

# Financial

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# Consolidated Seven-year Summary

Daiwa House Industry Co., Ltd. and Subsidiaries  
Years ended March 31, 2000 to 2006

	Millions of yen						
	2006	2005	2004	2003	2002	2001	2000
Net sales	¥1,528,983	¥1,365,914	¥1,224,648	¥1,184,544	¥1,197,925	¥1,016,237	¥ 951,073
Cost of sales	1,213,644	1,082,133	963,457	936,861	945,474	794,170	736,310
Selling, general and administrative expenses	235,267	215,932	201,530	202,411	206,420	177,777	167,266
Operating income	80,072	67,849	59,661	45,272	46,031	44,290	47,497
Income (loss) before income taxes and minority interests	82,155	63,108	67,897	(155,157)	9,538	12,796	32,123
Net income (loss)	45,184	40,262	37,257	(91,388)	5,217	6,256	17,450
Total assets	1,475,197	1,358,807	1,087,658	1,094,441	1,187,127	1,066,457	981,893
Shareholders' equity	576,534	524,110	493,050	483,684	582,438	613,867	617,421
Property, plant and equipment, less accumulated depreciation	505,471	441,388	344,268	349,646	426,630	383,853	376,489
Capital investments	110,144	56,696	20,108	24,711	64,432	30,559	16,923
Depreciation	26,815	19,243	15,165	21,386	20,883	19,731	20,327
Net cash provided by operating activities	90,482	56,095	69,659	40,459	87,021	64,074	40,574
Net cash used in investing activities	(107,857)	(53,069)	(25,937)	(27,316)	(36,229)	(25,273)	(9,340)
Net cash provided by (used in) financing activities	(9,264)	5,889	(6,126)	(57,713)	(89,535)	(6,217)	(41,443)
Issued and outstanding* (thousands)	546,915	546,222	546,426	546,816	546,054	519,340	523,893
Stock prices at the end of term (in yen)	2,040	1,232	1,328	683	815	811	703
Per share of common stock (in yen):							
Basic net income (loss)	81.88	73.26	68.16	(167.06)	9.55	12.05	33.52
Diluted net income							33.50
Shareholders' equity	1,053.37	959.08	902.32	884.55	1,066.63	1,182.01	1,188.63
Price earnings ratio (PER)	24.91	16.82	19.48	—	85.31	67.30	20.97
Price to book value ratio (PBR)	1.94	1.28	1.47	0.77	0.76	0.69	0.59
Return on equity (ROE) (%)	8.2	7.9	7.6	(17.1)	0.9	1.0	2.9
Shareholder's equity to total assets (%)	39.1	38.6	45.3	44.2	49.1	57.6	62.9
Current ratio (%)	145.1	159.0	177.6	174.2	157.5	195.0	230.8
Fixed ratio (%)	148.3	142.4	119.0	129.5	110.6	88.8	86.1

\* Excluding shares in treasury

# Management's Discussion and Analysis (On a Consolidated Basis)

Year Ended March 31, 2006

## Business Environment and Financial Strategy

During the term under review, the year ended March 31, 2006, the Japanese economy sustained its ongoing recovery, with an increase in capital investment on the back of improved corporate earnings, as well as robust personal consumption.

Conditions were favorable overall in the housing and construction industry, too, with the number of new housing starts increasing for the third year in a row. Condominiums and rental housing made a strong showing, feeding off the boom in inner-city apartments and the burgeoning construction of rental apartments for real-estate investment. This comes in spite of the second consecutive fall in the construction of single-family houses following on from the previous term. Meanwhile, general construction also appears to be making a moderate recovery, despite sluggish public sector investment overall due to strong private-sector capital investment.

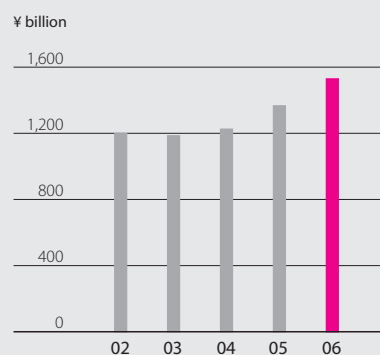
In this business environment, the Daiwa House Group has been working to bolster its sales network, by emphasizing close ties with the local community, creating a service network that will allow the Group to meet the specific needs of individual customers, and develop ever more attractive new products. The term under review marks the first year of our Medium-Term Management Plan "Challenge 2005." By strengthening cooperation among group companies, we have been able to offer a full line-up of services, ranging from building construction and maintenance, to facility management and renovation. We have worked hard to maintain ties with our valued customers, specifically by creating a system that supports our relations with them.

In addition to pursuing synergies within the Group, we made the Nippon Athletic Service Co., Ltd., which manages the NAS chain of sports clubs, into a consolidated subsidiary, to substantially increase revenues. Besides this, with the approval of the Boards of Directors of companies involved, the Group's publicly listed consolidated subsidiaries Daiwa Kosho Lease Co., Ltd., Daiwa Rakuda Industry Co., Ltd., and Daiwa Logistics Co., Ltd. are to be turned into wholly owned subsidiaries through exchange of shares.

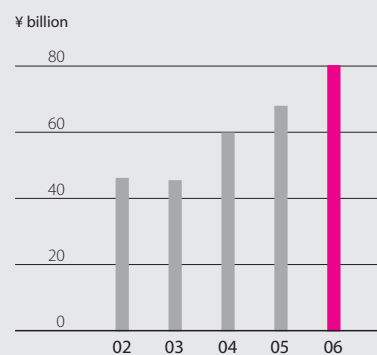
In the Medium-Term Management Plan "Challenge 2005," sales, recurring profit\*, and the return on equity (ROE) are presented as management indexes to be used to gauge the growth and development achieved through the promotion of group management as outlined above. The targets for each of these indexes that are to be achieved by the final year of the program, the year ending March 2008, are as follows: sales of ¥1,700 billion, recurring profit of ¥100 billion, and an ROE of 9.0%. However, with these figures coming in at ¥1,528.9 billion (US\$13,068 million), ¥103.0 billion (US\$881 million), and 8.2%, respectively, in the first year of the program, the Group is evidently well on track to achieving these targets.

Of these targets, sales and recurring profit have surged 11.9% and 38.9% (up 9.6% excluding the impact of amortization of actuarial losses on the retirement benefits) respectively year-on-year, and if this trend is maintained, the Group can be expected to achieve the targets it has set. In addition to this, ROE, which provides the benchmark for measuring progress made in improving management efficiency, a core issue in group management, has also seen a 0.3 percentage point

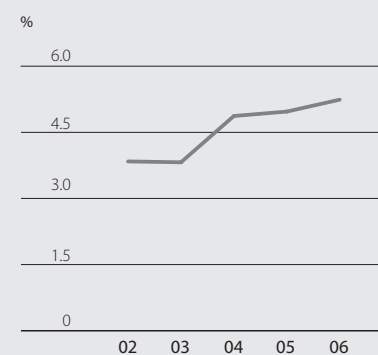
Net sales



Operating income



Operating profit margin



year-on-year improvement thanks to a stronger financial leverage and better profit margin. The Group plans to leverage this position, and plans to spend some ¥150 billion over the three years up to FY2007 on investments geared towards further business growth, and to continue to push forward with further efficiency improvements.

\* Due to reclassification, recurring profit does not appear on the income statement.

## Results of Operations

### Sales

Consolidated sales for the year ended March 2006 hit an all-time high of ¥1,528.9 billion (US\$13,068 million), up 11.9% over the previous period. This increased revenue is due in part to the fact that full-year sales of Daiwa Kosho Lease Co., Ltd. (which had become a consolidated subsidiary in the previous period) were counted this time around, whereas results for six months only had been counted for the previous term. Another contributing factor to the reporting term's higher sales turnover was the conversion of Nippon Athletic Service Co., Ltd. into a consolidated subsidiary.

Overall, the recovery in economic conditions saw the number of new housing starts top the previous fiscal year's figures for the third consecutive time at 1.249 million, thanks to strong growth in both rental housing and condominiums.

A look at sales by segment (including inter-segment transactions) shows housing sales of ¥909.5 billion (US\$7,774 million) (up 6.4% year-on-year), commercial construction sales of ¥445.2 billion (US\$3,806 million) (up 22.4%), resort hotel and sports

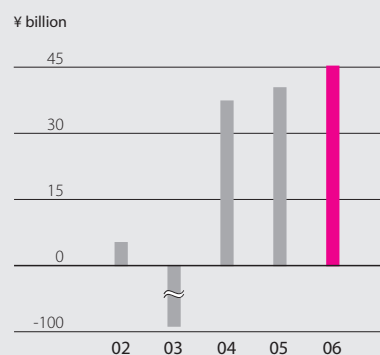
life business\* sales of ¥66.4 billion (US\$568 million) (up 19.3%), home center business sales of ¥63.2 billion (US\$541 million) (up 6.9%), and sales in other businesses of ¥121.9 billion (US\$1,043 million) (up 17.1%). However, while sales were up across the board in all segments, the percentage increase in revenue was the greatest in the commercial construction business. In light of the contribution made to sales by the inclusion of full-year sales by Daiwa Kosho Lease, this segment has proven itself to be the major driving force behind the higher sales turnover figure this fiscal year. As a result of this, the housing business' share of overall business came in under 60% at 59.2% (based on this segment's ratio of external sales). In addition, the conversion of Nippon Athletic Service Co., Ltd. into a consolidated subsidiary also translated into increased growth in resort hotel and sports life business sales this period as well.

\* Note that this segment — renamed this period after Nippon Athletic Service Co., Ltd., which manages a chain of sports clubs — came under the formerly named resort hotel business.

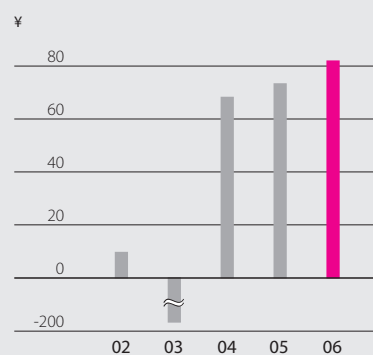
### Cost of Sales, and Selling, General and Administrative Expenses

The cost of sales this period increased ¥131.5 billion compared to the previous period to ¥1,213.6 billion (US\$10,373 million). This in turn led to a 0.2-percentage-point deterioration in the ratio of costs to sales from last period to 79.4%. This deterioration is the result of the fall in sales prices spurred on by intensified competition in the single-family house market and the increase in raw material costs that has flowed on from the persistently high crude oil prices, even though the Group has worked on keeping costs down by pushing ahead with efforts to cut procurement costs through centralized buying,

Net income (loss)



Basic net income (loss) per share



and with improvements to the production system through the promotion of shared group production facilities.

Selling, general and administrative expenses increased ¥19.3 billion compared to the previous period to stand at ¥235.2 billion (US\$2,011 million). While labor costs did increase through the Group's active investment in human resources, the Group continued to work on curbing administrative expenses, which brought the ratio of SG&A expenses to sales down 0.4 percentage points from the previous fiscal year's figure to 15.4%.

### Operating Income

The Group posted an operating income for the fiscal year ended March 2006 of ¥80.0 billion (US\$684 million), up ¥12.2 billion (18.0%) on the previous fiscal year. Whilst the increased sales and lower administrative expenses succeeded in driving up operating income, Daiwa Kosho Lease's contribution was also substantial, thanks to its healthy operating income margin of 6.6%. Moreover, despite the fall in profits in the resort hotel and sports life business segment, the increased earnings across the board in all other segments left operating income higher overall. As a result of the above, the Group's operating income margin stood at 5.2%, up 0.2 percentage points from the previous period.

