

ANNUAL REPORT 2018

For the fiscal year ended December 31, 2018

Otsuka Corporation

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

Consolidated Financial Highlights

OTSUKA CORPORATION and Consolidated Subsidiaries Years ended December 31, 2016, 2017 and 2018			Millions of yen	Thousands of U.S. dollars	%
	2016	2017	2018	2018	Change
Net sales	¥643,417	¥691,166	¥759,871	\$6,851,240	+9.9
System Integration business	376,391	408,718	463,293	4,177,200	+13.4
Service and Support business	266,625	282,064	296,577	2,674,039	+5.1
Other business	400	383	—	—	—
Operating income	39,684	44,386	48,058	433,308	+8.3
Ordinary income	40,780	45,460	49,285	444,372	+8.4
Profit before income taxes	40,280	45,363	49,100	442,702	+8.2
Profit attributable to owners of parent	26,675	31,560	33,601	302,965	+6.5
Total assets	343,821	380,317	406,732	3,667,226	+6.9
Interest-bearing debt	9,008	8,873	8,256	74,447	-6.9
Equity	189,851	212,897	229,726	2,071,287	+7.9
Earnings per share (EPS) (Yen and U.S. dollars)	140.69	166.46	177.22	1.60	+6.5
Dividend per share of common stock (Yen and U.S. dollars)	60.00	70.00	85.00	0.77	+21.4
Cash flows from operating activities per share (Yen and U.S. dollars)	126.22	190.68	203.83	1.84	+6.9
Operating income to Net sales ratio (%)	6.17	6.42	6.32	—	
Net income to Net sales ratio* (%)	4.15	4.57	4.42	—	
Interest-bearing debt ratio (%)	2.62	2.33	2.03	—	
Equity ratio (%)	55.22	55.98	56.48	—	
Return on equity (ROE) (%)	14.69	15.67	15.18	—	

Notes:

* Net income stands for Profit attributable to owners of parent

Equity = Total net assets - Share subscription rights - Non-controlling interests

Figures for ROE are calculated using average equity.

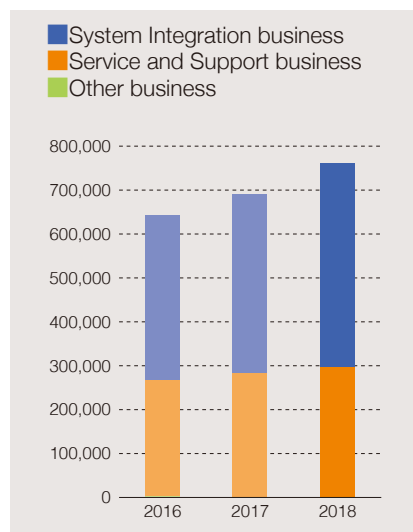
U.S. dollar amounts are computed using the December 31, 2018 exchange rate of ¥110.91 = US\$1.

Otsuka Auto Service Co., LTD., which was a consolidated subsidiary, was excluded from consolidation from the fiscal year 2018 due to its reduced impact on consolidated business results. Along with this, the Other business segment is not listed from the fiscal year 2018 due to the absence of business results.

The Company conducted a 2-for-1 stock split for shares of common stock of the Company with April 1, 2018 as the effective date. Accordingly, the amount of Per Share Data is calculated based on the assumption that the share split was conducted at the beginning of the fiscal year 2016.

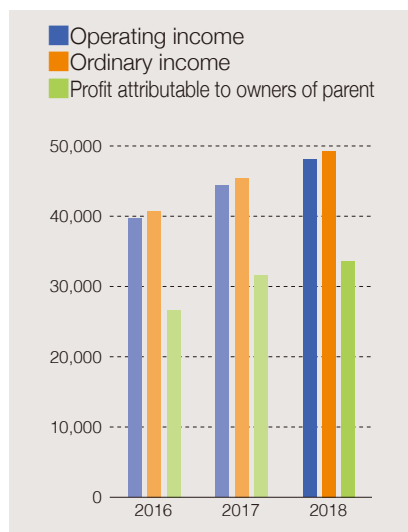
Net sales

(Millions of yen)



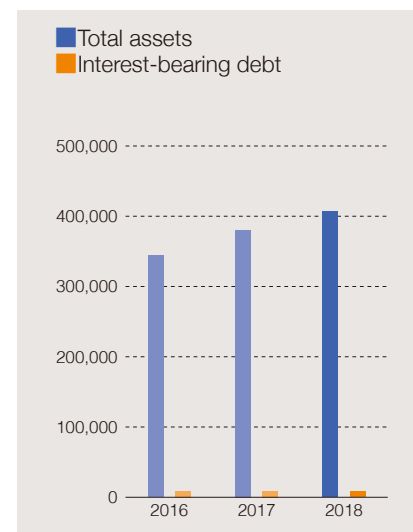
Operating income, Ordinary income, Profit attributable to owners of parent

(Millions of yen)



Total assets, Interest-bearing debt

(Millions of yen)



Note:

Sums of less than a million yen are rounded down.

To Our Shareholders and Investors



I am pleased to announce the results for the fiscal year ended December 31, 2018 and to thank our shareholders and investors for their loyal support.

During the fiscal year, the Japanese economy continued a moderate recovery and corporate IT investments trended firmly. The OTSUKA Group worked to strengthen relationships with customers through its regional-led business management structure.

As a result, net sales increased 9.9% from the previous fiscal year to ¥759,871 million. At the earnings level, operating income increased 8.3% to ¥48,058 million, ordinary income increased 8.4% to ¥49,285 million and profit attributable to owners of parent increased 6.5% to ¥33,601 million. This marked the ninth consecutive year of increases in sales and profits.

Management has resolved to pay year-end dividends per share of ¥85 in line with our efforts to return profits to shareholders, who have given us their support. This also marked the ninth consecutive year of an increase in dividends.

In the coming fiscal year, corporate IT investments are expected to be firm. Within this environment, we will implement regional-led business management and further strengthen our solution proposals that resolve issues faced by customers for their entire office and ensure their satisfaction.

In working to realize our Mission Statement, the OTSUKA Group will continue to pursue management reforms to ensure the trust of all stakeholders. Your ongoing support is greatly appreciated as we move forward with these endeavors.

Yuji Otsuka, President & Chief Executive Officer

March 2019

Overview of Consolidated Operations

■ Japanese Economy Continues a Moderate Recovery

During the fiscal year under review (January 1, 2018 to December 31, 2018), despite a standstill in some areas, the Japanese economy continued a moderate recovery overall amid a pickup in personal consumption and a steadily improving employment situation.

Under these economic conditions, a cautious stance was also seen in corporate business sentiment that reflected concerns about the direction of trade issues and other factors. Nevertheless, amid strong corporate earnings, capital investment remained at a high level while there was also high interest in IT by Japanese companies due to such factors as government efforts to promote work style reform, demand for business supporting the adoption of IT and PC replacement demand, and corporate IT investments trended firmly.

■ Continuing Regional-led Business Management

Within this environment, under the fiscal 2018 slogan “Leverage solutions on all fronts and live up to customer trust,” the OTSUKA Group continued to implement regional-led business management and strived to strengthen relationships to respond to the characteristics and needs of customers in each region. Regarding work style reform, the Company specifically proposed solutions to management issues faced by customers through its own case examples implemented in the past that aim at raising productivity and reducing costs.

**Corporate earnings strong
IT investments trending firmly**

**Strengthening relationships with
customers through regional-led
business management
Specifically proposing solutions**

■ Sales and Profits Increase for the Ninth Consecutive Year and Sales, Operating Income, Ordinary Income and Net Income Reach Record-high Levels

As a result of the above measures, net sales increased 9.9% from the previous fiscal year to ¥759,871 million. At the profit level, operating income rose 8.3% to ¥48,058 million. Ordinary income increased 8.4% to ¥49,285 million and profit attributable to owners of parent was up 6.5% to ¥33,601 million. This marks the ninth consecutive year of increases in sales and profits.

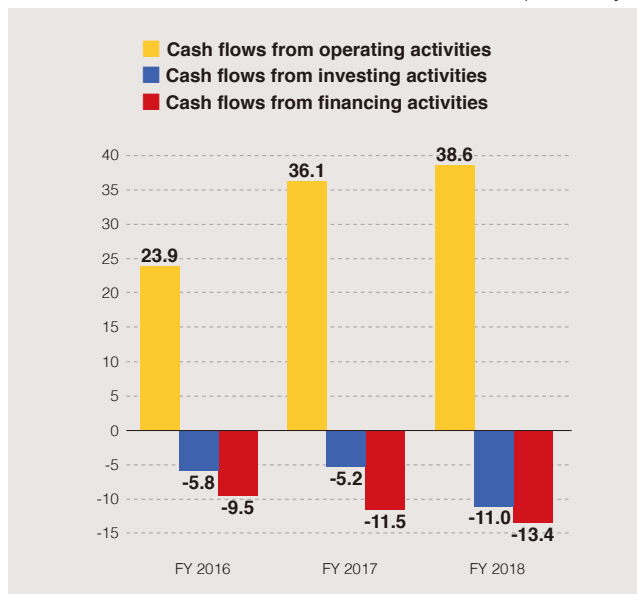
(Millions of yen)

	FY 2017	FY 2018	
	Amount	Amount	Change to Last Year
Net sales	691,166	759,871	+9.9%
Operating income	44,386	48,058	+8.3%
Ordinary income	45,460	49,285	+8.4%
Net income*	31,560	33,601	+6.5%

*Profit attributable to owners of parent

■ Cash Flows

(Billions of yen)



Net cash provided by operating activities amounted to ¥38,646 million, an increase of ¥2,492 million from the previous fiscal year due to an increase in profit before income taxes.

Net cash used in investing activities amounted to ¥11,096 million, an increase of ¥5,853 million from the previous fiscal year due to the purchase of investment securities.

Net cash used in financing activities increased ¥1,942 million to ¥13,470 million due to an increase in cash dividends paid.

Overview of Results by Quarter

Net Sales

Net sales increased in all quarters of the fiscal year and the uptrend in net sales has continued.

Net sales in the first quarter (January-March) of 2018 amounted to ¥191,225 million, a 6.1% increase from the previous first quarter. Net sales in the second quarter (April-June) of 2018 amounted to ¥198,637 million, a 12.0% increase from the previous second quarter. Net sales in the third quarter (July-September) of 2018 amounted to ¥176,262 million, a 10.9% increase from the previous third quarter. Net sales in the fourth quarter (October-December) of 2018 amounted to ¥193,745 million, an increase of 10.9% over the previous fourth quarter.

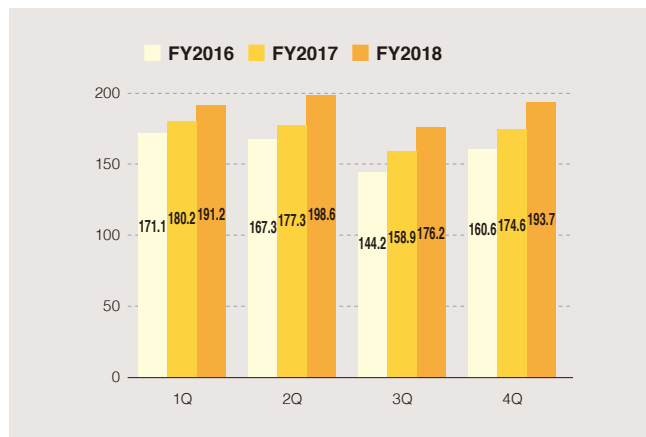
Ordinary Income

Despite increasing only slightly in the first quarter (January-March), ordinary income gradually improved from the second quarter (April-June) onward.

Ordinary income in the first quarter (January-March) of 2018 amounted to ¥12,222 million, an increase of 0.8% from the previous first quarter. Ordinary income in the second quarter (April-June) of 2018 amounted to ¥15,645 million, an increase of 2.6% from the previous second quarter. Ordinary income in the third quarter (July-September) of 2018 amounted to ¥7,167 million, an increase of 7.5% from the previous third quarter. Ordinary income in the fourth quarter (October-December) of 2018 amounted to ¥14,250 million, up 24.9% from the previous fourth quarter.

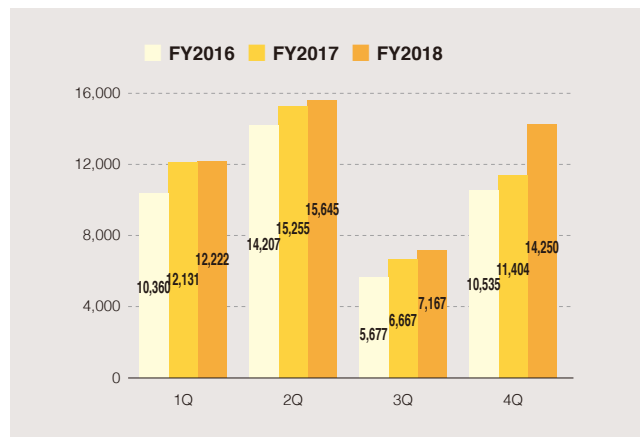
Quarterly Net Sales

(Billions of yen)



Quarterly Ordinary Income

(Millions of yen)



Overview of Business Segments

■ System Integration Business

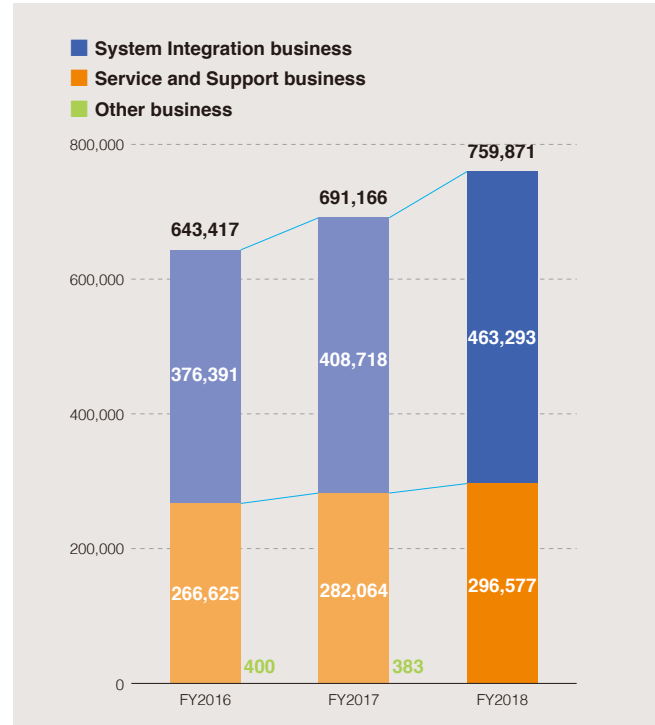
The System Integration business provides optimized system services ranging from consulting to system design and development, transport and installation work and network construction. We recorded high growth in unit sales of PCs by meeting replacement demand. Additionally, we also achieved smooth growth in sales of packaged software and consigned software. As a result, net sales increased 13.4% from the previous fiscal year to ¥463,293 million. On the other hand, unit sales of copiers declined from the previous fiscal year.

■ Service and Support Business

The Service and Support business provides customers with total service and support for their business operations and installed systems encompassing supplies, hardware and software maintenance, telephone support and outsourcing. We worked to strengthen the competitiveness of our “tanomail” office supply mail-order service business and together with the “tayoreru” support service business recorded steady growth in sales, which led to a 5.1% increase in net sales from the previous fiscal year to ¥296,577 million.

Net Sales by Segments

(Millions of yen)



Note: Otsuka Auto Service Co., LTD., which was a consolidated subsidiary, was excluded from consolidation from the fiscal year under review due to its reduced impact on consolidated business results. Along with this, the Other business segment is not listed from the fiscal year under review due to the absence of business results.

Focusing Efforts on the Accumulated Business

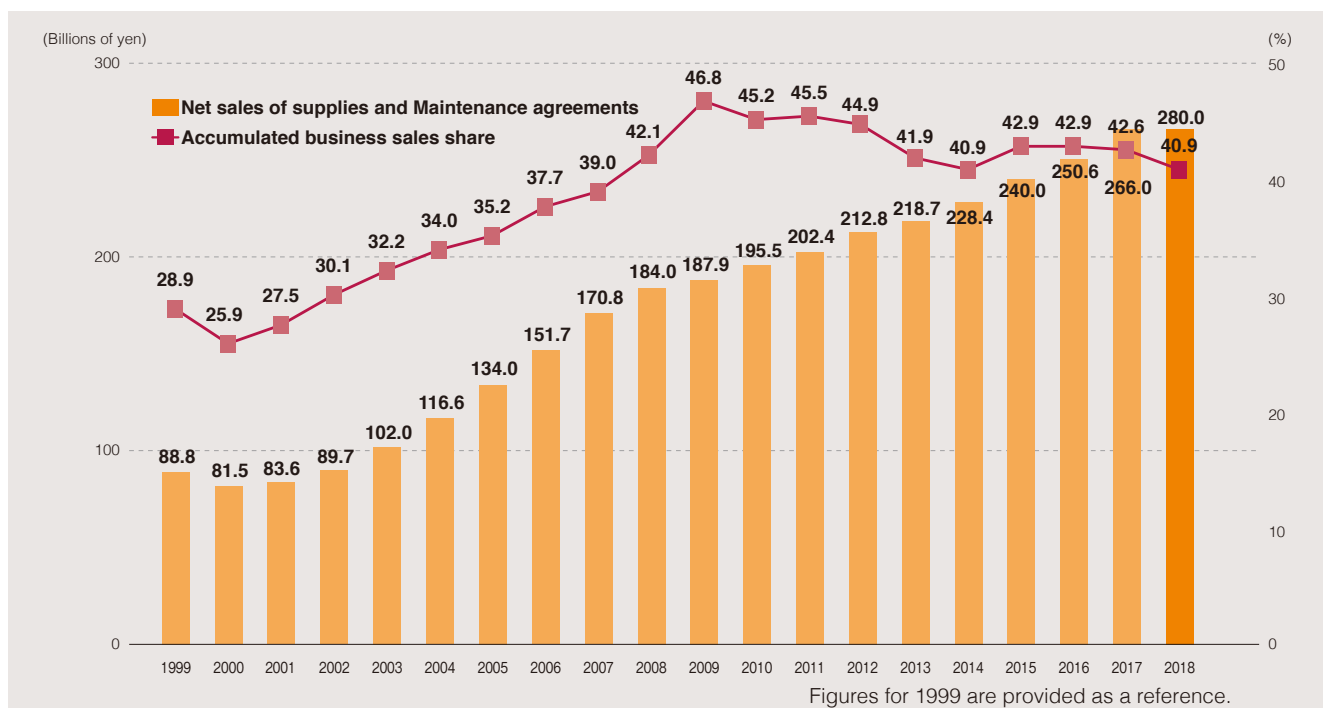
OTSUKA CORPORATION places special emphasis on office supply and maintenance agreement services as the “accumulated business” within the Service and Support business.

