

# Financial Review

Financial Report for Oki Electric Industry Co., Ltd. and its Consolidated Subsidiaries

## SCOPE OF CONSOLIDATION

In the fiscal year ended March 31, 2006, six companies were included in and two companies excluded as subsidiary companies from the Oki Electric Industry Co., Ltd. ("Oki" or "the Company") Group's scope of consolidation, for a total of 84 companies. There were two affiliated companies accounted for under the equity-method, unchanged from the previous fiscal year.

## OVERVIEW OF THE FISCAL YEAR ENDED MARCH 31, 2006

### Net Sales and Operating Income

In the fiscal year under review, the Japanese economy was generally steady, supported by an increase in capital investment reflecting an improvement in corporate earnings and a recovery in consumer spending. Overseas, the global economy also enjoyed an upward swing. In the business areas in which the Oki Group operates, however, business conditions were mixed. Growth in the color printer market was a positive factor supporting the Group's performance. Delays in security-related investment by financial institutions and declining semiconductor and printer prices caused by continued deflationary conditions in the overall IT market, on the other hand, placed downward pressure on operating results. In addition, the Group was impacted by a lull in investment by telecom carriers in broadband IP networks in the second half of the fiscal year.

Against this backdrop, the Oki Group reported consolidated net sales of ¥680.5 billion, down 1.2% compared with the previous fiscal year. Consolidated operating income was ¥10.6 billion from ¥27.2 billion, falling ¥16.6 billion year on year.

## SEGMENT INFORMATION

### Info-Telecom Systems

Results in this segment were affected by the decline in bank branch terminal demand, and delays in security-enhanced ATM investment anticipated at the beginning of the fiscal year. Despite signs of a pickup in investment activity in back office concentration systems, back office systems and other efficiency solutions, demand was also less than expected.

In the telecom carrier market, investment in fixed-line systems declined due to the lull in expenditure for broadband IP networks and fixed-phone direct collection systems. Looking at corporate capital investment in general, interest was high in IP telephony-based info-telecom converged systems. The market is in its early stage, however, and yet to take hold on a full-fledged basis.

Accounting for these factors, consolidated segment sales declined 9.4% compared with the previous fiscal year to ¥338.0 billion. Reflecting the drop in sales, operating income fell ¥4.9 billion year on year from ¥15.8 billion to ¥10.9 billion.

### Semiconductors

While the semiconductor market continued its recovery, prices declined across the board. In its mainstay products of P2ROMs and drivers, the Oki Group worked to reduce costs and improve product value by expanding capacity and introducing new products. This was, however, more than offset by falling prices owing to the rush of new market entrants and resultant intense competition. In addition, delays in developing new system LSI products impacted the Group's performance.

As a result, consolidated sales in this segment totaled ¥150.7 billion, essentially unchanged from the previous fiscal year. Operating income declined from ¥12.0 billion to ¥3.0 billion, a decline of ¥9.0 billion, due to the aforementioned drop in product prices reflecting fierce competition.

### Printers

Rapid growth in the business-use color NIP market continued throughout the fiscal year under review. Against this backdrop, the Oki Group increased sales by introducing new multifunction printers that leverage the Group's strength in color LED printers, combining compact designs with high printing speeds and resolutions, and expanded sales and production sites. Especially in the color printer market, competition is becoming fiercer as competitors struggle to increase market share.

Based on the aforementioned, consolidated sales in this segment climbed 16.5% year on year to ¥160.5 billion. Operating income, on the other hand, declined ¥3.7 billion from ¥7.8 billion in the previous fiscal year to ¥4.1 billion. This was attributed to declining product prices in the core color printer market, a deteriorating model mix and proactive investment in sales and production.

