



ANNUAL REPORT 2006

For the fiscal year ended December 31, 2006

Otsuka Corporation

C O N T E N T S

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Mission Statement

Mission

OTSUKA CORPORATION serves a wide range of companies, providing comprehensive support for their business activities by presenting, within a concrete framework, new business opportunities and management improvement strategies brought about by innovations in information and telecommunication technology. By so doing, we continue to facilitate the growth of our client companies and contribute to the development of our country and the creation of a spiritually enriching society.

Goals

- To become a corporate group that is recognized and trusted as a valuable corporate citizen.
- To encourage employee growth and self-realization through the attainment of personal goals and professional achievement.
- To demonstrate harmonious coexistence and growth with nature and society.
- To create business models that consistently keep pace with the changing times.

Principles

- Always thinking from the customer's perspective and acting through harmonious team work.
- Maintaining the spirit of challenge inherited from our predecessors, exercising our own critical judgment, and acting on our own initiative.
- Fully complying with all prevailing laws and regulations, and maintaining high ethical standards.

Otsuka Corporation

Forward-Looking Statements

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, 2004, 2005 and 2006			Millions of yen	Thousands of U.S. dollars	%
	2004	2005	2006	2006	Change
Net sales	¥372,481	¥409,413	¥433,617	\$3,640,173	+5.9
System Integration Business	238,729	258,275	263,425	2,211,425	+2.0
Service and Support Business	130,959	149,100	168,701	1,416,232	+13.1
Other Business	2,792	2,037	1,490	12,515	-26.8
Operating income	17,009	21,911	26,158	219,595	+19.4
Recurring profit	17,036	22,210	26,494	222,418	+19.3
Income before income taxes and minority interests	18,548	20,552	26,350	221,210	+28.2
Net income	11,247	11,747	15,621	131,138	+33.0
Total assets	167,228	173,927	189,357	1,589,633	+8.9
Total interest-bearing debt	21,337	11,695	10,854	91,119	-7.2
Equity	54,667	58,920	72,848	611,552	+23.6
Net income per share (EPS) (Yen and U.S. dollars)	355.88	371.72	494.30	4.15	+33.0
Dividends per share of common stock (Yen and U.S. dollars)	55.00	75.00	115.00	0.97	+53.3
Cash flows from operating activities per share (Yen and U.S. dollars)	743.43	710.97	440.14	3.69	-38.1
Operating income to net sales ratio (%)	4.57	5.35	6.03	—	
Net income to net sales ratio (%)	3.02	2.87	3.60	—	
Total interest-bearing debt ratio (%)	12.76	6.72	5.73	—	
Equity ratio (%)	32.69	33.88	38.47	—	
Return on equity (ROE) (%)	22.80	20.68	23.71	—	

Note:

Equity = Total net assets - Share subscription rights - Minority interests

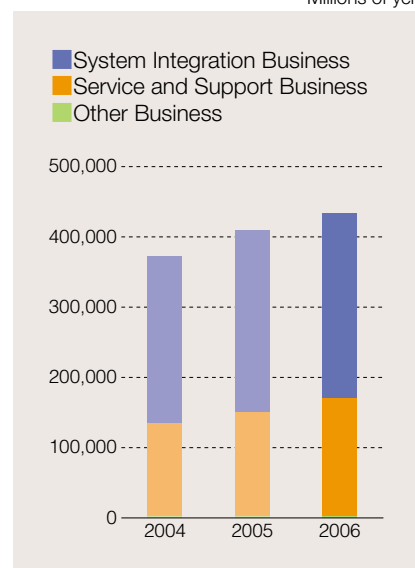
Figures for ROE are calculated using average equity.

U.S. dollar amounts are computed using the December 31, 2006 exchange rate of ¥119.12 = US\$1.

The dividend in 2006 includes a ¥10 special dividend commemorating the 45th anniversary of the Company.

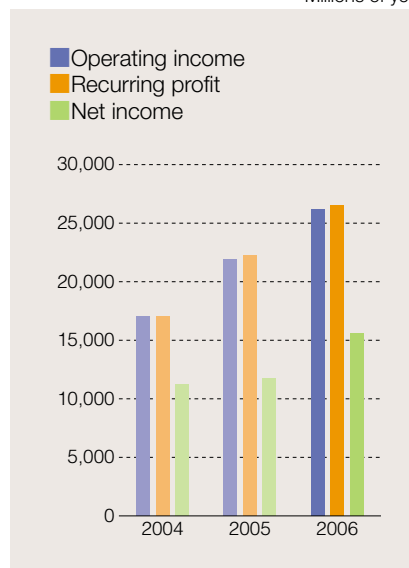
Net sales

Millions of yen



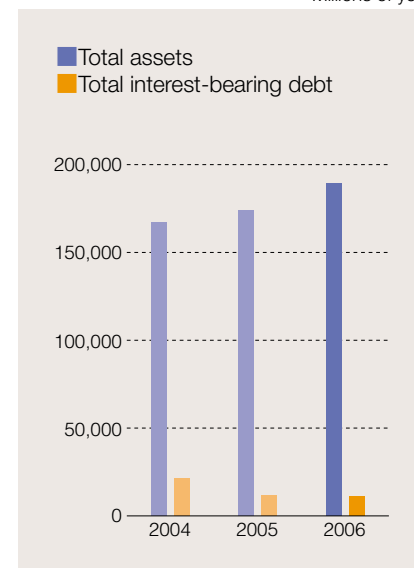
Operating income, Recurring profit, Net income

Millions of yen



Total assets, Total interest-bearing debt

Millions of yen



Note:

Rounding down sums of less than a million yen.

To Our Shareholders and Investors



I am pleased to announce the results for the fiscal year ended December 31, 2006.

In the fiscal year under review, the OTSUKA Group posted net sales of ¥433,617 million, which was an increase of 5.9% from the previous fiscal year. By segment, sales in the System Integration Business rose 2.0% to ¥263,425 million as a result of robust sales of servers, color copiers and information security-related products. In the Service and Support Business, sales increased 13.1% to ¥168,701 million on the back of a continued favorable performance for the “tanomail” office supply mail-order service and a strong showing by maintenance services.

Earnings reached another record high owing to the OTSUKA Group’s successful endeavors to hold down selling, general and administrative (SG&A) expenses relative to higher sales. Operating income rose 19.4% to ¥26,158 million, recurring profit increased 19.3% to ¥26,494 million and net income jumped 33.0% to ¥15,621 million, resulting in four consecutive terms of increased sales and income.

In view of these results, management has resolved to add ¥10 to normal dividends of ¥105 in commemoration of the 45th anniversary of the Company’s founding.

In line with its Mission Statement, the OTSUKA Group will continue to pursue management reforms to ensure the trust of all stakeholders. In these endeavors, your continued support is greatly appreciated.

Yuji Otsuka, President & Chief Executive Officer

March, 2007

Overview of Consolidated Operations

■ Sustained Mild Economic Recovery

In the fiscal year under review, the Japanese economy continued to experience a long-term mild economic recovery on the back of capital spending fueled by improved corporate earnings and higher demand.

In the IT-related industrial sector in which the OTSUKA Group operates, while there were some dark spots, the industry overall was strong amid greater business confidence and an improved capital procurement environment owing to strong sentiment toward IT investment among corporations endeavoring to strengthen operations and survive competition. Efforts included handling the computerization of legal and official procedures, improving efficiency in core facilities and operations for expanding business, reducing costs and tackling a shortage of personnel and other manpower.

Specifically, considerable activity has been seen in measures such as strengthening information security measures, remodeling system infrastructures and introducing integrated operational package software. Increased outsourcing of functions such as system operations and management also is evident.

However, with customers voicing strong demand for total cost reductions and clarifying investment efficiency, the biggest challenge for the entire industry lies in offering solutions with optimal added value while keeping costs down.

Despite room for growth in IT among many small- and medium-size businesses and heightened interest in IT investment, given a slight shortage in IT staff and personnel, customers are further demanding timely provision of product information and case studies for installing IT along with the provision of systems optimally designed for resolving management issues and friendly support and rapid response after installation.

■ Offering Systems that Meet Customer Needs

Amid these conditions, the OTSUKA Group will remain dedicated to its fiscal 2006 slogan “Respond to customers’ trust from their viewpoint” by strengthening the functionality and promoting greater use of “SPR,” a system developed by OTSUKA CORPORATION that combines the functions of customer relationship management (CRM) and sales force automation (SFA) programs. Concurrently, the Group will conduct aggressive and efficient provision of systems tailored to customer needs. The Group conducted aggressive proposals on integrated systems that include combining copiers, computers, facsimiles,

telephones and communication lines, as well as concentrated on the information security-related business, “SMILE series” of integrated mission-critical systems, the “tanomail” office supply mail-order business and the “ODS21” knowledge management system. Concurrently, the OTSUKA Group focused on expanding its business with existing customers while developing and cultivating new customers.

The Group also worked to raise productivity by expanding operations and raising operating efficiency in the Sales Support Center, as well as strengthening project management in system development projects.

In addition, the Group will consolidate the Service and Support Business into the “tanomail” and “tayoreru”* brands, and improve its service and support menu as well as enhance ease of understanding.

*“tayoreru”: A business brand that supports customer information systems and customers’ overall corporate activities

■ Increases of 5.9% in Net Sales, 19.4% in Operating Income and 19.3% in Recurring Profit

On a consolidated basis, net sales rose 5.9% to ¥433,617 million, operating income increased 19.4% to ¥26,158 million, recurring profit expanded 19.3% to ¥26,494 million and net income jumped 33.0% to ¥15,621 million, resulting in four consecutive terms of increased sales and income.

(Millions of yen)

	Fiscal 2005	Fiscal 2006	
	Amount	Amount	Change to Last Year
Net sales	409,413	433,617	+5.9%
Operating income	21,911	26,158	+19.4%
Recurring profit	22,210	26,494	+19.3%
Net income	11,747	15,621	+33.0%

What is “SPR”?

“SPR” is a combined customer relationship management (CRM) and sales force automation (SFA) system developed by OTSUKA CORPORATION. “SPR” handles customer profile information and acts as a database for transaction histories (Past) that includes details of daily meetings and contact information relating to some 20,000 companies customers. It also includes information on the status of proposals that have been submitted to customers (Present), and on customers’ needs and requirements (Future). The Company comprehensively analyzes and utilizes this information to efficiently create optimal solutions for each customer.

SPR : stands for **Sales Process Re-engineering**

OTSUKA CORPORATION's proprietary CRM (Customer Management) and SFA (Marketing Support) System

Learn customers' profiles accurately

Learn customers' transaction history (Past)

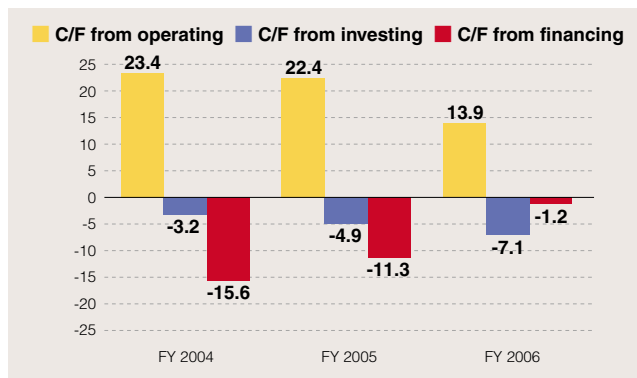
Learn status of proposals to customers (Present)

Learn customers' needs and requirements (Future)

Use a scientific sales approach to simultaneously improve CS and efficiency

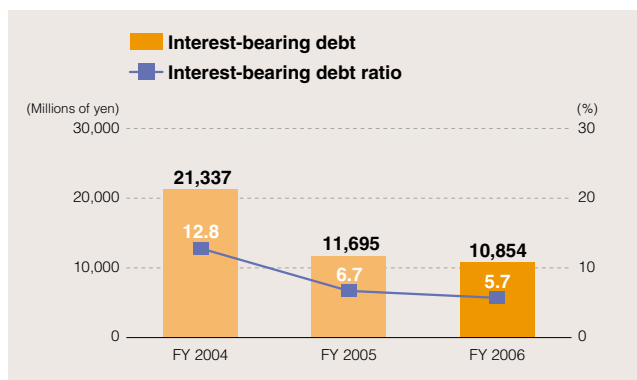
Cash Flows

(Billions of yen)



Cash provided by operating activities amounted to ¥13,909 million as a result of an increase in income taxes paid and other payments, compared with ¥22,468 million in the previous term. Cash used in investing activities amounted to ¥7,161 million owing to an increase in payments for purchase of investments in securities, compared with ¥4,986 million in the preceding term. Cash used in financing activities amounted to ¥1,250 million, compared with ¥11,338 million in the preceding term stemming from repayments of debts.

