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## **YUHO REPORT** **Annual**

Fiscal Year Ended	March 31, 2006
Traded	TSE1
Stock Code	6419



**MARS ENGINEERING CORPORATION**

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

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## Company Profile

### Financial highlights

Years ended March 31; Thousands of yen	2002	2003	2004	2005	2006	Change 2006/2002
<b>Consolidated</b>						
Net sales	21,404,851	24,959,669	30,723,810	35,208,425	33,703,740	157%
Ordinary profit	5,958,626	5,521,514	8,263,972	10,587,915	8,586,209	144%
Net income (loss)	3,030,640	(714,837)	4,240,475	6,063,611	4,353,043	144%
Shareholders' equity	26,446,783	25,030,579	28,987,920	34,108,043	33,091,859	125%
Total assets	39,879,762	38,699,119	45,280,360	49,668,130	46,146,327	116%
Shareholders' equity per share (Yen)	2,328.08	2,197.95	2,543.34	1,496.61	1,541.67	
Net income (loss) per share (Yen)	266.78	(68.38)	364.85	262.25	191.04	
Net income per share, fully diluted (Yen)	-	-	-	-	190.56	
Net cash provided by (used in) operating activities	4,158,507	1,853,845	8,948,394	6,394,301	3,124,818	75%
Net cash provided by (used in) investing activities	(1,286,444)	(1,030,841)	(823,020)	(1,082,945)	(1,489,009)	
Net cash provided by (used in) financing activities	(2,043,303)	1,343,337	(873,677)	(1,226,356)	(6,343,292)	
Cash and cash equivalents, end of term	6,513,699	8,680,028	15,931,724	19,787,424	15,079,940	232%
Employees	483	510	520	543	574	119%

*The Company conducted a 2-for-1 stock split with a recording date of September 17, 2004. Calculations of shareholders' equity per share and net income (loss) per share for the fiscal year ended March 2005 assume that the split occurred at the beginning of the year.*

**Common size statements**

Years ended March 31; Percent	Consolidated			Parent		
	2004	2005	2006	2004	2005	2006
<b>Balance sheet</b>						
<b>Assets</b>	100.0	100.0	100.0	100.0	100.0	100.0
Current assets	71.1	74.5	72.0	68.7	73.3	64.6
Tangible fixed assets	23.2	20.8	20.8	16.5	14.8	13.1
Intangible fixed assets	0.2	0.3	0.3	0.2	0.5	0.5
Investments and other assets	5.5	4.4	6.9	14.6	11.4	21.8
Total fixed assets	28.9	25.5	28.0	31.3	26.7	35.4
<b>Liabilities and shareholders' equity</b>	100.0	100.0	100.0	100.0	100.0	100.0
Current liabilities	27.8	24.9	20.8	16.6	15.6	12.7
Long-term liabilities	7.4	5.4	6.1	2.3	1.5	2.0
Total liabilities	35.2	30.3	26.9	18.9	17.1	14.7
Minority interests	0.8	1.0	1.4			
Common stock	17.5	16.0	17.2	22.6	20.6	22.8
Capital reserves	18.5	16.9	18.2	23.9	21.7	24.1
Retained earnings	27.5	35.3	44.7	34.0	39.9	49.5
Unrealized gains or losses on other securities	0.5	0.5	0.8	0.6	0.7	1.1
Treasury stock	(0.0)	(0.0)	(9.2)	(0.0)	(0.0)	(12.2)
Total shareholders' equity	64.0	68.7	71.7	81.1	82.9	85.3
<b>Statement of income</b>						
<b>Net sales</b>	100.0	100.0	100.0	100.0	100.0	100.0
Cost of sales	53.7	52.2	54.8	56.2	54.1	57.0
Gross profit	46.3	47.8	45.2	43.8	45.9	43.0
Selling, general and administrative expenses	19.7	18.0	20.0	20.5	19.4	22.0
Operating income	26.6	29.8	25.2	23.3	26.5	21.0
Nonoperating income	0.4	0.3	0.3	0.5	0.5	0.8
Nonoperating expenses	0.1	0.0	0.0	0.0	0.0	0.0
Ordinary profit	26.9	30.1	25.5	23.8	27.0	21.8
Extraordinary income	0.0	-	0.4	0.0	0.0	0.5
Extraordinary losses	2.4	0.6	3.2	2.9	1.0	4.0
Income before taxes and other adjustments	24.5	29.5	22.7	20.9	26.0	18.3
	10.2	11.7	9.2	8.9	10.6	7.5
Minority interest in income of consolidated companies	0.5	0.6	0.6			
Net income	13.8	17.2	12.9	12.0	15.4	10.8

## Business Overview

### *Description of business*

The Mars Engineering Group consists of the Company (Mars Engineering Corporation) and six subsidiaries (four consolidated subsidiaries and two nonconsolidated subsidiaries). Its primary business is the manufacture and sales of pachinko-related electronic products.

The Group's businesses and the relationship of the Company and its subsidiaries to these businesses are outlined below.

#### (1) Pachinko business

The Company, Mars Corporation, Mars Techno-Science Corporation and WINTEC Co., Ltd.

#### (2) Other business

Hotel Sunroute Hakata, Inc.

### *Group companies*

<b>Name</b>	<b>Operations</b>	<b>Common stock, Millions of yen</b>	<b>Percent ownership</b>
<i>(Consolidated subsidiaries)</i>			
Mars Corporation	Pachinko business	2,000	100
Mars Techno-Science Corporation	Pachinko business	250	87
WINTEC Co., Ltd.	Pachinko business	107	80
Hotel Sunroute Hakata, Inc.	Other business	10	100

## History

Year	Month	Event
1974	September	Mars Engineering Corporation is established in Shinjuku-ku, Tokyo, to design, trial-manufacture, manufacture and sell electronic devices.
1975	December	Enters into an exclusive distributorship agreement with Casio Computer Co., Ltd. to sell Casio business systems.
1980	August	Develops and begins selling a prize-control system for amusement centers.
1981	October	Enters into a distributorship agreement with NEC Corp. to sell office computers.
1985	February	Develops and begins selling counting machines.
1987	October	Concludes an agreement with Nippon Signal Co., Ltd. related to the development, manufacture and sales of small magnetic-card readers and writers; develops and begins selling a magnetic card-based prize control-system.
1989	October	Opens Higashi Fuji Plant in Gotemba, Shizuoka Pref.
1990	October	Develops and begins selling auto-dispenser systems; expands Higashi Fuji Plant.
1992	March	Develops and begins selling a prize-control system with membership management capabilities.
1993	March	Opens Technical Center in Mishima, Shizuoka Pref.
	November	Registers shares for over-the-counter trading with Japan Securities Dealers Association.
1994	July	Develops and begins selling computers for pachinko parlor management (parlor computer systems).
1995	October	Opens Technology and Distribution Center in Gotemba, Shizuoka Pref.
1996	July	Obtains ISO 9001 certification for meeting quality control standards.
	August	Develops and begins selling "personal systems."
	September	Lists shares on the Second Section of the Tokyo Stock Exchange.
	November	Makes AM Planning Corp., which was established to operate pachinko parlors as antenna outlets for the Company, an affiliated company.
	December	Completes construction of a new headquarters building and moves its corporate headquarters to the new site; establishes Mars Corporation (now a consolidated subsidiary) to engage in real estate management and general leasing.
1997	April	Opens Technology Center in Susono, Shizuoka Pref.
	October	Acquires Asama Sangyo Inc., a leading developer and builder of pachinko ball replenishment systems; incorporates this company into the Group as an affiliate (in Sept. 1998, changes its trade name to ASAMA Engineering Corp.).
1998	July	Develops and begins selling a reusable pachinko cycle card (PCC) system.
	October	Establishes Hotel Sunroute Hakata Inc. (now a consolidated subsidiary) to develop and operate a business hotel; establishes KARD Information System Inc. to provide card issuance and data management services for third parties.
1999	April	Completes construction of Hotel Sunroute Hakata.
	August	Launches K1 Cycle Card system as part of the prepaid card business.
2000	July	Acquires WINTEC Co., Ltd., a leading developer of peripheral devices for pachinko parlor operations; incorporates this company (now a consolidated subsidiary) into the Group as an affiliate.
	September	Acquires RFID business (manufacture of IC cards and radio identification tags) from Toshiba Chemical Corp.; establishes M&T Card Technology Corp. to sell RFID products.
	December	Discontinues operations of AM Planning Corp. after concluding that it had achieved its objectives.
2001	September	Lists shares on the First Section of the Tokyo Stock Exchange.

Year	Month	Event
2002	January	Liquidates AM Planning Corp.
	March	KARD Information System Inc. absorbs operations of M&T Card Technology Corp.
	April	KARD Information System Inc. changes its trade name to Mars Techno-Science Corp. (now a consolidated subsidiary); ASAMA Engineering Corp. changes its trade name to Mars Line-Tech Corp. (now a consolidated subsidiary).
	October	Expands Higashi Fuji Plant.
2006	January	Establishes Mars Frontier Co., Ltd. to develop new businesses and market electronics devices, computer-related goods and premium gifts.
	February	Develops and begins selling "Personal PC Systems" (personal pachinko ball counter systems).
	March	Expands Higashi Fuji Plant.

