





## (2) Consolidated financial position

	Total assets	Net assets	Equity ratio	Net assets per share
	(Millions of yen)	(Millions of yen)	%	(Yen)
December 31, 2006	11,074	8,680	77.8	738.88
December 31, 2005	13,487	8,769	65.0	751.61

(Note) Number of shares issued and outstanding at year-end (consolidated):

December 2006 term: 11,660,952

December 2005 term: 11,661,484

## (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 2006	4,016	114	(5,037)	2,108
Fiscal 2005	772	138	(310)	3,013

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

Number of consolidated subsidiaries:

3

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): 1

(Elimination):

Equity method (new):

(Elimination):

## 2. Consolidated forecasts for fiscal year to December 2007

(From January 1, 2007 to December 31, 2007)

	Net sales	Operating income	Ordinary income	Net income
	(Millions of yen)	(Millions of yen)	(Millions of yen)	(Millions of yen)
Interim 2007	9,200	(438)	(458)	(283)
Fiscal 2007	21,500	(315)	(370)	(230)

(N.b.) Projected net income per share for fiscal 2007: (19.72) yen

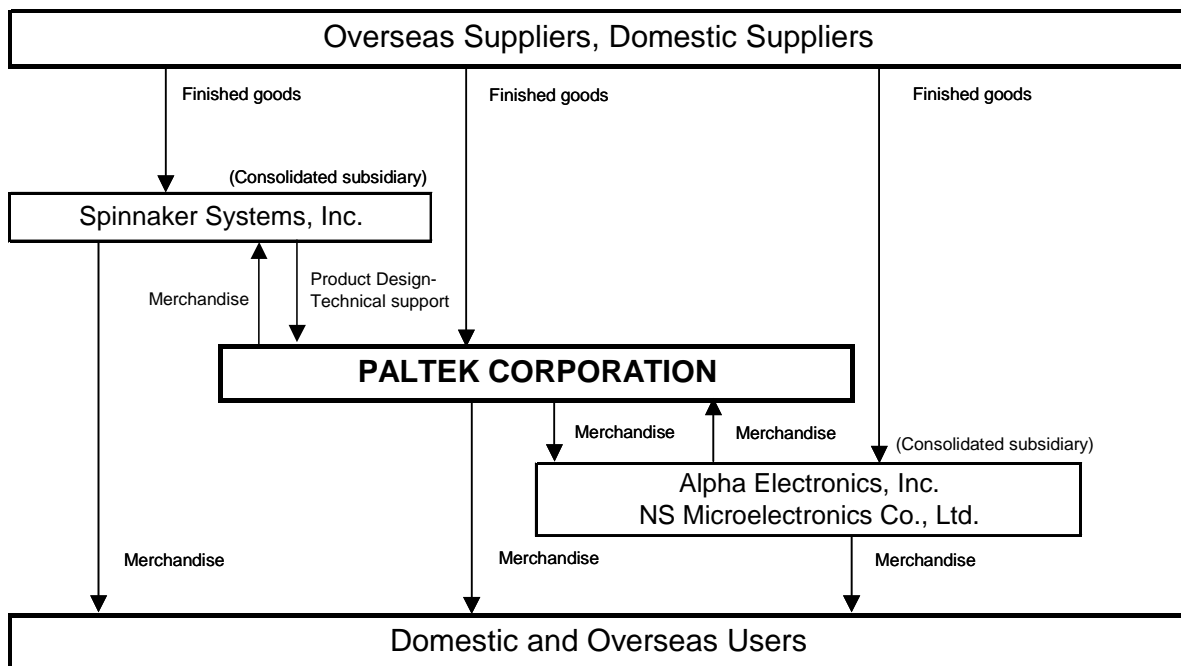
*The forecasts stated above are based on our current expectations and assumptions prepared using information available at present and subject to various uncertainties. Actual results may differ significantly due to a variety of causes. Please refer to the attached Page 15 for information regarding the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

On May 16, 2006, PALTEK added NS Microelectronics Co., Ltd. to its Group by acquiring 100% of the company’s shares.

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) NS Microelectronics Co., Ltd. (NS Microelectronics) Spinnaker Systems, Inc. (Spinnaker Systems)



## Management policy and results of operations

### 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 its customers, suppliers, employees, and shareholders, and the local communities in which it operates.

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. More than just a distributor, the PALTEK Group endeavors to provide its customers with the best possible solutions 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 continue to work diligently to develop the electronics industry and to contribute to a more convenient and dynamic ubiquitous network society—and, on that basis, to coexist in a mutually beneficial way with all its stakeholders.

#### **2. Basic policy regarding the distribution of profits**

The PALTEK Group recognizes that providing shareholders with value 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 its 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 in consideration of 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 five management strategies to achieve these medium-term goals.

(1) Rebuilding and strengthening the mainstay PLD solutions business

PLDs (programmable logic devices) are customized products for specific functions with the ability to respond flexibly and speedily to changes in the market environment. The PALTEK Group has been marketing them as core products for more than 20 years. In the fiscal year under review, the Company changed its supplier of PLDs, signing a distribution agreement with Xilinx, Inc., a worldwide leader in PLD solutions, on January 25, 2006 and began marketing Xilinx's products. The Group has recommitted itself to supporting its existing customer base by proposing system-based solutions which utilize the know-how and experience in technical support 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 the 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 under-served market segments and to expand the devices and instruments to 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. The PALTEK Group's operations in the field of analog solutions have been led by Alpha Electronics, Inc., a subsidiary whose customer base is centered in Western Japan and whose principal business is the distribution of products manufactured by National Semiconductor Corporation, a worldwide leader in high performance analog devices and subsystems. On May 16, 2006, the PALTEK Group strengthened its position in this field further with the acquisition of NS Microelectronics Co., Ltd., the top distributor of National Semiconductor's products in the Japanese market whose customers include major electric manufacturers with operations centered in the Kanto region. Taking this opportunity, the PALTEK Group will bring to bear the knowledge and experience it has accumulated in this field in an 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.

(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 these networks are prompting the

development of new markets driven by the convergence of communications, broadcasting and consumer appliances. To meet the needs of these 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 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 volumes 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" that respond to a wide variety of customer needs, including those for high-speed memory and power management 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): a high-performance semiconductor that is 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 this environment, the PALTEK Group believes it constantly tuned in to the latest products and technological trends and capable of developing methods and products that assist in the solution of its customers' problems.

It realizes, more over that it must continue to provide technical support regarding these new and increasingly complex products. Toward this end, the PALTEK Group will endeavor to attract and nurture engineers and sales personnel who are highly knowledgeable about markets and technologies and capable of providing proficient technical support.

- (5) Strengthening the Group management

Effective May 16, 2006, the Company acquired NS Microelectronics Co., Ltd., a leading Japanese distributor of National Semiconductor's products, and made it a Group company. The PALTEK Group now comprises four companies. Each of the Group companies has special features in terms of products handled and customer base. In the future, the Group intends to collaborate by sharing the strengths of the individual companies to target overall growth in business opportunities. In addition, the Group will pursue efficient Group management through business reorganization and integration and personnel exchanges.

**5. Matters related to the parent company, etc.**

The Company has no parent company.

**6. Development of a system of internal control; operational status of this system****(1) Policies with respect to internal control**

The PALTEK Group regards internal control as a corporate governance function aimed at maximizing the continued growth of enterprise value and at realizing “*kyosei*—cooperative growth.” The Group considers internal control to be the structure by which its fundamental policy on governance, which is “to enhance the transparency of management in order to respond quickly to changes in the market environment,” can be appropriately and reasonably executed.

