HAPPINET CORPORATION AND CONSOLIDATED SUBSIDIARIES

Consolidated Financial Statements

March 31, 2008 and 2007

(With Independent Auditors' Report Thereon)

Note:
The accompanying consolidated financial statements have been compiled from the consolidated financial statements filed with the Ministry of Finance as required by the Securities and Exchange Law of Japan. All figures have been rounded to the nearest million yen.

Happinet Corporation and Consolidated Subsidiaries
Consolidated Balance Sheets
March 31, 2008 and 2007

	Millions of yen		Thousands of U.S. dollars (note 2)
	2008	2007	2008
Assets			
Current assets:			
Cash (note 3)	¥ 5,928	¥ 6,253	$ 59,167
Trade notes and accounts receivable	21,331	22,095	212,906
Inventories	7,451	6,208	74,369
Deferred income taxes (note 8)	1,997	585	19,932
Other current assets	4,260	4,919	42,519
Less allowance for doubtful receivables	166	38	1,657
Total current assets	40,801	40,022	407,236
Property, plant and equipment (note 6):			
Buildings and structures	1,824	1,016	18,205
Machinery, equipment and vehicles	920	901	9,183
Tools, furniture and fixtures	2,643	602	26,380
Land	852	548	8,504
	6,239	3,067	62,272
Less accumulated depreciation	4,020	1,464	40,124
Net property, plant and equipment	2,219	1,603	22,148
Intangible assets:			
Goodwill	771	536	7,695
Other	1,444	1,000	14,413
Total intangible assets	2,215	1,536	22,108
Investments and other assets:			
Investments in securities (notes 4, 5, 6 and 16)	2,210	1,823	22,058
Refundable deposits	674	545	6,727
Deferred income taxes (note 8)	17	115	170
Other investments and other assets	528	244	5,270
Less allowance for doubtful receivables	177	86	1,767
Total investments and other assets	3,252	2,641	32,458
Total assets	¥ 48,487	¥ 45,802	$ 483,950

	Millions of yen		Thousands of U.S. dollars (note 2)
	2008	2007	2008
Liabilities and Net Assets			
Current liabilities:			
Trade notes and accounts payable (notes 15 and 16)	¥ 21,097	¥ 19,113	$ 210,570
Short-term bank loans (note 6)	30	–	299
Current installments of long-term loans payable (note 6)	97	–	968
Other payables (note 15)	2,494	3,052	24,893
Accrued income taxes (note 8)	58	589	579
Accrued bonuses	390	323	3,893
Accrued restructuring costs	2,599	–	25,941
Other current liabilities	661	484	6,597
Total current liabilities	27,426	23,561	273,740
Non-current liabilities:			
Long-term loans payable (note 6)	31	–	309
Liabilities for retirement and severance benefits (note 7)	1,136	933	11,338
Other non-current liabilities (note 8)	1,082	705	10,800
Total non-current liabilities	2,249	1,638	22,447
Total liabilities	29,675	25,199	296,187
Stockholders' equity:			
Common stock (note 11): Authorized 32,000,000 shares; issued 12,025,000 shares in 2008 and 2007	2,751	2,751	27,458
Additional paid-in capital (note 11)	2,776	2,776	27,707
Retained earnings (note 12)	12,545	14,490	125,212
Treasury stock, at cost; 175,645 shares in 2008 and 9,825 shares in 2007	(239)	(13)	(2,385)
Total stockholders' equity	17,833	20,004	177,992
Valuation and translation adjustments:			
Net unrealized gain on other securities (note 4)	725	599	7,236
Total valuation and translation adjustments	725	599	7,236
Minority interests	254	–	2,535
Total net assets	18,812	20,603	187,763
Commitments and contingencies (note 16)			
Total liabilities and net assets	¥ 48,487	¥ 45,802	$ 483,950

See accompanying notes to consolidated financial statements.

Happinet Corporation and Consolidated Subsidiaries
Consolidated Statements of Operations
March 31, 2008 and 2007