### ***Risk factors***

- (1) The Company is subject to certain indirect legal restrictions
  - On its ball-dispensing devices, installed between game consoles, which are considered to be a part of a pachinko machine
  - Specifically, ball-dispensing devices are subject to "type testing" under National Public Safety Commission Regulation No. 4.
- (2) Testing can have a significant impact on the manufacture and sales of new ball-dispensing devices due to
  - The need to pass type testing overseen by the Security Electronics and Communication Technology Association
  - The need to pass type testing overseen by prefectural public safety commissions
  - The fact that the Company's customers (pachinko parlors) are subject to restrictions established under the Law Regulating Adult Entertainment Businesses

### ***Research and development***

The Mars Engineering Group has shifted the focus of its new product development to basic and applied technologies in the area of radio frequency identification. It has successfully commercialized a number of products based on RF technology.

The Group spent a total of 947 million yen on research and development during the year ended March 2006.

The Group's R&D activities during the year can be summarized as follows:



- (1) Organization: R&D is conducted primarily at the Susono Technical Center and R&D Center, where work focuses on hardware and software development and on mechanical design.
- (2) Major results of R&D—pachinko business
  - SL-750DS IC card-operated token-issuing machine for installation between game consoles
  - RX-140Z1-VIII coin unit for IC card machines
  - RX-140Z1-IX coin unit for IC card machines
  - MX140K1-X card unit for IC card machines
  - MX140K1-XI card unit for IC card machines
  - m3300 IC card reader for vending machines
  - MX140K1-XII card unit for IC card machines
  - MX140K1-XIII card unit for IC card machines
  - HC-8000 prize and customer management system
  - m80 PCC terminal for management by non-players
  - m8800 POS prize-management device
  - m17 ball counter with receipt-issuing function
  - m21 token-counting machine with receipt-issuing function
  - m18 ball-counting machine for installation between game consoles
  - Personal Counter p160-personal system

The hotel business has no R&D program.

## ***Important agreements with third parties***

### **(1) Technology development agreement**

<b>Name of licensor</b>	<b>Nature of agreement</b>	<b>Period of agreement</b>
Nippon Signal Co., Ltd.	Joint development and manufacture of small magnetic-card readers and writers	Three years, beginning January 9, 1996 (renewed automatically on an annual basis thereafter)

### **(2) Marketing agreements**

<b>Name of licensor</b>	<b>Nature of agreement</b>	<b>Period of agreement</b>
Casio Computer Co., Ltd.	Exclusive distributorship agreement related to business machines and personal computers	One year, beginning March 21, 1982 (renewed automatically on an annual basis thereafter)
Nippon Signal Co., Ltd.	Exclusive rights to sell jointly developed magnetic-card readers and writers; joint development and manufacture	Three years, beginning January 9, 1996 (renewed automatically on an annual basis thereafter)

### **(3) Franchise agreement**

<b>Name of licensor</b>	<b>Nature of agreement</b>	<b>Period of agreement</b>
Sunroute Co., Ltd.	Sunroute Co., Ltd. agrees to allow the Company to use the "Hotel Sunroute xxx" name and to conduct business using its trademarks, services and other hotel management know-how; the Company will continue to operate hotels in accordance with guidance and advice provided by Sunroute, with the aim of achieving prosperity for both companies.	Twenty years, beginning June 1, 1999 (renewed automatically every five years thereafter)

*The franchise agreement described above requires the Company to pay a certain percentage of its sales to cover franchise membership, franchisee deposits, general planning charges and royalties.*

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

### ***Analysis of financial condition (year-on-year comparisons)***

Current assets: decreased by 3,785 million yen to 33,245 million yen

- 2,301 million yen decrease in cash and deposits to 11,664 million yen; largely the result of the purchase of treasury stock valued at 4,247 million yen
- 2,613 million yen decrease in marketable securities to 6,148 million yen; mainly due to the sale of commercial paper, whose balances declined by 2,049 million yen to 2,499 million yen
- The marketable securities included 3,422 million yen in cash equivalents

Fixed assets: increased by 263 million yen to 12,900 million yen

- 755 million yen increase in investment securities to 1,890 million yen
- Decline in land holdings of 1,082 million yen to 4,719 million yen

Current liabilities: declined by 2,834 million yen to 9,576 million yen

- Repayment of short-term borrowings (outstanding debt decreased from 1,000 million yen to zero.)
- Decrease in income taxes payable of 1,804 million yen to 1,022 million yen

Long-term liabilities: increased by 166 million yen to 2,827 million yen—marginal increase in long-term debt and marginal decrease in others

Shareholders' equity: declined by 1,016 million yen to 33,091 million yen

- 3,108 million yen increase in retained earnings to 20,642 million yen
- Shareholders' equity reduced as a result of acquisition of treasury stock valued at 4,239 million yen

### ***Cash flows***

Cash and cash equivalents stood at 15,079 million yen, a 4,707 million yen decrease compared to the end of the previous year. This reflected a year-on-year decline in the Company's sales, which in turn resulted from the deteriorating operating environment for its principal customers, pachinko parlor operators.

Net cash provided by operating activities amounted to 3,124 million yen.

- Cash provided: 7,647 million yen in income before taxes and other adjustments, a 2,721 million yen decline
- Cash used:
  - 972 million yen outlay for operating loans, a 940 million yen increase year on year
  - 173 million yen for trade receivables, a 608 million yen increase year on year
  - 4,929 million yen for income taxes and others, a 652 million yen increase year on year

Net cash used in investing activities amounted to 1,489 million yen, reflecting the following:

- Acquisition of investment securities: 510 million yen in stocks; 198 million yen in corporate bonds
- Acquisition of fixed assets: 484 million yen for purchase of the Higashi Fuji No. 3 Plant

Net cash used in financing activities amounted to 6,343 million yen.

- Cash provided: a 558 million yen long-term loan
- Cash used:
  - 1,000 million yen repayment of short-term borrowings
  - 493 million yen repayment of long-term debt
  - 4,247 million yen purchase of treasury stock
  - 1,130 million yen payment of dividends

### ***Analysis of results of operation***

While net sales declined by 4.3%, SG&A expenses increased by 6.3%. The major components of the increase in SG&A expenses were the following:

- Higher personnel expenses due to an increase in the number of employees
- Increases in R&D expenditures

### ***Corporate governance***

#### ***Fundamental thinking with regard to corporate governance***

The Company's aims with regard to corporate governance are twofold: to promote rapid decision-making by its directors, and to ensure management oversight by all the directors and enforcement and follow-up with respect to matters of legal compliance. The Company's view is that increasing the effectiveness of corporate governance depends most critically on its ability to clarify management and reporting responsibilities vis-à-vis all its stakeholders, including its shareholders. While taking steps to increase its enterprise value through enhanced profitability and a stronger balance sheet, the Company recognizes the importance of establishing a highly transparent management structure, and it is implementing various measures to achieve this end.

- Corporate institutions
  - The Company has adopted a system of corporate auditors. The Board of Corporate Auditors consists of four auditors, of whom three are outside corporate auditors.
  - In April 2002, the Company adopted a system of corporate executive officers to separate management decision-making from execution of operations clarify authority and responsibility; and ensure swift decision-making.
  - The Company's Board of Directors comprises six members who are

responsible both for discussing and making decisions on important management matters and for evaluating, discussing and reaching decisions on matters prescribed under law and under the Articles of Incorporation and other internal regulations.

- Internal control

- Internal control is maintained through a system of corporate auditors. The corporate auditors participate in meetings of the Board of Directors and other important management meetings, including the Senior Management Meeting, and meet on a regular basis to evaluate and review the execution of operations by the Board of Directors.
- In conjunction with the Company's financial auditors, the corporate auditors also carry out financial audits that are prescribed under the Commercial Code and the Securities and Exchange Law.

- Risk management

The directors and corporate executive officers all understand the characteristics of the different risks they face. When necessary, they discuss the issues with lawyers and CPAs and receive advice on matters requiring expert opinion.

- Internal audits and audits by corporate auditors; financial audits

The corporate auditors participate in Board of Directors meetings and monitor the manner in which the directors execute operations. They also exchange opinions with the directors. With respect to internal audits, the Company has established an Office of Internal Audits (with a staff of one), which conducts periodic audits of the various departments. When necessary, the corporate auditors and the Office of Internal Audits exchange information and coordinate their actions with respect to audit-related issues.

The Company has entered into a financial auditing agreement with Tohmatsu & Co., which audits the Company's financial statements in accordance with the Commercial Code and the Securities and Exchange Law.

Information related to the certified public accountants directly involved in the financial audit is as follows:

Names of CPAs conducting the audit:

Designated partners: Shigeki Yasunami; Yasuhiko Endo

Others who assisted in the audit:

3 CPAs; 4 junior accountants; 2 other staff

- Compensation to directors and auditors

For the year ended March 2006, the Company paid the following amounts of compensation to its directors and corporate auditors and to its financial auditor:

Compensation paid to directors: 112 million yen

Compensation paid to corporate auditors: 12 million yen

Auditing fees

Remuneration in accordance with Article 2-1 of the Certified Public Accountants Law: 17 million yen

- Relationships with outside directors and with outside corporate auditors

The Company has no relationship—in terms of employment, financing, technology or commercial transactions—with any of its outside corporate auditors or their close relatives, nor with any company in which its corporate auditors or their close relatives serve as directors.

