

YUHOREPORT

# AXELL CORPORATION

Fiscal Year Ended	<b>March 31, 2004</b>
Traded	<b>JASDAQ</b>
Stock Code	<b>6730</b>

This report is based on the Company’s Japanese-language annual filing with the Financial Services Agency and supplemented with materials that facilitate comparison with the Company’s peers. The materials from the annual filing with the Financial Services Agency have been edited and reorganized in a format more familiar to the international investment community. All information contained in this report has been obtained from sources believed to be reliable, but the accuracy of the data and the translation, completeness, or timeliness of the information are not warranted by the Company, Pacific Associates, or Asia Securities Printing. None of the above parties shall be responsible for any error or omission or for results obtained from the use of this information.

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## Company Profile

### *Financial highlights*

Years ended March 31; Thousands of yen	2000	2001	2002	2003	2004	Change 2004/2000
<b>Nonconsolidated</b>						
Net sales	367,725	1,107,799	1,984,361	3,256,952	5,391,084	1,466%
Ordinary profit	37,378	411,175	757,644	1,216,779	2,375,412	6,355%
Net income	6,702	239,374	459,073	663,153	1,425,765	21,274%
Equity income assuming application of equity method	-	-	-	-	-	
Common stock	124,750	640,250	722,250	947,500	953,833	765%
Shares outstanding	2,320	4,815	14,445	15,445	30,966	1,335%
Shareholders' equity	136,742	1,410,477	1,857,672	2,949,108	4,219,987	3,086%
Total assets	219,521	1,723,397	2,289,883	3,496,014	5,426,725	2,472%
Shareholders' equity per share (Yen)	58,940.81	292,933.96	128,603.12	189,835.44	135,535.34	230%
Dividends per share (Yen)	-	Old shares 5,000.00 New shares (1st issuance) 232.88 New shares (2nd issuance) 54.80	8,000.00	11,700.00	10,000.00	
Net income per share (Yen)	2,888.90	94,692.34	31,780.78	43,792.23	45,380.57	
Net income per share, fully diluted (Yen)	-	-	-	43,228.45	44,296.14	
Dividend payout ratio (%)	-	5.2	25.1	27.2	22.0	
Net cash provided by (used in) operating activities	-	268,631	525,340	910,585	1,659,231	
Net cash provided by (used in) investing activities	-	(220,878)	(53,685)	(88,531)	(226,661)	
Net cash provided by (used in) financing activities	-	1,008,909	(47,298)	423,477	(173,405)	
Cash and cash equivalents at end of term	-	1,162,369	1,586,725	2,832,257	4,091,421	
Employees	4	8	13	17	24	600%

*Dividends per share for the year ended March 2003 included a 2,700 yen payout commemorating the Company's listing on the JASDAQ.*

*To date the Company has split its stock twice, the first time at a 3-to-1 ratio with a recording date of August 20, 2001 and the second time at a 2-to-1 ratio with a recording date of May 20, 2003. Calculations of earnings per share and diluted earnings per share for the fiscal years ended March 2002 and March 2004 assumed that the respective splits occurred at the beginning of those years.*

*As a result of the Company's 2-for-1 stock split (for shareholders recorded on May 20, 2003), the share price as of the end of the fiscal year to March 2003 is an ex-rights share price. To achieve consistency with figures for shareholders' equity per share, etc., the PER for the fiscal year ended March 2003 is based on the pre-adjusted share price, which was arrived at by multiplying the ex-rights share price by the stock split ratio.*

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## *Common size statements*

Years ended March 31; Percent	Nonconsolidated	
	2003	2004
<b>Balance sheet</b>		
<b>Assets</b>	100.0	100.0
Current assets	92.0	92.0
Tangible fixed assets	2.5	2.2
Intangible fixed assets	0.8	1.0
Investments and other assets	4.7	4.8
Total fixed assets	8.0	8.0
<b>Liabilities and shareholders' equity</b>	100.0	100.0
Current liabilities	15.6	22.1
Long-term liabilities	-	0.1
Total liabilities	15.6	22.2
Common stock	27.1	17.6
Capital reserves	22.6	14.7
Retained earnings	34.7	44.9
Unrealized gains or losses on other securities	(0.0)	0.6
Total shareholders' equity	84.4	77.8
<b>Statement of income</b>		
<b>Net sales</b>	100.0	100.0
Cost of sales	37.2	35.5
Gross profit on sales	62.8	64.5
Selling, general and administrative expenses	24.9	20.3
Operating income	37.9	44.2
Nonoperating income	0.1	0.0
Nonoperating expenses	0.6	0.1
Ordinary profit	37.4	44.1
Extraordinary losses	2.3	0.1
Income (loss) before taxes and other adjustments	35.1	44.0
	14.7	17.5
Net income	20.4	26.5

## Business Overview

### *Description of business*

#### (1) Outline of business

The Company is an R&D-oriented fabless semiconductor company whose primary focus is the development and sale of graphics and sound LSIs. In the area of graphics LSIs, the Company provides products that respond to a wide variety of customer needs by developing and selling both application-specific standard products (ASSP), such as its AG-1, AG-2 and AG-9 series, and application-specific integrated circuits (ASIC). Particularly in the area of graphics display, the Company is seeking to develop new markets by adopting a product-development concept that seeks to position the graphics rendering capability within the LSI itself, thereby relieving the CPU of the processing burden. In the area of sound LSIs, the Company is working on development of its AS-2 Series, which will complement the current AS-1 Series and feature a compression/decompression technology for sound generator data.

#### *ASSPs*

The Company develops and sells ASSPs, which offer specified functions and performance to a targeted customer segment. The focus of its research and development in this area is graphics and sound generation. The Company's current range of products includes the AX51102 and AX51201 graphics LSIs for amusement-related devices; the AX51901 graphics LSI for information technology, factory automation, measurement, and medical equipment-related applications; and the AX31102 sound LSI. In addition to such graphics rendering capabilities as expansion, reduction, rotation and translucence, the AX51102 offers a decompression engine for graphic data, which has made it a widely used LSI for the liquid crystal displays used in pachinko and pinball-slot machines. The AX51201 quadruples the overall graphics rendering performance of the AX51102 (and, in terms of compression/decompression capabilities, increases performance by a factor of 50). The result is a rendering capability of 100 million dots per second for SVGA (for "Super Video Electronics Standards Association") monitors, where the standard for screen resolution is 800 X 600 dots. The AX51201, which incorporates the new RAPIC compression/decompression technology offering the sharp picture quality and high compression rates required for moving images, is currently being sold to the amusement market.

The AX51901 is the first of the Company's new AG-9 Series of products. Sales began at the end of the year to March 2003 to what are new markets for the Company: users in information technology, factory automation, measurement, and medical equipment-related fields. In addition to advanced performance and high resolution, the AX51901 features a variety of graphics rendering capabilities, including embedded multilayer functions (the ability to control textual information, waveform information, visual information, etc., in each layer and to display these layers in stacked form) and video capture functions (the ability to display video images—another such layer—in real time). The AX51901 is being tested and evaluated by large numbers of customers, along with a second product in the series, the AX51902 scheduled for release next fiscal year.

