Financial Section

Three-Year Financial Data

OTSUKA CORPORATION and Its Consolidated Subsidiaries
Years ended December 31, 2002, 2003 and 2004

	Millions of yen			Thousands of U.S. dollars
	2002	2003	**2004**	**2004**
Net sales	¥324,289	¥344,377	**¥372,481**	**$3,574,673**
System Integration Business	219,690	225,842	**238,729**	**2,291,065**
Service and Support Business	103,380	116,665	**130,959**	**1,256,804**
Other Business	1,219	1,869	**2,792**	**26,794**
Operating income	7,990	9,221	**17,009**	**163,234**
Recurring profit	7,766	9,055	**17,036**	**163,493**
Income before income taxes and minority interests	4,706	4,619	**18,548**	**178,003**
Net income	2,405	2,457	**11,247**	**107,936**
Total assets	148,563	162,144	**167,228**	**1,604,875**
Total interest-bearing debt	29,795	36,858	**21,337**	**204,769**
Total shareholders' equity	42,351	43,978	**54,667**	**524,635**
Net income per share (EPS) (Yen and U.S. dollars)	75.96	77.67	**355.88**	**3.41**
Dividends per share of common stock (Yen and U.S. dollars)	20.00	20.00	**55.00**	**0.52**
Cash flows from operating activities per share (Yen and U.S. dollars)	468.47	497.87	**743.43**	**7.13**
Operating income to net sales ratio (%)	2.46	2.68	**4.57**	**—**
Net income to net sales ratio (%)	0.74	0.71	**3.02**	**—**
Total interest-bearing debt ratio (%)	20.06	22.73	**12.76**	**—**
Shareholders' equity ratio (%)	28.51	27.12	**32.69**	**—**
Return on equity (ROE) (%)	5.76	5.69	**22.80**	**—**

Notes:
Figures for ROE are calculated using average shareholders' equity.
U.S. dollar amounts are computed using the December 31, 2004 exchange rate of ¥104.2=US$1.
Figures in parentheses are negative figures.

Management's Analysis of Operating Results & Financial Position

Summary of Sales and Profits

	2003	2004	Difference, year to year	% change, year to year
			Millions of yen	
Net sales	¥344,377	**¥372,481**	+28,104	+8.2%
System Integration Business	225,842	**238,729**	+12,886	+5.7
Service & Support Business	116,665	**130,959**	+14,294	+12.3
Other Business	1,869	**2,792**	+923	+49.4
Cost of sales	266,651	**285,655**	+19,004	+7.1
Gross profit	77,725	**86,825**	+9,100	+11.7
Selling, general and administrative expenses	68,503	**69,815**	+1,312	+1.9
Operating income	9,221	**17,009**	+7,788	+84.5
Recurring profit	9,055	**17,036**	+7,981	+88.1
Income before income taxes and minority interests	4,619	**18,548**	+13,928	+301.5
Income taxes*	2,047	**7,077**	+5,029	+245.6
Net income	2,457	**11,247**	+8,789	+357.7

*Including adjustment amount for corporate and other taxes

Sales Summary

For the term, the System Integration Business and Service & Support Business both recorded robust sales. In combination with decent sales growth among the majority of consolidated subsidiaries, consolidated net sales rose 8.2% to a record ¥372,481 million.

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, continued brisk sales of color copiers, computers and servers resulted in a 5.7% rise in net sales to ¥238,729 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. Continued strong growth in the "tanomail" office supply mail-order services via Website and catalog channels combined with favorable performance in maintenance and similar fields to fuel a 12.3% increase in net sales to ¥130,959 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 a 49.4% increase in net sales to ¥2,792 million.

Summary of Income and Expenses

Despite a 7.1% increase in cost of sales to ¥285,655 million, gross profit increased 11.7% to ¥86,825 million as a result of increased net sales as well as a 0.7 percentage point increase in the gross profit margin to 23.3%.

Operating income jumped 84.5% to ¥17,009 million against the backdrop of increased gross profit and a 1.2 percentage point decline in SG&A expenses to net sales to 18.7%. Consequently, the operating income to net sales ratio improved 1.9 percentage points.

Recurring profit achieved a record high for the fourth-straight fiscal year to rise 88.1% to ¥17,036 million following a decrease in other expenses on the back of lower interest expenses.

Despite ¥1,724 million in amortization of transition amount arising from adopting new accounting standard for retirement benefits as well as the recording of ¥1,491 million in impairment losses for a portion of fixed assets following implementation of asset impairment accounting two terms ahead of schedule, income before income taxes and minority interests soared 301.5% to ¥18,548 million from the contribution of ¥5,481 million in extraordinary income associated with the gain from the exemption from the obligation under the substitutional portion of social welfare pension fund.

In aggregate, net income soared 357.7% to ¥11,247 million and net income per shared rose dramatically from ¥77.67 in the previous fiscal year to ¥355.88.

Financial Position

Millions of yen

	2003	**2004**	Difference, year to year	% change, year to year
Assets:	¥162,144	**¥167,228**	+5,084	+3.1%
Current assets	78,918	**87,984**	+9,065	+11.5
Fixed assets	83,226	**79,244**	-3,981	-4.8
Liabilities:	117,572	**111,463**	-6,108	-5.2
Current liabilities	100,683	**100,409**	-274	-0.3
Long-term liabilities	16,888	**11,054**	-5,834	-34.5
Minority interests	594	**1,098**	+503	+84.8
Shareholders' equity	43,978	**54,667**	+10,688	+24.3

Assets

Total assets edged up ¥5,084 million (3.1%) to ¥167,228 million. Current assets rose ¥9,065 million (11.5%) to ¥87,984 million on the back of higher cash, time deposits and other cash equivalents as well as accounts and notes receivable. Fixed assets edged down ¥3,981 million (4.8%) to ¥79,244 million from loss on sale of the former head office, valuation loss on a portion of fixed assets following early implementation of asset impairment accounting and accumulated depreciation on buildings and structures.

