



## **PALTEK CORPORATION**

### **Summary of Financial Statements for the term ended December 31, 2004**

**(UNAUDITED)**

**NOTES:**

All information has been prepared in accordance with generally accepted accounting principles in Japan. Amounts shown in this accounting report and in the attached material have been rounded down to omit fractions less than one thousand yen. This document is an English translation of the Japanese Financial Statement (Kessan Tanshin) which was filed at stock exchange in Japan on February 14, 2005.

Company Name : PALTEK CORPORATION    Head Office : Kanagawa, JAPAN  
Security Code No : 7587    URL : <http://www.paltek.co.jp/>  
Representative : Tadahito Takahashi, President  
Contact : Tadashi Ito, Director, General Manager of Operational Service  
                  Division and Environment  
Telephone : +81-45-477-2000  
Date of Board of Directors' Meeting: February 14, 2005  
US GAAP : Not adopted



## (2) Consolidated financial position

	Total assets (Millions of yen)	Shareholders' equity (Millions of yen)	Shareholders' equity ratio %	Shareholders' equity per share (Yen)
December 31, 2004	12,744	8,711	68.4	740.13
December 31, 2003	11,987	8,429	70.3	709.55

(Note) Number of shares issued and outstanding at the end of term (consolidated):

December 2004 term: 11,742,332 shares

December 2003 term: 11,833,880 shares

## (3) Consolidated cash flows

	Net cash from operating activities (Millions of yen)	Net cash from investing activities (Millions of yen)	Net cash from financing activities (Millions of yen)	Cash and cash equivalents at end of term (Millions of yen)
Fiscal 2004	1,273	(22)	(18)	2,412
Fiscal 2003	249	(230)	56	1,179

## (4) Scope of consolidation and application of the equity method

Number of consolidated subsidiaries:

2

Number of unconsolidated subsidiaries accounted for by the equity method:

Number of associated companies accounted for by the equity method:

## (5) Changes in scope of consolidation and in application of the equity method

Consolidation (new): (elimination):

Equity method (new): (elimination):

## 2. Consolidated forecasts for December 2005 term

(From January 1, 2005 to December 31, 2005)

	Net sales (Millions of yen)	Operating income (Millions of yen)	Ordinary income (Millions of yen)	Net income (Millions of yen)
Interim 2005	8,819	190	165	92
Fiscal 2005	20,900	865	804	463

(N.b.) Projected net income per share for fiscal 2005: 39.43 yen

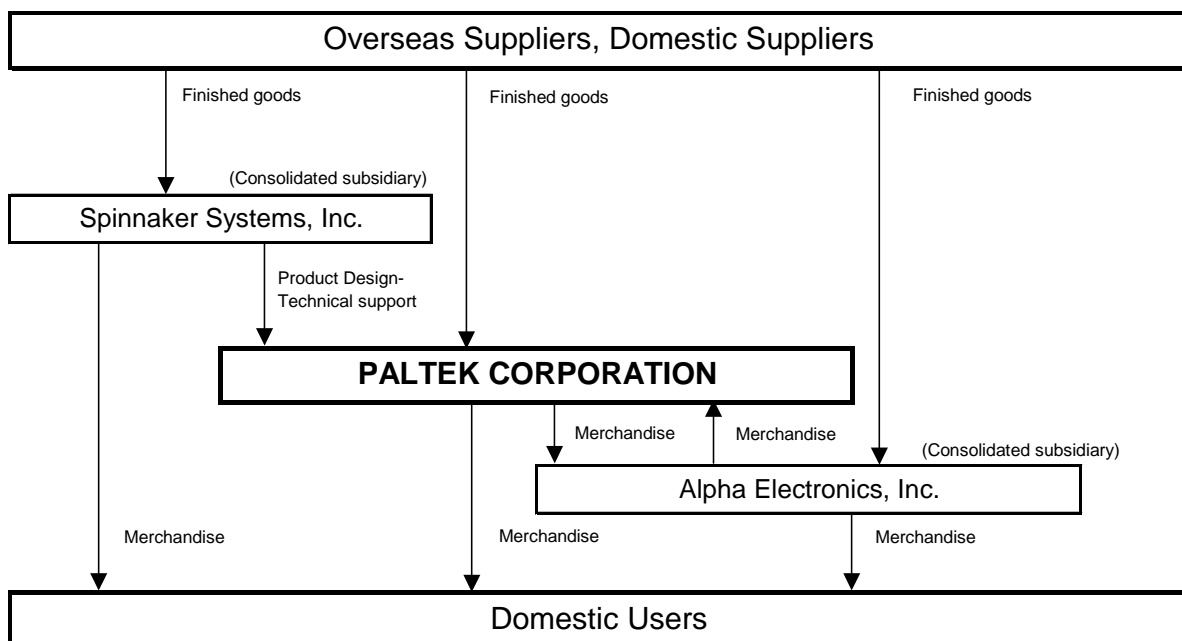
*The forecasts stated above are based on our current expectations and assumptions prepared using information available at present and subject to various uncertainties. Actual results may differ significantly due to a variety of causes. Please refer to the attached Page 15 for information regarding the 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.

Separately, liquidation procedures for axelec corporation were completed at the end of July 2004.

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)



## 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. The group's customers are developers of electronic equipment, who are dealing with electronic technologies and market needs that change and evolve on a daily basis. The group's aim is to become a "strategic partner" of such companies. Toward that end it identifies innovative products that are emerging around the world and provides them to its customers along with technical support. In this way, it aims to generate high values and to foster cooperative growth for all of its stakeholders.

#### **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**

##### (1) Targeted financial ratios

To provide high-value-added solutions to its customers through a highly efficient operating structure, the PALTEK group is seeking to achieve as its medium-term goal sales of 50,000 million yen and an operating margin of 10%.

