A MESSAGE FROM THE PRESIDENT

OVERVIEW

The Japanese economy during the consolidated financial period under review ("current consolidated period") witnessed some improvements in terms of corporate income, but it moved on an even keel, overall, reflecting deep-rooted concerns in the industry over redundant employment and plant/equipment, which eventually resulted in inactive personal consumption and capital investment. Towards the end of the year, however, thanks to an increase in exports, manufacturing business (especially of large-size production and manufacturing entities) turned upward. Consequently, there were signs of recovery in private capital investments and business trends seemed to be taking a turn for the better.

The business environment surrounding the Company's Group (i.e., the Company and its consolidated subsidiaries), on the other hand, has become much tougher and harsher as competition has been intensifying owing to participation of new comers from different sectors of business. To make the situation worse, sales of our Environmental Control Division - which constitutes the central core of business for our Group - marked a sharp decline adversely affected by the Government's cutback in public investments.

Under such an unaccommodating economic climate, the Company's Group has diligently pursued sales activities, putting its focus on environmental preservation related plants such as waste incineration plants, resource recovery plants, water treatment plants, etc., as well as energy supply and saving equipment such as various types of boilers, cogeneration devices, etc. And yet, the total amount of orders received during the current consolidated period declined by 3,134 million yen (a 3.5% drop) from the previous consolidated period to 85,531 million yen.

Business Performance

Net sales attained during the current consolidated period totaled no greater than 95,183 million yen marking a sharp decline of 66,106 million, or a 41.0% drop, from the previous consolidated period.

With respect to the profit-loss aspect, we deeply regret having to inform that the Group registered an operating loss of 169 million yen mostly affected by marked intensification of price competition in the market, even though every possible effort to curtail expenses and lower costs was made companywide throughout the Group; ordinary profit decreased by 14,809 million yen to 410 million yen, marking a sharp 97.3 drop from the previous consolidated period. In addition, an extraordinary loss of 985 million yen was set aside for special retirement allowances paid to employees who applied voluntarily for early retirement. As a corollary, there was no alternative for the Company but to post a net loss of 1,032 million yen for the current consolidated period.

By-Division incoming order status for the current period was as follows;

[Machinery Division]
In the industrial boiler and machinery/plant area, the Division has aggressively evolved sales activities putting its focus on waste thermal recycling facilities for effective utilization of "Renewal Energy", such as biomass power plants and/or biomass charcoal boiler plants, etc. to receive total orders worth 41,753 million yen exceeding by 3,601 million yen (up 9.4%) over the previous consolidated period, while net sales dropped by 8,055 million yen (down 17.4%) from the previous consolidated period to 38,315 million yen. Viewing this from the point of profit-loss aspect, however, the Division incurred its operating loss of 1,103 million yen for the current consolidated period, which exceeds by 936 million yen over the previous consolidated period.

[Environmental Control Plants Division]
In the waste treatment area, the Division continually received orders for urban waste incineration plants for shipment abroad in addition to conventional incineration plants for domestic use, and in the water treatment sector, orders for various water treatment plants plus advanced sand filtration sewage treatment facilities. The total amount of the orders received for the current consolidated period, however, declined by 7,752 million yen (down 18.1%) from the previous consolidated period to 35,138 million yen. Net sales, therefore, dropped markedly by 59,211 million yen, down 55.1%, from the previous consolidated period. The total being no greater than 48,277 million yen. As a result, operating profit was reduced sharply by 16,391 million yen (down 88.4%) from the previous consolidated period to 2,159 million yen.

[Operation and Maintenance Division]
Net sales increased by 9 million yen to 9,135 million yen or up 0.1% over the previous consolidated period. Operating profit, too, was raised by 225 million yen (up 33.8%) over the previous consolidated period to 892 million yen.

[Real Estate Division]
Net sales dropped by 12 million yen (down 3.4%) from the previous consolidated period to 361 million yen, while operating profit marked an increase of 28 million yen, or up 17.6%, over the previous consolidated period, coming to the total of 190 million yen.

The Board of Directors of the Company has resolved and decided to designate four members of our business group including Katsuta Co., Ltd. to be eligible as from the current consolidated period to apply for the Company's equity method in due consideration of increasing relative importance in their role in our business group. The four member companies so designated are engaged in the main in disposing of general and industrial waste, sales of which in the current consolidated period totaled 5,936 million yen, and net profit, 602 million yen, respectively.