### Business Overview by Segment

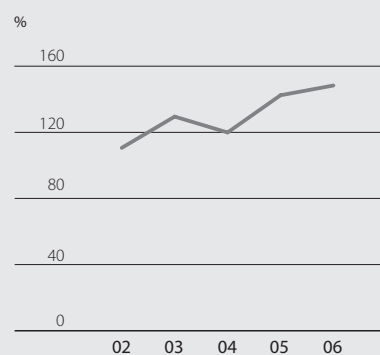
The business overview by segment below also takes trade between business segments into account.

### Housing Business

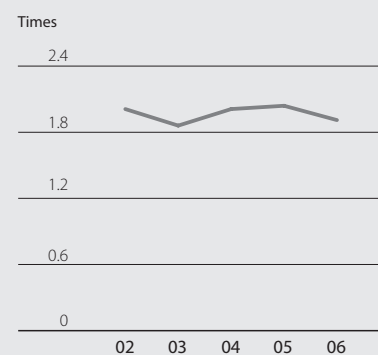
Having established the three requirements of 1) providing objective information and taking responsibility by supplying adequate explanations; 2) ensuring freedom of choice by offering a wide selection; and 3) improving our product standards relating to environmental preservation and enhancing the natural beauty of neighborhoods, as well as minimization of damage caused by earthquakes and other natural disasters, the Group has worked on furthering efforts in these areas. Based on these policies, we have released a number of new products, including a two-story house incorporating "50 proposals and 100 items" centered on the four themes of health, safety, comfort, and economy, as well as suitably priced family homes designed to suit junior baby boomers raising children. We have also released a wooden two-story housing product that offers superior cost performance, as well as another wooden two-story product designed to meet the anticipated rise in demand for renovation in major metropolitan areas. As a result of the above, housing business segment unit sales including both single-family houses and single-family subdivisions (nonconsolidated basis, excluding land) were 7.1% down on the previous period at 11,585 houses, while sales turnover fell by 2.7% to ¥334.1 billion (nonconsolidated basis, excluding land). Despite this, however, the sales price per house was 4.8% up over the previous term, with high-value-added products accounting for a larger proportion of total sales.

In the rental apartments buildings division, the launch of a two-story rental unit offering various superior features and targeting the new singles segment generated a 3.7% increase

Fixed ratio



Fixed asset turnover



in the number of units sold to 27,656, with the sales price also increasing 6.2% to ¥243.1 billion (nonconsolidated basis). The condominium division develops and markets condominiums tailored to the requirements of the city-center market and high-rise condominiums fitted with earthquake-absorbing technology. In addition to our existing D'series, we have developed the *aie* (amenity of intelligence and elegance) line, and we have worked to bolster the brand's strength. These efforts have resulted in the number of units sold surging 17.8% from the previous period to 4,391, accompanied by a sharp 19.8% rise in the revenue from sales, too, to ¥100 billion (nonconsolidated basis, excluding land). In this regard, condominiums are increasingly becoming a main source of earnings.

In the home renovation division, we are making full use of our extensive know-how — the sort that only an experienced house-builder could possess — to offer a wide range of house renovation and/or extension plans that take into account a wide variety of needs arising from changes in family structure, lifestyles, the environment, the aging of the population, and Japan's transformation into a truly information-based society.

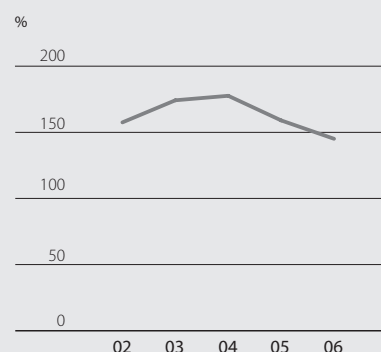
As a result, the housing business segment's sales increased by 6.4% this fiscal year to ¥909.5 billion (US\$7,774 million), with operating income also putting on 1.9% to finish on ¥50.6 billion (US\$433 million). This segment's operating income margin, however, shed 0.2 percentage points during the reporting term to finish on 5.6%.

### Commercial Construction Business

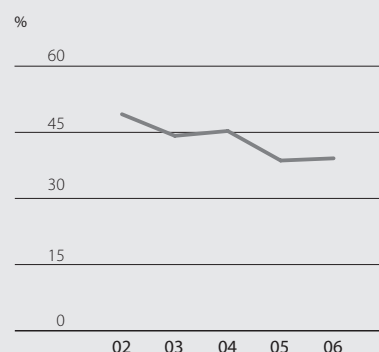
In the commercial facilities division, the upturn in business sentiment in the distribution and service divisions prompted by the gradual economic recovery in Japan has started to inspire people's willingness to invest. In light of these business conditions, we have leveraged our wealth of property information and consulting capabilities, especially in the area of providing assistance to tenant companies moving into commercial facilities, in undertaking the construction of these facilities, primarily on sites situated on main roads in suburban residential areas. We have also developed multiplex/large-scale commercial facilities comprising numerous specialty shops and restaurants on broad tracts of land. As a result of this, our building floor space for lease this period increased 13.6% on last fiscal year, expanding to 2,599,000 m<sup>2</sup>. As of the end of the reporting period, we had 4,007 tenants in this division.

Moreover, in the distribution and medical and nursing care facilities division, we are broadening the scope of our business through the construction of facilities incorporating logistics solutions that make use of our network of specialist providers to accompany increases in the efficiency of distribution and food-related facilities and the enhancement of services. Looking ahead to the progressively aging demographics of Japan in the future, we are also expanding our business through the construction of private nursing homes for the aged, which represent a culmination of the knowledge and expertise in medical and nursing care that our Silver Age Research Center has accumulated over many years.

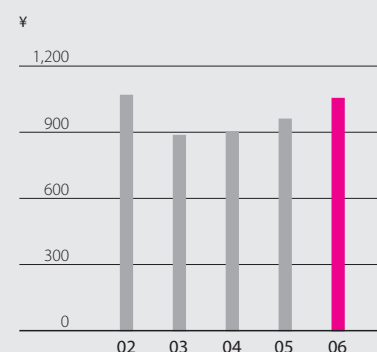
Current ratio



Shareholders' equity to total assets



Shareholders' equity per share



As a result of these initiatives, sales in the commercial construction segment saw a 22.4% increase over last fiscal year to finish on ¥445.2 billion (US\$3,806 million), with operating income also jumping 44.3% to ¥39.4 billion (US\$337 million). The operating income margin for this segment also improved 1.4 percentage points this period, reaching 8.9%.

#### Resort Hotel and Sports Life Business

The resort hotel division has strengthened its customer appeal by introducing a macrobiotic menu (a diet for prolonging life through eating natural foods) and by introducing new services such as a system for ordering in advance throughout our hotels nationwide. As a result of these efforts, the total number of guests staying in our hotels jumped by some 70,000 from the previous period to more than 3.1 million, with occupancy rates over the fiscal year also exceeding 55%.

In our sports facility operations, we are working to raise club membership numbers, and to improve business performance, we have also implemented various initiatives such as new sports clubs for children to cultivate their intellectual and moral qualities. Meanwhile, although golf club membership is gradually falling, both the number of users and golf course sales remain steady.

As a result of the above, sales in the resort hotel and sports life business this period increased 19.3% with the inclusion of Nippon Athletic Service Co., Ltd. sales as well, to ¥66.4 billion (US\$568 million), although operating income was down 46.6%

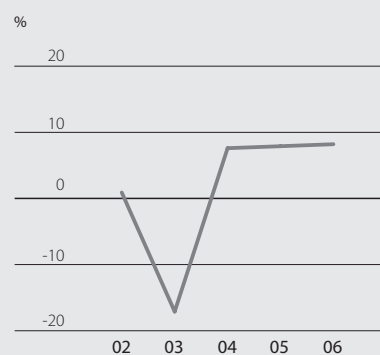
year-on-year at ¥1.0 billion (US\$9 million). This segment thus posted an operating income margin of 1.5%.

#### Home Center Business

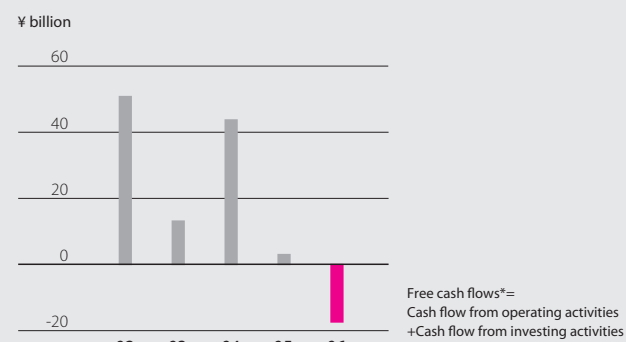
In the home center business segment during the period under review, the ever-intensifying competition in this sector led us to focus our efforts on making changes and efficiency improvements by reviewing our prices. This is taking place as we move towards discontinuing our strategy of competing on a price basis and reassessing our practice of using standardized salesroom facilities. We also endeavored to improve the efficiency with which we allocate management resources, only opening one new store and merging and integrating one of our consolidated subsidiaries. Although these activities resulted only in a minor increase in total shop floor space of some 3% by the end of the period, our facilities attracted 4.5% more customers, while the average purchase amount per customer rose sharply by 7.7% in the second half of the fiscal year, in line with the strong recovery in personal consumption in the wider economy.

As a result of the above, sales in the home center business segment this period were up 6.9% over the previous period at ¥63.2 billion (US\$541 million), with operating income increasing 10-fold over the same period to ¥1.1 billion (US\$9 million). The home center business segment thus posted an operating income margin of 1.7%.

Return on equity



Free cash flows\*



### Other Businesses

In the construction materials manufacturing and sales business unit, we strengthened our sales set-up for prefab manufacturers and building contractors, as well as our efforts to acquire new orders for medical and nursing care facilities. Besides this, we also launched a new infill business that centers on offering solutions for the renovation or interior fit-out of condominiums.

In the logistics business unit, we completed the construction of eight logistics centers around Japan, turning the bulk logistics consignment business that operates out of these facilities into a new source of revenue for the Group.

In the city hotel business unit, we worked on improving management efficiency by seeking to boost occupancy rates and cut administrative costs.

As a result of the above, our other businesses for the reporting period saw a 17.1% jump in sales to ¥121.9 billion (US\$1,043 million), as well as a 29.0% jump in operating income to ¥4.5 billion (US\$39 million).

### **Other Income and Expenses**

Our other expenses increased ¥10.7 billion during the period under review to ¥29.4 billion (US\$251 million), but given that our other income also saw a ¥17.5 billion increase over the same period to ¥31.5 billion (US\$269 million), overall, the net amount left after other expenses are deducted from other income took us from a ¥4.7 billion loss in the previous period to a ¥2.0 billion (US\$17 million) gain this time around.

The improvement in earnings relating to retirement benefits

was the main driver behind the increase in other income. A substantial figure of ¥21.7 billion (US\$185 million) was posted for gains on changes in actuarial assumptions in retirement benefits, thanks to the increased returns on plan assets reflecting the recovery of the stock market. We also posted costs of ¥1.0 billion (US\$9 million) in amortization of prior service obligations in line with changes in the retirement benefit systems at some consolidated subsidiaries.

The increase in other expenses, on the other hand, was largely fueled by an increase in fixed-asset-related losses and the posting of expenses associated with our 50th anniversary celebrations. We posted losses on the sale, impairment, and revaluation of fixed assets, including real-estate for sale, of ¥14.7 billion (US\$126 million) with a view to shoring up the soundness of our asset base. We also posted ¥4.3 billion (US\$37 million) of expenses related to events associated with the 50th anniversary of our establishment in 1955.

