HAPPINET CORPORATION AND CONSOLIDATED SUBSIDIARIES

Consolidated Financial Statements

March 31, 2004 and 2003

(With Independent Auditors' Report Thereon)

Happinet Corporation and Consolidated Subsidiaries
Consolidated Balance Sheets
March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (note 2)
	2004	2003	2004
Assets			
Current assets:			
Cash (note 3)	¥ 5,845	¥ 6,295	$ 55,303
Trade notes and accounts receivable	18,044	17,498	170,726
Inventories	4,564	7,857	43,183
Deferred income taxes (note 7)	494	497	4,674
Other current assets	3,300	2,428	31,223
Less allowance for doubtful receivables	243	158	2,299
Total current assets	32,004	34,417	302,810
Property, plant and equipment:			
Buildings and structures	1,336	1,695	12,640
Machinery, equipment and vehicles	849	835	8,033
Tools, furniture and fixtures	383	390	3,624
Land	273	1,220	2,583
	2,841	4,140	26,880
Less accumulated depreciation	1,404	1,459	13,284
Net property, plant and equipment	1,437	2,681	13,596
Intangible assets, net	883	853	8,355
Investments and other assets:			
Investments in securities (notes 4 and 5)	1,309	1,199	12,385
Refundable deposits	462	464	4,371
Deferred income taxes (note 7)	837	226	7,920
Other investments and other assets	190	201	1,798
Less allowance for doubtful receivables	88	66	833
Total investments and other assets	2,710	2,024	25,641
Total assets	¥ 37,034	¥ 39,975	$ 350,402

	Millions of yen		Thousands of U.S. dollars (note 2)
	2004	2003	2004
Liabilities and Stockholders' Equity			
Current liabilities:			
Trade notes and accounts payable (note 14)	¥ 16,684	¥ 19,760	$ 157,858
Other payables (note 14)	1,424	1,420	13,474
Accrued income taxes (note 7)	393	406	3,718
Accrued bonuses	332	347	3,141
Other current liabilities	765	390	7,238
Total current liabilities	19,598	22,323	185,429
Non-current liabilities:			
Liabilities for retirement and severance benefits (note 6)	687	432	6,500
Deferred income taxes (note 7)	–	36	–
Other non-current liabilities	721	672	6,822
Total non-current liabilities	1,408	1,140	13,322
Total liabilities	21,006	23,463	198,751
Minority interests	(29)	–	(274)
Stockholders' equity:			
Common stock (note 10):	2,751	2,751	26,029
Authorized 32,000,000 shares; issued and outstanding 12,025,000 shares in 2004 and 2003			
Additional paid-in capital (note 10)	2,776	2,776	26,265
Retained earnings (note 11)	10,278	11,279	97,247
Net unrealized gain (loss) on other securities (note 4)	257	(36)	2,431
Treasury stock	(5)	(258)	(47)
Total stockholders' equity	16,057	16,512	151,925
Commitments and contingencies (note 15)			
Total liabilities and stockholders' equity	¥ 37,034	¥ 39,975	$ 350,402

See accompanying notes to consolidated financial statements.

Happinet Corporation and Consolidated Subsidiaries
Consolidated Statements of Income
March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (note 2)
	2004	2003	2004
Net sales	¥ 122,723	¥ 122,516	$ 1,161,160
Cost of sales (note 14)	107,997	107,540	1,021,828
Gross profit	14,726	14,976	139,332
Selling, general and administrative expenses (notes 8, 9 and 14)	13,585	13,797	128,536
Operating income	1,141	1,179	10,796
Other income (deductions):			
Interest income	3	2	28
Dividend income	11	9	104
Interest expenses	(0)	(1)	(0)
Rent income	41	41	388
Gain on sale of investments in securities (note 4)	18	87	170
Loss on sale/disposal of property, plant and equipment	(436)	(12)	(4,125)
Loss on devaluation of investments in securities and other investments (note 4)	(378)	(82)	(3,576)
Loss on devaluation of inventories	(1,100)	–	(10,408)
Other, net	(368)	181	(3,482)
	(2,209)	225	(20,901)
Income (loss) before income taxes and minority interests	(1,068)	1,404	(10,105)
Income taxes (note 7):			
Current	467	476	4,419
Deferred	(848)	150	(8,024)
	(381)	626	(3,605)
Income (loss) before minority interests	(687)	778	(6,500)
Minority interests	–	11	–
Net income (loss)	¥ (687)	¥ 767	$ (6,500)

	Yen		U.S. dollars (note 2)
	2004	2003	2004
Per share of common stock:			
Net income (loss) – basic (note 12)	¥ (57.36)	¥ 64.40	$ (0.54)
Cash dividends applicable to the year (note 11)	25.00	25.00	0.24

See accompanying notes to consolidated financial statements.