Our AX31102 sound LSI is a multi-channel audio decoder featuring a built-in sequencer. Based on a core audio compression/decompression technology, it is capable of playing back four sounds simultaneously and is suitable for use in arcade game machines, pachinko and pinball-slot machines, audio guidance systems, and other applications. We are currently developing a next-generation sound-generator LSI, which will feature a special compression/decompression technology. Completion is scheduled for sometime in the next fiscal year.

### ***ASICs***

The Company develops and sells ASICs, which are customized LSIs offering specified functions and performance for specific devices. Focusing on graphics, the Company is developing LSIs that meet customer needs by amalgamating its knowledge of systems and LSIs. The Company's current range of products includes graphics LSIs for liquid crystal displays in pachinko machines, for arcade game machines, and for factory automation equipment.

## **(2) Characteristics of the Company**

The Company's key characteristic is summarized by the phrase "an R&D-oriented fabless semiconductor company." In terms of LSI manufacturing processes, this means that it is involved in so-called "upstream" processes, which range from planning to design. Outsourcing the actual manufacturing enables the Company to operate without being burdened by the substantial capital investment required to acquire and maintain manufacturing equipment. But a company must possess an R&D capability which is differentiated from others in terms of LSI design to be fabless. It is this kind of R&D capability that primarily characterizes the Company.

A second characteristic of the Company is its product planning and marketing capabilities, which enable it to translate its strengths in R&D into specific products.

But the Company's services go beyond providing customers with manufactured products. They also include an emphasis on developing and providing products aimed at supporting customers' program development environments, including development and evaluation boards and development support software. This focus on program development environments is a third characteristic of the Company.

By organically fusing these characteristics, the Company is aiming to expand the size of its business through product development activities.

### (3) Sales methods

The Company's basic policy in relation to sales is to use sales agents (Midoriya Electric Co., Ltd., Internix Incorporated and Okaya Electronics Corp.). Since the Company is basically a make-to-order manufacturer, the sales agents gather all necessary information about required quantities and delivery dates and provide the inventory and distribution functions necessary to get the products to the customer. The relationship between the Company and its sales agents is a close one, which is not limited to selling. It includes cooperation in collecting and analyzing information on important customer needs, which is then incorporated into improvements to existing products and new product development.

### (4) Regarding manufacturing

As a fabless semiconductor company, the Company specializes in design operations and outsources all of its manufacturing. The relationships between the Company and those to whom it delegates these manufacturing tasks are consequently critical to the success of its LSI business. The Company currently maintains excellent relationships with Fujitsu Limited and Rohm Co., Ltd., which provide it with this critical element of its business, assuring it the necessary production capacity.

## History

Year	Month	Event
1996	February	Capitalized at 99 million yen, Axell Corp. (headquartered in Nakano-ku, Tokyo) is established to develop and sell system LSIs.
	April	Commissioned to develop customized graphics LSI (ASIC) for use in amusement-related applications.
	December	Commissioned to develop customized high-speed graphics LSI (ASIC) for factory-automation systems.
1997	May	Commissioned to develop customized image-processing LSI (ASIC).
1998	January	Enters into sales agency agreement with electronics distributor, Internix Incorporated.
	April	Enters into sales agency agreement with electronics distributor, Midoriya Electric Co., Ltd. Commissioned to develop customized graphics LSI (ASIC) with built-in, high-speed JPEG decoder for use in amusement-related applications.
	July	Begins selling the AX51101 graphics LSI, the Company's first LSI for a specific application area (ASSP).
	September	Begins selling the AX3010 sound LSI for a specific application area (ASSP).
1999	November	Begins selling the AX51102 graphics LSI for a specific application area (ASSP).
2000	April	Begins development of RAPIC graphics compression/decompression technology.
	August	Commissioned to develop customized high-resolution graphics LSI (ASIC) for amusement-related applications.
2001	January	Corporate headquarters moved to 4-8-13, Iidabashi, Chiyoda-ku, Tokyo.
	May	Enters into sales agency agreement with electronics distributor, Okaya Electronics Corp.
2002	January	Begins selling AX31102 sound LSI for a specific application area (ASSP).
	June	Begins selling "AX51201" graphics LSI with built-in "RAPIC" compression/decompression technology (ASSP).
	December	Registers shares for over-the-counter trading with the Japan Securities Dealers Association.
2003	March	Begins selling AX51901 graphics LSI for information technology, factory automation, measurement, and medical equipment applications (ASSP).
	June	Begins collaboration with Access Co., Ltd. in the area of advanced image processing for embedded devices. Adopts MiSPO Co., Ltd.'s NORTi as a development environment for the AX51901 graphics LSI.
	November	Enters into agreement with Aval Data Corporation for joint development of a systems solutions business.

*Although the Company began selling its products through Midoriya Electric Co., Ltd. in April 1998, a sales agency agreement with Midoriya Electric was formally entered into in December 2000.*

*"LSI" is an abbreviation for "Large Scale Integrated Circuit."*

*"ASIC" is an abbreviation for "Application Specific Integrated Circuit." ASICs are designed and manufactured for the applications and uses of specific customers and are sold only to these customers.*

*"ASSP" is an abbreviation for "Application Specific Standard Product." While ASSPs are designed and manufactured for specific applications and uses, they are sold to multiple customers.*

## *Risk factors*

### (1) Regarding singularities of management policy

The Company has recognized a net income for the past four years and paid a dividend for each of those years. For the year under review, it recognized a net income of 45,380 yen per share and paid a dividend of 10,000 yen a share. In determining dividends, the Company takes into consideration a number of factors, including the amount paid the previous year, the increase in unappropriated profits between the previous fiscal year and the latest year, and the amount of profit it believes must be retained internally. Since it began paying dividends, the Company has increased its payout for four consecutive years. Future decisions on dividends could be affected by financial requirements, however, such as the need to plow back more retained earnings.

### (2) Regarding anomalous changes in financial conditions and operating results

#### 1) Nature of the Company's business

The Company's business revolves primarily around the manufacture and sale of ASSPs, which have enabled it to recognize a string of record-high sales and ordinary profit annually since the year to March 2000. The ASSPs could fail to meet the needs of the Company's customers or markets for reasons of competitiveness, however, in which case the Company's financial performance could be severely affected.

#### 2) Market size

The Company includes estimates on the size of the market for amusement-related applications, its principal market, in its securities reports to the Ministry of Finance (MOF). Based on such estimates, it calculates its share of total industry sales and sales forecasts for the following fiscal year. These estimates of market size are internally produced; the Company arrives at the figures by analyzing publicly available information, to which it adds other data it obtains from the same market. Were the size of the amusement market to contract unexpectedly, however, it would have a material impact on the Company's financial performance.

#### 3) Competition

The Company now has an approximately 50% share of the graphics LSI segment of the amusement market. Besides the Company's ASSPs and ASICs, customers in this market use ASICs provided by other semiconductor

companies and LSIs that have been converted to amusement-related uses from original uses in 3D game consoles. Although the Company will seek to differentiate itself through the development of products that respond to the needs of its customers and its markets, other semiconductor manufacturers could develop products that are superior in performance, or the Company's products might face significant price competition. Any of these developments could seriously impact the Company's financial performance.

