



To Our Shareholders

# **PALTEK REPORT**

Half-year Ended June 30, 2005

**JASDAQ**

Code : 7587

# Message to Our Shareholders

## Financial Highlights (Consolidated)

### Results of Operations

		FY2005 (Interim)	FY2004 (Interim)
Net sales	(Millions of yen)	8,289	9,230
Operating income	(Millions of yen)	239	450
Operating profit margin	(%)	2.9	4.9
Ordinary income	(Millions of yen)	105	515
Net income	(Millions of yen)	82	274
Net income per share	(yen)	7.01	23.20

### Financial Position

		FY2005 (Interim)	FY2004 (Interim)
Total assets	(Millions of yen)	13,158	12,744
Shareholders' equity	(Millions of yen)	8,587	8,711
Shareholders' equity per share	(yen)	736.35	740.13

## To Our Shareholders,

It is my pleasure to present the results for the first half of our 24th fiscal year (covering the period from January 1, 2005 to December 31, 2005).

### Our First-Half Results

The results for the first half, on a consolidated basis, are shown in the accompanying table on the left.

The electronics industry in which we conduct business suffered a decline in capital investment and inventory adjustment due to a rapid drop in demand from the middle of the preceding year. Transactions in the industry remained sluggish, especially in the first quarter, however, inventory adjustment made progress in the second quarter, while sales of digital consumer equipment such as flat-panel TVs and HDD players held steady, suggesting that the downturn had hit bottom. Nevertheless, it is advised not to be too optimistic about the outlook for market recovery, as we are seeing tough competition for market share, as well as very short product lifecycles resulting in fierce product development races and rapidly falling unit prices.

Amid these circumstances, the Group focused on improving the efficiency of operations by expanding the sale of existing products, including our market-leading PLD (Programmable Logic Device) products, which are customizable for specific applications; launching new products; expanding customer coverage; further improving existing products; and taking various steps to further improve low-cost operation. However, our first-half results suffered from the effects of overall production cutbacks by our customers, especially in the communications and consumer equipment segments.

### Measures to Achieve Medium-Term Goals, and the Business Environment

The Group's medium-term goals are sales of ¥50 billion with a 10% operating profit margin, and we are implementing a range of measures to achieve these goals. Currently, major transformations are occurring in the business environment in which the Group operates. When looking at the external factors which affect our Group, broadband networks are proliferating in advanced and newly industrialized countries around the world; and the BRICs (Brazil, Russia, India and China) as well as other East Asian countries have become major competitors in both an economic and technical sense. Internally, the most important change is that innovations in technology have raised the performance of PLD products significantly while increasing their price competitiveness. While this provides opportunities to expand our customer base, it also means we must sell larger quantities in order to increase our revenues. The Group is operating with these external and internal changes in business environment in mind.

In this interim business report, we would like to discuss some of the changes which affect our business, specific measures we are taking to answer to these changes, and issues the Group face.

The PALTEK Group will continue to strive to improve its operations under its corporate philosophy of "coexistence with diverse partners." It is our goal to contribute to the realization of a more useful and dynamic ubiquitous network society by providing products with high added value and technical support. We always appreciate and ask your continued understanding and support. Thank you.

## Changes in the Business Environment Surrounding PALTEK

The last few years have seen major changes in the business environment in which the Group operates. For the Group to grow in these changes, we must fully understand what is happening out there and respond effectively to the ongoing changes. At this point, we recognize the following three changes affect our business most significantly.

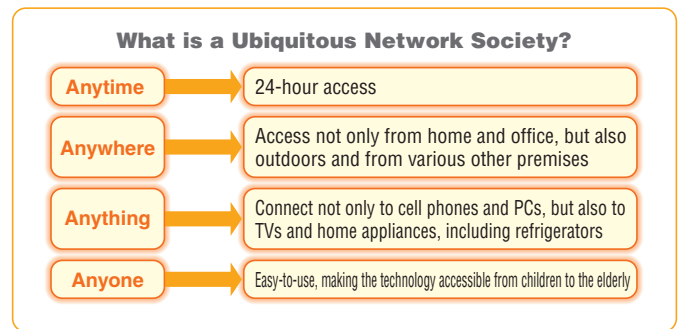
### 1. The Development of a Ubiquitous Network Society

The Japanese government launched the “e-Japan Strategy” in January 2001, which aimed to make Japan the world’s most advanced nation in information technology by the end of 2005. After 5 years later in 2005, we can see the dramatic changes and transformation that have taken place around us since its inception.

For example, Japan has:

- The least expensive broadband environment in the world
- Digital terrestrial broadcasts, enabling two-way communications
- Diverse mobile phones features such as being used like a wallet, TV watching, Internet shopping, etc.

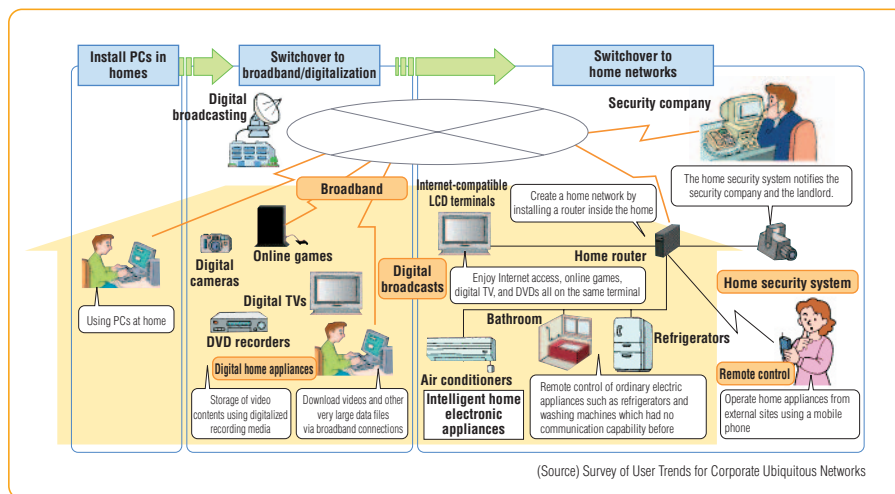
As seen from these examples, the vision of the “e-Japan Strategy” is becoming reality. To ensure that Japan will continue to be the world’s most advanced



nation in terms of information technology after 2006, the Ministry of Internal Affairs and Communications announced the “u-Japan Initiative” in December 2004.

The final objective of the “u-Japan Initiative” is “to become a world leader in the use and application of Information & Communication Technology (ICT)\* by 2010, by quickly making the ‘ubiquitous network society’ a reality for Japan.” In other words, the initiative is aimed at disseminating information into all aspects of people’s lives. Its aim is for Japan to develop into a society that creates new value for users in line with the slogan of “anytime, anywhere, anything, anyone,” so that anyone can easily connect to the network and make use of its applications in creative and useful ways.

\* What is referred to as IT in Japan is generally called ICT in the international market. Since 2004, the Ministry of Internal Affairs and Communications use the word ICT instead of IT.



