

## Consolidated Financial Results for the First Nine Months of the Fiscal Year Ending 31st March 2003

Company name: ELMIC SYSTEMS, INC.

Stock code and stock market listing: 4770, TSE Mothers Market

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### 1. Financial Highlights

#### (1) Financial results for the first nine months of the fiscal year ending March 2003 (From April 1, 2002 to December 31, 2002)

¥ millions

Term	FY 2001 1st - 3rd Qtr.	FY 2002 1st - 3rd Qtr.	% Change	FY 2001 Full year
Net sales	1,246	1,231	(1.1)	1,906
Operating income	(136)	(90)	-	(230)
Ordinary income	(120)	(88)	-	(196)
Net income (for the period)	(149)	(834)		(235)
Total assets	3,912	2,854	(27.0)	3,902
Shareholders' equity	3,423	2,274	(33.6)	3,415

#### (2) Sales breakdown

Products			FY 2001 1st - 3rd Qtr.		FY 2002 1st - 3rd Qtr.		% Change	FY 2001 Full year	
Source	Group	Type	¥ mil	%	¥ mil	%		¥ mil	%
Own	Communications	Multi-purpose telecom board related	208	16.8	224	18.2	7.4	296	15.6
		ISDN board related	130	10.4	50	4.2	(60.8)	177	9.3
	Internet Protocol		288	23.2	421	34.2	45.4	475	24.9
	Windows		66	5.3	81	6.6	23.0	122	6.4
	Real-time OS		67	5.4	81	6.6	21.1	97	5.1
	System Integration (Customization)		394	31.7	305	24.8	(22.6)	617	32.4
	Subtotal		1,155	92.8	1,165	94.6	0.7	1,787	93.7
Resale	Proprietary software		90	7.2	66	5.4	(26.0)	119	6.3
Total			1,246	100.0	1,231	100.0	(1.3)	1,906	100.0

## 2. Results of Operations (April 1 to December 31, 2002)

In the third quarter of the current fiscal year, economic conditions remained difficult. A recessionary mood persisted due to the downturn in the U.S. IT industry and deflationary forces in Japan.

### Results by Product Category

#### **Communications** (Volume and repeat orders)

In this category, communication boards for factory automation and ISDN applications account for more than 90% of sales. Third quarter sales were down 18.8% year-on-year because of weakness in the semiconductor and POS terminal manufacturing sectors.

#### **Internet Protocol Stacks** (Initial fees and licenses)

Sales in this category are derived from TCP/IP protocol stacks, which are vital to the functioning of all devices connected to the Internet, and optional software. This category posted strong growth, a reflection of the expanding scope of networks to include products such as car navigation devices and home IT electronics. Sales growth was particularly strong in the United States. Overall, category sales were up 45.4% year on year.

#### **Windows and RTOS** (embedded OS) (Initial fees and licenses)

This category is made up of sales of embedded OS products, software that is required by all network-enabled information devices having no magnetic storage medium. In the third quarter, sales increased 22.0%, backed by the introduction in the current fiscal year of an ITRON-based OS that includes a memory protection function.

#### **System Integration** (Customized services to match specific user needs) (Initial fees)

All areas of customizing services for industrial applications, except for manufacturers of LCD production equipment, posted lower sales. This decline was mainly attributable to Japan's lackluster economy. The result was a 22.5% decrease in sales. However, due to the seasonal nature of the system integration business, most sales are typically recorded near the close of the fiscal year.

#### **Elmic Systems USA, Inc.**

Due to the adoption of U.S. Statement of Financial Accounting Standards (SFAS) "Goodwill and Other Intangible Assets" by Elmic Systems USA, Inc., this company recorded an extraordinary loss of ¥618 million for the impairment of goodwill. The result was a large loss in the third quarter.

This action was taken in response to the weakness of the U.S. economy following the September 2001 terrorist attacks and continuing uncertainty about the future direction of the IT industry. The write-off of this goodwill was implemented after applying the impairment test based on an extremely conservative earnings plan. However, it should be noted that this is a one-time charge and that the Elmic Group's operating results are now largely insulated from the ups and downs of the U.S. economy.

Due to the above factors, third-quarter net sales decreased 1.1% year-on-year to ¥1,231 million, there was an ordinary loss of ¥88 million and a net loss of ¥834 million.

### **3. Outlook (Year ending March 31, 2003)**

The operations of the Elmic Group are currently shifting from the B-to-B and B-to-B-to-B domains to the B-to-B-to-C domain. Illustrating this shift is the decline in communications sales in each of the past three years. About three years ago, B-to-B operations accounted for roughly 70% of net sales.

The current outlook for operating results is as follows.

