

annual report
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NAKAYO

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President's Message



President
Susumu Akiyama

Chairman
Hisayoshi Takeuchi

The dream was of a time when information would be available to people anytime and anywhere. And people would be able to obtain any kind of information they wanted, anytime they wanted. They could then process the information and send it on to somewhere or someone else. The 21st century will turn this dream into reality. It will be a time when anyone will have the ability to organically utilize an extensive range of knowledge and information. Together with new developments in digitalization, broadband, and other telecommunication technologies, information networks have been advancing and globalization has been progressing at phenomenal speed, causing business styles to undergo a great many changes.

And now, we face matters of a global scale, such as the issues of natural resources and the environment, that must be addressed immediately. The social responsibilities of companies are becoming a much more important matter. But although we are in the midst of great changes, we at Nakayo have continuously maintained throughout our history an unwavering business philosophy. Our philosophy can be summarized as: (1) to be a part of the society, (2) to be receptive to global trends, and (3) to be responsive to public demands.

These guiding principles form the foundation of how we at Nakayo conduct our business activities as well as how we should fulfil our social responsibilities and earn the genuine satisfaction of our customers. And by providing a variety of attractive services together with our *nexus solutions*, a comprehensive integration of a wide range of highly creative and innovative cutting-edge technologies that only Nakayo is capable of creating, we are able to quickly and precisely meet the diverse needs of our customers.

Consolidated Balance Sheets

March 31, 2004 and 2003

Assets	Yen (Millions)		U.S.dollars (Thousands)
	2004	2003	2004
Assets			
Current assets:			
Cash and cash equivalents (Note 2)	¥ 7,940	¥ 7,508	\$ 75,159
Trade notes and accounts receivable	4,796	4,545	45,405
Inventories (Note 2)	1,310	1,219	12,400
Deferred income taxes	368	220	3,481
Other assets	380	401	3,600
Less: allowance for doubtful accounts (Note 2)	(115)	(112)	(1,093)
Total current assets	14,679	13,781	138,952
Property, plant and equipment: (Note 2 and 3)			
Land	1,211	1,211	11,466
Buildings and structures	3,170	3,154	30,011
Machinery, equipment and vehicles	1,470	1,631	13,912
Other	2,662	2,702	25,196
Construction in progress	3	10	28
	8,516	8,708	80,613
Less: accumulated depreciation	(6,081)	(6,212)	(57,565)
Net property, plant and equipment	2,435	2,496	23,048
Investments and other assets:			
Investment securities (Note 2)	1,903	928	18,016
Deferred income taxes	124	96	1,176
Other assets	974	754	9,219
Less: allowance for doubtful accounts (Note 2)	(10)	(0)	(97)
Total investments and other assets	2,991	1,778	28,314
Total assets	¥ 20,105	¥ 18,055	\$ 190,314
Liabilities and Shareholders' Equity			
Current liabilities:			
Short-term bank loans	¥ 636	¥ 978	\$ 6,020
Trade notes and accounts payable	3,063	2,614	28,996
Account payables other	588	740	5,562
Income taxes payable	168	34	1,595
Accrued expenses and other current liabilities	642	563	6,071
Total current liabilities	5,097	4,929	48,244
Long-term liabilities			
Deferred taxes	459	77	4,345
Accrued retirement benefits	578	636	5,476
Deposits received for guarantees	273	228	2,579
Total long-term liabilities	1,310	941	12,400
Minority interest	41	54	390
Shareholders' equity: (Note 5)			
Common stock:			
Authorized - 57,346,000 shares			
Issued - 23,974,816 shares as of March 31, 2004	4,909	-	46,470
Issued - 23,974,816 shares as of March 31, 2003	-	4,909	-
Capital surplus	4,512	4,521	42,712
Retained earnings	3,905	2,769	36,969
Net unrealized gains on available-for-sale securities	715	128	6,768
Treasury stock	(384)	(196)	(3,639)
Total shareholders' equity	13,657	12,131	129,280
Total liabilities and shareholders' equity	¥ 20,105	¥ 18,055	\$ 190,314