Happinet Corporation and Consolidated Subsidiaries
Consolidated Statements of Stockholders' Equity
March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (note 2)
	2004	2003	2004
Common stock (note 10):			
Balance at beginning of year	¥ 2,751	¥ 2,751	$ 26,029
Balance at end of year	2,751	2,751	26,029
Additional paid-in capital (note 10):			
Balance at beginning of year	2,776	2,776	26,265
Increase resulting from sale of treasury stock	0	–	0
Balance at end of year	2,776	2,776	26,265
Retained earnings (note 11):			
Balance at beginning of year	11,279	10,812	106,718
Decrease resulting from a newly consolidated subsidiary	(17)	–	(161)
Cash dividends	(297)	(300)	(2,810)
Net income (loss)	(687)	767	(6,500)
Balance at end of year	10,278	11,279	97,247
Net unrealized gain (loss) on other securities at end of year (note 4)	257	(36)	2,432
Treasury stock at end of year	(5)	(258)	(47)
Total stockholders' equity at end of year	¥ 16,057	¥ 16,512	$ 151,926

See accompanying notes to consolidated financial statements.

Happinet Corporation and Consolidated Subsidiaries
Consolidated Statements of Cash Flows
March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (note 2)
	2004	2003	2004
Cash flows from operating activities:			
Income (loss) before income taxes and minority interests	¥ (1,068)	¥ 1,404	$ (10,105)
Adjustments to reconcile income before income taxes and minority interests to net cash used in operating activities:			
Depreciation and amortization	521	565	4,929
Allowance for doubtful receivables	107	(161)	1,012
Decrease in accrued bonuses	(16)	(36)	(151)
Increase in liabilities for retirement and severance benefits	255	28	2,413
Interest and dividend income	(14)	(11)	(132)
Interest expenses	0	1	0
Loss on sale/disposal of property, plant and equipment	436	12	4,125
Gain on sale of investments in securities	(18)	(87)	(170)
Loss on devaluation of investments in securities and other investments	378	82	3,576
(Increase) decrease in trade notes and accounts receivable	(654)	8,451	(6,188)
Decrease in inventories	3,297	370	31,195
Decrease in trade notes and accounts payable	(3,152)	(10,853)	(29,823)
Decrease in other payables	(1)	(1,100)	(9)
Other, net	(83)	(1,229)	(785)
Sub total	(12)	(2,564)	(113)
Interest and dividend received	14	11	132
Interest paid	0	(1)	0
Income taxes paid	(480)	(823)	(4,542)
Net cash used in operating activities	(478)	(3,377)	(4,523)
Cash flows from investing activities:			
Capital expenditures	(71)	(61)	(672)
Proceeds from sale of property, plant and equipment	735	83	6,954
Purchase of intangible assets	(181)	(163)	(1,712)
Purchase of investments in securities	(21)	(225)	(199)
Proceeds from sale of investments in securities	63	133	596
Other, net	(417)	(292)	(3,945)
Net cash provided by (used in) investing Activities	108	(525)	1,022

Cash flows from financing activities:			
(Increase) decrease in treasury stock	254	(257)	2,403
Dividends paid to stockholders	(299)	(299)	(2,829)
Dividends paid to minority stockholders of subsidiaries	–	(3)	–
Net cash used in financing activities	(45)	(559)	(426)
Net decrease in cash and cash equivalents	(415)	(4,461)	(3,927)
Cash and cash equivalents at beginning of year	6,295	10,756	59,561
Cash and cash equivalents of newly consolidated subsidiaries	(35)	–	(331)
Cash and cash equivalents at end of year (note 3)	¥ 5,845	¥ 6,295	$ 55,303

See accompanying notes to consolidated financial statements.

