Kyokuto Kaihatsu Kogyo Co., Ltd.

Annual Report 2004

Year ended March 31, 2004

FINANCIAL HIGHLIGHTS

Years ended March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	**2004**
For the Year:			
Net Sales	**57,428**	55,269	**548,556**
Operating income	**3,163**	1,759	**30,219**
Net income	**1,328**	201	**12,690**
At Year-end:			
Total assets	**85,566**	78,943	**817,329**
Total shareholders' equity	**55,172**	52,737	**527,006**

	Yen		U.S. dollars (Note 1)
	2004	2003	**2004**
Amounts per Share of Common Stock (Note 2)**:**			
Net Income	**45.73**	5.94	**0.44**
Cash dividend attributable to the year	**10.00**	6.00	**0.10**

Note 1. U.S. dollar amounts are translated for convenience only, at the rate of ¥104.69 to US$1.

2. The computations of net income per share of common stock are based on the weighted average number of shares outstanding during each year.

CONTENTS

TO OUR SHAREHOLDERS

Katsushi Tanaka

1. Summary of Operations

We are pleased to report the business results of Kyokuto Kaihatsu Kogyo Co., Ltd. For the year ending March 31, 2004.

(1) Business Results

Japanese economy during the first half of this fiscal year showed a slow recovery because of struggling employment situation and consumer spending as well as uncertain international situations. However during the second half of the year, it had an increasing economic resurgence with a sign of recovery in stock market and corporate investment backed up by well-conditioned export markets and improved corporate performance.

The environments surrounding our special purpose vehicle business created in our domestic market a drastic replacement demands with a central focus on Tokyo metropolitan area mainly because of gaseous mission control enforcement on diesel trucks. For export markets, a demand for construction vehicles made a good progress in China where active investment demands are still continuing.

Our environmental business has experienced fierce competition due to buying restraint after the enforcement of anti-dioxin and cash-strapped public finances of local governments, which resulted in rugged environments for order entry.

Such being the circumstances, we have tried to expand our corporate value by efficient capital operation and improved profitability in the framework of the last year of our Medium-Term Management Planning "Plan 2001," which was started in April 2001. In this direction, we have made every effort to improve the business performance by strengthening the sales forces for increasing demands of Tokyo metropolitan area backed-up by gaseous emission control, expanding export business, reducing costs, developing new products, strengthening sales and service forces, promoting more effective use of resources, etc.

Our business results in the consolidated basis thus achieved in this fiscal year are shown below in comparison with the last year: The sales revenue is 57,428 million yen achieving year-on-year increase of 2,158 million yen (+4%) mainly because of the increases of special purpose vehicles sales while the plant construction of environmental business being decreased. The ordinary income is 2,918 million yen achieving year-on-year drastic increase of 1,293 million yen (+80%) along with the sales increase of special purpose vehicle segment. The net income is 1,328 million yen achieving year-on-year increase of 1,126 million yen.

The summary of each business segment in the consolidated basis is reported below in comparison with the last fiscal year.

1. Specialty Truck Division

Demands for special purpose vehicles drastically increased in Japan with a central focus on Tokyo metropolitan area due to the gaseous emission control for the diesel trucks that was enforced in October last year.

We reinforced our sales forces in Tokyo metropolitan area and promoted sales tie-up and OEM with the competitors. We also made the effort to expand the sales and to improve the profitability through the various effective measures: reducing the cost by material procurement from China, strengthening the product-line up by developing new products, enhancing the service structure, etc.

Consequently, most of our main product segments experienced a large-scale increase of sales: construction segment (dump truck, concrete pump truck, mixer truck, etc.), distribution and energy saving segment (Bulk Carrier, tank lorry, tail-gate lifter, car carrier, etc.), environment and civil work segment (garbage collector, detachable body truck, other special purpose truck, multistory car park, etc.), and spare parts/repair services, etc.

Our export business enjoyed steady sales by focusing on construction related business such as mixer trucks and concrete pump trucks mainly for China.

Consequently, the sales revenue is 39,058 million yen achieving year-on-year increase of 6,725 million yen (+21%). The operating income is 1,896 million yen achieving year-on-year increase of 1,723 million yen (+996%) as the results of sales increase and cost reduction effect.

2. Environmental Equipment and Systems Division

In a difficult market situation, our environmental equipment and systems business made every effort to maintain the appropriate level of the sales and orders received through various sales activities in recycle plaza and recycle center that are our mainline business, plant-related equipment such as RDF (Refuse Derived Fuel) equipment and leachate treatment facilities in final disposal sites, contracted business for maintenance and operation. Besides, we worked on actively R&D and sales of Refuse Gasification and Melting System, next generation incinerator whose prospective demands can be well expected.

As a result, we received 3 plant construction orders including recycle plaza amounting 10,835 million yen achieving year-on-year increase of 554 million yen (+5%). The sales revenue is 10,246 million yen resulting in year-on-year decrease of 4,586 million yen (-31%) due to the plant construction order decrease while the contracted business for maintenance and operation being kept at the same level of sales as the last year. The operating income is 534 million yen resulting in year-on-year decrease of 715 million yen (-57%) due to the sales decrease.

3. Automobile Sales Division

For automobile sales division, we have enhanced sales and service capabilities including renewal of the shops as well as made every effort of cost reduction to improve the profitability. However, new vehicle sales decreased due to diminishing consumer spending. Consequently the sales revenue is 6,086 million yen resulting in year-on-year decrease of 444 million yen (-7%). The operating income is 17 million yen achieving year-on-year increase of 89 million yen from the last year's operating loss of 71 million yen.

