.

• Other securities

Securities with market quotations are stated at fair value, based on market prices at the balance sheet date. (Unrealized gains/losses from valuation of marketable securities are charged directly to shareholders’ equity at a net-of-tax amount, while cost of sale is determined by the moving-average method.)

Securities without market quotations are stated at cost; this is calculated by the moving-average method.

Regarding investments in limited partnerships and similar investments, which are accounted for as “investment securities” in the consolidated balance sheet effective from the fiscal year ended December 31, 2005, under Article 2-2 of Securities and Exchange Law, an amount equivalent to the Company’s partnership investment gain or loss under the equity method of accounting, with such a gain or loss being based on the latest available financial statements of the corresponding limited partnerships, was recognized in the consolidated financial statements for the fiscal year ended December 31, 2005.

(b) Derivatives

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.

Also, if interest rate swap contracts are used as a hedge and meet certain hedging criteria, the amount to be paid or received under the interest rate swap contract is added to or deducted from the interest on the assets or liabilities for which the swap contract was executed.

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

The Companies have a policy to utilize the above hedging instruments in order to reduce the Companies’ exposure to the risks 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 the 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.

(8)Property, plant and equipment

Depreciation is computed using the declining-balance method, at rates based on the estimated useful lives of assets, which are prescribed by 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

Leases that transfer substantially all the risks and rewards of ownership of the assets to lessees are accounted for as capital leases, except that leases that do not transfer ownership of the assets at the end of the lease term are accounted for as operating leases, in accordance with accounting principles and practices generally accepted in Japan.

(10)Software

The amortization of costs of software developed for external sales is computed at an amount based on the ratio of actual sales during the year to total estimated sales for the estimated salable period. However, the amortization costs should not be lower than the amount computed based on asset purchase value on a straight-line basis over the estimated remaining useful life of the asset, which is 3 years.

Software developed for internal use is amortized on a straight-line basis over the estimated useful life of the asset, which is 5 years.

(11)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 have 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.

(12)Allowance for bad debts

An allowance for bad debts is provided at an amount of potential losses from uncollectable receivables based on the actual historical rate of losses from bad debts for ordinary receivables, and on the estimated recoverability of specific doubtful receivables.

(13)Reserve for retirement benefits

(a) Retirement benefits for employees

The reserve for retirement benefits represents the estimated present value of projected benefit obligations in excess of the fair value of the plan assets, except that the unrecognized transition amount arising from adopting the new accounting standard is amortized on a straight-line basis over 5 years, the unrecognized actuarial differences are amortized on a straight-line basis over a period of 12 years from year following the year in which they arise, and the unrecognized prior service cost is amortized on a straight-line basis over a period of 12 years.

(Fiscal year 2004)
On February 1, 2004, the Company and certain domestic subsidiaries were granted the approval by the government relieving them of the obligation to pay benefits related to past employee services under the substitutional portion. Since then on August 17, 2004, the Company and 7 consolidated subsidiaries had restituted substitutional portion.

On April, 2004, the Company and certain of its subsidiaries changed the type of a termination allowance plan.

(b) Retirement benefits for directors
The Company and 6 consolidated subsidiaries have provided for accrued retirement benefits to directors at an amount equivalent to 100% of the benefits the Company would be required to pay, had all eligible directors retired at the balance sheet date.

(Fiscal year 2004)
Along with the maintenance of bylaw, 4 consolidated subsidiaries have provided for accrued retirement benefits to directors from this fiscal year. The effect is negligible.

(Fiscal year 2005)
Along with the maintenance of bylaw, 2 consolidated subsidiaries have provided for the accrued retirement benefits to directors from this fiscal year. This effect is negligible.

(14)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.

(15)Accounting for the consumption tax
The Japanese Consumption Tax Law generally imposes 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, but is offset against the balance withheld, and the net balance is included in “Other current liabilities” in the consolidated balance sheets.

(16) Change of accounting policy
(Fiscal year 2004)
Accounting standard for impairment of Fixed Assets
On August 9, 2002, the Business Accounting Council in Japan issued “Accounting Standard for Impairment of Fixed Assets.” The standard requires that fixed assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss shall be recognized in the income statement by reducing the carrying amount of impaired assets or a group of assets to the recoverable amount to be measured as the higher of net selling price and value in use.
The standard shall be effective for fiscal years beginning April 1, 2005. However, earlier adoption is permitted for fiscal years beginning January 1, 2005 and for fiscal years ending between December 31, 2004 and December 30, 2005.
The Company and its subsidiaries adopted this standard with effect from the year ended December 31, 2004. As a result of this adoption, income before income taxes decreased by 1,491 million yen. The impairment loss was included in accumulated depreciation.

