# *DTS CORPORATION and Subsidiaries*

*Consolidated Financial Statements for the Years Ended March 31, 2006 and 2005, and Independent Auditors' Report*

**INDEPENDENT AUDITORS' REPORT**

To the Board of Directors and Shareholders of
DTS CORPORATION:

We have audited the accompanying consolidated balance sheets of DTS CORPORATION and subsidiaries as of March 31, 2006 and 2005, 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall 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 DTS CORPORATION and subsidiaries as of March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

As discussed in Note 2.e, effective April 1, 2005, the consolidated financial statements have been prepared in accordance with the new accounting standard for impairment of fixed assets.

Our audits also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 1. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

June 23, 2006

## DTS CORPORATION and Subsidiaries

**Consolidated Balance Sheets**
**March 31, 2006 and 2005**

| ASSETS | Millions of Yen 2006 | Millions of Yen 2005 | Thousands of U.S. Dollars (Note 1) 2006 |
|---|---|---|---|
| CURRENT ASSETS: | | | |
| Cash and cash equivalents | ¥ 7,103 | ¥ 6,925 | $ 60,467 |
| Time deposits other than cash equivalents | | 20 | |
| Notes and accounts receivable: | | | |
| Trade | 8,052 | 6,739 | 68,545 |
| Other | 25 | 22 | 213 |
| Allowance for doubtful receivables | (7) | (6) | (60) |
| Inventories (Note 3) | 704 | 634 | 5,993 |
| Deferred tax assets (Note 8) | 1,016 | 1,013 | 8,649 |
| Prepaid expenses and other current assets | 216 | 213 | 1,839 |
| Total current assets | 17,109 | 15,560 | 145,646 |
| PROPERTY, PLANT AND EQUIPMENT: | | | |
| Land | 6,320 | 6,320 | 53,801 |
| Buildings and structures | 4,607 | 4,596 | 39,218 |
| Furniture and fixtures | 1,220 | 1,185 | 10,386 |
| Other assets | 24 | 24 | 204 |
| Total | 12,171 | 12,125 | 103,609 |
| Accumulated depreciation | (2,816) | (2,556) | (23,972) |
| Net property, plant and equipment | 9,355 | 9,569 | 79,637 |
| INVESTMENTS AND OTHER ASSETS: | | | |
| Investment securities (Note 4) | 3,907 | 2,036 | 33,260 |
| Investments in associated companies | 357 | | 3,039 |
| Software | 3,506 | 3,644 | 29,846 |
| Goodwill | | 33 | |
| Guarantee deposit | 129 | 114 | 1,098 |
| Life insurance premiums | 232 | 225 | 1,975 |
| Deferred tax assets (Note 8) | 34 | 93 | 289 |
| Other assets | 156 | 128 | 1,328 |
| Total investments and other assets | 8,321 | 6,273 | 70,835 |
| TOTAL | ¥ 34,785 | ¥ 31,402 | $ 296,118 |

| LIABILITIES AND SHAREHOLDERS' EQUITY | Millions of Yen 2006 | Millions of Yen 2005 | Thousands of U.S. Dollars (Note 1) 2006 |
|---|---|---|---|
| CURRENT LIABILITIES: | | | |
| Payables: | | | |
| Trade accounts | ¥ 1,544 | ¥ 1,272 | $ 13,144 |
| Other | 1,466 | 1,439 | 12,480 |
| Income taxes payable | 1,420 | 1,235 | 12,088 |
| Accrued expenses | 1,829 | 1,844 | 15,570 |
| Other current liabilities | 743 | 483 | 6,325 |
| Total current liabilities | 7,002 | 6,273 | 59,607 |
| LONG-TERM LIABILITIES: | | | |
| Liability for employees' retirement benefits (Note 5) | 89 | 82 | 758 |
| Retirement allowances for directors and corporate auditors | 254 | 214 | 2,162 |
| Deferred tax liabilities (Note 8) | 317 | | 2,698 |
| Other long-term liabilities | 2 | | 17 |
| Total long-term liabilities | 662 | 296 | 5,635 |
| MINORITY INTERESTS | 573 | 437 | 4,878 |
| SHAREHOLDERS' EQUITY (Notes 6 and 12): | | | |
| Common stock—authorized, 50,000,000 shares; issued, 12,611,133 shares in 2006 and 2005 | 6,113 | 6,113 | 52,039 |
| Capital surplus | 6,195 | 6,191 | 52,737 |
| Retained earnings | 14,550 | 12,702 | 123,861 |
| Net unrealized gain on available-for-sale securities | 902 | 383 | 7,679 |
| Treasury stock—at cost, 427,916 shares in 2006 and 381,788 shares in 2005 | (1,212) | (993) | (10,318) |
| Total shareholders' equity | 26,548 | 24,396 | 225,998 |
| TOTAL | ¥ 34,785 | ¥ 31,402 | $ 296,118 |

See notes to consolidated financial statements.