### 2. Progress toward a Borderless World and Globalization

The proliferation of high-speed broadband networks, the impressive economic development of the BRICs and East Asian countries, and the development of worldwide transportation and distribution networks have enabled electronics manufacturers to operate globally without being confined inside of each national borders. Manufacturers are conducting their day-to-day business in many different markets around the world, competing against companies from all over the world. Many Japanese manufacturers are shifting not only the production factories but also their design and procurement functions to China and other East Asian countries to target these high-growth markets. If they want to be successful in these markets, they need to develop products which meet the unique tastes and preferences of local consumers.

While this global competition drives electronics manufacturers to technological innovation, it is also creating severe price wars.

### 3. Progress and Increasing Complexity in Electronics Technology

Progress in the electronics industry, including semiconductors, has been impressive. For example, a mobile phone weighing just 100g or so functions not only as a phone, but also as a game machine, or a TV and Internet device. Such terminals are developed based on continuous improvement in technology. The manufacturers face a mountain of issues including thermal problem due to ever advancing process technology, problems with complex power supplies, the need to respond to frequently changing standards, and a constant demand to achieve higher speed. Because of these issues, electronics manufacturers expect multifaceted support from their parts suppliers (makers and distributors) that are not limited to just offering components to them.

Please provide some specific details of the measures taken by PALTEK in these changing business environment which you have described.



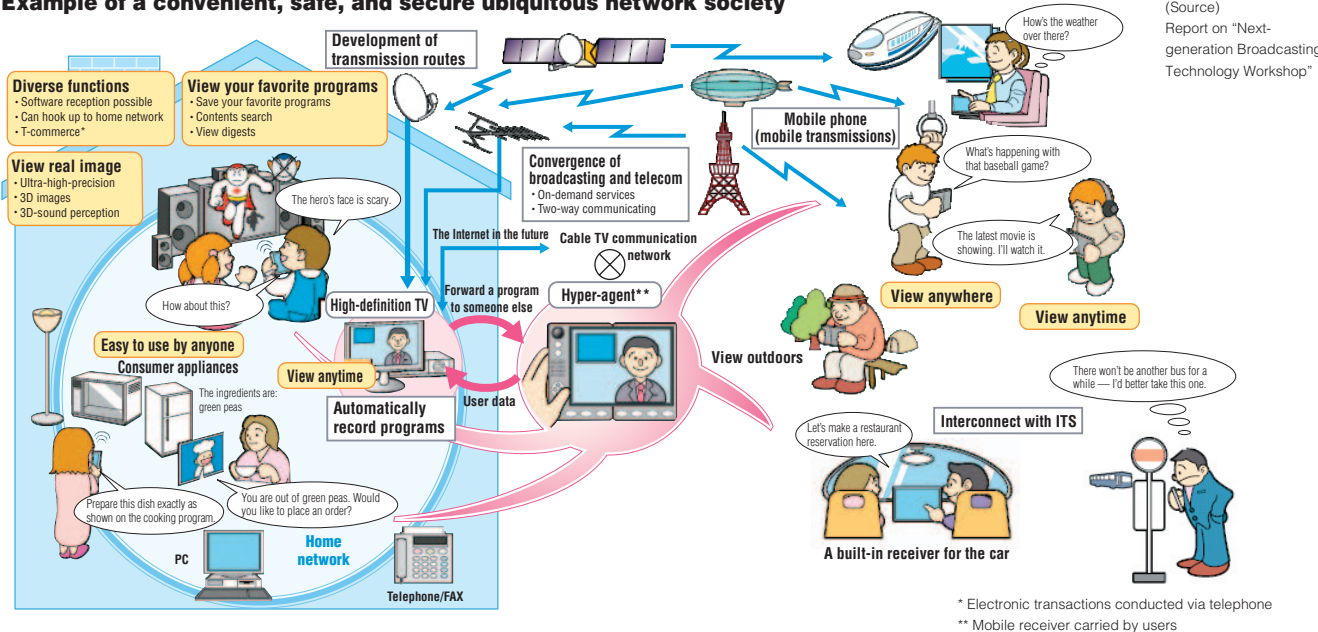
PALTEK CORPORATION  
**Tadahito Takahashi**  
President

**Q** Firstly, what specific effects will the ubiquitous network society have on the PALTEK Group's business?

I believe the Group can contribute in many ways when building the infrastructure system for the ubiquitous network society. The PALTEK Group has always been strong in communications-related technology, and I believe we can continue to provide products as well as technical support to customers who develop and manufacture equipments that belong to "network layer" and the "terminal layer" as shown in the accompanying figure on the right.

We have also begun to offer products for use in the next generation wireless and power-line communications. We would like to contribute to the realization of a convenient, secure and safe ubiquitous network society by meeting our customers' product development needs and offering them the new products they require.

## Example of a convenient, safe, and secure ubiquitous network society



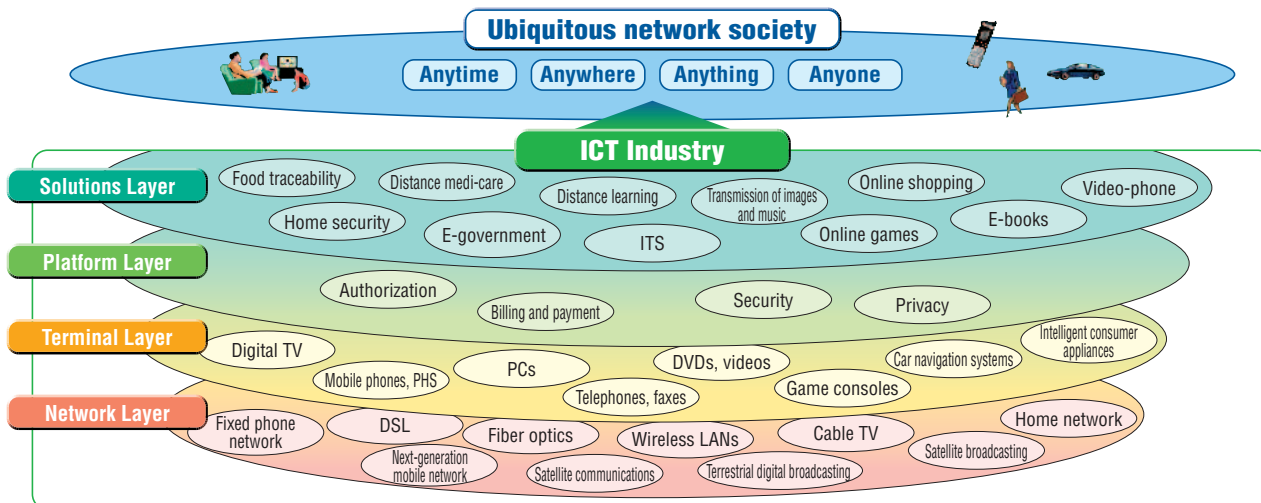
**Q** How are you responding to globalization?

The shift of business to Asian market among our customers is not a mere shift of manufacturing locations but it is more strategic one to take advantage of these markets' high growth potentials. In response to this, we established a subsidiary, Alpha Electron HK, in Hong Kong in March 2003 to support Japanese customers in this area. We also opened a representative office in Shanghai in October 2004. We will be further enhancing logistics and operations capabilities to meet the increasing volume of our customers' export from Japan to their own factories overseas.

