

H<sub>2</sub>O RETAILING CORPORATION

# FINANCIAL REPORT 2011

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## Profile

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Hankyu Department Stores, Inc. was established in 1929 in Umeda, Osaka, as the world's first railway terminal department store by Mr. Ichizo Kobayashi, the founder of the Hankyu Corporation. Helped by the ability of a railway terminal to attract customers, the store grew together with the Umeda area, and a succession of stores in other areas were subsequently opened.

In 1947, the Company was spun off from Hankyu Corporation and the Hankyu Department Stores Group was formed.

On 1st October 2007, Hankyu Department Stores, Inc. changed its name to H2O RETAILING CORPORATION and became a holding company in accordance with the management integration between Hankyu Department Stores, Inc. and Hanshin Department Store, Ltd.

Currently, the Group consists of 37 subsidiaries and 7 affiliates that operate retail businesses, including its core-department store operations, supermarket operations and shopping center operations.

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# General Business Conditions

## Business Performance

To increase market share in the Kansai commercial area, the Group has compiled a long-term business plan, Grand Prix 10 (GP10) Plan, with fiscal 2014 as its final year. Various measures have been taken based on this plan to strengthen Group businesses.

In fiscal 2010, ended 31st March 2011, sales in the mainstay Department Store Business declined by approximately ¥13,000 million due to a reduction in the retail space at Hankyu Department Store's Umeda Main Store, which is currently undergoing renovation. Despite this business interruption, sales on a consolidated basis declined by only 1.1% year-on-year as sales at the Hanshin Umeda Main Store and the Nishinomiya Hankyu store exceeded sales in the previous fiscal year. Profits increased year-on-year with efforts to boost management efficiency leading to stronger operating income, recurring income, and net income than amounts projected in our start-of-year forecasts.

In fiscal 2010, we opened our first store in Kyushu, the Hakata Hankyu store (Hakata Ward, Fukuoka), on 3rd March 2011. The Hakata Hankyu store is located in retail premises in the new JR Hakata Station building, which was completed in conjunction with the opening of the last planned Shinkansen line in Kyushu. The department store, located near the rail terminal, has a retail area of approximately 42,000m<sup>2</sup>. We have developed the store and its retail spaces to maximize the store's prime location, and sales have been stronger than expected since it opened.

In the Tokyo metropolitan area, we have been pushing ahead with the redevelopment of a site in front of JR Oimachi Station (Shinagawa Ward) since the spring of 2008. In March 2011, the first phase of the redevelopment project was completed with the opening of Hankyu Oimachi Garden, which includes a 1,100 room business hotel and a Hankyu Department Store food outlet called Oi Hankyu Food Hall.

Meanwhile, we closed Shijo Kawaramachi Hankyu Department Store (Shimogyo Ward, Kyoto City) on 22nd August 2010 and the Sannomiya Hanshin Food Hall (Chuo Ward, Kobe City) on 31st December 2010 as part of our efforts to boost the profitability of the Group.

Consolidated results for fiscal 2010 were as follows:

### Results for the term

	Millions of yen	YoY %
Net sales	465,034	98.9
Operating income	10,555	131.5
Net income	3,110	103.1

The following is a breakdown of performance by business segment.

### Department Store Business

Due to ongoing renovation work, the retail space at Hankyu Department Store's Umeda Main Store was reduced to around 68% of its former levels (including the "ings" store), despite the launch of operations in September 2009 of Phase I of the renovated southern section. As a result, sales in the Phase I Building were down 19.6% year-on-year through to the second quarter, but recovered to a decline of 1.1% from the third quarter, as the impact from the reduction in retail space eased. Overall, sales at Hankyu Department Store's Umeda Main Store, including sales at the MEN's Emporium, declined by only 9.0% year-on-year, supported by a year-on-year increase in sales at the MEN's Emporium.

Since completing a full renovation of Hanshin Department Store's Umeda Main Store in autumn 2009, we have enhanced our lineup of accessories, ladies clothing and confectionery, sales of which have grown strongly. As a result, sales have risen year-on-year for 14 consecutive months, with sales at the Hanshin Department Store's Umeda Main Store rising 4.2% year-on-year in fiscal 2010.

The closure of Shijo Kawaramachi Hankyu Department Store and Sannomiya Hanshin Food Hall led to a decline in sales at branch stores of approximately ¥3,500 million. However, cumulative sales at other branch stores were essentially the same level as the previous year, declining just 0.7%. The Nishinomiya Hankyu store was an exception, achieving an increase in sales of 13.4% year-on-year, with a locally focused lineup of products and services finding support from local customers.

We opened the Hakata Hankyu store on 3rd March 2011. The store has a retail area of around 42,000m<sup>2</sup>, making it the third largest store in the Group after the Hankyu and Hanshin Main Stores. In order to create a new type of rail terminal-type department store that maximizes the advantages of this vast retail space (around 100,000m<sup>2</sup> when combined with JR Hakata City), and its prime rail terminal location, we have developed the site based on the concept of a store that provides shoppers with new lifestyle ideas. In particular, we created a confectionery sales floor featuring popular brands from across Japan and Hakata Sisters, Kyushu's largest retail venue for youth fashion, with both attracting a high level of interest prior to opening. As a result, sales got off to a strong start and the store recorded stronger than expected sales of ¥4,289 million in March. In addition, registrations for the store's house credit card exceeded initial projections of 200,000 members by the end of March. We plan to ensure the store remains "a fun place to visit and a nice place to shop."

# General Business Conditions

Also in fiscal 2010, we opened Hankyu Department Store Oi Hankyu Food Hall on 16th March. Although the facility is compact, with a retail area of around 2,000m<sup>2</sup>, the store achieved stronger than expected sales of ¥386 million thanks to a sales strategy that has carefully targeted the needs of local shoppers, with a focus on fresh produce and product lineups that change depending on the time of day.

As a result of the foregoing, despite the impact on sales of a reduction in retail area at the Hankyu Department Store's Umeda Main Store and the closure of other stores, which were both anticipated at the start of the fiscal year, operating income was sharply higher than initial projections owing to the success of sales initiatives implemented during the year and efforts to boost management efficiency.

## Department Store Business

	Millions of yen	YoY %
Sales	350,383	97.9
Segment income (Operating income)	8,228	141.5

## Supermarket Business

In the Supermarket Business, we have been developing and opening prototype stores that incorporate new retail ideas since July 2009. In fiscal 2010, we opened the Hankyu Oasis Yamashina store (Yamashina Ward, Kyoto City) in April, the Hankyu Oasis Takarazuka Yamatedai store (Takarazuka City, Hyogo Prefecture) in May and the Hankyu Oasis Awaji store (renovation of existing store; Higashi Yodogawa Ward, Osaka City) in November, with sales from new stores sharply exceeding our projections. Starting with the Hankyu Oasis Minami Senri store (Suita City, Osaka Prefecture) in July 2010, we have also been gradually renovating our network of existing stores, including incorporating new retail ideas from our prototype stores. Sales at these stores have risen by an average of 12.8% after their renovation, and combined sales at existing stores declined by only 0.5% year-on-year in fiscal 2010.

In food production operations, we have been shifting to in-house preparation of delicatessen items since completing our new delicatessen plant in fiscal 2008. In fiscal 2010, profitability in this division improved sharply, partly due to gains in operating efficiency.

As a result of the foregoing, revenues and earnings in the Supermarket Business both exceeded levels in the previous year.

## Supermarket Business

	Millions of yen	YoY %
Sales	90,912	102.8
Segment income (Operating income)	1,737	121.9

## Property Management Business

Looking at the main companies in this business, revenues and earnings fell at Hankyu Shopping Center Development Co., Ltd., which manages and operates retail facilities, while revenues and earnings rose at Hankyu Seisakusho Co., Ltd., which performs interior renovation work, owing to major new orders.

Since 2008, we have continued to push ahead with the redevelopment of a site in front of JR Oimachi Station. In March 2011, Phase I of Hankyu Oimachi Garden was completed with the opening of a 1,100 room business hotel, Ours Inn Hankyu, and a retail facility that includes a Hankyu Department Store food outlet called Oi Hankyu Food Hall. Sales at the retail facility have been stronger than expected since it opened, but room occupancy rates at the hotel have been slightly lower than projected because of the impact of the Great East Japan Earthquake.

As a result, performance in the Property Management Business was as follows.

## Property Management Business

	Millions of yen	YoY %
Sales	13,489	104.7
Segment income (Operating income)	625	82.9

## Other Businesses

Of the 19 existing companies in the Other Businesses segment such as Hankyu Kitchen Yell Kansai, Inc., which provides home delivery services, and Hankyu Design Systems Co., Ltd., which is involved in commercial design, web design and production, photographing & printing, 9 reported an increase in revenues and 11 achieved an improvement in operating income on efforts to boost operating efficiency.

Overall performance in the Other Businesses segment, which includes the holding company H<sub>2</sub>O RETAILING CORPORATION, reflects the impact of the sale of 2 companies—Esaka Logistics Services Co., Ltd. and Hanshin Unso—in October 2009.

#### Other Businesses

	Millions of yen	YoY %
Sales	10,250	92.2
Segment income (Operating income)	1,771	87.3

\* Segment amounts for the previous fiscal year have been adjusted in line with the reportable segments for the year under review to facilitate a year-on-year comparison.

#### Management Issues to be Resolved

In light of changes in the social environment such as increased competition across industry sectors and business categories as well as an aging society with declining birthrates, the Group instituted the GP10 Plan, a long-term business plan for the expansion of its business through the opening of new stores. At the same time, the Group has taken steps to upgrade its business foundation by raising the earning capacity of existing stores and business companies. However, in addition to changes in the social environment, sudden changes consumption have emerged since the financial crisis struck in the autumn of 2008. The construction of a new business model to deal with these changes is now a crucial issue for the management of H<sub>2</sub>O RETAILING CORPORATION.