The accumulated business is not easily impacted by fluctuations in the economy and is steadily achieving growth annually. As such, this can be said to be a cumulative or accumulation business.

In fiscal 2018 as well, sales in the accumulated business grew steadily, increasing ¥14.0 billion, or 5.2%, to ¥280.0 billion. The accumulated business accounted for 40.9% of net sales (non-consolidated basis) due to high growth in the System Integration business. Since our public listing in 2000, net sales have increased ¥198.5 billion, an approximately 240% increase.

OTSUKA CORPORATION will continue to focus on the accumulated business as it works to raise the stability of its operations.

Accumulated Business (Non-consolidated)



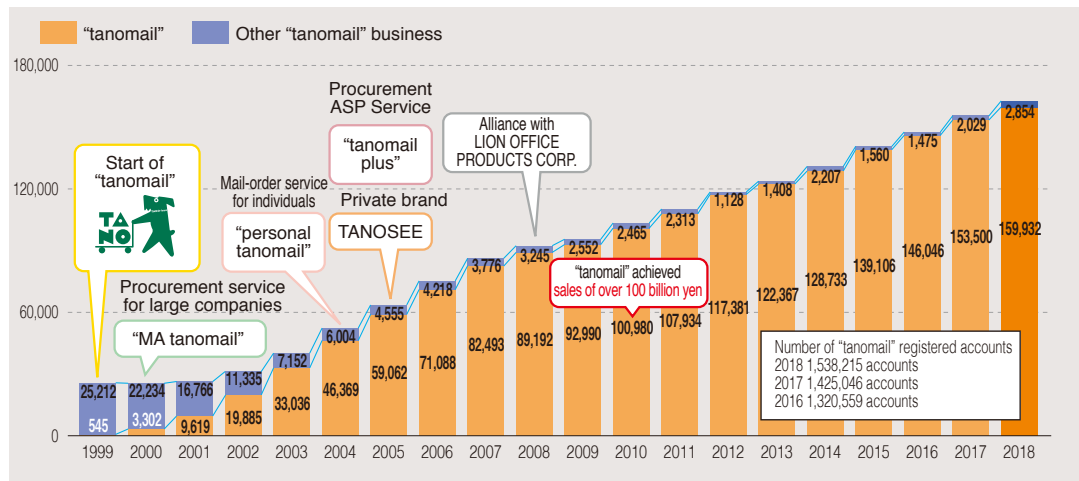
“tanomail” and “tayoreru” are the core pillars of the accumulated business.

たのめーる “tanomail”

Net sales in our “tanomail” office supply mail-order service business are expanding steadily. In fiscal 2018, net sales increased 4.2% to ¥159,932 million.

Annual Sales of “tanomail” (Non-consolidated)

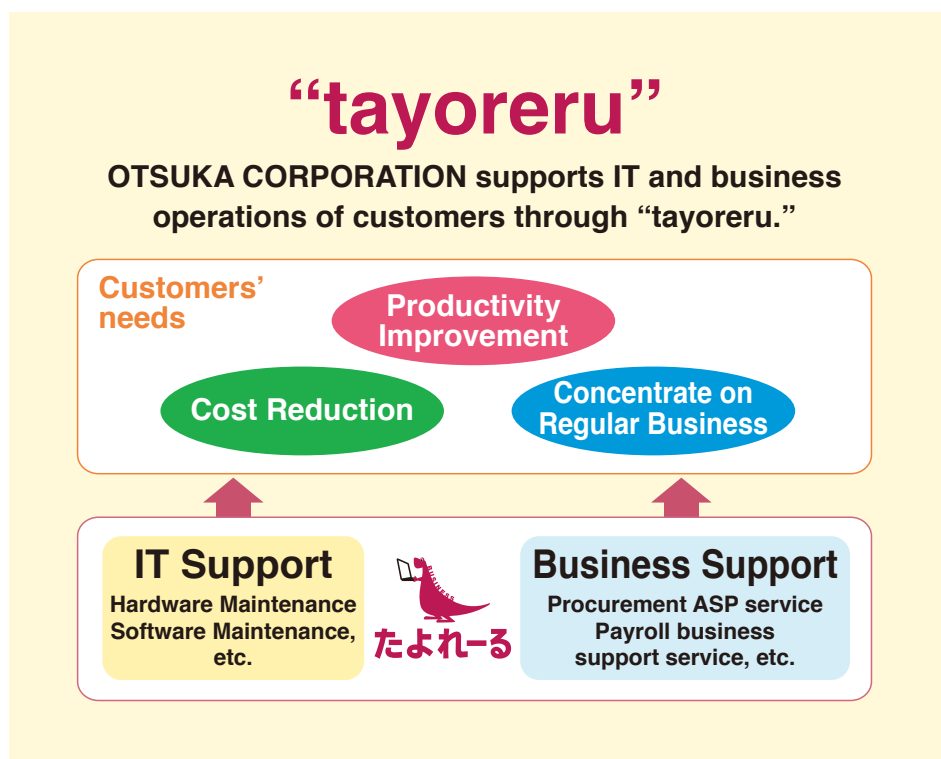
(Millions of yen)



たよれーる “tayoreru”

The “tayoreru” support service business supports customers’ IT and business operations.

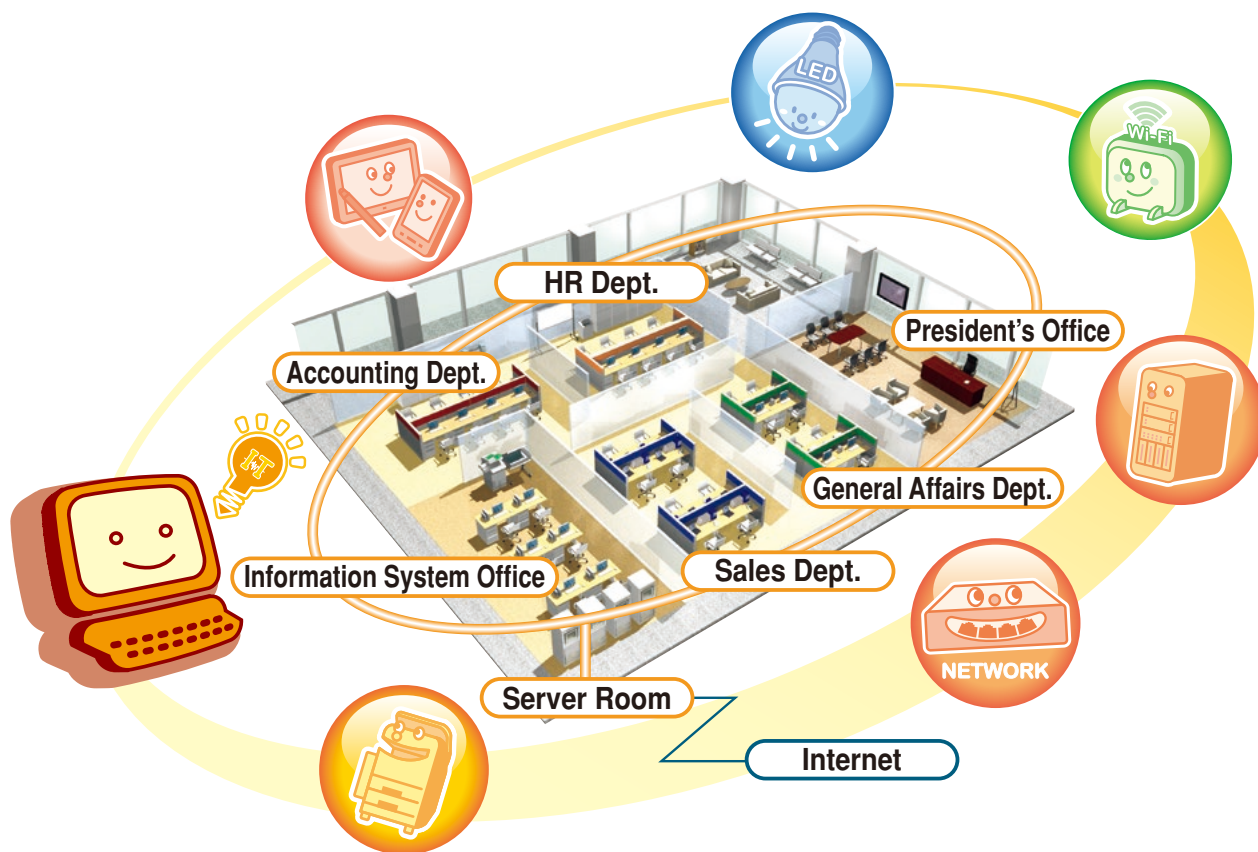
OTSUKA CORPORATION aims to be an indispensable presence in customers’ business infrastructure.



OTSUKA CORPORATION—A Partner to Our Customers

OTSUKA CORPORATION offers one-stop solutions and even one-stop support for the entire offices of customers that integrates the various kinds of business equipment, information and telecommunication devices essential to corporate offices.

OTSUKA CORPORATION aims to be a partner that grows together with our customers.

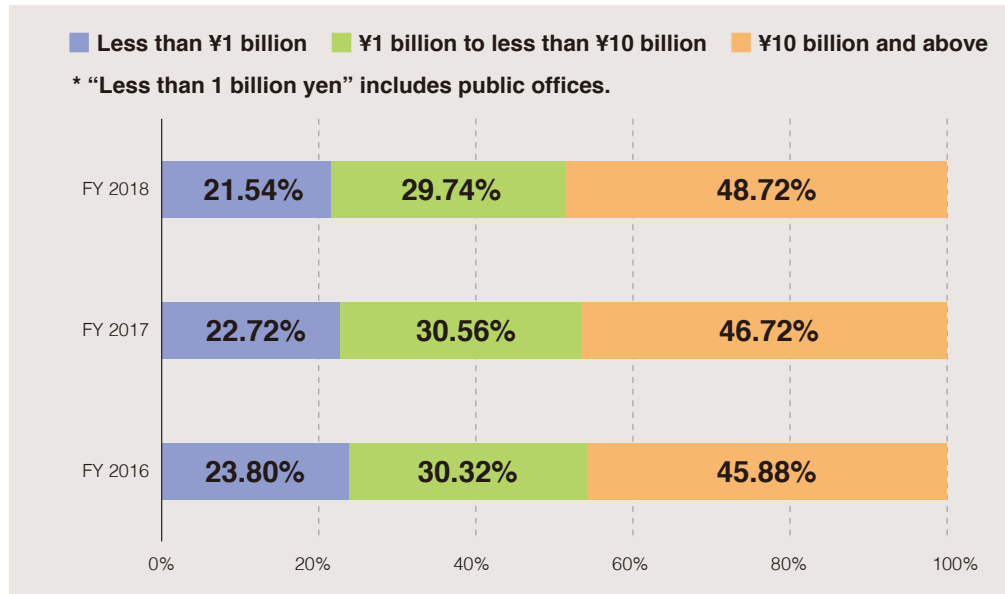


OTSUKA CORPORATION—Backed by a Diverse Range of Customers

OTSUKA CORPORATION maintains a well-balanced composition of customers, with the corporate scale of the Company’s customers ranging from major enterprises to small- and medium-sized firms.

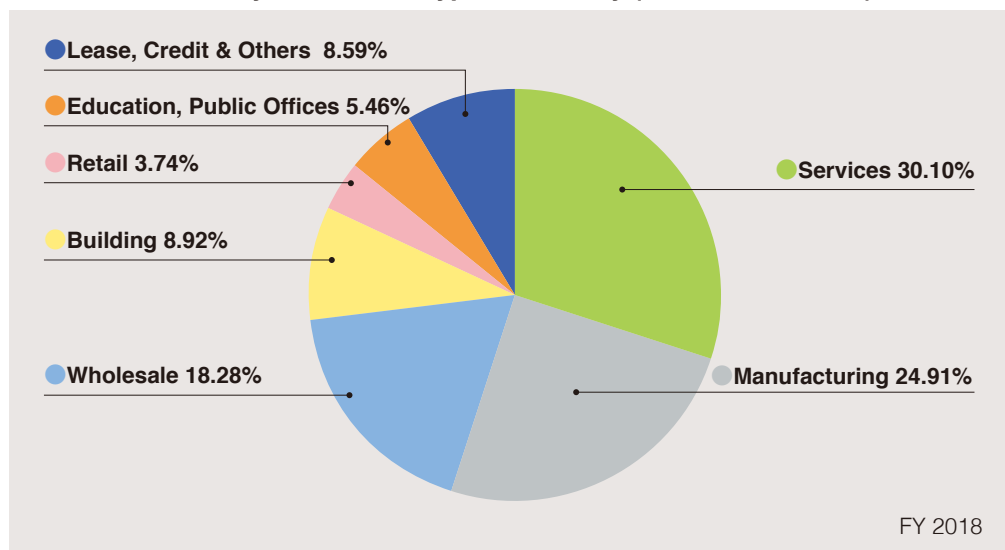
In terms of annual net sales, in fiscal 2018 the ratio of companies with sales of ¥10 billion and above increased, ¥1 billion to less than ¥10 billion and while the ratio of companies with sales of less than ¥1 billion decreased.

Net sales structure on Customers’ total annual business scale (Non-consolidated)



We also have a well-balanced customer base by customers’ type of industry. In fiscal 2018, there was no major change in the sales breakdown of customers by type of industry.

Sales Breakdown by Customers’ type of Industry (Non-consolidated)



Overview of Key Strategic Businesses (Non-consolidated)

<Amount of Sales>

(Millions of yen)

	FY 2016	FY 2017		FY 2018	
	Amount	Amount	Change to Last Year	Amount	Change to Last Year
"tanomail"	146,046	153,500	+5.1%	159,932	+4.2%
SMILE	9,774	10,817	+10.7%	11,715	+8.3%
ODS	51,746	55,997	+8.2%	55,715	-0.5%
OSM	67,937	67,514	-0.6%	71,662	+6.1%

(ODS : Otsuka Document Solutions OSM : Otsuka Security Management)

<Reference: Number of Units Sold>

(Units)

	Units	Units	Change to Last Year	Units	Change to Last Year
Copiers	44,583	43,807	-1.7%	41,046	-6.3%
(of which color copiers)	42,060	41,942	-0.3%	39,825	-5.0%
Servers	32,917	31,232	-5.1%	32,000	+2.5%
Personal computers	854,876	887,640	+3.8%	1,178,899	+32.8%
Client Total	904,393	927,835	+2.6%	1,222,643	+31.8%

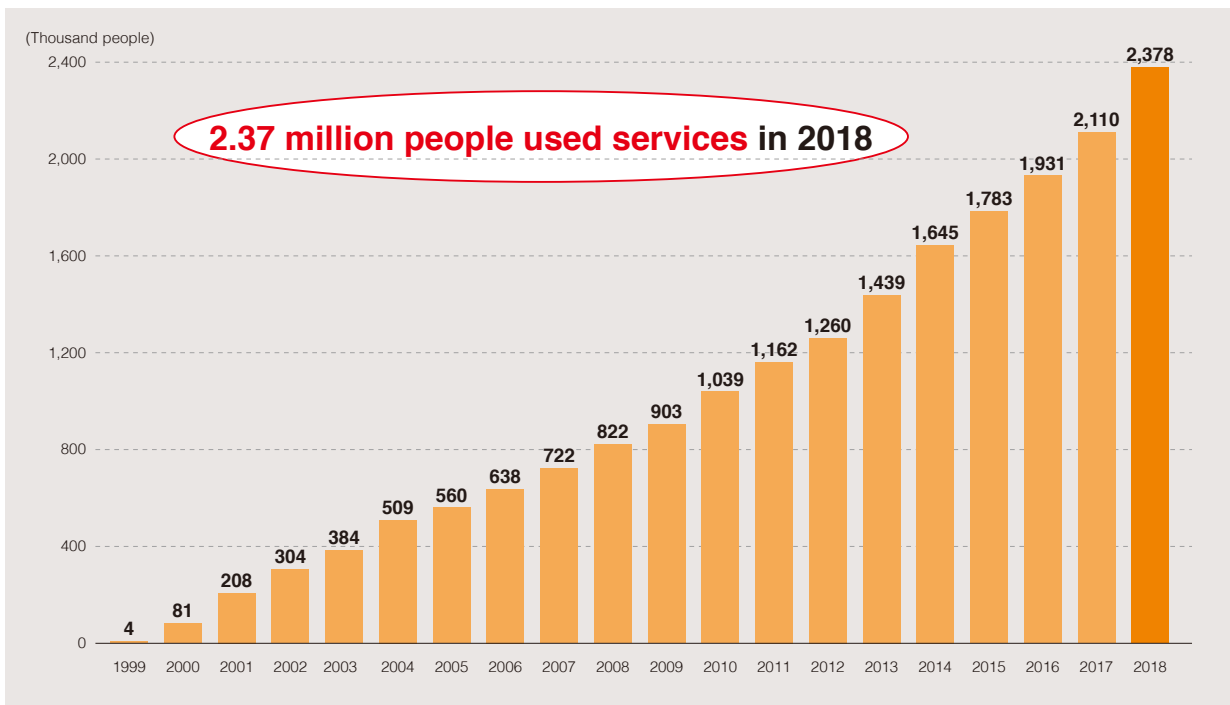
Personal computers and Client computers registered high growth exceeding 30%. Sales of copiers and ODS, our document solutions business, declined.

OTSUKA CORPORATION's Web Services (ASP)

■ Provision of services commenced in 1999. The number of users exceeded 2.37 million in 2018.

OTSUKA CORPORATION has been providing its main Web services since 1999. The number of users has been rising steadily, and in 2018, the number reached 2.37 million.

Number of Users of OTSUKA CORPORATION's Main Web Services (ASP)



Outlook for Fiscal 2019

■ Corporate IT Investments Expected to Remain Stable

In the future, uncertainties in the global economy such as U.S.-China trade frictions and rapid changes in international financial markets are creating risks that could push down the Japanese economy. Nevertheless, the Japanese economy is forecast to continue a moderate recovery driven by expected brisk domestic demand that includes a pickup in personal consumption and an increase in capital investment.

Under these conditions, amid strengthened economic measures in addition to strong business results by Japanese companies as well as the establishment of an infrastructure for the Tokyo Olympics, there is expected to be demand for responding to work style reform and labor shortages as well as rising interest in utilizing new technologies such as artificial intelligence (AI), robotic process automation (RPA) and the Internet of Things (IoT). Moreover, there will also be several notable events from 2019 through 2020 that include a change in the name of the era denoting Japan's emperor, a revision of the consumption tax rate and the ending of support for Windows 7. Due to such factors, corporate IT investments are forecast to continue to trend firmly.