**Q** How are you responding to your customers' demand for a more sophisticated technical support?

To provide even more valuable technical support to our customers, our engineers must understand our customers' systems and all the properties of their products. We have organized our engineers by field of application and product, so that we can provide more detailed technical support by each engineer's expertise. I believe this allows us to promote more wholistic system-based solutions to our customers without limiting our support to individual products we offer.

**The ICT industry supporting a ubiquitous society**



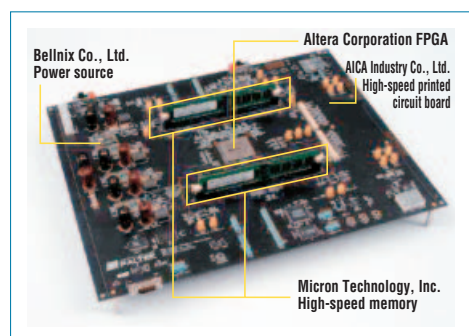
(Source) u-Japan Policy

**Please explain the issues you will need to address to attain your medium-term goals of ¥50 billion in sales and 10% operating profit margin.**

We will attain our objectives by responding swiftly and flexibly to changes in the business environment. To do this, our strategy must be to aggressively promote the system-based solution, and to enhance our appeal to growing applications and markets. Specifically, we are taking these three steps:

**1. Increasing Product Offerings**

To be able to bring high-value system-based solutions, we must further extend our product offerings with products that address new technologies. Since we are relying very heavily on specific products and suppliers, we endeavor to introduce new products to diversify risk.



**2. Expanding our Customer Base**

Up to now, our Group has focused on the communications applications and on specific industrial applications, acquiring technology and cultivating customers. But compared with other semiconductor distributors, we are still limited in application fields we can support and address customer needs. For further growth, we must expand our customer base. Also, we must further expand our operations into the international market to support our customers who operate internationally.

**3. Nurturing Capable Staff and Strengthening our Organization**

Innovation speed of the electronics industry is remarkable, and customer needs are diversifying. Currently, 40% of our employees are engineers. To ensure our engineers can provide the technical support that our customers need on the continuous bases, we are providing trainings to our engineers almost daily. Not only that we will expand our support by furthering our relationships with such partners like design firms and our sub-distributors. This will broaden the collective expertise of our support personnel. At the same time, we must strengthen our procurement and logistics operations as well as information systems in order to stay ahead of global competition and increasing number of products we handle.

Every one of the employees of the PALTEK Group will share ideas and cooperate in taking the actions I have explained above. In this way, we will address and tackle all problems one at a time and get closer to our second-half objectives, one step at a time.

## Specific Actions Taken in the First Half

**Q** Please tell us about new products signed during the first half.

We entered into new distributorship contracts with a total of three companies – two suppliers with whom we expect synergy for system-based solutions, and one supplier that carries products for a new communication system called power-line communications.

### 1. MailVision Ltd. (Israel)



We added MailVision products to our line cards to enhance the synergy with VoIP (voice-over-Internet Protocol) solutions from AudioCodes Ltd., which we have been selling for close to 10 years. MailVision provides SIP (Session Initiation Protocol) application software for VoIP platform.

### 2. Gennum Corporation (Canada)



Gennum is a world leader in the SDI (Serial Digital Interface) broadcast equipment standard. Broadcasting application is

an extremely important market for our Group. With Gennum, we can aggressively provide system-based solutions for our customers.



### 3. Xeline Co., Ltd. (Korea)



Xeline is a semiconductor manufacturer that provides solutions for communication over power-lines. Because of legal restrictions, we cannot use power lines for communication in Japan yet, but the technology is being applied commercially in Spain and other European countries, and in Hong Kong and Korea. Power-line communication makes it possible to set up indoor networks by simply connecting modems to home or office electric outlets, saving the effort and expense of laying new LAN wires. Thus, this technology is gathering much attention as one that can facilitate realization of the ubiquitous network.

While possible deregulation in Japan is closely watched and expected in this area, we intend to start providing system-based solutions to firms that are manufacturing equipment for preceding overseas markets. We believe that as the restrictions are eased in Japan, more and more firms will develop products for sale in Japan. We will be focusing our sales efforts accordingly.



## TOPICS

### Participation in the ESEC Exhibition

We exhibited our products in cooperation with Group companies Alpha Electronics and Spinnaker Systems at the Embedded Systems Expo & Conference held at Tokyo Big Sight between June 29 and July 1. We are pleased that many customers stopping by to see our exhibition. We presented our wide range of products. A circuit board we developed in-house that includes a high speed memory called DDR2 was shown as an example of our system-based solutions. Some customers who visited us at the expo also later attended technical seminars that we held at our offices.



## Shareholder Returns

**Q** Finally, please tell us the Company's policy on shareholder returns.

First, I believe that transparency in our operation is paramount, always communicating the state of our operations to our shareholders accurately and promptly. We believe everything starts with being a trustworthy enterprise. It is important that we grow our business and make our operations even more efficient, which is driving force to enhance profitability and to steadily achieve our medium-term goals of ¥50 billion in sales and 10% operating profit margin.

We also aim to make regular payments of dividends to our shareholders. We hope to achieve an optimal balance between the payment of dividends and the need to retain sufficient earnings to finance future growth.

# Business Overview

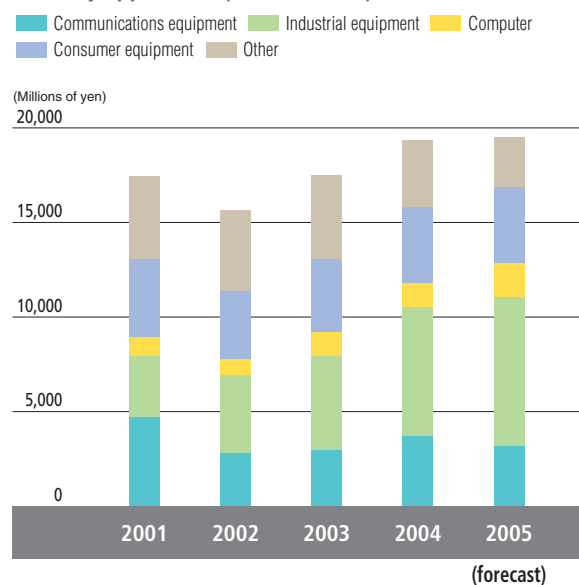
We expect a modest recovery in the second half of the fiscal year ending December 2005 as the electronics industry gets through the current inventory adjustment phase. However, we expect a continued tough competition for market share and severe price competition. This will put downward pressure on earnings.

In such an environment, we will leverage new PLD products that realize high performance thanks to technical innovations, allowing us to price our products competitively. In this way, we will focus on expanding our customer base and providing solutions in growth applications. We will also expand our customer base for analog semiconductors in the Kanto area, while enhancing their sales of these products for use in industrial equipment and digital consumer equipment such as mobile phones and digital cameras in the Kansai area. We will cultivate new customers for memories and ASSPs through synergy with PLDs.

Our projections for business performance for the full year, on a consolidated basis, are ¥19,500 million in net sales, ¥770 million in operating income, ¥600 million in ordinary income, and ¥417 million in net income. We plan to achieve these numbers through the above measures.