Liabilities

Total liabilities declined ¥6,108 million (5.2%) to ¥111,463 million. Current liabilities edged down ¥274 million (0.3%) to ¥100,409 million. Long-term liabilities fell ¥5,834 million (34.5%) to ¥11,054 million on account of repayment of long-term debts using surplus cash provided by operating activities.

Shareholders' Equity

Shareholders' equity grew ¥10,688 million (24.3%) to ¥54,667 million. The key factors for this growth were increased retained earnings and excess of land revaluation after tax-effect accounting following sale of land from the former head office.

The interest coverage ratio was 48.94 times; interest-bearing debt ratio was 12.76%; return on assets (ROA) was 10.36%; and return on equity (ROE) was 22.80%.

	2003	**2004**
Interest coverage ratio (times)	17.57	**48.94**
Interest-bearing debt ratio (%)	22.73	**12.76**
ROA*1 (%)	5.97	**10.36**
ROE*2 (%)	5.69	**22.80**

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

Cash flows

				Millions of yen
	2003	**2004**	Difference, year to year	% change, year to year
Cash flows from operating activities	¥15,749	**¥23,494**	+7,745	+49.2%
Cash flows from investing activities	-23,405	**-3,245**	+20,160	—
Cash flows from financing activities	6,284	**-15,617**	-21,901	—
Cash and cash equivalents at end of year	3,020	**7,717**	+4,696	+155.5

Cash and cash equivalents at end of year jumped 155.5% to ¥7,717 million.

Cash provided by operating activities increased ¥7,745 million (49.2%) to ¥23,494 million. Key factors were increased income before income taxes and minority interests as well as accounts and notes payable.

Cash used in investing activities declined ¥20,160 million to ¥3,245 million, chiefly from a significant decline in payments for purchase of property, plant and investment. There were, however, other payments for purchase of property, plant and investment pertaining to the new head office in the previous fiscal term.

Cash used in financing activities was ¥15,617 million. Cash used in financing activities was ¥15,617 million, compared to cash provided by financing activities of ¥6,284 million in the previous term. The key factors were lower short-term bank loans and a decrease in proceeds from long-term debts.

Outlook

In the current fiscal year ending December 31, 2005, consolidated projections call for a 5.0% increase in net sales to ¥391 billion, a 5.7% rise in recurring profit to ¥18 billion and a 22.5% decline in net income to ¥8,720 million.

Consolidated Balance Sheets

OTSUKA CORPORATION and Its Consolidated Subsidiaries
December 31, 2003 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2003	**2004**	**2004**
ASSETS			
Current assets			
Cash, time deposits and other cash equivalents (Notes 11 and 15)	¥ 4,353	**¥ 9,043**	**$ 86,785**
Accounts and notes receivable:			
Trade	49,406	**54,415**	**522,224**
Unconsolidated subsidiaries and affiliates	30	**11**	**107**
Other	4,614	**3,383**	**32,475**
	54,051	**57,810**	**554,807**
Less: Allowance for bad debts	(336)	**(299)**	**(2,873)**
	53,714	**57,511**	**551,933**
Inventories (Note 6)	16,574	**16,277**	**156,211**
Deferred tax assets (Note 10)	1,499	**1,794**	**17,226**
Other current assets	2,776	**3,357**	**32,221**
Total current assets	78,918	**87,984**	**844,377**
Investments and advances			
Investments in securities (Note 4)	2,771	**2,943**	**28,249**
Investments in unconsolidated subsidiaries and affiliates	473	**379**	**3,645**
Guarantee deposits	2,807	**2,699**	**25,905**
Deferred tax assets non-current (Note 10)	2,725	**2,437**	**23,389**
Deferred tax assets on revaluation of land	8,386	**6,228**	**59,779**
Other investments	1,614	**4,960**	**47,606**
Less: Allowance for bad debts	(929)	**(786)**	**(7,550)**
	17,850	**18,862**	**181,025**
Property, plant and equipment (Notes 14 and 15)			
Land	18,926	**17,592**	**168,833**
Buildings and structures	67,224	**65,111**	**624,874**
Construction in progress	1	**—**	**—**
Others	9,629	**11,218**	**107,667**
	95,781	**93,923**	**901,375**
Less: Accumulated depreciation	(37,047)	**(39,325)**	**(377,401)**
Net property, plant and equipment	58,734	**54,598**	**523,974**
Intangibles and deferred charges			
Software	5,837	**5,197**	**49,881**
Others	804	**586**	**5,624**
	6,641	**5,783**	**55,506**
Total assets	¥162,144	**¥167,228**	**$1,604,883**

The accompanying notes are an integral part of these statements.