Consolidated Statements of Income

Years ended March 31, 2004 and 2003

	Yen (Millions)		U.S.dollars (Thousands)
	2004	2003	2004
Net sales	¥ 18,175	¥ 17,580	\$ 172,050
Cost of sales	<u>12,382</u>	<u>12,798</u>	<u>117,215</u>
Gross profit	<u>5,793</u>	<u>4,782</u>	<u>54,835</u>
Selling, general and administrative expenses (Note 4)	<u>4,191</u>	<u>3,922</u>	<u>39,666</u>
Operating income	<u>1,602</u>	<u>860</u>	<u>15,169</u>
Other income:			
Interest and dividends	<u>18</u>	<u>40</u>	<u>172</u>
Other	<u>46</u>	<u>53</u>	<u>437</u>
	<u>64</u>	<u>93</u>	<u>609</u>
Other expenses:			
Interest	<u>12</u>	<u>16</u>	<u>116</u>
Other	<u>318</u>	<u>613</u>	<u>3,011</u>
	<u>330</u>	<u>629</u>	<u>3,127</u>
Income before income taxes and minority interest	<u>1,336</u>	<u>324</u>	<u>12,651</u>
Income taxes (Note 2)			
Current	<u>223</u>	<u>123</u>	<u>2,112</u>
Deferred	<u>(197)</u>	<u>(42)</u>	<u>(1,866)</u>
	<u>26</u>	<u>81</u>	<u>246</u>
Minority interest in earnings of consolidated subsidiaries	<u>38</u>	<u>8</u>	<u>361</u>
Net income	<u>¥ 1,272</u>	<u>¥ 235</u>	<u>\$ 12,044</u>
		Yen	U.S.dollars
	<u>2004</u>	<u>2003</u>	<u>2004</u>
Net income per share: (Note 2)			
Basic	¥ 56.38	¥ 9.13	\$ 0.53
Diluted	¥ 56.07	-	\$ 0.53

Consolidated Statements of Shareholders' Equity

Years ended March 31, 2004 and 2003

	Yen (Millions)		U.S.dollars (Thousands)
	2004	2003	2004
Common stock			
Balance at beginning of year	<u>¥ 4,909</u>	<u>¥ 4,909</u>	<u>\$ 46,470</u>
Balance at end of the year	<u>¥ 4,909</u>	<u>¥ 4,909</u>	<u>\$ 46,470</u>
Capital surplus			
Balance at beginning of year	¥ 4,521	¥ 4,521	\$ 42,794
Loss on disposal of treasury stocks	<u>(9)</u>	<u>-</u>	<u>(82)</u>
Balance at end of year	<u>¥ 4,512</u>	<u>¥ 4,521</u>	<u>\$ 42,712</u>
Retained earnings			
Balance at beginning of year	¥ 2,769	¥ 2,609	\$ 26,216
Net income for the year	<u>1,272</u>	<u>235</u>	<u>12,044</u>
Cash dividends	<u>(113)</u>	<u>(72)</u>	<u>(1,074)</u>
Director's bonuses	<u>(23)</u>	<u>(3)</u>	<u>(217)</u>
Balance at end of year	<u>¥ 3,905</u>	<u>¥ 2,769</u>	<u>\$ 36,969</u>
Net unrealized gains on available-for-sale securities			
Balance at beginning of year	¥ 128	¥ 130	\$ 1,211
Net change during year	<u>587</u>	<u>(2)</u>	<u>5,557</u>
Balance at end of year	<u>¥ 715</u>	<u>¥ 128</u>	<u>\$ 6,768</u>
Treasury stock			
Balance at beginning of year	¥(196)	¥(1)	\$ (1,631)
Net change during year	<u>(188)</u>	<u>(195)</u>	<u>(2,008)</u>
Balance at end of year	<u>¥(384)</u>	<u>¥(196)</u>	<u>\$ (3,639)</u>