In the department store business, the reconstruction of the Hankyu Umeda Main Store is moving forward with completion scheduled for the third quarter of fiscal 2012. By forging a balance between the Hankyu and Hanshin Main Stores that is both competitive and complimentary, through a well defined product line-up, trusted brand image as well as our credit card policies and the sharing of customer traffic between these stores, the Group will build a firm business foundation in the Umeda area.

In addition, we are clarifying the competitive position of the supermarket business, and in 2009 we developed prototype stores that introduced a new retailing approach as a new business model for creating profitable food supermarkets. To raise store earning capacity, we will open new stores based on this new business model and gradually convert existing stores to the new model as well. At the same time, we are moving further ahead with the integrated production and marketing of our own delicatessen items at our delicatessen facility.

In fiscal 2002, we developed a home delivery business in the Kansai business area which we plan to roll out in the Tokyo metropolitan area and in Kyushu. In conjunction with these plans, we have expanded the delivery platform business that provides home delivery system know-how to customers throughout Japan. In this way, we will expand

our market share in the Kansai business area by creating our own business model that incorporates retail businesses including department stores, food supermarkets and the home delivery business. We are also establishing a business foundation in Kyushu and the Tokyo metropolitan area with the goal of building a strong business group that can survive future competition.

# Corporate Governance System

## 1) Corporate Governance System

Outline and Rationale of Corporate Governance System in the H<sub>2</sub>O Retailing Group, H<sub>2</sub>O Retailing Corporation (the Company), a holding company, is responsible for the business planning, management and oversight of the entire Group. It seeks through proper and legal means to raise the corporate value of Group companies by building a corporate governance system in order to create a fast-acting and efficient company. The Company has adopted a company with corporate auditor system and has appointed several highly independent outside directors (board directors and corporate auditors). As a holding company, the Company has enhanced its management and oversight functions of the business conduct in the Group companies through stronger oversight of corporate auditors.

The Board of Directors and Board of Corporate Auditors are explained below.

(Board of Directors)

The Board of Directors is comprised of 10 members, with one highly independent directors with corporate management experience appointed from outside the Company.

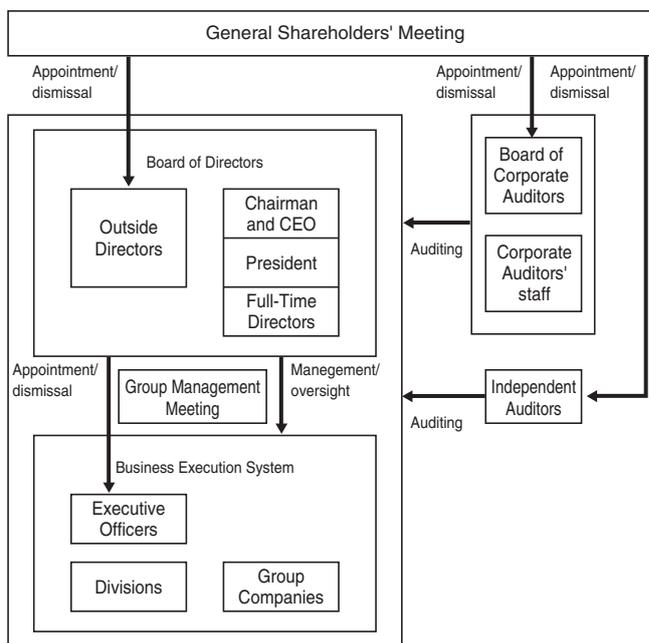
(Board of Corporate Auditors)

The Board of Corporate Auditors is comprised of 4 members, with 3 of them highly independent corporate auditors including specialists with corporate management and legal experience appointed from outside the Company.

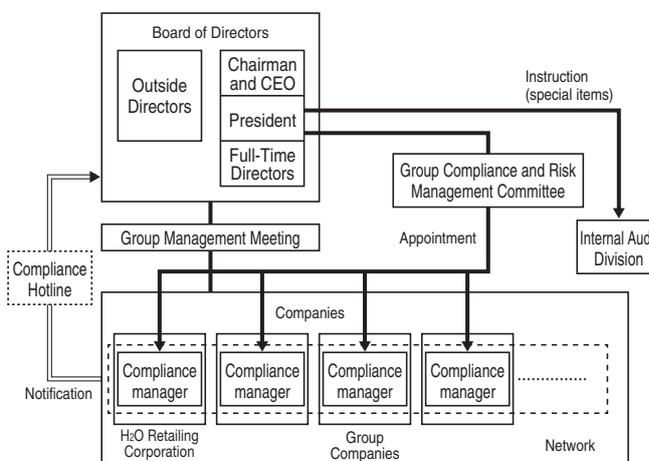
In addition, for swift decision making and management efficiency of the Group, the Group Management Meeting was established as the fronting body for the Board of Directors, making decisions on important matters for the Group companies. Group companies including H<sub>2</sub>O Retailing Corporation have clearly defined business execution responsibilities through the adoption of an executive officer system. The directors and the board of directors of each company have adopted this system for managing and overseeing the business execution of executive officers.

Corporate auditors and the board of corporate auditors oversee the business execution of directors, the board of directors and executive officers.

To clearly define the responsibilities of directors and executive officers, a term of 1 year has been established.



## 2) Internal Control and Risk Management System



The H<sub>2</sub>O RETAILING Group has a code of conduct stipulating basic principles so that executives and employees will act based on the Companies' ethics, laws, rules and regulations. The Companies strive to have the code of conduct embraced by both executives and employees. Lectures are held in each subsidiary to enhance consciousness of compliance and to develop a mastery of the basic knowledge of compliance.

To ensure that the directors and employees of the H<sub>2</sub>O RETAILING Group act strict in compliance with the law and the Company's internal regulations, the Company has drawn up the Group Compliance Regulations, which lay down the basic policies and rules to be followed for the implementation of compliance within the Group. The president of H<sub>2</sub>O RETAILING Corporation has final responsibility for all compliance related matters at the Group level.

The H<sub>2</sub>O RETAILING Group has set up the Group Compliance and Risk Management Committee to take the lead in the creation of a system for ensuring compliance throughout the Group. The Group Compliance and Risk Management Committee is chaired by the president of the Company, with whom final responsibility rests for all compliance related matters.

The Group Compliance and Risk Management Committee designates the president of each Group company as the officer with final responsibility for compliance matters at the company in question, with the exception of H<sub>2</sub>O RETAILING CORPORATION, Hankyu Hanshin Department Stores, Inc. and Hanshoku Co., Ltd., in whose case the director (or executive officer) in charge of general affairs has final responsibility. Meetings are held with the attendance of officers involved in compliance from all Group companies so as to share information on compliance related measures and report on progress in the implementation of such measures.

Moreover, a Group Compliance Hotline, or whistleblower system, has been established, and a Compliance Hotline has also been established in Hankyu Hanshin Department Store and Hanshoku, the core business companies within the Group.

The Company plans to draw up a new set of rules regarding disciplinary measures to be taken in the event of an illegal or improper act by a director or employee of the Company or any other Group company. The Company will also designate an internal audit officer(s) with responsibility for group-wide business and accounting and will draw up a set of rules relating to internal auditing without delay.

As for the Risk Management Systems, the Companies have stipulated basic policies and rules relating to risk management and have established risk management regulations which include guidelines for risk prevention, for reporting risks when they occur, for measures to take when risks occur and for how to implement those measures.

At the Group Compliance and Risk Management Committee, the Company formulates measures to gather and deal with risk information, and constructs the system which the companies implement to deal with each risk voluntarily and systematically to prevent risks and minimise loss caused when risks occur.

The officer responsible for compliance matters at each group company will also be responsible for overseeing measures related to the monitoring and analysis of risk factors at that company, as well as measures to prevent the realisation of risks and measures to minimise the impact of such risks in the event that they are realised (contingency planning). A compliance network will be constructed that facilitates

liaising on compliance matters, and regular compliance meetings will be held to share information on risks affecting Group companies.

### **3) Internal Audits, Corporate Auditors' Audits and Accounting Audits**

The Company has 4 corporate auditors, 3 outside corporate auditors and 1 full-time auditor. The Company assigns professionals with corporate management experience and specialised knowledge of the law or other subjects as outside corporate auditors. Professionals from within the Company with substantial knowledge of finance and accounting experience in the Company or those who have served as accountants in the Company or as accounting managers are assigned as full-time corporate auditors. In addition, a corporate auditors' staff of six works in the Corporate Auditors' Office to augment the corporate auditors' audit.

In the consolidated reporting period, the internal audit division (4 members) and The officer in charge of financial reporting as stipulated in the Financial Instruments and Exchange Act (J-SOX) (3 members) were responsible for internal audits. They worked to strengthen the audit function by making proposals for improvements based on regular interviews and on-site audits and assessing the internal control systems for financial reports and work processes.

In the consolidated reporting period, following audit plans for the corporate auditors' audit, the corporate auditors attend regular meetings with directors and the president. Outside corporate auditors give their opinion and ask questions, as necessary, from the standpoint of a specialist with extensive business management experience or an attorney. All full-time corporate auditors attend the monthly Group Management Meeting, the weekly 830 Meetings and the Group Compliance and Risk Management Committee, which is held as needed. The full-time corporate auditors express their opinions at these meetings as necessary and inspect final decision reports on key matters as well as the minutes of meeting. They are also directly briefed on the execution of Company business affairs by the internal control division (Control Office, General Affairs Office, System Planning Office, etc.). Regarding the auditing of subsidiaries, full-time corporate auditors assume the position of corporate auditors of Hankyu Hanshin Department Stores, Inc., a core company, while corporate auditors' staff assumes the position of dedicated auditors and augments the audit system for corporate auditors of other subsidiaries. At the same time, they work to perform more effective audits by closely monitoring the site through auditing visits, holding a weekly Group Board of Corporate Auditors' meeting and verifying the progress of the audit plan.