### **Net Income**

Thanks to the results described above, we posted the highest net income in seven years, at ¥45.1 billion (US\$386 million), which represents a 12.2% increase over the previous period. This also generated a 0.1 percentage-point improvement in the ratio of net income to sales, bringing it to 3.0%. Net income per share also reached the highest level in seven years, at ¥81.88 per share (US\$0.70). In light of these results, we have decided to offer an annual dividend for the term of ¥20 per share (US\$0.17), or ¥3 higher than last fiscal year.

## Liquidity and Capital Resources

### Financial Position

#### Assets

Total assets on a consolidated basis as of the end of March 2006 were 8.6% up over previous term-end, at ¥1,475.1 billion (US\$12,609 million). This increase stemmed from our acquisition of land for investment and our posting of gains on the reappraisal of investment securities.

Although there has only been a 1.2% year-on-year increase in current assets, the composition of that asset base has changed substantially. Most noticeably, over the reporting period, there was a big increase in land and buildings for sale, including condominiums, while conversely there was a contraction in cash and cash equivalents — the very capital used to acquire such — leaving current assets only marginally up on the previous term's figure at ¥620.0 billion (US\$5,299 million).

Property, plant and equipment increased 14.5% over the previous term-end to reach ¥505.4 billion (US\$4,320 million). The biggest increases in this sector were in land, buildings and other structures. While this is reflective of the rapid surge in capital investment during the reporting period, the commercial construction segment of our business accounts for nearly 70% of capital investment. These increases also incorporate provisions made for the real-estate investment trust due to be publicly listed in 2008.

Investments and other assets (including intangible assets) were up 14.7% year-on-year to ¥349.7 billion (US\$2,989 million), with a substantial increase in investment securities. In line with

the recovery in the stock market, where the TOPIX saw a gain of more than 50%, the book value of investment securities dramatically increased. In addition, the purchase of investment securities also contributed to the increase.

#### Liabilities

Total liabilities as of the end March 2006 rose 8.0% from the previous term-end to ¥824.0 billion (US\$7,043 million).

Current liabilities saw a 10.9% year-on-year increase to ¥427.3 billion (US\$3,653 million), with the bulk of this increase in accounts payable for capital investments and deposits received from customers. Additionally, our consolidated subsidiaries have brought about a decrease in interest-bearing liabilities, which include the current portion of long-term loans due to be repaid within one year, while the parent company continues to hold no interest-bearing liabilities, long-term or otherwise.

As a result of the above, net working capital (current assets less current liabilities) was down 15.2% from the previous term-end, at ¥192.6 billion (US\$1,646 million), with the ratio of current assets to current liabilities also falling from 159.0% to 145.1%. Despite this, however, we are still in a sufficiently liquid asset position.

Long-term liabilities increased 5.0% over the previous term, to ¥396.6 billion (US\$3,390 million). Included in this increase were rises in long-term deposits and guarantee monies, but the primary contributing factor was the inclusion following on from last period of Daiwa Kosho Lease's and other entities' construction funds receivable and long-term deposits. There was also

an increase seen in long-term loans payable by consolidated subsidiaries, but this also included the refinancing of short-term loans in anticipation of higher interest rates in the near future. Thus, while total interest-bearing liabilities rose from ¥21.0 billion in the previous fiscal year to ¥22.6 billion (US\$193 million) for the reporting term, our debt ratio (interest-bearing liabilities/total assets) has remained at 1.5% over both periods.

#### **Minority Interests**

Minority interests as of the end of March 2006 stood at ¥74.6 billion (US\$638 million), up ¥2.8 billion from ¥71.8 billion at the end of the previous accounting period on a consolidated basis.

#### **Shareholders' Equity**

With the substantial increase in earnings this period, shareholders' equity increased by 10.0% compared to the previous period to ¥576.5 billion (US\$4,928 million). With this increase in profits, retained earnings increased, with a significant rise in unrealized gains on available-for-sale securities in line with the massive increase in gains made through the revaluation of investment securities. Thanks to these changes, the shareholders' equity ratio rose 0.5 percentage points to 39.1%. ROE (Return on equity: the ratio of net income to equity) was also up 0.3 percentage points over last fiscal year to 8.2%, while ROA (Return on assets: the ratio of net income to total assets) dipped slightly to finish on 3.2%. This is indicative of further improvements in asset management efficiency.

#### **Cash Flows**

The balance of cash and cash equivalents at the end of the period under review stood at ¥123.8 billion (US\$1,058 million), ¥26.6 billion down on the end of the previous period. This was the result of large outflows in net cash used for investing activities, despite an increase in the net cash provided by operating activities thanks to the increased income before income taxes and a decline in trade receivables.

Net cash provided by operating activities rose ¥34.4 billion from the previous fiscal year to ¥90.4 billion (US\$773 million). This resulted from the increase in income before income taxes, higher depreciation after greater capital investment, and a fall in trade receivables.

Net cash used in investing activities came to ¥107.8 billion (US\$922 million), substantially up by ¥54.8 billion year-on-year. The major expenditure here was on the ongoing acquisition of property, plant and equipment. Capital investment was almost double that of the previous term, amounting to over ¥100 billion.

Net cash used in financing activities amounted to ¥9.2 billion (US\$79 million), compared with ¥5.9 billion net cash provided for the previous term. Whilst dividend payments increased with the higher dividends paid, cash expenditures are mainly attributable to expenditures on the repayment of short-term loans and the redemption securities under a loan securitization scheme.

As a result of the above, free cash flow, the total cash flow netted by operating activities and investing activities, amounted to minus ¥17.4 billion (US\$149 million).

### Outlook for the Current Fiscal Year, Ending March 2007

In the current fiscal year, private-sector demand in Japan is predicted to continue along an expansionary track, in spite of instability in the materials sector associated with heightened crude oil prices. Within our industry, we are starting to see signs of a more widespread recovery, and the number of new housing starts looks likely to be strong, with higher interest rates anticipated to come.

Amid this economic climate, the Daiwa House Group will continue working to strengthen its regional sales network, create products that respond to customer needs, and undertake development of new services. In particular, in pushing ahead with "Challenge 2005," which was launched in the FY2005, we intend to further promote group management and work on strengthening and making more efficient the joint management base and business cooperation established across the Group.

Moreover, with enhancing customer satisfaction being one of our priorities, in order to respond to customer needs in an integrated manner, we are planning to open several Customer Centers, the aim of which is to find out directly from customers exactly what sort of products and services they would like. Meanwhile, we will look for ways to improve operational systems. Such initiatives will enable us to more closely meet specific customer needs. In addition to this, we will bolster our service structure while keeping a close eye on the renovation market, with the aim of expanding and strengthening operations.

Corporate social responsibility (CSR) is another priority issue. We are improving our in-house training program to raise awareness of the importance of corporate ethics, compliance with laws and regulations, and respect for individual rights. We will continue working to build a management structure that can respond to the requests of our various stakeholders.

With regard to products and services, we will expand our environmental protection activities, and use our proprietary technologies to build products — including medical and nursing care facilities — that meet our strict criteria for "safety, reliability, trust," thereby contributing to society while simultaneously raising our enterprise value.

As a result of these initiatives, in our business performance on a consolidated basis for the coming fiscal year ending March 2007, we envisage sales of ¥1,600 billion, operating income of ¥85 billion, recurring profit of ¥85 billion, and a net income of ¥46 billion.

Please note that gains on changes in actuarial assumptions on retirement benefits have not been factored into forecasts for the fiscal year ending March 2007, as this will be dependent on changes in plan asset management conditions and other factors in the current fiscal year. (For the reporting term, other income of ¥21.7 billion (US\$185 million) was posted.)

# Consolidated Balance Sheets

Daiwa House Industry Co., Ltd. and Subsidiaries  
March 31, 2006 and 2005

## Assets

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
<b>Current assets:</b>			
Cash and cash equivalents	¥ 123,822	¥ 150,461	\$ 1,058,308
Marketable securities (Note 3)		25	
Short-term investments (Note 2-d)	199	279	1,701
Receivables (Note 7):			
Trade notes	9,278	8,010	79,299
Trade accounts	51,354	62,294	438,923
Allowance for doubtful receivables	(2,161)	(1,861)	(18,470)
Inventories (Note 4)	368,334	324,239	3,148,154
Deferred tax assets (Note 12)	26,920	31,058	230,085
Prepaid expenses and other current assets	42,273	38,038	361,307
Total current assets	620,019	612,543	5,299,307
<b>Property, plant and equipment (Notes 5, 6 and 7):</b>			
Land	286,700	243,699	2,450,427
Buildings and structures	494,944	466,359	4,230,291
Accumulated depreciation	(314,394)	(311,645)	(2,687,128)
Machinery and equipment	80,636	78,000	689,197
Accumulated depreciation	(54,917)	(55,076)	(469,376)
Furniture and fixtures	37,038	35,446	316,564
Accumulated depreciation	(28,734)	(29,075)	(245,590)
Construction in progress	4,198	13,680	35,880
Net property, plant and equipment	505,471	441,388	4,320,265
<b>Investments and other assets:</b>			
Investment securities (Note 3)	103,236	57,688	882,359
Investments in and advances to associated companies (Note 2-c)	4,039	4,095	34,521
Long-term loans (Note 2-c)	14,496	10,482	123,898
Deferred tax assets (Note 10)	59,113	75,405	505,239
Lease deposits (Note 7)	147,366	140,057	1,259,538
Other assets (Note 6)	29,988	25,445	256,308
Allowance for doubtful accounts	(8,531)	(8,296)	(72,914)
Total investments and other assets	349,707	304,876	2,988,949
Total	¥1,475,197	¥1,358,807	\$12,608,521

See notes to consolidated financial statements.

## Liabilities and shareholders' equity

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
<b>Current liabilities:</b>			
Short-term bank loans (Note 7)	¥ 6,183	¥ 13,175	\$ 52,846
Current portion of long-term debt (Note 7)	2,928	1,368	25,026
Payables:			
Trade notes	32,975	29,062	281,838
Trade accounts	136,879	127,911	1,169,906
Other accounts	93,023	81,227	795,068
Deposits received from customers	65,423	48,005	559,171
Income taxes payable	16,212	15,699	138,564
Accrued bonuses	17,950	15,242	153,419
Provision for product warranties	5,740	4,874	49,060
Accrued expenses and other current liabilities	50,056	48,693	427,829
Total current liabilities	427,369	385,256	3,652,727
<b>Long-term liabilities:</b>			
Long-term debt (Note 7)	13,528	6,555	115,624
Liability for employees' retirement benefits (Note 8)	90,235	99,871	771,239
Long-term deposits received from the Company's club members	54,431	57,023	465,222
Lease deposits received	168,568	148,831	1,440,752
Other long-term liabilities	69,876	65,362	597,231
Total long-term liabilities	396,638	377,642	3,390,068
<b>Minority interests</b>	74,656	71,799	638,085
<b>Shareholders' equity</b> (Notes 2-c, 2-n, 5, 9 and 17):			
Common stock, authorized, 1,900,000,000 shares; issued, 550,664,416 shares in both 2006 and 2005	110,120	110,120	941,196
Capital surplus	148,019	147,759	1,265,120
Retained earnings	355,495	325,893	3,038,419
Land revaluation difference	(63,392)	(69,230)	(541,812)
Net unrealized gain on available-for-sale securities	30,746	14,663	262,786
Foreign currency translation adjustments	(883)	(927)	(7,547)
Treasury stock — at cost, 3,748,885 shares in 2006 and 4,441,777 shares in 2005	(3,571)	(4,168)	(30,521)
Total shareholders' equity	576,534	524,110	4,927,641
Total	¥1,475,197	¥1,358,807	\$12,608,521

# Consolidated Statements of Income

Daiwa House Industry Co., Ltd. and Subsidiaries  
Years Ended March 31, 2006, 2005 and 2004