None of the Company's outside corporate auditors is a former employee of any Mars Engineering Group company.

## Directors

Name	Title	Date joined company	Previous or current employers/occupations	Date of birth	Shares owned (1,000)
Hirokazu Matsunami	Representative Director	Sep-74	TAKACHIHO KOHEKI	9-Apr-38	1,405.6
Shigeo Komiya	Chairman and Representative Director	Sep-74	TAKACHIHO KOHEKI	19-Dec-50	490.0
Akihiro Matsunami	President and Representative Director	Feb-95	Kawasho Corp.	1-Jul-65	1,000.0
Teruo Gomi	Executive Vice President	Apr-75	Hitachi, TAKACHIHO KOHEKI	10-Mar-44	450.0
Toshihisa Oya	Director	Sep-74		29-Nov-44	388.0
Hiroshi Murakami	Director	Mar-96		5-Apr-62	248.0
Toshiyuki Goto	Standing Corporate Auditor	Sep-89		22-Aug-41	10.0
Koichi Takemata	Corporate Auditor	Jun-91	Tokai Bank	18-Nov-52	-
Chikawo Takashima	Corporate Auditor	Jun-05		4-Aug-33	3.0
Ikuo Kobayashi	Corporate Auditor	Jun-06	Attorney at law	11-Feb-42	-
					3,994.6

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

## Employees

Consolidated	
Business segment	Number
Pachinko business	560
Other business	14
	574
Parent	
	Total or average
Number	468
Average age	33.0
Average years of service	8.9
Average annual salary (Yen)	5,707,070

*The average annual salary includes bonuses.*

## Union

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

**Stock option plan**


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Date of resolution	June 29, 2005
Categories and numbers of persons to be granted rights	Directors, corporate auditors and employees of the Company and its subsidiaries Actual decisions concerning the number of recipients, etc., will be made at the Board of Directors meeting that follows the Regular General Meeting of Shareholders.
Type of shares subject to rights	Common stock
Number of shares	1,500,000 maximum
Amount paid in at time of execution of rights	(Note)
Period of execution of rights	July 1, 2007 - June 30, 2011
Item concerning the assignment of rights	Approval of Board of Directors required.

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*Payment per share is calculated by the "average closing price in previous month" x 1.01. However, if this amount is less than the closing price of the Company's stock in normal transactions on the Tokyo Stock Exchange on the day on which the stock acquisition rights are issued (or, in the event that the Company's shares are not traded on the day of such issuance, the closing price on the nearest preceding day), then the closing price on the day of issuance shall be the amount paid in.*



## Cash Flows

### *Consolidated statement of cash flows*

Years ended March 31; Thousands of yen	2004	2005	2006
<b>Net cash provided by (used in) operating activities</b>			
Income (loss) before taxes and other adjustments	7,531,525	10,369,558	7,647,575
Depreciation	568,510	511,257	536,833
Increase (decrease) in allowances	690,297	148,546	326,416
Interest and dividend income	(72,762)	(28,568)	(74,431)
Interest expenses	12,996	5,557	2,233
Amortization of consolidation differences	9,529	8,565	(1,340)
Loss (gain) on sales of investment securities	84,993	-	(5,084)
Gain on redemption of investment securities	-	-	(143,478)
Valuation loss on investment securities	-	38,879	-
Loss on disposal and sales of fixed assets	8,973	13,653	2,212
Valuation loss on tangible fixed assets	-	-	1,083,013
Decrease (increase) in operating loans	-	-	(972,846)
Decrease (increase) in trade receivables	(340,062)	434,741	(173,587)
Decrease (increase) in inventories	336,470	(243,752)	(113,949)
Increase (decrease) in trade payables	(24,319)	145,181	236,183
Increase (decrease) in advances	(168,670)	(284,938)	(93,420)
Directors' and corporate auditors' bonuses	(64,000)	(99,000)	(117,823)
Others	783,270	(334,813)	(162,861)
	9,356,752	10,684,868	7,975,643
Interest and dividend income	71,676	27,333	80,274
Interest expenses	(14,388)	(40,775)	(1,552)
Income tax and others	(465,645)	(4,277,124)	(4,929,545)
	8,948,394	6,394,301	3,124,818
<b>Net cash provided by (used in) investing activities</b>			
Net change in holdings of marketable securities	199,168	(392,221)	472,634
Payments for acquisition of investment securities	(540,000)	(201,800)	(708,895)
Proceeds from sales of investment securities	172,483	-	28,637
Payments for acquisition of tangible fixed assets	(695,092)	(343,664)	(892,877)
Payments for acquisition of stock of a consolidated subsidiary	-	(47,278)	-
Others	40,420	(97,981)	(388,509)
	(823,020)	(1,082,945)	(1,489,009)

Years ended March 31; Thousands of yen	2004	2005	2006
<b>Net cash provided by (used in) financing activities</b>			
Net increase (decrease) in short-term borrowings	-	-	(1,000,000)
Proceeds from increase in long-term debt	-	-	558,000
Payments of long-term debt	(300,000)	(300,000)	(493,000)
Payments for purchase of treasury stock	-	-	(4,247,862)
Dividends	(569,677)	(909,716)	(1,130,995)
Dividend payments to minority shareholders	(4,000)	(16,290)	(21,435)
Others	-	(350)	(8,000)
	(873,677)	(1,226,356)	(6,343,292)
Cash and cash equivalents	7,251,696	4,084,998	(4,707,483)
Cash and cash equivalents, beginning of term	8,680,028	15,931,724	19,787,424
Net change due to elimination of a subsidiary from consolidation	-	(229,298)	-
Cash and cash equivalents, end of term	15,931,724	19,787,424	15,079,940

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

Years ended March 31; Thousands of yen	2004	2005	2006
Cash and deposit accounts at end of term	10,633,446	13,966,457	11,664,964
Marketable securities at end of term	7,134,206	8,762,072	6,148,816
Short-term investments with redemption periods longer than 3 months	(1,835,928)	(2,941,104)	(2,733,839)
Cash and cash equivalents at end of term	15,931,724	19,787,424	15,079,940

### **Capital expenditures**

The Group conducts necessary investments from a long-term perspective, focusing on R&D projects and business operations that promise growth. During the fiscal year ended March 2006, it spent 858 million yen on capital investments in these areas.

The Group's principal investments in the pachinko business consisted of 484 million yen for construction costs related to the expansion of the Company's Higashi Fuji Plant and 268 million yen for product-related dies.

The Group made no significant investments in the Company's Other business division.

During the fiscal year under review, the Company sold fixed assets (land) located in Gotemba, Shizuoka Prefecture, to Mars Corporation, a subsidiary. This resulted in its recognizing an extraordinary loss of 1,083 million yen, due to a write-down of the land's value.

**Capital expenditure and disposal plan**

The Group adopts capital investment plans based on a comprehensive assessment of economic conditions, industry trends, investment efficiency and other factors.

Generally, each consolidated subsidiary formulates its own capital expenditure plan, with Mars Engineering Corp. functioning as a coordinator to prevent duplication on a Group-wide basis.

As of year-end, the Company had no plans to add any important new facilities or to dispose of or sell any important existing facilities.

***Dividend policy***

The Company considers its policy on dividends to be extremely significant. Its goal with respect to dividends is to make payouts in a manner that contributes to stable business growth over the long term. This requires that it strengthen its financial structure and pay dividends that more closely reflect changes in its financial performance each term with due consideration given to maintaining a stable payout to its shareholders.

In accordance with this basic policy, and to reward shareholders for their support, the Company has declared a common dividend of 20 yen per share.

Addition to this of the 20 yen per share paid out as an interim dividend brings total dividends for the year to 40 yen per share.

The Company intends to invest retained earnings in areas that will foster stable growth, including measures aimed at strengthening its balance sheet and capital investments.