#### **(1) Targeting market segments**

1) Supplying embedded software for mobile phones (Initial revenues and license revenues)

Elmic Systems products for this market are TCP/IP IPv4, H.323 audio and video handling software, and the IPSec security software, which includes an encryption function. Manufacturers have started using Elmic Systems software in camera-equipped cellular phones. Plans call for targeting the entire market for mobile products.

2) Custom LSIs

Demand is expected to grow for LSIs designed for specific devices. For example, fiber-optic communication networks require LSIs capable of facilitating high-speed (100Mbps) communications. Elmic Systems is placing its software on LSIs that are produced in lots numbering in the millions. One application is home routers, a market where rapid growth is foreseen. To expand along with this market, the company is forming alliances with major LSI manufacturers. Current research and development expenses in this field are expected to lead to substantial licensing revenues in the future.

3) Automotive systems

Automobiles today rely heavily on microcomputers and other types of electronics for everything from controlling vehicle operation to navigation systems. Automakers generally upgrade these systems every year. That spells demand for Elmic Systems software and software customized for specific user requirements. To capitalize on this opportunity, the company is working on forming alliances with prominent automakers.

4) Liquid crystal displays (B-to-B)

Elmic Systems has long been skilled in the provision of software for semiconductor manufacturing equipment and communications applications, as well as packaged software for the control of industrial equipment. The company is now applying this know-how to make inroads among manufacturers of LCD production equipment. Prospects are excellent in the LCD production equipment sector. Dramatic growth in demand for these displays is expected for use in next-generation mobile phones, TVs and other new products. Software customization-related sales (SI) are likely to increase by more than 50% in the current term.

#### **(2) Targeting Key Technologies**

Elmic Systems has assigned about 60 software engineers to the development of new products and customizing products. Over the years, the company has developed many types of software that make factories and other facilities more productive. Among the company's numerous achievements are software for controlling cranes at steel mills, performing remote surveillance of operations at power plants, and controlling railroad signals.

Today's rapid expansion of high-speed, broadband networks (fiber-optic, wireless LAN, cable TV and others) is generating demand for embedded software having the following components:

1. A high-speed OS
2. TCP/IP IPv6 (including mobile IP)

### 3. High-speed wireless communication software (IEEE802 11x, Bluetooth and others)

Furthermore, each of these three software components also requires a variety of optional peripherals.

To offer a high-speed OS, Elmic Systems has developed and begun selling a hybrid OS that combines the unrestricted development environment of Linux and the fast processing speed of ITRON. At the same time, the company introduced its own ITRON that includes a memory protection function.

Regarding TCP/IP IPv6 (including optional software), a beta-version has been completed and is now undergoing final testing. Elmic Systems expects IPv6 technology will become widely adopted by information devices in the 2004 to 2006 time frame. Interoperability tests using different types of equipment under the auspices of the TAHI Project have been completed, too.

Once high-speed, broadband networks reach the home, individuals will require home routers to direct signals to specific IT devices. Without these routers, it will be impossible to send and receive data (image and voice) in a high-speed, wireless environment. Elmic Systems has already completed the development of the necessary wireless communications software.

For the development and production of software products, Elmic Systems is dividing tasks between itself and group members (consolidated companies) as follows.

1. IPv6 protocol stacks and optional software: ELMIC SYSTEMS, INC.
2. VoIP (voice and image processing software): AIRFORC Corporation
3. Other items: WESCOM Inc.

Since its establishment in 2000, consolidated subsidiary Elmic Systems USA, Inc. has been focusing on bolstering its sales organization. The company is now on the verge of becoming profitable. However, the company recorded a charge of ¥618 million in the current fiscal year due to the application of the impairment test on goodwill in accordance with the U.S. SFAS on "Goodwill and Other Intangible Assets."

Due to the above factors, sales and earnings forecasts for the current fiscal year have been lowered as follows.

## Consolidated Forecast

¥ millions

	Net sales	Ordinary income	Net income
Year ending March 31, 2002	1,931	(67)	(823)

Compared with the forecast released at the beginning of the fiscal year, these figures represent reductions of ¥248 million (11.4%) in net sales, ¥89 million in operating income and ¥835 million in net income.

Consolidated forecasts for the fiscal year ending March 31, 2003 are based on management's judgments in accordance with information currently available. Actual results may differ significantly from these forecasts for a variety of reasons. Therefore, investors are cautioned not to make investment decisions based solely on these forecasts. Factors that could affect operating results include but are not limited to economic conditions in major markets, shifts in demand for products and pricing trends, rapid advances in technology, changes in foreign exchange rates, changes in regulations in Japan and overseas, and changes in accounting methods and practices.

