

2. Consolidated forecasts for December 2004 term

(From January 1, 2004 to December 31, 2004)

	Net sales	Operating income	Ordinary income	Net income
	(Millions of yen)	(Millions of yen)	(Millions of yen)	(Millions of yen)
Interim 2004	9,030	492	445	221
Fiscal 2004	20,032	1,206	1,099	568

(N.b.) Projected net income per share for fiscal 2004: 48.0 yen

The forecasts stated above are based on our current expectations and assumptions prepared using information available at present and subject to various uncertainties. Actual results may differ significantly due to a variety of causes. Please refer to the attached Page 12 for information regarding the preparation of the forecasts.

Group organization

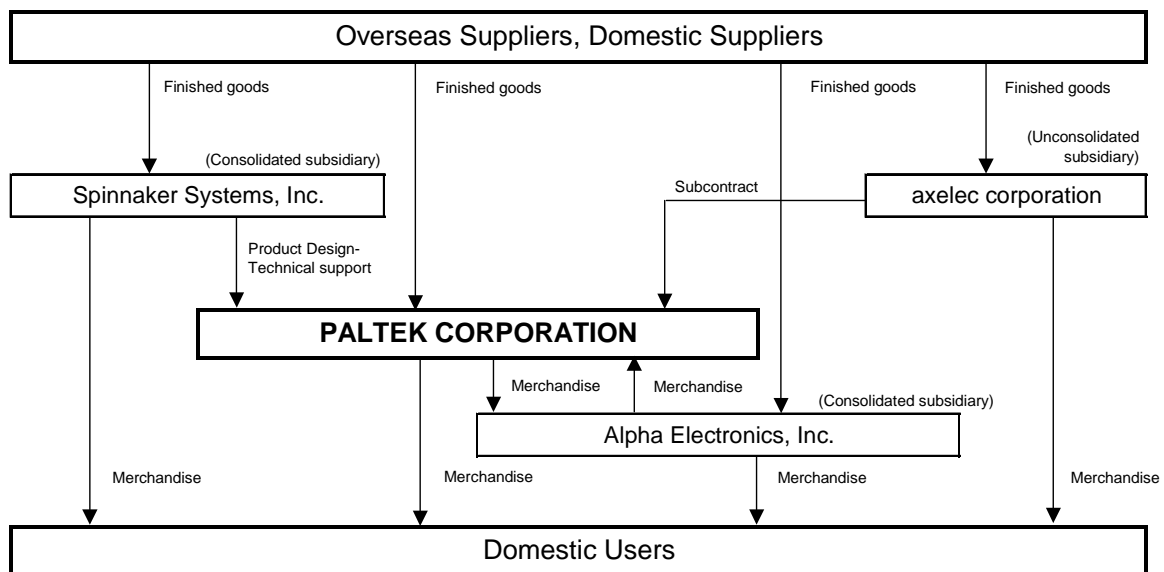
The PALTEK group’s primary business activities are the distribution of semiconductors and design software used in electronics equipment, as well as design support services. The structure of the group and the business relationships among the group companies are illustrated in the diagram below.

On October 31, 2003, the Company dissolved axelec corporation, which it had placed under its control at the end of March 2003. The Company decided that, from the standpoint of operational efficiency, continuation of axelec’s business in this manner would no longer be feasible. axelec corporation is currently being liquidated. Separately, liquidation procedures for HYPER-PALTEK Corporation were completed at the end of November 2003.

Business segment	Business description	Main companies
Semiconductors and related business	Design, development and sales of semiconductor-related products; design-technology support	PALTEK Corporation (PALTEK) Alpha Electronics Inc. (Alpha Electronics) Spinnaker Systems, Inc. (Spinnaker Systems)

(Note)

The “Other” category of business no longer appears in this section because of the liquidation of HYPER-PALTEK Corporation, whose operations constituted the major part of the activities under this category.



(Note) axelec corporation is now undergoing liquidation.

Management policy and operating results

Management policy

1. Basic management policies

The PALTEK group's management philosophy is "cooperative growth with diverse partners." Guided by this philosophy, it aims to create significant social value for all its stakeholders, including customers/suppliers, employees, shareholders, and local communities. Before new technologies or markets are established, the group identifies unique products generated by the world's diverse cultures and works to obtain recognition and acceptance for these products in the Japanese market. Its goal is to become a "strategic partner" with companies developing electronic equipment. Toward that end, it edits these new technologies and products and provides them to customers in the form of "optimum solutions." Through this means, it is aiming to contribute to the development of the "networking industry," as broadly defined.

2. Basic policy regarding the distribution of profits

The PALTEK group recognizes that providing value to shareholders is one of management's primary concerns. Accordingly, its basic policy on dividends will be to continue to make payouts that are appropriate in light of its needs to build a strong operating foundation and to finance future business initiatives. It will do so while endeavoring to enhance financial performance and operating efficiency.

With respect to dividend payouts, the Company will maintain a dividend rate of 10 yen per share. With this as a baseline, it will decide on any future changes by considering the appropriateness of its dividend payout ratio in relation to consolidated and parent company earnings.

3. Medium- to long-term management policies

3-(1) Targeted financial ratios

To provide high-value-added solutions to its customers through a highly efficient operating structure, the PALTEK group will be seeking to achieve as its medium-term goal sales of 50 billion yen and an operating margin of 10%.

3-(2) Medium- to Long-term management strategies

The group will undertake the following three management strategies to achieve these medium-term goals.

1. Strengthening its mainstay PLD solutions business

The ability to respond flexibly to changes in the market environment is a hallmark of programmable logic devices. Because these devices meet the needs of an age that requires "individuality, diversity, quality and speed," they are gradually becoming the

semiconductor of choice for the design and development of electronic equipment that must be brought to market on a timely basis. The PALTEK group has cultivated an ability to provide prompt and knowledgeable technical support and to respond to the detailed needs of a wide variety of projects. By utilizing these abilities, it will continue to promote the expansion of the PLD market.

2. Offering a wider array of analog solutions for digital consumer equipment

PALTEK will provide solutions for the design and production of digital consumer equipment, which has become a new source of value added for electronic equipment manufacturers. The core of such solutions is analog semiconductors, which have become indispensable in the development of digital devices. Basic to the group's success in this area has been its ability to form close relationships with its customers and to provide outstanding technical support. It will continue to develop its solutions business on this basis, while responding to expanding needs for analog semiconductors in product areas such as mobile phones and digital cameras. Simultaneously, the group will aim to implement this strategy in a way that facilitates future expansion among manufacturers of consumer equipment.

3. Developing a wider range of system solutions for newly emerging markets

The growing dissemination of broadband networks is prompting the development of new markets that arise from a fusion of communications, broadcasting, and consumer equipment. To meet the needs in these emerging markets, PALTEK will provide solutions built primarily around application-specific standard products (ASSP*). This will require that it provide not only high levels of knowledge on individual semiconductors to support design activities but also "system solutions" that support product development. This shift will entail that technologies be edited into optimal forms for customers—that they be provided, for example, as modules that combine multiple semiconductors or as equipment-level proposals that are closer to the final product.

ASSP (Application Specific Standard Product): high-performance semiconductors that are dedicated to specific applications.*

3-(3) Issues requiring action from the standpoint of medium-term goals

As new markets come into existence through the fusion of different product areas (communications, broadcasting, consumer equipment, etc.), customers of the PALTEK group are striving to accelerate the development of high-value-added products and to bring products rapidly to market. To meet their needs, the group is aiming to provide "high-value-added solutions based on a highly efficient operational structure." The following is a discussion of the issues that will have to be dealt with to achieve this goal.

- a. Establishing a highly efficient operational foundation: reallocating managerial resources and generating group-wide synergies

To establish a highly efficient operating structure that will support the development of its business, the group is endeavoring to achieve a more efficient allocation of managerial resources. It will measure its progress from two perspectives, operating margins and ROA. In regards to the former, it will endeavor to achieve a steady reduction of operating costs through improvements in various operational flows. In regards to the latter, it will aim to put into practice a “firm approach to management” in which it holds no unnecessary assets and maintains trade receivables and inventories at optimum levels while turning over these assets effectively and efficiently.

In the fiscal year ended December 31, 2003, considerable progress was made in reducing the periods required to collect receivables and in increasing liquidity. We expect these efforts will be reflected in next term business results. Achieving maximum utilization of managerial resources will require that the group tackle these kinds of issues on a group-wide basis.