# DTS CORPORATION and Subsidiaries

**Consolidated Statements of Income**
**Years Ended March 31, 2006 and 2005**

| | Millions of Yen | | Thousands of U.S. Dollars (Note 1) |
|---|---|---|---|
| | 2006 | 2005 | 2006 |
| NET SALES | ¥ 42,953 | ¥ 37,928 | $ 365,651 |
| COST OF SALES (Notes 5, 7 and 9) | 35,009 | 30,600 | 298,025 |
| Gross profit | 7,944 | 7,328 | 67,626 |
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (Notes 5, 7 and 9) | 3,338 | 3,036 | 28,416 |
| Operating income | 4,606 | 4,292 | 39,210 |
| OTHER INCOME (EXPENSES): | | | |
| Interest and dividends income | 47 | 39 | 400 |
| Interest expense | (1) | (2) | (9) |
| Loss on sale or disposal of property, plant and equipment | (2) | (274) | (17) |
| Other—net | 25 | 58 | 213 |
| Other income (expenses)—net | 69 | (179) | 587 |
| INCOME BEFORE INCOME TAXES AND MINORITY INTERESTS | 4,675 | 4,113 | 39,797 |
| INCOME TAXES (Note 8): | | | |
| Current | 1,919 | 1,773 | 16,336 |
| Deferred | 14 | (88) | 119 |
| Total income taxes | 1,933 | 1,685 | 16,455 |
| MINORITY INTERESTS IN NET INCOME | 86 | 63 | 732 |
| NET INCOME | ¥ 2,656 | ¥ 2,365 | $ 22,610 |

| | Yen | | U.S. Dollars |
|---|---|---|---|
| PER SHARE OF COMMON STOCK (Notes 2.o and 11): | | | |
| Net income | ¥ 211.49 | ¥ 187.19 | $ 1.80 |
| Diluted net income | 210.02 | 187.14 | 1.79 |
| Cash dividends applicable to the year | 60.00 | 55.00 | 0.51 |

See notes to consolidated financial statements.

## DTS CORPORATION and Subsidiaries

**Consolidated Statements of Shareholders' Equity**
**Years Ended March 31, 2006 and 2005**

| | Outstanding Number of Shares of Common Stock | Millions of Yen | | | | |
|---|---|---|---|---|---|---|
| | | Common Stock | Capital Surplus | Retained Earnings | Unrealized Gain on Available-for-sale Securities | Treasury Stock |
| BALANCE, APRIL 1, 2004 | 12,230,083 | ¥ 6,113 | ¥ 6,191 | ¥ 10,888 | ¥ 273 | ¥ (991) |
| Net income | | | | 2,365 | | |
| Cash dividends, ¥40 per share | | | | (490) | | |
| Bonuses to directors and corporate auditors | | | | (61) | | |
| Repurchase of treasury stock | (738) | | | | | (2) |
| Net change in unrealized gain on available-for-sale securities | | | | | 110 | |
| BALANCE, MARCH 31, 2005 | 12,229,345 | 6,113 | 6,191 | 12,702 | 383 | (993) |
| Net income | | | | 2,656 | | |
| Cash dividends, ¥60 per share | | | | (732) | | |
| Bonuses to directors and corporate auditors | | | | (76) | | |
| Repurchase of treasury stock | (110,828) | | | | | (402) |
| Disposal of treasury stock | 64,700 | | 4 | | | 183 |
| Net change in unrealized gain on available-for-sale securities | | | | | 519 | |
| BALANCE, MARCH 31, 2006 | 12,183,217 | ¥ 6,113 | ¥ 6,195 | ¥ 14,550 | ¥ 902 | ¥ (1,212) |

| | Thousands of U.S. Dollars (Note 1) | | | | |
|---|---|---|---|---|---|
| | Common Stock | Capital Surplus | Retained Earnings | Unrealized Gain on Available-for-sale Securities | Treasury Stock |
| BALANCE, MARCH 31, 2005 | $ 52,039 | $ 52,703 | $ 108,130 | $ 3,261 | $ (8,453) |
| Net income | | | 22,610 | | |
| Cash dividends, $0.51 per share | | | (6,232) | | |
| Bonuses to directors and corporate auditors | | | (647) | | |
| Repurchase of treasury stock | | | | | (3,422) |
| Disposal of treasury stock | | 34 | | | 1,557 |
| Net change in unrealized gain on available-for-sale securities | | | | 4,418 | |
| BALANCE, MARCH 31, 2006 | $ 52,039 | $ 52,737 | $ 123,861 | $ 7,679 | $ (10,318) |

See notes to consolidated financial statements.