(17) Change of presentation
(Fiscal year 2005)
In accordance with the “Law for the Partial Revision of the Securities and Exchange Law etc.” (Low No.97 of June 9, 2004), effective from December 1, 2004, and the revision of the “Practical Guidelines Concerning Accounting for

Financial Instruments" (Accounting Committee Report No.14) on February 15, 2005, the investments in investment limited liability partnerships or similar partnerships (Which are defined as securities under the Securities and Exchange Law) are changed to be presented as the "Investments in securities". The relevant amount included in "Investments in securities" is ¥182 million (1,544 thousand U.S. dollars) at December 31, 2005 and these amount included in "Other investments" was ¥183 million at December 31, 2004.

(18) Rounding of amounts

Rounding down sums of less than a million yen.

3. U.S. Dollar Amounts

Amounts in U.S. dollars are included solely for the convenience of readers outside Japan. The rate of ¥118.07=US$1, the rate of exchange on December 31, 2005, 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, 2004 and 2005 investments in securities were as follows:

(1) Other securities with fair value

	Millions of yen						Thousands of U.S. dollars		
	2004			2005			2005		
	Cost	Carrying amount	Differences	Cost	Carrying amount	Differences	Cost	Carrying amount	Differences
Fair value greater than cost									
Stocks	¥ 747	¥1,444	¥697	**¥1,316**	**¥3,087**	**¥1,771**	**$11,146**	**$26,152**	**$15,005**
Bonds	—	—	—	**—**	**—**	**—**	**—**	**—**	**—**
Other securities	38	62	24	**89**	**182**	**93**	**757**	**1,549**	**792**
	¥ 785	¥1,506	¥721	**¥1,405**	**¥3,270**	**¥1,865**	**$11,904**	**$27,702**	**$15,798**
Fair value less than or equal to cost									
Stocks	¥ 350	¥ 333	¥(17)	**¥ 1**	**¥ 1**	**¥ (0)**	**$ 16**	**$ 11**	**$ (4)**
Bonds	—	—	—	**—**	**—**	**—**	**—**	**—**	**—**
Other securities	51	50	(0)	**—**	**—**	**—**	**—**	**—**	**—**
	¥ 401	¥ 384	¥(17)	**¥ 1**	**¥ 1**	**¥ (0)**	**$ 16**	**$ 11**	**$ (4)**
Total	¥1,187	¥1,890	¥703	**¥1,407**	**¥3,272**	**¥1,864**	**$11,920**	**$27,714**	**$15,793**

(2) Other securities sold in 2004 and 2005 (for the years ended December 31, 2004 and 2005)

	Millions of yen						Thousands of U.S. dollars		
	2004			2005			2005		
	Amount for sale	Total gains on sale	Total losses on sale	Amount for sale	Total gains on sale	Total losses on sale	Amount for sale	Total gains on sale	Total losses on sale
	¥79	¥9	¥0	**¥2**	**—**	**¥4**	**$18**	**—**	**$42**

(3) Securities not stated at fair value

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
	Stated amount on consolidated balance sheets	Stated amount on consolidated balance sheets	Stated amount on consolidated balance sheets
Other securities			
Unlisted stocks	¥1,040	**¥1,068**	**$9,050**
Mid-term government bonds fund	2	**—**	**—**
Foreign currency-denominated mutual fund	—	**35**	**300**
Preferred subscription certification	10	**10**	**84**
Investment limited liability partnerships	—	**182**	**1,544**

(4) Prospected amounts of redemption of other securities with maturity dates subsequent to the consolidated balance sheet dates

	Millions of yen				Thousands of U.S. dollars	
	2004		**2005**		**2005**	
	Within one year	More than one year	Within one year	More than one year	Within one year	More than one year
Others	—	¥10	**—**	**¥10**	**—**	**$84**
Total	—	¥10	**—**	**¥10**	**—**	**$84**

5. Derivative Information

At December 31,2004 and 2005 derivatives were as follows:

Currency

	Millions of yen			
	2004			
	Contractual value or notional principal amount			
	Total	Over one year	Fair value	Valuation gain(loss)
Currency swap Purchased U.S.dollar	¥377	¥377	¥328	¥(48)