- b. Providing high-value-added solutions: evolving from design support to development support

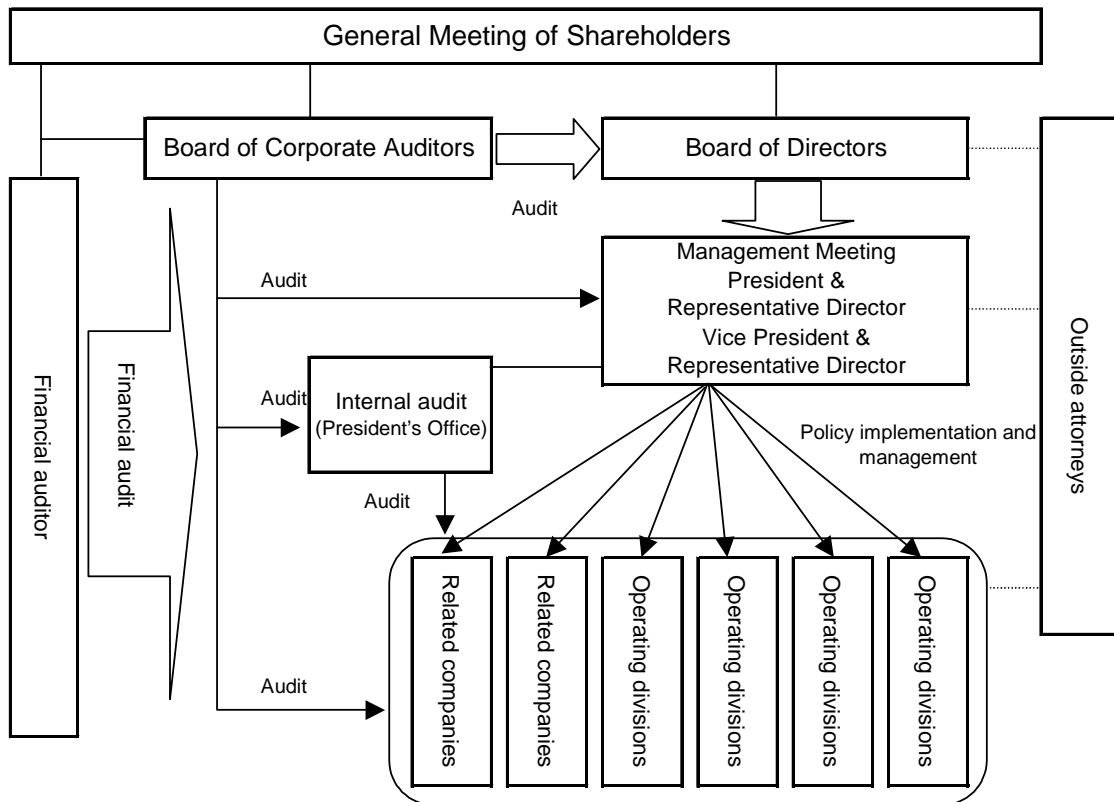
Customers are requiring the group to provide increasingly new and advanced solutions, which entails that it shift from design-support services based on knowledge of individual semiconductors to the provision of modules that combine multiple semiconductors or of proposals at the equipment level. Taking this requirement a step further, the PALTEK group believes that its task must be to evolve into a company that provides support for the development of unique and original electronic equipment.

Toward that end, it will widen and deepen the array of products that it handles in areas with the potential for creating new markets. And to fully exploit the technologies and products that it obtains, it will take steps to sustain an improvement in its technological capabilities through the hiring and training of exceptionally talented engineers. To create new business models, it will participate in cooperative ventures with start-up companies that possess originally developed technologies. Currently, the group is involved in such ventures in the areas of advanced semiconductors and network security. It will work systematically hereafter to translate these technologies into new businesses launches.

To generate the synergies necessary to tackle these issues, the group established a corporate marketing division during the year to December 2003. This will enable it to integrate information originating from workplaces throughout its organization and to accelerate its acquisition of new products.

4. Basic philosophy regarding corporate governance and corporate governance-related policies

4-(1) The PALTEK group views corporate governance as a managerial control aimed at maximizing corporate value for all stakeholders and at putting its philosophy of symbiosis into practice. Its basic aim for corporate governance is to “respond rapidly to changes in the market environment and to enhance the transparency of management.” In light of this policy, the PALTEK group has established the following system of governance.



a. Composition of Board of Directors and Board of Corporate Auditors

The Company’s Board of Directors is structured with the aim of providing more effective and appropriate solutions to customers. Accordingly, members of the board bring to their jobs not only advanced technical knowledge but also varied perspectives and experiences, which are derived from their varied backgrounds as former customers of the firm or members of other industries. To further enhance transparency and efficiency and assure greater objectivity in governance, one highly experienced outside directors have been elected to the board.

The Company uses a system of corporate auditors. The Board of Corporate Auditors contributes to greater independence and transparency of management through its inclusion of auditors from outside the firm and its emphasis on the independence of auditors from Company directors.

b. Operational execution and oversight

Each month, the companies in the PALTEK group hold management meetings attended by directors, the heads of the respective divisions, and the chief executives of group companies. The purpose of the meetings is to provide a means for quickly resolving the issues faced by each division and for making management decisions from a more all-embracing standpoint. The meetings are attended by the standing corporate auditor and by corporate auditor, who express their opinions and make reports when appropriate. Policy management is used to assure that policies adopted at management meetings are implemented throughout the organization. And by holding Board of Directors' meetings on the same day as management meetings, the system is set up to encourage rapid judgments on important managerial issues.

In addition to these regularly scheduled meetings, the Company convenes meetings on an ad hoc basis, whenever required. The ability to meet in this way enables the Company to digest information rapidly and to link this information to rapid decision-making and action. In this way, the PALTEK group is endeavoring to respond flexibly to a rapidly and unpredictably changing market situation.

c. Internal controls

To enhance the overall quality of management, the Company has also established a mechanism for internal audits, which are conducted by the staff of the President's Office acting on behalf of the president. Through this mechanism, the Company endeavors to maintain continuous improvement in all of the Company's activities and systems, including general operations. Assessing reasonableness and efficiency, the staff reviews such activities and systems in light of management objectives, and offers evaluations, suggestions and guidance from an impartial standpoint.

d. Involvement of attorneys and CPAs

Attorneys advise the Company on issues of compliance. In addition to biannual financial audits by outside auditing firms, the Company also consults with CPAs at appropriate times on issues of accounting.

4-(2) Specific actions taken during the past year to improve corporate governance

a. Strengthening adaptability to change and improving crisis management capabilities

In January 2003, Director Hiroyuki Takasaki was elected Vice President and Representative Director. Mr. Takasaki's appointment was designed to enhance the group's ability to make rapid management decisions in response to future changes in the operational environment and to strengthen its crisis management capabilities. This appointment will enable the Company to make more rapid decisions based on a clearer

understanding of the conditions of the workplace and will especially contribute to improved operational efficiency.

In other actions, we enhanced our ability to audit operations from a wider variety of perspectives by electing an additional outside auditor to Board of Corporate Auditors. The newest appointee, who assumed office from the current term, brings to the board substantial experience in semiconductor technology and manufacturing and in developing related ventures. The appointment also fits in with our long-standing policy of selecting persons to the Board of Auditors who have substantial experience outside the Company.

b. Strengthening a sense of responsibility to shareholders

In April 2003, the group established a “directors’ stock holding system” which emphasizes that success is “linked to shareholder profits” and that directors are responsible for results.

Our grants of stock options to employees have had as their aim “establishing linkages with shareholder profitability” and “enhancing a sense of participation in management.” However, given recent conditions in the equity markets and the level of the Company’s share price, and considering the potential impact of options on existing shareholder value, we have concluded that they are not an optimal approach to compensation under current conditions. Consequently, we will be terminating all further grants of options to employees in the current fiscal year. In place of options, we will be increasing incentives for employees to purchase the Company’s stock and endeavoring to realize the foregoing objectives through stock purchasing plans.

5. Other important issues related to company management

There are no other important issues to report related to the company’s management.

Financial Performance

1. Overview of the period to December 31, 2003

1-(1) Operating results

The Japanese economy in the year ended December 31, 2003 started off in a lackluster fashion but showed clear signs of recovery beginning in the fall. The early weakness, which lasted through the summer, reflected a tailing off of export momentum to Asia and the US in response to the war in Iraq and the outbreak of SARS, as well as a sharp decline in domestic demand because of the cold summer. The trend turned positive in September, when exports to Asia and the US recovered and demand for digital consumer equipment reaccelerated.

The electronics industry, on the other hand, saw new markets emerge through the fusion of communications, broadcasting, and consumer equipment—a trend aptly symbolized by the commencement of terrestrial digital broadcasting during the year. In response, our customers, the development engineers working for electronics equipment manufacturers, were increasingly pressed to expedite the development and commercialization of equipment that offers new added value.

