

(2) Consolidated financial position

	Total assets	Shareholders' equity	Shareholders' equity ratio	Shareholders' equity per share
	(Millions of yen)	(Millions of yen)	%	(Yen)
December 31, 2005	13,487	8,769	65.0	751.61
December 31, 2004	12,744	8,711	68.4	740.13

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

December 2005 term: 11,661,484 shares

December 2004 term: 11,742,332 shares

(3) Consolidated cash flows

	Net cash from operating activities	Net cash from investing activities	Net cash from financing activities	Cash and cash equivalents at end of term
	(Millions of yen)	(Millions of yen)	(Millions of yen)	(Millions of yen)
Fiscal 2005	772	138	(310)	3,013
Fiscal 2004	1,273	(22)	(18)	2,412

(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 affiliated 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 2006 term

(From January 1, 2006 to December 31, 2006)

	Net sales	Operating income	Ordinary income	Net income
	(Millions of yen)	(Millions of yen)	(Millions of yen)	(Millions of yen)
Interim 2006	4,620	(567)	(609)	(372)
Fiscal 2006	12,740	(490)	(575)	(344)

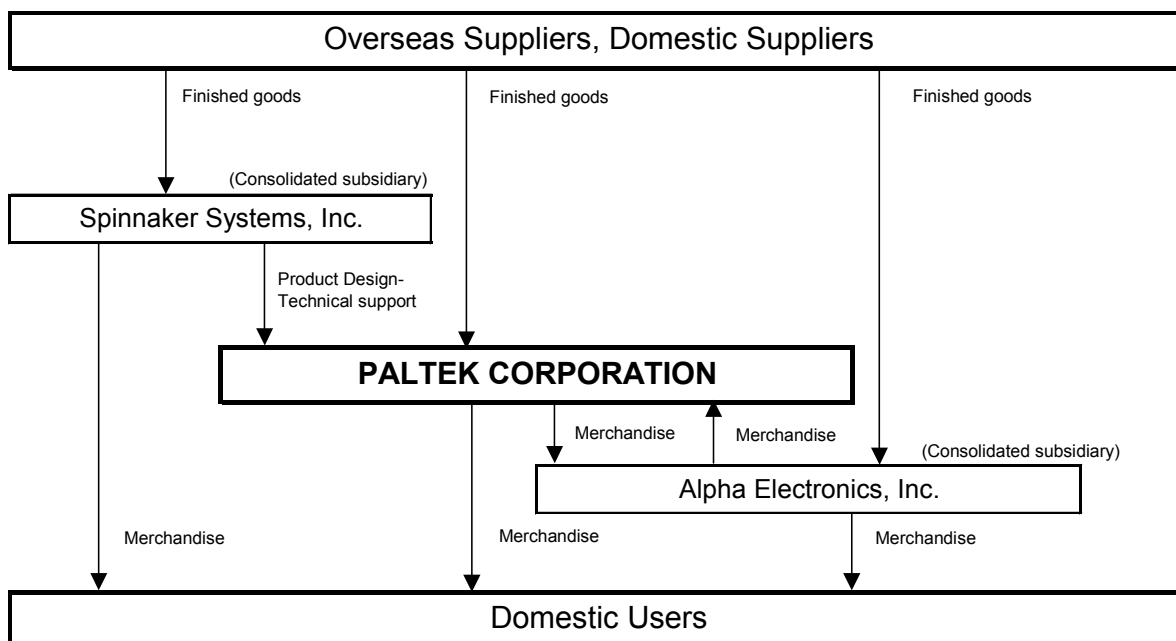
(N.b.) Projected net income per share for fiscal 2006: (29.50) yen

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 17 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.

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.

As part of the continually evolving and growing electronics industry, the PALTEK group searches and discovers innovative semiconductors, software and other products being developed around the world and provides them to those who develop and sell a variety of electronic devices and systems. In this search, it is guided by an understanding of leading-edge technologies and market needs. Beyond being simply a distributor, the PALTEK group endeavors to provide best possible solutions to its customers by supporting their development activities with a high level of technology and by proposing systems based solutions that take into consideration the entire architecture of each customer's electronic equipment.

Through such actions, the PALTEK group will work diligently to develop the electronics industry and to contribute to a more convenient and dynamic ubiquitous network society—and, on that basis, coexist in a mutually beneficial way with 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. Targeted financial ratios

The PALTEK group's medium-term goal is to achieve consolidated sales of 50 billion yen and an operating margin of 10%.

4. Medium- to long-term management strategies and issues requiring action

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

(1) Rebuilding and strengthening the mainstay PLD solutions business

The ability to respond flexibly and timely to changes in the market environment is the hallmark of programmable logic devices (customized products for specified functions). By offering the flexibility that enables development engineers to alter designs they are working on in response to each situation, PLDs make it possible for companies to bring high-value added products quickly to the market without large initial investment risks.

The PALTEK group began selling PLDs in 1985 when the technology was dawning and has worked hard since then to introduce the new technology and get it more widely accepted. Now, twenty years later, technological innovation has led to increased integration, higher performance, and greater speeds in the devices, enabling PLDs to be incorporated into a broad range of electronic equipment and appliances. Due to such expanded uses and a larger customer base, costs of production have declined as production scale has grown, making the technology increasingly cost competitive. And, in recent years, PLDs have become highly suited to the needs of the age as the globalizing economy and the spread of the Internet impose ever-shorter development timetables and product life cycle on manufacturers.

The PALTEK group will be terminating its distribution agreement with Altera Corporation, effective March 31, 2006. This brings to a close an approximately 20-year relationship in which the PALTEK group sold PLDs manufactured by Altera as one of its core products. To replace Altera, the Company has entered into a new distribution agreement with Xilinx, Inc., a worldwide leader in PLD solutions, and began marketing Xilinx's products on February 1, 2006. Against the background of these events, the PALTEK group has recommitted itself to supporting its existing customer base by proposing systems solutions which utilize the know-how and experience in technical support that it has accumulated over the years. In these proposals, the group will continue to rely on its strengths, which include an ability to provide technical support that meets each customer's specific needs and an approach to sales based on a thorough understanding of all of a customer's products. In addition, by taking advantage of Xilinx's broad array of product groups and the strengths of each of these groups, the PALTEK group will seek to make inroads into previously neglected market segments and to expand the devices and instruments in which PLD solutions can be applied.