Happinet Corporation and Consolidated Subsidiaries

Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies

(a) Basis of Presenting Consolidated Financial Statements

Happinet Corporation (the Company) and its consolidated subsidiaries maintain their books of account and prepare their financial statements in conformity with financial accounting standards of Japan.

The accompanying consolidated financial statements have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles and practices generally accepted in Japan, which may differ in some material respects from accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

In preparing the accompanying consolidated financial statements, certain reclassifications have been made in the financial statements issued 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 information which is not required under accounting principles generally accepted in Japan but is presented herein as additional information.

(b) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries (5 subsidiaries for 2004 and 2003).

All significant intercompany accounts and transactions have been eliminated in consolidation.

Investments in affiliates are accounted for by the equity method.

The Accounting Standards for Consolidation require the control or influence concept for the consolidation scope of subsidiaries and affiliates. Under the control or influence concept, a company in which the parent company or its consolidated subsidiaries, directly or indirectly, are able to exercise control over operations is fully consolidated, and another company over which the parent company and/or its consolidated subsidiaries have the ability to exercise significant influence is accounted for by the equity method.

The excess of cost over the underlying net assets at the dates of investments in subsidiaries is being amortized over 5 years.

(c) Cash and Cash Equivalents

For the purpose of the statements of cash flows, the Company considers all highly liquid investments with insignificant risk of changes in value which have maturities of generally three months or less when purchased to be cash equivalents.

(d) Investments in Securities

Under the Accounting Standards for Financial Instruments, securities are classified into four categories – “trading securities”, “held-to-maturity securities”, “investments in affiliates” and “other securities”. Securities classified as “trading securities” are stated at fair value and unrealized gains or losses are recorded in the consolidated statement of income. Securities classified as “held-to-maturity securities” are stated at amortized cost. Securities classified as “other securities” are stated at fair value and unrealized gains or losses, net of related taxes, are excluded from earnings and recorded in a separate component of stockholders’ equity. Realized gains or losses on the other securities are determined by the moving average method. Holding securities of the Company are classified as other securities.

(e) Inventories

Inventories are stated at the lower of cost or market. Cost is determined principally by the average method.

(f) Property, Plant and Equipment

Property, plant and equipment are carried substantially at cost. Depreciation is provided by the declining-balance method based on estimated useful lives, except for the buildings acquired on or after April 1, 1998, which are depreciated based on the straight-line method.

The estimated useful lives are as follows:

Buildings and structures	3 – 47 years
Machinery, equipment and vehicles	3 – 12 years
Tools, furniture and fixtures	2 – 20 years

(g) Intangible Assets

Software development expenses are deferred and amortized by the straight-line method over estimated useful lives (5 years). Intangible assets other than software are deferred and amortized by the straight-line method at the rates based on the estimated useful lives of the respective assets.

(h) Allowance for Doubtful Receivables

An allowance for doubtful receivables is provided at an amount of uncollectible receivables based on historical loss ratios and an amount that takes into consideration the possibility of specific liabilities.

(i) Retirement and Severance Benefits

The Company and its consolidated subsidiaries have contributory and noncontributory pension plans to provide retirement and severance benefits to substantially all employees.

Under the Accounting Standards for Retirement and Severance Benefits, provisions have been made in the accompanying consolidated financial statements based on the present value of the projected future retirement and severance benefits attributable to employee services rendered by the end of the year, less amounts funded under contributory and noncontributory pension plans.

In the standards, for smaller-sized companies, the simplified method would be applied to measurement of provisions, and consolidated subsidiaries of the Company provided the amounts if all eligible employees voluntarily terminated employment at the respective balance sheet date. Effective in the year ended March 31, 2004, consolidated subsidiaries of the Company changed their calculation method of retirement and severance benefits obligation from the simplified method to the principle method. This change was made in order to achieve more appropriate allocation of the subsidiaries’ pension cost by adopting the same calculation method of the Company.