4. Real Estate Leasing Division

Besides the real estate leasing, this business is also developing coin parking business in order to secure stable income through more effective use of idle properties. In this year, leasing income of Kanagawa Ryutsu Center in Atsugi city that started in September 2003 and increased sales of coin parking business contributed in the operation of this business. The sales revenue is 2,456 million yen achieving year-on-year increase of 505 million yen (+26%). The operating income is 692 million yen achieving year-on-year increase of 301 million yen (+77%).

(2) Financial standing

1. Asset, debt, and capital standings

We report below the financial standing as of the end of this consolidated accounting year. The total asset is 85,566 million yen making year-on-year increase of 6,622 million yen (+8%).

The current asset is 46,057 million yen making year-on-year increase of 4,216 million yen (+10%). The main factors causing this change are; accounts receivable decrease of 2,849 million yen due to payment received of the construction related to environmental business, bills receivable increase of 1,850 million yen and inventory assets increase of 1,741 million yen due to the increased sales and orders received in special purpose vehicle business, and securities increase obtained by surplus funds of 2,215 million yen.

The fixed asset is 39,508 million yen making year-on-year increase of 2,406 million yen (+6%). The main factors are; tangible fixed assets increase of 776 million yen caused by the construction of Kanagawa Ryutsu Center and Yokohama Service Center, investment and other assets increase of 1,630 million yen due to investment securities increase by stock market improvement.

The total debt is 30,393 million yen making year-on-year increase of 4,398 million yen (+17%). The current liability increased by 2,338 million yen (+12%) because of unpaid corporate tax increase, etc. The fixed liability increased by 2,060 million yen (+29%) because of increased long-term debt and deferred tax liability. The capital stock is 55,172 million yen making year-on-year increase of 2,434 million yen (+5%) due to the declaration of this year's net income and the increased variance of the estimated securities.

The return on equity (ROE) as of the end of this consolidated fiscal year is 64% (67% at the end of last year).

2. State of Cash Flow

The cash and cash equivalent as of the end of this consolidated fiscal year is 12,724 million yen making increase of 2,265 million yen (+22%) from the balance at the beginning of the year. The breakdown of the total is as follows.

<Cash Flow from Operating Activities>

Operating activities have resulted in cash inflow of 3,287 million yen (year-on-year increase of 3,618 million yen). This is due to increased current net income before tax created by the substantial increase of our mainline products; special purpose vehicle, and the improved profitability of our whole group operations, besides well-off collection of accounts receivable and increased payable accounts of purchase.

<Cash Flow from Investing Activities>

Investing activities have resulted in cash outflow of 2,109 million yen (year-on-year increase of cash inflow of 1,565 million yen). This is due to the expenditures to obtain the fixed assets; construction of Yokohama Service Center for special purpose vehicle business and of Kanagawa Ryutsu Center for real estate leasing business while income by the sale of securities being obtained.

<Cash Flow from Financing Activities>

Financing activities have resulted in cash inflow of 1,095 million yen (year-on-year increase of cash inflow of 1,558 million yen). This is due to financial income caused by long-term borrowing while expenditures being occurred to obtain common stock for treasury (treasury stock) and to pay the dividend to stockholders.

(3) Concept and Practice related to Corporate Governance

1. Basic policies on corporate governance

Our company group is now implementing reorganization of management system aiming at expanding our value of the enterprise by conducting speedy decisions on management policies and strategies to react appropriately to the changing business environment, by strengthening the executive system to implement speedily and timely the said policies and strategies. We are also reinforcing our audit and supervisory functions for thorough compliance with the legal imperatives and regulations in the process from decision-making to its execution. We well recognize that it is our important managerial task to keep good relationship with various stake-holders; stockholders, customers, local society, and employees by enhancing our corporate ethics and realizing rightly our role as a corporation and a member of our society through our healthy corporate activities.

On such viewpoint, we are sure to develop our company by enhancing, improving, and maintaining not only the juridical functions and regulations such as general meeting of shareholders, board meeting, board of auditors, and accounting auditor but also our voluntary regulations such as company regulations.

2. Practice related to corporate governance

We are conducting renewed business operation based on new management framework having operating officer system that was introduced in June 2002. According to this change, we have reduced the limit number of directors set in the corporation charter from 20 to 12 directors in order to optimize the number of board members and to execute speedy decision makings. As of March 31st, 2004, there are 10 directors and 16 operating officers (including 9 concurrent directors). We are planning to propose an agenda to change the number of directors from 10 to 7 reducing 3 members at the fixed general meeting to be held on June 29, 2004. This is to speed up further our business judgment. We have also shortened the term of directors of our company and all our affiliated companies to one year from two years that is stipulated by the Commercial Law. This is to activate further the board meeting.

Our group does not appoint any outside board members. However, as far as the auditing system concerns, we have implemented 4 auditors system including 2 outside auditors to enhance the audit and supervisory functions.

For administrative decision making, the board meeting is held once a month and the management committee twice a month. There, with attendance of the auditors, the board members deliberate and decide the management policies and strategies. We also hold contingent board meeting as occasion arises.

For execution control, the business operation meeting consisting of operation officers is held once a month to execute the business plan and management policy as well as to assure the planned performances.