■ OTSUKA CORPORATION for the Entire Office

Given the above economic conditions and outlook for corporate IT investments, under its policy "For the Entire Office," the OTSUKA Group will utilize our wide range of products and services, which is OTSUKA CORPORATION's strength, to provide high-added-value, specific and easy-to-understand proposals that can solve various office issues and contribute to the growth of our customers. In conjunction, we will carry out activities that enable customers that we have had no transactions with until now to understand the benefits of doing business with the OTSUKA Group.

To do so, we will further promote regional-led business management, strengthen customer contact points and strengthen on-site capabilities to ensure we can utilize the information gained from these activities for proposing solutions that solve office issues faced by customers.

Moreover, we will also continue to strengthen our lineup of office supplies and develop a lineup of maintenance services to bolster the accumulated business and enhance our earnings foundation based on stable and long-term business relationships with customers.

Market Forecast in 2019

- Continued moderate growth of the Japanese economy
- Demand for aggressive IT investment, raising productivity and cost reductions
- Demand for responding to labor shortages and for labor-savings
- Market expansion in new domains such as AI and IoT
- Office "2020 Problem"
- Strong demand by companies for IT utilization and energy-saving

Policies and Measures in 2019

- "Leverage solutions from the perspective of customers and live up to customer trust"
- Further deepen business management led by local area sales groups
- "OTSUKA CORPORATION for the entire office"
- Utilize AI internally and provide to customers
- Strengthen solution proposals for the office "2020 Problem"

■ Strategies by Segment

In the System Integration business, we will focus closely on replacement demand trends, mainly for PCs, as well as on needs in work style reform, improving productivity and reducing costs. We will also further promote comprehensive proposals and combined system proposals that combine products and services as we strengthen our solutions proposals. For copiers as well, we will continue to thoroughly implement our sales strategies.

In the Service and Support business, the OTSUKA Group will continue to upgrade and expand our lineup of products matched to customer needs and enhance our lineup of “TANOSEE” private brand products in “tanomail,” which marked its 20th year since commencing services. In our “tayoreru” support service business, we will develop comprehensive operational agent-type services and other services that can help compensate for our customers’ shortages of IT personnel. Moreover, we will enhance schemes, centering on “Customer Personalized Pages,” that support the building of relationships with customers.

■ Forecast for Fiscal 2019

In fiscal 2019 the Company forecasts a 5.7% increase in consolidated net sales to ¥803,000 million, a 4.9% increase in operating income to ¥50,400 million, a 3.9% increase in ordinary income to ¥51,200 million and a 1.8% increase in profit attributable to owners of parent to ¥34,210 million.

By segment, we forecast a 6.0% increase in net sales to ¥491,150 million in the System Integration business and a 5.1% increase to ¥311,850 million in the Service and Support business.

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

	Fiscal 2018	Fiscal 2019 (Forecast)	
	Amount	Amount	Change to Last Year
Net sales	759,871	803,000	+5.7%
Operating income	48,058	50,400	+4.9%
Ordinary income	49,285	51,200	+3.9%
Net income*	33,601	34,210	+1.8%

*Profit attributable to owners of parent

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

	Fiscal 2018	Fiscal 2019 (Forecast)	
	Amount	Amount	Change to Last Year
System Integration business	463,293	491,150	+6.0%
Service and Support business	296,577	311,850	+5.1%

Social Contribution and Environmental Protection Activities

We undertake social contribution activities and environmental protection activities in aiming “to demonstrate harmonious coexistence and growth with nature and society,” which is one of the goals prescribed in our Mission Statement. Here we introduce noteworthy topics in 2018.

■ Commencing Cooperation with “Becoming Independent from Children’s Home Project”

Since 2003, OTSUKA CORPORATION has implemented the “Gift from TANO-kun” program that donates products in the “tanomail” office supply mail-order service business. Through this program, we donate products that have suffered damage to exterior packaging during transport to nonprofit and other organizations. To the present, we have mainly donated office supplies and living supplies that have delighted many people. In 2018, we began donating home appliances and furniture to the “Becoming Independent Project” that supports children beginning independent lives after leaving a children’s home operated by PlanetCanal, a nonprofit organization that undertakes activities mainly in Musashino city, Tokyo.

OTSUKA CORPORATION currently donates such items as vacuum cleaners, rice cookers, and clothing cases to children through PlanetCanal.



Photo provided by PlanetCanal

■ Environmental Protection Activities through Tree Planting in Brazil

As a program commemorating OTSUKA CORPORATION's 50th anniversary in 2011, we are planting Tasmanian blue gum trees to be used as a raw material for copy paper in Macapá, Amapá State, Brazil, and have named this program "Tanokun No Mori (TANO-kun Forest)." Tasmanian blue gum trees are fast growing and can be felled in approximately six years.

Beginning with the use of trees felled from 2017, we have created "TANO-Kun Forest αEco-Paper," an original "tanomail" copy paper. In commemoration of the 20th anniversary of "tanomail," we will donate ¥10 per package sold to the Japan Committee for UNICEF, Japanese Red Cross Society and Guide Dog & Service Dog & Hearing Dog Association of Japan.



2011



2017 (Tree felling commenced.)



TANO-Kun Forest αEco-Paper

■ Holding Social Contribution Seminars

As a seminar for employees, in March we invited Yasuke Imai, representative director of the public interest incorporated association Chance for Children, to give a lecture based on the theme Children's Poverty. Chance for Children is an organization that provides children in impoverished households with study coupons for use at private tutoring schools or for various lessons in regions devastated by the Great East Japan Earthquake and other areas. In doing so, the organization is working to eliminate educational gaps resulting from economic disparities among households and to break intergenerational chains of poverty. On the day of the lecture, employees throughout Japan were able to attend the lecture via a videoconferencing system.

In September, in collaboration with the Guide Dog & Service Dog & Hearing Dog Association of Japan, we held an event at the Head Office building to provide participants with the chance to interact with and deepen their understanding of assistance dogs (guide dogs, service dogs and hearing dogs).

Corporate Governance

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.

1. Corporate Governance System

A. Overview of the Corporate Governance System

OTSUKA CORPORATION consists of various statutory bodies such as the General Meeting of Shareholders, Directors and Board of Directors, Audit & Supervisory Board Members and Audit & Supervisory Board and Independent Auditor. An Audit & Supervisory Board Members System has therefore been adopted. Additionally, the Company appoints outside directors and outside auditors with the aim of strengthening the monitoring of the execution of duties.

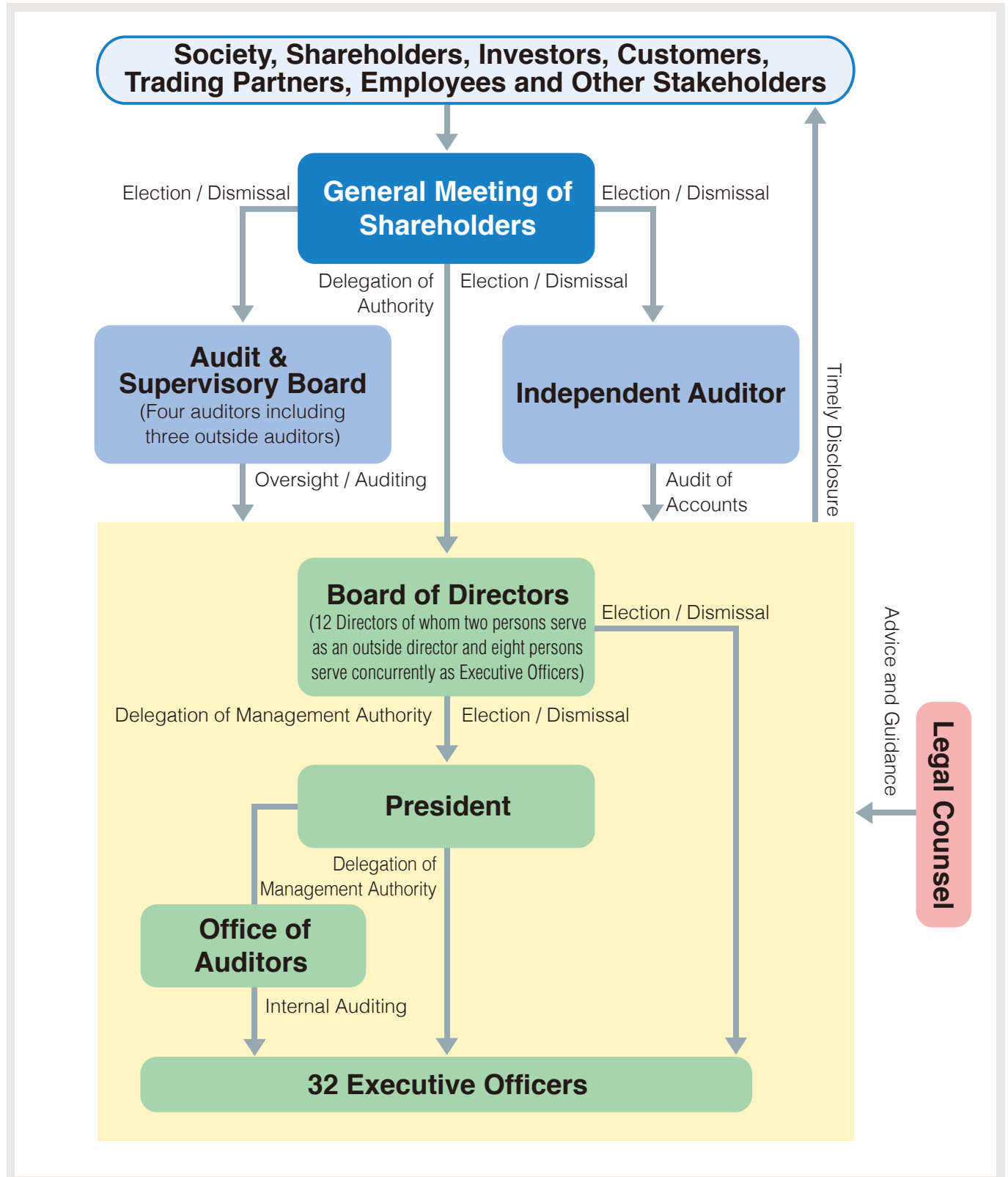
With regard to outside directors and outside auditors, the Company selects and appoints individuals with a sufficient level of knowledge and experience regarding laws, financial affairs and accounting.

The Board of Directors consists of 12 persons, including two outside directors, and the Board of Directors meets regularly once a month to discuss and make decisions on critical management issues requiring resolution based on relevant laws and the Articles of Incorporation, and monitors the execution of duties by directors. The introduction of the Executive Officer System aims to separate the functions of business execution and supervision in order to realize more rapid decision-making on operational matters and strengthen the oversight of the Board of Directors. To this end, Executive Officers elected by the Board of Directors are responsible for the execution of business operations while the Board of Directors and Audit & Supervisory Board Members handle the oversight of business execution.

The Audit & Supervisory Board is comprised of four auditors, including three outside auditors. The Audit & Supervisory Board Members attend such important meetings as the Board of Directors meetings to provide appropriate recommendations and advice, monitor that suitable management is being carried out and closely audit the execution of duties by Directors.

Group Management Meetings comprising top management of all Group companies (Special Executive Officers) are also held to clarify operational conditions at each company and make progress in achieving profit targets in addition to working to strengthen corporate governance.

The structure for corporate management decision-making, business operations and oversight is as follows:



B. Reason for Adopting Present Corporate Governance System

It has been deemed that a governance system led by outside directors would not be suitable due to a wide range of business domains of the Company and the importance of understanding these domains and being familiar with the IT industry. An Audit & Supervisory Board Members System has therefore been adopted in the manner above.

The Company assures transparency of decision-making by strengthening management oversight and audit functions by auditors, including outside auditors, and appoints outside directors with no conflict of interest with general shareholders to strengthen management supervision functions. By doing so, the Company aims to contribute to proper decision-making by the Board of Directors.

In this manner, the Company believes that its Corporate Governance system under which Executive Officers handle business execution based on the Board of Directors, including outside directors, and the Audit & Supervisory Board, including outside auditors, functions effectively.

C. Other Matters Concerning Corporate Governance

State of Internal Control Systems

At a meeting of the Board of Directors, the Company has determined the following basic policies for a system for ensuring that the execution of duties by Directors is in compliance with laws and the Articles of Incorporation as well as for a system deemed necessary as prescribed by an ordinance of the Ministry of Justice for ensuring appropriate operations of stock companies and of corporate groups consisting of stock companies and their subsidiaries.

- Basic policies for internal control systems

- a) System for ensuring compliance with laws and the Articles of Incorporation in the execution of duties by directors and employees

Directors shall take the lead and set an example in complying with and promoting the Mission Statement as the basis of our compliance structure.

Directors and employees shall strive to enhance the compliance system by taking such measures as improving awareness through continuous compliance education, improving business operations through internal audits, and properly applying the internal reporting system in working to ensure compliance with laws and the Articles of Incorporation in the execution of their duties.

- b) System for storing and managing information concerning the execution of duties by directors

Information concerning the execution of duties by Directors (paper or electronically recorded) as well as other important information shall be properly stored and managed in accordance with laws and internal regulations.

- c) Regulations and other systems concerning management of risk of losses

Based on internal regulations, we shall establish a risk management system, identify, analyze and evaluate any risk that could affect business results, financial condition or other areas and respond appropriately.

In the event of unexpected contingencies, we shall set up a task force, collect risk information and devise quick and appropriate countermeasures.

- d) System for ensuring the efficient execution of duties by directors

The Board of Directors shall in principle convene once per month to discuss and decide important matters concerning management and supervise the state of execution of business duties.

Also, the Board of Directors shall clarify criteria for convening and bringing up matters for debate at council bodies set up to raise the suitability of decision-making, while specific details shall be stipulated in Duty Authority Regulations and Separation of Duty Regulations and efficiency shall be raised.

- e) System for ensuring proper operations of the Group consisting of the Company and its subsidiaries

- 1) System for reporting to the Company matters concerning the execution of duties by Directors of subsidiaries

Group Management Meetings are held and these clarify operational conditions at consolidated subsidiaries and progress in achieving profit plans.

The Special Executive Officer System has also been established, with the presidents of consolidated subsidiaries selected to serve as Special Executive Officers, to promote thorough compliance and strengthen governance at consolidated subsidiaries.

When the need arises, the Special Executive Officers shall be asked to report to the Company's Board of Directors or the

Representative Directors on the state of the execution of duties.

2) Regulations and other systems concerning management of risk of losses at subsidiaries

The Board of Directors of consolidated subsidiaries shall identify, analyze and evaluate any risk that could affect business results, financial condition or other areas and respond appropriately.

Information regarding recognized risk by consolidated subsidiaries shall be shared at Group Management Meetings and efforts shall be made for the early detection and prevention of risk.

In the event of unexpected contingencies, we shall set up a task force at the Company, collect risk information, collaborate with the relevant consolidated subsidiaries and devise quick and appropriate countermeasures.

3) System for ensuring the efficient execution of duties by directors of subsidiaries

Consolidated subsidiaries shall ensure the autonomy and independence of management and formulate an annual plan in accordance with the Group's policies. The targets and responsibilities of each company shall be clarified and efforts shall be made to attain the intended performance targets through the analyses of variances between budget estimates and actual results. Consolidated subsidiaries shall establish Board of Directors regulations and convene meetings of the Board of Directors to deliberate on and resolve important matters concerning management and monitor the state of the execution of duties. Moreover, details on the execution of duties shall be prescribed in the various types of internal company regulations and efficiency shall be raised.

4) System for ensuring compliance with laws and the Articles of Incorporation in the execution of duties by Directors and employees

Consolidated subsidiaries shall ensure the proper execution of business operations by the functioning of self-cleansing mechanisms through the execution of business operations that are in accordance with the Mission Statement. Consolidated subsidiaries shall strive to enhance their compliance systems and ensure the execution of business operations is in compliance with laws and the Articles of Incorporation by taking such measures as raising awareness through continuous compliance education, setting up internal audit offices within each company to improve business operations, and properly applying the internal reporting system established by the Company and shared by consolidated subsidiaries.

5) Other systems for ensuring proper operations of the Group consisting of the Company and its subsidiaries

The Company's Office of Auditors shall receive reports on the results of internal audits implemented at each consolidated subsidiary by internal auditing offices established at each consolidated subsidiary. Additionally, it shall implement regular audits of consolidated subsidiaries as well as audit the state of compliance with laws and regulations and provide necessary guidance.

f) Matters regarding employees assisting Audit & Supervisory Board Members when requested by Audit & Supervisory Board Members

When a Audit & Supervisory Board Member makes such a request, an appropriate employee shall be appointed from the Business Administration Headquarters and assigned to a concurrent position as an employee assisting the Audit & Supervisory Board Member.

g) Matters concerning the independence of such employees from Directors as mentioned in the preceding item and matters related to ensuring the effectiveness of instructions from the Audit & Supervisory Board Member to the relevant employees

Concerning the determination of matters related to the delegation of authority over personnel matters to the relevant employee as mentioned in the previous item, the independence of such employees from Directors shall be ensured by obtaining the prior consent of the Audit & Supervisory Board Member.

Effectiveness shall be ensured by establishing a structure under which the Audit & Supervisory Board Member provides direct instructions to and receives reports from the relevant employee.

h) System regarding reporting to the Audit & Supervisory Board Members

1) System for reporting to Audit & Supervisory Board Members by Directors and employees

A system shall be established that enables Audit & Supervisory Board Members to receive reports from Directors and employees on the state of the execution of duties. At the same time, collaboration and coordination with internal departments carrying out audits shall be strengthened.

2) System that enables directors, Audit & Supervisory Board Members, employees and other employees executing business operations of consolidated subsidiaries, as well as parties receiving reports from these persons, to report to the Audit & Supervisory Board Members

Directors, Audit & Supervisory Board Members, employees and other employees executing business operations of consolidated subsidiaries, as well as parties receiving reports from these persons shall, depending on the importance and urgency of the matters, report to the Audit & Supervisory Board Members about any improprieties regarding the execution of duties by directors or employees of the Company or consolidated subsidiaries, about any actual matters in violation of laws and regulations or the Articles of Incorporation or regarding actual matters that could cause significant damage to the Company.

- i) System for ensuring that persons reporting matters described in the previous item are not treated unfavorably as a result of such reports
In accordance with employment regulations, persons reporting matters to the Audit & Supervisory Board Members shall not be treated unfavorably as a result of such reports.
- j) Matters related to the treatment of expenses and liabilities incurred in business execution by Audit & Supervisory Board Members
In the case Audit & Supervisory Board Members request prepayment of expenses from the Company for their execution of duties, based on Article 388 of the Companies Act, the Company shall upon deliberation with the Compliance Office process these requested expenses except in the case these are determined to be unnecessary for the execution of duties by such Audit & Supervisory Board Members.
- k) Other systems for ensuring effective audits by Audit & Supervisory Board Members
Representative Directors shall exchange opinions with Audit & Supervisory Board Members on a timely basis. The Company's Office of Auditors shall maintain close relations with the Audit & Supervisory Board Members and undertake inspections in accordance with the requests of Audit & Supervisory Board Members.