With respect to internal audits, the Group has strengthened its auditing function by having full-time corporate auditors

# Corporate Governance System

verify the audit plan (particularly for the business audit at the beginning of a term), receive monthly reports on audit plan progress and the results of findings and exchange views.

The Company has designated KPMG AZSA LLC. as its accounting auditing firm. The certified public accountants who executed the accounting audit were Mr. Takashi Yoshida, Mr. Katsuhiro Wakita and Mr. Yusuke Kawasaki. 10 other certified public accountants and 17 other staff assisted them with the audit. In drafting the accounting audit plan, the auditors bounce opinions about important accounting audit matters off of each other. Full-time corporate auditors receive monthly audit result reports, and at the Board of Corporate Auditors, close coordination is maintained through mutual verification of audit plan progress.

At the Board of Corporate Auditors, details of the audit status are reported and explained by full-time corporate auditors, and an audit consensus is formed through the discussion of business issues.

#### 4) Outside Directors and Outside Corporate Auditors

The Company has 1 outside director and 3 outside corporate auditors.

##### Relationship with Outside Directors and Outside Corporate Auditors

Mr. Yohsaku Fuji was appointed as an outside director for his management supervisory and investigative skills based on his extensive management experience and broad insight. Furthermore, since the Company has determined that he has no conflict of interest with shareholders and has no cause for it as defined by the stock exchange, Mr. Yohsaku Fuji has

been appointed as an independent director. Outside director Mr. Yohsaku Fuji also has no special interests in the Company.

Mr. Hideyuki Takai was appointed as an outside corporate auditor for his management supervisory and investigative skills based on his career as former president and former representative director of Toho Co., Ltd., a core company of the Hankyu Hanshin Toho Group. The Toho Co., Ltd., of which outside corporate auditor Mr. Hideyuki Takai is the president and representative director, has business relationships with the Hankyu Hanshin Department Stores, Inc., which include the rental of real estate.

Mr. Takeshi Nakagawa was appointed as an outside corporate auditor for his management supervisory and investigative skills based on his extensive management experience and broad insight. Furthermore, since the Company has determined that he has no conflict of interest with shareholders and has no cause for it as defined by the stock exchange, Mr. Takeshi Nakagawa has been appointed as an independent director. Outside corporate auditor Mr. Takeshi Nakagawa also has no special interests in the Company.

Mr. Toshihisa Takamura was appointed as an outside corporate auditor for his management supervisory and investigative skills based on his deep insight as an attorney. Furthermore, since the Company has determined that he has no conflict of interest with shareholders and has no cause for it as defined by the stock exchange, Mr. Toshihisa Takamura has been appointed an independent director. Outside corporate auditor Mr. Toshihisa Takamura also has no special interests in the Company.

#### Main Activities of Outside Directors and Outside Corporate Auditors during the Reporting Period

Classification	Name	Main Activities
Director	Yohsaku Fuji	Attended all 7 Board of Directors' meeting (excluding written resolutions) held during the reporting period, giving his opinion on measures and asking questions based on his extensive management experience.
Corporate Auditor	Hideyuki Takai	Attended 6 of 7 Board of Directors' meetings (excluding written resolutions) and all 8 Board of Corporate Auditors' meeting held during the reporting period, giving his opinion on measures and asking questions based on his extensive management experience.
Corporate Auditor	Takeshi Nakagawa	Attended all 7 Board of Directors' meeting (excluding written resolutions) and all 8 Board of Corporate Auditors' meetings held during the reporting period, giving his opinion on measures and asking questions based on his extensive management experience.
Corporate Auditor	Toshihisa Takamura	Attended all 7 Board of Directors' meeting (excluding written resolutions) and all 8 Board of Corporate Auditors' meetings held during the reporting period, giving his opinion on measures and asking questions based primarily on his specialised knowledge as an attorney.

## 5) Compensation for Directors and Corporate Auditors

For directors we have instituted a system of compensation that allows for higher incentives for improving short and medium-to long-term performance. Specifically, it consists of the following 3 components: 1) a monthly salary which is not directly linked to the performance that director is compensated for, 2) an annual bonus that reflects single-year performance and other factors, and 3) stock option-based compensation that is linked to stock price. However, the compensation for part-time directors including outside directors consists only of monthly compensation, in consideration of their function. Moreover, compensation for corporate auditors, just as for part-time directors, consists only of monthly compensation, in consideration of their function, and is determined through discussion with the corporate auditors, taking into account directors'

compensation.

The maximum compensation paid by the Company is based on a resolution of the General Shareholders' Meeting and is outlined below.

a. At the 69th Ordinary General Shareholders' Meeting (held on June 29th, 1988), basic compensation was set at a maximum of ¥26 million per month for all directors and at a maximum of ¥4 million per month for all corporate auditors.

b. Bonuses are decided at each General Shareholders' Meeting.

c. At the 89th Ordinary General Shareholders' Meeting (held on June 24th, 2008), it was resolved that stock option-based compensation for directors (excluding outside directors) would be based on a different framework from the monthly compensation described in a. above, and set at a maximum annual compensation of ¥120 million.

Classification	Total compensation (millions of yen)	Total compensation by type (millions of yen)			Number of directors receiving
		Basic compensation	Stock option-based compensation	Bonus	
Director (excluding outside directors)	245	181	35	29	9
Corporate auditors (excluding outside corporate auditors)	25	25	-	-	1
Outside directors	29	29	-	-	4

## 6) Shareholdings

a. Number of different investment securities and the total balance sheet value of those investment securities whose purpose for holding is for other than net investment purposes.

Number of different stocks	65
Balance sheet value	¥43,395 million

b. Description, number of shares, balance sheet value and purpose for holding of investment securities whose purpose of holding is for other than net investment purposes.

In the year ended 31st March 2010

Stock	Number of shares	Balance sheet value (Millions of yen)	Purpose of holding
Takashimaya Co., Ltd.	33,083,000	25,408	To strengthen relationship between both companies through business partnership
Toho Co., Ltd.	13,664,280	20,578	To strengthen relationship with the Hankyu Hanshin Toho Group
Mitsubishi UFJ Financial Group, Inc.	2,949,110	1,445	For financial policy reasons
Mitsubishi Logistics Corporation	1,109,000	1,289	To strengthen business management relationship
Toho Real Estate Co., Ltd.	840,236	418	To strengthen relationship with the Hankyu Hanshin Toho Group
Asahi Breweries, Ltd.	217,000	380	To strengthen business management relationship
Sumitomo Mitsui Financial Group, Inc.	117,168	362	For financial policy reasons
T & D Holdings, Inc.	154,400	342	For financial policy reasons
Daiwa Securities Group Inc.	504,998	248	For financial policy reasons
Resona Holdings, Inc.	78,445	93	For financial policy reasons

# Corporate Governance System

In the year ended 31st March 2011

Stock	Number of shares	Balance sheet value (Millions of yen)	Purpose of holding
Takashimaya Co., Ltd.	33,083,000	17,567	To strengthen relationship between both companies through business partnership
Toho Co., Ltd.	13,664,280	16,301	To strengthen relationship with the Hankyu Hanshin Toho Group
Mitsubishi UFJ Financial Group, Inc.	2,949,110	1,132	For financial policy reasons
Mitsubishi Logistics Corporation	1,109,000	1,031	To strengthen business management relationship
Toho Real Estate Co., Ltd.	840,236	437	To strengthen relationship with the Hankyu Hanshin Toho Group
T & D Holdings, Inc.	154,400	317	For financial policy reasons
Sumitomo Mitsui Financial Group, Inc.	117,168	303	For financial policy reasons
Asahi Breweries, Ltd.	217,000	300	To strengthen business management relationship
Daiwa Securities Group Inc.	504,998	193	For financial policy reasons
Chuo Mitsui Trust Holdings, Inc.	247,523	73	For financial policy reasons
Toyo Seikan Kaisha, Ltd.	33,000	45	To facilitate business activity
Onward Holdings Co., Ltd.	68,672,959	42	To strengthen business management relationship
Asahi Broadcasting Corporation	90,000	37	To facilitate business activity
The Sankei Building Co., Ltd.	66,528	33	To facilitate business activity
Resona Holdings, Inc.	78,445	31	For financial policy reasons
Tokio Marine Holdings, Inc.	12,600	28	For financial policy reasons
Kubota Corporation	20,000	16	To facilitate business activity
Aplus Financial Co., Ltd.	294,368	15	To strengthen business management relationship
Tokyo Rakutenchi Co., Ltd.	55,000	14	To strengthen relationship with the Hankyu Hanshin Toho Group
Mitsubishi Heavy Industries, Ltd.	30,000	11	To facilitate business activity
Osaka Securities Finance Co., Ltd.	60,000	10	For financial policy reasons
Fukushima Industries Corp.	7,350	7	To facilitate business activity
Tokyo Theatres Company, Incorporated	50,000	6	To facilitate business activity
Asahi Kasei Corporation	10,000	6	To facilitate business activity
Tobu Railway Co., Ltd.	15,450	5	To facilitate business activity
Nippon Telegraph And Telephone Corporation	1,020	4	To facilitate business activity
Kobayashi Pharmaceutical Co., Ltd.	900	3	To strengthen business management relationship
Mizuho Securities Co., Ltd.	13,784	3	For financial policy reasons
Tokyo Dome Corporation	15,434	3	To facilitate business activity
Taisho Pharmaceutical Co., Ltd.	1,000	2	To facilitate business activity

c. Investment securities whose purpose for holding is for net investment purposes

