

# ANNUAL REPORT 2003

For the fiscal year ended December 31, 2003

***Otsuka Corporation***

# C O N T E N T S

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## Mission Statement

### Mission

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

### Goals

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

### Principles

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

***Otsuka Corporation***

#### Forward-Looking Statements

The forecasts, plans and outlooks concerning future operating results that are described in this Annual Report are judgments believed to be reasonable by the Company's management, based upon the information available to OTSUKA CORPORATION and member companies of the OTSUKA Group at the time such future projections were created. Various factors that form the basis of these forward-looking statements may differ from the OTSUKA Group's assumptions, and actual results may differ significantly from those presented here. Such factors include changes to the economic situation in principal markets and to product demand, and changes in various domestic and international regulations, accounting standards and customary business practices.

# Consolidated Financial Highlights

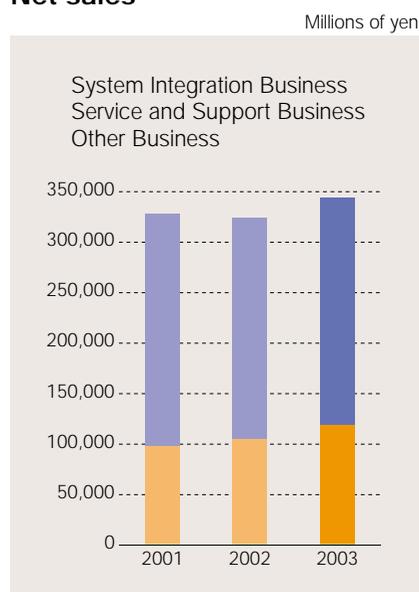
OTSUKA CORPORATION and its Consolidated Subsidiaries Years ended December 31, 2001, 2002 and 2003			Millions of yen	Thousands of U.S. dollars	%
	2001	2002	2003	2003	Change
Net sales	¥328,151	¥324,289	¥344,377	\$3,213,972	+6.2
System Integration Business	230,561	219,690	225,842	2,107,722	+2.8
Service and Support Business	96,338	103,380	116,665	1,088,802	+12.9
Other Business	1,252	1,219	1,869	17,447	+53.3
Operating income	8,178	7,990	9,221	86,064	+15.4
Recurring profit	7,665	7,766	9,055	84,514	+16.6
Income before income taxes and minority interests	4,859	4,706	4,619	43,113	-1.8
Net income	2,531	2,405	2,457	22,931	+2.2
Total assets	148,111	148,563	162,144	1,513,249	+9.1
Total interest-bearing debt	36,983	29,795	36,858	343,993	+23.7
Total shareholders' equity	41,131	42,351	43,978	410,435	+3.8
Net income per share (EPS) (Yen and U.S. dollars)	79.94	75.96	77.67	0.72	+2.3
Dividends per share of common stock (Yen and U.S. dollars)	25.00	20.00	20.00	0.18	0.0
Cash flows from operating activities per share (Yen and U.S. dollars)	496.55	468.47	497.87	4.64	+6.3
Operating income to net sales ratio (%)	2.49	2.46	2.68	—	
Net income to net sales ratio (%)	0.77	0.74	0.71	—	
Total interest-bearing debt ratio (%)	24.97	20.06	22.73	—	
Shareholders' equity ratio (%)	27.77	28.51	27.12	—	
Return on equity (ROE) (%)	5.48	5.76	5.69	—	

Note:

Figures for ROE are calculated using average shareholders' equity.

U.S. dollar amounts are computed using the December 31, 2002 exchange rate of ¥107.15=US\$1.

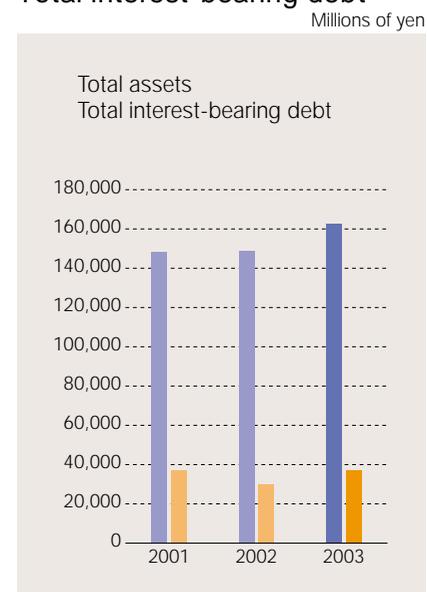
## Net sales



## Operating income, Recurring profit, Net income



## Total assets, Total interest-bearing debt



Note:

During the fiscal year 2003, the Company changed its policy from rounding off sums of less than a million yen to rounding down.

## To Our Shareholders



Yuji Otsuka, President

I am pleased to announce the results for the fiscal year ended December 31, 2003.

In the fiscal year under review, net sales increased 6.2% to ¥344,377 million. By segment, sales in the System Integration Business increased 2.8% to ¥225,842 million on the back of favorable performance for color copiers, computers and servers. Similarly, sales in the Service and Support Business increased 12.9% to ¥116,665 million as a result of increased sales in the “tanomail” office supply mail-order service and the “Total  $\alpha$  Support 21” support business.

Despite expenses entailed in relocating to the new head office and withdrawing from over-the-counter sales, operating income was up 15.4% to ¥9,221 million, recurring profit increased 16.6% to ¥9,055 million and net income edged up 2.2% to ¥2,457 million, with record recurring profit achieved for the third consecutive fiscal year.

The OTSUKA Group will further work toward achieving the tenets of our Mission Statement and pursue management reforms that respond to the trust of shareholders.

In fiscal 2004, ending December 31, 2004, the Group is targeting a 4.2% increase in net sales to ¥359,000 million, an 11.5% rise in recurring profit to ¥10,100 million and a 144.2% increase in net income to ¥6,000 million. The dramatic rise in projected net income will be the result of anticipated extraordinary income associated with the proxy portion of the employee pension fund.

We ask for the continued support of our shareholders and investors.

Yuji Otsuka, President

March 2004

# Overview of Consolidated Operations

## Limited Recovery within the Japanese Economy

In the fiscal year under review, some industries within the Japanese economy displayed signs of a recovery despite political instability overseas as characterized by the Iraq conflict and friction with North Korea. Nonetheless, the recovery covered only a portion of industries, owing to a rise in stock prices in Japan from the middle of the year after earlier dramatic fluctuations coupled with a scaling back of domestic production in the manufacturing industry following the SARS outbreak. Despite some positive indications, a sustainable recovery remained illusive during the fiscal year.

## Capital investment begins in corporate information technology

In the IT-related industries, in which the OTSUKA Group is involved, the push among large-scale companies to improve their business conditions has spread to small and medium companies, finally setting in motion previously delayed investment in computerization of corporate operations. Accordingly, a rebound was witnessed in both business and consumer applications for computers and similar equipment.

## “Act from the Customer’s Perspective and Respond to their Trust”

Amid such conditions, the OTSUKA Group has rallied behind the slogan “Act from the Customer’s Perspective and Respond to their Trust” to focus efforts on proposing new IT-based solutions for improving operations. Also, customer service capabilities and productivity was also boosted through the consolidation and integration of head office functions following the relocation of key functions to the new head office. Similarly, OTSUKA CORPORATION finished withdrawing from the “ $\alpha$  Land” retail business, which was scaled back in increments. Additionally, the Company introduced an executive officer system from July to augment corporate governance and bolster operational efficiency, as well as developed a corporate framework to enable rapid decision-making in order to properly handle new developments in the business environment.



OTSUKA CORPORATION new head office

## Achieving Record Recurring Profit for a Third Consecutive Fiscal Year

Increased sales were the result of both the above measures as well as the Company’s focused efforts on such key strategic businesses as “MRO,” “SMILE” and “ODS21.” A third consecutive fiscal year of record recurring profit was achieved on account of strong performance in the highly profitable maintenance operations of the Service & Support Business, coupled with efforts in expense reduction. Net income for the term rose from the previous fiscal year despite an extraordinary loss associated with relocation of the head office and withdrawal from the over-the-counter sales business.

In aggregate, net sales rose 6.2% to ¥344,377 million, operating income increased 15.4% to ¥9,221 million, recurring profit increased 16.6% to ¥9,055 million and net income edged up 2.2% to ¥2,457 million.

- MRO** : Marketing business for such peripheral products as stationary, daily necessities used in the office and OA supplies.
- tanomail** : Office supply mail-order service centered around the “MRO” business.
- SMILE** : The Company’s proprietary integrated mission-critical operational system Possessing 24 years of experience extending back to the Office computer days, OTSUKA CORPORATION boasts “SMILE  $\alpha$  AD” geared to the needs of midsize companies and small-medium-sized businesses and “SMILE ie” for large and mid-size companies.
- ODS21** : A knowledge management system that digitally captures paper-based information using copiers, allowing such information to be stored with other data as a centrally managed bank that can be shared and utilized.

## Overview of Business Segments

### System Integration Business

The System Integration Business provides optimized system services ranging from consulting to system design and introduction, transport and installation and network construction. As a result of focusing resources on the innovative “ODS21” knowledge management system and the “SMILE” integrated mission-critical operational system, brisk sales of color copiers, computers and servers produced a 2.8% rise in net sales to ¥225,842 million.

### Service and Support Business

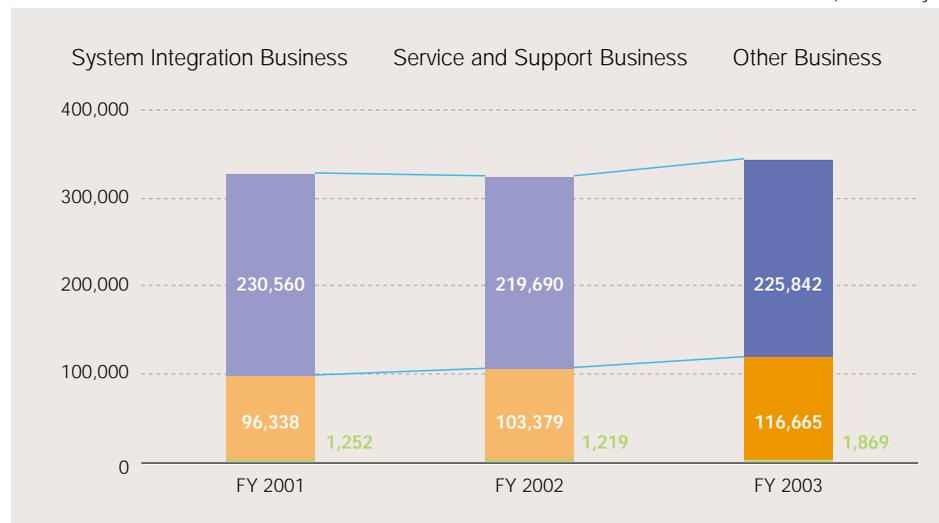
The Service and Support Business offers total support for systems installed by customers with supplies, hardware and software maintenance, telephone support and IT education. Focused efforts on the “tanomail” office supply mail-order services via Website and catalog channels fueled continued growth in sales of supplies chiefly for OA supplies. Combined with favorable performance in maintenance and similar fields, net sales climbed 12.9% to ¥116,665 million.