(2) Expanding and Strengthening analog solutions

Analog semiconductors are an essential part of the accelerating shift toward digitalized household equipment and appliances. Strong demand for analog technology is likely to continue hereafter because of the essential role played by this technology in complex power source controls for advanced devices and in power management for mobile phones, digital cameras and other portable devices. By bringing to bear the knowledge and experience that it has accumulated in this field, the PALTEK group will endeavor to increase its sales and its

base of customers for analog semiconductors. It will do so by selling not only to manufacturers of consumer products such as mobile phones and digital cameras but also to the extensive universe of industrial equipment manufacturers, where it has competitive strengths.

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

The increasing proliferation of broadband networks and rapidly advancing technological innovation aimed at enhancing the speed and capacity of such networks are prompting the development of new markets driven by the convergence of communications, broadcasting and consumer appliances. To meet the needs of such markets, the PALTEK group will provide solutions built around application-specific standard products (ASSP*). Its primary focus will be in the following areas, where it can exploit the knowledge, experience and customer networks that it has developed in the field of communications:

- 1) Solutions related to next-generation wireless communications
- 2) Solutions related to the high-speed transfer of large amounts of data
- 3) Solutions related to image processing

The group's focus will not be limited to supplying individual semiconductors to manufacturers in these markets. Rather it will endeavor to provide "system solutions" which capture a wide variety of customer needs, including those for high-speed memory and power source ICs used at the periphery of the ASSP, for modules and packaged products that combine semiconductors with software, and for device-level proposals on near-final products.

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

(4) Development of new sources of products and the provision of advanced technical support

In the electronics industry, rapid and unpredictable technological progress and increasingly severe international competition are the rule. In such an environment, the PALTEK group believes that it must be constantly tuned in to the latest products and technological trends and must be capable of developing methods and products that assist in the solution of its customers' problems.

Furthermore it realizes that it must continue to provide technical support regarding these new and increasingly complex products. Toward that end, the PALTEK group will endeavor to attract and nurture engineers and sales force who are highly knowledgeable about markets and technologies and who will be capable of providing proficient technical support.

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

(1) Basic philosophy regarding corporate governance

The PALTEK group views corporate governance as a managerial control aimed at maximizing corporate value for all stakeholders and to realize the group's philosophy of "*Kyosei* - cooperative growth." The PALTEK group's basic policy regarding corporate governance is to "enhance the transparency of management in order to respond quickly to changes in the market environment." Toward this end, it is endeavoring to enhance its corporate governance-related capabilities in the following specific ways.

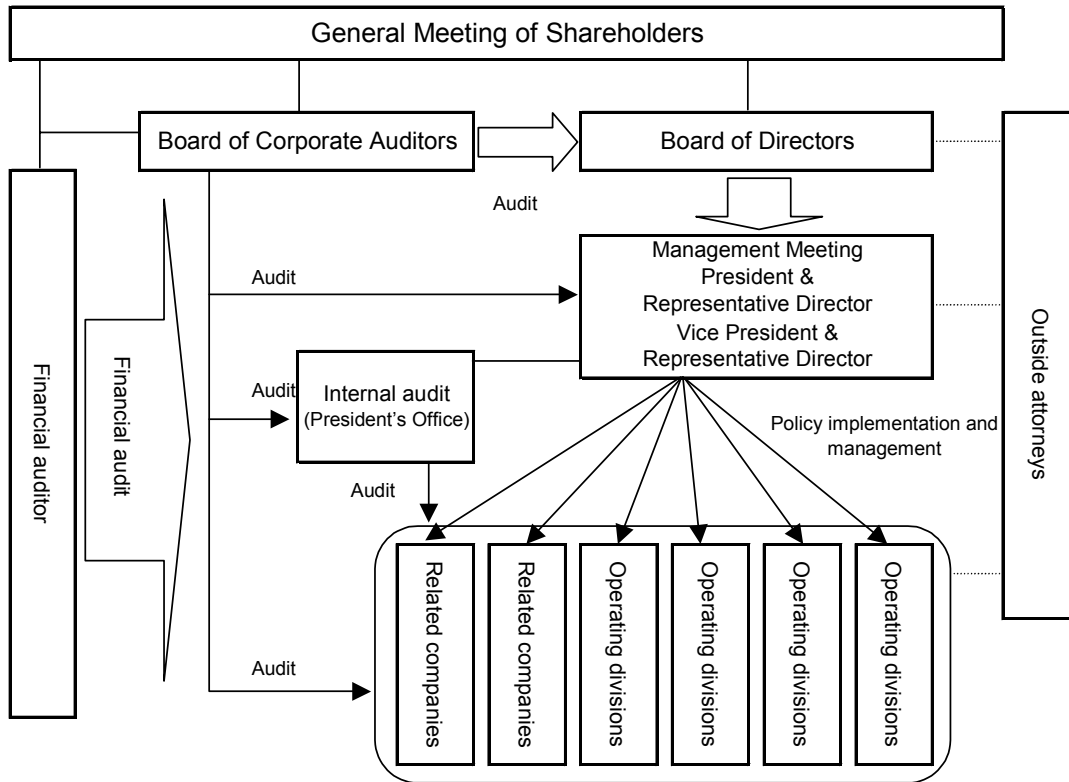
Basic policies	Specific measures
Responding quickly to changes in the market environment	- Expediting decision making by holding senior management meetings and Board of Directors' meetings on the same day
Enhancing the transparency of management	- Establishing greater objectivity through the appointment of outside directors and corporate auditors - Improving the quality of information disclosure to employees (through internal IR meetings; intranet-based information disclosure; communicating information through meetings in which all employees can participate)

(2) Corporate governance-related policies

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. Both corporate auditors and outside corporate auditors participate in these meetings, where they express opinions and issue reports in a timely manner on the appropriateness of the decisions being made and on management's abidance with relevant laws. Object-based management is employed 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 timely decision-making and action. In this way, the PALTEK group is endeavoring to respond flexibly to a rapidly and continuously changing market situation.

Based on these policies, the PALTEK group has established the following structure of corporate governance.



a. Composition of Board of Directors

The Board of Directors is composed of six directors (of whom one is an outside director). The board's organization facilitates the provision of optimum solutions to its customers. Accordingly, each director brings not only a high level of expertise to his position but also a depth and breadth of experience that will contribute to enhancing the transparency and efficiency of management.

b. Composition of Board of Corporate Auditors

The Company uses a system of corporate auditors. The composition of highly experienced outside auditors is recognition of the importance that the Board of Corporate Auditors attaches to independence from the Board of Directors. The current members of corporate auditors will contribute toward enhancing the health of management.

The Board of Corporate Auditors is composed of four corporate auditors (of whom three are outside corporate auditors). Corporate auditors participate in all important management meetings, including Board of Directors' meetings and management meetings, where they endeavor to grasp the decision-making process and all details of operational execution, and where they receive reports necessary for them to perform their jobs.