#### 4. Consolidated Financial Statements for the First Nine Months Ended December 31, 2002

##### (1) Consolidated Balance Sheets

Account	Period	FY2001 1st - 3rd Qtr. As of Dec. 31, 2001		FY2002 1st - 3rd Qtr. As of Dec. 31, 2002		FY2001 Selected data As of March 31, 2002	
		¥ thousands	%	¥ thousands	%	¥ thousands	%
(Assets)							
I	Current assets						
	1. Cash and deposits	217,347		146,793		350,594	
	2. Notes & accounts receivable #3	634,525		645,627		793,869	
	3. Available for sale securities	1,454,539		1,190,164		1,331,813	
	4. Inventories	135,450		150,304		85,750	
	5. Other current assets	69,924		128,962		117,389	
	6. Reserve for doubtful receivables	(1,165)		(484)		(1,499)	
	Total current assets	2,510,620	64.2	2,261,368	79.2	2,677,918	68.6
II	Fixed assets						
	1. Property, plant and equipment #1	42,321		46,605		40,995	
	2. Intangible assets						
	(1) Goodwill	669,671		60,167		730,322	
	(2) Other intangible assets	332,401		118,308		111,854	
	Total intangible assets	1,002,072		178,476		842,177	
	3. Investments and other assets						
	(1) Investment securities	-		227,501		176,094	
	(2) Other	357,829		142,105		165,120	
	(3) Reserve for doubtful receivables	-		(1,344)		-	
	Total investments and other assets	357,829		368,263		341,215	
	Total fixed assets	1,402,223	35.8	593,345	20.8	1,224,387	31.4
	Total assets	3,912,844	100.0	2,854,713	100.0	3,902,306	100.0

Account	Period	FY2001 1st - 3rd Qtr. As of Dec. 31, 2001		FY2002 1st - 3rd Qtr. As of Dec. 31, 2002		FY2001 Selected data As of March 31, 2002	
		¥ thousands	%	¥ thousands	%	¥ thousands	%
(Liabilities)							
I	Current liabilities						
	1. Accounts payable-trade	115,651		85,287		109,075	
	2. Income taxes payable	2,940		6,005		3,591	
	3. Reserve for accrued bonuses	28,993		28,979		52,662	
	4. Other current liabilities #2	108,086		201,835		88,218	
	Total current liabilities	255,671	6.5	322,107	11.3	253,547	6.5
II	Long-term liabilities						
	1. Reserve for directors' retirement benefits	155,322		158,447		157,406	
	2. Other long-term liabilities	71,162		90,404		69,067	
	Total long-term liabilities	226,485	5.8	248,851	8.7	226,474	5.8
	Total liabilities	482,157	12.3	570,958	20.0	480,022	12.3
(Minority interest)							
	Minority interest	7,090	0.2	9,171	0.3	7,155	0.2
(Shareholders' equity)							
I	Common stock	1,160,041	29.6	-	-	1,160,041	29.7
II	Additional paid-in capital	1,459,152	37.3	-	-	1,459,152	37.4
III	Consolidated retained earnings	710,971	18.2	-	-	624,316	16.0
IV	Net Unrealized gain on other securities	24,432	0.6	-	-	17,637	0.4
V	Foreign currency translation adjustment	69,353	1.8	-	-	154,335	4.0
IV	Treasury stock	(355)	(0.0)	-	-	(355)	(0.0)
	Total shareholders' equity	3,423,596	87.5	-	-	3,415,128	87.5
I	Common stock	-	-	1,160,041	40.7	-	-
II	Capital surplus	-	-	1,459,152	51.1	-	-
III	Retained earnings	-	-	(250,211)	(8.8)	-	-
IV	Net Unrealized gain on other securities	-	-	(5,914)	(0.2)	-	-
V	Foreign currency translation adjustment	-	-	96,135	3.4	-	-
VI	Treasury stock	-	-	(184,619)	(6.5)	-	-
	Total shareholders' equity			2,274,583	79.7		
	Total liabilities, minority interest and shareholders' equity	3,912,844	100.0	2,854,713	100.0	3,902,306	100.0