For accounting auditors, we have appointed Yuko Audit Corporation and concluded a contract with them. We disclose accordingly our business conditions and are subject to accounting audit for fair accounting practices.

For the judgment relating to legal problems and issues such as contract and lawsuit, we have established a system to obtain appropriate advices if necessary through legal aid service organized by our corporate lawyers.

June, 2004

Katsushi Tanaka

Katsushi Tanaka
President

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

Years ended March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	**2004**
Net sales	**57,428**	55,269	**548,556**
Cost of sales	**44,687**	44,481	**426,854**
Gross profit	**12,741**	10,788	**121,702**
Selling, general and administrative expenses	**9,577**	9,028	**91,483**
Operating income (loss)	**3,163**	1,759	**30,219**
Other income (expenses)			
Interest and dividend income	**62**	45	**599**
Interest expenses	**(96)**	(94)	**(925)**
Gain (loss) on sales of property and equipment	**(114)**	776	**(1,090)**
Gain (loss) on sales of securities	**290**	(142)	**2,771**
Write-down of investment securities	**(1)**	(2,003)	**(11)**
Special research and development expenditures	**(539)**	—	**(5,153)**
Other-net	**(257)**	187	**(2,456)**
Income (loss) before income taxes	**2,507**	528	**23,953**
Income taxes (Note 12)			
current	**1,560**	290	**14,903**
deferred (prepaid), net	**(375)**	52	**(3,584)**
Total income taxes	**1,185**	343	**11,319**
Minority interest	**(5)**	(17)	**(55)**
Net income (loss)	**1,328**	201	**12,690**
Retained earnings:			
Balance at beginning of period	**29,642**	29,645	**283,145**
Cash dividends paid	**(194)**	(169)	**(1,854)**
Bonuses to directors and statutory auditors	**(34)**	(26)	**(330)**
Adjustment of retained earnings for eliminations of treasury stock	**—**	(8)	**0**
Balance at end of period	**30,742**	29,642	**293,650**
	Yen		U.S. dollars
Per share of common stock:			
Net income (loss)	**46.05**	5.94	**0.44**
Diluted net income (loss)	**45.73**	5.94	**0.44**
Cash dividend, applicable to earnings of the year	**10.00**	6.00	**0.10**

The accompanying notes are an integral part of this statements.

CONSOLIDATED BALANCE SHEETS

Years ended March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	**2004**
ASSETS			
Current assets:			
Cash and time deposits	**5,961**	5,911	**56,946**
Short-term investments (Note 3)	**6,832**	4,616	**65,262**
Trade note and accounts receivable	**23,945**	24,836	**228,723**
Less: Allowance for doubtful accounts	**(181)**	(64)	**(1,737)**
Inventories	**7,169**	5,428	**68,486**
Deferred income taxes (Note 12)	**993**	555	**9,485**
Prepaid expenses	**91**	69	**870**
Other current assets	**1,246**	487	**11,905**
Total current assets	**46,057**	41,841	**439,944**
Investments and other assets:			
Investments in securities (Note 3)	**5,417**	3,575	**51,743**
Deferred income taxes (Note 12)	**284**	282	**2,722**
Other	**3,579**	3,793	**34,192**
Total investments and other assets	**9,281**	7,650	**88,658**
Property and equipment:			
Land	**12,386**	12,386	**118,311**
Buildings and structures	**26,029**	24,228	**248,637**
Machinery and equipment	**7,111**	6,953	**67,931**
Construction in progress	**215**	576	**2,056**
Other	**2,257**	2,254	**21,562**
	48,000	46,398	**458,499**
Less — Accumulated depreciation	**(18,044)**	(17,219)	**(172,359)**
Total property and equipment	**29,955**	29,179	**286,139**
Intangible assets			
Cost in excess of net assets of subsidiaries	**24**	40	**229**
Other	**246**	232	**2,357**
Total intangible assets	**270**	272	**2,586**
Total assets	**85,566**	78,943	**817,329**

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	**2004**
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Short-term bank loans (Note 4)	**2,955**	2,608	**28,227**
Current portion of long-term debt (Note 4)	**32**	98	**312**
Trade note and account payable	**13,101**	12,354	**125,146**
Accrued income and other taxes	**1,597**	706	**15,259**
Accrued expenses	**1,946**	1,758	**18,595**
Other current liabilities	**1,653**	1,424	**15,797**
Total current liabilities	**21,287**	18,949	**203,338**
Long-term liabilities:			
Long-term debt (Note 4)	**1,137**	112	**10,865**
Accrued retirement benefits (Note 5)	**1,802**	1,726	**17,213**
Directors' and statutory auditors' retirement benefits	**301**	341	**2,878**
Net assets of subsidiaries in excess of cost	**—**	1	**—**
Deferred income taxes (Note 12)	**1,145**	286	**10,942**
Other long-term liabilities	**4,719**	4,578	**45,083**
Total long-term liabilities	**9,106**	7,045	**86,984**
Minority interests	**—**	210	**—**
Shareholders' equity:			
Common stock, no par value (Note 10)			
Authorized — 117,708,100 shares			
Issued — 28,326,779 shares in 2004 and 28,165,779 shares in 2003	**11,842**	11,786	**113,119**
Additional paid-in capital (Note 10)	**11,661**	11,508	**111,390**
Retained earnings	**30,742**	29,642	**293,650**
Net unrealized holding gains on securities	**1,231**	70	**11,762**
Foreign currency translation adjustments	**(28)**	—	**(271)**
Treasury stock, at cost	**(276)**	(270)	**(2,644)**
Total shareholders' equity	**55,172**	52,737	**527,006**
Total liabilities and shareholders' equity	**85,566**	78,943	**817,329**