Our non-consolidated forecasts for the full year are ¥16,150 million in sales, ¥606 million in operating income, ¥473 million in ordinary income, and ¥348 million in net income.

## Sales by application (Consolidated)



## Report on the 23rd Annual General Meeting of Shareholders

The 23rd Annual General Meeting of Shareholders was held on March 26, 2005 (Saturday), in our headquarters' seminar room. These meetings offer excellent opportunities for us to talk directly with our shareholders. We began the meeting at 1:00 p.m. in an effort to maximize shareholder turnout. As a result, many shareholders attended, offered valuable opinions, and asked many insightful questions. After the General Meeting, we held an explanatory meeting to tell more about our Group and business. We showed actual semiconductors and boards we offer, hoping to help our shareholders to understand our business better.

This is the third year since we introduced voting by proxy over the Internet. Among all voting rights exercised, 2.67% were exercised online.

We would like to make our shareholders meeting more accessible and understandable to our shareholders. Please let us know your opinions and requests.

## Report on the Individual Investors' Meeting

We participated in an Individual Investors' Meeting sponsored by Trias Corporation, which was held on June 11 (Saturday) at the Foreign Correspondents' Club of Japan (Yurakucho, Tokyo). Over 100 individual investors were in attendance, including 14 of our shareholders. We exhibited some of our products to allow attendees to familiarize themselves with them. To enhance understanding of our operations, we included staff from our engineering and sales and marketing departments among our presenters.

We intend to continue creating opportunities to introduce our Group to individual investors.



At a private investor briefing on June 11

### ●IR Events

Date	Event
February 14 (Monday)	Explanatory Meeting on Results for 2004
March 26 (Saturday)	Shareholders Meeting and Company Briefing
May 13 (Friday)	Explanatory Meeting on Q1 2005
June 11 (Saturday)	Company Briefing for Individual Investors
August 11 (Thursday)	Explanatory Meeting on Results for First Half 2005
October 28 (Friday)	Explanatory Meeting on Q3 2005
December 3 (Saturday)	Company Briefing for Individual Investors

We have listed the events that are currently scheduled. The events in rows with colored backgrounds have already taken place.

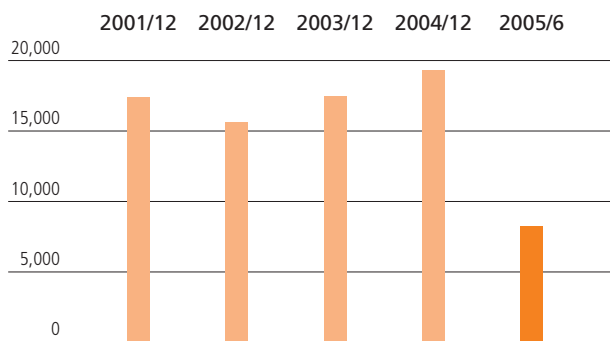
### Please participate in an Individual Investors' Meeting.

We plan to hold Individual Investors Meetings on continuous bases. We will inform you as soon as the details of the meetings are finalized. We will be very happy to tell about our Group and meet with more individual investors in these meetings.

# Financial Highlights

## Net sales

(Millions of yen)



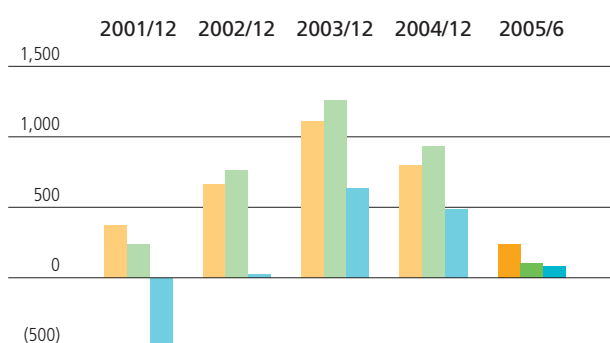
Net sales were firm for industrial applications, but sales have moved into low gear in general as our communications and consumer applications were hit by production cutbacks by our customers. Sales was ¥8,289 million on a consolidated basis (down 10.2% compared with the same period of the previous year).

## Net sales

Net sales	17,443	15,614	17,502	19,355	8,289
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## Earnings

(Millions of yen)

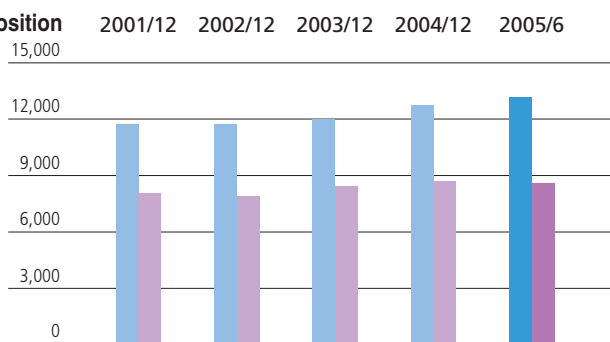


Because of the decline in sales compared with the same period of the previous year, and because of the decline in gross margin due to aggressive pricing to expand market share, our operating income was ¥239 million, a year-on-year decline of 46.8%. As we experienced a greater-than-expected foreign currency exchange loss due to the sudden weakening of the yen against the dollar, our ordinary income was ¥105 million, down 79.6% year-on-year. As a result, net income for the first half was ¥82 million, down 70.1%.

Operating income	370	660	1,111	798	239
Ordinary income	239	762	1,258	935	105
Net income	(459)	21	632	483	82

## Financial position

(Millions of yen)



Although notes and accounts receivables declined in line with the drop in sales, we increased our inventory in anticipation of longer lead times (time between order and delivery) for new products.

Shareholders' equity declined compared with the end of December 2004, as we purchased a number of our own shares in the first half.

## Total assets

(Millions of yen)

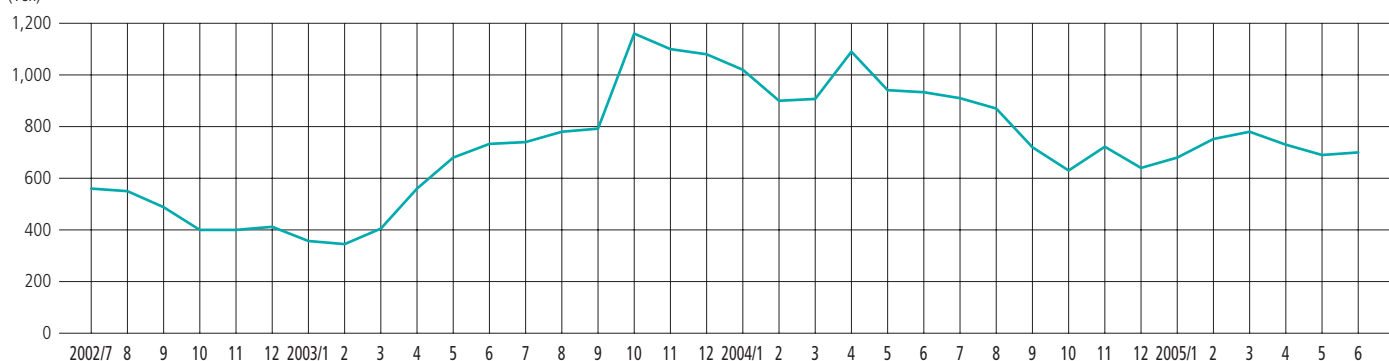
Total assets	11,734	11,723	11,987	12,744	13,158
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## Shareholders' equity