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 internal auditing office endeavors continually to improve all activities and systems of the Company, including its day-to-day operations. Viewing such activities and systems from the perspective of management objectives, Company regulations and compliance with the relevant laws, the auditing office impartially evaluates, cites, and guides each group being audited on the appropriateness and efficiency of its activities, etc. On an as-needed basis, it mutually shares information with the Company's corporate and financial auditors to enhance the efficiency of its audits.

d. Involvement of attorneys and CPAs

The Company receives timely advice from outside attorneys regarding compliance of its overall operations with relevant laws and regulations. The Company's financial auditor is Deloitte Touche Tohmatsu, whose audits are governed by the Law for Special Provisions for the Commercial Code Concerning Audits, etc. of Kabushiki Kaisha and by the Securities and Exchange Law. Shigetsugu Sugimoto and Yasunori Kusaka are the certified public accountants in charge of the Company's audits. They are assisted by two other CPAs and five junior accountants.

e. Directors' compensation

The following are details of compensation paid during the term to directors and corporate auditors.

Directors:	127,634 thousand yen (of which 8,251 thousand yen was paid to outside directors)
Corporate Auditors:	37,064 thousand yen (of which 19,507 thousand yen was paid to outside corporate auditors)

The above amounts do not include directors' bonuses (which amounted to 10,730 thousand yen).

f. Fees paid to financial auditor

During the term, the Company paid 16,000 thousand yen in fees to Deloitte Touche Tohmatsu, in accordance with the provisions of Article 2-1 of the Certified Public Accountants Law.

The Company also paid 3,160 thousand yen to Deloitte Touche Tohmatsu, for other services rendered, including research and consultation on financial matters.

- g. Relationships between the Company and its outside directors and outside corporate auditors, including relationships based on personal ties, shareholdings, business relationships, etc.

There are no family relationship among our directors and outside directors and corporate auditors. There is no significant shareholdings and commercial relationships between the Company and its outside directors and corporate auditors.

- h. Specific actions taken during the 2005 term to improve corporate governance

During the consolidated fiscal year under review, the Company held 24 Board of Directors' meetings, where directors made decisions and examined important issues related to management direction and policy. In addition, the Company's management meeting, which comprises the heads of the Company's divisions and chief executives of group companies, met on twelve occasions on the days when Board of Directors meetings were being held. This enabled the Company to integrate all of its actions—discussions, decision-making and execution—on important operational matters.

The Board of Corporate Auditors held meetings on a timely basis. With outside auditors bringing substantial experience in various areas of operation, the board was able to monitor directors' execution of operations and other aspects of management from an independent perspective, while taking into consideration the group's overall operations. In addition, during the period, the internal auditing office conducted fifteen internal audits on the basis of an annual plan that encompassed the group's overall operations. These audits were aimed at enhancing the Company's ability to operate in compliance with the relevant laws and regulations, to act in accordance with its own operational regulations, and to carry out operations in an effective manner.

In terms of information disclosure and control, the Board of Directors adopted a resolution that established the position of director in charge of information disclosure, who was given responsibility for managing internal information. The Company assigned this role to the director of its Operational Services Division. In this way, the Company is endeavoring to the extent possible to clear away all procedural barriers to the prompt disclosure of important information.

By resolution of the Board of Directors, the Company also established the position of director in charge of investor relations, assigning this role to the president and chief executive officer of the Company. The day-to-day tasks of investor relations are being actively carried out by the Relations Group.

6. Matters related to the parent company, etc.

The Company has no parent company.

7. Development of system of internal control; operational status of this system

(1) Internal checks and other internal controls

As stated above in section 5-(2), item c., "Internal controls," the Company has established, as a part of the PALTEK group's system of internal controls, an internal audit department that implements internal checks over the entire PALTEK group.

Organizationally, the Company's administrative division is divided distinctly from business divisions, and encompasses operations which includes legal affairs, human resources, accounting and finance, corporate communications and investor relations, facilities and services, and information systems. This administrative division not only supports the business divisions; they also carry out internal checks and implement risk-control measures.

While all of its necessary internal regulations and rule books have already been established, the Company continues to upgrade and develop other regulations in response to need. This occurs when laws and regulations governing the Company's operations are amended or when a given operation requires the implementation of new regulations to tighten internal control.

(2) Measures adopted during the period under review to improve and enhance internal controls

- 1) Annual review of internal regulations in light of changes in the environment and in operational conditions; also carried out to confirm compliance with laws and regulations
- 2) ISMS audit, aimed at ensuring the protection of personal information, confidential information and other informational assets

For commentary on other measures adopted during the period, please refer to section 5-h. above.

8. Other important issues related to company management

The Company will terminate its distribution agreement with Altera Corporation effective March 31, 2006.

On January 25, 2006, the Company entered into a distribution agreement with Xilinx, Inc. It began marketing Xilinx's products on February 1, 2006 and will start shipments from April 1, 2006.

Financial Performance

1. Overview of the period to December 31, 2005

(1) Operating results

During the year ended December 31, 2005, the Japanese economy maintained a firm overall tone, benefiting from increased capital spending by corporations experiencing stronger earnings, from a recovery in the employment environment, and from improvements in personal incomes. These trends overshadowed worrisome developments in the external sector, such as the skyrocketing price of oil, the revaluation of the yuan, and hurricanes and an overheated housing market in the US.

In the electronics industry, the downturn in the market that began in the second half of 2004 continued through the first half of 2005. From around the middle of 2005, inventories began to adjust and the industry moved into a gradual recovery mode due to strong consumer spending. However, unit prices have continued to decline because of intense price competition. This has split the industry clearly between manufacturers who are prospering and those who are not. While some companies generate higher sales and earnings or reap higher profits through expanding market share, other companies are reporting deficits due to sharp declines in product prices and weak sales. Some of those manufacturers were even forced to withdraw from certain product markets.

In this kind of market environment, the PALTEK group has endeavored to enhance the efficiency of its operations by expanding sales of existing products (including its core PLDs), by launching new products, and by increasing the number of new customers and reducing costs of operations. In the fourth quarter, however, Altera Corporation, whose PLDs have constituted approximately 70 percent of the PALTEK group's sales, informed the Company of its intentions to terminate its distribution agreement. Following discussions, the two sides agreed that the contract would end on March 31, 2006. The Company made the announcement on November 16, 2005.

In the face of such conditions, the PALTEK group determined that the best way to continue its business and to make the business grow would be to exploit its strengths, which were an ability to propose systems built around PLDs and its experience and track record in technical support. Accordingly, it proposed a distribution agreement with Xilinx, Inc., a worldwide leader in PLD solutions. Both parties concluded after discussions that such an agreement would advance their respective business development goals. A letter of intent to enter into a distribution agreement was signed and announced on November 17, 2005. On January 25, 2006, the parties concluded a formal distribution agreement. The PALTEK group began sales activities for Xilinx products on February 1, 2006 and is making preparations for the commencement of shipments on April 1, 2006.