#### 4) Liability for defect warranties

To date, the Company has never had to assume any liability for defect warranties on its products. For this reason, it has not been realistic from an accounting standpoint to recognize provisions for this eventuality. To deal with this issue, the Company has enhanced its internal reserves by transferring funds from its unappropriated profits as of term end to the retained earnings account. If such a liability should arise and exceed the amount that has been reserved, however, and, if such liability could not be covered by retained earnings carried forward, the Company's financial performance would be seriously impacted.

### (3) Matters relating to the Company's organization

#### 1) Building organizational foundations

Today the Company is run by an eight-person management team, which includes five directors and three auditors. It is not an organization that depends solely on President and Representative Director, Yuzuru Sasaki. That said, however, Mr. Sasaki has been chief executive officer of the Company since its founding and has played a vital role in building its organization, utilizing his experience in management and new business start-ups at Aval Data Corporation and Nippon Steel Corporation. If Mr. Sasaki should suddenly leave the Company, therefore, it could have an impact on the Company's financial performance.

#### 2) Adequacy of management structure to size of Company

The Company's small size, comprising 8 directors and 24 employees, allows it to function properly under its current management structure. As evidenced by last year's addition of seven employees, however, the Company is gradually increasing in size. Any failure by the Company's internal management systems to respond appropriately to further increases in personnel and future expansions in the size of its business could constrain future business development and have a significant impact on the Company's financial performance.

### 3) Limited size of the sales organization

As of the end of the fiscal year, the Company's sales group comprised three persons: the general manager of the sales group (who is also a managing director of the Company); one manager; and one sales assistant dispatched by a temporary personnel agency. The Company sells its products through a network of sales agents, and this relationship encompasses not only sales but also marketing and information gathering on market needs. It may become necessary to increase the number of personnel involved in sales, however, if business expands in response to a growing market, necessitating a larger product offering. Failure to meet the personnel needs identified in its business plans could exert a significant impact on the Company's financial performance.

### (4) Research and development

#### 1) Recruitment of R&D personnel

The Company relies for its design and development work on the abilities and experience of its design engineers. It thus recognizes that ongoing recruitment of talented and experienced professionals is an important management issue. It expects recruitment to remain an uphill battle, however, given the scarcity of talented engineers in the fields of graphics-related technologies (algorithms and architecture of image processing, graphics compression/decompression technology, etc.) and system LSI design, and the intensifying competition in the industry for such personnel. For this reason, if the Company should fail to hire adequately or if currently employed engineers were lost to other companies, it could have a significant impact on the Company's financial performance.

#### 2) Growing R&D expenditures

As an R&D-oriented fabless semiconductor company, Axell Corporation is engaged in the development of LSIs based on medium-to-long term product strategies. At the present time, the development of a single LSI can cost between several tens of millions of yen and several hundreds of millions of yen. Hence, as the Company expands the range of its operations hereafter, the turn-around time for product development and R&D personnel hiring trends could lead to increases in R&D expenditures, which could impact financial performance in turn.

### 3) Technical trends

Advances in semiconductor technology are enhancing the performance of ASSPs and ASICs (in terms of level of integration, speed, number of pins). This trend is particularly noticeable in the area of graphics LSIs, where we expect embedded peripheral functions (communications, signal processing, codes, sound generation, etc.) to increase in diversity and capabilities. Meeting these challenges will require that we build and maintain excellence in our technical development capabilities and that we provide the latest in design environments. It will also be important in terms of our lead in the industry to achieve timely development of new architectures and algorithms. To remain competitive, the Company is steering its R&D into proprietary areas such as the development of graphics rendering and graphics compression/decompression technologies. The Company is also actively pursuing opportunities to engage in collaborative research with universities. This approach has proven effective as a means not only of achieving specific research results, but also of recruiting talented research personnel due to the student internships and other arrangements we offer as a part of such collaboration. We also foresee a need to bring in high-caliber graphics-related technologies from outside, including technologies that supplement our own technologies—and to consider alliances or other arrangements with companies that possess technologies that can benefit our businesses. If we fall behind in our technological development, on the other hand, or fail to achieve research results because of a lack of timely collaboration—or if we are slow to bring in effective technologies from other companies—this could have a serious impact on the financial performance of the Company.

### (5) Manufacturing and sales systems

#### 1) Outsourcing

As a fabless semiconductor company, we outsource our manufacturing. The process of outsourcing is therefore a crucial element in the success of our LSI business. The Company recognizes the importance of establishing the best possible manufacturing arrangements, which entails building and maintaining good relationships with outside manufacturing concerns. Currently, our manufacturing relationships are excellent, and we have secured all necessary production capacity. There is no guarantee, however, that if problems should arise hereafter—if, for instance, we were unable to secure sufficient production capacity from our outsourcing partners, mechanical problems occurred in their

manufacturing equipment, or outsourcing agreements were terminated for some reason—we would be able to find replacements in a timely manner under acceptable conditions. In such an event, the Company's financial performance would be seriously affected.

## 2) The build-to-order system

As a rule, all the Company's proprietary ASSP and ASIC manufacturing is done on a build-to-order basis. This exposes the Company to the impact of changes in sales plans, production plans, and sales performance by its principle final customers, which could result in higher or lower unit sales, delays in the timing of sales, and other issues for the Company that effect its financial performance.

## 3) Sales organization

The Company runs its operations with an eye to efficiency, using a small number of employees. This is reflected in its policy regarding sales, where it eschews direct sales to customers in favor of arrangements with three companies that function as its sales agents: Midoriya Electric Co., Ltd.; Internix Incorporated; and Okaya Electronics Corp. This collaboration enables the Company to take advantage of these companies' existing information resources and sales networks to engage in both sales and marketing activities. As the Company expands its business hereafter, it will be important to strengthen this already successful sales organization, while responding to future needs for sales agency agreements with other trading companies. If the Company fails to act expeditiously in this regard, it could have a major impact on its financial performance.

## (6) Future directions of the business

The Company began selling its AG-9 Series at the end of the fiscal year to March 2003. Whereas the Company previously targeted customers developing amusement-related applications for its AG-1 and AG-2 series, it began efforts this year to create new markets among manufacturers involved in information technology, factory automation, measurement, and medical equipment. Next year, the Company plans to complete development of the AX51902, the second product in the AG-9 Series. Featuring new compression/decompression technology, the AX51902 has been designed for the surveillance, security, and image recording equipment markets. Should these new markets turn out to be disappointingly small, however, notwithstanding the Company's efforts to reorganize them, this could have a significant impact on its financial performance.

## (7) Legal regulations

### 1) Product quality and reliability

To date, the Company has never been sued for product liability under the Product Liability Law or any other law. There is no guarantee, however, that it will never be sued for such liabilities in the future. Generally speaking, moreover, there is no guarantee that it will never supply flawed LSIs to its customers, which cause damage to final customers. The Company controls use of its products in non-designated machinery and equipment by requiring that users receive prior consent before installing them. Recognizing that losses from product liability constitute a major risk, the Company takes steps to assure sufficient reliability and quality in product design and intends to strengthen these measures in the future. Notwithstanding such efforts, however, the Company may be forced to assume liability as a result of flaws in its products. In such an event, the Company would not only be liable for damages, but it would also lose significant amounts of credibility with respect to its products. This would negatively affect financial performance over both the short and longer term.