### Other Business

In Other Business, the construction industry, in which Fujimi Construction Co., LTD. operates, continued to experience harsh conditions, but aggressive marketing activities resulted in brisk sales. This performance, combined with the inclusion of Otsuka Auto Service Co., LTD. (automobile maintenance, etc.) and Otsuka Business Service Co., LTD. (direct mail production and shipment outsourcing, etc.) into the scope of consolidation, contributed to a sharp increase of 53.3% in net sales to ¥1,869 million.

## Net Sales by Segment

(Millions of yen)



## Overview of Key Strategic Businesses (Non-consolidated)

OTSUKA CORPORATION has positioned “MRO,” “SMILE,” “ODS21” and “Security” as its key strategic businesses and has concentrated resources accordingly.

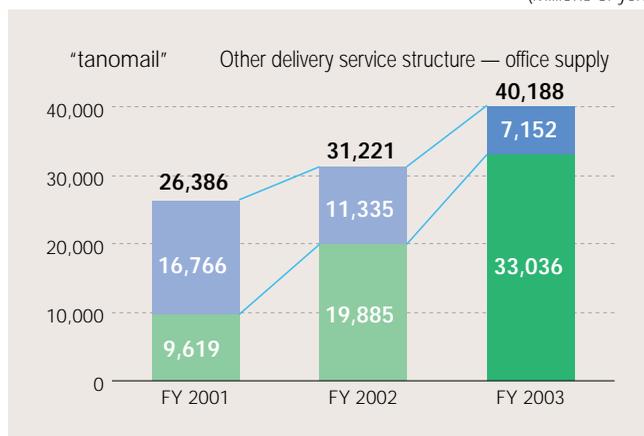
Key Strategic Business

# MRO

For the fiscal year under review, net sales rose 28.7% to ¥40,188 million.

### Net Sales of “MRO”

(Millions of yen)



Sales in the “MRO” business exceeded the ¥40,000 million mark owing to great strides made in the “tanomail” business. The performance of “tanomail” is likely attributed to its two-pronged approach of serving large corporate customers through “MA tanomail” and other services while simultaneously providing services for small and medium companies. In this way, “tanomail” has become the portal for OTSUKA CORPORATION’s one-stop solutions.



“tanomail” catalog, Vol.11



“tanomail” via Internet  
<http://www.tanomail.com>

## Advantages of "tanomail"

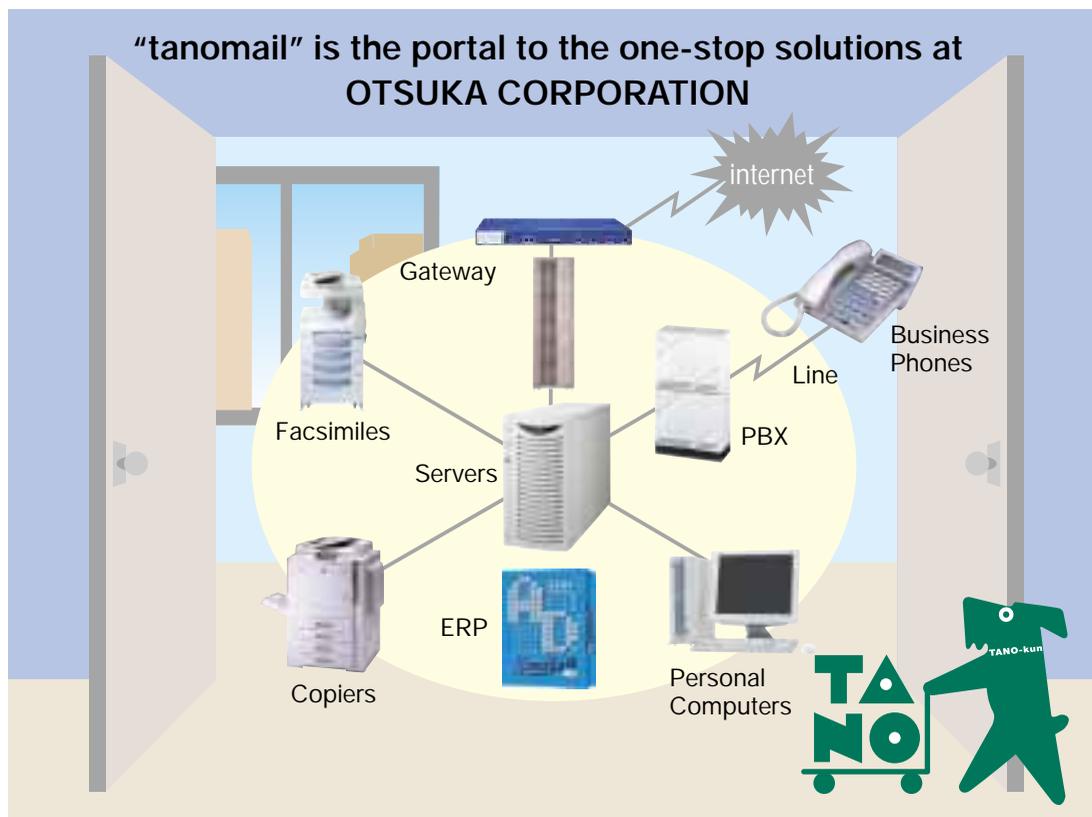
### Developing New Customers

The corporate activities undertaken within offices require such OA supplies as copy and printing paper as well as toner cartridges and stationary and daily necessities used in the office, all of which "tanomail" provides.

In addition to OA supplies, which have been handled from the beginning, "tanomail" also provides products spanning a wide range of corporate office activities, including stationary and daily necessities. OTSUKA CORPORATION develops and operates the system in-house, enabling the Company to make finely-tailored adjustments to customer needs while also customizing the system. "tanomail" is a business offering a full lineup of products and an area that is growing rapidly owing to a highly reliable structural framework in place at the Company, which is also contributing to the development of new customers.

### Portal to One-stop Solutions

OTSUKA CORPORATION has sales managers assigned to each region to maintain contact with customers on a daily basis. These managers even visit first-time customers to the Company's online "tanomail" service to provide solutions to their unique needs. In this way, "tanomail" acts as the portal for our one-stop solutions for customers.



Key Strategic Business

## SMILE

For the fiscal year under review, net sales rose 8.9% to ¥19,197 million.

### Net Sales of "SMILE"

(Millions of yen)



"SMILE" system capitalizes on its ease of introduction into any customer's corporate system owing to the broad range of optional software for specific industries and operations. It is this user-friendliness that has ensured strong sales against the backdrop of midsize companies revamping their mission-critical systems in line with management reforms.

Key Strategic Business

## ODS21

In the fiscal year under review, net sales sharply increased 34.1% to ¥18,581 million.

### Net Sales of "ODS21"

(Millions of yen)



"ODS21" provides proposals to improve operations at midsize companies by relying on the unique strengths of OTSUKA CORPORATION for providing copiers and computers, resulting in brisk sales for this business.

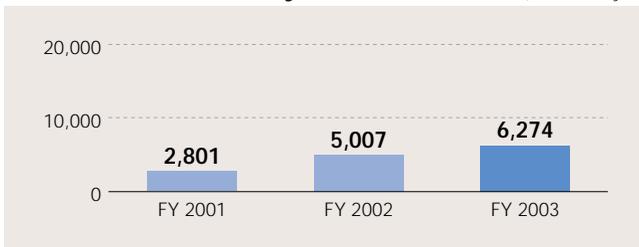
Key Strategic Business

## Security

In the fiscal year under review, net sales jumped 25.3% to ¥6,274 million.

### Net Sales of "Security"

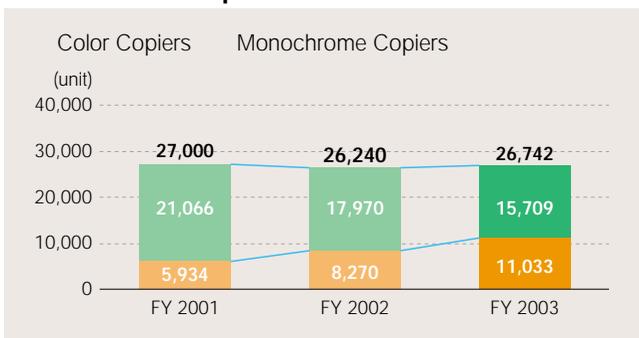
(Millions of yen)



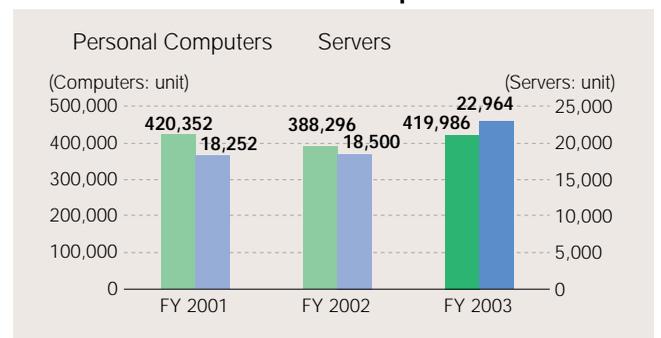
Sales in the "Security" Business have been very favorable from the impact of such factors as the rampant computer virus "MS Blast."

Through the above measures, OTSUKA CORPORATION was able to achieve unit sales for copiers and computers as shown in the graph.

### Unit Sales of Copiers



### Units Sales of Personal Computers and Servers



# Challenges and Forecasts for Fiscal 2004

In the coming fiscal year, while some positive indicators have been seen in the economic climate, numerous factors are compounding to weaken the economy, including lackluster exports against an appreciating yen and depreciating dollar.

## Future of the IT Market

Against this backdrop, every company, regardless of size, is being forced to make aggressive use of IT and improve management. Behind this push lies the ongoing dramatic overhaul taking place in B2B trading and mission-critical systems, the spread of ADSL and fiber optics as well as advances in broadband, which will likely further fuel the integration of data, voice and image. We are undoubtedly entering an era in which solutions will have to address customer needs in a more a complex and comprehensive way, including through the integration of mission-critical systems and information systems, infrastructure, applications, digital copiers and computers. This means that merely handling one small field of expertise—be it in computer, copier or communication systems—will no longer enable companies to provide comprehensive solutions.