The PALTEK group sells semiconductors and design-support services to such customers. By utilizing the knowledge and experience that it has cultivated through involvement in data communications and other markets, it will endeavor to meet the needs of these customers by making proposals in new markets and expanding the depth and breadth of the products it can offer. At the same time, the group has been actively selling its mainstay PLD products to new customers, spurred by the daily expansion of the areas in which PLDs are applied. Against this background, the group recorded brisk sales to manufacturers of industrial equipment and equipment for use in terrestrial digital broadcasting. Also noteworthy was the performance of Alpha Electronics Inc., which primarily markets analog semiconductors. Based on the close relationships that it has developed with customers through everyday contact, Alpha Electronics has steadily increased its sales amid buoyant demand for consumer equipment, such as mobile phones and digital cameras, and for industrial equipment.

Consequently, the PALTEK group achieved the following results for the year ended December 31, 2003 (percentage changes, year-on-year): net sales of 17,502 million yen (+12.1%); operating income of 1,111 million yen (+68.3%); ordinary income of 1,258 million yen (+64.9%); and net income of 632 million yen (+2,815.8%).

(Note)

As a result of a change in its fiscal year end, the above results include 15 months' worth of sales and earnings for Alpha Electronics Inc. (for the period from October 2001 to December 2002).

1-(2) Cash flow

Cash and cash equivalents increased by 38 million yen compared to the balance at the beginning of the term to stand at 1,179 million yen as of the end of the fiscal year.

The various components of cash flow during the period and factors affecting increases or decreases are summarized below.

(Net cash from operating activities)

Cash provided by operating activities amounted to 249 million yen (compared with 343 million yen in cash used in the year-earlier period), reflecting the recognition of 1,232 million yen in net income before taxes and other adjustments and the faster collection of trade receivables, which offset an increase in inventory assets and a decrease in trade payables.

(Net cash from investing activities)

Cash used in investing activities amounted to 230 million yen (compared with 94 million yen cash provided in the year-earlier period). This reflected expenditures for the acquisition of investment and marketable securities and of shares in related companies.

(Net cash from financing activities)

Cash provided by financing activities amounted to 56 million yen (compared with 211 million yen in cash used in the year-earlier period). This reflected an increase in borrowings, which offset payments of dividends.

Trends in cash flow-related indices for the corporate group are shown below.

	December 31, 2002	December 31 2003
Equity ratio	67.4%	70.3%
Equity ratio based on market prices	41.6%	106.6%
Years required to redeem liabilities	-	7.1 years
Interest-coverage ratio	-	12.3

(Notes)

1. *Equity ratio: Shareholders' equity/total assets*

2. *Equity ratio based on market prices: Market capitalization/total assets*

3. *Years required to redeem liabilities: Interest-bearing liabilities/operating cash flow*

4. *Interest-coverage ratio: Operating cash flow/interest payments*

(1) *Each of the foregoing ratios is calculated on the basis of consolidated financial data.*

(2) *"Market capitalization" is calculated by multiplying the share price on the final day of the fiscal year by the number of shares outstanding on the same day.*

(3) *For "operating cash flow," we use the figure for "cash flow from operations" in the consolidated statement of cash flows. "Interest-bearing liabilities" refers to all liabilities on the consolidated balance sheet on which interest payments are made. For "interest payments," we use the figure for "interest expenses" in the consolidated statement of cash flows.*

(4) *In the 2002 fiscal year, "years required to redeem liabilities" and "interest-coverage ratio" are not shown because cash flow from operations was negative.*

2. Outlook for the year ending December 2004

Despite the risk of further yen appreciation, we expect the recovery in the Japanese economy to persist, driven by exports and abundant demand for digital consumer appliances. In the electronics industry, we continue to foresee an expansion of new markets that result from the fusion of communications, broadcasting, and consumer equipment.

In this environment, applications for PLD products are expanding due to the introduction of high-performance PLDs, which now offer excellent versatility at low cost. We expect these new devices to enter a period of vigorous market penetration hereafter. By holding down gross profit margins, the group will endeavor to expand its base of customers, while at the same time it devotes significant resources to furthering support activities for customers in growth areas. While maintaining its primary emphasis in the Kansai region, the group will also expand its marketing of analog semiconductors in the Kanto area.

Consequently, we are forecasting the following results for the full year to December 31, 2004: net sales of 20,032 million yen; operating income of 1,206 million yen; ordinary income of 1,099 million yen; and net income of 568 million yen. On a non-consolidated basis, we are forecasting: net sales of 16,100 million yen; operating income of 1,120 million yen; ordinary income of 1,030 million yen; and net income of 597 million yen.

Consolidated balance sheet

Thousands of yen	December 31, 2002	%	December 31, 2003	%	Year-on-year change
Current assets					
Cash and bank deposits	1,187,549		1,216,737		29,188
Notes and accounts receivable	4,670,434		4,251,387		(419,047)
Inventories	3,411,841		4,107,826		695,984
Deferred tax assets	368,490		257,195		(111,294)
Others	584,477		966,875		382,398
Allowance for doubtful accounts	(7,382)		(6,421)		960
	<u>10,215,410</u>	87.1	<u>10,793,601</u>	90.0	<u>578,190</u>
Fixed assets					
Tangible fixed assets					
Buildings	161,714		135,462		
Accumulated depreciation	<u>77,169</u>		<u>69,246</u>		
	84,545		66,215		(18,330)
Vehicle equipment	1,884		1,884		
Accumulated depreciation	<u>1,719</u>		<u>1,777</u>		
	165		106		(58)
Furniture and fixtures	377,949		388,274		
Accumulated depreciation	<u>258,860</u>		<u>291,127</u>		
	119,089		97,147		(21,942)
Land	<u>37,228</u>		<u>14,736</u>		<u>(22,491)</u>
	241,028	2.1	178,205	1.5	(62,822)
Intangible fixed assets					
Goodwill	39,509		7,972		(31,536)
Others	<u>212,987</u>		<u>181,372</u>		<u>(31,615)</u>
	252,496	2.1	189,345	1.6	(63,151)
Investments and other assets					
Investment securities	142,266		329,251		186,985
Long-term loans receivable	53,365		-		(53,365)
Deferred tax assets	524,845		144,767		(380,077)
Others	359,749		360,429		680
Allowance for doubtful accounts	<u>(65,868)</u>		<u>(8,346)</u>		<u>57,522</u>
	<u>1,014,357</u>	8.7	<u>826,102</u>	6.9	<u>(188,255)</u>
Total fixed assets	<u>1,507,883</u>	12.9	<u>1,193,653</u>	10.0	<u>(314,229)</u>
Total assets	<u>11,723,294</u>	100.0	<u>11,987,254</u>	100.0	<u>263,960</u>

PALTEK CORPORATION

Thousands of yen	December 31, 2002	%	December 31, 2003	%	Year-on-year change
Current liabilities					
Notes and accounts payable	1,292,742		929,258		(363,483)
Short-term bank loans	1,524,572		1,716,670		192,098
Income taxes payable	201,017		81,939		(119,078)
Accrued bonuses	43,226		55,751		12,524
Others	405,663		351,519		(54,143)
	<u>3,467,221</u>	29.6	<u>3,135,137</u>	26.1	<u>(332,083)</u>
Long-term liabilities					
Long-term bank loans	16,670		-		(16,670)
Liability for employees' retirement benefits	10,603		33,712		23,109
Liability for directors' and corporate auditors' retirement benefits	248,492		260,047		11,555
Others	47,475		74,590		27,115
	<u>323,240</u>	2.7	<u>368,350</u>	3.1	<u>45,109</u>
Total liabilities	<u>3,790,461</u>	32.3	<u>3,503,487</u>	29.2	<u>(286,973)</u>
Minority interests	31,239	0.3	54,370	0.5	23,131
Shareholders' equity					
Capital stock	1,335,487	11.4	1,335,487	11.1	-
Capital surplus	2,694,389	23.0	2,694,389	22.5	-
Retained earnings	3,891,354	33.2	4,391,414	36.6	500,059
Net - unrealized gains (losses) on securities	(17,570)	(0.2)	12,041	0.1	29,611
Treasury stock	(2,067)	(0.0)	(3,935)	(0.0)	(1,867)
	<u>7,901,593</u>	67.4	<u>8,429,397</u>	70.3	<u>527,803</u>
Total liabilities, minority interests and shareholders' equity	<u>11,723,294</u>	100.0	<u>11,987,254</u>	100.0	<u>263,960</u>