CONSOLIDATED STATEMENT OF CASH FLOWS

Years ended March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	**2004**
Operating activities:			
Net income before income taxes	**2,507**	528	**23,953**
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	**1,373**	1,301	**13,123**
Write-down of investment securities	**45**	2,049	**431**
Net gains (loss) on sales of marketable securities and investments	**(290)**	124	**(2,771)**
Net gains (loss) on sales of property	**57**	(788)	**551**
Provision (reversal) for accrued retirement benefits	**38**	98	**368**
Interest and dividend income	**(62)**	(45)	**(599)**
Interest expenses	**96**	94	**925**
Decrease (increase) in accounts receivable	**576**	(3,998)	**5,510**
Decrease (increase) in inventories	**(1,741)**	(3)	**(16,638)**
Decrease (increase) in prepaid expenses	**230**	(247)	**2,200**
Decrease (increase) in accounts payable	**991**	2,216	**9,471**
Decrease (increase) in accrued expenses	**248**	(388)	**2,374**
Decrease (increase) in income taxes payable	**(406)**	374	**(3,883)**
Other,net	**780**	(1,181)	**7,459**
Sub total	**4,446**	133	**42,475**
Interest and dividend income received	**61**	42	**588**
Interest expenses paid	**(31)**	(29)	**(303)**
Income taxes paid	**(262)**	(434)	**(2,505)**
Other,net	**(926)**	(42)	**(8,850)**
Net cash provided by operating activities	**3,287**	(330)	**31,404**
Investing activities:			
Decrease (increase) in time deposits	**—**	—	**—**
Payment for purchase of marketable securities and investments	**(367)**	(1,791)	**(3,505)**
Proceeds from sales of marketable securities and investments	**770**	492	**7,357**
Payment for purchase of facilities	**(2,551)**	(3,141)	**(24,371)**
Proceeds from sale of facilities	**66**	1,159	**631**
Disbursement of loan receivables	**(22)**	(401)	**(213)**
Collection of loan receivables	**8**	7	**76**
Net cash provided by (used in) investing activities	**(2,096)**	(3,675)	**(20,024)**
Financing activities:			
Increase (decrease) in short-term debt	**330**	180	**3,152**
Proceeds from long-term debt	**1,068**	—	**10,201**
Payment on long-term debt	**(107)**	(98)	**(1,028)**
Proceeds from issuance of common stock	**111**	0	**1,068**
Purchases of treasury stock	**(112)**	(375)	**(1,078)**
Dividends paid	**(194)**	(170)	**(1,855)**
Net cash provided by (used in) financing activities	**1,095**	(463)	**10,460**
Effect of exchange rate change on cash and cash equivalents	**(21)**	—	**(197)**
Net increase in cash and cash equivalents	**2,266**	(4,469)	**21,642**
Cash and cash equivalents at beginning of year	**10,458**	14,927	**99,898**
Increase in cash and cash equivalents by increase of number of consolidated subsidiaries	**—**	—	**—**
Cash and cash equivalents at end of year	**12,724**	10,458	**121,540**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presenting Consolidated Financial Statements

Kyokuto Kaihatsu Co.,Ltd (the "Company") and its domestic subsidiaries maintain their accounts and records in accordance with the provisions set forth in the Commercial Code of Japan (the "Code") and the Securities and Exchange Law and in conformity with accounting principles and practices generally accepted in Japan.

The accompanying consolidated financial statements are prepared based on the consolidated financial statements of the Company and its subsidiaries (the "Group") which were filed with the Director of Kanto Local Finance Bureau as required by the Securities and Exchange Law.

In preparing the accompanying consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan.

The translation of the Japanese yen amounts into U.S. dollars is included solely for the convenience of the reader, using the approximate exchange rate at March 31, 2004, which was ¥104.69 to US$1.00. These convenience translations should not be construed as representations that the Japanese yen amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any other rate of exchange.

As permitted by the regulations under the Securities and Exchange Law of Japan, amounts of less than one million yen have been omitted. As a result, the totals shown in the accompanying consolidated financial statements (both in yen and in U.S.dollars) do not necessarily agree with the sums of the individual amounts.

2. Summary of Significant Accounting Policies

(a) Consolidation Principles:

The consolidated financial statements include the accounts of the Company and its significant subsidiaries in accordance with the Securities and Exchange Law and related regulations of Japan. The minor differences arising from the cost of the companies' investments in subsidiaries and affiliates over the equity in their net assets at fair value are charged or credited to income in the year of acquisition. Significant differences are, as a rule, amortized over periods of 5 years. All significant inter-company accounts and transactions have been eliminated.

Investments in associates are accounted for by the equity method whereby the Group includes in net income its share of income or losses of these companies, and records its investments at cost adjusted for its share of income, losses or dividends received.

(b) Consolidated Statement of Cash Flows:

In preparing the consolidated statements of cash flows, cash on hand, readily-available deposits and short-term highly liquid investments with maturity of not exceeding three months at the time of purchase are considered to be cash and cash equivalents.