	Millions of yen		Thousands of U.S. dollars (note 2)
	2008	2007	2008
Net sales	¥ 168,959	¥ 160,606	$ 1,686,386
Cost of sales (note 15)	150,652	142,158	1,503,663
Gross profit	18,307	18,448	182,723
Selling, general and administrative expenses (notes 9, 10 and 15)	16,855	16,295	168,231
Operating income	1,452	2,153	14,492
Other income (deductions):			
Interest income	16	3	160
Dividend income	31	20	309
Interest expenses	(21)	(45)	(210)
Loss on sale/disposal of property, plant and equipment	(27)	(18)	(269)
Loss on devaluation of investments in securities and other investments	(67)	–	(669)
Restructuring costs	(3,253)	–	(32,468)
Loss on disposal of inventories	(526)	–	(5,250)
Other, net	(63)	424	(629)
	(3,910)	384	(39,026)
Income (loss) before income taxes and minority interests	(2,458)	2,537	(24,534)
Income taxes (note 8):			
Current	379	729	3,783
Deferred	(1,347)	191	(13,445)
	(968)	920	(9,662)
Income (loss) before minority interests	(1,490)	1,617	(14,872)
Minority interests	(0)	0	(0)
Net income (loss)	¥ (1,490)	¥ 1,617	$ (14,872)

See accompanying notes to consolidated financial statements.

Happinet Corporation and Consolidated Subsidiaries
Consolidated Statements of Changes in Net Assets
For the years ended March 31, 2008 and 2007

Millions of yen

	Stockholders' equity					Valuation and translation adjustments		Minority interests	Total net assets
	Common stock	Additional paid-in capital	Retained earnings	Treasury stock	Total	Net unrealized gain on other securities	Total		
	(note 11)	(note 11)	(note 12)			(note 4)			
Balance at March 31, 2006	¥ 2,751	¥ 2,776	¥ 13,233	¥ (12)	¥ 18,748	¥ 362	¥ 362	¥ –	¥ 19,110
Changes arising during year:									
Cash dividends			(360)		(360)				(360)
Net income			1,617		1,617				1,617
Purchase of treasury stock				(1)	(1)				(1)
Disposition of treasury stock		0		0	0				0
Net changes other than stockholders' equity						237	237		237
Total changes during the year	–	0	1,257	(1)	1,256	237	237	–	1,493
Balance at March 31, 2007	2,751	2,776	14,490	(13)	20,004	599	599	–	20,603
Changes arising during year:									
Cash dividends			(481)		(481)				(481)
Net loss			(1,490)		(1,490)				(1,490)
Purchase of treasury stock				(226)	(226)				(226)
Disposition of treasury stock		0		0	0				0
Increase resulting from newly consolidated subsidiaries			26		26				26
Net changes other than stockholders' equity						126	126	254	380
Total changes during the year	–	0	(1,945)	(226)	(2,171)	126	126	254	(1,791)
Balance at March 31, 2008	¥ 2,751	¥ 2,776	¥ 12,545	¥ (239)	¥ 17,833	¥ 725	¥ 725	¥ 254	¥ 18,812

Thousands of U.S. dollars
(note 2)

	Stockholders' equity					Valuation and translation adjustments		Minority interests	Total net assets
	Common stock	Additional paid-in capital	Retained earnings	Treasury stock	Total	Net unrealized gain on other securities	Total		
Balance at March 31, 2007	$ 27,458	$ 27,707	$ 144,625	$ (129)	$ 199,661	$ 5,978	$ 5,978	$ –	$ 205,639
Changes arising during year:									
Cash dividends			(4,801)		(4,801)				(4,801)
Net loss			(14,872)		(14,872)				(14,872)
Purchase of treasury stock				(2,256)	(2,256)				(2,256)
Disposition of treasury stock		0		0	0				0
Increase resulting from newly consolidated subsidiaries			260		260				260
Net changes other than stockholders' equity						1,258	1,258	2,535	3,793
Total changes during the year	–	0	(19,413)	(2,256)	(21,669)	1,258	1,258	2,535	(17,876)
Balance at March 31, 2008	$ 27,458	$ 27,707	$ 125,212	$ (2,385)	$ 177,992	$ 7,236	$ 7,236	$ 2,535	$ 187,763

See accompanying notes to consolidated financial statements.

Happinet Corporation and Consolidated Subsidiaries
Consolidated Statements of Cash Flows
March 31, 2008 and 2007