### 2) Scarcity of registered intellectual property rights

Despite a policy of filing and registering all intellectual property rights relating to its products or technologies, the Company has succeeded in registering only a relatively small number of intellectual property rights to date. While the Company's products and/or technologies are protected under certain provisions of the Civil Code, Unfair Competition Prevention Law, and other statutes, including the Copyright Law which confer rights without the need for filings or registration, problems could arise should the protection under such laws be insufficient or should the Company be unable to exercise its rights in reaction to the development and sale of similar products by other companies. The Company's inability to effectively counteract such actions would expose it to significant impact on its financial performance.

### 3) Disputes arising from infringements of intellectual property rights

To date, the Company has never been sued by a third party for infringement of intellectual property rights because of its alleged use of such intellectual property in its technologies or products. Based on its own surveys, moreover, it believes there is no possibility of such lawsuits. It cannot rule out the possibility that intellectual property rights relating to its businesses will be established in the name of a third party, however, or that such intellectual property rights may

already exist. In such instance, it could be sued for infringement of such a third party's intellectual property rights. Involvement in such a lawsuit would require the Company to expend enormous amounts of time, money and other management resources. Furthermore, if a court should rule against it in such lawsuit, the Company would be forced to discontinue the production and sale of products that include the technology in question and to pay substantial damages. Alternatively, it might have to assume an obligation to pay the holder of the right consideration for the granting of a license. In either case, the suit would result in a significant impact on the Company's financial performance.

### *Research and development*

The Company's active program of research and development is aimed at solidifying the competitiveness of its graphics and sound LSI products. This effort, complemented by collaboration with universities and by licensed technologies, has enabled the Company to bring a number of products to the stage of commercialization. The Company is also taking steps to improve the quality and efficiency of its design activities by establishing the most advanced design development environment possible for LSI design (computer-aided design, various measuring devices, etc.).

In addition to developing various technologies that enhance the functions and performance of LSIs, the Company is actively involved in the development of systems that support the development of application software for its LSIs (development support software, development and evaluation boards). The Company is currently engaged in the development of new graphics and sound LSIs to fill the product pipeline in two targeted areas: amusement-related applications; and the broad range of markets for devices requiring graphics rendering capabilities of the type offered by the AG-9 Series.

These efforts resulted in the expenditure of 628 million yen for research and development during the fiscal year under review.

#### 1) R&D in the area of graphics rendering technology

Because of its powerful graphics engines, the Company's LSIs offer rapid, versatile rendering and a rich range of effects (rotation, expansion and reduction, translucence processing, movement, and shape change). Development in this area is focused on strengthening these capabilities and enabling the technology to adapt to higher resolution display.

In the area of graphics LSIs for amusement applications, we are continuing to work on enhancing the processing capabilities of our graphics engines and on increasing the resolution and multi-functional capabilities of our chips. Work is proceeding on a next-generation graphics engine from the algorithm stage.

2) R&D in the area of graphics compression/decompression technologies

Graphics compression/decompression technologies represent a key element in the Company's ability to differentiate its products in the market. The Company's RAPIC technology offers compression performance and processing speeds greater than MPEG2. The major contribution to sales made during the year under review by the AX51201 graphics LSI for amusement-related applications, which includes RAPIC, testifies to the technology's effectiveness. During the year, we also completed development of a next-generation compression/decompression technology, Dual-RAPIC, intended for inclusion in the AX51902 graphics LSI for surveillance, security, and image recording-related applications. We have already begun work on the next two generations of successors to Dual-RAPIC as well.

3) R&D in the area of audio compression/decompression technologies

Another aspect of the R&D program involves work on a new audio compression/decompression technology that is designed to achieve differentiation in the market for next-generation sound LSIs. Based on one of the Company's elemental technologies in the area of audio playback, the goal of this development effort is to create an LSI offering multi-channel, high-speed audio compression/decompression capabilities.

4) R&D concerning systems on chips

The Company is involved in the creation of system-on-a-chip solutions for graphics and sound LSIs. The aim of this research is to enable the construction of graphics and sound systems that use virtually no peripheral components. This will be accomplished by integrating such peripheral functions as interfaces, memory and computing engines into the LSI.

5) R&D concerning development support environments

Incorporating the Company's graphics and sound LSIs into final products requires customers to develop complex programs that control the graphics and sound. The Company's AGENT 2 is a development support environment that enables customers to dramatically reduce the workload related to such program development. With the aim of offering total solutions to its customers, the

Company will continue to develop support environments that shorten the development period for its customers and facilitate the development process itself.

### *Technology transfer agreement*

<b>Name of licensor</b>	<b>Items covered by agreement</b>	<b>Nature of agreement</b>	<b>Period of agreement</b>
Internix Incorporated	Application-specific standard product LSIs, application-specific integrated circuit LSIs, and their derivatives and related products	Non-exclusive sales agency agreement for sales within Japan	From January 16, 1998 to January 15, 1999, with term extended automatically each year
Midoriya Electric Co., Ltd.	Application-specific standard product LSIs, application-specific integrated circuit LSIs, and their derivatives and related products	Non-exclusive sales agency agreement for sales within Japan	From December 12, 2000 to December 11, 2001, with term extended automatically each year
Okaya Electronics Corp.	Application-specific standard product LSIs, application-specific integrated circuit LSIs, and their derivatives and related products	Non-exclusive sales agency agreement for sales within Japan	From May 1, 2001 to April 30, 2002, with term extended automatically each year
ADM INC.	Application-specific standard product LSIs, application-specific integrated circuit LSIs, and their derivatives and related products	Basic agreement relating to product procurement transactions	From February 22, 2001 to February 21, 2002, with term extended automatically each year
Rohm Co., Ltd.	Application-specific standard product LSIs, application-specific integrated circuit LSIs, and their derivatives and related products	Basic agreement relating to product procurement transactions	From May 21, 2001 to May 20, 2002, with term extended automatically each year
Fujitsu, Ltd.	LSI development and prototypes, and their derivatives and related products	Basic agreement relating to development	From February 7, 2003 to February 6, 2004, with term extended automatically each year

*Although the Company entered into an operational alliance with Midoriya Electric Co., Ltd. in April 1998, it did not enter into a sales agency agreement with that company until December 12, 2000.*

### *Analysis of financial condition and results of operations*

In the following section, statements regarding the future are based on judgments made as of the end of the fiscal year (March 31, 2004).

#### (1) Important accounting principles and estimates

The Company's financial statements have been prepared in accordance with accounting standards deemed fair and appropriate in Japan and accurately represent the condition of the Company's assets and earnings. In addition, while we have prepared the financial statements using properly recorded accounting

records as our basic data, the figures may contain valuations based on a managerial perspective and may therefore differ from estimates.

#### 1) Inventories

Because of the Company's build-to-order method of operations, it has never had to write down and dispose of inventories for reasons of obsolescence. Consequently, it does not estimate amounts of obsolescence in future inventories. As it begins to handle more products and the variety of such products increases, however, the Company could be required to recognize valuation losses on small portions of its inventory hereafter.