Unrecognized differences arising from the change at the time the standards introduced which had been amortized over 5 years were fully charged to fiscal 2004 income. Furthermore, unrecognized prior service cost and unrecognized actuarial loss generated in the previous years which had been amortized over 5 years were fully charged to fiscal 2004 income, and the amortization of unrecognized prior service cost and unrecognized actuarial loss are recognized in the year in which they were generated. These changes were made for financial health improvement as a result of reviewing the assumptions of pension plans in consideration of personnel transfers between the Company and its subsidiaries and change in the personnel organization.

Owing to these changes, ¥218 million ($2,063 thousand) of unrecognized transition difference, unrecognized prior service cost and unrecognized actuarial loss generated in the previous years are charged to fiscal 2004 income. And ¥38 million ($360 thousand) of differences between the simplified method and the principle method of the consolidated subsidiaries at April 1, 2003 is charged to fiscal 2004 income.

Due to the changes described above, operating income increased by ¥66 million ($624 thousand), and loss before income taxes and minority interests increased by ¥190 million ($1,798 thousand).

(j) Leases

Finance leases, except for those where the legal title of the underlying property is transferred from the lessor to the lessee at the end of the lease term, are accounted for similarly to operating leases.

(k) Income Taxes

The Accounting Standards for Deferred Income Taxes require that deferred income taxes be accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled, and the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(l) Appropriation of Retained Earnings

Under the Commercial Code of Japan, the appropriation of retained earnings with respect to a given financial period is made by resolution of the stockholders at a general meeting to be held subsequent to the close of such financial period. The accounts for that period do not, therefore, reflect such appropriation. (See note 11)

(m) Data per Common Share

Net income (loss) per share is computed on the basis of the weighted average number of shares of common stock outstanding during the respective years. (See note 12)

Cash dividends per share are computed based on dividends actually paid during the year.

(n) Reclassifications

Certain reclassifications of the accompanying consolidated financial statements as of and for the year ended March 31, 2003 have been made to conform to the 2004 presentation.

(2) Financial Statement Translation

The consolidated financial statements are expressed in Japanese yen. However, solely for the convenience of the reader, the consolidated financial statements as of and for the year ended March 31, 2004 have been translated into United States dollars at the rate of ¥105.69=U.S.$1, the approximate exchange rate on the Tokyo Foreign Exchange Market on March 31, 2004. This translation should not be construed as a representation that the amounts shown could be converted into U.S. dollars at such rate.

(3) Cash and Cash Equivalents

A reconciliation of the cash and cash equivalents of consolidated balance sheets and that of consolidated statements of cash flows at March 31, 2004 and 2003 is follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Cash	¥ 5,845	¥ 6,295	$ 55,303
Cash and cash equivalents	¥ 5,845	¥ 6,295	$ 55,303

(4) Investments in Securities

Acquisition cost, balance sheet amount and gross unrealized gain and gross unrealized loss of other securities with fair value as of March 31, 2004 and 2003 are summarized as follows:

	Millions of yen			
	Acquisition cost	Unrealized gain	Unrealized loss	Balance sheet amount
March 31, 2004				
Equity securities	¥ 603	¥ 435	¥ (2)	¥ 1,036
March 31, 2003				
Equity securities	¥ 874	¥ 188	¥ (248)	¥ 814

	Thousands of U.S. dollars			
	Acquisition cost	Unrealized gain	Unrealized loss	Balance sheet amount
March 31, 2004				
Equity securities	$ 5,705	$ 4,116	$ (19)	$ 9,802

It is not practicable to estimate the fair value of securities as of March 31, 2004 and 2003 described bellow because of lack of market price and difficulty in estimating fair value.

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Unlisted equity securities	¥ 19	¥ 142	$ 180

For the years ended March 31, 2004 and 2003, proceeds from sale of other securities are ¥63 million ($596 thousand) and ¥133 million, the gross realized gains are ¥19 million ($180 thousand) and ¥114 million, and the gross realized losses are ¥1 million ($9 thousand) and ¥27 million, respectively.

(5) Investments in Affiliates

The aggregate carrying amount of investments in affiliates as of March 31, 2004 and 2003 is ¥254 million ($2,403 thousand) and ¥242 million, respectively.

(6) Retirement and Severance Benefits

The Company and consolidated subsidiaries have defined benefit retirement and pension plans, which consist of unfunded retirement and severance plans that provide for lump-sum payment of benefits and contributory benefit plans provided under the Welfare Pension Insurance Law of Japan.

