

# Financial Section

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# Consolidated Balance Sheets

Hitachi, Ltd. and Subsidiaries  
March 31, 2006 and 2005

| Assets   | Millions of yen    |                   | Thousands of<br>U.S. dollars (note 3) |
|--|--------------------|-------------------|---------------------------------------|
|  | 2006               | 2005              | 2006                                  |
| Cash and cash equivalents . . . . .  | ¥ 658,255          | ¥ 708,715         | \$ 5,626,111                          |
| Short-term investments (note 4) . . . . .  | 162,756            | 146,568           | 1,391,077                             |
| Trade receivables, net of allowance for doubtful receivables of<br>¥41,610 million (\$355,641 thousand) for 2006 and ¥40,330 million for 2005: |                    |                   |                                       |
| Notes (notes 8 and 18) . . . . .   | 127,284            | 132,572           | 1,087,897                             |
| Accounts (notes 5 and 8) . . . . .   | 2,303,397          | 2,065,194         | 19,687,154                            |
| Inventories (note 6) . . . . .   | 1,262,308          | 1,198,955         | 10,788,957                            |
| Prepaid expenses and other current assets (note 10) . . . . .  | 547,048            | 560,072           | 4,675,624                             |
| Investments in leases (notes 7 and 8) . . . . .  | 451,757            | 526,759           | 3,861,171                             |
| Investments and advances, including affiliated companies (note 4) . . . . .  | 1,029,673          | 894,851           | 8,800,624                             |
| Property, plant and equipment (note 7):  |                    |                   |                                       |
| Land . . . . .   | 435,961            | 436,308           | 3,726,162                             |
| Buildings . . . . .  | 1,748,318          | 1,740,057         | 14,942,889                            |
| Machinery and equipment . . . . .  | 5,522,253          | 5,222,157         | 47,198,744                            |
| Construction in progress . . . . .   | 74,114             | 57,291            | 633,453                               |
|  | <b>7,780,646</b>   | <b>7,455,813</b>  | <b>66,501,248</b>                     |
| Less accumulated depreciation . . . . .  | <b>5,320,460</b>   | <b>5,097,882</b>  | <b>45,474,017</b>                     |
| Net property, plant and equipment . . . . .  | <b>2,460,186</b>   | <b>2,357,931</b>  | <b>21,027,231</b>                     |
| Other assets (notes 9 and 10) . . . . .  | <b>1,018,531</b>   | <b>1,144,630</b>  | <b>8,705,393</b>                      |
|  | <b>¥10,021,195</b> | <b>¥9,736,247</b> | <b>\$85,651,239</b>                   |

See accompanying notes to consolidated financial statements.

| <b>Liabilities and Stockholders' Equity</b>                  | Millions of yen    |            | Thousands of<br>U.S. dollars (note 3) |
|--|--------------------|------------|---------------------------------------|
|  | 2006               | 2005       | 2006                                  |
| Short-term debt (note 11) . . . . .                          | ¥ 752,527          | ¥ 676,611  | \$ 6,431,855                          |
| Current portion of long-term debt (notes 7 and 11) . . . . . | 248,028            | 506,863    | 2,119,897                             |
| Trade payables:  |                    |            |                                       |
| Notes . . . . .  | 68,599             | 62,855     | 586,316                               |
| Accounts . . . . .   | 1,416,367          | 1,246,401  | 12,105,701                            |
| Accrued expenses . . . . .                                   | 863,683            | 843,022    | 7,381,906                             |
| Income taxes (note 10) . . . . .                             | 66,101             | 61,789     | 564,966                               |
| Advances received . . . . .                                  | 277,887            | 247,586    | 2,375,103                             |
| Other current liabilities (note 10) . . . . .                | 428,259            | 419,419    | 3,660,333                             |
| Long-term debt (notes 7 and 11) . . . . .                    | 1,418,489          | 1,319,032  | 12,123,838                            |
| Retirement and severance benefits (note 12) . . . . .        | 827,669            | 1,033,005  | 7,074,094                             |
| Other liabilities (note 10) . . . . .                        | 109,006            | 90,781     | 931,675                               |
| Total liabilities . . . . .                                  | <b>6,476,615</b>   | 6,507,364  | <b>55,355,684</b>                     |
| Minority interests . . . . .                                 | 1,036,807          | 921,052    | 8,861,598                             |
| Stockholders' equity:  |                    |            |                                       |
| Common stock (notes 11 and 13) . . . . .                     | 282,033            | 282,033    | 2,410,538                             |
| Capital surplus (note 13) . . . . .                          | 561,484            | 565,360    | 4,799,008                             |
| Legal reserve (note 14) . . . . .                            | 111,005            | 110,214    | 948,761                               |
| Retained earnings (notes 14) . . . . .                       | 1,667,198          | 1,668,984  | 14,249,556                            |
| Accumulated other comprehensive loss (note 16) . . . . .     | (95,997)           | (301,524)  | (820,487)                             |
| Treasury stock, at cost (note 15) . . . . .                  | (17,950)           | (17,236)   | (153,419)                             |
| Total stockholders' equity . . . . .                         | <b>2,507,773</b>   | 2,307,831  | <b>21,433,957</b>                     |
| Commitments and contingencies (note 18)                      |                    |            |                                       |
|  | <b>¥10,021,195</b> | ¥9,736,247 | <b>\$85,651,239</b>                   |

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Income

Hitachi, Ltd. and Subsidiaries  
Years ended March 31, 2006, 2005 and 2004

|   | Millions of yen    |             |             | Thousands of<br>U.S. dollars (note 3) |
|---|--------------------|-------------|-------------|---------------------------------------|
|   | 2006               | 2005        | 2004        | 2006                                  |
| <b>Revenues:</b>  |                    |             |             |                                       |
| Product sales (note 5) . . . . .                            | <b>¥8,486,190</b>  | ¥8,055,179  | ¥7,652,205  | <b>\$72,531,538</b>                   |
| Financial and other services . . . . .                      | <b>978,611</b>     | 971,864     | 980,245     | <b>8,364,197</b>                      |
| Total revenues . . . . .                                    | <b>9,464,801</b>   | 9,027,043   | 8,632,450   | <b>80,895,735</b>                     |
| <b>Cost of sales:</b>                                       |                    |             |             |                                       |
| Product sales . . . . .                                     | <b>(6,683,759)</b> | (6,258,922) | (5,966,578) | <b>(57,126,145)</b>                   |
| Financial and other services . . . . .                      | <b>(703,985)</b>   | (702,348)   | (743,576)   | <b>(6,016,966)</b>                    |
| Total cost of sales . . . . .                               | <b>(7,387,744)</b> | (6,961,270) | (6,710,154) | <b>(63,143,111)</b>                   |
| Selling, general and administrative expenses . . . . .      | <b>(1,821,045)</b> | (1,786,718) | (1,737,433) | <b>(15,564,487)</b>                   |
| Impairment losses for long-lived assets (note 19) . . . . . | <b>(27,408)</b>    | (26,797)    | (26,085)    | <b>(234,256)</b>                      |
| Restructuring charges (note 20) . . . . .                   | <b>(4,429)</b>     | (33,307)    | (28,613)    | <b>(37,855)</b>                       |
| Interest income . . . . .                                   | <b>18,170</b>      | 13,413      | 12,808      | <b>155,299</b>                        |
| Dividends income . . . . .                                  | <b>6,421</b>       | 5,971       | 6,352       | <b>54,880</b>                         |
| Other income (notes 21 and 22) . . . . .                    | <b>63,002</b>      | 67,024      | 142,010     | <b>538,479</b>                        |
| Interest charges . . . . .                                  | <b>(33,265)</b>    | (29,057)    | (30,855)    | <b>(284,316)</b>                      |
| Other deductions (note 21) . . . . .                        | <b>(3,639)</b>     | (11,796)    | (23,331)    | <b>(31,103)</b>                       |
| Income before income taxes and minority interests . . . . . | <b>274,864</b>     | 264,506     | 237,149     | <b>2,349,265</b>                      |
| Income taxes (note 10) . . . . .                            | <b>(154,348)</b>   | (149,990)   | (198,655)   | <b>(1,319,214)</b>                    |
| Income before minority interests . . . . .                  | <b>120,516</b>     | 114,516     | 38,494      | <b>1,030,051</b>                      |
| Minority interests . . . . .                                | <b>(83,196)</b>    | (63,020)    | (22,618)    | <b>(711,077)</b>                      |
| Net income . . . . .  | <b>¥ 37,320</b>    | ¥ 51,496    | ¥ 15,876    | <b>\$ 318,974</b>                     |
| <b>Net income per share (note 23):</b>                      |                    |             |             |                                       |
| Basic . . . . .   | <b>¥11.20</b>      | ¥15.53      | ¥4.81       | <b>\$0.10</b>                         |
| Diluted . . . . .   | <b>10.84</b>       | 15.15       | 4.75        | <b>0.09</b>                           |

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Stockholders' Equity

Hitachi, Ltd. and Subsidiaries  
Years ended March 31, 2006, 2005 and 2004

|   | Millions of yen |             |             | Thousands of<br>U.S. dollars (note 3) |
|---|-----------------|-------------|-------------|---------------------------------------|
|   | 2006            | 2005        | 2004        | 2006                                  |
| <b>Common stock (notes 11 and 13):</b>  |                 |             |             |                                       |
| Balance at beginning of year . . . . .  | ¥ 282,033       | ¥ 282,032   | ¥ 282,032   | \$ 2,410,538                          |
| Conversion of convertible debentures . . . . .                                | -               | 1           | 0           | -                                     |
| Balance at end of year . . . . .  | ¥ 282,033       | ¥ 282,033   | ¥ 282,032   | \$ 2,410,538                          |
| <b>Capital surplus (note 13):</b>   |                 |             |             |                                       |
| Balance at beginning of year . . . . .  | ¥ 565,360       | ¥ 551,690   | ¥ 562,214   | \$ 4,832,137                          |
| Gains on sales of treasury stock . . . . .                                    | 150             | 353         | 48          | 1,282                                 |
| Gains on stock exchange upon a merger . . . . .                               | -               | 12,509      | -           | -                                     |
| Increase (decrease) arising from divestiture and other . . . . .              | (4,026)         | 808         | (10,572)    | (34,411)                              |
| Balance at end of year . . . . .  | ¥ 561,484       | ¥ 565,360   | ¥ 551,690   | \$ 4,799,008                          |
| <b>Legal reserve (note 14):</b>   |                 |             |             |                                       |
| Balance at beginning of year . . . . .  | ¥ 110,214       | ¥ 109,163   | ¥ 111,309   | \$ 942,000                            |
| Net transfer from (to) retained earnings . . . . .                            | 601             | 921         | (1,849)     | 5,137                                 |
| Net transfer from (to) minority interests . . . . .                           | 190             | 130         | (297)       | 1,624                                 |
| Balance at end of year . . . . .  | ¥ 111,005       | ¥ 110,214   | ¥ 109,163   | \$ 948,761                            |
| <b>Retained earnings (note 14):</b>   |                 |             |             |                                       |
| Balance at beginning of year . . . . .  | ¥1,668,984      | ¥1,651,272  | ¥1,655,029  | \$14,264,821                          |
| Net income . . . . .  | 37,320          | 51,496      | 15,876      | 318,974                               |
| Cash dividends . . . . .  | (36,644)        | (34,628)    | (19,990)    | (313,196)                             |
| Net transfer from (to) legal reserve . . . . .                                | (601)           | (921)       | 1,849       | (5,137)                               |
| Net transfer from (to) minority interests . . . . .                           | (1,861)         | 1,765       | (1,492)     | (15,906)                              |
| Balance at end of year . . . . .  | ¥1,667,198      | ¥1,668,984  | ¥1,651,272  | \$14,249,556                          |
| <b>Accumulated other comprehensive loss (note 16):</b>                        |                 |             |             |                                       |
| Balance at beginning of year . . . . .  | ¥ (301,524)     | ¥ (393,864) | ¥ (755,525) | \$ (2,577,128)                        |
| Other comprehensive income,<br>net of reclassification adjustments . . . . .  | 206,519         | 92,666      | 359,116     | 1,765,120                             |
| Net transfer from (to) minority interests . . . . .                           | (992)           | (326)       | 2,545       | (8,479)                               |
| Balance at end of year . . . . .  | ¥ (95,997)      | ¥ (301,524) | ¥ (393,864) | \$ (820,487)                          |
| <b>Treasury stock, at cost (note 15):</b>                                     |                 |             |             |                                       |
| Balance at beginning of year . . . . .  | ¥ (17,236)      | ¥ (32,162)  | ¥ (1,847)   | \$ (147,316)                          |
| Acquisition for treasury . . . . .  | (1,058)         | (1,177)     | (30,464)    | (9,043)                               |
| Sales of treasury stock . . . . .   | 344             | 478         | 149         | 2,940                                 |
| Stock exchange upon a merger . . . . .  | -               | 15,625      | -           | -                                     |
| Balance at end of year . . . . .  | ¥ (17,950)      | ¥ (17,236)  | ¥ (32,162)  | \$ (153,419)                          |
| Total stockholders' equity . . . . .  | ¥2,507,773      | ¥2,307,831  | ¥2,168,131  | \$21,433,957                          |
| <b>Comprehensive income (note 16):</b>  |                 |             |             |                                       |
| Net income . . . . .  | ¥ 37,320        | ¥ 51,496    | ¥ 15,876    | \$ 318,974                            |
| Other comprehensive income arising during the year . . . . .                  | 221,157         | 97,878      | 362,893     | 1,890,231                             |
| Reclassification adjustments for net gain included in<br>net income . . . . . | (14,638)        | (5,212)     | (3,777)     | (125,111)                             |
| Comprehensive income . . . . .  | ¥ 243,839       | ¥ 144,162   | ¥ 374,992   | \$ 2,084,094                          |

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

Hitachi, Ltd. and Subsidiaries  
Years ended March 31, 2006, 2005 and 2004

|  | Millions of yen  |                  |                  | Thousands of<br>U.S. dollars (note 3) |
|--|------------------|------------------|------------------|---------------------------------------|
|  | 2006             | 2005             | 2004             | 2006                                  |
| <b>Cash flows from operating activities (note 25):</b>                               |                  |                  |                  |                                       |
| Net income   | ¥ 37,320         | ¥ 51,496         | ¥ 15,876         | \$ 318,974                            |
| Adjustments to reconcile net income to net cash provided<br>by operating activities: |                  |                  |                  |                                       |
| Depreciation   | 451,170          | 425,080          | 436,053          | 3,856,154                             |
| Amortization   | 138,727          | 132,370          | 117,561          | 1,185,701                             |
| Impairment losses for long-lived assets  | 27,408           | 26,797           | 26,085           | 234,256                               |
| Deferred income taxes  | 33,815           | 45,310           | 77,056           | 289,017                               |
| Equity in (earnings) losses of affiliated companies, net                             | (8,688)          | 162              | (10,120)         | (74,256)                              |
| Gain on sale of investments and subsidiaries'<br>common stock                        | (46,468)         | (54,741)         | (137,925)        | (397,162)                             |
| Impairment of investments in securities  | 4,858            | 9,665            | 12,893           | 41,521                                |
| Loss on disposal of rental assets and other property                                 | 8,983            | 15,202           | 13,274           | 76,778                                |
| Income applicable to minority interests  | 83,196           | 63,020           | 22,618           | 711,077                               |
| (Increase) decrease in receivables   | (94,078)         | 103,246          | (187,545)        | (804,085)                             |
| Increase in inventories  | (107,069)        | (95,191)         | (67,026)         | (915,120)                             |
| (Increase) decrease in prepaid expenses<br>and other current assets                  | 35,947           | (29,973)         | (3,075)          | 307,239                               |
| Increase (decrease) in payables  | 107,271          | (53,785)         | 145,234          | 916,846                               |
| Increase (decrease) in accrued expenses and retirement<br>and severance benefits     | (30,505)         | (26,823)         | 109,152          | (260,726)                             |
| Increase (decrease) in accrued income taxes  | 2,047            | (18,861)         | 27,741           | 17,496                                |
| Increase (decrease) in other liabilities   | 44,060           | (408)            | 5,276            | 376,581                               |
| Net change in inventory-related receivables from<br>financial services               | 14,328           | (22,036)         | (3,140)          | 122,462                               |
| Other  | (11,447)         | (5,174)          | 3,415            | (97,838)                              |
| Net cash provided by operating activities  | <b>690,875</b>   | <b>565,356</b>   | <b>603,403</b>   | <b>5,904,915</b>                      |
| <b>Cash flows from investing activities (note 25):</b>                               |                  |                  |                  |                                       |
| Decrease in short-term investments   | 1,104            | 47,179           | 10,035           | 9,436                                 |
| Capital expenditures   | (382,386)        | (368,896)        | (289,753)        | (3,268,256)                           |
| Purchase of assets to be leased  | (466,681)        | (483,192)        | (439,047)        | (3,988,727)                           |
| Collection of investments in leases  | 419,956          | 301,614          | 340,376          | 3,589,367                             |
| Proceeds from disposal of rental assets and other property                           | 80,718           | 90,726           | 122,258          | 689,897                               |
| Proceeds from sale of investments<br>and subsidiaries' common stock                  | 99,717           | 112,932          | 301,553          | 852,282                               |
| Purchase of investments and subsidiaries' common stock                               | (67,643)         | (61,711)         | (110,837)        | (578,145)                             |
| Purchase of software   | (121,983)        | (121,415)        | (117,896)        | (1,042,590)                           |
| Other  | (64,164)         | (44,225)         | (84,102)         | (548,410)                             |
| Net cash used in investing activities  | <b>(501,362)</b> | <b>(526,988)</b> | <b>(267,413)</b> | <b>(4,285,146)</b>                    |
| <b>Cash flows from financing activities (note 25):</b>                               |                  |                  |                  |                                       |
| Increase (decrease) in short-term debt, net  | 5,121            | 27,029           | (193,286)        | 43,769                                |
| Proceeds from long-term debt   | 342,309          | 533,442          | 460,144          | 2,925,718                             |
| Payments on long-term debt   | (551,265)        | (599,637)        | (587,335)        | (4,711,666)                           |
| Proceeds (payments) on subsidiaries' common stock, net                               | (3,139)          | (8,431)          | 9,984            | (26,829)                              |
| Dividends paid to stockholders   | (36,509)         | (34,815)         | (19,961)         | (312,043)                             |
| Dividends paid to minority stockholders of subsidiaries                              | (17,591)         | (16,671)         | (13,714)         | (150,350)                             |
| Acquisition of common stock for treasury   | (1,058)          | (1,177)          | (30,464)         | (9,043)                               |
| Proceeds from sales of treasury stock  | 494              | 831              | 197              | 4,222                                 |
| Net cash used in financing activities  | <b>(261,638)</b> | <b>(99,429)</b>  | <b>(374,435)</b> | <b>(2,236,222)</b>                    |
| Effect of exchange rate changes on cash and cash equivalents                         | 21,665           | 5,380            | (25,330)         | 185,171                               |
| Net decrease in cash and cash equivalents  | <b>(50,460)</b>  | <b>(55,681)</b>  | <b>(63,775)</b>  | <b>(431,282)</b>                      |
| Cash and cash equivalents at beginning of year                                       | <b>708,715</b>   | <b>764,396</b>   | <b>828,171</b>   | <b>6,057,393</b>                      |
| Cash and cash equivalents at end of year   | <b>¥658,255</b>  | <b>¥708,715</b>  | <b>¥764,396</b>  | <b>\$5,626,111</b>                    |

See accompanying notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

Hitachi, Ltd. and Subsidiaries

## 1. NATURE OF OPERATIONS

Hitachi, Ltd. (the Company) is a Japanese corporation, whose principal office is located in Japan. The Company's and its subsidiaries' businesses are diverse, and include information and telecommunication systems, electronic devices, power and industrial systems, digital media and consumer products, high functional materials and components, and other services including financial services and logistics services.