**(2) Internal control structure**

Based on the policy described in item (1) above, the Company has developed the following structure for internal control:

- 1) It has established an internal audit division with the authority to function as an internal checking mechanism for the Group as a whole.
- 2) In relation to administration, it has established a clear distinction between its Operations and business divisions. The Operations Division, which comprises legal affairs, human resources, accounting and finance, public/investor relations, facilities and services, and information systems, not only supports the Business Division, but it also provides oversight and risk management-related functions.
- 3) In terms of internal regulations, the Company has completed all the work with respect to necessary regulations. If the need arises to prepare new regulations in response to changes in laws and ordinances, the Company is prepared to respond to such needs.
- 4) It has established a risk management office within the Operations Division to protect the Company against various risks, including economic loss, natural disasters, etc; and it has developed measures to deal quickly and appropriately with such emergencies should they arise.

**(3) Measures adopted over the past year to improve the system of internal control**

The Company has taken the following recent actions with respect to internal control and internal oversight systems.

- 1) With the coming into force of the Corporation Law, it has rebuilt its internal control system and established a risk management office.

- 2) To ensure the effectiveness of the actions described in item 1), the Company has adopted the following regulations: “basic regulations on compliance”; “risk management regulations”; and “regulations on the communication of risk-related information.”
- 3) Over the past year, the Company has conducted 15 internal audits covering the operations of the entire Group. These audits examined the Group’s activities from a number of perspectives, including: adherence to rules on information security; legal compliance; degree of conformity to operational regulations; efficiency of operational execution; etc.

**7. 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, 2006

#### (1) Operating results

The Japanese economy remained in a recovery mode during the fiscal year ended December 31, 2006. Private sector capital expenditures increased amid favorable corporate earnings, and personal consumption remained firm due to improvements in the employment environment and in personal income. The electronics industry also maintained a firm overall tone, benefiting from the growth in capital expenditures and firm consumer spending.

Operating in this market environment, the PALTEK Group gave priority to rebuilding its business after making a change in its supplier of PLDs (customized products for specified functions), its core business. To begin with, the Group transferred all customers and returned all inventory related to its business with Altera Corporation, with which its distributor agreement ended on March 31, 2006, and completed collection of all related outstanding amounts for returned inventory by June 30, 2006.

At the same time, the PALTEK Group commenced the development of business with Xilinx, Inc., a worldwide leader in PLD solutions with which the Company formally concluded a distribution agreement on January 25, 2006. Proceeding with sales operations and construction of a sales promotion organization, the Group worked to transfer the customers it is now responsible for servicing and to acquire new customers. As a result, sales operations commenced as originally planned, with shipments starting on April 1, 2006. The sales promotion organization also began in a timely fashion, with staff responsible for operations obtaining certification as Xilinx sales representatives by May. The Group is currently making steady progress in its sales activities, actively expanding its customer base and acquiring contracts by conducting a variety of sales promotions and holding technical seminars.

Despite these efforts, the booking of full-scale sales for the operations has been postponed into the next fiscal year because the transfer of customers the Group currently services took three to six months longer than originally planned. The Group had completed most transfers of major customers or decided their transfer dates by the end of the year, and it expects sales to recover steadily in the new year.

There were also changes in the analog solutions business, the PALTEK Group's second core business, during the fiscal year. Effective May 16, 2006, the Company acquired NS Microelectronics Co., Ltd., a leading Japanese distributor of National Semiconductor's products, and made it a Group company. This action will enable the Group to target growth in its customer base, particularly among major electronics manufacturers in Eastern Japan. In the future, the Group plans to rebuild its PLD solution sales quickly, while also achieving greater synergies with the reinforced analog solution business. At the same time, it will pursue further

development of its systems-based solution strategy using PLDs as the core. Sales of the system solutions business also are expanding, with memory product sales growing especially quickly. There has also been growth in the number of design wins for several ASSP products.

Against this background, consolidated net sales for the fiscal year declined 17.9% year on year to 14,729 million yen. Sales exceeded forecasts made at the beginning of the year due to the major contribution to sales made by NS Microelectronics, which was acquired during the fiscal year and made a subsidiary, and because of sales growth by several products, particularly memory products. These additional sales could not make up for the substantial drop in the sales of the core PLD solution business, however, which switched suppliers during the fiscal year, resulting in substantially reduced sales compared with the previous fiscal year.

Operating income also decreased, falling to an operating loss of 412 million yen compared with operating income of 541 million yen in the previous fiscal year. Despite efforts to reduce operating costs and expenses in consideration of the transfer period required for the PLD solution business, the gross profit ratio registered a decline in addition to the decline in net sales, because of the consolidation of NS Microelectronics and the resulting increase in operating costs and expenses.

Similarly, the Company posted an ordinary loss of 42 million yen compared with ordinary income of 373 million yen in the previous fiscal year. The operating loss was significantly offset by the exchange rate gain realized when converting the payments for the return of foreign-currency denominated inventory to Altera Corporation to yen, net nonoperating income and a gain on the valuation of derivatives used to hedge the exposure to currency risk on the foreign-currency denominated inventory held by the new subsidiary NS Microelectronics because of the depreciation of the yen. These in-flows could not, however, fully offset the operating loss.

Accordingly, the Company recorded a net loss of 36 million yen compared with net income of 243 million yen in the previous fiscal year.

## (2) Cash flow

Cash and cash equivalents decreased by 904 million yen compared to the end of the previous consolidated period, registering 2,108 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 4,016 million yen (cf. cash provided of 772 million yen during the previous fiscal year). This reflected a decline in inventories due to the temporary contraction in business caused by the termination of the Company's core business

with Altera Corporation and the delayed startup of its business with Xilinx. In addition, the collection of accounts receivable-trade progressed during the period.

*(Net cash from investing activities)*

Cash provided by investing activities amounted to 114 million yen (cf. cash provided of 138 million yen in the previous year), which largely reflected cash proceeds resulting from the addition of NS Microelectronics Co., Ltd. to the Group as a new subsidiary.

*(Net cash from financing activities)*

Cash used in financing activities amounted to 5,037 million yen (cf. cash used of 310 million yen in the previous period), reflecting the repayment of debt, redemption of corporate bonds, and payment of dividends.

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

	December 31, 2003	December 31, 2004	December 31, 2005	December 31, 2006
Equity ratio	70.3%	68.4%	65.0%	77.8%
Equity ratio based on market prices	106.6%	59.0%	40.6%	51.0%
Years required to redeem liabilities	7.1 years	1.5 years	2.4 years	0.0 years
Interest-coverage ratio	12.3	69.4	45.5	211.0

*(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 should 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 year ended December 2006.

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

The customers of the PALTEK Group principally comprise companies in the Japanese electronics industry. The financial performance of the Group is therefore 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 earnings structure 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 under review, the performance of the PALTEK Group was substantially affected by the termination as of March 31, 2006 of its long-withstanding distribution agreement with major business partner Altera Corporation, exposing the Group to business risk. In response, on January 25, 2006, the Group entered into a distributorship agreement with Xilinx, Inc., a global leader in PLD solutions, which will provide it with PLD products. In this way, the Group is endeavoring to mitigate the impact of the change on its future financial performance. In addition, on May 16, 2006, the Company added NS Microelectronics Co., Ltd. to the PALTEK Group through acquisition of its shares. NS Microelectronics is a leading distributor in Japan of products manufactured by National Semiconductor Corporation, a global leader in high performance analog devices and subsystems.

With this acquisition, Group sales of analog solutions, which had been principally the province of Alpha Electronics, Inc., will exceed 10,000 million yen. While analog solutions at this level will become a second major pillar of the Group's operations alongside PLD solutions, the amount procured from National Semiconductor will also increase sharply. Although the business relationships with both Xilinx and National Semiconductor are currently stable, if these supplier relationships were to become difficult to sustain in the future due to changes in the suppliers' distribution policies, reorganization of their sales networks, or other reasons, this could affect the Group's financial performance.

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

The PALTEK Group possesses information assets that are important tools for 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 of 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 were to fall 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 such factors as the need to pay indemnification for damages.

*ISMS (information security management system) Certification\*: Accreditation 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. Such measures cannot, however, guarantee the elimination of all foreign exchange risks. Consequently, sudden and rapid fluctuations in the 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 capabilities and the marketing prowess that enables it to tailor its services to individual clients.