## Achieving the Tenets of the Company Mission Statement

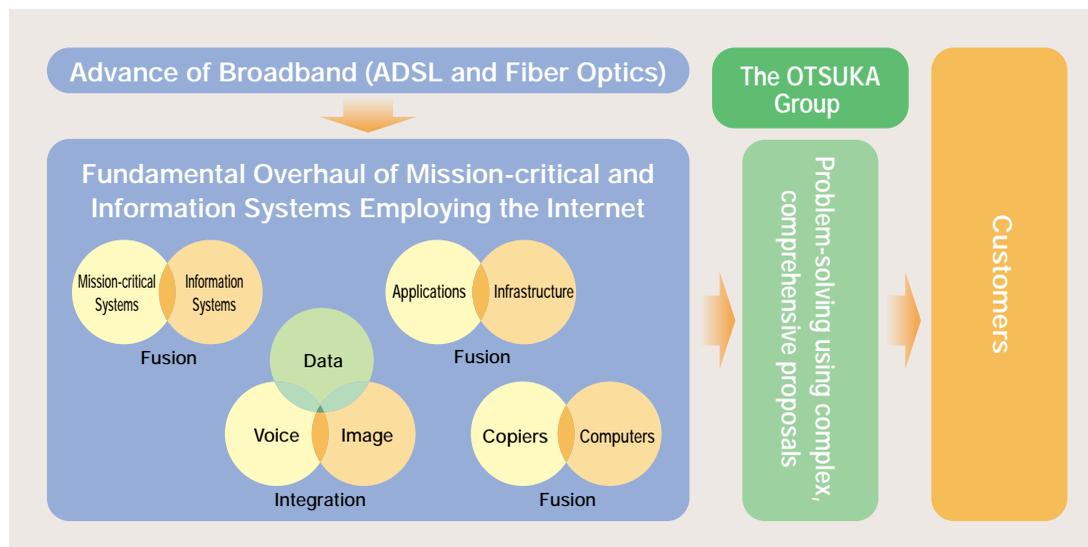
Since its founding, the OTSUKA Group has worked to meet customer needs while also expanding the number of solutions available within the Company from copiers to computers, communication devices and

the Internet, as well as growing the Service and Support Business. In the future, OTSUKA CORPORATION will strive to achieve its Mission Statement using the Company’s medium-term management strategy to further raise corporate value. Specifically, the Company will retain and expand its base of regular customers through the promotion of “New-Web Strategy,” bolster its “Total  $\alpha$  Support 21” support business and maintain profitability while expanding sales in “tanomail,” “SMILE” and “ODS21” to further raise the overall value associated with Company projects. To that end, OTSUKA CORPORATION will commit further management resources to fields with promising growth prospects while enhancing Group management.

## Forecasts for Fiscal 2004

In the coming fiscal year under review, forecasts call for a 4.2% rise in net sales to ¥359,000 million, a 11.5% climb in recurring profit to ¥10,100 million and a 144.2% jump in net income to ¥6,000 million. A key factor in the dramatic rise in net income is extraordinary income associated with the proxy portion of the employee pension fund.

## IT Market and Role of The OTSUKA Group



## A Precise Systematic Approach Using “SPR”

The Company employs Sales Process Re-engineering (SPR) as a mechanism for efficiently providing solutions that raise customer satisfaction. “SPR” is an information system developed by OTSUKA CORPORATION and features functions that combine Customer Relationship Management (CRM) with Sales Force Automation (SFA). “SPR” naturally handles customer profile information, but also acts as a database for transaction histories (past), status reports for

submitted proposals (present) and desires and needs (future). The database includes interviews and daily contact information for up to 20,000 companies as well as information on other companies. Analyzing and using this data in various creative ways enables the Company to efficiently provide customers with optimal solutions.

### SPR Abbreviation for Sales Process Re-engineering

Proprietary CRM (Customer Management) and SFA (Marketing Support) System

Have accurate customer profiles

Know transaction history with customers (Past)

Know the status of current proposals to customers (Present)

Know about the demands and needs of customers (Future)

Improve CS and efficiency precisely

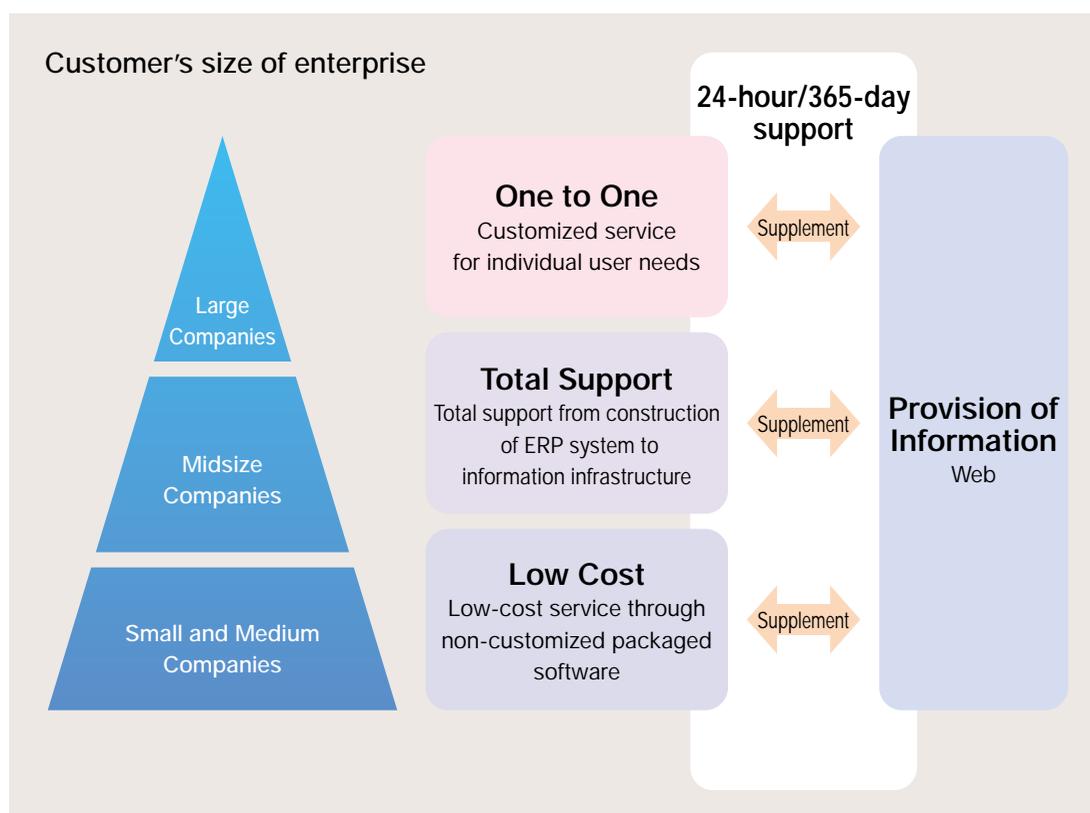
# Establishing a New Relationship with Customers

OTSUKA CORPORATION believes that providing optimal systems and services to customers has a direct effect on their growth, and accordingly, is striving to establish a strong relationship with them that will support future growth.

## Providing Optimal Systems and Services that Capitalize on Comprehensive Strengths

The systems and services that customers need varies depending on such factors as their management environment, industry and corporate scale. OTSUKA CORPORATION provides systems and services to match the unique conditions at every customer's office. This includes high value-added, one-to-one services that enable consulting and indi-

vidualized customization, as well as system construction and comprehensive support in minimal time with minimal cost through the combination of various package software and standardized services, and finally provision of products and services that make maximum use of the Internet and minimize costs.



# Topics

## Retirement of OTSUKA CORPORATION's Founder and Chairman

Mr. Minoru Otsuka, founder and Chairman of the Board for OTSUKA CORPORATION, stepped down from the Board of Directors at the 43rd annual general meeting on March 30, 2004 to help rejuvenate the management structure and energize the Board of Directors. On the same day, Mr. Minoru Otsuka assumed the post of Founder, Advisory and Honorary Chairman.

## Introduction of Executive Officer System

To augment corporate governance and further raise management efficiency, OTSUKA CORPORATION introduced an executive officer system on July 1, 2003. Consequently, the Board of Directors will henceforth augment functions to develop management policies and oversee business management. On the other hand, routine business management will be delegated to executive officers and their powers and responsibilities will be clarified.

OTSUKA CORPORATION will continue to develop a management structure that can provide quick decision-making as well as agilely adapt to changes in the management environment, while further improving transparency within management.

## Establishment of Otsuka System and Trading Corporation (Shanghai)—Operations Launched in October 2003

OTSUKA CORPORATION established the wholly owned subsidiary, Otsuka System and Trading Corporation (OSTC, Shanghai) in China, and has already launched business operations primarily handling the sale and support of CAD systems and related products. In the future, OSTC will provide the same level of one-stop support as currently available in Japan, including development of a network infrastructure and provision of Web-related solution services.

## Internet Data Center (iDC) Acquires ISMS Certification

In February 2003, the Internet Data Center (iDC) received certification in Information Security Management Systems (ISMS). ISMS publicly certifies that a business office is ensuring the security of information and adequately managing such data, and is the singular certification agency in Japan for information security management structures.

## Establishment of OTSUKA CORPORATION Heartful Fund Program

One of the goals of the OTSUKA Group's Mission Statement is: "To demonstrate harmonious coexistence and growth with nature and society." To achieve this goal, the Company established the OTSUKA CORPORATION Heartful Fund Program to help contribute to society, and has subsequently launched various activities that will be of service to society in numerous ways. Under this system, the monthly donations to the fund from interested employees will be combined with those of the Company and effectively used in environmental preservation, handicapped assistance and disaster relief.

# Board of Directors and Corporate Auditors (as of March 30, 2004)



President\*  
Yuji Otsuka



Senior Managing Director\*  
Akira Ishitani



Executive Managing Director  
Yoshiaki Nagashima



Executive Managing Director  
Youichi Harada



Managing Director  
Kazuhide Hamada



Managing Director  
Kazuyuki Katakura



Managing Director  
Katsuhiko Nakajima

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Directors

Yuuichi Itou  
Kimio Shiokawa  
Masakazu Tachibana  
Shinji Usami  
Toshiyasu Takahashi  
Katsuhiro Yano

Standing Auditor

Tatsuzo Yoshida

Auditors

Katsuhide Haneishi  
Katsumi Furuhata  
Jiro Makino

\*Director with representation rights

# Financial Section

## Three-Year Financial Data

OTSUKA CORPORATION and Its Consolidated Subsidiaries  
Years ended December 31, 2001, 2002 and 2003

	Millions of yen			Thousands of U.S. dollars
	2001	2002	2003	2003
Net sales	¥328,151	¥324,289	<b>¥344,377</b>	<b>\$3,213,972</b>
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Operating income	8,178	7,990	<b>9,221</b>	<b>86,064</b>
Recurring profit	7,665	7,766	<b>9,055</b>	<b>84,514</b>
Income before income taxes and minority interests	4,859	4,706	<b>4,619</b>	<b>43,113</b>
Net income	2,531	2,405	<b>2,457</b>	<b>22,931</b>
Total assets	148,111	148,563	<b>162,144</b>	<b>1,513,249</b>
Total interest-bearing debt	36,983	29,795	<b>36,858</b>	<b>343,993</b>
Total shareholders' equity	41,131	42,351	<b>43,978</b>	<b>410,435</b>
Net income per share (EPS) (Yen and U.S. dollars)	79.94	75.96	<b>77.67</b>	<b>0.72</b>
Dividends per share of common stock (Yen and U.S. dollars)	25.00	20.00	<b>20.00</b>	<b>0.18</b>
Cash flows from operating activities per share (Yen and U.S. dollars)	496.55	468.47	<b>497.87</b>	<b>4.64</b>
Operating income to net sales ratio (%)	2.49	2.46	<b>2.68</b>	—
Net income to net sales ratio (%)	0.77	0.74	<b>0.71</b>	—
Total interest-bearing debt ratio (%)	24.97	20.06	<b>22.73</b>	—
Shareholders' equity ratio (%)	27.77	28.51	<b>27.12</b>	—
Return on equity (ROE) (%)	5.48	5.76	<b>5.69</b>	—

Notes:

Figures for ROE are calculated using average shareholders' equity.