## (2) Consolidated Statements of Income

Account	Period	FY2001 1st - 3rd Qtr. From April 1, 2001 to Dec. 31, 2001		FY2002 1st - 3rd Qtr. From April 1, 2002 to Dec. 31, 2002		FY2001 Selected data From April 1, 2001 to March 31, 2002	
		¥ thousands	%	¥ thousands	%	¥ thousands	%
I Net sales #1		1,246,070	100.0	1,231,945	100.0	1,906,922	100.0
II Cost of sales		601,210	48.2	508,826	41.3	903,754	47.4
Gross profit		644,860	51.8	723,119	58.7	1,003,167	52.6
III SG&A #2		781,505	62.8	814,067	66.1	1,233,827	64.7
Operating loss		136,645	(11.0)	90,947	(7.4)	230,659	(12.1)
IV Non-operating income							
1. Interest received		4,204		1,724		6,345	
2. Dividends received		132		100		132	
3. Equity in earnings of affiliates		6,339		10,926		6,271	
4. Gain on anonymous partnerships		2,140		3,784		3,045	
5. Foreign exchange gains		2,247		-		18,154	
6. Gain on revaluation of options		1,957		-		-	
7. Other non-operating income		1,039	1.5	1,177	1.5	1,194	1.9
V Non-operating expenses							
1. Interest expense		897		349		1,467	
2. Foreign exchange loss		-		8,321		-	
3. Loss on options		-		6,700		-	
4. Other non-operating expenses		751	0.1	313	1.3	1	0.1
Ordinary loss		120,232	(9.6)	88,920	(7.2)	196,983	(10.3)
VI Extraordinary income							
1. Gain on reversal from doubtful account reserve		1,140		-		633	
2. Insurance premiums surrendered		24,566		-		24,566	
3. Gain on sales of investment securities		-	2.1	3,102	0.3	-	1.3
VII Extraordinary loss							
1. Loss on removal of fixed assets		330		-		43,931	
2. Loss on revaluation of investment securities		10,440		26,880		-	
3. Loss on revaluation of inventories		-		-		14,400	
4. Loss on impairment of goodwill		-	1.0	618,404	52.4	-	3.1
Net loss before income taxes and minority interest (for the period)		105,296	(8.5)	731,102	(59.3)	230,115	(12.1)
Income taxes –Current (Corporation, residential and enterprise taxes)		6,384		5,347		7,367	
Income taxes - Deferred		37,477	3.5	96,258	8.3	(1,734)	0.3
Minority interest		90	0.0	2,015	0.2	155	0.0
Net loss		149,249	(12.0)	834,723	(67.8)	235,904	(12.4)

**(3) Consolidated Statement of Retained Earnings**

Account	Period	FY2001 1st - 3rd Qtr. From April 1, 2001 to Dec. 31, 2001		FY2002 1st - 3rd Qtr. From April 1, 2002 to Dec. 31, 2002		FY2001 Selected data From April 1, 2001 to March 31, 2002	
		¥ thousands		¥ thousands		¥ thousands	
I Consolidated retained earnings at beginning of period			901,684		-		901,684
II Decline in consolidated retained earnings							
1. Cash dividends		39,800		-		39,800	
2. Directors' bonuses		1,662	41,463	-	-	1,662	41,463
III Net loss			149,249		-		235,904
IV Consolidated retained earnings at end of period			710,971		-		624,316
	(Capital surplus)						
I Capital surplus at beginning of period			-		1,459,152		-
II Capital surplus at end of period			-		1,459,152		-
	(Retained earnings)						
I Retained earnings at beginning of period			-		624,316		-
II Decline in retained earnings							
1. Cash dividends		-		39,804		-	
2. Net loss at end of period				834,723	874,528		
III Retained earnings at end of period					(250,211)		

**(4) Consolidated Statements of Cash Flows**

Account	Period	FY2001 1st - 3rd Qtr. From April 1, 2001 to Dec. 31, 2001	FY2002 1st - 3rd Qtr. From April 1, 2002 to Dec. 31, 2002	FY2001 Selected data From April 1, 2001 to March 31, 2002
		¥ thousands	¥ thousands	¥ thousands
<b>I</b>	<b>Cash flows from operating activities</b>			
	Net loss before income taxes and minority interest	(105,296)	(731,102)	(230,115)
	Depreciation and amortization	92,851	47,583	130,977
	Equity in earnings of affiliates	(6,339)	(10,926)	(6,271)
	Increase (decrease) in reserve for doubtful receivables	(1,140)	329	(806)
	Increase (decrease) in reserve for accrued bonuses	(22,006)	(23,683)	1,662
	Increase in reserve for directors' retirement benefits	1,714	1,040	3,798
	Interest and dividends received	(4,336)	(1,824)	(6,478)
	Interest paid	897	349	1,467
	Foreign exchange gain (loss)	(5,551)	6,889	(4,890)
	Gain on investment in anonymous partnerships	(2,140)	(3,784)	(3,045)
	Gain on revaluation of options	(1,957)	-	-
	Loss on options	-	6,700	-
	Proceeds from life insurance premiums surrendered	(24,566)		(24,566)
	Gain on sales of investment securities	-	(3,102)	-
	Loss on removal of fixed assets	330	-	43,931
	Unrealized loss on investment securities	10,440	26,880	-
	Loss on revaluation of inventories	-	-	14,400
	Loss on impairment of goodwill	-	618,404	-
	Decrease (increase) in accounts receivable-trade	151,284	144,932	(3,464)
	Increase in inventories	(49,673)	(64,499)	(14,517)
	Decrease in accounts payable-trade	(61,039)	(23,242)	(68,818)
	Increase in other assets	(46,497)	(32,457)	(25,518)
	Increase (decrease) in other liabilities	15,021	8,056	(12,504)
	Decrease (increase) in suspense receipt of consumption tax	-	9,302	(9,302)
	Increase (decrease) in suspense payment of consumption tax	(7,101)	5,138	(6,688)
	Directors' remuneration paid	(1,662)	-	(1,662)
	Others	(127)	-	(127)
	<b>Subtotal</b>	<b>(66,897)</b>	<b>(19,015)</b>	<b>(222,540)</b>
	Interest and dividends received	4,336	1,824	6,478
	Interest paid	(897)	(349)	(1,467)
	Income taxes paid	(109,158)	(4,681)	(109,490)
	<b>Net cash provided by (used in) operating activities</b>	<b>(172,617)</b>	<b>(22,222)</b>	<b>(327,021)</b>
<b>II</b>	<b>Cash flows from investing activities</b>			
	Payments for acquisition of securities	(166,600)	(101,500)	(166,600)
	Proceeds from redemption of securities	-	-	166,600