(c) Short-term investments and Investments in Securities:

For the Accounting Standards for Financial Instruments which was issued by the Business Accounting Deliberation Council, securities are classified into three categories: trading securities, held-to-maturity debt securities, equity investments in associates and other securities.

Those classified as other would be reported at fair value with unrealized gains, net of related taxes reported in equity. Under the Code, unrealized holding gains on securities, net of related taxes is not available for distribution as dividends and bonuses to directors and corporate auditors.

Other investments are carried at cost. The cost is determined by the moving average method.

(Trading securities)

Trading securities are held for resale in anticipation of short-term market movements. Trade securities, consisting of debt and marketable equity securities, are stated at fair value. Gains and losses, both realized and unrealized, are charged to income.

(Held-to-maturity debt securities and other securities)

Management determines the appropriate classification of debt securities at the time of purchase and reevaluates the classification as of each balance sheet date. Debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. Held-to-maturity debt securities are stated at amortized cost adjusted for the amortization of premiums and the accretion of discounts to maturity.

Marketable equity securities and debt securities not classified as held-to-maturity are classified as other securities. Other securities are carried at fair value with the unrealized gains and losses, net of tax, reported in a separate component of shareholders' equity. The amortized cost of debt securities in this category is adjusted for the amortization of premiums and the accretion of discounts to maturity. Realized gains and losses and declines in value judged to be other than temporary on other securities are charged to income.

(Golf club membership)

An impairment loss on deposits for golf club membership is required to be recognized in accordance with the new standard.

(d) Inventories:

Merchandise inventories are stated at cost, determined by the specific identification method. Materials and work in process are stated at cost, determined by the periodic average method. Supplies are stated at cost, determined by the last purchase cost method.

(e) Depreciation:

Depreciation is principally computed on the declining-balance method, based on the estimated useful lives of assets which are prescribed by Japanese income tax laws. Buildings are depreciated on a straight-line basis.

Amortization of intangible assets is computed by the straight-line method over periods prescribed primarily by the Japanese Commercial Code or Japanese income tax laws.

(f) Stock and bond issue expenses:

Stock and bond issue expenses are charged to income as incurred.

(g) Accrued Retirement Benefits:

To provide for the payment of retirement benefits and pension plans to employees, the Company and certain consolidated subsidiaries have entered an amount into a reserve equivalent to the amount recognized as necessary at the end of the period under review based on the expected retirement and severance obligations and the assets of pension plans at fiscal year-end.

The Company and its domestic subsidiaries provide for lump-sum severance benefits with respect to directors and corporate auditors. While the Company has no legal obligation, it is a customary practice in Japan to make lump-sum payments to a director or a corporate auditor upon retirement. Annual provisions are made in the accounts for the estimated costs of this termination plan, which is not funded. Any amounts payable to officers upon retirement are subject to approval at the shareholders' meeting.

(h) Construction Contract:

The construction contract takes longer than one year and the contract amount exceeded ¥0.5 billion, the percentage of completion method is applied.

(i) Leases:

In Japan finance leases other than those that are deemed to transfer the ownership of the leased assets to lessees are accounted for by a method similar to that applicable to ordinary operating leases.

(j) Research and Development and Computer Software:

Research and development expenditure is charged to income when incurred.

Expenditure relating to computer software developed for internal use is charged to income when incurred, except if it contributes to the generation of income or to future cost savings. Such expenditure is capitalized as an asset is amortized using the straight-line method over its estimated useful life which is in the range of 3 to 5 years.

(k) Income Taxes:

Income taxes consist of corporation, inhabitants and enterprise taxes for domestic companies and foreign income taxes.

Deferred income taxes are provided for the income tax expenses under the asset and liability method. Deferred income tax assets and liabilities are determined based on temporary differences between the financial statements and tax bases of assets and liabilities, using enacted tax rates in effect during the years in which the differences are expected to reverse, and on available tax credits carryforward.

(l) Per Share Information

The computation of basic net income per share is based on the weighted average number of shares of common stock outstanding during each period. The average number of shares used in the computation was 27,784 thousand shares for 2004 and 28,098 thousand shares for 2003.

For the year ended 31, 2004 and 2003, fully diluted net income per share of common stock assumes full exercise of right of the outstanding stock option plan at the beginning of the year.

Cash dividends per share shown in the statements of income are the amounts applicable to the respective years.

3. Short-Term Investments, Investments in Securities and Investments in and Advances to associates:

Short-term securities at March 31, 2004 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Market value available:			
Trading securities	¥ 101	¥ 101	$ 966
Market value not available:			
M.M.F. and F.F.F.	¥6,701	¥4,515	$64,010
Other investment trust	30	—	287
Total	¥6,832	¥4,616	$65,262

The following is a summary of other securities at March 31, 2004 and 2003:

	Millions of yen			
	March 31, 2004			
	Other securities			
	Cost	Gross unrealized gains	Gross unrealized losses	Book Value (Estimated fair value)
Market value available:				
Equity securities	¥ 2,292	¥ 2,118	¥ 43	¥ 4,367
Bonds and debentures ...	—	—	—	—
Other securities	—	—	—	—
	¥ 2,292	¥ 2,118	¥ 43	¥ 4,367
Market value not available				1,050
Total				¥ 5,417