## 2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### *(a) Basis of Presentation*

The Company and its domestic subsidiaries maintain their books of account in conformity with the financial accounting standards of Japan, and its foreign subsidiaries in conformity with those of the countries of their domicile.

The consolidated financial statements presented herein have been prepared in a manner and reflect the adjustments which are necessary to conform them with accounting principles generally accepted in the United States of America. Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements. Actual results could differ from those estimates.

### *(b) Principles of Consolidation*

The consolidated financial statements include the accounts of the Company, its majority-owned subsidiaries and all variable interest entities (VIEs) for which any of the Company and its consolidated entities are the primary beneficiary. The consolidated financial statements include accounts of certain subsidiaries, of which fiscal years differ from March 31 by 93 days or less, to either comply with local statutory requirements or facilitate timely reporting. There have been no significant transactions, which would materially affect the Company's financial position and results of operations, with such subsidiaries during the period from their fiscal year-end to March 31. Intercompany accounts and significant intercompany transactions have been eliminated in consolidation.

A VIE is defined in Financial Accounting Standards Board (FASB) Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51." This interpretation addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. The application of this interpretation did not have a material effect on the Company's consolidated financial statements for the year ended March 31, 2004.

Investments in corporate joint ventures and affiliated companies that are accounted for using the equity method primarily relate to 20% to 50% owned companies to which the Company has the ability to exercise significant influence over operational and financial policies of the investee company. Investments where the Company does not have significant influence are accounted for using the cost method.

### *(c) Cash Equivalents*

For the purpose of the statement of cash flows, the Company considers all highly liquid investments with insignificant risk of changes in value which have initial maturities of generally three months or less when purchased to be cash equivalents.

### *(d) Allowance for Doubtful Receivables*

Allowance for doubtful receivables, including both trade receivables and investments in leases, is the Company's and subsidiaries' best estimate of the amount of probable credit losses in their existing receivables. The allowance is determined based on, but are not limited to, historical collection experience adjusted for the effects of current economic environment, assessment of inherent risks, aging and financial performance of debtors. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

***(e) Foreign Currency Translation***

Foreign currency financial statements have been translated in accordance with Statement of Financial Accounting Standards (SFAS) No. 52, "Foreign Currency Translation." Under this standard, the assets and liabilities of the Company's subsidiaries located outside Japan are translated into Japanese yen at the rates of exchange in effect at the balance sheet date. Income and expense items are translated at the average exchange rates prevailing during the year. Gains and losses resulting from foreign currency transactions are included in other income (deductions), and those resulting from translation of financial statements are excluded from the consolidated statements of income and are accumulated and included in accumulated other comprehensive loss as part of stockholders' equity.

***(f) Investments in Securities and Affiliated Companies***

Equity securities that do not have readily determinable fair values, except for equity-method investments, are accounted for under the cost method. The Company classifies investments in equity securities that have readily determinable fair values and all investments in debt securities in three categories: held-to-maturity securities, trading securities and available-for-sale securities.

Held-to-maturity securities are debt securities that the Company has the positive intent and ability to hold to maturity. Trading securities are debt and equity securities that are bought and held principally for the purpose of selling them in the near term. Available-for-sale securities are debt and equity securities not classified as either held-to-maturity securities or trading securities.

Held-to-maturity securities are reported at amortized cost. Trading securities are reported at fair value, with unrealized gains and losses included in earnings. Available-for-sale securities are reported at fair value, with unrealized gains and losses reported in other comprehensive income.

A decline in fair value of any available-for-sale, held-to-maturity security or cost-method investments below the cost basis or the amortized cost basis that is deemed to be other-than-temporary results in a write-down of the cost basis or the amortized cost basis to fair value as a new cost basis and the amount of the write-down is included in earnings. On a continuous basis, but no less frequently than at the end of each semi-annual period, the Company evaluates an available-for-sale security, a held-to-maturity security and a cost-method investment for possible impairment. Fair value is determined based on quoted market prices, projected discounted cash flows or other valuation techniques as appropriate. For certain cost-method investments that it is not practicable to estimate the fair value, if an event or change in circumstances has occurred that may have a significant adverse effect on the fair value of the investment, the Company estimates the fair value of the investment. Factors considered in determining whether an impairment of available-for-sale security or cost-method investment is other-than-temporary include: the length of time and extent to which the fair value of the investment has been less than cost, the financial condition and near-term prospect of the issuer, and the intent and ability to retain the investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Factors considered in assessing whether an impairment of held-to-maturity security is other-than-temporary include the financial condition, business prospects and credit worthiness of the issuer.

On a continuous basis, but no less frequently than at the end of each semi-annual period, the Company evaluates the carrying amount of its ownership interests in equity-method investees for possible impairment. Factors considered in assessing whether an indication of other-than-temporary impairment exists include the achievement of business plan objectives and milestones including cash flow projections and the results of planned financing activities, the financial condition and prospects of each investee company, the fair value of the ownership interest relative to the carrying amount of the investment, the period of time during which the fair value of the ownership interest has been below the carrying amount of the investment and other relevant factors. Impairment to be recognized is measured based on the amount by which the carrying amount of the investment exceeds the fair value of the investment. Fair value is determined based on quoted market prices, projected discounted cash flows or other valuation techniques as appropriate.

The cost of a security sold or the amount reclassified out of accumulated other comprehensive income into earnings is determined by the average cost method.

**(g) Securitizations**

The Company and certain subsidiaries have a number of securitization programs. Under those programs, certain financial assets such as lease receivables, trade receivables and others are sold to Special Purpose Entities (SPEs) which are funded through the issuance of asset-backed securities to investors. When a transfer of financial assets is eligible to be accounted for as a sale under SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," the carrying amount of the financial assets is allocated based on relative fair values to the portions to be retained and sold. The Company and its subsidiaries recognize a gain or loss for the difference between the net proceeds received and the allocated carrying amount of the assets sold when the transaction is consummated.

Fair values are based on the present value of estimated future cash flows which take into consideration various factors such as expected credit loss and others.

**(h) Inventories**

Inventories are stated at the lower of cost or market. Cost is determined by the specific identification method for job order inventories and generally by the average cost method for raw materials and other inventories.

**(i) Property, Plant and Equipment**

Property, plant and equipment are stated at cost. Property, plant and equipment are principally depreciated by the declining-balance method, except for some assets which are depreciated by the straight-line method, over the following estimated useful lives:

|  |               |
|--|---------------|
| Buildings                                  |               |
| Buildings and building equipment . . . . . | 3 to 50 years |
| Structures . . . . .                       | 7 to 60 years |
| Machinery and equipment                    |               |
| Machinery . . . . .                        | 4 to 13 years |
| Vehicles . . . . .                         | 4 to 7 years  |
| Tools, furniture and fixtures . . . . .    | 2 to 20 years |

**(j) Goodwill and Other Intangible Assets**

The Company tests goodwill and indefinite-lived intangible assets for impairment at least annually. The Company performs its annual impairment test during the fourth quarter after the annual forecasting process is completed. Furthermore, goodwill is reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Fair value is estimated using the expected present value of future cash flows. Intangible assets with finite useful lives are amortized over their respective estimated useful lives on either a straight-line basis or the method that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up. The estimated useful lives are follows:

|                                     |               |
|-------------------------------------|---------------|
| Software . . . . .                  | 1 to 8 years  |
| Software for internal use . . . . . | 2 to 10 years |
| Patents . . . . .                   | 4 to 8 years  |
| Other . . . . .                     | 5 to 20 years |

**(k) Capitalized Software Costs**

Costs incurred for computer software developed or obtained for internal use are capitalized and amortized on a straight-line basis over their estimated useful lives in accordance with Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." In addition, the Company and its subsidiaries develop certain computer software to be sold where related costs are capitalized after establishment of technological feasibility in accordance with SFAS No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed." The annual amortization of such capitalized costs is the greater of the amount computed using the ratio of each software's expected future revenue to current year's revenue or the straight-line method over the remaining estimated economic life of each software.

***(l) Impairment of Long-lived Assets***

The Company reviews the carrying value of long-lived assets or related group of assets to be held and used, including intangible assets with finite useful lives, for impairment whenever events or circumstances occur that indicate that the carrying value of the assets may not be recoverable. The assets are considered to be impaired when estimated undiscounted cash flows expected to result from the use of the assets and their eventual disposition is less than their carrying values. The impairment losses are measured as the amount by which the carrying value of the asset exceeds the fair value. In determining the fair value, the Company uses available quoted market prices and present value techniques, if appropriate, based on the estimated future cash flow expected to result from the use of the assets and their eventual disposition.

***(m) Retirement and Severance Benefits***

The Company accounts for retirement and severance benefits in accordance with SFAS No. 87, "Employers' Accounting for Pensions." Unrecognized gains and losses are amortized using the straight-line method over the average remaining service period of active employees.

***(n) Derivative Financial Instruments***

The Company accounts for derivative financial instruments in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. SFAS No. 133 requires that all derivative financial instruments, such as forward exchange and interest rate swap contracts, be recognized in the financial statements as either assets or liabilities and measured at fair value regardless of the purpose or intent for holding them.

The Company designates and accounts for hedging derivatives as follows:

- "Fair value" hedge: a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment. The changes in fair value of the recognized assets or liabilities or unrecognized firm commitment and the derivatives are recorded in earnings if the hedge is considered highly effective.
- "Cash flow" hedge: a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability. The changes in the fair value of the derivatives designated as cash flow hedges are recorded as other comprehensive income if the hedge is considered highly effective. This treatment is continued until earnings are affected by the variability in cash flows or the unrecognized firm commitment of the designated hedged item, at which point changes in fair value of the derivative is recognized in income.
- "Foreign currency" hedge: a hedge of foreign-currency fair value or cash flow. The changes in fair value of the recognized assets or liabilities or unrecognized firm commitment and the derivatives are recorded as either earnings or other comprehensive income if the hedge is considered highly effective. Recognition as earnings or other comprehensive income is dependent on the treatment of foreign currency hedges as fair value or cash flow hedges.

The Company follows the documentation requirements as prescribed by the standard, which includes risk management objective and strategy for undertaking various hedge transactions. In addition, a formal assessment is made at the hedge's inception and periodically on an ongoing basis, as to whether the derivative used in hedging activities is highly effective in offsetting changes in fair values or cash flows of hedged items. Hedge accounting is discontinued for ineffective hedges, if any. Subsequent changes in the fair value of derivatives related to discontinued hedges are recognized in earnings immediately.

**(o) Revenue Recognition**

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services are rendered, the sales price is fixed and determinable and collectibility is reasonably assured. The Company adopted the consensus of the FASB Emerging Issue Task Force (EITF) Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables," during the year ended March 31, 2004. The impact of adopting the consensus was not material to the Company's results of operations.

The Company offers multiple solutions to its customers' needs. Those solutions may involve the delivery or performance of multiple elements, such as products, services, or rights to use assets, and performance may occur at different points in time or over different periods of time. When one element is delivered prior to the other in an arrangement, revenue is deferred until the delivery of the last element, unless transactions are such that the delivered item has value to the customer on a standalone basis, there is objective and reliable evidence of the fair value of the undelivered item, and delivery or performance of the undelivered item is considered probable and substantially in the control of the Company if the arrangement includes a general right of return relative to the delivered item. If all conditions described above are met, each element in an arrangement is considered a separate unit of accounting, and the arrangement consideration is allocated to the separate units of accounting based on the relative fair values provided that there is objective and reliable evidence of the fair values of all units of accounting in the arrangement. The Company allocates revenue on software arrangements involving multiple elements to each element based on its relative fair value, as evidenced by vendor specific objective evidence (VSOE), or in the absence of VSOE, the residual method. VSOE is the price charged by the Company to an external customer for the same element when such an element is sold separately.

**Product Sales:**

Revenue from sales of these products is recognized when title and risk of loss have been transferred to the customer. Depending upon the terms of the contract or arrangement with the customer, this may occur at the time of shipment, when installation is completed or upon the attainment of customer acceptance. The Company's policy is not to accept product returns unless the products are defective. The conditions of acceptance are governed by the terms of the contract or customer arrangement and those not meeting the predetermined specification are not recorded as revenue. Product warranties are offered on the Company's and certain subsidiaries' products (in certain cases separately priced) and a warranty accrual is established when sales are recognized and is based on estimated future costs of repair and replacement principally using our historical experience of warranty claims.

Price protection is provided to retailers of the Company's consumer products business and others to compensate the customer retailers for a decline in the product's value due mainly to competition. Price protection granted to the customers is classified as a reduction of revenue on the consolidated statements of income. In addition, it is our policy to accrue reasonably and reliably estimated price adjustment at the later of the date at which the related sales are recognized, or the date at which price protection is offered. The estimate is made based primarily upon historical experience or agreement on the adjustment rate and the number of units that are subject to such adjustment (e.g., units in distribution channels).

Product revenues which are recognized upon shipment are information technology system products, construction equipment, displays, disk drives, televisions, air conditioners, batteries, magnetic tapes, high functional materials, cable products and automotive equipment. Revenues for railway vehicles are recognized upon acceptance or shipment, depending on contract terms. Product revenues that are recognized upon acceptance are medical electronic devices, industrial machinery and equipment, elevators and escalators.

Revenue from sales of tangible products under long-term construction type arrangements, principally in connection with the construction of nuclear, thermal and hydroelectric power plants, are recognized under the percentage-of-completion method. Under the percentage-of-completion method, revenue is recognized as a percentage of estimated total revenue that incurred costs to date bear to estimated total costs after giving effect to estimates of costs to complete based upon most recent information. Any anticipated losses on fixed price contracts are charged to operations when such losses can be estimated. Provisions are made for contingencies (i.e. performance penalty, benchmarking, etc.) in the period in which they become known pursuant to specific contract terms and conditions and are estimable.

The Company recognizes software revenue in accordance with the provisions of SOP 97-2, "Software Revenue Recognition," as amended. Revenue from software consists of software licensing, customized software development and post contract customer support. Revenues from software license arrangements are recognized upon shipment of the software if evidence of the arrangement exists, pricing is fixed and determinable and collectibility is probable. Customized software revenue is recognized upon customer acceptance. Revenue from post contract customer support is amortized over the period of the post contract customer support. Consulting and training services are recognized when the services are rendered.

**Service Revenues:**

Service revenues from maintenance and distribution services are recognized upon completion of service delivery. Revenue from time service contracts is recognized as services are rendered. Revenue from long-term fixed price service contracts such as support or maintenance contracts is recognized ratably over the contractual period. Finance lease income is recognized at level rates of return over the term of the leases. Operating lease income is recognized on a straight-line basis over the term of the lease.

***(p) Advertising***

Advertising costs are expensed as incurred.

***(q) Research and Development Costs***

Research and development costs are expensed as incurred. Costs incurred in connection with the development of software products for sale are accounted for in accordance with SFAS No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed." Development costs incurred in the research and development of new software products and enhancements to existing products are expensed as incurred until technological feasibility has been established.

***(r) Income Taxes***

Deferred income taxes are accounted for under the asset and liability method in accordance with SFAS No. 109, "Accounting for Income Taxes." Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating losses and tax credit carryforwards. Under this method, deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under SFAS No. 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established to reduce deferred tax assets to their net realizable value if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

***(s) Sales of Stock by Subsidiaries***

The change in the Company's proportionate share of a subsidiary's equity resulting from issuance of stock by the subsidiary is recognized as other income in the accompanying consolidated statements of income.

**(t) Net Income per Share**

Net income per share is computed in accordance with SFAS No. 128, "Earnings per Share." This standard requires a dual presentation of basic and diluted net income per share amounts on the face of the statements of income. Under this standard, basic net income per share is computed based upon the weighted average number of shares of common stock outstanding during each year. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company.

**(u) Stock-Based Compensation**

The Company and certain subsidiaries have stock-based compensation plans. The Company accounts for those plans under the recognition and measurement principles of Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees," and related interpretations. For the years ended March 31, 2006, 2005 and 2004, the Company recognized no material stock-based compensation expense.

SFAS No. 123, "Accounting for Stock-Based Compensation," prescribes the recognition of compensation expense based on the fair value of options on the grant date and allows continuous application of APB No. 25 if certain pro forma disclosures are made assuming hypothetical fair value method application. The Company elects to continue applying APB No. 25, however, the pro forma effects of applying SFAS No. 123 on net income and the per share information for the years ended March 31, 2006, 2005 and 2004 are as follows:

|   | Millions of yen |         |         | Thousands of<br>U.S. dollars |
|---|-----------------|---------|---------|------------------------------|
|   | 2006            | 2005    | 2004    | 2006                         |
| Net income — as reported . . . . .  | <b>¥37,320</b>  | ¥51,496 | ¥15,876 | <b>\$318,974</b>             |
| Stock-based compensation expense<br>included in reported net income . . . . . | <b>214</b>      | 215     | —       | <b>1,829</b>                 |
| Stock-based compensation expense<br>determined under SFAS No. 123 . . . . .   | <b>(440)</b>    | (459)   | (3,034) | <b>(3,760)</b>               |
| Net income — pro forma . . . . .  | <b>¥37,094</b>  | ¥51,252 | ¥12,842 | <b>\$317,043</b>             |
|   |                 |         |         |                              |
| Net income per share:   |                 |         | Yen     | U.S. dollars                 |
| Basic — as reported . . . . .   | <b>¥11.20</b>   | ¥15.53  | ¥4.81   | <b>\$0.10</b>                |
| Basic — pro forma . . . . .   | <b>11.14</b>    | 15.45   | 3.89    | <b>0.10</b>                  |
|   |                 |         |         |                              |
| Diluted — as reported . . . . .   | <b>10.84</b>    | 15.15   | 4.75    | <b>0.09</b>                  |
| Diluted — pro forma . . . . .   | <b>10.78</b>    | 15.08   | 3.83    | <b>0.09</b>                  |

***(v) Disclosures about Segments of an Enterprise and Related Information***

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," establishes standards for the manner in which a public business enterprise is required to report financial and descriptive information about its operating segments. This standard defines operating segments as components of an enterprise for which separate financial information is available and evaluated regularly as a means for assessing segment performance and allocating resources to segments. A measure of profit or loss, total assets and other related information is required to be disclosed for each operating segment. Further, this standard requires the disclosure of information concerning revenues derived from the enterprise's products or services, countries in which it earns revenue or holds assets and major customers. However, certain foreign issuers are presently exempted from the segment disclosure requirements of SFAS No. 131 in filings with the United States Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934, and the Company has not presented the segment information required to be disclosed in the footnotes to the consolidated financial statements under SFAS No. 131.