The semiconductor industry is, however, 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 win influential suppliers. Even if agreements can be reached with such suppliers and their products begin to be supplied to customers, 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 endeavor to achieve the targets set in its projections by acquiring competitive new products, its financial performance could be affected by delays in getting the businesses that use these 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 provide these customers with products and technical support, the PALTEK Group established Alpha Electron (HK) Co., Ltd. in March 2002 and a representative office in Shanghai in October 2004. NS Microelectronics, which the Company acquired on May 16, 2006, and made a Group company, has a branch office in Singapore. The PALTEK Group intends to use this company as its sales and distribution base for Southeast Asia. Should there be a further shift overseas of the product development of the Group's customers in Japan, however, and should this shift be to regions beyond the reach of the PALTEK Group's sales operations, it could have a negative impact on the Group's financial performance.

### **3. Outlook for the year ending December 2007**

With respect to the operating environment, against the backdrop of a lull in the surge in oil prices and solid corporate performances, the PALTEK Group expects consumer spending to remain firm. The group projects that the electronics industry will achieve gradual growth, driven by growth in capital expenditures and consumer spending.

In this environment, the PALTEK Group will aim to rebuild the sales of its core PLD solutions business, focusing on building sales of the products of Xilinx, a worldwide leader in PLD solutions. Sales of these products commenced as of February 1, 2006. 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 rebuild its customer base and to acquire new business. It also intends to work to achieve an early recovery in profitability. This recovery will be gradual, however, because it will take at least six months to a year for the new business to contribute to sales. This amount of time is required for new products to become mass-produced. For this reason, the PLD solution business is expected to post an operating loss on a non-consolidated basis.

In the analog solution business, the PALTEK Group plans to strengthen sales through the mutually complementary collaboration of Alpha Electronics, Inc., and NS Microelectronics Co., Ltd. These sales efforts will be centered on the product lines of National Semiconductor Corporation and will take advantage of the regional features and customer bases of Alpha Electronics and NS Microelectronics as well as their individual strengths in various application coverages. In addition, viewing product supplier National Semiconductor's strategic strengthening of its high-performance analog IC business as a business opportunity, the Group will strengthen its sales in the communications and industrial equipment fields. Aiming to enhance the synergies among PLDs, memory products, and ASSPs, the Group will pursue sales of its specialty area, systems, proceeding with the expansion of its customer base and the development of applied devices.

Based on the foregoing, the PALTEK Group is projecting the following results for the fiscal year ending December 31, 2007: net sales, 21,500 million yen (up 46.0% year on year); operating loss, 315 million yen (cf. operating loss of 412 million yen in the previous year); ordinary loss, 370 million yen (cf. ordinary loss of 42 million yen in the previous year); and net loss, 230 million yen

(cf. net loss of 66 million yen in the previous year). On a non-consolidated basis, the Group is projecting the following: net sales, 10,640 million yen (up 62.6% year on year); operating loss, 425 million yen (cf. operating loss of 724 million yen in the previous year); ordinary loss, 460 million yen (cf. ordinary loss of 405 million yen in the previous year); and net loss, 280 million yen (cf. net loss of 254 million in the previous year).

## Consolidated balance sheet

Thousands of yen	December 31, 2005	%	December 31, 2006	%	Year-on-year change
<b>Current assets</b>					
Cash and bank deposits	3,049,169		2,148,622		
Notes and accounts receivable	4,058,171		3,966,758		
Inventories	4,273,456		3,246,472		
Consumption taxes receivable	1,026,014		148,951		
Deferred tax assets	71,154		36,876		
Others	78,301		153,365		
Allowance for doubtful accounts	(4,262)		(504)		
	<u>12,552,004</u>	93.1	<u>9,700,542</u>	87.6	<u>(2,851,461)</u>
<b>Fixed assets</b>					
<b>Tangible fixed assets</b>					
Buildings	137,074		153,980		
Accumulated depreciation	<u>86,742</u>		<u>106,580</u>		
	50,332		47,399		
Vehicle equipment	920		920		
Accumulated depreciation	<u>874</u>		<u>874</u>		
	46		46		
Furniture and fixtures	387,464		392,720		
Accumulated depreciation	<u>318,188</u>		<u>335,004</u>		
	69,276		57,715		
Land	<u>14,736</u>		<u>598</u>		
	134,390	1.0	105,759	1.0	(28,631)
<b>Intangible fixed assets</b>	59,534	0.4	116,529	1.0	56,994
<b>Investments and other assets</b>					
Investment securities	268,022		263,658		
Deferred tax assets	139,367		381,139		
Others	334,536		513,922		
Allowance for doubtful accounts	<u>-</u>		<u>(7,244)</u>		
	741,926	5.5	1,151,475	10.4	409,549
<b>Total fixed assets</b>	<u>935,851</u>	6.9	<u>1,373,764</u>	12.4	<u>437,912</u>
<b>Total assets</b>	<u>13,487,856</u>	100.0	<u>11,074,307</u>	100.0	<u>(2,413,549)</u>

PALTEK CORPORATION

Thousands of yen	December 31, 2005	%	December 31, 2006	%	Year-on-year change
<b>Current liabilities</b>					
Notes and accounts payable	1,970,953		1,430,343		
Short-term bank loans	1,738,350		95,820		
Income taxes payable	52,010		127,959		
Accrued bonuses	42,156		57,212		
Others	406,602		308,922		
	<u>4,210,073</u>	31.2	<u>2,020,257</u>	18.2	<u>(2,189,815)</u>
<b>Long-term liabilities</b>					
Long-term bank loans	5,820		-		
Liability for employees' retirement benefits	42,309		44,852		
Liability for directors' and corporate auditors' retirement benefits	288,776		290,187		
Goodwill	1,914		-		
Others	102,306		38,272		
	<u>441,126</u>	3.3	<u>373,312</u>	3.4	<u>(67,813)</u>
Total liabilities	<u>4,651,199</u>	34.5	<u>2,393,570</u>	21.6	<u>(2,257,629)</u>
<b>Minority interests</b>	67,619	0.5	-		-
<b>Shareholders' equity</b>					
Common stock	1,339,634	9.9	-		-
Capital surplus	2,698,526	20.0	-		-
Retained earnings	4,829,522	35.8	-		-
Unrealized gains on securities - net	31,515	0.2	-		-
Treasury stock	(130,161)	(0.9)	-		-
	<u>8,769,037</u>	65.0	<u>-</u>		<u>-</u>
<b>Total liabilities, minority interests and shareholders' equity</b>	<u>13,487,856</u>	100.0	<u>-</u>		<u>-</u>
<b>Net assets</b>					
<b>Shareholders' equity</b>					
Common stock	-	-	1,339,634	12.1	-
Capital surplus	-	-	2,698,526	24.4	-
Retained earnings	-	-	4,672,259	42.2	-
Treasury stock	-	-	(130,421)	(1.2)	-
	<u>-</u>	<u>-</u>	<u>8,579,998</u>	77.5	<u>-</u>
<b>Valuation/translation gains (losses)</b>					
Unrealized gains on securities - net	-	-	36,032	0.3	-
	<u>-</u>	<u>-</u>	<u>36,032</u>	0.3	<u>-</u>
<b>Minority interests</b>	<u>-</u>	<u>-</u>	<u>64,705</u>	0.6	<u>-</u>
Total net assets	<u>-</u>	<u>-</u>	<u>8,680,736</u>	78.4	<u>-</u>
<b>Total liabilities and net assets</b>	<u>-</u>	<u>-</u>	<u>11,074,307</u>	100.0	<u>-</u>