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2003	**2004**	**2004**
LIABILITIES, MINORITY INTERESTS AND SHAREHOLDERS' EQUITY			
Current liabilities			
Short-term bank loans (Note 7)	¥ 22,756	**¥ 13,850**	**$ 132,917**
Current maturities of long-term debts (Note 7)	8,224	**6,208**	**59,580**
Accounts and notes payable:			
Trade	36,411	**42,918**	**411,886**
Unconsolidated subsidiaries and affiliates	177	**232**	**2,230**
Other	18,977	**20,531**	**197,038**
	55,566	**63,682**	**611,155**
Income taxes payable (Note 10)	2,418	**3,112**	**29,872**
Other current liabilities	11,718	**13,555**	**130,092**
Total current liabilities	100,683	**100,409**	**963,619**
Long-term liabilities			
Long-term debt (Note 7)	5,878	**1,279**	**12,274**
Reserve for retirement benefits (Note 8)	10,778	**9,572**	**91,866**
Deferred tax liabilities non-current (Note 10)	79	**26**	**253**
Other long-term liabilities	151	**176**	**1,693**
	16,888	**11,054**	**106,088**
Minority interests in consolidated subsidiaries	594	**1,098**	**10,539**
Contingent liabilities (Note 9)			
Shareholders' equity			
Common stock:			
Authorized: 112,860,000 shares			
Outstanding: December 31, 2003 31,667,020 shares			
December 31, 2004 31,667,020 shares	10,374	**10,374**	**99,566**
Capital surplus	16,254	**16,254**	**155,995**
Retained earnings	29,485	**36,932**	**354,439**
Excess of land revaluation after tax-effect accounting (Note14)	(12,219)	**(9,075)**	**(87,098)**
Unrealized gain on investment securities after tax-effect accounting	325	**413**	**3,965**
Foreign currency translation adjustment	(133)	**(122)**	**(1,178)**
Less: Treasury stock			
December 31, 2003 63,800 shares			
December 31, 2004 63,990 shares	(108)	**(109)**	**(1,053)**
Total shareholders' equity	43,978	**54,667**	**524,636**
Total liabilities, minority interests and shareholders’ equity	¥162,144	**¥167,228**	**$1,604,883**

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, 2003 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2003	**2004**	**2004**
Net sales (Note 18)	¥344,377	**¥372,481**	**$3,574,679**
Cost of sales (Notes 17 and 18)	266,651	**285,655**	**2,741,417**
Gross profit	77,725	**86,825**	**833,261**
Selling, general and administrative expenses (Notes 17 and 18)	68,503	**69,815**	**670,018**
Operating income	9,221	**17,009**	**163,243**
Other income (expenses)			
Interest and dividend income	55	**54**	**522**
Interest expenses	(528)	**(348)**	**(3,345)**
Gain on sale of property, plant and equipment	136	**—**	**—**
Gain on sale of investments in securities	25	**9**	**86**
Gain on sale of investments in unconsolidated subsidiaries	—	**456**	**4,382**
Transfer from allowance for bad debts	—	**93**	**892**
Gain from the exemption from the obligation under the substitutional portion of social welfare pension fund	—	**5,481**	**52,607**
Dilution gain from change in equity interest	—	**248**	**2,380**
Loss on sale / disposal of property, plant and equipment	(346)	**(808)**	**(7,760)**
Impairment losses(Notes2(16)and16)	—	**(1,491)**	**(14,315)**
Loss on revaluation/ sale of investments in securities	(798)	**(253)**	**(2,433)**
Loss on revaluation/ sale of investments in unconsolidated subsidiaries	(32)	**(26)**	**(250)**
Loss on revaluation of membership	(15)	**(23)**	**(229)**
Loss on withdrawal from over-the-counter sales business activities(Note16)	(661)	**—**	**—**
Removal costs for head office(Note16)	(607)	**—**	**—**
Amortization of transition amount arising from adopting new accounting standard for retirement benefits	(2,135)	**(1,724)**	**(16,551)**
Losses on the settlement of the retirement benefits plan	—	**(448)**	**(4,304)**
Other, net	306	**321**	**3,082**
	(4,602)	**1,538**	**14,764**
Income before income taxes and minority interests	4,619	**18,548**	**178,007**
Income taxes (Note 10)			
Current	3,886	**5,040**	**48,373**
Deferred	(1,839)	**2,036**	**19,544**
	2,047	**7,077**	**67,918**
Minority interests in net gains of consolidated subsidiaries	114	**224**	**2,152**
Net income	¥ 2,457	**¥ 11,247**	**$ 107,937**

	yen		U.S. dollars (Note 3)
Net income and dividends per share (Note 2(14))			
Net income	¥77.67	**¥355.88**	**$3.41**
Cash dividends	20.00	**55.00**	**0.52**

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, 2003 and 2004

	Number of shares of common stock	Millions of yen						
		Common stock	Capital surplus	Retained earnings	Excess of land revaluation	Unrealized gain on investment securities	Foreign currency translation adjustment	Treasury stock
Balance at December 31, 2002	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)
Balance at December 31, 2003	31,667,020	¥10,374	¥16,254	¥29,485	¥(12,219)	¥325	¥(133)	¥(108)
Sale of land	**—**	**—**	**—**	**(3,143)**	**3,143**	**—**	**—**	**—**
Retirement of treasury stocks relating to merger	**—**	**—**	**—**	**(24)**	**—**	**—**	**—**	**—**
Unrealized gain on investment securities	**—**	**—**	**—**	**—**	**—**	**88**	**—**	**—**
Foreign currency translation adjustment	**—**	**—**	**—**	**—**	**—**	**—**	**11**	**—**
Net income for the year	**—**	**—**	**—**	**11,247**	**—**	**—**	**—**	**—**
Cash dividends paid	**—**	**—**	**—**	**(632)**	**—**	**—**	**—**	**—**
Purchase of treasury stock	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**(0)**
Balance at December 31, 2004	**31,667,020**	**¥10,374**	**¥16,254**	**¥36,932**	**¥ (9,075)**	**¥413**	**¥(122)**	**¥(109)**

	Number of shares of common stock	Thousands of U.S. dollars (Note 3)						
		Common stock	Capital surplus	Retained earnings	Excess of land revaluation	Unrealized gain on investment securities	Foreign currency translation adjustment	Treasury stock
Balance at December 31, 2003	31,667,020	$99,566	$155,995	$282,971	$(117,268)	$3,119	$(1,285)	$(1,044)
Sale of land	**—**	**—**	**—**	**(30,170)**	**30,170**	**—**	**—**	**—**
Retirement of treasury stocks relating to merger	**—**	**—**	**—**	**(233)**	**—**	**—**	**—**	**—**
Unrealized gain on investment securities	**—**	**—**	**—**	**—**	**—**	**845**	**—**	**—**
Foreign currency translation adjustment	**—**	**—**	**—**	**—**	**—**	**—**	**106**	**—**
Net income for the year	**—**	**—**	**—**	**107,937**	**—**	**—**	**—**	**—**
Cash dividends paid	**—**	**—**	**—**	**(6,065)**	**—**	**—**	**—**	**—**
Purchase of treasury stock	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**(9)**
Balance at December 31, 2004	**31,667,020**	**$99,566**	**$155,995**	**$354,439**	**$ (87,098)**	**$3,965**	**$(1,178)**	**$(1,053)**

The accompanying notes are an integral part of these statements.