Basic thinking on the elimination of antisocial forces and establishment of measures

a) Basic thinking

The Mission Statement and Compliance Regulations stipulate that the Company shall take a firm stance against and maintain no relations with antisocial forces that threaten the order and safety of society.

b) Establishment of measures

The Company shall express its Action Guidelines against antisocial forces in its Mission Statement and Compliance Manual while designating its Compliance Office, Human Resources and General Affairs Department, and Customer Relationship Office as the department and office responsible for responding to antisocial forces. The Company shall collaborate with legal counsel and external organizations that include police departments and the Metropolitan Police Department Joint Association for the Prevention of Particular Violence. At the same time, employees shall be thoroughly familiarized with the Action Guidelines.

State of Establishment of Risk Management Structure

OTSUKA CORPORATION has established a Risk Management Committee as the body to promote and control business risk management as part of a risk management system.

The Risk Management Committee identifies and assesses all risk related to the Company and investigates respective measures for key risks. The Committee provides direction on the creation of a risk management system to ensure the ongoing and stable maintenance and management of risk in each division and department in its scope. At the same time, efforts are made to enhance crisis management by (1) preparing for such emergencies during ordinary times, (2) taking appropriate steps during a crisis and (3) formulating and managing a business continuity plan.

D. Summary of Details of Contract of Limited Liability

As prescribed by Article 427-1 of the Companies Act, the Company, each outside director and each Audit & Supervisory Board Member conclude a contract that limits liability under Article 423-1 of the Act. The amount limit of the liability based on these contracts shall be the amount prescribed by law.

2. Status of Internal Audits and Audits by Audit & Supervisory Board Members

The Office of Auditors (14 persons) under the direction of the President has been established to conduct periodic and on-demand internal audits of all operations across the Group and assess the adequacy of policies, plans and procedures, the effectiveness of their implementation and compliance with laws, as well as to offer concrete advice and recommendations for improving operations and raising awareness.

The Office of Auditors receives reports on the results of internal audits implemented at each Group company from the Internal Auditing Office established within each Group company.

The Audit & Supervisory Board formulates auditing policies and assigns relevant duties regarding audits. Each Audit & Supervisory Board Member complies with the standards set by the Audit & Supervisory Board when conducting audits and works to gather information and ensure smooth lines of communication with Directors and the Office of Auditors in order to create an effective environment for auditing. Audit & Supervisory Board Members attend the Board of Directors meetings and other important meetings to hear reports from Directors and others on the status of execution of duties and to examine the condition of business operations and assets at the Head Office and key business locations. Other functions include oversight and inspection of the status of internal control systems.

Audit & Supervisory Board Members and staff from the Office of Auditors meet regularly once a month to exchange information regarding such matters as auditing plans as well as the condition of audit implementation and business execution, and take appropriate steps as required.

Audit & Supervisory Board Members and the Independent Auditor meet on a timely basis to confirm auditing plans and the condition of audit implementation and progress on improvements to recommended areas, exchange information confirming the legality of actions taken by Directors and take appropriate steps as required.

3. Accounting Audits

OTSUKA CORPORATION contracts Ernst & Young ShinNihon LLC to handle its accounting auditing.

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.

Ernst & Young ShinNihon LLC

Seiji Yamamoto, Designated Employee with Limited Liability and
Managing Partner

Shigeyuki Kano, Designated Employee with Limited Liability and
Managing Partner

Tomo Ito, Designated Employee with Limited Liability and
Managing Partner

Number of Staff Assisting in Accounting-related Operations

CPAs 9

Other individuals 17

* Summarized, as all members have less than seven years of continuous auditing experience

4. Outside Directors and Outside Auditors

The Company has two outside directors and three outside auditors.

Although Outside Director Jiro Makino had no involvement in corporate management in the past other than serving as an outside officer, he has been appointed as an outside director because of his insights and experience as a lawyer and long years of involvement in the actual practice of legal affairs. He makes reports to the Tokyo Stock Exchange (TSE) as an independent Director, as provided by the TSE.

There are no special interests or otherwise relationship between the Company and Jiro Makino Law Office legal professional corporation, in which outside director Jiro Makino currently has a key position.

Tetsuo Saito has been appointed as an outside director because of his long years of experience in participating in the management of numerous companies in multiple industries. He makes reports to the Tokyo Stock Exchange (TSE) as an independent Director, as provided by the TSE.

There are no special interests or otherwise relationship between the Company and Work Two Co., Ltd., DD Holdings Co., Ltd., DM SOLUTIONS Co., Ltd., and Career Design Center Co., Ltd., in which Tetsuo Saito currently has key positions.

Kazuhiko Nakai has been appointed as an outside auditor because of his qualifications as a certified public accountant and tax accountant to the management of the Company. He makes reports to the Tokyo Stock Exchange (TSE) as an independent Auditor, as

provided by the TSE.

Additionally, there are no special interests or otherwise relationship between the Company and Kazuhiko Nakai CPA Office, Kazuhiko Nakai Tax Accountant Office, Nippon Antenna Co., Ltd., and S-Pool, Inc., in which Kazuhiko Nakai concurrently has key positions.

Mr. Nakai joined Ernst & Young ShinNihon (currently, Ernst & Young ShinNihon LLC) as a representative employee in 2007 and resigned from the firm in 2010. Although OTSUKA CORPORATION and Ernst & Young ShinNihon LLC have concluded an agreement and OTSUKA CORPORATION receives accounting audits from the firm, there are no special interests or otherwise relationship with the Company and this firm.

Tetsutaro Wakatsuki has been appointed as an outside auditor because of his qualifications as a lawyer to the management of the Company. He makes reports to the Tokyo Stock Exchange (TSE) as an Independent Auditor, as provided by the TSE.

Additionally, there are no special interests or otherwise relationship between the Company and Murata & Wakatsuki Law Offices, in which Tetsutaro Wakatsuki concurrently has key positions.

Etsuo Hada has been appointed as an outside auditor because of his qualifications as a Certified Public Accountant (CPA), licensed tax accountant, judicial scrivener and administrative scrivener, as well as his long years of involvement the actual practice of corporate accounting and legal affairs. He makes reports to the TSE as an independent Auditor, as provided by the TSE.

Additionally, there are no special interests or otherwise relationship between the Company and Hada CPA and Judicial Scrivener Office and Nikkan Kogyo Shimbun Ltd. in which outside auditor Etsuo Hada currently has key positions.

OTSUKA CORPORATION does not stipulate standards and other criteria regarding independence in terms of the selection and appointment of outside directors and outside auditors. However, the Company selects and appoints individuals who are able to ensure independence from the Company by making a decision on an individual basis according to the background and relationship with the Company based on various regulations and other relevant matters concerning independence including regulations of the Tokyo Stock Exchange (TSE).

The outside directors and outside auditors each attend Board of Directors meetings to provide insights and impart opinions based on their extensive experience. This strengthens the function of overseeing business execution by the Board of Directors and decision-making by the Board of Directors.

The outside auditors receive on a regular basis auditing reports at the Audit & Supervisory Board, reports concerning the state of establishment and operation of internal controls from the Internal Control Committee and reports on internal audits from the Office of Auditors. Also, they exchange information and opinions with the Finance and Accounting Dept. and Compliance Office at their discretion. Additionally, outside auditors exchange information and opinions with the Independent Auditor and internal auditing departments, beginning with the Office of Auditors, at their discretion and work to share auditing information.

5. Remuneration of Directors and Audit & Supervisory Board Members

A. Total Remuneration, Breakdown of Remuneration and Number of Applicable Officers by Classification

Class	Total Remuneration (Millions of yen)	Breakdown of Remuneration (Millions of yen)			Number of Officers (Persons)
		Base Pay	Bonus	Retirement Benefits	
Directors (excluding outside directors)	390	266	84	40	12
Audit & Supervisory Board Members (except outside auditors)	18	16	–	1	1
Outside Directors and Auditors	43	43	–	–	5

Notes:

1. Remuneration to Directors does not include compensation for services rendered outside the realm of their directorships.
2. The amount of annual remuneration for Directors is up to ¥650 million as approved at the General Meeting of Shareholders on March 13, 1990 (although this does not include employee compensation).
3. The amount of annual remuneration for Audit & Supervisory Board Members is up to ¥50 million as approved at the General Meeting of Shareholders on March 30, 2005.
4. The increase in allowance for retirement benefits for directors in the year under review is included in the above retirement benefits.

B. Total Consolidated Remuneration by Director and Audit & Supervisory Board Member

Not disclosed since there are no Directors or Audit & Supervisory Board Members that receive consolidated remuneration of ¥100 million or more.

C. Policy for Determination of Remuneration Policy and Its Calculation Method for Directors and Audit & Supervisory Board Members

Remuneration for Directors comprises basic pay, bonus, retirement benefits and others. The method of calculation for each is as follows. Basic pay refers to fixed remuneration determined based on the maximum annual income of the employee and the importance of their role in each position. It is set within the limit determined by a resolution passed at the General Meeting of Shareholders. In order to link contribution to business performance, bonuses are determined based on target achievement for operating income and the degree of contribution of each Director. Remuneration for Audit & Supervisory Board Members is determined based on deliberation by Audit & Supervisory Board Members and set within the limit determined by a resolution passed at the General Meeting of Shareholders. In principle, the Company sets an annual basic total amount for retirement benefits for each class of Standing Officer. Retirement benefits are paid at the time of retirement in an amount adjusted for company and individual performance. The Company does not employ a stock option system.

6. Principal Stockholdings by the Company

A. Investment Shares Held for Any Purpose Other Than Pure Investment

Number of securities	58
Total amount on balance sheet	¥7,470 million

B. Name, Number, Amount on Balance Sheet of Investment Shares Held for Any Purpose Other Than Pure Investment and Purpose for Holding Them

(Previous Fiscal Year)

Specified investment stocks

Name	Number of Shares	Amount on Balance Sheet (Millions of yen)	Purpose for Holding
PERSOL HOLDINGS CO., LTD.	3,000,000	8,472	To facilitate and maintain business relationship
Billing System Corporation	50,000	632	Same as above
Daiwa House Industry Co., Ltd.	100,000	432	Same as above
ThreePro Group Co., Ltd.	360,000	357	Same as above
Ricoh Company, Ltd.	326,949	342	Same as above
Daito Trust Construction Co., Ltd.	13,100	300	Same as above
Concordia Financial Group, Ltd.	382,204	259	Same as above
Uchida Esco Co., Ltd.	180,000	215	Same as above
Credit Saison Co., Ltd.	50,000	102	Same as above
Meiko Network Japan Co., Ltd.	60,000	80	Same as above
Zeon Corporation	32,283	52	Same as above
NAMUCO BANDAI Holdings Inc.	9,504	35	Same as above
Mitsubishi Tanabe Pharma Corporation	13,300	31	Same as above
Nippon Kayaku Co., Ltd.	17,983	30	Same as above
The Keiyo Bank, Ltd.	50,000	25	Same as above
Mitsubishi UFJ Financial Group, Inc.	29,110	24	Same as above
J ESCOM HOLDINGS, INC.	150,000	21	Same as above
Iino Kaiun Kaisha, Ltd.	32,213	20	Same as above
Morinaga & Co., Ltd.	3,104	17	Same as above
Kyowa Hakko Kirin Co., Ltd.	8,000	17	Same as above
Iwabuchi Corporation	2,083	13	Same as above
HYPER Inc.	12,000	12	Same as above
Dai-ichi Life Holdings, Inc.	4,300	9	Same as above
Rengo Co., Ltd.	7,600	6	Same as above
Maruzen Co., Ltd.	2,000	4	Same as above
Mizuho Financial Group, Inc.	21,520	4	Same as above
Canon Marketing Japan Inc.	1,155	3	Same as above
Autobacs Seven Co., Ltd.	1,500	3	Same as above
Tsuchiya Holdings Co., Ltd.	10,818	2	Same as above
Daikyo Incorporated	940	2	Same as above

Note: The top 30 stocks held are listed and include stocks for which the amount on the balance sheet is 1% or less of the amount of capital.

(Current Fiscal Year)

Specified investment stocks

Name	Number of Shares	Amount on Balance Sheet (Millions of yen)	Purpose for Holding
PERSOL HOLDINGS CO., LTD.	3,000,000	4,908	To facilitate and maintain business relationship
Billing System Corporation	100,000	409	Same as above
Ricoh Company, Ltd.	341,989	368	Same as above
Daiwa House Industry Co, Ltd.	100,000	349	Same as above
ThreePro Group Co., Ltd.	360,000	310	Same as above
Uchida Esco Co., Ltd.	180,000	252	Same as above
Daito Trust Construction Co., Ltd.	13,100	196	Same as above
Concordia Financial Group, Ltd.	382,204	161	Same as above
Credit Saison Co., Ltd.	50,000	64	Same as above
Meiko Network Japan Co., Ltd.	60,000	53	Same as above
BANDAI NAMCO Holdings Inc.	9,504	46	Same as above
Zeon Corporation	33,160	33	Same as above
Nippon Kayaku Co., Ltd.	18,605	26	Same as above
Mitsubishi Tanabe Pharma Corporation	13,300	21	Same as above
The Keiyo Bank, Ltd.	25,000	17	Same as above
Kyowa Hakko Kirin Co., Ltd.	8,000	16	Same as above
Mitsubishi UFJ Financial Group, Inc.	29,110	15	Same as above
Morinaga & Co., Ltd.	3,153	14	Same as above
Iino Kaiun Kaisha, Ltd.	33,492	13	Same as above
J ESCOM HOLDINGS, INC.	150,000	12	Same as above
HYPER Inc.	24,000	10	Same as above
Iwabuchi Corporation	2,213	10	Same as above
Dai-ichi Life Holdings, Inc.	4,300	7	Same as above
Rengo Co., Ltd.	7,600	6	Same as above
Maruzen Co., Ltd.	2,000	3	Same as above
Mizuho Financial Group, Inc.	21,520	3	Same as above
Autobacs Seven Co., Ltd.	1,500	2	Same as above
Canon Marketing Japan Inc.	1,155	2	Same as above
Tsuchiya Holdings Co., Ltd.	11,621	1	Same as above
Levi Strauss Japan K.K.	440	0	Same as above

Note: The top 30 stocks held are listed and include stocks for which the amount on the balance sheet is 1% or less of the amount of capital.

C. Investment Stocks Held for the Purpose of Pure Investment

Not applicable

7. Number of Directors

The Company's Articles of Incorporation stipulate that the number of Company Directors shall be 19 or fewer.

8. Resolutions for Appointment and Dismissal of Director

The Company's Articles of Incorporation stipulate that a resolution for the appointment of a Director requires attendance by shareholders with more than one-third of the voting rights of shareholders capable of exercising such rights, and is decided by a majority of shareholders. In addition, a resolution for the appointment of a Director shall not be decided by cumulative voting.

9. Requirements for Special Resolution of the General Meeting of Shareholders

The Company's Articles of Incorporation stipulate that a special resolution of the General Meeting of Shareholders, pursuant to Article 309, Paragraph 2 of the Companies Act, shall be adopted when it is approved by a vote of two-thirds or more of the voting rights present at a General Meeting of Shareholders, a quorum for which shall be the presence of shareholders of one-third of the aggregate voting rights if the total shareholders are capable of exercising such rights. This aim is to facilitate efficient operation of the General Meeting of Shareholders through the moderation of special resolutions at the General Meeting of Shareholders.

10. Decision-making Body for the Distribution of Retained Earnings

The regular General Meeting of Shareholders shall serve as the decision-making body for the distribution of retained earnings at year-end.

11. Interim Dividend

Pursuant to Paragraph 5, Article 454 of the Companies Act, the Company's Articles of Incorporation stipulate that based on a resolution of the Board of Directors, the Company can pay interim dividends with the date of record being June 30 of each year. This is in order to allow the flexible return of profits to shareholders.

12. Purchase of Own Shares

The purport of the Company's Articles of Incorporation stipulates that the Company shall be able to purchase its own shares based on a resolution of the Board of Directors as prescribed under Article 165, Paragraph 2 of the Companies Act. This is aimed at purchasing own shares through market transactions to enable the execution of a flexible capital policy that responds to changes in economic conditions.

Remuneration for Independent Auditor

1. Breakdown of Remuneration for Independent Auditor

Class	Previous Fiscal Year		Current Fiscal Year	
	For auditing and certification services (Millions of yen)	Non-auditing services (Millions of yen)	For auditing and certification services (Millions of yen)	Non-auditing services (Millions of yen)
Otsuka Corporation	66	—	67	—
Consolidated Subsidiaries	14	—	14	—
Total	80	—	81	—

2. Other Major Remuneration

Not applicable

3. Non-auditing Services by Independent Auditor for Otsuka Corporation

Not applicable

4. Audit Remuneration Policy

The Company determines with an agreement of the Audit & Supervisory Board an appropriate amount of audit remuneration based on a number of factors, including the number of days of auditing work, the nature of auditing duties and scale of work to ensure the accounting auditor can conduct auditing and certification services fairly and in good faith from an independent standpoint.

Directors and Audit & Supervisory Board Members (As of March 27, 2019)



President & Chief Executive Officer

Yuji Otsuka



Managing Director & Senior Executive Operating Officer

Kazuyuki Katakura



Managing Director & Senior Executive Operating Officer

Toshiyasu Takahashi



Managing Director & Executive Operating Officer

Hironobu Tsurumi



Managing Director & Senior Operating Officer

Hironobu Saito



Managing Director & Operating Officer

Katsuhiro Yano



Managing Director & Operating Officer

Minoru Sakurai



Managing Director & Operating Officer

Norihiko Moriya

Director & Senior Managing Officer
Mitsuya Hirose

Directors
Yasuhiro Wakamatsu
Jiro Makino
Tetsuo Saito

Standing Audit & Supervisory Board Member
Naoto Minai

Audit & Supervisory Board Members
Kazuhiko Nakai
Tetsutaro Wakatsuki
Etsuo Hada

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 27, 2019.

■ Customer-related Risks

The OTSUKA Group's customers range from large enterprises to small firms that span a broad range in terms of company scale and industries. Consequently, its level of dependency on any specific customer 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 Company received approval to use the Privacy Mark of the Japan Institute for Promotion of Digital Economy and Community, and its Internet Data Center acquired certification for Information Security Management Systems (ISMS).