Consolidated statement of income

Thousands of yen	Year ended December 31, 2002	%	Year ended December 31, 2003	%	Year-on-year change
Net sales	15,614,300	100.0	17,502,490	100.0	1,888,190
Cost of sales	11,530,872	73.8	13,331,486	76.2	1,800,614
Gross profit	4,083,427	26.2	4,171,003	23.8	87,576
Selling, general and administrative expenses					
Provision for doubtful accounts	9,595		-		
Salary	979,239		888,060		
Provision for bonuses	59,631		45,018		
Provision for directors' and corporate auditors' retirement benefits	18,598		24,786		
Rent expense	460,886		416,192		
Amortization of goodwill	235,612		31,504		
Others	1,659,468		1,654,055		
	3,423,031	21.9	3,059,616	17.5	(363,415)
Operating income	660,395	4.3	1,111,387	6.3	450,992
Nonoperating income					
Interest income	1,121		759		
Dividend income	261		201		
Foreign exchange gain	179,795		214,418		
Gain on sale of investment securities	4,289		2,940		
Amortization of negative goodwill	79		41		
Others	43,977		9,743		
	229,526	1.4	228,104	1.3	(1,421)
Nonoperating expenses					
Interest expenses	22,176		22,586		
Provision for doubtful accounts	57,522		-		
Equity in losses of associated companies	7,947		-		
Loss on surrender of insurance policy	14,094		-		
Commissions paid	14,000		17,771		
Payment for settlement of lawsuit	-		22,500		
Losses on assignment of receivables	-		9,398		
Others	11,512		9,224		
	127,253	0.8	81,481	0.4	(45,772)
Ordinary income	762,667	4.9	1,258,011	7.2	495,343
Extraordinary income					
Gain on sales of fixed assets	4		503		
Reversal of allowance for doubtful accounts	-		919		
Gain on reversal of expenses for dissolution of joint venture	-		39,883		
	4	0.0	41,305	0.2	41,301

PALTEK CORPORATION

Thousands of yen	Year ended December 31, 2002	%	Year ended December 31, 2003	%	Year-on-year change
Extraordinary losses					
Loss on sales of fixed assets	-		8,700		
Loss on devaluation of fixed assets	22,585		-		
Loss on disposal of fixed assets	10,632		12,033		
Loss on devaluation of investment securities	24,753		38,181		
Amortization of goodwill	508,674		-		
Loss on liquidation of subsidiaries and associated companies	386,307		7,545		
	<u>952,953</u>	6.1	<u>66,460</u>	0.4	(886,492)
Income (loss) before income taxes and minority interests	(190,281)	(1.2)	1,232,856	7.0	1,423,138
Income taxes - current	474,436		87,176		
Income taxes - deferred	(661,451)		470,216		
	<u>(187,015)</u>	(1.2)	<u>557,393</u>	3.2	744,408
Minority interest in net income (loss) of consolidated subsidiaries	(24,947)	(0.2)	43,265	0.2	68,213
Net income	<u>21,681</u>	0.2	<u>632,197</u>	3.6	610,515

Consolidated statement of retained earnings

Thousands of yen	December 31, 2002	December 31, 2003	Year-on-year change
Capital surplus			
Balance, beginning of period	2,694,389	2,694,389	-
Balance, end of period	2,694,389	2,694,389	-
Retained earnings			
Balance, beginning of period	3,990,100	3,891,354	(98,745)
Increase			
Net income	21,681	632,197	
	21,681	632,197	610,515
Decrease			
Cash dividends	118,384	118,362	
Directors' bonuses	2,042	13,775	
	120,427	132,138	11,711
Balance, end of period	3,891,354	4,391,414	500,059

Consolidated statement of cash flows

Thousands of yen	Year ended December 31, 2002	Year ended December 31, 2003	Year-on-year change
Net cash from operating activities			
Income (loss) before taxes and minority interests	(190,281)	1,232,856	1,423,138
Depreciation	155,365	132,420	(22,944)
Amortization of goodwill	744,207	31,463	(712,744)
Equity in net losses of associated companies	7,947	-	(7,947)
Loss on devaluation of fixed assets	22,585	-	(22,585)
Loss on devaluation of investment securities	24,753	38,181	13,428
Increase (decrease) in allowance for doubtful accounts	54,177	(960)	(55,137)
Increase (decrease) in accrued bonuses	(408)	12,524	12,932
Increase (decrease) in liability for employees' retirement benefits	(2,930)	23,109	26,039
Increase in liability for directors' and corporate auditors' retirement benefits	18,598	11,555	(7,043)
Interest and dividends income	(1,382)	(960)	421
Interest expense	22,176	22,586	409
Foreign exchange gain	(476)	-	476
Foreign exchange loss	-	1,687	1,687
Gain on sales of investment securities	(4,289)	(2,940)	1,349
Loss (gain) on sales of investment securities	83	3,417	3,334
Gain on sales of tangible fixed assets	(4)	(503)	(498)
Loss on sales of tangible fixed assets	-	8,700	8,700
Loss on disposal of tangible fixed assets	8,309	6,168	(2,141)
Loss on disposal of intangible fixed assets	2,322	5,865	3,542
Payment for settlement of lawsuit	-	22,500	22,500
Gain on reversal of expenses for dissolution of joint venture	-	(39,883)	(39,883)
Loss on liquidation of subsidiaries and associated companies	322,614	7,545	(315,068)
Decrease (increase) in accounts receivable - trade	(802,605)	419,278	1,221,884
Decrease (increase) in inventories	(542,784)	(696,762)	(153,978)
Increase (decrease) in accounts payable - trade	212,253	(363,483)	(575,737)
Increase in consumption tax receivable	(80,085)	(165,268)	(85,182)
Decrease in advance payments	176,519	11,016	(165,503)
Decrease in advances	-	(100,582)	(100,582)
Bonus paid to directors and corporate auditors	(2,400)	(14,010)	(11,610)
Others	107,307	73,299	(34,007)
	<u>251,572</u>	<u>678,819</u>	<u>427,247</u>
Interest and dividends received	70	153	82
Interest paid	(22,369)	(20,361)	2,007
Payment for settlement of lawsuit	-	(22,500)	(22,500)
Proceeds from reversal of previously budgeted for dissolution of joint venture	-	39,883	39,883
Payments on liquidation of subsidiaries and associated companies	(273,755)	(6,341)	267,414
Income taxes paid	(298,743)	(419,967)	(121,223)
	<u>(343,225)</u>	<u>249,686</u>	<u>592,912</u>

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Thousands of yen	Year ended December 31, 2002	Year ended December 31, 2003	Year-on-year change
Net cash from investing activities			
Increase in time deposits	(43,033)	(21,000)	22,032
Decrease in time deposits	20,000	30,033	10,033
Purchases of investment securities	(98)	(171,032)	(170,934)
Proceeds from sales of investment securities	99,916	6,169	(93,747)
Payments for acquisition of affiliate's equity	(11,246)	(20,000)	(8,754)
Purchases of tangible fixed assets	(43,534)	(28,609)	14,925
Proceeds from sales of tangible fixed assets	9,282	26,257	16,975
Purchases of intangible fixed assets	(30,717)	(39,687)	(8,970)
Increase in investment in partnership	(10,749)	(13,575)	(2,826)
Proceeds from sale of investment to partnership	8,054	4,423	(3,631)
Payments for loans	-	(61,500)	(61,500)
Proceeds from collections of loans	5,845	72,748	66,903
Proceeds from surrender of insurance policy	120,435	-	(120,435)
Increase in other investments	(46,319)	(21,765)	24,553
Decrease in other investments	16,604	7,296	(9,308)
	94,442	(230,243)	(324,685)
Net cash from financing activities			
Net increase (decrease) in short term bank loans	(90,402)	211,160	301,562
Proceeds from long term bank loans	4,140	-	(4,140)
Repayment of long term bank loans	(25,490)	(35,732)	(10,241)
Purchases of treasury stock	(1,332)	(1,867)	(534)
Proceeds from issuance of common stock	20,000	-	(20,000)
Cash dividends paid to minority shareholders	(665)	(166)	498
Cash dividends paid	(117,610)	(117,291)	318
	(211,359)	56,102	267,462
Effect of exchange rate changes on cash and cash equivalents	(7,138)	(7)	7,130
Net increase (decrease) in cash and cash equivalents	(467,281)	75,538	542,819
Cash and cash equivalents at beginning of period	1,652,477	1,141,516	(510,960)
Decrease in cash and cash equivalents due to decrease in consolidated subsidiaries	(43,679)	(37,317)	6,361
Cash and cash equivalents at end of period	1,141,516	1,179,737	38,220