***(w) Guarantees***

The Company recognizes, at the inception of the guarantees, a liability for the fair value of the obligation undertaken in issuing the guarantee for guarantees issued or modified after December 31, 2002, in accordance with the FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of SFAS No. 5, 57, and 107 and rescission of FASB Interpretation No. 34."

***(x) New Accounting Standards***

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4." The amendments made by SFAS No. 151 clarify that abnormal amounts of costs should be recognized as current-period charges rather than as a portion of the inventory cost. In addition, SFAS No. 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. SFAS No. 151 is not expected to have a material effect on the consolidated financial position or results of operations of the Company and subsidiaries.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29." The amendments made by SFAS No. 153 is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged and adopted a broader exception for exchanges of nonmonetary assets that do not have commercial substance and should be measured based on the recorded amount of the asset relinquished. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. SFAS No. 153 is not expected to have a material effect on the consolidated financial position or results of operations of the Company and subsidiaries.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123 (R) supersedes APB No. 25, "Accounting for Stock Issued to Employees," and amends SFAS No. 95, "Statement of Cash Flows." SFAS No. 123 (R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. Also, the SEC issued Staff Accounting Bulletin No. 107, in which interpretations expressed views of the staff regarding the interaction between SFAS No. 123 (R) and certain SEC rules and regulations, and provided the staff's views regarding the valuation of share-based payment arrangements for public companies. The provisions of SFAS No. 123 (R) is effective no later than the beginning of the first fiscal year beginning after June 15, 2005, as deferred by the SEC. SFAS No. 123 (R) is not expected to have a material effect on the consolidated financial position or results of operations of the Company and subsidiaries.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and SFAS No. 3." This statement provides the guidance for the accounting for and reporting of a change in accounting principle and the correction of an error, and requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. SFAS No. 154 is effective for accounting changes and corrections made in fiscal years beginning after December 15, 2005. SFAS No. 154 is not expected to have a material effect on the consolidated financial position or results of operations of the Company and subsidiaries.

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instrument, an amendment of SFAS No. 133 and No. 140." The amendments made by SFAS No. 155 resolve issues addressed in SFAS No. 133 Implementation Issue No. D1, and require to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of the first fiscal year that begins after September 15, 2006. The Company is currently evaluating the effect of adopting this statement on the consolidated financial position or result of operations.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets, an amendment of SFAS No. 140." This statement provides the guidance for the measurement methods for servicing assets and servicing liabilities. SFAS No. 156 shall be effective as of the beginning of the first fiscal year that begins after September 15, 2006. The Company is currently evaluating the effect of adopting this statement on the consolidated financial position or result of operations.

**(y) Reclassifications**

Certain reclassifications have been made to prior year balances in order to conform to the current year presentations.

### 3. BASIS OF FINANCIAL STATEMENT TRANSLATION

The accompanying consolidated financial statements are expressed in yen and, solely for the convenience of the reader, have been translated into United States dollars at the rate of ¥117=U.S.\$1, the approximate exchange rate prevailing on the Tokyo Foreign Exchange Market as of March 31, 2006. This translation should not be construed as a representation that all amounts shown could be converted into U.S. dollars.

### 4. INVESTMENTS IN SECURITIES AND AFFILIATED COMPANIES

Short-term investments as of March 31, 2006 and 2005 are as follows:

|                               | Millions of yen |                 | Thousands of U.S. dollars |
|-------------------------------|-----------------|-----------------|---------------------------|
|                               | 2006            | 2005            | 2006                      |
| Investments in securities:    |                 |                 |                           |
| Available-for-sale securities | ¥ 75,975        | ¥ 81,583        | \$ 649,359                |
| Held-to-maturity securities   | 57              | 392             | 487                       |
| Trading securities            | 86,724          | 64,593          | 741,231                   |
|                               | <b>¥162,756</b> | <b>¥146,568</b> | <b>\$1,391,077</b>        |

Investments and advances, including affiliated companies as of March 31, 2006 and 2005 are as follows:

|   | Millions of yen   |                 | Thousands of U.S. dollars |
|---|-------------------|-----------------|---------------------------|
|   | 2006              | 2005            | 2006                      |
| Investments in securities:                          |                   |                 |                           |
| Available-for-sale securities                       | ¥ 447,298         | ¥314,471        | \$3,823,060               |
| Held-to-maturity securities                         | 1,316             | 658             | 11,248                    |
| Securities without readily determinable fair values | 79,321            | 77,755          | 677,957                   |
| Investments in affiliated companies                 | 368,989           | 388,076         | 3,153,752                 |
| Advances and other                                  | 132,749           | 113,891         | 1,134,607                 |
|   | <b>¥1,029,673</b> | <b>¥894,851</b> | <b>\$8,800,624</b>        |

The following is a summary of the amortized cost basis, gross unrealized holding gains, gross unrealized holding losses and aggregate fair value of available-for-sale securities by the consolidated balance sheets classification as of March 31, 2006 and 2005.

|                             | Millions of yen         |                 |                 |                         |                         |                |                 |                         |
|-----------------------------|-------------------------|-----------------|-----------------|-------------------------|-------------------------|----------------|-----------------|-------------------------|
|                             | Amortized<br>cost basis | Gross<br>gains  | Gross<br>losses | Aggregate<br>fair value | Amortized<br>cost basis | Gross<br>gains | Gross<br>losses | Aggregate<br>fair value |
|                             | 2006                    |                 |                 |                         | 2005                    |                |                 |                         |
| Short-term investments:     |                         |                 |                 |                         |                         |                |                 |                         |
| Debt securities . . . . .   | ¥ 26,956                | ¥ 10            | ¥ 16            | ¥ 26,950                | ¥ 37,195                | ¥ 34           | ¥ 20            | ¥ 37,209                |
| Other securities . . . . .  | 49,045                  | 29              | 49              | 49,025                  | 44,355                  | 19             | -               | 44,374                  |
|                             | <b>76,001</b>           | <b>39</b>       | <b>65</b>       | <b>75,975</b>           | 81,550                  | 53             | 20              | 81,583                  |
| Investments and advances:   |                         |                 |                 |                         |                         |                |                 |                         |
| Equity securities . . . . . | 138,449                 | 208,048         | 2,168           | 344,329                 | 98,751                  | 102,170        | 3,623           | 197,298                 |
| Debt securities . . . . .   | 76,838                  | 1,323           | 2,718           | 75,443                  | 91,412                  | 1,383          | 907             | 91,888                  |
| Other securities . . . . .  | 26,972                  | 768             | 214             | 27,526                  | 24,928                  | 450            | 93              | 25,285                  |
|                             | <b>242,259</b>          | <b>210,139</b>  | <b>5,100</b>    | <b>447,298</b>          | 215,091                 | 104,003        | 4,623           | 314,471                 |
|                             | <b>¥318,260</b>         | <b>¥210,178</b> | <b>¥5,165</b>   | <b>¥523,273</b>         | ¥296,641                | ¥104,056       | ¥4,643          | ¥396,054                |

|                             | Thousands of U.S. dollars |                    |                 |                         |
|-----------------------------|---------------------------|--------------------|-----------------|-------------------------|
|                             | Amortized<br>cost basis   | Gross<br>gains     | Gross<br>losses | Aggregate<br>fair value |
|                             | 2006                      |                    |                 |                         |
| Short-term investments:     |                           |                    |                 |                         |
| Debt securities . . . . .   | \$ 230,393                | \$ 85              | \$ 136          | \$ 230,342              |
| Other securities . . . . .  | 419,188                   | 248                | 419             | 419,017                 |
|                             | <b>649,581</b>            | <b>333</b>         | <b>555</b>      | <b>649,359</b>          |
| Investments and advances:   |                           |                    |                 |                         |
| Equity securities . . . . . | 1,183,325                 | 1,778,188          | 18,530          | 2,942,983               |
| Debt securities . . . . .   | 656,735                   | 11,308             | 23,231          | 644,812                 |
| Other securities . . . . .  | 230,530                   | 6,564              | 1,829           | 235,265                 |
|                             | <b>2,070,590</b>          | <b>1,796,060</b>   | <b>43,590</b>   | <b>3,823,060</b>        |
|                             | <b>\$2,720,171</b>        | <b>\$1,796,393</b> | <b>\$44,145</b> | <b>\$4,472,419</b>      |

The following is a summary of gross unrealized holding losses on available-for-sale securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of March 31, 2006 and 2005.

|                             | Millions of yen      |               |                      |               |                      |               |                      |               |
|-----------------------------|----------------------|---------------|----------------------|---------------|----------------------|---------------|----------------------|---------------|
|                             | Less than 12 months  |               | 12 months or longer  |               | Less than 12 months  |               | 12 months or longer  |               |
|                             | Aggregate fair value | Gross losses  | Aggregate fair value | Gross losses  | Aggregate fair value | Gross losses  | Aggregate fair value | Gross losses  |
|                             | 2006                 |               |                      |               | 2005                 |               |                      |               |
| Short-term investments:     |                      |               |                      |               |                      |               |                      |               |
| Debt securities . . . . .   | ¥ 8,279              | ¥ 7           | ¥ 991                | ¥ 9           | ¥ 3,842              | ¥ 20          | ¥ -                  | ¥ -           |
| Other securities . . . . .  | 1,152                | 49            | -                    | -             | -                    | -             | -                    | -             |
|                             | <b>9,431</b>         | <b>56</b>     | <b>991</b>           | <b>9</b>      | <b>3,842</b>         | <b>20</b>     | <b>-</b>             | <b>-</b>      |
| Investments and advances:   |                      |               |                      |               |                      |               |                      |               |
| Equity securities . . . . . | 1,105                | 111           | 14,035               | 2,057         | 10,112               | 2,694         | 5,025                | 929           |
| Debt securities . . . . .   | 28,152               | 1,410         | 13,110               | 1,308         | 14,559               | 669           | 10,937               | 238           |
| Other securities . . . . .  | 5,007                | 86            | 4,717                | 128           | 5,317                | 59            | 905                  | 34            |
|                             | <b>34,264</b>        | <b>1,607</b>  | <b>31,862</b>        | <b>3,493</b>  | <b>29,988</b>        | <b>3,422</b>  | <b>16,867</b>        | <b>1,201</b>  |
|                             | <b>¥43,695</b>       | <b>¥1,663</b> | <b>¥32,853</b>       | <b>¥3,502</b> | <b>¥33,830</b>       | <b>¥3,442</b> | <b>¥16,867</b>       | <b>¥1,201</b> |

|                             | Thousands of U.S. dollars |                 |                      |                 |
|-----------------------------|---------------------------|-----------------|----------------------|-----------------|
|                             | Less than 12 months       |                 | 12 months or longer  |                 |
|                             | Aggregate fair value      | Gross losses    | Aggregate fair value | Gross losses    |
|                             | 2006                      |                 |                      |                 |
| Short-term investments:     |                           |                 |                      |                 |
| Debt securities . . . . .   | \$ 70,761                 | \$ 59           | \$ 8,470             | \$ 77           |
| Other securities . . . . .  | 9,846                     | 419             | -                    | -               |
|                             | <b>80,607</b>             | <b>478</b>      | <b>8,470</b>         | <b>77</b>       |
| Investments and advances:   |                           |                 |                      |                 |
| Equity securities . . . . . | 9,445                     | 949             | 119,957              | 17,581          |
| Debt securities . . . . .   | 240,615                   | 12,051          | 112,052              | 11,180          |
| Other securities . . . . .  | 42,795                    | 735             | 40,316               | 1,094           |
|                             | <b>292,855</b>            | <b>13,735</b>   | <b>272,325</b>       | <b>29,855</b>   |
|                             | <b>\$373,462</b>          | <b>\$14,213</b> | <b>\$280,795</b>     | <b>\$29,932</b> |

Debt securities consist primarily of national, local and foreign governmental bonds, debentures issued by banks and corporate bonds. Other securities consist primarily of investment trusts.

The proceeds from sale of available-for-sale securities for the years ended March 31, 2006, 2005 and 2004 were ¥60,969 million (\$521,103 thousand), ¥60,653 million and ¥83,886 million, respectively. The gross realized gains on the sale of those securities for the years ended March 31, 2006, 2005 and 2004 were ¥22,480 million (\$192,137 thousand), ¥15,889 million and ¥33,887 million, respectively, while gross realized losses on the sale of those securities for the years ended March 31, 2006, 2005 and 2004 were ¥482 million (\$4,120 thousand), ¥64 million and ¥2,160 million, respectively.

Trading securities consist mainly of investments in trust accounts. Net unrealized holding gains on trading securities as of March 31, 2006, 2005 and 2004 were ¥7,556 million (\$64,581 thousand), ¥2,223 million and ¥2,214 million, respectively, and were classified as other income in the consolidated statements of income.

The contractual maturities of debt securities and other securities classified as investments and advances in the consolidated balance sheets as of March 31, 2006 are as follows:

|                                 | Millions of yen  |                    |                 | Thousands of U.S. dollars |                    |                  |
|---------------------------------|------------------|--------------------|-----------------|---------------------------|--------------------|------------------|
|                                 | Held-to-maturity | Available-for-sale | Total           | Held-to-maturity          | Available-for-sale | Total            |
|                                 |                  |                    | <b>2006</b>     |                           |                    | <b>2006</b>      |
| Due within five years . . . . . | <b>¥1,118</b>    | <b>¥ 44,571</b>    | <b>¥ 45,689</b> | <b>\$ 9,555</b>           | <b>\$380,949</b>   | <b>\$390,504</b> |
| Due after five years . . . . .  | <b>198</b>       | <b>58,398</b>      | <b>58,596</b>   | <b>1,693</b>              | <b>499,128</b>     | <b>500,821</b>   |
|                                 | <b>¥1,316</b>    | <b>¥102,969</b>    | <b>¥104,285</b> | <b>\$11,248</b>           | <b>\$880,077</b>   | <b>\$891,325</b> |

Expected redemptions may differ from contractual maturities because some of these securities are redeemable at the option of the issuers.

The aggregate carrying amounts of cost-method investments which were not evaluated for impairment as of March 31, 2006 and 2005 were ¥75,764 million (\$647,556 thousand) and ¥75,838 million, respectively, mainly because the Company did not identify any events or changes in circumstances that might have had a significant adverse effect on their fair value.

The aggregate fair values of investments in affiliated companies, for which a quoted market price was available, as of March 31, 2006 and 2005 were ¥184,504 million (\$1,576,957 thousand) and ¥206,942 million, respectively. The aggregate carrying amounts of such investments as of March 31, 2006 and 2005 were ¥91,191 million (\$779,410 thousand) and ¥130,850 million, respectively.

As of March 31, 2006 and 2005, cumulative recognition of other-than-temporary declines in values of investments in certain affiliated companies resulted in the difference of ¥13,576 million (\$116,034 thousand) and ¥14,673 million, respectively, between the carrying amount of the investment and the amount of underlying equity in net assets. In addition, as of March 31, 2006 and 2005, equity-method goodwill included in investments in certain affiliated companies were ¥11,848 million (\$101,265 thousand) and ¥8,669 million, respectively.

Summarized combined financial information relating to affiliated companies accounted for by the equity method is as follows:

|                                   | Millions of yen   |            | Thousands of U.S. dollars |
|-----------------------------------|-------------------|------------|---------------------------|
|                                   | <b>2006</b>       | 2005       | <b>2006</b>               |
| Current assets . . . . .          | <b>¥1,293,236</b> | ¥1,516,004 | <b>\$11,053,299</b>       |
| Non-current assets . . . . .      | <b>965,574</b>    | 1,096,151  | <b>8,252,769</b>          |
| Current liabilities . . . . .     | <b>1,106,243</b>  | 1,094,051  | <b>9,455,068</b>          |
| Non-current liabilities . . . . . | <b>319,149</b>    | 540,773    | <b>2,727,769</b>          |

  

|                        | Millions of yen   |            |            | Thousands of U.S. dollars |
|------------------------|-------------------|------------|------------|---------------------------|
|                        | <b>2006</b>       | 2005       | 2004       | <b>2006</b>               |
| Revenues . . . . .     | <b>¥2,302,913</b> | ¥2,588,526 | ¥2,457,443 | <b>\$19,683,017</b>       |
| Gross profit . . . . . | <b>370,979</b>    | 432,615    | 374,535    | <b>3,170,761</b>          |
| Net income . . . . .   | <b>22,177</b>     | 1,850      | 14,581     | <b>189,547</b>            |

The balances and transactions with affiliated companies accounted for by the equity method are as follows:

|                         | Millions of yen |          | Thousands of U.S. dollars |
|-------------------------|-----------------|----------|---------------------------|
|                         | 2006            | 2005     | 2006                      |
| Trade receivables ..... | <b>¥166,484</b> | ¥163,152 | <b>\$1,422,940</b>        |
| Trade payables .....    | <b>64,654</b>   | 63,029   | <b>552,598</b>            |

  

|                 | Millions of yen |          |          | Thousands of U.S. dollars |
|-----------------|-----------------|----------|----------|---------------------------|
|                 | 2006            | 2005     | 2004     | 2006                      |
| Revenues .....  | <b>¥535,084</b> | ¥559,954 | ¥498,564 | <b>\$4,573,368</b>        |
| Purchases ..... | <b>315,356</b>  | 362,771  | 299,331  | <b>2,695,350</b>          |

## 5. RECEIVABLES

The aggregate annual maturities of the long-term trade receivables after March 31, 2007 included in trade receivables-accounts are as follows:

| Years ending March 31 | Millions of yen | Thousands of U.S. dollars |
|-----------------------|-----------------|---------------------------|
| 2008 .....            | ¥31,361         | \$268,043                 |
| 2009 .....            | 2,251           | 19,239                    |
| 2010 .....            | 1,236           | 10,564                    |
| 2011 .....            | 1,206           | 10,308                    |
| Thereafter .....      | 1,246           | 10,649                    |
|                       | <b>¥37,300</b>  | <b>\$318,803</b>          |

Sales on an installment payment basis for the years ended March 31, 2006, 2005 and 2004 totaled ¥8,440 million (\$72,137 thousand), ¥8,275 million and ¥9,021 million, respectively.