	Millions of yen		Thousands of U.S. dollars (note 2)
	2008	2007	2008
Cash flows from operating activities:			
Income (loss) before income taxes and minority interests	¥ (2,458)	¥ 2,537	$ (24,534)
Adjustments to reconcile income (loss) before income taxes and minority interests to net cash provided by operating activities:			
Depreciation and amortization	427	357	4,262
Amortization of goodwill	204	166	2,036
Allowance for doubtful receivables	66	(101)	659
Increase (decrease) in accrued bonuses	20	(342)	199
Increase in liabilities for retirement and severance benefits	78	16	778
Increase in accrued restructuring costs	2,599	–	25,941
Interest and dividend income	(47)	(23)	(469)
Interest expenses	21	45	210
Loss on sale/disposal of property, plant and equipment	27	17	269
Loss on devaluation of investments in securities and other investments	67	–	669
Decrease in trade notes and accounts receivable	2,744	1,831	27,388
Increase in inventories	(305)	(323)	(3,044)
Decrease in trade notes and accounts payable	(1,040)	(2,133)	(10,380)
Increase (decrease) in other payables	(631)	554	(6,298)
Other, net	795	(524)	7,935
Sub total	2,567	2,077	25,621
Interest and dividend received	47	23	469
Interest paid	(20)	(45)	(199)
Income taxes paid	(902)	(1,248)	(9,003)
Net cash provided by operating activities	1,692	807	16,888
Cash flows from investing activities:			
Capital expenditures	(261)	(242)	(2,605)
Proceeds from sale of property, plant and equipment	0	3	0
Purchase of intangible assets	(591)	(511)	(5,899)
Purchase of investments in securities	(24)	(29)	(239)
Proceeds from sale of investments in securities	0	61	0
Payment for acquisition of consolidated subsidiary, net of cash acquired	211	(804)	2,106
Other, net	170	(264)	1,697
Net cash used in investing activities	(495)	(1,786)	(4,940)

Cash flows from financing activities:			
Decrease in short-term debt	(189)	–	(1,886)
Payments on long-term debt	(741)	(1,887)	(7,396)
Purchase of treasury stock	(226)	(1)	(2,256)
Dividends paid to stockholders	(479)	(360)	(4,781)
Other, net	(20)	0	(200)
Net cash used in financing activities	(1,655)	(2,248)	(16,519)
Net decrease in cash and cash equivalents	(458)	(3,227)	(4,571)
Cash and cash equivalents at beginning of year	6,253	9,480	62,411
Cash and cash equivalents of newly consolidated subsidiaries	42	–	419
Cash and cash equivalents at end of year (note 3)	¥ 5,837	¥ 6,253	$ 58,259

See accompanying notes to consolidated financial statements.

Happinet Corporation and Consolidated Subsidiaries

Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies

(a) Basis of Presenting Consolidated Financial Statements

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

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

In preparing the accompanying consolidated financial statements, certain reclassifications have been made in the financial statements issued domestically in Japan in order to present them in a form which is more familiar to readers outside Japan. In addition, the notes to the consolidated financial statements include information which is not required under accounting principles generally accepted in Japan but is presented herein as additional information.

(b) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries (8 subsidiaries for 2008 and 5 subsidiaries for 2007).

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

Investments in affiliates are accounted for by the equity method.

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

The difference between the cost and the underlying net assets at the date of investments in subsidiaries or affiliates is allocated to identifiable assets and liabilities based on fair market value at the date of investments.

The unallocated portion of the difference, which is recognized as goodwill or negative goodwill, is amortized over 5 years.

(c) Cash and Cash Equivalents

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

(d) Investments in Securities

Under the Accounting Standards for Financial Instruments, securities are classified into four categories – “trading securities,” “held-to-maturity securities,” “investments in affiliates” and “other securities.” Securities classified as “trading securities” are stated at fair value and unrealized gains or losses are recorded in the consolidated statements of income. Securities classified as “held-to-maturity securities” are stated at amortized cost. Securities classified as “other securities” with fair value are stated at fair value and unrealized gains or losses, net of related taxes, are excluded from earnings and recorded in a separate component of net assets. Debt classified as “other securities” for which fair value is not available are stated at the amortized cost. Equity securities classified “other securities” for which fair value is not available are stated at the moving-average cost. Realized gains and losses on the other securities are computed using the moving-average cost. Holding securities of the Company are classified as other securities.

(e) Inventories

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

(f) Property, Plant and Equipment

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

The estimated useful lives are as follows:

Buildings and structures	2 – 65 years
Machinery, equipment and vehicles	3 – 12 years
Tools, furniture and fixtures	2 – 20 years

Pursuant to an amendment to the Corporation Tax Law, the Company and its domestic consolidated subsidiaries changed the estimated residual value of property and equipment which was acquired on or after April 1, 2007 from 5% of the acquisition cost to ¥1. The effect of this change was immaterial.

Pursuant to an amendment to the Corporation Tax Law, property and equipment acquired on or before March 31, 2007 which were depreciated to the allowable limit (95% of the acquisition cost) in a particular business year can be further depreciated down to ¥1 evenly over five years starting from the following business year. The effect of this change was immaterial.

