Financial Review

Overview of fiscal year ended March 2004

In the period under review, the economy improved in the United States and Asia as the negative impacts of the situation in Iraq and of the SARS epidemic started to fade, while the European economy also moved onto a recovery track helped by robust external demand. Against this backdrop, the Japanese economy showed some bright signs of recovery, with exports increasing, corporate earnings and capital spending recovering, and the Nikkei average even reaching the 12,000. However, the economic recovery was generally moderate in Japan, due to lingering fears over future economic prospects: the yen's sharp appreciation; a rise in long-term interest rates; and uncertainties over the economic outlook in the United States and Europe.

In the consumer electronics market, demand was strong for the so-called "three digital crown jewels" comprising digital cameras, DVD recorders, and flat-screen TVs. As for the markets the Company is involved in, business sentiment varied from market to market, with the audio equipment market shrinking while the visual device market expanded.

Consolidated operating results

In the year under review, the Company suffered negative effects in the wake of its phasing-out of the production of cell phone terminals as part of the corporate structural reform and the reassessment of models and sales territories in the home electronics business. This was combined with such external factors as the much higher-than-expected yen's strengthening, as well as a contraction in the global audio equipment market. As a result, consolidated net sales dropped 20.8% from the previous year to ¥178.731 billion.

Meanwhile, earnings in the communications and home electronics businesses improved thanks to business restructuring effects, fixed costs declined through cost restructuring efforts, interest burdens decreased, while procurement and production costs declined due to production innovation effects. As a result, profitability increased, with the operating and ordinary profit margins marking their second consecutive year of record highs. Net income margin hit an all-time high for the first time in 15 years, significantly exceeding the last record high.

Despite a decline in net sales, operating income gained from a year earlier to ¥12.610 billion, helped by the effects of business restructuring, cost restructuring and production innovation. Ordinary profit jumped 21.0%, year on year, to ¥8.541 billion, hitting a record high for the first time in five years, due mainly to a fall in the interest burden as a result of financial restructuring. Net income soared 73.4% to ¥7.318 billion, posting an all-time high for the second straight year. The impact of extraordinary loss on net income was low due to the restructuring which was completed in the previous fiscal year.

(Millions of yen)

Segment		Current fiscal year	Previous fiscal year	Year-on-year change
Car electronics	Sales	100,783	117,002	△16,219
	Operating income	7,019	11,712	△4,693
Communications	Sales	50,373	61,015	△10,642
	Operating income	6,876	5,207	1,669
Home electronics	Sales	23,987	41,904	△17,917
	Operating income	△1,217	△4,483	3,266
Others	Sales	3,588	5,658	△2,070
	Operating income	△68	△176	108
Total	Sales	178,731	225,579	△46,848
	Operating income	12,610	12,260	350
	Ordinary income	8,541	7,059	1,481
	Net income	7,318	4,221	3,097

■ Car electronics business

In the OEM market, sales soared approximately 70% over the preceding year's, as some audio systems were adopted as standard specs by one Japanese automaker for its vehicles.

The consumer market was adversely affected by external factors, including a higher-than-expected rise in the yen's value, a contraction in the global audio systems market, the war against Iraq and the SARS epidemic in the first half of the fiscal year. In Japan, the navigation/visual systems market expanded, while the visual equipment market grew both in Europe and the United States. However, the Company failed to capitalize on this golden opportunity, because the introduction of new products was substantially behind schedule due to a delay in the development of LSI engines outsourced to outside companies. As a result, sales declined and profitability deteriorated. Nevertheless, the Company had raised the ratio of navigation/visual systems, which are projected to grow, to total sales. Therefore, given that new visual products launched in February and March in the domestic and overseas markets, respectively, are selling well, the initial losses caused by their delayed introduction is likely to be offset.

The Company also shifted manufacture of new visual products for the domestic market to Kenwood Yamagata Corporation, so that well-coordinated production and marketing activities are directly linked to the market.

Sales of digital broadcasting-related products remained strong in the United States. In this sector, the Company reinforced its multimedia product line, by launching tuners for digital satellite broadcasting (supplied by Sirius Satellite Radio, Inc. of the USA) and the first civilian use of tuners for terrestrial digital broadcasting high definition radios.

The Company also embarked on the full-fledged introduction of complete navigation systems on the Chinese consumer market as the first Japanese manufacturer to do so.