The funded status of the pension plans at March 31, 2004 and 2003 is outlined as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Projected benefit obligation	¥ 687	¥ 650	$ 6,500
Amount recognized in the consolidated balance sheets	687	432	6,500
Unrecognized prior service cost	–	(34)	–
Unrecognized actuarial loss	–	77	–
Unrecognized transition obligation existing at April 1, 2000	–	175	–

Net periodic pension cost for the years ended March 31, 2004 and 2003 consists of the following components:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Service cost	¥ 78	¥ 72	$ 738
Interest cost	17	6	161
Differences between the simplified method and the principle method of the consolidated subsidiaries at April 1, 2003	38	–	360
Amortization of prior service cost	(34)	(17)	(322)
Amortization of transition obligation existing at April 1, 2000	175	88	1,656
Amortization of actuarial loss	–	5	–
Amortization of actuarial loss generated in the previous years	77	–	729
Amortization of actuarial loss generated in the current fiscal year	26	–	246
Contribution by the Company to the Welfare Pension Fund	83	81	785
Additional benefits, etc.	40	81	378
Net periodic pension cost	¥ 500	¥ 316	$ 4,731

Significant assumptions of pension plans used to determine these amounts in fiscal 2004 and 2003 are as follows:

	2004	2003
Discount rate	2.0%	2.5%
Periodic allocation method for projected benefit	Straight-line	Straight-line
Period for amortization of unrecognized prior service cost	1 year*	5 years
Period for amortization of unrecognized actuarial loss	1 year*	5 years
Period for amortization of transition obligation existing at April 1, 2000	Fully amortized	5 years

Note: *Amortized in the year in which they were generated

Plan assets of the welfare pension fund at March 31, 2004 and 2003 are estimated to be ¥1,669 million ($15,791 thousand) and ¥1,316 million, respectively.

(7) Income Taxes

The Company and its consolidated subsidiaries are subject to Japanese corporate, inhabitant and business taxes based on income which, in the aggregate, result in a statutory tax rate of approximately 42.0% in 2004 and 2003.

Amendments to Japanese tax regulations were enacted on March 31, 2003. As a result of these amendments, the normal income tax rate was to be reduced from approximately 42.0% to 40.4% effective from the Company's fiscal year beginning April 1, 2004. Deferred income tax assets and liabilities as of March 31, 2003 which expected to be eliminated after April 1, 2004 were revaluated at a rate of 40.4%. As a result of the change in the tax rate, net deferred income tax assets as of March 31, 2003 were decreased by ¥8 million and net unrealized gain on other securities was decreased by ¥1 million, and ¥7 million was charged to income.

Tokyo Prefectural Government Ordinance was promulgated on October 14, 2003. And, the normal income tax rate is to be changed from approximately 40.4% to 40.6% effective from the Company's fiscal year beginning April 1, 2004. Deferred income tax assets and liabilities as of March 31, 2004 were revaluated at a rate of 40.6%. As a result of the change in the tax rate, net deferred income tax assets as of March 31, 2004 were increased by ¥6 million ($57 thousand) and net unrealized gain on other securities was decreased by ¥1 million ($9 thousand), and ¥7 million ($66 thousand) was credited to income.

A reconciliation of the statutory tax rate and the effective tax rate as a percentage of income (loss) before income taxes and minority interests for the years ended March 31, 2004 and 2003 is follows:

	2004	2003
Statutory tax rate	42.0%	42.0%
Expenses not deductible for tax purposes	(1.5)	1.5
Income not credited for tax purposes	0.2	(0.2)
Per capita tax	(1.7)	1.5
Effect of change in the tax rate	(3.6)	0.8
Other	0.7	(1.0)
Effective tax rate	35.7%	44.6%