None

d. Investment securities whose purpose for holding has changed

None

# Five-Year Summary

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

Years ended 31st March	Millions of yen					Thousands of U.S. dollars (Note1)
	2007	2008	2009	2010	2011	2011
<b>For the year:</b>						
Net sales .....	¥395,950	¥471,617	¥509,525	¥470,395	¥465,034	\$5,602,819
Cost of sales .....	279,365	334,688	364,028	339,027	335,876	4,046,698
Gross profit .....	116,585	136,929	145,497	131,368	129,158	1,556,121
Selling, general and administrative expenses.....	101,821	119,815	132,080	123,344	118,603	1,428,952
Interest expense .....	125	72	98	337	393	4,735
Income before income taxes .....	14,308	16,905	9,449	5,766	5,847	70,446
Net income .....	8,100	9,450	6,380	3,017	3,110	37,470
Comprehensive income .....	—	—	—	8,070	(5,632)	(67,855)
Per share data (in yen and dollars)						
Net income - basic .....	43.23	50.07	31.02	14.62	15.07	0.18
Net income - diluted .....	38.99	45.19	28.23	13.30	13.70	0.17
Cash dividends .....	12.50	12.50	12.50	12.50	12.50	0.15
<b>At year-end:</b>						
Inventories .....	¥13,050	¥15,686	¥16,916	¥15,319	¥15,597	\$187,916
Property, plant and equipment (book value) ...	74,788	80,892	87,396	91,526	106,905	1,288,012
Total assets .....	282,759	337,778	323,044	344,700	344,188	4,146,843
Long-term debt .....	23,044	21,159	40,921	60,755	40,589	489,024
Shareholders' equity .....	121,180	147,165	150,297	150,720	151,237	1,822,132
<b>Ratio analysis:</b>						
Gross profit / Net sales (%) .....	29.44	29.03	28.56	27.93	27.77	
Income before income taxes / Net sales (%) ...	3.61	3.58	1.85	1.23	1.26	
Net income / Net sales (%) .....	2.05	2.00	1.25	0.64	0.67	
Net income / Total assets (%) .....	2.90	3.05	1.93	0.90	0.90	
Net income / Shareholders' equity (%) .....	5.75	6.15	4.02	1.93	2.00	
Shareholders' equity / Total assets (%) .....	50.64	48.52	47.62	46.22	43.91	
Long-term debt / Shareholders' equity (times) .....	0.16	0.13	0.27	0.38	0.27	
Net sales / Inventories (times) .....	30.34	30.07	30.12	30.71	29.81	
Net sales / Total assets (times) .....	1.40	1.40	1.58	1.36	1.35	

Note 1: U.S. dollar amounts represent translations of yen amounts at the rate of ¥83 = U.S.\$1.00.

2: As for "Net income / Total assets", the Company uses the average of total assets at the beginning and end of the year.

As for "Net income / Shareholders' equity", the Company uses the average of shareholders' equity at the beginning and end of the the year.

3: A consolidated statements of comprehensive income for the year ended 31st March 2007, 2008 and 2009 was not prepared and therefore is not included.

# Consolidated Balance Sheets

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

As of 31st March, 2009, 2010 and 2011	Millions of yen			Thousands of U.S. dollars (Note1)
	2009	2010	2011	2011
<b>Assets</b>				
<b>Current assets:</b>				
Cash on hand and in banks (Note 8, 29 and 30) .....	¥39,890	¥45,890	¥42,150	\$507,831
Notes and accounts receivable:				
Trade(Note 30) .....	20,613	17,595	18,995	228,855
Other (Note 30) .....	3,738	3,560	2,702	32,554
Allowance for doubtful receivables .....	(157)	(129)	(59)	(711)
	24,194	21,026	21,638	260,698
Inventories (Note 5) .....	16,916	15,319	15,597	187,916
Deferred tax assets (Note 14) .....	5,025	3,485	4,279	51,554
Prepaid expenses and other (Note 4, 9 and 30) .....	3,319	2,916	2,668	32,145
Total current assets .....	89,344	88,636	86,332	1,040,144
<b>Investments and long-term loans receivable:</b>				
Investment securities (Note 4 and 30) .....	63,344	69,990	54,560	657,349
Investments in an unconsolidated subsidiary and affiliates .....	820	808	613	7,386
Long-term loans receivable .....	1,862	1,487	2,569	30,952
Long-term loans to employees .....	179	211	252	3,036
Total investments and long-term loans receivable .....	66,205	72,496	57,994	698,723
<b>Property, plant and equipment:</b>				
Land (Note 8 and 16) .....	32,494	33,948	33,948	409,012
Buildings and structures (Note 8) .....	124,756	120,796	140,770	1,696,024
Machinery and equipment .....	19,078	18,927	21,030	253,373
Construction in progress .....	3,785	4,511	115	1,386
	180,113	178,182	195,863	2,359,795
Accumulated depreciation .....	(92,717)	(86,656)	(88,958)	(1,071,783)
Total property, plant and equipment .....	87,396	91,526	106,905	1,288,012
<b>Other noncurrent assets:</b>				
Long-term leasehold deposits (Note 6) .....	40,956	54,011	56,248	677,687
Goodwill .....	17,971	17,004	16,038	193,229
Intangibles .....	7,180	7,241	7,507	90,446
Deferred tax assets (Note 14) .....	12,487	12,373	10,624	128,000
Other assets .....	1,540	1,465	2,646	31,879
Allowance for doubtful receivables .....	(35)	(52)	(106)	(1,277)
Total other noncurrent assets .....	80,099	92,042	92,957	1,119,964
	¥323,044	¥344,700	¥344,188	\$4,146,843

See accompanying notes.

	Millions of yen			Thousands of U.S. dollars (Note1)
	2009	2010	2011	2011
<b>Liabilities and Net Assets</b>				
<b>Liabilities</b>				
<b>Current liabilities:</b>				
Current portion of bonds (Notes 7, 17 and 30) .....	¥ —	¥ —	¥20,000	\$240,964
Current portion of long-term debt (Notes 7, 8 and 30) .....	238	166	166	2,000
Notes and accounts payable:				
Trade (Note 30) .....	30,456	28,972	32,517	391,771
Other .....	6,708	7,114	18,592	224,000
	37,164	36,086	51,109	615,771
Accrued expenses .....	2,837	2,715	3,356	40,434
Income taxes payable .....	2,886	1,428	2,033	24,494
Consumption tax payable .....	623	551	433	5,217
Advances received .....	32,989	33,344	32,628	393,109
Deferred tax liabilities (Note 14) .....	240	—	4	48
Provision for bonuses to employees .....	4,613	4,733	3,734	44,988
Provision for bonuses to directors and corporate auditors .....	80	58	89	1,072
Provision for loss of store rebuilding .....	3,228	—	1,564	18,843
Provision for loss on store closing .....	—	784	689	8,301
Asset retirement obligations (Note 31) .....	—	—	123	1,482
Provision for business reorganisation of subsidiaries and affiliates .....	971	—	—	—
Other current liabilities .....	2,976	2,757	2,463	29,675
Total current liabilities .....	88,845	82,622	118,391	1,426,398
<b>Long-term liabilities:</b>				
Long-term debt (Notes 7, 8 and 30) .....	40,921	60,755	40,589	489,024
Deferred tax liabilities (Note 14) .....	9,294	13,252	7,495	90,301
Deferred tax liabilities related to land revaluation (Note 16) .....	348	348	348	4,193
Provision for retirement benefits to employees (Note 10) .....	18,292	15,577	15,807	190,446
Provision for retirement benefits to directors and corporate auditors .....	101	104	108	1,301
Provision for loss of store rebuilding .....	1,179	1,189	—	—
Provision for redemption of gift certificates .....	1,785	1,804	1,771	21,337
Long-term payable accrued .....	796	2,279	1,805	21,747
Guarantee deposits .....	7,433	7,200	6,268	75,518
Asset retirement obligations (Note 31) .....	—	—	148	1,783
Other long-term liabilities .....	55	4	21	253
Total long-term liabilities .....	80,204	102,512	74,359	895,891
Total liabilities .....	169,049	185,134	192,750	2,322,289
<b>Net assets (Note 15)</b>				
<b>Shareholders' equity :</b>				
Common stock:				
Authorised - 300,000,000 shares,				
Issued - 206,740,777 shares in 2009, 2010 and 2011 .....	17,797	17,797	17,797	214,422
Capital surplus .....	37,172	37,172	37,172	447,855
Retained earnings .....	95,608	96,045	96,575	1,163,554
Treasury stock - 401,899 shares in 2009				
- 425,885 shares in 2010 .....	(280)	(294)	(307)	(3,699)
- 450,757 shares in 2011 .....				
Total shareholders' equity .....	150,297	150,720	151,237	1,822,132
<b>Accumulated other comprehensive income:</b>				
Net unrealised holding gains on securities .....	3,904	8,933	380	4,579
Land revaluation, net of tax (Note 16) .....	43	43	43	518
Foreign currency translation adjustments .....	(405)	(366)	(514)	(6,193)
Total accumulated other comprehensive income .....	3,542	8,610	(91)	(1,096)
<b>Subscription rights to shares</b> .....	45	139	232	2,795
<b>Minority interests</b> .....	111	97	60	723
Total net assets .....	153,995	159,566	151,438	1,824,554
	¥323,044	¥344,700	¥344,188	\$4,146,843

See accompanying notes.