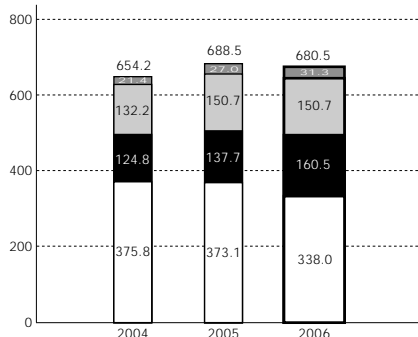
## GEOGRAPHIC SEGMENT INFORMATION

### Japan

The Japanese domestic economy is performing comparatively well owing to greater capital expenditure, improved corporate earnings and revived personal consumption. However, in the fields where Oki is active, delayed security-related investment by financial institutions along with and the low ebb of the investment cycle in broadband IP

### Net Sales

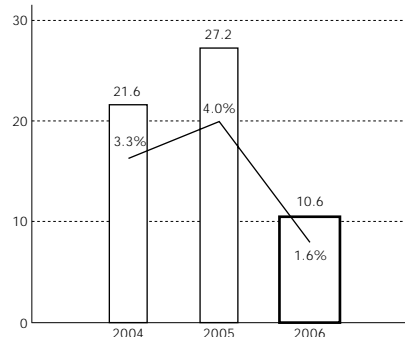
Billions of yen



Info-Telecom Systems
  Printers
  Semiconductors
  Other

### Operating Income / Operating Income Margin

Billions of yen



Operating Income
  Operating Income Margin (%)

networks in the second half of the year by telecom carriers both had a negative effect on consolidated net sales, which declined by 3.8% to ¥494.5 billion. The drop in semiconductor prices also exerted a negative influence on operating income, which fell ¥15.4 billion from ¥36.0 billion to ¥20.6 billion.

#### North America

Sales rose 12.4% to ¥65.7 billion on the back of firm printer sales in North America. Mirroring improved printer sales, operating income climbed from ¥0.9 billion in the previous fiscal year to ¥1.1 billion, an increase of ¥0.2 billion year on year.

#### Europe

Despite a drop in prices due to increased competition in the printer market, sales in Europe climbed 6.7% to ¥84.9 billion. This was attributed to continued increase in sales volumes. From operating income of ¥0.9 billion in the previous fiscal year, the Oki Group incurred an operating loss of ¥1.9 billion. The aforementioned drop in product prices and additional sales costs in line with increased sales caused this deterioration totaling ¥2.8 billion.

#### Asia

Sales in Asia declined 3.1% to ¥35.5 billion due to continued semiconductor inventory adjustments mainly in China. Impacted by the drop in semiconductor prices, operating income fell ¥0.9 billion to ¥1.5 billion from ¥2.4 billion in the previous fiscal year.

### NET INCOME

While operating income deteriorated ¥16.6 billion to ¥10.6 billion in the fiscal year under review, the Oki Group reported a gain on sale of investments in securities of ¥5.0 billion. As a result, income before income taxes, minority interests and equity in earnings of affiliates was ¥10.5 billion, a year-on-year decline of ¥7.8 billion. Net income for the fiscal year ended March 31, 2006 totaled ¥ 5.1 billion, down ¥6.1 billion from ¥11.2 billion in the previous fiscal year.

In line with the drop in net income, net income per share declined from ¥18.27 to ¥8.27. ROE also deteriorated from 9.5% to 3.9%.

### FINANCIAL POSITION

#### Assets, Liabilities and Shareholders' Equity

Compared with the previous fiscal year-end, total assets and shareholders' equity increased ¥10.9 billion and ¥9.1 billion, respectively. As a result, the shareholders' equity ratio improved 1.1 percentage points to 21.6%.

In current assets, inventories increased ¥17.6 billion while cash and cash equivalents and time deposits declined ¥11.0 billion. Investments in securities classified as fixed assets rose ¥9.7 billion year on year. The increase in inventories was primarily attributed to a jump in the volume of color printers and yen conversion resulting from foreign currency movements.

Total liabilities climbed ¥1.4 billion. Interest-bearing liabilities rose ¥3.1 billion mainly due to the increase in debt.

#### CASH FLOWS

In the fiscal year under review, net cash provided by operating activities fell ¥44.3 billion from ¥59.3 billion in the previous fiscal year to ¥15.0 billion mainly due to the increase in working capital.

Net cash used in investing activities narrowed ¥12.9 billion to ¥28.6 billion from ¥41.5 billion in the previous fiscal year. This was attributed to a drop in purchases of property, plant and equipment and an increase in proceeds from the sale of shares.

Free cash flows, which are the total of cash flows from operating and investing activities were negative totaling ¥13.6 billion. This was a turnaround of ¥31.4 billion from positive free cash flows of ¥17.8 billion in the previous fiscal year.

