

**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 21<sup>st</sup> 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, 2005 and 2004

Assets	Yen (Millions)		U.S.dollars (Thousands)
	2005	2004	2005
Current assets:			
Cash and cash equivalents (Note 2)	¥ 6,647	¥ 7,940	\$ 61,894
Trade notes and accounts receivable	5,829	4,796	54,277
Inventories (Note 2)	1,377	1,310	12,827
Deferred income taxes	352	368	3,277
Other assets	207	380	1,933
Less: allowance for doubtful accounts (Note 2)	(17)	(115)	(158)
Total current assets	14,395	14,679	134,050
Property, plant and equipment: (Note 2 and 3)			
Land	1,211	1,211	11,279
Buildings and structures	3,067	3,170	28,559
Machinery, equipment and vehicles	1,410	1,470	13,133
Other	2,830	2,662	26,346
Construction in progress	7	3	63
	8,525	8,516	79,380
Less: accumulated depreciation	(6,117)	(6,081)	(56,960)
Net property, plant and equipment	2,408	2,435	22,420
Investments and other assets:			
Investment securities (Note 2)	2,742	1,903	25,532
Deferred income taxes	176	124	1,643
Other assets	1,483	974	13,810
Less: allowance for doubtful accounts (Note 2)	(6)	(10)	(58)
Total investments and other assets	4,395	2,991	40,927
Total assets	¥ 21,198	¥ 20,105	\$ 197,397
<b>Liabilities and Shareholders' Equity</b>			
Liabilities and Shareholders' Equity	Yen (Millions)		U.S.dollars (Thousands)
	2005	2004	2005
Current liabilities:			
Short-term bank loans	¥ 368	¥ 636	\$ 3,422
Trade notes and accounts payable	2,845	3,063	26,489
Account payables other	846	588	7,880
Income taxes payable	451	168	4,199
Accrued expenses and other current liabilities	615	642	5,736
Total current liabilities	5,125	5,097	47,726
Long-term liabilities			
Deferred income taxes	428	459	3,981
Accrued retirement benefits	617	578	5,749
Deposits received for guarantees	319	273	2,971
Total long-term liabilities	1,364	1,310	12,701
Minority interest	59	41	549
Shareholders' equity: (Note 5)			
Common stock:			
Authorized - 57,346,000 shares			
Issued - 23,974,816 shares as of March 31, 2005	4,909	-	45,713
Issued - 23,974,816 shares as of March 31, 2004	-	4,909	-
Capital surplus	4,509	4,512	41,991
Retained earnings	4,771	3,905	44,429
Net unrealized gains on available-for-sale securities	844	715	7,855
Treasury stock	(383)	(384)	(3,567)
Total shareholders' equity	14,650	13,657	136,421
Total liabilities and shareholders' equity	¥ 21,198	¥ 20,105	\$ 197,397

# Consolidated Statements of Income

Years ended March 31, 2005 and 2004

	Yen (Millions)		U.S.dollars (Thousands)
	2005	2004	2005
Net sales	¥ 19,548	¥ 18,175	\$ 182,024
Cost of sales	13,582	12,382	126,468
Gross profit	5,966	5,793	55,556
Selling, general and administrative expenses (Note 4)	4,450	4,191	41,440
Operating income	1,516	1,602	14,116
Other income:			
Interest and dividends	27	18	252
Other	176	46	1,635
	203	64	1,887
Other expenses:			
Interest	9	12	85
Other	244	318	2,270
	253	330	2,355
Income before income taxes and minority interest	1,466	1,336	13,648
Income taxes (Note 2)			
Current	520	223	4,842
Deferred	(156)	(197)	(1,454)
	364	26	3,388
Minority interest in earnings of consolidated subsidiaries	26	38	238
Net income	¥ 1,076	¥ 1,272	\$ 10,022
		Yen	U.S.dollars
	2005	2004	2005
Net income per share: (Note 2)			
Basic	¥ 47.68	¥ 56.38	\$ 0.44
Diluted	¥ 47.65	¥ 56.07	\$ 0.44

# Consolidated Statements of Shareholders' Equity

Years ended March 31, 2005 and 2004

	Yen (Millions)		U.S.dollars (Thousands)
	2005	2004	2005
<b>Common stock</b>			
Balance at beginning of year	¥ 4,909	¥ 4,909	\$ 45,713
Balance at end of year	¥ 4,909	¥ 4,909	\$ 45,713
<b>Capital surplus</b>			
Balance at beginning of year	¥ 4,512	¥ 4,521	\$ 42,016
Loss on disposal of treasury stocks	(3)	(9)	(25)
Balance at end of year	¥ 4,509	¥ 4,512	\$ 41,991
<b>Retained earnings</b>			
Balance at beginning of year	¥ 3,905	¥ 2,769	\$ 36,367
Net income for the year	1,076	1,272	10,022
Cash dividends	(187)	(113)	(1,744)
Director's bonuses	(23)	(23)	(216)
Balance at end of year	¥ 4,771	¥ 3,905	\$ 44,429
<b>Net unrealized gains on available-for-sale securities</b>			
Balance at beginning of year	¥ 715	¥ 128	\$ 6,657
Net change during year	129	587	1,198
Balance at end of year	¥ 844	¥ 715	\$ 7,855
<b>Treasury stock</b>			
Balance at beginning of year	¥(384)	¥(196)	\$ (3,580)
Net change during year	1	(188)	13
Balance at end of year	¥(383)	¥(384)	\$ (3,567)