Account	Period	FY2001 1st - 3rd Qtr. From April 1, 2001 to Dec. 31, 2001	FY2002 1st - 3rd Qtr. From April 1, 2002 to Dec. 31, 2002	FY2001 Selected data From April 1, 2001 to March 31, 2002
		¥ thousands	¥ thousands	¥ thousands
	Payments for acquisition of property, plant and equipment	(3,780)	(16,358)	(4,961)
	Proceeds from sale of property, plant and equipment	178	-	414
	Payments for acquisition of intangible assets	(207,260)	(44,708)	(50,210)
	Payments for acquisition of investment securities	(81,250)	(30,204)	(84,750)
	Gain on sales of investment securities	1,010	15,327	1,010
	Payments for short-term loans receivable	-	(10,000)	-
	Proceeds from collection of short-term loans	742	-	-
	Payments for long-term loans receivable	(6,500)	(200)	(9,475)
	Proceeds from collection of long-term loans	300	1,435	1,222
	Proceeds from life insurance premiums surrendered	92,990	-	92,990
	Proceeds from return of leasehold and security deposits	-	323	9,093
	Others	(4,121)	(1,246)	(5,036)
	Net cash provided by (used in) investment activities	(374,290)	(187,132)	(49,704)
III	Cash flows from financing activities			
	Payments for finance lease liabilities	(2,072)	(2,701)	(3,441)
	Cash dividends paid	(39,500)	(39,466)	(39,524)
	Payments for acquisition of treasury stock	-	(184,264)	-
	Others	405	-	405
	Net cash provided by (used in) financing activities	(41,167)	(226,432)	(42,560)
IV	Translation gain (loss) in cash and cash equivalents	7,107	(10,578)	14,739
V	Decrease in cash and cash equivalents	(580,967)	(446,365)	(404,546)
VI	Cash and cash equivalents at beginning of period	2,054,954	1,682,407	2,054,954
VII	Cash and cash equivalents of newly consolidated subsidiaries at beginning of period	32,000	-	32,000
VIII	Cash and cash equivalent at end of period	1,505,986	1,236,042	1,682,407

## Significant Accounting Policies in the Preparation of Consolidated Financial Statements

Consolidated nine-month period ended December 31, 2002 (From April 1, 2002 to December 31, 2002)

### 1. Scope of consolidation

#### (1) Consolidated subsidiaries: 2

Names of consolidated subsidiaries: Elmic Systems USA, Inc., AIRFOLC Corporation

#### (2) Unconsolidated subsidiaries: None

### 2. Equity method accounting

#### (1) Affiliates accounted for by the equity method of accounting: 1

Affiliate name: WESCOM Inc.

(2) RockHand Technology, an equity method affiliate, is excluded from the scope of affiliates accounted for by the equity method since it does not have material effect on consolidated net income (loss) or consolidated retained earnings for the nine-month periods and is of relatively little significance in the context of consolidated financial statements.

### 3. Balance sheet dates of subsidiaries

The consolidated financial statements for the period include the nine-month accounts of the following consolidated subsidiaries, of which the nine-month periods end on a different day:

Elmic Systems USA, Inc.: Fiscal year ended September 30

AIRFOLC Corporation: Fiscal year ended November 30

In the preparation of consolidated financial statements for the period, the financial statements of the subsidiaries for their respective nine-month periods have been used. With respect to significant transactions, which occurred after the balance sheet dates of the consolidated subsidiaries, necessary adjustments have been made in the consolidated financial statements.

### 4. Accounting standards

#### A. Valuation criteria and methods for significant assets:

##### (1) Securities

Securities held-to-maturity:

Valued using the amortized cost method

Affiliate company stock:

Stated at cost using the moving average method

Other securities:

Securities with market quotations

Stated at fair value based on market prices on the balance sheet date

(Unrealized holding gains and losses are accounted for as a component of the shareholders' equity; cost of other securities sold is determined using the moving average method.)