(g) Intangible Assets

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

(h) Allowance for Doubtful Receivables

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

(i) Retirement and Severance Benefits

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

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

(j) Leases

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

(k) Income Taxes

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

(l) Subcontract Income

Subcontract income had been recorded as other income. Because the income expects to be incurred regularly in the future and is a result of main operations, and with increasing the amount, the income is recorded as sales from the year ended March 31, 2008 to more appropriately disclose the profit and loss.

As a result of this change, sales and operating income increased ¥258 million ($2,575 thousand), other income (deductions) decreased the same amount and there was no effect on income before income and minority interests.

(m) Accrued Restructuring Costs

Restructuring costs related to video software business were recorded.

(n) Presentation of Net Assets on Balance Sheet

Effective from the year ended March 31, 2007, the Company adopted the “Accounting Standard for Presentation of Net Assets in the Balance Sheet” (Accounting Standards Board of Japan Statement No. 5, issued by Accounting Standards Board of Japan on December 9, 2005) and the “Guidance on Accounting Standard for Presentation of Net Assets in the Balance Sheet” (Accounting Standards Board of Japan Guidance No. 8, issued by Accounting Standards Board of Japan on December 9, 2005).

According to the Standards, former “Stockholders’ equity” is presented as “Net assets” and classified into “Stockholders’ equity” and “Valuation and translation adjustments.” The stockholders’ equity amounted to ¥20,603 million at March 31, 2008 based on the former classification.

(o) Reclassifications

Certain reclassifications have been made to the prior years’ consolidated financial statements to conform to the presentation used as of and for the year ended March 31, 2008.

(2) Financial Statement Translation

The consolidated financial statements are expressed in Japanese yen. However, solely for the convenience of the reader, the consolidated financial statements as of and for the year ended March 31, 2008 have been translated into United States dollars at the rate of ¥100.19=U.S.$1, the approximate exchange rate on the Tokyo Foreign Exchange Market on March 31, 2008. This translation should not be construed as a representation that the amounts shown could be converted into U.S. dollars at such rate.

(3) Cash and Cash Equivalents

Reconciliation between "Cash" in the accompanying consolidated balance sheets and "Cash and cash equivalents" in the accompanying consolidated statements of cash flows at March 31, 2008 and 2007 is follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Cash	¥ 5,928	¥ 6,253	$ 59,167
Time deposits with maturities of over three months	(91)	–	(908)
Cash and cash equivalents	¥ 5,837	¥ 6,253	$ 58,259

(4) Investments in Securities

Acquisition cost, balance sheet amount and gross unrealized gain and gross unrealized loss of other securities with fair value as of March 31, 2008 and 2007 are summarized as follows:

	Millions of yen			
	Acquisition cost	Gross Unrealized gain	Gross Unrealized loss	Balance sheet amount
March 31, 2008				
Equity securities	¥ 751	¥ 1,288	¥ (21)	¥ 2,018
Other securities	41	1	(8)	34
March 31, 2007				
Equity securities	¥ 650	¥ 1,035	¥ (4)	¥ 1,681

	Thousands of U.S. dollars			
	Acquisition cost	Gross Unrealized gain	Gross Unrealized loss	Balance sheet amount
March 31, 2008				
Equity securities	$ 7,496	$ 12,856	(210)	$ 20,142
Other securities	409	10	(80)	339

It is not practicable to estimate the fair value of securities as of March 31, 2008 and 2007 described bellow because of lack of market price and difficulty in estimating fair value.

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Other securities:			
Unlisted equity securities	¥ 151	¥ 122	$ 1,507

For the year ended March 31, 2008, proceeds from sale of other securities and the realized gains are immaterial and no gross realized losses are recognized. For the year ended March 31, 2007, proceeds from sale of other securities were ¥60 million, no realized gains were recognized and the gross realized losses were immaterial.

(5) Investments in Affiliates

The aggregate carrying amounts of investments in affiliates as of March 31, 2008 and 2007 are ¥7 million ($70 thousand) and ¥20 million, respectively.

(6) Short-term and Long-term Debt

The weighted average interest rate of short-term bank loans at March 31, 2008 is 1.5%.

Long-term debt as of March 31, 2008 is summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Loans, principally from banks, maturing in installments through 2009 with weighted average interest of 1.7% at March 31, 2008, secured by mortgage of investment in securities and property, plant and equipment	¥ 128	$ 1,278
0.4% unsecured bond issued by a consolidated subsidiary, due August 2008	10	100
1.0% unsecured bond issued by a consolidated subsidiary, due June9	30	299
	168	1,677
Less current installments	127	1,268
	¥ 41	$ 409

The aggregate annual maturities of long-term debt after March 31, 2009 are as follows:

	Millions of yen	Thousands of U.S. dollars
Year ending March 31:		
2010	¥ 41	$ 409

At March 31, 2008, investment in securities with a book value of ¥1,285 million ($12,826 thousand) and property, plant and equipment with a book value of ¥231 million ($2,306 thousand) are mortgaged to secure short-term and long-term loans.