■ **Communications business**

With the phasing out of its cell phone terminals through corporate restructuring, the Company focused on the radio business. This led the communications business sector to sharply improve profitability. In the radio market, demand sagged in the first half of the year as the war against Iraq made itself felt, but, steadily recovered after the headquarters was relocated to Atlanta in the United States (the largest market), and improved the coordination of its marketing, development and production. With development of digital radios progressing smoothly, the Company launched new products based on the Association of Public-Safety Communication Officials (APCO) standard in the USA. It also plans to switch to digital systems for its Formula One racing radio communications.

On February 6 of this year, Kenwood and Toyo Communication Equipment negotiated the Company's acquisition of the latter's radio business, and the two parties on April 9 signed an agreement for the business transfer. Accordingly, the Company will acquire the radio business from Toyo Communication Equipment on June 1. This is expected to increase the Company's presence in the commercial-use radio sector (especially for government and municipal offices and electric power companies) in Japan, as well as provide the Company with a strong contact nexus in the sector. Furthermore, the Company will obtain radio business-related resources and technologies. Using these benefits as a springboard, the Company will strive to further expand its radio business at home.

■ **Home electronics business**

Through business restructuring efforts, the Company concentrated on home theater systems, pure audio equipment, and portable audio devices in terms of product categories, in the related sales territories as Japan, Europe and the United States. Resultant reorganization of production and marketing structures led to a reduction in fixed costs. In addition, production innovation and introduction of new products generated favorable effects, while European sales continued to be strong. As a result, the Company's earnings improved significantly and turned to a profit in the second half of the year, weathering a decline in sales.

Consolidated financial position

■ **Assets, liabilities and shareholders' equity at the end of the year under review**

Total assets decreased ¥6.361 billion from the previous year to ¥135.763 billion at the end of March 2004. Due to the effects of restructuring and production innovation, cash and deposits increased ¥6.619 billion, while trade notes and accounts receivable dropped ¥3.674 billion, inventories fell ¥7.650 billion and tangible fixed assets sagged ¥2.159 billion.

Total liabilities declined ¥12.462 billion to ¥115.596 billion. The Company reduced short-term bank borrowings by ¥6.253 billion and long-term debt by ¥2.324 billion, benefiting from strong cash flows from operating activities.

(Millions of yen)

	Current fiscal year	Previous fiscal year	Year-on-year change
Total assets	135,763	142,124	△6,361
Shareholders' equity	20,161	13,704	+6,457
Equity ratio	14.9%	9.6%	+5.3 percentage point
Interest coverage ratio (Note)	12.61	—	—

Note: As the Company began to disclose the interest coverage ratio (cash flows from operating activities/interest expenses) from this fiscal year, no year-on-year comparison is available.

Total shareholders' equity was ¥20.161 billion, up ¥6.457 billion from ¥13.704 billion posted at the end of the previous fiscal year. The growth was attributed to an increase of ¥24.460 billion in retained earnings, as a result of disposition of capital surplus worth ¥17.087 billion and booking of net income totaling ¥7.318 billion.

■ **Cash flows**

Cash flows from operating activities increased ¥17.144 billion, or more than 150%, from the preceding year and the Company reported an income of ¥27.502 billion, due mainly to a reduction in inventories through production innovations, increased net income and contraction in accounts receivable due to the reforms in marketing structure that started during the previous year.

Cash flows from investing activities saw a net spending of ¥7.674 billion, ¥1.779 billion more than the previous year, due chiefly to acquisition of tangible and intangible fixed assets and spending related to making a Chinese joint venture into a wholly owned subsidiary.

Cash flows from financial activities decreased ¥13.751 billion and posted a net spending of ¥12.783 billion, as a result of proactive repayment of borrowings due to the strong cash flows from operating activities.

(Millions of yen)

	Current fiscal year	Previous fiscal year	Year-on-year change
Cash flows from operating activities	10,358	27,502	+17,144
Cash flows from investing activities	△5,895	△7,674	△1,779
Cash flows from financial activities	968	△12,783	△13,751
Effect of exchange rate changes on cash and cash equivalents	△210	△409	△199
Net increase (decrease) in cash and cash equivalents	5,220	6,634	+1,414
Cash and cash equivalents at beginning of year	21,686	27,064	+5,378
Net increase (decrease) in cash and cash equivalents in accordance with change of consolidated subsidiaries	157	△0	△157
Cash and cash equivalents at end of year	27,064	33,698	+6,634