## DTS CORPORATION and Subsidiaries

**Consolidated Statements of Cash Flows**
**Years Ended March 31, 2006 and 2005**

| | Millions of Yen | | Thousands of U.S. Dollars (Note 1) |
|---|---|---|---|
| | 2006 | 2005 | 2006 |
| OPERATING ACTIVITIES: | | | |
| Income before income taxes and minority interests | ¥ 4,675 | ¥ 4,113 | $ 39,797 |
| Adjustments for: | | | |
| Income taxes paid | (1,691) | (1,329) | (14,395) |
| Depreciation and amortization | 879 | 582 | 7,483 |
| Loss on sale or disposal of property, plant and equipment | 2 | 274 | 17 |
| Changes in assets and liabilities: | | | |
| (Increase) decrease in receivables | (1,316) | 488 | (11,203) |
| Increase in inventories | (69) | (188) | (587) |
| (Increase) decrease in other assets | (5) | 29 | (43) |
| Increase (decrease) in payables | 442 | (591) | 3,763 |
| (Decrease) increase in accrued expenses | (15) | 130 | (128) |
| Increase (decrease) in other current liabilities | 216 | (32) | 1,839 |
| Increase in liability for retirement benefits | 47 | 47 | 400 |
| Other—net | (103) | (23) | (877) |
| Total adjustments | (1,613) | (613) | (13,731) |
| Net cash provided by operating activities | 3,062 | 3,500 | 26,066 |
| INVESTING ACTIVITIES: | | | |
| Increase in time deposits other than cash equivalents | (20) | (20) | (170) |
| Decrease in time deposits other than cash equivalents | 20 | | 170 |
| Payment for purchases of investment securities | (991) | | (8,436) |
| Payment for purchases of investments in associated companies | (357) | | (3,039) |
| Payment for purchases of property, plant and equipment | (244) | (415) | (2,077) |
| Proceeds from sales of property, plant and equipment | | 335 | |
| Payment for purchases of software | (396) | (3,861) | (3,371) |
| Net (increase) decrease in other assets | (2) | 87 | (17) |
| Net cash used in investing activities | (1,990) | (3,874) | (16,940) |
| FINANCING ACTIVITIES: | | | |
| Proceeds from short-term bank loans | 950 | 1,600 | 8,087 |
| Repayment of short-term bank loans | (950) | (1,600) | (8,087) |
| Dividends paid | (738) | (488) | (6,282) |
| Disposal of treasury stock | 187 | | 1,592 |
| Repurchase of treasury stock | (403) | (2) | (3,431) |
| Other—net | 60 | | 511 |
| Net cash used in financing activities | (894) | (490) | (7,610) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 178 | (864) | 1,516 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 6,925 | 7,789 | 58,951 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | ¥ 7,103 | ¥ 6,925 | $ 60,467 |

See notes to consolidated financial statements.

## 1. BASIS OF PRESENTING CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which DTS CORPORATION (the "Company") is incorporated and operates. The translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥117.47 to $1, the approximate rate of exchange at March 31, 2006. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***a. Consolidation***—The consolidated financial statements include the accounts of the Company and all subsidiaries (together, the "Group").

Under the control or influence concept, those companies in which the Company, directly or indirectly, is able to exercise control over operations are fully consolidated, and those companies over which the Group has the ability to exercise significant influence are accounted for by the equity method.

Investments in all associated companies are accounted for by the equity method.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Group is eliminated.

***b. Cash Equivalents***—Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value. Cash equivalents include demand deposits, time deposits and other short-term investments, all of which mature or become due within three months of the date of acquisition.

***c. Inventories***—Merchandise is mainly stated at cost determined by the moving-average method. Work in process is stated at cost determined by the specific identification method. Supplies are stated at the most recent purchase price which approximates cost determined by the first-in, first-out method.

***d. Property, Plant and Equipment***—Property, plant and equipment are stated at cost. Depreciation is computed by the declining-balance method for most assets at rates based on the estimated useful lives of the assets except for buildings acquired after April 1, 1998, to which the straight-line method is applied. The range of useful lives is principally from 3 to 50 years for buildings and structures, from 4 to 15 years for machinery and equipment and from 2 to 20 years for furniture and fixtures.

Assets with an acquisition cost of ¥100,000 to ¥200,000 are depreciated by the straight-line method over 3 years.

e. ***Long-lived Assets—***In August 2002, the Business Accounting Council ("BAC") issued a Statement of Opinion, "Accounting for Impairment of Fixed Assets," and in October 2003 the Accounting Standards Board of Japan ("ASBJ") issued ASBJ Guidance No. 6, "Guidance for Accounting Standard for Impairment of Fixed Assets."

These new pronouncements were effective for fiscal years beginning on or after April 1, 2005 with early adoption permitted for fiscal years ending on or after March 31, 2004.

The Group adopted the new accounting standard for impairment of fixed assets as of April 1, 2005.

The Group reviews its long-lived assets for impairment whenever events or changes in circumstance indicate the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.