Against this background, sales for the fiscal year declined by 7.3% year-on-year to 17,946 million yen (or a decline of 1,408 million yen). The drop reflected weak demand in the first half and the winding down of business with Altera in the second half.

Despite various efforts and measures taken to reduce operating costs and expenses, ordinary income fell by 60.1% to 373 million yen (or by 561 million yen). Currency losses, caused by the rapid depreciation of the yen, were also a significant cause of the decline in ordinary income during the period.

Accordingly, net income decreased by 49.6% to 243 million yen (or by 240 million yen).

(2) Cash flow

Cash and cash equivalents increased by 600 million yen compared to the end of the previous consolidated period, standing at 3,013 million yen at term end.

The following is a summary of the major components of cash flow during the period.

(Net cash from operating activities)

Cash provided by operations amounted to 772 million yen (cf. cash provided of 1,273 million yen during the previous year). This reflected the recognition of 409 million yen in income before taxes and other adjustments, and an increase in trade payables.

(Net cash from investing activities)

Due to the sale of investment securities, cash provided by investing activities amounted to 138 million yen (cf. cash used of 22 million yen in the previous year).

(Net cash from financing activities)

Cash used in financing activities amounted to 310 million yen (cf. cash used of 18 million yen in the previous period), reflecting the repayment of debt, cash dividends paid, and purchases of treasury stock.

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

	December 31, 2003	December 31, 2004	December 31, 2005
Equity ratio	70.3%	68.4%	65.0%
Equity ratio based on market prices	106.6%	59.0%	40.6%
Years required to redeem liabilities	7.1 years	1.5 years	2.4 years
Interest-coverage ratio	12.3	69.4	45.5

(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 paid” in the consolidated statement of cash flows.*

2. 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 countermeasure 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 fiscal term ended December 2005.

(1) Risk factors resulting from a dependence on semiconductor business

The customers of the PALTEK group comprise principally companies in the Japanese electronics 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 specific suppliers

During the fiscal year, the PALTEK group agreed to terminate its distribution agreement with Altera Corporation, effective March 31, 2006. This change, which involved one of the group’s major suppliers, brought to the fore the business challenges that can arise from dependence on any one supplier. Endeavoring to reduce such impacts, the PALTEK group concluded a distribution agreement on January 25, 2006 with Xilinx, Inc., a world leader in PLD solutions, under which Xilinx would supply it with PLD products similar to those provided by Altera. However, if other supplier relationships become difficult to sustain hereafter due to changes or reorganizations in the distribution policies of such suppliers, the group’s financial performance could again be impacted.

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

The PALTEK group possesses informational assets that are an important tool deploying its sales strategies. 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 of fluctuation in exchange rates

The PALTEK group's primary business is the selling of semiconductors and related products, the bulk of which are procured from overseas suppliers. Because currency transactions are a regular part of the group's operations, fluctuations in foreign exchange rates could have an impact on the group's financial performance. 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) Recruitment of new suppliers and the advancement of business

The PALTEK group has endeavored to "increase its areas of competitive advantage" and "broaden its base of customers" by procuring the most competitive products in the industry and by expanding and deepening its product offerings. To stay ahead in terms of products and product offerings, the group has effectively utilized its highly proficient technical support capability and a marketing prowess which enables it to tailor its services to individual clients.

The semiconductor industry, however, is characterized by rapid technological innovation and intense competition. In such an environment, it is becoming increasingly difficult to prevail over the competition in the battle to sign influential suppliers. Even if agreements can be reached with such suppliers and their products begin to be supplied to the customer, there is no guarantee that the PALTEK group's business will unfold as planned. This is because business is affected by factors such as the competitiveness of the customer's final product and by shortened product life cycles. Consequently, while the PALTEK group will continue to keep a close eye on market and technology trends and will endeavor to achieve the targets set in its projections by acquiring competitive new products, its financial performance could be affected by delays in getting businesses that use such new products up and running.

(6) Impact of the shift of production facilities overseas

The PALTEK group sells semiconductors and other products to domestic electronic manufacturers, who, motivated by lower costs and rapidly growing markets, are increasingly shifting their manufacturing plants to overseas locations, principally in China and other parts of Asia. In order to continue to provide products and technical support to these clients, the PALTEK

group established Alpha Electron (HK) Co., Ltd. in March 2002 and a representative office in Shanghai in October 2004. However, if the development work that is now based in Japan continues to be shifted abroad, and if such activities get transplanted to areas outside the reach of the group's sales activities, it could have an impact on the group's financial performance.

3. Outlook for the year ending December 2006

With respect to the operating environment, the PALTEK group continues to be concerned globally about trends in oil prices and about the reaction of foreign exchange rates to additional increases in interest rates in the US and Europe. On the other hand, the group projects that the Japanese economy will remain on a course of gradual recovery, benefiting from stronger corporate profits and healthy consumer spending.

In this environment, the PALTEK group will place priority on rebuilding its core PLD business following the change of suppliers for PLD products. The first half of the year will be especially difficult. The group expects net sales to decline and operating income to fall into deficit as customers are being transferred from one distributor to another for our PLD products as the group's sales organization completes preparations to handle the new Xilinx business. Sales of Xilinx products began on February 1, 2006. The group's goal is to bring its sales force and other sales capabilities rapidly in place and ready to go as soon as possible. By providing technical support and proposing system-based solutions based on the group's long experience and knowledge in selling PLDs, the group will endeavor to move in the second half toward restoring profitability. With respect to analog ICs, ASSPs, and memory products, the group focus will be on enhancing synergies with the PLD business and on developing product mixes that maximize growth and profitability.

Based on the foregoing, the PALTEK group is projecting the following results for the fiscal year ending December 2006: net sales, 12,740 million yen; operating deficit, 490 million yen; ordinary loss, 575 million yen; and net loss, 344 million yen. On a non-consolidated basis, the group is projecting net sales of 9,000 million yen, an operating deficit of 570 million yen, an ordinary loss of 620 million yen, and a net loss of 368 million yen.