## Operations

### *Consolidated statement of income*

Years ended March 31; Thousands of yen	2004	2005	2006
<b>Net sales</b>	30,723,810	35,208,425	33,703,740
<b>Cost of goods sold</b>	16,510,304	18,364,947	18,468,667
Gross profit on sales	14,213,505	16,843,478	15,235,073
<b>Selling, general and administrative expenses</b>	6,038,483	6,340,039	6,738,749
Operating income	8,175,022	10,503,438	8,496,324
<b>Nonoperating income</b>			
Interest income	69,364	24,831	65,411
Rental income	17,400	17,400	17,400
Gain from conclusion of interest rate swap	-	34,433	-
Others	25,528	24,151	28,333
	112,292	100,815	111,144
<b>Nonoperating expenses</b>			
Interest expenses	12,996	5,557	2,233
New share issuance expenses	-	-	8,000
Commissions paid on the purchase of treasury stock	-	-	9,289
Others	10,345	10,781	1,737
	23,342	16,338	21,259
Ordinary profit	8,263,972	10,587,915	8,586,209
<b>Extraordinary income</b>			
Gain on sales of investment securities	6,962	-	5,084
Gain on redemption of investment securities	-	-	143,478
Reversal of allowance for doubtful accounts	2,200	-	-
Gain on sales of memberships	5,000	-	-
Others	1,000	-	-
	15,162	-	148,563
<b>Extraordinary losses</b>			
Loss on disposal of inventories	158,081	165,824	1,971
Valuation loss on fixed assets	-	-	1,083,013
Valuation loss on investment securities	-	38,879	-
Loss on sales of investment securities	91,956	-	-
Provision for directors' retirement allowances for prior years	487,669	-	-
Others	9,902	13,653	2,212
	747,610	218,357	1,087,197
Income (loss) before taxes and other adjustments	7,531,525	10,369,558	7,647,575
Corporate, inhabitant and enterprise taxes	3,029,952	4,267,214	3,125,212
Deferred taxes	104,940	(150,540)	(20,068)
	3,134,892	4,116,673	3,105,143
Minority interest in income of consolidated companies	156,156	189,273	189,387
Net income (loss) for the term	4,240,475	6,063,611	4,353,043

**Consolidated statement of retained earnings**

March 31; Thousands of yen	2004	2005	2006
<b>Capital reserves</b>			
Capital reserves, beginning of term	8,371,830	8,371,830	8,371,830
Capital reserves, end of term	8,371,830	8,371,830	8,371,830
<b>Retained earnings</b>			
Retained earnings, beginning of term	8,865,052	12,475,532	17,534,549
Increase in retained earnings			
Net income	4,240,475	6,063,611	4,353,043
	4,240,475	6,063,611	4,353,043
Decrease in retained earnings			
Dividends	567,996	908,793	1,132,379
Directors' and corporate auditors' bonuses	62,000	95,800	112,235
	629,996	1,004,593	1,244,614
Retained earnings, end of term	12,475,532	17,534,549	20,642,978

**Results of operations****Fiscal year ended March 31, 2006****Economic and other factors affecting operations**

## (1) A steadily recovering economy

- Increasingly widespread recovery of corporate profits in Japan, leading to further growth in capital spending and aggressive hiring by businesses
- But these positive trends clouded by uncertainties surrounding skyrocketing oil and raw materials prices

## (2) Trends in pachinko industry

- Amid excessive competition, a continuing polarization of the industry, which is leaving only very large parlors or very small parlors in operation—with a resulting further decline in the number of parlors in business
- The decision by the police to enforce orders to remove unlicensed or uncertified game machines from business premises has provoked considerable uncertainty among parlor operators—and this is causing postponement of investments in peripheral equipment.

**Marketing strategies**

- (1) Continued focus on prepaid Cycle Card systems, marketed and sold as “total systems”

- (2) Amid declining demand for peripherals in the market, successive launches of major new products with the aim of realizing potential replacement demand for peripherals

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

- (1) Year-on-year declines in sales and profits
- (2) Overview of income statement
- Net sales: down 4.3%
  - Operating income: down 19.1%
  - Ordinary profit: down 18.9%
  - Net income: down 28.2%

***Segment breakdown (year-on-year percentage change)***

- (1) Pachinko business: sales declined by 4.4% to 33,145 million yen. By product area, sales broke down as follows:
- Cycle Card systems (includes Personal PC Systems, which make revolutionary changes in pachinko parlor operations possible through their ability to improve parlor operations, enhance parlor environments and reduce parlor expenses): 15,897 million yen
    - Sales of Personal PC Systems, begun in February, have already resulted in contracts with large pachinko parlors.
    - The Company added 307 new Cycle Card system installations, bringing its cumulative installations to 1,729. This represented a market share of 15.4%
  - Prize-control systems: 5,514 million yen
    - The Company is the industry leader in this segment, having pioneered this type of system.
    - Introduction of an LCD touch panel model and renewal of the “m series,” featuring enhanced security features
  - RFID division: 833 million yen
    - IC tags, for controlling access to and from offices and other locations
    - Also for personnel management systems, to record employees’ presence in or absence from office
- (2) Other business: Hotel revenues increased by 5.5% to 557 million yen.

**Fiscal year ended March 31, 2005**

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

(1) Mixed economic picture

- Capital spending continuing to increase, supported by ongoing recovery in corporate profits
- Unimpressive recovery in consumer spending
- Other factors weighing on the economy: sharply rising oil prices, fears of pension system insolvency, etc.

(2) Trends in pachinko industry

- Increasing demand for peripheral equipment due to the government's issuance of new yen-denominated banknotes (10,000, 5,000 and 1,000 yen bills)
- Amendment of the Regulation Concerning Certification and Official Inspection of Pachinko Game Machines (effective July 2004), giving rise to a flurry of game machine replacements and a resulting over-investment by pachinko parlor operators

***Marketing strategies and results***

- (1) Continuing emphasis on Cycle Card prepaid systems—leading to sales of Cycle Card systems to 404 customers, mostly large parlors
- (2) Proposal and sales of *comprehensive systems*, which include prize-control systems and table-top auto dispensers
- (3) Quick response to the government's issuance of new banknotes in November 2004, using the Company's nationwide maintenance capabilities to complete adjustment of existing machines, and, in so doing, creating considerable goodwill among customers because of the slower reaction by the rest of the industry

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

- (1) Second consecutive year of record high sales and profits
- (2) Income statement
  - Net sales: up 14.6%
  - Operating income: up 28.5%
  - Ordinary profit: up 28.1%
  - Net income: up 43.0%

***Segment breakdown (year-on-year percentage change)***

- (1) Pachinko business: sales increase by 14.9% to 34,679 million yen, due principally to the following:
- Continued strong support in the market for the Company's ability to offer prize-control capabilities and Cycle Card functions; the Company's large market share for prize-control systems and its ability to set the industry standard for convenience in relation to reusable cards (Cycle Cards)
    - The growth rate of new installations (based on machines in place and in use) moderated, but sales of new Cycle Card systems to existing customers remained strong, resulting in sustained high growth levels in terms of total installations.
    - Cumulative installations, as of the end of March 2005, were 1,582, accounting for 13.3% of the market.
  - Staying attuned to market opinions and requests and translating these into innovative new products
- (2) Other business: Hotel revenues decreased by 0.5% to 528 million yen.
- Both sales and occupancy rates failed to meet targets set by the Company, reflecting the following:
    - Pricing pressures against the background of a growing trend toward Internet reservations
    - A decline in leisure and other travel to Fukuoka, reflecting fewer conventions and other special events during the year
  - Despite this, higher average revenue per room due to increases in the numbers of customers choosing more expensive rooms and repeat customers
  - Based on customer feedback, the hotel's "front desk department" is ranked No. 1 in the Sunroute chain for the second consecutive year in 2004.



**Issues requiring action**

- (1) In the pachinko industry, a lack of clarity concerning future directions is creating an extremely difficult environment for business decisions-making.
- With the deadline for removal from premises of unlicensed or uncertified game machines set for June 2006, the industry is being put in the position of having to invest in new machines to replace the restricted models.
  - Yet it faces the reality of a slowly declining population of pachinko players.
  - Thus, even greater effort on its part will be required to change its methods of operation in order to attract more pachinko players.
- (2) Issues for the Company
- Lowering costs and investing optimum levels of organizational resources into each facet of its business: development, manufacturing, sales, maintenance
  - Differentiating the Company from its competitors through creative product development
- (3) Actions by the Company
- Development of the Personal PC System, which improves profitability by enabling pachinko parlor operators to shift from “volume-dependent” to “quality-driven” operations
  - Aiming to increase market share for prepaid card systems to 20% by enhancing the brand image and increasing brand recognition

**Production and sales****Production**

Thousands of yen	2006	
	Amount	Year-on-year comparison (%)
Pachinko business	20,714,368	87.4
Other business	-	-
	20,714,368	87.4

**Procurement**

Thousands of yen	2006	
	Amount	Year-on-year comparison (%)
Pachinko business	1,205,873	95.8
Other business	103,770	109.5
	1,309,644	96.8

**Sales by product**

Thousands of yen	2006	
	Amount	Year-on-year comparison (%)
Pachinko business	33,145,899	95.6
Other business	557,841	105.5
	33,703,740	95.7

## Leases

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

The Company’s main finance lease contracts are as follows:

Thousands of yen	Rent or lease	Number of employees	Land (square meters)	Current payments
<b>Parent</b>				
Head office				
Office	Rent	77	-	214,765
OA equipment	Lease		-	7,886
Vehicles and delivery equipment	Lease		-	5,834
Susono Technical Center				
Office	Rent	39	-	73,473
OA equipment	Lease		-	193
Vehicles and delivery equipment	Lease		-	558
Mishima Technical Center				
Office	Rent	7	-	39,033
OA equipment	Lease		-	36
Gotemba Technology and Distribution Center				
Parking lot	Rent	33	-	514
OA equipment	Lease		-	164
Vehicles and delivery equipment	Lease		-	5,078
Gotemba Warehouse				
OA equipment	Lease	6	-	25
Vehicles and delivery equipment	Lease		-	1,123
Higashi Fuji Plant				
Parking lot	Rent	33	-	937
OA equipment	Lease		-	42
Vehicles and delivery equipment	Lease		-	972
Tokyo Branch, etc.				
Office	Rent	273	-	205,399
OA equipment	Lease		-	4,763
Vehicles and delivery equipment	Lease		-	75,181