Material information regarding preparation of consolidated financial statements

Item	December 31, 2002	December 31, 2003
1. Scope of consolidation	<p>(1) Number of consolidated subsidiaries: 3</p> <p>Names of consolidated subsidiaries:</p> <p style="padding-left: 20px;">Alpha Electronics, Inc. Spinnaker Systems, Inc. axelec corporation</p> <p>Cygnat Technologies, Inc., treated as a consolidated subsidiary in the previous year, was excluded from consolidation results starting with the second half of this year as liquidation procedures have progressed and the Company became insignificant for the purpose of consolidation.</p> <p>(2) Names of unconsolidated subsidiaries:</p> <p style="padding-left: 20px;">Cygnat Technologies, Inc. AlphaMetric, Inc. Alpha Electron (HK) Co., Ltd.</p> <p>(Reasons for exclusion from consolidation)</p> <p style="padding-left: 20px;">Scale of operations of these unconsolidated subsidiaries are small and their total assets, net sales, net income (as calculated by the equity method) and retained earnings (as calculated by the equity method) have no significant impact on the consolidated financial statements. Alpha Electron (HK) Co., Ltd. was established during this consolidated accounting period.</p>	<p>(1) Number of consolidated subsidiaries: 2</p> <p>Names of consolidated subsidiaries:</p> <p style="padding-left: 20px;">Alpha Electronics, Inc. Spinnaker Systems, Inc.</p> <p>axelec corporation treated as a consolidated subsidiary in the previous year, was excluded from consolidation results starting with the end of this year as liquidation procedures have progressed and the Company became insignificant for the purpose of consolidation.</p> <p>(2) Names of unconsolidated subsidiaries:</p> <p style="padding-left: 20px;">Alpha Electron (HK) Co., Ltd. axelec corporation</p> <p>(Reasons for exclusion from consolidation)</p> <p style="padding-left: 20px;">Scale of operations of these unconsolidated subsidiaries are small and their total assets, net sales, net income (as calculated by the equity method) and retained earnings (as calculated by the equity method) have no significant impact on the consolidated financial statements.</p>
2. Application of equity method	<p>(1) Number of associated companies to which the equity method is applicable: 1</p> <p>Name of associated company to which the equity method is applicable:</p> <p style="padding-left: 20px;">HYPER-PALTEK Corporation</p> <p>(2) Name of unconsolidated subsidiary to which the equity method is not applicable:</p> <p style="padding-left: 20px;">Alpha Electron (HK) Co., Ltd.</p> <p>(Reasons for exclusion from consolidation)</p> <p style="padding-left: 20px;">Unconsolidated subsidiaries to which the equity method is not applicable have no significant impact on the consolidated net income and consolidated retained earnings. In addition, unconsolidated subsidiaries all combined do not have a significant impact on the consolidated results.</p>	<p>(1) Number of associated companies to which the equity method is applicable: -</p> <p>In the year to December 31, 2002, the Company used the equity method to account for its holdings in HYPER-PALTEK Corporation. Because HYPER-PALTEK Corporation was liquidated during the year to December 31, 2003, however, it is no longer included in this section.</p> <p>(2) Name of unconsolidated subsidiary to which the equity method is not applicable:</p> <p style="padding-left: 20px;">Same as previous year</p> <p>(Reasons for exclusion from consolidation)</p> <p style="padding-left: 20px;">Same as previous year</p>
3. Accounting period of consolidated subsidiaries	<p>Until the previous accounting period, Alpha Electronics, Inc., one of the Company's consolidated subsidiaries, had its annual accounting period ending on September 30. Effective this consolidated accounting period, Alpha Electronics, Inc. changed its accounting period to end on December 31. The balance sheet as of December 31, 2002, statement of income and statement of cash flows for the 15-month period between October 1, 2001 and December 31, 2002 were used for consolidation.</p>	<p>All subsidiaries have fiscal-year ends that are the same as the day of consolidated closing.</p>

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Item	December 31, 2002	December 31, 2003
4. Significant accounting policies		
(1) Valuation of material assets	<p>(A) Securities:</p> <p>Available-for-sale securities:</p> <p>Available-for-sale securities with market values:</p> <p style="padding-left: 20px;">Stated at fair market value as of the balance sheet date.</p> <p style="padding-left: 20px;">(Unrealized gains and losses are reported in the shareholders' equity section of the consolidated balance sheet. Sales cost is calculated using the moving average method)</p> <p>Available-for-sale securities without market values:</p> <p style="padding-left: 20px;">Stated at moving average cost.</p> <p>(B) Derivatives:</p> <p>As a principle, derivatives are stated at fair market value.</p> <p>(C) Inventories:</p> <p>(a) Merchandise:</p> <p style="padding-left: 20px;">Stated by moving average cost (last purchased price method used by some of the consolidated subsidiaries)</p> <p>(b) Supplies:</p> <p style="padding-left: 20px;">Stated by last purchased price method</p>	<p>(A) Securities:</p> <p>Available-for-sale securities:</p> <p>Available-for-sale securities with market values:</p> <p style="padding-left: 20px;">Same as previous year</p> <p>Available-for-sale securities without market values:</p> <p style="padding-left: 20px;">Same as previous year</p> <p>(B) Derivatives:</p> <p style="padding-left: 20px;">Same as previous year</p> <p>(C) Inventories:</p> <p>(a) Merchandise:</p> <p style="padding-left: 20px;">Same as previous year</p> <p>(b) Supplies:</p> <p style="padding-left: 20px;">Same as previous year</p>
(2) Depreciation of fixed assets	<p>(A) Tangible fixed assets:</p> <p>Declining balance method (Note: Buildings, excluding ancillary facilities, acquired on or after April 1, 1998 are depreciated based on the straight line method)</p> <p>Useful lives are as follows:</p> <p style="padding-left: 20px;">Buildings: 10 - 45 years</p> <p style="padding-left: 20px;">Vehicle equipment: 6 years</p> <p style="padding-left: 20px;">Furniture and fixtures: 5 - 15 years</p> <p>(B) Intangible fixed assets:</p> <p>The straight line method.</p> <p>Useful life of the software for internal use is 5 years.</p>	<p>(A) Tangible fixed assets:</p> <p style="padding-left: 20px;">Same as previous year</p> <p>(B) Intangible fixed assets:</p> <p style="padding-left: 20px;">Same as previous year</p>
(3) Allowances	<p>(A) Allowance for doubtful accounts:</p> <p>An allowance for doubtful accounts is provided to cover possible losses from bad debts. The allowance with respect to non-classified loans/receivables is calculated based on historical default rates. For classified loans/receivables, the Company and its domestic consolidated subsidiaries states an amount deemed to be unrecoverable based on the prospect of recovery of individual loans/receivables.</p> <p>(B) Accrued bonuses:</p> <p>Reserves are provided to cover the estimated amount of bonuses payable to employees.</p> <p>(C) Liability for employees' retirement benefits:</p> <p>The amount estimated to represent the potential liability, as of the end of this consolidated accounting period, is calculated by taking retirement benefit liabilities and the estimated value of pension assets into consideration.</p> <p>(D) Liability for directors' and corporate auditors' retirement benefits:</p> <p>An allowance is provided by the Company and a domestic subsidiary to cover the estimated amount of retirement benefits payable to directors and corporate auditors.</p>	<p>(A) Allowance for doubtful accounts:</p> <p style="padding-left: 20px;">Same as previous year</p> <p>(B) Accrued bonuses:</p> <p style="padding-left: 20px;">Same as previous year</p> <p>(C) Liability for employees' retirement benefits:</p> <p style="padding-left: 20px;">Same as previous year</p> <p>(D) Liability for directors' and corporate auditors' retirement benefits:</p> <p>An allowance is provided by the Company and a subsidiary to cover the estimated amount of retirement benefits payable to directors and corporate auditors.</p>

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Item	December 31, 2002	December 31, 2003
(4) Translation of foreign currency denominated assets and liabilities into Japanese yen	Foreign currency denominated monetary rights and obligations are translated into Japanese yen using the prevailing spot exchange rate as of the consolidated balance sheet date. Translation differences are recognized as foreign exchange gains or losses. Foreign currency denominated monetary obligations that are subject to hedging by forward foreign exchange contracts are translated into Japanese yen using the actual contracted exchange rate.	Same as previous year
(5) Lease transactions	Finance leases for which ownership does not transfer to the lessees are not capitalized, and are accounted for in the same manner as operating leases.	Same as previous year
(6) Hedge accounting	(A) Hedge accounting method: The Company adopts deferred hedge accounting. Derivatives that meet the criteria for hedging accounting are accounted for using deferral hedge accounting, which requires unrealized gains or losses to be deferred as liabilities or assets. Forward foreign exchange contracts that are effective hedges are accounted for using the allocation method, which requires recognized foreign currency receivables or payables to be translated using the corresponding foreign exchange contract rates.	(A) Hedge accounting method: Same as previous year
	(B) Hedging instruments and targets: Hedging instruments: Forward foreign exchange contract Hedging targets: Foreign currency denominated monetary liabilities and transactions scheduled to be denominated in a foreign currency.	(B) Hedging instruments and targets: Hedging instruments: Same as previous year Hedging targets: Same as previous year
	(C) Hedging policies: Derivative transactions are used only by the Company. Eligible hedging instruments are approved at the Board of Directors Meeting at the time of the preparation of the import plan.	(C) Hedging policies: Same as previous year
	(D) Method for assessing effectiveness of hedges: Accumulated changes in the cash flow of hedged items are compared to the accumulated changes in the cash flow of hedging instruments on a semi-annual basis. The effectiveness of hedging is evaluated by taking the degree of changes in cash flows of the hedged item and hedging transaction into consideration.	(D) Method for assessing effectiveness of hedges: Same as previous year
(7) Other	(A) Treatment of consumption tax: Transactions subject to consumption tax are recorded at amounts exclusive of consumption taxes.	(A) Treatment of consumption tax: Same as previous year
	-	(B) Per share information Starting on April 1, 2002, companies have been required to apply ASBJ 2, "Financial Standards Relating to Net Earnings Per Share," and ASBJ Interpretation 4, "Guidelines for Applying Financial Standards Relating to Net Earnings Per Share." Consequently, the Company's financial statements for the term ended March 2003 have been prepared in accordance with this new standard and new guideline. A comment on the impact of this change appears under "Note regarding per share information."