Consolidated Statements of Cash Flows

Years ended March 31, 2004 and 2003

	Yen (Millions)		U.S.dollars (Thousands)
	2004	2003	2004
Cash flows from operating activities:			
Income before income taxes and minority interest	¥ 1,336	¥ 324	\$ 12,651
Adjustments for:			
Depreciation and amortization	448	502	4,243
Increase in allowance for doubtful accounts	13	67	129
Increase (decrease) in accrued retirement benefits	(58)	205	(549)
Interest and dividend income	(18)	(40)	(172)
Interest expenses	12	16	116
Increase in trade notes and accounts receivable	(278)	(183)	(2,632)
(Increase) decrease in inventories	(91)	225	(860)
Increase (decrease) in trade notes and accounts payable	449	(107)	4,247
Other, net	(24)	786	(236)
Subtotal	1,789	1,795	16,937
Interest and dividends received	18	40	172
Interest paid	(12)	(16)	(116)
Income taxes paid	(89)	(250)	(841)
Net cash provided by operating activities	1,706	1,569	16,152
Cash flows from investing activities:			
Payments for time deposits	(396)	(395)	(3,748)
Proceeds from time deposits	496	907	4,696
Payments for purchases of property, plant and equipment	(290)	(385)	(2,745)
Payments for purchases of investment securities	(51)	(34)	(487)
Proceeds from sales of investment securities	72	610	681
Other, net	(451)	(150)	(4,272)
Net cash provided by used in investing activities	(620)	553	(5,875)
Cash flows from financing activities:			
Decrease in short-term bank loans	(342)	(91)	(3,237)
Payments for purchases of treasury stock	(240)	(194)	(2,272)
Dividends paid	(113)	(72)	(1,074)
Other, net	41	(2)	393
Net cash (used in) financing activities	(654)	(359)	(6,190)
Effect of exchange rate changes on cash and cash equivalents	(0)	(0)	(1)
Net increase in cash and cash equivalents	432	1,763	4,086
Cash and cash equivalents at beginning of year	7,508	5,745	71,073
Cash and cash equivalents at end of year	¥ 7,940	¥ 7,508	\$ 75,159

Notes to Consolidated Financial Statements

March 31, 2004 and 2003

1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements of Nakayo Telecommunications Inc. (the "Company") and its consolidated subsidiaries have been prepared in accordance with accounting principles and practices generally accepted in Japan.

In preparing the accompanying consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements prepared domestically in Japan in order to present them in a form which is more familiar to readers outside Japan. In addition, the notes to the consolidated financial statements include additional information which is not required under accounting principles and practices generally accepted in Japan.

The U.S. dollar amounts included herein are solely for the convenience of the readers and have been translated from the Japanese yen amounts at the rate of ¥105.64 = U.S. \$1, the approximate exchange rate on March 31, 2004.

2. Summary of Significant Accounting Policies

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and any significant companies controlled directly or indirectly by the Company. All significant intercompany accounts and transactions have been eliminated.

(b) Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments, generally with an original maturity of three months or less, that are readily convertible to known amounts of cash and are so near maturity that they present insignificant risk of changes in value because of changes in interest rates.

(c) Inventory Valuation

Finished goods and work in process are stated at cost determined by the specific cost method. Raw materials are stated at cost determined by the average cost method.

Inventories held by the consolidated subsidiaries are stated at cost which is determined principally by the last purchase price method.

(d) Marketable Securities and Investment Securities

Securities classified designated as "available-for-sale" securities, whose fair value is readily determinable, are carried at fair value with unrealized gains or losses reported as a separate component of shareholders' equity, net of applicable taxes. Costs are determined by the moving average methods.

Available-for-sale securities whose fair value is not readily determinable are carried at cost determined by the moving average method.

(e) Depreciation

Depreciation is computed by the declining-balance method at rates based on the estimated useful lives of the assets, while the straight-line method is applied to the buildings of the Company and domestic subsidiaries acquired after April 1, 1998. The range of useful lives is from 3 to 47 years for buildings and

structures, from 2 to 11 years for machinery, equipment and vehicles and from 2 to 20 years for other.

(f) Allowance for Doubtful Accounts

The allowance for doubtful accounts is provided based on the actual ratio of bad debts in the past and the estimated uncollectible amount.