Consolidated Statements of Cash Flows

OTSUKA CORPORATION and Its Consolidated Subsidiaries
December 31, 2003 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2003	**2004**	**2004**
Cash flows from operating activities:			
Income before income taxes and minority interests	¥ 4,619	**¥18,548**	**$ 178,007**
Depreciation and amortization	6,704	**6,162**	**59,145**
Amortization of difference between cost of investment and equity in net assets of consolidated subsidiaries	63	**37**	**355**
Increase(decrease) in reserve for retirement benefits	2,742	**(4,531)**	**(43,489)**
Increase(decrease) in allowance for bad debts	148	**(179)**	**(1,722)**
Interest and dividend income	(55)	**(54)**	**(522)**
Interest expenses	528	**348**	**3,345**
Loss on sale / disposal of property, plant and equipment	346	**808**	**7,760**
Impairment losses	—	**1,491**	**14,315**
Loss on revaluation of investments in securities	798	**253**	**2,431**
Gain on sale of investments in consolidated subsidiaries	—	**(456)**	**(4,382)**
Loss on revaluation of investments in securities in unconsolidated subsidiaries	32	**—**	**—**
Loss on revaluation of membership	15	**23**	**229**
Loss on withdrawal from over-the-counter business activities and removal costs for head office	980	**—**	**—**
Dilution gain from change in equity interest	—	**(248)**	**(2,380)**
Increase in accounts and notes receivable	(1,292)	**(2,995)**	**(28,751)**
Decrease (increase) in inventories	(556)	**292**	**2,804**
Increase (decrease) in accounts and notes payable	(1,253)	**7,544**	**72,401**
Other	5,353	**1,087**	**10,438**
Subtotal	19,174	**28,132**	**269,986**
Interest and dividend income received	58	**55**	**532**
Interest expenses paid	(540)	**(351)**	**(3,376)**
Income taxes paid	(2,943)	**(4,341)**	**(41,667)**
Net cash provided by operating activities	15,749	**23,494**	**225,475**
Cash flows from investing activities:			
Payments for purchase of property, plant and equipment	(22,559)	**(3,081)**	**(29,574)**
Proceeds from sale of property, plant and equipment	1,116	**1,482**	**14,226**
Payments for software developed	(1,902)	**(1,877)**	**(18,020)**
Payments for purchase of investments in securities	(228)	**(367)**	**(3,522)**
Proceeds from sale of investments in securities	57	**79**	**767**
Proceeds from sale of investments in consolidated subsidiaries(Note 11(3))	—	**449**	**4,314**
Payments for long-term loans receivable	(16)	**(5)**	**(47)**
Proceeds from long-term loans receivable	36	**28**	**277**
Other	90	**45**	**433**
Net cash used in investing activities	(23,405)	**(3,245)**	**(31,146)**
Cash flows from financing activities:			
Increase(Decrease) in short-term bank loans, net	2,560	**(8,910)**	**(85,508)**
Proceeds from long-term debts	16,850	**1,800**	**17,274**
Repayments for long-term debts	(12,385)	**(8,378)**	**(80,411)**
Proceeds from issue of new shares	—	**520**	**4,998**
Cash dividends paid	(631)	**(633)**	**(6,077)**
Other	(108)	**(15)**	**(151)**
Net cash provided by (used in) financing activities	6,284	**(15,617)**	**(149,876)**
Effect of exchange rate changes on cash and cash equivalents	(9)	**3**	**37**
Net Increase(Decrease) in cash and cash equivalents	(1,381)	**4,635**	**44,491**
Cash and cash equivalents at beginning of year	4,297	**3,020**	**28,985**
Increase in cash and cash equivalents for newly consolidated subsidiaries	104	**—**	**—**
Increase in cash and cash equivalents due to merger (Note 11(2))	—	**60**	**583**
Cash and cash equivalents at end of year (Note 11(1))	¥ 3,020	**¥ 7,717**	**$ 74,059**

The accompanying notes are an integral part of these statements.

1. Basis of Presenting the Consolidated Financial Statements

Accounting Principles

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

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

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

2. Summary of Significant Accounting Policies

(1)Scope of consolidation

The Company had 20 subsidiaries (majority-owned companies) and 16 subsidiaries as at December 31, 2003 and 2004, respectively. The consolidated financial statements include the accounts of the Company and 12 subsidiaries and 11 subsidiaries for the years ended December 31, 2003 and 2004, respectively.

The 11 subsidiaries which were consolidated in the year ended December 31, 2004 are listed below:

	Equity ownership percentage
OSK Co., LTD.	100.0%
Netplan Co., LTD.	100.0%
Alpha Techno Co., LTD.	100.0%
Fujimi Construction Co., LTD.	100.0%
Alpha System Co., LTD.	100.0%
Alpha Net Co., LTD.	100.0%
Otsuka Information Technology Corp.	100.0%
Otsuka Auto Service Co., LTD	100.0%
Net World Corporation	68.4%
Otsuka Business Service Co., LTD.	65.0%
10art-ni Corporation	53.9%

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

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

Generally, Companies that are more than 50 % owned are classified as subsidiaries and companies that are more than 20 % owned are classified as affiliates. However, companies that are between 40 % and 50 % owned may also be classified as subsidiaries and companies that are between 15 % and 20 % owned 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 8 and 5 unconsolidated subsidiaries as at December 31, 2003 and 2004, respectively, consisted of insignificant amounts in terms of total assets, net sales, net income and retained earnings, and they 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 the common stock of consolidated subsidiaries, together with the equity in the net assets of such subsidiaries, any difference between such investment costs and the amount of underlying equity in the net assets of the subsidiary is deferred and amortized to income over five years on a straight-line basis.