#### 2) Impairment of investments

The Company holds the shares of a number of companies in its "investment in securities" account. These shares were purchased for the purpose of maintaining long-term cooperative relationships and providing technical support. These shares include those of publicly traded companies whose share prices are volatile and those of unlisted companies for which valuations are difficult to obtain. When the Company believes that a decline in the value of such holdings is more than just temporary, it recognizes an impairment loss on the basis of prescribed procedures. In the year to March 2003, it recognized such a loss on the shares of a privately held company. Further impairment losses may have to be recognized for this company if its financial performance continues to weaken due to poor market conditions, or if we believe that its losses are not reflected in the book value of its shares, or if the book value becomes irrecoverable.

#### (2) Analysis of results for the year to March 31, 2004

Please refer to our earlier discussion under "Results of operations." During the year under review, we reported high rates of growth in both sales and profits. This resulted from strong unit growth in sales of our major product, the AX51201 graphics LSI, which is sold for amusement-related applications. We believe that this growth resulted from an appreciation of the value of our total solutions approach, which aimed to achieve two ends: to create differentiation in terms of comprehensive systems costs through a product concept that sought to commercialize LSIs that included graphics rendering capabilities and many peripheral functions, thus relieving the CPU of the processing burden; and to go beyond differentiation in terms of products per se, by providing development and evaluation boards and development support software to support our customers' program development environments.

(3) Regarding factors with a significant impact on financial performance

Please refer to our earlier discussion under item (2) of the “Risk factors” section entitled “Regarding anomalous changes in financial condition and operating results.” We recognize that any of the four factors cited in this section, including changes in the nature of the Company’s business, changes in the size of the market for amusement-related applications, changes in the competitive status of our products, and assumptions of liability for defect warranties, could have a significant impact on our business.

(4) Current strategic considerations and longer-term strategic outlook

As of the end of the year to March 2004, we believe that we held more than a 50% share of the market for amusement-related applications. Our analysis indicates that the remaining share is held by other semiconductor manufacturers who are producing ASICs for individual customers and by those who are converting ASSPs originally designed for use in 3D game consoles to other amusement-related applications. Our efforts hereafter will focus on increasing our share in this market as needs shift from the performance levels of the AG-1 Series to the performance levels of the AG-2 Series. This will entail a comprehensive approach aimed both at increasing the number of new customers and at increasing the number of LSIs used by existing customers. We will also seek to differentiate our technologies further by continuing development of the AG-3 Series, the next-generation graphics LSI.

With respect to ongoing efforts to create new markets through the AG-9 Series, we will be collaborating with our sales agents to extend sales of the AX51901 to customers in the IT, FA, measurement and medical equipment markets. We will also be working with our sales agents to market the AX51902 graphics LSI, of which we expect to complete development on sometime next year, among customers working on surveillance, security, and image recording-related applications. In our medium-term management strategy, these new markets are being targeted for development into a second major area following amusement-related applications.

### *Corporate governance*

The Company aims to expand its business in accordance with the interests of its shareholders. Toward this end, it has built a structure of corporate governance appropriate to the size of its operations. This involves the use of a system of corporate auditors, which has enabled the Company to abide by statutory requirements and by internal regulations and to conduct operations with effective management oversight.

Compensation for directors and auditors comprises salaries that fall within amounts approved by shareholders at the General Meeting and directors' bonuses that have been similarly approved in the form of appropriations of earnings.

(1) Governing bodies and systems of internal controls

The Board of Directors is composed of five directors (including one representative director). This size of the Board enables the Company to expedite its management decisions. Although there are no outside directors, the release of one director from all operational duties and his assignment to the role of overseeing the activities of the other directors (including the representative director) has created an oversight capability within the board. (Three of the directors also assumed their positions to implement the provisions of the Commercial Code Article 260-3(2).) Based on internal regulations, all directors, including persons directly involved in any issue, may express an opinion on all matters decided by the Board. This results in a system of mutual checks and balances. In addition, the director who has been freed of all operational responsibilities has been placed in charge of internal auditing, which provides the Board with an internal auditing mechanism.

The Board of Corporate Auditors is composed of three external auditors (including one standing auditor) with no direct stake in the Company. The corporate auditors attend Board of Directors' meetings where they express their opinions. In addition, the standing corporate auditor regularly attends monthly management meetings (known as "GM Meetings," which comprise the president and the general managers of each group), where discussions relating to budgetary control are held. The understanding of operations gained through such meetings provides a basis for the standing auditor to conduct audits and inquiries into the state of the Company's operations. The standing auditor also cooperates with the Company's financial auditor, Shin Nihon & Co., and with internal staff involved in operational audits to enhance the Company's auditing capabilities. Finally, the Company's books are audited by the financial auditor, not only at fiscal year-end but also quarterly. This enables the Company to respond to the public's requirements for rapid disclosure.

The Company has adopted a system of stock options, by which it confers options not only on directors but also on employees. This increases the motivation of employees to contribute to improved financial performance, while fostering a sense of participation among employees in company management. To create an atmosphere of openness, the Company also holds meetings involving everyone in the Company when business plans and other matters of Company policy are

adopted or amended. At such meetings, directors and employees exchange opinions, which are reflected in the operations of the business.

We also endeavor to provide appropriate opportunities for shareholders to gain an understanding of matters relating to the Company, through more timely disclosure of Company-related information and more effective investor relations activities. As part of this effort, we disclose balance sheets and income statements on a quarterly basis and hold information meetings for investors from the general public. We also make a point of avoiding the busiest periods when scheduling General Meetings and of sending out notifications of Shareholder Meetings prior to legal deadlines.

In terms of internal controls, our goal is to create a system of internal checks and balances by building the system of internal auditing mentioned above and by establishing appropriate organizational and work-related regulations, including regulations dealing with organizational authority. After familiarizing employees with these regulations, the Company posted them on its internal homepage, where they are available for browsing. This system has been designed to promote a constant awareness of the regulations among employees and directors. While we have yet to systematize compliance and risk management through a separate set of regulations, we have dealt satisfactorily with these issues through the implementation of related rules and regulations. As our business expands hereafter, we will consider taking further action to strengthen our controls in these areas.

Our legal advice is provided by outside counsel.

As detailed above, we believe that the Company has established a system of corporate governance that is appropriate for the scale of our operations. We believe, furthermore, that this system is functioning in an effective manner.