The adoption of the new accounting standard for impairment of fixed assets has no impact on the financial position or result of operations for the year ended March 31, 2006.

f. ***Software Costs***

(1) *Software for sale to the market*—Software development costs, incurred through the completion of a Beta version of specific software for sale to the market, are charged to income when incurred. Such costs incurred subsequent to the completion of the Beta version are capitalized and amortized at the greater of either the amount to be amortized in proportion to the actual sales volume and revenue of the software during the current year to the estimated total sales volume and revenue over the estimated salable years of the software up to 3 years or the amount to be amortized by the straight-line method over such salable years.

(2) *Software for internal use*—Software costs for the purpose of rendering services to clients under specific license contracts are amortized by the straight-line method over the relevant contract period (mainly 8 years). Most of other purchased software costs are charged to income as incurred because of the uncertainty that such costs will be recovered from related future economic benefits.

g. ***Investment Securities—***Based on management's intent, all investment securities are classified as available-for-sale securities. Available-for-sale securities with readily determinable market values are stated at fair value at each balance sheet date, with unrealized gains and losses, net of tax, reported as a component of shareholders' equity. The cost of securities sold is determined based on the moving-average method.

Non-marketable available-for-sale securities are stated at cost being determined by the moving-average method. For other than temporary declines in fair value, investment securities are reduced to net realizable value by a charge to income.

h. ***Goodwill—***The excess of the cost of an acquisition over the fair value of the net assets of the acquired subsidiary at the date of acquisition is recorded as goodwill. Goodwill is amortized using the straight-line method over 5 years.

*i.* ***Employees' Retirement and Pension Plans*****—**The Company has a contributory funded pension plan, a defined contribution pension plan and a benefit plan of advance retirement payment covering substantially all of its employees. In addition, the Company has an unfunded retirement benefit plan for the operating officers.

The subsidiaries have contributory or non-contributory funded pension plans covering substantially all of their employees. Employees whose service with the subsidiary has been terminated are, under most circumstances, entitled to retirement and pension benefits determined by reference to basic rates of pay at the time of termination, length of service and conditions under which the termination occurs. If the termination is involuntary, caused by retirement at the mandatory retirement age or caused by death, the employee is entitled to greater payment than in the case of voluntary termination.

One of the subsidiaries participates in the Smaller Enterprise Retirement Allowance Mutual Aid Plan.

The Company charges the contributions for a defined contribution pension plan and a benefit plan of advance retirement payments to income when paid.

The Company and a subsidiary accounted for the liability for retirement benefits based on the amounts that would be required if their operating officers or employees retired at each balance sheet date.

The policy of the Company and a subsidiary for its contributory pension plan is to charge such costs to income as incurred.

*j.* ***Retirement Allowances for Directors and Corporate Auditors*****—**Directors and corporate auditors are generally entitled to receive lump-sum payments based on compensation at the time of resignation and the number of years of service when they resign from the Company. The accrued provisions are not funded and any amounts payable to directors and corporate auditors upon resignation are subject to the approval of the shareholders. The provision for severance payments is calculated to state the severance liability at the amount that would be payable if all directors and corporate auditors were to resign at the balance sheet date.

*k.* ***Research and Development Costs*****—**Research and development costs are charged to income as incurred.

*l.* ***Leases*****—**All leases are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the lessee's financial statements.

*m.* ***Income Taxes*****—**The provision for income taxes is computed based on income before income taxes and minority interests. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

*n.* ***Appropriations of Retained Earnings*****—**Appropriations of retained earnings are reflected in the consolidated financial statements for the following year upon shareholders' approval.

*o.* ***Per Share Information*—**Basic net income per share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period, retroactively adjusted for stock splits.

Diluted net income per share reflects the potential dilution that could occur if warrants or stock options were exercised. Diluted net income per share of common stock assumes full exercise of the outstanding warrants and stock options at the beginning of the year.

Cash dividends per share presented in the accompanying consolidated statements of income are dividends applicable to the respective years including dividends to be paid after the end of the year.

***p. New Accounting Pronouncements***

*Business combination and business separation*

In October 2003, the BAC issued a Statement of Opinion, "Accounting for Business Combinations," and on December 27, 2005 the ASBJ issued "Accounting Standard for Business Separations" and ASBJ Guidance No. 10, "Guidance for Accounting Standard for Business Combinations and Business Separations." These new accounting pronouncements are effective for fiscal years beginning on or after April 1, 2006.

The accounting standard for business combinations allows companies to apply the pooling of interests method of accounting only when certain specific criteria are met such that the business combination is essentially regarded as a uniting-of-interests. These specific criteria are as follows:

(a) the consideration for the business combination consists solely of common shares with voting rights,

(b) the ratio of voting rights of each predecessor shareholder group after the business combination is nearly equal, and

(c) there are no other factors that would indicate any control exerted by any shareholder group other than voting rights.