## Consolidated statement of income

Thousands of yen	Year ended December 31, 2005	% December 31, 2006	Year ended December 31, 2006	%	Year-on-year change
<b>Net sales</b>	17,946,928	100.0	14,729,321	100.0	(3,217,606)
<b>Cost of sales</b>	14,585,245	81.3	12,284,141	83.4	(2,301,104)
Gross profit	3,361,682	18.7	2,445,179	16.6	(916,502)
<b>Selling, general and administrative expenses</b>					
Provision for doubtful accounts	327		-		
Salary	915,424		961,297		
Provision for bonuses	41,185		46,272		
Provision for directors' and corporate auditors' retirement benefits	14,183		8,726		
Rent expenses	356,776		308,228		
Amortization of goodwill	-		7,751		
Others	1,492,234		1,525,222		
	2,820,132	15.7	2,857,500	19.4	37,367
Operating income	541,549	3.0	(412,320)	(2.8)	(953,869)
<b>Nonoperating income</b>					
Interest income	765		8,022		
Dividend income	206		157		
Commissions received	-		219,866		
Foreign exchange gain	-		118,753		
Gain on valuation of derivatives	-		59,517		
Gain on sale of investment securities	2,136		81		
Interest on refunds of consumption taxes	2,163		3,457		
Amortization of negative goodwill	1,276		1,355		
Others	2,847		22,747		
	9,396	0.1	433,958	2.9	424,562
<b>Nonoperating expenses</b>					
Interest expenses	17,312		16,523		
Provision for doubtful accounts	-		7,147		
Losses on doubtful accounts	6,195		-		
Commissions paid	13,747		17,913		
Foreign exchange loss	114,239		-		
Losses on assignment of receivables	16,440		13,921		
Others	9,648		8,404		
	177,584	1.0	63,909	0.4	(113,674)
Ordinary income	373,361	2.1	(42,271)	(0.3)	(415,632)

PALTEK CORPORATION

Thousands of yen	Year ended December 31, 2005	% December 31, 2006	Year ended December 31, 2006	%	Year-on-year change
<b>Extraordinary income</b>					
Gain on sale of fixed assets	1,292		28		
Gain on reversal of directors' and corporate auditors' retirement benefits	1,664		75		
Reversal of allowance for doubtful accounts	-		3,660		
Gain on sale of investment securities	41,558		18,000		
Gain on redemption of investment securities	2,041		-		
Gain on reversal of guarantee liabilities	752		176		
	<u>47,308</u>	0.3	<u>21,940</u>	0.1	(25,368)
<b>Extraordinary losses</b>					
Loss on revision of earnings from previous period	-		10,389		
Loss on sale of fixed assets	1,295		-		
Loss on disposal of fixed assets	1,201		4,731		
Loss on valuation of investment securities	2,972		-		
Impairment losses	-		17,111		
Loss on liquidation of subsidiaries and associated companies	5,302		2,826		
	<u>10,771</u>	0.1	<u>35,058</u>	0.2	24,287
Income (loss) before income taxes and minority interests	409,899	2.3	(55,389)	(0.4)	(465,289)
Income taxes - current	163,951		146,482		
Income taxes - deferred	(3,504)		(175,643)		
	<u>160,446</u>	0.9	<u>(29,160)</u>	(0.2)	(189,607)
Minority interest in income (loss) of consolidated subsidiaries	5,957	0.0	10,243	0.0	4,285
Net income	<u>243,494</u>	1.4	<u>(36,472)</u>	(0.2)	(279,967)

PALTEK CORPORATION

Consolidated statement of retained earnings

Thousands of yen	Year ended December 31, 2005
<b>Capital surplus</b>	
Balance, beginning of period	2,698,526
Balance, end of period	2,698,526
<b>Retained earnings</b>	
Balance, beginning of period	4,723,951
Net income	243,494
	243,494
Decrease	
Cash dividends	117,423
Directors' and corporate auditors' bonuses	20,500
	137,923
Balance, end of period	4,829,522

## Consolidated statement of changes in net assets

Thousands of yen; December 31, 2006	Shareholders' equity				Total shareholders' equity
	Common stock	Capital surplus	Retained earnings	Treasury stock	
Balance as of Dec 31, 2005	1,339,634	2,698,526	4,829,522	(130,161)	8,737,521
Changes during the term					
Dividends			(116,614)		(116,614)
Directors' and corporate auditors' bonuses			(4,174)		(4,174)
Net income (loss)			(36,472)		(36,472)
Acquisition of treasury stock				(260)	(260)
Other changes in non-shareholders' equity items during the term (net)					
Total changes during the term			(157,262)	(260)	(157,522)
Balance as of Dec 31, 2006	1,339,634	2,698,526	4,672,259	(130,421)	8,579,998

Thousands of yen; December 31, 2006	Valuation/translation gains (losses)		Minority interests	Total net assets
	Unrealized gains on securities - net	Total valuation/translation gains (losses)		
Balance as of Dec 31, 2005	31,515	31,515	67,619	8,836,656
Changes during the term				
Dividends				(116,614)
Directors' and corporate auditors' bonuses				(4,174)
Net income (loss)				(36,472)
Acquisition of treasury stock				(260)
Other changes in non-shareholders' equity items during the term (net)	4,516	4,516	(2,913)	1,602
Total changes during the term	4,516	4,516	(2,913)	(155,920)
Balance as of Dec 31, 2006	36,032	36,032	64,705	8,680,736

## Consolidated statement of cash flows

Thousands of yen	Year ended December 31, 2005	Year ended December 31, 2006	Year-on-year change
<b>Net cash from operating activities</b>			
Income (loss) before taxes and minority interests	409,899	(55,389)	(465,289)
Depreciation	103,631	64,664	(38,967)
Amortization of goodwill	(1,276)	6,396	7,672
Impairment losses	-	17,111	17,111
Loss on valuation of investment securities	5,302	2,826	(2,476)
Increase (decrease) in allowance for doubtful accounts	(2,444)	3,486	5,931
Increase (decrease) in accrued bonuses	(9,187)	15,056	24,243
Increase (decrease) in liability for employees' retirement benefits	(4,282)	1,148	5,431
Increase (decrease) in liability for directors' and corporate auditors' retirement benefits	12,125	(49,611)	(61,736)
Interest and dividend income	(972)	(8,179)	(7,207)
Interest expenses	17,312	16,523	(789)
Foreign exchange gain	(354)	(1,299)	(944)
Gain on sale of investment securities	(43,694)	(18,081)	25,612
Gain on redemption of investment securities	(2,041)	-	2,041
Gain on sale of tangible fixed assets	(1,292)	(28)	1,264
Loss on sale of tangible fixed assets	1,295	-	(1,295)
Loss on disposal of tangible fixed assets	1,201	4,081	2,880
Loss on valuation of tangible fixed assets	2,694	-	(2,694)
Loss on disposal of intangible fixed assets	-	649	649
Loss on valuation of intangible fixed assets	278	-	(278)
Commissions received	-	(219,866)	(219,866)
Gain on valuation of derivatives	-	(59,517)	(59,517)
Decrease (increase) in accounts receivable - trade	(79,999)	2,152,004	2,232,003
Decrease (increase) in inventories	(162,687)	2,645,082	2,807,769
Increase (decrease) in payables - trade	899,158	(1,158,067)	(2,057,226)
Decrease (increase) in consumption tax receivable	(108,088)	808,849	916,937
Decrease (increase) in advance payments	21,872	(6,322)	(28,194)
Increase (decrease) in advances	2,911	(989)	(3,900)
Bonuses paid to directors and corporate auditors	(21,730)	(4,700)	17,030
Others	88,276	(136,738)	(225,014)
	1,127,907	4,019,089	2,891,182
Interest and dividends received	293	7,512	7,218
Interest paid	(17,000)	(19,031)	(2,030)
Commissions received	-	219,866	219,866
Income tax paid	(338,288)	(210,915)	127,372
	772,912	4,016,521	3,243,608