(2) Directors' compensation

Compensation paid to directors and corporate auditors

Millions of yen	
Compensation paid to directors	72
Compensation paid to corporate auditors	7
	79

### (3) Compensation of auditors

#### Professional fees paid to the auditing firm, Shin Nihon & Co.

<b>Millions of yen</b>	
Amount of professional fees paid for financial auditing based on auditing contract	12
	12

### *Directors*

<b>Name</b>	<b>Title</b>	<b>Date joined company</b>	<b>Previous or current employers/occupations</b>	<b>Date of birth</b>	<b>Shares</b>
Yuzuru Sasaki	President and Representative Director	Feb-96	Aval Data Corp., Nippon Steel Corp.	29-Nov-48	6,542
Tatsuaki Okumura	Director and Chairman	Feb-96	OKK Corp., Aval Data Corp.	28-Aug-38	4,626
Sumihiko Ichihara	Managing Director	Apr-97	Aval Data Corp., Nippon Steel Corp.	24-Sep-55	3,280
Takayuki Shibata	Director	Feb-96	Casio Computer, Nippon Steel Corp.	21-Nov-59	3,020
Nobuhiro Sendai	Director	Aug-00	Toyo Engineering Corp., National Space Development Agency of Japan	26-Sep-52	180
Yoshiki Yoshida	Standing Corporate Auditor	Feb-01	Nikon Corp., Aval Data Corp.	24-Sep-37	54
Masaru Abe	Corporate Auditor	Jun-97	Licensed tax accountant	11-Nov-38	-
Katsumi Satoyoshi	Corporate Auditor	Jun-01	Sumitomo Mitsui Banking Corporation, Licensed tax accountant	6-Nov-35	-
					17,702

*Current assignments and previous positions in the Company have been omitted.*

### *Employees*

	<b>Total or average</b>
Number	24
Average age	33.3
Average years of service	2.0
Average annual salary (Thousands of yen)	10,742

*The average annual salary includes bonuses.*

*The seven new employees added during the fiscal year were hired to meet the demands of expanded operations.*

### *Union*

The Company has no labor union and enjoys amicable labor relations.

## Cash Flows

*Nonconsolidated statement of cash flows*

Years ended March 31; Thousands of yen	2003	2004
<b>Net cash provided by (used in) operating activities</b>		
Net income before taxes and other adjustments	1,142,649	2,370,875
Depreciation	32,813	59,430
Amortization of long-term prepaid expenses	395	804
Amortization of deferred assets	18,962	6,355
Interest and dividend income	(74)	(40)
Loss on disposal of tangible fixed assets	222	4,536
Loss on valuation of investment securities	73,907	-
Loss on sale of investment securities	-	12
Decrease (increase) in trade receivables	97,694	(369,972)
Decrease (increase) in inventories	(54,082)	(33,838)
Decrease (increase) in other current assets	1,823	(28,472)
Increase (decrease) in trade payables	(1,636)	138,510
Increase (decrease) in other current liabilities	(26,355)	56,256
Increase (decrease) in consumption tax payable	318	48,261
Director's bonuses	(14,000)	(17,100)
	1,272,638	2,235,618
Interest and dividend income	74	40
Income tax and others	(362,127)	(576,428)
	910,585	1,659,231
<b>Net cash provided by (used in) investing activities</b>		
Payments for acquisition of tangible fixed assets	(43,863)	(81,152)
Payments for acquisition of intangible fixed assets	(32,354)	(83,362)
Proceeds from sales of investment securities	-	137
Payments for investment securities	-	(66,240)
Proceeds from repayments of guarantees and deposits	-	4,987
Payments of guarantees and deposits	(12,333)	(400)
Others	19	(631)
	(88,531)	(226,661)
<b>Net cash provided by (used in) financing activities</b>		
Proceeds from issuing of securities	558,000	12,666
Payments for issuing of securities	(18,962)	(6,355)
Dividends	(115,560)	(179,716)
	423,477	(173,405)
Cash and cash equivalents	1,245,531	1,259,164
Cash and cash equivalents at beginning of term	1,586,725	2,832,257
Cash and cash equivalents at end of term	2,832,257	4,091,421

Relationship between balance of cash and cash equivalents as of term end and balance sheet items

<b>Years ended March 31; Thousands of yen</b>	<b>2003</b>	<b>2004</b>
Cash and deposit accounts	2,832,257	4,091,421
Cash and cash equivalents at end of term	2,832,257	4,091,421

### *Capital expenditures*

In February 2004, we increased our office space to meet the needs of a larger development staff and to improve the development environment. We also sought to add development-related equipment to meet the needs of an expanded range of business activities. Consequently, capital investment on fixed assets during the year amounted to 80 million yen. There were no removals or sales of major facilities during the year.

### *Dividend policy*

The Company recognizes that providing value to shareholders is an important issue for management. With respect to cash dividends, its basic policy is to determine the amount of payouts based on a comprehensive consideration of the requirements of future business expansion balanced by the need to strengthen the Company's financial structure and to enhance the level of its internal reserves.

In accordance with the foregoing policy, the Company has declared a dividend of 10,000 yen per share for the year ended March 31, 2004, representing a dividend payout ratio of 22%.

## Operations

### *Nonconsolidated statement of income*

<b>Years ended March 31; Thousands of yen</b>	<b>2003</b>	<b>2004</b>
<b>Net sales</b>	3,256,952	5,391,084
<b>Cost of sales</b>		
Finished goods inventory, beginning of term	3,272	55,983
Finished goods purchased during term	1,262,969	1,951,234
Production costs for the term	895	-
	1,267,137	2,007,218
Finished goods inventory, end of term	55,983	91,004
	1,211,153	1,916,214
	1,211,153	1,916,214
Gross profit on sales	2,045,798	3,474,870
<b>Selling, general and administrative expenses</b>	811,863	1,093,371
Operating income	1,233,935	2,381,498
<b>Nonoperating income</b>		
Interest income	58	27
Dividend income	16	13
Subsidy-relation income	1,516	-
Income from published manuscript	-	40
Dividends from life insurance policies	-	116
Miscellaneous income	221	106
	1,812	304
<b>Nonoperating expenses</b>		
New share issuance expenses	18,962	6,355
Loss on sale of investment securities	-	12
Miscellaneous losses	5	22
	18,967	6,390
Ordinary profit	1,216,779	2,375,412
<b>Extraordinary losses</b>		
Loss on removal of fixed assets	222	4,536
Valuation loss on investment securities	73,907	-
	74,130	4,536
Income (loss) before taxes and other adjustments	1,142,649	2,370,875
Corporate, inhabitant and enterprise taxes	487,464	982,824
Deferred taxes	(7,968)	(37,715)
	479,496	945,109
Net income	663,153	1,425,765
Retained earnings carried forward from previous term	346,586	511,933
Unappropriated profit, end of term	1,009,739	1,937,698

## *Appropriation of retained earnings*

Thousands of yen	June 19, 2003	June 17, 2004
Unappropriated profit, end of term	1,009,739	1,937,698
Appropriation of retained earnings		
Dividends	180,706	309,660
Directors' bonuses	17,100	23,000
[of which corporate auditor's portion]	[600]	[2,000]
Voluntary reserves		
Special reserves	300,000	1,000,000
	497,806	1,332,660
Retained earnings carried forward to next term	511,933	605,038

## *Cost of goods sold*

Years ended March 31; Thousands of yen	2003	%	2004	%
Labor costs	479	53.6	-	-
Manufacturing overhead	415	46.4	-	-
Total manufacturing costs for the term	895	100.0	-	-
Production costs for the term	895		-	

The major expense categories are the following.