	Millions of yen			
	March 31, 2003			
	Other securities			
	Cost	Gross unrealized gains	Gross unrealized losses	Book Value (Estimated fair value)
Market value available:				
Equity securities	¥ 2,383	¥ 256	¥ 135	¥ 2,504
Bonds and debentures ...	—	—	—	—
Other securities	—	—	—	—
	¥ 2,383	¥ 256	¥ 135	¥ 2,504
Market value not available				1,070
Total				¥ 3,575

	Thousands of U.S. dollars			
	March 31, 2004			
	Other securities			
	Cost	Gross unrealized gains	Gross unrealized losses	Book Value (Estimated fair value)
Market value available:				
Equity securities	$21,898	$20,237	$ 417	$41,719
Bonds and debentures ...	—	—	—	—
Other securities	—	—	—	—
	$21,898	$20,237	$ 417	$41,719
Market value not available				10,036
Total				$51,755

4. Short-term bank loans and long-term debt:

The annual average interest rates applicable to short-term bank loans at March 31, 2004 and 2003 are 0.81% and 0.86%, respectively.

Long-term debt at March 31, 2004 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
0.75% bank loans due 2005	¥ 32	¥ 98	$ 312
0.61% bank loans due 2009	¥1,137	¥ 112	$10,865
1.50% guarantee money due 2023	¥3,111	¥3,056	$29,723
	¥4,282	¥3,266	$40,902

Aggregate annual maturities of long-term debt subsequent to March 31, 2004 are as follows:

Year ending March 31	Millions of yen	Thousands of U.S. dollars
2005	¥ 32	$ 312
2006	17	169
2007	1,017	9,721
2008	250	2,395
2009 and thereafter	2,962	28,302
	¥ 4,282	$ 40,902

5. Accrued Retirement Benefits

The following tables sets forth the changes in benefit obligation, plan assets and funded status of the Company and its subsidiaries at March 31, 2004 and 2003.

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Benefit obligation at end of year	¥ 5,350	¥ 5,273	$51,105
Fair value of plan assets at end of year	2,846	2,711	27,186
Funded status:			
Benefit obligation in excess of plan assets	2,504	2,562	23,919
Unrecognized net transition obligation at date of adoption	—	—	—
Unrecognized prior service cost	—	—	—
Unrecognized actuarial loss	712	849	6,810
Prepaid expenses for plan assets at end of year	(10)	(12)	(104)
Accrued pension liability recognized in the consolidation balance sheets	1,802	1,726	17,213

Note: Some domestic subsidiaries have adopted allowed alternative treatment of the accounting standards for retirement benefit for small business entity.

Severance and pension costs of the Company and its subsidiaries included the following components for the year ended March 31, 2004 and 2003.

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Service cost	¥ 257	¥ 260	$ 2,462
Interest cost	131	153	1,260
Expected return on plan assets	(99)	(65)	(949)
Amortization:			
Transition obligation at date of adoption	—	—	—
Prior service cost	—	—	—
Actuarial losses	162	75	1,548
Net periodic benefit cost	¥ 452	¥ 424	$ 4,321

Assumption used in the accounting for the defined benefit plans for the year ended March 31, 2004 and 2003 is as follows:

	2004	2003
Method of attributing benefit to periods of service	straight-line basis	straight-line basis
Discount rate	2.0%	2.5%
Long-term rate of return on fund assets	2.5%	3.0%
Amortization period for transition obligation at date of adoption	—	—
Amortization period for prior service cost	—	—
Amortization period for actuarial losses	10 years	10 years

6. Contingencies

At March 31, 2004 and 2003, the Group was contingently liable as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
As an endorser of notes discounted or endorsed	¥2,084	¥1,719	$19,915
As a guarantor of indebtedness of:			
Associates	¥1,715	¥ 450	$16,382
Others	37	2	356
	¥1,752	¥ 452	$16,737

7. Cash and Cash Equivalents

Cash and cash equivalents at March 31, 2004 and 2003 is as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Cash and time deposits ...	¥ 5,961	¥ 5,911	$ 56,947
Short-term investment	6,832	4,616	65,263
Less-time deposits with original maturities more than three months	(70)	(70)	(669)
Less-stock	—	—	—
	¥12,724	¥10,458	$121,540

8. Leases

The Group leases certain machinery and equipment, and other assets. Total lease payments under these leases were ¥402 million ($3,843 thousand) , and ¥359 million for the years ended March 31, 2004 and 2003, respectively.

Pro forma information relating to acquisition costs, accumulated depreciation and future minimum lease payments for property held under finance leases which do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2004 and 2003, are as follows:

	Millions of yen		
	2003		
	Machinery and Equipment	Other	Total
Acquisition costs	¥ 1,214	¥ 629	¥ 1,844
Accumulated Depreciation	429	305	735
Net leased property	¥ 784	¥ 324	¥ 1,109

	Millions of yen		
	2004		
	Machinery and Equipment	Other	Total
Acquisition costs	¥ 1,010	¥ 1,060	¥ 2,071
Accumulated Depreciation	522	556	1,079
Net leased property	¥ 488	¥ 504	¥ 992

	Thousands of U.S. dollars		
	2004		
	Machinery and Equipment	Other	Total
Acquisition costs	$ 9,655	$10,130	$19,785
Accumulated Depreciation	4,993	5,314	10,307
Net leased property	$ 4,662	$ 4,816	$ 9,478

Future minimum lease payments under finance leases as of March 31, 2004 and 2003 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Due within one year	¥ 391	¥ 368	$3,736
Due after one year	601	740	5,742
Total	¥ 992	¥1,109	$9,478

The acquisition costs and future minimum lease payments under finance leases include the imputed interest expense portion.