Consolidated balance sheet

Thousands of yen	December 31, 2004	%	December 31, 2005	%	Year-on-year change
Current assets					
Cash and bank deposits	2,444,243		3,049,169		
Notes and accounts receivable	3,983,536		4,058,171		
Inventories	4,111,324		4,273,456		
Consumption taxes receivable	837,521		1,026,014		
Deferred tax assets	64,175		71,154		
Others	173,479		78,301		
Allowance for doubtful accounts	(6,706)		(4,262)		
	<u>11,607,573</u>	91.1	<u>12,552,004</u>	93.1	944,430
Fixed assets					
Tangible fixed assets					
Buildings	136,046		137,074		
Accumulated depreciation	(78,621)		(86,742)		
	<u>57,425</u>		<u>50,332</u>		
Vehicle equipment	920		920		
Accumulated depreciation	(873)		(874)		
	<u>46</u>		<u>46</u>		
Furniture and fixtures	386,814		387,464		
Accumulated depreciation	(308,647)		(318,188)		
	<u>78,166</u>		<u>69,276</u>		
Land	14,736		14,736		
	<u>150,374</u>	1.2	<u>134,390</u>	1.0	(15,983)
Intangible fixed assets	117,924	0.9	59,534	0.4	(58,389)
Investments and other assets					
Investment securities	413,389		268,022		
Deferred tax assets	148,621		139,367		
Others	306,164		334,536		
	<u>868,175</u>	6.8	<u>741,926</u>	5.5	(126,249)
Total fixed assets	<u>1,136,474</u>	8.9	<u>935,851</u>	6.9	(200,622)
Total assets	<u>12,744,048</u>	100.0	<u>13,487,856</u>	100.0	743,808

PALTEK CORPORATION

Thousands of yen	December 31, 2004	%	December 31, 2005	%	Year-on-year change
Current liabilities					
Notes and accounts payable	1,071,794		1,970,953		
Short-term bank loans	1,763,152		1,738,350		
Income taxes payable	211,338		52,010		
Accrued bonuses	51,344		42,156		
Others	344,496		406,602		
	<u>3,442,125</u>	27.0	<u>4,210,073</u>	31.2	<u>767,947</u>
Long-term liabilities					
Long-term bank loans	114,170		5,820		
Liability for employees' retirement benefits	46,592		42,309		
Liability for directors' and corporate auditors' retirement benefits	276,651		288,776		
Consolidation translation adjustments	3,190		1,914		
Others	85,343		102,306		
	<u>525,947</u>	4.1	<u>441,126</u>	3.3	<u>(84,821)</u>
Total liabilities	3,968,073	31.1	4,651,199	34.5	683,126
Minority interests	64,567	0.5	67,619	0.5	3,051
Shareholders' equity					
Capital stock	1,339,634	10.5	1,339,634	9.9	-
Capital surplus	2,698,526	21.2	2,698,526	20.0	-
Retained earnings	4,723,951	37.1	4,829,522	35.8	105,571
Unrealized gains on securities - net	22,173	0.2	31,515	0.2	9,342
Treasury stock	(72,877)	(0.6)	(130,161)	(0.9)	(57,283)
	<u>8,711,407</u>	68.4	<u>8,769,037</u>	65.0	<u>57,630</u>
Total liabilities, minority interests and shareholders' equity	<u>12,744,048</u>	100.0	<u>13,487,856</u>	100.0	<u>743,808</u>

Consolidated statement of income

Thousands of yen	Year ended December 31, 2004	%	Year ended December 31, 2005	%	Year-on-year change
Net sales	19,355,863	100.0	17,946,928	100.0	(1,408,935)
Cost of sales	15,551,144	80.3	14,585,245	81.3	(965,898)
Gross profit	3,804,719	19.7	3,361,682	18.7	(443,036)
Selling, general and administrative expenses					
Provision for doubtful accounts	-		327		
Salary	934,578		915,424		
Provision for bonuses	50,258		41,185		
Provision for directors' and corporate auditors' retirement benefits	28,253		14,183		
Rent expenses	410,327		356,776		
Amortization of goodwill	11,163		-		
Others	1,571,677		1,492,234		
	3,006,260	15.5	2,820,132	15.7	(186,127)
Operating income	798,459	4.2	541,549	3.0	(256,909)
Nonoperating income					
Interest income	857		765		
Dividend income	235		206		
Foreign exchange gain	184,908		-		
Gain on sale of investment securities	3,516		2,136		
Interest on refunds of consumption taxes	-		2,163		
Amortization of negative goodwill	-		1,276		
Others	18,945		2,847		
	208,462	1.0	9,396	0.1	(199,066)
Nonoperating expenses					
Interest expenses	19,099		17,312		
Losses on doubtful accounts	15,025		6,195		
Commissions paid	11,453		13,747		
Foreign exchange loss	-		114,239		
Losses on assignment of receivables	15,748		16,440		
Others	10,393		9,648		
	71,720	0.4	177,584	1.0	105,863
Ordinary income	935,201	4.8	373,361	2.1	(561,839)
Extraordinary income					
Gain on sale of fixed assets	-		1,292		
Gain on reversal of directors' retirement benefits	900		1,664		
Reversal of allowance for doubtful accounts	112		-		
Gain on sale of investment securities	-		41,558		
Gain on redemption of investment securities	-		2,041		
Gain on reversal of guarantee liabilities	-		752		
	1,012	0.0	47,308	0.3	46,296

PALTEK CORPORATION

Thousands of yen	Year ended December 31, 2004	%	Year ended December 31, 2005	%	Year-on-year change
Extraordinary losses					
Loss on sale of fixed assets	-		1,295		
Loss on disposal of fixed assets	8,038		1,201		
Loss on valuation of investment securities	-		2,972		
Loss on liquidation of subsidiaries and affiliated companies	-		5,302		
	<u>8,038</u>	0.0	<u>10,771</u>	0.1	2,733
Income (loss) before income taxes and minority interests	928,175	4.8	409,899	2.3	(518,276)
Income taxes - current	251,487		163,951		
Income taxes - deferred	181,237		(3,504)		
	<u>432,724</u>	2.2	<u>160,446</u>	0.9	(272,277)
Minority interest in income (loss) of consolidated subsidiaries	11,865	0.1	5,957	0.0	(5,908)
Net income	<u>483,584</u>	2.5	<u>243,494</u>	1.4	(240,089)

Consolidated statement of retained earnings

Thousands of yen	Year ended December 31, 2004	Year ended December 31, 2005	Year-on-year change
Capital surplus			
Balance, beginning of period	2,694,389	2,698,526	4,137
Increase			
New shares issued due to exercise of subscription rights	4,137	-	
	4,137	-	(4,137)
Balance, end of period	2,698,526	2,698,526	-
Retained earnings			
Balance, beginning of period	4,391,414	4,723,951	332,536
Increase			
Net income	483,584	243,494	
	483,584	243,494	(240,089)
Decrease			
Cash dividends	118,338	117,423	
Directors' bonuses	32,709	20,500	
	151,047	137,923	(13,124)
Balance, end of period	4,723,951	4,829,522	105,571