Securities without market quotations:

Stated at cost using the moving average method

##### (2) Derivatives

Stated at fair value based on market prices.

##### (3) Inventories

Merchandise:

Stated at cost, cost being determined by the moving average method.

Products, work in process and raw materials:

Stated at cost, cost being determined by the weighted average method.

#### B. Depreciation and amortization of significant depreciable assets

##### (1) Property, plant and equipment

The Company and its domestic subsidiaries compute depreciation using the declining balance method, in accordance with Corporation Tax laws. Overseas consolidated subsidiaries compute depreciation using the straight-line method in accordance with the generally accepted accounting standards of the countries of their domicile.

##### (2) Intangible assets

The Company and its domestic subsidiaries amortize capitalized costs using one of two alternate methods, which is higher, depreciation based on estimated sales volume or the straight-line method based on remaining the estimated period to expiration. Software for internal use is amortized using the straight-line method over its estimated useful life of five years. Overseas consolidated subsidiaries compute depreciation in accordance with the generally accepted accounting standards of the countries of their domicile.

#### Goodwill and Other Intangible Assets

Effective the nine-month periods of the current consolidated fiscal year, subsidiary in US adopted SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 requires that goodwill no longer be amortized but instead tested for impairment at least annually. The application of the new standards caused depreciation, operating loss and ordinary loss to decline by ¥27,142 thousand compared to amounts that would have been reported if the previous method had been applied consistently. Net loss before income taxes and minority interest increased by ¥591,261 thousand since impairment evaluation for goodwill resulted in a ¥618,404 thousand extraordinary charge to income.

### C. Recognition of reserves

#### (1) Reserve for doubtful receivables

To prepare for credit losses on accounts receivable, the Company and its domestic subsidiaries provide an allowance equal to the estimated amount of uncollectible receivables for general receivables based on the historical write-off ratio, and bad receivables based on a case-by-case determination of collectibility. Overseas consolidated subsidiaries provide allowances for credit losses based on a case-by-case determination of collectibility.

#### (2) Reserve for accrued bonuses

As a means of providing for bonus obligations, the Company and its domestic subsidiaries designate in the reserve account an amount accrued for the nine-month periods among the estimated future obligations.

#### (3) Reserve for retirement benefits

To provide for employees' retirement benefits, an allowance for retirement benefits is provided in the amount deemed to have accrued, determined based on the estimated retirement benefit obligations and pension assets at the end of the period. Since pension assets at the end of the period exceeded the estimated retirement benefit obligations ¥2,401 thousand was charged to income as a pre-paid expense.

#### (4) Reserve for directors' retirement benefits

To provide for directors' retirement benefits, an allowance is provided pursuant to the Company's rules on directors' retirement benefits.

### D. Accounting for lease transactions

The Company and its overseas subsidiaries account all finance lease contracts other than those that are deemed to transfer the ownership of the leased assets to lessees by the method similar to that applicable to ordinary operating leases. Overseas consolidated subsidiaries account lease transactions by the method similar to that applicable to regular trading transactions.

### E. Accounting for significant hedge transactions

#### (1) Hedge accounting method

The deferred hedge accounting method is applied.

#### (2) Hedging method and risks hedged

Hedging method: Currency swap contracts

Risks hedged: Planned foreign currency denominated transactions.

#### (3) Hedging policy

Currently the company uses currency swap contracts only to hedge exchange rate risk on its planned future foreign currency denominated transactions.

#### (4) Assessing hedge effectiveness

No reportable information since the principal terms of the planned foreign currency denominated transactions and currency swap contracts is identical.

### F. Other significant accounting policies in the preparation of consolidated financial statements for the period

#### (1) Equity method of accounting based on the anonymous partnership agreement.

The Company in March 1995 entered a leveraged lease agreement (term of agreement: 12 years) with an anonymous partnership. The ¥50,000 thousand investment at the time of participation is recognized as a claim against the anonymous association. A share of the anonymous partnership's net assets (as recorded in the most recent settlement of accounts) proportional to the Company's investment in the anonymous partnership is recognized as a claim or liability against the anonymous partnership. A share anonymous partnership's net income (as recorded in the settlement of accounts for the nine-month period) proportional to the Company's investment in the anonymous partnership is

recognized as a gain or loss on investment in the anonymous partnership.

(2) Accounting treatment for consumption taxes

Consumption Tax is accounted by the tax exclusion method.

(3) Accounting treatment of current income taxes

The statement of appropriations for the current period reflects the amounts for provision for reserves and reversals from the program reserve and from the special depreciation reserve.