U.S. dollar amounts are computed using the December 31, 2003 exchange rate of ¥107.15=US\$1.

Figures in parentheses are negative figures.

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# Management's Analysis of Operating Results & Financial Position

## Summary of Sales and Profits

	Millions of yen			
	2002	2003	Amount of change, year on year	% change, year on year
Net Sales	¥324,289	<b>¥344,377</b>	+20,088	+6.2%
System Integration Business	219,690	<b>225,842</b>	+6,152	+2.8
Service & Support Business	103,380	<b>116,665</b>	+13,285	+12.9
Other Business	1,219	<b>1,869</b>	+650	+53.3
Cost of sales	247,837	<b>266,651</b>	+18,815	+7.6
Gross profit	76,452	<b>77,725</b>	+1,273	+1.7
Selling, general and administrative expenses	68,462	<b>68,503</b>	+41	+0.1
Operating income	7,990	<b>9,221</b>	+1,231	+15.4
Recurring profit	7,766	<b>9,055</b>	+1,289	+16.6
Income before income taxes and minority interests	4,706	<b>4,619</b>	-86	-1.8
Income taxes*	2,269	<b>2,047</b>	-221	-9.8
Net income	2,405	<b>2,457</b>	+51	+2.2

\*Including adjustment amount for corporate and other taxes

### Sales Summary

For the term, the Service & Support Business enjoyed robust sales, while the System Integration Business also made a strong showing. In combination with decent sales growth among the majority of consolidated subsidiaries, consolidated net sales rose 6.2% to ¥344,377 million, which was the third consecutive fiscal term of record-high sales.

### System Integration Business

The System Integration Business provides optimized system services ranging from consulting to system design and development, transport and installation and network construction. As a result of focusing resources on the innovative "ODS21" knowledge management system and the "SMILE" integrated mission-critical operational system, brisk sales of color copiers, computers and servers produced a 2.8% rise in net sales to ¥225,842 million.

### Service & Support Business

The Service & Support Business offers total support for systems installed by customers with supplies, hardware and software maintenance, telephone support and IT education. Focused efforts on the "tanomail" office supply mail-order services via Website and catalog channels fueled continued growth in sales of supplies chiefly for OA supplies. Combined with favorable performance in maintenance and similar fields, net sales climbed 12.9% to ¥116,665 million.

### Other Business

In Other Business, the construction industry, in which Fujimi Construction Co., Ltd. operates, continued to experience harsh conditions, but aggressive marketing activities resulted in brisk sales. This performance, combined with the inclusion of Otsuka Auto Service Co., LTD. (automobile maintenance, etc.) and Otsuka Business Service Co., LTD. (direct mail production and shipment outsourcing, etc.) into the scope of consolidation, contributed to a 53.3% increase in net sales to ¥1,869 million.

### Summary of Income and Expenses

Gross profit rose 1.7% to ¥77,725 million, while the gross profit margin edged down 1.0 percentage point to 22.6%.

Operating income climbed 15.4% to ¥9,221 million following efforts to reduce selling, general and administrative expenses.

Recurring profit reached record levels for the third consecutive fiscal term, increasing 16.6% to ¥9,055 million, following a decrease in other expenses on the back of lower interest expenses.

Income before income taxes and minority interests declined 1.8% to ¥4,619 million. This was the effect of amortiza-

tion of transition amount arising from adopting new accounting standard for retirement benefits of ¥2,135 million, loss on revaluation of investments in securities, loss on withdrawal from over-the-counter sales business activities and removal cost of head office.

In aggregate, net income edged up 2.2% to ¥2,457 million, and net income per share improved from ¥75.96 to ¥77.67.

During the year ended December 31, 2003, the Company changed the consolidated statement of income classification of the system engineering cost relating to commissioned business from selling, general and administrative expenses to cost of sales, according to man-hours. This change was made due to the growth in significance of the system engineering cost and the reconstruction of the Company's cost accounting system. This reclassification resulted in an increase in cost of sales and decrease in selling, general and administrative expenses, respectively, of ¥1,761 million for the year ended December 31, 2003, as compared with the amounts which would have been reported if the previous policy had been applied consistently. This reclassification did not have an impact on operating income and income before taxes.

## Financial Position

	Millions of yen			
	2002	2003	Amount of change, year on year	% change, year on year
Assets:	¥148,563	<b>¥162,144</b>	+13,581	+9.1%
Current assets	77,201	<b>78,918</b>	+1,717	+2.2
Fixed assets	71,362	<b>83,226</b>	+11,864	+16.6
Liabilities:	105,765	<b>117,572</b>	+11,806	+11.2
Current liabilities	94,894	<b>100,683</b>	+5,789	+6.1
Long-term liabilities	10,871	<b>16,888</b>	+6,017	+55.4
Minority interests	447	<b>594</b>	+147	+32.9
Shareholders' equity	42,351	<b>43,978</b>	+1,627	+3.8

### Assets

Current assets rose ¥1,717 million to ¥78,918 million owing to higher accounts and notes receivable. Total fixed assets expanded ¥11,864 million to ¥83,226 million as tangible fixed assets increased following acquisition of the new head office building, and investments in securities and guarantee deposits both dropped. Total assets increased ¥13,581 million to ¥162,144 million.

### Liabilities

Current liabilities rose ¥5,789 million to ¥100,683 million as a result of increased short-term bank loans needed to acquire the new head office building. Fixed liabilities expanded ¥6,017 million to ¥16,888 million owing to long-term debt associated with the acquisition of the new head office building, while total liabilities increased ¥11,806 million to ¥117,572 million.

### Shareholders' Equity

Shareholders' equity rose ¥1,627 million to ¥43,978 million on account of higher retained earnings.

The interest coverage ratio was 17.57 times; interest-bearing debt ratio was 22.73%; return on assets (ROA) was 5.97%; and return on equity (ROE) was 5.69%.

	2002	2003
Interest coverage ratio (times)	12.90	<b>17.57</b>
Interest-bearing debt ratio (%)	20.06	<b>22.73</b>
ROA* (%)	5.45	<b>5.97</b>
ROE (%)	5.76	<b>5.69</b>

\* ROA = Business profit / total assets (average during the year)  
 Business profit = Operating income + interest received + dividends received  
 Figures for ROE are calculated using average shareholders' equity.

## Cash Flows

	Millions of yen			
	2002	2003	Amount of change, year on year	% change, year on year
Cash flows from operating activities	¥14,835	<b>¥15,749</b>	+914	+6.2%
Cash flows from investing activities	-7,574	<b>-23,405</b>	-15,832	+209.0
Cash flows from financing activities	-7,969	<b>6,284</b>	+14,253	—
Cash and cash equivalents at end of year	4,298	<b>3,020</b>	-1,277	-29.7

Cash provided by operating activities expanded 6.2% to ¥15,749 million. Key sources included income before income taxes and minority interests of ¥4,619 million, depreciation and amortization of ¥6,704 million and reserve for retirement benefits of ¥2,742 million, as well as other sources.

Cash used in investing activities jumped 209.0% to ¥23,405 million. Key uses included payments for purchase of property, plant and equipment of ¥22,559 million and payments for software developed of ¥1,902 million.

Cash provided by financing activities was ¥6,284 million. Key sources included proceeds from long-term debts associated with acquisition of the new head office building and others of ¥16,850 million, increase in short-term bank loans, net of ¥2,560 million, repayments of long-term debts of ¥9,085 million using excess operating activity cash flows, and retirement of corporate bonds of ¥3,300 million.

As a result of the above factors, cash and cash equivalents were down 29.7% to ¥3,020 million.

## Outlook

In the current fiscal year ending December 31, 2004, consolidated projections call for a 4.2% rise in net sales to ¥359,000 million, an 11.5% increase in recurring profit to ¥10,100 million and a 144.2% jump in net income to ¥6,000 million. The key factor for dramatic growth in net income will be extraordinary income associated with the proxy portion of the employee pension fund.

## Consolidated Balance Sheets

OTSUKA CORPORATION and Its Consolidated Subsidiaries  
December 31, 2002 and 2003

Thousands of  
U.S. dollars  
(Note 3)

	Millions of yen		2003
	2002	2003	
<b>ASSETS</b>			
<b>Current assets:</b>			
Cash, time deposits and other cash equivalents (Notes 7 and 11)	¥ 5,696	¥ 4,353	\$ 40,626
Accounts and notes receivable:			
Trade	45,147	49,406	461,092
Unconsolidated subsidiaries and affiliates	19	30	285
Other	7,224	4,614	43,067
	52,390	54,051	504,445
Less: Allowance for bad debts	(332)	(336)	(3,143)
	52,058	53,714	501,301
Inventories (Note 6)	15,999	16,574	154,684
Deferred tax assets (Note 10)	863	1,499	13,998
Other current assets	2,585	2,776	25,912
<b>Total current assets</b>	<b>77,201</b>	<b>78,918</b>	<b>736,523</b>
<b>Investments and advances:</b>			
Investments in securities (Note 4)	3,240	2,771	25,867
Investments in unconsolidated subsidiaries and affiliates	546	473	4,421
Guarantee deposits	6,138	2,807	26,198
Deferred tax assets non-current (Note 10)	1,401	2,725	25,437
Deferred tax assets on revaluation of land	8,823	8,386	78,270
Other investments	1,145	685	6,395
	21,293	17,850	166,590
<b>Property, plant and equipment (Notes 7 and 14):</b>			
Land	9,334	18,926	176,637
Buildings and structures	58,211	67,224	627,389
Construction in progress	1,073	1	11
Others	9,472	9,629	89,865
	78,090	95,781	893,903
Less: Accumulated depreciation	(36,877)	(37,047)	(345,752)
<b>Net property, plant and equipment</b>	<b>41,213</b>	<b>58,734</b>	<b>548,151</b>
<b>Intangibles and deferred charges:</b>			
Software	7,859	5,837	54,477
Others	997	804	7,506
	8,856	6,641	61,983
<b>Total assets</b>	<b>¥148,563</b>	<b>¥162,144</b>	<b>\$1,513,249</b>

The accompanying notes are an integral part of these statements.