As a concrete measure to manage data, the Company 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 Company has its employees take a pledge of confidentiality as well as works to prevent information leakage outside of the Company and raises awareness of information management through its proprietary educational "CP (Compliance Program) License System" and other measures. Moreover, the Company implements even more stringent measures for its information systems. These include respective technical measures used at entrances, internally, and at exits as well as third-party external diagnoses, regular drills against targeted e-mail attacks and establishing the Computer Security Incident Response Team (CSIRT) and the Security Surveillance Committee.

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 Consolidated Subsidiaries Years ended December 31, 2016, 2017 and 2018	Millions of yen			Thousands of U.S. dollars
	2016	2017	2018	2018
Net sales	¥643,417	¥691,166	¥759,871	\$6,851,240
System Integration business	376,391	408,718	463,293	4,177,200
Service and Support business	266,625	282,064	296,577	2,674,039
Other business	400	383	—	—
Operating income	39,684	44,386	48,058	433,308
Ordinary income	40,780	45,460	49,285	444,372
Profit before income taxes	40,280	45,363	49,100	442,702
Profit attributable to owners of parent	26,675	31,560	33,601	302,965
Total assets	343,821	380,317	406,732	3,667,226
Interest-bearing debt	9,008	8,873	8,256	74,447
Equity	189,851	212,897	229,726	2,071,287
Earnings per share (EPS) (Yen and U.S. dollars)	140.69	166.46	177.22	1.60
Dividend per share of common stock (Yen and U.S. dollars)	60.00	70.00	85.00	0.77
Cash flows from operating activities per share (Yen and U.S. dollars)	126.22	190.68	203.83	1.84
Operating income to Net sales ratio (%)	6.17	6.42	6.32	—
Net income to Net sales ratio* (%)	4.15	4.57	4.42	—
Interest-bearing debt ratio (%)	2.62	2.33	2.03	—
Equity ratio (%)	55.22	55.98	56.48	—
Return on equity (ROE) (%)	14.69	15.67	15.18	—

Notes:

* Net income stands for Profit attributable to owners of parent

Equity = Total net assets - Share subscription rights - Non-controlling interests

Figures for ROE are calculated using average equity.

U.S. dollar amounts are computed using the December 31, 2018 exchange rate of ¥110.91 = US\$1.

Otsuka Auto Service Co., LTD., which was a consolidated subsidiary, was excluded from consolidation from the fiscal year 2018 due to its reduced impact on consolidated business results. Along with this, the Other business segment is not listed from the fiscal year 2018 due to the absence of business results.

The Company conducted a 2-for-1 stock split for shares of common stock of the Company with April 1, 2018 as the effective date. Accordingly, the amount of Per Share Data is calculated based on the assumption that the share split was conducted at the beginning of the fiscal year 2016.

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Management's Analysis of Operating Results and Financial Position

Summary of Sales and Profits

	Millions of yen			
	2017	2018	Difference to Last Year	% Change to Last Year
Net sales	¥691,166	¥759,871	+68,704	+9.9%
System Integration business	408,718	463,293	+54,574	+13.4
Service and Support business	282,064	296,577	+14,513	+5.1
Other business	383	—	—	—
Cost of sales	541,339	602,054	+60,714	+11.2
Gross profit	149,827	157,817	+7,989	+5.3
Selling, general and administrative expenses	105,440	109,758	+4,318	+4.1
Operating income	44,386	48,058	+3,671	+8.3
Ordinary income	45,460	49,285	+3,825	+8.4
Profit before income taxes	45,363	49,100	+3,736	+8.2
Income taxes				
Current	13,853	15,744	+1,891	+13.7
Deferred	-392	-622	-229	—
Profit attributable to owners of parent	31,560	33,601	+2,041	+6.5

Sales Summary

In the fiscal year under review, the OTSUKA Group recorded net sales of ¥759,871 million, an increase of ¥68,704 million (9.9%) from the previous fiscal year.

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. We achieved high growth in unit sales of PCs by meeting replacement demand. Moreover, we also recorded smooth growth in sales of packaged software and consigned software. As a result, net sales increased 13.4% from the previous fiscal year to ¥463,293 million. On the other hand, unit sales of copiers declined from the previous fiscal year.

Service and Support Business

The Service and Support business provides customers with total service and support for their business operations and installed systems encompassing supplies, hardware and software maintenance, telephone support and outsourcing. We made efforts to strengthen the competitiveness of our "tanomail" office supply mail-order service business and together with the "tayoreru" support service business recorded steady growth in sales, which resulted in a 5.1% increase in net sales from the previous fiscal year to ¥296,577 million.

Otsuka Auto Service Co., LTD., which was a consolidated subsidiary, was excluded from consolidation from the fiscal year under review due to its reduced impact on consolidated business results. Along with this, the Other business segment is not listed from the fiscal year under review due to the absence of business results.

Summary of Income and Expenses

Regarding profits, gross profit increased 5.3% from the previous fiscal year to ¥157,817 million due to the growth in net sales.

Because the rise in gross profit exceeded the increase in selling, general and administrative (SG&A) expenses, operating income increased 8.3% to ¥48,058 million, ordinary income increased 8.4% to ¥49,285 million and profit attributable to owners of parent rose 6.5% to ¥33,601 million. Earnings per share (EPS) amounted to ¥177.22.

Financial Position

	Millions of yen			
	2017	2018	Difference to Last Year	% Change to Last Year
Assets:	¥380,317	¥406,732	+26,414	+6.9%
Current assets	309,245	334,650	+25,404	+8.2
Non-current assets	71,071	72,081	+1,009	+1.4
Liabilities:	165,785	175,067	+9,281	+5.6
Current liabilities	152,334	161,327	+8,992	+5.9
Non-current liabilities	13,451	13,740	+288	+2.1
Net assets	214,532	231,664	+17,132	+8.0

Assets

Total assets at fiscal year-end increased ¥26,414 million from the previous fiscal year-end to ¥406,732 million.

Current assets increased ¥25,404 million from the previous fiscal year-end to ¥334,650 million due to such factors as an increase in cash and deposits. Non-current assets increased ¥1,009 million from the previous fiscal year-end to ¥72,081 million.

Liabilities

Total liabilities at fiscal year-end increased ¥9,281 million from the previous fiscal year-end to ¥175,067 million.

Current liabilities increased ¥8,992 million from the previous fiscal year-end to ¥161,327 million due to such factors as an increase in notes and accounts payable – trade.

Non-current liabilities increased ¥288 million from the previous fiscal year-end to ¥13,740 million.

Net Assets

Total net assets at fiscal year-end increased ¥17,132 million from the previous fiscal year-end to ¥231,664 million due to an increase in retained earnings.

As a result, the equity ratio increased 0.5 percentage point from the previous fiscal year-end to 56.5%.

The interest coverage ratio was 1,013.55 times, the interest-bearing debt ratio was 2.03%, return on equity (ROE) was 15.18% and return on assets (ROA) was 12.32%.

	2017	2018
Interest coverage ratio (times)	951.53	1,013.55
Interest-bearing debt ratio (%)	2.33	2.03
ROE (%)	15.67	15.18
ROA (%)	12.37	12.32

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 income + Interest on securities + Dividends income + Share of profit (loss) of entities accounted for using equity method

Cash Flows

	Millions of yen	
	2017	2018
Cash flows from operating activities	¥36,153	¥38,646
Cash flows from investing activities	-5,243	-11,096
Cash flows from financing activities	-11,528	-13,470
Cash and cash equivalents at end of year	137,545	151,585

Cash and cash equivalents at end of year totaled ¥151,585 million, an increase of ¥14,040 million from the end of the previous fiscal year. Factors relating to each cash flow category were as follows.

Cash Flows from Operating Activities

Net cash provided by operating activities amounted to ¥38,646 million, an increase of ¥2,492 million from the previous fiscal year due to an increase in profit before income taxes.

Cash Flows from Investing Activities

Net cash used in investing activities amounted to ¥11,096 million, an increase of ¥5,853 million from the previous fiscal year due to the purchase of investment securities.

Cash Flows from Financing Activities

Net cash used in financing activities increased ¥1,942 million to ¥13,470 million due to an increase in cash dividends paid.

As a result, free cash flows, the sum of cash flows from operating activities and cash flows from investing activities, decreased ¥3,360 million to ¥27,549 million.

Forecast for Fiscal 2019

In fiscal 2019 the Company forecasts a 5.7% increase in consolidated net sales to ¥803,000 million, a 4.9% increase in operating income to ¥50,400 million, a 3.9% increase in ordinary income to ¥51,200 million and a 1.8% increase in profit attributable to owners of parent to ¥34,210 million.

By segment, we forecast a 6.0% increase in net sales to ¥491,150 million in the System Integration business and a 5.1% increase to ¥311,850 million in the Service and Support business.

Consolidated Balance Sheets

OTSUKA CORPORATION and Consolidated Subsidiaries
As of December 31, 2017 and 2018

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Assets			
Current assets			
Cash and deposits (Note 2)	¥136,410	¥150,888	\$1,360,456
Notes and accounts receivable - trade (Note 4)	122,144	132,352	1,193,332
Merchandise	24,999	25,721	231,909
Work in process	762	957	8,634
Raw materials and supplies	837	828	7,473
Deferred tax assets	2,887	3,181	28,688
Other	21,324	20,833	187,841
Allowance for doubtful accounts	(120)	(113)	(1,022)
Total current assets	309,245	334,650	3,017,315
Non-current assets			
Property, plant and equipment			
Buildings and structures	58,754	58,138	524,194
Accumulated depreciation and impairment loss	(40,498)	(40,761)	(367,521)
Buildings and structures, net	18,255	17,376	156,673
Land (Note 3)	16,165	15,604	140,691
Other	12,618	13,038	117,555
Accumulated depreciation and impairment loss	(9,429)	(9,389)	(84,654)
Other, net	3,189	3,649	32,901
Total property, plant and equipment	37,610	36,629	330,266
Intangible assets			
Software	12,106	13,729	123,790
Other	59	59	535
Total intangible assets	12,166	13,789	124,326
Investments and other assets			
Investment securities (Note 1)	15,306	14,609	131,723
Guarantee deposits	2,605	2,424	21,855
Deferred tax assets	1,369	2,962	26,712
Other	2,183	1,854	16,719
Allowance for doubtful accounts	(170)	(187)	(1,693)
Total investments and other assets	21,294	21,662	195,318
Total non-current assets	71,071	72,081	649,910
Total assets	¥380,317	¥406,732	\$3,667,226

The accompanying notes are an integral part of these statements.

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Liabilities			
Current liabilities			
Notes and accounts payable – trade (Note 2)	¥ 83,107	¥ 89,322	\$ 805,363
Electronically recorded obligations - operating	17,887	17,904	161,434
Short-term loans payable	4,900	4,800	43,278
Income taxes payable	8,274	9,326	84,087
Advances received	12,361	14,350	129,387
Provision for bonuses	3,379	3,564	32,139
Other	22,424	22,058	198,886
Total current liabilities	152,334	161,327	1,454,577
Non-current liabilities			
Long-term loans payable	1,700	1,700	15,327
Lease obligations	1,408	1,058	9,544
Provision for directors' retirement benefits	647	690	6,224
Net defined benefit liability	8,533	9,205	82,999
Other	1,162	1,085	9,790
Total non-current liabilities	13,451	13,740	123,887
Total liabilities	165,785	175,067	1,578,464
Net assets			
Shareholders' equity			
Capital stock	10,374	10,374	93,542
Capital surplus	16,254	16,254	146,558
Retained earnings	189,816	209,335	1,887,435
Treasury shares	(137)	(139)	(1,259)
Total shareholders' equity	216,308	235,825	2,126,276
Accumulated other comprehensive income			
Valuation difference on available-for-sale securities	7,348	4,544	40,974
Deferred gains or losses on hedges	2	(23)	(210)
Revaluation reserve for land (Note 3)	(12,097)	(11,650)	(105,048)
Foreign currency translation adjustment	45	3	29
Remeasurements of defined benefit plans	1,289	1,027	9,264
Total accumulated other comprehensive income	(3,411)	(6,098)	(54,989)
Non-controlling interests	1,634	1,938	17,474
Total net assets	214,532	231,664	2,088,761
Total liabilities and net assets	¥380,317	¥ 406,732	\$ 3,667,226

The accompanying notes are an integral part of these statements.

Consolidated Statements of Income

OTSUKA CORPORATION and Consolidated Subsidiaries
For the years ended December 31, 2017 and 2018

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Net sales	¥691,166	¥759,871	\$6,851,240
Cost of sales	541,339	602,054	5,428,311
Gross profit	149,827	157,817	1,422,928
Selling, general and administrative expenses			
Salaries, allowances and bonuses	42,178	42,549	383,639
Directors' compensations	584	580	5,237
Welfare expenses	6,921	7,094	63,964
Rent expenses	6,439	6,699	60,403
Transportation and warehousing expenses	19,043	20,812	187,649
Provision for bonuses	2,252	2,383	21,488
Retirement benefit expenses	2,132	2,299	20,730
Provision for directors' retirement benefits	67	65	591
Provision of allowance for doubtful accounts	72	73	663
Depreciation	4,787	5,126	46,223
Other	20,959	22,074	199,026
Total Selling, general and administrative expenses (Note 1)	105,440	109,758	989,619
Operating profit	44,386	48,058	433,308
Non-operating income			
Interest income	17	13	122
Dividend income	129	162	1,469
House rent income	233	248	2,240
Income from recycling	145	175	1,584
Share of profit of entities accounted for using equity method	264	259	2,342
Foreign exchange gains	133	179	1,620
Other	208	241	2,179
Total non-operating income	1,129	1,282	11,560
Non-operating expenses			
Interest expenses	47	47	431
Other	8	7	64
Total non-operating expenses	56	55	496
Ordinary profit	45,460	49,285	444,372
Extraordinary income			
Gain on sales of non-current assets (Note 2)	107	96	874
Other	70	10	90
Total extraordinary income	178	106	964
Extraordinary losses			
Loss on retirement of non-current assets (Note 3)	34	61	556
Impairment loss	234	227	2,052
Other	6	2	24
Total extraordinary losses	275	292	2,634
Profit before income taxes	45,363	49,100	442,702
Income taxes-current	13,853	15,744	141,957
Income taxes-deferred	(392)	(622)	(5,609)
Total income taxes	13,460	15,122	136,348
Profit	31,902	33,977	306,353
Profit attributable to non-controlling interests	342	375	3,387
Profit attributable to owners of parent	¥ 31,560	¥ 33,601	\$ 302,965

The accompanying notes are an integral part of these statements.

Consolidated Statements of Comprehensive Income

OTSUKA CORPORATION and Consolidated Subsidiaries For the years ended December 31, 2017 and 2018	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Profit	¥31,902	¥33,977	\$306,353
Other comprehensive income			
Valuation difference on available-for-sale securities	2,857	(2,763)	(24,914)
Deferred gains or losses on hedges	3	(31)	(285)
Remeasurements of defined benefit plans, net of tax	(17)	(263)	(2,371)
Share of other comprehensive income of entities accounted for using equity method	50	(45)	(408)
Total other comprehensive income (Note 1)	2,893	(3,103)	(27,979)
Comprehensive income	¥34,795	¥30,874	\$278,374
(Breakdown)			
Comprehensive income attributable to owners of parent	¥34,421	¥30,468	\$274,709
Comprehensive income attributable to non-controlling interests	374	406	3,664

The accompanying notes are an integral part of these statements.

Consolidated Statements of Changes in Net Assets

OTSUKA CORPORATION and Consolidated Subsidiaries					Millions of yen
For the year ended December 31, 2017					
	Shareholders' equity				
	Capital stock	Capital surplus	Retained earnings	Treasury shares	Total shareholders' equity
Balance as of January 1, 2017	¥10,374	¥16,254	¥170,572	¥(137)	¥197,064
Dividends of surplus			(11,376)		(11,376)
Profit attributable to owners of parent			31,560		31,560
Reversal of revaluation reserve for land			(940)		(940)
Net changes of items other than shareholders' equity					
Total changes of items during the period	—	—	19,243	—	19,243
Balance as of December 31, 2017	¥10,374	¥16,254	¥189,816	¥(137)	¥216,308

OTSUKA CORPORATION and Consolidated Subsidiaries									Millions of yen
For the year ended December 31, 2017									
	Accumulated other comprehensive income								
	Valuation difference on available-for-sale securities	Deferred gains or losses on hedges	Revaluation reserve for land	Foreign currency translation adjustment	Remeasurements of defined benefit plans	Total accumulated other comprehensive income	Non-controlling interests	Total net assets	
Balance as of January 1, 2017	¥4,517	—	¥(13,037)	¥13	¥1,293	¥(7,212)	¥1,321	¥191,173	
Dividends of surplus								(11,376)	
Profit attributable to owners of parent								31,560	
Reversal of revaluation reserve for land								(940)	
Net changes of items other than shareholders' equity	2,831	2	940	31	(4)	3,801	313	4,115	
Total changes of items during the period	2,831	2	940	31	(4)	3,801	313	23,359	
Balance as of December 31, 2017	¥7,348	¥2	¥(12,097)	¥45	¥1,289	¥(3,411)	¥1,634	¥214,532	

OTSUKA CORPORATION and Consolidated Subsidiaries					Millions of yen
For the year ended December 31, 2018					
	Shareholders' equity				
	Capital stock	Capital surplus	Retained earnings	Treasury shares	Total shareholders' equity
Balance as of January 1, 2018	¥10,374	¥16,254	¥189,816	¥(137)	¥216,308
Dividends of surplus			(13,272)		(13,272)
Profit attributable to owners of parent			33,601		33,601
Reversal of revaluation reserve for land			(446)		(446)
Purchase of treasury shares				(2)	(2)
Change of scope of consolidation			(364)		(364)
Net changes of items other than shareholders' equity					
Total changes of items during the period	—	—	19,518	(2)	19,516
Balance as of December 31, 2018	¥10,374	¥16,254	¥209,335	¥(139)	¥235,825

OTSUKA CORPORATION and Consolidated Subsidiaries									Millions of yen
For the year ended December 31, 2018									
	Accumulated other comprehensive income								
	Valuation difference on available-for-sale securities	Deferred gains or losses on hedges	Revaluation reserve for land	Foreign currency translation adjustment	Remeasurements of defined benefit plans	Total accumulated other comprehensive income	Non-controlling interests	Total net assets	
Balance as of January 1, 2018	¥7,348	¥ 2	¥(12,097)	¥45	¥1,289	¥(3,411)	¥1,634	¥214,532	
Dividends of surplus								(13,272)	
Profit attributable to owners of parent								33,601	
Reversal of revaluation reserve for land								(446)	
Purchase of treasury shares								(2)	
Change of scope of consolidation								(364)	
Net changes of items other than shareholders' equity	(2,804)	(25)	446	(41)	(261)	(2,687)	303	(2,384)	
Total changes of items during the period	(2,804)	(25)	446	(41)	(261)	(2,687)	303	17,132	
Balance as of December 31, 2018	¥4,544	¥(23)	¥(11,650)	¥ 3	¥1,027	¥(6,098)	¥1,938	¥231,664	

OTSUKA CORPORATION and Consolidated Subsidiaries
For the year ended December 31, 2018

Thousands of U.S. dollars

	Shareholders' equity				Total shareholders' equity
	Capital stock	Capital surplus	Retained earnings	Treasury shares	
Balance as of January 1, 2018	\$93,542	\$146,558	\$1,711,445	\$(1,239)	\$1,950,307
Dividends of surplus			(119,665)		(119,665)
Profit attributable to owners of parent			302,965		302,965
Reversal of revaluation reserve for land			(4,023)		(4,023)
Purchase of treasury shares				(19)	(19)
Change of scope of consolidation			(3,287)		(3,287)
Net changes of items other than shareholders' equity					
Total changes of items during the period	—	—	175,989	(19)	175,969
Balance as of December 31, 2018	\$93,542	\$146,558	\$1,887,435	\$(1,259)	\$2,126,276

Thousands of U.S. dollars

	Accumulated other comprehensive income							Total net assets
	Valuation difference on available-for-sale securities	Deferred gains or losses on hedges	Revaluation reserve for land	Foreign currency translation adjustment	Remeasurements of defined benefit plans	Total accumulated other comprehensive income	Non-controlling interests	
Balance as of January 1, 2018	\$66,258	\$ 22	\$(109,072)	\$407	\$11,626	\$(30,757)	\$14,740	\$1,934,290
Dividends of surplus								(119,665)
Profit attributable to owners of parent								302,965
Reversal of revaluation reserve for land								(4,023)
Purchase of treasury shares								(19)
Change of scope of consolidation								(3,287)
Net changes of items other than shareholders' equity	(25,283)	(232)	4,023	(377)	(2,361)	(24,232)	2,733	(21,498)
Total changes of items during the period	(25,283)	(232)	4,023	(377)	(2,361)	(24,232)	2,733	154,471
Balance as of December 31, 2018	\$40,974	\$(210)	\$(105,048)	\$ 29	\$ 9,264	\$(54,989)	\$17,474	\$2,088,761

The accompanying notes are an integral part of these statements.