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2006	2005	2004	2006
<b>Net sales</b>	¥1,528,983	¥1,365,914	¥1,224,648	\$13,068,231
<b>Cost of sales</b>	1,213,644	1,082,133	963,457	10,373,026
<b>Gross profit</b>	315,339	283,781	261,191	2,695,205
<b>Selling, general and administrative expenses</b> (Note 13)	235,267	215,932	201,530	2,010,829
<b>Operating income</b>	80,072	67,849	59,661	684,376
<b>Other income (expenses):</b>				
Interest income and dividends	1,590	1,067	651	13,590
Interest expense	(1,321)	(736)	(423)	(11,291)
Write-down of inventories	(6,055)	(2,252)	(3,285)	(51,752)
Loss on sales and disposal of property, plant and equipment	(2,999)	(1,978)	(641)	(25,632)
Prior service benefit (cost) (Note 8)	1,000	(2,282)		8,547
Amortization of actuarial gain for employees' retirement benefits (Note 8)	21,730	2,214	15,460	185,726
Impairment loss on property, plant and equipment (Note 6)	(5,500)	(1,204)	(370)	(47,009)
Loss on sublease agreements	(1,247)	(2,928)	(3,503)	(10,658)
Expenses in relation to the fiftieth anniversary	(4,323)			(36,949)
Other — net (Note 11)	(792)	3,358	347	(6,769)
Other income (expenses) — net	2,083	(4,741)	8,236	17,803
<b>Income before income taxes and minority interests</b>	82,155	63,108	67,897	702,179
<b>Income taxes</b> (Note 12):				
Current	23,814	21,825	10,409	203,538
Deferred	9,831	(1,468)	19,199	84,026
Total	33,645	20,357	29,608	287,564
<b>Minority interests in net income of subsidiaries</b>	(3,326)	(2,489)	(1,032)	(28,427)
<b>Net income</b>	¥ 45,184	¥ 40,262	¥ 37,257	\$ 386,188
		<b>Yen</b>		<b>U.S. dollars</b>
<b>Per share of common stock</b> (Note 2-o):				
Basic net income	¥81.88	¥73.26	¥68.16	\$0.70
Cash dividends applicable to the year	20.00	17.00	15.00	0.17

See notes to consolidated financial statements.

# Consolidated Statements of Shareholders' Equity

Daiwa House Industry Co., Ltd. and Subsidiaries  
Years Ended March 31, 2006, 2005 and 2004

	Thousands		Millions of yen					
	Issued number of shares of common stock	Common stock	Capital surplus	Retained earnings	Land revaluation difference	Net unrealized gain on available-for-sale securities	Foreign currency translation adjustments	Treasury stock
<b>Balance, April 1, 2003</b>	550,664	¥110,120	¥147,755	¥289,840	¥(60,409)	¥ 777	¥(881)	¥(3,518)
Net income				37,257				
Cash dividends, ¥10.0 per share				(5,457)				
Transfer due to sales of land				(8,425)	8,425			
Devaluation of deferred tax assets on land revaluation and other					(34,216)			
Net increase in unrealized gain on available-for-sale securities (Note 2-c)						12,181		
Foreign currency translation adjustments (Note 2-n)							(36)	
Net increase in treasury stock			2					(365)
<b>Balance, March 31, 2004</b>	550,664	110,120	147,757	313,215	(86,200)	12,958	(917)	(3,883)
Net income				40,262				
Cash dividends, ¥15.0 per share				(8,185)				
Decrease due to newly consolidation of subsidiaries				(1,953)				
Decrease due to exclusion from consolidation of former subsidiaries				(517)				
Decrease due to exclusion from equity method accounting of former associated companies				(125)				
Transfer due to sales of land				(16,804)	16,804			
Net decrease in land revaluation difference					166			
Net increase in unrealized gain on available-for-sale securities (Note 2-c)						1,705		
Foreign currency translation adjustments (Note 2-n)							(10)	
Net increase in treasury stock			2					(285)
<b>Balance, March 31, 2005</b>	550,664	110,120	147,759	325,893	(69,230)	14,663	(927)	(4,168)
Net income				45,184				
Cash dividends, ¥17.0 per share				(9,210)				
Bonuses to directors and corporate auditors				(226)				
Decrease due to exclusion from equity method accounting of former associated companies				(527)				
Transfer due to sales of land				(5,619)	5,619			
Net decrease in land revaluation difference					219			
Net increase in unrealized gain on available-for-sale securities (Note 2-c)						16,083		
Foreign currency translation adjustments (Note 2-n)							44	
Net decrease in treasury stock			260					597
<b>Balance, March 31, 2006</b>	550,664	110,120	148,019	355,495	(63,392)	30,746	(883)	(3,571)

	Thousands of U.S. dollars (Note 1)						
	Common stock	Capital surplus	Retained earnings	Land revaluation difference	Net unrealized gain on available-for-sale securities	Foreign currency translation adjustments	Treasury stock
<b>Balance, March 31, 2005</b>	\$941,196	\$1,262,897	\$2,785,410	\$(591,709)	\$125,325	\$(7,923)	\$(35,624)
Net income			386,188				
Cash dividends, \$0.15 per share			(78,718)				
Bonuses to directors and corporate auditors			(1,932)				
Decrease due to exclusion from equity method accounting of former associated companies			(4,504)				
Transfer due to sales of land			(48,025)	48,025			
Net decrease in land revaluation difference				1,872			
Net increase in unrealized gain on available-for-sale securities (Note 2-c)					137,461		
Foreign currency translation adjustments (Note 2-n)						376	
Net decrease in treasury stock			2,223				5,103
<b>Balance, March 31, 2006</b>	\$941,196	\$1,265,120	\$3,038,419	\$(541,812)	\$262,786	\$(7,547)	\$(30,521)

See notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

Daiwa House Industry Co., Ltd. and Subsidiaries  
Years Ended March 31, 2006, 2005 and 2004

		Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2004	2006
<b>Operating activities:</b>				
Income before income taxes and minority interests	¥ 82,155	¥ 63,108	¥ 67,897	\$ 702,179
Adjustments to reconcile income before income taxes and minority interests to net cash provided by operating activities:				
Income taxes — paid	(22,986)	(22,809)	(4,671)	(196,462)
Depreciation	26,815	19,243	15,165	229,188
Write-down of golf club membership	264	121	62	2,256
Loss on sales and disposal of property, plant and equipment	2,999	1,978	641	25,632
Impairment loss on property, plant and equipment	5,500	1,204	370	47,009
Equity in earnings of associated companies	(350)	(1,611)	(2,384)	(2,991)
Provision for (reversal of) employees' retirement benefits, net of payments	(29,084)	6,350	(30,067)	(248,581)
Loss on sublease agreements	1,247	2,928	3,503	10,658
Changes in certain assets and liabilities, net of consolidation:				
Decrease (increase) in receivables	9,795	(3,090)	9,568	83,718
Increase in inventories	(41,598)	(48,814)	(13,447)	(355,538)
Increase in payables — trade	17,384	25,733	9,618	148,581
Increase in deposits received from customers	17,418	8,353	3,639	148,872
Other — net	20,923	3,401	9,765	178,830
Total adjustments	8,327	(7,013)	1,762	71,172
Net cash provided by operating activities	90,482	56,095	69,659	773,351
<b>Investing activities:</b>				
Purchases of property, plant and equipment	(90,850)	(56,331)	(21,647)	(776,496)
Purchases of marketable and investment securities	(17,018)	(7,876)	(514)	(145,453)
Increase in investments in and advances to associated companies	(704)	(85)	(2,549)	(6,017)
Proceeds from sales of marketable and investment securities	2,777	1,570	220	23,735
Proceeds from sales of property, plant and equipment	5,258	4,905	2,207	44,940
Purchases of investments in subsidiaries	(129)	(1,257)	(559)	(1,103)
Proceeds from sales of shares of subsidiaries		655		
Net increase (decrease) from sales of shares of the former consolidated subsidiaries		639	(640)	
Net proceeds from purchases of shares of the newly consolidated subsidiaries		9,164		
Payments for purchases of shares of the newly consolidated subsidiaries	(1,898)			(16,222)
Increase in lease deposits	(1,875)	(2,383)	(4,028)	(16,026)
Net decrease (increase) in other assets	(3,418)	(2,070)	1,573	(29,213)
Net cash used in investing activities	(107,857)	(53,069)	(25,937)	(921,855)
<b>Financing activities:</b>				
Net increase (decrease) in short-term bank loans	(6,992)	750	(250)	(59,761)
Proceeds from long-term debt	10,600	7,039		90,598
Repayments of long-term debt	(8,697)	(78)	(38)	(74,333)
Net of purchases and proceeds from sales of treasury stock	1,017	(132)	(109)	8,692
Dividends paid to shareholders	(9,210)	(8,185)	(5,457)	(78,718)
Dividends paid to minority shareholders of subsidiaries	(1,354)	(773)	(272)	(11,572)
Proceeds from receivables sold to trust	10,045	8,446		85,855
Remittance to trust of receivables collected	(4,673)	(1,178)		(39,940)
Net cash provided by (used in) financing activities	(9,264)	5,889	(6,126)	(79,179)
<b>Net increase (decrease) in cash and cash equivalents</b>	(26,639)	8,915	37,596	(227,683)
<b>Cash and cash equivalents, beginning of year</b>	150,461	141,546	103,950	1,285,991
<b>Cash and cash equivalents, end of year</b>	¥123,822	¥150,461	¥141,546	\$1,058,308

(Continued)

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2004
<b>Non-cash investing and financing activities:</b>			
Net proceeds from purchases of shares of the newly consolidated subsidiaries for the year ended March 31, 2005 resulted principally from purchases of shares of Daiwa Kosho Lease Co., Ltd., former the associated companies including its subsidiaries. Assets and liabilities increased by purchases of shares of Daiwa Kosho Lease Co., Ltd. and associated proceeds consisted of the followings:			
Current assets		¥ 65,096	
Long-term assets		140,084	
Current liabilities		(43,093)	
Long-term liabilities		(69,313)	
Consolidation differences		(1,701)	
Minority interests		(55,403)	
Company's interest prior to acquisition		(32,551)	
Acquisition cost		(3,119)	
Cash and cash equivalents of the consolidated subsidiaries		11,729	
Net proceeds from purchases of shares of the newly consolidated subsidiaries		<u>¥ 8,610</u>	
Assets and liabilities decreased by sales of shares of the former consolidated subsidiaries and associated proceeds and gain for the year ended March 31, 2004 consisted of the followings:			
Current assets			¥19,139
Long-term assets			6,598
Current liabilities			(13,000)
Long-term liabilities			(6,851)
Minority interests			(3,337)
Company's interest prior to acquisition			(1,252)
Gain on sales of securities			77
Proceeds from sales of securities			1,374
Cash and cash equivalents of the subsidiaries			<u>(2,014)</u>
Net decrease in cash from sales of shares of the former consolidated subsidiaries			<u>¥ (640)</u>

See notes to consolidated financial statements.

(Concluded)

# Notes to Consolidated Financial Statements

Daiwa House Industry Co., Ltd. and Subsidiaries

## 1. Basis of presenting consolidated financial statements

The accompanying consolidated financial statements have been prepared from the consolidated financial statements issued for domestic reporting purposes in accordance with the provisions set forth in the Japanese Securities and Exchange Law. Daiwa House Industry Co., Ltd. (the "Company") and its domestic subsidiaries maintain their accounts and records in accordance with the provisions set forth in the Japanese Commercial Code (the "Code") and in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards, and its foreign subsidiaries in conformity with those of their countries of domicile.

