
***DTS CORPORATION (Formerly
Data Communication System
Co., Ltd.) and Subsidiaries***

*Consolidated Financial Statements for the
Years Ended March 31, 2004 and 2003,
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 (formerly Data Communication System Co., Ltd.) and subsidiaries as of March 31, 2004 and 2003, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards 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, 2004 and 2003, 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.

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 25, 2004

**DTS CORPORATION (Formerly Data Communication System Co., Ltd.)
and Subsidiaries**

**Consolidated Balance Sheets
March 31, 2004 and 2003**

ASSET \$	Millions of Yen		Thousands of U.S. Dollars (Note 1)	LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2004	2003	2004		2004	2003	2004
CURRENT ASSETS:				CURRENT LIABILITIES:			
Cash and cash equivalents	¥ 7,789	¥ 7,065	\$ 73,697	Current portion of long-term debt (Note 5)		¥ 700	
Receivables:				Payables:			
Trade accounts	7,208	7,526	68,199	Trade accounts	¥ 2,116	2,038	\$ 20,021
Other	42	21	397	Other	1,040	976	9,840
Allowance for doubtful receivables	(7)	(11)	(66)	Income taxes payable	694	1,097	6,566
Inventories (Note 3)	446	743	4,220	Accrued expenses	1,714	1,703	16,217
Deferred tax assets (Note 9)	911	825	8,620	Other current liabilities	611	549	5,782
Prepaid expenses and other current assets	241	92	2,280				
				Total current liabilities	6,175	7,063	58,426
Total current assets	16,630	16,261	157,347				
PROPERTY, PLANT AND EQUIPMENT:				LONG-TERM LIABILITIES:			
Land (Note 14)	6,643	7,063	62,854	Liability for employees' retirement benefits (Note 6)	69	567	653
Buildings and structures (Note 14)	4,440	4,925	42,010	Retirement allowances for directors and corporate auditors	180	250	1,703
Furniture and fixtures	1,111	1,045	10,512				
Construction in progress	468	23	4,428	Total long-term liabilities	249	817	2,356
Other assets	27	34	254				
Total	12,689	13,090	120,058	MINORITY INTERESTS	376	248	3,557
Accumulated depreciation	(2,750)	(2,797)	(26,019)				
Net property, plant and equipment	9,939	10,293	94,039	SHAREHOLDERS' EQUITY (Notes 7 and 14):			
				Common stock—authorized, 18,000,000 shares; issued, 12,611,133 shares in 2004 and 2003	6,113	6,113	57,839
INVESTMENTS AND OTHER ASSETS:				Capital surplus	6,191	6,191	58,577
Investment securities (Note 4)	1,854	1,388	17,542	Retained earnings	10,888	9,763	103,018
Goodwill	65	122	615	Net unrealized gain (loss) on available-for-sale securities	273	(1)	2,583
Guarantee deposit	313	387	2,961	Treasury stock—at cost, 381,050 shares in 2004 and 189,422 shares in 2003	(991)	(628)	(9,376)
Life insurance premiums	154	390	1,457				
Deferred tax assets (Note 9)	182	570	1,722	Total shareholders' equity	22,474	21,438	212,641
Other assets	330	155	3,123				
Allowance for doubtful receivables	(193)		(1,826)				
Total investments and other assets	2,705	3,012	25,594				
TOTAL	¥ 29,274	¥ 29,566	\$ 276,980	TOTAL	¥ 29,274	¥ 29,566	\$ 276,980

See notes to consolidated financial statements.