PALTEK CORPORATION

Thousands of yen	Year ended December 31, 2005	Year ended December 31, 2006	Year-on-year change
<b>Net cash from investing activities</b>			
Increase in time deposits	(44,001)	(44,005)	(4)
Decrease in time deposits	40,000	40,000	-
Purchases of investment securities	(5,954)	(23,915)	(17,961)
Proceeds from sale of investment securities	195,605	49,641	(145,964)
Payments for acquisition of affiliates equity	-	(11,220)	(11,220)
Proceeds received from inclusion of NS Microelectronics Co., Ltd. as a subsidiary	-	99,953	99,953
Purchases of tangible fixed assets	(29,482)	(19,183)	10,299
Proceeds from sale of tangible fixed assets	2,600	4,804	2,204
Purchases of intangible fixed assets	(8,645)	(15,988)	(7,343)
Proceeds from sale of investment to partnership	-	18	18
Payments for loans	(315)	(500)	(185)
Proceeds from collection of loans	-	235	235
Increase in other investments	(21,052)	(25,864)	(4,812)
Decrease in other investments	9,515	61,016	51,500
	138,272	114,992	(23,279)
<b>Net cash from financing activities</b>			
Net decrease in short-term bank loans	-	(3,124,000)	(3,124,000)
Repayment of long-term bank loans	(133,152)	(1,045,730)	(912,578)
Payments for redemption of bonds	-	(750,000)	(750,000)
Purchases of treasury stock	(57,283)	(260)	57,022
Cash dividends paid to minority shareholders	(1,995)	(665)	1,330
Cash dividends paid	(117,877)	(116,746)	1,130
	(310,307)	(5,037,402)	(4,727,094)
Effect of exchange rate changes on cash and cash equivalents	48	1,336	1,288
Net increase in cash and cash equivalents	600,925	(904,552)	(1,505,477)
Cash and cash equivalents, beginning of period	2,412,243	3,013,168	600,925
Cash and cash equivalents, end of period	3,013,168	2,108,616	(904,552)

## Material information regarding preparation of the consolidated financial statements

Item	December 31, 2005	December 31, 2006
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: 3 Names of consolidated subsidiaries: Alpha Electronics, Inc. Spinnaker Systems, Inc. NS Microelectronics Co., Ltd. The newly acquired NS Microelectronics Co., Ltd. became a consolidated subsidiary as of the end of the fiscal year.
	(2) Names of unconsolidated subsidiaries: Alpha Electron (HK) Co. Ltd. (Reasons for exclusion from consolidation) The 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 associated companies to which the equity method is applicable: -	(1) Number of associated companies to which the equity method is applicable: -
	(2) Names of unconsolidated subsidiaries 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 or consolidated retained earnings. In addition, all the unconsolidated subsidiaries combined do not have a significant impact on the consolidated results.	(2) Names of unconsolidated subsidiaries 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.	All subsidiaries have fiscal year-ends that are the same as the day of consolidated closing. Commencing with the fiscal year under review, NS Microelectronics Co., Ltd., changed its fiscal year-end from May 31 to December 31. Consequently, the company's balance sheet at December 31, 2006 and its income and cash flow statements for the 7-month period from June 1, 2006 to December 31, 2006 have been used for accounting purposes.

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Item	December 31, 2005	December 31, 2006
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.</p> <p>(Unrealized gains and losses are reported in the shareholders' equity section of the consolidated balance sheet. Sales costs are calculated using the moving-average method)</p> <p>Available-for-sale securities without market value:</p> <p>Stated as moving-average cost</p> <hr/> <p>(B) Derivatives:</p> <p>Stated at fair market value</p> <hr/> <p>(C) Inventories:</p> <p>(a) Merchandise:</p> <p>Stated as moving-average cost</p> <hr/> <p>(b) Supplies:</p> <p>Stated by last purchased price method</p>	<p>(A) Securities:</p> <p>Available-for-sale securities:</p> <p>Available-for-sale securities with market values:</p> <p>Stated at fair market value as of the balance sheet date.</p> <p>(Unrealized gains and losses are reported in the net assets section of the consolidated balance sheet. Sales costs are calculated using the moving-average method.)</p> <p>Available-for-sale securities without market value:</p> <p>Same as previous year</p> <hr/> <p>(B) Derivatives:</p> <p>Same as previous year</p> <hr/> <p>(C) Inventories:</p> <p>(a) Merchandise:</p> <p>Stated as moving-average cost (Additional information)</p> <p>During the period, one (several) subsidiary (subsidiaries) changed its (their) inventory valuation method from the last-invoice cost method to the moving-average cost method.</p> <p>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> <hr/> <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)</p> <p>Useful lives are as follows:</p> <p>Buildings: 10 - 45 years</p> <p>Vehicle equipment: 6 years</p> <p>Furniture and fixtures: 5 - 15 years</p> <hr/> <p>(B) Intangible fixed assets:</p> <p>Straight-line method.</p> <p>The useful life of the software for internal use is 5 years.</p>	<p>(A) Tangible fixed assets:</p> <p>Same as previous year</p> <p>Useful lives are as follows:</p> <p>Same as previous year</p> <hr/> <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> <hr/> <p>(B) Accrued bonuses:</p> <p>Reserves are provided to cover the estimated amount of bonuses payable to employees.</p>	<p>(A) Allowance for doubtful accounts:</p> <p>Same as previous year</p> <hr/> <p>(B) Accrued bonuses:</p> <p>Same as previous year</p>

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Item	December 31, 2005	December 31, 2006
	<p>(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.</p>	<p>(C) Liability for employees' retirement benefits: Same as previous year</p>
	<p>(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. 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>	<p>(D) Liability for directors' and corporate auditors' retirement benefits: Same as previous year</p>
(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	<p>(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.</p> <p>(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.</p> <p>(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.</p>	<p>(A) Hedge accounting method: Same as previous year</p> <p>(B) Hedging instruments and targets: Hedging instruments: Same as previous year Hedging targets: Same as previous year</p> <p>(C) Hedging policies: Derivative transactions are used by the Company and one of its subsidiaries.</p>

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Item	December 31, 2005	December 31, 2006
	(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 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 tax: Transactions subject to consumption tax are recorded at amounts exclusive of consumption taxes.	Treatment of consumption tax: 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.	-----
8. Cash and cash equivalents	The "cash and cash equivalents" in the statements of cash flows include cash in hand, demand deposits, and short-term investments with maturities arriving three months from the date of acquisition that are readily convertible to cash and subject to minimal risk of price fluctuations.	Same as previous year

## Changes in material information regarding preparation of the consolidated financial statements

### *December 2006 term*

(Accounting standards related to impairment of fixed assets)

In the fiscal year to December 2006, the Company began applying accounting standards related to the impairment of fixed assets ["Statement of Opinion on Accounting for Impairment of Fixed Assets" (Business Accounting Council, August 9, 2002) and "Guidance for Accounting Standards for Impairment of Fixed Assets" (ASB, Guidance No. 6; October 31, 2003)]. As a result of this change, the net loss before taxes and other adjustments increased by ¥17,111 thousand.

In accordance with the rules regarding the preparation of consolidated financial statements, the Company deducted accumulated impairment losses directly from the value of each of the affected assets.

(Accounting standard for presentation of net assets on the balance sheet)

In the fiscal year to December 2006, the Company began applying the “Accounting Standard for Presentation of Net Assets on the Balance Sheet” (Accounting Standards Board of Japan, Statement 5, December 9, 2005) and the “Guidance on Accounting Standard for Presentation of Net Assets on the Balance Sheet” (ASB Guidance No. 8, December 9, 2005).

The amount that corresponds to net assets under the previous standard is ¥8,616,030 thousand.

The Company has prepared the net assets portion of the balance sheet as of December 31, 2006 in accordance with the revised rules related to the preparation of consolidated financial statements.

## Changes in method of presentation

### *December 2005 term*

(Consolidated statement of income)

In the fiscal year to 2004, “additional reimbursements of consumption taxes” were included in the “others” category of nonoperating income. Because such expenses exceeded 10 percent of all nonoperating income during the current report period, however, they are shown as a separate category.