## 6. INVENTORIES

Inventories as of March 31, 2006 and 2005 are summarized as follows:

|                       | Millions of yen   |            | Thousands of U.S. dollars |
|-----------------------|-------------------|------------|---------------------------|
|                       | 2006              | 2005       | 2006                      |
| Finished goods .....  | <b>¥ 420,943</b>  | ¥ 371,331  | <b>\$ 3,597,803</b>       |
| Work in process ..... | <b>654,943</b>    | 651,227    | <b>5,597,803</b>          |
| Raw materials .....   | <b>186,422</b>    | 176,397    | <b>1,593,351</b>          |
|                       | <b>¥1,262,308</b> | ¥1,198,955 | <b>\$10,788,957</b>       |

Inventories include items associated with major contracts which require long-term processing performed for more than twelve months. These items as of March 31, 2006 and 2005 aggregated ¥38,061 million (\$325,308 thousand) and ¥39,474 million, respectively.

## 7. LEASES

The Company and certain subsidiaries are lessors of certain assets such as manufacturing machinery and equipment under financing and operating lease arrangements with terms ranging from 3 to 6 years.

The amount of leased assets at cost under operating leases and accumulated depreciation as of March 31, 2006 amounted to ¥1,719,894 million (\$14,699,949 thousand) and ¥1,316,286 million (\$11,250,308 thousand), respectively. The leased assets are depreciated using the straight-line method over their estimated useful lives.

The following table shows the future minimum lease receivables of financing and non-cancelable operating leases as of March 31, 2006 and the future minimum lease receivables of financing leases as of March 31, 2005:

| Years ending March 31                 | Millions of yen        |                  | Thousands of U.S. dollars |                    |
|---------------------------------------|------------------------|------------------|---------------------------|--------------------|
|                                       | Financing leases       | Operating leases | Financing leases          | Operating leases   |
|                                       | <u>2006</u>            |                  | <u>2006</u>               |                    |
| 2007                                  | ¥163,124               | ¥ 72,617         | \$1,394,222               | \$ 620,658         |
| 2008                                  | 127,185                | 55,187           | 1,087,051                 | 471,684            |
| 2009                                  | 95,882                 | 37,865           | 819,504                   | 323,633            |
| 2010                                  | 59,541                 | 19,516           | 508,898                   | 166,803            |
| 2011                                  | 25,107                 | 9,497            | 214,590                   | 81,171             |
| Thereafter                            | 41,483                 | 12,345           | 354,556                   | 105,513            |
| Total minimum payments to be received | 512,322                | <u>¥207,027</u>  | 4,378,821                 | <u>\$1,769,462</u> |
| Amount representing executory costs   | (20,449)               |                  | (174,778)                 |                    |
| Unearned income                       | (33,934)               |                  | (290,034)                 |                    |
| Allowance for doubtful receivables    | (6,182)                |                  | (52,838)                  |                    |
| Net investment in financing leases    | <u>¥451,757</u>        |                  | <u>\$3,861,171</u>        |                    |
|                                       | <u>Millions of yen</u> |                  |                           |                    |
|                                       | Financing leases       |                  |                           |                    |
|                                       | <u>2005</u>            |                  |                           |                    |
| Total minimum payments to be received | ¥603,442               |                  |                           |                    |
| Amount representing executory costs   | (32,029)               |                  |                           |                    |
| Unearned income                       | (39,650)               |                  |                           |                    |
| Allowance for doubtful receivables    | (5,004)                |                  |                           |                    |
| Net investment in financing leases    | <u>¥526,759</u>        |                  |                           |                    |

The Company and certain subsidiaries lease certain manufacturing machinery and equipment. The amounts of leased assets at cost under capital leases as of March 31, 2006 and 2005 amounted to ¥33,516 million (\$286,462 thousand) and ¥33,239 million, respectively, and accumulated depreciation as of March 31, 2006 and 2005 amounted to ¥19,307 million (\$165,017 thousand) and ¥17,803 million, respectively.

In March 2006, a certain subsidiary sold its land for proceeds of ¥10,560 million (\$90,256 thousand), and entered into a lease back agreement for a portion of the land. The lease back is classified as an operating lease with a term of 25 years. The gain of the leased back portion in the amount of ¥2,736 million (\$23,385 thousand) has been deferred and is being recognized over the lease term.

The following table shows the future minimum lease payments of capital and non-cancelable operating leases as of March 31, 2006:

| Years ending March 31                             | Millions of yen |                  | Thousands of U.S. dollars |                  |
|---|-----------------|------------------|---------------------------|------------------|
|   | Capital leases  | Operating leases | Capital leases            | Operating leases |
|   |                 | <b>2006</b>      |                           | <b>2006</b>      |
| 2007  | ¥ 4,602         | ¥12,702          | \$ 39,333                 | \$108,564        |
| 2008  | 3,196           | 9,355            | 27,316                    | 79,957           |
| 2009  | 1,677           | 7,463            | 14,333                    | 63,786           |
| 2010  | 995             | 4,710            | 8,504                     | 40,257           |
| 2011  | 712             | 1,975            | 6,086                     | 16,880           |
| Thereafter  | 981             | 10,020           | 8,385                     | 85,641           |
| Total minimum lease payments                      | 12,163          | <u>¥46,225</u>   | 103,957                   | <u>\$395,085</u> |
| Amount representing executory costs               | (459)           |                  | (3,923)                   |                  |
| Amount representing interest                      | (698)           |                  | (5,966)                   |                  |
| Present value of net minimum lease payments       | 11,006          |                  | 94,068                    |                  |
| Less current portion of capital lease obligations | 4,278           |                  | 36,564                    |                  |
| Long-term capital lease obligations               | <u>¥ 6,728</u>  |                  | <u>\$ 57,504</u>          |                  |

## 8. SECURITIZATIONS

For the years ended March 31, 2006, 2005 and 2004, Hitachi Capital Corporation and certain other financing subsidiaries sold primarily lease receivables to Special Purpose Entities (SPE) and the SPEs issued asset-backed commercial paper to investors. The investors and the SPEs have no recourse to the subsidiaries' other assets for failure of debtors to pay when due. The subsidiaries retained servicing responsibilities and subordinated interests, but have not recorded a servicing asset or liability because the cost to service the receivables approximates the servicing income. The retained interests are subordinate to investor's interests. For the years ended March 31, 2006, 2005 and 2004, gains recognized on the sale of lease receivables amounted to ¥21,619 million (\$184,778 thousand), ¥12,985 million and ¥12,394 million, respectively.

The table below summarizes certain cash flows received from and paid to the SPEs during the years ended March 31, 2006, 2005 and 2004:

|  | Millions of yen |          |          | Thousands of U.S. dollars |
|--|-----------------|----------|----------|---------------------------|
|  | 2006            | 2005     | 2004     | 2006                      |
| Proceeds from transfer of lease receivables  | ¥436,919        | ¥310,668 | ¥271,281 | \$3,734,350               |
| Servicing fees received                      | 43              | 22       | 23       | 368                       |
| Purchases of delinquent or ineligible assets | (28,074)        | (25,717) | (14,775) | (239,949)                 |

Quantitative information about delinquencies, net credit losses, and components of lease receivables subject to transfer and other assets managed together as of and for the year ended March 31, 2006 is as follows:

|                                      | Millions of yen                       |  |                   | Thousands of U.S. dollars             |  |                   |
|--------------------------------------|---------------------------------------|--|-------------------|---------------------------------------|--|-------------------|
|                                      | Total principal amount of receivables | Principal amount of receivables 90 days or more past due | Net credit losses | Total principal amount of receivables | Principal amount of receivables 90 days or more past due | Net credit losses |
|                                      | 2006                                  |  |                   | 2006                                  |  |                   |
| Total assets managed or transferred: |                                       |  |                   |                                       |  |                   |
| Lease receivables . . . . .          | ¥1,159,294                            | ¥651   | ¥1,676            | \$9,908,496                           | \$5,564  | \$14,325          |
| Assets transferred . . . . .         | (707,537)                             |  |                   | (6,047,325)                           |  |                   |
| Assets held in portfolio . . . . .   | <u>¥ 451,757</u>                      |  |                   | <u>\$3,861,171</u>                    |  |                   |

For the years ended March 31, 2006, 2005 and 2004, the Company and certain subsidiaries sold trade receivables mainly to SPEs which securitized these receivables. In these securitizations, the Company and certain subsidiaries retained servicing responsibility. No servicing asset or liability has been recorded because the fees for servicing the receivables approximate the related costs. In addition, the Company and certain subsidiaries retained subordinated interests which were not material.

During the years ended March 31, 2006, 2005 and 2004, proceeds from the transfer of trade receivables were ¥1,361,784 million (\$11,639,179 thousand), ¥1,252,656 million and ¥1,006,164 million, respectively, and losses recognized on those transfers were ¥2,445 million (\$20,897 thousand), ¥3,388 million and ¥2,973 million, respectively.

## 9. GOODWILL AND OTHER INTANGIBLE ASSETS

Intangible assets other than goodwill acquired during the years ended March 31, 2006, 2005 and 2004 amounted to ¥190,207 million (\$1,625,701 thousand), ¥228,085 million and ¥190,059 million, respectively, and related amortization expense during the years ended March 31, 2006, 2005 and 2004 amounted to ¥138,727 million (\$1,185,701 thousand), ¥132,370 million and ¥117,561 million, respectively.

The main component of intangible assets subject to amortization was capitalized software. Amortization of capitalized costs for software to be sold, leased or otherwise marketed is charged to cost of sales. The amounts charged during the years ended March 31, 2006, 2005 and 2004 were to ¥52,705 million (\$450,470 thousand), ¥57,293 million and ¥52,863 million, respectively.

Intangible assets other than goodwill as of March 31, 2006 and 2005 are as follows:

|  | Millions of yen       |                          |                     |                       |                          |                     |
|--|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|  | 2006                  |                          |                     | 2005                  |                          |                     |
|  | Gross carrying amount | Accumulated amortization | Net carrying amount | Gross carrying amount | Accumulated amortization | Net carrying amount |
| Amortized intangible assets                  |                       |                          |                     |                       |                          |                     |
| Software . . . . .                           | ¥ 431,208             | ¥318,794                 | ¥112,414            | ¥402,523              | ¥279,139                 | ¥123,384            |
| Software for internal use . . . . .          | 432,952               | 242,182                  | 190,770             | 362,426               | 189,024                  | 173,402             |
| Patents . . . . .                            | 127,130               | 40,103                   | 87,027              | 123,445               | 24,375                   | 99,070              |
| Other . . . . .                              | 104,523               | 71,502                   | 33,021              | 96,371                | 61,769                   | 34,602              |
|  | <u>¥1,095,813</u>     | <u>¥672,581</u>          | <u>¥423,232</u>     | <u>¥984,765</u>       | <u>¥554,307</u>          | <u>¥430,458</u>     |
| Indefinite-lived intangible assets . . . . . | ¥ 7,753               | ¥ -                      | ¥ 7,753             | ¥ 9,382               | ¥ -                      | ¥ 9,382             |

|                                     | Thousands of U.S. dollars |                          |                     |
|-------------------------------------|---------------------------|--------------------------|---------------------|
|                                     | <b>2006</b>               |                          |                     |
|                                     | Gross carrying amount     | Accumulated amortization | Net carrying amount |
| <b>Amortized intangible assets</b>  |                           |                          |                     |
| Software . . . . .                  | <b>\$3,685,538</b>        | <b>\$2,724,735</b>       | <b>\$ 960,803</b>   |
| Software for internal use . . . . . | <b>3,700,445</b>          | <b>2,069,932</b>         | <b>1,630,513</b>    |
| Patents . . . . .                   | <b>1,086,581</b>          | <b>342,761</b>           | <b>743,820</b>      |
| Other . . . . .                     | <b>893,359</b>            | <b>611,128</b>           | <b>282,231</b>      |
|                                     | <b>\$9,365,923</b>        | <b>\$5,748,556</b>       | <b>\$3,617,367</b>  |
| <b>Indefinite-lived</b>             |                           |                          |                     |
| intangible assets . . . . .         | <b>\$ 66,265</b>          | <b>\$ -</b>              | <b>\$ 66,265</b>    |

The following table shows the estimated aggregate amortization expense of intangible assets for the next five years.

| Years ending March 31 | Millions of yen | Thousands of U.S. dollars |
|-----------------------|-----------------|---------------------------|
| 2007 . . . . .        | ¥115,457        | \$986,812                 |
| 2008 . . . . .        | 93,302          | 797,453                   |
| 2009 . . . . .        | 67,881          | 580,179                   |
| 2010 . . . . .        | 37,756          | 322,701                   |
| 2011 . . . . .        | 23,651          | 202,145                   |

The changes in the carrying amount of goodwill for the years ended March 31, 2006 and 2005 are as follows:

|  | Millions of yen |          | Thousands of U.S. dollars |
|--|-----------------|----------|---------------------------|
|  | <b>2006</b>     | 2005     | <b>2006</b>               |
| Balance at beginning of the year . . . . .                     | <b>¥45,898</b>  | ¥53,478  | <b>\$392,290</b>          |
| Acquired during the year . . . . .                             | <b>15,271</b>   | 6,424    | <b>130,521</b>            |
| Impairment loss . . . . .                                      | <b>(1,452)</b>  | (13,646) | <b>(12,410)</b>           |
| Translation adjustment and other . . . . .                     | <b>4,493</b>    | (358)    | <b>38,402</b>             |
| Balance at end of the year, included in other assets . . . . . | <b>¥64,210</b>  | ¥45,898  | <b>\$548,803</b>          |

Mainly due to severe demands for price reduction in the Automotive Industry reporting units in the Power and Industrial Systems, operating profits and cash flows were lower than expected. Based on that trend, the earnings forecast for the next three years was revised. The Company's determination of fair values of the reporting units incorporate the earnings forecast into its valuation assumptions resulting in a fair market value that was less than its carrying value. The Company recorded a pretax impairment loss of ¥11,526 million, which was reported in selling, general and administrative expenses for the year ended March 31, 2005.

## 10. INCOME TAXES

Components, as either domestic or foreign, of income before income taxes and minority interests, and income taxes attributable to continuing operations are as follows:

|   | Millions of yen |                |                 |
|---|-----------------|----------------|-----------------|
|   | Domestic        | Foreign        | Total           |
| Income before income taxes and minority interests . . . . . | <b>¥242,786</b> | <b>¥32,078</b> | <b>¥274,864</b> |
| Income taxes:   |                 |                |                 |
| Current tax expense . . . . .                               | <b>99,753</b>   | <b>20,780</b>  | <b>120,533</b>  |
| Deferred tax expense . . . . .                              | <b>21,915</b>   | <b>11,900</b>  | <b>33,815</b>   |
|   | <b>¥121,668</b> | <b>¥32,680</b> | <b>¥154,348</b> |

|   | Thousands of U.S. dollars |                  |                    |
|---|---------------------------|------------------|--------------------|
|   | Domestic                  | Foreign          | Total              |
| Income before income taxes and minority interests . . . . . | <b>\$2,075,094</b>        | <b>\$274,171</b> | <b>\$2,349,265</b> |
| Income taxes:   |                           |                  |                    |
| Current tax expense . . . . .                               | <b>852,590</b>            | <b>177,607</b>   | <b>1,030,197</b>   |
| Deferred tax expense . . . . .                              | <b>187,308</b>            | <b>101,709</b>   | <b>289,017</b>     |
|   | <b>\$1,039,898</b>        | <b>\$279,316</b> | <b>\$1,319,214</b> |

|   | Millions of yen |         |          |
|---|-----------------|---------|----------|
|   | Domestic        | Foreign | Total    |
| Income before income taxes and minority interests . . . . . | ¥212,424        | ¥52,082 | ¥264,506 |
| Income taxes:   |                 |         |          |
| Current tax expense . . . . .                               | 85,263          | 19,417  | 104,680  |
| Deferred tax expense . . . . .                              | 41,847          | 3,463   | 45,310   |
|   | ¥127,110        | ¥22,880 | ¥149,990 |

|   | Millions of yen |          |          |
|---|-----------------|----------|----------|
|   | Domestic        | Foreign  | Total    |
| Income before income taxes and minority interests . . . . . | ¥211,000        | ¥26,149  | ¥237,149 |
| Income taxes:   |                 |          |          |
| Current tax expense . . . . .                               | 93,264          | 28,335   | 121,599  |
| Deferred tax expense (benefit) . . . . .                    | 89,293          | (12,237) | 77,056   |
|   | ¥182,557        | ¥16,098  | ¥198,655 |

Significant components of income tax expense (benefit) attributable to continuing operations and other comprehensive income (loss), net of reclassification adjustments, for the years ended March 31, 2006, 2005 and 2004 are as follows:

|   | Millions of yen |          |          | Thousands of<br>U.S. dollars |
|---|-----------------|----------|----------|------------------------------|
|   | 2006            | 2005     | 2004     | 2006                         |
| <b>Continuing operations:</b>   |                 |          |          |                              |
| Current tax expense . . . . .   | <b>¥120,533</b> | ¥104,680 | ¥121,599 | <b>\$1,030,197</b>           |
| Deferred tax expense (benefit) (exclusive of the effects of other components listed below) . . . . .        | <b>(5,716)</b>  | 23,672   | 35,714   | <b>(48,855)</b>              |
| Adjustments of deferred tax assets and liabilities for enacted changes in tax laws and rates in Japan . . . | -               | -        | 2,318    | -                            |
| Change in valuation allowance . . . . .   | <b>39,531</b>   | 21,638   | 39,024   | <b>337,872</b>               |
|   | <b>154,348</b>  | 149,990  | 198,655  | <b>1,319,214</b>             |
| <b>Other comprehensive income (loss),<br/>net of reclassification adjustments:</b>                          |                 |          |          |                              |
| Minimum pension liability adjustments . . . . .   | <b>75,306</b>   | 77,535   | 259,788  | <b>643,641</b>               |
| Net unrealized holding gain on available-for-sale securities . . . . .                                      | <b>39,562</b>   | 3,115    | 19,154   | <b>338,136</b>               |
| Cash flow hedges . . . . .  | <b>985</b>      | (523)    | 162      | <b>8,419</b>                 |
|   | <b>115,853</b>  | 80,127   | 279,104  | <b>990,196</b>               |
|   | <b>¥270,201</b> | ¥230,117 | ¥477,759 | <b>\$2,309,410</b>           |

The Company adopted the consolidated taxation system in Japan effective from the year ended March 31, 2003. Under the consolidated taxation system, the Company had consolidated, for Japanese tax purposes, all wholly-owned domestic subsidiaries. A temporary 2% surtax for the period between April 1, 2002 through March 31, 2004 was assessed for adopting the consolidated taxation system. The aggregated statutory income tax rate for the consolidated group for tax purposes was approximately 43.6% for the year ended March 31, 2004.