##### (2) Medium- to long-term management strategies

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

a. Strengthening its mainstay PLD solutions business

Programmable logic devices (PLDs) are semiconductors that give customers the flexibility to adapt to changes in the market environment. By using PLDs, development engineers can change their designs any number of times as required by the situation. This shortens the time necessary to develop high-value-added devices and enables companies to introduce products to the market without incurring excessive risks in their initial investments. Previously, because of prices, PLDs were used primarily in the development of prototypes. Today, with technological innovation PLDs have dramatically improved chip functionality and performance as well as price competitiveness. Now, PLDs are finding their way into more and more end products. These expanding uses began with the adoption of PLDs for mass-produced models of high-priced machinery such as communications and industrial equipment and continue more recently with their incorporation into high-volume digital consumer goods. Having cultivated an ability to provide prompt and knowledgeable technical support and to respond to the detailed needs of a wide variety of projects, the PALTEK group is well prepared to promote the expansion of the PLD market.

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

Analog semiconductors are an essential part of the accelerating shift toward digitalized household equipment and appliances. Based on the strong relationship that it has established with its customers, the PALTEK group will continue to provide solutions to manufacturers of household and industrial equipment that meet their growing needs for analog semiconductors in mobile phones, digital cameras and other products. At the same time, it will aim to build on its success in this business hereafter by expanding its reach among a wider range of customers in the consumer electronics industry.

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

The growing dissemination of broadband networks is prompting the emergence 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) Issues requiring action from the standpoint of medium-term goals

As new markets come into existence through the convergence 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: expanding scale of operations and enhancing management capabilities

To establish a highly efficient operating structure that will support the development of its business, the PALTEK group will have to expand its operational scale and improve its management capabilities. It will use operating profit margins and ROA as measuring sticks to monitor progress toward these goals.

In addition to expanding its scale of operations, the group will continue to make improvements in operating efficiency and endeavor to reduce operating costs. With PLDs entering a take-off phase as a result of technological innovation, the group will take steps to expand sales of these and other existing products as a means of enhancing the efficiency of sales activity and expanding operating profit margins. In this regard, it will also focus on identifying new products that are capable of generating significant synergies with PLDs. On the other hand, it will aim to increase ROA by sustaining the improvements that it continued to make in its balance sheet during the fiscal year—specifically, in the areas of reducing collection periods for receivables, of increasing the liquidity of receivables, and of maintaining optimum inventory levels.

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 will entail shifting 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. The enhanced performance and higher speeds of the electronic devices developed in recent years have further complicated the tasks of design and development, forcing development engineers to deal with issues such as intricate power supply controls and heat generated by components. In light of this situation, the group believes that it must induce a shift toward supporting development at the level of substrates and equipment, in addition to providing support services for semiconductors.

Toward this end, the group will endeavor to broaden and deepen its coverage of technologies with the potential of creating new markets. And, to continue to offer total solutions based on this expanded product range, it will focus on hiring and training engineering talent that generates the knowledge to sustain high-value-added solutions.

#### **4. Risk-related factors**

The following is a list of issues that could affect the financial performance and financial standing of the PALTEK group. Recognizing the reality of such risks, the group intends to take steps to prevent their occurrence and to develop effective responses if such events come to pass. This section includes forward-looking statements, which are based on judgments made as of the date of the announcement of the group's preliminary financial results for the year ended December 2004.

(1) Risk factors resulting from a dependence on semiconductors for specific uses

The customers of the PALTEK group comprise principally companies in the Japanese electronic industry. The financial performance of the group, therefore, is affected by demand for products in its customers' industries and by capital investment trends, as well as by cyclical economic fluctuations that occur in the semiconductor industry as a whole. In response to these risks, the group is implementing changes in its structure of earnings which will allow it to deal effectively with such fluctuations. Notwithstanding such efforts, however, sharp and sudden changes in business conditions in the Japanese electronics industry and changes in demand patterns in the electronics industry could have an impact on the group's financial results.

## (2) Dependence on a specific number of suppliers

The group's principal suppliers are Altera International Ltd. and National Semiconductor Japan, Ltd., with which it has entered into distribution agreements. In the fiscal year ended December 2004, these companies accounted for 72.0% and 15.7%, respectively, of the group's total procurements. Although the group's relationships with these suppliers have been stable, any change in their distribution policies or reorganization of their distribution channels could make it difficult to continue the relationships. In that event, the group's financial results could be affected.

## (3) Regarding security breaches that result in the loss of informational assets

The PALTEK group possesses informational assets that are an important tool in its sales strategy. The Company has endeavored to prevent breaches in the security surrounding this information through a variety of "soft" and "hard" measures, including strengthening its control over information security through ISMS certification\*, increasing employees' awareness of the importance of protecting information, and limiting the number of persons authorized to access these assets. If, however, despite the Company's best efforts, information falls into other hands due to unforeseen events, the Company's financial performance could suffer from the resulting loss of public trust in the PALTEK group or from other factors such as the need to pay indemnification for damages.

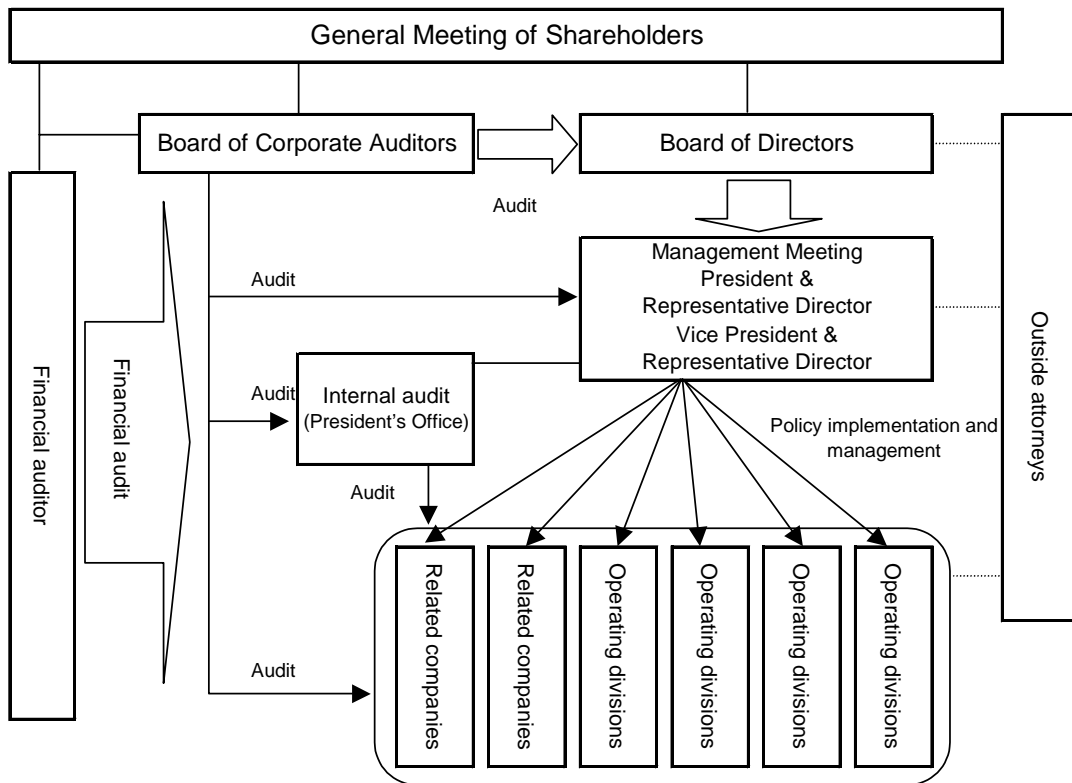
*(ISMS Certification\*: Accredited by the Japan Information Processing Development Corporation in accordance with ISO standards)*