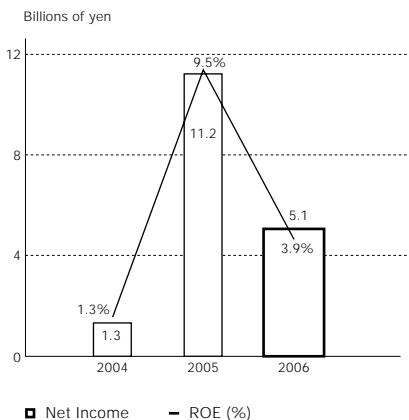
Net cash provided by financing activities amounted to ¥0.8 billion. This was due to the issuance of bonds and the repayment of long-term debt.

As a result of these cash flow movements, cash and cash equivalents as of March 31, 2006 were ¥38.4 billion. This represents a year-on-year decline of ¥11.0 billion compared with the previous fiscal year-end's total of ¥49.4 billion.

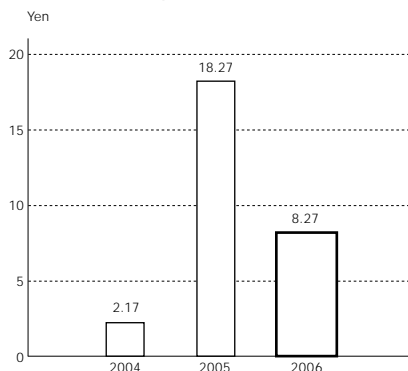
### CAPITAL EXPENDITURES, DEPRECIATION AND RESEARCH AND DEVELOPMENT EXPENSES

As a result of progress in restricting investment mainly on semiconductors, capital expenditures as a whole were reduced by ¥4.3 billion yen

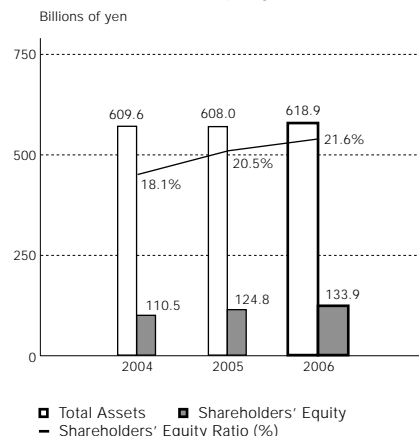
#### Net Income / Return on Equity [ROE]



#### Net Income per Share



#### Total Assets / Shareholders' Equity / Shareholders' Equity Ratio



to ¥33.5 billion yen. Depreciation of property, plant and equipment increased by ¥1.1 billion to ¥26.6 billion. Research and development expenses were reduced by ¥2.4 billion to ¥19.6 billion.

#### OUTLOOK FOR THE YEAR ENDING MARCH 31, 2007

The Japanese economy is exhibiting clearer signs of recovery supported by improvements in the corporate sector. Despite this favorable outlook, however, the Oki Group remains cautious with growing concerns over the sharp increase in crude oil prices and continued price deterioration in the IT industry.

Under these conditions, the Oki Group is forecasting increased revenues in the financial market of the Info-Telecom Systems segment owing to robust demand for security-enhanced ATMs, ATMs for overseas markets particularly China and Korea, and IP Network-related investment expansion by financial institutions. While telecom carriers are expected to expand optical IP telephony-related investment, efforts to limit overall investment in broadband infrastructure in preparation of NGN growth is anticipated to dampen revenues.

In the public sector, sales of municipal wireless systems to local governments are expected to rise. Enterprise sales are also forecast to expand on the back of strong demand for IP-based info-telecom systems. Accounting for these factors, sales in the Info-Telecom Systems segment are forecast to total ¥360.0 billion, and increase of ¥22.0 billion year on year. Despite the drop in overall prices and a decline in relatively high-profit margin telecommunication carrier products, operating income is expected to climb ¥1.6 billion to ¥12.5 billion.

Conditions in the Semiconductors business segment are clouded by the possibility of continued downward price revisions. Sales are expected to increase, however, spurred by the introduction of new communication system LSI products and greater interest in driver LSIs reflecting strong demand for LCD TVs. Accordingly, sales in this segment are expected to edge up ¥3.3 billion to ¥154.0 billion. Operating income is also forecast at ¥5.5 billion, a year-on-year increase of ¥2.5 billion. This is attributed to a sales upswing in drivers and cost reduction measures as well as the introduction of new products.