Depreciation expense, which is not reflected in the accompanying consolidated statements of income, computed by the straight-line method, would have been ¥402 million ($3,843 thousand) for the year ended March 31, 2004.

9. Derivatives and Hedging Activities

Derivative financial instruments are utilized by the Company principally to reduce interest rate and foreign exchange rate risks. The Company has established a control environment which includes policies and procedures for risk assessment and for the approval, reporting and monitoring of transactions involving derivative financial instruments. The Company does not hold or issue derivative financial instruments for trading purposes.

At March 31, 2004 and 2003, all forward exchange contracts outstanding were entered into in order to hedge receivables and payables denominated in foreign currencies which have been translated and reflected at the corresponding contracted rates in the accompanying consolidated balance sheets at March 31, 2004 and 2003.

10. Shareholders' Equity

Changes in common stock and additional paid-in capital have resulted from the following.

		Millions of yen	
	Number of shares	Common stock	Additional paid-in capital
Balance of March 31, 2002	28,310,779	11,786	11,613
Retirement of stock during 2003	(145,000)	0	(105)
Balance of March 31, 2003	28,165,779	11,786	11,508
Retirement of stock during 2004	161,000	56	153
Balance of March 31, 2004	28,326,779	11,842	11,661

	Thousands of U.S. dollars	
	Common stock	Additional paid-in capital
Balance of March 31, 2003	112,584	109,926
Retirement of stock during 2004	535	1,465
Balance of March 31, 2004	113,119	111,390

The Company adopted 100 shares of common stock as "low unit". A holder of shares representing less than one unit cannot exercise any voting rights with respect to such shares. However, the holder is entitled to receive dividends and other distributions. A holder of a fraction of a unit may at any time require the Company to purchase such shares at the prevailing market price. Shares so purchased must be sold or otherwise transferred to a third party within a reasonable time.

11. Research and Development and Computer Software

Research and development expenditure charged to income was ¥1,284 million ($12,266 thousand) and ¥702 million for the years ended March 31, 2004 and 2003, respectively.

12. Income Taxes

The Company and its domestic subsidiaries are subject to several taxes based on income, which in the aggregate resulted in statutory tax rates of approximately 42.0% and 42.0% for the years ended March 31, 2004 and 2003, respectively. Foreign subsidiaries are subject to income taxes of the countries in which they operate.

The effective rate for the two years ended March 31, 2004 differs from the Company's statutory tax rate for the following reasons:

	2004	2003
Statutory tax rate	42.0	42.0%
Dividend income	(0.3)	(8.0)
Expenses not deductible for income tax purposes	2.5	9.7
Per capital inhabitant tax	2.5	11.8
Other	0.6	9.5
Effective tax rate	47.3	65.0%

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets at March 31, 2004 and 2003 are presented below:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Deferred tax assets:			
Accrued expenses	¥ 426	¥ 336	$ 4,073
Accrued retirement benefits	773	760	7,386
Depreciation	210	221	2,006
Unrealized profits	302	302	2,891
Tax loss carryforwards	42	170	404
Other	725	365	6,929
Total gross deferred tax assets	2,479	2,157	23,688
Less valuation allowance	(159)	(211)	(1,527)
Net deferred tax assets	2,320	1,946	22,161
Deferred tax liabilities:			
Special tax-purpose reserve for condensed booking of fixed assets	(1,344)	(1,345)	(12,838)
Unrealized gains of other securities	(843)	(49)	(8,058)
Total gross deferred tax liabilities	(2,187)	(1,394)	(20,896)
Net deferred tax assets	¥ 132	¥ 551	$ 1,265

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 entirely dependent upon the generation of future taxable income in specific tax jurisdictions during the periods in which those temporary differences become deductible. Although realization is not assured, management considered the projected future taxable income in making this assessment. Based on these factors, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of the existing valuation allowance as of March 31, 2004.

Tax loss carryforwards will expire between 2005 and 2008.

13. Segment Information:

Information about operations in different industry segments of the Group for the years ended March 31, 2004 and 2003, is as follows:

Industry Segments

a. Sales and Operating Income

	Millions of yen					
	2004					
	Industry A	Industry B	Industry C	Industry D	Eliminations /Corporate	Consolidated
Sales to customers	¥39,058	¥10,246	¥ 6,086	¥ 2,036	¥ —	¥57,428
Intersegment	0	—	—	419	(419)	—
Total sales	39,058	10,246	6,086	2,456	(419)	57,428
Operating expenses	37,162	9,712	6,068	1,763	(442)	54,264
Operating income	¥ 1,896	¥ 534	¥ 17	¥ 692	¥ 22	¥ 3,163

	Millions of yen					
	2003					
	Industry A	Industry B	Industry C	Industry D	Eliminations /Corporate	Consolidated
Sales to customers	¥32,317	¥14,829	¥ 6,531	¥ 1,590	¥ —	¥55,269
Intersegment	14	3	—	360	(378)	—
Total sales	32,332	14,833	6,531	1,951	(378)	55,269
Operating expenses	32,159	13,583	6,603	1,559	(395)	53,510
Operating income	¥ 172	¥ 1,249	¥ (71)	¥ 391	¥ 16	¥ 1,759