On March 31, 2003, amendments to local business tax law in Japan were enacted, resulting in the lower business tax rates. During the year ended March 31, 2004, additional minor changes in tax rates for business taxes were enacted in certain local administrative divisions of Japan. Those changes became effective on April 1, 2004. As a result, the aggregated statutory income tax rate for domestic companies was approximately 40.6% for the years ended March 31, 2006 and 2005.

In accordance with EITF Issue No. 93-13, "Effect of a Retroactive Change in Enacted Tax Rates That Is Included in Income from Continuing Operations," the Company determined the tax effect of retroactive changes or changes in enacted tax rates on current and deferred tax assets and liabilities. The effect of these changes on the Company's deferred tax balances amounted to ¥2,318 million in income from continuing operations for the year ended March 31, 2004.

Reconciliations between the combined statutory income tax rate and the effective income tax rate as a percentage of income before income taxes and minority interests are as follows:

|   | 2006         | 2005  | 2004  |
|---|--------------|-------|-------|
| Combined statutory income tax rate . . . . .  | <b>40.6%</b> | 40.6% | 43.6% |
| Equity in (earnings) losses of affiliated companies . . . . .   | <b>(1.3)</b> | 0.0   | (1.9) |
| Impairment of investments in affiliated companies . . . . .   | <b>0.3</b>   | -     | 1.4   |
| Change in excess amounts over the tax basis of investments in subsidiaries and affiliated companies . . . . . | <b>0.2</b>   | 2.6   | 3.0   |
| Adjustment of net gain on sale of investments in subsidiaries and affiliated companies . . . . .              | <b>1.1</b>   | 1.6   | 12.6  |
| Expenses not deductible for tax purposes . . . . .  | <b>5.4</b>   | 4.6   | 7.2   |
| Enacted changes in tax laws and rates in Japan . . . . .  | -            | -     | 1.0   |
| Change in valuation allowance . . . . .   | <b>14.4</b>  | 8.2   | 16.5  |
| Difference in statutory tax rates of foreign subsidiaries . . . . .   | <b>(4.0)</b> | (2.1) | (1.5) |
| Other . . . . .   | <b>(0.5)</b> | 1.2   | 1.9   |
| Effective income tax rate . . . . .   | <b>56.2%</b> | 56.7% | 83.8% |

The tax effects of temporary differences and carryforwards that give rise to significant portions of the deferred tax assets and liabilities as of March 31, 2006 and 2005 are presented below:

|   | Millions of yen  |           | Thousands of<br>U.S. dollars |
|---|------------------|-----------|------------------------------|
|   | 2006             | 2005      | 2006                         |
| Total gross deferred tax assets:  |                  |           |                              |
| Retirement and severance benefits . . . . .                                 | ¥ 300,732        | ¥ 380,254 | \$2,570,359                  |
| Accrued expenses . . . . .  | 221,107          | 216,139   | 1,889,804                    |
| Property, plant and equipment, due to differences in depreciation . . . . . | 33,356           | 34,769    | 285,094                      |
| Net operating loss carryforwards . . . . .                                  | 136,399          | 119,930   | 1,165,803                    |
| Other . . . . .   | 323,299          | 293,735   | 2,763,239                    |
|   | <b>1,014,893</b> | 1,044,827 | <b>8,674,299</b>             |
| Valuation allowance . . . . .   | <b>(282,295)</b> | (196,811) | <b>(2,412,778)</b>           |
|   | <b>732,598</b>   | 848,016   | <b>6,261,521</b>             |
| Total gross deferred tax liabilities:                                       |                  |           |                              |
| Deferred profit on sale of properties . . . . .                             | <b>(32,548)</b>  | (33,077)  | <b>(278,188)</b>             |
| Tax purpose reserves regulated by Japanese tax laws . . . . .               | <b>(20,944)</b>  | (24,268)  | <b>(179,008)</b>             |
| Net unrealized gain on securities . . . . .                                 | <b>(78,337)</b>  | (35,477)  | <b>(669,547)</b>             |
| Other . . . . .   | <b>(34,175)</b>  | (27,706)  | <b>(292,094)</b>             |
|   | <b>(166,004)</b> | (120,528) | <b>(1,418,837)</b>           |
| Net deferred tax asset . . . . .  | <b>¥ 566,594</b> | ¥ 727,488 | <b>\$4,842,684</b>           |

In addition to the above, income taxes paid on net intercompany profit on assets remaining within the group, which had been deferred in accordance with Accounting Research Bulletin No. 51, "Consolidated Financial Statements," as of March 31, 2006 and 2005 are reflected in the accompanying consolidated balance sheets under the following captions:

|   | Millions of yen |         | Thousands of<br>U.S. dollars |
|---|-----------------|---------|------------------------------|
|   | 2006            | 2005    | 2006                         |
| Prepaid expenses and other current assets . . . . . | <b>¥16,187</b>  | ¥11,781 | <b>\$138,351</b>             |
| Other assets . . . . .                              | <b>58,325</b>   | 51,610  | <b>498,504</b>               |
|   | <b>¥74,512</b>  | ¥63,391 | <b>\$636,855</b>             |

Net deferred tax assets as of March 31, 2006 and 2005 are reflected in the accompanying consolidated balance sheets under the following captions:

|   | Millions of yen |          | Thousands of<br>U.S. dollars |
|---|-----------------|----------|------------------------------|
|   | 2006            | 2005     | 2006                         |
| Prepaid expenses and other current assets . . . . . | <b>¥281,347</b> | ¥295,532 | <b>\$2,404,675</b>           |
| Other assets . . . . .                              | <b>325,526</b>  | 460,721  | <b>2,782,274</b>             |
| Other current liabilities . . . . .                 | <b>(2,390)</b>  | (3,011)  | <b>(20,427)</b>              |
| Other liabilities . . . . .                         | <b>(37,889)</b> | (25,754) | <b>(323,838)</b>             |
| Net deferred tax asset . . . . .                    | <b>¥566,594</b> | ¥727,488 | <b>\$4,842,684</b>           |

A valuation allowance was recorded against deferred tax assets for deductible temporary differences, net operating loss carryforwards and tax credit carryforwards, taking into account the tax laws of various jurisdictions in which the Company and its subsidiaries operate. The net changes in the total valuation allowance for the years ended March 31, 2006 and 2005 were an increase of ¥85,484 million (\$730,632 thousand) and ¥5,615 million, respectively.

In assessing the realizability of deferred tax assets, management of the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income in specific tax jurisdictions during the periods in which these deductible differences become deductible. Although realization is not assured, management considered the scheduled reversals of deferred tax liabilities and projected future taxable income, including the execution of certain available tax strategies if needed, in making this assessment. Based on these factors, management believes it is more likely than not the Company will realize the benefits of these deductible differences, net of the existing valuation allowance as of March 31, 2006.

As of March 31, 2006, the Company and various subsidiaries have operating loss carryforwards of ¥373,151 million (\$3,189,325 thousand) which are available to offset future taxable income, if any. Operating loss carryforwards of ¥238,025 million (\$2,034,402 thousand) expire by March 31, 2011, and ¥135,126 million (\$1,154,923 thousand) expire in various years thereafter or do not expire.

Deferred tax liabilities have not been recognized for excess amounts over the tax basis of investments in foreign subsidiaries that are considered to be reinvested indefinitely, because such differences will not reverse in the foreseeable future and those undistributed earnings, if remitted, generally would not result in material additional Japanese income taxes because of available foreign tax credits.

## 11. SHORT-TERM AND LONG-TERM DEBT

The components of short-term debt as of March 31, 2006 and 2005 are summarized as follows:

|   | Millions of yen |          | Thousands of<br>U.S. dollars |
|---|-----------------|----------|------------------------------|
|   | 2006            | 2005     | 2006                         |
| Borrowings, mainly from banks . . . . . | <b>¥305,139</b> | ¥333,183 | <b>\$2,608,026</b>           |
| Commercial paper . . . . .              | <b>394,396</b>  | 295,821  | <b>3,370,906</b>             |
| Borrowings from affiliates . . . . .    | <b>52,992</b>   | 47,607   | <b>452,923</b>               |
|   | <b>¥752,527</b> | ¥676,611 | <b>\$6,431,855</b>           |

The weighted average interest rate on short-term debt outstanding as of March 31, 2006 and 2005 was 0.1%.

The components of long-term debt as of March 31, 2006 and 2005 are summarized as follows:

|  | Millions of yen   |            | Thousands of<br>U.S. dollars |
|--|-------------------|------------|------------------------------|
|  | 2006              | 2005       | 2006                         |
| Unsecured notes and debentures:  |                   |            |                              |
| Due 2006, interest 3.45% debenture . . . . .   | ¥ –               | ¥ 200,000  | \$ –                         |
| Due 2013, interest 0.72% debenture . . . . .   | <b>80,000</b>     | 80,000     | <b>683,761</b>               |
| Due 2010, interest 0.7% debenture . . . . .  | <b>49,882</b>     | –          | <b>426,342</b>               |
| Due 2015, interest 1.56% debenture . . . . .   | <b>49,977</b>     | –          | <b>427,154</b>               |
| Due 2008, interest 0.52% debenture . . . . .   | <b>5,000</b>      | 5,000      | <b>42,735</b>                |
| Due 2010, interest 0.74% debenture . . . . .   | <b>5,000</b>      | 5,000      | <b>42,735</b>                |
| Due 2006–2018, interest 0.04–5.92%, issued by subsidiaries . . . .   | <b>599,626</b>    | 704,097    | <b>5,125,009</b>             |
| Unsecured convertible debentures:  |                   |            |                              |
| Series A, due 2009, zero coupon . . . . .  | <b>50,000</b>     | 50,000     | <b>427,350</b>               |
| Series B, due 2009, zero coupon . . . . .  | <b>50,000</b>     | 50,000     | <b>427,350</b>               |
| Loans, principally from banks and insurance companies:   |                   |            |                              |
| Secured by various assets and mortgages on property, plant and<br>equipment, maturing 2006–2015, interest 0.85–4.65% . . . . . | <b>43,244</b>     | 12,140     | <b>369,607</b>               |
| Unsecured, maturing 2006–2020, interest 0.4–5.7% . . . . .   | <b>722,782</b>    | 706,507    | <b>6,177,624</b>             |
| Capital lease obligations . . . . .  | <b>11,006</b>     | 13,151     | <b>94,068</b>                |
|  | <b>1,666,517</b>  | 1,825,895  | <b>14,243,735</b>            |
| Less current portion . . . . .   | <b>248,028</b>    | 506,863    | <b>2,119,897</b>             |
|  | <b>¥1,418,489</b> | ¥1,319,032 | <b>\$12,123,838</b>          |

The aggregate annual maturities of long-term debt after March 31, 2007 are as follows:

| Years ending March 31 | Millions of yen   | Thousands of<br>U.S. dollars |
|-----------------------|-------------------|------------------------------|
| 2008 . . . . .        | ¥ 306,904         | \$ 2,623,111                 |
| 2009 . . . . .        | 270,264           | 2,309,949                    |
| 2010 . . . . .        | 346,155           | 2,958,590                    |
| 2011 . . . . .        | 145,728           | 1,245,538                    |
| Thereafter . . . . .  | 349,438           | 2,986,650                    |
|                       | <b>¥1,418,489</b> | <b>\$12,123,838</b>          |

As is customary in Japan, both short-term and long-term bank loans are made under general agreements that provide that securities and guarantees for present and future indebtedness will be given upon request of the bank, and that the bank shall have the right, as the obligations become due, or in the event of their default, to offset cash deposits against such obligations.

Generally, the mortgage debenture trust agreements and certain secured and unsecured loan agreements provide, among other things, that the lenders or trustees shall have the right to have any distribution of earnings, including the payment of dividends and the issuance of additional capital stock, submitted to them for prior approval and also grant them the right to request additional securities or mortgages on property, plant and equipment.

In October, 2004, the Company issued Euro yen zero coupon convertible bonds. The bonds consist of ¥50,000 million series A zero coupon convertible bonds due 2009 and ¥50,000 million series B zero coupon convertible bonds due 2009. The bondholders are entitled to stock acquisition rights effective from November 2, 2004 to October 5, 2009. The initial conversion price was ¥1,009 per share for both bonds at which time the fair value of the Company's common stock was ¥686. In accordance with the terms of the debenture, the conversion price was adjusted to ¥822 (\$7.03) on October 19, 2005 for series A zero coupon convertible bonds and on April 19, 2006 for series B zero coupon convertible bonds. The conversion prices will be adjusted on October 19, 2007 for series A zero coupon convertible bonds and on April 19, 2008 for series B zero coupon convertible bonds. The prices will be 95% (rounded upwards to the nearest one yen) of the average closing prices of the Company's shares on the Tokyo Stock Exchange for 30 consecutive trading days up to each conversion dates, no less than ¥822 (\$7.03). During the conversion period, the bondholders may exercise the stock acquisition rights anytime after the closing price of the Company's shares at the Tokyo Stock Exchange on at least one trading day is 115 percent or more of the then applicable conversion price rounded down to the nearest yen. In addition, the bondholders are entitled, at their option, to require the Company to redeem the bonds at a redemption price of 100 percent of the principal amount on October 17, 2008.

## 12. RETIREMENT AND SEVERANCE BENEFITS

### *(a) Defined benefit plans*

The Company and its subsidiaries have a number of contributory and noncontributory pension plans to provide retirement and severance benefits to substantially all employees.

Under unfunded defined benefit pension plans, employees are entitled to lump-sum payments based on their earnings and the length of service by retirement or termination of employment for reasons other than dismissal for cause.

Directors, Executive Officers and certain employees are not covered by the programs described above. Certain benefits paid to such persons are charged to income as paid as it is not practicable to compute the liability for future payments because amounts vary with circumstances.

In addition to unfunded defined benefit pension plans, the Company and certain subsidiaries make contributions to a number of defined benefits pension plans. During the years ended March 31, 2006, 2005 and 2004, the Company and certain subsidiaries amended certain of their defined benefit plans to cash balance plans.

Under the cash balance plans, each employee has a notional account which represents pension benefits. The balance in the notional account is based on principal credits, which are accumulated as employees render services, and interest credits, which are determined based on the market interest rates.

Net periodic benefit costs for the funded benefit pension plans and the unfunded lump-sum payment plans for the years ended March 31, 2006, 2005 and 2004 consist of the following components:

|   | Millions of yen |           |           | Thousands of<br>U.S. dollars |
|---|-----------------|-----------|-----------|------------------------------|
|   | 2006            | 2005      | 2004      | 2006                         |
| Service cost .....  | ¥ 74,131        | ¥ 85,500  | ¥107,002  | \$ 633,598                   |
| Interest cost .....   | 56,166          | 63,637    | 78,493    | 480,051                      |
| Expected return on plan assets for the period .....   | (34,045)        | (33,749)  | (32,863)  | (290,983)                    |
| Amortization of transition asset .....  | -               | (208)     | (368)     | -                            |
| Amortization of prior service benefit .....   | (17,381)        | (13,842)  | (13,423)  | (148,555)                    |
| Recognized actuarial loss .....   | 67,678          | 100,274   | 151,567   | 578,445                      |
| Transfer to defined contribution pension plan .....   | (87)            | 3,223     | 1,557     | (744)                        |
| Derecognition of previously accrued salary progression<br>due to transfer of substitutional portion .....                   | (5,956)         | (16,235)  | (17,215)  | (50,906)                     |
| Recognition of deferred actuarial losses<br>due to transfer of substitutional portion .....                                 | 26,193          | 105,758   | 375,049   | 223,872                      |
| Curtailment and settlement loss .....   | -               | 173       | 1,072     | -                            |
| Employees' contributions .....  | (731)           | (3,187)   | (9,735)   | (6,248)                      |
| Net periodic benefit cost .....   | 165,968         | 291,344   | 641,136   | 1,418,530                    |
| Difference between the obligations settled and<br>the assets transferred due to transfer of<br>substitutional portion ..... | (30,593)        | (165,247) | (411,621) | (261,479)                    |
|   | ¥135,375        | ¥126,097  | ¥229,515  | \$1,157,051                  |

Unrecognized transition asset, unrecognized prior service benefit and cost and unrecognized actuarial gain and loss are amortized using the straight-line method over the average remaining service period of active employees.

The Employees Pension Fund (EPF) stipulated by the Japanese Pension Insurance Law is one of the defined benefit pension plans to which the Company and certain domestic subsidiaries had contributed. The pension plans under the EPF are composed of the substitutional portion of Japanese Welfare Pension Insurance and the corporate portion which is the contributory defined benefit pension plan covering substantially all of their employees and provides benefits in addition to the substitutional portion. The Company, certain subsidiaries and their employees had contributed the pension premiums for the substitutional portion and the corporate portion to each EPF. The plan assets of each EPF cannot be specifically allocated to the individual participants nor to the substitutional and corporate portions.

On June 15, 2001, the Japanese government issued a new law concerning defined benefit plans. This law allows a company, at its own discretion, to apply for an exemption from the future benefit obligation and return the past benefit obligation of the substitutional portion of the EPF to the government. In accordance with the new law, the Company and all the subsidiaries obtained approvals from the government for the exemption from the future benefit obligation and for the return of the past benefit obligation through March 31, 2006. Consequently, the Company and all the subsidiaries transferred the substitutional portion of each of their benefit obligations related to past service and the related portion of the plan assets of the EPF to the government during the years ended March 31, 2006, 2005 and 2004.

The Company and certain subsidiaries accounted for the entire separation process as a single settlement transaction upon the completion of the transfer to the government in accordance with EITF Issue No. 03-2, "Accounting for the Transfer to the Japanese Government of the Substitutional Portion of Employee Pension Fund Liabilities."