	Millions of yen			
	2005			
	Contractual value or notional principal amount			
	Total	Over one year	Fair value	Valuation gain(loss)
Currency swap Purchased U.S.dollar	**¥377**	**¥266**	**¥379**	**¥1**

	Thousands of U.S. dollars			
	2005			
	Contractual value or notional principal amount			
	Total	Over one year	Fair value	Valuation gain(loss)
Currency swap Purchased U.S.dollar	**$3,195**	**$2,255**	**$3,210**	**$14**

(Note)

Except for derivatives that are designed as hedging instruments

6. Inventories

Inventories at December 31, 2004 and 2005 comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
Merchandise and maintenance parts	¥15,356	**¥15,766**	**$133,536**
Work-in-process	746	**763**	**6,462**
Supplies	173	**122**	**1,037**
	¥16,277	**¥16,652**	**$141,036**

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

The annual average interest rates applicable to short-term bank loans at December 31, 2004 and 2005 were 0.74% and 0.75%, respectively.

Long-term debt at December 31, 2004 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
Long-term loans from banks with annual interest rates from 0.66% to 2.25%	¥7,487	**¥4,095**	**$34,690**
	7,487	**4,095**	**34,690**
Less : Current maturities of long-term debts	(6,208)	**(891)**	**(7,553)**
	¥1,279	**¥3,204**	**$27,137**

Aggregate annual maturities of long-term debt subsequent to December 31, 2005 are as follows:

Year ending December 31	Millions of yen	Thousands of U.S. dollars
2006	¥891	$7,553
2007	622	5,274
2008	2,581	21,862
	¥4,095	$34,690

8. Reserve for Retirement Benefits

(1) Retirement benefit plan

(Fiscal year 2004)

The Company and certain of its subsidiaries operate a fund-type corporate pension plan, an agreement type corporate pension plan and a termination allowance plan as defined-benefit pension plans.

(Fiscal year 2005)

The Company and certain of its subsidiaries operate a fund type corporate pension plan, an agreement type corporate pension plan and a termination allowance plan as defined-benefit pension plans.

(2) The reserve for retirement benefits as of December 31, 2004 and 2005 is analyzed as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
Projected benefit obligations	¥(35,894)	**¥(38,389)**	**$(325,143)**
Plan assets	27,708	**36,958**	**313,025**
	(8,186)	**(1,430)**	**(12,117)**
Unrecognized transition amount	1,668	**—**	**—**
Unrecognized prior service cost	(7,770)	**(7,079)**	**(59,962)**
Unrecognized actuarial differences	8,758	**1,877**	**15,905**
	(5,530)	**(6,632)**	**(56,175)**
Prepaid pension cost	(3,734)	**(3,261)**	**(27,620)**
Reserve for retirement benefits	¥ (9,264)	**¥ (9,893)**	**$ (83,795)**

The balance of the reserve for retirement benefits in the accompanying consolidated balance sheets at December 31, 2004 and 2005 included retirement benefits for directors in the amounts of 307 million yen and 384 million yen (3,253 thousand U.S. dollars), respectively.

(3) Pension expense related to the retirement benefits for the year ended December 31, 2004 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
Service cost	¥2,708	**¥2,910**	**$24,649**
Interest cost	667	**527**	**4,463**
Expected return on plan assets	(1,128)	**(554)**	**(4,693)**
Amortization of transition amount	1,724	**1,668**	**14,127**
Amortization of the unrecognized prior service cost	(539)	**(690)**	**(5,850)**
Amortization of the unrecognized actuarial differences	530	**831**	**7,044**
Additional benefits for employees' early retirement	—	**126**	**1,074**
Net pension expense	¥3,963	**¥4,819**	**$40,815**
Gain from the exemption from the obligation under the substitutional portion of social welfare pension fund	(5,481)	**—**	**—**
Loss on the settlement of the retirement benefits plan	448	**—**	**—**

Service cost includes the pension costs of subsidiaries under the simplified method

(4) Computation Basis of Pension Liabilities

As of December 31, 2004 and 2005

	2004	**2005**
Discount rate	1.5%	**1.5%**
Expected rate of return on plan assets	3.7%	**2.0%**
Periodic allocation principle for projected benefit obligation	Standard of fixed-amount-for-period	**Standard of fixed-amount-for-period**
Amortization of unrecognized prior service cost	12 years	**12 years**
Amortization of transition amount	5 years	**5 years**
Amortization of unrecognized actuarial differences	12 years from the fiscal year following occurrence	**12 years from the fiscal year following occurrence**

9. Contingent Liabilities

The Company was contingently liable for guarantees of loans at December 31, 2004 and 2005 as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
Loans taken out by:			
NACOS COMPUTER SYSTEMS CORP.	¥40	**—**	**—**
	¥40	**—**	**—**

10. Income Taxes

The statutory tax rate used for calculating deferred tax assets and liabilities at December 31, 2005 was 40.7%.