5. Scope of cash and cash equivalents on consolidated statements of cash flows

For the purpose of 3rd quarter consolidated statements of cash flows, the Company considers cash and bank deposits which may be withdrawn on demand and all highly liquid short-term investments with maturities of three months or less that are easily transferable to cash with minimal risk of diminution of principle to be funds (cash and cash equivalents)

## Reclassifications

"Investment securities", presented as a component (Other) "Investments and other assets" in the previous consolidated balance sheets for the nine-months ended Dec. 2001, are reclassified as an independent item in the current consolidated balance sheets for the nine-months ended Dec. 2002 since the value of Investment Securities exceeded 5% of total assets. The amount of investment securities as of the end of the previous account period (as of Dec. 31, 2001) totaled ¥177,945 thousand.

## Supplementary Information

Effective the nine-month period, the Company has adopted the new accounting standards for treasury stock and reduction of legal reserves (Financial Accounting Standard No. 1, Accounting Standard for Treasury Stock and Reduction of Legal Reserves, Business Accounting Deliberation Council). The effect of this change on profit/loss is insignificant.

Effective the nine-month period, in accordance with the revised Regulations of Interim Financial Statements, the "Shareholders' equity" section in the consolidated balance sheets and the "Consolidated Statements of Retained Earnings" conform with the revised Regulations of Interim Financial Statements.

## Notes to Consolidated Financial Statements

Consolidated nine-month period ended December 31, 2002 (From April 1, 2002 to December 31, 2002)

### Notes to consolidated balance sheets

#1. Accumulated depreciation on property, plant and equipment: ¥106,707 thousand

#2. Accounting for consumption tax:

Net balance of consumption tax withheld and paid is included in "Other current liabilities" in the Current liabilities section since the amount is relatively insignificant.

#3. Accounting of trade notes maturing on the balance sheet date of the period. The settlement of trade notes maturing on the balance sheet date of the period is accounted on the clearance date. As the balance sheet date of the period was a bank holiday, the trade notes maturing on the balance sheet date of the period, in the following amounts were included in trade notes outstanding at the end of the period.

Notes receivable-trade: ¥9,876 thousand

### Notes to consolidated statements of income

#1. The Company's financial results are affected by seasonal factors. These include a marked difference in the Company's first half and second half sales, since the weight of production on order is markedly higher heavier in the second half in comparison to the first half.

#2. Principal components and corresponding amounts of selling, general and administrative expenses:

Wages & allowances: ¥259,780 thousand

Provision for accrued bonuses: ¥11,140 thousand

Provision for directors' retirement benefits: ¥5,773 thousand

R&D expenses: ¥155,353 thousand

#3: None

#4: Elmic Systems USA, Inc. adopted SFAS No. 142, "Goodwill and Other Intangible Assets." The above amounts show impairment of goodwill based on the goodwill impairment test according to the new standard.

## Notes to consolidated statements of cash flows

Reconciliation of cash and cash equivalents of the statements of cash flows and account balances of balance sheets for the period is made as follows (As of December 31, 2002):

- Cash and deposits: ¥146,793 thousand
- Securities: ¥1,190,164 thousand
- Short-term investments with risk of diminution: (¥100,915 thousand)
- Cash and cash Equivalents: ¥1,236,042 thousand

## Accounting for Leases

Finance lease transactions not involving a transfer of title to the lessee

1. Acquisition cost, accumulated depreciation and period-end balance equivalents of the lease property (Property, plant and equipment)
  - Acquisition cost equivalents: ¥4,884 thousand
  - Accumulated depreciation equivalents: ¥4,884 thousand
  - Period-end balance equivalents: None
2. Outstanding lease commitments, and the nine-month period-end balance equivalents
  - Less than a year: None
  - More than a year: None
  - Total: None
3. Lease rental expenses, accumulated depreciation and interest equivalents
  - Lease payments: ¥532 thousand
  - Depreciation equivalents: ¥474 thousand
  - Interest equivalents: ¥6 thousand
4. Calculation of accumulated depreciation equivalents
 

Depreciation is based on the straight-line method, assuming the lease period to be the useful life and no residual value.
5. Calculation of interest equivalents
 

The difference between total lease payments and acquisition cost equivalent is treated as interest equivalent. It is allocated to each period using the simple-interest method.

## Securities (As of December 31, 2002)

Securities classified as other securities

### 1. Securities with market quotations

Yen in thousands			
Security	Acquisition cost	Carrying value	Unrealized gain or loss
(1) Equity securities	41,289	45,140	3,850
(2) Debt securities			
a. JGBs and municipal bonds	-	-	-
b. Corporate bonds	102,928	100,915	(2,013)
c. Others	-	-	-
(3) Others	94,800	85,200	(9,600)
Total	239,018	231,255	(7,762)

Note: In the third quarter of the current fiscal year ending March 31, 2003, the impairment loss on securities with market quotations classified as "Other securities" totaled ¥26,880 thousand. All securities whose market values are at least 50% (inclusive) below book value on the third quarter balance sheet date are tested for impairment. All securities whose market values are at least 30% (inclusive) to 50% below book value on the third quarter balance sheet date are reviewed for impairment based on materiality of the security and prospects of recovery in market price.