# Consolidated Statements of Income

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

Years ended 31st March, 2009, 2010 and 2011	Millions of yen			Thousands of U.S. dollars (Note 1)
	2009	2010	2011	2011
<b>Net sales</b> .....	¥509,525	¥470,395	¥465,034	\$5,602,819
<b>Cost of sales (Note 27)</b> .....	364,028	339,027	335,876	4,046,698
Gross profit .....	145,497	131,368	129,158	1,556,121
<b>Selling, general and administrative expenses</b> .....	132,080	123,344	118,603	1,428,952
Operating income .....	13,417	8,024	10,555	127,169
<b>Other income (expenses):</b>				
Interest and dividend income .....	897	941	921	11,096
Equity in losses of affiliated companies .....	(60)	—	(43)	(518)
Amortisation of negative goodwill .....	44	43	44	530
Gain on reversal of provision for loss of store rebuilding .....	58	—	—	—
Gain on sales of property, plant and equipment (Note 19) .....	68	1,994	—	—
Gain on sales of investment securities (Note 4) .....	145	33	137	1,651
Gain on sales of subsidiaries and affiliates stocks .....	—	171	—	—
Gain on reversal of asset retirement obligations (Note 20) .....	—	—	402	4,843
Compensation for transfer (Note 21) .....	—	—	240	2,891
Interest expense .....	(98)	(337)	(393)	(4,735)
Loss of store rebuilding (Note 22) .....	(173)	(154)	(376)	(4,530)
Loss on store closing (Note 23) .....	—	(1,343)	(2,085)	(25,120)
Loss on disposal of property, plant and equipment and intangibles (Note 26) ..	(692)	(861)	(466)	(5,614)
Impairment losses (Note 25) .....	(204)	(3,050)	(226)	(2,723)
Outplacement expenses .....	(1,004)	—	0	0
Expenses for opening new stores (Note 28) .....	(556)	(327)	(1,685)	(20,301)
Loss on revision of retirement benefit plan .....	—	(236)	—	—
Business reorganisation expenses (Note 24) .....	(2,723)	—	—	—
Loss on valuation of investment securities (Note 4) .....	(529)	—	(147)	(1,771)
Loss on provision for redemption of gift certificates .....	(1,058)	(955)	(936)	(11,277)
Environmental expenses .....	—	—	(305)	(3,675)
Loss on adjustment for changes of accounting standard for asset retirement obligations ..	—	—	(174)	(2,096)
Other - net .....	1,917	1,823	384	4,626
	(3,968)	(2,258)	(4,708)	(56,723)
Income before income taxes .....	9,449	5,766	5,847	70,446
<b>Income taxes (Note 14) :</b>				
Current .....	3,577	1,241	1,884	22,699
Deferred .....	(533)	1,523	893	10,759
	3,044	2,764	2,777	33,458
<b>Income before minority interests</b> .....	6,405	3,002	3,070	36,988
<b>Minority interests in net income (losses)</b> .....	25	(15)	(40)	(482)
Net income .....	¥6,380	¥3,017	¥3,110	\$37,470
		Yen		U.S. dollars (Note 1)
<b>Net income per share - basic (Note 33)</b> .....	¥31.02	¥14.62	¥15.07	\$0.18
<b>Net income per share - diluted (Note 33)</b> .....	¥28.23	¥13.30	¥13.70	\$0.17
<b>Cash dividends</b> .....	¥12.50	¥12.50	¥12.50	\$0.15

See accompanying notes.

# Consolidated Statements of Comprehensive Income

H2O RETAILING CORPORATION and Consolidated Subsidiaries

Years ended 31st March, 2010 and 2011	Millions of yen		Thousands of U.S. dollars (Note1)
	2010	2011	2011
<b>Income before minority interests</b> .....	¥3,002	¥3,070	\$36,988
<b>Other comprehensive income</b>			
Net unrealised holding gains on securities .....	5,029	(8,553)	(103,048)
Foreign currency translation adjustments .....	39	(149)	(1,795)
Total other comprehensive income .....	5,068	(8,702)	(104,843)
<b>Comprehensive income</b> .....	¥8,070	(¥5,632)	(\$67,855)
Comprehensive income attributed to:			
Comprehensive income attributable to owners of the parent .....	8,085	(5,592)	(67,373)
Comprehensive income attributable to minority interests .....	(15)	(40)	(482)

A consolidated statements of comprehensive income for the year ended 31st March 2009 was not prepared and therefore is not included.  
See accompanying notes.

# Consolidated Statements of Changes in Net Assets

H2O RETAILING CORPORATION and Consolidated Subsidiaries

Years ended 31st March, 2009, 2010 and 2011	Thousands		Millions of yen									Total
	Number of shares of common stock	Common stock	Capital surplus	Retained earnings	Treasury stock	Net unrealised holding gains (losses) on securities	Deferred hedge gains	Land revaluation, net of tax (Note 16)	Foreign currency translation adjustments	Subscription rights to shares	Minority interests	
<b>Balance at 31st March, 2008</b>	206,740	¥17,797	¥37,172	¥92,388	(¥192)	¥16,840	¥41	¥43	(¥191)	—	¥89	¥163,987
Cash dividends - ¥12.5 per share	—	—	—	(2,581)	—	—	—	—	—	—	—	(2,581)
Net income	—	—	—	6,380	—	—	—	—	—	—	—	6,380
Gain on treasury stock	—	—	—	(579)	(88)	—	—	—	—	—	—	(667)
Land revaluation, net of tax (Note 16)	—	—	—	—	—	—	—	—	—	—	—	—
Decrease in net unrealised holding gains on securities	—	—	—	—	—	(12,936)	—	—	—	—	—	(12,936)
Deferred hedge gains	—	—	—	—	—	—	(41)	—	—	—	—	(41)
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	—	—	(214)	—	—	(214)
Subscription rights to shares	—	—	—	—	—	—	—	—	—	45	—	45
Minority interests	—	—	—	—	—	—	—	—	—	—	22	22
<b>Balance at 31st March, 2009</b>	206,740	¥17,797	¥37,172	¥95,608	(¥280)	¥3,904	—	¥43	(¥405)	¥45	¥111	¥153,995
Cash dividends - ¥12.5 per share	—	—	—	(2,579)	—	—	—	—	—	—	—	(2,579)
Net income	—	—	—	3,017	—	—	—	—	—	—	—	3,017
Gain on treasury stock	—	—	—	(1)	(14)	—	—	—	—	—	—	(15)
Land revaluation, net of tax (Note 16)	—	—	—	—	—	—	—	—	—	—	—	—
Decrease in net unrealised holding gains on securities	—	—	—	—	—	5,029	—	—	—	—	—	5,029
Deferred hedge gains	—	—	—	—	—	—	—	—	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	—	—	39	—	—	39
Subscription rights to shares	—	—	—	—	—	—	—	—	—	94	—	94
Minority interests	—	—	—	—	—	—	—	—	—	—	(14)	(14)
<b>Balance at 31st March, 2010</b>	206,740	¥17,797	¥37,172	¥96,045	(¥294)	¥8,933	—	¥43	(¥366)	¥139	¥97	¥159,566
Cash dividends - ¥12.5 per share	—	—	—	(2,579)	—	—	—	—	—	—	—	(2,579)
Net income	—	—	—	3,110	—	—	—	—	—	—	—	3,110
Gain on treasury stock	—	—	—	(1)	(13)	—	—	—	—	—	—	(14)
Land revaluation, net of tax (Note 16)	—	—	—	(0)	—	—	—	0	—	—	—	—
Decrease in net unrealised holding gains on securities	—	—	—	—	—	(8,553)	—	—	—	—	—	(8,553)
Deferred hedge gains	—	—	—	—	—	—	—	—	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	—	—	(148)	—	—	(148)
Subscription rights to shares	—	—	—	—	—	—	—	—	—	93	—	93
Minority interests	—	—	—	—	—	—	—	—	—	—	(37)	(37)
<b>Balance at 31st March, 2011</b>	206,740	¥17,797	¥37,172	¥96,575	(¥307)	¥380	—	¥43	(¥514)	¥232	¥60	¥151,438

	Thousands of U.S. dollars (Note 1)										
	Common stock	Capital surplus	Retained earnings	Treasury stock	Net unrealised holding gains (losses) on securities	Deferred hedge gains	Land revaluation, net of tax (Note 16)	Foreign currency translation adjustments	Subscription rights to shares	Minority interests	Total
<b>Balance at 31st March, 2010</b>	\$214,422	\$447,855	\$1,157,168	(\$3,542)	\$107,627	—	\$518	(\$4,410)	1,675	\$1,169	\$1,922,482
Cash dividends - \$0.15 per share	—	—	(31,072)	—	—	—	—	—	—	—	(31,072)
Net income	—	—	37,470	—	—	—	—	—	—	—	37,470
Gain on treasury stock	—	—	(12)	(157)	—	—	—	—	—	—	(169)
Land revaluation, net of tax (Note 16)	—	—	(0)	—	—	—	0	—	—	—	—
Decrease in net unrealised holding gains on securities	—	—	—	—	(103,048)	—	—	—	—	—	(103,048)
Deferred hedge gains	—	—	—	—	—	—	—	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	—	(1,783)	—	—	(1,783)
Subscription rights to shares	—	—	—	—	—	—	—	—	1,120	—	1,120
Minority interests	—	—	—	—	—	—	—	—	—	(446)	(446)
<b>Balance at 31st March, 2011</b>	\$214,422	\$447,855	\$1,163,554	(\$3,699)	\$4,579	—	\$518	(\$6,193)	\$2,795	\$723	\$1,824,554

See accompanying notes.