Interest-bearing debt



In the fiscal year under review, interest-bearing debt (including short-term and long-term loans) decreased by approximately ¥800 million to ¥10,854 million. As a result, interest-bearing debt was less than “cash, time deposits and other cash equivalents,” which amounted to ¥18,421 million.

As a result, the interest-bearing debt ratio declined 1.0 percentage points, to 5.7%.

Overview of Business Segments

■ System Integration Business

The System Integration Business provides optimized system services ranging from consulting to system design and development, transport and installation work and network construction. By focusing resources on information security-related products, servers, color copiers, the “SMILE series” of integrated mission-critical systems, the “ODS21” knowledge management system and CAD systems, net sales edged up 2.0% to ¥263,425 million.

■ Service and Support Business

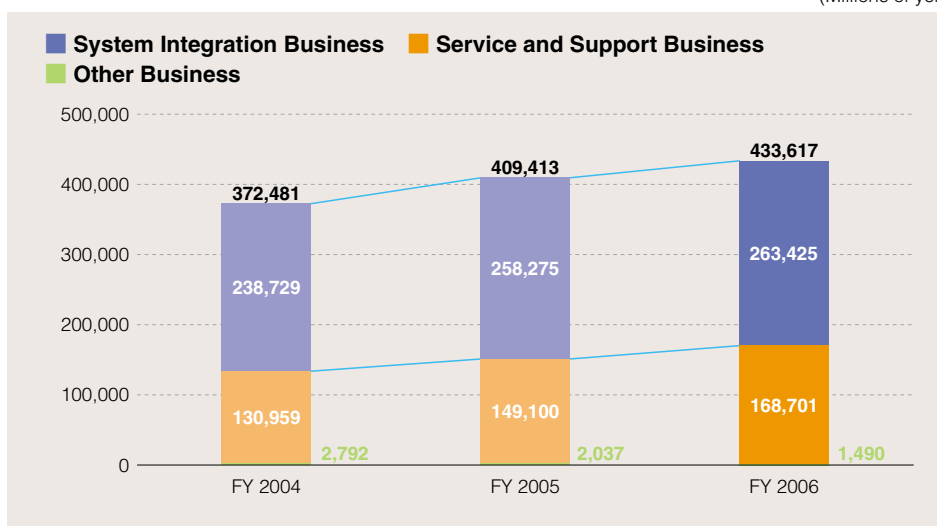
The Service and Support Business provides customers with total support for installed systems encompassing supplies, hardware and software maintenance, telephone support, IT education and outsourcing. The “tanomail” office supply mail-order service via the Company’s Website and catalog channels continued to generate solid growth, and robust results were also posted by the maintenance business. As a result, net sales amounted to ¥168,701 million, 13.1% higher than the preceding year.

■ Other Business

In the Other Business, net sales amounted to ¥1,490 million, representing a 26.8% decrease compared with the previous year.

Net Sales by Segments

(Millions of yen)



Overview of Key Strategic Businesses (Non-consolidated)

OTSUKA CORPORATION has positioned “MRO”, “SMILE”, “ODS21” and “OSM” as its key strategic businesses and concentrated resources accordingly. Below is an overview of each strategic business for the fiscal year under review.

Key Strategic Business

MRO

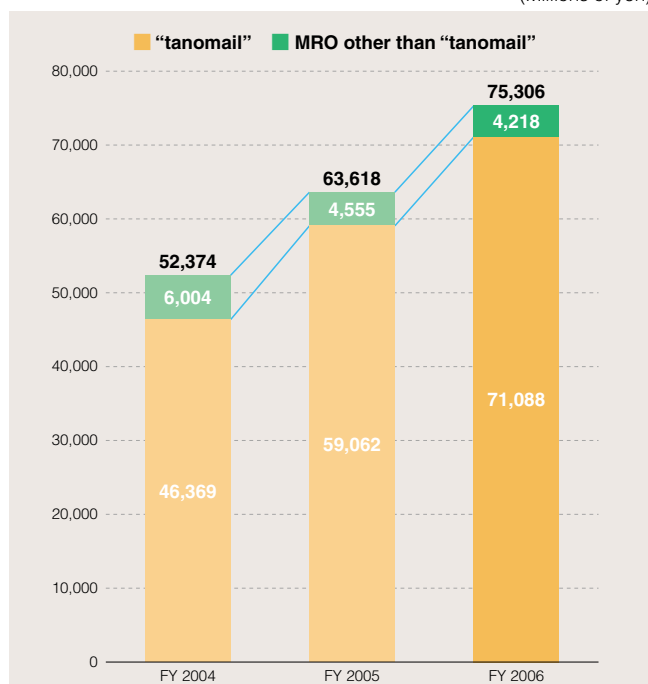
For the fiscal year under review, net sales rose **18.4%** to **¥75,306 million**.

of the above, “tanomail”:

For the fiscal year under review, net sales rose **20.4%** to **¥71,088 million**.

MRO Net Sales

(Millions of yen)



The “MRO” business, which engages in selling products such as stationery, daily office necessities and OA supplies, was able to achieve sales exceeding ¥75 billion due to the strong performance by the “tanomail” office supply mail-order service, the core pillar of the “MRO” business.

The number of “tanomail” accounts is steadily increasing, which in turn is contributing to the acquisition of new customers.



“tanomail” catalog, Vol. 17



“tanomail” on the Internet at <http://www.tanomail.com>

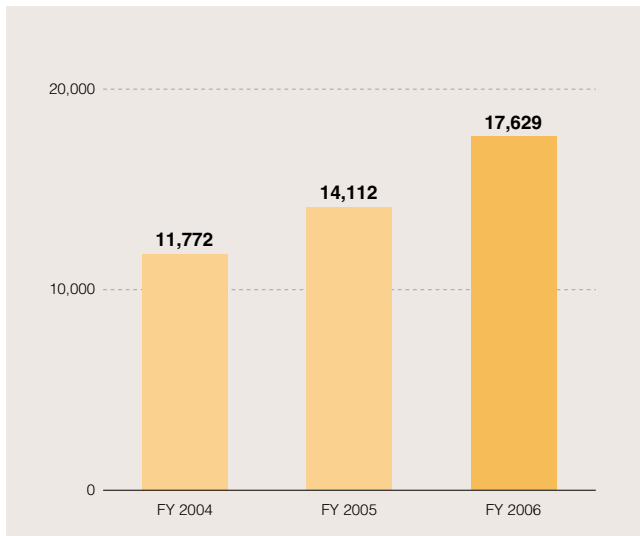
Key Strategic Business

SMILE

For the fiscal year under review, net sales rose **24.9%** to **¥17,629 million**.

SMILE Net Sales

(Millions of yen)



“SMILE” is the Company’s proprietary integrated mission-critical operational system, which encompasses 28 years of experience. There are two products: “SMILE α AD,” which is geared to the needs of midsize and smaller companies, and “SMILE ie” for large and midsize companies.

In addition to packages for customers looking to revamp their mission-critical systems, strong sales were generated by reinforcing product functionality and enhancing the range of program options.

(Software and maintenance sales only are included from the year under review.)

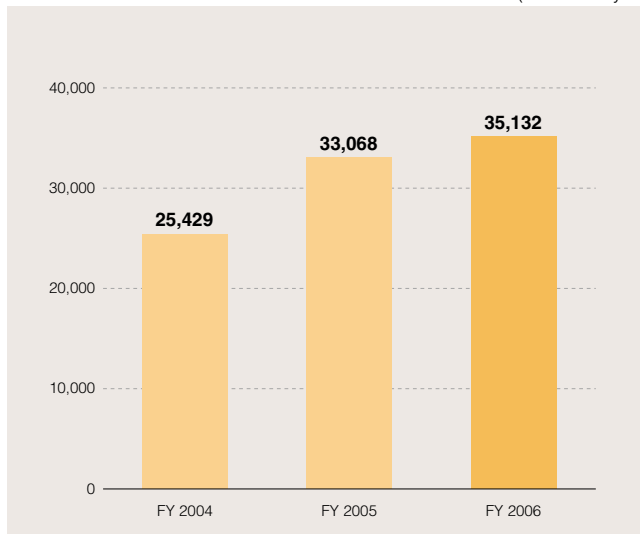
Key Strategic Business

ODS21

For the fiscal year under review, net sales rose **6.2%** to **¥35,132 million**.

ODS21 Net Sales

(Millions of yen)



“ODS21” is a knowledge management system that combines copiers and computers to digitally capture paper-based information, bringing it under the same central management as other digital information, and in turn, facilitating the sharing and utilization of such information.

Net sales were up 6.2%, hampered by delays in demand due to revisions in law and regulation.

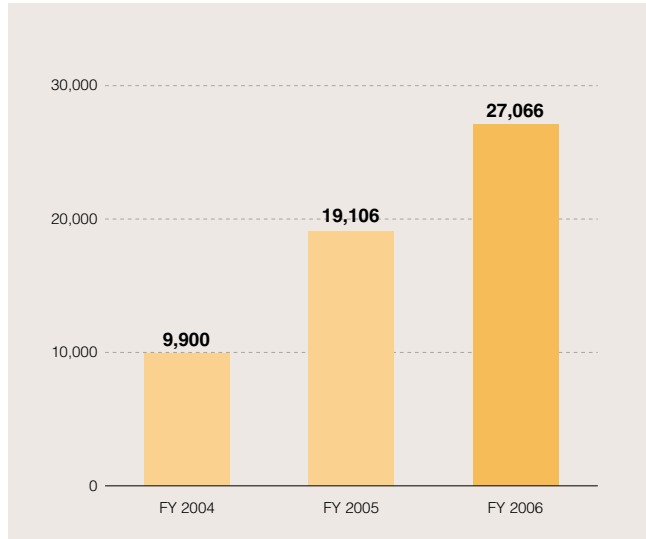
Key Strategic Business

OSM

For the fiscal year under review, net sales rose 41.7% to ¥27,066 million.

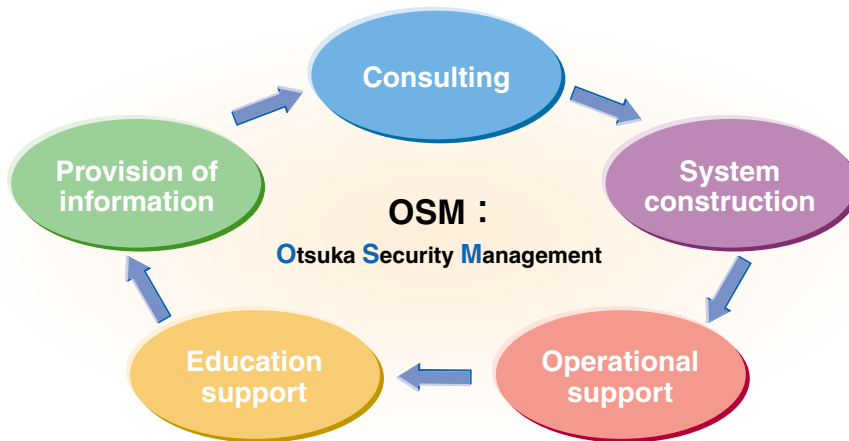
OSM Net Sales

(Millions of yen)



“OSM,” OTSUKA CORPORATION’s name-brand information security business, recorded a 41.7% increase in sales on the back of continued brisk investment in information security measures.