For purposes of comparison “interest on refunds of consumption taxes” amounted to ¥1,393 thousand in the fiscal year ended December 31, 2005.

(Consolidated statement of cash flows)

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 as investment securities.

Accordingly, the items “increase in investment in partnership (expense of ¥9,335 thousand in the previous consolidated fiscal statement) and “proceeds from sale of investment to partnership” (income of ¥4,903 thousand in the previous consolidated fiscal statement) included under net cash from investing activities in the cash flow statement of the previous fiscal year, have been reclassified under “purchases of investment securities” and “proceeds from sale of investment securities” under net cash from investing activities in the cash flow statement of the fiscal year under review.

Investment in partnership amounts included under investment securities in the current fiscal year were an expense of ¥5,954 thousand under “purchases of investment securities” and income of ¥4,475 thousand under “proceeds from sale of investment securities.”

## Additional information

### *December 2005 term*

(Introduction of system of pro forma standard taxation for corporate enterprise taxes)

With the promulgation of the “Law for Partial Amendment of the Local Taxes Law” (Law No. 9, 2003) on March 31, 2003, a system of pro forma standard taxation came into force starting in the fiscal year beginning April 1, 2004. In accordance with the guidelines contained in the “Practical Treatment of Pro Forma Standard Local Taxes on the Income Statement” (Report of Practical Issues No. 12, Accounting Standards Board of Japan, February 13, 2004), therefore, the Company began recognizing enterprise tax levies for added value and capital in the “other” category of sales, general and administrative expenses beginning in the fiscal year under review.

Consequently, SG&A expenses increased by ¥15,276 thousand, and operating income, ordinary income, and income before income taxes and minority interests all decreased by the same amount.

## Notes

### (Consolidated balance sheet)

Thousands of yen	December 31, 2005		December 31, 2006
1.Amount of accounts receivable-trade offered as collateral	8,617	1.Amount of accounts receivable-trade offered as collateral	14,077
2.Retroactive liability due to securitization	303,713	2.Retroactive liability due to securitization	53,113
*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	8,050,000	Overdraft and loan commitment agreements	8,750,000
Amounts drawn down	1,400,000	Amounts drawn down	50,000
Unused lines of credit	6,650,000	Unused lines of credit	8,700,000
*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	188,415 shares	Common stock	188,947 shares

PALTEK CORPORATION

(Consolidated statement of income)

Thousands of yen	December 31, 2005		December 31, 2006
*1.Total research and development expenses		*1.Total research and development expenses	
Research and development expenditures included in selling, general and administrative expenses	2,912	Research and development expenditures included in selling, general and administrative expenses	1,715
*2.Breakdown of gains on sale of fixed assets		*2.Breakdown of gains on sale of fixed assets	
Furniture and fixtures	1,292	Furniture and fixtures	28
*3.Breakdown of loss on sale of fixed assets		*3.	-----
Furniture and fixtures	1,295		
*4.Breakdown of loss on disposal of fixed assets		*4.Breakdown of loss on disposal of fixed assets	
Furniture and fixtures	1,201	Furniture and fixtures	4,081
		Software	649
*5.Loss on valuation of fixed assets		*5.	-----
Furniture and fixtures	2,694		
Software	278		
*6.	-----	*6.Impairment losses	
		The PALTEK Group has recognized impairment losses in the following asset groups.	
		Location      Use      Type of asset      Impairment loss	
		Yamato-shi, Idle      Land      11,194	
		Kanagawa      Building      5,917	
		The PALTEK Group classifies impairment losses under the categories of "operating company" and "idle assets."	
		When the market value of idle assets declines sharply, the group reduces the book value amounts cited above to levels that are recoverable, and considers the amount of such reductions as impairment losses. These amounts are then recognized as extraordinary losses.	
		The assessment of recoverable amounts for each classification of assets is based on the projected sales value.	

(Consolidated statement of changes in net assets)

*December 2006 term*

1. Types of shares issued; types of treasury stock owned; items related to number of shares

Shares	No. of shares outstanding at end of previous fiscal year	Increase in No. of shares outstanding during term under review	Decrease in No. of shares outstanding during term under review	No. of shares outstanding at end of term under review
Shares outstanding				
Common stock	11,849,899	-	-	11,849,899
	11,849,899	-	-	11,849,899
Treasury stock				
Common stock	118,415	532	-	188,947
	118,415	532	-	188,947

2. Types of shares issued; types of treasury stock owned; items related to number of shares

Shares; Thousands of yen	Breakdown of stock purchase/subscription warrants	Type of shares subject to warrants	No. of shares subject to stock purchase/subscription warrants				Balance at end of term
			At end of previous fiscal year	Increase during term under review	Decrease during term under review	At end of term under review	
Reporting company (parent company)	2001: stock purchase/subscription warrant (note 1)	Common stock	143,300	-	17,000	126,300	-
	2002: stock purchase/subscription warrant (note 2)	Common stock	172,000	-	22,500	149,500	-
	2003: stock purchase/subscription warrant (note 3)	Common stock	70,000	-	10,000	60,000	-
	2004: stock purchase/subscription warrant	Common stock	110,000	-	-	110,000	-
	2005: stock purchase/subscription warrant	Common stock	80,000	-	-	80,000	-
	2006: stock purchase/subscription warrant (note 4)	Common stock	-	277,200	5,900	271,300	-
Consolidated subsidiaries	-	-	-	-	-	-	-
			-	575,300	277,200	55,400	797,100

(Notes)

1. The decline in stock purchase/subscription warrants in 2001 was due to warrant expiration.
2. The decline in stock purchase/subscription warrants in 2002 was due to warrant expiration.
3. The decline in stock purchase/subscription warrants in 2003 was due to warrant expiration.
4. The decline in stock purchase/subscription warrants in 2006 was due to warrant expiration.

3. Items related to dividends

(1) Payment of dividends

Resolution	Type of shares	Total amount of dividends (Thousands of yen)	Dividend per share (yen)	Date of record	Effective date
Regular General Meeting of Shareholders on March 25, 2006	Common stock	116,614	10	December 31, 2005	March 25, 2006

(2) Dividends with record date in current fiscal year for which payment date falls in the next fiscal year.

Resolution	Type of shares	Total amount of dividends (Thousands of yen)	Dividend source	Dividend per share (yen)	Date of record	Effective date
Regular General Meeting of Shareholders on March 24, 2007	Common stock	116,609	Retained earnings	10	December 31, 2006	March 26, 2007

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(Consolidated statement of cash flows)

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

Thousands of yen	December 31, 2005		December 31, 2006
1. Cash and deposits	3,049,169	1. Cash and deposits	2,148,622
Time deposits with maturities longer than 3 months	(36,001)	Time deposits with maturities longer than 3 months	(40,006)
Cash and cash equivalents	3,013,168	Cash and cash equivalents	2,108,616
		* Major assets and liabilities of newly acquired consolidated subsidiary	
		As a result of its acquisition, NS Microelectronics Co., Ltd., was included in consolidation in the fiscal year under review. The following is a reconciliation of the value of assets and liabilities at the beginning of the consolidated accounting period and the acquisition price of the company's shares and the cost of acquisition (net amount).	
		Current assets	4,433,273
		Fixed assets	179,655
		Goodwill	77,517
		Current liabilities	(2,971,898)
		Long-term liabilities	(1,155,957)
		Acquisition price of shares of NS Microelectronics	562,589
		Cash and bank deposits of NS Microelectronics	(662,542)
		Net gain on acquisition of NS Microelectronics	99,953

## Lease transactions

## 1. Finance leases where ownership does not transfer to 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, 2005	December 31, 2006
<b>Furniture and fixtures</b>		
Acquisition cost equivalent	38,834	10,834
Accumulated depreciation equivalent	32,069	8,125
Book value equivalent	6,765	2,708
<b>Vehicle equipment</b>		
Acquisition cost equivalent	33,020	33,020
Accumulated depreciation equivalent	6,688	12,296
Book value equivalent	26,331	20,723
<b>Software</b>		
Acquisition cost equivalent	35,850	37,494
Accumulated depreciation equivalent	30,692	32,238
Book value equivalent	5,157	5,256
<b>Total</b>		
Acquisition cost equivalent	107,705	81,349
Accumulated depreciation equivalent	69,450	52,660
Book value equivalent	38,254	28,688

## (2) Future minimum lease payments

Thousands of yen	December 31, 2005	December 31, 2006
Within one year	14,960	11,671
Over one year	24,239	17,988
	39,200	29,660

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

Thousands of yen	December 31, 2005	December 31, 2006
Lease payments	81,938	18,965
Depreciation equivalent	77,966	17,768
Interest expense equivalent	1,637	983

(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 amortizing the difference between the total amount of the lease payment and acquisition cost equivalent of the leased property over the lease period based on the interest method.