## (4) Impact on profitability from fluctuations in exchange rates

In the fiscal year ended December 2004, the PALTEK group relied on overseas sources for 80.0% of its procurements. Hence, fluctuations in exchange rates could have an impact on transactions conducted in foreign currencies. The group has adopted a variety of measures to minimize these risks and to avoid such impacts. However, such measures cannot guarantee the elimination of all foreign exchange risks. Consequently, sudden and rapid fluctuations in foreign exchange markets could have an impact on the group's financial performance and financial standing.

**5. Basic philosophy regarding corporate governance and corporate governance-related policies**

- (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 "kyosei" (cooperative growth) 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 dramatically changing market situation.

c. Internal controls

With authority delegated to them by the president, the President's Office conducts internal audits as part of the Company's system of internal control. The aim of the audits is to enhance the overall quality of management. 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 independent auditors

Attorneys advise the Company on issues of compliance. The Company's financial statements are also audited upon the conclusion of each semiannual period.

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

a. Creating greater adaptability to change and strengthening systems of risk management

The Company has for some time appointed experienced outsiders to serve as part-time auditors on its Board of Statutory Auditors. To increase its ability to manage risk, the Company proposed adding another part-time auditor to its Board of Statutory Auditors to enhance its auditing capabilities. Accordingly, based on approval by shareholders at the Regular General Meeting of Shareholders held on March 27, 2004, the Company appointed a person with long and rich experience in the legal and accounting professions to this position.

b. Strengthening a sense of responsibility to shareholders

In a turbulent business environment, there is a need to make management responsibility clearer on a yearly basis and to establish an agile management structure capable of responding effectively to change. With that end in mind, the Company shortened the terms of its directors from two years to one year following approval of this change by shareholders at their General Meeting of March 27, 2004.

c. Strengthening the Company's ability to control and manage information

The Company has long recognized that information security is one of its most important responsibilities. Accordingly, it has sought to set up various mechanisms to deal with this concern, including policies on privacy and various technological measures. To make further progress on this issue, the Company launched the ISMS Project, whose aim is to assure that informational resources (including personal and confidential information on customers, suppliers, and investors) are firmly protected. Starting with a firm grasp of detailed information on internal security procedures, this project has developed "a basic policy on total company security," which the Company is carefully conveying to its employees through training programs. As a result of this activity, in December 2004, the Company obtained a certification for Information Security Management Systems, based on an audit carried out by Tohmatsu Evaluation and Certification Organization Co., Ltd.

**6. 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, 2004

#### (1) Operating results

During the fiscal year, the Japanese economy performed steadily, benefiting from expanding capital investment in China and from growing consumer spending in Japan, the latter stimulated by demand for digital electronic appliances. For the electronics industry, strong sales of digital consumer electronics, particularly flat-screen TVs and DVD recorders, continued until the middle of the year, spurred on by Olympics-related demand. In the second half, however, economic growth decelerated, as capital investment weakened and businesses gradually took steps to adjust production in the face of excess inventories. In the semiconductor industry, business remained brisk through the third quarter, benefiting from stronger capital investment and growth in digital consumer electronics. However, conditions weakened considerably in the fourth quarter, as industrial equipment manufacturers, including semiconductor equipment makers, and the consumer electronics industry began to adjust to the overall economic slowdown.

In this kind of market environment, the PALTEK group focused on expanding sales of existing products, including its mainstay programmable logic devices (customized products designed for specific uses), which have entered a take-off phase in the industry. The group also endeavored to identify new products for incorporation into its product portfolio and to enhance the efficiency of its operations through cost reductions. And mindful of the trend among its customers to move manufacturing capacity to China, it also opened a representative office in Shanghai, viewing this as a foothold for future business development in China.

During the year, net sales increased by 10.6% over the previous year (or by 1,853 million yen) to 19,355 million yen. This increase mostly reflected strong sales to manufacturers of industrial equipment, who benefited from expanding capital investment, and strong sales to manufacturers of broadband-related communications equipment, who capitalized on ongoing development of broadband-related infrastructure.

Ordinary income was affected by a decline in gross profit margins. To promote PLDs to a wider range of applications, which now offer customers enhanced performance at a lower price due to technological innovation, the group increasingly expanded market coverage of PLDs to mass-produced equipment in communication and industrial equipment. As a result, the revenue has increased. However, because of the extremely competitive nature of this market, gross margin declined, which negated the effects of a 53 million yen reduction in SG&A expenses. Consequently, ordinary income fell by 25.7% (or by 322 million yen) to 935 million yen.

Net income, affected by this lower level of ordinary income, declined by 23.5% (or by 148 million yen) to 483 million yen.