Since the difference between the statutory tax rate (40.7%) and the effective tax rate (41.7%) for the fiscal year ended December 31, 2005 is less than 5%, a reconciliation of these two rates are not presented.

At December 31, 2004 and 2005, significant components of the deferred tax assets and liabilities were as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
Deferred tax assets:			
Allowance for bad debts	¥ 208	**¥ 248**	**$ 2,104**
Enterprise taxes	357	**684**	**5,793**
Accrued bonuses	970	**1,029**	**8,717**
Retirement benefits for employees	3,730	**3,994**	**33,832**
Retirement benefits for directors	137	**168**	**1,431**
Membership	303	**291**	**2,469**
Impairment losses	951	**912**	**7,726**
Software cost	225	**137**	**1,166**
Operating loss carryforwards	412	**173**	**1,466**
Eliminated unrealized profits	411	**445**	**3,772**
Other	651	**837**	**7,096**
Total deferred tax assets	8,359	**8,923**	**75,577**
Less: Valuation allowance	(229)	**(326)**	**(2,766)**
Net deferred tax assets	8,129	**8,596**	**72,810**
Deferred tax liabilities:			
Reserve for computer program	2,103	**1,786**	**15,128**
Prepaid pension cost	1,522	**1,333**	**11,292**
Unrealized gain on investment securities	283	**761**	**6,449**
Other	17	**17**	**146**
Total deferred tax liabilities	3,927	**3,898**	**33,017**
Net deferred tax assets	¥4,202	**¥4,698**	**$39,793**

11. Supplementary Cash Flow Information

(1)Cash and cash equivalents consisted of:

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
Cash, time deposits and other cash equivalents	¥9,043	**¥14,507**	**$122,869**
Time deposits with deposit terms of more than three months	(1,326)	**(616)**	**(5,217)**
Cash and cash equivalents at end of year	¥7,717	**¥13,891**	**$117,652**

(2)The property and the debt that were taken over from Quark Co., LTD., which merged with the Alpha System Co.,LTD (consolidated subsidiary), were as follows:

(Fiscal year 2004)

	Millions of yen
Current assets	¥ 99
Non-current assets	3
Total assets	¥103
Current liabilities	¥ 51
Non-current liabilities	8
Total liabilities	¥ 60

(3)The main items of property and debt of JPSS Co., LTD. excluded from the scope of consolidation through share transfer are as follows:

(Fiscal year 2004)

	Millions of yen
Current assets	¥258
Non-current assets	34
Current liabilities	(211)
Non-current liabilities	(22)
Minority interests in consolidated subsidiaries	(1)
Consolidated adjustment account	16
Gain on sale of investments in securities	226
Amount for sale of investments in securities	300
Cash and cash equivalents	(110)
Proceeds from sale of investments in securities	¥189

12. Subsequent Events

(1) Appropriation

The following appropriation of the Company's retained earnings in respect of the year ended December 31, 2005 was as proposed by the Board of Directors and approved by the shareholders at the annual general meeting held on March 30, 2006:

Appropriation	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥75.00 per share)	¥2,730	$20,074

13. Lease Transactions

Acquisition costs, accumulated depreciation and net book values of leased assets at December 31, 2004 and 2005 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
Acquisition cost	¥4,589	**¥6,154**	**$52,126**
Accumulated depreciation	(3,005)	**(3,307)**	**(28,011)**
Net book value	¥1,584	**¥2,847**	**$24,114**

Accumulated depreciation at December 31, 2005 included accumulated impairment loss in the amount of 0 million yen (2 thousand U.S. dollars).