(3)Investments in unconsolidated subsidiaries and affiliates

The Company had 8 unconsolidated subsidiaries and 5 affiliates at December 31, 2003 and 5 unconsolidated subsidiaries and 6 affiliates at December 31, 2004.

No investments in affiliates for the years ended December 31, 2003 and 2004, were accounted for by the equity method. Investments in unconsolidated subsidiaries and affiliates not accounted for by the equity method were carried at cost or less, since they did not have a material impact on consolidated net income and retained earnings in the consolidated financial statements.

(4)Translation of foreign currency

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

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

(5) Cash and cash equivalents

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

(6)Inventories

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

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

(7)Financial instruments

(a) Securities

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

• Equity investment in subsidiaries and affiliates

Investments of the Company in equity securities issued by unconsolidated subsidiaries and affiliates are accounted for by the equity method.In exceptional cases, investments in certain unconsolidated subsidiaries and affiliates are stated at cost, 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 by the moving-average method.)

Securities without a market quotation are stated at cost; this is calculated 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 of utilizing 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 the 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 3 years.

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

(11)Accounting for income taxes

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

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

(12)Allowance for bad debts

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

(13)Reserve for retirement benefits

(a) Retirement benefits for employees

The reserve for retirement benefits represents the estimated present value of projected benefit obligations in excess of the fair value of the plan assets, except that the unrecognized transition amount arising from adopting the new accounting standard is amortized on a straight-line basis over 5 years, the unrecognized actuarial differences are amortized on a straight-line basis over a period of 12 years from the 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 2003)

• Termination of substitute portion employee pension fund

The employees' pension fund of the OTSUKA Group was permitted immunity from 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 the 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."

(Fiscal year 2004)

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

On April, 2004, the Company and certain of its subsidiaries changed the type of a termination allowance plan. It was changed from a defined-benefit to an agreement-type corporate pension plan.

(b) Retirement benefits for directors

The Company and 4 consolidated subsidiaries have provided for accrued retirement benefits to directors at an amount equivalent to 100% of the benefits the Company would be required to pay had all eligible directors retired at the balance sheet date.

(Fiscal year 2004)

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

(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.

(Fiscal year 2003)

Effective from the fiscal year 2003, the Ccompany 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 Standards 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 generally imposes consumption tax at a flat rate on all domestic consumption of goods and services. The consumption tax withheld upon sale is not included in the amount of "Net sales" in the accompanying consolidated statements of income but is recorded as a liability. Consumption tax, which is paid by the Company and domestic subsidiaries on purchases of goods and services, is not included in the amounts of costs/expenses in the consolidated statements of income , but is offset against the balance withheld, and the net balance is included in "Other current liabilities" in the consolidated balance sheets.

(16) Change of accounting policy

(Fiscal year 2003)

During the year ended December 31, 2003, the Company changed the consolidated statement of income classification for the system engineering costs 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 the significance of the system engineering costs and the restructuring 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 of 1,761 millions yen 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.

(Fiscal year 2004)

Accounting standard for impairment of Fixed Assets

On August 9, 2002, the Business Accounting Council in Japan issued "Accounting Standard for Impairment of Fixed Assets." The standard requires that fixed assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss shall be recognized in the income statement by reducing the carrying amount of impaired assets or groups of assets to the recoverable amount to be measured as the higher of net selling price and value in use.

The standard shall be effective for fiscal years beginning April 1, 2005. However, earlier adoption is permitted for fiscal years beginning January 1, 2005 and for fiscal years ending between December 31, 2004 and December 31, 2005.

The Company and its subsidiaries adopted this standard with effect from the year ended December 31, 2004. As a result of this adoption, income before income taxes decreased by 1,491 million yen (14,315 thousand U.S. dollars). The impairment loss was included in accumulated depreciation.

(17) Rounding of amounts

Sums of less than a million yen are rounded down.

3. U.S. Dollar Amounts

Amounts in U.S. dollars are included solely for the convenience of readers outside Japan. The rate of ¥104.2=US$1, the rate of exchange on December 31, 2004, 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, 2003 and 2004 investments in securities were as follows:

(1) Other securities with fair value

						Millions of yen			Thousands of U.S. dollars
		2003				**2004**			**2004**
	Cost	Carrying amount	Differences	Cost	Carrying amount	Differences	Cost	Carrying amount	Differences
Fair value greater than cost									
Stocks	¥667	¥1,214	¥546	**¥ 747**	**¥1,444**	**¥697**	**$ 7,173**	**$13,862**	**$6,689**
Bonds	—	—	—	**—**	**—**	**—**	**—**	**—**	**—**
Other securities	96	114	17	**38**	**62**	**24**	**368**	**599**	**230**
	¥764	¥1,328	¥564	**¥ 785**	**¥1,506**	**¥721**	**$ 7,542**	**$14,462**	**$6,919**
Fair value less than or equal to cost									
Stocks	¥127	¥ 111	¥(16)	**¥ 350**	**¥ 333**	**¥(17)**	**$ 3,366**	**$ 3,201**	**$ (165)**
Bonds	—	—	—	**—**	**—**	**—**	**—**	**—**	**—**
Other securities	—	—	—	**51**	**50**	**(0)**	**489**	**484**	**(5)**
	¥127	¥ 111	¥(16)	**¥ 401**	**¥ 384**	**¥(17)**	**$ 3,856**	**$ 3,685**	**$ (171)**
Total	¥892	¥1,440	¥548	**¥1,187**	**¥1,890**	**¥703**	**$11,398**	**$18,147**	**$6,748**