For business combinations that do not meet the uniting-of-interests criteria, the business combination is considered to be an acquisition and the purchase method of accounting is required. This standard also prescribes the accounting for combinations of entities under common control and for joint ventures. Goodwill, including negative goodwill, is to be systematically amortized over 20 years or less, but is also subject to an impairment test.

Under the accounting standard for business separations, in a business separation where the interests of the investor no longer continue and the investment is settled, the difference between the fair value of the consideration received for the transferred business and the book value of net assets transferred to the separated business is recognized as a gain or loss on business separation in the statement of income. In a business separation where the interests of the investor continue and the investment is not settled, no such gain or loss on business separation is recognized.

*Stock options*

On December 27, 2005, the ASBJ issued "Accounting Standard for Stock Options" and related guidance. The new standard and guidance are applicable to stock options newly granted on and after May 1, 2006.

This standard requires companies to recognize compensation expense for employee stock options based on the fair value at the date of grant and over the vesting period as consideration for receiving goods or services. The standard also requires companies to account for stock options granted to non-employees based on the fair value of either the stock option or the goods or services received. In the balance sheet, the stock options are presented as stock acquisition rights as a separate component of shareholders' equity until exercised. The standard covers equity-settled, share-based payment transactions, but does not cover cash-settled, share-based payment transactions. In addition, the standard allows unlisted companies to measure options at their intrinsic value if they cannot reliably estimate fair value.

*Bonuses to directors and corporate auditors*

Prior to the fiscal year ended March 31, 2005, bonuses to directors and corporate auditors were accounted for as a reduction of retained earnings in the fiscal year following approval at the general shareholders meeting. The ASBJ issued ASBJ Practical Issues Task Force (PITF) No. 13, "Accounting Treatment for Bonuses to Directors and Corporate Auditors," which encouraged companies to record bonuses to directors and corporate auditors on the accrual basis with a related charge to income, but still permitted the direct reduction of such bonuses from retained earnings after approval of the appropriation of retained earnings.

The ASBJ replaced the above accounting pronouncement by issuing a new accounting standard for bonuses to directors and corporate auditors on November 29, 2005. Under the new accounting standard, bonuses to directors and corporate auditors must be expensed and are no longer allowed to be directly charged to retained earnings. This accounting standard is effective for fiscal years ending on or after May 1, 2006. The companies must accrue bonuses to directors and corporate auditors at the year end to which such bonuses are attributable.

## 3. INVENTORIES

Inventories at March 31, 2006 and 2005, consisted of the following:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | 2006 | 2005 | 2006 |
| Merchandise | ¥ 4 | ¥ 8 | $ 34 |
| Work in process | 678 | 616 | 5,772 |
| Supplies | 22 | 10 | 187 |
| Total | ¥ 704 | ¥ 634 | $ 5,993 |

## 4. INVESTMENT SECURITIES

Investment securities as of March 31, 2006 and 2005, consisted of the following:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | 2006 | 2005 | 2006 |
| Non-current: | | | |
| Equity securities | ¥ 3,742 | ¥ 2,036 | $ 31,855 |
| Government, corporate and other bonds | 165 | | 1,405 |
| Total | ¥ 3,907 | ¥ 2,036 | $ 33,260 |

The carrying amounts and aggregate fair values of investment securities at March 31, 2006 and 2005, were as follows:

| | Millions of Yen | | | |
|---|---|---|---|---|
| March 31, 2006 | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Securities classified as available-for-sale: | | | | |
| Equity securities | ¥ 982 | ¥ 1,550 | ¥ 4 | ¥ 2,528 |
| Debt securities | 193 | | 28 | 165 |
| March 31, 2005 | | | | |
| Securities classified as available-for-sale equity securities | 183 | 653 | 14 | 822 |

| | Thousands of U.S. Dollars | | | |
|---|---|---|---|---|
| March 31, 2006 | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Securities classified as available-for-sale: | | | | |
| Equity securities | $ 8,359 | $ 13,195 | $ 34 | $ 21,520 |
| Debt securities | 1,643 | | 238 | 1,405 |

Available-for-sale securities whose fair value is not readily determinable as of March 31, 2006 and 2005, were as follows:

| | Carrying Amount | | |
|---|---|---|---|
| | Millions of Yen | | Thousands of U.S. Dollars |
| | 2006 | 2005 | 2006 |
| Available-for-sale equity securities | ¥ 1,214 | ¥ 1,214 | $ 10,335 |

Proceeds from sales of available-for-sale securities for the years ended March 31, 2006 and 2005 were ¥1 million ($9 thousand) and ¥89 million, respectively. Gross realized gains on these sales, computed on the moving average cost basis, for the years ended March 31, 2006 and 2005 were ¥1 million ($9 thousand) and ¥86 million, respectively.