**DTS CORPORATION (Formerly Data Communication System Co., Ltd.)
and Subsidiaries**

**Consolidated Statements of Income
Years Ended March 31, 2004 and 2003**

	<u>Millions of Yen</u>		Thousands of U.S. Dollars (Note 1)
	<u>2004</u>	<u>2003</u>	<u>2004</u>
NET SALES	¥ 37,095	¥ 36,921	\$ 350,979
COST OF SALES (Notes 6, 8 and 10)	<u>30,366</u>	<u>30,327</u>	<u>287,312</u>
Gross profit	6,729	6,594	63,667
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (Notes 6, 8 and 10)	<u>3,119</u>	<u>3,032</u>	<u>29,511</u>
Operating income	<u>3,610</u>	<u>3,562</u>	<u>34,156</u>
OTHER INCOME (EXPENSES):			
Interest and dividends income	32	17	303
Interest expense	(3)	(23)	(28)
Gain on settlement of qualified retirement benefit pension plan (Note 6)	179		1,694
Loss on sale or disposal of property, plant and equipment	(417)	(10)	(3,946)
Provision for allowance for doubtful receivables	(193)		(1,826)
Loss on write-down of investment securities		(79)	
Other—net	<u>3</u>	<u>48</u>	<u>28</u>
Other expenses—net	<u>(399)</u>	<u>(47)</u>	<u>(3,775)</u>
INCOME BEFORE INCOME TAXES AND MINORITY INTERESTS	<u>3,211</u>	<u>3,515</u>	<u>30,381</u>
INCOME TAXES (Note 9):			
Current	1,289	1,733	12,196
Deferred	<u>113</u>	<u>(160)</u>	<u>1,069</u>
Total income taxes	<u>1,402</u>	<u>1,573</u>	<u>13,265</u>
MINORITY INTERESTS IN NET INCOME	<u>3</u>	<u>16</u>	<u>28</u>
NET INCOME	<u>¥ 1,806</u>	<u>¥ 1,926</u>	<u>\$ 17,088</u>
	<u>Yen</u>		<u>U.S. Dollars</u>
PER SHARE OF COMMON STOCK (Notes 2.n and 12):			
Net income	¥ 142.21	¥ 149.38	\$ 1.35
Diluted net income		149.37	
Cash dividends applicable to the year	40.00	47.00	0.38

See notes to consolidated financial statements.

**DTS CORPORATION (Formerly Data Communication System Co., Ltd.)
and Subsidiaries**

**Consolidated Statements of Shareholders' Equity
Years Ended March 31, 2004 and 2003**

	Outstanding Number of Shares of Common Stock	Millions of Yen				
		Common Stock	Capital Surplus	Retained Earnings	Unrealized Gain (Loss) on Available-for-sale Securities	Treasury Stock
BALANCE, APRIL 1, 2002	12,494,207	¥ 6,111	¥ 6,189	¥ 8,691	¥ (3)	¥ (480)
Net income				1,926		
Cash dividends, ¥57 per share				(712)		
Bonuses to directors and corporate auditors				(142)		
Repurchase of treasury stock	(73,996)					(148)
Exercise of warrants	1,500	2	2			
Net change in unrealized gain (loss) on available -for-sale securities					2	
BALANCE, MARCH 31, 2003	12,421,711	6,113	6,191	9,763	(1)	(628)
Net income				1,806		
Cash dividends, ¥50 per share				(618)		
Bonuses to directors and corporate auditors				(63)		
Repurchase of treasury stock	(191,628)					(363)
Net change in unrealized gain (loss) on available -for-sale securities					274	
BALANCE, MARCH 31, 2004	<u>12,230,083</u>	<u>¥ 6,113</u>	<u>¥ 6,191</u>	<u>¥ 10,888</u>	<u>¥ 273</u>	<u>¥ (991)</u>

	Thousands of U.S. Dollars (Note 1)				
	Common Stock	Capital Surplus	Retained Earnings	Unrealized Gain (Loss) on Available-for-sale Securities	Treasury Stock
BALANCE, MARCH 31, 2003	\$ 57,839	\$ 58,577	\$ 92,374	\$ (9)	\$ (5,942)
Net income			17,088		
Cash dividends, \$0.47 per share			(5,848)		
Bonuses to directors and corporate auditors			(596)		
Repurchase of treasury stock					(3,434)
Net change in unrealized gain (loss) on available -for-sale securities				2,592	
BALANCE, MARCH 31, 2004	<u>\$ 57,839</u>	<u>\$ 58,577</u>	<u>\$ 103,018</u>	<u>\$ 2,583</u>	<u>\$ (9,376)</u>

See notes to consolidated financial statements.