The Oki Group is expecting growth in the color NIP business owing to market expansion of business-use color NIPs and our growing shift away from low-priced models. Sales of monochrome NIP and dot print-

ers are expected to remain unchanged, reflecting the general trend toward market contraction. As a result, sales in the Printers segment are forecast to increase ¥11.5 billion year on year to ¥172.0 billion. Despite increased costs related to the upgrade of sales channels and release of new products, operating income is expected to climb ¥0.9 billion to ¥5.0 billion.

In the Other segment, the Oki Group is anticipating sales of ¥34.0 billion and operating income of ¥2.0 billion.

Accounting for the aforementioned factors, consolidated net sales for the fiscal year ending March 31, 2007 are expected to reach ¥720.0 billion. Operating income is forecast at ¥15.0 billion with net income of ¥2.5 billion.

Forecasts for the fiscal year ending March 31, 2007 are based on exchange rates of ¥115 equivalent to U.S.\$1.00 and ¥140 equivalent to one euro in the first half of the fiscal year, and ¥110 equivalent to U.S.\$1.00 and ¥135 equivalent to one euro in the second half.

#### Performance Forecasts for the Fiscal Year Ending March 31, 2007

(Billions of yen unless otherwise stated)

Net Sales	Operating Income	Net Income	Net Income per Share (Yen)
¥ 720.0	¥ 15.0	¥ 2.5	¥ 4.09

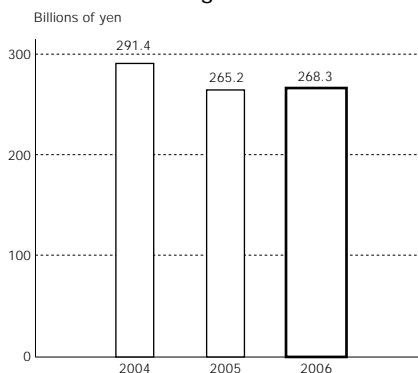
#### BUSINESS AND OTHER RISKS

The following risks may affect the Oki Group's performance and financial position. The Company recognizes that the occurrence of such risks may significantly influence the decisions of investors with respect to the Oki Group. Forward-looking statements in this document are based upon the Company's judgment as of June 29, 2006.

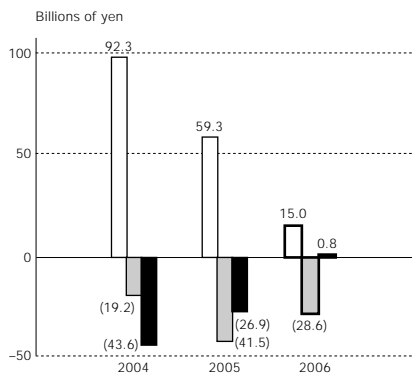
#### Political and Economic Trends

Demand for the Group's products is subject to political and economic trends in the individual countries and regions in which they are sold. Accordingly, economic recession and the resulting contraction in demand in the Group's principal operating markets of Japan, North America, Europe and Asia may impact its business performance and financial position.

#### Interest-Bearing Debt

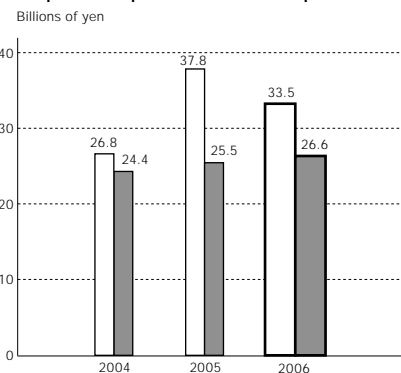


#### Cash Flows



- Cash Flows from Operating Activities
- Cash Flows from Investing Activities
- Cash Flows from Financing Activities

#### Capital Expenditures / Depreciation



- Capital Expenditures
- Depreciation

### Sudden Technological Innovation

The Oki Group's principal business segments comprising Info-Telecom Systems, Semiconductors and Printers are subject to rapid technological innovation. Accordingly, the Oki Group strives to preserve its competitive advantage through new technologies and product research and development. In the event, however, the Group is unable to keep pace with new innovations in technologies and products, is labored with obsolete products, and is unable to deliver products and services that appeal to customers, its performance and financial position may be affected.