As is customary in Japan, both short-term and long-term bank loans are under general agreements which provide that security and guarantees for present and future indebtedness will be given upon request of the bank, and that the bank shall have the right, as the obligations become due or in the event of default, to offset cash deposits against obligations due the banks.

(7) Retirement and Severance Benefits

The Company and certain consolidated subsidiaries have defined benefit retirement and pension plans, which consist of unfunded retirement and severance plans that provide for lump-sum payment of benefits and defined contribution retirement and pension plans, and certain consolidated subsidiaries have tax qualified pension plans.

The funded status of the pension plans at March 31, 2008 and 2007 is outlined as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Projected benefit obligation	¥ (1,136)	¥ (869)	$ (11,338)
Net amount recognized in the consolidated balance sheets	(1,136)	(869)	(11,338)
Prepaid pension cost	–	64	–
Liabilities for retirement and severance benefits	¥ (1,136)	¥ (933)	$ (11,338)

Net periodic pension cost for the years ended March 31, 2008 and 2007 consists of the following components:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Service cost	¥ 112	¥ 101	$ 1,118
Interest cost	14	14	140
Amortization of actuarial loss generated in the current fiscal year	24	9	240
Contribution by the Company to the Welfare Pension Fund	28	29	279
Additional benefits, etc.	1	177	10
Contribution to the defined contribution fund	46	44	459
Net periodic pension cost	¥ 225	¥ 374	$ 2,246

Significant assumptions of pension plans used to determine these amounts in fiscal 2008 and 2007 are as follows:

	2008	2007
Discount rate	1.5%	1.5%
Periodic allocation method for projected benefit	Straight-line	Straight-line
Period for amortization of unrecognized prior service cost	1 year*	1 year*
Period for amortization of unrecognized actuarial loss	1 year*	1 year*

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

(8) Income Taxes

The Company and its consolidated subsidiaries are subject to Japanese corporate, inhabitant and business taxes based on income which, in the aggregate, result in a statutory tax rate of approximately 40.6% in 2008 and 2007.

A reconciliation of the statutory tax rate and the effective tax rate as a percentage of income before income taxes and minority interests for the years ended March 31, 2008 and 2007 is follows:

	2008	2007
Statutory tax rate	40.6%	40.6%
Expenses not deductible for tax purposes	(0.9)	0.9
Income not credited for tax purposes	0.2	(0.2)
Per capita tax	(1.0)	1.1
Tax benefits not recognized on operating losses of subsidiaries	0.1	(4.3)
Other	0.3	(1.8)
Effective tax rate	39.3%	36.3%

Significant components of deferred tax assets and liabilities at March 31, 2008 and 2007 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Deferred tax assets:			
Deferred tax assets (current):			
Tax loss carryforward	¥ 162	¥ –	$ 1,617
Accrued business tax	7	46	70
Valuation loss for inventories	171	260	1,707
Accrued bonuses	155	130	1,547
Allowance for doubtful receivables	104	–	1,038
Accrued restructuring cost	1,055	–	10,530
Cost of sales	344	–	3,433
Other	53	149	529
Valuation allowance	(54)	–	(539)
	1,997	585	19,932
Deferred tax assets (non-current):			
Tax loss carryforward	1,083	–	10,810
Liabilities for retirement and severance benefits	459	378	4,581
Loss on devaluation of other investments	39	35	389
Loss on devaluation of investments in securities	241	46	2,406
Loss on devaluation of land	119	–	1,188
Other	158	88	1,577
Valuation allowance	(1,592)	–	(15,890)
Offset with deferred tax liabilities (non-current)	(490)	(432)	(4,891)
	17	115	170
Net deferred tax assets	¥ 2,014	¥ 700	$ 20,102
Deferred tax liabilities:			
Deferred tax liabilities (non-current):			
Net unrealized gain on other securities	¥ (534)	¥ (439)	$ (5,330)
Offset with deferred tax assets (non-current)	490	432	4,891
Net deferred tax liabilities	¥ (44)	¥ (7)	$ (439)

(9) Selling, General and Administrative Expenses

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

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Storage expenses	¥ 1,302	¥ 1,530	$ 12,995
Freight	2,387	2,420	23,825
Promotion	734	1,197	7,326
Salary and executive compensation	6,283	5,772	62,711

(10) Research and Development Costs

Research and development costs charged to income for the years ended March 31, 2008 and 2007 are ¥22 million ($220 thousand) and ¥15 million, respectively.