Reconciliations of beginning and ending balances of the benefit obligation of the funded defined benefit pension plans and the unfunded defined benefit pension plans and the fair value of the plan assets are as follows:

|   | Millions of yen    |                    | Thousands of<br>U.S. dollars |
|---|--------------------|--------------------|------------------------------|
|   | 2006               | 2005               | 2006                         |
| Change in benefit obligation:                                     |                    |                    |                              |
| Benefit obligation at beginning of year . . . . .                 | ¥2,307,266         | ¥2,717,784         | \$19,720,222                 |
| Service cost . . . . .  | 74,131             | 85,500             | 633,598                      |
| Interest cost . . . . .   | 56,166             | 63,637             | 480,051                      |
| Plan amendments . . . . .   | (7,844)            | (57,625)           | (67,043)                     |
| Actuarial loss . . . . .  | 5,105              | 18,377             | 43,633                       |
| Benefits paid . . . . .   | (139,896)          | (138,245)          | (1,195,692)                  |
| Acquisitions and divestitures . . . . .                           | 2,339              | 13,559             | 19,991                       |
| Transfer to defined contribution pension plan . . . . .           | (1,644)            | (18,308)           | (14,051)                     |
| Transfer of substitutional portion . . . . .                      | (70,823)           | (368,132)          | (605,325)                    |
| Curtailment and settlement . . . . .                              | -                  | (10,956)           | -                            |
| Foreign currency exchange rate changes . . . . .                  | 5,500              | 1,675              | 47,009                       |
| Benefit obligation at end of year . . . . .                       | <u>2,230,300</u>   | <u>2,307,266</u>   | <u>19,062,393</u>            |
| Change in plan assets:  |                    |                    |                              |
| Fair value of plan assets at beginning of year . . . . .          | 1,159,007          | 1,257,195          | 9,906,043                    |
| Actual return on plan assets . . . . .                            | 200,792            | 59,117             | 1,716,171                    |
| Employers' contributions . . . . .                                | 124,577            | 130,247            | 1,064,760                    |
| Employees' contributions . . . . .                                | 731                | 3,187              | 6,248                        |
| Benefits paid . . . . .   | (100,157)          | (98,183)           | (856,043)                    |
| Acquisitions and divestitures . . . . .                           | 1,122              | 2,441              | 9,590                        |
| Transfer to defined contribution pension plan . . . . .           | (660)              | (1,209)            | (5,641)                      |
| Transfer of substitutional portion . . . . .                      | (34,274)           | (186,650)          | (292,940)                    |
| Settlement . . . . .  | -                  | (8,234)            | -                            |
| Foreign currency exchange rate changes . . . . .                  | 3,585              | 1,096              | 30,641                       |
| Fair value of plan assets at end of year . . . . .                | <u>1,354,723</u>   | <u>1,159,007</u>   | <u>11,578,829</u>            |
| Funded status . . . . .   | (875,577)          | (1,148,259)        | (7,483,564)                  |
| Unrecognized prior service benefit . . . . .                      | (227,851)          | (235,757)          | (1,947,444)                  |
| Unrecognized actuarial loss . . . . .                             | 548,019            | 803,104            | 4,683,923                    |
| Net amount recognized in the consolidated balance sheet . . . . . | <u>¥ (555,409)</u> | <u>¥ (580,912)</u> | <u>\$ (4,747,085)</u>        |
| Amounts recognized in the consolidated balance sheet consist of:  |                    |                    |                              |
| Prepaid benefit cost . . . . .                                    | ¥ 9,870            | ¥ 2,212            | \$ 84,359                    |
| Accrued benefit cost . . . . .                                    | (827,669)          | (1,033,005)        | (7,074,094)                  |
| Intangible asset . . . . .  | 915                | 1,416              | 7,821                        |
| Accumulated other comprehensive loss . . . . .                    | 261,475            | 448,465            | 2,234,829                    |
| Net amount recognized . . . . .                                   | <u>¥ (555,409)</u> | <u>¥ (580,912)</u> | <u>\$ (4,747,085)</u>        |

The Company and substantially all subsidiaries use their year-end as a measurement date. Weighted-average assumptions used to determine the year-end benefit obligations are as follows:

|   | 2006 | 2005 |
|---|------|------|
| Discount rate . . . . .                 | 2.5% | 2.5% |
| Rate of compensation increase . . . . . | 2.5% | 2.9% |

Weighted-average assumptions used to determine the net periodic pension cost for the years ended March 31, 2006, 2005 and 2004 are as follows:

|  | 2006 | 2005 | 2004 |
|--|------|------|------|
| Discount rate . . . . .                            | 2.5% | 2.5% | 2.5% |
| Expected long-term return on plan assets . . . . . | 3.0% | 3.0% | 3.7% |
| Rate of compensation increase . . . . .            | 2.9% | 3.1% | 3.3% |

The expected long-term rate of return on plan assets is developed for each asset class, and is determined primarily on historical returns on the plan assets and other factors.

The accumulated benefit obligation was ¥2,112,216 million (\$18,053,128 thousand) as of March 31, 2006 and ¥2,167,152 million as of March 31, 2005.

Information for pension plans with accumulated benefit obligations in excess of plan assets and pension plans with projected benefit obligations in excess of plan assets is as follows:

|  | 2006       | Millions of yen<br>2005 | Thousands of<br>U.S. dollars<br>2006 |
|--|------------|-------------------------|--------------------------------------|
| Plans with accumulated benefit obligations in excess of plan assets: |            |                         |                                      |
| Accumulated benefit obligations . . . . .                            | ¥1,988,054 | ¥2,128,876              | \$16,991,915                         |
| Plan assets . . . . .  | 1,217,060  | 1,118,739               | 10,402,222                           |
| Plans with projected benefit obligations in excess of plan assets:   |            |                         |                                      |
| Projected benefit obligations . . . . .                              | ¥2,144,176 | ¥2,306,142              | \$18,326,291                         |
| Plan assets . . . . .  | 1,261,697  | 1,157,541               | 10,783,735                           |

Asset allocations for the pension plans as of March 31, 2006 and 2005 are as follows:

|   | 2006          | 2005          |
|---|---------------|---------------|
| Equity securities . . . . .                       | 44.7%         | 40.9%         |
| Debt securities . . . . .                         | 31.3          | 33.2          |
| Cash . . . . .                                    | 3.7           | 7.0           |
| Life insurance company general accounts . . . . . | 6.1           | 6.3           |
| Investment trusts . . . . .                       | 11.3          | 10.2          |
| Other . . . . .                                   | 2.9           | 2.4           |
|   | <b>100.0%</b> | <b>100.0%</b> |

The objective of the Company's investment policy is to ensure a stable return from the plan's investments over the long term, which allows the Company's and certain subsidiaries' pension funds to meet their future obligations. In order to achieve the above objective, a target rate of return is established, taking into consideration composition of participants, level of funded status, the Company's and certain subsidiaries' capacity to absorb risks and the current economic environment. Also, a target asset allocation is established to achieve the target rate of return, based on expected rate of return by each asset class, standard deviation of rate of return and correlation coefficient among the assets. The investments are diversified primarily into domestic and foreign equity and debt securities according to the target asset allocation. Rebalancing will occur if market fluctuates in excess of certain levels. The Company and certain subsidiaries periodically review actual returns on assets, economic environments and their capacity to absorb risk and realign the target asset allocation if necessary.

The Company and its subsidiaries expect to contribute ¥126,633 million (\$1,082,233 thousand) to their defined benefit plans for the year ending March 31, 2007.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid.

| Years ending March 31 | Millions of yen | Thousands of U.S. dollars |
|-----------------------|-----------------|---------------------------|
| 2007                  | ¥115,138        | \$ 984,085                |
| 2008                  | 118,640         | 1,014,017                 |
| 2009                  | 127,948         | 1,093,573                 |
| 2010                  | 135,010         | 1,153,932                 |
| 2011                  | 136,409         | 1,165,889                 |
| 2012–2016             | 656,315         | 5,609,530                 |

**(b) Defined contribution plans**

The Company and certain subsidiaries have a number of defined contribution plans. The amount of cost recognized for the Company's and certain subsidiaries' contributions to the plans for the years ended March 31, 2006, 2005 and 2004 were ¥11,776 million (\$100,650 thousand), ¥10,749 million and ¥7,718 million, respectively.

## 13. COMMON STOCK

The Company has authorized for issuance 10 billion shares of common stock.

Issued shares, changes in shares and the amount of common stock for the years ended March 31, 2006, 2005 and 2004 are summarized as follows:

|  | Issued shares        | Millions of yen | Thousands of       |
|--|----------------------|-----------------|--------------------|
|  |                      | Amount          | U.S. dollars       |
|  |                      |                 | Amount             |
| Balance as of March 31, 2003                     | 3,368,124,286        | ¥282,032        |                    |
| Issued upon conversion of convertible debentures | 590                  | 0               |                    |
| Balance as of March 31, 2004                     | 3,368,124,876        | 282,032         |                    |
| Issued upon conversion of convertible debentures | 1,180                | 1               |                    |
| Balance as of March 31, 2005 and 2006            | <b>3,368,126,056</b> | <b>¥282,033</b> | <b>\$2,410,538</b> |

Conversions of convertible debt issued subsequent to October 1, 1982 into common stock were accounted for in accordance with the provisions of the Japanese Commercial Code, the former Japanese corporate law, by crediting one-half of the conversion price to each of the common stock accounts and the capital surplus accounts.

## 14. LEGAL RESERVE AND CASH DIVIDENDS

The Japanese Corporate Law provides that earnings in an amount equal to at least 10 percent of appropriations of retained earnings to be paid in cash should be appropriated as a legal reserve until the total of capital surplus and legal reserve equals 25 percent of stated common stock. In addition to reduction of a deficit and transfer to stated common stock, either capital surplus or legal reserve may be available for dividends by resolution of the shareholders' meeting.

Cash dividends and appropriations to the legal reserve charged to retained earnings during the years ended March 31, 2006, 2005 and 2004 represent dividends declared during those years and the related appropriations to the legal reserve. A provision has not been made in the accompanying consolidated financial statements for the dividend for the second half year ended March 31, 2006 of ¥5.5 (\$0.05) per share, aggregating ¥18,319 million (\$156,573 thousand). This dividend will be reported by the Board of Directors at the ordinary general shareholders' meeting in respect to the year ended March 31, 2006.

Cash dividends per share for the years ended March 31, 2006, 2005 and 2004 were ¥11.0 (\$0.09), ¥11.0 and ¥8.0, respectively, based on dividends declared with respect to earnings for the periods.

## 15. TREASURY STOCK

The Japanese Corporate Law (JCL) allows a company to acquire treasury stock upon shareholders' approval to the extent that sufficient distributable funds are available. Effective September 25, 2003, the Japanese Commercial Code (JCC), the former Japanese corporate law, was amended to no longer require shareholders' approval but Board of Directors' approval to the extent that the Board of Directors' authority was stated in the articles of incorporation. In this connection, the related amendment of the articles of incorporation was approved at the ordinary general shareholders' meeting on June 24, 2004.

Pursuant to the provisions of the JCL, shareholders may request the Company to acquire their shares below a minimum trading lot (1,000 shares) as shares below a minimum trading lot cannot be publicly traded and do not carry a voting right. The JCL also states that a shareholder holding shares less than a minimum trading lot is entitled to request the company to sell its treasury stock, if any, to the shareholder up to a minimum trading lot, provided that sale of treasury stock is allowed under the articles of incorporation. In this connection, the related amendment of the articles of incorporation was approved at the ordinary general shareholders' meeting on June 25, 2003.

The changes in treasury stock for the years ended March 31, 2006, 2005 and 2004 are summarized as follows:

|  | Shares            | Millions of yen<br>Amount | Thousands of<br>U.S. dollars<br>Amount |
|--|-------------------|---------------------------|--|
| Balance as of March 31, 2003           | 3,235,291         | ¥ 1,847                   |  |
| Acquisition for treasury               | 67,199,843        | 30,464                    |  |
| Sales of treasury stock                | (325,161)         | (149)                     |  |
| Balance as of March 31, 2004           | 70,109,973        | 32,162                    |  |
| Acquisition for treasury               | 1,697,685         | 1,177                     |  |
| Sales of treasury stock                | (1,321,295)       | (478)                     |  |
| Stock exchange upon a merger (note 29) | (33,937,141)      | (15,625)                  |  |
| Balance as of March 31, 2005           | 36,549,222        | 17,236                    | \$147,316                              |
| Acquisition for treasury               | 1,440,676         | 1,058                     | 9,043                                  |
| Sales of treasury stock                | (708,603)         | (344)                     | (2,940)                                |
| Balance as of March 31, 2006           | <b>37,281,295</b> | <b>¥17,950</b>            | <b>\$153,419</b>                       |

At the ordinary general shareholders' meeting on June 25, 2003, the Company was authorized to acquire for treasury up to 300,000,000 shares of its common stock for an aggregate acquisition amount not exceeding ¥150,000 million during the period from the close of the ordinary general shareholders' meeting to the close of the next ordinary general shareholders' meeting, pursuant to the provisions of the JCC.

In April 2006, the Board of Directors approved to acquire for treasury up to 6,500,000 shares of its common stock for an aggregate acquisition amount not exceeding ¥5,000 million (\$42,735 thousand) during May 2006. In this connection, the Company acquired a total of 6,210,000 shares for ¥4,996 million (\$42,701 thousand) during the period.

## 16. ACCUMULATED OTHER COMPREHENSIVE LOSS

Accumulated other comprehensive loss, net of related tax effects, displayed in the consolidated statements of stockholders' equity is classified as follows:

|   | Millions of yen |            |            | Thousands of<br>U.S. dollars |
|---|-----------------|------------|------------|------------------------------|
|   | 2006            | 2005       | 2004       | 2006                         |
| <b>Foreign currency translation adjustments:</b>                                    |                 |            |            |                              |
| Balance at beginning of year . . . . .  | ¥ (90,904)      | ¥ (95,786) | ¥ (60,948) | \$ (776,957)                 |
| Other comprehensive income (loss),<br>net of reclassification adjustments . . . . . | 48,435          | 5,320      | (34,275)   | 413,974                      |
| Net transfer to minority interests . . . . .  | (957)           | (438)      | (563)      | (8,179)                      |
| Balance at end of year . . . . .  | ¥ (43,426)      | ¥ (90,904) | ¥ (95,786) | \$ (371,162)                 |
| <b>Minimum pension liability adjustments:</b>                                       |                 |            |            |                              |
| Balance at beginning of year . . . . .  | ¥(242,672)      | ¥(329,536) | ¥(698,916) | \$ (2,074,120)               |
| Other comprehensive income . . . . .  | 96,808          | 86,541     | 366,707    | 827,419                      |
| Net transfer from (to) minority interests . . . . .                                 | (39)            | 323        | 2,673      | (333)                        |
| Balance at end of year . . . . .  | ¥(145,903)      | ¥(242,672) | ¥(329,536) | \$ (1,247,034)               |
| <b>Net unrealized holding gain on available-for-sale securities:</b>                |                 |            |            |                              |
| Balance at beginning of year . . . . .  | ¥ 32,996        | ¥ 31,499   | ¥ 4,874    | \$ 282,017                   |
| Other comprehensive income,<br>net of reclassification adjustments . . . . .        | 59,624          | 1,458      | 26,635     | 509,607                      |
| Net transfer from (to) minority interests . . . . .                                 | 6               | 39         | (10)       | 51                           |
| Balance at end of year . . . . .  | ¥ 92,626        | ¥ 32,996   | ¥ 31,499   | \$ 791,675                   |
| <b>Cash flow hedges:</b>  |                 |            |            |                              |
| Balance at beginning of year . . . . .  | ¥ (944)         | ¥ (41)     | ¥ (535)    | \$ (8,068)                   |
| Other comprehensive income (loss),<br>net of reclassification adjustments . . . . . | 1,652           | (653)      | 49         | 14,120                       |
| Net transfer from (to) minority interests . . . . .                                 | (2)             | (250)      | 445        | (18)                         |
| Balance at end of year . . . . .  | ¥ 706           | ¥ (944)    | ¥ (41)     | \$ 6,034                     |
| <b>Total accumulated other comprehensive loss:</b>                                  |                 |            |            |                              |
| Balance at beginning of year . . . . .  | ¥(301,524)      | ¥(393,864) | ¥(755,525) | \$ (2,577,128)               |
| Other comprehensive income,<br>net of reclassification adjustments . . . . .        | 206,519         | 92,666     | 359,116    | 1,765,120                    |
| Net transfer from (to) minority interests . . . . .                                 | (992)           | (326)      | 2,545      | (8,479)                      |
| Balance at end of year . . . . .  | ¥ (95,997)      | ¥(301,524) | ¥(393,864) | \$ (820,487)                 |

The following is a summary of reclassification adjustments by each classification of other comprehensive income (loss) arising during the years ended March 31, 2006, 2005 and 2004 and the amounts of income tax expense or benefit allocated to each component of other comprehensive income (loss), including reclassification adjustments.