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which the Company is incorporated and operates. The translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥117 to \$1, the approximate rate of exchange at March 31, 2006. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

## 2. Summary of significant accounting policies

### a. Consolidation

The consolidated financial statements include the accounts of the Company and all subsidiaries (together the "Group") based on the control or influence concept. Under the control or influence concept, those companies over whose operations the Parent, directly or indirectly, is able to exercise control are fully consolidated, and those companies over which the Group has the ability to exercise significant influence are accounted for by the equity method.

The differences between the cost and underlying net equity of investments in subsidiaries and associated companies at acquisition, are amortized over five years.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Group is eliminated.

During the year ended March 31, 2004, Daiwa System Co., Ltd. and three subsidiaries, have been excluded from consolidation as a result of sales of their shares.

During the year ended March 31, 2005, Daiwa Kosho Lease Co., Ltd. and its four subsidiaries and one other subsidiary which were formerly associated companies, have been included in the consolidation as a result of the additional acquisition of their shares.

During the year ended March 31, 2006, Nippon Athletic Service Co., Ltd. and two subsidiaries, have been included in the consolidation as a result of acquisition or new formation and two subsidiaries have been excluded from the consolidation as a result of the sale of their shares or liquidation.

### b. Cash and cash equivalents

Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value. Cash equivalents include time deposits and certificate of deposits, all of which mature or become due within three months of the date of acquisition.

### c. Marketable and investment securities

Marketable and investment securities are classified and accounted for, depending on management's intent, as follows: i) held-to-maturity debt securities, which are expected to be held to maturity with the positive intent and ability to hold to maturity are reported at amortized cost and ii) available-for-sale securities, which are not classified as held-to-maturity.

Non-marketable available-for-sale securities are stated at cost, determined by the moving-average method. For other than temporary declines in fair value, investment securities are reduced to net realizable value by a charge to income.

Investment securities, investment in an associated company and long-term loans pledged as collateral for an associated company and other was ¥44 million (\$376 thousand) and ¥20 million as of March 31, 2006 and 2005.

#### **d. Short-term investments**

Short-term investments are time deposits and certificates of deposit, all of which mature or become due later than three months after the date of acquisition. Time deposits pledged as collateral as substitutes of deposits for certain construction and advertisement contracts were ¥29 million (\$248 thousand) as of March 31, 2006 and 2005, respectively.

#### **e. Inventories**

Inventories are stated at cost. Inventories of land, residential homes and condominiums, and construction projects in progress include all costs of land, land development and construction. The cost of construction materials and supplies is determined by the average method. However, appropriate write-downs are recorded for inventories with values considered to have been permanently or substantially impaired.

#### **f. Property, plant and equipment**

Property, plant and equipment are stated at cost. Depreciation is computed substantially by the declining-balance method while the straight-line method is applied to buildings acquired after April 1, 1998. The range of useful lives is principally from 15 to 50 years for buildings and structures, from 10 to 13 years for machinery and equipment and from 5 to 15 years for furniture and fixtures.

#### **g. Long-lived assets**

In August 2002, the Business Accounting Council (BAC) issued a Statement of Opinion, *Accounting for Impairment of Fixed Assets*, and in October 2003 the Accounting Standards Board of Japan (ASBJ) issued ASBJ Guidance No. 6, *Guidance for Accounting Standard for Impairment of Fixed Assets*. These new pronouncements are effective for fiscal years beginning on or after April 1, 2005 with early adoption permitted for fiscal years ending on or after March 31, 2004.

The Group adopted the new accounting standard for impairment of fixed assets from the year ended March 31, 2004. The Group reviews its long-lived assets for impairment whenever events or changes in circumstance indicate the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which

the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.

#### **h. Leases**

All leases are accounted for as operating leases. Under Japanese accounting standard for leases, finance leases that are deemed to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the lessee's financial statements.

#### **i. Retirement and pension plans**

The Company and its domestic subsidiaries have unfunded retirement benefit plans and a contributory funded pension plan.

Liability for employees' retirement benefits are provided based on the projected benefit obligations and plan assets at the balance sheet date.

#### **j. Revenue and profit recognition**

Sales and related profits are generally recorded when sales contracts are completed and customers have satisfied the down payment and other requirements stipulated by the contracts. Land and land development costs are allocated to units sold based upon relative area.

#### **k. Income taxes**

The provision for income taxes is computed based on the pretax income included in the consolidated statements of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

#### **l. Appropriations of retained earnings**

Appropriations of retained earnings at each year end are reflected in the financial statements of the following year after shareholders' approval has been obtained.

#### **m. Foreign currency transactions**

All short-term and long-term monetary receivables and payables denominated in foreign currencies are translated into Japanese yen at the current exchange rates at the balance sheet date. The foreign exchange gains and losses from translation are recognized in the statements of income.

#### **n. Foreign currency financial statements**

The balance sheet accounts of the consolidated foreign subsidiaries and associated companies are translated into Japanese yen at the current exchange rate as of the balance sheet date except for shareholders' equity, which is translated at historical exchange rates. Revenue and expense accounts of the consolidated foreign subsidiaries and associated companies are translated into yen at the current exchange rate.

Differences arising from such translation are shown as "Foreign currency translation adjustments" as a separate component of shareholders' equity.

#### **o. Per share information**

Basic net income per share is computed by dividing net income available to common shareholders, by the weighted-average number of common shares outstanding for the year.

The weighted-average number of common shares outstanding for the years ended March 31, 2006, 2005 and 2004 were 546,567 thousand, 546,329 thousand and 546,625 thousand, respectively.

Diluted net income per share of common stock for the years ended March 31, 2006, 2005 and 2004 are not disclosed because the Company does not issue warrants with dilutive effects.

Cash dividends per share presented in the accompanying consolidated statements of income are dividends applicable to the respective years including dividends to be paid after the end of the year.

#### **p. Treasury stock**

The stock of the Company, which is held by its subsidiaries and associated companies, is stated as treasury stock according to the percentage of ownership.

#### **q. New accounting pronouncements**

##### ***Business combination and business separation***

In October 2003, the BAC issued a Statement of Opinion, *Accounting for Business Combinations*, and on December 27, 2005 the ASBJ issued *Accounting Standard for Business Separations* and ASBJ Guidance No. 10, *Guidance for Accounting Standard for Business Combinations and Business Separations*. These new accounting pronouncements are effective for fiscal years beginning on or after April 1, 2006.

The accounting standard for business combinations allows companies to apply the pooling of interests method of accounting only when certain specific criteria are met such that the business combination is essentially regarded as a uniting-of-interests. These specific criteria are as follows:

- (a) the consideration for the business combination consists solely of common shares with voting rights,
- (b) the ratio of voting rights of each predecessor shareholder group after the business combination is nearly equal, and
- (c) there are no other factors that would indicate any control exerted by any shareholder group other than voting rights.

For business combinations that do not meet the uniting-of-interests criteria, the business combination is considered to be an acquisition and the purchase method of accounting is required. This standard also prescribes the accounting for combinations of entities under common control and for joint ventures. Goodwill, including negative goodwill, is to be systematically amortized over 20 years or less, but is also subject to an impairment test.

Under the accounting standard for business separations, in a business separation where the interests of the investor no longer continue and the investment is settled, the difference between the fair value of the consideration received for the transferred business and the book value of net assets transferred to the separated business is recognized as a gain or loss on business separation in the statement of income. In a business separation where the interests of the investor continue and the investment is not settled, no such gain or loss on business separation is recognized.

However, the above mentioned pronouncement does not apply to the share exchange agreements between the Company and three subsidiaries (see Note 17) according to the maintenance law of the Code, because its agreement date is prior to May 1, 2006.

#### **Stock options**

On December 27, 2005, the ASBJ issued *Accounting Standard for Stock Options and related guidance*. The new standard and guidance are applicable to stock options newly granted on and after May 1, 2006.

This standard requires companies to recognize compensation expense for employee stock options based on the fair value at the date of grant and over the vesting period as consideration for receiving goods or services. The standard also requires companies to account for stock options granted to non-employees based on the fair value of either the stock option or the goods or services received. In the balance sheet, the stock option is presented as a stock acquisition right as a separate component of shareholders' equity until exercised. The standard covers equity-settled, share-based payment transactions, but does not cover cash-settled, share-based payment transactions. In addition, the standard allows unlisted companies to measure options at their intrinsic value if they cannot reliably estimate fair value.

#### **Bonuses to directors and corporate auditors**

Prior to the fiscal year ended March 31, 2005, bonuses to directors and corporate auditors were accounted for as a reduction of retained earnings in the fiscal year following approval at the general shareholders meeting. The ASBJ issued ASBJ Practical Issues Task Force (PITF) No. 13, *Accounting treatment for bonuses to directors and corporate auditors*, which encouraged companies to record bonuses to directors and corporate auditors on the accrual basis with a related charge to income, but still permitted the direct reduction of such bonuses from retained earnings after approval of the appropriation of retained earnings.

The ASBJ replaced the above accounting pronouncement by issuing a new accounting standard for bonuses to directors and corporate auditors on November 29, 2005. Under the new accounting standard, bonuses to directors and corporate auditors must be expensed and are no longer allowed to be directly charged to retained earnings. This accounting standard

is effective for fiscal years ending on or after May 1, 2006. The companies must accrue bonuses to directors and corporate auditors at the year end to which such bonuses are attributable.

#### **r. Reclassifications**

Certain reclassifications have been made in the 2005 and 2004 financial statements to conform to the classifications used in 2006.

### 3. Marketable and investment securities

Marketable and investment securities as of March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Current:			
Government and corporate bonds		¥ 25	
Non-current:			
Equity securities	¥101,435	¥56,644	\$866,966
Government and corporate bonds	456	9	3,897
Investments in limited liability partnership	1,345	1,035	11,496
Total	<u>¥103,236</u>	<u>¥57,688</u>	<u>\$882,359</u>

The carrying amounts and aggregate fair values of marketable and investment securities at March 31, 2006 and 2005 were as follows:

	Millions of yen			
	2006			
	Cost	Unrealized gains	Unrealized losses	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	¥41,346	¥54,151	¥435	¥95,062
Debt securities	520		73	447
Held-to-maturity	9			9
	Millions of yen			
	2005			
	Cost	Unrealized gains	Unrealized losses	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	¥25,280	¥25,954	¥352	¥50,882
Held-to-maturity	34			34
	Thousands of U.S. dollars			
	2006			
	Cost	Unrealized gains	Unrealized losses	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	\$353,385	\$462,829	\$3,718	\$812,496
Debt securities	4,444		623	3,821
Held-to-maturity	77			77

Available-for-sale securities whose fair value is not readily determinable as of March 31, 2006 and 2005 were as follows:

	Carrying amount		
	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Available-for-sale:			
Equity securities	¥6,373	¥5,762	\$54,470
Investments in limited liability partnership	1,345	1,035	11,496
Total	<u>¥7,718</u>	<u>¥6,797</u>	<u>\$65,966</u>

The carrying values of debt securities by contractual maturities for securities classified as held-to-maturity at March 31, 2006 are as follows:

	Held to maturity	
	Millions of yen	Thousands of U.S. dollars
Due in one to five years	¥ 20	\$ 171
Due in five to ten years	9	77
Due after ten years	427	3,649
Total	<u>¥456</u>	<u>\$3,897</u>

#### 4. Inventories

Inventories at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Finished residential homes and condominiums	¥ 27,373	¥ 27,521	\$ 233,957
Construction projects in progress	49,561	35,248	423,598
Residential homes and condominiums in process	30,044	27,426	256,786
Land held:			
For resale	204,194	174,177	1,745,248
Under development	31,708	34,099	271,009
Undeveloped	11,667	11,669	99,718
Merchandise, construction materials and others	13,787	14,099	117,838
Total	<u>¥368,334</u>	<u>¥324,239</u>	<u>\$3,148,154</u>

The Group engages in two principal business activities. They manufacture and construct prefabricated houses and structures and also engage in various contracted construction projects, primarily for the construction of large-scale commercial and residential buildings. To further such business, the Group purchases land for development and resale.