MARS ENGINEERING CORPORATION

Thousands of yen	Rent or lease	Number of employees (square meters)	Land	Current payments
<b>Mars Corporation</b>				
Peripheral equipment	Lease	3	-	1,682,029
<b>Mars Techno-Science Corporation</b>				
Office	Rent	42	-	0
Peripheral equipment	Lease		-	0
OA equipment	Lease		-	0
Vehicles and delivery equipment	Lease		-	0
<b>WINTEC Co., Ltd.</b>				
Land	Rent	42	-	1,185
OA equipment	Lease		-	171
Equipment and machinery	Lease		-	231
Vehicles and delivery equipment	Lease		-	846
<b>Hotel Sunroute Hakata, Inc.</b>				
Buildings and structures	Rent	14	644	146,727
Equipment and machinery	Lease		-	1,816
OA equipment	Lease		-	349

Pro forma information on leased property is as follows:

**Lessee**

Thousands of yen	2005	2006
<b>Tools, appliances and fixtures</b>		
Acquisition cost	1,924,493	1,152,710
Accumulated depreciation	1,246,469	640,382
Net leased property	678,023	512,328
<b>Future minimum lease payments, including interest portion</b>		
Due within one year	1,804,235	1,595,779
Due after one year	2,291,107	2,200,657
	4,095,343	3,796,436
Lease payments	2,241,511	2,161,029
Pro forma depreciation expenses (assuming declining-balance method)	610,481	462,004
Pro forma interest expenses	189,439	156,737
<b>Operating leases - future minimum lease payments</b>		
Due within one year	1,003	1,003
Due after one year	1,337	334
	2,340	1,337

MARS ENGINEERING CORPORATION

**Lessor**

<b>Thousands of yen</b>	<b>2005</b>	<b>2006</b>
<b>Tools, appliances and fixtures</b>		
Acquisition cost	148,139	18,600
Accumulated depreciation	128,441	10,580
Net leased property	19,698	8,019
<b>Future minimum lease payments, including interest portion</b>		
Due within one year	1,456,931	1,391,078
Due after one year	2,243,230	2,122,183
	3,700,161	3,513,261
Lease payments received	1,870,866	1,851,638
Depreciation expenses	29,627	3,720
Revenues from interest	234,655	189,876

## Capital Structure

### Consolidated balance sheet

#### Assets

March 31; Thousands of yen	2004	2005	2006
<b>Current assets</b>			
Cash and deposits	10,633,446	13,966,457	11,664,964
Notes and accounts receivable	10,518,982	10,082,028	10,255,616
Marketable securities	7,134,206	8,762,072	6,148,816
Inventories	3,184,929	3,367,321	3,481,270
Deferred tax assets	499,330	510,895	468,809
Others	239,754	403,424	1,373,608
Allowance for doubtful accounts	(36,021)	(61,045)	(147,476)
	32,174,627	37,031,152	33,245,608
<b>Fixed assets</b>			
<b>Tangible fixed assets</b>			
Buildings and structures	6,147,187	6,214,459	6,715,617
Accumulated depreciation	1,913,295	2,151,362	2,376,528
	4,233,891	4,063,097	4,339,088
Machinery and transportation equipment	246,231	247,720	248,940
Accumulated depreciation	127,053	148,841	171,175
	119,177	98,879	77,765
Tools, appliances and fixtures	2,357,083	2,241,066	2,449,036
Accumulated depreciation	1,981,340	1,883,713	1,985,109
	375,742	357,352	463,926
Land	5,782,399	5,802,266	4,719,872
	10,511,211	10,321,596	9,600,653
<b>Intangible fixed assets</b>			
Consolidation translation adjustments	6,901	-	-
Others	84,565	151,425	139,939
	91,466	151,425	139,939
<b>Investments and other assets</b>			
Investment securities	1,575,342	1,135,722	1,890,841
Deferred tax assets	587,287	684,103	667,718
Others	608,629	618,195	1,019,950
Allowance for doubtful accounts	(268,206)	(274,065)	(418,384)
	2,503,053	2,163,955	3,160,125
Total fixed assets	13,105,732	12,636,977	12,900,719
<b>Total assets</b>	45,280,360	49,668,130	46,146,327

**Liabilities and shareholders' equity**

<b>March 31; Thousands of yen</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Current liabilities</b>			
Notes and accounts payable	3,392,821	3,364,138	3,600,322
Short-term borrowings	1,000,000	1,000,000	-
Long-term debt due within 1 year	300,000	300,000	186,000
Income taxes payable	2,836,977	2,826,977	1,022,644
Allowance for bonuses	285,551	348,710	395,100
Advances received	4,008,890	3,723,951	3,630,531
Others	742,424	846,949	741,569
	12,566,665	12,410,727	9,576,168
<b>Long-term liabilities</b>			
Long-term debt	400,000	100,000	279,000
Employees' retirement benefits	-	-	11,235
Reserve for directors' and corporate auditors' retirement allowances	503,954	522,741	560,581
Consolidation translation adjustments	-	1,664	323
Others	2,458,826	2,037,376	1,976,663
	3,362,781	2,661,782	2,827,803
Total liabilities	15,929,447	15,072,510	12,403,971
<b>Minority interests</b>	362,992	487,576	650,495
<b>Shareholders' equity</b>			
Common stock	7,934,100	7,934,100	7,934,100
Capital reserves	8,371,830	8,371,830	8,371,830
Retained earnings	12,475,532	17,534,549	20,642,978
Unrealized gains or losses on other securities	206,751	268,206	382,166
Treasury stock	(292)	(642)	(4,239,215)
Total shareholders' equity	28,987,920	34,108,043	33,091,859
<b>Total liabilities, minority interests and shareholders' equity</b>	<b>45,280,360</b>	<b>49,668,130</b>	<b>46,146,327</b>

**Market value of securities****Other quoted securities**

Thousands of yen	2005			2006		
	Cost of acquisition	Book value	Unrealized gain (loss)	Cost of acquisition	Book value	Unrealized gain (loss)
Securities valued on the consolidated balance sheet at amounts greater than purchase cost						
Shares	170,949	530,800	359,851	563,127	1,047,380	484,253
Bonds						
JGB, local government bonds, etc.	-	-	-	-	-	-
Corporate bonds	-	-	-	-	-	-
Others	-	-	-	-	-	-
Others	1,658,501	1,763,606	105,105	2,019,978	2,195,339	175,361
	<u>1,829,451</u>	<u>2,294,407</u>	<u>464,956</u>	<u>2,583,105</u>	<u>3,242,719</u>	<u>659,614</u>
Securities valued on the consolidated balance sheet at amounts not greater than purchase cost						
Shares	-	-	-	-	-	-
Bonds						
JGB, local government bonds, etc.	-	-	-	-	-	-
Corporate bonds	-	-	-	-	-	-
Others	-	-	-	-	-	-
Others	983,176	970,436	(12,739)	800,544	786,200	(14,343)
	<u>983,176</u>	<u>970,436</u>	<u>(12,739)</u>	<u>800,544</u>	<u>786,200</u>	<u>(14,343)</u>
	<u>2,812,627</u>	<u>3,264,844</u>	<u>452,216</u>	<u>3,383,649</u>	<u>4,028,920</u>	<u>645,270</u>

When the market value of a security at fiscal year-end has fallen to less than 50% of the acquisition price, a valuation write-off is made for the full amount. When the market price has fallen by 30%-50% of the acquisition price, an amount deemed necessary is written off, taking into consideration the actual amount in question and the possibility of recovery.