(2) Cash flow

Cash and cash equivalents increased by 1,232 million yen compared to the balance at the beginning of the term to stand at 2,412 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 1,273 million yen (compared with 249 million yen cash provided in the year-earlier period), reflecting the recognition of 928 million yen in income before taxes and minority interests and further progress in the collection of trade receivables.

*(Net cash from investing activities)*

Cash used in investing activities amounted to 22 million yen (compared with 230 million yen cash used in the year-earlier period). This reflected expenditures for the acquisition of furniture and fixtures, and software, etc.

*(Net cash from financing activities)*

Cash used in financing activities amounted to 18 million yen (compared with 56 million yen cash provided in the year-earlier period). Although the Company incurred further debt, this was offset by payments for dividends and for acquisition of treasury stock.

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

	December 31, 2002	December 31, 2003	December 31, 2004
Equity ratio	67.4%	70.3%	68.4%
Equity ratio based on market prices	41.6%	106.6%	59.0%
Years required to redeem liabilities	-	7.1 years	1.5 years
Interest-coverage ratio	-	12.3	69.4

*(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 2005

With respect our outlook for the operating environment, the Japanese economy appears to remain sluggish and exports have hit a plateau, due to tighter monetary policies in America and China. In the electronics industry, fears have arisen about the potential impact of the extremely severe price cutting on digital consumer electronic goods that is occurring around the world, following the strong demand for such products generated by the Olympics in the first half of 2004. In the industrial equipment segment, inventory adjustments that began in the second half of 2004 are continuing in certain areas of the industry.

In this environment, PLDs are finding increasingly wider applications due to technological advances which are resulting in the introduction of new devices that offer both enhanced performance and price competitiveness. In the year to December 2005, a number of new product lines are set for introduction. The PALTEK group will endeavor to exploit this kind of price competitiveness in expanding its base of customers and new applications in growth areas. In the area of analog semiconductors, the group will continue to strengthen sales in the Kansai region to manufacturers of digital consumer electronic products such as mobile phones and digital cameras and to manufacturers of industrial equipment, while continuing to expand its customers base in the Kanto region. In the year to December 2004, the Company entered into a number of distribution agreements with memory and other semiconductor manufacturers. While offering potential synergies with PLDs, these products will enable the Company to forge relationships with potential new customers.

Accordingly, for the year ending December 2005, the group is forecasting net sales of 20,900 million yen, operating income of 865 million yen, and ordinary income of 804 million yen. Consolidated net income is projected at 463 million yen. On a parent company basis, the group is forecasting net sales of 17,500 million yen, operating income of 704 million yen and ordinary income of 666 million yen. Net income is projected at 395 million yen.

## Consolidated balance sheet

Thousands of yen	December 31, 2003	%	December 31, 2004	%	Year-on-year change
<b>Current assets</b>					
Cash and bank deposits	1,216,737		2,444,243		
Notes and accounts receivable	4,251,387		3,983,536		
Inventories	4,107,826		4,111,324		
Consumption taxes receivable	-		837,521		
Deferred tax assets	257,195		64,175		
Others	966,875		173,479		
Allowance for doubtful accounts	(6,421)		(6,706)		
	<u>10,793,601</u>	90.0	<u>11,607,573</u>	91.1	<u>813,972</u>
<b>Fixed assets</b>					
<b>Tangible fixed assets</b>					
Buildings	135,462		136,046		
Accumulated depreciation	<u>69,246</u>		<u>78,621</u>		
	66,215		57,425		
Vehicle equipment	1,884		920		
Accumulated depreciation	<u>1,777</u>		<u>873</u>		
	106		46		
Furniture and fixtures	388,274		386,814		
Accumulated depreciation	<u>291,127</u>		<u>308,647</u>		
	97,147		78,166		
Land	<u>14,736</u>		<u>14,736</u>		
	178,205	1.5	150,374	1.2	(27,831)
<b>Intangible fixed assets</b>					
Goodwill	7,972		-		
Others	<u>181,372</u>		<u>117,924</u>		
	189,345	1.6	117,924	0.9	(71,420)
<b>Investments and other assets</b>					
Investment securities	329,251		350,142		
Deferred tax assets	144,767		148,621		
Others	360,429		369,411		
Allowance for doubtful accounts	<u>(8,346)</u>		<u>-</u>		
	826,102	6.9	868,175	6.8	42,073
Total fixed assets	<u>1,193,653</u>	10.0	<u>1,136,474</u>	8.9	(57,179)
<b>Total assets</b>	<u>11,987,254</u>	100.0	<u>12,744,048</u>	100.0	<u>756,793</u>

PALTEK CORPORATION

Thousands of yen	December 31, 2003	%	December 31, 2004	%	Year-on-year change
<b>Current liabilities</b>					
Notes and accounts payable	929,258		1,071,794		
Short-term bank loans	1,716,670		1,763,152		
Income taxes payable	81,939		211,338		
Accrued bonuses	55,751		51,344		
Others	351,519		344,496		
	<u>3,135,137</u>	26.1	<u>3,442,125</u>	27.0	<u>306,988</u>
<b>Long-term liabilities</b>					
Long-term bank loans	-		114,170		
Liability for employees' retirement benefits	33,712		46,592		
Liability for directors' and corporate auditors' retirement benefits	260,047		276,651		
Consolidation translation adjustments	-		3,190		
Others	74,590		85,343		
	<u>368,350</u>	3.1	<u>525,947</u>	4.1	<u>157,597</u>
Total liabilities	3,503,487	29.2	3,968,073	31.1	464,585
<b>Minority interests</b>					
	54,370	0.5	64,567	0.5	10,197
<b>Shareholders' equity</b>					
Capital stock	1,335,487	11.1	1,339,634	10.5	4,147
Capital surplus	2,694,389	22.5	2,698,526	21.2	4,137
Retained earnings	4,391,414	36.6	4,723,951	37.1	332,536
Unrealized gains (losses) on securities - net	12,041	0.1	22,173	0.2	10,131
Treasury stock	(3,935)	(0.0)	(72,877)	(0.6)	(68,942)
	<u>8,429,397</u>	70.3	<u>8,711,407</u>	68.4	<u>282,010</u>
<b>Total liabilities, minority interests and shareholders' equity</b>	<u>11,987,254</u>	100.0	<u>12,744,048</u>	100.0	<u>756,793</u>