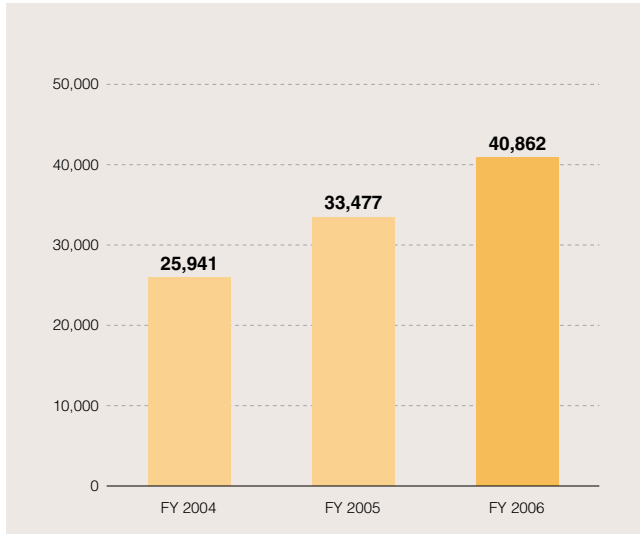
Overall information security support during system life-cycle



Unit Sales of Computers and Copiers

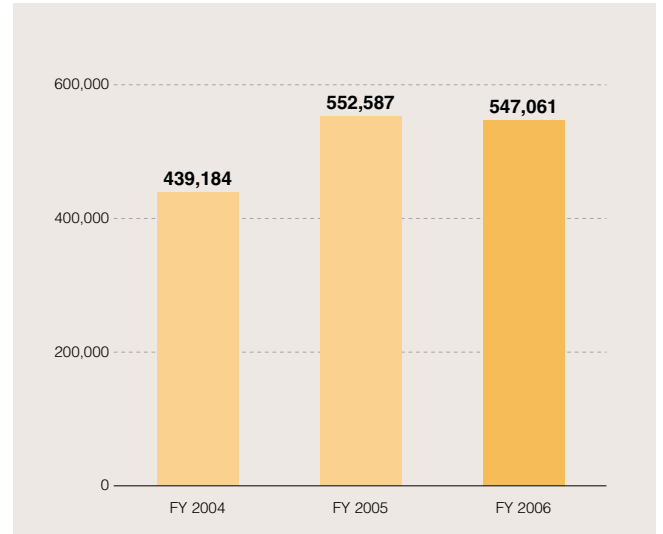
Unit Sales of Servers

(units)



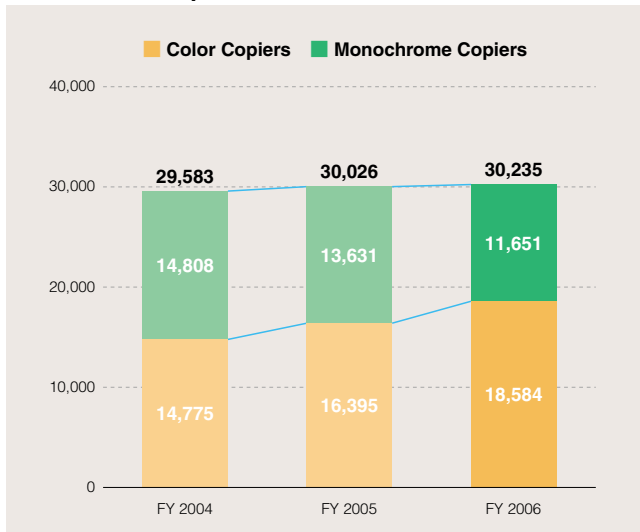
Unit Sales of Personal Computers

(units)



Unit Sales of Copiers

(units)



Forecast for Fiscal 2007

■ Management Improvement by Utilizing IT

Looking ahead, although there are concerns over how materials costs such as crude oil will impact corporate earnings, as well as U.S. economic trends, strong corporate capital investment and improving employment conditions are expected to contribute to continued expansion of the Japanese economy.

Within this context, companies of every size and industry must employ IT in order to resolve their management issues. In particular, developing an internal control structure is a pressing management concern among corporations following the announcement of the Implementation Standards for Evaluation and Auditing of Internal Control over Financial Reporting under the

Financial Instruments and Exchange Law, and will likely translate into a gradual increase in IT investment. Predictions also call for brisk demand for updating information system infrastructures, including replacing communication lines.

The OTSUKA Group takes the client's perspective in order to resolve their management issues under the fiscal 2007 slogan "Respond to customers' trust from their viewpoint and grow with customers" and offers one-stop solutions and one-stop support that relies on the comprehensive strengths of the Group. The Group will aim to grow with its customers, work to achieve its Mission Statement and seek to further enhance its enterprise value.

Medium-term Goals and Action Principles

Basic principle

- Grow with customers through realization of the Mission Statement

Mid-term plan

- Work-force basically remains flat
- Strive to expand business by increasing revenues and profits
Target operating income and recurring profit to net sales ratio of 6.5%
- Spur new demand with the help of the customer information
- Effective use of individuals/materials/capital and increasing productivity

■ Specific Policies

The slogan for fiscal 2007 is:

“Respond to customers’ trust from their viewpoint and grow with customers”

Specific Policies

1. Expand business with existing customers

The Company has business dealings with some 700,000 companies ranging in size from very large enterprises to small firms, and accordingly, will work to expand the number of items per company.

2. Promote further development and utilization of “SPR”

The number of information entry in “SPR” has significantly increased, and has been a factor in improving companies’ performance. Further development and utilization of “SPR” will be pursued to promote optimal proposals solutions with increased efficiency.

3. Raising Productivity through the Sales Support Center

The Company established the Sales Support Center, where sales personnel concentrate on conducting surveys, drafting proposals, preparing estimates and other such tasks. Further increases in productivity are being targeted by promoting utilization of the Center.

4. Use “tanomail” to acquire new customers

There will be further emphasis on employing “tanomail” to acquire new customers, using the service as a portal linked to the provision of one-stop solutions.

5. Expansion and Improvement of “tayoreru” menu

The Company will offer one-stop solutions for every aspect of customer businesses by creating a new menu and expanding content.

■ Forecast for Fiscal 2007

The Company forecasts that in fiscal 2007, net sales will increase 4.7%, to ¥454 billion; operating income will rise 7.8%, to ¥28.2 billion; recurring profit will increase 7.6%, to ¥28.5 billion; and net income will expand 2.4%, to ¥16.0 billion.

By segment, projections call for a 2.5% increase in sales, to ¥270,030 million, in the System Integration Business; an 8.4% rise in sales, to ¥182,866 million, in the Service and Support Business; and a 25.9% decline in sales, to ¥1,104 million, in the Other Business.

Forecast for Consolidated Net Sales and Income (Millions of yen)

	Fiscal 2006	Fiscal 2007 (Forecast)	
	Amount	Amount	Change to Last Year
Net sales	433,617	454,000	+4.7%
Operating income	26,158	28,200	+7.8%
Recurring profit	26,494	28,500	+7.6%
Net income	15,621	16,000	+2.4%

Forecast for Consolidated Net Sales by Segments (Millions of yen)

	Fiscal 2006	Fiscal 2007 (Forecast)	
	Amount	Amount	Change to Last Year
System Integration Business	263,425	270,030	+2.5%
Service and Support Business	168,701	182,866	+8.4%
Other Business	1,490	1,104	-25.9%

Topics

■ Launch of the “tayoreru” Brand

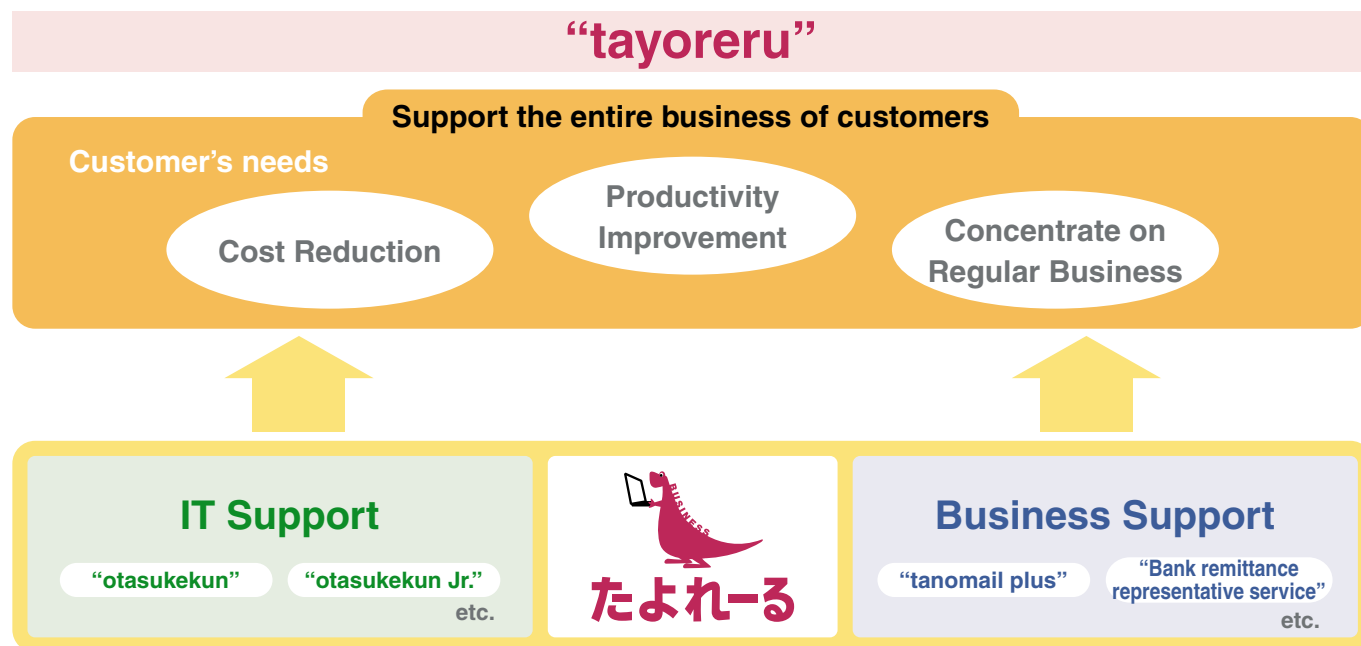
The IT outsourcing services and operational outsourcing service within the Service and Support Business have been integrated and will be provided under the “tayoreru” brand.



While OTSUKA CORPORATION has offered a growing number of services and support menus over the years, many users expressed their desire for more user-friendly and all-in-one menus given the countless services menus and packages available.

Accordingly, the Company consolidated its many services and support menus provided by the Service and Support Business under the all-in-one “tayoreru” brand.

Under the motto of “your personal physician reliable any time and for any need,” “tayoreru” aids in resolving the varying management issues of customers.



■ SIOS Technology, Inc. Becomes an Affiliate for the Equity Method

SIOS Technology, Inc. (name changed from 10art-ni Corporation on November 6, 2006), which was a consolidated subsidiary of OTSUKA CORPORATION, was converted from a subsidiary to an affiliate for the equity method, because of the dissolution of direct control by the Company on November 28, 2006.

Social Contribution and Environmental Preservation Activities

Starting from our immediate surroundings, OTSUKA CORPORATION is contributing to society and helping to preserve the environment in a diverse range of fields. Here are some highlights in 2006.

■ Cooperating in the preservation of rice terrace

Oyama Senmaida (Oyama Rice Terrace) in Kamogawa City, Chiba, has been designated by the Ministry of Agriculture, Forestry and Fisheries as one of “Japan’s 100 Signature Rice Terraces,” and is the closest rice terrace to Tokyo. Visitors can readily try their hand at rice planting and can visit as many times as they like, which is why it has received so much attention. OTSUKA CORPORATION is cooperating in the preservation of Oyama Senmaida through such activities as introducing a rice terrace owner system and through agricultural support on the part of employees.



Rice planting at Oyama Senmaida



Weeding at Oyama Senmaida

■ Launch of Sales of “Lake Papyrus 20”

OTSUKA CORPORATION began marketing “Lake Papyrus 20,” which uses pulp made from reeds from Lake Biwa.

The reeds that cluster around the lakes, ponds and rivers of Japan have a high capacity to absorb phosphorous and nitrogen, which contribute to the pollution of water, and are used as both building materials and reed screens. One reed is said to have the ability to purify two tons of water, but their use has not made effective progress owing to recent changes in people’s living environments.



Reeds growing in Lake Biwa

“Lake Papyrus 20” contains 20% reeds, and with an amount equivalent to one business card, it can purify roughly 20 liters of water. The degree of whiteness is roughly 80%, and can be used as pulp in such office paper supplies as business cards and company envelopes.

OTSUKA CORPORATION is gradually phasing in “Lake Papyrus 20” business cards as the paper source for all employee business cards.