(2) Other securities sold in 2003 and 2004 (for the years ended December 31, 2003 and 2004)

	Millions of yen						Thousands of U.S. dollars		
	2003			**2004**			**2004**		
	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
	¥18	¥25	¥—	**¥79**	**¥9**	**¥0**	**$767**	**$92**	**$2**

(3) Securities not stated at fair value

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
	Stated amount on consolidated balance sheets	Stated amount on consolidated balance sheets	Stated amount on consolidated balance sheets
Other securities			
Unlisted stocks	¥1,319	**¥1,040**	**$9,985**
Mid-term government bonds fund	2	**2**	**20**
Preferred subscription certification	10	**10**	**95**

(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	
	2003		**2004**		**2004**	
	Within one year	More than one year	Within one year	More than one year	Within one year	More than one year
Others	—	¥10	**—**	**¥10**	**—**	**$95**
Total	—	¥10	**—**	**¥10**	**—**	**$95**

5. Derivative Information

At December 31,2003 and 2004 derivatives were as follows:

Currency

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

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

	Thousands of U.S. dollars			
	2004			
	Contractual value or notional principal amount			
	Total	Over one year	Fair value	Valuation gain(loss)
Currency swap Purchased U.S.dollar	**$3,621**	**$3,621**	**$3,155**	**$(465)**

(Note)

Except for derivatives that are designed as hedging instruments

6. Inventories

Inventories at December 31, 2003 and 2004 comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
Merchandise and maintenance parts	¥14,820	**¥15,356**	**$147,376**
Work-in-process	1,587	**746**	**7,167**
Supplies	166	**173**	**1,666**
	¥16,574	**¥16,277**	**$156,211**

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

The annual average interest rates applicable to short-term bank loans at December 31, 2003 and 2004 were 0.77% and 0.74%, respectively.

Long-term debt at December 31, 2003 and 2004 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
Long-term loans from banks with annual interest rates from 0.70% to 3.12%	¥12,102	**¥7,487**	**$71,855**
0.75% secured Japanese yen bonds due March 2004	2,000	**—**	**—**
	14,102	**7,487**	**71,855**
Less : Current maturities of long-term debts	(8,224)	**(6,208)**	**(59,580)**
	¥ 5,878	**¥1,279**	**$12,274**

Aggregate annual maturities of long-term debt subsequent to December 31, 2004 are as follows:

Year ending December 31	Millions of yen	Thousands of U.S. dollars
2005	¥6,208	$59,580
2006	759	7,284
2007	490	4,702
2008	30	287
	¥7,487	$71,855

8. Reserve for Retirement Benefits

(1) Retirement benefit plan

(Fiscal year 2003)

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.

(Fiscal year 2004)

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

(2) The reserve for retirement benefits as of December 31, 2003 and 2004 is analyzed as follows:

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
Projected benefit obligations	¥(58,148)	**¥(35,894)**	**$(344,476)**
Plan assets	34,325	**27,708**	**265,915**
	(23,822)	**(8,186)**	**(78,560)**
Unrecognized transition amount	4,271	**1,668**	**16,008**
Unrecognized prior service cost	(2,714)	**(7,770)**	**(74,573)**
Unrecognized actuarial differences	12,212	**8,758**	**84,052**
	(10,052)	**(5,530)**	**(53,073)**
Prepaid pension cost	—	**(3,734)**	**(35,840)**
Reserve for retirement benefits	¥(10,052)	**¥ (9,264)**	**$ (88,913)**

The balance of the reserve for retirement benefits in the accompanying consolidated balance sheets at December 31, 2003 and 2004 included retirement benefits for directors in the amounts of 726 million yen and 307 million yen (2,953 thousand U.S. dollars), respectively.

(Fiscal year 2003)

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

(3) Pension expenses related to retirement benefits for the year ended December 31, 2003, and 2004 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
Service cost	¥2,905	**¥2,708**	**$25,992**
Interest cost	1,248	**667**	**6,403**
Expected return on plan assets	(1,107)	**(1,128)**	**(10,828)**
Amortization of transition amount	2,135	**1,724**	**16,551**
Amortization of the unrecognized prior service cost	(252)	**(539)**	**(5,173)**
Amortization of the unrecognized actuarial differences	974	**530**	**5,090**
Additional benefits for employees' early retirement	3	**—**	**—**
Net pension expense	¥5,908	**¥3,963**	**$38,036**
Gain from the exemption from the obligation under the substitutional portion of social welfare pension fund	—	**(5,481)**	**(52,607)**
Loss on revaluation of investments in securities in unconsolidated subsidiaries	—	**448**	**4,304**

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

(4) Computation Basis of Pension Liabilities

As of December 31, 2003 and 2004

	2003	**2004**
Discount rate	2.0%	**1.5%**
Expected rate of return on plan assets	3.9%	**3.7%**
Periodic allocation principle for projected benefit obligation	Standard of fixed-amount-for-period	**Standard of fixed-amount-for-period**
Amortization of unrecognized prior service cost	12 years	**12 years**
Amortization of transition amount	5 years	**5 years**
Amortization of unrecognized actuarial differences	12 years from the fiscal year following occurrence	**12 years from the fiscal year following occurrence**

9. Contingent Liabilities

The Company was contingently liable for guarantees of loans at December 31, 2003 and 2004 as follows:

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
Loans taken out by:			
NACOS COMPUTER SYSTEMS CORP.	¥48	**¥40**	**$383**
	¥48	**¥40**	**$383**

10. Income Taxes

The statutory tax rate used for calculating deferred tax assets and liabilities at December 31, 2004 was 42.1%.