Significant components of deferred tax assets and liabilities at March 31, 2004 and 2003 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Deferred tax assets:			
Deferred tax assets (current):			
Accrued business tax	¥ 27	¥ 35	$ 255
Valuation loss for inventories	164	268	1,552
Accrued bonuses	134	120	1,268
Unrealized profit on sale of inventories eliminated on consolidation	0	4	0
Accrued loss on warehouse etc. closedown	33	–	312
Other	136	70	1,287
	494	497	4,674
Deferred tax assets (non-current):			
Liabilities for retirement and severance benefits	263	149	2,488
Loss on devaluation of other investments	44	44	416
Loss on devaluation of investments in securities	51	27	483
Tax loss carryforwards	656	79	6,207
Other	25	27	237
Offset with deferred tax liabilities (non-current)	(202)	(100)	(1,911)
	837	226	7,920
Net deferred tax assets	¥ 1,331	¥ 723	$ 12,594
Deferred tax liabilities:			
Deferred tax liabilities (non-current):			
Net unrealized gain on other securities	¥ (176)	¥ 28	$ (1,665)
Gain on evaluation of subsidiaries' assets and liabilities	(26)	(164)	(246)
Offset with deferred tax assets (non-current)	202	100	1,911
Net deferred tax liabilities	¥ –	¥ (36)	$ –

(8) Selling, General and Administrative Expenses

Significant components of selling, general and administrative expenses are as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Storage expenses	¥ 2,468	¥ 2,160	$ 23,351
Freight	2,073	2,118	19,614
Promotion	986	763	9,329
Salary and wages	3,631	3,926	34,355

(9) Research and Development Costs

Research and development costs charged to income for the years ended March 31, 2004 and 2003 are ¥25 million ($237 thousand) and ¥116 million, respectively.

(10) Common Stock

Under the Commercial Code of Japan, at least 50% of the issue price of new shares is required to be designated as stated common stock. The actual portion to be designated as stated common stock is determined by resolution of the Board of Directors. Proceeds in excess of the amount designated as stated common stock are credited to additional paid-in capital.

(11) Retained Earnings and Dividends

The Commercial Code of Japan provides that an amount equal to at least 10% of appropriations paid in cash be appropriated as a legal reserve until an aggregated amount of additional paid-in capital and the legal reserve equal 25% of common stock.

This legal reserve and additional paid-in capital may be used to reduce a deficit by approval at the meeting of stockholders or may be transferred to stated common stock by resolution of the Board of Directors. On condition that the total amount of legal reserve and additional paid-in capital remains equal to or exceeds 25% of stated common stock, they are available for distributions by approval at the meeting of stockholders.

Balances of the legal reserve are included in retained earnings in the accompanying consolidated balance sheets.

The amount available for dividends is based on the amount recorded in the Company's non-consolidated books of account in accordance with the Commercial Code of Japan.

In accordance with the Commercial Code of Japan, proposed appropriations of retained earnings have not been reflected in the financial statements at the end of each fiscal year. The proposed appropriation of retained earnings at March 31, 2004 was cash dividends of ¥150 million ($1,419 thousand).

(12) Net Income (Loss) per Share Information

Reconciliation of the numbers and the amounts used in the basic net income (loss) per share computations for the years ended March 31, 2004 and 2003 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Net income (loss) applicable to common stockholders	¥ (687)	¥ 767	$ (6,500)

	Number of shares (Thousands)	
	2004	2003
Weighted average number of shares on which basic net income (loss) per share is calculated	11,973	11,906

(13) Leases

Finance leases, except for those where the legal title of the underlying property is transferred from the lessor to the lessee at the end of the lease term, are accounted for similarly to operating leases under accounting principles generally accepted in Japan.

A summary of assumed amounts of acquisition cost, accumulated depreciation and net book value at March 31, 2004 and 2003 are as follows:

	Millions of yen			
	Machinery, equipment and vehicles	Tools, furniture and fixtures	Intangible assets	Total
March 31, 2004				
Acquisition cost	¥ 3	¥ 305	¥ 372	¥ 680
Accumulated depreciation	2	221	232	455
Net book value	¥ 1	¥ 84	¥ 140	¥ 225
March 31, 2003				
Acquisition cost	¥ 10	¥ 621	¥ 378	¥ 1,009
Accumulated depreciation	8	408	146	562
Net book value	¥ 2	¥ 213	¥ 232	¥ 447