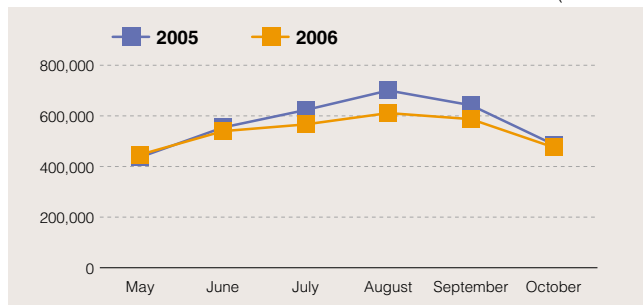
■ Implementing “Cool Biz” in All Offices

As a step in working to prevent global warming, OTSUKA CORPORATION, which participates in “Team Minus 6%,” expanded “Cool Biz” campaign activities to all offices in 2006 after running a trial in offices in western Japan during summer 2005. Over roughly three months from June 19 to September 22, employees were no longer required to wear suit jackets and neckties and office thermostats were set at 28°C. Consequently, the headquarters was able to decrease its electricity use for July and August by roughly 10%.



Headquarters Electricity Use

(Unit: kWh)



■ OTSUKA CORPORATION CSR Report 2006

The Company has published the CSR Report 2006 as a more content-rich version of the previous Social and Environmental Report. The report broadly communicates the Company’s social contributions, environmental preservation activities and other activities to such stakeholders as customers, shareholders and investors, business partners, outside communities and employees. To reduce the use of paper resources, the report is posted on the Company’s website instead of being printed.



<http://www.otsuka-shokai.co.jp/eco/2006/index.html>

Environmental Solutions

OTSUKA CORPORATION develops and offers customers a broad selection of environmental solutions based on its track record and expertise in applying them to its in-house environmental improvement efforts.

- Helped to reduce the amount of paper consumed by using “ODS21” to shift to a paperless environment
- Used “tanomail” to promote green procurement
- Used the “Web Learning” to help improve education about the environment
- Contributed to reduced use of resources by promoting the recycling of PCs and toner cartridges

Corporate Governance

■ Basic Stance Regarding Corporate Governance

Based on a corporate ethic and spirit of compliance spelled out in its Mission Statement, the OTSUKA Group aims to adapt nimbly to changes in the environment and augment its competitiveness by ensuring thorough compliance and raising both operational transparency and fairness.

■ Current Status of Implementation of Corporate Governance Measures

As a company with a Corporate Auditors system, OTSUKA CORPORATION aims to augment corporate governance by further enhancement of the General Shareholders Meeting, augmenting the auditing capabilities of corporate auditors, reforming the Board of Directors and making an active and ongoing commitment to disclosure and investor relations (IR) activities.

1. Enhancement of the General Shareholders Meeting

The OTSUKA Group believes that enhancement of the General Shareholders Meeting is crucial to improving corporate governance, and is working to ensure that as many shareholders as possible attend meetings, while concurrently introducing an electronic voting system that will allow shareholders to exercise their voting rights via the Internet.

2. Board of Directors

As of December 31, 2006, the Board of Directors consists of 13 directors, of which 11 board members concurrently serve as Executive Officers responsible for making decisions and overseeing business operations based on actual on-site conditions. There are no outside directors at present.

The Board of Directors meet regularly twice a month to discuss critical management issues as well as to deliberate on progress regarding businesses performance and make swift decisions toward resolving relevant issues. Group Management Meetings comprising top management of all Group companies are also held to clarify operational conditions at each company and progress in achieving profitability in addition to working to strengthen corporate governance.

As of March 29, 2007, there were 14 Directors (12 of which are Executive Officers).

3. Executive Officer System

OTSUKA CORPORATION introduced the Executive Officer System on July 1, 2003, and has since been working to realize more rapid decision-making of management policies and execution of business operations as well as to strengthen the oversight structure for more efficient business operations. Consequently, the Board of Directors handles overall decision-making for important management matters as well as supervisory functions pertaining to business operations. Executive Officers elected by the Board of Directors are responsible for execution of business operations as decided by the Board of Directors and under the direction of the President. As of December 31, 2006, there were 33 Executive Officers (11 of which are Directors). As of March 29, 2007, there were 34 Executive Officers (12 of which are Directors).

4. Corporate Auditors System

OTSUKA CORPORATION uses a Corporate Auditors system. The Board of Corporate Auditors is comprised of four auditors that include two outside auditors, all of whom attend such important meetings as Board of Directors meetings and management meetings to monitor that the management of operations is being properly carried out. The corporate auditors reinforce auditing at the operational level through such means as identifying potential problems at an early stage by regularly engaging in dialogue with management via the Board of Corporate Auditors along with independent auditors, as well as by collaborating and coordinating with internal departments conducting auditing of subsidiaries and affiliates.

No personal, capital or business interests exist between outside auditors and OTSUKA CORPORATION.

5. Corporate Audits

OTSUKA CORPORATION has designated MISUZU Audit Corporation (formerly Chuo Aoyama Pricewaterhouse Coopers until a name change effective September 1, 2006) as an independent auditor.

There are no interests among MISUZU, Managing Partners responsible for auditing the Company and OTSUKA CORPORATION. The names of CPAs involved in auditing-related operations and composition of staff assisting in auditing-related operations for the fiscal year under review are as follows.

- Names of CPAs Involved in Auditing-related Operations

Name of CPA	Years of Continuous Auditing Experience*
Kenichi Akiyama, Designated Employee and Managing Partner	2 years
Tetsuya Ishii, Designated Employee and Managing Partner	6 years

*Years of continuous auditing experience indicates the number of years that the individual has conducted audits in compliance with the Securities and Exchange Law or in compliance with the Company Law, whichever period is longer.

- Composition of Staff Assisting in Accounting-related Operations

11 CPAs, four assistant CPAs and six other individuals

Note:

1. On May 10, 2006, the Financial Services Agency ordered Chuo Aoyama Pricewaterhouse Coopers, which was the Company's independent auditor at that time, to halt statutory auditing required under the relevant laws and regulations. Consequently, Chuo Aoyama Pricewaterhouse Coopers lost its qualification to act as OTSUKA CORPORATION's independent accounting auditor from July 1, 2006. In accordance with Article 346, Paragraphs 4 and 6 of the Company Law, OTSUKA CORPORATION responded by selecting MISUZU Audit Corporation as its temporary independent auditor as of September 1, 2006 following a resolution by the Board of Corporate Auditors on August 25, 2006.
2. MISUZU Audit Corporation was chosen and assumed its position as the Company's independent auditor at the General Meeting of Shareholders on March 29, 2007.

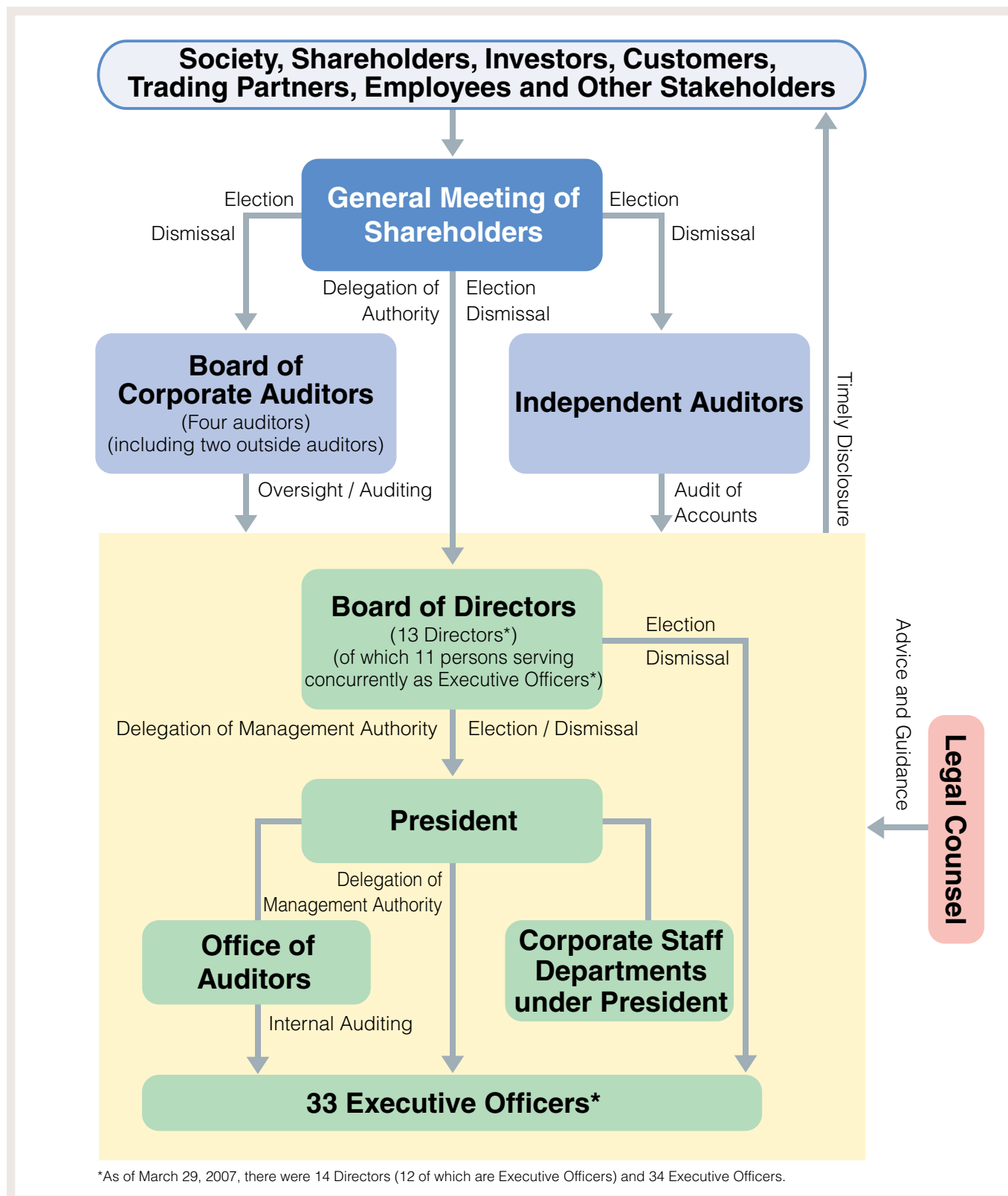
6. Status of Monitoring Operations

Critical items that impact operations and performance are reported immediately to the Board of Directors and the Board of Corporate Auditors as they arise. Moreover, the Office of Auditors under the direction of the President has been established to conduct periodic and on-demand internal audits of all operations and assess the adequacy of policies, plans and procedures, the effectiveness of their implementation in operations and progress in compliance, as well as to offer concrete advice and recommendations for improving operations and raising awareness. The Office of Auditors has 13 staff as of December 31, 2006.

OTSUKA CORPORATION has established and operates an Internal Reporting and Improvement Proposal System that allows employees to directly report and propose improvements to the President. The purpose of the system is as follows:

- To quickly identify, address and prevent occurrences pertaining to dishonesty and misconduct in relation to corporate ethics and fair trade.
- To assess, suitably handle and prevent such incidences as abuse of authority and sexual harassment.
- To receive proposals and consultation, as well as to individually address issues related to business operations and work flows.

As of December 31, 2006, the structure for corporate management decision-making, business operations and oversight is as follows:



*As of March 29, 2007, there were 14 Directors (12 of which are Executive Officers) and 34 Executive Officers.

■ The following measures were implemented recently to strengthen corporate governance.

(As of March 30, 2006)

In order to promote the separation of the execution of business operations by Executive Officers and oversight by directors, OTSUKA CORPORATION has separated the positions of Executive Officers to include Senior Executive Operating Officers and Operating Officers. Respective directors' positions, except the Chief Executive Officer and Executive Managing Director, will remain the same.

(As of April 1, 2006)

In response to the Whistleblower Protection Act, which came into effect from April 1 2006, OTSUKA CORPORATION has strengthened its conventional Internal Reporting and Improvement Proposal System by establishing a "Compliance Hotline" as a means of improving the convenience of reporting procedures and explicitly further protect the confidentiality of informants. In doing so, the Company seeks to take action early on through effective and swift response by rapidly gathering risk-related information from inside and outside the Company.

(As of May 16, 2006)

In order to realize a fundamental stance related to corporate governance, a resolution of the Company's "Basic Policy Regarding Improvement of the Internal Control System" was passed at the Board of Directors on May 16, 2006.