(11) Common Stock

On May 1, 2006, a new corporation law (the "Corporation Law") became effective, which reformed and replaced the Commercial Code of Japan 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. Under the Corporation Law, the entire amount of the issue price of shares is required to be designated as stated common stock account although a company in Japan may, by resolution of its Board of Directors, account for an amount not exceeding 50% of the issue price of new shares as additional paid-in capital.

(12) Retained Earnings and Dividends

The Corporation Law provides that an amount equal to 10% of distributions from retained earnings paid by the Company and its Japanese subsidiaries be appropriated as a legal reserve. No further appropriations are required when the total amount of the additional paid-in capital and the legal reserve equals 25% of their respective stated capital. The Corporation Law also provides that additional paid-in capital and legal reserve are available for appropriations by the resolution of the stockholders. Balances of the legal reserve are included in retained earnings in the accompanying consolidated balance sheets.

Cash dividends charged to retained earnings for the years ended March 31, 2008 and 2007 represent dividends paid out during those years. The amount available for dividends is based on the amount recorded in the Company’s non-consolidated books of account in accordance with the Corporation Law.

(a) Dividends paid during the year ended March 31, 2007

The following was approved by the general meeting of stockholders held on June 16, 2006.

(a)	Total dividends	¥180 million
(b)	Cash dividends per common share	¥15
(c)	Record date	March 31, 2006
(d)	Effective date	June 16, 2006

The following was approved by the Board of Directors held on November 8, 2006.

(a)	Total dividends	¥180 million
(b)	Cash dividends per common share	¥15
(c)	Record date	September 30, 2006
(d)	Effective date	December 14, 2006

(b) Dividends paid during the year ended March 31, 2008
The following was approved by the general meeting of stockholders held on June 22, 2007.

(a)	Total dividends	¥180 million ($1,797 thousand)
(b)	Cash dividends per common share	¥15 ($0.15)
(c)	Record date	March 31, 2007
(d)	Effective date	June 25, 2007

The following was approved by the Board of Directors held on November 8, 2007.

(a)	Total dividends	¥300 million ($2,994 thousand)
(b)	Cash dividends per common share	¥25 ($0.25)
(c)	Record date	September 30, 2007
(d)	Effective date	December 25, 2007

(c) Dividends to be paid after the balance sheet date but the record date for the payment belongs to the year ended March 31, 2008
The following was approved by the general meeting of stockholders held on June 23, 2008.

(a)	Total dividends	¥178 million ($1,777 thousand)
(b)	Dividend source	Retained earnings
(c)	Cash dividends per common share	¥15 ($0.15)
(d)	Record date	March 31, 2008
(e)	Effective date	June 24, 2008

(13) Per Share Information

(a) Net Income (Loss) per Share

Basic net income (loss) per share, and reconciliation of the numbers and the amounts used in the basic net income (loss) per share computations for the years ended March 31, 2008 and 2007 are as follows:

	Yen		U.S. dollars
	2008	2007	2008
Basic net income (loss) per share	¥ (124.11)	¥ 134.54	$ 1.24

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Net income (loss) applicable to common stockholders	¥ (1,490)	¥ 1,617	$ (14,872)

	Number of shares (Thousands)	
	2008	2007
Weighted average number of shares outstanding on which basic net income per share is calculated	12,005	12,015

(b) Net Assets per Share

Net assets per share at March 31, 2008 and 2007 are as follows:

	Yen		U.S. dollars
	2008	2007	2008
Net assets per share	¥ 1,566.17	¥ 1,714.73	$ 15.63

(14) Leases

A summary of assumed amounts of acquisition cost, accumulated depreciation and net book value at March 31, 2008 and 2007 are as follows:

	Millions of yen		
	Machinery, equipment and vehicles	Tools, furniture and fixtures	Total
March 31, 2008			
Acquisition cost	¥ 92	¥ 314	¥ 406
Accumulated depreciation	34	207	241
Net book value	¥ 58	¥ 107	¥ 165
March 31, 2007			
Acquisition cost	¥ 6	¥ 191	¥ 197
Accumulated depreciation	3	112	115
Net book value	¥ 3	¥ 79	¥ 82

	Thousands of U.S. dollars		
	Machinery, equipment and vehicles	Tools, furniture and fixtures	Total
March 31, 2008			
Acquisition cost	$ 918	$ 3,134	$ 4,052
Accumulated depreciation	339	2,066	2,405
Net book value	$ 579	$ 1,068	$ 1,647