**Other marketable securities sold during the years ended March 31, 2006**

Thousands of yen	2005	2006
Amount sold	-	3,552
Total gains on sales	-	5,084
Total losses on sales	-	-

**Major investment securities without market prices**

Thousands of yen	2005	2006
Bonds being held to maturity		
Corporate bonds	253,661	422,875
Commercial paper	4,548,439	2,499,385
Other securities		
Unlisted stocks	51,120	165,684
Money management funds	1,169,570	812,624
Medium-term government bond funds	110,156	110,167
Bonds	500,000	-



**Scheduled redemptions of bonds with maturity dates and bonds being held to maturity (among holdings in the “other securities” account)**

Thousands of yen	Up to 1 year	Longer than 1 and up to 5 years	Longer than 5 and up to 10 years	Longer than 10 years
<b>2006</b>				
Bonds				
JGB, local government bonds, etc.	-	-	-	-
Corporate bonds	208,225	214,650	-	-
Others	2,499,385	-	-	-
Others	786,200	349,326	-	-
	3,493,811	563,977	-	-
<b>2005</b>				
Bonds				
JGB, local government bonds, etc.	-	-	-	-
Corporate bonds	8,000	245,661	-	-
Others	4,548,439	-	-	-
Others	701,518	216,705	-	-
	5,257,958	462,366	-	-

## Facilities

Thousands of yen	Buildings and structures	Tools, appliances and fixtures	Land		Other	Total book value	Number of employees
			Book value	Square meters			
<b>Parent</b>							
Higashi Fuji Plant							
Manufacturing equipment	939,497	311,531	597,253	11,447	1,415	1,849,697	33
Gotemba Technology and Distribution Center							
Manufacturing and distribution facilities	567,138	14,164	535,660	2,692	58,873	1,175,836	33
Head Office							
Facilities for corporate administration	23,975	29,321	-	-	945	54,242	77
Susono Technical Center							
R&D facilities	-	17,946	-	-	492	18,439	39
Gotemba Warehouse							
Warehousing facilities	252,592	1,881	172,813	7,654	2,761	430,048	6
Fuji Training Center							
Training facilities	277,439	636	-	-	-	278,076	-
Mishima Technical Center							
Inactive	151	645	-	-	-	796	7
Dormitories							
Employee recreation and welfare facilities	164,063	297	550,024	1,202	2,193	716,579	-
Tokyo Branch, etc.							
Sales, installation and maintenance facilities	3,133	13,076	-	-	-	16,209	273
<b>Mars Corporation</b>							
Buildings and structures	1,759,298	-	2,773,364	21,676	-	4,532,662	3
Equipment and machinery	-	4,391	-	-	-	4,391	
OA equipment	-	911	-	-	-	911	
Peripheral equipment	-	-	-	-	44,470	44,470	
<b>Mars Techno-Science Corporation</b>							
Equipment and machinery	973	21,159	-	-	-	22,133	42
OA equipment	-	4,535	-	-	-	4,535	
Peripheral equipment	-	326	-	-	-	326	
<b>WINTEC Co., Ltd.</b>							
Buildings and structures	349,932	-	90,757	4,038	-	440,690	42
Equipment and machinery	-	5,197	-	-	10,708	15,905	
OA equipment	-	1,556	-	-	-	1,556	
Dies	-	12,246	-	-	-	12,246	
Vehicles and delivery equipment	-	-	-	-	375	375	
<b>Hotel Sunroute Hakata, Inc.</b>							
Equipment and machinery	893	2,551	-	-	-	3,444	14
OA equipment	-	88	-	-	-	88	

**Borrowings**

Thousands of yen	Previous term	Outstanding	Average rate	Maturity
Short-term borrowings	1,000,000	-	-	-
Current portion of long-term debt	300,000	186,000	0.40364%	-
Long-term debt (excluding current portion of long-term debt)	100,000	279,000	0.40364%	2006-2008
Other interest-bearing liabilities	-	-	-	-
	1,400,000	465,000	-	-

Long-term debt repayable within 5 years of the end of the fiscal year to March 2006 (excluding the amount payable within one year) is as follows:

Thousands of yen	Longer than 1 and up to 2 years	Longer than 2 and up to 3 years	Longer than 3 and up to 4 years	Longer than 4 and up to 5 years
Long-term debt	186,000	93,000	-	-

**Retirement benefits****Summary of retirement benefit system**

The Company has established a qualified defined-benefit pension plan. It has also joined a corporate pension plan formed by multiple employers (the National Employers Welfare Pension Fund for the Information Service Industry).

Upon the retirement of an employee, the Company may make extra retirement payments to the employee. These are unrelated to liabilities calculated on the basis of actuarial assumptions, which the Company recognizes in accordance with retirement-benefit accounting guidelines.

**Items related to retirement benefit liabilities**

Thousands of yen	2005	2006
Retirement benefit liabilities	(1,041,911)	(1,265,099)
Pension assets	901,933	1,079,956
Unaccrued pension benefit liabilities	(139,978)	(185,143)
Unrecognized actuarial gains or losses	248,237	256,512
Net amount shown on consolidated balance sheet	108,259	71,368
Prepaid pension expenses	108,259	82,604
Allowance for retirement benefits	-	(11,235)

**Items related to retirement benefit expenses**

Thousands of yen	2005	2006
Current service costs	84,501	107,304
Pension premiums paid under multi-party employers' welfare pension fund	106,915	141,504
Interest expenses	16,252	16,932
Expected earnings on pension fund assets	-	-
Expensing of actuarial differences	35,603	33,682
Retirement benefit expenses	243,272	299,424

**Assumptions underlying the calculation of retirement benefit liabilities**

Thousands of yen	2005	2006
Discount rate	1.7%	1.7%
Expected rate of return	0.0%	0.0%
Method of allocating prospective retirement benefits to each period	Equal payments basis	Equal payments basis
Amortization period for actuarial gains or losses	10 years	10 years
	(Expensed beginning in the consolidated fiscal year following the year in which the expenses arise, using straight-line amortization over a prescribed number of years that is equal to or less than the average remaining period of service of employees.)	(Expensed beginning in the consolidated fiscal year following the year in which the expenses arise, using straight-line amortization over a prescribed number of years that is equal to or less than the average remaining period of service of employees.)

**Company's share of pension assets based on the percentage of premiums contributed to multi-party employers' pension system**

Thousands of yen	2005	2006
	1,146,296	1,675,535

**Deferred taxes**

Thousands of yen	2005	2006
Deferred tax assets (current)	551,732	480,445
Deferred tax liabilities (current)	40,836	11,636
Deferred tax assets - net	510,895	468,809
Deferred tax assets (fixed)	884,995	972,414
Deferred tax liabilities (long-term)	200,892	304,696
Deferred tax assets - net	684,103	667,718

## Nonconsolidated Financial Statements

### *Nonconsolidated statement of income*

Years ended March 31; Thousands of yen	2004	2005	2006
<b>Net sales</b>			
Net sales - finished goods	25,900,391	28,918,150	27,097,086
Net sales - merchandise	212,688	209,679	196,355
	26,113,079	29,127,830	27,293,442
<b>Cost of goods sold</b>			
Cost of finished goods sold			
Finished goods inventory, beginning of term	1,562,263	1,547,961	1,599,592
Production costs for the term	14,650,062	15,840,204	15,177,625
	16,212,326	17,388,165	16,777,218
Transfers to other accounts	90,512	126,391	20,132
Finished goods inventory, end of term	1,547,961	1,599,592	1,310,196
	14,573,851	15,662,181	15,446,888
Cost of merchandise sold			
Merchandise inventory, beginning of term	4,207	5,384	4,654
Merchandise purchased during term	107,303	107,359	99,623
	111,511	112,743	104,278
Merchandise inventory, end of term	5,384	4,654	4,912
	106,127	108,088	99,366
	14,679,979	15,770,270	15,546,255
Gross profit on sales	11,433,100	13,357,560	11,747,187
<b>Selling, general and administrative expenses</b>			
After-sales service expenses	410,120	418,286	478,832
Directors' salaries	125,130	122,440	124,800
Employees' salaries	1,581,695	1,712,929	1,933,937
Bonuses	445,467	421,331	313,306
Provision for bonuses	210,956	266,520	294,035
Legal welfare expenses	299,583	310,882	340,393
Rent	525,460	515,069	533,071
Depreciation expenses	83,811	84,721	79,895
Provision for doubtful accounts	-	-	49,841
Provision for directors' and corporate auditors' retirement allowances	36,614	40,629	38,240
Others	1,626,330	1,744,882	1,825,008
	5,345,169	5,637,694	6,011,361
Operating income	6,087,931	7,719,866	5,735,825

MARS ENGINEERING CORPORATION

Years ended March 31; Thousands of yen	2004	2005	2006
<b>Nonoperating income</b>			
Interest income	14,609	6,719	3,751
Interest income from securities	65,975	22,135	64,005
Dividend income	19,378	76,027	120,484
Income from contracted operations	9,600	9,600	9,600
Gain from conclusion of interest rate swap	-	34,433	-
Miscellaneous income	21,733	10,587	17,109
	131,296	159,502	214,951
<b>Nonoperating expenses</b>			
Commissions paid on the purchase of treasury stock	-	-	9,289
Interest expenses	6,143	-	-
Miscellaneous losses	54	4,050	1,078
	6,197	4,050	10,367
Ordinary profit	6,213,030	7,875,317	5,940,409
<b>Extraordinary income</b>			
Gain on sales of investment securities	6,962	-	5,084
Gain on redemption of investment securities	-	-	143,478
Reversal of allowance for doubtful accounts	2,200	2,459	-
	9,162	2,459	148,563
<b>Extraordinary losses</b>			
Loss on disposal of inventories	158,081	163,841	1,971
Loss on sales of fixed assets	-	-	1,083,013
Loss on removal of fixed assets	8,979	2,439	1,676
Provision for directors' retirement allowances for prior years	487,669	-	-
Loss on sales of investment securities	91,956	-	-
Valuation loss on investment securities	-	38,879	-
Valuation loss on shares in affiliates	-	100,000	-
	746,687	305,161	1,086,660
Income (loss) before taxes and other adjustments	5,475,505	7,572,615	5,002,311
Corporate, inhabitant and enterprise taxes	2,161,037	3,150,912	2,059,624
Adjustment for income and other taxes	171,440	(63,563)	(19,979)
	2,332,478	3,087,349	2,039,644
Net income (loss) for the term	3,143,026	4,485,265	2,962,666
Retained earnings brought forward from previous term	4,031,533	6,409,965	9,684,241
Interim dividends	227,198	454,396	450,787
Unappropriated retained earnings, fiscal year-end	6,947,362	10,440,834	12,196,121