# Consolidated Statements of Cash Flows

H2O RETAILING CORPORATION and Consolidated Subsidiaries

Years ended 31st March, 2009, 2010 and 2011	Millions of yen			Thousands of U.S. dollars (Note 1)
	2009	2010	2011	2011
<b>Cash flows from operating activities:</b>				
Income before income taxes	¥9,449	¥5,766	¥5,847	\$70,446
Depreciation and amortisation	10,104	10,397	9,822	118,337
Loss on disposal of property, plant and equipment and intangibles	692	790	466	5,614
Impairment losses	204	3,630	226	2,723
Decrease in allowance for doubtful receivables	(193)	(10)	(16)	(193)
Increase (decrease) in provision for bonuses to employees	(185)	264	(1,000)	(12,048)
Increase (decrease) in provision for bonuses to directors and corporate auditors	(55)	(22)	31	374
Increase (decrease) in provision for retirement benefits	(123)	(2,319)	234	2,819
Increase (decrease) in provision for loss of store rebuilding	(822)	—	376	4,530
Increase in provision for loss on store closing	—	784	667	8,036
Increase in provision for redemption of gift certificates	100	19	(34)	(410)
Increase (decrease) in provision for business reorganisation of subsidiaries and affiliates	971	(971)	—	—
Interest and dividend income	(897)	(941)	(921)	(11,096)
Interest expense	98	337	393	4,735
Gain on sales of property, plant and equipment	(68)	(1,994)	—	—
Gain on sales of investment securities	(145)	(204)	(137)	(1,651)
Loss on valuation of investment securities	529	—	147	1,771
Decrease (increase) in notes and accounts receivable	3,985	2,622	(1,399)	(16,855)
Decrease (increase) in inventories	(1,229)	1,359	(279)	(3,361)
Increase (decrease) in notes and accounts payable	(5,928)	(1,124)	3,546	42,723
Decrease in consumption tax payable	(952)	(51)	(118)	(1,422)
Other	1,253	2,586	(257)	(3,096)
	16,788	20,918	17,594	211,976
Interest and dividends income received	857	937	915	11,024
Interest expense paid	(44)	(355)	(424)	(5,108)
Income taxes paid	(6,470)	(2,649)	(1,119)	(13,482)
Net cash provided by operating activities	11,131	18,851	16,966	204,410
<b>Cash flows from investing activities:</b>				
Net decrease (increase) in time deposits	100	(5,500)	500	6,024
Purchases of property, plant and equipment	(19,460)	(17,165)	(13,317)	(160,446)
Proceeds from sales of property, plant and equipment	536	53	6	72
Purchases of intangibles	(3,394)	(2,394)	(1,954)	(23,542)
Proceeds from sales of intangibles	15	—	—	—
Purchases of investment securities	(25,816)	(379)	(113)	(1,362)
Proceeds from sales of investment securities	1,543	2,631	1,639	19,747
Payments for exercise of asset retirement obligations	—	—	(525)	(6,325)
Proceeds from sales of investments in subsidiaries resulting in change in scope of consolidation	—	1,515	—	—
Payments of long-term loans receivable	—	—	(1,460)	(17,590)
Proceeds from collection of long-term loans receivable	321	310	401	4,831
Payments for guarantee deposits	—	(15,317)	(4,258)	(51,301)
Proceeds from collection of guarantee deposits	—	736	1,846	22,241
Net cash provided by (used in) investing activities	(46,155)	(35,510)	(17,235)	(207,651)
<b>Cash flows from financing activities:</b>				
Proceeds from long-term debt	20,000	20,000	20,000	240,964
Repayments of long-term debt	(1,324)	(238)	(20,166)	(242,964)
Dividends paid	(2,585)	(2,579)	(2,579)	(31,072)
Proceeds from issuance of stock to minority shareholders	—	—	4	48
Proceeds from sale of treasury stock	2,267	2	1	12
Additions to treasury stock	(2,933)	(16)	(18)	(217)
Other	(1)	(49)	(61)	(735)
Net cash provided by (used in) financing activities	15,424	17,120	(2,819)	(33,964)
<b>Foreign exchange differences of cash and cash equivalents</b>	(222)	39	(152)	(1,831)
<b>Net increase (decrease) in cash and cash equivalents</b>	(19,822)	500	(3,240)	(39,036)
<b>Cash and cash equivalents at beginning of year</b>	54,688	34,866	35,366	426,096
<b>Cash and cash equivalents at end of year (Note 29)</b>	¥34,866	¥35,366	¥32,126	\$387,060

See accompanying notes.

# Notes to the Consolidated Financial Statements

H2O RETAILING CORPORATION and Consolidated Subsidiaries

## 1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements have been prepared in accordance with the provisions set forth in the Japanese Financial Instruments and Exchange Law which took effect on 30th September 2007, and replaced the Japanese Securities and Exchange Law and its related accounting regulations and in conformity with accounting principles generally accepted in Japan (“Japanese GAAP”), which are different in certain respects as to application and disclosure requirements from International Financial Reporting Standards.

H2O RETAILING CORPORATION (“the Company”) and its consolidated domestic subsidiaries maintain their official accounting records in Japanese yen, and the accompanying consolidated financial statements have been restructured and translated into English, with some expanded descriptions, from the consolidated financial statements of the Company prepared in

accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Financial Instruments and Exchange Law. Certain supplementary information included in the statutory Japanese language consolidated financial statements, but not required for fair presentation, is not presented in the accompanying consolidated financial statements.

The translations of the Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan, using the prevailing exchange rate at 31st March 2011, which was ¥83 to U.S.\$1.00. The translations should not be construed as representations that the Japanese yen amounts have been, could have been or could in the future be converted into U.S. dollars at this or any other rate of exchange.

## 2. Summary of Significant Accounting Policies

### Consolidation and investments in affiliates

The accompanying consolidated financial statements include the accounts of the Company and significant companies (together “the Companies”) over which the Company has power of control through majority voting rights or the existence of certain other conditions evidencing control by the Company.

Investments in affiliates over which the Company has the ability to exercise significant influence over operating and financial policies are accounted for by the equity method.

The consolidated financial statements include the accounts of the Company and its 36 (34 in 2010 and 37 in 2009) significant majority owned subsidiaries. All significant inter-company transactions and accounts have been eliminated in consolidation.

In the year ended 31st March 2011, KAETOKU SERVICE Co., Ltd., Hankyu Kitchen Yell Kansai, Inc., and Hankyu Kitchen Yell Tokyo, Inc., have been included within the scope of consolidation due to the establishment. Further, Hankyu Kitchen Yell, Inc. has been removed from the scope of consolidation due to its liquidation. However, any profit or loss generated by the company until the time it was liquidated has been included in the consolidated statements of income and consolidated statements of comprehensive income.

In the year ended 31st March 2010, Hanshin Shouji Co., Ltd., Esaka Logistics Service Co., Ltd. and Hanshin Unso have been removed from the scope of consolidation due to the sale of shares held in those companies.

In the year ended 31st March 2009, several subsidiaries listed below have been removed from the scope of consolidation. Hanshin Department Store, Ltd. (attendant on merger with consolidated subsidiary Hankyu Department Stores, Inc. on 1st October 2008) Hankyu Oasis, Inc.; Hankyu Nissho Store.; Hankyu Family Store Co., Ltd.; Hankyu Fresh Yell Co., Ltd. (as a result of a merger with consolidated subsidiary Hanshoku Co., Ltd. on 1st October

2008) Canteen West Co., Ltd.; Hansel Co., Ltd. (as a result of a merger with consolidated subsidiary HumeK Foods, Inc. on 1st October 2008)

Hanshin Gift Service Co., Ltd. (as a result of a liquidation with effect from 31st January 2009)

Mosaic Realty Co., Ltd. (as a result of a merger with the parent company on 6th February 2009)

The trade name of Hankyu Department Stores, Inc., has been changed to Hankyu Hanshin Department Stores, Inc., and that of HumeK Foods, Inc. has been changed to Heart Dining, Inc.

One of the consolidated subsidiaries has a financial year ending on 31st December. With respect to the period from the subsidiary’s year-end to 31st March, necessary adjustments are made for significant transactions to reflect them appropriately in the consolidated financial statements.

In the elimination of investments in consolidated subsidiaries, the assets and liabilities of the subsidiaries, including the portion attributable to minority shareholders, are evaluated using the fair value at the time the Company acquired control of the respective subsidiary.

The difference between the cost of investments in consolidated subsidiaries and the equity in their net assets at dates of acquisition has been, with minor exceptions, amortised over five to twenty years.

The equity method has been applied to 7 (6 in 2010 and 6 in 2009) affiliates for the year ended 31st March 2011.

Hankyu Hanshin Point Co., Ltd., a newly established company, and EveryD. com, inc. have been included in the scope of the equity-method affiliates following the acquisition of shares in each of these companies. In addition, from the fiscal year ended 31st March 2011, High Security System Co., Ltd. has been removed from the scope of the equity-method affiliates due to the sale of its share holdings. However, any profit or loss generated during the period leading up to the share sell-off has

been included in the consolidated statements of income and consolidated statements of comprehensive income.

Investments in nonconsolidated subsidiaries and non-equity-method affiliates are accounted for at cost because of the immaterial effect on the consolidated financial statements. Income from these nonconsolidated subsidiaries and non-equity-method affiliates is recognised only when the Companies receive dividends.

### **Cash flow statements**

In preparing the consolidated statements of cash flows, cash on hand, readily available deposits and short-term highly liquid investments with maturities not exceeding three months at the time of purchase are considered to be cash and cash equivalents.

### **Securities**

Investment securities consist principally of marketable and nonmarketable equity securities. The Companies categorise the securities as “available-for-sale.” Available-for-sale securities with fair market values are stated at fair value. Unrealised holding gains and losses on these securities are reported, net of applicable income taxes, as a separate component of net assets.

Realised gains and losses on sales of such securities are determined principally by the average cost method. Available-for-sale securities with no fair market value are stated at an average cost.

If the fair market value of available-for-sale securities declines significantly, the securities are stated at fair market value, and the difference between fair market value and the carrying amount is recognised as loss in the period of decline. If the net asset value of available-for-sale securities with no available fair market value declines significantly, the securities are written down to the net asset value and charged to income. In these cases, the fair market value or the net asset value will be carried forward as book value to the next year.

### **Allowance for doubtful receivables**

The allowance for doubtful receivables is provided in amounts management considers sufficient to cover possible losses on collection. With respect to normal trade accounts receivable, it is stated at an amount based on the actual rate of historical bad debts, and for certain doubtful receivables, the uncollectible amount is individually estimated.