Future minimum payments required under finance leases at March 31, 2008 and 2007 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Within one year	¥ 83	¥ 47	$ 829
Over one year	84	36	838
	¥ 167	¥ 83	$ 1,667

Lease payments, depreciation equivalents and amounts representing interest under the finance leases which are accounted for in the same manner as operating leases for the years ended March 31, 2008 and 2007 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Lease payments	¥ 83	¥ 64	$ 828
Depreciation equivalents	81	61	808
Amounts representing interest	3	2	30

(15) Balances and Transactions with Related Party

The Company’s outstanding common stock was owned by NAMCO BANDAI Holdings Inc. by 25% at both March 31, 2008 and 2007.

Balances with NAMCO BANDAI Holdings Inc. at March 31, 2008 and 2007, and related transactions for the years then ended are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Balances:			
Other payables	¥ 3	¥ 4	$ 30
Transactions:			
Business management fee	¥ 37	¥ 40	$ 369

Bandai Co., Ltd. and Bandai Visual Co., Ltd. are subsidiaries of NAMCO BANDAI Holdings Inc. as at March 31, 2008 and 2007. Balances with the companies at March 31, 2008 and 2007, and related transactions for the years then ended are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Bandai Co., Ltd.			
Balances:			
Trade accounts payable	¥ 6,100	¥ 6,128	$ 60,884
Transactions:			
Purchases	¥ 29,545	¥ 32,103	$ 294,890
Bandai Visual Co., Ltd.			

Balances:						
Trade accounts payable	¥	902	¥	590	$	9,003
Transactions:						
Purchases	¥	5,038	¥	4,299	$	50,284

(16) Commitments and Contingencies

Investment in securities with a book value of ¥856 million were pledged for trade accounts payable of ¥15 million at March 31, 2007. No assets are pledged for trade accounts payable at March 31, 2008.

(17) Segment Information

(a) Industry segments

The Company categorizes its business into the five segments of “Toy business”, “Video software business”, “TV game business”, “Amusement business” and “Other business.” The segments are divided based on type of products and natures, sales system and markets.

Segment information by industry for the years ended March 31, 2008 and 2007 is summarized as follows:

	Millions of yen							
	2008							
	Toy	Video software	TV game	Amusement	Other	Total	Elimination / corporate	Consolidated
Sales to outside customers	¥ 57,785	¥ 38,555	¥ 54,535	¥ 12,957	¥ 5,127	¥ 168,959	¥ –	¥ 168,959
Inter-segment sales	–	–	–	–	–	–	–	–
	57,785	38,555	54,535	12,957	5,127	168,959	–	168,959
Operating expenses	56,504	38,518	53,213	12,983	5,086	166,304	1,203	167,507
Operating income	¥ 1,281	¥ 37	¥ 1,322	¥ (26)	¥ 41	¥ 2,655	¥ (1,203)	¥ 1,452
Assets	¥ 13,327	¥ 9,867	¥ 10,388	¥ 7,399	¥ 892	¥ 41,873	¥ 6,614	¥ 48,487
Depreciation and amortization	225	67	49	99	16	456	14	470
Capital expenditures	284	194	168	145	27	818	17	835

	Millions of yen							
	2007							
	Toy	Video software	TV game	Amusement	Other	Total	Elimination / corporate	Consolidated
Sales to outside customers	¥ 57,213	¥ 46,145	¥ 45,093	¥ 6,347	¥ 5,808	¥ 160,606	¥ –	¥ 160,606
Inter-segment sales	–	–	–	–	–	–	–	–
	57,213	46,145	45,093	6,347	5,808	160,606	–	160,606
Operating expenses	55,395	45,516	44,286	6,227	5,742	157,166	1,287	158,453
Operating income	¥ 1,818	¥ 629	¥ 807	¥ 120	¥ 66	¥ 3,440	¥ (1,287)	¥ 2,153
Assets	¥ 15,187	¥ 11,939	¥ 8,026	¥ 1,362	¥ 1,188	¥ 37,702	¥ 8,100	¥ 45,802
Depreciation and amortization	208	71	54	37	21	391	10	401
Capital expenditures	338	214	141	29	42	764	19	783