**Nonconsolidated appropriation of retained earnings**

Thousands of yen	June 29, 2004	June 29, 2005	June 29, 2006
Unappropriated profit, end of term	6,947,362	10,440,834	12,196,121
Appropriation of retained earnings			
Dividends	454,396	681,592	427,807
Directors' and corporate auditors' bonuses	83,000	75,000	75,000
[Corporate auditors' bonuses]	[ 6,000 ]	[ 2,000 ]	[ 2,000 ]
	537,396	756,592	502,807
Retained earnings carried forward to following term	6,409,965	9,684,241	11,693,313

**Cost of goods sold**

Years ended March 31; Thousands of yen	2004	%	2005	%	2006	%
Cost of materials	13,092,715	88.1	14,262,441	87.7	13,382,855	88.1
Subcontracted processing expenses	1,112,824	7.5	1,300,164	8.0	1,032,363	6.8
Labor costs	335,221	2.3	367,470	2.3	367,777	2.4
Manufacturing overhead	314,684	2.1	322,570	2.0	406,765	2.7
Total manufacturing costs for the term	14,855,444	100.0	16,252,646	100.0	15,189,761	100.0
Work-in-process inventory, beginning of term	34,447		66,296		159,192	
	14,889,893		16,318,942		15,348,954	
Work-in-process inventory, end of term	66,296		159,192		58,884	
Transfers to other accounts	173,534		319,546		112,443	
Production costs for the term	14,650,062		15,840,204		15,177,625	

*Primary items and amounts included under Labor costs and Manufacturing overhead.*

**Labor costs**

Provision for bonuses	26,271	27,260	27,364
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**Manufacturing overhead**

Depreciation expenses	200,062	182,022	232,903
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**Transfers to other accounts**

Selling, general and administrative expenses	107,689	156,150	103,709
Loss on disposal of inventories	65,844	33,621	-
Software under development	-	129,774	8,734
	173,534	319,546	112,443

**Nonconsolidated balance sheet****Assets**

March 31; Thousands of yen	2004	2005	2006
<b>Current assets</b>			
Cash and deposits	8,217,074	10,950,330	7,482,487
Notes receivable	1,801,918	1,791,588	1,736,860
Accounts receivable - trade	3,988,099	3,744,326	4,093,473
Marketable securities	6,873,957	8,501,804	5,888,526
Merchandise	5,384	4,654	4,912
Finished goods	1,547,961	1,599,592	1,310,196
Materials	463,288	599,347	934,054
Work in process	66,296	159,192	58,884
Supplies	420,965	376,045	351,594
Prepaid expenses	54,946	102,274	102,755
Short-term loans	283,000	180,000	221,651
Deferred tax assets	344,647	279,518	223,668
Others	14,591	14,493	43,447
Allowance for doubtful accounts	(10,341)	(9,146)	(28,446)
	24,071,791	28,294,021	22,424,068
<b>Fixed assets</b>			
<b>Tangible fixed assets</b>			
Buildings	3,507,299	3,534,278	3,985,203
Accumulated depreciation	1,613,388	1,717,374	1,815,167
	1,893,910	1,816,904	2,170,035
Structures	191,175	192,451	216,184
Accumulated depreciation	145,425	152,416	158,229
	45,750	40,034	57,955
Machinery and equipment	216,723	218,388	218,388
Accumulated depreciation	109,156	133,845	152,920
	107,566	84,543	65,468
Vehicles and delivery equipment	18,304	12,324	12,324
Accumulated depreciation	15,302	10,554	11,110
	3,002	1,769	1,213
Tools, appliances and fixtures	1,633,514	1,756,557	2,076,824
Accumulated depreciation	1,406,291	1,510,103	1,687,322
	227,223	246,453	389,502
Land	3,496,763	3,496,763	1,855,750
	5,774,217	5,686,468	4,539,925



MARS ENGINEERING CORPORATION

<b>March 31; Thousands of yen</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Intangible fixed assets</b>			
Patents	17,461	14,276	11,094
Telephone subscription rights	15,214	15,214	15,214
Software	23,819	154,032	137,953
Software under development	-	18,921	8,693
	56,495	202,444	172,956
<b>Investments and other assets</b>			
Investment securities	1,575,342	1,135,722	1,777,091
Capital stock of affiliated companies	2,476,860	2,424,138	4,434,138
Investments other than securities	454	5,454	5,454
Long-term loans to affiliates	410,000	60,000	320,868
Rental and guarantee deposits	365,400	388,139	390,063
Claims in bankruptcy and substantial bankruptcy	93,309	62,390	83,438
Long-term prepaid expenses	9,694	11,612	11,593
Deferred tax assets	151,271	237,803	236,970
Prepaid pension expenses	131,363	108,259	82,604
Others	66,100	66,100	367,561
Allowance for doubtful accounts	(141,895)	(110,805)	(139,271)
	5,137,902	4,388,814	7,570,512
Total fixed assets	10,968,615	10,277,728	12,283,395
<b>Total assets</b>	35,040,407	38,571,749	34,707,463

**Liabilities and shareholders' equity**

March 31; Thousands of yen	2004	2005	2006
<b>Current liabilities</b>			
Notes payable	4,160	10,658	141,100
Accounts payable - trade	2,939,070	3,137,342	3,056,085
Accounts payable - other	158,023	135,485	315,473
Income taxes payable	2,165,011	2,137,324	481,403
Consumption taxes payable	138,358	195,367	-
Accrued expenses	90,518	56,306	63,881
Advances from customers	39,465	17,476	1,901
Deposits received	25,546	16,663	19,891
Deferred income	3,534	2,957	1,677
Allowance for bonuses	237,228	293,780	321,399
	5,800,916	6,003,361	4,402,813
<b>Long-term liabilities</b>			
Interest rate swap liability	257,379	-	-
Reserve for directors' and corporate auditors' retirement allowances	503,954	522,741	560,581
Others	46,320	59,234	129,200
	807,655	581,976	689,781
Total liabilities	6,608,571	6,585,338	5,092,595
<b>Shareholders' equity</b>			
Common stock	7,934,100	7,934,100	7,934,100
Capital reserves			
Additional paid-in capital	8,371,830	8,371,830	8,371,830
	8,371,830	8,371,830	8,371,830
Retained earnings			
Legal income reserves	372,109	372,109	372,109
Voluntary reserves - total			
Special reserve	4,600,000	4,600,000	4,600,000
Unappropriated retained earnings, fiscal year-end	6,947,362	10,440,834	12,196,121
	11,919,471	15,412,943	17,168,230
Unrealized gains or losses on other securities	206,726	268,180	379,923
Treasury stock	(292)	(642)	(4,239,215)
Total shareholders' equity	28,431,835	31,986,411	29,614,868
<b>Total liabilities and shareholders' equity</b>	<b>35,040,407</b>	<b>38,571,749</b>	<b>34,707,463</b>

**Trade credits****Notes receivable**

Thousands of yen	2006
GAIA	172,836
Sana Shoji	151,200
Karen	101,050
Sanpo Shoji	93,821
W Holdings	85,541
Others	1,132,411
	<u>1,736,860</u>

**Accounts receivable — trade**

Thousands of yen	2006
Riso	266,526
Dynam Co., Ltd.	222,713
Fuyo General Lease	215,901
Paradise	215,000
Mars Techno-Science Corporation	163,392
Others	3,009,939
	<u>4,093,473</u>

**Turnover of accounts receivable**

Thousands of yen	2006
Beginning balance	3,744,326
Increase	28,951,191
Collected	28,602,044
Ending balance	4,093,473
Turnover	87.4%
Average days for collection	49.4

## Securities

### Marketable and investment securities

Thousands of yen

<b>Stocks</b>	<b>Number of shares</b>	<b>Book value</b>
<b>Investment securities</b>		
Other securities		
Japan Cash Machine (6418)	250,387	569,630
Resona Holdings, Inc. (8038)	465	188,385
Atom Corp. (7412)	4,000	45,684
Tokyo Tomin Bank (8339)	21,242	114,494
P ARK	20,000	40,000
Mitsubishi UFJ Financial Group, Inc. (8306)	31	55,800
Nippon Signal (6741)	5,000	5,320
Japan Network System	200	20,000
Tokyo Tomin Preferred Capital (Cayman) Limited, variable-dividend, noncumulative preferred stock	6	60,000
TMI	30	-
	301,361	1,099,315
<b>Bonds</b>		
	<b>Total face value</b>	<b>Book value</b>
<b>Marketable securities</b>		
Bonds being held to maturity	2,708,000	2,707,610
<b>Investment securities</b>		
Bonds being held to maturity	216,000	214,650
	2,924,000	2,922,261
<b>Others</b>		
	<b>Number of units invested</b>	<b>Book value</b>
<b>Marketable securities</b>		
Other securities	1,005,556	3,180,916
<b>Investment securities</b>		
Other securities	46,990	463,125
	1,052,546	3,644,041