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2002	2003	2003
<b>LIABILITIES, MINORITY INTERESTS AND SHAREHOLDERS' EQUITY</b>			
<b>Current liabilities:</b>			
Short-term bank loans (Note 7)	¥ 20,201	¥ 22,756	\$ 212,378
Current maturities of long-term debts (Note 7)	6,886	8,224	76,753
Accounts and notes payable:			
Trade	34,188	36,411	339,815
Unconsolidated subsidiaries and affiliates	359	177	1,660
Other	21,941	18,977	177,107
	56,488	55,566	518,584
Income taxes payable (Note 10)	1,565	2,418	22,567
Other current liabilities	9,754	11,718	109,368
<b>Total current liabilities</b>	<b>94,894</b>	<b>100,683</b>	<b>939,652</b>
<b>Long-term liabilities:</b>			
Long-term debt (Note 7)	2,708	5,878	54,861
Reserve for retirement benefits (Note 8)	7,962	10,778	100,596
Deferred tax liabilities non-current (Note 10)	70	79	745
Other long-term liabilities	131	151	1,412
	10,871	16,888	157,615
<b>Minority interests in consolidated subsidiaries</b>	<b>447</b>	<b>594</b>	<b>5,545</b>
<b>Contingent liabilities (Note 9)</b>			
<b>Shareholders' equity:</b>			
Common stock: (Note 2 (17))			
Authorized: 112,860,000 shares			
Outstanding: December 31, 2002   31,667,020 shares			
December 31, 2003   31,667,020 shares	10,375	10,374	96,825
Capital surplus (Note 2 (17))	16,255	16,254	151,700
Retained earnings	27,745	29,485	275,180
Excess of land revaluation after tax-effect accounting (Note 14)	(12,134)	(12,219)	(114,040)
Unrealized gain on investment securities after tax-effect accounting	212	325	3,033
Foreign currency translation adjustment	(102)	(133)	(1,250)
Less: Treasury stock			
December 31, 2002           160 shares			
December 31, 2003       63,800 shares	(0)	(108)	(1,015)
<b>Total shareholders' equity</b>	<b>42,351</b>	<b>43,978</b>	<b>410,435</b>
<b>Total liabilities, minority interests and shareholders' equity</b>	<b>¥148,563</b>	<b>¥162,144</b>	<b>\$1,513,249</b>

The accompanying notes are an integral part of these statements.

## Consolidated Statements of Income

OTSUKA CORPORATION and Its Consolidated Subsidiaries  
For the years ended December 31, 2002 and 2003

Thousands of  
U.S. dollars  
(Note 3)

	Millions of yen		2003
	2002	2003	
<b>Net sales</b> (Note 15)	¥324,289	<b>¥344,377</b>	<b>\$3,213,972</b>
<b>Cost of sales</b> (Note 15)	247,837	<b>266,651</b>	<b>2,488,580</b>
Gross profit	76,452	<b>77,725</b>	<b>725,391</b>
<b>Selling, general and administrative expenses</b> (Note 15)	68,462	<b>68,503</b>	<b>639,326</b>
Operating income	7,990	<b>9,221</b>	<b>86,064</b>
<b>Other income (expenses):</b>			
Interest and dividend income	93	<b>55</b>	<b>522</b>
Interest expenses	(627)	<b>(528)</b>	<b>(4,929)</b>
Gain on sale of property, plant and equipment	—	<b>136</b>	<b>1,270</b>
Gain on sale of investments in securities	153	<b>25</b>	<b>235</b>
Loss on liquidation of affiliate	(57)	—	—
Loss on sale/disposal of property, plant and equipment	(338)	<b>(346)</b>	<b>(3,234)</b>
Loss on revaluation/sale of investments in securities	(657)	<b>(798)</b>	<b>(7,450)</b>
Loss on revaluation of investments in unconsolidated subsidiaries	—	<b>(32)</b>	<b>(298)</b>
Loss on revaluation of membership	(33)	<b>(15)</b>	<b>(147)</b>
Loss on withdrawal from over-the-counter sales business activities	—	<b>(661)</b>	<b>(6,170)</b>
Removal costs for head office	—	<b>(607)</b>	<b>(5,672)</b>
Amortization of transition amount arising from adopting new accounting standard for retirement benefits	(2,129)	<b>(2,135)</b>	<b>(19,934)</b>
Other, net	311	<b>306</b>	<b>2,856</b>
	(3,284)	<b>(4,602)</b>	<b>(42,951)</b>
Income before income taxes and minority interests	4,706	<b>4,619</b>	<b>43,113</b>
<b>Income taxes</b> (Note 10):			
Current	2,950	<b>3,886</b>	<b>36,272</b>
Deferred	(681)	<b>(1,839)</b>	<b>(17,162)</b>
	2,269	<b>2,047</b>	<b>19,109</b>
<b>Minority interests in net gains of consolidated subsidiaries</b>	32	<b>114</b>	<b>1,072</b>
Net income	¥ 2,405	<b>¥ 2,457</b>	<b>\$ 22,931</b>
		Yen	U.S. dollars (Note 3)
<b>Net income and dividends per share</b> (Note 2 (14)):			
Net income	¥75.96	<b>¥77.67</b>	<b>\$0.72</b>
Cash dividends	20.00	<b>20.00</b>	<b>0.18</b>

The accompanying notes are an integral part of these statements.

## Consolidated Statements of Shareholders' Equity

OTSUKA CORPORATION and Its Consolidated Subsidiaries  
For the years ended December 31, 2002 and 2003

	Millions of yen							
	Number of shares of common stock	Common stock	Capital surplus	Retained earnings	Excess of land revaluation	Unrealized gain on investment securities	Foreign currency translation adjustment	Treasury stock
<b>Balance at December 31, 2001</b>	31,667,020	¥10,375	¥16,255	¥26,122	¥(12,134)	¥558	¥ (45)	¥ (0)
Increase due to exclusion of an affiliate for the equity method	—	—	—	10	—	—	—	—
Unrealized gain on investment securities	—	—	—	—	—	(346)	—	—
Foreign currency translation adjustment	—	—	—	—	—	—	(57)	—
Net income for the year	—	—	—	2,405	—	—	—	—
Cash dividends paid	—	—	—	(792)	—	—	—	—
Purchase of treasury stock	—	—	—	—	—	—	—	(0)
<b>Balance at December 31, 2002 (Note 2 (17))</b>	31,667,020	¥10,375	¥16,255	¥27,745	¥(12,134)	¥212	¥(102)	¥ (0)
Increase due to inclusion of subsidiaries in the consolidation	—	—	—	119	—	—	—	—
Sale of land	—	—	—	(203)	203	—	—	—
Decrease due to changes in tax rates	—	—	—	—	(288)	—	—	—
Unrealized gain on investment securities	—	—	—	—	—	113	—	—
Foreign currency translation adjustment	—	—	—	—	—	—	(32)	—
Net income for the year	—	—	—	2,457	—	—	—	—
Cash dividends paid	—	—	—	(633)	—	—	—	—
Purchase of treasury stock	—	—	—	—	—	—	—	(108)
<b>Balance at December 31, 2003 (Note 2 (17))</b>	<b>31,667,020</b>	<b>¥10,374</b>	<b>¥16,254</b>	<b>¥29,485</b>	<b>¥(12,219)</b>	<b>¥325</b>	<b>¥(133)</b>	<b>¥(108)</b>

	Thousands of U.S. dollars (Note 3)							
	Number of shares of common stock	Common stock	Capital surplus	Retained earnings	Excess of land revaluation	Unrealized gain on investment securities	Foreign currency translation adjustment	Treasury stock
<b>Balance at December 31, 2002</b>	31,667,020	\$96,825	\$151,700	\$258,937	\$(113,243)	\$1,978	\$ (945)	\$ (3)
Increase due to inclusion of subsidiaries in the consolidation	—	—	—	1,119	—	—	—	—
Sale of land	—	—	—	(1,896)	1,896	—	—	—
Decrease due to changes in tax rates	—	—	—	—	(2,692)	—	—	—
Unrealized gain on investment securities	—	—	—	—	—	1,055	—	—
Foreign currency translation adjustment	—	—	—	—	—	—	(304)	—
Net income for the year	—	—	—	22,931	—	—	—	—
Cash dividends paid	—	—	—	(5,910)	—	—	—	—
Purchase of treasury stock	—	—	—	—	—	—	—	(1,012)
<b>Balance at December 31, 2003</b>	<b>31,667,020</b>	<b>\$96,825</b>	<b>\$151,700</b>	<b>\$275,180</b>	<b>\$(114,040)</b>	<b>\$3,033</b>	<b>\$(1,250)</b>	<b>\$(1,015)</b>

The accompanying notes are an integral part of these statements.

# Consolidated Statements of Cash Flows

OTSUKA CORPORATION and Its Consolidated Subsidiaries  
For the years ended December 31, 2002 and 2003

Thousands of  
U.S. dollars  
(Note 3)

	Millions of yen		2003
	2002	2003	
<b>Cash flows from operating activities:</b>			
Income before income taxes and minority interests	¥ 4,706	¥ 4,619	\$ 43,113
Depreciation and amortization	6,388	6,704	62,569
Amortization of difference between cost of investment and equity in net assets of consolidated subsidiaries	80	63	590
Reserve for retirement benefits	2,400	2,742	25,599
Allowance for bad debts	141	148	1,385
Interest and dividend income	(93)	(55)	(522)
Interest expenses	627	528	4,929
Loss on sale/disposal of property, plant and equipment	338	346	3,234
Loss on revaluation of investments in securities	602	798	7,450
Loss on revaluation of investments in securities in unconsolidated subsidiaries	—	32	298
Loss on revaluation of membership	33	15	147
Loss on withdrawal from over-the-counter business activities and removal costs for head office	—	980	9,148
Increase in accounts and notes receivable	(3,118)	(1,292)	(12,063)
Decrease (increase) in inventories	156	(556)	(5,196)
Increase (decrease) in accounts and notes payable	3,730	(1,253)	(11,698)
Other	2,514	5,353	49,965
Subtotal	18,504	19,174	178,950
Interest and dividend income received	94	58	541
Interest expenses paid	(622)	(540)	(5,042)
Income taxes paid	(3,141)	(2,943)	(27,467)
Net cash provided by operating activities	14,835	15,749	146,982
<b>Cash flows from investing activities:</b>			
Payments for purchase of property, plant and equipment	(3,515)	(22,559)	(210,538)
Proceeds from sale of property, plant and equipment	—	1,116	10,424
Payments for software developed	(3,571)	(1,902)	(17,756)
Payments for purchase of investments in securities	(469)	(228)	(2,135)
Proceeds from sale of investments in securities	414	57	535
Payments for purchase of investments in consolidated subsidiaries	(128)	—	—
Increase in long-term loans receivable	(38)	(16)	(153)
Decrease in long-term loans payable	152	36	339
Other	(419)	90	844
Net cash used in investing activities	(7,574)	(23,405)	(218,439)
<b>Cash flows from financing activities:</b>			
Increase (decrease) in short-term bank loans, net	(3,743)	2,560	23,891
Proceeds from long-term debts	452	16,850	157,256
Repayments of long-term debts	(3,888)	(12,385)	(115,591)
Cash dividends paid	(790)	(631)	(5,896)
Other	(0)	(108)	(1,012)
Net cash provided by (used in) financing activities	(7,969)	6,284	58,647
<b>Effect of exchange rate changes on cash and cash equivalents</b>	(6)	(9)	(85)
<b>Net decrease in cash and cash equivalents</b>	(714)	(1,381)	(12,896)
<b>Cash and cash equivalents at beginning of year</b> (Note 2 (17))	4,963	4,297	40,107
<b>Increase in cash and cash equivalents for newly consolidated subsidiaries</b>	—	104	975
<b>Increase in cash and cash equivalents due to merger</b>	49	—	—
<b>Cash and cash equivalents at end of year</b> (Notes 2 (17) and 11)	¥ 4,298	¥ 3,020	\$ 28,187

The accompanying notes are an integral part of these statements.