As the basic policy of carrying out business operations, the Company aims to respond quickly to environmental changes and enhance its competitiveness by pursuing thorough compliance and greater management transparency and fairness, thereby pursuing agile and continuous improvement and augmentation of its internal control system.

■ Remuneration for Board Members and Auditors

1) Remuneration for Directors and Corporate Auditors in the current fiscal year is as follows:

Category	Directors		Auditors		Total	
	Number of persons	Compensation (Millions of yen)	Number of persons	Compensation (Millions of yen)	Number of persons	Compensation (Millions of yen)
Remuneration based on Articles of Incorporation or General Meeting of Shareholders resolution (Notes 1, 2, 3 and 4)	13	321	4	30	17	351
Retirement bonuses determined by General Meeting of Shareholders resolution	—	—	—	—	—	—
Total		321		30		351

Notes:

1. Amounts are paid within the range specified below:

Directors: Up to ¥650 million as approved at the General Meeting of Shareholders on March 13, 1990

Auditors: Up to ¥50 million as approved at the General Meeting of Shareholders on March 30, 2005

2. Aside from the above amounts, ¥95 million is used for compensation to 5 Directors for services rendered outside the realm of their directorships.

3. As of the end of the fiscal year, there were 13 directors and 4 auditors.

4. The Company does not have any outside directors.

2) Remuneration for MISUZU Audit Corporation (formerly Chuo Aoyama Pricewaterhouse Coopers) in the current fiscal year is as follows:

Category	Compensation (Millions of yen)
Remuneration for Auditing & Attestation	37
Remuneration for Other Services	—
Total	37

■ Number of Directors

The Company's Articles of Incorporation as of December 31, 2006 stipulate that the number of Company directors shall be within 25 directors.

The Company's Articles of Incorporation as of March 29, 2007 stipulate that the number of Company directors shall be within 19 directors.

Board of Directors and Corporate Auditors (As of March 29, 2007)



President & Chief Executive Officer
Yuji Otsuka



Executive Managing Director
Akira Ishitani



Managing Director
& Senior Executive Operating Officer
Yoshiaki Nagashima



Managing Director
& Senior Executive Operating Officer
Youichi Harada



Managing Director
& Executive Operating Officer
Kazuhide Hamada



Managing Director
& Executive Operating Officer
Kazuyuki Katakura



Managing Director
& Executive Operating Officer
Katsuhiko Nakajima



Managing Director
& Operating Officer
Toshiyasu Takahashi



Managing Director
& Operating Officer
Kimio Shiokawa

Director & Senior Managing Officers

Masakazu Tachibana

Shinji Usami

Katsuhiko Yano

Koji Yama

Hironobu Saito

Standing Auditor

Tatsuzo Yoshida

Auditors

Yuuichi Itou

Jiro Makino

Mikio Sugiyama

Business Risks

The most common risks that could potentially impact the Group's business performance results and financial condition are outlined below. While these are the most common risks, they do not represent all potential risks.

The items covered herein are possible future occurrences determined by the OTSUKA Group as of March 29, 2007.

■ Customer related Risks

OTSUKA CORPORATION does business with over 700,000 companies ranging from large enterprises to small firms. Consequently, its level of dependency on any one customer base, industry or business scale is low. However, the Group's operations could be impacted by convergent changes in IT investment trends by a large number of companies as a result of unexpected changes in the economic environment.

■ Supplier related Risks

The OTSUKA Group is supplied with high-quality products, services and technologies (hereafter called "products") by numerous suppliers for respective segments in order to optimally resolve the problems of each customer. While working to deepen its relationship with suppliers to ensure stable supply of these "products", the Group is constantly working to acquire information on newer "products" as well. However, the Group's operations could be impacted by the inability to supply "products" in the quantity demanded by customers because of insufficient supply of "products" due to issues at supplier sites, as well as by the Group's inability to obtain substitutes.

■ Information Leakage Risks

The OTSUKA Group possesses an abundance of individual and corporate information pertaining to operations that is handled carefully. The Group received approval to use the Privacy Mark of the Japan Information Processing Development Corporation, and its Internet Data Center acquired certification for Information Security Management Systems (ISMS).

As a concrete measure to manage data, the Group has released an internal and external Personal Information Protection Policy, as well as established regulations on personal information protection, confidentiality and information system security. The Group has its employees take a pledge of confidentiality as well as works to prevent information leakage outside of the Group and raises awareness of information management through its proprietary educational "CP (Compliance Program) License System" and other measures. Even with these measures, however, the Group's operations could be impacted by assuming liabilities for damage and loss of trust by society in the unlikely event that personal or corporate information is leaked outside the Group.

Financial Section

Three-Year Financial Data

OTSUKA CORPORATION and Its Consolidated Subsidiaries
Years ended December 31, 2004, 2005 and 2006

	Millions of yen			Thousands of U.S. dollars
	2004	2005	2006	2006
Net sales	¥372,481	¥409,413	¥433,617	\$3,640,173
System Integration Business	238,729	258,275	263,425	2,211,425
Service and Support Business	130,959	149,100	168,701	1,416,232
Other Business	2,792	2,037	1,490	12,515
Operating income	17,009	21,911	26,158	219,595
Recurring profit	17,036	22,210	26,494	222,418
Income before income taxes and minority interests	18,548	20,552	26,350	221,210
Net income	11,247	11,747	15,621	131,138
Total assets	167,228	173,927	189,357	1,589,633
Total interest-bearing debt	21,337	11,695	10,854	91,119
Equity	54,667	58,920	72,848	611,552
Net income per share (EPS) (Yen and U.S. dollars)	355.88	371.72	494.30	4.15
Dividends per share of common stock (Yen and U.S. dollars)	55.00	75.00	115.00	0.97
Cash flows from operating activities per share (Yen and U.S. dollars)	743.43	710.97	440.14	3.69
Operating income to net sales ratio (%)	4.57	5.35	6.03	—
Net income to net sales ratio (%)	3.02	2.87	3.60	—
Total interest-bearing debt ratio (%)	12.76	6.72	5.73	—
Equity ratio (%)	32.69	33.88	38.47	—
Return on equity (ROE) (%)	22.80	20.68	23.71	—

Note:

Equity = Total net assets - Share subscription rights - Minority interests

Figures for ROE are calculated using average equity.

U.S. dollar amounts are computed using the December 31, 2006 exchange rate of ¥119.12 = US\$1.

The dividend in 2006 includes a ¥10 special dividend commemorating the 45th anniversary of the Company.

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Management's Analysis of Operating Results and Financial Position

Summary of Sales and Profits

	2005	2006	Millions of yen	
			Difference to Last Year	% Change to Last Year
Net sales	¥409,413	¥433,617	+24,203	+5.9%
System Integration Business	258,275	263,425	+5,149	+2.0
Service & Support Business	149,100	168,701	+19,600	+13.1
Other Business	2,037	1,490	-546	-26.8
Cost of sales	314,142	330,173	+16,030	+5.1
Gross profit	95,271	103,444	+8,173	+8.6
Selling, general and administrative expenses	73,360	77,286	+3,925	+5.4
Operating income	21,911	26,158	+4,247	+19.4
Recurring profit	22,210	26,494	+4,283	+19.3
Income before income taxes and minority interests	20,552	26,350	+5,797	+28.2
Income taxes				
Current	9,569	9,972	+402	+4.2
Deferred	-994	693	—	—
Net income	11,747	15,621	+3,873	+33.0

Sales Summary

In the term under review, the System Integration Business and Service and Support Business both recorded robust sales, and consolidated subsidiaries also did well as a whole. As a result, consolidated net sales rose 5.9%, to a record ¥433,617 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 information security-related products, servers, color copiers, the "SMILE series" of integrated mission-critical operational systems, the innovative "ODS21" knowledge management system and CAD systems remained brisk, resulting in a 2.0% increase in net sales, to ¥263,425 million.

Service and Support Business

The Service and Support Business follows up system installation by providing total support that includes the provision of supplies, hardware and software maintenance, telephone support, IT education and outsourcing services. Website and catalog sales by the "tanomail" office supply mail-order service business continued to do well, and a solid performance was also recorded by the maintenance business. As a result, net sales grew 13.1%, to ¥168,701 million.

Other Business

In the Other Business, net sales decreased 26.8%, to ¥1,490 million.

Summary of Income and Expenses

Gross profit increased 8.6%, to ¥103,444 million, and the gross profit margin was 23.8%.

As a result of efforts to reduce the cost of sales, operating income rose 19.4%, to ¥26,158 million.

Recurring profit reached a record high for the sixth-straight fiscal year, increasing 19.3%, to ¥26,494 million, following a decrease in other expenses stemming from lower interest expenses.

Due to a completion of amortization of transition amount arising from adopting new accounting standard for retirement benefits in the previous fiscal year, income before income taxes and minority interests increased 28.2%, to ¥26,350 million.

In aggregate, net income increased 33.0%, to ¥15,621 million. Net income per share was ¥494.30, up from ¥371.72 in the preceding fiscal year.

Financial Position

	Millions of yen			
	2005	2006	Difference to Last Year	% Change to Last Year
Assets:	¥173,927	¥189,357	+15,430	+8.9%
Current assets	100,396	116,232	+15,836	+15.8
Fixed assets	73,530	73,124	-406	-0.6
Liabilities:	113,647	115,942	+2,295	+2.0
Current liabilities	99,655	104,279	+4,624	+4.6
Long-term liabilities	13,991	11,663	-2,328	-16.6
Minority interests	1,359	—	—	—
Shareholders' equity	58,920	—	—	—
Net assets	—	73,414	—	—

Assets

Total assets increased ¥15,430 million, to ¥189,357 million. Current assets rose ¥15,836 million, to ¥116,232 million, as the favorable 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 ¥406 million to ¥73,124 million.

Liabilities

Total liabilities rose ¥2,295 million, to ¥115,942 million. Current liabilities increased ¥4,624 million, to ¥104,279 million. This is attributable to the fact that although there was a decrease in income taxes payable, there were increases in accounts and notes payables and other items. Long-term liabilities decreased ¥2,328 million to ¥11,663 million.

Net Assets

Net assets totaled ¥73,414 million owing to such factors as an increase in retained earnings. As a result, the equity ratio rose 4.6 percentage points, to 38.5%.

The interest coverage ratio was 199.91 times; the interest-bearing debt ratio was 5.73%; return on equity (ROE) was 23.71%; and return on assets (ROA) was 14.46%.

	2005	2006
Interest coverage ratio (times)	129.08	199.91
Interest-bearing debt ratio (%)	6.72	5.73
ROE (%)	20.68	23.71
ROA (%)	12.88	14.46

Interest coverage ratio = Business profit / (Interest expenses + Interest payable on bonds)

ROA = Business profit / Total assets (average during the fiscal year)

Business profit = Operating income + Interest and dividend income

Cash flows

	Millions of yen	
	2005	2006
Cash flows from operating activities	¥22,468	¥13,909
Cash flows from investing activities	-4,986	-7,161
Cash flows from financing activities	-11,338	-1,250
Cash and cash equivalents at end of year	13,891	18,305

Cash Flows from Operating Activities

Cash provided by operating activities decreased ¥8,558 million (38.1%) to ¥13,909 million. This is mainly due to an increase in income taxes paid.

Cash Flows from Investing Activities

Cash used in investing activities increased ¥2,175 million (43.6%), to ¥7,161 million, mainly due a rise in payments for purchase of investments in securities.

Free cash flows, which are the sum of cash provided by operating activities and cash used in investing activities, decreased ¥10,734 million, to ¥6,747 million.

Cash Flows from Financing Activities

Cash used in financing activities decreased ¥10,087 million (89.0%) to ¥1,250 million. This is chiefly attributable to payments for the reimbursement of debts in the previous term.

Outlook

Consolidated projections for the current fiscal year ending December 31, 2007, are as follows: a 4.7% increase in net sales, to ¥454 billion; a 7.8% rise in operating income, to ¥28.2 billion; a 7.6% increase in recurring profit, to ¥28.5 billion; and a 2.4% rise in net income, to ¥16.0 billion.

For respective segments, the System Integration Business is expected to increase 2.5%, to ¥270,030 million; the Service and Support Business is expected to increase 8.4%, to ¥182,866 million; and the Other Business is expected to decrease 25.9%, to ¥1,104 million.