### 2. Securities without market quotations

Yen in thousands	
	Carrying value
Other securities	
Money management funds	682,128
Free financial funds	300,020
Medium-term government bond funds	107,099
Unlisted stock (Excluding OTC stocks)	24,090
Total	1,113,338

## Derivatives

Notional principal amounts, market values and valuation gains and losses of derivative financial instruments outstanding as of the balance sheet date.

Yen in thousands

Instrument hedged	Type	Contract amount	Market value	Unrealized gain (loss)
Investment trust	Options			
	Short Put	100,654	2,274	-
Total		100,654	2,274	-

Notes: 1. Market value is based on quotations posted by financial institutions

2. Excludes derivatives subject to hedge accounting

## Segment Information

### 1. Segment information by operating segment

No reportable items. The Company and its major consolidated subsidiaries operate in a single industry commonly classified as electronics component manufacturing. These activities include manufacturing and marketing of components products related to communications and real-time operating systems

### 2. Geographical segment information

Yen in thousands

	Japan	N. America	Other	Total	Elimination or Corporate	Consolidated
Net sales						
(1) Sales to external customers	983,266	246,901	1,777	1,231,945	-	1,231,945
(2) Inter-segment sales and transfers	308	63,002	-	63,310	(63,310)	-
Total	983,574	309,903	1,777	1,295,256	(63,310)	1,231,945
Operating expenses	1,050,474	293,595	9,343	1,353,413	(30,519)	1,322,893
Operating income (loss)	(66,899)	16,307	(7,565)	(58,157)	(32,790)	(90,947)

Notes: 1. Countries and regions are grouped together according to the proximity of their geographical locations.

2. The principal countries or areas included in each region, outside Japan, are as follows:

(1) North America: U. S. A.

(2) Other: France

3. Unallocatable operating expenses included in eliminations or corporate.

Amount of unallocatable operating expenses included in eliminations or corporate: ¥31,799 thousand

Significant components: Represent expenses related to the administration division

4. Supplementary information

Amortization of goodwill:

Effective the third quarter of the current consolidated fiscal year ending March 31, 2003, overseas subsidiaries adopted SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 requires that goodwill no longer be amortized but instead tested for impairment at least annually. (See Significant Accounting Policies in the Preparation of Consolidated Financial Statements for the Third Quarter of the Fiscal Year Ending March 2003, Section 4. Accounting Standards, Subsection: B Depreciation and amortization of significant depreciable assets). The application of the new standards caused third quarter operating expenses in the North American operations to decline by ¥27,142 thousand and operating income to increase by an equivalent amount.

### 3. Overseas sales

Yen in thousands

	North America	Other	Total
I. Overseas sales	229,534	35,412	264,946
II. Consolidated net sales	-	-	1,231,945
II. Weight of overseas sales in total consolidated net sales	18.6%	2.9%	21.5%

Notes: 1. Countries and regions are grouped together according to the proximity of their geographical locations.

2. The principal countries or areas included in each region, outside Japan, are as follows:

(1) North America: U. S. A., Canada

(2) Other regions: Germany, Britain, Hong Kong and India etc.

3. Overseas sales of the Company and its consolidated subsidiaries represent sales in countries and regions other than Japan.

## Per Share Information

Net assets per share: ¥472.23

Net loss per share (3rd Qtr.) basic: ¥165.84

Net income per share (diluted) is not presented since the company reported net loss per share for the period.

Note: The basis of calculation of net loss per share and the diluted net loss per share for the period is as follows.

Net loss for the period: ¥834,723 thousand

Equity in net loss not account of regular shareholders: None

Regular shareholders' equity in net loss: ¥834,723

Average number of shares outstanding for the period: 5,033,000 shares

Details on potential stock not included in the calculation of diluted net earnings per share since there is no dilution:

Pursuant to Article 280-19 of the Commercial Code of Japan, the Company has only one type of share acquisition right by way of stock options outstanding (Shares to be issued upon execution of share acquisition rights: Common shares, Number of shares to be issued upon execution of share acquisition rights: 181,000 shares)

## 5. Others

Financial statements for the current nine-month period ended December 2002, that is consolidated balance sheet, consolidated income statement, and consolidated statement of cash flows for the period, have been audited by the company's auditors in conformation with the "Standards for Report of the Independent Certified Public Accountants on Quarterly Financial Statements" set forth in the supplement to the "Rules Regarding Timely Disclosure of Corporate Information by Companies Issuing Listed Securities."

*This financial report is solely a translation of summary of "Kessan Tanshin" (in Japanese, including attachments), which has been prepared in accordance with accounting principles and practices generally accepted in Japan, for the convenience of readers who prefer an English translation.*