**DTS CORPORATION (Formerly Data Communication System Co., Ltd.)
and Subsidiaries**

**Consolidated Statements of Cash Flows
Years Ended March 31, 2004 and 2003**

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	<u>2004</u>	<u>2003</u>	<u>2004</u>
OPERATING ACTIVITIES:			
Income before income taxes and minority interests	¥ 3,211	¥ 3,515	\$ 30,381
Adjustments for:			
Income taxes paid	(1,688)	(2,131)	(15,971)
Depreciation and amortization	363	394	3,435
Loss on sale or disposal of property, plant and equipment	417	10	3,946
Changes in assets and liabilities:			
Decrease (increase) in receivables	294	(123)	2,782
Decrease (increase) in inventories	297	(307)	2,810
Decrease (increase) in other assets	164	(12)	1,552
Increase (decrease) in payables	133	(306)	1,258
Increase in accrued expenses	15	213	142
Increase (decrease) in other current liabilities	58	(185)	549
Decrease in liability for retirement benefits	(568)	(214)	(5,374)
Other—net	(6)	(184)	(59)
Total adjustments	<u>(521)</u>	<u>(2,845)</u>	<u>(4,930)</u>
Net cash provided by operating activities	<u>2,690</u>	<u>670</u>	<u>25,451</u>
INVESTING ACTIVITIES:			
Payment for purchase of investment securities	(5)	(777)	(47)
Proceeds from sales of investment securities in a subsidiary	104		984
Payment for purchase of property, plant and equipment	(605)	(1,316)	(5,724)
Proceeds from sales of property, plant and equipment	229		2,167
Net increase in other assets	<u>(7)</u>	<u>(14)</u>	<u>(67)</u>
Net cash used in investing activities	<u>(284)</u>	<u>(2,107)</u>	<u>(2,687)</u>
FINANCING ACTIVITIES:			
Redemption of bonds	(700)	(1,323)	(6,623)
Dividends paid	(616)	(708)	(5,828)
Repurchase of treasury stock	(363)	(148)	(3,435)
Other—net	<u>(3)</u>	<u>(59)</u>	<u>(28)</u>
Net cash used in financing activities	<u>(1,682)</u>	<u>(2,238)</u>	<u>(15,914)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	724	(3,675)	6,850
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>7,065</u>	<u>10,740</u>	<u>66,847</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>¥ 7,789</u>	<u>¥ 7,065</u>	<u>\$ 73,697</u>

See notes to consolidated financial statements.

DTS CORPORATION (Formerly Data Communication System Co., Ltd.) and Subsidiaries

Notes to Consolidated Financial Statements Years Ended March 31, 2004 and 2003

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. In addition, certain reclassifications have been made in the 2003 financial statements to conform to the classifications used in 2004.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which DTS CORPORATION (formerly Data Communication System Co., Ltd.) (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 ¥105.69 to \$1, the rate of exchange at March 31, 2004. 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 concept, those companies in which the Company, directly or indirectly, is able to exercise control over operations are fully consolidated.

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 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 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 three years.

- e. **Software Costs**—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 three years or the amount to be amortized by the straight-line method over such salable years.

Most of purchased software costs are charged to income as incurred because of the uncertainty that such costs will be recovered from related future economic benefits.

- f. **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.

- g. **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 five years.

- h. **Employees' Pension Plan**—The Company has contributory funded pension plan, a defined contribution pension plan and a benefit plan of advance retirement payment covering substantially all of its employees.

The subsidiaries have contributory or non-contributory funded pension plans covering substantially all of their employees. Employees whose service with the subsidiaries 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.

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

The subsidiaries accounted for the liability for retirement benefits based on the amounts that would be required if their 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.

According to the enactment of the Defined Contribution Pension Plan Law in October 2001, the Company implemented a defined contribution pension plan in January 2004 by which the former qualified retirement benefit pension plan was terminated. The Company applied accounting treatments specified in the guidance issued by the Accounting Standards Board of Japan ("ASB"). The effect of this transfer increased income before income taxes and minority interests by ¥179 million (\$1,694 thousand) and was recorded as a gain on settlement of qualified retirement benefit pension plan in the consolidated statement of income for the year ended March 31, 2004.

- i. 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.
- j. Research and Development Costs*—Research and development costs are charged to income as incurred.
- k. 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.
- l. 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.
- m. Appropriations of Retained Earnings*—Appropriations of retained earnings are reflected in the consolidated financial statements for the following year upon shareholders' approval.
- n. 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. Diluted net income per share in 2004 is not disclosed because it is anti-dilutive.

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, retroactively adjusted for stock splits.

- o. New Accounting Pronouncements*—In August 2002, the Business Accounting Council issued a Statement of Opinion, "Accounting for Impairment of Fixed Assets," and in October 2003 ASB issued ASB Guidance No. 6, "Guidance for Accounting Standard for Impairment of Fixed Assets." These new pronouncements are 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 new accounting standard requires an entity to review its long-lived assets for impairment whenever events or changes in circumstances indicate that 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.