Consolidated Statements of Cash Flows

OTSUKA CORPORATION and Consolidated Subsidiaries
For the years ended December 31, 2017 and 2018

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Cash flows from operating activities:			
Profit before income taxes	¥ 45,363	¥ 49,100	\$ 442,702
Depreciation	6,138	6,438	58,055
Impairment loss	234	227	2,052
Increase (decrease) in allowance for doubtful accounts	(16)	9	87
Interest and dividend income	(146)	(176)	(1,591)
Interest expenses	47	47	431
Share of loss (profit) of entities accounted for using equity method	(264)	(259)	(2,342)
Loss on retirement of non-current assets	34	61	556
Loss (gain) on sales of non-current assets	(107)	(94)	(849)
Decrease (increase) in notes and accounts receivable - trade	(12,119)	(10,255)	(92,470)
Decrease (increase) in inventories	39	(909)	(8,201)
Increase (decrease) in notes and accounts payable - trade	7,319	6,246	56,320
Other, net	2,080	2,540	22,904
Subtotal	48,605	52,976	477,655
Interest and dividend income received	218	207	1,867
Interest expenses paid	(46)	(48)	(433)
Income taxes paid	(12,622)	(14,489)	(130,638)
Net cash provided by (used in) operating activities	36,153	38,646	348,450
Cash flows from investing activities:			
Proceeds from withdrawal of time deposits	300	—	—
Purchase of property, plant and equipment	(1,476)	(2,436)	(21,964)
Proceeds from sales of property, plant and equipment	900	243	2,199
Purchase of software	(4,925)	(5,864)	(52,873)
Purchase of investment securities	(46)	(3,065)	(27,636)
Proceeds from sales of investment securities	140	10	96
Collection of long-term loans receivable	25	39	358
Other, net	(161)	(25)	(233)
Net cash provided by (used in) investing activities	(5,243)	(11,096)	(100,052)
Cash flows from financing activities:			
Net increase (decrease) in short-term loans payable	(100)	(100)	(901)
Cash dividends paid	(11,367)	(13,265)	(119,605)
Other, net	(60)	(105)	(949)
Net cash provided by (used in) financing activities	(11,528)	(13,470)	(121,457)
Effect of exchange rate change on cash and cash equivalents	(19)	(7)	(67)
Net increase (decrease) in cash and cash equivalents	19,362	14,071	126,873
Cash and cash equivalents at beginning of period	118,183	137,545	1,240,158
Decrease in cash and cash equivalents resulting from exclusion of subsidiaries from consolidation	—	(31)	(283)
Cash and cash equivalents at end of period (Note 1)	¥137,545	¥151,585	\$1,366,747

The accompanying notes are an integral part of these statements.

Notes to Consolidated Financial Statements

OTSUKA CORPORATION and Consolidated Subsidiaries

(FRAMEWORK FOR PREPARING CONSOLIDATED FINANCIAL STATEMENTS)

1. Basis of Presentation of 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 the application and disclosure requirements from International Financial Reporting Standards.

2. Summary of Significant Accounting Policies

(1) Scope of consolidation

As of December 31, 2017 and 2018 the numbers of subsidiaries and consolidated subsidiaries were as follows:

	2017	2018
Subsidiaries	8	8
(Consolidated subsidiaries)	(5)	(4)

The 4 subsidiaries which were consolidated in the year ended December 31, 2018 are listed below:

	A ratio of voting rights held by the Company
OSK Co., LTD.	100.0%
Alpha Techno Co., LTD.	100.0%
Alpha Net Co., LTD.	100.0%
Networld Corporation	81.5%

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

Because Otsuka Auto Service Co., LTD., which was one of the consolidated subsidiaries as of December 31, 2017, has less impact on total assets, net sales, profit (loss), retained earnings, etc. and its overall materiality has declined, it was excluded from the scope of consolidation from the year ended December 31, 2018.

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 unconsolidated subsidiaries had little impact on total assets, net sales, profit (loss) attributable to owners of parent and retained earnings in the consolidated financial statements.

(2) Investments in unconsolidated subsidiaries and affiliates

As of December 31, 2017 and 2018 the numbers of unconsolidated subsidiaries and affiliates were as follows:

	2017	2018
Unconsolidated subsidiaries	3	4
Affiliates	7	7
(Affiliates accounted for using equity method)	(2)	(3)

Investments in unconsolidated subsidiaries and affiliates not accounted for using equity method were carried at cost, since they had little impact on profit (loss) attributable to owners of parent and retained earnings and their overall materiality did not exist in the consolidated financial statements as well.

The 3 investments in affiliates accounted for using equity method as of December 31, 2018 are listed below:

	A ratio of voting rights held by the Company
Otsuka Information Technology Corp.	37.8%
LION OFFICE PRODUCTS CORP.	40.4%
RO Holdings, Inc.	33.4%

RO Holdings, Inc. is accounted for using equity method since it became an affiliate through stock acquisition by the Company during the year ended December 31, 2018.

As for affiliates accounted for using equity method whose fiscal year-end are different from the Company's fiscal year-end, the Company consolidates its financial statements whose fiscal year-end are the nearest to that of the Company's and makes necessary adjustments to reflect any significant transaction which occurred between its closing dates and the Company's for equity accounting purpose.

(3) Financial instruments

(a) Securities

Securities held by the Companies are as follows:

- Available-for-sale 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, determined 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, with such a gain or loss being based on the latest available financial statements of the corresponding limited partnerships, was recognized in the consolidated statement of income.

(b) Derivatives

Derivatives are recognized at fair value.

(4) Inventories

Inventories are stated at cost (Carrying value of inventories on the balance sheet is stated by writing down based on their decrease in profitability).

Merchandise	Primarily, moving-average method
Work in process	Specific identification method
Raw materials and supplies	Primarily, moving-average method

(5) Property, plant and equipment (excluding lease assets)

Depreciation is calculated using the declining-balance method, at rates based on the estimated useful lives of assets. Buildings (excluding facilities attached to buildings) acquired on or after April 1, 1998, facilities attached to buildings and structures acquired on or after April 1, 2016 are depreciated by the straight-line method.

Estimated useful lives of assets are principally as follows:

Buildings and structures	— 15 to 50 years
Other	— 4 to 10 years

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

(6) Intangible assets (excluding lease assets)

Development costs of computer software to be sold are amortized based on the estimated sales revenue with the minimum amortization amount calculated based on a useful life within 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.

(7) Leases assets

Depreciation of finance lease assets, which do not transfer ownership of the assets at the end of the lease term, is calculated by the straight-line method over the lease periods, which are deemed as the useful lives, assuming no residual value.

(8) Allowance for doubtful accounts

An allowance for doubtful accounts is provided at an amount of potential losses from uncollectable receivables based on the historical rate of losses from bad debts for ordinary receivables, and on the estimated collectability of receivables from companies in financial difficulty.

(9) Provision for bonuses

The Companies provide accrued bonuses for employees based on the estimated amounts to be paid in respect of the fiscal year.

(10) Provision for directors' retirement benefits

The Companies have retirement benefits for directors.

Retirement benefits for directors at the balance sheet date are based on an estimate of the amounts to be paid as retirement allowance for services rendered by directors by that date.

(11) Accounting methods for retirement benefits

(a) The method to attribute expected benefit to periods of service

The retirement benefit obligation for employee is attributed to each period by the benefit formula basis over the estimated years of service of the eligible employees.

(b) The method of recording of actuarial gains and losses and prior service costs

Prior service cost is amortized as incurred by the straight-line method over periods (12 years), which are shorter than the average remaining years of service of the employees.

Actuarial gain or loss is amortized in the following year in which the gain or loss is recognized primarily by the straight-line method over periods (mainly 12 years), which are shorter than the average remaining years of service of the employees.

(12) The revenue and cost recognition basis regarding the make-to-order software

Revenues and costs of the make-to-order software contracts of which the percentage of completion can be reliably estimated, are recognized by the percentage-of-completion method. The completed-contract method continues to be applied for contracts of which the percentage of completion cannot be reliably estimated.

(13) Foreign currency translation

Receivables and payables denominated in foreign currencies are translated into Japanese yen at the spot exchange rates in effect at the balance sheet date, and the differences arising from the translation are recognized as gains/losses in the consolidated statements of income.

(14) Hedge accounting

(a) Hedge accounting method

Deferral hedge accounting method. Interest rate swap agreements are not recognized at fair value if the agreements meet the criteria for application of the exceptional treatment for the recognition of derivatives at fair value.

(b) Hedging instruments and hedged items

1. Hedging instruments: Forward foreign exchange contracts
Hedged items: Forecasted transactions denominated in foreign currencies
2. Hedging instruments: Interest rate swaps
Hedged items: Loans payable

(c) Hedge policy

The Companies utilize derivatives based on internal rules for the purpose of hedging its exposure to fluctuations in foreign exchange rates and interest rates.

(d) Evaluation of hedging effectiveness

The Companies assess its hedging effectiveness by comparing the accumulated changes in fair value of hedging instruments with the accumulated changes in fair value of hedged items. The assessment is omitted, if the substantial terms and conditions concerning hedging instruments and hedged items are same, and the fluctuations are expected to be offset perfectly.

In addition, the assessment of the effectiveness is omitted for interest rate swaps that meet the criteria for application of the exceptional treatment for the recognition of derivatives at fair value.

(15) 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.

(16) Accounting for income taxes

Income taxes of the Companies consist of corporate income taxes, local inhabitant taxes and enterprise taxes.

The Companies 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.

(17) 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 recorded as a liability. Consumption tax, which is paid by the Companies on purchases of goods and services, is not included in the amounts of costs/expenses in the consolidated statements of income, but offset consumption tax for the sales by the one for the purchase, and the net balance is included in "Other" in current liabilities in the consolidated balance sheets.

(18) Accounting pronouncement not yet adopted

– Accounting Standard for Revenue Recognition (ASBJ Statement No.29 on March 30, 2018)

– Implementation Guidance on Accounting Standard for Revenue Recognition (ASBJ Guidance No.30 on March 30, 2018)

(1) Overview

This is a comprehensive accounting standard for revenue recognition. Specifically, the accounting standard establishes the following five-step model that will apply to revenue from customers:

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognize revenue when (or as) the entity satisfies a performance obligation

(2) Scheduled date of adoption

The Company expects to adopt the accounting standard and implementation guidance from the beginning of the fiscal year ending December 31, 2022.

(3) Impact of the adoption of accounting standard and implementation guidance

The Company is currently evaluating the impact of the adoption of this accounting standard and implementation guidance on its consolidated financial statements.

(19) Rounding of amounts

Amounts of less than a million yen have been omitted.

3. U.S. Dollar Amounts

Amounts in U.S. dollars are included solely for the convenience of readers outside Japan. The rate of ¥110.91 = US\$1, exchange rates on December 31, 2018, 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 rate.

(CONSOLIDATED BALANCE SHEETS)

*1. Investment securities

As of December 31, 2017 and 2018, principal items related to unconsolidated subsidiaries and affiliates were as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Investment securities (stock)	¥2,953	¥6,214	\$56,029
Investment securities (capital)	217	217	1,958

*2. Pledged Assets

As of December 31, 2017 and 2018, pledged assets were as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Time deposits	¥5	¥5	\$45

Liabilities corresponding to above assets were as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Notes and accounts payable - trade	¥5	¥5	\$45

*3. Land Revaluation

Pursuant to the "Act on Revaluation of Land", and "Act on Partial Amendment to the Act on Revaluation of Land", the Company revalued land used for business activities.

The amount which is deducted deferred tax liabilities for land revaluation from revaluation difference was recorded as "Revaluation reserve for land", net assets in the accompanying consolidated balance sheets.

Revaluation method provided in article 3-3 of "Act on Revaluation of Land"

The Company revalued land using the price of land which is determined based on article 2-4 of "Order for Enforcement of Act on Revaluation on Land" and assessed value of fixed assets provided in article 2-3 for land without price of land after making reasonable adjustments for land shape and so on.

The date of Land Revaluation December 31, 2001

As of December 31, 2017 and 2018, the differences between fair value and carrying value after revaluation were as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
The differences between fair value and carrying value after revaluation	¥(210)	¥73	\$658

*4. Notes matured at the balance sheet date

December 31, 2017 and 2018 were a bank holiday, and notes matured at the balance sheet date were accounted for as if they were settled on the maturity dates.

As of December 31, 2017 and 2018, notes matured at the balance sheet date were as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Notes receivable	¥418	¥555	\$5,004

CONSOLIDATED STATEMENTS OF INCOME

*1. Research and development expenses

For the years ended December 31, 2017 and 2018, Research and development expenses were as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Research and development expenses included in general and administrative expenses and manufacturing costs	¥1,207	¥1,004	\$9,055

*2. Gain on sales of non-current assets

For the years ended December 31, 2017 and 2018, Gain on sales of non-current assets were as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Buildings and structures	¥ 96	¥59	\$533
Land	11	37	335
Other property, plant and equipment	—	0	5
Gain on sales of non-current assets	¥107	¥96	\$874

*3. Loss on retirement of non-current assets

For the years ended December 31, 2017 and 2018, Loss on retirement of non-current assets were as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Buildings and structures	¥19	¥27	\$251
Other property, plant and equipment	14	33	305
Software	0	—	—
Loss on retirement of non-current assets	¥34	¥61	\$556

(CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME)

*1. Other comprehensive income

For the years ended December 31, 2017 and 2018, reclassification adjustments and tax effects related to other comprehensive income were as follows:

	Millions of yen		Thousands of
	2017	2018	U.S. dollars
			2018
Valuation difference on available-for-sale securities			
Amount arising during the year	¥4,119	¥(3,993)	\$(36,010)
Reclassification adjustments	(0)	(2)	(18)
Amount before tax effect	4,119	(3,996)	(36,029)
Tax effect	(1,261)	1,232	11,114
Valuation difference on available-for-sale securities	2,857	(2,763)	(24,914)
Deferred gains or losses on hedges			
Amount arising during the year	21	(22)	(204)
Reclassification adjustments	(17)	(23)	(207)
Amount before tax effect	4	(45)	(411)
Tax effect	(1)	13	126
Deferred gains or losses on hedges	3	(31)	(285)
Remeasurements of defined benefit plans			
Amount arising during the year	250	(452)	(4,083)
Reclassification adjustments	(276)	74	668
Amount before tax effects	(25)	(378)	(3,415)
Tax effects	7	115	1,043
Remeasurements of defined benefit plans	(17)	(263)	(2,371)
Share of other comprehensive income of entities accounted for using equity method			
Amount arising during the year	48	(47)	(423)
Reclassification adjustments	1	1	15
Share of other comprehensive income of entities accounted for using equity method	50	(45)	(408)
Total other comprehensive income	¥2,893	¥(3,103)	\$(27,979)

(CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS)

1. Shareholders' Equity

The Companies Act of Japan provides that an amount equal to 10% of distributions from capital surplus (other than capital reserves) and retained earnings (other than retained earnings reserves) should be appropriated to capital reserves and retained earnings reserves.

No further appropriations are required when the total amount of capital reserves and retained earnings reserves reach 25% of stated capital.

Such distributions can be made at any time by resolution of the shareholders or the Board of Directors if certain conditions are met, but neither capital reserves nor retained earnings reserves are available for distributions.

2. Dividends from surplus, etc.

(1) Number of shares outstanding

	Thousands of shares	
	2017	2018
Number of shares at the beginning of the fiscal year	95,001	95,001
Increase (*)	—	95,001
Decrease	—	—
Number of shares as of the end of the fiscal year	95,001	190,002

Type of all shares outstanding is common stock.

* The Company implemented a two-for-one stock split of its common stock with an effective date of April 1, 2018.

The shares increase in the number of shares outstanding arise from the stock split.

(2) Number of treasury shares

	Thousands of shares	
	2017	2018
Number of shares at the beginning of the fiscal year	200	200
Increase (*)	—	200
Decrease	—	—
Number of shares as of the end of the fiscal year	200	400

Type of all treasury shares is common stock.

* The increase in the number of treasury shares consists of 200 thousand of shares by the stock split with an effective date of April 1, 2018 and 0 thousand of shares by purchase of less than standard unit.

(3) Items related to subscription rights to shares and own stock option

None.

(4) Items related to dividends

General meeting of shareholders approved resolutions on the amount of dividend payments as follows:

Resolution date	Dividends paid		Dividend per share		Record date	Effective date
	(Millions of yen)	(Thousands of U.S. dollars)	(Yen)	(U.S. dollars)		
29-Mar-17	¥11,376	\$102,570	¥120.00	\$1.08	31-Dec-16	30-Mar-17
28-Mar-18	¥13,272	\$119,665	¥140.00	\$1.26	31-Dec-17	29-Mar-18
27-Mar-19	¥16,116	\$145,307	(*) ¥85.00	\$0.77	31-Dec-18	28-Mar-19

Type of all shares outstanding is common stock.