2. Operating leases - future minimum lease payments

Thousands of yen	December 31, 2005	December 31, 2006
Within one year	1,094	1,135
Over one year	2,214	1,078
	3,309	2,214

## Securities

*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
	77,889	131,754	53,864
Fair market value does not exceed acquisition cost			
Stocks	4,336	3,230	(1,106)
Bonds			
JGB, local government bonds	-	-	-
Corporate bonds	-	-	-
Others	-	-	-
Others	3,472	3,145	(327)
	7,808	6,375	(1,433)
	85,698	138,129	52,431

*(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	54,788
Investment in limited partnerships, etc.	73,309
	128,097

**December 2006 term**

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

Thousands of yen	December 31, 2006		
	Acquisition cost	Book value	Difference
Fair market value exceeds acquisition cost			
Stocks	7,252	19,218	11,965
Bonds			
JGB, local government bonds	-	-	-
Corporate bonds	-	-	-
Others	-	-	-
Others	65,178	112,763	47,584
	<u>72,431</u>	<u>131,981</u>	<u>59,550</u>
Fair market value does not exceed acquisition cost			
Stocks	1,510	1,510	-
Bonds			
JGB, local government bonds	-	-	-
Corporate bonds	-	-	-
Others	-	-	-
Others	9,513	9,496	(16)
	<u>11,023</u>	<u>11,006</u>	<u>(16)</u>
	<u>83,454</u>	<u>142,987</u>	<u>59,533</u>

*(Note)*

During the term ended December 31, 2006, an impairment loss in the amount of ¥2,826 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, 2006
Amount sold	49,641
Total gain on sales	18,081
Total loss on sales	-

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

Thousands of yen	December 31, 2006
Available-for-sale securities	
Unlisted securities	44,788
Investment in limited partnerships, etc.	74,086
	<u>118,874</u>

## Derivative transactions

December 31, 2005	December 31, 2006
<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 conducted by the Company.</p>	<p>(1) Types of derivatives used by the Group</p> <p>The types of derivatives used by the Group are foreign exchange contracts and currency options.</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. 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 are provided in "Material information regarding preparation of the consolidated financial statements" (Section 4. "Significant accounting policies", Paragraph (6) "Hedge accounting")</p>	<p>(2) Transaction policy and purpose of use</p> <p>Derivative instruments are used by the Group in the normal course of its business in order to effectively manage the risk arising from fluctuations in foreign exchange rates. 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 are provided in "Material information regarding preparation of the consolidated financial statements" (Section 4. "Significant accounting policies", Paragraph (6) "Hedge accounting")</p> <p>Currency options are utilized to eliminate the exchange rate risk on foreign-currency denominated bonds for the purpose of achieving stable income flows.</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 losses that may be realized due to fluctuations in foreign exchange rates. The Company believes that credit risk associated with the transactions entered into by the Company is minimal as the 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>Derivative instruments used by the Group 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 losses that may be realized due to fluctuations in foreign exchange rates. The Group believes that credit risk associated with the transactions entered into by the Group is minimal as the counter parties are all highly rated domestic financial institutions.</p> <p>The forward foreign exchange contracts entered into by the Group 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 Group's balance sheets, and that changes in the value of derivatives offset the changes in the value of hedged obligations.</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>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 Division based on the policies determined by the Board with specific transactional approval by the director in charge of the division. The Finance Division prepares a position report in order to monitor and analyze outstanding transactions and to report to the director in charge.</p>

2. Matters related to the estimated fair value of transactions

***December 2005 term***

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

***December 2006 term***

December 31; Thousands of yen	2006			Unrealized gain (loss)
	Amount of contract, etc.		Market value	
Category and type	Over one year			
Transactions other than market transactions				
<b>Option transactions</b>				
Put option to sell (US\$)	938,070	759,390	1,023,747	85,677
Call option to buy (US\$)	938,070	759,390	922,450	(15,619)
	1,876,140	1,518,780	1,946,198	70,058

(Notes)

1. Market value calculation method

Market value calculated based on prices and other information provided by financial institutions with which the PALTEK Group has a business relationship.

2. Derivative transactions for which hedge accounting is applied are not included.

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 small and medium-sized companies.

The Company has joined Kanto IT Software Welfare Pension Fund, a jointly established contributory plan, which is prescribed in Article 33 of the Accounting Standards for Retirement Benefits.

The total amounts of the Company's plan assets as of December 31, 2005 were 308,759 thousand yen and 322,972 thousand yen as of December 31, 2006.

2. Retirement benefit obligations

Thousands of yen	December 31, 2005	December 31, 2006
Projected benefit obligations	(186,409)	(206,127)
Fair value of plan assets	144,100	161,275
Liability for employees' retirement benefits	(42,309)	(44,852)

### 3. Pension and severance costs

Thousands of yen	December 31, 2005	December 31, 2006
Retirement benefit costs		
Service costs	20,087	25,162
Contributions to the jointly established welfare pension fund	26,219	24,549
Contributions to the mutual funds for retirement allowances for small and medium-sized companies	1,380	6,453
Special retirement benefit	18	861
Retirement benefit costs	47,705	57,026

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

	December 31, 2005	December 31, 2006
Method of computation of projected benefit obligations	The simplified method is used in calculating the projected benefit obligations.	Same as previous year

## Stock option plan

### *December 2006 term*

### Details, amounts, and conversions of stock options

#### (1) Details of stock options

	Stock options in 2001	Stock options in 2002	Stock options in 2003
Categories and numbers of persons to be granted rights	Directors and corporate auditors of the Company: 5 Employees of the Company: 157	Directors and corporate auditors of the Company: 6 Employees of the Company: 168	Directors and corporate auditors of the Company: 6
Number of stock options	Common stock: 219,700 shares	Common stock: 265,500 shares	Common stock: 80,000 shares
Date options granted	May 1, 2001	May 1, 2002	July 1, 2003
Conditions for establishment of rights	Not applicable	Not applicable	Not applicable
Period of employment covered by options	Not applicable	Not applicable	Not applicable
Execution period	From May 1, 2003 to April 30, 2008	From May 1, 2004 to April 30, 2009	From June 1, 2006 to May 31, 2008

*(Note)*

*At the regular General Meeting of Shareholders held on March 27, 2004, the period for executing new share subscription rights was changed to the period from July 1, 2006 to June 30, 2008 in response to a variety of circumstances faced by those receiving the new share subscription rights.*

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	Stock options in 2004	Stock options in 2005	Stock options in 2006
Categories and numbers of persons to be granted rights	Directors and corporate auditors of the Company: 5 Directors and corporate auditors of the subsidiaries: 8	Directors and corporate auditors of the Company: 5 Directors and corporate auditors of the subsidiary: 1	Employees of the Company: 146 Employees of the subsidiaries: 34
Number of stock options	Common stock: 120,000 shares	Common stock: 80,000 shares	Common stock: 277,200 shares
Date options granted	June 1, 2004	June 1, 2005	April 25, 2006
Conditions for establishment of rights	Not applicable	Not applicable	Not applicable
Period of employment covered by options	Not applicable	Not applicable	Not applicable
Execution period	From June 1, 2006 to May 31, 2008	From June 1, 2007 to May 31, 2009	From April 1, 2009 to March 31, 2012

(2) Amounts and conversions of stock options

The following shows the number of shares represented by the number of stock options outstanding as of the fiscal year under review.