(g) Income Taxes

The Company provides for income taxes applicable to all items included in the consolidated statements of income operations regardless of when such taxes are payable. Income taxes arising from temporary differences in the recognition of assets and liabilities for tax and financial reporting purposes are reflected as deferred income taxes in the consolidated financial statements by the asset and liability method.

Deferred tax assets and liabilities are measured using the enacted tax rates which will be in effect when the temporary differences are expected to reverse.

(h) Net Income per Share

The computation of basic net income per share is based on the weighted average number of shares of common stock outstanding during the respective fiscal year. Diluted net income per share is computed based on the weighted average number of common stock outstanding during the respective fiscal year and assuming the exercise of stock options.

(i) Accrued Retirement Benefits

The Company and its consolidated subsidiaries provide a reserve for employees' retirement benefits based on the projected benefit obligation and pension assets on the consolidated account settlement date.

Unrecognized actuarial differences are amortized on a straight-line method over the average remaining service period of employees from the next year in which they arise.

The annual provision for accrued retirement benefits for directors, officers and corporate auditors of the Company and its consolidated subsidiaries is also calculated to state the liability at the amount that would be required if all directors, officers and corporate auditors retired at the end of the consolidated fiscal year according to internal regulation.

(j) Leases

Finance leases other than those that are deemed to transfer the ownership of the leased assets to the lessee are accounted for by the method that is applicable to ordinary operating leases.

3. Assets Pledged to Secure Bank Loans

Pledged assets were as follows:

	Yen (Millions)		U.S.dollars (Thousands)
	2004	2003	2004
Property, plant and equipment			
Land	¥ 30	¥ 24	\$ 284
Buildings and structures	315	30	2,985
Machinery, equipment and vehicles	163	1	1,538
Other	313	-	2,965
Time deposits	10	10	95
Total	¥ 831	¥ 65	\$ 7,867

4. Pension and Severance Plans

(1) General Information about the Pension Plan

The Company and its consolidated subsidiaries have welfare pension fund plans and tax-qualified pension plans as defined benefit plans.

(2) Benefit Obligation

	Yen (Millions)		U.S.dollars (Thousands)
	2004	2003	2004
Benefit obligation	¥(2,973)	¥(2,719)	\$ (28,150)
Plan assets	1,491	1,063	14,121
Benefit obligation in excess of plan assets	(1,482)	(1,656)	(14,029)
Unrecognized actuarial loss	1,253	1,297	11,864
Net recognized retirement benefit obligation	(229)	(359)	(2,165)
Prepaid pension cost	137	89	1,296
Accrued retirement benefits	¥(366)	¥(448)	\$ (3,461)

Notes:

- (1) The annual provision for accrued retirement benefits for directors and corporate auditors (¥212 millions (\$2,014 thousands) in 2004, and ¥188 millions in 2003) is not included.
- (2) In computing projected benefit obligation, several simplified methods are permitted to small companies, and subsidiaries have adopted such methods.

5. Legal Reserve

The Commercial Code of Japan provides that an amount equal to at least 10% of the amount of cash dividends and directors' bonuses paid shall be appropriated as legal reserve until the total of legal reserve and capital surplus account equals 25% of the common stock account. This reserve may be used to reduce a deficit or may be transferred to capital stock, but if the total amount of capital surplus and legal reserve exceeds 25% of the amount of common stock, the excess may be distributed to the shareholders either as return of capital or as dividends subjects to the approval of the shareholders.