Consolidated Balance Sheets

OTSUKA CORPORATION and Its Consolidated Subsidiaries
December 31, 2005 and 2006

Thousands of
U.S. dollars
(Note 3)

	Millions of yen		2006
	2005	2006	
ASSETS			
Current assets			
Cash, time deposits and other cash equivalents (Notes 10 and 14)	¥ 14,507	¥ 18,421	\$ 154,646
Accounts and notes receivable:			
Trade	60,515	71,726	602,139
Unconsolidated subsidiaries and affiliates	2	21	184
Other	2,763	3,074	25,811
	63,281	74,823	628,134
Less: Allowance for bad debts	(283)	(237)	(1,992)
	62,997	74,586	626,142
Inventories (Note 6)	16,652	16,561	139,035
Deferred tax assets (Note 9)	2,151	1,984	16,660
Other current assets	4,086	4,678	39,271
Total current assets	100,396	116,232	975,756
Investments and advances			
Investments in securities (Note 4)	4,568	5,699	47,847
Investments in unconsolidated subsidiaries and affiliates	408	1,969	16,536
Guarantee deposits	2,763	2,701	22,675
Deferred tax assets non-current (Note 9)	2,579	1,581	13,276
Other investments	5,132	5,286	44,383
Less: Allowance for bad debts	(830)	(777)	(6,527)
	14,621	16,461	138,190
Property, plant and equipment (Notes 13 and 14)			
Land	17,592	17,425	146,287
Buildings and structures	65,841	66,317	556,728
Construction in progress	63	—	—
Others	12,242	12,504	104,973
	95,739	96,247	807,988
Less: Accumulated depreciation	(42,094)	(44,195)	(371,017)
Net property, plant and equipment	53,645	52,051	436,970
Intangibles and deferred charges			
Software	4,830	4,306	36,153
Others	433	305	2,561
	5,264	4,611	38,715
Total assets	¥173,927	¥189,357	\$1,589,633

The accompanying notes are an integral part of these statements.

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
LIABILITIES, MINORITY INTERESTS AND SHAREHOLDERS' EQUITY (LIABILITIES AND NET ASSETS)			
Current liabilities			
Short-term bank loans (Note 7)	¥ 7,600	¥ 7,650	\$ 64,220
Current maturities of long-term debts (Note 7)	891	622	5,228
Accounts and notes payable:			
Trade	46,932	51,241	430,163
Unconsolidated subsidiaries and affiliates	146	366	3,080
Other	22,251	23,889	200,547
	69,330	75,497	633,791
Income taxes payable (Note 9)	7,447	5,446	45,726
Other current liabilities	14,385	15,062	126,451
Total current liabilities	99,655	104,279	875,418
Long-term liabilities			
Long-term debt (Note 7)	3,204	2,581	21,669
Reserve for retirement benefits (Note 8)	10,277	8,549	71,774
Deferred tax liabilities non-current (Note 9)	29	42	355
Deferred tax liabilities on revaluation of land	267	267	2,249
Other long-term liabilities	212	221	1,860
	13,991	11,663	97,910
Minority interests in consolidated subsidiaries	1,359	—	—
Shareholders' equity			
Common stock:			
Authorized: 112,860,000 shares			
Outstanding: December 31, 2005 31,667,020 shares	10,374	—	—
Capital surplus	16,254	—	—
Retained earnings	46,941	—	—
Excess of land revaluation after tax-effect accounting (Note 13)	(15,572)	—	—
Unrealized gain on investment securities after tax-effect accounting	1,109	—	—
Foreign currency translation adjustment	(74)	—	—
Less: Treasury stock			
December 31, 2005 64,431 shares	(113)	—	—
Total shareholders' equity	58,920	—	—
Total liabilities, minority interests and shareholders' equity	¥ 173,927	—	—

The accompanying notes are an integral part of these statements.

Consolidated Balance Sheets

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Net assets			
Owners' equity			
Common stock:			
Authorized: 112,860,000 shares			
Outstanding: December 31, 2006 31,667,020 shares	—	¥ 10,374	\$ 87,095
Capital surplus	—	16,254	136,456
Retained earnings	—	60,120	504,703
Treasury stock			
December 31, 2006 64,726 shares	—	(117)	(985)
Total owners' equity	—	86,632	727,271
Revaluation and translation adjustments			
Unrealized gain on investment securities after tax-effect accounting	—	1,779	14,942
Deferred losses on hedges	—	(0)	(3)
Excess of land revaluation after tax-effect accounting (Note 13)	—	(15,500)	(130,122)
Foreign currency translation adjustment	—	(63)	(534)
Total revaluation and translation adjustments	—	(13,784)	(115,718)
Minority interests in consolidated subsidiaries			
Total net assets	—	566	4,751
Total net assets	—	73,414	616,304
Total liabilities and net assets	—	¥189,357	\$1,589,633

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, 2005 and 2006

Thousands of
U.S. dollars
(Note 3)

	Millions of yen		2006
	2005	2006	
Net sales (Note 16)	¥409,413	¥433,617	\$3,640,173
Cost of sales (Notes 15 and 16)	314,142	330,173	2,771,769
Gross profit	95,271	103,444	868,404
Selling, general and administrative expenses (Notes 15 and 16)	73,360	77,286	648,808
Operating income	21,911	26,158	219,595
Other income (expenses)			
Interest and dividend income	61	105	881
Interest expenses	(170)	(131)	(1,102)
Gain on sale of investments in subsidiaries and affiliates	86	—	—
Transfer from allowance for bad debts	16	49	411
Dilution gain from change in equity interest	13	344	2,892
Loss on sale / disposal of property, plant and equipment	(99)	(267)	(2,245)
Impairment losses	—	(102)	(861)
Loss on sale of investments in securities	(4)	—	—
Loss on revaluation of investments in securities	—	(34)	(291)
Loss on revaluation of investments in subsidiaries and affiliates	—	(132)	(1,114)
Loss on revaluation of membership	(1)	—	—
Amortization of transition amount arising from adopting new accounting standard for retirement benefits	(1,668)	—	—
Other, net	408	362	3,043
	(1,358)	192	1,614
Income before income taxes and minority interests	20,552	26,350	221,210
Income taxes (Note 9)			
Current	9,569	9,972	83,719
Deferred	(994)	693	5,819
	8,575	10,665	89,538
Minority interests in net gains of consolidated subsidiaries	229	63	532
Net income	¥ 11,747	¥ 15,621	\$ 131,138
		yen	U.S. dollars (Note 3)
Net income and dividends per share (Note 2(14))			
Basic net income	¥371.72	¥494.30	\$4.15
Diluted net income	371.66	—	—
Cash dividends	75.00	115.00	0.97

The accompanying notes are an integral part of these statements.

Consolidated Statements of Changes in Net Assets

OTSUKA CORPORATION and Its Consolidated Subsidiaries For the years ended December 31, 2005 and 2006						Millions of yen
	Number of shares issued	Owners' equity				Total owners' equity
		Common stock	Capital surplus	Retained earnings	Treasury stock	
Balance at December 31, 2004	31,667,020	¥10,374	¥16,254	¥36,932	¥(109)	¥63,452
Dividends from surplus				(1,738)		(1,738)
Net income				11,747		11,747
Acquisition of treasury stock					(3)	(3)
Items other than changes in owners' equity						
Balance at December 31, 2005	31,667,020	10,374	16,254	46,941	(113)	73,457
Dividends from surplus				(2,370)		(2,370)
Net income				15,621		15,621
Reversal of revaluation difference on land				(72)		(72)
Acquisition of treasury stock					(3)	(3)
Items other than changes in owners' equity						
Balance at December 31, 2006	31,667,020	¥10,374	¥16,254	¥60,120	¥(117)	¥86,632

							Millions of yen
	Unrealized gain on investment securities	Revaluation and translation adjustments			Total revaluation and translation adjustments	Minority interest in consolidated subsidiaries	Total net assets
		Deferred losses on hedges	Revaluation of land	Foreign currency translation adjustments			
Balance at December 31, 2004	¥413	—	¥(9,075)	¥(122)	¥(8,785)	¥1,098	¥55,765
Dividends from surplus							(1,738)
Net income							11,747
Acquisition of treasury stock							(3)
Items other than changes in owners' equity	696		(6,496)	48	(5,751)	261	(5,490)
Balance at December 31, 2005	1,109	—	(15,572)	(74)	(14,537)	1,359	60,279
Dividends from surplus							(2,370)
Net income							15,621
Reversal of revaluation difference on land							(72)
Acquisition of treasury stock							(3)
Items other than changes in owners' equity	670	(0)	72	10	752	(793)	(40)
Balance at December 31, 2006	¥1,779	¥(0)	¥(15,500)	¥(63)	¥(13,784)	¥566	¥73,414

The consolidated statements of changes in net assets for the fiscal year ended December 31, 2005 are presented under the new standard.

The accompanying notes are an integral part of these statements.

OTSUKA CORPORATION and Its Consolidated Subsidiaries
For the years ended December 31, 2005 and 2006

Thousands of U.S. dollars (Note 3)

	Number of shares issued	Owners' equity				Total owners' equity
		Common stock	Capital surplus	Retained earnings	Treasury stock	
Balance at December 31, 2005	31,667,020	\$87,095	\$136,456	\$394,071	\$(954)	\$616,668
Dividends from surplus				(19,897)		(19,897)
Net income				131,138		131,138
Reversal of revaluation difference on land				(608)		(608)
Acquisition of treasury stock					(30)	(30)
Items other than changes in owners' equity						
Balance at December 31, 2006	31,667,020	\$87,095	\$136,456	\$504,703	\$(985)	\$727,271

Thousands of U.S. dollars (Note 3)

	Revaluation and translation adjustments						Total net assets
	Unrealized gain on investment securities	Deferred losses on hedges	Revaluation of land	Foreign currency translation adjustments	Total revaluation and translation adjustments	Minority interest in consolidated subsidiaries	
Balance at December 31, 2005	\$9,314	—	\$(130,730)	\$(621)	\$(122,037)	\$11,411	\$506,043
Dividends from surplus							(19,897)
Net income							131,138
Reversal of revaluation difference on land							(608)
Acquisition of treasury stock							(30)
Items other than changes in owners' equity	5,627	(3)	608	86	6,318	(6,660)	(341)
Balance at December 31, 2006	\$14,942	\$(3)	\$(130,122)	\$(534)	\$(115,718)	\$4,751	\$616,304

The consolidated statements of changes in net assets for the fiscal year ended December 31, 2005 are presented under the new standard.

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, 2005 and 2006

Thousands of
U.S. dollars
(Note 3)

	Millions of yen		2006
	2005	2006	
Cash flows from operating activities:			
Income before income taxes and minority interests	¥20,552	¥26,350	\$221,210
Depreciation and amortization	6,066	5,883	49,387
Amortization of difference between cost of investment and equity in net assets of consolidated subsidiaries	20	—	—
Amortization of goodwill	—	132	1,111
Increase(decrease) in reserve for retirement benefits	1,100	(1,666)	(13,986)
Increase(decrease) in allowance for bad debts	28	(81)	(680)
Interest and dividend income	(61)	(105)	(881)
Interest expenses	170	131	1,102
Loss on sale / disposal of property, plant and equipment	99	267	2,245
Impairment losses	—	102	861
Gain on sale of investments in subsidiaries and affiliates	(86)	—	—
Loss on sale of investments in securities	4	—	—
Loss on revaluation of investments in securities	—	34	291
Loss on revaluation of investments in subsidiaries and affiliates	—	132	1,114
Loss on revaluation of membership	1	—	—
Dilution gain from change in equity interest	(13)	(344)	(2,892)
Increase in accounts and notes receivable	(5,249)	(11,090)	(93,105)
Increase in inventories	(367)	(113)	(948)
Increase in accounts and notes payable	4,178	5,961	50,047
Other	1,764	123	1,034
Subtotal	28,209	25,719	215,911
Interest and dividend income received	61	102	862
Interest expenses paid	(169)	(124)	(1,048)
Income taxes paid	(5,632)	(11,787)	(98,956)
Net cash provided by operating activities	22,468	13,909	116,769
Cash flows from investing activities:			
Payments for purchase of property, plant and equipment	(2,561)	(2,253)	(18,915)
Proceeds from sale of property, plant and equipment	11	206	1,733
Payments for software developed	(2,166)	(2,146)	(18,017)
Payments for purchase of investments in securities	(357)	(2,486)	(20,874)
Proceeds from sale of investments in securities	144	39	331
Payments for long-term loans receivable	(6)	(6)	(50)
Proceeds from long-term loans receivable	4	5	42
Other	(53)	(520)	(4,371)
Net cash used in investing activities	(4,986)	(7,161)	(60,123)
Cash flows from financing activities:			
Increase (decrease) in short-term bank loans, net	(6,250)	50	419
Proceeds from long-term debts	2,900	1,000	8,394
Repayments for long-term debts	(6,291)	(891)	(7,486)
Proceeds from issue of new shares	63	1,008	8,465
Cash dividends paid	(1,737)	(2,370)	(19,897)
Other	(22)	(46)	(391)
Net cash used in financing activities	(11,338)	(1,250)	(10,496)
Effect of exchange rate changes on cash and cash equivalents	29	7	62
Net increase in cash and cash equivalents	6,174	5,504	46,212
Cash and cash equivalents at beginning of year	7,717	13,891	116,615
Decrease in cash and cash equivalents due to exclusion of subsidiaries from scope of consolidation (Note 10(2))	—	(1,090)	(9,155)
Cash and cash equivalents at end of year (Note 10(1))	¥13,891	¥18,305	\$153,672

The accompanying notes are an integral part of these statements.