Consolidated statement of cash flows

Thousands of yen	Year ended December 31, 2004	Year ended December 31, 2005	Year-on-year change
Net cash from operating activities			
Income (loss) before taxes and minority interests	928,175	409,899	(518,276)
Depreciation	117,104	103,631	(13,472)
Amortization of goodwill	11,163	(1,276)	(12,439)
Loss on valuation of investment securities	-	5,302	5,302
Decrease in allowance for doubtful accounts	(8,060)	(2,444)	5,616
Decrease in accrued bonuses	(4,406)	(9,187)	(4,780)
Increase (decrease) in liability for employees' retirement benefits	12,880	(4,282)	(17,162)
Increase in liability for directors' and corporate auditors' retirement benefits	16,603	12,125	(4,478)
Interest and dividend income	(1,092)	(972)	119
Interest expenses	19,099	17,312	(1,786)
Foreign exchange gain	-	(354)	(354)
Foreign exchange loss	351	-	(351)
Gain on sale of investment securities	(3,516)	(43,694)	(40,178)
Gain on redemption of investment securities	-	(2,041)	(2,041)
Gain on sale of tangible fixed assets	-	(1,292)	(1,292)
Loss on sale of tangible fixed assets	-	1,295	1,295
Loss on disposal of tangible fixed assets	2,373	1,201	(1,172)
Loss on valuation of tangible fixed assets	-	2,694	2,694
Loss on disposal of intangible fixed assets	5,664	-	(5,664)
Loss on valuation of intangible fixed assets	-	278	278
Decrease (increase) in accounts receivable - trade	277,223	(79,999)	(357,222)
Decrease (increase) in inventories	(3,498)	(162,687)	(159,188)
Increase in payables - trade	142,536	899,158	756,622
Increase in consumption tax receivable	(326,320)	(108,088)	218,231
Decrease in advance payments	56,630	21,872	(34,758)
Increase (decrease) in advances	(4,914)	2,911	7,825
Bonus paid to directors and corporate auditors	(33,715)	(21,730)	11,985
Others	(4,736)	88,276	93,012
	1,199,547	1,127,907	(71,639)
Interest and dividends received	398	293	(104)
Interest paid	(18,354)	(17,000)	1,353
Tax refunds	214,245	-	(214,245)
Income tax paid	(122,047)	(338,288)	(216,240)
	1,273,789	772,912	(500,876)

PALTEK CORPORATION

Thousands of yen	Year ended December 31, 2004	Year ended December 31, 2005	Year-on-year change
Net cash from investing activities			
Increase in time deposits	(44,001)	(44,001)	0
Decrease in time deposits	49,001	40,000	(9,001)
Purchases of investment securities	(376)	(5,954)	(5,578)
Proceeds from sale of investment securities	-	195,605	195,605
Purchases of tangible fixed assets	(19,400)	(29,482)	(10,081)
Proceeds from sale of tangible fixed assets	-	2,600	2,600
Purchases of intangible fixed assets	(25,464)	(8,645)	16,819
Increase in investment in partnership	(9,335)	-	9,335
Proceeds from sale of investment to partnership	4,903	-	(4,903)
Payments for loans	-	(315)	(315)
Increase in other investments	(21,943)	(21,052)	891
Decrease in other investments	44,244	9,515	(34,728)
	(22,371)	138,272	160,643
Net cash from financing activities			
Net decrease in short term bank loans	(70,000)	-	70,000
Proceeds from long term bank loans	300,000	-	(300,000)
Repayment of long term bank loans	(69,348)	(133,152)	(63,804)
Purchases of treasury stock	(68,942)	(57,283)	11,658
Proceeds from issuance of common stock	8,284	-	(8,284)
Cash dividends paid to minority shareholders	(665)	(1,995)	(1,330)
Cash dividends paid	(118,024)	(117,877)	147
	(18,695)	(310,307)	(291,612)
Effect of exchange rate changes on cash and cash equivalents	(215)	48	264
Net increase in cash and cash equivalents	1,232,506	600,925	(631,580)
Cash and cash equivalents, beginning of period	1,179,737	2,412,243	1,232,505
Cash and cash equivalents, end of period	2,412,243	3,013,168	600,925

Material information regarding preparation of consolidated financial statements

Item	December 31, 2004	December 31, 2005
1. Scope of consolidation	(1) Number of consolidated subsidiaries: 2 Names of consolidated subsidiaries: Alpha Electronics, Inc. Spinnaker Systems, Inc.	(1) Number of consolidated subsidiaries: 2 Names of consolidated subsidiaries: Same as previous year
	(2) Names of unconsolidated subsidiaries: Alpha Electron (HK) Co., Ltd. (Reasons for exclusion from consolidation) 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.	(2) Names of unconsolidated subsidiaries: Same as previous year (Reasons for exclusion from consolidation) Same as previous year
2. Application of equity method	(1) Number of affiliated companies to which the equity method is applicable: -	(1) Number of affiliated companies to which the equity method is applicable: -
	(2) Name of unconsolidated subsidiary to which the equity method is not applicable: Alpha Electron (HK) Co., Ltd. (Reasons for exclusion from consolidation) 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.	(2) Name of unconsolidated subsidiary to which the equity method is not applicable: Same as previous year (Reasons for exclusion from consolidation) Same as previous year
3. Accounting period of consolidated subsidiaries	All subsidiaries have fiscal-year ends that are the same as the day of consolidated closing.	Same as previous year
4. Significant accounting policies		
(1) Valuation of material assets	(A) Securities: Available-for-sale securities: Available-for-sale securities with market values: 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) Available-for-sale securities without market values: Stated at moving average cost	(A) Securities: Available-for-sale securities: Available-for-sale securities with market values: Same as previous year Available-for-sale securities without market values: Same as previous year
	(B) Derivatives: Stated at fair market value	(B) Derivatives: Same as previous year