	Thousands of U.S. dollars			
	Machinery, equipment and vehicles	Tools, furniture and fixtures	Intangible assets	Total
March 31, 2004				
Acquisition cost	$ 28	$ 2,886	$ 3,520	$ 6,434
Accumulated depreciation	19	2,091	2,195	4,305
Net book value	$ 9	$ 795	$ 1,325	$ 2,129

Future minimum payments required under finance leases at March 31, 2004 and 2003 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Within one year	¥ 146	¥ 226	$ 1,382
Over one year	87	233	823
	¥ 233	¥ 459	$ 2,205

Lease payments, depreciation equivalents and amounts representing interest under the finance leases which are accounted for in the same manner as operating leases for the years ended March 31, 2004 and 2003 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Lease payments	¥ 228	¥ 287	$ 2,157
Depreciation equivalents	214	270	2,025
Amounts representing interest	10	18	95

(14) Balances and Transactions with Related Party

The Company's outstanding common stock was owned by Bandai Co., Ltd. by 25% and 23% at March 31, 2004 and 2003, respectively.

Balances with Bandai Co., Ltd. at March 31, 2004 and 2003, and related transactions for the years then ended are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Balances:			
Trade accounts payable	¥ 1,412	¥ 576	$ 13,360
Transactions:			
Purchases	¥ 5,018	¥ 5,363	$ 47,478

A director of the Company is concurrently serving as a representative director of SENRYAKU KEIEI KAIHATSU Center, and the balances with the company at March 31, 2004 and 2003, and related transactions for the years then ended are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Balances:			
Other payables	¥ 1	¥ 0	$ 9
Transactions:			
Consultant fee	¥ 3	¥ 7	$ 28

A corporate auditor of the Company is concurrently serving as a representative of TAKAISHI Law Office, and the balances with the firm at March 31, 2004, and related transactions for the year then ended are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Balances:		
Other payables	¥ 0	$ 0
Transactions:		
Consultant fee	¥ 2	$ 19

(15) Commitments and Contingencies

It is common practice in Japan for companies, in the ordinary course of business, to receive promissory notes in settlement of trade accounts receivable and to subsequently discount such notes at banks or to transfer them by endorsement to suppliers in the settlement of accounts payable. At March 31, 2004 and 2003, the company was contingently liable with respect to trade notes receivable endorsed in the amounts of ¥12 million ($114 thousand) and ¥18 million, respectively.

(16) Segment Information

(a) Industry segments

Operations by business group are summarized as follows:

	Millions of yen				
	2004				
	Toy and TV game etc.	Video software	Total	Elimination / corporate	Consolidated
Sales to outside customers	¥ 93,461	¥ 29,262	¥ 122,723	¥ –	¥ 122,723
Inter-segment sales	–	–	–	–	–
	93,461	29,262	122,723	–	122,723
Operating expenses	92,498	27,912	120,410	1,172	121,582
Operating income	¥ 963	¥ 1,350	¥ 2,313	¥ (1,172)	¥ 1,141
Assets	¥ 24,465	¥ 7,312	¥ 31,777	¥ 5,257	¥ 37,034
Depreciation and amortization	461	26	487	22	509
Capital expenditures	169	69	238	8	246

	Millions of yen				
	2003				
	Toy and TV game etc.	Video software	Total	Elimination / corporate	Consolidated
Sales to outside customers	¥ 96,553	¥ 25,963	¥ 122,516	¥ –	¥ 122,516
Inter-segment sales	–	–	–	–	–
	96,553	25,963	122,516	–	122,516
Operating expenses	95,015	25,128	120,143	1,194	121,337
Operating income	¥ 1,538	¥ 835	¥ 2,373	¥ (1,194)	¥ 1,179
Assets	¥ 27,580	¥ 6,605	¥ 34,185	¥ 5,790	¥ 39,975
Depreciation and amortization	501	25	526	25	551
Capital expenditures	158	5	163	10	173

Thousands of U.S. dollars

	2004				
	Toy and TV game etc.	Video software	Total	Elimination / corporate	Consolidated
Sales to outside customers	$ 884,294	$ 276,866	$ 1,161,160	$ –	$ 1,161,160
Inter-segment sales	–	–	–	–	–
	884,294	276,866	1,161,160	–	1,161,160
Operating expenses	875,182	264,093	1,139,275	11,089	1,150,364
Operating income	$ 9,112	$ 12,773	$ 21,885	$ (11,089)	$ 10,796
Assets	$ 231,479	$ 69,183	$ 300,662	$ 49,740	$ 350,402
Depreciation and amortization	4,362	246	4,608	208	4,816
Capital expenditures	1,599	653	2,252	76	2,328

Notes: 1. The non-categorized operating expenses of ¥1,172 million ($11,089 thousand) and ¥1,202 million for the years ended March 31, 2004 and 2003 in the Elimination/ corporate line consist primarily of administrative operation expenses.