3. INVENTORIES

Inventories at March 31, 2004 and 2003, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	<u>2004</u>	<u>2003</u>	<u>2004</u>
Merchandise	¥ 11	¥ 72	\$ 104
Work in process	425	661	4,021
Supplies	<u>10</u>	<u>10</u>	<u>95</u>
Total	<u>¥ 446</u>	<u>¥ 743</u>	<u>\$ 4,220</u>

4. INVESTMENT SECURITIES

Investment securities as of March 31, 2004 and 2003, consisted of non-current equity securities.

The carrying amounts and aggregate fair value of investment securities at March 31, 2004 and 2003, were as follows:

	Millions of Yen			
	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
<u>March 31, 2004</u>				
Securities classified as available-for-sale equity securities	¥ 184	¥ 465	¥ 10	¥ 639
<u>March 31, 2003</u>				
Securities classified as available-for-sale equity securities	184	9	16	177
	Thousands of U.S. Dollars			
	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
<u>March 31, 2004</u>				
Securities classified as available-for-sale equity securities	\$ 1,741	\$4,400	\$ 95	\$ 6,046

Available-for-sale securities whose fair value was not readily determinable as of March 31, 2004 and 2003, were as follows:

	Carrying Amount		
	Millions of Yen		Thousands of U.S. Dollars
	<u>2004</u>	<u>2003</u>	<u>2004</u>
Securities classified as available-for-sale equity securities	¥ 1,215	¥ 1,211	\$ 11,496

5. SHORT-TERM AND LONG-TERM DEBT

Short-term and long-term debt at March 31, 2003, consisted of the following:

	<u>Millions of Yen</u>
	<u>2003</u>
Unsecured 2.0% bonds, due June 2004	¥ 700
Total	<u>700</u>
Less current portion	<u>(700)</u>
Long-term debt, less current portion	<u> </u>

The Board of Directors of the Company approved the early redemption of the unsecured 2.0% bonds, due June 2004 on September 4, 2002 and redeemed them on June 13, 2003.

6. EMPLOYEES' RETIREMENT BENEFITS

The liability for employees' retirement benefits at March 31, 2004 and 2003, consisted of the following:

	<u>Millions of Yen</u>		<u>Thousands of</u>
	<u>2004</u>	<u>2003</u>	<u>U.S. Dollars</u>
			<u>2004</u>
Projected benefit obligation	¥ 181	¥ 3,050	\$ 1,713
Fair value of plan assets	(112)	(2,042)	(1,060)
Unrecognized actuarial loss	<u> </u>	<u>(441)</u>	<u> </u>
Net liability	<u>¥ 69</u>	<u>¥ 567</u>	<u>\$ 653</u>

The components of net periodic retirement benefit costs for the years ended March 31, 2004 and 2003, were as follows:

	<u>Millions of Yen</u>		<u>Thousands of</u>
	<u>2004</u>	<u>2003</u>	<u>U.S. Dollars</u>
			<u>2004</u>
Service cost	¥ 322	¥ 366	\$ 3,046
Interest cost	54	65	511
Expected return on plan assets	(14)	(18)	(132)
Recognition of actuarial loss	82	76	776
Contributions to the defined contribution pension plan and the benefit plan of advance retirement payment	<u>67</u>	<u> </u>	<u>634</u>
Net periodic retirement benefit costs	<u>¥ 511</u>	<u>¥ 489</u>	<u>\$ 4,835</u>

The effect of the transfer to the defined contribution pension plan and the benefit plan of advance retirement payment was as follows:

	<u>Millions of Yen</u>	<u>Thousands of</u>
	<u>2004</u>	<u>U.S. Dollars</u>
		<u>2004</u>
Decrease in projected benefit obligation	¥ 3,169	\$ 29,984
Transferred plan assets	(2,231)	(21,109)
Unrecognized actuarial loss	<u>(299)</u>	<u>(2,829)</u>
Decrease in liability for employees' retirement benefits	<u>¥ 639</u>	<u>\$ 6,046</u>

Assumptions used for the year ended March 31, 2003, were set forth as follows:

	<u>2003</u>
Discount rate	2.5%
Expected rate of return on plan assets	1.0%
Recognition period of actuarial gain/loss	5 years

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 employees' portion, which are charged to operations, amounted to ¥295 million (\$2,791 thousand) and ¥295 million for the years ended March 31, 2004 and 2003, respectively. The amounts of plan assets as of March 31, 2004 and 2003, applicable to the Company based on its contribution to the fund, were ¥4,893 million (\$46,294 thousand) and ¥3,671 million, respectively.