## Consolidated statement of income

Thousands of yen	Year ended December 31, 2003		Year ended December 31, 2004		Year-on-year change
		%		%	
<b>Net sales</b>	17,502,490	100.0	19,355,863	100.0	1,853,372
<b>Cost of sales</b>	13,331,486	76.2	15,551,144	80.3	2,219,657
Gross profit	4,171,003	23.8	3,804,719	19.7	(366,284)
<b>Selling, general and administrative expenses</b>					
Salary	888,060		934,578		
Provision for bonuses	45,018		50,258		
Provision for directors' and corporate auditors' retirement benefits	24,786		28,253		
Rent expenses	416,192		410,327		
Amortization of goodwill	31,504		11,163		
Others	1,654,055		1,571,677		
	3,059,616	17.5	3,006,260	15.5	(53,355)
Operating income	1,111,387	6.3	798,459	4.2	(312,928)
<b>Nonoperating income</b>					
Interest income	759		857		
Dividend income	201		235		
Foreign exchange gain	214,418		184,908		
Gain on sale of investment securities	2,940		3,516		
Amortization of negative goodwill	41		-		
Others	9,743		18,945		
	228,104	1.3	208,462	1.0	(19,642)
<b>Nonoperating expenses</b>					
Interest expenses	22,586		19,099		
Losses on doubtful accounts	-		15,025		
Commissions paid	17,771		11,453		
Payment for settlement of lawsuit	22,500		-		
Losses on assignment of receivables	9,398		15,748		
Others	9,224		10,393		
	81,481	0.4	71,720	0.4	(9,760)
Ordinary income	1,258,011	7.2	935,201	4.8	(322,810)
<b>Extraordinary income</b>					
Gain on sales of fixed assets	503		-		
Gain on reversal of directors' retirement benefits	-		900		
Reversal of allowance for doubtful accounts	919		112		
Gain on reversal of expenses for dissolution of joint venture	39,883		-		
	41,305	0.2	1,012	0.0	(40,293)

PALTEK CORPORATION

Thousands of yen	Year ended December 31, 2003	%	Year ended December 31, 2004	%	Year-on-year change
<b>Extraordinary losses</b>					
Loss on sales of fixed assets	8,700		-		
Loss on disposal of fixed assets	12,033		8,038		
Loss on devaluation of investment securities	38,181		-		
Loss on liquidation of subsidiaries and associated companies	7,545		-		
	<u>66,460</u>	0.4	<u>8,038</u>	0.0	(58,422)
Income (loss) before income taxes and minority interests	1,232,856	7.0	928,175	4.8	(304,681)
Income taxes - current	87,176		251,487		
Income taxes - deferred	470,216		181,237		
	<u>557,393</u>	3.2	<u>432,724</u>	2.2	(124,668)
Minority interest in income (loss) of consolidated subsidiaries	43,265	0.2	11,865	0.1	(31,400)
Net income	<u>632,197</u>	3.6	<u>483,584</u>	2.5	(148,612)

## Consolidated statement of retained earnings

Thousands of yen	Year ended December 31, 2003	Year ended December 31, 2004	Year-on-year change
<b>Capital surplus</b>			
Balance, beginning of period	2,694,389	2,694,389	-
Increase			
New shares issued due to exercise of subscription rights	-	4,137	
	-	4,137	4,137
Balance, end of period	2,694,389	2,698,526	4,137
<b>Retained earnings</b>			
Balance, beginning of period	3,891,354	4,391,414	500,059
Increase			
Net income	632,197	483,584	
	632,197	483,584	(148,612)
Decrease			
Cash dividends	118,362	118,338	
Directors' bonuses	13,775	32,709	
	132,138	151,047	18,909
Balance, end of period	4,391,414	4,723,951	332,536

## Consolidated statement of cash flows

Thousands of yen	Year ended December 31, 2003	Year ended December 31, 2004	Year-on-year change
<b>Net cash from operating activities</b>			
Income (loss) before taxes and minority interests	1,232,856	928,175	(304,681)
Depreciation	132,420	117,104	(15,316)
Amortization of goodwill	31,463	11,163	(20,300)
Loss on devaluation of investment securities	38,181	-	(38,181)
Decrease in allowance for doubtful accounts	(960)	(8,060)	(7,100)
Increase (decrease) in accrued bonuses	12,524	(4,406)	(16,931)
Increase in liability for employees' retirement benefits	23,109	12,880	(10,228)
Increase in liability for directors' and corporate auditors' retirement benefits	11,555	16,603	5,048
Interest and dividend income	(960)	(1,092)	(131)
Interest expenses	22,586	19,099	(3,486)
Foreign exchange loss	1,687	351	(1,336)
Gain on sales of investment securities	(2,940)	(3,516)	(575)
Loss on sales of investment securities	3,417	-	(3,417)
Gain on sales of tangible fixed assets	(503)	-	503
Loss on sales of tangible fixed assets	8,700	-	(8,700)
Loss on disposal of tangible fixed assets	6,168	2,373	(3,794)
Loss on disposal of intangible fixed assets	5,865	5,664	(201)
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	7,545	-	(7,545)
Decrease (increase) in accounts receivable - trade	419,278	277,223	(142,054)
Decrease (increase) in inventories	(696,762)	(3,498)	693,264
Increase (decrease) in payables - trade	(363,483)	142,536	506,020
Increase in consumption tax receivable	(165,268)	(326,320)	(161,052)
Decrease in advance payments	11,016	56,630	45,614
Increase (decrease) in advances	(100,582)	(4,914)	95,668
Bonus paid to directors and corporate auditors	(14,010)	(33,715)	(19,705)
Others	73,299	(4,736)	(78,036)
	678,819	1,199,547	520,727
Interest and dividends received	153	398	245
Interest paid	(20,361)	(18,354)	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	(6,341)	-	6,341
Tax refunds	-	214,245	214,245
Income tax paid	(419,967)	(122,047)	297,919
	249,686	1,273,789	1,024,102