2. Corporate assets of ¥5,257 million ($49,740 thousand) and ¥5,790 million as of March 31, 2004 and 2003 in the Elimination/ corporate line consist primarily of cash and deposits, long-term investments (investments in securities) and assets relating to the administrative operations.

3. As described in Note 1 (i), the Company changed its accounting for retirement and severance benefits. As a result of the changes, operating expenses of "Toy and TV game etc." segment and "Elimination/ corporate" decreased by ¥45 million ($426 thousand) and ¥27 million ($255 thousand), respectively, and operating expenses of "Video software" segment increased by ¥6 million ($57 thousand), thereby operating income of "Toy and TV game etc." segment and "Elimination/ corporate" increased by ¥45 million ($426 thousand) and ¥27 million ($255 thousand), respectively, and operating income of "Video software" segment decreased by ¥6 million ($57 thousand).

(b) Geographic segments

Both domestic sales and assets located in Japan are over 90% of all segments for the years ended March 31, 2004 and 2003.

(c) Overseas sales

Overseas sales are less than 10% of consolidated sales for the years ended March 31, 2004 and 2003.

(17) Supplemental Cash Flow Information

Assets and liabilities of the newly consolidated subsidiary in 2004 by acquisition at the inception of consolidation, and net expenditure for acquisition were as follows:

	Millions of yen	Thousands of U.S. dollars
Current assets	¥ 78	$ 738
Non-current assets	131	1,240
The excess of cost over the underlying net assets	83	785
Current liabilities	(265)	(2,507)
Non-current liabilities	(56)	(530)
Minority interests	29	274
Acquisition cost of stock	–	–
Cash and cash equivalents held by acquired subsidiary	12	114
Net proceeds from acquisition	¥ 12	$ 114

(18) Subsequent Event

The Company acquired the whole operations of Happinet AM Service Higashi-Nihon Co. Ltd., an amusement products sales company and a wholly owned subsidiary of the Company, as at April 1, 2004.

Acquired assets and liabilities were as follows:

	Millions of yen	Thousands of U.S. dollars
Assets	¥ 335	$ 3,170
Liabilities	219	2,072

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Independent Auditors' Report

To the Stockholders and Board of Directors of
Happinet Corporation

We have audited the accompanying consolidated balance sheets of Happinet Corporation and consolidated subsidiaries as of March 31, 2004 and 2003, and related consolidated statements of income, stockholders' equity and cash flows for the years then ended, all expressed in Japanese yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan and, accordingly, our audits included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As more fully described in Note 1(i) to the consolidated financial statements, effective in the year ended March 31, 2004, the Company has changed its method of accounting for retirement and severance benefits of consolidated subsidiaries from the simplified method to the principle method. Furthermore, the Company has changed its methods of accounting for unrecognized transition obligation existing at April 1, 2000, unrecognized prior service cost and unrecognized actuarial loss generated in the previous years.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Happinet Corporation and consolidated subsidiaries as of March 31, 2004 and 2003, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan on a consistent basis, except for the change, with which we concur, as discussed in the preceding paragraph.

The accompanying consolidated financial statements as of and for the year ended March 31, 2004 have been translated into United States dollars solely for the convenience of the reader. We have recomputed the translation and, in our opinion, the consolidated financial statements expressed in yen have been translated into United States dollars on the basis described in Note 2 to the consolidated financial statements.

Toyo & Co.

Toyo & Co.
Tokyo, Japan
June 18, 2004

See Note 1(a) to the consolidated financial statements which explains the basis of preparing the consolidated financial statements of Happinet Corporation and consolidated subsidiaries under Japanese accounting principles and practices.