|  | Millions of yen    |                       |                    |
|--|--------------------|-----------------------|--------------------|
|  | Before-tax amount  | Tax benefit (expense) | Net-of-tax amount  |
| <b>2006</b>  |                    |                       |                    |
| Other comprehensive income arising during the year:                    |                    |                       |                    |
| Foreign currency translation adjustments . . . . .                     | ¥ 51,492           | ¥ -                   | ¥ 51,492           |
| Minimum pension liability adjustments . . . . .                        | 160,654            | (63,846)              | 96,808             |
| Net unrealized holding gain on available-for-sale securities . . . . . | 120,305            | (48,742)              | 71,563             |
| Cash flow hedges . . . . .   | 2,385              | (1,091)               | 1,294              |
|  | <b>334,836</b>     | <b>(113,679)</b>      | <b>221,157</b>     |
| Reclassification adjustments for net gain included in net income:      |                    |                       |                    |
| Foreign currency translation adjustments . . . . .                     | (3,057)            | -                     | (3,057)            |
| Net unrealized holding gain on available-for-sale securities . . . . . | (20,096)           | 8,157                 | (11,939)           |
| Cash flow hedges . . . . .   | 239                | 119                   | 358                |
|  | <b>(22,914)</b>    | <b>8,276</b>          | <b>(14,638)</b>    |
| Other comprehensive income, net of reclassification adjustments:       |                    |                       |                    |
| Foreign currency translation adjustments . . . . .                     | 48,435             | -                     | 48,435             |
| Minimum pension liability adjustments . . . . .                        | 160,654            | (63,846)              | 96,808             |
| Net unrealized holding gain on available-for-sale securities . . . . . | 100,209            | (40,585)              | 59,624             |
| Cash flow hedges . . . . .   | 2,624              | (972)                 | 1,652              |
|  | <b>¥311,922</b>    | <b>¥(105,403)</b>     | <b>¥206,519</b>    |
| <b>2005</b>  |                    |                       |                    |
| Thousands of U.S. dollars  |                    |                       |                    |
|  | Before-tax amount  | Tax benefit (expense) | Net-of-tax amount  |
| Other comprehensive income arising during the year:                    |                    |                       |                    |
| Foreign currency translation adjustments . . . . .                     | \$ 440,102         | \$ -                  | \$ 440,102         |
| Minimum pension liability adjustments . . . . .                        | 1,373,111          | (545,692)             | 827,419            |
| Net unrealized holding gain on available-for-sale securities . . . . . | 1,028,248          | (416,598)             | 611,650            |
| Cash flow hedges . . . . .   | 20,385             | (9,325)               | 11,060             |
|  | <b>2,861,846</b>   | <b>(971,615)</b>      | <b>1,890,231</b>   |
| Reclassification adjustments for net gain included in net income:      |                    |                       |                    |
| Foreign currency translation adjustments . . . . .                     | (26,128)           | -                     | (26,128)           |
| Net unrealized holding gain on available-for-sale securities . . . . . | (171,761)          | 69,718                | (102,043)          |
| Cash flow hedges . . . . .   | 2,043              | 1,017                 | 3,060              |
|  | <b>(195,846)</b>   | <b>70,735</b>         | <b>(125,111)</b>   |
| Other comprehensive income, net of reclassification adjustments:       |                    |                       |                    |
| Foreign currency translation adjustments . . . . .                     | 413,974            | -                     | 413,974            |
| Minimum pension liability adjustments . . . . .                        | 1,373,111          | (545,692)             | 827,419            |
| Net unrealized holding gain on available-for-sale securities . . . . . | 856,487            | (346,880)             | 509,607            |
| Cash flow hedges . . . . .   | 22,428             | (8,308)               | 14,120             |
|  | <b>\$2,666,000</b> | <b>\$(900,880)</b>    | <b>\$1,765,120</b> |

|  | Millions of yen      |                          |                      |
|--|----------------------|--------------------------|----------------------|
|  | 2005                 |                          |                      |
|  | Before-tax<br>amount | Tax benefit<br>(expense) | Net-of-tax<br>amount |
| Other comprehensive income arising during the year:                    |                      |                          |                      |
| Foreign currency translation adjustments . . . . .                     | ¥ 4,650              | ¥ –                      | ¥ 4,650              |
| Minimum pension liability adjustments . . . . .                        | 147,163              | (60,622)                 | 86,541               |
| Net unrealized holding gain on available-for-sale securities . . . . . | 13,174               | (5,627)                  | 7,547                |
| Cash flow hedges . . . . .   | (1,233)              | 373                      | (860)                |
|  | 163,754              | (65,876)                 | 97,878               |
| Reclassification adjustments for net gain included in net income:      |                      |                          |                      |
| Foreign currency translation adjustments . . . . .                     | 670                  | –                        | 670                  |
| Net unrealized holding gain on available-for-sale securities . . . . . | (10,566)             | 4,477                    | (6,089)              |
| Cash flow hedges . . . . .   | 259                  | (52)                     | 207                  |
|  | (9,637)              | 4,425                    | (5,212)              |
| Other comprehensive income, net of reclassification adjustments:       |                      |                          |                      |
| Foreign currency translation adjustments . . . . .                     | 5,320                | –                        | 5,320                |
| Minimum pension liability adjustments . . . . .                        | 147,163              | (60,622)                 | 86,541               |
| Net unrealized holding gain on available-for-sale securities . . . . . | 2,608                | (1,150)                  | 1,458                |
| Cash flow hedges . . . . .   | (974)                | 321                      | (653)                |
|  | <u>¥154,117</u>      | <u>¥(61,451)</u>         | <u>¥92,666</u>       |

|  | Millions of yen      |                          |                      |
|--|----------------------|--------------------------|----------------------|
|  | 2004                 |                          |                      |
|  | Before-tax<br>amount | Tax benefit<br>(expense) | Net-of-tax<br>amount |
| Other comprehensive income arising during the year:                    |                      |                          |                      |
| Foreign currency translation adjustments . . . . .                     | ¥ (42,535)           | ¥ –                      | ¥ (42,535)           |
| Minimum pension liability adjustments . . . . .                        | 619,719              | (253,012)                | 366,707              |
| Net unrealized holding gain on available-for-sale securities . . . . . | 66,059               | (26,678)                 | 39,381               |
| Cash flow hedges . . . . .   | (722)                | 62                       | (660)                |
|  | 642,521              | (279,628)                | 362,893              |
| Reclassification adjustments for net gain included in net income:      |                      |                          |                      |
| Foreign currency translation adjustments . . . . .                     | 8,260                | –                        | 8,260                |
| Net unrealized holding gain on available-for-sale securities . . . . . | (21,599)             | 8,853                    | (12,746)             |
| Cash flow hedges . . . . .   | 722                  | (13)                     | 709                  |
|  | (12,617)             | 8,840                    | (3,777)              |
| Other comprehensive income, net of reclassification adjustments:       |                      |                          |                      |
| Foreign currency translation adjustments . . . . .                     | (34,275)             | –                        | (34,275)             |
| Minimum pension liability adjustments . . . . .                        | 619,719              | (253,012)                | 366,707              |
| Net unrealized holding gain on available-for-sale securities . . . . . | 44,460               | (17,825)                 | 26,635               |
| Cash flow hedges . . . . .   | 0                    | 49                       | 49                   |
|  | <u>¥629,904</u>      | <u>¥(270,788)</u>        | <u>¥359,116</u>      |

## 17. PLEDGED ASSETS

As of March 31, 2006, certain subsidiaries pledge a portion of their assets as collateral for bank loans, trade payables and other liabilities as follows:

|                                     | Millions of yen | Thousands of<br>U.S. dollars |
|-------------------------------------|-----------------|------------------------------|
|                                     | 2006            | 2006                         |
| Cash and cash equivalents . . . . . | ¥ 102           | \$ 872                       |
| Other current assets . . . . .      | 68              | 581                          |
| Investments and advances . . . . .  | 186             | 1,590                        |
| Land . . . . .                      | 6,134           | 52,427                       |
| Buildings . . . . .                 | 6,405           | 54,744                       |
| Machinery and equipment . . . . .   | 7,849           | 67,085                       |
|                                     | <u>¥20,744</u>  | <u>\$177,299</u>             |

## 18. COMMITMENTS AND CONTINGENCIES

The Company and its operating subsidiaries are contingently liable for loan guarantees to its affiliates in the amount of approximately ¥31,154 million (\$266,274 thousand) as of March 31, 2006.

Hitachi Capital Corporation (HCC) and certain other financial subsidiaries provide guarantees to financial institutions for extending loans to customers of the subsidiaries. As of March 31, 2006, the undiscounted maximum potential future payments under such guarantees amounted to ¥496,569 million (\$4,244,179 thousand). The Company has accrued ¥6,564 million (\$56,103 thousand) as an obligation to stand ready to perform over the term of the guarantees in the event the customer can not make its scheduled payments.

The subsidiaries provide certain revolving lines of credit to its credit card holders in accordance with the terms of the credit card business customer service contracts. Furthermore, the subsidiaries provide credit facilities to parties in accordance with the service agency business contracts from which temporary payments on behalf of such parties are made. In addition, the Company and HCC provide loan commitments to its affiliates.

The outstanding balance of these revolving lines of credit, credit facilities and loan commitments as of March 31, 2006 is as follows:

|                                      | Millions of yen | Thousands of<br>U.S. dollars |
|--------------------------------------|-----------------|------------------------------|
|                                      | 2006            | 2006                         |
| Total commitment available . . . . . | ¥660,828        | \$5,648,102                  |
| Less amount utilized . . . . .       | 26,556          | 226,974                      |
| Balance available . . . . .          | <u>¥634,272</u> | <u>\$5,421,128</u>           |

A portion of these revolving lines of credit is pending credit approval and cannot be utilized.

The Company and certain subsidiaries have line of credit arrangements with banks in order to secure a source of working capital. The unused line of credit as of March 31, 2006 amounted to ¥220,438 million (\$1,884,085 thousand).

As of March 31, 2006, outstanding commitments for the purchase of property, plant and equipment were approximately ¥60,381 million (\$516,077 thousand).

The Company and its subsidiaries provide warranties for certain of their products. The accrued product warranty costs are based primarily on historical experience of actual warranty claims. The changes in accrued product warranty costs for the years ended March 31, 2006 and 2005 are summarized as follows:

|   | Millions of yen |          | Thousands of<br>U.S. dollars |
|---|-----------------|----------|------------------------------|
|   | 2006            | 2005     | 2006                         |
| Balance at beginning of year . . . . .                            | <b>¥74,046</b>  | ¥61,417  | <b>\$632,872</b>             |
| Expense recognized upon issuance of warranties . . . . .          | <b>59,550</b>   | 61,696   | <b>508,974</b>               |
| Usage . . . . .   | <b>(56,177)</b> | (48,996) | <b>(480,145)</b>             |
| Other, including effect of foreign currency translation . . . . . | <b>4,031</b>    | (71)     | <b>34,453</b>                |
| Balance at end of year . . . . .                                  | <b>¥81,450</b>  | ¥74,046  | <b>\$696,154</b>             |

It is a common practice in Japan for companies, in the ordinary course of business, to receive promissory notes in the settlement of trade accounts receivable and to subsequently discount such notes to banks or to transfer them by endorsement to suppliers in the settlement of accounts payable.

As of March 31, 2006 and 2005, the Company and subsidiaries were contingently liable for trade notes discounted and endorsed in the following amounts:

|                            | Millions of yen |         | Thousands of<br>U.S. dollars |
|----------------------------|-----------------|---------|------------------------------|
|                            | 2006            | 2005    | 2006                         |
| Notes discounted . . . . . | <b>¥ 4,478</b>  | ¥ 4,853 | <b>\$38,273</b>              |
| Notes endorsed . . . . .   | <b>6,433</b>    | 6,644   | <b>54,983</b>                |
|                            | <b>¥10,911</b>  | ¥11,497 | <b>\$93,256</b>              |

The Company and certain subsidiaries are subject to several legal proceedings and claims which have arisen in the ordinary course of business and have not been finally adjudicated. These actions when ultimately concluded and determined will not, in the opinion of management, have a material adverse effect on the consolidated financial position or results of operations of the Company and subsidiaries.

## 19. IMPAIRMENT LOSSES FOR LONG-LIVED ASSETS

For the year ended March 31, 2006, the majority of the impairment losses were recorded on long-lived property, plant and equipment located in the U.S. and Japan, which primarily consisted of ¥11,631 million (\$99,410 thousand) in the Information & Telecommunication Systems division, ¥7,265 million (\$62,094 thousand) in the Electronic Devices division and ¥4,120 million (\$35,214 thousand) in the High Functional Materials & Components division. These losses were mainly the result of change in the extent or manner the assets were used and were determined based primarily on discounted future cash flows.

For the year ended March 31, 2005, the majority of the impairment losses were recorded on long-lived property, plant and equipment located in Japan, which primarily consisted of ¥8,517 million in the Electronic Devices division, ¥4,954 million in the High Functional Materials & Components division and ¥4,453 million in the Corporate division. These losses were mainly the results of change in the extent or manner the assets were used and were determined based primarily on discounted future cash flows.

For the year ended March 31, 2004, the majority of the impairment losses were recorded on long-lived property, plant and equipment located in Japan, which primarily consisted of ¥13,391 million in the Corporate division and ¥8,175 million in the Information & Telecommunication Systems division. These losses, in part, were the result of change in the manner the assets were used.

## 20. RESTRUCTURING CHARGES

Certain losses incurred in the reorganization of the Company's operations are considered restructuring charges. Components and related amounts of the restructuring charges, before the related tax effects, for the years ended March 31, 2006, 2005 and 2004 are as follows:

|  | Millions of yen |         |         | Thousands of<br>U.S. dollars |
|--|-----------------|---------|---------|------------------------------|
|  | 2006            | 2005    | 2004    | 2006                         |
| Special termination benefits . . . . . | <b>¥2,786</b>   | ¥29,426 | ¥18,155 | <b>\$23,812</b>              |
| Loss on fixed assets . . . . .         | <b>1,643</b>    | 3,881   | 10,458  | <b>14,043</b>                |
|  | <b>¥4,429</b>   | ¥33,307 | ¥28,613 | <b>\$37,855</b>              |

The Company and certain subsidiaries provided special termination benefits to those employees voluntarily leaving the companies. The accrued special termination benefits were recognized at the time voluntary termination was offered and benefits accepted by the employees. An analysis of the accrued special termination benefits for the years ended March 31, 2006, 2005 and 2004 is as follows:

|  | Millions of yen |          |          | Thousands of<br>U.S. dollars |
|--|-----------------|----------|----------|------------------------------|
|  | 2006            | 2005     | 2004     | 2006                         |
| Balance at beginning of the year . . . . .       | <b>¥14,389</b>  | ¥ 908    | ¥ –      | <b>\$122,983</b>             |
| New charges . . . . .                            | <b>2,786</b>    | 29,426   | 18,155   | <b>23,812</b>                |
| (employee to be terminated) . . . . .            | <b>691</b>      | 3,714    | 2,143    | <b>–</b>                     |
| Cash payments . . . . .                          | <b>(16,158)</b> | (15,939) | (17,247) | <b>(138,103)</b>             |
| (employee actually terminated) . . . . .         | <b>1,861</b>    | 2,334    | 2,037    | <b>–</b>                     |
| Foreign currency exchange rate changes . . . . . | <b>89</b>       | (6)      | –        | <b>761</b>                   |
| Balance at end of the year . . . . .             | <b>¥ 1,106</b>  | ¥14,389  | ¥ 908    | <b>\$ 9,453</b>              |

The restructuring charges for the year ended March 31, 2006 mainly consist of special termination benefits for the early terminated employees of subsidiaries in the Electronic Devices division and loss on fixed assets in the High Functional Materials & Components division.

The following represent significant restructuring activities for the year ended March 31, 2005 by business line:

1. Information & Telecommunication Systems division restructured in order to strengthen its business structure primarily in Japan. The accrued special termination benefits expensed during the year ended March 31, 2005 amounted to ¥16,666 million. The liabilities for special termination benefits amounting to ¥9,599 million at March 31, 2005 were paid by March 2006. Total restructuring charges during the year ended March 31, 2005 amounted to ¥16,708 million.
2. Digital Media & Consumer Products division restructured mainly its digital media plants in order to reorganize digital media operations primarily in Japan. The accrued special termination benefits expensed during the year ended March 31, 2005 amounted to ¥8,080 million. The liabilities for special termination benefits amounting to ¥2,696 million were paid by March 2006. Total restructuring charges during the year ended March 31, 2005 amounted to ¥9,685 million.
3. High Functional Materials & Components division restructured its magnetic materials operations and cable operations in order to strengthen its management structure. The accrued special termination benefits expensed during the year ended March 31, 2005 amounted to ¥1,711 million and were paid by March 2005. Total restructuring charges during the year ended March 31, 2005 amounted to ¥3,945 million.

The following represent significant restructuring activities for the year ended March 31, 2004 by business line:

1. Power & Industrial Systems division restructured in order to address the general weakness in demand primarily in Japan. The accrued special termination benefits expensed during the year ended March 31, 2004 amounted to ¥1,414 million. The liabilities for special termination benefits amounting to ¥715 million were paid by March 2005. Total restructuring charges during the year ended March 31, 2004 consisted only of special termination benefits.
2. Digital Media & Consumer Products division restructured its consumer products plants and related distribution network in order to address the general weakness in consumer demand primarily, in Japan. The accrued special termination benefits expensed during the year ended March 31, 2004 amounted to ¥14,394 million. The liabilities for special termination benefits amounting to ¥26 million were paid by March 2005. Total restructuring charges during the year ended March 31, 2004 amounted to ¥17,760 million.
3. High Functional Materials & Components division restructured its semiconductor packaging materials operations because the business environment took a dramatic downturn in Japan. The accrued special termination benefits expensed during the year ended March 31, 2004 amounted to ¥2,347 million. The liabilities for special termination benefits amounting to ¥167 million were paid by March 2005. Total restructuring charges during the year ended March 31, 2004 amounted to ¥9,439 million.

## 21. OTHER INCOME AND OTHER DEDUCTIONS

The following items are included in other income or other deductions for the years ended March 31, 2006, 2005 and 2004.

|   | Millions of yen |         |          | Thousands of<br>U.S. dollars |
|---|-----------------|---------|----------|------------------------------|
|   | 2006            | 2005    | 2004     | 2006                         |
| Net gain on securities . . . . .  | <b>¥46,402</b>  | ¥46,463 | ¥130,175 | <b>\$396,598</b>             |
| Equity in earnings (losses) of affiliated companies . . . .                           | <b>8,688</b>    | (162)   | 10,120   | <b>74,256</b>                |
| Net gain (loss) on sale and disposal of rental assets<br>and other property . . . . . | <b>(3,107)</b>  | (9,545) | 1,715    | <b>(26,556)</b>              |
| Exchange gain (loss) . . . . .  | <b>4,000</b>    | 4,389   | (17,484) | <b>34,188</b>                |

Other income for the year ended March 31, 2005 includes a net gain of ¥14,422 million from issuance of stock by certain subsidiaries and affiliated companies which resulted in changes of the Company's ownership interest.

## 22. SALES OF STOCK BY SUBSIDIARIES OR AFFILIATED COMPANIES

In November 2004, Elpida Memory, Inc., an affiliated company which is a Japanese manufacturer of Dynamic Random Access Memory silicon chips, issued 29,150,000 shares of common stock at ¥3,325 per share to third parties with the initial public offering. In December 2004, Elpida Memory, Inc. issued 2,700,000 shares of common stock at ¥3,325 per share to a third party. As a result of the issuance of new shares, the Company's ownership interest of common stock decreased from 50.0% to 25.0% at March 31, 2005.

The Company provided deferred tax liability on this gain.

During the year ended March 31, 2006, the Company sold a portion of the investment in Elpida Memory, Inc. As a result, the Company discontinued the use of equity method accounting for the remaining investment.

## 23. NET INCOME PER SHARE INFORMATION

The reconciliations of the numbers and the amounts used in the basic and diluted net income per share computations are as follows:

|   | Number of shares     |               |               |
|---|----------------------|---------------|---------------|
|   | 2006                 | 2005          | 2004          |
| Weighted average number of shares on which basic net income per share is calculated . . . . . | <b>3,331,116,787</b> | 3,316,354,127 | 3,303,624,737 |
| Effect of dilutive securities:  |                      |               |               |
| Series A zero coupon convertible bonds . . . . .  | <b>54,619,248</b>    | 22,265,365    | –             |
| Series B zero coupon convertible bonds . . . . .  | <b>49,554,013</b>    | 22,265,365    | –             |
| Stock options . . . . .   | <b>143,341</b>       | 215,813       | 134,551       |
| Number of shares on which diluted net income per share is calculated . . . . .                | <b>3,435,433,389</b> | 3,361,100,670 | 3,303,759,288 |

  

|  | Millions of yen |         |         | Thousands of U.S. dollars |
|--|-----------------|---------|---------|---------------------------|
|  | 2006            | 2005    | 2004    | 2006                      |
| Net income applicable to common stockholders . . . . .                   | <b>¥37,320</b>  | ¥51,496 | ¥15,876 | <b>\$318,974</b>          |
| Effect of dilutive securities:   |                 |         |         |                           |
| Series A zero coupon convertible bonds . . . . .                         | <b>2</b>        | 1       | –       | <b>17</b>                 |
| Series B zero coupon convertible bonds . . . . .                         | <b>2</b>        | 1       | –       | <b>17</b>                 |
| Other . . . . .  | <b>(77)</b>     | (579)   | (192)   | <b>(658)</b>              |
| Net income on which diluted net income per share is calculated . . . . . | <b>¥37,247</b>  | ¥50,919 | ¥15,684 | <b>\$318,350</b>          |

  

|                       | Yen           |        |       | U.S. dollars  |
|-----------------------|---------------|--------|-------|---------------|
|                       | 2006          | 2005   | 2004  | 2006          |
| Net income per share: |               |        |       |               |
| Basic . . . . .       | <b>¥11.20</b> | ¥15.53 | ¥4.81 | <b>\$0.10</b> |
| Diluted . . . . .     | <b>10.84</b>  | 15.15  | 4.75  | <b>0.09</b>   |

The net income per share computation for the year ended March 31, 2004 excludes 6th and 7th series convertible debentures because their effect would have been antidilutive. The net income per share computation for the year ended March 31, 2005 excludes 7th series convertible debentures because their effect would have been antidilutive. 6th and 7th series convertible debentures were redeemed in September 2003 and September 2004, respectively.