Notes to Consolidated Financial Statements

OTSUKA CORPORATION and Its Consolidated Subsidiaries

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 Company Law and 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 15 subsidiaries (majority-owned companies) and 15 subsidiaries as at December 31, 2005 and 2006, respectively. The consolidated financial statements include the accounts of the Company and 11 subsidiaries and 10 subsidiaries for the years ended December 31, 2005 and 2006, respectively.

The 10 subsidiaries which were consolidated in the year ended December 31, 2006 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%

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 4 and 5 unconsolidated subsidiaries as at December 31, 2005 and 2006, 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 2006)

SIOS Technology, Inc. (formerly 10art-ni Corporation) was changed from a consolidated subsidiary to an affiliate for the equity method from fiscal year 2006, due to a decrease in the share ratio and decrease in the number of the directors from the Company. The Consolidated Statements of Income for the year ended December 31, 2006 included the Statements of Income of SIOS Technology, Inc.

(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 4 unconsolidated subsidiaries and 10 affiliates at December 31, 2005 and 5 unconsolidated subsidiaries and 9 affiliates at December 31, 2006.

The Company had no investment in affiliate for the equity method and 1 investment in affiliate for the equity method at December 31, 2005 and 2006. 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.

The 1 investment in affiliate by the equity method at December 31, 2006, is listed below:

	Equity ownership percentage
SIOS Technology, Inc.	46.0%

(Fiscal year 2006)

SIOS Technology, Inc. was changed from a consolidated subsidiary to an affiliate for the equity method from fiscal year 2006, due to a decrease in the share ratio and decrease in the number of the directors from the Company.

(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 net assets.

(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 the 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 net assets 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, 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.

(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.

(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 2005)

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

(Fiscal year 2006)

Along with the maintenance of bylaw, 1 consolidated subsidiary has 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.

Diluted net income per common share assumes full exercise of outstanding stock options which have a dilutive effect.

Diluted net income per common share for the year ended December 31, 2006, is not disclosed because there were no potentially dilutive securities outstanding.

(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 2006)

Accounting standard for presentation of net assets in the balance sheet

Effective from the year ended December 31, 2006, the Company has applied "Accounting standards for presentation of net assets in the balance sheet (Accounting Standards Board of Japan Statement No.5)", and "Implementation guidance for Accounting standards for presentation of net assets in the balance sheet (Accounting Standards of Japan Guidance No.8)" both issued by the Accounting Standard Board of Japan on December 9, 2005.

The amount corresponding to the conventional "Shareholders' equity" in the balance sheet is ¥72,848 million.

"Net assets" in the balance sheets for this year is presented according to the revision of "Regulations concerning the Terminology, Form and Presentation Methods of Consolidated Financial Statements" dated on April 25, 2006.

Furthermore, the Company presented its net assets in the balance sheets using the new presentation as of December 31, 2006.

(17) Change of presentation

(Fiscal year 2005)

Balance Sheet

In accordance with the "Law for the Partial Revision of the Securities and Exchange Law etc." (Law 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 at December 31, 2005 and these amount included in "Other investments" was ¥183 million at December 31, 2004.

(Fiscal year 2006)

Statement of Cash Flows

In accordance with the revision of "Regulations concerning the Terminology Form and Presentation Methods of Consolidated Financial Statements" dated on April 25, 2006, "Amortization of Goodwill", which was included in "Depreciation" in the previous fiscal year, is presented separately in the current year. "Amortization of Goodwill" included in "Depreciation" was ¥126 million at December 31, 2005. "Amortization of difference between cost of investment and equity in net assets of consolidated subsidiaries" which was presented separately in the previous fiscal year, is included in "Amortization of Goodwill" in the current year.

(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 ¥119.12=US\$1, the rate of exchange on December 31, 2006, 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, 2005 and 2006 investments in securities were as follows:

(1) Other securities with fair value

	Millions of yen						Thousands of U.S. dollars		
	2005			2006			2006		
	Cost	Carrying amount	Differences	Cost	Carrying amount	Differences	Cost	Carrying amount	Differences
Fair value greater than cost									
Stocks	¥1,316	¥3,087	¥1,771	¥1,311	¥4,304	¥2,992	\$11,011	\$36,135	\$25,124
Bonds	—	—	—	—	—	—	—	—	—
Other securities	89	182	93	92	151	59	774	1,271	497
	¥1,405	¥3,270	¥1,865	¥1,403	¥4,455	¥3,052	\$11,785	\$37,407	\$25,621
Fair value less than or equal to cost									
Stocks	¥1	¥1	¥(0)	¥266	¥216	¥(50)	\$2,237	\$1,814	\$(423)
Bonds	—	—	—	—	—	—	—	—	—
Other securities	—	—	—	—	—	—	—	—	—
	¥1	¥1	¥(0)	¥266	¥216	¥(50)	\$2,237	\$1,814	\$(423)
Total	¥1,407	¥3,272	¥1,864	¥1,670	¥4,672	¥3,001	\$14,023	\$39,221	\$25,197

(2) Other securities sold in 2005 and 2006 (for the years ended December 31, 2005 and 2006)

						Millions of yen	Thousands of U.S. dollars		
2005			2006			2006			
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	
¥2	—	¥4	¥38	¥1	—	\$322	\$8	—	

(3) Securities not stated at fair value

		Millions of yen	Thousands of U.S. dollars	
2005		2006	2006	
Stated amount on consolidated balance sheets		Stated amount on consolidated balance sheets	Stated amount on consolidated balance sheets	
Other securities				
Unlisted stocks	¥1,068	¥713	\$5,992	
Foreign currency-denominated mutual fund	35	—	—	
Preferred subscription certification	10	10	83	
Investment limited liability partnerships	182	303	2,549	

(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	
2005		2006		2006		2006	
Within one year	More than one year	Within one year	More than one year	Within one year	More than one year	Within one year	More than one year
Others	¥10	¥10	—	\$83	—	—	—
Total	¥10	¥10	—	\$83	—	—	—

5. Derivative Information

At December 31, 2005 and 2006 derivatives were as follows:

Currency

		Millions of yen		Thousands of U.S. dollars	
2005		2006		2006	
Contractual value or notional principal amount		Contractual value or notional principal amount		Fair value	Valuation gain(loss)
Total	Over one year	Total	Over one year	Fair value	Valuation gain(loss)
Currency swap Purchased U.S.dollar	¥377	¥266	—	¥379	¥1

		Millions of yen		Thousands of U.S. dollars	
2006		2006		2006	
Contractual value or notional principal amount		Contractual value or notional principal amount		Fair value	Valuation gain(loss)
Total	Over one year	Total	Over one year	Fair value	Valuation gain(loss)
Currency swap Purchased U.S.dollar	¥266	—	—	¥279	¥13

		Thousands of U.S. dollars		Thousands of U.S. dollars	
2006		2006		2006	
Contractual value or notional principal amount		Contractual value or notional principal amount		Fair value	Valuation gain(loss)
Total	Over one year	Total	Over one year	Fair value	Valuation gain(loss)
Currency swap Purchased U.S.dollar	\$2,235	—	—	\$2,347	\$111

(Note)

Except for derivatives that are designed as hedging instruments

6. Inventories

Inventories at December 31, 2005 and 2006 comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2005	2006	2006
Merchandise and maintenance parts	¥15,766	¥15,797	\$132,618
Work-in-process	763	655	5,502
Supplies	122	108	914
	¥16,652	¥16,561	\$139,035

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

The annual average interest rates applicable to short-term bank loans at December 31, 2005 and 2006 were 0.75% and 1.14%, respectively.

Long-term debt at December 31, 2005 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2005	2006	2006
Long-term loans from banks with annual interest rates from 0.83% to 1.87%	¥4,095	¥3,204	\$26,898
	4,095	3,204	26,898
Less : Current maturities of long-term debts	(891)	(622)	(5,228)
	¥3,204	¥2,581	\$21,669

Aggregate annual maturities of long-term debt subsequent to December 31, 2006 are as follows:

Year ending December 31	Millions of yen	Thousands of U.S. dollars
2007	¥ 622	\$ 5,228
2008	2,581	21,669
	¥3,204	\$26,898

8. Reserve for Retirement Benefits

(1) Retirement benefit plan

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, 2005 and 2006 is analyzed as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2006	2006
Projected benefit obligations	¥(38,389)	¥(40,623)	\$(341,033)
Plan assets	36,958	42,723	358,658
	(1,430)	2,099	17,625
Unrecognized prior service cost	(7,079)	(6,389)	(53,635)
Unrecognized actuarial differences	1,877	(683)	(5,739)
	(6,632)	(4,973)	(41,750)
Prepaid pension cost	(3,261)	(3,134)	(26,313)
Reserve for retirement benefits	¥ (9,893)	¥ (8,107)	\$ (68,064)

The balance of the reserve for retirement benefits in the accompanying consolidated balance sheets at December 31, 2005 and 2006 included retirement benefits for directors in the amounts of 384 million yen and 441 million yen (3,709 thousand U.S. dollars), respectively.

(3) Pension expense related to the retirement benefits for the year ended December 31, 2005 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2006	2006
Service cost	¥2,910	¥3,028	\$25,420
Interest cost	527	563	4,728
Expected return on plan assets	(554)	(1,108)	(9,307)
Amortization of transition amount	1,668	—	—
Amortization of the unrecognized Prior service cost	(690)	(690)	(5,798)
Amortization of the unrecognized actuarial differences	831	328	2,756
Additional benefits for employees' early retirement	126	126	1,057
Net pension expense	¥4,819	¥2,246	\$18,856

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

(4) Computation Basis of Pension Liabilities

As of December 31, 2005 and 2006

	2005	2006
Discount rate	1.5%	1.5%
Expected rate of return on plan assets	2.0%	3.0%
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	—
Amortization of unrecognized actuarial differences	12 years from the fiscal year following occurrence	12 years from the fiscal year following occurrence

9. Income Taxes

(Fiscal year 2005)

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 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 is not presented.

(Fiscal year 2006)

The statutory tax rate used for calculating deferred tax assets and liabilities at December 31, 2006 was 40.7%.

Since the difference between the statutory tax rate and the effective tax rate (40.5%) for the fiscal year ended December 31, 2006 is less than 5%, a reconciliation of these two rates is not presented.