	Thousands of U.S. dollars					
	2004					
	Industry A	Industry B	Industry C	Industry D	Eliminations /Corporate	Consolidated
Sales to customers	$373,088	$ 97,877	$ 58,139	$ 19,454	$ —	$548,557
Intersegment	0	—	—	4,010	(4,011)	—
Total sales	373,088	97,877	58,139	23,464	(4,011)	548,557
Operating expenses	354,974	92,774	57,970	16,845	(4,226)	518,337
Operating income	$ 18,114	$ 5,103	$ 169	$ 6,619	$ 215	$ 30,219

b. Assets, Depreciation and Capital Expenditures

	Millions of yen					
	2004					
	Industry A	Industry B	Industry C	Industry D	Eliminations /Corporate	Consolidated
Assets	¥44,850	¥ 7,386	¥ 6,051	¥ 9,693	¥17,584	¥85,566
Depreciation	749	43	110	334	—	1,238
Capital expenditure	945	26	230	1,072	—	2,275

	Millions of yen					
	2003					
	Industry A	Industry B	Industry C	Industry D	Eliminations /Corporate	Consolidated
Assets	¥40,597	¥10,930	¥ 6,112	¥ 5,544	¥15,760	¥78,943
Depreciation	740	46	111	272	—	1,169
Capital expenditure	2,510	67	99	685	—	3,361

	Thousands of U.S. dollars					
	2004					
	Industry A	Industry B	Industry C	Industry D	Eliminations /Corporate	Consolidated
Assets	$428,408	$ 70,558	$ 57,802	$ 92,596	$ 167,963	$817,329
Depreciation	7,162	419	1,059	3,192	—	11,833
Capital expenditure	9,031	254	2,206	10,241	—	21,733

Notes: Industry A consists of special equipment car.
Industry B consists of environmental equipment and systems.
Industry C consists of car sales business.
Industry D consists of real estate business.
Corporate assets consist primarily of cash and cash equivalents, investment in and advances to affiliates, investments in securities and the corporate headquarters assets.

14. Subsequent Event

The following appropriations of the Company's retained earnings in respect of the year ended March 31, 2004 were as proposed by the Board of Directors and approved by the shareholders at the annual general meeting held on 29 June, 2004:

Appropriations	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥6.0 per share)	¥ 167	$ 1,603
Bonuses to directors	26	248
Total appropriations	¥ 193	$ 1,851

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Shareholders and
Board of Directors
of Kyokuto Kaihatsu Kogyo Co., Ltd.

We have audited the accompanying consolidated balance sheets of Kyokuto Kaihatsu Co., Ltd. and subsidiaries as of March 31, 2003 and 2004, and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the two-year period ended March 31, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kyokuto Kaihatsu Kogyo Co.,Ltd. and subsidiaries as of March 31, 2003 and 2004, and the results of their operations and their cash flows for each of the years in the two-year period ended March 31, 2004 in conformity with accounting principles generally accepted in Japan.

The accompanying consolidated financial statements as of and for the year ended March 31, 2004 have been translated into United States dollars solely for the convenience of the reader. We have recomputed the translation and, in our opinion, the consolidated financial statements expressed in yen have been translated into dollars on the basis set forth in note 1 to the consolidated financial statements.

Yukoh Audit Corporation

Osaka, Japan
June 29, 2004

CORPORATE INFORMATION

Kyokuto Kaihatsu Kogyo Co., Ltd.

Established:
June, 1955

Paid-in Capital:
¥11,842 million (at March 31, 2004)

Number of Shares Issued:
27,962,658 shares (at March 31, 2004)

Number of Employees:
1,331

Head Office:
1-45, Koshienguchi 6-chome, Nishinomiya City, Hyogo Prefecture,
663-8545, Japan
Tel: 0798-66-1000
Fax: 0798-66-8146

Tokyo Office:
1-1, Asahicho, Haneda, Ota-ku, Tokyo, 144-0042, Japan
Tel: 03-5737-2271
Fax: 03-5737-7791

Plants:

Yokohama Plant
Occupies 51,890m^2
Since March, 1962
Located in Yamato, Kanagawa

Nagoya Plant
Occupies 132,537m^2
Since June, 1970
Located in Komaki, Aichi

Miki Plant
Occupies 98,274m^2
Since October, 1979
Located in Miki, Hyogo

Fukuoka Plant
Occupies 66,832m^2
Since September, 1970
Located in Iizuka, Fukuoka

Hachinohe Plant
Occupies 57,600m^2
Since April, 1999
Located in Hachinohe, Aomori

BOARD OF DIRECTORS AND STATUTORY AUDITORS

(at June 29, 2004)

President and Representative of the Board of Directors, CEO
Katsushi Tanaka

Senior Managing Director, Senior Managing Executive Officer
Tadao Yasuda

Managing Director, Managing Executive Officer
Hiroki Uoi

Director, Managing Executive Officer
Yukinori Matsuhashi

Director, Executive Officer
Takeshi Kunisada
Takaaki Hudetani
Syunji Nakamura

Executive Officer
Kiyoshi Urasaka
Yukitoshi Masumura
Toshihide Sakai
Tomoki Ueyama
Genpachi Hashimoto
Rikio Sagawa
Kozo Ueda
Daisuke Nagumo
Akira Yamasita

Standing Auditor
Yasuhiko Tamaki

Auditor
Kazuyoshi Kira
Rikuyuki Tentaku
Yasuo Mizuno

KYOKUTO KAIHATSU KOGYO CO., LTD.

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