PALTEK CORPORATION

Thousands of yen	Year ended December 31, 2003	Year ended December 31, 2004	Year-on-year change
<b>Net cash from investing activities</b>			
Increase in time deposits	(21,000)	(44,001)	(23,000)
Decrease in time deposits	30,033	49,001	18,968
Purchases of investment securities	(171,032)	(376)	170,656
Proceeds from sales of investment securities	6,169	-	(6,169)
Payments for acquisition of affiliate's equity	(20,000)	-	20,000
Purchases of tangible fixed assets	(28,609)	(19,400)	9,208
Proceeds from sales of tangible fixed assets	26,257	-	(26,257)
Purchases of intangible fixed assets	(39,687)	(25,464)	14,223
Increase in investment in partnership	(13,575)	(9,335)	4,239
Proceeds from sale of investment to partnership	4,423	4,903	480
Payments for loans	(61,500)	-	61,500
Proceeds from collection of loans	72,748	-	(72,748)
Increase in other investments	(21,765)	(21,943)	(178)
Decrease in other investments	7,296	44,244	36,948
	(230,243)	(22,371)	207,871
<b>Net cash from financing activities</b>			
Net increase (decrease) in short term bank loans	211,160	(70,000)	(281,160)
Proceeds from long term bank loans	-	300,000	300,000
Repayment of long term bank loans	(35,732)	(69,348)	(33,616)
Purchases of treasury stock	(1,867)	(68,942)	(67,074)
Proceeds from issuance of common stock	-	8,284	8,284
Cash dividends paid to minority shareholders	(166)	(665)	(498)
Cash dividends paid	(117,291)	(118,024)	(733)
	56,102	(18,695)	(74,797)
Effect of exchange rate changes on cash and cash equivalents	(7)	(215)	(208)
Net increase (decrease) in cash and cash equivalents	75,538	1,232,506	1,156,967
Cash and cash equivalents, beginning of period	1,141,516	1,179,737	38,220
Decrease in cash and cash equivalents due to decrease in consolidated subsidiaries	(37,317)	-	37,317
Cash and cash equivalents, end of period	1,179,737	2,412,243	1,232,505

## Material information regarding preparation of consolidated financial statements

Item	December 31, 2003	December 31, 2004
1. Scope of consolidation	<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>(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>(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>	<p>(2) Names of unconsolidated subsidiaries:</p> <p style="padding-left: 20px;">Alpha Electron (HK) Co., Ltd.</p> <p>(Reasons for exclusion from consolidation)</p> <p style="padding-left: 20px;">Scale of operations of this unconsolidated subsidiary is small and its 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: - 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>(1) Number of associated companies to which the equity method is applicable: -</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>(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>All subsidiaries have fiscal-year ends that are the same as the day of consolidated closing.</p>	<p>Same as previous year</p>

PALTEK CORPORATION

Item	December 31, 2003	December 31, 2004
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>Stated at fair market value as of the balance sheet date. (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>Stated at moving-average cost</p>	<p>(A) Securities:</p> <p>Available-for-sale securities:</p> <p>Available-for-sale securities with market values:</p> <p>Same as previous year</p> <p>Available-for-sale securities without market values:</p> <p>Same as previous year</p>
	<p>(B) Derivatives:</p> <p>As a principle, derivatives are stated at fair market value.</p>	<p>(B) Derivatives:</p> <p>Stated at fair market value</p>
	<p>(C) Inventories:</p> <p>(a) Merchandise:</p> <p>Stated by moving-average cost (last purchased price method used by some of the consolidated subsidiaries)</p>	<p>(C) Inventories:</p> <p>(a) Merchandise:</p> <p>Stated by moving-average cost (Changes in accounting methods) During the interim period, one subsidiary changed their inventory valuation methods from the last-invoice cost to the moving-average cost method. This change eliminates the impact on valuations of momentary monthly fluctuations and allows a more appropriate calculation of periodic income. The change had only a very small impact on the period's financial statements.</p>
	<p>(b) Supplies:</p> <p>Stated by last purchased price method</p>	<p>(b) Supplies:</p> <p>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) Useful lives are as follows: Buildings: 10 - 45 years Vehicle equipment: 6 years Furniture and fixtures: 5 - 15 years</p>	<p>(A) Tangible fixed assets:</p> <p>Same as previous year</p>
	<p>(B) Intangible fixed assets:</p> <p>The straight-line method. Useful life of the software for internal use is 5 years.</p>	<p>(B) Intangible fixed assets:</p> <p>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>(A) Allowance for doubtful accounts:</p> <p>Same as previous year</p>
	<p>(B) Accrued bonuses:</p> <p>Reserves are provided to cover the estimated amount of bonuses payable to employees.</p>	<p>(B) Accrued bonuses:</p> <p>Same as previous year</p>

PALTEK CORPORATION

Item	December 31, 2003	December 31, 2004
	(C) Liability for employees' retirement benefits: 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.	(C) Liability for employees' retirement benefits: Same as previous year
	(D) Liability for directors' and corporate auditors' retirement benefits: An allowance is provided by the Company and a subsidiary to cover the estimated amount of retirement benefits payable to directors and corporate auditors.	(D) Liability for directors' and corporate auditors' retirement benefits: An allowance is provided by the Company to cover the estimated amount of retirement benefits payable to directors and corporate auditors.
(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

PALTEK CORPORATION

Item	December 31, 2003	December 31, 2004
(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."	-
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.	Same as previous year
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, 2003	December 31, 2004
	-	-
		(Consolidated balance sheet)
		Until the previous fiscal year, "consumption taxes receivable" had been included in the "others" category of current assets. Because these consumption taxes receivable exceeded 5 percent of total assets during the fiscal year, they were categorized in a separate account.
		For comparison purposes "consumption taxes receivable" amounted to ¥496,312 thousand in the year ended December 31, 2003.
(Consolidated statement of income)		
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.		
(Consolidated statement of cash flows)		
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.		