At December 31, 2004, the reconciliation of the statutory tax rate to the effective income tax rate was as follows:

Statutory tax rate	42.1%
Entertainment expenses	0.7
Inhabitants' tax per capita	0.7
Valuation allowance	(3.2)
Consolidated adjustment account	0.1
Effect on deferred tax assets and deferred tax liabilities from a change in the tax regulations	(0.5)
Deduction for investment in information technologies	(2.0)
Others	0.3
Effective tax rate	38.2%

At December 31, 2003 and 2004, significant components of the deferred tax assets and liabilities were as follows:

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
Deferred tax assets:			
Allowance for bad debts	¥ 254	**¥ 208**	**$ 2,004**
Enterprise taxes	304	**357**	**3,430**
Accrued bonuses	737	**970**	**9,311**
Retirement benefits for employees	3,412	**3,730**	**35,796**
Retirement benefits for directors	327	**137**	**1,317**
Membership	303	**303**	**2,915**
Impairment losses	—	**951**	**9,128**
Software cost	157	**225**	**2,167**
Operating loss carryforwards	884	**412**	**3,955**
Eliminated unrealized profits	461	**411**	**3,949**
Other	652	**651**	**6,248**
Total deferred tax assets	7,495	**8,359**	**80,226**
Less: Valuation allowance	(714)	**(229)**	**(2,206)**
Net deferred tax assets	6,781	**8,129**	**78,020**
Deferred tax liabilities:			
Reserve for computer program	2,397	**2,103**	**20,191**
Prepaid pension cost	—	**1,522**	**14,607**
Unrealized gain on investment securities	223	**283**	**2,721**
Other	19	**17**	**166**
Total deferred tax liabilities	2,640	**3,927**	**37,687**
Net deferred tax assets	¥4,141	**¥4,202**	**$40,333**

(Fiscal year 2003)

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 and a deferred tax assets revaluation of 288 million yen, and an increase in excess of land revaluation after tax-effect accounting of 288 million yen and unrealized gain on investment securities after tax-effect accounting by 7 million yen 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 was also reduced by 74 million yen as a result of these changes in statutory local enterprise tax regulations.

11. Supplementary Cash Flow Information

(1)Cash and cash equivalents consisted of:

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
Cash, time deposits and other cash equivalents	¥4,353	**¥9,043**	**$86,785**
Time deposits with deposit terms of more than three months	(1,332)	**(1,326)**	**(12,725)**
Cash and cash equivalents at end of year	¥3,020	**¥7,717**	**$74,059**

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

(Fiscal year 2004)

	Millions of yen	Thousands of U.S. dollars
Current assets	¥ 99	**$953**
Non-current assets	3	**37**
Total assets	¥103	**$990**
Current liabilities	¥ 51	**$492**
Non-current liabilities	8	**84**
Total liabilities	¥ 60	**$576**

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

(Fiscal year 2004)

	Millions of yen	Thousands of U.S. dollars
Current assets	¥258	**$2,478**
Non-current assets	34	**328**
Current liabilities	(211)	**(2,032)**
Non-current liabilities	(22)	**(217)**
Minority interests in consolidated subsidiaries	(1)	**(10)**
Consolidated adjustment account	16	**158**
Gain on sale of investments in securities	226	**2,175**
Amount for sale of investments in securities	300	**2,879**
Cash and cash equivalents	(110)	**(1,063)**
Proceeds from sale of investments in securities	¥189	**$1,815**

12. Subsequent Events

(1) Appropriation

The following appropriation of the Company's retained earnings in respect of the year ended December 31, 2004 was as proposed by the Board of Directors and approved by the shareholders at the annual general meeting held on March 30, 2005:

Appropriation	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥55.00 per share)	¥1,738	$16,681

(2) Termination of substitute portion employee pension fund

(Fiscal year 2003)

On February 1, 2004, the Company and its seven consolidated subsidiaries obtained governmental approval for 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 Post-retirement 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 at the date of the approval.

13. Lease Transactions

Acquisition costs, accumulated depreciation and net book values of leased assets at December 31, 2003 and 2004 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
Acquisition cost	¥6,465	**¥4,589**	**$44,049**
Accumulated depreciation	(4,298)	**(3,005)**	**(28,841)**
Net book value	¥2,167	**¥1,584**	**$15,208**

Accumulated depreciation at December 31, 2004 included an accumulated impairment loss of 0 million yen (3 thousand U.S. dollars).

Future minimum lease payments under finance leases at December 31, 2003 and 2004 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
Due within one year	¥1,141	**¥ 717**	**$ 6,890**
Due after one year	1,063	**859**	**8,595**
	¥2,205	**¥1,613**	**$15,485**
Accumulated impairment loss on leaseholds	¥ —	**¥ 0**	**$ 3**

Lease rental expenses, depreciation and interest expenses for the years ended December 31, 2003 and 2004 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
Lease rental expenses	¥1,650	**¥1,223**	**$11,746**
Depreciation	1,506	**1,158**	**11,121**
Release of accumulated impairment loss on leaseholds	—	**—**	**—**
Interest expenses	73	**42**	**407**
Impairment loss on leaseholds	—	**0**	**3**

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, 2003 and 2004 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
Due within one year	¥204	**¥337**	**$3,236**
Due after one year	150	**520**	**4,990**
	¥355	**¥857**	**$8,227**

14. Land Revaluation

Pursuant to the Law on 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 on Land Revaluation, after making reasonable adjustments. Revaluation is permitted once only. The excess of the book value after revaluation over the fair value is 1,382 million yen (13,263 thousand U.S. dollars).