Future minimum lease payments under finance leases at December 31, 2004 and 2005 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
Due within one year	¥ 717	**¥1,159**	**$ 9,822**
Due after one year	895	**1,734**	**14,686**
	¥1,613	**¥2,893**	**$24,509**
Accumulated impairment loss on leaseholds	¥ 0	**¥ 0**	**$ 2**

Lease rental expenses, depreciation and interest expenses for the years ended December 31, 2004 and 2005 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
Lease rental expenses	¥1,223	**¥1,395**	**$11,822**
Depreciation	1,158	**1,330**	**11,270**
Release of accumulated impairment loss on leaseholds	—	**0**	**2**
Interest expenses	42	**55**	**466**
Impairment loss on leaseholds	0	**—**	**—**

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

The amounts of future lease payments on operating leases at December 31, 2004 and 2005 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
Due within one year	¥337	**¥ 479**	**$ 4,061**
Due after one year	520	**1,152**	**9,762**
	¥857	**¥1,632**	**$13,823**

14. 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 revaluation was recorded as "Excess of land revaluation after tax-effect accounting" 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 for one time only. The excess of the book value after revaluation over the fair value is 1,571 million yen (13,309 thousand U.S. dollars) at December 31, 2005. As a result of assessing the realization, deferred tax assets on revaluation of land, the amount of 6,496 million yen (55,026 thousand U.S dollars), is deducted at December 31, 2005. Because management considers that it is more likely than not that the deferred tax assets on revaluation of land will not be realized.

15. Pledged Assets

At December 31, 2004 and 2005, assets pledged as collateral for accounts and notes payable and loan from banks were as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
Land	¥ 816	**¥ 816**	**$ 6,914**
Buildings	832	**813**	**6,894**
Time deposits	43	**11**	**93**
	¥1,692	**¥1,641**	**$13,901**

16. Explanatory Notes of Other Income and Expenses

(Fiscal year 2004)

• Impairment losses

The Company acknowledged "Loss on impairment of Fixed Assets" as follows;

a. Grouping

The assets of the Company are grouped into each of business departments, assets held by hotel business, leaseholds and common assets.

b. Assessment of recoverable value

Recoverable value is assessed net sale value.

c. Assets subject to impairment

- Leaseholds whose fair values have diminished significantly compared to their book value due to the recent decline in land price.
- Assets which provided a low level operating profit (hotel business) due to excessive depreciation costs arising from investments during the past year.

d. Details of impairment loss

Assets held by hotel business (location: Shizuoka)

	Millions of yen
Land	¥ 246
Buildings and structures	1,082
Other tangible assets	16
Other intangible assets	24
Guarantee deposits	0
Leaseholds	0

Leaseholds (location: Saitama)

	Millions of yen
Land	¥120

The impairment loss was included in accumulated depreciation.

17. Research and Development Costs

Research and development costs included in cost of sales and selling, general and administrative expenses for the years ended December 31, 2004 and 2005 amounted to 721 million yen and 667 million yen (5,654 thousand U.S. dollars), respectively.

18. Segment Information

The business segment information of the Company and its consolidated subsidiaries for the years ended December 31, 2004 and 2005 is summarized as follows:

(1)Business segment information

	Millions of yen					
	2004					
	System Integration	Service & Support	Other	Total	Elimination or corporate	Consolidated total
Net sales to:						
Outside customers	¥238,729	¥130,959	¥2,792	¥372,481	¥ —	¥372,481
Inter-segment sales/transfers	78	151	2,152	2,382	(2,382)	—
	238,807	131,111	4,945	374,863	(2,382)	372,481
Operating expenses	225,160	122,664	4,858	352,683	2,788	355,471
Operating income	¥ 13,647	¥ 8,446	¥ 86	¥ 22,180	¥ (5,170)	¥ 17,009
Assets, depreciation and capital expenditure:						
Assets	¥ 85,641	¥ 55,667	¥1,959	¥143,268	¥23,960	¥167,228
Depreciation and amortization	3,053	2,461	37	5,552	610	6,162
Impairment losses	—	1,370	—	1,370	120	1,491
Capital expenditure	2,558	2,125	21	4,705	414	5,120

	Millions of yen					
	2005					
	System Integration	Service & Support	Other	Total	Elimination or corporate	Consolidated total
Net sales to:						
Outside customers	**¥258,275**	**¥149,100**	**¥2,037**	**¥409,413**	**¥ —**	**¥409,413**
Inter-segment sales/transfers	**96**	**203**	**2,331**	**2,631**	**(2,631)**	**—**
	258,372	**149,304**	**4,368**	**412,045**	**(2,631)**	**409,413**
Operating expenses	**239,706**	**140,040**	**4,262**	**384,008**	**3,494**	**387,502**
Operating income	**¥ 18,665**	**¥ 9,263**	**¥ 106**	**¥ 28,036**	**¥ (6,125)**	**¥ 21,911**
Assets, depreciation and capital expenditure:						
Assets	**¥ 87,140**	**¥ 60,411**	**¥1,954**	**¥149,506**	**¥24,421**	**¥173,927**
Depreciation and amortization	**3,237**	**2,211**	**33**	**5,482**	**583**	**6,066**
Capital expenditure	**2,512**	**1,940**	**4**	**4,456**	**273**	**4,730**