### **Inventories**

Inventories are stated at cost (book value is reduced on the basis of declines in profitability and is determined principally by the retail method for merchandise and finished goods, the specific identification method for work in progress and the weighted average method for raw materials and supplies.)

### **Property, plant and equipment**

Property, plant and equipment excluding lease assets: Property, plant and equipment excluding lease assets are carried at cost. Depreciation is computed principally by the declining balance

method at rates based on the estimated useful life of the asset. Expenditures for maintenance and repairs, including minor replacements and betterments, are charged to income as incurred. Buildings acquired after 1st April 1998 (excluding peripheral facilities) are depreciated using the straight-line method.

The estimated useful life of the assets are as follows:

- Buildings and structures: 3 to 50 years
- Machinery and equipment: 4 to 17 years
- Other: 3 to 20 years

Lease assets:

Lease assets under lease contracts that are not deemed to transfer ownership of the leased property to the lessee are depreciated using the straight-line method over the period of the lease, with a residual value at zero.

### **Goodwill**

The difference between the cost of investments in consolidated subsidiaries and the equity in their net assets at the date of acquisition is, with minor exceptions, amortised over 5 to 20 years.

### **Software**

Software is amortised using the straight-line method over the estimated useful life of 5 years.

### **Provision for bonuses to employees**

The Companies accrue estimated amounts of employee bonuses based on the estimated amount to be paid in the subsequent period.

### **Provision for bonuses to directors and corporate auditors**

The Company accrues bonuses for directors and corporate auditors based on the estimated payments to be made after the end of the year.

### **Provision for retirement benefits**

The Companies provide two types of post-employment benefit plans, unfunded lump-sum payment plans and funded contributory and non-contributory pension plans, under which all eligible employees are entitled to benefits based on the level of wages and salaries at the time of retirement or termination, length of service and certain other factors.

Hankyu Hanshin Department Stores, Inc. has a retirement benefits plan which consists of unfunded lump-sum payment plans (50% of the whole plan), contributory pension plans (25% of the whole plan) and non-contributory pension plans (25% of the whole plan). Other subsidiaries also have unfunded lump-sum payment plans, contributory pension plans or noncontributory pension plans. The employees of the Company are all seconded from the consolidated subsidiaries and provided with the respective subsidiary's post-employment benefit plans.

The Companies provide for employees' severance and retirement benefits based on the estimated amounts of projected benefit obligation and the fair value of plan assets.

# Notes to the Consolidated Financial Statements

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Prior service costs are mainly recognised in expenses when incurred, and actuarial gains and losses are recognised in expenses in equal amounts within the average of the estimated remaining service years (mainly over 13 years) commencing with the following period.

With regard to retirement benefits for directors and corporate auditors of some consolidated subsidiaries, the liability for lump-sum payments is stated at the amount which would be required to be paid if they retired as of the balance sheet date.

The Companies have executive officers' severance and retirement benefits. The amount of liability as of 31st March 2009, 2010 and 2011 was ¥27 million, ¥35 million, and ¥34 million (\$410 thousand) respectively.

(Additional Information)

In the year ended 31st March 2009, the Company and its subsidiary, Hankyu Hanshin Department Stores, Inc., resolved to abolish the retirement benefits plan for directors at the Board of Directors' meeting, and the Shareholders meeting approved payments to directors and corporate auditors to settle the allowances for retirement benefits for directors and corporate auditors.

Accordingly, ¥417 million corresponding to the allowances for retirement benefits for the directors and corporate auditors of the two companies was posted under "long-term payables accrued."

## Derivative and hedge accounting

Derivative financial instruments are stated at fair value, and changes in fair value are recognised as gains or losses unless the derivative financial instruments are used for hedging purposes.

All derivative financial instruments are used as hedges and meet certain hedging criteria. The Companies defer recognition of gain or loss resulting from changes in fair value of a derivative financial instruments until the related loss or gain on the hedged items is recognised.

## Translation of foreign currencies

Monetary assets and liabilities denominated in foreign currency are translated into Japanese yen at the rates prevailing at each balance sheet date, and the resulting translation gains or losses are charged to income.

In the translation of the financial statements of the overseas subsidiary, assets, liabilities, revenues and expenses are translated at the rates prevailing at the subsidiary's balance sheet date and shareholders' equity accounts are translated at historical rates. The resulting foreign currency translation adjustments are shown as a separate component of net assets.

## Reclassifications

Certain reclassifications of the financial statements for the year ended 31st March 2009 and 2010 have been made to conform to the presentation for the year ended 31st March 2011.

## Provision for loss of store rebuilding

The Companies made a provision to cover estimated losses arising from the rebuilding of the Umeda Main Store, Hankyu-Oi Building and Oi Development Building. The estimates of these losses were based on historical precedents, the book value of the store's property at the time of demolition, and the estimated cost of the demolition work for the year ended 31st March 2009.

Gain on reversal of provision for loss of store rebuilding for the year ended 31st March 2009 was the reversal of the reserve to cover losses arising from the demolition of the Hankyu Oi Building, which were recorded as extraordinary gains, was made in an amount corresponding to the difference between the estimated and actual expenses.

The Companies made a provision to cover estimated loss arising from the rebuilding of the Hankyu-Oi Building and Oi Development Building. The estimates of these losses were based on historical precedents, the book value of the store's property at the time of demolition, and estimated cost of the demolition work for the year ended 31st March 2010. The estimates of losses were based on historical precedents, the book value of the store's property at the time of demolition and the estimated cost of the demolition work and removal expense with the dismantling construction for the year ended 31st March 2011.

The provision for loss of stores rebuilding in relation to the Umeda Main Store of Hankyu Department Stores was completely reversed following the start of the second phase of construction in fiscal 2009.

## Provision for loss on store closing

To provide for losses incurred from the closing of the Shijo Kawaramachi Hankyu in fiscal 2009 and to provide for losses incurred from the Hanshin Mikage store's floor area reduction in fiscal 2010, the Company posted a reasonably estimated amount of the loss expected from the store closing.

## Provision for redemption of gift certificates

The Company records a liability for gift certificates upon the issuance of the certificates to its customers. If gift certificates are not redeemed by customers within a certain time period, the Company reverses the liability and recognises a gain. A provision is recorded by the Company for the unredeemed gift certificates previously recognised as a gain based on the estimated future redemption of those certificates.

## Provision for business reorganisation of subsidiaries and affiliates

To cover losses on investments in affiliated companies as a result of the reorganisation of the Group's business portfolio, provisions have been made to reserves for this purpose in the estimated amount of such losses. In the consolidated statements of income, these provisions to reserves are posted under the category of "business reorganisation expenses."

## Per share information

Computations of basic net income per share are based on the

weighted average number of shares outstanding during each period. As for diluted net income per share for the years ended 31st March 2009, 2010 and 2011, see Note 33.

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.

### Consumption taxes

Consumption taxes are excluded from the revenue and expense accounts which are subject to such taxes.

## 3. Change in accounting policies

### The Equity Method

Effective from the fiscal year ended 31st March 2011, the Company has adopted “Accounting Standard for the Equity Method” (ASBJ Statement No. 16, issued 10th March 2008) and “Practical Solution on Unification of Accounting Policies Applied to Associates Accounted for Using the Equity Method” (Practical Issues Task Force (“PITF”) No. 24, 10th March 2008.)

This change had no material impact on Company profit or loss.

### Inventories

Effective from the year ended 31st March 2009, the Company and its consolidated subsidiaries adopted the new accounting standard, “Accounting Standard for Measurement of Inventories” (Statement No. 9, issued by ASBJ on 5th July 2006). This change had no material effect on profits and losses.

### Provision for retirement benefits

In consolidated fiscal 2009, the Company began applying the “Partial Amendments to Accounting Standard for Retirement Benefits (Part3)” (Statement No.19, issued by ASBJ on 31st July 2008).

This change had no impact on Company profit or loss or retirement benefit obligations.

### Finance leases

Until the fiscal period ended 31st March 2008, finance leases which did not transfer ownership were accounted for in the same manner as operating leases in accordance with Japanese GAAP.

Effective from the year ended 31st March 2009, the Company and its domestic consolidated subsidiaries have adopted the new accounting standards, “Accounting Standard for Lease Transactions” (Statement No.13, issued by ASBJ on 30th March 2007) and “the Implementation Guidance for Accounting Standards for Lease Transactions” (the Financial Accounting Standard Implementation Guidance No.16, issued by ASBJ on 30th March 2007). The new standard requires the recording of capital leases as ordinary purchase and sale transactions.

Finance lease transactions that are not deemed to transfer ownership of the leased property to the lessee and that were

(Additional Information)

Statements of comprehensive income

Effective from the fiscal year ended 31st March 2011, the Company adopted the “Accounting Standard for Presentation of Comprehensive Income” (Accounting Standards Board of Japan (“ASBJ”) Statement No.25, issued on 30th June,2010). As a result of the adoption, the Company has presented the consolidated statement of comprehensive income in the consolidated financial statements for the fiscal year ended 31st March 2011.

concluded prior to 1st April 2008 continue to be accounted for by the method applied to ordinary operating leases.

This change had no material effect on the profits and losses of the Company.

### Asset retirement obligations

Effective from the fiscal year ended 31st March 2011, the Company and its consolidated domestic subsidiaries adopted “Accounting Standard for Asset Retirement Obligations” (ASBJ Statement No. 18, issued 31st March 2008) and “Guidance on Accounting Standard for Asset Retirement Obligations” (ASBJ Guidance No. 21, issued 31st March 2008).