#### 5. Land revaluation

Under the "Law of Land Revaluation," the Company and certain subsidiaries elected a one-time revaluation of their own-use land to a value based on real estate appraisal information as of March 31, 2002.

The resulting land revaluation difference represents unrealized depreciation of land and is stated, net of income taxes, as a component of shareholders' equity. There was no effect on the statement of income. Continuous readjustment is not permitted unless the land value subsequently declines significantly such that the amount of the decline in value should be removed from the land revaluation difference account and related deferred tax liabilities.

As of March 31, 2006, the carrying amount of the land after the above one-time revaluation exceeded the market value by ¥4,860 million (\$41,538 thousand).

As to significant change in the land revaluation difference, see the statements of shareholders' equity.

## 6. Long-lived assets

The Group recognized impairment loss on property, plant and equipment for the following group of assets in the fiscal year ended March 31, 2006.

Classification of group	Type of assets	Location	Impairment loss on property, plant and equipment	
			Millions of yen	Thousands of U.S. dollars
Resort hotel	Buildings and structures, machinery and equipment, and furniture and fixtures	Ishikawa Prefecture and others	¥1,422	\$ 12,154
Golf course	Land, buildings and structures, machinery and equipment and furniture and fixtures	Nara Prefecture and others	2,167	18,521
Assets used under sublease agreements	Buildings and structures, machinery and equipment, furniture and fixtures, and other assets	Okinawa Prefecture and others	1,283	10,966
Other	Land, buildings and structures, machinery and equipment and furniture and fixtures	Osaka Prefecture and others	628	5,368
Total			<u>¥5,500</u>	<u>\$47,009</u>

The Group classified the fixed assets by business control unit such as branch office, plant, and each property leased, which controls its revenue and expenditure continuously.

Book values of the above assets were written down to the recoverable amounts due to decrease in the land prices and significant decline in profitability caused by severe competition.

The recoverable amount of assets is mainly measured by its net selling price based on real estate appraisal standards.

## 7. Short-term bank loans and long-term debt

Short-term bank loans at March 31, 2006 and 2005 consisted of bank loans. The annual interest rates for the short-term bank loans ranged from 0.4% to 0.9% and ranged from 0.4% to 1.9% at March 31, 2006 and 2005, respectively.

Long-term debt at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Loans from banks, 0.5% to 3.0% (0.5% to 3.0% in 2005), due on various dates through 2025:			
Collateralized	¥11,346	¥2,423	\$ 96,975
Unsecured	5,110	5,500	43,675
Total	<u>16,456</u>	<u>7,923</u>	<u>140,650</u>
Less current portion	<u>2,928</u>	<u>1,368</u>	<u>25,026</u>
Long-term debt, net of current portion	<u>¥13,528</u>	<u>¥6,555</u>	<u>\$115,624</u>

Annual maturities of long-term debt at March 31, 2006, were as follows:

Year ending March 31	Millions of yen	Thousands of U.S. dollars
2007	¥ 2,928	\$ 25,026
2008	860	7,350
2009	8,663	74,043
2010	2,885	24,658
2011	88	752
2012 and thereafter	1,032	8,821
Total	<u>¥16,456</u>	<u>\$140,650</u>

At March 31, 2006, assets pledged as collateral for secured long-term debt were as follows:

	Millions of yen	Thousands of U.S. dollars
Receivables	¥ 1,840	\$ 15,727
Buildings and structures	4,354	37,214
Land	6,929	59,222
Lease deposits	450	3,846
Total	<u>¥13,573</u>	<u>\$116,009</u>

As is customary in Japan, a company maintains deposit balances with banks with which it has bank loans. Such deposit balances are not legally or contractually restricted as to withdrawal. In addition, collateral must be provided if requested by the lending banks and certain banks have the right to offset cash deposited with them against any bank loan or obligation that becomes due and, in case of default and certain other specified events, against all other debt payable to the bank concerned. The Group has never received any such request.

## 8. Retirement and pension plans

Under the unfunded employees' retirement benefit plan, employees of the Company and certain subsidiaries terminating their employment are entitled, in most circumstances, to lump-sum severance payments determined by reference to wage rates at the time of termination and years of service. In addition, the Company, together with certain subsidiaries and associated companies, has adopted a contributory funded defined benefit pension plan covering most of their employees.

The liability for employees' retirement benefits at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Projected benefit obligation	¥255,716	¥241,123	\$2,185,607
Fair value of plan assets	(165,481)	(141,342)	(1,414,368)
Net liability	90,235	99,781	771,239
Prepaid benefit costs		90	
Liability for employees' retirement benefits	<u>¥ 90,235</u>	<u>¥ 99,871</u>	<u>\$ 771,239</u>

The components of net periodic benefit costs are as follows:

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	2006
Service cost	¥13,939	¥12,578	¥11,647	\$119,136
Interest cost	6,013	5,395	4,856	51,393
Expected return on plan assets	(2)	(5)	(4)	(17)
Prior service cost (benefit)	(1,000)	2,282		(8,547)
Recognized actuarial gain	(21,730)	(2,214)	(15,460)	(185,726)
Net periodic benefit costs	<u>¥ (2,780)</u>	<u>¥18,036</u>	<u>¥ 1,039</u>	<u>\$ (23,761)</u>

Prior service cost for the year ended March 31, 2005 represents the net effect of (1) an increase in the benefit obligation of ¥2,732 million from the adoption of the revised contributory funded defined benefit pension plan and (2) a decrease in the benefit obligation of ¥450 million from the adoption of the revised benefit plan concerning the lump-sum severance payments of a subsidiary.

Prior service cost for the year ended March 31, 2006 represents a decrease in the benefit obligation of ¥1,000 million (\$8,547 thousand) from the adoption of the revised benefit plan concerning the lump-sum severance payments of a subsidiary.

For the year ended March 31, 2006, in addition to the net periodic costs, the Company and certain subsidiaries recognized a gain in amount of ¥200 million (\$1,709 thousand) in accordance with the actual transfer of the pension obligations and related assets to the government. Certain subsidiaries recognized a loss in amount of ¥1,414 million (\$12,085 thousand) in accordance with the secession from the funded employees' retirement benefit plan.

Assumptions used for the years ended March 31, 2006 and 2005 are set forth as follows:

	2006	2005
Discount rate	2.5%	2.5%
Expected rate of return on plan assets	Principally 0%	Principally 0%
Recognition period of actuarial gain/loss	1 year	1 year

The contributory funded defined benefit pension plan, which is established under the Japanese Welfare Pension Insurance Law, covers a substitutional portion of the governmental pension program managed by the company on behalf of the government and a corporate portion established at the discretion of the company. According to the enactment of the Defined Benefit Pension Plan Law in April 2002, the Company applied for an exemption from obligation to pay benefits for employee services related to the substitutional portion which would result in the transfer of the pension obligations and related assets to the government by another subsequent application. The Company obtained an approval of exemption from future obligation by the Ministry of Health, Labour and Welfare on October 28, 2002. The Company applied for transfer of the substitutional portion of past pension obligations to the government and obtained approval by the Ministry of Health, Labour and Welfare on June 1, 2004. The actual transfer of the pension obligations and related assets to the government took place in the year ended March 31, 2006.

## 9. Shareholders' equity

Through May 1, 2006, Japanese companies are subject to the Code.

The Code requires that all shares of common stock be issued with no par value and at least 50% of the issue price of new shares is required to be recorded as common stock and the remaining net proceeds are required to be presented as additional paid-in capital, which is included in capital surplus. The Code permits Japanese companies, upon approval of the Board of Directors, to issue shares to existing shareholders without consideration by way of a stock split. Such issuance of shares generally does not give rise to changes within the shareholders' accounts.

The Code also provides that an amount of 10% or more of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period (such as bonuses to directors) shall be appropriated as a legal reserve (a component of retained earnings) until the total of such reserve and additional paid-in capital equals 25% of common stock. The amount of total legal reserve and additional paid-in capital that exceeds 25% of the common stock may be available for dividends by resolution of the shareholders after transferring such excess in accordance with the Code. In addition, the Code permits the transfer of a portion of additional paid-in capital and legal reserve to the common stock by resolution of the Board of Directors.

The Code allows Japanese companies to purchase treasury stock and dispose of such treasury stock upon resolution of the Board of Directors. The aggregate purchased amount of treasury stock cannot exceed the amount available for future dividends plus the amount of common stock, additional paid-in capital or legal reserve that could be transferred to retained earnings or other capital surplus other than additional paid-in capital upon approval of such transfer at the annual general meeting of shareholders.

In addition to the provision that requires an appropriation for a legal reserve in connection with the cash outlays, the Code also imposes certain limitations on the amount of capital surplus and retained earnings available for dividends. The amount of capital surplus and retained earnings available for dividends under the Code was ¥229,119 million (\$1,958,282 thousand) as of March 31, 2006, based on the amount recorded in the parent company's general books of account.

Dividends are approved by the shareholders at a meeting held subsequent to the end of the fiscal year to which the dividends are applicable. Semiannual interim dividends may also be paid upon resolution of the Board of Directors, subject to certain limitations imposed by the Code.

On May 1, 2006, a new corporate law (the "Corporate Law") became effective, which reformed and replaced the Code with various revisions that would, for the most part, be applicable to events or transactions which occur on or after May 1, 2006 and for the fiscal years ending on or after May 1, 2006. The significant changes in the Corporate Law that affect financial and accounting matters are summarized below;

### (a) Dividends

Under the Corporate Law, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the shareholders meeting. For companies that meet certain criteria such as; (1) having the Board of Directors, (2) having independent auditors, (3) having the Board of Corporate Auditors, and (4) the term of service of the directors is prescribed as one year rather than two years of normal term by its articles of incorporation, the Board of Directors may declare dividends (except for dividends in kind) if the company has prescribed so in its articles of incorporation.

The Corporate Law permits companies to distribute dividends-in-kind (non-cash assets) to shareholders subject to a certain limitation and additional requirements.

Semiannual interim dividends may also be paid once a year upon resolution by the Board of Directors if the articles of incorporation of the company so stipulate. Under the Code, certain limitations were imposed on the amount of capital surplus and retained earnings available for dividends. The Corporate Law also provides certain limitations on the amounts available for dividends or the purchase of treasury stock. The limitation is defined as the amount available for distribution to the shareholders, but the amount of net assets after dividends must be maintained at no less than ¥3 million.

(b) Increases/decreases and transfer of common stock, reserve and surplus

The Corporate Law requires that an amount equal to 10% of dividends must be appropriated as a legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus) depending on the equity account charged upon the payment of such dividends until the total of aggregate amount of legal reserve and additional paid-in capital equals 25% of the common stock. Under the Code, the aggregate amount of additional paid-in capital and legal reserve that exceeds 25% of the common stock may be made available for dividends by resolution of the shareholders. Under the Corporate Law, the total amount of additional paid-in capital and legal reserve may be reversed without limitation of such threshold. The Corporate Law also provides that common stock, legal reserve, additional paid-in capital, other capital surplus and retained earnings can be transferred among the accounts under certain conditions upon resolution of the shareholders.

(c) Treasury stock and treasury stock acquisition rights

The Corporate Law also provides for companies to purchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The amount of treasury stock purchased cannot exceed the amount available for distribution to the shareholders which is determined by specific formula.

Under the Corporate Law, stock acquisition rights, which were previously presented as a liability, are now presented as a separate component of shareholders' equity.