Shareholders' equity	8,067	7,901	8,429	8,711	8,587
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## Stock quotes

(Yen)



# Financial Statements

## Consolidated balance sheet

(Thousands of yen)

	June 30, 2005	June 30, 2004	December 31, 2004
<b>●Assets</b>			
<b>Current assets</b>	<b>12,170,294</b>	<b>12,181,472</b>	<b>11,607,573</b>
Cash and bank deposits	2,702,401	2,542,099	2,444,243
Notes and accounts receivable	3,511,289	4,083,083	3,983,536
Inventories	5,357,678	4,910,575	4,111,324
Others	599,787	648,911	1,075,177
Allowance for doubtful accounts	(862)	(3,197)	(6,706)
<b>Fixed assets</b>	<b>987,894</b>	<b>1,177,289</b>	<b>1,136,474</b>
<b>Tangible fixed assets</b>	<b>152,765</b>	<b>164,789</b>	<b>150,374</b>
<b>Intangible fixed assets</b>	<b>85,551</b>	<b>159,181</b>	<b>117,924</b>
Goodwill	—	2,391	—
Others	85,551	156,790	117,924
<b>Investments and other assets</b>	<b>749,578</b>	<b>853,318</b>	<b>868,175</b>
Investment securities	259,413	348,219	413,389
Others	490,165	505,099	454,786
<b>Total assets</b>	<b>13,158,189</b>	<b>13,358,761</b>	<b>12,744,048</b>
<b>●Liabilities</b>			
<b>Current liabilities</b>	<b>4,033,999</b>	<b>4,293,561</b>	<b>3,442,125</b>
Notes and accounts payable	1,820,357	2,989,393	1,071,794
Short-term bank loans	1,683,152	733,240	1,763,152
Accrued bonuses	60,520	63,677	51,344
Others	469,968	507,250	555,834
<b>Long-term liabilities</b>	<b>473,796</b>	<b>435,082</b>	<b>525,947</b>
Long-term bank loans	40,664	52,910	114,170
Liability for employees' retirement benefits	52,131	37,372	46,592
Liability for directors' and corporate auditors' retirement benefits	284,186	261,331	276,651
Goodwill	2,552	—	3,190
Others	94,262	83,468	85,343
<b>Total liabilities</b>	<b>4,507,795</b>	<b>4,728,643</b>	<b>3,968,073</b>
<b>●Minority interests</b>			
<b>Minority interests</b>	<b>63,052</b>	<b>58,987</b>	<b>64,567</b>
<b>●Shareholders' equity</b>			
<b>Capital stock</b>	<b>1,339,634</b>	<b>1,339,634</b>	<b>1,339,634</b>
<b>Capital surplus</b>	<b>2,698,526</b>	<b>2,698,526</b>	<b>2,698,526</b>
<b>Retained earnings</b>	<b>4,668,194</b>	<b>4,514,877</b>	<b>4,723,951</b>
<b>Net - unrealized gains (losses) on securities</b>	<b>10,813</b>	<b>23,099</b>	<b>22,173</b>
<b>Treasury stock</b>	<b>(129,827)</b>	<b>(5,007)</b>	<b>(72,877)</b>
<b>Total shareholders' equity</b>	<b>8,587,341</b>	<b>8,571,129</b>	<b>8,711,407</b>
<b>Total liabilities, minority interests and shareholders' equity</b>	<b>13,158,189</b>	<b>13,358,761</b>	<b>12,744,048</b>

# Financial Statements

## Consolidated statement of income

(Thousands of yen)

	Six months ended June 30, 2005	Six months ended June 30, 2004	Year ended December 31, 2004
<b>Net sales</b>	<b>8,289,020</b>	<b>9,230,898</b>	<b>19,355,863</b>
<b>Cost of sales</b>	<b>6,629,507</b>	<b>7,307,969</b>	<b>15,551,144</b>
<b>Gross profit</b>	<b>1,659,513</b>	<b>1,922,928</b>	<b>3,804,719</b>
<b>Selling, general and administrative expenses</b>	<b>1,420,043</b>	<b>1,472,443</b>	<b>3,006,260</b>
Salary	464,284	463,474	934,578
Provision for bonuses	59,608	52,890	50,258
Provision for directors' and corporate auditors' retirement benefits	9,021	12,934	28,253
Rent expenses	202,291	205,673	410,327
Others	684,837	737,470	1,582,840
<b>Operating income</b>	<b>239,470</b>	<b>450,484</b>	<b>798,459</b>
<b>Nonoperating income</b>	<b>7,350</b>	<b>92,181</b>	<b>208,462</b>
Interest income	627	661	857
Dividend income	130	116	235
Foreign exchange gain	—	75,979	184,908
Gain on sale of investment securities	2,136	—	3,516
Amortization of goodwill	638	—	—
Interest on refunds of consumption taxes	2,163	—	—
Others	1,654	15,423	18,945
<b>Nonoperating expenses</b>	<b>141,740</b>	<b>27,576</b>	<b>71,720</b>
Interest expenses	8,529	9,364	19,099
Commissions paid	10,218	7,490	11,453
Foreign exchange loss	103,131	—	—
Losses on assignment of accounts receivables	8,745	6,636	15,748
Others	11,115	4,086	25,418
<b>Ordinary income</b>	<b>105,080</b>	<b>515,089</b>	<b>935,201</b>
<b>Extraordinary income</b>	<b>35,775</b>	<b>4,521</b>	<b>1,012</b>
Gain on sales of fixed assets	1,292	—	—
Reversal of allowance for doubtful accounts	3,072	3,621	112
Gain on reversal of directors' and corporate auditors' retirement benefits	1,092	900	900
Gain on sale of investment securities	29,558	—	—
Others	759	—	—
<b>Extraordinary losses</b>	<b>7,105</b>	<b>584</b>	<b>8,038</b>
Loss on sales of fixed assets	1,295	—	—
Loss on disposal of fixed assets	508	584	8,038
Loss on devaluation of investment securities	5,302	—	—
<b>Income before income taxes and minority interests</b>	<b>133,749</b>	<b>519,026</b>	<b>928,175</b>
<b>Income taxes - current</b>	<b>28,427</b>	<b>62,540</b>	<b>251,487</b>
<b>Income taxes - deferred</b>	<b>21,518</b>	<b>175,783</b>	<b>181,237</b>
<b>Minority interest in income of consolidated subsidiaries</b>	<b>1,636</b>	<b>6,190</b>	<b>11,865</b>
<b>Net income</b>	<b>82,167</b>	<b>274,511</b>	<b>483,584</b>

## Consolidated statement of cash flows

(Thousands of yen)