7. SHAREHOLDERS' EQUITY

Japanese companies are subject to the Japanese Commercial Code (the "Code"), to which various amendments became effective from October 1, 2001.

The Code was revised whereby common stock par value was eliminated resulting in all shares being recorded 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 as additional paid-in capital, which is included in capital surplus. The Code permits companies, upon approval of the Board of Directors, to issue shares to existing shareholders without consideration as a stock split. Such issuance of shares generally does not give rise to changes within the shareholders' accounts.

The revised Code also provides that an amount at least equal to 10% of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period shall be appropriated as a legal reserve (a component of retained earnings) until such reserve and additional paid-in capital equals 25% of common stock. The amount of total additional paid-in capital and legal reserve that exceeds 25% of the common stock may be available for dividends by resolution of the shareholders. 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 revised Code eliminated restrictions on the repurchase and use of treasury stock allowing Japanese companies to repurchase treasury stock by a resolution of the shareholders at the general shareholders meeting and dispose of such treasury stock by resolution of the Board of Directors. The repurchased amount of treasury stock cannot exceed the amount available for future dividend plus amount of common stock, additional paid-in capital or legal reserve to be reduced in the case where such reduction was resolved at the general shareholders meeting.

The amount of retained earnings available for dividends under the Code was ¥9,367 million (\$88,627 thousand) as of March 31, 2004, based on the amount recorded in the parent company's general books of account. In addition to the provision that requires an appropriation for a legal reserve in connection with the cash payment, the Code imposes certain limitations on the amount of retained earnings available for dividends.

Dividends are approved by the shareholders at a meeting held subsequent to 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 91,000 shares of common stock of the Company. The exercise period of 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 more 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 102,200 shares of common stock of the Company. The exercise period of the options is from October 2003 to June 2013 and the exercise price of the options is ¥2,675.

8. RESEARCH AND DEVELOPMENT COSTS

Research and development costs charged to income were ¥89 million (\$842 thousand) and ¥112 million for the years ended March 31, 2004 and 2003, respectively.

9. 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 42% for the years ended March 31, 2004 and 2003.

On March 31, 2003, a tax reform law concerning enterprise tax was enacted in Japan which changed the normal effective statutory tax rate from 42% to 40.7%, effective for years beginning on or after April 1, 2004. The effect of this change was to decrease deferred tax assets by ¥13 million and increase income taxes—deferred by ¥13 million in the consolidated financial statements for the year ended March 31, 2003.

The tax effects of significant temporary differences which resulted in deferred tax assets and liabilities at March 31, 2004 and 2003, were as follows:

	<u>Millions of Yen</u>		<u>Thousands of U.S. Dollars</u>
	<u>2004</u>	<u>2003</u>	<u>2004</u>
Deferred tax assets:			
Accrued bonuses	¥ 741	¥ 603	\$ 7,011
Accrued social insurance premium	86	85	814
Enterprise tax payable	62	99	587
Software	84	88	795
Retirement allowances for directors and corporate auditors	73	102	691
Membership right	52	62	492
Allowance for doubtful receivable	41		388
Liability for employees' retirement benefits	27	229	255
Investment securities		128	
Other	<u>23</u>	<u>38</u>	<u>217</u>
Total	<u>1,189</u>	<u>1,434</u>	<u>11,250</u>
Deferred tax liabilities:			
Investment securities	65		615
Special reserve for tax-purpose depreciation for personal computers	30	39	284
Other	<u>1</u>		<u>9</u>
Total	<u>96</u>	<u>39</u>	<u>908</u>
Net deferred tax assets	<u>¥ 1,093</u>	<u>¥ 1,395</u>	<u>\$ 10,342</u>

A reconciliation between the normal effective statutory tax rate and the actual effective tax rate for the year ended March 31, 2004, is not disclosed as the difference between them was less than 5% of the normal effective statutory tax rate.