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Item	December 31, 2002	December 31, 2003
5. Valuation of assets and liabilities of consolidated subsidiaries	The assets and liabilities of the subsidiaries are evaluated using the fair value at the time the respective subsidiaries were initially consolidated.	Same as previous year
6. Amortization of goodwill	Goodwill is amortized in equal amounts over a five year period. In the event that the amount is minimal, the amount is expensed in the year in which the adjustment is made. With regard to the goodwill recognized at the time of the acquisition of Spinnaker Systems, Inc. shares by the Company, the entire amount of unamortized balance as of the close of this accounting period was fully expensed and recognized as an extraordinary loss.	Goodwill is amortized in equal amounts over a five year period. In the event that the amount is minimal, the amount is expensed in the year in which the adjustment is made.
7. Consolidated statement of retained earnings	The Consolidated statement of retained earnings is based on the officially confirmed appropriation schedules of the consolidated subsidiaries for the year.	Same as previous year
8. Cash and cash equivalents	Included in "cash and cash equivalents" in the statements of cash flows are cash in hand, demand deposits, and short-term investments with maturities arriving in three months from the date of acquisition that are readily convertible to cash and are subject to minimum risk of price fluctuations.	Same as previous year

Changes in method of presentation

Thousands of yen	
December 31, 2002	December 31, 2003
(Consolidated statement of income)	(Consolidated statement of income)
1. Through the year ended December 31, 2001, "losses on surrender of insurance policy" had been included in the "others" category of nonoperating expenses. But because such expenses exceeded 10 percent of all nonoperating expenses during the current report period, they are shown as a separate category. For comparison "losses on surrender of insurance policy" amounted to ¥8,867 thousand in the year ended December 31, 2001.	1. Through the year ended December 31, 2002, "losses on assignment of receivables" had been included in the "others" category of nonoperating expenses. But because such expenses exceeded 10 percent of all nonoperating expenses during the current report period, they are shown as a separate category. For comparison purposes "losses on assignment of receivables" amounted to ¥6,484 thousand in the year ended December 31, 2002.
2. Through the year ended December 31, 2001, "commissions paid" had been included in the "interest expenses" category of nonoperating expenses. But because such expenses exceeded 10 percent of all nonoperating expenses during the current report period, they are shown as a separate category. For comparison purposes "commissions paid" amounted to ¥3,742 thousand in the year ended December 31, 2001.	2. -
(Consolidated statement of cash flows)	(Consolidated statement of cash flows)
1. Through the year ended December 31, 2001, "decrease (increases) in consumption tax receivable" had been included in the "others" category of cash flow. However, because of the increasing materiality of the amounts, they are now shown as a separate category. For comparison purposes "decrease (increases) in consumption tax receivable" amounted to ¥45,720 thousand in the year ended December 31, 2001.	1. Through the year ended December 31, 2002, "(increases) decrease in advance payments" had been included in the "others" category of cash flow. However, because of the increasing materiality of the amounts, they are now shown as a separate category. For comparison purposes "increases (decrease) in advance payments" amounted to ¥(23,016 thousand) in the year ended December 31, 2002.
2. Through the year ended December 31, 2001, "proceeds from surrender of insurance policy" had been included in the "decrease in other investments" category of cash flow. However, because of the increasing materiality of the amounts, they are now shown as a separate category. For comparison purposes "proceeds from surrender of insurance policy" amounted to ¥32,392 thousand in the year ended December 31, 2001.	2. -

Additional information

December 2002 term

(Presentation of consolidated balance sheets and consolidated statements of retained earnings)

The shareholders' equity section of the consolidated balance sheets and consolidated statements of retained earnings are presented in a manner consistent with the Regulations Concerning Consolidated Financial Statements as revised in accordance with the provisions of the second paragraph of the Supplementary Provision to "The Cabinet Office Ordinance Regarding Partial Revision of the Regulations Concerning Terminology, Forms and Preparation of Consolidated Financial Statements (The Cabinet Office Ordinance No.11 on March 26, 2002)"

(Treasury stock and reversal of legal reserves)

Effective this consolidated accounting period, the Company has adopted the "Accounting Standard for Treasury Stock and Reduction of Legal Reserves" (Financial Accounting Standards No.1). The change on the consolidated operating results for the consolidated accounting period under review has no effect.

Notes (Consolidated balance sheet)

Thousands of yen	December 31, 2002		December 31, 2003
1. Amount of notes receivable discounted	126,842	1. Amount of notes receivable discounted	45,435
Amount of accounts receivable-trade offered as collateral	797,649	Amount of accounts receivable-trade offered as collateral	17,945
*2. Investment in unconsolidated subsidiaries	1,794	*2. Investment in unconsolidated subsidiaries	1,796
3. For more efficient financing of working capital, the Company has entered into overdraft and loan commitment agreements with a single bank. As of the end of the fiscal year, it had the following unused lines of credit on these loan facilities.		3. For more efficient financing of working capital, the Company has entered into overdraft and loan commitment agreements with a single bank. As of the end of the fiscal year, it had the following unused lines of credit on these loan facilities.	
Overdraft and loan commitment agreements	4,000,000	Overdraft and loan commitment agreements	2,000,000
Amounts drawn down	-	Amounts drawn down	700,000
Unused lines of credit	4,000,000	Unused lines of credit	1,300,000
As of December 31, 2002, the Company had the following unused lines of credit on these loan facilities			
Overdraft and loan commitment agreements	4,000,000		
Amounts drawn down	-		
Unused lines of credit	4,000,000		
*4. -		*4. Total number of shares outstanding	
		Common stock	11,839,399 shares
*5. Number of treasury shares held		*5. Number of treasury shares held	
Common stock	3,127 shares	Common stock	5,519 shares

(Consolidated statement of income)

Thousands of yen	December 31, 2002		December 31, 2003
*1. -		*1. Total research and development expenses	
		Research and development expenditures included in selling, general and administrative expenses	68,599
*2. Breakdown of gains on sale of fixed assets		*2. Breakdown of gains on sale of fixed assets	
Furniture and fixtures	4	Buildings	226
		Furniture and fixtures	24
		Land	251
*3. -		*3. Breakdown of loss on sale of fixed assets	
		Buildings	3,218
		Land	5,482
*4. Breakdown of loss on devaluation of planned sales of fixed assets whose book values have substantially declined		*4. -	
Buildings	2,347		
Land	20,238		
*5. Breakdown of loss on disposal of fixed assets		*5. Breakdown of loss on disposal of fixed assets	
Buildings	4,141	Buildings	4,534
Furniture and fixtures	4,168	Furniture and fixtures	1,634
Software	2,322	Software	5,865
*6. Breakdown of loss on liquidation of subsidiaries		*6. -	
Loss on sale of fixed assets	2,589		
Loss on devaluation of fixed assets	112,300		
Loss on devaluation of inventories	71,322		
Other liquidation expenses	223,663		
Reversal of foreign exchange translation adjustment	(23,569)		

(Consolidated statement of cash flows)

“Cash and bank deposits” on the consolidated balance sheet and “cash and cash equivalents” on the consolidated statement of cash flows are reconciled as follows:

Thousands of yen	December 31, 2002	December 31, 2003
Cash and deposits	1,187,549	1,216,737
Time deposits with maturities longer than 3 months	(46,033)	(37,000)
Cash and cash equivalents	1,141,516	1,179,737

Lease transactions

1. Finance lease where ownership does not transfer the lessee

(1) Acquisition cost equivalent, accumulated depreciation equivalent and book value equivalent of leased properties as of the end of this consolidated accounting period.