Source of dividends is Retained earnings.

* The dividend per share whose record date is December 31, 2018 stated above is calculated in consideration of the stock split with an effective date of April 1, 2018.

The dividend per share whose record date is December 31, 2018 not considering the stock split is ¥ 170.00.

(CONSOLIDATED STATEMENTS OF CASH FLOWS)

*1. Supplementary Cash Flow Information

Cash and cash equivalents as of December 31, 2017 and 2018 consisted of:

	Millions of yen		Thousands of
	2017	2018	U.S. dollars
Cash and deposits	¥136,410	¥150,888	\$1,360,456
Time deposits with deposit terms of more than three months	(55)	(55)	(495)
Trust beneficiary interests included in other current assets with investment terms with three months or less	1,190	752	6,786
Cash and cash equivalents	¥137,545	¥151,585	\$1,366,747

(LEASE TRANSACTIONS)

1. Finance Lease Transactions (lessee)

The disclosure is omitted because finance lease transaction was immaterial in the consolidated financial statements as of December 31, 2017 and 2018.

2. Operating Lease Transactions

The amounts of future lease payments on noncancelable operating leases as of December 31, 2017 and 2018 are summarized as follows:

	Millions of yen		Thousands of
	2017	2018	U.S. dollars
Due within one year	¥336	¥614	\$5,537
Due after one year	264	149	1,351
Total	¥601	¥764	\$6,888

(FINANCIAL INSTRUMENTS)

1. Financial Instruments

(1) Policy for financial instruments

The Companies manage temporary surplus through low-risk financial instruments, and raise working capital through bank loans.

(2) Types of financial instruments, related risk and risk management

Trade receivables -trade notes and accounts receivable- are exposed to customers' credit risk.

The Companies try to reduce credit risk by monitoring and analyzing the creditworthiness of each customer, as well as managing due dates and balances.

Investment securities are mainly the securities of the companies with which the Companies have operational relationships.

Although listed securities are exposed to the risk arising from fluctuations in the market, the Companies monitor and analyze fair value and the issuers' financial status periodically to reduce these risks.

Trade payables - trade notes and accounts payable, electronically recorded obligations- have payment due date within almost three months. Short-term loans payable and long-term loans payable are mainly financing related to working capital.

Trade payables, short-term loans payable, income tax payables, and other payables are exposed to liquidity risk.

The Companies reduce liquidity risk relating to these payables by developing a cash flow plan.

Long-term loans payable are exposed to interest rate fluctuation risk.

The Companies hedge this risk by using interest rate swap transactions.

Derivative transactions are interest rate swap agreements and foreign exchange contracts entered into by one of the consolidated subsidiaries.

Conducting and managing derivative transactions are in accordance with the internal policies, which set forth delegation of authority.

2. Estimated fair value of financial instruments

Carrying value of financial instruments on the consolidated balance sheet as of December 31, 2017 and 2018 and estimated fair value were as follows:

	Millions of yen		
	Carrying value	Fair value	Difference
2017			
Assets			
1) Cash and deposits	¥136,410	¥136,410	—
2) Notes and accounts receivable - trade	122,144	122,144	—
3) Investments securities			
Other securities	11,984	11,984	—
Investments in affiliates	1,156	2,108	952
Total assets	¥271,695	¥272,648	¥ 952
Liabilities			
4) Notes and accounts payable – trade	¥ 83,107	¥ 83,107	—
5) Electronically recorded obligations – operating	17,887	17,887	—
6) Short-term loans payable	4,900	4,900	—
7) Income taxes payable	8,274	8,274	—
8) Long-term loans payable	1,700	1,704	4
Total liabilities	¥115,869	¥115,873	¥ 4
Derivative transaction (*)			
Derivative transaction which hedge accounting is not applied	¥ 6	¥ 6	—
Derivative transaction which hedge accounting is applied	4	4	—
Total derivative transaction	¥ 11	¥ 11	—

* The value of assets and liabilities arising from derivatives is shown at net value, and with the amount in parentheses representing net liability position.

	Millions of yen		
	Carrying value	Fair value	Difference
2018			
Assets			
1) Cash and deposits	¥150,888	¥150,888	—
2) Notes and accounts receivable - trade	132,352	132,352	—
3) Investments securities			
Other securities	8,021	8,021	—
Investments in affiliates	1,185	1,755	569
Total assets	¥292,447	¥293,017	¥ 569
Liabilities			
4) Notes and accounts payable – trade	¥ 89,322	¥ 89,322	—
5) Electronically recorded obligations – operating	17,904	17,904	—
6) Short-term loans payable	4,800	4,800	—
7) Income taxes payable	9,326	9,326	—
8) Long-term loans payable	1,700	1,702	2
Total liabilities	¥123,053	¥123,056	¥ 2
Derivative transaction (*)			
Derivative transaction which hedge accounting is not applied	¥ (12)	¥ (12)	—
Derivative transaction which hedge accounting is applied	(41)	(41)	—
Total derivative transaction	¥ (53)	¥ (53)	—

* The value of assets and liabilities arising from derivatives is shown at net value, and with the amount in parentheses representing net liability position.

	Thousands of U.S. dollars		
	2018		
	Carrying value	Fair value	Difference
Assets			
1) Cash and deposits	\$1,360,456	\$1,360,456	—
2) Notes and accounts receivable - trade	1,193,332	1,193,332	—
3) Investments securities			
Other securities	72,326	72,326	—
Investments in affiliates	10,688	15,823	5,135
Total assets	\$2,636,803	\$2,641,939	\$ 5,135
Liabilities			
4) Notes and accounts payable – trade	\$ 805,363	\$ 805,363	—
5) Electronically recorded obligations – operating	161,434	161,434	—
6) Short-term loans payable	43,278	43,278	—
7) Income taxes payable	84,087	84,087	—
8) Long-term loans payable	15,327	15,350	22
Total liabilities	\$1,109,491	\$1,109,514	\$ 22
Derivative transaction (*)			
Derivative transaction which hedge accounting is not applied	\$ (108)	\$ (108)	—
Derivative transaction which hedge accounting is applied	(372)	(372)	—
Total derivative transaction	\$ (480)	\$ (480)	—

* The value of assets and liabilities arising from derivatives is shown at net value, and with the amount in parentheses representing net liability position.

Notes:

1. Methods to determine the estimated fair value of financial instruments and other matters related to investment securities and derivative transactions.

Assets

1) Cash and deposits 2) Notes and accounts receivable - trade

Since these items are settled in a short term, their carrying value approximates fair value.

3) Investment securities

The fair value of stocks is based on quoted market prices.

For information on securities classified by holding purpose, please refer to SECURITIES, of Notes to Consolidated Financial Statements.

Liabilities

4) Notes and accounts payable - trade 5) Electronically recorded obligations - operating 6) Short-term loans payable 7) Income taxes payable

Since these items are settled in a short term, their carrying value approximates fair value.

8) Long-term loans payable

The fair value of long-term loans payable is based on the present value of the total of principal and interest discounted by the interest rate presumed in the case of new borrowings.

Derivative transaction

Please refer to DERIVATIVES, of Notes to Consolidated Financial Statements.

2. As of December 31, 2017 and 2018, financial instruments for which it is extremely difficult to determine the fair value were as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Unlisted stocks	¥2,140	¥5,372	\$48,441
Investments in investment business limited partnerships	24	29	267

Because no quoted market price is available and it is extremely difficult to determine the fair value, the above financial instruments are not included "3) Investment securities" in the above table.

3. Redemption schedule for receivables as of December 31, 2017 and 2018 are as follows:

Millions of yen				
2017				
	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years
Cash and deposits	¥136,410	—	—	—
Notes and accounts receivable - trade	122,144	—	—	—
Total	¥258,555	—	—	—

Millions of yen				
2018				
	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years
Cash and deposits	¥150,888	—	—	—
Notes and accounts receivable - trade	132,352	—	—	—
Total	¥283,240	—	—	—

Thousands of U.S. dollars				
2018				
	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years
Cash and deposits	\$1,360,456	—	—	—
Notes and accounts receivable - trade	1,193,332	—	—	—
Total	\$2,553,789	—	—	—

4. Repayment schedules for long-term loans payable and other interest-bearing debt as of December 31, 2017 and 2018 are as follows:

Millions of yen				
2017				
	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years
Short-term loans payable	¥4,900	—	—	—
Long-term loans payable	—	—	¥1,700	—

Millions of yen				
2018				
	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years
Short-term loans payable	¥4,800	—	—	—
Long-term loans payable	—	¥1,700	—	—

Thousands of U.S. dollars				
2018				
	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years
Short-term loans payable	\$43,278	—	—	—
Long-term loans payable	—	\$15,327	—	—

(SECURITIES)

As of December 31, 2017 and 2018, securities were as follows:

(1) Available-for-sale securities with fair value as of December 31, 2017 and 2018

	Millions of yen						Thousands of U.S. dollars		
	2017			2018			2018		
	Carrying value	Acquisition cost	Unrealized gain (loss)	Carrying value	Acquisition cost	Unrealized gain (loss)	Carrying value	Acquisition cost	Unrealized gain (loss)
Securities whose carrying value exceeds their acquisition costs									
Stocks	¥11,775	¥1,279	¥10,496	¥7,826	¥1,272	¥6,554	\$70,563	\$11,469	\$59,094
Bonds	—	—	—	—	—	—	—	—	—
Other securities	208	89	119	170	102	67	1,540	928	612
	¥11,984	¥1,368	¥10,615	¥7,997	¥1,375	¥6,622	\$72,104	\$12,397	\$59,706
Securities whose carrying value does not exceed their acquisition costs									
Stocks	—	—	—	¥ 24	¥ 26	¥ (2)	\$ 221	\$ 243	\$ (21)
Bonds	—	—	—	—	—	—	—	—	—
Other securities	—	—	—	—	—	—	—	—	—
	—	—	—	¥ 24	¥ 26	¥ (2)	\$ 221	\$ 243	\$ (21)
Total	¥11,984	¥1,368	¥10,615	¥8,021	¥1,402	¥6,619	\$72,326	\$12,641	\$59,684

Note. The following other securities are not included in the above table because these were no quoted market price available and it is extremely difficult to determine their fair value:

	Millions of yen		Thousands of U.S. dollars	
	2017		2018	
	Carrying value	Carrying value	Carrying value	Carrying value
Available-for-sale securities				
Unlisted stocks		¥126	¥126	\$1,142
Investment in limited liability partnerships		24	29	267

(2) Available-for-sale securities sold for the years ended December 31, 2017 and 2018

	Millions of yen						Thousands of U.S. dollars		
	2017			2018			2018		
	Sales proceeds	Aggregate gains	Aggregate losses	Sales proceeds	Aggregate gains	Aggregate losses	Sales proceeds	Aggregate gains	Aggregate losses
Stocks	¥140	¥70	—	¥2	¥2	—	\$25	\$18	—

(3) Securities impairment losses recognized for the years ended December 31, 2017 and 2018

	Millions of yen		Thousands of U.S. dollars	
	2017		2018	
Stocks		¥6	—	—

Note. As for securities whose fair value as of the year-end are on or less than 50% of the acquisition costs or more than 50% but less than 70% and deemed to be unrecoverable, the impairment losses are recognized.

(DERIVATIVES)

As of December 31, 2017 and 2018, derivative transactions were as follows:

(1) Derivative transactions to which hedge accounting is not applied

Currency-related transactions

	Millions of yen			
	2017			
	Contractual value or notional principal amount		Fair value	Valuation gain (loss)
Total	Over one year			
Forward foreign exchange contracts Buy U.S. dollar	¥1,493	—	¥6	¥6

	Millions of yen			
	2018			
	Contractual value or notional principal amount		Fair value	Valuation gain (loss)
Total	Over one year			
Forward foreign exchange contracts Buy U.S. dollar	¥817	—	¥(12)	¥(12)

	Thousands of U.S. dollars			
	2018			
	Contractual value or notional principal amount		Fair value	Valuation gain (loss)
Total	Over one year			
Forward foreign exchange contracts Buy U.S. dollar	\$7,373	—	\$(108)	\$(108)

Note. Fair value calculation : Fair value is estimated on the basis of mainly value quoted by counterparty financial institutions.

(2) Derivative transactions to which hedge accounting is applied

Currency-related transactions

	Millions of yen		
	2017		
	Contractual value or notional principal amount		Fair value
Total	Over one year		
Forward foreign exchange contracts Buy U.S. dollar	¥1,235	—	¥4

	Millions of yen		
	2018		
	Contractual value or notional principal amount		Fair value
Total	Over one year		
Forward foreign exchange contracts Buy U.S. dollar	¥2,008	—	¥(41)

	Thousands of U.S. dollars		
	2018		
	Contractual value or notional principal amount		Fair value
Total	Over one year		
Forward foreign exchange contracts Buy U.S. dollar	\$18,110	—	\$(372)

Note. Fair value calculation : Fair value is estimated on the basis of mainly value quoted by counterparty financial institutions.

Interest rate-related transactions

	Millions of yen		
	2017		
	Contractual value or notional principal amount		Fair value
Total	Over one year		
Long-term loans payable Interest-rate swaps Pay/fixed and receive/floating	¥1,700	¥1,700	Note

	Millions of yen		
	2018		
	Contractual value or notional principal amount		Fair value
Total	Over one year		
Long-term loans payable Interest-rate swaps Pay/fixed and receive/floating	¥1,700	¥1,700	Note

	Thousands of U.S. dollars		
	2018		
	Contractual value or notional principal amount		Fair value
Total	Over one year		
Long-term loans payable Interest-rate swaps Pay/fixed and receive/floating	\$15,327	\$15,327	Note

Note. The fair value of interest-rate swaps which meet the criteria for application of the exceptional treatment for the recognition of derivatives is included in the fair value of long-term loans payable designated as the hedged item.

(RETIREMENT BENEFITS)

(1) Retirement benefit plans

The Companies have defined contribution pension plans, agreement type corporate pension plans and lump-sum plans as retirement benefit plans. Of the Companies as of December 31, 2018, 4 have enrolled in defined contribution pension plans, 3 in agreement type corporate pension plans and 4 in lump-sum plans.

The Companies that have lump-sum plans calculate net benefit liabilities and retirement benefit expenses using the simplified method.

1 consolidated subsidiary participates in multi-employer pension plan.

Because the plan cannot be reasonably calculated the amount of plan assets attributed to the company's contribution, it is accounted for in the same way as the defined contribution plans.

The company may pay premium benefits for employees' retirement.

(2) Defined benefit pension plans

(a) Changes in retirement benefit obligations (excluding plans that apply the simplified method)

	Millions of yen		Thousands of
	2017	2018	U.S. dollars
			2018
Balance at the beginning of the year	¥50,539	¥51,763	\$466,718
Service costs	2,562	2,536	22,872
Interest costs	103	105	954
Actuarial loss (gain)	(206)	474	4,277
Retirement benefits paid	(1,235)	(1,261)	(11,375)
Balance as of the end of the year	¥51,763	¥53,619	\$483,446

(b) Changes in plan assets

	Millions of yen		Thousands of
	2017	2018	U.S. dollars
			2018
Balance at the beginning of the year	¥42,765	¥43,925	\$396,042
Actuarial loss (gain)	44	21	193
Contribution paid by the employer	2,265	2,276	20,528
Retirement benefits paid	(1,149)	(1,168)	(10,537)
Balance as of the end of the year	¥43,925	¥45,054	\$406,226

(c) Changes in net defined benefit liability of the plans that apply the simplified method

	Millions of yen		Thousands of
	2017	2018	U.S. dollars
			2018
Balance at the beginning of the year	¥681	¥694	\$6,260
Retirement benefit expenses	87	77	695
Retirement benefits paid	(75)	(97)	(875)
Deconsolidation of subsidiaries	—	(33)	(302)
Balance as of the end of the year	¥694	¥640	\$5,778

(d) Reconciliation between the funded status of the plans and the amounts recognized as net defined liabilities in the consolidated balance sheets as of the end of the fiscal years

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Funded retirement benefit obligations	¥49,447	¥51,211	\$461,739
Plan assets	(43,925)	(45,054)	(406,226)
	5,522	6,157	55,513
Unfunded retirement benefit obligations	3,010	3,048	27,485
Total net defined benefit liability and asset	8,533	9,205	82,999
Net defined benefit liability	8,533	9,205	82,999
Total net defined benefit liability and asset	¥ 8,533	¥ 9,205	\$ 82,999

Note: Plans to which simplified methods are applied are included.

(e) Components of retirement benefit expenses

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Service costs	¥2,562	¥2,536	\$22,872
Interest costs	103	105	954
Amortization of actuarial differences	(168)	181	1,637
Amortization of prior service costs	(107)	(107)	(969)
Retirement benefit expenses calculated by simplified methods	87	77	695
Additional benefits for employees' retirement	50	15	138
Retirement benefit expenses	¥2,527	¥2,809	\$25,328

(f) Remeasurements of defined benefit plans included in other comprehensive income

Components of items (before tax) were as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Prior service cost	¥(107)	¥(107)	\$ (969)
Actuarial difference	82	(271)	(2,446)
Total	¥ (25)	¥(378)	\$(3,415)

(g) Remeasurements of defined benefit plans included in accumulated other comprehensive income

Components of items (before tax) were as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Unrecognized prior service costs	¥ (538)	¥ (431)	\$ (3,886)
Unrecognized actuarial differences	(1,319)	(1,048)	(9,449)
Total	¥(1,857)	¥(1,479)	\$(13,335)

(h) Items for plan assets

1. Components of the major plan assets

The ratios of the major types of assets to the total plan assets were as follows:

	2017	2018
Cash and deposits	86%	86%
Life insurance company general accounts	14%	14%
Total	100%	100%

2. Method of determining the long-term expected rate of return on plan assets

Current and target asset allocations, and historical and expected returns on various categories of plan assets have been considered in determining the long-term expected rate of return on plan assets.

(i) Items related to actuarial assumptions

The major actuarial assumptions

	2017	2018
Discount rate	0.2%	0.1%
Long-term expected rate of return on plan assets	0.0%	0.0%
Salary increasing rate	7.5%	7.5%

* Salary increasing rate is calculated based on a point based plan.

(3) Defined contribution pension plans

Required contributions to defined contribution pension plans of the Companies for the years ended December 31, 2017 and 2018 were ¥808 million, ¥805 million (\$7,263 thousand), respectively.

(4) Multi-employer pension plan

Required contributions to the multi-employer pension plan which was treated the same as the defined contribution plans for the years ended December 31, 2017 and 2018 were ¥20 million and ¥22 million (\$201 thousand), respectively.