1) Number of stock option

Shares	Stock options in 2001	Stock options in 2002	Stock options in 2003
<b>Before deciding options</b>			
At prior fiscal year-end	-	-	-
Granted	-	-	-
Expired	-	-	-
Decided	-	-	-
Undecided	-	-	-
<b>After deciding options</b>			
At prior fiscal year-end	143,300	172,000	70,000
Decided	-	-	-
Options executed	-	-	-
Expired	17,000	22,500	10,000
Balance of unexecuted options	126,300	149,500	60,000
	<b>Stock options in 2004</b>	<b>Stock options in 2005</b>	<b>Stock options in 2006</b>
<b>Before deciding options</b>			
At prior fiscal year-end	-	80,000	-
Granted	-	-	277,200
Expired	-	-	5,900
Decided	-	-	-
Undecided	-	80,000	271,300
<b>After deciding options</b>			
At prior fiscal year-end	110,000	-	-
Decided	-	-	-
Options executed	-	-	-
Expired	-	-	-
Balance of unexecuted options	110,000	-	-

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2) Price information

<b>Yen</b>	<b>Stock options in 2001</b>	<b>Stock options in 2002</b>	<b>Stock options in 2003</b>
Exercise price	1,974	789	730
Average execution price	-	949	-
Balance of unexecuted options	-	-	-

	<b>Stock options in 2004</b>	<b>Stock options in 2005</b>	<b>Stock options in 2006</b>
Exercise price	1,015	748	752
Average execution price	-	-	-
Balance of unexecuted options	-	-	-

## Tax effect accounting

	December 31, 2005		December 31, 2006
1. A breakdown of deferred tax assets and liabilities is shown below		1. A breakdown of deferred tax assets and liabilities is shown below	
Deferred tax assets		Deferred tax assets	
Accrued enterprise tax	6,889	Accrued enterprise tax	11,885
Loss on valuation of inventories	39,253	Loss on valuation of inventories	9,852
Accrued bonuses in excess of tax limit	17,210	Accrued bonuses in excess of tax limit	20,566
Liability for employees' retirement benefits	16,859	Liability for employees' retirement benefits	17,278
Liability for retirement benefits to directors' and corporate auditors'	117,818	Liability for retirement benefits to directors' and corporate auditors'	118,845
Loss on valuation of investment securities	16,105	Loss on valuation of investment securities	17,275
Loss carried forward	50,873	Loss carried forward	311,183
Others	16,664	Others	29,322
	<u>281,675</u>		<u>536,209</u>
Valuation allowance	(60,167)	Valuation allowance	(67,087)
	<u>221,508</u>		<u>469,122</u>
Deferred tax liabilities		Deferred tax liabilities	
Revaluation gain on investment securities	(10,986)	Revaluation gain on investment securities	(13,671)
	<u>(10,986)</u>	Investments in subsidiaries and affiliated companies	(20,581)
Net deferred tax assets	<u>210,521</u>	Revision of allowance for doubtful accounts	(10,433)
		Others	(6,420)
			<u>(51,106)</u>
		Net deferred tax assets	418,015
The net amounts of deferred tax assets are included in the following consolidated balance sheet accounts.		The net amounts of deferred tax assets are included in the following consolidated balance sheet accounts.	
Current assets - deferred tax assets	71,154	Current assets - deferred tax assets	36,876
Fixed assets - deferred tax assets	139,367	Fixed assets - deferred tax assets	381,139
2. Reconciliation between the statutory tax rate and the effective tax rate		2. Reconciliation between the statutory tax rate and the effective tax rate	
Pursuant to the provisions of Article 15-5-3 of the rules related to financial statements, etc., the difference between the effective tax rate as stipulated by law and the corporate tax rate after application of inter-period tax allocation is less than 5 percent, and the figure is therefore not reported in this section.		Statutory tax rate	40.64%
		(Adjustment)	
		Entertainment expenses, etc., non deductible portion	(24.43)%
		Dividends receivable and other income permanently excluded from taxable income	56.18%
		Directors' bonuses and distributed income	(5.69)%
		Amortization of goodwill	(4.69)%
		Inhabitants tax	(10.92)%
		Tax credits for foreign taxes	1.24%
		Effect of increases in valuation allowances	8.58%
		Others	(8.26)%
			<u>52.65%</u>
		Effective income tax rate	52.65%

## 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). There is consequently no information to report in this section.

### Geographic segment information

The PALTEK Group has no subsidiaries operating outside Japan and no significant overseas branches. This section is consequently 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				
<b>Director or close relative</b>										
Kazutaka Muraguchi	-	-	Corporate auditor of the Company	Direct 0.1	-	-	Sale of investment securities (see notes 1 and 2)  Proceeds from sale  Profit from sale	60,980  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 the transaction and policy for deciding on the terms of the transaction  
The sales price for the shares was determined taking into account the paid-in value of a recent allocation of new shares to a third party by the issuing company.

### December 2006 term

#### Subsidiaries, etc.

December 31, 2006; 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				
<b>Subsidiaries</b>										
Alpha Electron Co. Ltd.	Hong Kong (HK)	110	IC sales	Direct 100.0	-	-	IC sales	366,571	Accounts receivable	117,056

Per-share-related financial information

Yen	December 31, 2005	December 31, 2006
Net assets per share	751.61	738.88
Net income per share	20.47	3.13
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.		Despite the existence of residual securities, no figure for net income after adjustment for residual securities is shown, because the Company reported a net loss per share.

*(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, 2005	December 31, 2006
Net income per share		
Net income	243,494	(36,472)
Amount not attributable to common shareholders	4,174	-
[Of which, the amount paid out as bonuses to directors and corporate auditors pursuant to Statement of Appropriation of Net Income]	[ 4,174 ]	[ - ]
Net income related to common stock	239,320	(36,472)
Average number of shares outstanding during term (shares)	11,691,064	11,661,101
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: 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)	(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: 275,800 shares) (Stock acquisition rights based on Articles 280-20 and 280-21 of the Commercial Code) 4 types, 5,213 stock acquisition rights (number of shares to be issued through the exercise of stock acquisition rights: 521,300 shares)

Significant subsequent events

There are no other important issues to report related to the Company's management.

## Purchases, Orders Received and Sales

### 1. Purchases

Purchases made during the term ended December 31, 2006 are as follows:

Thousands of yen	December 31, 2005		December 31, 2006		Change from the previous year (%)	
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)
Semiconductor business	14,660,752	100.0	9,596,871	100.0	(5,063,880)	(34.5)
	14,660,752	100.0	9,596,871	100.0	(5,063,880)	(34.5)

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

### 2. Orders received

Orders received during the term ended December 31, 2006 as follows:

Thousands of yen	December 31, 2005		December 31, 2006		Change from the previous year (%)	
	Orders received	Backlog	Orders received	Backlog	Orders received	Backlog
Semiconductor business	18,647,353	1,982,619	15,162,024	2,415,321	(3,485,329)	432,702
	18,647,353	1,982,619	15,162,024	2,415,321	(3,485,329)	432,702

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

### 3. Sales

Sales during the term ended December 31, 2006 as follows:

Thousands of yen	December 31, 2005		December 31, 2006		Change from the previous year (%)	
	Amount	Ratio (%)	Amount	Ratio (%)	Amount	Ratio (%)
Semiconductor business	17,946,928	100.0	14,729,321	100.0	(3,217,606)	(17.9)
	17,946,928	100.0	14,729,321	100.0	(3,217,606)	(17.9)

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