Thousands of yen	December 31, 2002	December 31, 2003
Furniture and fixtures		
Acquisition cost equivalent	28,000	38,834
Accumulated depreciation equivalent	9,333	16,489
Book value equivalent	18,666	22,345
Software		
Acquisition cost equivalent	560,391	560,391
Accumulated depreciation equivalent	266,143	378,221
Book value equivalent	294,248	182,170
Total		
Acquisition cost equivalent	588,391	599,226
Accumulated depreciation equivalent	275,476	394,710
Book value equivalent	312,915	204,515

(2) Future minimum lease payments

Thousands of yen	December 31, 2002	December 31, 2003
Within one year	118,350	122,644
Over one year	201,066	87,811
	319,416	210,455

(3) Lease expenses and pro forma data as to depreciation expenses and interest expenses are summarized as follows

Thousands of yen	December 31, 2002	December 31, 2003
Lease payments	123,190	124,031
Depreciation equivalent	117,678	118,442
Interest expense equivalent	6,967	4,946

(4) Calculation of depreciation equivalent

Depreciation is based on the straight line method over the lease term of the leased assets with no residual value.

(5) Calculation of interest expense equivalent

The interest expense equivalent is calculated by taking the difference between the total amount of lease payment and acquisition cost equivalent of the leased property, and amortizing it over the lease period based on the interest method.

2. Operating leases - future minimum lease payments

Thousands of yen	December 31, 2002	December 31, 2003
Within one year	-	1,198
Over one year	-	4,695
	-	5,894

Securities

1. Available-for-sale securities with market values

Thousands of yen	December 31, 2002			December 31, 2003		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Fair market value exceeds acquisition cost						
Stocks	13,370	16,909	3,538	20,102	40,122	20,019
Bonds						
JGB, Local government bonds	-	-	-	-	-	-
Corporate bonds	-	-	-	-	-	-
Others	-	-	-	-	-	-
Others	27,785	28,759	974	55,527	64,384	8,857
	41,156	45,669	4,512	75,630	104,506	28,876
Fair market value does not exceeds acquisition cost						
Stocks	9,977	8,209	(1,767)	359	170	(188)
Bonds						
JGB, Local government bonds	-	-	-	-	-	-
Corporate bonds	-	-	-	-	-	-
Others	-	-	-	-	-	-
Others	82,429	47,142	(35,286)	25,418	22,365	(3,052)
	92,406	55,352	(37,053)	25,778	22,536	(3,241)
	133,563	101,022	(32,541)	101,408	127,043	25,635

Notes:

During the term ended December 31, 2002 an impairment loss in the amount of 3,665 thousand yen, and during the term ended December 31, 2003 an impairment loss in the amount of 28,181 thousand yen was recognized for available-for-sale securities with market values.

During the term ended December 31, 2003, except when it is reasonably clear that the possibility of a recovery in market prices exists, the Company recognizes impairment charges in the following instances: when the market price of a security has declined to less than 50% of its purchase price as of the final day of the fiscal year; or when the market price of a security has declined by between 30% and 50% of its purchase price as of the final day of the fiscal year and has remained at these levels for the past two years—and, when the Company determines in such cases that there is no possibility of a recovery in market prices.

2. Available-for-sale securities sold during the period

Thousands of yen					
December 31, 2002			December 31, 2003		
Amount sold	Total gain on sales	Total loss on sales	Amount sold	Total gain on sales	Total loss on sales
109,720	4,289	83	8,747	2,940	3,417

3. Major components of debt and equity securities without market values

Thousands of yen	December 31, 2002	December 31, 2003
Available-for sale securities		
Unlisted securities (excluding OTC-traded stocks)	39,450	200,412
	39,450	200,412

Derivative transactions

1. Matters related to condition of transactions

December 31, 2002	December 31, 2003
<p>(1) Types of derivatives used by the Group</p> <p>Forward foreign exchange contracts are the only derivative instruments used by the Group. Among the Group companies, the Company is the only user of derivative instruments. The following information therefore relates to transactions engaged by the Company.</p>	<p>(1) Types of derivatives used by the Group</p> <p>Same as previous year</p>
<p>(2) Transaction policy and purpose of use</p> <p>Derivative instruments are used by the Company in the normal course of its business in order to effectively manage the risk arising from fluctuations in foreign exchange rates.</p> <p>Forward foreign exchange contracts are used to hedge the risk of foreign exchange fluctuations with respect to future scheduled transactions denominated in foreign currencies as well as foreign currency denominated obligations. Forward foreign exchange contracts are not used for speculative purposes or for the purpose of realizing short-term trading gains.</p> <p>Derivative transactions are accounted for using hedge accounting. Details with respect to the method of hedge preparation of consolidated financial statements" (Section 4. "Significant accounting policies", Paragraph (6) "Hedge accounting")</p>	<p>(2) Transaction policy and purpose of use</p> <p>Same as previous year</p>
<p>(3) Risks associated with derivative transactions</p> <p>Derivative instruments used by the Company involve credit risk and market risk. Credit risk refers to the risk of default by the counter party of the derivative transaction concerned. Market risk refers to potential loss that may be realized by the fluctuation in foreign exchange rates. The Company believes that credit risk associated with the transactions entered into by the Company is minimal as counter parties are all highly rated domestic financial institutions.</p> <p>The forward foreign exchange contracts entered into by the Company are exposed to future fluctuations in foreign exchange rates. However, it should be noted that these forward exchange contracts are engaged for the purpose of hedging the foreign currency denominated obligations on the Company's balance sheets, and that changes in the value of derivatives offset the changes in the value of hedged obligations.</p>	<p>(3) Risks associated with derivative transactions</p> <p>Same as previous year</p>
<p>(4) Risk management</p> <p>Hedging policies are determined at the Board of Directors' Meeting at the time of the formulation of the import schedule. Transactions are executed by the Finance Team, Finance/Legal Group, Operational Service Division based on the policies determined by the Board with specific transactional approval by the director in charge of the Division. The Finance Team prepares a position report in order to monitor and analyze outstanding transactions and to report to the director in charge.</p>	<p>(4) Risk management</p> <p>Hedging policies are determined at the Board of Directors' Meeting at the time of the formulation of the import schedule. Transactions are executed by the Finance Group, Operational Service Division based on the policies determined by the Board with specific transactional approval by the director in charge of the Division. The Finance Group prepares a position report in order to monitor and analyze outstanding transactions and to report to the director in charge.</p>

2. Matters related to estimated fair value of transactions

December 2002 and 2003 term

No details are provided herein as these transactions are for hedging purpose only.

Retirement benefits

1. The retirement benefit program adopted

The Company has an employees' pension fund and a tax-qualified pension plan, both of which are defined benefit plans. Our domestic consolidated subsidiaries have lump-sum retirement payment plans and mutual funds for retirement allowances for medium and small companies.

The Company has joined the welfare pension fund for the computer industry association, a jointly established contributory plan, which is prescribed in the article 33 of the Accounting Standards for Retirement Benefits.

Total amount of the plan assets for the Company as of the December 31, 2002 was 179,995 thousand yen and 225,017 thousand yen as December 31, 2003.

2. Retirement benefit obligations

Thousands of yen	December 31, 2002	December 31, 2003
Projected benefit obligations	(89,695)	(141,715)
Fair value of plan assets	86,674	108,002
Net amount stated in the consolidated B/S	(3,021)	(33,712)
Prepaid pension cost	7,581	-
Liability for employees' retirement benefits	(10,603)	(33,712)

3. Pension and severance costs

Thousands of yen	December 31, 2002	December 31, 2003
Retirement benefit costs		
Service cost	14,915	53,911
Contribution to the jointly established welfare pension fund	20,756	22,709
Contribution to the mutual funds for retirement allowances for medium and small companies	2,463	1,660
Special retirement benefit	8,878	1,353
Retirement benefit costs	47,014	79,634

4. Assumptions used in the accounting for retirement benefit obligations

	December 31, 2002	December 31, 2003
Method of computation of projected benefit obligation	The simplified method is used in calculating the projected benefit obligation.	Same as previous year