The Corporate Law also provides that companies can purchase both treasury stock acquisition rights and treasury stock. Such treasury stock acquisition rights are presented as a separate component of shareholders' equity or deducted directly from stock acquisition rights.

On December 9, 2005, the ASBJ published a new accounting standard for presentation of shareholders' equity. Under this accounting standard, certain items which were previously presented as liabilities are now presented as components of shareholders' equity. Such items include stock acquisition rights, minority interest, and any deferred gain or loss on derivatives accounted for under hedge accounting. This standard is effective for fiscal years ending on or after May 1, 2006.

## 10. Segment information

Information about operations in different industry segments of the Group for the years ended March 31, 2006, 2005 and 2004 is as follows:

### Sales and operating income

Millions of yen							
2006							
	Residential	Commercial	Resort and Sports	Home Center	Other	Eliminations/Corporate	Consolidated
Sales to customers	¥905,385	¥436,822	¥66,482	¥61,899	¥ 58,395		¥1,528,983
Intersegment sales	4,203	8,429		1,375	63,587	¥(77,594)	
Total sales	909,588	445,251	66,482	63,274	121,982	(77,594)	1,528,983
Operating expenses	858,890	405,833	65,480	62,167	117,423	(60,882)	1,448,911
Operating income	¥ 50,698	¥ 39,418	¥ 1,002	¥ 1,107	¥ 4,559	¥(16,712)	¥ 80,072
Millions of yen							
2005							
	Residential	Commercial	Resort	Home Center	Other	Eliminations/Corporate	Consolidated
Sales to customers	¥850,586	¥355,017	¥55,749	¥57,919	¥ 46,643		¥1,365,914
Intersegment sales	3,989	8,813		1,245	57,486	¥(71,533)	
Total sales	854,575	363,830	55,749	59,164	104,129	(71,533)	1,365,914
Operating expenses	804,800	336,506	53,872	59,064	100,595	(56,772)	1,298,065
Operating income	¥ 49,775	¥ 27,324	¥ 1,877	¥ 100	¥ 3,534	¥(14,761)	¥ 67,849
Millions of yen							
2004							
	Residential	Commercial	Resort	Home Center	Other	Eliminations/Corporate	Consolidated
Sales to customers	¥797,627	¥270,002	¥53,612	¥56,069	¥47,338		¥1,224,648
Intersegment sales	3,004	6,986		1,158	50,428	¥(61,576)	
Total sales	800,631	276,988	53,612	57,227	97,766	(61,576)	1,224,648
Operating expenses	752,365	256,319	53,531	57,088	94,943	(49,259)	1,164,987
Operating income	¥ 48,266	¥ 20,669	¥ 81	¥ 139	¥ 2,823	¥(12,317)	¥ 59,661
Thousands of U.S. dollars							
2006							
	Residential	Commercial	Resort and Sports	Home Center	Other	Eliminations/Corporate	Consolidated
Sales to customers	\$7,738,333	\$3,733,521	\$568,222	\$529,051	\$ 499,104		\$13,068,231
Intersegment sales	35,923	72,043		11,752	543,477	\$(663,195)	
Total sales	7,774,256	3,805,564	568,222	540,803	1,042,581	(663,195)	13,068,231
Operating expenses	7,340,940	3,468,658	559,658	531,341	1,003,615	(520,357)	12,383,855
Operating income	\$ 433,316	\$ 336,906	\$ 8,564	\$ 9,462	\$ 38,966	\$(142,838)	\$ 684,376

**Total assets, depreciation and capital investments**

	Millions of yen						
	2006						
	Residential	Commercial	Resort and Sports	Home Center	Other	Eliminations/Corporate	Consolidated
Total assets	¥498,910	¥464,318	¥108,856	¥40,183	¥123,911	¥239,019	¥1,475,197
Depreciation	5,228	7,897	1,918	665	9,636	1,471	26,815
Capital investments	12,643	77,100	3,072	612	17,411	(694)	110,144
	Millions of yen						
	2005						
	Residential	Commercial	Resort	Home Center	Other	Eliminations/Corporate	Consolidated
Total assets	¥468,068	¥393,990	¥101,327	¥40,655	¥116,954	¥237,813	¥1,358,807
Depreciation	4,486	4,623	1,869	705	5,875	1,685	19,243
Capital investments	7,700	31,909	851	725	15,842	(331)	56,696
	Millions of yen						
	2004						
	Residential	Commercial	Resort	Home Center	Other	Eliminations/Corporate	Consolidated
Total assets	¥396,552	¥212,235	¥102,740	¥36,779	¥72,961	¥266,391	¥1,087,658
Depreciation	4,822	2,771	1,530	647	3,628	1,767	15,165
Capital investments	6,688	4,465	2,272	2,098	4,916	(331)	20,108
	Thousands of U.S. dollars						
	2006						
	Residential	Commercial	Resort and Sports	Home Center	Other	Eliminations/Corporate	Consolidated
Total assets	\$4,264,188	\$3,968,530	\$930,393	\$343,444	\$1,059,068	\$2,042,898	\$12,608,521
Depreciation	44,684	67,496	16,393	5,684	82,359	12,572	229,188
Capital investments	108,060	658,974	26,256	5,231	148,812	(5,931)	941,402

Due to the acquisition of Nippon Athletic Service Co., Ltd., the Group changed the name of the "Resort" segment to "Resort and Sports" starting in the year ended March 31, 2006.

The industry segments consisted of the following:

Components of net sales	Industry segment				
	Residential	Commercial	Resort and Sports	Home Center	Other
Construction	Construction of single/ multi-family houses and condominiums	Construction of commercial buildings			
Real estate	Sales of real estate for residential use	Sales and rental of real estate for commercial use			
	Real estate commissions				
	Rental of residential complexes				
Other	Care of condominiums	Care of commercial buildings	Operation of resort type hotels, golf courses and fitness clubs	Operation of "do-it-yourself" hardware centers	Manufacture and sales of building materials
					Physical distribution
					Operation of city type hotels

Eliminations/Corporate include unallocated operating expenses, principally consisting of general corporate expenses incurred by the administration headquarters of the Company.

Corporate assets are principally cash and cash equivalents, marketable securities and investment securities.

### 11. Other income (expenses): Other — net

"Other income (expenses): Other — net" for the years ended March 31, 2006, 2005 and 2004 consisted of the following:

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	2006
Exchange gain (loss)	¥ (2)	¥ 5	¥ (2)	\$ (17)
Real estate acquisition tax and other taxes	(205)	(237)	(369)	(1,752)
Retirement benefits for directors	(1,266)	(175)	(214)	(10,821)
Gain on sales of marketable and investment securities	1,021	938	99	8,727
Allowance for doubtful accounts	(351)	(3)	(386)	(3,000)
Equity in earnings of associated companies	350	1,611	2,384	2,991
Write-down of golf club membership	(264)	(121)	(62)	(2,256)
Gain (loss) on sales of membership	(71)		3	(607)
Loss on closure of "do-it-yourself" hardware centers			(2,637)	
Consulting, advertising and other expenses for corporate branding and identity		(1,676)		
Loss on secession of subsidiaries' pension fund (Note 8)	(1,414)			(12,085)
Other — net	1,410	3,016	1,531	12,051
Total	<u>¥ (792)</u>	<u>¥3,358</u>	<u>¥ 347</u>	<u>\$ (6,769)</u>

## 12. Income taxes

The Company and its domestic subsidiaries are subject to Japanese national and local income taxes which, in the aggregate, resulted in a normal effective statutory tax rates of approximately 40.6% for the year ended March 31, 2006 and 2005 and 42.0% for the year ended March 31, 2004.

The tax effects of significant temporary differences and loss carryforwards which resulted in deferred tax assets and liabilities at March 31, 2006 and 2005 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Current:			
Deferred tax assets:			
Write-down of land held for resale	¥ 12,356	¥ 10,961	\$ 105,606
Accrued bonuses	7,303	6,254	62,419
Accrued enterprise tax	1,314	1,359	11,231
Other	5,947	12,484	50,829
Deferred tax assets	<u>¥ 26,920</u>	<u>¥ 31,058</u>	<u>\$ 230,085</u>
Non-current:			
Deferred tax assets:			
Employees' retirement benefits	¥ 38,364	¥ 42,048	\$ 327,897
Unrealized gains on sales of property, plant and equipment	7,484	8,743	63,966
Extraordinary depreciation for property, plant and equipment	24,715	26,756	211,239
Other	13,109	11,501	112,043
Less valuation allowance	(499)	(925)	(4,265)
Deferred tax assets	<u>¥ 83,173</u>	<u>¥ 88,123</u>	<u>\$ 710,880</u>
Deferred tax liabilities:			
Retained earnings appropriated for tax allowable reserves	¥ (2,221)	¥ (2,258)	\$ (18,983)
Net unrealized gain on available-for-sale securities	(21,788)	(10,391)	(186,222)
Other	(51)	(69)	(436)
Deferred tax liabilities	<u>¥(24,060)</u>	<u>¥(12,718)</u>	<u>\$(205,641)</u>
Net deferred tax assets	<u>¥ 59,113</u>	<u>¥ 75,405</u>	<u>\$ 505,239</u>

A reconciliation between the normal effective statutory tax rates and the actual effective tax rates reflected in the accompanying consolidated statements of income for the years ended March 31, 2005 and 2004 is as follows:

	2005	2004
Normal effective statutory tax rates	40.6%	42.0%
Increase (decrease) in tax rates due to:		
Permanently non-deductible expenses	1.7	1.3
Non-taxable dividend income	(0.1)	(0.0)
Equity in earnings of associated companies	(1.0)	(0.9)
Write-down of investments in and advances to associated companies		(0.1)
Per capita levy	1.0	0.8
Increase in valuation allowance for deferred tax assets	0.3	0.1
Reversal of land revaluation difference	(10.8)	
Other — net	0.6	0.4
Actual effective tax rates	<u>32.3%</u>	<u>43.6%</u>

On March 31, 2003, Cabinet Order No. 9 entitled "Reform of a Portion of Local Tax Law" was issued and this reform will apply to fiscal years beginning after April 1, 2004. As a result of this reform, the statutory income tax rate to be used for the calculation of deferred income taxes concerning temporary differences which are expected to be realized or settled after April 1, 2004 was changed from 42.0% to 40.6%.

A reconciliation between the normal effective statutory tax rate and the actual effective tax rate for the year ended March 31, 2006 is insignificant and not disclosed.

### 13. Research and development costs

Research and development costs charged to income were ¥6,190 million (\$52,906 thousand), ¥5,713 million and ¥5,667 million for the years ended March 31, 2006, 2005 and 2004, respectively.

### 14. Leases

#### Finance leases:

##### (Lessee)

Total rental expenses including lease payments under finance leases that are not deemed to transfer ownership of the leased property to the lessee were ¥4,154 million (\$35,504 thousand), ¥4,647 million, and ¥5,514 million for the years ended March 31, 2006, 2005 and 2004, respectively.