# Notes to Consolidated Financial Statements

OTSUKA CORPORATION and Its Consolidated Subsidiaries

## 1. Basis of Presenting the Consolidated Financial Statements

### Accounting Principles

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

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

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

## 2. Summary of Significant Accounting Policies

### (1) Scope of Consolidation

The Company had 22 subsidiaries (majority-owned companies) and 20 subsidiaries as at December 31, 2002 and 2003, respectively. The consolidated financial statements include the accounts of the Company and 10 subsidiaries and 12 subsidiaries for the years ended December 31, 2002 and 2003, respectively.

The 12 subsidiaries, which were consolidated in the year ended December 31, 2003, are listed below:

	Equity ownership percentage
OSK Co., LTD.	100.0%
Netplan Co., LTD.	100.0%
Alpha Techno Co., LTD.	100.0%
Fujimi Construction Co., LTD.	100.0%
Alpha System Co., LTD.	100.0%
Alpha Net Inc.	100.0%
Otsuka Information Technology Corp.	100.0%
Otsuka Auto Service Co., LTD.*	100.0%
JPSS Co., LTD.	98.0%
Net World, INC.	68.4%
Otsuka Business Service Co., LTD.*	65.0%
10art-ni Corporation	59.7%

\* Newly-consolidated with effect from the year ended December 31, 2003.

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

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

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

The accounts of the remaining 12 and 8 unconsolidated subsidiaries as at December 31, 2002 and 2003, respectively, consisted of insignificant amounts in terms of total assets, net sales, net income and retained earnings, and have, therefore, been excluded from consolidation.

### (2) Elimination of intercompany accounts

For the purposes of preparing the consolidated financial statements, all significant intercompany transactions,

account balances and unrealized profits among the Companies have been eliminated in full, and the portion attributable to minority interests is charged/credited to minority interests.

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

### **(3) Investments in unconsolidated subsidiaries and affiliates**

The Company had 12 unconsolidated subsidiaries and 6 affiliates at December 31, 2002 and 8 unconsolidated subsidiaries and 5 affiliates at December 31, 2003.

No investments in affiliates for the years ended December 31, 2002 and 2003, were accounted for by the equity method. Investments in unconsolidated subsidiaries and affiliates not accounted for by the equity method were carried at cost or less, since they did not have a material impact on consolidated net income and retained earnings in the consolidated financial statements.

### **(4) Translation of foreign currency**

All monetary assets and liabilities denominated in foreign currencies, whether long-term or short-term, are translated into Japanese yen at the exchange rates prevailing at the balance sheet date. Resulting gains and losses are included in net profit or loss for the period.

Assets and liabilities of the foreign subsidiaries and affiliates are translated into Japanese yen at the exchange rates prevailing at the balance sheet date. The shareholders' equity at the beginning of the year is translated into Japanese yen at the historical rates. Profit and loss accounts for the year are translated into Japanese yen using the average exchange rate during the year. Differences in yen amounts arising from the use of different rates are presented as "Foreign currency translation adjustment" in shareholders' equity.

### **(5) Cash and cash equivalents**

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

### **(6) Inventories**

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

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

### **(7) Financial instruments**

#### **(a) Securities**

Securities held by the Company and its subsidiaries are classified into two categories:

- Equity investment in subsidiaries and affiliates

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

- Other securities

Securities with a market quotation are stated at fair value, based on market prices at the balance sheet date.

(Unrealized gains/losses from valuation of marketable securities are charged directly to shareholders' equity at a net-of-tax amount, while cost of sale is determined mainly by the moving-average method.)

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

(b) Derivatives

All derivatives are stated at fair value, with changes in fair value included in net profit or loss for the period in which they arise, except for derivatives that are designated as "hedging instruments."

(c) Hedge accounting

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

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

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

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

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

**(8) Property, plant and equipment**

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

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

**(9) Accounting for leases**

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

**(10) Software**

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

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

**(11) Accounting for income taxes**

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

The Company and its subsidiaries have adopted the deferred tax accounting method. Income taxes were deter-

mined using the asset and liability approach, whereby deferred tax assets and liabilities were recognized in respect of temporary differences between the tax basis of assets and liabilities and those as reported in the consolidated financial statements.

#### **(12) Allowance for bad debts**

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

#### **(13) Reserve for retirement benefits**

##### **(a) Retirement benefits for employees**

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

(Fiscal year 2002)

##### • Termination of substitute portion employee pension fund

The employees' pension fund of the OTSUKA Group was permitted immunity of future payments by the Minister of Health, Labour and Welfare.

In accordance with the JICPA's revised Accounting for Retirement Benefits, the Company and its consolidated subsidiaries did not record a gain on termination of the requirement to make pension contributions to the government assuming the obligation for the government portion of the Company's employment pension scheme and related assets have been transferred to the government. The unrecognized prior service cost generated in this period is calculated in accordance with Note 8 (4) "Computation basis of pension liabilities."

##### **(b) Retirement benefits for directors**

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

#### **(14) Net income and dividends per share**

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

Effective from the fiscal year 2003, the Company adopted the Statement of Accounting Standard No.2 "Accounting Standard for Earnings per Share" and of Accounting Standard Implementation Guideline No.4 "Implementation Guidance on Accounting Standard for Earnings per Share" issued by the Accounting Standard Board of Japan for the computation of net income per share of common stock. The adoption of these statements did not have any material impact on the financial statements.

#### **(15) Accounting for the consumption tax**

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

ance is included in "Other current liabilities" in the consolidated balance sheets.

#### (16) Change of accounting policy

During the year ended December 31, 2003, the Company changed the consolidated statement of income classification of the system engineering cost relating to commissioned business from selling, general and administrative expenses to cost of sales, according to man-hours. This change was made due to the growth in significance of the system engineering cost and the reconstruction of the Company's cost accounting system. This reclassification resulted in an increase in cost of sales and decrease in selling, general and administrative expenses, respectively, of 1,761 million yen (16,439 thousand U.S. dollars) for the year ended December 31, 2003, as compared with the amounts which would have been reported if the previous policy had been applied consistently. This reclassification did not have an impact on operating income and income before taxes.

#### (17) Rounding of amounts

During the fiscal year 2003, the Company changed its policy from rounding off sums of less than a million yen to rounding down.

### 3. U.S. Dollar Amounts

Amounts in U.S. dollars are included solely for the convenience of readers outside Japan. The rate of ¥107.15=US\$1, the rate of exchange on December 31, 2003, has been used in translation. The inclusion of such amounts is not intended to imply that Japanese yen have been or could be readily converted, realized or settled in U.S. dollars at this or any other rate.

### 4. Investments in Securities

At December 31, 2002 and 2003 investments in securities were as follows:

#### (1) Other securities with fair value

	2002			Millions of yen 2003			Thousands of U.S. dollars 2003		
	Cost	Carrying amount	Differences	Cost	Carrying amount	Differences	Cost	Carrying amount	Differences
Fair value greater than cost:									
Stocks	¥572	¥ 972	¥400	¥667	¥1,214	¥546	\$6,231	\$11,330	\$5,099
Bonds	—	—	—	—	—	—	—	—	—
Other securities	—	—	—	96	114	17	899	1,067	167
	¥572	¥ 972	¥400	¥764	¥1,328	¥564	\$7,131	\$12,398	\$5,266
Fair value less than or equal to cost:									
Stocks	¥183	¥ 157	¥(26)	¥127	¥ 111	¥(16)	\$1,193	\$ 1,042	\$ (150)
Bonds	—	—	—	—	—	—	—	—	—
Other securities	89	81	(8)	—	—	—	—	—	—
	¥272	¥ 238	¥(34)	¥127	¥ 111	¥(16)	\$1,193	\$ 1,042	\$ (150)
Total	¥844	¥1,210	¥366	¥892	¥1,440	¥548	\$8,324	\$13,440	\$5,116

#### (2) Other securities sold in 2002 and 2003 (for the years ended December 31, 2002 and 2003)

	2002			Millions of yen 2003			Thousands of U.S. dollars 2003		
	Amount for sale	Total gains on sale	Total losses on sale	Amount for sale	Total gains on sale	Total losses on sale	Amount for sale	Total gains on sale	Total losses on sale
	¥175	¥152	¥55	¥18	¥25	¥—	\$170	\$235	\$—

### (3) Securities not stated at fair value

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
	Stated amount on consolidated balance sheets	Stated amount on consolidated balance sheets	Stated amount on consolidated balance sheets
Other securities:			
Unlisted stocks (excluding stocks traded over the counter)	¥2,011	¥1,319	\$12,313
Discount bonds (IBJ)	6	—	—
Mid-term government bonds fund	2	2	20
Preferred subscription certification	11	10	93

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

	Millions of yen				Thousands of U.S. dollars	
	2002		2003		2003	
	Within one year	More than one year	Within one year	More than one year	Within one year	More than one year
Bonds:						
Government bond and municipal bond	¥—	¥—	¥—	¥—	\$—	\$—
Corporate bonds	—	—	—	—	—	—
Others	6	—	—	—	—	—
Others	—	10	—	10	—	93
Total	¥ 6	¥10	—	¥10	—	\$93

## 5. Derivative information

At December 31, 2002 and 2003 derivatives were as follows:

#### Currency

	Millions of yen			
	2002		2003	
	Contractual value or notional principal amount		Fair value	Valuation gain(loss)
	Total	Over one year		
Currency swap Purchased U.S.dollar	—	—	—	—

	Millions of yen			
	2002		2003	
	Contractual value or notional principal amount		Fair value	Valuation gain(loss)
	Total	Over one year		
Currency swap Purchased U.S.dollar	¥377	¥377	¥336	¥(41)

	Thousands of U.S. dollars			
	2002		2003	
	Contractual value or notional principal amount		Fair value	Valuation gain(loss)
	Total	Over one year		
Currency swap Purchased U.S.dollar	\$3,521	\$3,521	\$3,135	\$(385)

(Note)

Except for derivatives that are designed as hedging instruments

## 6. Inventories

Inventories at December 31, 2002 and 2003 comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Merchandise and maintenance parts	¥15,180	<b>¥14,820</b>	<b>\$138,312</b>
Work-in-process	680	<b>1,587</b>	<b>14,817</b>
Supplies	139	<b>166</b>	<b>1,554</b>
	¥15,999	<b>¥16,574</b>	<b>\$154,684</b>

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

The annual average interest rates applicable to short-term bank loans at December 31, 2002 and 2003 were 0.90% and 0.77%, respectively.