PALTEK CORPORATION

Item	December 31, 2004	December 31, 2005
	<p>(C) Inventories:</p> <p>(a) Merchandise:</p> <p style="padding-left: 20px;">Stated by moving average cost (Changes in accounting methods)</p> <p style="padding-left: 20px;">During the period, one subsidiary changed their inventory valuation methods from the last-invoice cost to the moving-average cost method.</p> <p style="padding-left: 20px;">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>(C) Inventories:</p> <p>(a) Merchandise:</p> <p style="padding-left: 20px;">Stated by moving average cost</p>
	<p>(b) Supplies:</p> <p style="padding-left: 20px;">Stated by last purchased price method</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 style="padding-left: 20px;">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 style="padding-left: 20px;">Useful lives are as follows:</p> <p style="padding-left: 40px;">Buildings: 10 - 45 years</p> <p style="padding-left: 40px;">Vehicle equipment: 6 years</p> <p style="padding-left: 40px;">Furniture and fixtures: 5 - 15 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;">The straight-line method.</p> <p style="padding-left: 20px;">Useful life of the software for internal use is 5 years.</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 style="padding-left: 20px;">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 style="padding-left: 20px;">Same as previous year</p>
	<p>(B) Accrued bonuses:</p> <p style="padding-left: 20px;">Reserves are provided to cover the estimated amount of bonuses payable to employees.</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;">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>(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 style="padding-left: 20px;">An allowance is provided by the Company to cover the estimated amount of retirement benefits payable to directors and corporate auditors.</p>	<p>(D) Liability for directors' and corporate auditors' retirement benefits:</p> <p style="padding-left: 20px;">An allowance is provided by the Company to cover the estimated amount of retirement benefits payable to directors and corporate auditors.</p> <p style="padding-left: 20px;">The Company froze its system of retirement bonuses for directors and corporate auditors on March 26, 2005. Consequently, there has been no new provisioning of retirement bonuses for directors since that date.</p>

PALTEK CORPORATION

Item	December 31, 2004	December 31, 2005
(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 employs deferred hedge accounting. Foreign exchange contracts with accounts payable in a foreign currency as their hedge target are translated, however, at the yen value of the contract date. Difference from the balance sheet date should be recognized over the intervening period if the gap is not immaterial.	(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	Treatment of consumption taxes: Transactions subject to consumption taxes are recorded at amounts exclusive of consumption taxes.	Treatment of consumption taxes: Same as previous year
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

Item	December 31, 2004	December 31, 2005
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

	December 31, 2004	December 31, 2005
(Consolidated balance sheet)		
1. 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.		-
2. Based on a revision passed in 2004 ("Law Revising a Part of the Securities and Exchange Law"; Law no. 97, 2004), Article 2-2 of the Securities and Exchange Law now considers investments in limited partnerships and similar associations to be investment securities. Consequently, investments recorded in the year-earlier period in the "others" category of "investments and other assets" (in the amount of ¥60,142 thousand) are included this year in the "investment securities" category. As of the end of the period under review, investments in limited partnerships (which are included under "investment securities") amounted to ¥63,247 thousand.		

Notes (Consolidated balance sheet)

Thousands of yen	December 31, 2004	December 31, 2005
1. Amount of notes receivable discounted	39,255	1. Amount of accounts receivable - trade offered as collateral 8,617
Amount of accounts receivable - trade offered as collateral	7,017	
2. Retroactive liability due to securitization	325,221	2. Retroactive liability due to securitization 303,713
3. Investment in unconsolidated subsidiaries	1,796	3. Investment in unconsolidated subsidiaries 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.		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	Overdraft and loan commitment agreements 8,050,000
Amounts drawn down	1,430,000	Amounts drawn down 1,400,000
Unused lines of credit	6,720,000	Unused lines of credit 6,650,000
5. Total number of shares outstanding		5. Total number of shares outstanding
Common stock	11,849,899 shares	Common stock 11,849,899 shares
6. Number of treasury shares held		6. Number of treasury shares held
Common stock	107,567 shares	Common stock 188,415 shares

(Consolidated statement of income)

Thousands of yen	December 31, 2004		December 31, 2005
1. Total research and development expenses		1. Total research and development expenses	
Research and development expenditures included in selling, general and administrative expenses	21,000	Research and development expenditures included in selling, general and administrative expenses	2,912
2.	-	2. Breakdown of gain on sale of fixed assets	
		Furniture and fixtures	1,292
3.	-	3. Breakdown of loss on sale of fixed assets	
		Furniture and fixtures	1,295
4. Breakdown of loss on disposal of fixed assets		4. Breakdown of loss on disposal of fixed assets	
Buildings	49	Furniture and fixtures	1,201
Vehicle equipment	33		
Furniture and fixtures	2,290		
Software	5,664		
5.	-	5. Loss on valuation of fixed assets	
		Furniture and fixtures	2,694
		Software	278

(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, 2004	December 31, 2005
Cash and bank deposits	2,444,243	3,049,169
Time deposits with maturities longer than 3 months	(32,000)	(36,001)
Cash and cash equivalents	2,412,243	3,013,168

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, 2004	December 31, 2005
Furniture and fixtures		
Acquisition cost equivalent	38,834	38,834
Accumulated depreciation equivalent	24,279	32,069
Book value equivalent	14,555	6,765
Vehicle equipment		
Acquisition cost equivalent	29,880	33,020
Accumulated depreciation equivalent	1,447	6,688
Book value equivalent	28,433	26,331
Software		
Acquisition cost equivalent	560,391	35,850
Accumulated depreciation equivalent	490,299	30,692
Book value equivalent	70,091	5,157
Total		
Acquisition cost equivalent	629,106	107,705
Accumulated depreciation equivalent	516,025	69,450
Book value equivalent	113,081	38,254

(2) Future minimum lease payments

Thousands of yen	December 31, 2004	December 31, 2005
Within one year	80,060	14,960
Over one year	36,300	24,239
	116,360	39,200

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

Thousands of yen	December 31, 2004	December 31, 2005
Lease payments	127,116	81,938
Depreciation equivalent	121,315	77,966
Interest expense equivalent	3,141	1,637

(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, 2004	December 31, 2005
Within one year	1,055	1,094
Over one year	3,309	2,214
	4,364	3,309

Securities

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
Investment in limited partnership, etc.	63,247
	264,035

December 2005 term

1. Available-for-sale securities with market values

Thousands of yen	December 31, 2005		
	Acquisition cost	Book value	Difference
Fair market value exceeds acquisition cost			
Stocks	7,252	17,534	10,282
Bonds			
JGB, Local government bonds	-	-	-
Corporate bonds	-	-	-
Others	-	-	-
Others	70,637	114,219	43,581
	<u>77,889</u>	<u>131,754</u>	<u>53,864</u>
Fair market value does not exceeds acquisition cost			
Stocks	4,336	3,230	(1,106)
Bonds			
JGB, Local government bonds	-	-	-
Corporate bonds	-	-	-
Others	-	-	-
Others	3,472	3,145	(327)
	<u>7,808</u>	<u>6,375</u>	<u>(1,433)</u>
	<u>85,698</u>	<u>138,129</u>	<u>52,431</u>

(Note)

During the term ended December 31, 2005, an impairment loss in the amount of ¥302 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, 2005
Amount sold	195,605
Total gain on sales	43,694
Total loss on sales	-

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

Thousands of yen	December 31, 2005
Available-for-sale securities	
Unlisted securities (excluding OTC-traded stocks)	54,788
Investment in limited partnerships, etc.	73,309
	<u>128,097</u>

Derivative transactions

December 31, 2004	December 31, 2005
<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 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>	<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 Kanto IT Software Welfare Pension Fund, 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 December 31, 2004 was 262,356 thousand yen and 308,759 thousand yen as of December 31, 2005.