	Six months ended June 30, 2005	Six months ended June 30, 2004	Year ended December 31, 2004
<b>Cash flows from operating activities:</b>			
Income before taxes and minority interests	133,749	519,026	928,175
Depreciation	54,168	57,928	117,104
Amortization of goodwill	(638)	5,581	11,163
Loss on devaluation of investment securities	5,302	—	—
Decrease in allowance for doubtful accounts	(5,844)	(11,569)	(8,060)
Increase in accrued bonuses	9,176	7,926	(4,406)
Increase in liability for employees' retirement benefits	5,539	3,660	12,880
Increase in liability for directors' and corporate auditors' retirement benefits	7,535	1,284	16,603
Interest and dividends income	(757)	(778)	(1,092)
Interest expense	8,529	9,364	19,099
Gain on sales of investment securities	(31,694)	—	(3,516)
Gain on sales of tangible fixed assets	(1,292)	—	—
Loss on sales of tangible fixed assets	1,295	—	—
Loss on disposal of tangible fixed assets	508	584	2,373
Loss on disposal of intangible fixed assets	—	—	5,664
Decrease in accounts receivable - trade	472,013	177,582	277,223
Increase in inventories	(1,249,157)	(802,749)	(3,498)
Increase in accounts payable - trade	748,562	2,060,134	142,536
(Increase) decrease in advance payments	25,369	(2,500)	56,630
Increase (decrease) in accounts payable - other	61,311	87,597	(2,386)
(Increase) decrease in advances	18,788	4,177	(4,914)
Decrease (increase) in consumption tax receivable	437,976	166,272	(326,320)
Bonus paid to directors and corporate auditors	(21,730)	(33,715)	(33,715)
Others	40,689	37,195	(1,998)
Sub total	719,399	2,287,003	1,199,547
Interest and dividends received	158	125	398
Interest paid	(8,415)	(9,603)	(18,354)
Tax refunds	—	214,245	214,245
Income taxes paid	(213,570)	(81,231)	(122,047)
<b>Net cash provided by operating activities</b>	<b>497,572</b>	<b>2,410,538</b>	<b>1,273,789</b>
<b>Cash flows from investing activities</b>			
Increase in time deposits	(32,000)	(32,000)	(44,001)
Decrease in time deposits	20,000	37,000	49,001
Purchases of investment securities	(3,927)	(376)	(376)
Proceeds from sales of investment securities	134,250	—	—
Purchases of tangible fixed assets	(22,261)	(11,826)	(19,400)
Proceeds from sales of tangible fixed assets	2,600	—	—
Purchases of intangible fixed assets	(2,126)	(16,049)	(25,464)
Increase in investment in partnership	—	(4,385)	(9,335)
Proceeds from sale of investment in partnership	—	—	4,903
Payments for loans	(315)	—	—
Increase in other investments	(18,947)	(19,186)	(21,943)
Decrease in other investments	150	7,544	44,244
<b>Net cash provided by (used in) investing activities</b>	<b>77,423</b>	<b>(39,278)</b>	<b>(22,371)</b>
<b>Cash flows from financing activities</b>			
Net decrease in short-term bank loans	(80,000)	(1,000,000)	(70,000)
Proceeds from long-term bank loans	—	100,000	300,000
Repayment of long-term bank loans	(73,506)	(30,520)	(69,348)
Purchases of treasury stock	(56,949)	(1,072)	(68,942)
Proceeds from issuance of common stock	—	8,284	8,284
Cash dividends paid to minority shareholders	(1,995)	(665)	(665)
Cash dividends paid	(117,122)	(116,684)	(118,024)
<b>Net cash used in financing activities</b>	<b>(329,573)</b>	<b>(1,040,657)</b>	<b>(18,695)</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>735</b>	<b>(240)</b>	<b>(215)</b>
<b>Net increase in cash and cash equivalents</b>	<b>246,158</b>	<b>1,330,362</b>	<b>1,232,506</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>2,412,243</b>	<b>1,179,737</b>	<b>1,179,737</b>
<b>Cash and cash equivalents at end of period</b>	<b>2,658,401</b>	<b>2,510,099</b>	<b>2,412,243</b>

# Notes to Consolidated Financial Statements

## Notes to consolidated financial statements (June 30, 2005)

### Material information regarding preparation of consolidated financial statements

#### 1. Scope of consolidation

- (1) Number of consolidated subsidiaries: 2  
Names of consolidated subsidiaries:  
Alpha Electronics, Inc.  
Spinnaker Systems, Inc.
- (2) Name of unconsolidated subsidiary:  
Alpha Electron (HK) Co. Ltd.  
(Reasons for exclusion from consolidation)  
Scale of operations of these unconsolidated subsidiaries are small and their total assets, net sales, interim net income (as calculated by the equity method) and retained earnings (as calculated by the equity method) have no significant impact on the consolidated interim financial statements.

#### 2. Application of equity method

- (1) Number of associated companies to which the equity method is applicable: -
- (2) Name of unconsolidated subsidiary to which the equity method is not applicable:  
Scale of operations of these unconsolidated subsidiaries are small and their total assets, net sales, interim net income (as calculated by the equity method) and retained earnings (as calculated by the equity method) have no significant impact on the consolidated interim financial statements.  
  
(Reasons for exclusion from consolidation)  
Unconsolidated subsidiaries to which the equity method is not applicable have no significant impact on the consolidated interim net income and consolidated retained earnings. In addition, unconsolidated subsidiaries all combined do not have a significant impact on the consolidated results.

#### 3. Accounting period of consolidated subsidiaries

All subsidiaries have interim term ends that are the same as the day of consolidated interim closing.

#### 4. Significant accounting policies

- (A) Valuation of material assets
  - (1) 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.
  - (2) Derivatives:  
Stated at fair market value.
  - (3) Inventories:
    - (a) Merchandise:  
Stated by moving average cost.
    - (b) Supplies:  
Stated by last purchased price method.
- (B) Depreciation of fixed assets
  - (1) Tangible fixed assets:  
Declining balance method (Note: Buildings, excluding ancillary facilities, acquired on or after April 1, 1998 are depreciated based on the straight line method.)  
Useful lives are as follows:  
Buildings: 10 - 45 years  
Vehicle equipment: 6 years  
Furniture and fixtures: 5 - 15 years
  - (2) Intangible fixed assets:  
The straight-line method

Useful life of the software for internal use is 5 years.

#### (C) Allowances

- (1) Allowance for doubtful accounts:  
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.
- (2) Accrued bonuses:  
Reserves are provided to cover the estimated amount of bonuses payable to employees.
- (3) 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.
- (4) Liability for directors' and corporate auditors' retirement benefits:  
An allowance is provided to cover the estimated amount of retirement benefits payable to directors and corporate auditors. In addition, the Board of Directors, at a meeting held on February 14, 2005, resolved to freeze the system of retirement bonuses for directors and corporate auditors as of the end of the 23rd Regular General Meeting of Shareholders held on March 26, 2005. Consequently, there has been no new provisioning of retirement bonuses for directors since that day.

#### (D) 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.

#### (E) 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.

#### (F) Hedge accounting

- (1) Hedge accounting method:  
The Company adopts deferred hedge accounting. Foreign exchange contracts for foreign currency demonstrated monetary liabilities are accounted for using the allocation method.
- (2) 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.
- (3) 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.
- (4) 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.