CASH FLOW SUMMARY

Cash and cash equivalents (hereinafter collectively referred to as "Funds") as of the end of the current consolidated period were reduced by 13,173 million yen from the previous consolidated period to 56,320 million yen. A review of By-Activity cash flow for the current consolidated period and relevant factors are stated in the following:

[Cash Flow from Operating Activities]
Cash flow from operating activities was reduced by 21,937 million yen from the same period of the previous year to minus 8,293 million yen, this being ascribed partly to the fact that net profit before tax and other adjustments decreased by 12,468 million yen from the same period of the previous year to minus 480 million yen and partly due to the fact that the increment in cash flow, thanks to diminution of trade receivables, shrank by 6,231 million yen from the same period of the previous year.

[Cash Flow from Investing Activities]
Cash flow from investing activities increased by 385 million yen over the same period of the previous year to minus 2,545 million yen, this being mainly ascribed to the decrease by 691 million yen from the same period of the previous year in defrayment for purchase of investment securities.

[Cash flow from Financing Activities]
Cash flow from financing activities was raised by 990 million yen over the same period of the previous year to minus 2,253 million yen, this being partly ascribed to the diminution in the repayment on short-term loans from the same period of the previous year and partly due to no defrayment necessitated for redemption of debentures.

EQUIPMENT INVESTMENT

The primary equipment investment by the Company's Group (i.e., the Company and its consolidated subsidiaries) during the current consolidated period was only for maintenance and repair work of production facilities in the Harima and Kyoto plants; for this reason, the breakdown of the amount invested for each type of business segment is not contained in this report (the classification of such segments is extremely difficult and complicated.) For the sake of reference, the total amount of equipment investment made during the current consolidated period was 253 million yen.

FUTURE OUTLOOK

The Company started out the new (2nd) 3-year Medium-Term Operations Plan called "Breakthrough for Growth of TAKUMAs (G-TAKUMAs)" in April last year with the aim of realizing the Company's three major visions - (i) To become a leading company indispensable to Japanese industries in the field of waste treatment, biomass energy supply and environmental preservation, (ii) To grow as a No.1 manufacturer in the area of consumer-use thermal energy and (iii) To expand and increase overseas operations in size and volume comparable to those in Japan - and is working hard and diligently to bring them to fruition as early as possible.

The Company's business environment, however, has become much tougher and harsher,

especially in the area of "Environmental Control" and "Energy Supply and Saving" against the backdrop of marked intensification of competition in the market owing to participation of new comers from different sectors of business, cutback by the Government in public investments and structural changes in the industry and market. Notwithstanding such difficult business circumstances, the Company is making all possible efforts to not only enhance its technical capabilities but build waste treatment plants and boiler plants as well so as to cope with and satisfy diversified needs of customers by supplying new technologies, products and service; by so doing, we believe we can enjoy receiving many more orders in future. The Company will also continue to implement active investment in the waste treatment and energy supply related businesses.

As for the area of consumer-use thermal energy, the Company bought up Ebara Boiler Co., Ltd. this March to accelerate productivity of the Small-sized Once-through Boiler Division. We intend to make the most of its product technology, expertise, service network and other managerial resources in the marketing and servicing sector in hopes of it bringing about a great synergy among the group companies so as to help us reinforce and expand the Company's business structure in the area of all-purpose boilers.

The Company reviewed the functionality of the Harima Plant in order to improve its efficiency and in consequence, solicited voluntary retirement first from among the plant workers, and then from among employees in all divisions companywide as well. This was done in an attempt to enhance the Company's competitiveness in costs by resorting to outsourcing abroad. The Company will continue to make further efforts to be a knowledge-intensive entity, promoting and challenging its structural reform in order to bring in slim management and pursue low-cost oriented operations and management so as to win the keen cost competition in the market.

As for the international operations strategy, the Company set up overseas operating bases in Southeast Asia, Europe and China, and established the International Business and Operations Division in April 2003 to cope with and handle inquiries and other business-related matters from overseas customers in an efficient manner in an attempt to increase business on a global basis. The Company commits itself to continue to make further efforts to manage and operate the overseas business bases in as much an efficient manner as possible so that they will soon be capable of operating, designing and/or procuring independently by themselves to manufacture and supply systems and equipment at the costs and of the quality that meet the local needs.

Further, the Company realizes it an important managerial issue for the Company to strengthen corporate governance, and therefore, has introduced an "Administrative Operating System" to come into immediate effect after the close of Ordinary General Meeting of Shareholders convened for this fiscal year. This System works to separate the decision-making function and the administrative operating function respectively in order to expedite management's decision-making and pursue clarification of management responsibility. We feel confident that the introduction of this System will also contribute to the strengthening of compliance.

The Company is striving hard to reform and reinforce the management base in efforts to improve the business results at as an early stage as possible and thus to enjoy continuous growth and success of the Company's operations.

T. Nishida

Tsuneo Nishida
President and CEO, TAKUMA CO., LTD.