## Tangible fixed assets

Thousands of yen	Beginning of term	Increase	Decrease	End of term	Depreciation		End of term, net
					Accumulated	Current	
<b>Tangible fixed assets</b>							
Buildings	3,534,278	450,924	-	3,985,203	1,815,167	97,792	2,170,035
Structures	192,451	23,733	-	216,184	158,229	5,812	57,955
Machinery and equipment	218,388	-	-	218,388	152,920	19,074	65,468
Vehicles and delivery equipment	12,324	-	-	12,324	11,110	555	1,213
Tools, appliances and fixtures	1,756,557	333,292	13,025	2,076,824	1,687,322	189,563	389,502
Land	3,496,763	-	1,641,013	1,855,750	-	-	1,855,750
Construction in progress	-	511,050	511,050	-	-	-	-
	9,210,764	1,319,000	2,165,088	8,364,676	3,824,750	312,799	4,539,925
<b>Intangible fixed assets</b>							
Patents	-	-	-	25,323	14,228	3,181	11,094
Telephone subscription rights	-	-	-	15,214	-	-	15,214
Software	-	-	-	222,611	84,657	62,749	137,953
Software under development	-	-	-	8,693	-	-	8,693
	-	-	-	271,842	98,886	65,931	172,956
Long-term prepaid expenses	71,077	5,451	51,114	25,414	13,821	5,110	11,593

## Reserves

Thousands of yen	Beginning of term	Increase	Decrease	End of term
Allowance for doubtful accounts	119,951	60,453	12,687	167,717
Reserve for bonuses	293,780	321,399	293,780	321,399
Reserve for directors' retirement allowances	522,741	38,240	400	560,581

## Accounting Policies

### Summary of accounting policies: consolidated

<b>Basis for presentation</b>	Japanese GAAP
<b>Marketable securities and Investments in securities</b>	<p>Bonds held to maturity: cost amortization method (straight-line)</p> <p>Other securities:            Quoted securities: The market value method is applied, based on the market value as of the fiscal year-end. The entire positive or negative valuation difference from the purchase price is booked directly as shareholders' equity, and the cost of securities sold is calculated using the moving-average method.            Unquoted securities: valued at cost using the moving-average method</p>
<b>Inventories</b>	Valued at cost using the moving-average method
<b>Depreciation</b>	<p>Tangible fixed assets: declining-balance method</p> <p>Provided, however, that buildings acquired after April 1, 1998 (excluding appurtenances) and assets used in hotel operations are depreciated on a straight-line basis.</p> <p>Intangible fixed assets:            Software for sale: amortized over a period of three years from the commencement of sales, based on the projected number of sales. However, if the amount calculated on this basis is less than straight-line amortization over the estimated economic life of the software, then the latter is recognized as the minimum amount of amortization.            Other: straight-line method            Amortization of software for internal use is based on the period of potential use (5 years); patent rights are amortized over 5 years.            Long-term prepaid expenses: amortized in equal installments over the period covered</p>
<b>Allowance for doubtful accounts</b>	To provide for potential losses from doubtful accounts, the Company recognizes an amount calculated on the basis of a historical bad debt ratio for general accounts receivable, plus an amount for specific accounts for which collection appears doubtful.
<b>Reserve for bonuses</b>	Recognition of the expenses for the current term, based on estimated bonus expenses for the bonus period
<b>Retirement benefit accounting</b>	To provide for employees' retirement benefits, the Company recognizes an amount based on retirement benefit liabilities and estimated pension assets as of the end of the fiscal year to March 2006.
<b>Reserve for directors' and corporate auditors' retirement allowances</b>	Recognition of the full amount of liability at term-end based on employment regulations
<b>Opinion of independent auditors</b>	<p>Auditors: Tohmatsu &amp; Co.</p> <p>Opinion: unqualified</p>

**Summary of accounting policies: nonconsolidated**

<b>Basis for presentation</b>	Japanese GAAP
<b>Marketable securities and investments in securities</b>	<p>Bonds held to maturity: cost amortization method (straight-line)</p> <p>Shares in subsidiaries and affiliated companies: valued at cost using the moving-average method</p> <p>Other securities:          Quoted securities: The market value method is applied, based on the market value as of the fiscal year-end. The entire positive or negative valuation difference from the purchase price is booked directly as shareholders' equity, and the cost of securities sold is calculated using the moving-average method.</p> <p>Unquoted securities: valued at cost using the moving-average method</p>
<b>Inventories</b>	Merchandise, finished goods, work in process, raw materials and supplies: valued at cost using the moving-average method
<b>Depreciation</b>	<p>Tangible fixed assets: declining-balance method</p> <p>Provided, however, that buildings acquired after April 1, 1998 (excluding appurtenances) are depreciated on a straight-line basis.</p> <p>Intangible fixed assets:          Software for sale: amortized over a period of 3 years from the commencement of sales, based on the projected number of sales. However, if the amount calculated on this basis is less than straight-line amortization over the estimated economic life of the software, then the latter is recognized as the minimum amount of amortization.</p> <p>Others: straight-line method          Amortization of software for internal use is based on the period of potential use (5 years); patent rights are amortized over 5 years.</p> <p>Long-term prepaid expenses: amortized in equal installments over the period covered</p>
<b>Allowance for doubtful accounts</b>	To provide for potential losses from doubtful accounts, the Company recognizes an amount calculated on the basis of a historical bad debt ratio for general accounts receivable, plus an amount for specific accounts for which collection appears doubtful.
<b>Reserve for bonuses</b>	Recognition of the expenses for the current term, based on estimated bonus expenses for the bonus period
<b>Reserve for directors' and corporate auditors' retirement allowances</b>	Recognition of the full amount of liability at term-end based on employment regulations
<b>Retirement benefit accounting</b>	To provide for employees' retirement benefits, the Company recognizes an amount based on retirement benefit liabilities and estimated pension assets as of the end of the fiscal year to March 2006.
<b>Opinion of independent auditors</b>	<p>Auditors: Tohmatsu &amp; Co.</p> <p>Opinion: unqualified</p>

## Share-related Information

### Shares in issue

<b>Class of shares</b>	Common
<b>Number of shares authorized</b>	67,620,000
<b>Issued</b>	
As of March 31, 2006	22,720,000
As of June 30, 2006	22,720,000
<b>Stock exchange listings</b>	Tokyo Stock Exchange, First Section
<b>Comments</b>	-

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

Thousands of yen Date	Shares outstanding		Common stock		Additional paid-in capital		Remarks
	Increase or decrease	Balance	Increase or decrease	Balance	Increase or decrease	Balance	
September 17, 2004	11,360	22,720	-	7,934,100	-	8,371,830	Split 2 for 1

### Shareholders by type of investor

Type of investor; Hundred shares	Number of shareholders	Number of units owned	% owned
National and local government agencies	-	-	-
Financial institutions	39	25,014	11.01
Securities companies	31	1,345	0.59
Business and other corporations	78	44,590	19.63
Non-residents (businesses and corporations)	79	41,556	18.29
Non-residents (individuals)	3	5	0.00
Individuals and others	6,776	114,686	50.48
	7,006	227,196	100.00
Shares less than one unit	-	400	-



**Largest shareholders**

<b>Name</b>	<b>Thousands of shares owned</b>	<b>Held in trust accounts</b>	<b>% of shares outstanding</b>
EM Planning	4,250.0		18.71
Hirokazu Matsunami	1,405.6		6.19
State Street Bank and Trust Company	1,071.3		4.72
Kayoko Matsunami	1,028.0		4.52
Akihiro Matsunami	1,000.0		4.40
The Master Trust Bank of Japan, Ltd. (Trust Account)	677.5	213.8	2.98
Mizuho Trust & Banking Co., Ltd., employee pension trust; sub-trustee, Tokyo Tomin Bank, Ltd. asset management service trust for sub-trustees	600.0		2.64
Shigeo Komiya	490.0		2.16
BBH PUTNAM INTERNATIONAL VOYAGER FUND	489.0		2.15
Teruo Gomi	450.0		1.98
	11,461.4		50.45

**Share information**

<b>Fiscal year-end</b>	March 31
<b>Ex-rights date</b>	March 31
<b>Ex-rights date for interim dividend</b>	September 30
<b>Annual general meeting of shareholders</b>	June
<b>Trading unit</b>	100 shares
<b>Types of share certificates</b>	100, 1,000 and 10,000 shares
<b>Transfer agent</b>	The Sumitomo Trust & Banking Co., Ltd. 1-4-4 Marunouchi, Chiyoda-ku, Tokyo
<b>Publication of record</b>	<i>The Company's official announcements shall be made electronically. However, when matters arise which cannot be conveyed electronically or when electronic announcements cannot be made for some other justifiable reason, the Company shall make its official announcements through The Nihon Keizai Shimbun.</i> <i>The Company's electronic announcements can be accessed through the Company's home page at the following address:</i> <i><a href="http://www.mars-eng.co.jp/kessan/index.html">http://www.mars-eng.co.jp/kessan/index.html</a></i>

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