## 24. SUPPLEMENTARY INCOME INFORMATION

|   | Millions of yen |                 |                 | Thousands of<br>U.S. dollars |
|---|-----------------|-----------------|-----------------|------------------------------|
|   | 2006            | 2005            | 2004            | 2006                         |
| Taxes other than income taxes consist of the following: |                 |                 |                 |                              |
| Property . . . . .                                      | ¥ 39,975        | ¥ 39,597        | ¥ 40,001        | \$ 341,667                   |
| Welfare . . . . .                                       | 204,124         | 192,763         | 199,630         | 1,744,649                    |
| Other . . . . .   | 25,551          | 22,890          | 12,969          | 218,385                      |
|   | <b>¥269,650</b> | <b>¥255,250</b> | <b>¥252,600</b> | <b>\$2,304,701</b>           |
| Maintenance and repairs . . . . .                       | ¥ 82,786        | ¥ 73,952        | ¥ 69,084        | \$ 707,573                   |
| Research and development expense . . . . .              | 405,079         | 388,634         | 371,825         | 3,462,214                    |
| Advertising expense . . . . .                           | 52,175          | 53,405          | 48,512          | 445,940                      |
| Rent . . . . .  | 149,241         | 137,179         | 142,649         | 1,275,564                    |

## 25. SUPPLEMENTARY CASH FLOW INFORMATION

|  | Millions of yen |          |         | Thousands of<br>U.S. dollars |
|--|-----------------|----------|---------|------------------------------|
|  | 2006            | 2005     | 2004    | 2006                         |
| Cash paid during the year for:   |                 |          |         |                              |
| Interest . . . . .   | ¥ 31,584        | ¥ 30,706 | ¥32,128 | \$ 269,949                   |
| Income taxes . . . . .   | 118,486         | 123,541  | 93,858  | 1,012,701                    |
| Noncash investing and financial activities:                              |                 |          |         |                              |
| Capitalized lease assets . . . . .                                       | ¥ 5,206         | ¥ 2,109  | ¥ 3,998 | \$ 44,496                    |
| Conversion of convertible debentures<br>issued by the Company . . . . .  | -               | 2        | 1       | -                            |
| Conversion of convertible debentures<br>issued by subsidiaries . . . . . | -               | 11,054   | 6,769   | -                            |

During the year ended March 31, 2005, the Company acquired and merged an affiliated company through exchange of equity securities procedure as shown in note 29.

The proceeds from sale of securities classified as available-for-sale discussed in note 4 are included in both decrease in short-term investments and proceeds from sale of investments and subsidiaries' common stock on the consolidated statements of cash flows.

## 26. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

### *Overall risk profile*

The major manufacturing bases of the Company and its subsidiaries are located in Japan and Asia. The selling bases are located globally, and the Company and its subsidiaries generate approximately 40% of their sales from overseas. These overseas sales are mainly denominated in the U.S. dollar or Euro. As a result, the Company and its subsidiaries are exposed to market risks from changes in foreign currency exchange rates.

The Company's financing subsidiaries in the U.K., the U.S. and Singapore issue variable rate medium-term notes mainly through the Euro markets to finance its overseas long-term operating capital. As a result, the Company and its subsidiaries are exposed to market risks from changes in foreign currency exchange rates and interest rates.

The Company and its subsidiaries are also exposed to credit-related losses in the event of non-performance by counterparties to derivative financial instruments, but it is not expected that any counterparties will fail to meet their obligations because most of the counterparties are internationally recognized financial institutions and contracts are diversified into a number of major financial institutions.

#### *Risk management policy*

The Company and its subsidiaries assess foreign currency exchange rate risk and interest rate risk by continually monitoring changes in these exposures and by evaluating hedging opportunities. It is the Company's principal policy that the Company and its subsidiaries do not enter into derivative financial instruments for speculation purposes.

#### *Foreign currency exchange rate risk management*

The Company and its subsidiaries have assets and liabilities which are exposed to foreign currency exchange rate risk and, as a result, they enter into forward exchange contracts and cross currency swap agreements for the purpose of hedging these risk exposures.

In order to fix the future net cash flows principally from trade receivables and payables recognized, which are denominated in foreign currencies, the Company and its subsidiaries on a monthly basis measure the volume and due date of future net cash flows by currencies. In accordance with the Company's policy, a certain portion of measured net cash flows is covered using forward exchange contracts, which principally mature within one year.

The Company and its subsidiaries enter into cross currency swap agreements with the same maturities as underlying debt to fix cash flows from long-term debt denominated in foreign currencies. The hedging relationship between the derivative financial instrument and its hedged item is highly effective in achieving offsetting changes in foreign currency exchange rates.

#### *Interest rate risk management*

The Company's and certain subsidiaries' exposure to interest rate risk is related principally to long-term debt obligations. Management believes it is prudent to minimize the variability caused by interest rate risk.

To meet this objective, the Company and certain subsidiaries principally enter into interest rate swaps to manage fluctuations in cash flows. The interest rate swaps entered into are receive-variable, pay-fixed interest rate swaps. Under the interest rate swaps, the Company and certain subsidiaries receive variable interest rate payments on long-term debt associated with medium-term notes and make fixed interest rate payments, thereby creating fixed interest rate long-term debt.

The Company and certain financing subsidiaries mainly finance a portion of their operations by long-term debt with a fixed interest rate and lend funds at variable interest rates. Therefore, such companies are exposed to interest rate risk. Management believes it is prudent to minimize the variability caused by interest rate risk. To meet this objective, the Company and certain financing subsidiaries principally enter into interest rate swaps converting the fixed rate to the variable rate to manage fluctuations in fair value resulting from interest rate risk. Under the interest rate swaps, the Company and certain financing subsidiaries receive fixed interest rate payments associated with medium-term notes and make variable interest rate payments, thereby creating variable-rate long-term debt.

The hedging relationship between the interest rate swaps and its hedged item is highly effective in achieving offsetting changes in cash flows and fair value resulting from interest rate risk.

#### **Fair value hedge**

Changes in fair value of both recognized assets and liabilities, and derivative financial instruments designated as fair value hedges of these assets and liabilities are recognized in other income (deductions). Derivative financial instruments designated as fair value hedges include forward exchange contracts associated with operating transactions, cross currency swap agreements and interest rate swaps associated with financing transactions.

Exchange gain for the year ended March 31, 2006 includes a net loss of ¥2,373 million (\$20,282 thousand) which represents the component excluded from the assessment of hedge effectiveness. The sum of the amount of hedge ineffectiveness is not material for the years ended March 31, 2006, 2005 and 2004.

Interest charges for the years ended March 31, 2006, 2005 and 2004 include a net gain of ¥1,192 million (\$10,188 thousand), net losses of ¥716 million and ¥1,098 million, respectively, which represent the component excluded from the assessment of hedge effectiveness. The sum of the amount of hedge ineffectiveness is not material for the years ended March 31, 2006, 2005 and 2004.

### **Cash flow hedge**

#### *Foreign currency exposure*

Changes in fair value of forward exchange contracts designated and qualifying as cash flow hedges of forecasted transactions are reported in accumulated other comprehensive income (AOCI). These amounts are reclassified into earnings in the same period as the hedged items affect earnings.

Exchange gain for the years ended March 31, 2006 and 2005 includes a net gain of ¥165 million (\$1,410 thousand) and a net loss of ¥351 million, respectively, which represent the component excluded from the assessment of hedge effectiveness. Exchange gain for the year ended March 31, 2006 includes a net loss of ¥119 million (\$1,017 thousand) which represents the component of the hedge ineffectiveness. The sum of the amount of the hedge ineffectiveness is not material for the years ended March 31, 2005 and 2004.

It is expected that a net loss of approximately ¥10 million (\$85 thousand) recorded in AOCI relating to existing forward exchange contracts will be reclassified into other income or other deductions during the year ending March 31, 2007.

As of March 31, 2006, the maximum length of time over which the Company and its subsidiaries are hedging their exposure to the variability in future cash flows associated with foreign currency forecasted transactions is approximately 33 months.

#### *Interest rate exposure*

Changes in fair values of interest rate swaps designated as hedging instruments for the variability of cash flows associated with long-term debt obligations are reported in AOCI. These amounts subsequently are reclassified into interest charges as a yield adjustment in the same period in which the hedged debt obligations affect earnings.

Interest charges for the years ended March 31, 2006 and 2004 include a net gain of ¥143 million (\$1,222 thousand) and a net loss of ¥356 million, respectively, which represent the component excluded from the assessment of hedge effectiveness. Net gain or loss excluded from the assessment of hedge effectiveness is not material for the year ended March 31, 2005. Interest charges for the years ended March 31, 2005 and 2004 include net losses of ¥202 million and ¥257 million, respectively, which represent the component of the hedge ineffectiveness. The sum of the amount of hedge ineffectiveness is not material for the year ended March 31, 2006.

It is expected that a net gain of approximately ¥81 million (\$692 thousand) recorded in AOCI related to the interest rate swaps will be reclassified into interest charges as a yield adjustment of the hedged debt obligations during the year ending March 31, 2007.

The contract or notional amounts of derivative financial instruments held as of March 31, 2006 and 2005 are summarized as follows:

|                                      | Millions of yen |          | Thousands of<br>U.S. dollars |
|--------------------------------------|-----------------|----------|------------------------------|
|                                      | 2006            | 2005     | 2006                         |
| Forward exchange contracts:          |                 |          |                              |
| To sell foreign currencies . . . . . | <b>¥310,941</b> | ¥282,333 | <b>\$2,657,615</b>           |
| To buy foreign currencies . . . . .  | <b>65,091</b>   | 62,104   | <b>556,333</b>               |
| Cross currency swap agreements:      |                 |          |                              |
| To sell foreign currencies . . . . . | <b>101,456</b>  | 91,732   | <b>867,145</b>               |
| To buy foreign currencies . . . . .  | <b>147,237</b>  | 148,007  | <b>1,258,436</b>             |
| Interest rate swaps . . . . .        | <b>446,823</b>  | 571,395  | <b>3,819,000</b>             |
| Option contracts . . . . .           | <b>13,852</b>   | 19,152   | <b>118,393</b>               |

## 27. CONCENTRATIONS OF CREDIT RISK

The Company and its subsidiaries generally do not have significant concentrations of credit risk to any counterparties nor any regions because they are diversified and spread globally.

## 28. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions are used to estimate the fair values of financial instruments:

### *Investments in securities*

The fair value of investments in securities is estimated based on quoted market prices for these or similar securities.

### *Long-term debt*

The fair value of long-term debt is estimated based on quoted market prices or the present value of future cash flows using the Company's and its subsidiaries' incremental borrowing rates for similar borrowing arrangements.

### *Cash and cash equivalents, Trade receivables, Short-term debt and Trade payables*

The carrying amount approximates the fair value because of the short maturity of these instruments.

### *Derivative financial instruments*

The fair values of forward exchange contracts, cross currency swap agreements, interest rate swaps and option contracts are estimated on the basis of the market prices of derivative financial instruments with similar contract conditions.

The carrying amounts and estimated fair values of the financial instruments as of March 31, 2006 and 2005 are as follows:

|  | Millions of yen  |                       |                  |                       | Thousands of U.S. dollars |                       |
|--|------------------|-----------------------|------------------|-----------------------|---------------------------|-----------------------|
|  | 2006             |                       | 2005             |                       | 2006                      |                       |
|  | Carrying amounts | Estimated fair values | Carrying amounts | Estimated fair values | Carrying amounts          | Estimated fair values |
| Investments in securities:               |                  |                       |                  |                       |                           |                       |
| Short-term investments . . . . .         | ¥ 162,756        | ¥ 162,756             | ¥ 146,568        | ¥ 146,568             | \$ 1,391,077              | \$ 1,391,077          |
| Investments and advances . . . . .       | 448,614          | 448,631               | 315,129          | 315,143               | 3,834,308                 | 3,834,453             |
| Derivatives (Assets):                    |                  |                       |                  |                       |                           |                       |
| Forward exchange contracts . . . . .     | 1,429            | 1,429                 | 683              | 683                   | 12,214                    | 12,214                |
| Cross currency swap agreements . . . . . | 354              | 354                   | 1,109            | 1,109                 | 3,026                     | 3,026                 |
| Interest rate swaps . . . . .            | 1,960            | 1,960                 | 1,407            | 1,407                 | 16,752                    | 16,752                |
| Option contracts . . . . .               | 11               | 11                    | –                | –                     | 94                        | 94                    |
| Long-term debt . . . . .                 | (1,666,517)      | (1,639,779)           | (1,825,895)      | (1,826,562)           | (14,243,735)              | (14,015,205)          |
| Derivatives (Liabilities):               |                  |                       |                  |                       |                           |                       |
| Forward exchange contracts . . . . .     | (3,423)          | (3,423)               | (5,211)          | (5,211)               | (29,256)                  | (29,256)              |
| Cross currency swap agreements . . . . . | (8,764)          | (8,764)               | (6,478)          | (6,478)               | (74,906)                  | (74,906)              |
| Interest rate swaps . . . . .            | (3,067)          | (3,067)               | (5,603)          | (5,603)               | (26,214)                  | (26,214)              |
| Option contracts . . . . .               | (824)            | (824)                 | (237)            | (237)                 | (7,043)                   | (7,043)               |

It is not practicable to estimate the fair value of investments in unlisted common stock because of the lack of a market price and difficulty in estimating fair value without incurring excessive cost. The carrying amounts of these investments at March 31, 2006 and 2005 totaled ¥79,321 million (\$677,957 thousand) and ¥77,755 million, respectively.

## 29. MERGER AND ACQUISITION

On May 25, 2004, the Company signed a merger agreement with TOKICO LTD. (TOKICO) and Hitachi Unisia Automotive, Ltd. and, on October 1, 2004, acquired full ownership of TOKICO by exchanging 0.521 of the Company's treasury stock for each of TOKICO's common stocks outstanding. Before the transaction, the Company and certain subsidiaries had owned approximately 42% of TOKICO, which had been accounted for under the equity method. The Company and TOKICO obtained third party appraisals of the respective share prices which were used as a basis of negotiation over the share exchange ratio. On October 1, 2004, the Company issued 33,937,141 shares of treasury stock, in the amount of ¥28,134 million calculated by using the quoted market price of ¥829 per share as of the announcement date, March 26, 2004, for the exchange with the TOKICO's shareholders registered as of September 30, 2004. As a result, ¥12,509 million of gains on stock exchange upon the merger was credited to capital surplus.

TOKICO manufactures automotive components and pneumatic equipment. The Company has strategically targeted the automotive products business and the purpose of the merger with TOKICO is to further expand this business.

The effects of the merger to the Company's consolidated financial position as of October 1, 2004 were not material. On a pro forma basis, revenue, net income and the per share information of the Company with an assumed merger date for TOKICO of April 1, 2004 and 2003 would not differ materially from the amount reported in the accompanying consolidated financial statements as of and for the years ended March 31, 2005 and 2004.

## 30. STOCK OPTION PLANS

The Company and certain subsidiaries have stock option plans. Under the Company's stock option plans, non-employee directors, executive officers and certain employees have been granted stock options to purchase the Company's common stock. Under these stock option plans, options were granted at prices not less than market value at the date of grant and are exercisable from one year after the date of grant and expire four or five years after the date of grant. The Company and certain subsidiaries recognized no material stock-based compensation expense for the years ended March 31, 2006, 2005 and 2004.

A summary of the Company's stock option plans activity for the years ended March 31, 2006, 2005 and 2004 is as follows:

|  | 2006                      |  | 2005                      |  | 2004                      |  | 2006                                       |
|--|---------------------------|--|---------------------------|--|---------------------------|--|--|
|  | Stock options<br>(shares) | Weighted-<br>average<br>exercised<br>price | Stock options<br>(shares) | Weighted-<br>average<br>exercised<br>price | Stock options<br>(shares) | Weighted-<br>average<br>exercised<br>price | Weighted-<br>average<br>exercised<br>price |
| Outstanding at beginning of year . . . | <b>2,691,000</b>          | <b>¥ 869</b>                               | 2,194,000                 | ¥ 866                                      | 1,165,000                 | ¥1,314                                     | <b>\$ 7</b>                                |
| Granted . . . . .                      | <b>1,201,000</b>          | <b>719</b>                                 | 1,278,000                 | 780  | 1,305,000                 | 561  | <b>6</b>                                   |
| Exercised . . . . .                    | <b>(220,000)</b>          | <b>589</b>                                 | (585,000)                 | 561  | -                         | -  | <b>5</b>                                   |
| Forfeited . . . . .                    | <b>(322,000)</b>          | <b>953</b>                                 | (196,000)                 | 1,174                                      | (276,000)                 | 1,315                                      | <b>8</b>                                   |
| Expired . . . . .                      | <b>(184,000)</b>          | <b>1,451</b>                               | -                         | -  | -                         | -  | <b>12</b>                                  |
| Outstanding at end of year . . . . .   | <b>3,166,000</b>          | <b>¥ 789</b>                               | 2,691,000                 | ¥ 869                                      | 2,194,000                 | ¥ 866                                      | <b>\$ 7</b>                                |

Weighted-average remaining

|  |                         |                  |                |
|--|-------------------------|------------------|----------------|
| contractual life . . . . .             | <b>2.3 years</b>        | 2.5 years        | 2.8 years      |
| Options exercisable at end of year . . | <b>1,965,000 shares</b> | 1,413,000 shares | 889,000 shares |

The exercise prices of the stock options outstanding as of March 31, 2006 are ¥1,270 (\$10.85), ¥561 (\$4.79), ¥782 (\$6.68), ¥705 (\$6.03) and ¥719 (\$6.15).

The Compensation Committee decided to cease granting stock options as part of the Company's compensation policy at the meeting held on March 30, 2006.