### Market Trends

- The product and geographical markets in which the Oki Group operates are subject to frequent entry by new participants and persistent competition. In an effort to secure competitive advantage, the Group strives to enhance product development and reduce costs. In the event the Oki Group is unable to implement effective product development and cost rationalization measures and fails to maintain and secure sufficient market share, business performance and financial position may be affected.
- The performance of the Info-Telecom Systems segment is subject to a variety of factors including: (1) changes in investment trends by financial institutions due to revisions of financial regulation, poor performance and other factors; (2) changes in investment trends by telecom carriers owing to amendments to telecommunication regulations, shifts in business strategy and other factors, and; (3) a significant decline in public-sector investment due to national and local government policies.
- The semiconductor market in which the Oki Group operates is characterized by intensive fluctuation. While the Group makes every effort to establish and develop a business structure that is resilient to movements in the market, in the event of a substantial unforeseen drop in demand or price deterioration, the Semiconductor segment's performance may be affected.
- The printer market, a core component of the Oki Group's field of operations, is experiencing intense price competition, particularly in color printers, as companies seek to secure and expand market share. In an effort to secure a strong market position and profitability, the Oki Group is endeavoring to develop new products and reduce costs. Despite these efforts, continued downward revisions to product prices beyond the Group's expectations may impact the Printer segment's performance.

### Raw Material and Component Procurement

The Oki Group procures a variety of raw materials and components in support of its manufacturing activities. In the event the Group is unable to procure such material and components in a timely manner or find alternative vendors or certain materials due to their highly specialized nature, delayed product shipment to customers may result in lost business opportunities. The Group's performance and financial position may be affected by such an event.

The Oki Group is reliant upon the direct and indirect supply of crude oil and gold as a part of its manufacturing activities. A sharp rise in the price of these and other key materials may impact the Group's performance and financial position.

### Products Defects and Delays in Delivery

Despite every effort to ensure quality assurance, the Oki Group is unable to eliminate all possibility of product and service defect. In the event of product or service defect, the Group may be liable for damages. In addition, any incidence of defect may impact the Group's reputation and standing and contribute to a drop in demand. In either case, the Group's performance and financial position may be affected.

While the Oki Group adopts complete and thorough measures to ensure the timely delivery of its products and services, unforeseen incidents in design, material procurement and production control may lead to a delay in shipment. In this case, the Group may become liable for the payment of damages.

### Success or Failure of Strategic Alliances

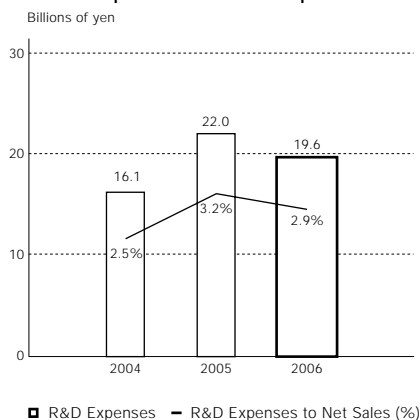
The Group is aggressively engaged with other companies in strategic alliances in research and development, manufacturing, sales and other activities. While the Group only enters into and maintains such alliances with the utmost circumspection, there may in theory be instances where the Group is not able to obtain the desired cooperation from the strategic partner in business strategy, production and technical development, finance or other activity, or where the alliance does not yield satisfactory results. The Group's performance and financial condition may be adversely affected by such an event.

### Overseas Business Activities

The Oki Group is engaged in business activities across a variety of countries and regions. Accordingly, it is subject to a number of risks specific to overseas business activities including country risk and foreign currency fluctuation risk. In the implementation of its business, the Oki Group takes all necessary care to avoid and minimize risks. In particular the Group enters into forward currency and currency swap contracts to minimize the risk of short-term movements in foreign currencies. Notwithstanding the aforementioned, a sharp appreciation of the yen against the U.S. dollar and the euro may affect the Group's performance and financial position.