The carrying values of debt securities by contractual maturities for securities classified as available-for-sale at March 31, 2006 are as follows:

| | Millions of Yen | Thousands of U.S. Dollars |
|---|---|---|
| | Available-for-sale | Available-for-sale |
| Due after ten years | ¥ 165 | $ 1,405 |
| Total | ¥ 165 | $ 1,405 |

## 5. EMPLOYEES' RETIREMENT BENEFITS

The liability for employees' retirement benefits at March 31, 2006 and 2005, consisted of the following:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | 2006 | 2005 | 2006 |
| Projected benefit obligation | ¥ 258 | ¥ 205 | $ 2,196 |
| Fair value of plan assets | (169) | (123) | (1,438) |
| Net liability | ¥ 89 | ¥ 82 | $ 758 |

The components of net periodic retirement benefit costs for the years ended March 31, 2006 and 2005, were as follows:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | 2006 | 2005 | 2006 |
| Service cost | ¥ 66 | ¥ 60 | $ 562 |
| Contributions to the defined contribution pension plan, the benefit plan of advance retirement payment and the Smaller Enterprise Retirement Allowance Mutual Aid Plan | 281 | 283 | 2,392 |
| Net periodic retirement benefit costs | ¥ 347 | ¥ 343 | $ 2,954 |

The contributory funded employees' pension plan, with companies in the same line of business, was not included in the above tables as the fair value of plan assets corresponding to the Company's contribution cannot be reasonably computed. The contributions to the plan, except for the employees' portion, which are charged to operations, amounted to ¥368 million ($3,133 thousand) and ¥305 million for the years ended March 31, 2006 and 2005, respectively. The amounts of plan assets as of March 31, 2006 and 2005, applicable to the Company based on its contribution to the fund, were ¥7,207 million ($61,352 thousand) and ¥5,399 million, respectively.

## 6. SHAREHOLDERS' EQUITY

Through May 1, 2006, Japanese companies are subject to the Commercial Code of Japan (the "Code").

The Code requires that all shares of common stock be issued with no par value and at least 50% of the issue price of new shares is required to be recorded as common stock and the remaining net proceeds are required to be presented as additional paid-in capital, which is included in capital surplus. The Code permits Japanese companies, upon approval of the Board of Directors, to issue shares to existing shareholders without consideration by way of a stock split. Such issuance of shares generally does not give rise to changes within the shareholders' accounts.

The Code also provides that an amount of 10% or more of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period (such as bonuses to directors) shall be appropriated as a legal reserve (a component of retained earnings) until the total of such reserve and additional paid-in capital equals 25% of common stock. The amount of total legal reserve and additional paid-in capital that exceeds 25% of the common stock may be available for dividends by resolution of the shareholders after transferring such excess in accordance with the Code. In addition, the Code permits the transfer of a portion of additional paid-in capital and legal reserve to the common stock by resolution of the Board of Directors.

The Code allows Japanese companies to purchase treasury stock and dispose of such treasury stock upon resolution of the Board of Directors. The aggregate purchased amount of treasury stock cannot exceed the amount available for future dividends plus the amount of common stock, additional paid-in capital or legal reserve that could be transferred to retained earnings or other capital surplus other than additional paid-in capital upon approval of such transfer at the annual general meeting of shareholders.

In addition to the provision that requires an appropriation for a legal reserve in connection with the cash outlays, the Code also imposes certain limitations on the amount of capital surplus and retained earnings available for dividends. The amount of capital surplus and retained earnings available for dividends under the Code was ¥12,642 million ($107,619 thousand) as of March 31, 2006, based on the amount recorded in the parent company's general books of account.

Dividends are approved by the shareholders at a meeting held subsequent to the end of the fiscal year to which the dividends are applicable. Semiannual interim dividends may also be paid upon resolution of the Board of Directors, subject to certain limitations imposed by the Code.

On September 17, 2002, the Company issued new stock acquisition rights as a stock option plan for the Company's directors, corporate auditors and key employees. The number of shares to be issued is 64,200 shares of common stock of the Company as of March 31, 2006. The exercise period for the options is from October 2002 to June 2012 and the exercise price of the options is ¥3,199.

On August 20, 2003, the Company issued additional stock acquisition rights as a stock option plan for the Company's directors, corporate auditors and key employees. The number of shares to be issued is 59,700 shares of common stock of the Company as of March 31, 2006. The exercise period for the options is from October 2003 to June 2013 and the exercise price of the options is ¥2,675.

On September 10, 2004, the Company issued additional stock acquisition rights as a stock option plan for the Company's directors, corporate auditors and key employees. The number of shares to be issued is 104,800 shares of common stock of the Company as of March 31, 2006. The exercise period for the options is from October 2004 to June 2014 and the exercise price of the options is ¥2,390.