At December 31, 2005 and 2006, significant components of the deferred tax assets and liabilities were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2006	2006
Deferred tax assets:			
Allowance for bad debts	¥ 248	¥ 244	\$ 2,052
Enterprise taxes	684	537	4,515
Accrued bonuses	1,029	1,076	9,033
Retirement benefits for employees	3,994	3,271	27,466
Retirement benefits for directors	168	192	1,614
Membership	291	—	—
Impairment losses	912	653	5,485
Software cost	137	347	2,915
Operating loss carryforwards	173	—	—
Eliminated unrealized profits	445	460	4,442
Other	837	921	7,156
Total deferred tax assets	8,923	7,704	64,681
Less: Valuation allowance	(326)	(231)	(1,940)
Net deferred tax assets	8,596	7,473	62,740
Deferred tax liabilities:			
Reserve for computer program	1,786	1,432	12,023
Prepaid pension cost	1,333	1,284	10,783
Unrealized gain on investment securities	761	1,221	10,255
Other	17	16	141
Total deferred tax liabilities	3,898	3,955	33,204
Net deferred tax assets	¥4,698	¥3,518	\$29,536

10. Supplementary Cash Flow Information

(1) Cash and cash equivalents consisted of:

	Millions of yen		Thousands of U.S. dollars
	2005	2006	2006
Cash, time deposits and other cash equivalents	¥14,507	¥18,421	\$154,646
Time deposits with deposit terms of more than three months	(616)	(116)	(973)
Cash and cash equivalents at end of year	¥13,891	¥18,305	\$ 153,672

(2) The main items of assets and liabilities of SIOS technology, Inc. which was changed from a consolidated subsidiary to an affiliate for the equity method are as follows:

(Fiscal year 2006)

	Millions of yen	Thousands of U.S. dollars
Current assets	¥2,825	\$23,723
(Cash and cash equivalents)	(1,090)	(9,155)
Non-current assets	2,437	20,460
Total assets	5,263	44,183
Current liabilities	1,454	12,206
Non-current liabilities	1,055	8,863
Total liabilities	2,509	21,069

11. Subsequent Events

(1) Appropriation

The following appropriation of the Company's retained earnings in respect of the year ended December 31, 2006 was as proposed by the Board of Directors and approved by the shareholders at the annual general meeting held on March 29, 2007:

Appropriation	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥115.00 per share)	¥3,634	\$30,509

The dividend in 2006 includes a 10-yen special dividend commemorating the 45th anniversary of the Company.

12. Lease Transactions

Acquisition costs, accumulated depreciation and net book values of leased assets at December 31, 2005 and 2006 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2006	2006
Acquisition cost	¥6,154	¥6,586	\$55,294
Accumulated depreciation	(3,307)	(3,630)	(30,479)
Net book value	¥2,847	¥2,955	\$24,814

Future minimum lease payments under finance leases at December 31, 2005 and 2006 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2006	2006
Due within one year	¥1,159	¥1,127	\$ 9,466
Due after one year	1,734	1,871	15,715
	¥2,893	¥2,999	\$25,181
Accumulated impairment loss on leaseholds	0	—	—

Lease rental expenses, depreciation and interest expenses for the years ended December 31, 2005 and 2006 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2006	2006
Lease rental expenses	¥1,395	¥1,317	\$11,059
Depreciation	1,330	1,246	10,461
Release of accumulated impairment loss on leaseholds	0	0	0
Interest expenses	55	65	553

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, 2005 and 2006 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2006	2006
Due within one year	¥ 479	¥ 475	\$3,992
Due after one year	1,152	711	5,977
	¥1,632	¥1,187	\$9,969

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 revaluation was recorded as "Excess of land revaluation after tax-effect accounting" net assets 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 1,509 million yen (12,671 thousand U.S. dollars) at December 31, 2006.

14. Pledged Assets

At December 31, 2005 and 2006, assets pledged as collateral for accounts and notes payable and loan from banks were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2006	2006
Land	¥ 816	¥ 535	\$ 4,493
Buildings	813	653	5,486
Time deposits	11	11	92
	¥1,641	¥1,199	\$10,072

15. 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, 2005 and 2006 amounted to 667 million yen and 839 million yen (7,048 thousand U.S. dollars), respectively.

16. Segment Information

The business segment information of the Company and its consolidated subsidiaries for the years ended December 31, 2005 and 2006 is summarized as follows:

(1) Business segment information

	Millions of yen					
	System Integration	Service & Support	Other	Total	Elimination or corporate	Consolidated total
2005						
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

	Millions of yen					
	System Integration	Service & Support	Other	Total	Elimination or corporate	Consolidated total
2006						
Net sales to:						
Outside customers	¥263,425	¥168,701	¥1,490	¥433,617	¥ —	¥433,617
Inter-segment sales/transfers	106	234	2,505	2,845	(2,845)	—
	263,531	168,935	3,996	436,463	(2,845)	433,617
Operating expenses	242,772	156,731	3,915	403,419	4,039	407,459
Operating income	¥ 20,758	¥ 12,204	¥ 80	¥ 33,044	¥ (6,885)	¥ 26,158
Assets, depreciation and capital expenditure:						
Assets	¥ 90,523	¥ 69,290	¥2,029	¥161,843	¥27,513	¥189,357
Depreciation and amortization	2,938	2,187	29	5,155	727	5,883
Impairment losses	68	34	—	102	(0)	102
Capital expenditure	2,171	2,115	7	4,294	210	4,504

	Thousands of U.S. dollars					
	System Integration	Service & Support	Other	Total	Elimination or corporate	Consolidated total
2006						
Net sales to:						
Outside customers	\$2,211,425	\$1,416,232	\$12,515	\$3,640,173	\$ —	\$3,640,173
Inter-segment sales/transfers	891	1,967	21,032	23,891	(23,891)	—
	2,212,317	1,418,199	33,548	3,664,065	(23,891)	3,640,173
Operating expenses	2,038,050	1,315,743	32,870	3,386,663	33,913	3,420,577
Operating income	\$ 174,267	\$ 102,456	\$ 678	\$ 277,401	\$ (57,805)	\$ 219,595
Assets, depreciation and capital expenditure:						
Assets	\$ 759,932	\$ 581,688	\$17,036	\$1,358,657	\$230,975	\$1,589,633
Depreciation and amortization	24,666	18,364	250	43,281	6,106	49,387
Impairment losses	575	286	—	861	(0)	861
Capital expenditure	18,232	17,758	62	36,054	1,764	37,818

Notes ;

1. Business segments are defined in consideration of the operations of the companies.
2. Significant operations of each segment are as summarized below;

Segment	Major product and services
System Integration business	Research, analysis, design, and introduction for comprehensive information system Transport and installation Network construction Introduction for packaged software Development of consigned software Other related services
Service and Support business	Supplies for comprehensive information system Telephone support Maintenance Consigned system operation Data recovery IT education Guidance for operation of packaged software Hotel business
Other business	Construction Sale, repair of automobiles Insurance Printing

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

	Millions of yen		Thousands of U.S. dollars
	2005	2006	2006
Non-allocable operating expenses	¥ 6,165	¥ 6,923	\$ 58,120
Corporate assets	26,126	29,214	245,251

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.

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

5. (Fiscal year 2006)

In accordance with the revision of "Regulations concerning the Terminology, Form and Presentation Methods of Consolidated Financial Statements" dated on April 25, 2006, amortization of goodwill is excluded from "Depreciation and amortization". Amortization of goodwill was included in "Depreciation and amortization" (¥126 million) at December 31, 2005.

(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.

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 2006, and the related consolidated statements of income, changes in net assets, 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 2006, 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.

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.



MISUZU Audit Corporation

Tokyo, Japan

March 29, 2007

Principal Group Companies (As of December 31, 2006)

The OTSUKA Group (OTSUKA CORPORATION and its subsidiaries) consists of 15 subsidiaries, including 10 consolidated subsidiaries as well as 10 affiliated companies, including 1 affiliate for the equity method that carry out System Integration, Service and Support, and Other Business. The 10 consolidated subsidiaries are listed below.

Company Name	Established	Capital (¥ million)	Voting right ratio	Scope of Business
■ System Integration Business				
OSK Co., Ltd.	1984	300	100.0%	• Development and sale of packaged software
Netplan Co., LTD.	1992	400	100.0%	• Electronic communications construction and interior construction
Alpha System Co., LTD.	1967	80	100.0%	• Consigned software development, packaged software development and ERP consulting business
Net World Corporation	1990	585	68.4%	• Sales and technical support for network related equipment
Otsuka Information Technology Corp. (Taiwan)	1997	NT\$116 million	100.0%	• Sale of CAD/CAM solutions
■ Service and Support Business				
Alpha Techno Co., LTD.	1996	50	100.0%	• Emergency repair of PCs and peripheral equipment, disposal and data recovery service
Alpha Net Co., LTD.	1997	400	100.0%	• Comprehensive service and support for network systems
■ Other Business				
Fujimi Construction Co., LTD.	1964	99	100.0%	• Construction, building maintenance and management
Otsuka Auto Service Co., LTD.	1987	50	100.0%	• Sale, maintenance and body work for automobiles, and commissioned sales of insurance
Otsuka Business Service Co., LTD.	1992	50	65.0%	• Creation and commissioned shipment of direct mail materials, data management and processing as well as commissioned creation of Websites

Corporate Data (As of December 31, 2006)

Name	OTSUKA CORPORATION
Founded	July 17, 1961 (registered as joint-stock company on December 13, 1961)
Paid-in Capital	¥10,374,851,000
Number of Employees	6,379 (with consolidated subsidiaries: 7,773)
Business	<p>System Integration Business :</p> <p>Sales of computers, copiers, communication equipment and software, and software development of consigned software, other activities</p> <p>Service and Support Business :</p> <p>Supplies, maintenance, and educational support, other activities</p>
Main Banks	<p>The Bank of Yokohama, Ltd.</p> <p>The Bank of Tokyo-Mitsubishi UFJ, Ltd.</p> <p>Mizuho Bank, Ltd.</p>

Base (As of December 31, 2006)

Head Office	2-18-4 Iidabashi, Chiyoda-ku, Tokyo, 102-8573		
	TEL 03-3264-7111		
Branch Offices	Metropolitan Office		
	2-18-4 Iidabashi, Chiyoda-ku, Tokyo, 102-8573		
	TEL 03-3264-7111		
	Kansai Office		
	6-14-1 Fukushima, Fukushima-ku, Osaka-shi, Osaka, 553-8558		
	TEL 06-6456-2711		
	Chubu Office		
	3-5-33 Masaki, Naka-ku, Nagoya-shi, Aichi, 460-0024		
	TEL 052-350-4811		
Local Area Sales Groups	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		
Regional Offices	Sapporo Branch	Sendai Branch	Utsunomiya Branch
	Nagoya Branch	Mikawa Branch	Kyoto Branch
	Kobe Branch	Hiroshima Branch	Kyushu Branch

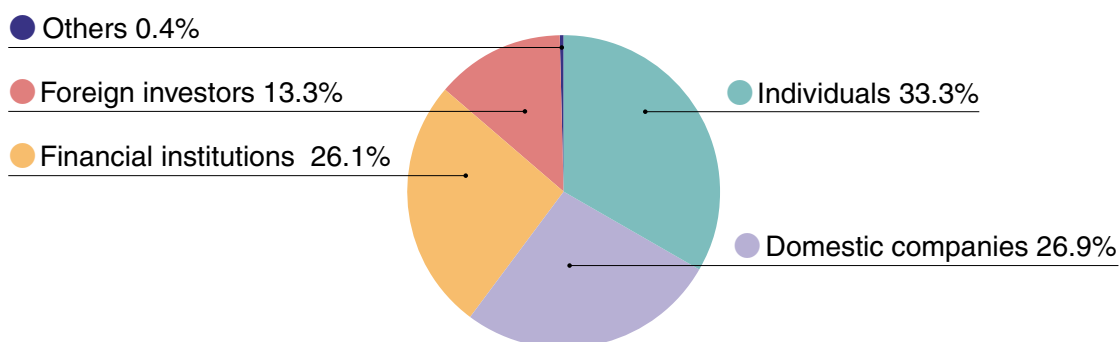
Stock Information (As of December 31, 2006)

Authorized Common Stock	112,860,000 shares
Issued Common Stock	31,667,020 shares
Number of Shares of Unit Stock	100 shares
Number of Shareholders	5,044

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.	8,158,730	25.76	—	—
Japan Trustee Services Bank, Ltd. (Trust Account)	2,702,200	8.53	—	—
Yuji Otsuka	2,576,580	8.13	—	—
The Master Trust Bank of Japan, Ltd. (Trust Account)	1,696,700	5.35	—	—
Minoru Otsuka	1,525,490	4.81	—	—
Atsushi Otsuka	1,075,650	3.39	—	—
OTSUKA CORPORATION Employee Stock-Sharing Plan	1,038,420	3.27	—	—
Terue Otsuka	645,500	2.03	—	—
The Chase Manhattan Bank, N.A. London Secs Lending Omnibus Account	564,330	1.78	—	—
Trustee of Individually Operated Designated Money Trusts (Shiteitan) Mitsui Asset Trust and Banking Company, Limited (Account 1)	549,200	1.73	—	—

Breakdown of Shareholders (Based on total shares)



OTSUKA CORPORATION WEBSITE

<http://www.otsuka-shokai.co.jp>

Otsuka Corporation

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