	Thousands of U.S. dollars							
	2008							
	Toy	Video software	TV game	Amusement	Other	Total	Elimination / corporate	Consolidated
Sales to outside customers	$ 576,754	$ 384,819	$ 544,316	$ 129,324	$ 51,173	$ 1,686,386	$ –	$ 1,686,386
Inter-segment sales	–	–	–	–	–	–	–	–
	576,754	384,819	544,316	129,324	51,173	1,686,386	–	1,686,386
Operating expenses	563,968	384,450	531,121	129,584	50,764	1,659,887	12,007	1,671,894
Operating income	$ 12,786	$ 369	$ 13,195	$ (260)	$ 409	$ 26,499	$ (12,007)	$ 14,492
Assets	$ 133,017	$ 98,483	$ 103,683	$ 73,850	$ 8,903	$ 417,936	$ 66,014	$ 483,950
Depreciation and amortization	2,246	669	489	988	159	4,551	140	4,691
Capital expenditures	2,835	1,936	1,677	1,447	269	8,164	170	8,334

Notes: 1. The main products of each segment are as follows:

Toy:	Toys for boys and girls.
Video software:	Video software and music software.
TV game:	Game consoles and related software.
Amusement:	Toy vending machines and products sold via the machines.
Other:	Miscellaneous goods and trading cards.

2. The non-categorized operating expenses of ¥1,203 million ($12,007 thousand) and ¥1,287 million for the years ended March 31, 2008 and 2007 in the Elimination/ corporate line consist primarily of administrative operation expenses.

3. Corporate assets of ¥6,614 million ($66,015 thousand) and ¥8,100 million as of March 31, 2008 and 2007 in the Elimination/ corporate line consist primarily of cash and deposits, long-term investments (investments in securities) and assets relating to the administrative operations.

4. For the year ended March 31, 2008, as described in Note 1 (l), the Company changed its accounting for subcontract income. As a result of the change, both of sales and operating income of "Toy business" and "Video software business" were increased by ¥240 million ($2,395 thousand) and ¥18 million ($180 thousand), respectively.

(b) Geographic segments

Both domestic sales and assets located in Japan are over 90% of all segments for the years ended March 31, 2008 and 2007.

(c) Overseas sales

Overseas sales are less than 10% of consolidated sales for the years ended March 31, 2008 and 2007.

(17) Supplemental Cash Flow Information

Assets and liabilities of the newly consolidated subsidiary, SUNLINK Co., Ltd. in 2008 by acquisition at the inception of consolidation, and net expenditure for acquisition were as follows:

	Millions of yen	Thousand of U.S. dollars
Current assets	¥ 2,629	$ 26,240
Non-current assets	593	5,919
Goodwill	452	4,511
Current liabilities	(3,089)	(30,831)
Non-current liabilities	(472)	(4,711)
Acquisition cost of stock	113	1,128
Cash and cash equivalents held by acquired subsidiary	253	2,525
Net expenditure for acquisition	¥ 140	$ 1,397

Assets and liabilities of the newly consolidated subsidiary, The Apple Corporation in 2008 by acquisition at the inception of consolidation, and net expenditure for acquisition were as follows:

	Millions of yen	Thousand of U.S. dollars
Current assets	¥ 1,413	$ 14,103
Non-current assets	637	6,358
Current liabilities	(895)	(8,933)
Non-current liabilities	(438)	(4,372)
Negative goodwill	(104)	(1,038)
Minority interests	(254)	(2,535)
Acquisition cost of stock	359	3,583
Cash and cash equivalents held by acquired subsidiary	430	4,292
Net expenditure for acquisition	¥ 71	$ 709

Assets and liabilities of the newly consolidated subsidiary, MORITOYS Co., Ltd. in 2007 by acquisition at the inception of consolidation, and net expenditure for acquisition were as follows:

	Millions of yen
Current assets	¥ 3,348
Non-current assets	648
Goodwill	539
Current liabilities	(1,441)
Non-current liabilities	(1,798)
Minority interests	(5)
Acquisition cost of stock	1,291
Cash and cash equivalents held by acquired subsidiary	487
Net expenditure for acquisition	¥ 804

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Independent Auditors' Report

To the Board of Directors of
Happinet Corporation

We have audited the accompanying consolidated balance sheets of Happinet Corporation and consolidated subsidiaries as of March 31, 2008 and 2007, and related consolidated statements of operations, changes in net assets and cash flows for the years then ended, 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 financial position of Happinet Corporation and consolidated subsidiaries as of March 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

The accompanying consolidated financial statements as of and for the year ended March 31, 2008 have been translated into United States dollars solely for the convenience of the reader. We have recomputed the translation and, in our opinion, the consolidated financial statements expressed in yen have been translated into United States dollars on the basis described in Note 2 to the consolidated financial statements.

Toyo Horwath

Toyo Horwath
Tokyo, Japan
June 5, 2008