On December 8, 2005, the Company issued additional stock acquisition rights as a stock option plan for the Company's directors, corporate auditors and key employees. The number of shares to be issued is 228,500 shares of common stock of the Company as of March 31, 2006. The exercise period for the options is from December 2005 to June 2015 and the exercise price of the options is ¥3,977.

On May 1, 2006, a new corporate law (the "Corporate Law") became effective, which reformed and replaced the Code with various revisions that would, for the most part, be applicable to events or transactions which occur on or after May 1, 2006 and for the fiscal years ending on or after May 1, 2006. The significant changes in the Corporate Law that affect financial and accounting matters are summarized below:

***a. Dividends***

Under the Corporate Law, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the shareholders meeting. For companies that meet certain criteria such as: (1) having the Board of Directors, (2) having independent auditors, (3) having the Board of Corporate Auditors, and (4) the term of service of the directors is prescribed as one year rather than two years of normal term by its articles of incorporation, the Board of Directors may declare dividends (except for dividends in kind) if the company has prescribed so in its articles of incorporation.

The Corporate Law permits companies to distribute dividends-in-kind (non-cash assets) to shareholders subject to a certain limitation and additional requirements.

Semiannual interim dividends may also be paid once a year upon resolution by the Board of Directors if the articles of incorporation of the company so stipulate. Under the Code, certain limitations were imposed on the amount of capital surplus and retained earnings available for dividends. The Corporate Law also provides certain limitations on the amounts available for dividends or the purchase of treasury stock. The limitation is defined as the amount available for distribution to the shareholders, but the amount of net assets after dividends must be maintained to be at least ¥3 million.

***b. Increases/Decreases and Transfer of Common Stock, Reserve and Surplus***

The Corporate Law requires that an amount equal to 10% of dividends must be appropriated as a legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus) depending on the equity account charged upon the payment of such dividends until the total of aggregate amount of legal reserve and additional paid-in capital equals 25% of the common stock. Under the Code, the aggregate amount of additional paid-in capital and legal reserve that exceeds 25% of the common stock may be made available for dividends by resolution of the shareholders. Under the Corporate Law, the total amount of additional paid-in capital and legal reserve may be reversed without limitation of such threshold. The Corporate Law also provides that common stock, legal reserve, additional paid-in capital, other capital surplus and retained earnings can be transferred among the accounts under certain conditions upon resolution of the shareholders.

***c. Treasury Stock and Treasury Stock Acquisition Rights***

The Corporate Law also provides for companies to purchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The amount of treasury stock purchased cannot exceed the amount available for distribution to the shareholders which is determined by a specific formula.

Under the Corporate Law, stock acquisition rights, which were previously presented as a liability, are now presented as a separate component of shareholders' equity.

The Corporate Law also provides that companies can purchase both treasury stock acquisition rights and treasury stock. Such treasury stock acquisition rights are presented as a separate component of shareholders' equity or deducted directly from acquisition rights.

On December 9, 2005, the ASBJ published a new accounting standard for presentation of shareholders' equity. Under this accounting standard, certain items which were previously presented as liabilities are now presented as components of shareholders' equity. Such items include stock acquisition rights, minority interest, and any deferred gain or loss on derivatives accounted for under hedge accounting. This standard is effective for fiscal years ending on or after May 1, 2006.

## 7. RESEARCH AND DEVELOPMENT COSTS

Research and development costs charged to income were ¥121 million ($1,030 thousand) and ¥94 million for the years ended March 31, 2006 and 2005, respectively.

## 8. INCOME TAXES

The Company and subsidiaries are subject to Japanese national and local income taxes which, in the aggregate, resulted in a normal effective statutory tax rate of approximately 41% for the years ended March 31, 2006 and 2005.

The tax effects of significant temporary differences which resulted in deferred tax assets and liabilities at March 31, 2006 and 2005, were as follows:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | 2006 | 2005 | 2006 |
| Deferred tax assets: | | | |
| Accrued bonuses | ¥ 777 | ¥ 784 | $ 6,615 |
| Accrued social insurance premium | 100 | 96 | 851 |
| Enterprise tax payable | 120 | 111 | 1,022 |
| Software | 32 | 81 | 272 |
| Retirement allowances for directors and corporate auditors | 104 | 88 | 885 |
| Membership right | 51 | 53 | 434 |
| Liability for employees' retirement benefits | 37 | 33 | 315 |
| Other | 24 | 24 | 205 |
| Total | 1,245 | 1,270 | 10,599 |
| Deferred tax liabilities: | | | |
| Investment securities | 498 | 140 | 4,239 |
| Special reserve for tax-purpose depreciation for personal computers | 13 | 22 | 111 |
| Other | 1 | 2 | 9 |
| Total | 512 | 164 | 4,359 |
| Net deferred tax assets | ¥ 733 | ¥ 1,106 | $ 6,240 |

A reconciliation between the normal effective statutory tax rate and the actual effective tax rate for the years ended March 31, 2006 and 2005, is not disclosed as the difference between them was less than 5% of the normal effective statutory tax rate.