Notes (Consolidated balance sheet)

Thousands of yen	December 31, 2003	December 31, 2004
1. Amount of notes receivable discounted	45,435	39,255
Amount of accounts receivable-trade offered as collateral	17,945	7,017
2.	-	325,221
3. Investment in unconsolidated subsidiaries	1,796	1,796
4. For more efficient financing of working capital, the Company has entered into overdraft and loan commitment agreements with four banks. 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	8,150,000	8,150,000
Amounts drawn down	1,500,000	1,430,000
Unused lines of credit	6,650,000	6,720,000
5. Total number of shares outstanding		
Common stock	11,839,399 shares	11,849,899 shares
6. Number of treasury shares held		
Common stock	5,519 shares	107,567 shares

(Consolidated statement of income)

Thousands of yen	December 31, 2003	December 31, 2004
1. Total research and development expenses		
Research and development expenditures included in selling, general and administrative expenses	68,599	21,000
2. Breakdown of gains on sale of fixed assets		
Buildings	226	-
Furniture and fixtures	24	-
Land	251	-
3. Breakdown of loss on sale of fixed assets		
Buildings	3,218	-
Land	5,482	-
4. Breakdown of loss on disposal of fixed assets		
Buildings	4,534	49
Furniture and fixtures	1,634	33
Software	5,865	2,290
		5,664

(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, 2003	December 31, 2004
Cash and deposit	1,216,737	2,444,243
Time deposits with maturities longer than 3 months	(37,000)	(32,000)
Cash and cash equivalents	1,179,737	2,412,243

## 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, 2003	December 31, 2004
<b>Furniture and fixtures</b>		
Acquisition cost equivalent	38,834	38,834
Accumulated depreciation equivalent	16,489	24,279
Book value equivalent	22,345	14,555
<b>Vehicle equipment</b>		
Acquisition cost equivalent	-	29,880
Accumulated depreciation equivalent	-	1,447
Book value equivalent	-	28,433
<b>Software</b>		
Acquisition cost equivalent	560,391	560,391
Accumulated depreciation equivalent	378,221	490,299
Book value equivalent	182,170	70,091
<b>Total</b>		
Acquisition cost equivalent	599,226	629,106
Accumulated depreciation equivalent	394,710	516,025
Book value equivalent	204,515	113,081

## (2) Future minimum lease payments

Thousands of yen	December 31, 2003	December 31, 2004
Within one year	122,644	80,060
Over one year	87,811	36,300
	210,455	116,360

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

Thousands of yen	December 31, 2003	December 31, 2004
Lease payments	124,031	127,116
Depreciation equivalent	118,442	121,315
Interest expense equivalent	4,946	3,141

## (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

<b>Thousands of yen</b>	<b>December 31, 2003</b>	<b>December 31, 2004</b>
Within one year	1,198	1,055
Over one year	4,695	3,309
	<hr/> 5,894	<hr/> 4,364

## Securities

*December 2003 term*

## 1. Available-for-sale securities with market values

Thousands of yen	December 31, 2003		
	Acquisition cost	Book value	Difference
Fair market value exceeds acquisition cost			
Stocks	20,102	40,122	20,019
Bonds			
JGB, Local government bonds	-	-	-
Corporate bonds	-	-	-
Others	-	-	-
Others	55,527	64,384	8,857
	75,630	104,506	28,876
Fair market value does not exceeds acquisition cost			
Stocks	359	170	(188)
Bonds			
JGB, Local government bonds	-	-	-
Corporate bonds	-	-	-
Others	-	-	-
Others	25,418	22,365	(3,052)
	25,778	22,536	(3,241)
	101,408	127,043	25,635

(Note)

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

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, 2003
Amount sold	8,747
Total gain on sales	2,940
Total loss on sales	3,417

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

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

**December 2004 term**

## 1. Available-for-sale securities with market values

Thousands of yen	December 31, 2004		
	Acquisition cost	Book value	Difference
Fair market value exceeds acquisition cost			
Stocks	15,766	50,644	34,877
Bonds			
JGB, Local government bonds	-	-	-
Corporate bonds	-	-	-
Others	-	-	-
Others	65,429	79,302	13,873
	81,195	129,946	48,750
Fair market value does not exceeds acquisition cost			
Stocks	4,695	3,606	(1,089)
Bonds			
JGB, Local government bonds	-	-	-
Corporate bonds	-	-	-
Others	-	-	-
Others	15,949	14,005	(1,944)
	20,645	17,611	(3,033)
	101,841	147,558	45,717

*(Note)*

None of the listed investments included under "other" investment securities required the application of impairment accounting.

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, 2004
Amount sold	4,903
Total gain on sales	3,516
Total loss on sales	-

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

Thousands of yen	December 31, 2004
Available-for sale securities	
Unlisted securities (excluding OTC-traded stocks)	200,788

## Derivative transactions

December 31, 2003	December 31, 2004
<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 accounting is provided in "Material information regarding 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>Same as previous year</p>

## 2. Matters related to estimated fair value of transactions

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, 2003 was 225,017 thousand yen and 262,356 thousand yen as December 31, 2004.

## 2. Retirement benefit obligations

Thousands of yen	December 31, 2003	December 31, 2004
Projected benefit obligations	(141,715)	(174,427)
Fair value of plan assets	108,002	127,834
Net amount stated in the consolidated B/S	(33,712)	(46,592)
Prepaid pension cost	-	-
Liability for employees' retirement benefits	(33,712)	(46,592)

## 3. Pension and severance costs

Thousands of yen	December 31, 2003	December 31, 2004
Retirement benefit costs		
Service cost	53,911	38,705
Contribution to the jointly established welfare pension fund	22,709	22,358
Contribution to the mutual funds for retirement allowances for medium and small companies	1,660	1,715
Special retirement benefit	1,353	2,111
Retirement benefit costs	79,634	64,890