# Consolidated Statements of Cash Flows

Years ended March 31, 2005 and 2004

	Yen (Millions)		U.S.dollars (Thousands)
	2005	2004	2005
<b>Cash flows from operating activities:</b>			
Income before income taxes and minority interest	¥ 1,466	¥ 1,336	\$ 13,648
Adjustments for:			
Depreciation and amortization	471	448	4,389
Increase (decrease) in allowance for doubtful accounts	(102)	13	(954)
Increase (decrease) in accrued retirement benefits	39	(58)	362
Interest and dividend income	(27)	(18)	(252)
Interest expenses	9	12	85
Increase in trade notes and accounts receivable	(1,033)	(278)	(9,612)
Increase in inventories	(67)	(91)	(629)
Increase (decrease) in trade notes and accounts payable	(218)	449	(2,034)
Other, net	314	(24)	2,930
<b>Subtotal</b>	<b>852</b>	<b>1,789</b>	<b>7,933</b>
Interest and dividends received	27	18	252
Interest paid	(9)	(12)	(85)
Income taxes paid	(276)	(89)	(2,566)
<b>Net cash provided by operating activities</b>	<b>594</b>	<b>1,706</b>	<b>5,534</b>
<b>Cash flows from investing activities:</b>			
Payments for time deposits	(378)	(396)	(3,519)
Proceeds from time deposits	177	496	1,651
Payments for purchases of property, plant and equipment	(365)	(290)	(3,395)
Payments for purchases of investment securities	(766)	(51)	(7,137)
Proceeds from sales of investment securities	144	72	1,338
Other, net	(241)	(451)	(2,249)
<b>Net cash used in investing activities</b>	<b>(1,429)</b>	<b>(620)</b>	<b>(13,311)</b>
<b>Cash flows from financing activities:</b>			
Decrease in short-term bank loans	(268)	(342)	(2,500)
Payments for purchases of treasury stock	(14)	(240)	(128)
Dividends paid	(187)	(113)	(1,744)
Other, net	11	41	109
<b>Net cash used in financing activities</b>	<b>(458)</b>	<b>(654)</b>	<b>(4,263)</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>0</b>	<b>(0)</b>	<b>0</b>
<b>Net increase in cash and cash equivalents</b>	<b>(1,293)</b>	<b>432</b>	<b>(12,040)</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>7,940</b>	<b>7,508</b>	<b>73,934</b>
<b>Cash and cash equivalents at end of year</b>	<b>¥ 6,647</b>	<b>¥ 7,940</b>	<b>\$ 61,894</b>

# Notes to Consolidated Financial Statements

March 31, 2005 and 2004

## 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 ¥107.39 = U.S. \$1, the approximate exchange rate on March 31, 2005.

## 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, work in process and 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.

Effective April 1, 2004, the Company changed its method of valuation for finished goods and work in process from the specific to the average cost method. As a result of this change, compared with the previous accounting method, cost of sales for the year decreased by ¥30 million (\$ 288 thousand), and operating income and income before income taxes and minority interest increased by ¥30 million (\$ 288 thousand).

### (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 42 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)
	2005	2004	2005
Property, plant and equipment			
Land	-	¥ 30	-
Buildings and structures	-	315	-
Machinery, equipment and vehicles	-	163	-
Other	-	313	-
Time deposits	¥ 10	10	\$ 93
<b>Total</b>	<b>¥ 10</b>	<b>¥ 831</b>	<b>\$ 93</b>

### 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)
	2005	2004	2005
Benefit obligation	¥ (3,019)	¥ (2,973)	\$ (28,116)
Plan assets	1,720	1,491	16,017
Benefit obligation in excess of plan assets	(1,299)	(1,482)	(12,099)
Unrecognized actuarial loss	1,077	1,253	10,031
Net recognized retirement benefit obligation	(222)	(229)	(2,068)
Prepaid pension cost	206	137	1,916
Accrued retirement benefits	¥ (428)	¥ (366)	\$ (3,984)

Notes:

- (1) The annual provision for accrued retirement benefits for directors and corporate auditors (¥189 millions (\$1,765 thousands) in 2005, and ¥212 millions in 2004) 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.