A reconciliation between the normal effective statutory tax rate and the actual effective tax rate reflected in the accompanying consolidated statement of income for the year ended March 31, 2003, was as follows:

Normal effective statutory tax rate	42.0 %
Expenses not deductible for income tax purposes	1.1
Inhabitants taxes—per capita	0.7
Amortization of consolidation goodwill	0.5
Effect of tax rate reduction	0.4
Other—net	<u>0.1</u>
Actual effective tax rate	<u>44.8 %</u>

10. LEASES

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

Total rental expenses for the years ended March 31, 2004 and 2003 were ¥56 million (\$530 thousand) and ¥61 million, respectively, including ¥43 million (\$409 thousand) and ¥46 million of lease payments under finance leases, respectively.

Pro forma information of leased property such as acquisition cost, accumulated depreciation, obligation under finance lease, 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, 2004 and 2003, was as follows:

	Millions of Yen					
	2004			2003		
	Furniture and Fixtures	Software	Total	Furniture and Fixtures	Software	Total
Acquisition cost	¥ 76	¥ 25	¥ 101	¥ 119	¥22	¥ 141
Accumulated depreciation	<u>34</u>	<u>9</u>	<u>43</u>	<u>87</u>	<u>9</u>	<u>96</u>
Net leased property	<u>¥ 42</u>	<u>¥ 16</u>	<u>¥ 58</u>	<u>¥ 32</u>	<u>¥ 13</u>	<u>¥ 45</u>
	Thousands of U.S. Dollars					
	2004					
	Furniture and Fixtures	Software	Total			
Acquisition cost	\$ 719	\$ 236	\$ 955			
Accumulated depreciation	<u>322</u>	<u>85</u>	<u>407</u>			
Net leased property	<u>\$ 397</u>	<u>\$ 151</u>	<u>\$ 548</u>			

Acquisition costs and obligations include the imputed interest expense portion.

Obligations under finance leases:

	Millions of Yen		Thousands of U.S. Dollars
	<u>2004</u>	<u>2003</u>	<u>2004</u>
Due within one year	¥ 22	¥ 20	\$ 208
Due after one year	<u>36</u>	<u>25</u>	<u>341</u>
Total	<u>¥ 58</u>	<u>¥ 45</u>	<u>\$ 549</u>

Depreciation expense including imputed interest expense under finance leases was ¥20 million (\$189 thousand) and ¥26 million for the years ended March 31, 2004 and 2003, respectively.

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

11. 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.

12. NET INCOME PER SHARE

Reconciliation of the differences between basic and diluted net income per share ("EPS") for the year ended March 31, 2003, was as follows:

	Millions of Yen	Thousands of Shares	Yen
<u>Year Ended March 31, 2003</u>	<u>Net Income</u>	<u>Weighted-average Shares</u>	<u>EPS</u>
Basic EPS—Net income available to common shareholders	¥ 1,864	12,473	¥ 149.38
Diluted EPS—Net income for computation	<u>¥ 1,864</u>	<u>12,473</u>	<u>¥ 149.37</u>

13. RELATED PARTY TRANSACTIONS

The Company repurchased almost all the warrants issued with bonds from the Company's nine directors, a corporate auditor and a main shareholder on April 15 and September 17, 2002 and extinguished them on April 18 and September 17, 2002. The total amount of the warrants which were repurchased and extinguished was ¥36 million.

14. SUBSEQUENT EVENTS

a. Appropriations of Retained Earnings

The following appropriations of retained earnings at March 31, 2004, were approved at the Company's shareholders meeting held on June 25, 2004:

	<u>Millions of Yen</u>	<u>Thousands of U.S. Dollars</u>
Year-end cash dividends, ¥25 (\$0.24) per share	¥ 306	\$ 2,895
Bonuses to directors and corporate auditors	60	568

b. Sale of Land and a Building

On April 14, 2004, the Company sold land and a building, which had been used as an employees' dormitory. The sale price and the loss on the sale were ¥133 million (\$1,258 thousand) and ¥141 million (\$1,334 thousand), respectively.

c. Stock Option Plan

At the general shareholders meeting held on June 25, 2004, the Company's shareholders approved the following stock option plan for the Company's directors, corporate auditors and key employees. The plan provides for granting options to directors, corporate auditors and key employees to purchase up to 115,000 shares of the Company's common stock in the period from June 2004 to June 2014. The options will be granted at an exercise price of 105% of the average fair market value of the Company's common stock at the date from 45 days to 16 days before the date of option grant. The Company plans to primarily issue acquired treasury stock upon exercise of the stock options.

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