(a) The most recent funded status related to multi-employer pension plan

	Millions of yen		Thousands of U.S. dollars
	March 31, 2017	March 31, 2018	March 31, 2018
Plan assets	¥27,094	¥28,441	\$256,440
Actuarial liability based on pension plan finance calculation and minimum actuarial reserve	26,532	27,649	249,299
Difference	¥ 562	¥ 792	\$ 7,141

(b) The contribution ratio of the Companies to the multi-employer pension plan

Fiscal year ended December 31, 2017. 1.2% (As of March 31, 2017)

Fiscal year ended December 31, 2018. 1.2% (As of March 31, 2018)

(c) Supplementary information:

The main factor of the difference shown in above (a)

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
General reserve	—	¥562	\$5,068
Surplus	562	229	2,073
Total	¥562	¥792	\$7,141

The ratio in above (b) have not presented the actual ratio of the Companies.

(DEFERRED TAX)

(1) Significant components of the Companies' deferred tax assets and liabilities

	Millions of yen		Thousands of
	2017	2018	U.S. dollars
Deferred tax assets:			2018
Allowance for doubtful accounts	¥ 89	¥ 92	\$ 831
Accrued enterprise taxes	556	635	5,729
Provision for bonuses	1,045	1,093	9,859
Net defined benefit liability	2,617	2,822	25,449
Provision for directors' retirement benefits	199	212	1,914
Impairment loss	814	853	7,691
Software development cost	1,209	1,331	12,008
Unrealized profit from non-current assets	267	300	2,707
Other	1,690	1,812	16,345
Subtotal	8,489	9,154	82,537
Less: Valuation allowance	(1,013)	(946)	(8,530)
Total deferred tax assets	7,476	8,208	74,007
Deferred tax liabilities:			
Valuation difference on available-for-sale securities	(3,234)	(2,001)	(18,047)
Other	(66)	(62)	(559)
Total deferred tax liabilities	(3,301)	(2,063)	(18,606)
Net deferred tax assets	¥4,175	¥6,144	\$55,401

Net deferred tax assets are included in the following items of Consolidated Balance Sheets.

	Millions of yen		Thousands of
	2017	2018	U.S. dollars
Current assets - Deferred tax assets	¥2,887	¥3,181	\$28,688
Non-current assets - Deferred tax assets	1,369	2,962	26,712
Non-current liabilities - Deferred tax liabilities	81	—	—

(2) A reconciliation of the material differences between the normal effective statutory tax rates and burden ratio of income taxes after application of tax effect accounting

Since the differences between the normal effective statutory tax rates and the burden ratio of income taxes after application of tax effect accounting are less than 5% of the normal effective statutory tax rates, a reconciliation of the differences is omitted.

(ASSET RETIREMENT OBLIGATIONS)

The disclosure is omitted because asset retirement obligations were immaterial in the consolidated financial statements.

(INVESTMENT AND RENTAL PROPERTIES)

The disclosure is omitted because investment and rental properties were immaterial in the consolidated financial statements.

(SEGMENT INFORMATION)

[Segment Information]

(1) Overview of reportable segments

The reportable segments of the Companies are periodically examined by the Board of Directors for the purpose of deciding the allocation of business resources and evaluating the operating results.

The Companies' main businesses are "System Integration", whose business fields encompass the construction of information systems and their cutover, and "Service and Support", which has support following the cutover of systems as its business field.

Therefore, the Companies are composed of two reportable segments, "System Integration business" and "Service and Support business."

The details of the two segments are as follows. The "System Integration business" provides optimized system services ranging from consulting to system design and development, transport and installation work and network construction. The "Service and Support business" provides customers with total service and support for their business operations and installed systems encompassing supplies, hardware and software maintenance, telephone support and outsourcing.

(2) Basis of measurement for reportable segment net sales, segment profit or loss, segment assets and other items

The accounting method for the Companies' reported business segments is substantially the same as "FRAMEWORK FOR PREPARING CONSOLIDATED FINANCIAL STATEMENTS".

Also, segment profit or loss is evaluated based on operating profit.

The prices of inter-segment transactions are determined by price after taking market conditions into account.

(3) Information about reportable segment net sales, segment profit or loss, segment assets and other items

	Millions of yen						
	Reportable segments						2017
	System integration business	Service and Support business	Subtotal	Other (Note 1)	Total	Adjustment (Note 2)	
Net sales							
Outside customers sales	¥408,718	¥282,064	¥690,783	¥383	¥691,166	—	¥691,166
Inter-segment sales/transfers	98	329	427	108	536	(536)	—
Total	¥408,817	¥282,393	¥691,211	¥491	¥691,702	¥ (536)	¥691,166
Segment profit	¥ 38,566	¥ 13,695	¥ 52,262	¥ 63	¥ 52,325	¥ (7,939)	¥ 44,386
Segment assets	¥135,017	¥102,083	¥237,100	¥736	¥237,836	¥142,480	¥380,317
Other items							
Depreciation (Note 4)	¥ 2,806	¥ 2,733	¥ 5,539	¥ 12	¥ 5,552	¥ 586	¥ 6,138
Investments in affiliates accounted for using equity method	761	1,721	2,483	—	2,483	—	2,483
Increase in property, plant and equipment and intangible assets (Note 4)	2,644	3,500	6,144	9	6,153	247	6,401

Millions of yen					
	Reportable segments			Adjustment (Note 2)	2018 Amount recorded in consolidated financial statements (Note 3)
	System integration business	Service and Support business	Total		
Net sales					
Outside customers sales	¥463,293	¥296,577	¥759,871	—	¥759,871
Inter-segment sales/transfers	124	429	553	(553)	—
Total	¥463,417	¥297,007	¥760,424	¥ (553)	¥759,871
Segment profit	¥ 41,645	¥ 14,670	¥ 56,315	¥ (8,257)	¥ 48,058
Segment assets	¥145,708	¥104,958	¥250,666	¥156,065	¥406,732
Other items					
Depreciation (Note 4)	¥ 2,956	¥ 2,727	¥ 5,684	¥ 754	¥ 6,438
Investments in affiliates accounted for using equity method	791	4,891	5,682	—	5,682
Increase in property, plant and equipment and intangible assets	3,356	4,188	7,544	755	8,300

Thousands of U.S. dollars					
	Reportable segments			Adjustment (Note 2)	2018 Amount recorded in consolidated financial statements (Note 3)
	System integration business	Service and Support business	Total		
Net sales					
Outside customers sales	\$4,177,200	\$2,674,039	\$6,851,240	—	\$6,851,240
Inter-segment sales/transfers	1,120	3,871	4,992	(4,992)	—
Total	\$4,178,320	\$2,677,911	\$6,856,232	\$ (4,992)	\$6,851,240
Segment profit	\$ 375,488	\$ 132,270	\$ 507,759	\$ (74,450)	\$ 433,308
Segment assets	\$1,313,750	\$ 946,335	\$2,260,085	\$1,407,140	\$3,667,226
Other items					
Depreciation (Note 4)	\$ 26,656	\$ 24,595	\$ 51,251	\$ 6,803	\$ 58,055
Investments in affiliates accounted for using equity method	7,133	44,101	51,235	—	51,235
Increase in property, plant and equipment and intangible assets	30,267	37,760	68,028	6,809	74,837

Notes 1. The "Other" segment refers to business other than those included in the reportable segments.

Other businesses include repair of automobiles and insurance businesses.

Because Otsuka Auto Service Co., LTD., which was one of the consolidated subsidiaries as of December 31, 2017, has less impact on total assets, net sales, profit (loss), retained earnings, etc. and its overall materiality has declined, it was excluded from scope of consolidation from the year ended December 31, 2018. Consequently, "Other" column is not presented herein as this business segment has no actual results.

2. Below is a description of adjustment.

(1) The companywide expenses (not allocated to the reportable segments) included in the "Segment profit" adjustment line for the years ended December 31, 2017 and 2018 were ¥ -7,958 million and ¥ -8,270 million (\$-74,573 thousand), consisting mainly of expenses related to administrative operations.

(2) The companywide assets (not allocated to the reportable segments) included in the "Segment assets" adjustment line as of December 31, 2017 and 2018 were ¥143,497 million and ¥156,743 million (\$1,413,246 thousand), consisting mainly of assets not belonging to the reportable segments (cash on hands and in bank, investments in securities) and assets related to administrative operations.

(3) The "Depreciation" adjustment refers to depreciation expenses related to companywide assets.

The "Increase in property, plant and equipment and intangible assets" refers to increase related to companywide assets.

3. The "Segment profit" is reconciled with "Operating profit" in Consolidated Statements of Income.

4. "Depreciation" and "Increase in property, plant and equipment and intangible assets" include relevant amount of Long-term prepaid expenses.

[Related Information]

(1) Products and services

The disclosure is omitted because similar information is disclosed in segment information for the years ended December 31, 2017 and 2018.

(2) Geographical area

1. Net Sales

The disclosure is omitted because outside customers sales in Japan constituted more than 90% of total net sales for the years ended December 31, 2017 and 2018.

2. Property, plant and equipment

Not applicable because all property, plant and equipment are located in Japan as of December 31, 2017 and 2018.

(3) Major customer

The disclosure is omitted because there was no outside customer whose net sales amount was more than 10% of net sales in the consolidated statements of income for the years ended December 31, 2017 and 2018.

[Impairment loss on fixed assets by reportable segment]

The disclosure is omitted because impairment loss on fixed assets by reportable segment is immaterial in the consolidated financial statements for the years ended December 31, 2017 and 2018.

[Amortization and unamortized balance of goodwill by reportable segment]

For the years ended December 31, 2017 and 2018, not applicable.

[Gain on negative goodwill by reportable segment]

For the years ended December 31, 2017 and 2018, not applicable.

[Related Party Transactions]

For the years ended December 31, 2017 and 2018, not applicable.

(PER SHARE INFORMATION)

Net assets per share as of December 31, 2017 and 2018 and basic earnings per share for the years ended December 31, 2017 and 2018 were summarized as follows:

	Yen		U.S. dollars
	2017	2018	2018
Net assets per share	¥1,122.87	¥1,211.63	\$10.92
Basic earnings per share	166.46	177.22	1.60

Notes 1. Diluted earnings per share for the years ended December 31, 2017 and 2018 are omitted, because the Companies have no dilutive shares.

2. The Company implemented a two-for-one stock split of its common stock with an effective date of April 1, 2018.

Accordingly, net assets per share and basic earnings per share stated above are calculated on the assumption that the stock split was implemented at the beginning of the previous year (the year ended December 31, 2017).

3. Basis for calculation of net assets per share as of December 31, 2017 and 2018 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Numerator:			
Net assets	¥214,532	¥231,664	\$2,088,761
Non-controlling interests in consolidated subsidiaries	(1,634)	(1,938)	(17,474)
Net assets attributable to common stock	¥212,897	¥229,726	\$2,071,287
Denominator:			
Number of shares of common stock outstanding	189,601	189,601	

4. Basis for calculation of basic earnings per share for the years ended December 31, 2017 and 2018 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2018	2018
Numerator:			
Profit attributable to owners of parent	¥31,560	¥33,601	\$302,965
Amount not attributable to common shareholders	—	—	—
Profit attributable to owners of parent related to common shareholders	¥31,560	¥33,601	\$302,965
Denominator:			
Weighted-average number of shares of common stock outstanding	189,601	189,601	

Basic earnings per share is based upon the weighted average number of common stock outstanding (excluding a treasury shares) during each year.

[CONSOLIDATED SUPPLEMENTARY STATEMENTS]

(ANNEXED CONSOLIDATED DETAILED SCHEDULE OF BORROWINGS)

Borrowings as of December 31, 2018 consisted of the following:

	Millions of yen	
	Balance at the beginning of the year	Balance as of the end of the year
		2018
Short-term loans payable at the average interest rate of 0.75%	¥4,900	¥4,800
Current portion of long-term loans payable	—	—
Current portion of lease obligations	865	698
Long-term loans payable due 2023 at the average interest rate of 0.66%	1,700	1,700
Lease obligations due 2020 through 2024	1,408	1,058
Other interest-bearing debt	—	—
Total	¥8,873	¥8,256

	Thousands of U.S. dollars	
	Balance at the beginning of the year	Balance as of the end of the year
		2018
Short-term loans payable at the average interest rate of 0.75%	\$44,179	\$43,278
Current portion of long-term loans payable	—	—
Current portion of lease obligations	7,800	6,296
Long-term loans payable due 2023 at the average interest rate of 0.66%	15,327	15,327
Lease obligations due 2020 through 2024	12,696	9,544
Other interest-bearing debt	—	—
Total	\$80,004	\$74,447

Notes 1. The annual average interest rate represents the weighted-average rate applicable to the ending balance.

2. The annual average interest rate is not shown for lease obligations because the amounts in the consolidated balance sheets include the amounts corresponding to interest paid from total lease payment.

3. The contractual maturities of long-term loans payable and lease obligations as of December 31, 2018 were as follows:

	Millions of yen			
	Due after one year through two years	Due after two years through three years	Due after three years through four years	Due after four years through five years
				2018
Long-term loans payable	—	—	—	¥1,700
Lease obligations	446	358	193	57

	Thousands of U.S. dollars			
	Due after one year through two years	Due after two years through three years	Due after three years through four years	Due after four years through five years
				2018
Long-term loans payable	—	—	—	\$15,327
Lease obligations	4,024	3,233	1,745	515

Independent Auditor's Report

The Board of Directors
OTSUKA CORPORATION

We have audited the accompanying consolidated financial statements of OTSUKA CORPORATION and its consolidated subsidiaries, which comprise the consolidated balance sheets as at December 31, 2018, and the consolidated statements of income, comprehensive income, changes in net assets, and cash flows for the year then ended and a summary of significant accounting policies and other explanatory information, all expressed in Japanese yen.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in Japan, and for designing and operating such internal control as management determines is necessary to enable the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. The purpose of an audit of the consolidated financial statements is not to express an opinion on the effectiveness of the entity's internal control, but in making these risk assessments the auditor considers internal controls relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 consolidated subsidiaries as at December 31, 2018, and their consolidated financial performance and cash flows for the year then ended in conformity with accounting principles generally accepted in Japan.

Convenience Translation

We have reviewed the translation of these consolidated financial statements into U.S. dollars, presented for the convenience of readers, and, in our opinion, the accompanying consolidated financial statements have been properly translated on the basis described in Note 3.

March 27, 2019
Tokyo, Japan



Corporate Data (As of December 31, 2018)

Name	OTSUKA CORPORATION
Founded	July 17, 1961 (registered as joint-stock company on December 13, 1961)
Capital Stock	¥10,374,851,000
Number of Employees	7,145 (with consolidated subsidiaries: 8,732)
Business	System Integration business: Sales of computers, copiers, communication equipment and software, and software development of consigned software, other activities Service and Support business: Supplies, maintenance and educational support, other activities
Main Banks	The Bank of Yokohama, Ltd. MUFG Bank, Ltd. Mizuho Bank, Ltd.

Bases (As of December 31, 2018)

Head Office	2-18-4 Iidabashi, Chiyoda-ku, Tokyo 102-8573 TEL 03-3264-7111		
Local Area Sales Departments	Chuo Sales Dept. 1 Josai Sales Dept. Northern Kanto Sales Dept. Osaka Southern Sales Dept.	Chuo Sales Dept. 2 Tama Sales Dept. Keiyo Sales Dept.	Kanagawa Sales Dept. Johoku Sales Dept. Osaka Northern Sales Dept.
Regional Offices	Sapporo Branch Takasaki Branch Kyoto Branch Kyushu Branch	Sendai Branch Tsukuba Branch Kobe Branch	Utsunomiya Branch Chubu Branch Hiroshima Branch

Principal Group Companies (As of December 31, 2018)

The OTSUKA Group (OTSUKA CORPORATION and its subsidiaries) consists of 8 subsidiaries, including 4 consolidated subsidiaries as well as 7 affiliated companies, including 3 affiliates accounted for using equity method that carry out the System Integration business, Service and Support business. The 4 consolidated subsidiaries are listed below.

Company Name	Established	Capital (¥ million)	Ratio of Voting Rights	Scope of Business
■ System Integration business				
OSK Co., LTD.	1984	400	100.0%	• Development and sale of packaged software, IT consulting, and consigned software development
Networkld Corporation	1990	585	81.5%	• Sales and technical support for network related equipment
■ Service and Support business				
Alpha Techno Co., LTD.	1996	50	100.0%	• Emergency repair of PCs and peripheral equipment, and data recovery service
Alpha Net Co., LTD.	1997	400	100.0%	• Comprehensive service and support for network systems

Stock Information (As of December 31, 2018)

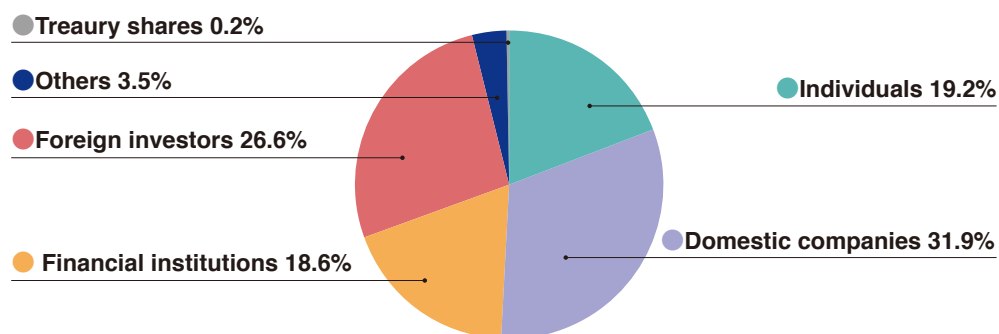
Authorized Common Stock	677,160,000 shares
Issued Common Stock	190,002,120 shares
Number of Shares of Unit Stock	100 shares
Number of Shareholders	6,151

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.	58,729,980	30.97	—	—
The Master Trust Bank of Japan, Ltd. (Trust Account)	8,613,800	4.54	—	—
Japan Trustee Services Bank, Ltd. (Trust Account)	7,986,600	4.21	—	—
Yuji Otsuka	5,681,880	2.99	—	—
Minoru Otsuka	5,672,940	2.99	—	—
OTSUKA CORPORATION Employee Stock-Sharing Plan	5,223,920	2.75	—	—
Atsushi Otsuka	5,095,700	2.68	—	—
Terue Otsuka	3,873,000	2.04	—	—
SMBC Nikko Securities Inc.	3,758,700	1.98	—	—
Japan Trustee Services Bank, Ltd. (Trust Account 5)	2,083,400	1.09	—	—

Note: Equity Ownership is calculated after deducting treasury shares (400,868 shares).

Breakdown of Shareholders (Based on total shares)



OTSUKA CORPORATION WEBSITE

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

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