## 9. LEASES

The Group leases furniture and fixtures, software and other assets.

Total rental expenses for the years ended March 31, 2006 and 2005 were ¥45 million ($383 thousand) and ¥50 million, respectively, including ¥34 million ($289 thousand) and ¥40 million of lease payments under finance leases, respectively.

Pro forma information of leased property such as acquisition cost, accumulated depreciation, obligation under finance lease and depreciation expense of finance leases that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2006 and 2005, was as follows:

| | Millions of Yen | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | | 2005 | | |
| | Furniture and Fixtures | Software | Total | Furniture and Fixtures | Software | Total |
| Acquisition cost | ¥ 59 | ¥ 22 | ¥ 81 | ¥ 79 | ¥ 25 | ¥ 104 |
| Accumulated depreciation | 42 | 14 | 56 | 47 | 15 | 62 |
| Net leased property | ¥ 17 | ¥ 8 | ¥ 25 | ¥ 32 | ¥ 10 | ¥ 42 |

| | Thousands of U.S. Dollars | | |
|---|---|---|---|
| | 2006 | | |
| | Furniture and Fixtures | Software | Total |
| Acquisition cost | $ 502 | $ 187 | $ 689 |
| Accumulated depreciation | 357 | 119 | 476 |
| Net leased property | $ 145 | $ 68 | $ 213 |

Acquisition costs and obligations include the imputed interest expense portion.

Obligations under finance leases:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | 2006 | 2005 | 2006 |
| Due within one year | ¥ 16 | ¥ 19 | $ 136 |
| Due after one year | 9 | 23 | 77 |
| Total | ¥ 25 | ¥ 42 | $ 213 |

Depreciation expense including imputed interest expense under finance leases was ¥19 million ($162 thousand) and ¥24 million for the years ended March 31, 2006 and 2005, respectively.

Depreciation expense, which is not reflected in the accompanying consolidated statements of income, is computed by the straight-line method.

## 10. SEGMENT INFORMATION

The Group is mainly engaged in the information service industry segment. The sales, operating income or assets of that segment accounted for more than 90% of the total consolidated sales, operating income or assets. Other sales, operating income or assets were not significant compared to the above segment. Therefore, information about operations in different industry segments has been omitted. As the Group had no foreign operations and sales to foreign customers, information about geographical segments and sales to foreign customers were not disclosed.

## 11. NET INCOME PER SHARE

Reconciliation of the differences between basic and diluted net income per share ("EPS") for the years ended March 31, 2006 and 2005 is as follows:

| | Millions of Yen | Thousands of Shares | Yen | U.S. Dollars |
|---|---|---|---|---|
| Year Ended March 31, 2006 | Net Income | Weighted-average Shares | EPS | |
| Basic EPS—Net income available to common shareholders | ¥ 2,574 | 12,171 | ¥ 211.49 | $ 1.80 |
| Effect of dilutive securities—Warrants | | 85 | | |
| Diluted EPS—Net income for computation | ¥ 2,574 | 12,256 | ¥ 210.02 | $ 1.79 |
| Year Ended March 31, 2005 | | | | |
| Basic EPS—Net income available to common shareholders | ¥ 2,289 | 12,230 | ¥ 187.19 | |
| Effect of dilutive securities—Warrants | | 2 | | |
| Diluted EPS—Net income for computation | ¥ 2,289 | 12,232 | ¥ 187.14 | |

## 12. SUBSEQUENT EVENTS

### a. *Appropriations of Retained Earnings*

The following appropriations of retained earnings at March 31, 2006, were approved at the Company's shareholders meeting held on June 23, 2006:

| | Millions of Yen | Thousands of U.S. Dollars |
|---|---|---|
| Year-end cash dividends, ¥40 ($0.34) per share | ¥ 487 | $ 4,146 |
| Bonuses to directors and corporate auditors | 70 | 596 |

### b. *Acquisition*

On March 23, 2006, the Board of Directors of the Company approved the acquisition, dated April 3, 2006, of all shares in RD CORPORATION for the purpose of expanding the basis of the system integration service in the Kansai region. As a result of this acquiring, RD CORPORATION became the Company's wholly owned subsidiary.

The acquisition totaled ¥200 million ($1,703 thousand) in cash.

***c. Foundation of a Subsidiary***

On March 23, 2006, the Board of Directors of the Company passed a resolution to establish a new subsidiary for the purpose of entering the new total solution business for logistics with RFID (Radio Frequency Identification).

The new subsidiary was established on April 25, 2006.

The outline of the new company is as follows:

| | |
|---|---|
| Name: | SOLIDWARE CORPORATION |
| Common stock: | ¥70 million ($596 thousand) |
| Ownership ratio: | 100% |

* * * * * *