### 6. Impairment of long-lived assets

On August 9, 2002, the Business Accounting Council of Japan issued new accounting standards entitled "Statement of Opinion on the Establishment of Accounting Standards for Impairment of Long-lived Assets." Further, on October 31, 2003, the Accounting Standards Board of Japan issued Financial Accounting Standards Implementation Guidance No.6 "Guidance for Application of Accounting Standards for Impairment of Long-lived Assets." This standard shall be effective from the fiscal year beginning April 1, 2005, and an earlier adoption for the fiscal year ending March 31, 2004 is permitted.

At March 31, 2005, the Companies adopted the accounting standards for impairment of long-lived assets.

And this change has no impact on profit and loss.

# 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 on 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.
- 2005** Stocks listed on the first section of the Tokyo Stock Exchange.

# Corporate Outline

## NAKAYO TELECOMMUNICATIONS, INC.

President: Susumu Akiyama  
Capital: 4,909 million YEN  
Established: 1944  
Employees: 499

### Director / Auditor

Chairman	Hisayoshi Takeuchi
President (CEO)	Susumu Akiyama
Managing Director	Takeshi Mochizuki
General Adviser	Rikio Hoshino
Director	Tatsuro Matsumae
Director	Yuki Sato
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	Naoyuki Masada
Corporate officer	Yasufumi Hagane

**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

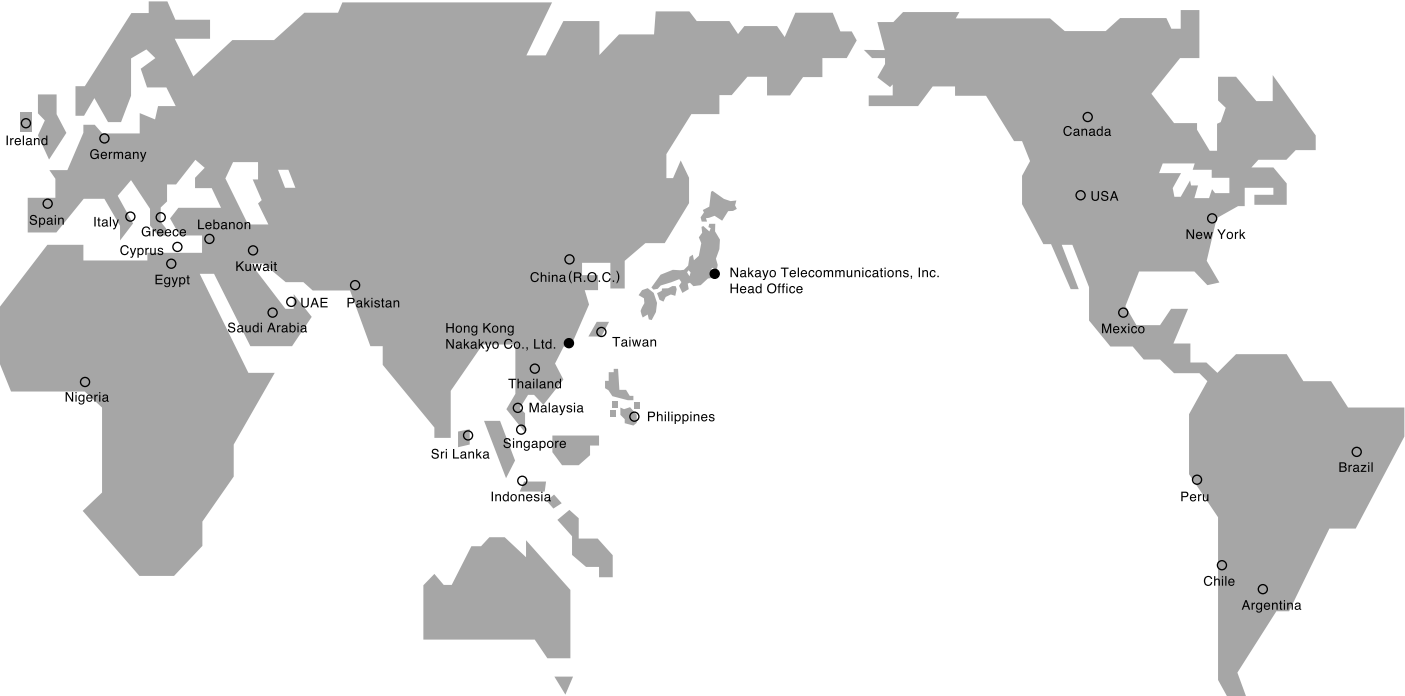
Japan Telecom Co., Ltd.

Keiko Corporation

NEXTEL

Telefonica de España

# Overseas Customers



**NAKAYO**

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