## (G) Other

Treatment of consumption tax:

Transactions subject to consumption tax are recorded at amounts exclusive of consumption taxes.

## 5. 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.

## Changes in method of presentation

## (Consolidated balance sheet)

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 interim period in the "other" category of "investments and other assets" (in the amount of ¥63,540 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 ¥67,857 thousand.

## (Consolidated statement of income)

In the year-earlier interim period, "interest on refunds of consumption taxes" had been included in the "others" category of nonoperating income. But because such expenses exceeded 10 percent of all nonoperating income during the current report period, they are shown as a separate category.

For comparison purposes "interest on refunds of consumption taxes" amounted to ¥3,705 thousand in the interim term ended June 30, 2004.

## (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 to be investment securities.

Consequently, investments recorded in the year-earlier term under "net cash from investing activities" as "investment in partnership" (the payment of ¥4,385 thousand) are included this year under "purchases of investment securities."

Payments for such investments during the period under review (which are included under "purchases of investment securities") amounted to ¥3,927 thousand (shown in the cash flow statement as a negative number).

## Additional information

## June 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. Therefore, in accordance with 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), 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 interim period under review.

Consequently, SG&A expenses increased by ¥6,959 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)

*1. Aggregate amount of depreciation on fixed assets	396,158
2. Retroactive liability due to securitization	311,813
3. Amount of accounts receivable-trade offered as collateral	4,019

4. For more efficient financing of working capital, the Company and a subsidiary have entered into overdraft and loan commitment agreements with four banks. As of the end of the interim term, it had the following unused lines of credit on these loan facilities.

Overdraft and loan commitment agreements	8,150,000
Amounts drawn down	1,350,000
Unused lines of credit	6,800,000

## (Consolidated statement of income)

(Thousands of yen)

*1. Breakdown of gains on sale of fixed assets	
Furniture and fixtures	1,292
*2. Breakdown of loss on sale of fixed assets	
Furniture and fixtures	1,295
*3. Breakdown of loss on disposal of fixed assets	
Furniture and fixtures	508

## (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)

Cash and deposit	2,702,401
Time deposits with maturities longer than 3 months	(44,000)
Cash and cash equivalents	2,658,401

## 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.

Furniture and fixtures	(Thousands of yen)
Acquisition cost equivalent	38,834
Accumulated depreciation equivalent	28,174
Book value equivalent	10,660
<b>Vehicles and delivery equipment</b>	
Acquisition cost equivalent	29,880
Accumulated depreciation equivalent	3,937
Book value equivalent	25,943
<b>Software</b>	
Acquisition cost equivalent	206,723
Accumulated depreciation equivalent	192,670
Book value equivalent	14,052
<b>Total</b>	
Acquisition cost equivalent	275,438
Accumulated depreciation equivalent	224,782
Book value equivalent	50,656

(2) Future minimum lease payments

(Thousands of yen)

Within one year	24,454
Over one year	27,427
	51,882

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

(Thousands of yen)

Lease payments	65,490
Depreciation equivalent	62,424
Interest expense equivalent	1,012

(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)
Within one year	1,074
Over one year	2,767
	<u>3,842</u>

**Securities**

June 2005 term

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

	(Thousands of yen)		
	Acquisition cost	Book value	Difference
Stocks	11,890	16,897	5,006
Bonds			
JGB, Local government bonds	—	—	—
Corporate bonds	—	—	—
Others	—	—	—
Others	81,725	98,073	16,348
	<u>93,616</u>	<u>114,971</u>	<u>21,354</u>

Note: During the term ended June 30, 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 interim term; 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 interim term 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. Major components of debt and equity securities without market values**

	(Thousands of yen)	
Available-for sale securities		
Unlisted securities (excluding OTC-traded stocks)		74,788
Investment in limited partnerships, etc.		67,857

**Derivative transactions**

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

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

**Overseas sales**

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

**Per share-related financial information**

Net assets per share	736.35
Net income per share	7.01

There is no entry of net income per share, fully diluted for the interim term ended June 30, 2005 because the Company had no residual securities capable of diluting earnings.

Note: The following standards apply to calculations of net interim period (and full-year) income per share and net interim period (and full-year) income per share after adjustment for residual securities.

Net income per share	
Net income	82,167
Amount not attributable to common shareholders	—
(Of which, amount paid out as bonuses to directors pursuant to Statement of Appropriation of Net Income)	[—]
Net income related to common stock	82,167
Average number of shares outstanding during term (sharers)	11,716,212
Net income per share, fully diluted	
Increase in common stock	—
(Warrants)	[—]
(New share subscription rights)	[—]

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: 319,000 shares)

(Stock acquisition rights based on Articles 280-20 and 280-21 of the Commercial Code)

3 types, 2,650 stock acquisition rights (number of shares to be issued through the exercise of stock acquisition rights: 265,000 shares)

**Purchases, Orders Received and Sales****(1) Purchases**

Purchases made during the interim term ended June 30, 2005 are as follows:

	(Thousands of yen)	
	June 30, 2005	
	Amount	Ratio (%)
Semiconductor business	7,835,864	100.0
	<u>7,835,864</u>	<u>100.0</u>

Note: Consumption tax is not included in the above figures.

**(2) Orders received**

Orders received during the interim term ended June 30, 2005 as follows:

	(Thousands of yen)	
	June 30, 2005	
	Orders received	Backlog
Semiconductor business	8,246,497	1,239,671
	<u>8,246,497</u>	<u>1,239,671</u>

Note: Consumption tax is not included in the above figures.

**(3) Sales**

Sales during the interim term ended June 30, 2005 as follows:

	(Thousands of yen)	
	June 30, 2005	
	Amount	Ratio (%)
Semiconductor business	8,289,020	100.0
	<u>8,289,020</u>	<u>100.0</u>

Note: Consumption tax is not included in the above figures.

# Company Profile

(as of June 30, 2005)

- **Company Name** PALTEK CORPORATION
- **Established** October 1982
- **President** Tadahito Takahashi
- **Employees** Parent basis: 179  
Consolidated basis: 216
- **Capital** 1,339,634 thousand yen
- **Subsidiaries** Alpha Electronics, Inc.,  
Spinnaker Systems, Inc.,  
Alpha Electron (HK), Co., Ltd.
- **Main Banks** Sumitomo Mitsui Banking Corporation,  
The Bank of Tokyo-Mitsubishi, Ltd.,  
UFJ Bank Limited,  
Mizuho Bank, Ltd.,  
UFJ Trust Bank Limited\*
- **Main Customers** NEC Corporation,  
Sony Corporation,  
Anritsu Corporation,  
Oki Electric Industry Co., Ltd.,  
Olympus Corporation
- **Main Suppliers** Altera Corporation (U.S.A.)  
AudioCodes Ltd. (ISRAEL)  
GSI Technology, Inc. (U.S.A.)  
Micron Technology, Inc.  
NetSilicon, Inc. (U.S.A.)  
PLX Technology Inc. (U.S.A.)