On October 1, 2005, the name of the welfare pension fund in which the Company participates was changed from the "welfare pension fund for the computer industry association" (the Tokyo Small Computer Software Industry Welfare Pension Fund) to the "Kanto IT Software Welfare Pension Fund."

2. Retirement benefit obligations

Thousands of yen	December 31, 2004	December 31, 2005
Projected benefit obligations	(174,427)	(186,409)
Fair value of plan assets	127,834	144,100
Liability for employees' retirement benefits	(46,592)	(42,309)

3. Pension and severance costs

Thousands of yen	December 31, 2004	December 31, 2005
Retirement benefit costs		
Service cost	38,705	20,087
Contribution to the jointly established welfare pension fund	22,358	26,219
Contribution to the mutual funds for retirement allowances for medium and small companies	1,715	1,380
Special retirement benefit	2,111	18
Retirement benefit costs	64,890	47,705

4. Assumptions used in the accounting for retirement benefit obligations

	December 31, 2004	December 31, 2005
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, 2004		December 31, 2005
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	
Accrued enterprise tax	19,115	Accrued enterprise tax	6,889
Loss on valuation of inventories	13,938	Loss on valuation of inventories	39,253
Accrued bonuses in excess of tax limit	20,957	Accrued bonuses in excess of tax limit	17,210
Liability for employees' retirement benefits	18,526	Liability for employees' retirement benefits	16,859
Liability for retirement benefits to directors and corporate auditors	112,867	Liability for retirement benefits to directors and corporate auditors	117,818
Loss on valuation of investment securities	22,009	Loss on valuation of investment securities	16,105
Loss carry forward	70,327	Loss carry forward	50,873
Others	<u>23,012</u>	Others	<u>16,664</u>
	300,754		281,675
Valuation allowance	<u>(75,797)</u>	Valuation allowance	<u>(60,167)</u>
	224,957		221,508
Deferred tax liabilities		Deferred tax liabilities	
Revaluation gain on investment securities	(11,817)	Revaluation gain on investment securities	<u>(10,986)</u>
Others	<u>(342)</u>		<u>(10,986)</u>
	(12,159)	Net deferred tax assets	210,521
Net deferred tax assets	212,797		
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	64,175	Current assets - deferred tax assets	71,154
Fixed assets - deferred tax assets	148,621	Fixed assets - deferred tax assets	139,367
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%	Pursuant to provisions of Article 15-5-3 of the rules relating to financial statements, etc., the difference between the effective tax rate as stipulated by law and the corporate tax rate after application of interperiod tax allocation is less than 5 percent, therefore the figure is not reported in this section.	
(Adjustment)			
Entertainment expenses, etc. non deductible portion	1.01%		
Amortization of goodwill	0.51%		
Inhabitants tax	0.64%		
Special corporate tax credit	(1.05)%		
Effect of changes in tax rates	0.22%		
Effect of the increase in valuation allowances	3.52%		
Others	<u>(0.23)%</u>		
Effective income tax rate	46.62%		

Segment information

Business segment information

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

The PALTEK group has no subsidiaries operating outside of Japan and no significant overseas branches. Consequently, this section is not applicable.

Overseas sales

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

Related party transactions

December 2005 term

Directors and major individual shareholders, etc.

December 31, 2005; 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				
Director or close relative										
Kazutaka Muraguchi	-	-	Corporate auditor of the Company	Direct 0.1	-	-	Sale of investment securities (see notes 1 and 2)		-	-
							Proceeds from sale	60,980		
							Profit from sale	19,980		

(Notes)

- This transaction involved the sale of shares in Trinity Security Systems Inc. to the following entities: Tokushima Market Creation Limited Investment Partnership No. 1, whose general partner, Mr. Kazutaka Muraguchi, was also the representative director of Nippon Technology Venture Partners; Nippon Technology Venture Partners i-S1 Investment Partnership, a partnership whose executive partner was the same Mr. Muraguchi; and Nippon Technology Venture Partners Limited Partnership No. 5, whose general partner was also Mr. Muraguchi.
- Terms of transaction and policy for deciding on the terms of the transaction
The sales price for the shares was determined by taking into account the paid-in value of a recent allocation of new shares to a third party by the issuing company.

Per share-related financial information

Yen	December 31, 2004	December 31, 2005
Net assets per share	740.13	751.61
Net income per share	39.16	20.47
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, 2005 because the Company had no residual securities capable of diluting earnings.	

(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, 2004	December 31, 2005
Net income per share		
Net income	483,584	243,494
Amount not attributable to common shareholders	20,500	4,174
[Of which, amount paid out as bonuses to directors pursuant to Statement of Appropriation of Net Income]	[20,500]	[4,174]
Net income related to common stock	463,084	239,320
Average number of shares outstanding during term (shares)	11,825,029	11,691,064
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) 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)	(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: 315,300 shares) (Stock acquisition rights based on Articles 280-20 and 280-21 of the Commercial Code) 3 types, 2,600 stock acquisition rights (number of shares to be issued through the exercise of stock acquisition rights: 260,000 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 Annual 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 Annual General Meeting of Shareholders), the Company shall propose such payments at the General Meeting of Shareholders 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, 2005 are as follows:

Thousands of yen	December 31, 2004		December 31, 2005		Change from the previous year (%)	
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)
Semiconductor business	15,461,671	100.0	14,660,752	100.0	(800,918)	(5.2)
	15,461,671	100.0	14,660,752	100.0	(800,918)	(5.2)

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

2. Orders received

Orders received during the term ended December 31, 2005 as follows:

Thousands of yen	December 31, 2004		December 31, 2005		Change from the previous year (%)	
	Orders received	Backlog	Orders received	Backlog	Orders received	Backlog
Semiconductor business	19,424,481	1,282,193	18,647,353	1,982,619	(777,128)	700,425
	19,424,481	1,282,193	18,647,353	1,982,619	(777,128)	700,425

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

3. Sales

Sales during the term ended December 31, 2005 as follows:

Thousands of yen	December 31, 2004		December 31, 2005		Change from the previous year (%)	
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)
Semiconductor business	19,355,863	100.0	17,946,928	100.0	(1,408,935)	(7.3)
	19,355,863	100.0	17,946,928	100.0	(1,408,935)	(7.3)

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