Pro forma information of leased property under finance leases that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen			
	2006			
	Buildings and structures	Machinery and equipment	Furniture and fixtures	Total
Acquisition cost	¥4,181	¥1,435	¥10,053	¥15,669
Accumulated depreciation	2,392	468	5,221	8,081
Net leased property	<u>¥1,789</u>	<u>¥ 967</u>	<u>¥ 4,832</u>	<u>¥ 7,588</u>

	Millions of yen			
	2005			
	Buildings and structures	Machinery and equipment	Furniture and fixtures	Total
Acquisition cost	¥7,620	¥1,093	¥10,037	¥18,750
Accumulated depreciation	5,051	278	4,833	10,162
Accumulated impairment loss		2		2
Net leased property	<u>¥2,569</u>	<u>¥ 813</u>	<u>¥ 5,204</u>	<u>¥ 8,586</u>

	Thousands of U.S. dollars			
	2006			
	Buildings and structures	Machinery and equipment	Furniture and fixtures	Total
Acquisition cost	\$35,735	\$12,265	\$85,923	\$133,923
Accumulated depreciation	20,444	4,000	44,624	69,068
Net leased property	<u>\$15,291</u>	<u>\$ 8,265</u>	<u>\$41,299</u>	<u>\$ 64,855</u>

Obligations under such finance leases as of March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
	Due within one year	¥3,040	¥3,514
Due after one year	4,548	5,072	38,872
Total	<u>¥7,588</u>	<u>¥8,586</u>	<u>\$64,855</u>

Impairment of leased property ¥ 2

The amount of acquisition cost and obligations under finance leases includes the imputed interest expense portion.

Depreciation expenses, which are not reflected in the accompanying statements of income, computed by the straight-line method, respectively.

**(Lessor)**

Total rental income under finance leases that are not deemed to transfer ownership of the leased property to the lessee was ¥8,051 million (\$68,812 thousand) and ¥3,936 million for the years ended March 31, 2006 and 2005, respectively.

The amount of the imputed interest income portion included in the above rental income, which is computed using the interest method, was ¥737 million (\$6,299 thousand) and ¥377 million for the years ended March 31, 2006 and 2005, respectively.

Property and equipment leased to customers under finance lease arrangements mentioned above consisted of the following at March 31, 2006 and 2005.

	Millions of yen		
	2006		
	Buildings and structures	Machinery and equipment	Total
Acquisition cost	¥10,900	¥22,067	¥32,967
Accumulated depreciation	6,280	10,075	16,355
Net leased property	<u>¥ 4,620</u>	<u>¥11,992</u>	<u>¥16,612</u>

	Millions of yen		
	2005		
	Buildings and structures	Machinery and equipment	Total
Acquisition cost	¥10,918	¥18,868	¥29,786
Accumulated depreciation	6,130	9,309	15,439
Net leased property	<u>¥ 4,788</u>	<u>¥ 9,559</u>	<u>¥14,347</u>

	Thousands of U.S. dollars		
	2006		
	Buildings and structures	Machinery and equipment	Total
Acquisition cost	\$93,162	\$188,607	\$281,769
Accumulated depreciation	53,675	86,111	139,786
Net leased property	<u>\$39,487</u>	<u>\$102,496</u>	<u>\$141,983</u>

Future rental income under finance leases at March 31, 2006 and 2005 was as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Due within one year	¥ 7,034	¥ 6,133	\$ 60,120
Due after one year	14,409	12,799	123,154
Total	<u>¥21,443</u>	<u>¥18,932</u>	<u>\$183,274</u>

The imputed interest income portion is excluded from the amount of rental income under finance leases.

Depreciation expensed relating to the leased assets under finance lease arrangements mentioned above was ¥5,361 million (\$45,821 thousand) and ¥2,561 million for the years ended March 31, 2006 and 2005, respectively.

**Operating leases:**

Obligations and future rental income under non-cancellable operating leases as of March 31, 2006 and 2005 were as follows:

<b>(Lessee)</b>	<b>Millions of yen</b>		<b>Thousands of U.S. dollars</b>
	2006	2005	2006
Due within one year	¥ 41,385	¥ 36,765	\$ 353,718
Due after one year	492,640	446,447	4,210,598
Total	<u>¥534,025</u>	<u>¥483,212</u>	<u>\$4,564,316</u>
<b>(Lessor)</b>	<b>Millions of yen</b>		<b>Thousands of U.S. dollars</b>
	2006	2005	2006
Due within one year	¥ 39,321	¥ 33,949	\$ 336,077
Due after one year	507,789	442,407	4,340,077
Total	<u>¥547,110</u>	<u>¥476,356</u>	<u>\$4,676,154</u>

**15. Derivatives**

The Group enters into foreign exchange forward contracts and interest rate swaps to hedge foreign exchange or interest rate risks.

It is the Group's policy to use derivatives only for the purpose of reducing market risks associated with liabilities.

Derivatives are subject to market risk and credit risk. Because the counterparties to those derivatives are limited to major international financial institutions, the Company does not anticipate any losses arising from such credit risk.

The Company implemented a risk control system for derivatives primarily to control the purpose, limitation and selection of the counterparties. The system's primary function is to avoid excess risks associated with derivatives. Each derivative transaction, which is based on these internal policies, is reported to the Director of the Financing Department, and the execution and control of derivatives are managed by the Finance Section of the Company.

As of March 31, 2006 and 2005, the Group did not have any derivative contracts outstanding.

**16. Contingencies**

At March 31, 2006, contingent liabilities for notes endorsed with recourse and loans guaranteed in the ordinary course of business amounted to ¥949 million (\$8,111 thousand) and ¥42,438 million (\$362,718 thousand), respectively. Included in loans guaranteed were customers' housing loans from banks in the amount of ¥38,222 million (\$326,684 thousand).

## 17. Subsequent events

### a. Share exchange agreements

The Company entered into share exchange agreements with Daiwa Kosho Lease Co., Ltd., Daiwa Rakuda Industry Co., Ltd. and Daiwa Logistics Co., Ltd. (the "Three subsidiaries of the Group") on March 13, 2006, to make the three subsidiaries wholly owned subsidiaries of the Company. The agreements were approved at the Company's general shareholders meeting held on June 29, 2006.

(1) Details of the share exchange agreements are as follows:

① Purpose of the share exchange

The purpose is to remove excess overlap of business and competition within the Group and to improve speed and efficiency of management from the point of view of the most suitable distribution of management resources and the efficiency of the management group as the whole.

② Date of share exchange

August 1, 2006

③ The method and outline of the share exchange

The Company will allocate 49,257,435 newly issued shares of common stock to shareholders of the three subsidiaries of the Group, excluding the Company, recorded on the list of shareholders of the three subsidiaries of the Group, at the end of the day before the date of share exchange, at a ratio of the following share in the Company to 1 share in the three subsidiaries of the Group.

Company name	Share exchange ratio
Daiwa Kosho Lease Co., Ltd.	0.421
Daiwa Rakuda Industry Co., Ltd.	0.455
Daiwa Logistics Co., Ltd.	0.620

(2) Outline of Daiwa Kosho Lease Co., Ltd. is follows:

Representative: Mutsuo Kajimoto

Capital: ¥21,768 million (\$186,051 thousand)

Head office: Osaka-shi, Osaka

① Business: Leasing of temporary buildings

Trading of real estate

Leasing and trading of machines, tools and vehicles

② Sales and net income for the year ended March 31, 2006

Sales: ¥121,283 million (\$1,036,607 thousand)

Net income: ¥4,336 million (\$37,060 thousand)

③ Assets, liabilities and shareholders' equity as of March 31, 2006

Total assets: ¥245,410 million (\$2,097,521 thousand)

Total liabilities: ¥146,495 million (\$1,252,094 thousand)

Shareholders' equity: ¥98,915 million (\$845,427 thousand)

(3) Daiwa Rakuda Industry Co., Ltd. is follows:

Representative: Katsumi Masumura  
 Capital: ¥4,346 million (\$37,145 thousand)  
 Head office: Osaka-shi, Osaka

- ① Business: Manufacture and sales of housing equipment, components and office furniture  
 Lease of office supplies  
 Life and non-life insurance agency

② Sales and net income for the year ended March 31, 2006

Sales: ¥41,483 million (\$354,556 thousand)  
 Net income: ¥892 million (\$7,624 thousand)

③ Assets, liabilities and shareholders' equity as of March 31, 2006

Total assets: ¥38,973 million (\$333,103 thousand)  
 Total liabilities: ¥15,284 million (\$130,633 thousand)  
 Shareholders' equity: ¥23,689 million (\$202,470 thousand)

(4) Outline of Daiwa Logistics Co., Ltd. is follows:

Representative: Katsuyoshi Tateno  
 Capital: ¥3,764 million (\$32,171 thousand)  
 Head office: Osaka-shi, Osaka

- ① Business: Trucking of cargos and storage, and packing of cargos  
 Selling and brokerage of real estate

② Sales and net income for the year ended March 31, 2006

Sales: ¥32,228 million (\$275,453 thousand)  
 Net income: ¥628 million (\$5,368 thousand)

③ Assets, liabilities and shareholders' equity as of March 31, 2006

Total assets: ¥22,694 million (\$193,966 thousand)  
 Total liabilities: ¥8,488 million (\$72,547 thousand)  
 Shareholders' equity: ¥14,206 million (\$121,419 thousand)

**b. Appropriations of retained earnings**

The following appropriations of retained earnings at March 31, 2006 were approved at the Company's shareholders' meeting held on June 29, 2006:

	Millions of yen	Thousands of U.S. dollars
Year-end cash dividends, ¥20.0 (\$0.17) per share	¥11,000	\$94,017
Bonuses to directors and corporate auditors	197	1,684

## Independent auditors' report

To the Board of Directors of Daiwa House Industry Co., Ltd.:

We have audited the accompanying consolidated balance sheets of Daiwa House Industry Co., Ltd. and subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended March 31, 2006, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. 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.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Daiwa House Industry Co., Ltd. and subsidiaries as of March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2006, in conformity with accounting principles generally accepted in Japan.

As discussed in Note 17, the Company entered into the share exchange agreements with Daiwa Kosho Lease Co., Ltd., Daiwa Rakuda Industry Co., Ltd. and Daiwa Logistics Co., Ltd. on March 13, 2006, and the agreements were approved at the Company's general shareholders meeting held on June 29, 2006.

Our audits also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 1. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

*Deloitte Touche Tohmatsu*

June 29, 2006

## Sources

- P18 Securities Markets in Japan/Survey on Distribution of shares
- P25 Statistics Bureau, Ministry of Internal Affairs and Communications/Population Census of Japan  
Statistics Bureau, Ministry of Internal Affairs and Communications/Population Census of Japan 2005; quick estimation  
National Institute of Population and Social Security Research/Population Projections for Japan: 2001-2050
- P26 Jutaku Sangyo Shimbun-sya/Housing Industry Data; FY2005 Yearbook
- P27 Ministry of Land, Infrastructure and Transport/Statistics on Building Construction Started
- P81 Ministry of Land, Infrastructure and Transport/Statistics on Building Construction Started
- P85 The Housing Loan Promotion Association/Current Data on Overseas Housing
- P89 Ministry of Land, Infrastructure and Transport/Statistics on Building Construction Started
- P92 The Japan Accreditation Board for Conformity Assessment
- P93 Statistics Bureau, Ministry of Internal Affairs and Communications/Population Census of Japan  
National Institute of Population and Social Security Research/Population Projections for Japan: 2001-2050  
UN, World Population Prospects: The 2004 Revision

# Corporate Data

As of April 1, 2006

<b>Founding:</b>	April 5, 1955 (Established: March 4, 1947)
<b>Paid-in capital:</b>	¥110,120,483,981
<b>Employees:</b>	12,725
<b>Head Office:</b>	3-3-5 Umeda, Kita-ku, Osaka 530-8241, Japan Phone: +81-6-6346-2111
<b>Tokyo Office:</b>	3-13-1 Iidabashi, Chiyoda-ku, Tokyo 102-8112, Japan Phone: +81-3-5214-2111
<b>Nagoya Office:</b>	1-20-22 Aoi, Naka-ku, Nagoya 460-8491, Japan Phone: +81-52-933-2703
<b>Branches:</b>	91 (including Head Branch)
<b>Factories:</b>	13
<b>Research center:</b>	Central Research Laboratory (Nara city)
<b>Training centers:</b>	Nara, Tokyo and Osaka