Tax effect accounting

Thousands of yen	December 31, 2002		December 31, 2003
1. A breakdown of deferred tax assets and liabilities are noted below		1. A breakdown of deferred tax assets and liabilities are noted below	
Deferred tax assets		Deferred tax assets	
Loss on valuation of inventories	27,893	Loss on valuation of inventories	20,347
Allowance for bad debts in excess of tax limit	27,091	Accrued bonuses in excess of tax limit	20,224
Liability for retirement benefits to directors' and corporate auditors'	104,068	Liability for employees' retirement benefits	12,973
Loss on devaluation of investment securities	15,586	Liability for retirement benefits to directors' and corporate auditors'	105,261
Revaluation loss on investment securities	15,563	Loss on devaluation of investment securities	30,514
Loss on liquidation of subsidiaries and associated companies	660,950	Loss on liquidation of subsidiaries and associated companies	41,045
Loss carry forward	34,641	Loss carry forward	224,281
Accrued enterprise tax	17,862	Others	23,355
Others	45,493		478,003
	949,152	Valuation allowance	(44,217)
Valuation allowance	(38,927)		433,786
	910,224		
Deferred tax liabilities		Deferred tax liabilities	
Revaluation gain on investment securities	(2,764)	Enterprise-tax refund receivable	(19,635)
Others	(14,124)	Revaluation gain on investment securities	(11,706)
	(16,888)	Others	(480)
Net deferred tax assets	893,335		(31,822)
		Net deferred tax assets	401,963
		Net amounts of deferred tax assets are included in the following consolidated balance sheet accounts.	
		Current assets - deferred tax assets	257,195
		Fixed assets - deferred tax assets	144,767
2. Reconciliation between the statutory tax rate and the effective tax rate		2. Reconciliation between the statutory tax rate and the effective tax rate	
Statutory tax rate	42.00%	Statutory tax rate	42.00%
(Adjustments)		(Adjustments)	
Entertainment expenses, etc. non deductible portion	(5.62)%	Entertainment expenses, etc. non deductible portion	0.73%
Amortization of goodwill	(164.27)%	Amortization of goodwill	1.07%
Inhabitants tax	(3.33)%	Inhabitants tax	0.52%
Effect of applying equity method	(1.75)%	Adjustment to reduction of deferred tax assets as of the end of the term, because of changes in tax rates	0.43%
Loss on liquidation of subsidiaries	23.74%	Effect of the increase in valuation allowances	0.55%
Effect of the increase in valuation allowances	205.80%	Others	(0.09)%
Others	1.71%	Effective income tax rate	45.21%
Effective income tax rate	98.28%		

Thousands of yen	December 31, 2002	December 31, 2003
3.	-	3. The normal effective statutory tax rate used in calculations of deferred tax assets and liabilities have been affected by an amendment to the Local Tax Law, which provides for the assessment of enterprise taxes based on size of business after April 1, 2004. In accordance with this amendment, the Company applies different tax rates to the temporary differences recognized as of the end of the fiscal year to December 31, 2003. For temporary differences that will be reversed during the fiscal year to December 31, 2004, it applies the tax rates in effect prior to the amendment; for temporary differences that will be reversed after January 1, 2005, it applies the new tax rates. This change in tax rates has resulted in a reduction in deferred tax assets of ¥5,029 thousand as of the end of the fiscal year to December 31, 2003 (net of deferred tax liabilities), an increase in valuation differences on other investment securities of ¥288 thousand, and an increase in corporate tax adjustments of ¥5,317 thousand.

Segment information

Business segment information

December 2002 term

Information by business segment is omitted as the semi-conductor-related business accounts for more than 90% of the total consolidated sales, operating income and total assets.

December 2003 term

In the fiscal year ended December 31, 2003, the Company stopped consolidating Cygnet Technologies, Inc., a provider of “communications systems equipment.” Beginning in this reporting period, therefore, the PALTEK group has operated in only one segment, the semiconductor-related segment (semiconductor-related sales and semiconductor-related design). Consequently, there is no information to report in this section.

Geographic segment information

December 2002 term

Information by geographic segment is omitted as the domestic business accounts for more than 90% of the total sales and total assets.

December 2003 term

Through the fiscal year ended December 31, 2002, Cygnet Technologies, Inc. operated in the North American market. When the Company stopped consolidating Cygnet Technologies, Inc. the group was left with no subsidiaries operating outside of Japan and no significant overseas branches. Consequently, this section is no longer applicable.

Overseas sales

December 2002 and 2003 term

Overseas sales information is omitted as it accounts for less than 10% of the total sales.

Related party transactions

December 2002 term

December 31, 2002; Thousands of yen	Address	Capital or investment	Line of business	% of voting rights held (held by others)	Relationship		Type of transaction	Value of transactions	Accounting classification	Balance at term end
					Shareholder and director	Business relationship				
Subsidiary										
Cygnnet Technologies, Inc.	Texas, USA	USD 8,255,000	Design and development of network equipment and software	Direct 100.0	1	-	Lending of funds	492,625	-	-

(Note)

Cygnnet Technologies, Inc. is currently being liquidated and is no longer material to the group's operations. The Company thus stopped consolidating Cygnnet as of the end of the six-month period to June 2003. The loan noted above is being used primarily to repay loans that had been guaranteed by the Company. Because the Company believes that there is no possibility of this loan being recovered, it has recognized it as a loss and it no longer appears on the balance sheet.

December 2003 term

N/A

Per share-related financial information

Yen	December 31, 2002	December 31, 2003
Net assets per share	667.57	709.55
Net income per share	1.83	50.65
Although the Company has issued warrants as stock options, it does not provide a figure for net income per share after adjustment for residual securities because there are currently no premiums on the warrants.		There is no entry for diluted net profit per share for the six-month term ended September 30, 2003 because the Company had no residual securities capable of diluting earnings. The Company began applying ASBJ 2, "Financial Standards Relating to Net Earnings Per Share," and ASBJ Interpretation 4, "Guidelines for Applying Financial Standards Relating to Net Earnings Per Share," during the consolidated fiscal year to March 2003. If this new standard and set of guidelines had been applied to the results of the previous consolidated fiscal year, the Company would have reported the following per-share figures:
		Net assets per share 666.41
		Net income per share 0.67

(Note) The basic facts underlying calculations of net income per share are as follows.

Thousands of yen	December 31, 2002	December 31, 2003
Net income per share		
Net income	-	632,197
Amount not attributable to common shareholders	-	32,709
(Of which, amount paid out as bonuses to directors pursuant to Statement of Appropriation of Net Income)	-	[32,709]
Net income related to common stock	-	599,488
Average number of shares outstanding during term (shares)		11,835,295
Residual securities which were not included in calculations of net income per share after adjustment for residual securities because they had no dilutive effect.	-	(Warrants based on Article 280-19 of the Old Commercial Code) 4 types of warrants (number of shares to be issued through exercise of warrants: 539,600 shares) (Stock acquisition rights based on Articles 280-20 and 280-21 of the Commercial Code) 1 type, 800 stock acquisition rights (number of shares to be issued through the exercise of stock acquisition rights: 80,000 shares)

Significant subsequent events

N/A

Purchases, Orders Received and Sales

1. Purchases

Purchases made during the term ended December 31, 2003 are as follows:

Thousands of yen	December 31, 2002		December 31, 2003		Change from the previous year (%)	
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)
Semiconductor business	12,046,785	100.0	13,949,652	100.0	1,902,866	15.8
Communications equipment business	416	0.0	-	-	(416)	(100.0)
	12,047,201	100.0	13,949,652	100.0	1,902,450	15.8

(Notes)

- Consumption tax is not included in the above figures.
- In the fiscal year ended December 31, 2003, the Company stopped consolidating Cygnet Technologies, Inc., a provider of "communications systems equipment." Consequently, the PALTEK group currently operates only a semiconductor-related business.

2. Orders received

Orders received during the term ended December 31, 2003 as follows:

Thousands of yen	December 31, 2002		December 31, 2003		Change from the previous year (%)	
	Orders received	Backlog	Orders received	Backlog	Orders received	Backlog
Semiconductor business	16,446,698	1,730,974	16,985,092	1,213,575	538,393	(517,398)
Communications equipment business	480	-	-	-	-	-
	16,447,178	1,730,974	16,985,092	1,213,575	538,393	(517,398)

(Notes)

- Consumption tax is not included in the above figures.
- In the fiscal year ended December 31, 2003, the Company stopped consolidating Cygnet Technologies, Inc., a provider of "communications systems equipment." Consequently, the PALTEK group currently operates only a semiconductor-related business.

3. Sales

Sales during the term ended December 31, 2003 as follows:

Thousands of yen	December 31, 2002		December 31, 2003		Change from the previous year (%)	
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)
Semiconductor business	15,613,820	100.0	17,502,490	100.0	1,888,670	12.1
Communications equipment business	480	0.0	-	-	(480)	(100.0)
	15,614,300	100.0	17,502,490	100.0	1,888,190	12.1

(Notes)

- Consumption tax is not included in the above figures.
- In the fiscal year ended December 31, 2003, the Company stopped consolidating Cygnet Technologies, Inc., a provider of "communications systems equipment." Consequently, the PALTEK group currently operates only a semiconductor-related business.
- Sales by major customers and the ratio to total sales for the last two accounting periods are as follows:

Thousands of yen	December 31, 2002		December 31, 2003	
	Amount	Ratio (%)	Amount	Ratio (%)
NEC Corporation	2,406,727	15.4	1,820,853	10.4

(Note) Consumption tax is not included in the above figures.