## 4. Assumptions used in the accounting for retirement benefit obligations

	December 31, 2003	December 31, 2004
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, 2003		December 31, 2004
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	20,347	Accrued enterprise tax	19,115
Accrued bonuses in excess of tax limit	20,224	Loss on valuation of inventories	13,938
Liability for employees' for retirement benefits	12,973	Accrued bonuses in excess of tax limit	20,957
Liability for retirement benefits to directors and corporate auditors	105,261	Liability for employees' for retirement benefits	18,526
Loss on devaluation of investment securities	30,514	Liability for retirement benefits to directors' and corporate auditors'	112,867
Loss on liquidation of subsidiaries and associated companies	41,045	Loss on devaluation of investment securities	22,009
Loss carry forward	224,281	Loss carry forward	70,327
Others	23,355	Others	23,012
	478,003		300,754
Valuation allowance	(44,217)	Valuation allowance	(75,797)
	433,786		224,957
Deferred tax liabilities		Deferred tax liabilities	
Enterprise-tax refund receivable	(19,635)	Revaluation gain on investment securities	(11,817)
Revaluation gain on investment securities	(11,706)	Others	(342)
Others	(480)		(12,159)
	(31,822)	Net deferred tax assets	212,797
Net deferred tax assets	401,963		
Net amounts of deferred tax assets are included in the following consolidated balance sheet accounts.		Net amounts of deferred tax assets are included in the following consolidated balance sheet accounts.	
Current assets - deferred tax assets	257,195	Current assets - deferred tax assets	64,175
Fixed assets - deferred tax assets	144,767	Fixed assets - deferred tax assets	148,621
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%
(Adjustment)		(Adjustment)	
Entertainment expenses, etc. non deductible portion	0.73%	Entertainment expenses, etc. non deductible portion	1.01%
Amortization of goodwill	1.07%	Amortization of goodwill	0.51%
Inhabitants tax	0.52%	Inhabitants tax	0.64%
Adjustment to reduction of deferred tax assets as of the end of the term, because of changes in tax rates	0.43%	Special corporate tax credit	(1.05)%
Effect of the increase in valuation allowances	0.55%	Effect of changes in tax rates	0.22%
Others	(0.09)%	Effect of the increase in valuation allowances	3.52%
Effective income tax rate	45.21%	Others	(0.23)%
		Effective income tax rate	46.62%

Thousands of yen	December 31, 2003	December 31, 2004
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 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

### *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.

### *December 2004 term*

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 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.

### *December 2004 term*

The PALTEK group was left with no subsidiaries operating outside of Japan and no significant overseas branches. Consequently, this section is no longer applicable.

## Overseas sales

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

## Related party transactions

N/A

Per share-related financial information

Yen	December 31, 2003	December 31, 2004
Net assets per share	709.55	740.13
Net income per share	50.65	39.16
		Net income per share, fully diluted 39.06

There is no entry for net income per share, fully diluted for the fiscal year ended December 31, 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 December 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 and net income per share, fully diluted are as follows.

Thousands of yen	December 31, 2003	December 31, 2004
Net income per share		
Net income	632,197	483,584
Amount not attributable to common shareholders	32,709	20,500
[Of which, amount paid out as bonuses to directors pursuant to Statement of Appropriation of Net Income]	[ 32,709 ]	[ 20,500 ]
Net income related to common stock	599,488	463,084
Average number of shares outstanding during term (shares)	11,835,295	11,825,029
Net income per share, fully diluted		
Adjustment for net income	-	-
Increase in common stock	-	29,757
[Warrants]	[ - ]	[ 17,973 ]
[New share subscription rights]	[ - ]	[ 11,784 ]
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)	(Warrants based on Article 280-19 of the Old Commercial Code) 2 types of warrants (number of shares to be issued through exercise of warrants: 246,900 shares) (Stock acquisition rights based on Articles 280-20 and 280-21 of the Commercial Code) 1 type, 1,200 stock acquisition rights (number of shares to be issued through the exercise of stock acquisition rights: 120,000 shares)

## Significant subsequent events

### ***December 2004 term***

(Freeze on system of retirement benefits for directors and corporate auditors)

At its Board of Directors Meeting held on February 14, 2005, the Company resolved to freeze its system of retirement benefits for directors and corporate auditors as of the end of the Regular General Meeting of Shareholders held on March 26, 2005.

For payments covering periods of service up to the date of the suspension of the system (i.e., up to the conclusion of said Regular General Meeting of Shareholders), the Company shall propose such payments at the General Shareholders Meetings convened for the periods in which each director retires or resigns and shall receive the approval of shareholders for such payments.

(Acquisition of treasury stock)

In accordance with Article 211-3-1-2 of the Commercial Code and with provisions of the Company's Articles of Incorporation, the Board of Directors at its meeting on February 14, 2005 approved the acquisition of treasury stock in the manner detailed below.

1. Type of stock to be acquired: common stock
2. Total number of shares to be acquired: 100,000 shares (maximum)
3. Total value of shares to be acquired: ¥100,000,000 (maximum)
4. Period in which purchases will be made: From February 15, 2005 to June 30, 2005
5. Method of purchasing shares  
On the market, through the Nasdaq Securities Exchange

## Purchases, Orders Received and Sales

### 1. Purchases

Purchases made during the term ended December 31, 2004 are as follows:

Thousands of yen	December 31, 2003		December 31, 2004		Change from the previous year (%)	
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)
Semiconductor business	13,949,652	100.0	15,461,671	100.0	1,512,019	10.8
	13,949,652	100.0	15,461,671	100.0	1,215,019	10.8

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

### 2. Orders received

Orders received during the term ended December 31, 2004 as follows:

Thousands of yen	December 31, 2003		December 31, 2004		Change from the previous year (%)	
	Orders received	Backlog	Orders received	Backlog	Orders received	Backlog
Semiconductor business	16,985,092	1,213,575	19,424,481	1,282,193	2,439,389	68,618
	16,985,092	1,213,575	19,424,481	1,282,193	2,439,389	68,618

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

### 3. Sales

Sales during the term ended December 31, 2004 as follows:

Thousands of yen	December 31, 2003		December 31, 2004		Change from the previous year (%)	
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)
Semiconductor business	17,502,490	100.0	19,355,863	100.0	1,853,373	10.6
	17,502,490	100.0	19,355,863	100.0	1,853,373	10.6

(Notes)

1. Consumption tax is not included in the above figures.

2. Sales by major customers and the ratio to total sales for the last two accounting periods are as follows:

Thousands of yen	December 31, 2003		December 31, 2004	
	Amount	Ratio (%)	Amount	Ratio (%)
NEC Corporation	1,820,853	10.4	2,523,314	13.0

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