Long-term debt at December 31, 2002 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Long-term borrowings from banks with annual interest rates from 0.60% to 3.50%	¥4,294	<b>¥12,102</b>	<b>\$112,949</b>
2.66% secured Japanese yen bonds due November 2003	2,300	—	—
3.04% secured Japanese yen bonds due February 2003	1,000	—	—
0.75% secured Japanese yen bonds due March 2004	2,000	<b>2,000</b>	<b>18,665</b>
	9,594	<b>14,102</b>	<b>131,615</b>
Less: Current maturities of long-term debts	(6,886)	<b>(8,224)</b>	<b>(76,753)</b>
	¥2,708	<b>¥ 5,878</b>	<b>\$ 54,861</b>

Aggregate annual maturities of long-term debt subsequent to December 31, 2003 are as follows:

Year ending December 31	Millions of yen	Thousands of U.S. dollars
2004	¥ 8,224	\$ 76,753
2005	5,635	52,596
2006	172	1,611
2007	40	373
2008 and thereafter	30	279
	¥14,102	\$131,615

At December 31, 2002 and 2003, assets pledged as collateral for short-term loans and long-term debt, including the current portion of long-term debt, were as follows:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Land	¥2,786	<b>¥1,117</b>	<b>\$10,433</b>
Buildings	5,142	<b>835</b>	<b>7,793</b>
Time deposits	11	<b>11</b>	<b>102</b>
	¥7,939	<b>¥1,964</b>	<b>\$18,330</b>

## 8. Reserve for Retirement Benefits

### (1) Retirement benefit plan

The Company and certain of its subsidiaries operate a qualified pension plan, a welfare pension plan and a termination allowance plan as defined-benefit pension plans.

### (2) The reserve for retirement benefits as of December 31, 2002 and 2003 is analyzed as follows:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Projected benefit obligations	¥(50,157)	<b>¥(58,148)</b>	<b>\$ (542,679)</b>
Plan assets	28,278	<b>34,325</b>	<b>320,349</b>
	(21,879)	<b>(23,822)</b>	<b>(222,330)</b>
Unrecognized transition amount	6,382	<b>4,271</b>	<b>39,868</b>
Unrecognized prior service cost	(2,960)	<b>(2,714)</b>	<b>(25,335)</b>
Unrecognized actuarial differences	11,187	<b>12,212</b>	<b>113,979</b>
	(7,270)	<b>(10,052)</b>	<b>(93,817)</b>
Prepaid pension cost	—	—	—
Reserve for retirement benefits	¥ (7,270)	<b>¥(10,052)</b>	<b>\$ (93,817)</b>

The above table includes the amounts related to the portion subject to the Japanese Welfare Pension Insurance Law.

The balance of the reserve for retirement benefits in the accompanying consolidated balance sheets at December 31, 2002 and 2003 included retirement benefits for directors in the amounts of 692 million yen and 726 million yen (6,779 thousand U.S. dollars), respectively.

### (3) Pension expense related to the retirement benefits for the year ended December 31, 2002 and 2003 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Service cost	¥3,618	<b>¥2,905</b>	<b>\$27,120</b>
Interest cost	1,188	<b>1,248</b>	<b>11,653</b>
Expected return on plan assets	(1,294)	<b>(1,107)</b>	<b>(10,337)</b>
Amortization of transition amount	2,129	<b>2,135</b>	<b>19,934</b>
Amortization of the unrecognized prior service cost	(63)	<b>(252)</b>	<b>(2,356)</b>
Amortization of the unrecognized actuarial differences	518	<b>974</b>	<b>9,098</b>
Additional benefits for employees' early retirement	55	<b>3</b>	<b>34</b>
Expense of changing accounting method	54	—	—
Net pension expense	¥6,205	<b>¥5,908</b>	<b>\$55,145</b>

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

### (4) Computation basis of pension liabilities

As of December 31, 2002 and 2003	2002	2003
Discount rate	2.5%	<b>2.0%</b>
Expected rate of return on plan assets	4.5%	<b>3.9%</b>
Periodic allocation principle for projected benefit obligation	Standard of fixed-amount -for-period	<b>Standard of fixed-amount -for-period</b>
Amortization of unrecognized prior service cost	12 years	<b>12 years</b>
Amortization of transition amount	5 years	<b>5 years</b>
Amortization of unrecognized actuarial differences	12 years from the fiscal year following occurrence	<b>12 years from the fiscal year following occurrence</b>

## 9. Contingent Liabilities

The Company was contingently liable for guarantees of loans at December 31, 2002 and 2003 as follows:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Loans taken out by:			
NACOS COMPUTER SYSTEMS CORP.	¥ 78	¥48	\$453
EMT Software, Inc.	22	—	—
	¥100	¥48	\$453

## 10. Income Taxes

The statutory tax rate used for calculating deferred tax assets and liabilities at December 31, 2003 was 42.1%.

At December 31, 2003, the reconciliation of the statutory tax rate to the effective income tax rate was as follows:

Statutory tax rate	42.1%
Entertainment expenses	2.5
Inhabitants' tax per capital	2.6
Valuation allowance	0.9
Consolidated adjustment account	0.6
Effect on deferred tax assets and deferred tax liabilities from a change in the tax regulations	1.6
Deduction for investment in information technologies	(5.5)
Others	(0.5)
Effective tax rate	44.3%

At December 31, 2002 and 2003, significant components of the deferred tax assets and liabilities were as follows:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Deferred tax assets:			
Allowance for bad debts	¥ 199	¥ 254	\$ 2,375
Enterprise taxes	193	304	2,845
Accrued bonuses	547	737	6,878
Retirement benefits for employees	2,067	3,412	31,852
Retirement benefits for directors	304	327	3,053
Membership	300	303	2,833
Software cost	252	157	1,466
Operating loss carryforwards	424	884	8,254
Eliminated unrealized profits	453	461	4,304
Other	269	652	6,093
Total deferred tax assets	5,008	7,495	69,956
Less: Valuation allowance	(399)	(714)	(6,669)
Net deferred tax assets	4,609	6,781	63,286
Deferred tax liabilities:			
Reserve for computer program	2,244	2,397	22,375
Unrealized gain on investment securities	154	223	2,083
Other	20	19	180
Total deferred tax liabilities	2,418	2,640	24,639
Net deferred tax assets	¥2,191	¥4,141	\$38,647

On March 31, 2003, the Japanese National Diet approved various changes to the calculation of the statutory local enterprise tax for companies with capital in excess of 100 million yen, effective April 1, 2004.

This resulted in a reduction in deferred taxes assets of 67 million yen (627 thousand U.S. dollars) and a deferred tax assets revaluation of 288 million yen (2,692 thousand U.S. dollars), and an increase in excess of land revaluation after tax-effect accounting of 288 million yen (2,692 thousand U.S. dollars) and unrealized gain on investment securities after tax-effect accounting by 7 million yen (71 thousand U.S. dollars) as compared with the amounts that would have been reported if the previous tax rate had been fully applied consistently for the fiscal year 2003. Deferred income tax also reduced by 74 million yen (699 thousand U.S. dollars) as a result of these changes in statutory local enterprise tax regulations.

## 11. Supplementary Cash Flow Information

Cash and cash equivalents consisted of:

	Millions of yen		Thousands of
	2002	2003	U.S. dollars
Cash, time deposits and other cash equivalents	¥5,696	¥4,353	\$40,626
Time deposits with deposit terms of more than three months	(1,398)	(1,332)	(12,439)
Cash and cash equivalents at end of year	¥4,298	¥3,020	\$28,187

(Fiscal year 2002)

The property and the debt that were taken over from Northern Lights Computer Inc. (affiliate), which merged with 10art-ni Corporation (consolidated subsidiary) were as follows:

Common stock and Capital surplus increases by the merger were 150 and 43 million yen, respectively.

	Millions of yen	Thousands of
		U.S. dollars
Current assets	¥257	\$2,143
Non-current assets	34	283
Total current assets	¥291	\$2,426
Current liabilities	¥ 98	\$ 817
Total liabilities	¥ 98	\$ 817

## 12. Subsequent Events

### (1) Appropriation

The following appropriation of the Company's retained earnings in respect of the year ended December 31, 2003 was as proposed by the Board of Directors and approved by the shareholders at the annual general meeting held on March 30, 2004:

Appropriation	Millions of yen	Thousands of
		U.S. dollars
Cash dividends (¥20.00 per share)	¥632	\$5,898

### (2) Termination of substitute portion employee pension fund

On February 1, 2004, the Company and its seven consolidated subsidiaries obtained governmental approval of the separation of the substitute portion employee pension fund service under the substitutional portion (second approval) from the Ministry of Health, Labour and Welfare. In accordance with Article 44-2 of Practical Guidelines on Accounting for Postretirement Benefits (Interim Report) issued by the JICPA, the Company and its seven consolidated subsidiaries recognized a one-off profit resulting from the separation of the substitutional portion of the EPF amounting to 5,481 million yen (51,159 thousand U.S. dollars) at the date of the approval.

### 13. Lease Transactions

Acquisition costs, accumulated depreciation and net book values of leased assets at December 31, 2002 and 2003 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Acquisition cost	¥6,958	<b>¥6,465</b>	<b>\$60,343</b>
Accumulated depreciation	(3,824)	<b>(4,298)</b>	<b>(40,118)</b>
Net book value	¥3,134	<b>¥2,167</b>	<b>\$20,225</b>

Future minimum lease payments under finance leases at December 31, 2002 and 2003 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Due within one year	¥1,492	<b>¥1,141</b>	<b>\$10,656</b>
Due after one year	1,712	<b>1,063</b>	<b>9,926</b>
	¥3,204	<b>¥2,205</b>	<b>\$20,583</b>

Lease rental expenses, depreciation and interest expenses for the years ended December 31, 2002 and 2003 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Lease rental expenses	¥1,621	<b>¥1,650</b>	<b>\$15,404</b>
Depreciation	1,526	<b>1,506</b>	<b>14,061</b>
Interest expenses	101	<b>73</b>	<b>686</b>

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

The amounts of future lease payments on operating leases at December 31, 2002 and 2003 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Due within one year	¥ 70	<b>¥204</b>	<b>\$1,911</b>
Due after one year	109	<b>150</b>	<b>1,408</b>
	¥179	<b>¥355</b>	<b>\$3,319</b>

### 14. Land Revaluation

Pursuant to the Law Concerning Land Revaluation, the Company revalued land used for business activities on December 31, 2001. The excess of the revalued carrying amount over the book value before revaluation was recorded as "Excess of land revaluation after tax-effect accounting" in shareholders' equity in the accompanying consolidated balance sheets. The land prices used for the revaluation were determined based on the prices in the official notice published by the Commissioner of the National Tax Agency in accordance with Article 2, Paragraphs 3 and 4 of the Enforcement Ordinance Concerning Land Revaluation, after making reasonable adjustments. Revaluation is permitted for one time only. The excess of the book value after revaluation over the fair value is 1,344 million yen (12,548 thousand U.S. dollars).