A Brief History

- 1944** Established by Yoichiro Nakamura in Tokyo as a manufacturer of telephone components.
- 1948** Designated by the Ministry of Posts and Telecommunications as an official supplier of telephone components.
- 1956** Under technical guidance provided by Hitachi, Ltd., began production of wire broadcasting systems for use in rural areas.
- 1958** Deming Prize awarded.
Production of T-4 transmitters and R-4 receivers for No.4 telephone sets began.
- 1963** Maebashi Plant, Gumma Prefecture, began operation with production of manual switchboards for Nippon Telegraph & Telephone Public Corporation.
- 1964** Type JN-4 decorative telephones exported to the U.S.A.
- 1965** R-3A receivers exported to the U.S.A.
- 1968** Under contract with Nippon Telegraph & Telephone Public Corporation, production of AR3 Rural Community Dial Exchange began.
- 1970** Mass production of Type 600 telephone sets began. Under contract with Nippon Telegraph & Telephone Public Corporation, production of CP-21 crossbar PABX began. Export to the U.S.A. of Type MB miniature relays began.
- 1972** NA-CP21 crossbar PABXs exported to the U.S.A.
- 1974** Three branch offices opened in Osaka, Hiroshima and Kumamoto.
Stocks listed in the second section of the Tokyo Stock Exchange.
- 1975** Two branch offices opened in Sendai and Sapporo.
PABX NYC-3 and NYC-12 developed.
- 1976** Trunk package for Type D10 electronic exchange delivered to Nippon Telegraph & Telephone Public Corporation.
- 1977** NYC-3 and NYC-12 crossbar PABX systems exported to Lebanon.
- 1978** NAM-N301 MODEM delivered to Tokyo University. 80 units of NYC-5 crossbar PABX delivered to Kuwait PTT.
- 1980** Nakayo Singapore Office opened.
- 1981** Electronic key telephone systems marketed.
- 1982** ET-308 system launched in the U.S.A.
- 1984** Gumma Plant began operation with production of electronic key telephone systems.
Capital increased to ¥4,909.07 million.
- 1985** Head Office moved to Shibuya, Tokyo.
- 1991** R & D AKITA LAB. opened.
- 1995** Listed as ISO9001 registered factory.
- 1998** Approved ISO14001 by Japan Audit And Certification Organization For Environment And Quality (JACO).
- 2000** Established HONG KONG NAKAYO CO., LTD. in HONG KONG.

Corporate Outline

NAKAYO TELECOMMUNICATIONS, INC.

President: Susumu Akiyama
Capital: 4,909 million YEN
Established: 1944
Employees: 472

Director / Auditor

Chairman	Hisayoshi Takeuchi
President (CEO)	Susumu Akiyama
Managing Director	Takeshi Mochizuki
General Adviser	Rikio Hoshino
Director	Tatsuro Matsumae
Director	Tetsuo Takemura
Standing Auditor	Hazime Nakazawa
Auditor	Yutaka Kimura
Auditor	Ko Ishii
Auditor	Hiroyoshi Sato

Corporate officer

Executive managing director	Syunsuke Nakagawa
Executive managing director	Sadao Iijima
Executive managing director	Kaoru Ishimaru
Corporate officer	Yoshikazu Mayuzumi
Corporate officer	Kouichi Ueno

Head Office: Tobu Fuji Bldg., 24-4, Sakuragaoka-cho, Shibuya-ku,
Tokyo 150-0031, Japan
Tel: (03) 3496-1151
Facsimile: (03) 3496-2089

Operation Headquarters: Maebashi City, Gumma Prefecture
(Maebashi Factory)

Gumma Operation Center: Maebashi City, Gumma Prefecture
(Gumma Factory)

Information Technology Laboratory: Setagaya-ku, Tokyo

Kitanihon Operation Center: Noshiro City, Akita Prefecture

West Japan Regional Headquarters: Osaka City, Osaka Prefecture

SUBSIDIARIES

Nakayo Electronics Co., Ltd., Tokyo

Sales, installation and maintenance service

Nakayo Engineering, Inc., Maebashi City, Gumma Prefecture

Packaging and Dispatching

Heartech Co., Ltd., Tokyo

Sales, installation and maintenance service

HONG KONG NAKAYO CO., LTD.

Purchase

PARTIAL LIST OF CLIENTS

Nippon Telegraph & Telephone

Nippon Telegraph & Telephone East Co., Ltd.

Nippon Telegraph & Telephone West Co., Ltd.

Hitachi, Ltd.

Hitachi Communication Technologies, Ltd.

NTT Communications Corporation

NTT FANET System Corporation

NTT TELECON CO., LTD

The Defense Agency

Japan Telecom Co., Ltd.

Keiko Corporation

NEXTEL

Telefonica de España

Overseas Customers



NAKAYO

NAKAYO TELECOMMUNICATIONS, INC.

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