Years ended March 31; Thousands of yen	2003	2004
Rent on real estate	123	-
Commissions	71	-
Repair expenses	51	-
Depreciation expenses	41	-

## *Results of operations*

### **Fiscal year ended March 31, 2004**

#### *Economic and other factors affecting operations*

- 1) Signs of economic recovery in Japan in second half of the year
  - Deflation remaining problematic in the first half, due to economic uncertainties from the Iraq war, SARS, etc.
  - Brighter prognosis in the second half, resulting from expanding overseas economies, primarily in America and the Asian region

- 2) Aggressive capital investment by the electronics industry, where trends most directly affect the Company. Industry begins to respond to stronger demand for digital home appliances, multipurpose cell phones, and PCs.

***Strategic responses by the Company***

Providing “total solutions” through:

- 1) A continuing emphasis on the development of LSIs incorporating proprietary technologies, such as graphics rendering and compression/decompression, with a focus on graphics and sound LSIs for the amusement market
- 2) Continuing work on products aimed at supporting customers’ development environment, aimed at simplifying and easing their development tasks

***Financial analysis (percentage change, year-on-year)***

- 1) 65.5% increase in net sales (see segment breakdown for analysis by product)
- 2) 95.2% increase in ordinary profit

***Segment breakdown***

ASSPs: Two factors contributed significantly to higher sales and profits in this segment. The first was a sharp increase in unit sales of the AX51201 for the amusement market, which incorporates extremely fine, high-resolution graphic rendering technology and the Company’s proprietary RAPIC compression/decompression technology. The second was better-than-expected sales of the existing AX51102 graphics LSI, the Company’s mainstay product through the preceding fiscal year. Consequently, sales in this segment increased by 70.0% to 5,272 million yen.

ASICs: The Company’s primary focus is the development and sale of ASSPs, into which it directs the bulk of its internal design resources. In principle, the Company allocates resources to ASIC development only when there is a pressing reason to do so, such as the advanced technological nature of the undertaking. There were consequently no new commissions for development of ASICs during the year, and sales were limited to commercial production of products developed through the previous fiscal year. As a result, sales in this segment declined by 23.4% to 118 million yen.

## *Issues requiring action*

### (1) Initiatives aimed at creating new markets

The Company began selling the AX51901 graphics LSI in the fiscal year ended March 2003. The first product in its AG-9 Series, the AX51901, has been designed for information technology, factory automation, design, and medical equipment applications. A second product in the series, the AX51902, is in the final stages of development and is being shown to prospective customers in the fields of surveillance, security, and image recording equipment, in advance of its formal release. In the factory automation market, one of the areas targeted for the AX51901, decisions concerning new product adoption can sometimes take years, but they vary in general. Among the companies that have made their decisions relatively quickly, some have begun to develop prototypes and appear set to begin commercial production sometime around the year to March 2005.

We define “creating new markets” for the AG-9 Series as a two-phased process: developing a base of customers in various market segments where efforts to use graphics rendering systems have been abandoned—whether for reasons of cost, performance or reliability—and restructuring such customers into a new market. Toward this end, we engage in a variety of sales-related initiatives, including collaborations and technical support arrangements with trading companies and alliances with related software developers and device manufacturers.

### (2) R&D organization

Continuing our efforts from the preceding year, we engaged in the development of next-generation graphics LSI products for the amusement market, focusing on enhancing graphics rendering capabilities and compression/decompression technologies. We also undertook development of a sound LSI, which we hope to complete during the year to March 2005. Given the likelihood that graphics and sound LSIs will be integrated in the future, our aim is to carve out a significant position in the market for sound LSIs at the earliest possible date. During the year, we also completed development of the Dual-RAPIC compression/decompression technology, which we cited in this section of last year’s securities report to the MOF. Dual-RAPIC has been incorporated into our new AG-9 Series of products, where the AX51902, the second product in the series, is now in the final stages of development.

Strengthening our R&D capabilities will depend significantly on our ability to attract and keep the most talented and experienced engineers available. Toward this end, we will continue to make active approaches to all potential candidates. At

the same time, we will endeavor to build a more efficient R&D structure by entering into multifaceted alliances, including collaborative research with universities, and by actively adopting functional verification technologies.

(3) Outsourcing of manufacturing

As a fabless semiconductor company, the Company specializes in design operations. Because it outsources its manufacturing, the Company is cognizant of the importance of maintaining good relationships with its cooperating manufacturers. With a series of new products scheduled to come down the development pipeline starting next fiscal year, the Company must continue its efforts to select the optimum manufacturer for each product. Another issue is the development of an internal system to strengthen the Company's quality control capabilities further.

(4) Protection of intellectual property

The Company acquired a number of patents during the fiscal year. It is also continuing to take steps to acquire patents for inventions now under consideration by government authorities. The Company is aware of the importance of intellectual property and is taking steps to build awareness within the technical group of the need to expedite applications for intellectual property rights for the group's products and technologies. In the year to March 2005, it will take steps to increase the efficiency of those involved administratively in supporting efforts to acquire patents. This will include entering into an advisory agreement with a law office.

(5) Strengthening internal controls

From the standpoint of compliance with laws and regulations, the Company believes that its internal systems of controls are adequate in light of its small number of employees. With the addition of seven new employees during the fiscal year, however, it now has 8 directors and 24 employees. While the increase has been gradual, the Company is growing larger, and as it continues to increase in size, it will have to take steps to solidify its crisis management capabilities and internal systems of control.

## *Selling, general and administrative expenses*

<b>Years ended March 31; Thousands of yen</b>	<b>2003</b>	<b>2004</b>
Directors' salaries	71,182	79,540
Salaries, bonuses and allowances	65,293	97,157
Commissions	44,104	-
Rent on real estate	44,169	-
Depreciation	12,727	11,946
Research and development expenses	461,861	628,015

## *Leases*

Under generally accepted accounting principles in Japan, finance leases that do not transfer ownership are accounted for in the same manner as operating leases when “as if capitalized” information is disclosed.

Pro forma information on leased property is as follows:

<b>Thousands of yen</b>	<b>2003</b>	<b>2004</b>
<b>Tools, appliances and fixtures</b>		
Acquisition cost	14,958	12,132
Accumulated depreciation	5,396	7,620
Net leased property	9,562	4,511
<b>Total</b>		
Acquisition cost	14,958	12,132
Accumulated depreciation	5,396	7,620
Net leased property	9,562	4,511
<b>Future minimum lease payments, including interest portion</b>		
Due within one year	5,059	2,227
Due after one year	4,755	2,527
	9,814	4,755
Lease payments	4,758	3,270
Pro forma depreciation expenses (assuming declining balance method)	4,332	2,933
Pro forma interest expenses	590	356
<b>Operating leases - future minimum lease payments</b>		
Due within one year	45	-
Due after one year	-	-
	45	-