15. Pledged Assets

At December 31, 2003 and 2004, assets pledged as collateral for accounts and notes payable and loan from banks were as follows:

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
Land	¥1,117	**¥ 816**	**$ 7,834**
Buildings	835	**832**	**7,993**
Time deposits	11	**43**	**418**
	¥1,964	**¥1,692**	**$16,245**

16. Explanatory Notes of Other Income and Expenses

(Fiscal year 2003)

• Loss on withdrawal from over-the-counter sales business activities

"Loss on withdrawal from over-the-counter sales business activities" represents a loss on disposal of equipment and systems due to withdrawal from over-the-counter sales business activities.

• Removal cost of head office

"Removal cost of head office" represents a loss on disposal of equipment and moving costs.

(Fiscal year 2004)

• Impairment losses

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

a. Grouping

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

b. Assessment of recoverable value

Recoverable value is assessed net sale value.

c. Assets subject to impairment

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

d. Details of impairment loss

Assets held by hotel business (location: Shizuoka)

	Millions of yen	Thousands of U.S. dollars
Land	¥ 246	$ 2,368
Buildings and structures	1,082	10,393
Other tangible assets	16	154
Other intangible assets	24	237
Guarantee deposits	0	0
Leaseholds	0	3

Leaseholds (location: Saitama)

	Millions of yen	Thousands of U.S. dollars
Land	¥120	$1,158

The impairment loss was included in accumulated depreciation.

17. Research and Development Costs

Research and development costs included in cost of sales and selling, general and administrative expenses for the years ended December 31, 2003 and 2004 amounted to 918 million yen and 721 million yen (6,922 thousand U.S. dollars), respectively.

18. Segment Information

The business segment information of the Company and its consolidated subsidiaries for the years ended December 31, 2003 and 2004 is summarized as follows:

(1)Business segment information

	Millions of yen					
	2003					
	System Integration	Service & Support	Other	Total	Elimination or corporate	Consolidated total
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

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

	Thousands of U.S. dollars					
	2004					
	System Integration	Service & Support	Other	Total	Elimination or corporate	Consolidated total
Net sales to:						
Outside customers	**$2,291,067**	**$1,256,811**	**$26,799**	**$3,574,679**	**$ —**	**$3,574,679**
Inter-segment sales/transfers	**751**	**1,452**	**20,658**	**22,862**	**(22,862)**	**—**
	2,291,819	**1,258,264**	**47,457**	**3,597,542**	**(22,862)**	**3,574,679**
Operating expenses	**2,160,847**	**1,177,199**	**46,628**	**3,384,675**	**26,761**	**3,411,436**
Operating income	**$ 130,972**	**$ 81,065**	**$ 829**	**$ 212,867**	**$ (49,623)**	**$ 163,243**
Assets, depreciation and capital expenditure:						
Assets	**$ 821,892**	**$ 534,237**	**$18,805**	**$1,374,935**	**$229,947**	**$1,604,883**
Depreciation and amortization	**29,308**	**23,622**	**355**	**53,285**	**5,859**	**59,145**
Impairment losses	**—**	**13,156**	**—**	**13,156**	**1,158**	**14,315**
Capital expenditure	**24,550**	**20,402**	**209**	**45,162**	**3,982**	**49,144**

Notes ;

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

3. Significant components of “Eliminations or Corporate” are as follows;

	Millions of yen		Thousands of U.S. dollars
	2003	**2004**	**2004**
Non-allocable operating expenses	¥5,193	**¥5,239**	**$50,278**
Corporate assets	22,102	**25,615**	**245,830**

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

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

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

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

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

(Change of accounting policy)
(Fiscal year 2003)
During the year ended December 31, 2003, the Company changed the consolidated statement of income classification for the system engineering costs relating to commissioned business from selling, general and administrative expenses to cost of sales, according to man-hours. This reclassification resulted in an decrease in the operating expenses of System Iintegration of 217 million yen and an increase in the operating income of System Iintegration of the same amount, and an increase in the operating cost of Service & Ssupport of 217 million yen and increase in the operating income of Service & Ssupport 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.

(Fiscal year 2004)
Accounting standard for impairment of Fixed Assets
As described in ‘Note 2(16) Change of accounting policy’ the Companies and its subsidiaries adopted “Accounting Standard for impairment of Fixed Assets” with effect from the year ended December 31, 2004. The effect of this adoption was to recognize impairment losses on the Service & Support business and the corporate, amounting to 1,370 million yen (13,156 thousand U.S. dollars), 120 million yen (1,158 thousand U.S. dollars), respectively. Operating assets of these business decreased by 1,370 million yen (13,156 thousand U.S. dollars), 120 million yen (1,158 thousand U.S. dollars), respectively.

Report of Independent Auditors

To the Board of Directors and Shareholders of

OTSUKA CORPORATION

We have audited the accompanying consolidated balance sheets of OTSUKA CORPORATION and its subsidiaries as of December 31, 2003 and 2004, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of OTSUKA CORPORATION and its subsidiaries as of December 31, 2003 and 2004, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

In note

1. As described in note 2(16), during the year ended December 31, 2003, the Company changed the consolidated statement of income classification for 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 in note 12(2), on February 1, 2004, the Company and its seven consolidated subsidiaries obtained governmental approval for the separation of the substitute portion employee pension fund service under substitutional portion (second approval) from the Ministry of Health, Labour and Welfare.
3. As described in Note 2(16), effective for the year ended March 31, 2004, OTSUKA CORPORATION and its subsidiaries adopted “Accounting Standard for impairment of Fixed Assets” with effect from the year ended December 31,2004.

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

ChuoAoyama PricewaterhouseCoopers

ChuoAoyama PricewaterhouseCoopers

Tokyo, Japan

March 30, 2005