	Thousands of U.S. dollars					
	2005					
	System Integration	Service & Support	Other	Total	Elimination or corporate	Consolidated total
Net sales to:						
Outside customers	**$2,187,479**	**$1,262,815**	**$17,256**	**$3,467,551**	**$ —**	**$3,467,551**
Inter-segment sales/transfers	**817**	**1,724**	**19,744**	**22,286**	**(22,286)**	**—**
	2,188,297	**1,264,539**	**37,001**	**3,489,838**	**(22,286)**	**3,467,551**
Operating expenses	**2,030,206**	**1,186,077**	**36,097**	**3,252,381**	**29,592**	**3,281,974**
Operating income	**$ 158,091**	**$ 78,461**	**$ 903**	**$ 237,456**	**$ (51,879)**	**$ 185,576**
Assets, depreciation and capital expenditure:						
Assets	**$ 738,042**	**$ 511,654**	**$16,551**	**$1,266,248**	**$206,835**	**$1,473,084**
Depreciation and amortization	**27,420**	**18,732**	**281**	**46,433**	**4,945**	**51,379**
Capital expenditure	**21,275**	**16,434**	**34**	**37,744**	**2,318**	**40,062**

Notes ;

1. Business segments are defined in consideration of the operations of the companies.
2. Significant operations of each segment are as summarized below;
   (a)The system integration business provides optimized system services ranging from consulting to system design and development, transport and installation and network construction.
   (b)The service & support business offers total support for systems installed by customers with supplies, hardware and software maintenance, telephone support and IT education.
   (c)Other business includes the construction industry, automobile maintenance and direct mail production and shipment outsourcing, etc.

3. Significant components of "Eliminations or corporate" are as follows;

	Millions of yen		Thousands of U.S. dollars
	2004	**2005**	**2005**
Non-allocable operating expenses	¥ 5,239	**¥ 6,165**	**$ 52,217**
Corporate assets	25,615	**26,126**	**221,283**

Non-allocable operating expenses include administrative expenses incurred by the management control department of the Company.

Corporate assets include surplus funds, long-term investments (investment securities) and assets used by the management control department of the Company.

Corporate assets include deferred tax assets on revaluation of land in fiscal year 2004.

4. Depreciation and amortization and capital expenditure include amortization and increase of long-term prepaid expenses.

(2) Segment information by geographic area is not disclosed pursuant to regulations on consolidated financial statements in Japan, since both net sales and assets of the Company and its domestic consolidated subsidiaries, taken as a whole, were more than 90% of consolidated net sales and assets.

(3) Information for overseas sales is not disclosed pursuant to regulations on consolidated financial statements in Japan, since aggregate of overseas sales of the Company and its domestic consolidated subsidiaries and overseas consolidated subsidiaries, were less than 10% of consolidated net sales.

(Change of accounting policy)

(Fiscal year 2004)

Accounting standard for impairment of Fixed Assets

As described in 'Note 2(16) Change of accounting policy' the Companies and its subsidiaries adopted "Accounting Standard for impairment of Fixed Assets" effective from the year ended December 31, 2004. The effect of the adoption was to recognize Impairment losses on the Service & Support business and the corporate, amounting to 1,370 million yen, 120 million yen, respectively. Operating assets of these businesses decreased by 1,370 million yen, 120 million yen, respectively.

Report of Independent Auditors

To the Board of Directors and Shareholders of

OTSUKA CORPORATION

We have audited the accompanying consolidated balance sheets of OTSUKA CORPORATION and its subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese Yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of OTSUKA CORPORATION and its subsidiaries as of December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

As described in Note 2(16), effective for the year ended March 31, 2004, OTSUKA CORPORATION and its subsidiaries adopted "Accounting Standard for impairment of Fixed Assets" with effect from the year ended December 31, 2004.

The amounts expressed in U.S. dollars, which are 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 Pricewaterhouse Coopers

ChuoAoyama PricewaterhouseCoopers

Tokyo, Japan

March 30, 2006