\* UFJ Trust Bank Limited will merge with The Mitsubishi Trust and Banking Corporation in October 1, 2005, and to become Mitsubishi UFJ Trust Bank Limited.

## ■ Directors and Corporate Auditors

President	Tadahito Takahashi
Vice President	Hiroyuki Takasaki
Director	Masanori Kanamori
Director	Tadashi Ito
Director	Hajime Yamazaki
Director	Masahiko Hirata
Standing Corporate Auditor	Yukio Miura
Corporate Auditor	Kazutaka Muraguchi
Corporate Auditor	Tatsuo Kawasaki
Corporate Auditor	Isao Tsubaki

## ■ Offices

### ● Head Office

Shin-Yokohama Square Bldg.,  
2-3-12 Shin-Yokohama, Kouhoku-ku, Yokohama  
222-0033, Kanagawa, Japan  
TEL : 045-477-2000  
FAX : 045-477-2010

### ● Osaka Branch

Omachi Bldg.,  
1-14-33 Esaka-cho, Suita 564-0063, Osaka, Japan  
TEL : 06-6369-4070  
FAX : 06-6369-4071

### ● Machida Logistics Center

Tenko Bldg. 17,  
687-1 Tsuruma, Machida, Tokyo 194-0004, Japan  
(Logistics Center)  
TEL : 042-788-5560  
(Programming Center)  
TEL : 042-788-5561 FAX : 042-788-5562

### ● PALTEK CORPORATION Shanghai Office

Liahua Business Center Room A-8121,  
No. 808, Hongqiao Road, Shanghai 200030 China  
TEL : +86-21-64480145 FAX : +86-21-64480146

# Stock Information

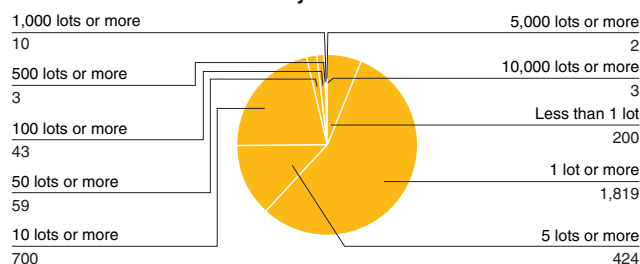
(as of June 30, 2005)

- **Total number of authorized shares** 23,562,000 shares
- **Total number of shares issued** 11,839,399 shares
- **Number of shares per lot** 100 shares
- **Number of shareholders** 3,263
- **Principal shareholders**

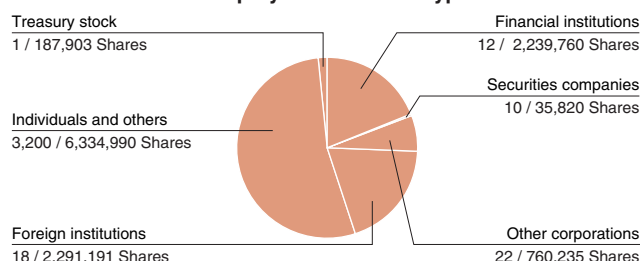
Name	Number of shares held (thousand)	Equity ownership (%)
Tadahito Takahashi	2,645.7	22.32
Japan Trustee Services Bank, Ltd. (Trust Account)	1,431.6	12.08
The Bank of New York Europe Limited Luxembourg 131800	1,035.0	8.73
Dave Brauer	775.2	6.54
Endeavor Corporation	593.2	5.00
The Bank of New York GCM Client Accounts EISG	450.1	3.79
The Master Trust Bank of Japan, Ltd. (Trust Account)	385.5	3.25
Keiko Takahashi	222.8	1.88
Kyoko Mizuno	214.7	1.81
NikkoCiti Trust and Banking Corporation (Investment Trust Account)	185.9	1.56

Note: The above list shows actual possession situation.

## ■ Breakdown of shareholders by owned volume



## ■ Breakdown of ownership by shareholders type



## Shareholder Memo

Account settlement date	December 31 each year
Annual general meeting of shareholders	End of March each year
Date of record	December 31 each year If necessary, the dates will be determined otherwise by a prior announcement.
Register closing date for dividend receivable	Term end dividend December 31 Interim dividend June 30
Transfer agent	UFJ Trust Bank, Limited 4-3 Marunouchi 1-chome, Chiyoda-ku, Tokyo
Business handling location of transfer agent	Transfer Agent Department, UFJ Trust Bank Limited 10-11 Higashisuna 7-chome, Koto-ku, Tokyo 137-8081
(General inquiries)	0120-232-711 (Toll free number)
(Request for application forms)	0120-244-479 (Toll free number)
Distributing agent	All nationwide branch offices of UFJ Trust Bank Limited
Public notice	Nihon Keizai Shimbun In place of a public notice of account settlement, balance sheets and statements of income are posted on the Company's Website ( <a href="http://www.paltek.co.jp">http://www.paltek.co.jp</a> ).

### Notice of the change of the transfer agent

From October 1, 2005, the Company's transfer agent, UFJ Trust Bank Limited changed through merger as follows:

Transfer agent	Mitsubishi UFJ Trust Bank Limited 4-5 Marunouchi 1-chome, Chiyoda-ku, Tokyo
Business handling location of transfer agent	Transfer Agent Department, Mitsubishi UFJ Trust Bank Limited 4-5 Marunouchi 1-chome, Chiyoda-ku, Tokyo
(Mailing address of the above)	Transfer Agent Department, Mitsubishi UFJ Trust Bank Limited 10-11 Higashisuna 7-chome, Koto-ku, Tokyo 137-8081 Tel. 0120-232-711 (Toll free number)
Distributing agent	All nationwide branch offices of Mitsubishi UFJ Trust Bank Limited

### Photograph taken at Shiratani Unsuijyo at Yakushima in August 2004

Photographer: Yukihiro Masuura

Every step takes one deeper and deeper into the cedar forest of Yakushima, where the air sweetens. The forest's rich smell is the breath of life, released by the trees, the grass and the soil. I breathe in the scents of the forest with the whole of my body. With every breath, body and mind are purified. In my mind's eye, I see myself as one of the large moss-covered boulders, witnessing the harmonious coexistence of life in the forest through the passing ages.

#### Profile

Yukihiro was born in 1963. At the age of 18, he traveled to France, and in 1987 he received an award in "Le Salon d'Automne." He is currently active as a commercial photographer, but his life work is focused on photographing sculptures. Some of his representative photographic works include his photographic compilation of Rodin's sculptures called "KHAOS," and his compilation of Michelangelo's sculptures called "GENESIS."

In 1998, thirty-one of Yukihiro Masuura's photographs were included in the permanent collection of the Bibliothèque Nationale de France.

#### Editor's Note:

Yoshinori Shibasaki, Relations Group

In this report, we have described how Japan is working as a nation to turn itself into a ubiquitous network society. I suspect that many of you are also feeling these changes that ICT has brought to our day-to-day lives. We at PALTEK have also seen changes in the way we work. For example, when we need to consult with employees and suppliers located far away, we are now able to easily hold video conferences at low cost, using PCs and Web cameras. It is clear that the way we work will continuously change and evolve.

With your input, I hope to make this report better in the future. Please let us know your opinions and comments.

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