The Oki Group operates production sites in Thailand and China. The Group's performance and financial position may therefore be affected in the event of a deterioration of political or economic conditions, movements in local currency exchange rates and unforeseen circumstances in either of these countries.

### R&D Expenses / R&D Expenses to Net Sales



### **Patents and Intellectual Property**

The Oki Group strives to protect its patents and to secure new patents with the aim of differentiating the Group from its competitors. Failure to do so may impact the performance of relevant businesses. The Oki Group is also active in developing new products and securing the right to use other companies' patents. In the event the Group is unable to secure patents or rights, or secures patents or rights under unfavorable terms and conditions, its performance and financial position may be affected.

The Oki Group endeavors to comply with patents held by third parties. It is not, however, in a position to completely guarantee the Group will not violate intellectual property rights held by another party. In the event the Group is involved in a claim relating to the violation of intellectual property rights, it is likely to incur legal and other expenses. In the event the Group is found to have breached intellectual property rights held by another party then it is likely to incur damages. In either event, the performance and financial position of the Group may be affected.

### **Statutory and Regulatory Compliance**

The Oki Group is subject to statutory and regulatory requirements, business and investment applications and approvals, export restrictions relating to national security and other factors, import regulations including customs and taxation and a variety of government ordinances in each of the countries and regions in which it operates. The Group is also subject to statutory and regulatory requirements relating to commerce, antitrust, patents and intellectual property rights, taxation, foreign currency, the environment and recycling. In the event the Group is unable to comply with any of the aforementioned, the possibility exists its activities would be restricted or suspended. Accordingly, the aforementioned and other statutory and regulatory requirements may impact the Group's performance and financial position.

### **Natural and Other Disaster**

The Oki Group conducts periodic inspections and implements a variety of accident, disaster and fire prevention measures to minimize stoppages of its production line. There is, however, no complete guarantee that accidents, disasters and fire that would impact the production line can be prevented.

In particular, stoppages to the Group's semiconductor production lines located in Hachioji (Tokyo), Miyazaki Prefecture, Miyagi Prefecture and Thailand due to earthquake, wide and flood damage and power blackout may affect the Group's performance and financial position.

### **Information Security**

The Oki Group has adopted various computer virus protection systems and other preventative measures to minimize information loss and leakage in connection with its internal systems. There is, however, no guarantee that a leak in information or system interruption due to human error, new kinds of computer viruses or other factors can be completely avoided. Furthermore, additional losses may arise in the each of the aforementioned.

### **Procurement and Training of Human Resources**

The ability to secure and foster high-quality human resources is a key factor in ensuring further growth as a stable earnings company. Accordingly, the Group strives to recruit capable employees at every level including new graduates and mid-career employees. In an effort to foster quality human resources the Group also conducts on-the-job training, education and a variety of training activities. In the event the Group is unable to secure and foster high-quality human resources or a number of key employees leave the Group, future growth may be affected.

### **Interest-Rate Fluctuations**

Although the Group has been reducing its interest-bearing debt, it is still susceptible to changes in interest rates. The Group utilizes interest-rate swaps and other instruments to manage the risks of interest-rate fluctuations, however, there is a possibility that interest charges may be increased associated with a rise in interest rates, and that the increased cost of raising capital would adversely affect the Company's ability to raise working capital.

### **Changes to Accounting Standards**

The Company makes consolidated and non-consolidated financial statements in accordance with accounting standards generally recognized as fair and accurate. Should changes to accounting standards occur, there is a possibility that the Group's performance and financial position may be adversely affected.

### **Debt Recovery**

While the Company constantly appraises the financial situation of its customers and makes provision for bad debts after the Balance Sheet date, a sudden deterioration in the financial condition of a major customer could exert a negative influence on the Group's performance.

### **Deferred Tax Assets**

The Oki Group amortizes deferred tax assets against retained losses carried forward and temporary differences as appropriate. In the event the Group is unable to eliminate retained losses and other temporary differences due to the decline in taxable income brought on by fluctuations in its business results, a liquidation of deferred tax assets may affect the Group's performance.

### **Retirement Benefit Obligations**

The Oki Group provides for retirement benefit obligations based on a discount rate established using actuarial calculations. Accordingly, a significant change in the discount rate and other preconditions and assumptions that leads to an increase in the retirement benefit obligation may impact the Group's performance and financial position.