## Capital Structure

### *Nonconsolidated balance sheet: assets*

<b>March 31; Thousands of yen</b>	<b>2003</b>	<b>2004</b>
<b>Current assets</b>		
Cash and deposits	2,832,257	4,091,421
Accounts receivable - trade	261,275	631,248
Finished products	55,983	91,004
Supplies	1,465	283
Advances paid	-	21,535
Prepaid expenses	22,058	28,980
Deferred tax assets	34,523	75,501
Others	8,042	54,777
	<u>3,215,606</u>	<u>4,994,751</u>
<b>Fixed assets</b>		
<b>Tangible fixed assets</b>		
Buildings	22,545	35,597
Accumulated depreciation	8,703	10,406
	<u>13,842</u>	<u>25,190</u>
Tools, appliances and fixtures	112,004	162,266
Accumulated depreciation	40,494	66,603
	<u>71,509</u>	<u>95,663</u>
	<u>85,352</u>	<u>120,853</u>
<b>Intangible fixed assets</b>		
Patents	-	2,150
Trademarks	2,107	1,881
Software	26,996	46,594
Telephone subscription rights	285	285
	<u>29,389</u>	<u>50,911</u>
<b>Investments and other assets</b>		
Investment securities	17,161	134,267
Long-term loans	500	-
Long-term prepaid expenses	430	432
Deferred tax assets	17,803	-
Rental and guarantee deposits	67,847	63,259
Contributions to insurance savings	61,923	62,247
	<u>165,666</u>	<u>260,207</u>
Total fixed assets	<u>280,408</u>	<u>431,973</u>
Total assets	<u>3,496,014</u>	<u>5,426,725</u>

*Nonconsolidated balance sheet: liabilities and shareholders' equity*

March 31; Thousands of yen	2003	2004
<b>Current liabilities</b>		
Accounts payable – trade	117,193	255,703
Accounts payable – other	52,453	96,960
Accrued expenses payable	4,140	10,930
Income taxes payable	332,769	739,166
Consumption taxes payable	31,265	79,526
Deposits received	9,085	18,229
	546,906	1,200,516
<b>Long-term liabilities</b>		
Deferred tax liabilities	-	6,221
	-	6,221
Total liabilities	546,906	1,206,738
<b>Shareholders' equity</b>		
Common stock	947,500	953,833
Capital reserves		
Additional paid-in capital	790,860	797,193
	790,860	797,193
Retained earnings		
Legal income reserve	1,185	1,185
Voluntary reserves		
Special reserves	200,000	500,000
Unappropriated profit, end of term	1,009,739	1,937,698
	1,210,925	2,438,884
Unrealized gains or losses on other securities	(177)	30,076
Total shareholders' equity	2,949,108	4,219,987
Total liabilities and shareholders' equity	3,496,014	5,426,725

## Accounting Policies

### Summary of accounting policies: nonconsolidated

<b>Basis of presentation</b>	Japanese GAAP
<b>Marketable securities and investments in securities</b>	Other securities: Quoted securities: the market value method is applied, based on the market value as of the fiscal year-end. The entire positive or negative valuation difference with the purchase price is booked directly as shareholders' equity, and the cost of securities sold is calculated using the moving average method Unquoted securities: valued at cost using the moving average method
<b>Inventories</b>	Finished goods: valued at cost, computed on a periodic average basis Supplies: valued at cost, using the final purchase cost method
<b>Depreciation</b>	Tangible fixed assets: declining-balance method Intangible fixed assets: Patents: straight-line depreciation over 8-year period Trademarks: straight-line depreciation over 10-year period Software for internal use is amortized on a straight-line basis (based on length of useful internal life (3 - 5 years))
<b>Deferred assets</b>	Expenses for issuance of new equity: recognized in full at time of expenditure
<b>Opinion of independent auditors</b>	Auditors: Shin Nihon & Co. Opinion: unqualified

## Share-related Information

### Shares in issue

<b>Class of shares</b>	Common
<b>Number of shares authorized</b>	57,780
<b>Issued</b>	
As of March 31, 2004	30,966
As of June 18, 2004	62,008
<b>Stock exchange listings or registration</b>	Japan Securities Dealers Association
<b>Comments</b>	The Company's standard shares, with no limitations as to shareholders' rights

### Changes in common stock and number of shares outstanding

Shares Thousands of yen Date	Shares outstanding		Common stock		Additional paid-in capital		Remarks
	Increase or decrease	Balance	Increase or decrease	Balance	Increase or decrease	Balance	
March 15, 2001	695	3,015	347,500	472,250	347,500	368,750	Private placement of shares
March 28, 2001	1,800	4,815	168,000	640,250	171,360	540,110	Exercise of stock acquisition rights on unsecured bonds with warrants
August 20, 2001	9,630	14,445	82,000	722,250	(82,000)	458,110	Credited to capital reserves Split 3 for 1
December 18, 2002	1,000	15,445	225,250	947,500	332,750	790,860	Public offering via the book-building formula
May 20, 2003	15,445	30,890	-	947,500	-	790,860	(Note)
April 1, 2003 – March 31, 2004	76	30,966	6,333	953,833	6,333	797,193	(Note)

At a meeting of the Board of Directors held on March 4, 2003, the directors approved a 2-for-1 stock split with a recording date of May 20, 2003 for all shares held by shareholders listed on the final registers of shareholders and beneficial shareholders as of March 31, 2003. Consequently, total shares outstanding increased by 15,445 shares to 30,890 shares.

This represents the execution of rights on stock options as defined under Article 280-19 of the Commercial Code prior to its recent revisions.

During the period from April 1, 2004 to June 18, 2004, the execution of stock options resulted in an increase in outstanding shares of 76 shares and an increase in both common stock and capital reserve accounts of 3,166,000 yen.

### Shareholders by type of investor

Type of investor	Number of shareholders	Number of units owned	% owned
National and local government agencies	-	-	-
Financial institutions	9	2,060	6.65
Securities companies	1	80	0.26
Business and other corporations	40	4,552	14.70
Nonresidents - businesses and corporations	18	1,147	3.70
(Included nonresidents - individuals)	(1)	(3)	(0.01)
Individuals and others	3,404	23,127	74.69
	3,472	30,966	100
Shares less than one unit	-	-	-

## Largest shareholders

Name	Shares owned	Held in trust accounts	% of shares outstanding
Yuzuru Sasaki	3,271		10.56
Tatsuaki Okumura	2,388		7.71
Midoriya Electric Co., Ltd.	1,800		5.81
Sumihiko Ichihara	1,740		5.61
Takayuki Shibata	1,510		4.87
Yoshinori Narita	1,478		4.77
Kazuyoshi Moriya	1,056		3.41
Aval Data Corporation	1,050		3.39
Kazunori Matsuura	960		3.10
Japan Trustee Services Bank (Trust Account)	889	839	2.87
	16,142		52.12

## Share information

<b>Fiscal year-end</b>	March 31
<b>Ex-rights date</b>	March 31
<b>Ex-rights date for interim dividend</b>	September 30
<b>Annual general meeting of shareholders</b>	June
<b>Trading unit</b>	-
<b>Types of share certificates</b>	1, 10 and 100 shares
<b>Transfer agent</b>	UFJ Trust Bank Limited, 1-4-3, Marunouchi, Chiyoda-ku, Tokyo
<b>Publication of record</b>	<i>Nihon Keizai Shimbun</i> (Whereas we had previously published our balance sheet and statement of income in the <i>Nihon Keizai Shimbun</i> , we are now making these available on our Company's homepage at: <a href="http://www.axell.co.jp/">http://www.axell.co.jp/</a> .)

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