## 15. Segment Information

### Business segment information

The business segment information of the Company and its consolidated subsidiaries for the years ended December 31, 2002 and 2003 is summarized as follows:

	Millions of yen					Consolidated total
	System Integration	Service & Support	Other	Total	Elimination	
2002						
Net sales to:						
Outside customers	¥219,690	¥103,380	¥1,219	¥324,289	¥ —	¥324,289
Inter-segment sales/transfers	20	60	985	1,065	(1,065)	—
	219,710	103,440	2,204	325,354	(1,065)	324,289
Operating expenses	214,492	95,724	2,160	312,376	3,923	316,299
Operating income	¥ 5,218	¥ 7,716	¥ 44	¥ 12,978	¥ (4,988)	¥ 7,990
Assets, depreciation and capital expenditure:						
Assets	¥ 78,811	¥ 49,391	¥1,493	¥129,695	¥18,868	¥148,563
Depreciation and amortization	3,294	2,792	19	6,105	283	6,388
Capital expenditure	4,268	2,245	—	6,513	1,137	7,650

	Millions of yen					Consolidated total
	System Integration	Service & Support	Other	Total	Elimination	
2003						
Net sales to:						
Outside customers	¥225,842	¥116,665	¥1,869	¥344,377	¥ —	¥344,377
Inter-segment sales/transfers	115	131	1,982	2,229	(2,229)	—
	225,958	116,796	3,851	346,606	(2,229)	344,377
Operating expenses	218,793	109,700	3,765	332,258	2,896	335,155
Operating income	¥ 7,165	¥ 7,096	¥ 86	¥ 14,347	¥ (5,126)	¥ 9,221
Assets, depreciation and capital expenditure:						
Assets	¥ 84,943	¥ 54,440	¥2,703	¥142,088	¥20,055	¥162,144
Depreciation and amortization	3,444	2,629	42	6,115	588	6,704
Capital expenditure	13,599	7,570	2	21,172	3,324	24,496

	Thousands of U.S. dollars					Consolidated total
	System Integration	Service & Support	Other	Total	Elimination	
2003						
Net sales to:						
Outside customers	\$2,107,722	\$1,088,802	\$17,447	\$3,213,972	\$ —	\$3,213,972
Inter-segment sales/transfers	1,082	1,225	18,501	20,809	(20,809)	—
	2,108,804	1,090,027	35,949	3,234,781	(20,809)	3,213,972
Operating expenses	2,041,933	1,023,801	35,141	3,100,877	27,029	3,127,907
Operating income	\$ 66,870	\$ 66,226	\$ 807	\$ 133,904	\$ (47,839)	\$ 86,064
Assets, depreciation and capital expenditure:						
Assets	\$ 792,757	\$ 508,081	\$25,235	\$1,326,074	\$187,174	\$1,513,249
Depreciation and amortization	32,143	24,536	399	57,078	5,490	62,569
Capital expenditure	126,916	70,657	20	197,595	31,024	228,619

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

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

(Change of accounting policy)

During the year ended December 31, 2003, the Company changed the consolidated statement of income classification of the system engineering cost relating to commissioned business from selling, general and administrative expenses to cost of sales, according to man-hours. This reclassification resulted in a decrease in operating expenses of System Integration of 217 million yen (2,029 thousand U.S. dollars) and an increase in operating income of System Integration of the same amount, and an increase in operating cost of Service & Support of 217 million yen (2,029 thousand U.S. dollars) and increase in operating income of Service & Support of the same amount, for the year ended December 31, 2003, as compared with the amounts which would have been reported if the previous policy had been applied consistently.

## Report of Independent Auditors

To the Board of Directors and Shareholders of  
OTSUKA CORPORATION

We have audited the accompanying consolidated balance sheets of OTSUKA CORPORATION and its subsidiaries as of December 31, 2002 and 2003, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of OTSUKA CORPORATION and its subsidiaries as of December 31, 2002 and 2003, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles and practices generally accepted in Japan (see Note 1).

In Note

1. As described note 2(16), during the year ended December 31, 2003, the Company changed the consolidated statement of income classification of the system engineering cost relating to commissioned business from selling, general and administrative expenses to cost of sales, according to man-hours.
2. As described note 12(2), On February 1, 2004, the Company and its seven consolidated subsidiaries obtained the governmental approval of the separation of the substitute portion employee pension fund service under the substitutational portion (second approval) from the Ministry of Health, Labour and Welfare.

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

*ChuoAoyama Audit Corporation*

ChuoAoyama Audit Corporation

Tokyo, Japan  
March 30, 2004

## Principal Group Companies (as of December 31, 2003)

The OTSUKA Group (OTSUKA CORPORATION and its subsidiaries) consists of 20 subsidiaries, including 12 consolidated subsidiaries as well as 5 affiliated companies that carry out System Integration, Service and Support, and Other Business. The 12 consolidated subsidiaries are listed below.

Company Name	Establishment	Capital (¥ million)	Controlling Share	Scope of Business
<b>System Integration Business</b>				
OSK Co., LTD.	1984	300	100.0%	<ul style="list-style-type: none"> <li>• Development, design, sale, and consulting for software</li> <li>• Education, guidance for IT-related systems</li> </ul>
Netplan Co., LTD.	1992	400	100.0%	<ul style="list-style-type: none"> <li>• Electronic communications construction and internal construction, sales of fixtures, etc.</li> </ul>
Alpha System Co., LTD.	1967	80	100.0%	<ul style="list-style-type: none"> <li>• Business and industry software development</li> </ul>
Net World, INC.	1990	585	68.4%	<ul style="list-style-type: none"> <li>• Sales and consulting for network peripheral equipment</li> </ul>
10art-ni Corporation	1997	750	59.7%	<ul style="list-style-type: none"> <li>• Integration using Linux-based systems</li> <li>• Java-based software development</li> </ul>
Otsuka Information Technology Corp. (Taiwan)	1997	NT\$116 million	100.0%	<ul style="list-style-type: none"> <li>• Sales and support of computer software, hardware, and network equipment</li> </ul>
<b>Service and Support Business</b>				
Alpha Techno Co., LTD.	1996	50	100.0%	<ul style="list-style-type: none"> <li>• Emergency repair of PCs and peripheral equipment, disposal, recycling, data recovery, and erasing services</li> </ul>
Alpha Net Inc.	1997	400	100.0%	<ul style="list-style-type: none"> <li>• Comprehensive service and support for network systems</li> <li>• System engineering outsourcing</li> </ul>
JPSS Co., LTD.	1996	480	98.0%	<ul style="list-style-type: none"> <li>• Support business for consumers and SOHO users</li> </ul>
<b>Other Business</b>				
Fujimi Construction Co., LTD.	1964	99	100.0%	<ul style="list-style-type: none"> <li>• Construction planning, execution, and oversight; maintenance of buildings and condominiums</li> </ul>
Otsuka Auto Service CO., LTD.	1987	50	100.0%	<ul style="list-style-type: none"> <li>• Sale, repair and inspection of automobiles, as well as commissioned sales of non-life insurance</li> </ul>
Otsuka Business Service CO., LTD.	1992	50	65.0%	<ul style="list-style-type: none"> <li>• Data processing, commissioned shipment of direct mail materials as well as planning and printing of printed matter and publications</li> </ul>

# Corporate Data (as of December 31, 2003)

## Corporate Data (as of December 31, 2003)

<b>Name</b>	OTSUKA CORPORATION
<b>Founded</b>	July 17, 1961 (registered as joint-stock company on December 13, 1961)
<b>Paid-in Capital</b>	¥10,374,851,000
<b>Number of Employees</b>	6,222 (including consolidated subsidiaries: 7,543)
<b>Business</b>	<p><b>System Integration Business :</b> Sales of computers, copiers, communication equipment and software, and software development of consigned software, other activities</p> <p><b>Service and Support Business :</b> Supplies, maintenance, and educational support, other activities</p>
<b>Main Banks</b>	<p>The Bank of Yokohama, Ltd.</p> <p>The Bank of Tokyo-Mitsubishi, Ltd.</p> <p>Mizuho Bank, Ltd.</p> <p>UFJ Bank Limited</p>

## Base (as of December 31, 2003)

<b>Head Office</b>	2-18-4 Iidabashi, Chiyoda-ku, Tokyo, 102-8573 TEL 03-3264-7111		
<b>Branch Offices</b>	<p>Metropolitan Office 2-18-4 Iidabashi, Chiyoda-ku, Tokyo, 102-8573 TEL 03-3264-7111</p> <p>Kansai Office 6-14-1 Fukushima, Fukushima-ku, Osaka-shi, Osaka, 553-8558 TEL 06-6456-2711</p> <p>Chubu Office* 3-5-33 Masaki, Naka-ku, Nagoya-shi, Aichi, 460-0024 TEL 052-350-4811</p>		
<b>Local Area Sales Groups</b>	Chuo Sales Group 1 Johoku Sales Group Kanagawa Sales Group Osaka Southern Sales Group	Chuo Sales Group 2 Tama Sales Group Saitama Sales Group	Josai Sales Group Keiyo Sales Group Osaka Northern Sales Group
<b>Regional Offices</b>	Sapporo Branch Nagoya Branch Kobe Branch	Sendai Branch Mikawa Branch Hiroshima Branch	Utsunomiya Branch Kyoto Branch Fukuoka Branch

\* This is the new telephone number and address for the Chubu Office, which relocated on February 16, 2004.

## Stock Information (as of December 31, 2003)

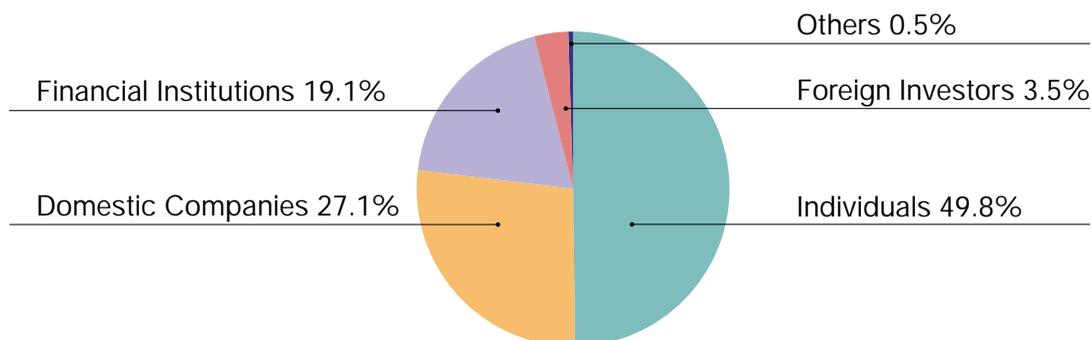
Authorized Common Stock	112,860,000 shares
Issued Common Stock	31,667,020 shares
Number of Shares of Unit Stock	100 shares
Number of Shareholders	10,789

(An decrease of 1,942 from the end of previous fiscal year)

### Major Shareholders

Name	Investment in OTSUKA CORPORATION		Investment in Major Shareholders by OTSUKA CORPORATION	
	Number of Shares Held	Voting right ratio (%)	Number of Shares Held	Voting right ratio (%)
Otsuka Sobi Co., Ltd.	8,112,730	25.67	—	—
Minoru Otsuka	2,765,490	8.75	—	—
Yuji Otsuka	2,622,580	8.30	—	—
OTSUKA CORPORATION Employee Stock-Sharing Plan	2,382,020	7.54	—	—
Japan Trustee Services Bank, Ltd. (Trust Account)	1,879,700	5.95	—	—
The Master Trust Bank of Japan, Ltd. (Trust Account)	748,800	2.37	—	—
Terue Otsuka	645,500	2.04	—	—
Trustee of Individually Operated Designated Money Trusts (Shiteitan) Mitsui Asset Trust and Banking Company, Limited (Account 1)	587,400	1.86	—	—
Atsushi Otsuka	485,550	1.54	—	—
The Sumitomo Trust & Banking Co., Ltd. ("B" Trust Account)	480,800	1.52	—	—

### Breakdown of Shareholders (Based on total shares)



OTSUKA CORPORATION WEBSITE

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

***Otsuka Corporation***

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