As a result, in the fiscal year ended 31st March 2011, operating income declined by ¥16 million (\$193 thousand), ordinary income by ¥16 million, and income before income taxes by ¥208 million (\$2,506 thousand). Further, the change in the amount of asset retirement obligations due to the adoption of this accounting standard was ¥1,007 million (\$12,133 thousand) at the beginning of the fiscal year, out of which ¥762 million (\$9,181 thousand) was a portion of the balance of provision for loss on store closing at the end of the previous fiscal year assumed as asset retirement obligations.

### Business combinations

Effective from the fiscal year ended 31st March 2011, the Company and its consolidated domestic subsidiaries adopted “Accounting Standard for Business Combinations” (ASBJ Statement No. 21, issued 26th December 2008), “Accounting Standard for Consolidated Financial Statements” (ASBJ Statement No. 22, issued 26th December 2008), “Partial Amendments to Accounting Standard for Research and Development Costs” (ASBJ Statement No. 23, issued 26th December 2008), “Accounting Standard for Business Divestitures” (ASBJ Statement No. 7, issued 26th December 2008), “Accounting Standard for Equity Method of Accounting for Investments” (ASBJ Statement No. 16, issued 26th December 2008), and “Guidance on Accounting Standard for Business Combinations and Accounting Standard for Business Divestitures” (ASBJ Guidance No. 10, issued 26th December 2008).

# Notes to the Consolidated Financial Statements

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## 4. Investment Securities

The following tables summarise acquisition costs and book values (fair values) of available-for-sale securities with available fair values as of 31st March 2009, 2010 and 2011.

Securities with book values exceeding acquisition costs:

	Millions of yen									Thousands of U.S. dollars		
	2009			2010			2011			2011		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities .....	¥ 21,300	¥ 32,893	¥ 11,593	¥ 45,386	¥ 60,602	¥ 15,216	¥ 20,770	¥ 27,851	¥ 7,081	\$ 250,241	\$ 335,554	\$ 85,313
Government bonds .....	2,952	3,017	65	510	525	15	319	338	19	3,843	4,072	229
Other .....	1,056	1,062	6	1,441	1,477	36	491	508	17	5,916	6,121	205
Total .....	¥ 25,308	¥ 36,972	¥ 11,664	¥ 47,337	¥ 62,604	¥ 15,267	¥ 21,580	¥ 28,697	¥ 7,117	\$ 260,000	\$ 345,747	\$ 85,747

Other securities:

	Millions of yen									Thousands of U.S. dollars		
	2009			2010			2011			2011		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities .....	¥ 25,047	¥ 19,842	(¥ 5,205)	¥ 1,200	¥ 862	(¥ 338)	¥ 25,667	¥ 19,194	(¥ 6,473)	\$ 309,241	\$ 231,253	(\$ 77,988)
Government bonds .....	75	68	(7)	-	-	-	-	-	-	-	-	-
Other .....	1,353	1,319	(34)	968	960	(8)	1,129	1,123	(6)	13,602	13,530	(72)
Total .....	¥ 26,475	¥ 21,229	(¥ 5,246)	¥ 2,168	¥ 1,822	(¥ 346)	¥ 26,796	¥ 20,317	(¥ 6,479)	\$ 322,843	\$ 244,783	(\$ 78,060)

The following table summarises sales of available-for-sale securities for the years ended 31st March 2009, 2010 and 2011:

	Millions of yen									Thousands of U.S. dollars		
	2009			2010			2011			2011		
	Sales	Gains on sales	Losses on sales	Sales	Gains on sales	Losses on sales	Sales	Gains on sales	Losses on sales	Sales	Gains on sales	Losses on sales
Equity securities .....	¥ 90	¥ 152	-	¥ 2,023	¥ 33	¥ 47	¥ 1,383	¥ 137	¥ 17	\$ 16,663	\$ 1,651	\$ 205

Impairment losses on investment securities as of 31st March 2009, 2010 and 2011

The "acquisition cost," which appears in the tables above, is the book value after impairment loss.

The Company incurred impairment losses and recorded losses on valuation of investment securities of ¥529 million at the end of year ended 31st March 2009, and ¥147 million (\$1,771 thousand) at the end of the consolidated fiscal year ended 31st March 2011.

## 5. Inventories

Inventories at 31st March 2009, 2010 and 2011 consisted of the following:

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Merchandise goods and finished goods .....	¥ 16,129	¥ 14,435	¥ 14,830	\$ 178,675
Work in progress .....	102	211	80	964
Raw materials and supplies .....	685	673	687	8,277
	¥ 16,916	¥ 15,319	¥ 15,597	\$ 187,916

## 6. Long-term Leasehold Deposits

In connection with its department store business, the Company has entered into long-term lease agreements for store sites and premises. Under such agreements, lessors in Japan generally require the lessee to make substantial deposits in addition to monthly rental payments. A large

portion of such deposits is refundable, generally by 10 to 15 equal annual installments commencing in the eleventh year of the lease term, with the balance refundable only on termination of the lease. The deposits bear no interest or bear interest only at a nominal rate.

## 7. Short-term Bank Loans and Long-term Debt

There were no short-term bank loans as of 31st March 2009, 2010 and 2011.  
Long-term debt at 31st March 2009, 2010 and 2011 consisted of the following:

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
0.40% to 1.85% loans from banks and others, due through 2011 .....	¥ 21,159	¥ 40,921	¥ 40,755	\$ 491,024
Finance lease obligations .....	296	1,187	1,121	13,506
Zero coupon convertible bonds, due 2011 .....	20,000	20,000	20,000	240,964
	¥ 41,455	¥ 62,108	¥ 61,876	\$ 745,494
Less amounts due within one year .....	(261)	(231)	(20,231)	(243,747)
	¥ 41,194	¥ 61,877	¥ 41,645	\$ 501,747

The conversion price of the zero coupon convertible bonds issued by the Company on 16th August 2004 was ¥982 (\$11.83).  
The convertible bonds are convertible into 20,366,598 shares of common stock as of 31st March 2011.

Annual maturities of long-term debt at 31st March 2011 were as follows:

Year ending 31st March,	Millions of yen	Thousands of U.S. dollars
2012 .....	¥ 20,231	\$ 243,747
2013 .....	232	2,795
2014 .....	229	2,759
2015 .....	35,227	424,422
2016 and thereafter .....	5,957	71,771
	¥ 61,876	\$ 745,494

## 8. Pledged Assets

The following assets were pledged as collateral for the current portion of long-term debt of ¥238 million, ¥166 million and ¥166 million (\$2,000 thousand) and long-term debt of ¥921 million, ¥755 million and ¥589 million (\$7,096 thousand) at 31st March 2009, 2010 and 2011:

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Time deposits .....	¥ 5	¥ 5	¥ -	\$ -
Buildings .....	1,898	1,843	1,787	21,530
Land .....	890	890	890	10,723
	¥ 2,793	¥ 2,738	¥ 2,677	\$ 32,253

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## 9. Deposited Securities

Certain securities, included in investment securities, were deposited with the Ministry of Justice in accordance with the relevant laws regarding the following transactions:

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Installment sales transactions .....	¥ 1,950	¥ -	¥ -	\$ -

## 10. Employees' Severance and Retirement Benefits

The liability for severance and retirement benefits included in the liability section of the consolidated balance sheets as of 31st March 2009, 2010 and 2011 consisted of the following:

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Projected benefit obligation .....	¥ 38,714	¥ 36,701	¥ 36,539	\$ 440,229
Unrecognised actuarial differences .....	(1,932)	(3,034)	(3,235)	(38,976)
Fair value of pension assets .....	(19,349)	(18,908)	(18,941)	(228,205)
Prepaid pension cost .....	859	818	1,444	17,398
Liability for severance and retirement benefits .....	¥ 18,292	¥ 15,577	¥ 15,807	\$ 190,446

Included in the consolidated statements of income for the years ended 31st March 2009, 2010 and 2011 were severance and retirement benefit expenses that comprised the following:

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Service costs - benefits earned during the year .....	¥ 1,620	¥ 1,384	¥ 1,299	\$ 15,651
Interest cost on projected benefit obligation .....	800	741	723	8,711
Expected return on plan assets .....	(438)	(386)	(645)	(7,771)
Amortisation of prior service cost .....	7	-	-	-
Amortisation of actuarial differences .....	15	179	293	3,530
Severance and retirement benefit expenses .....	2,004	1,918	1,670	20,121
Other .....	511	690	416	5,012
Total .....	¥ 2,515	¥ 2,608	¥ 2,086	\$ 25,133

Retirement benefit expenses of the consolidated subsidiaries which have adopted the simplified method are included in service costs.

The discount rate and the rate of expected return on plan assets used by the Companies were both mainly 2.0% for the years ended 31st March 2009, 2010. The discount rate was 2.0% and the rate of expected return on plan assets used by Companies was mainly 3.5% for the year ended 31st March 2011. The estimated

amount of all retirement benefits to be paid at future retirement dates is allocated equally to each service year using the estimated number of total service years. Past service costs are mainly recognised as expenses when incurred, and actuarial gains and losses are recognised in equal amounts mainly over 13 years.

## 11. Lease Transactions

### Finance lease transactions

The Group as lessee

Finance leases that are not deemed to transfer ownership of the leased property to the lessee

(1) Breakdown of lease investment assets

Property, plant and equipment

Store facilities used in the supermarket business (buildings and structures)

(2) Method of depreciation of leased assets

As described in Note 2 "Summary of Significant Accounting Policies-Property, plant and equipment", finance lease transactions that are not deemed to transfer ownership of the leased property to the lessee and that were concluded prior to 1st April 2008 are accounted for by the same method as that applied to ordinary operating leases.

Information, as lessee, for non-capitalised finance leases at 31st March 2009, 2010 and 2011 was as follows:

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Original lease obligations (including finance charges)				
for machinery and equipment .....	¥ 1,088	¥ 727	¥ 428	\$ 5,157
Payments remaining:				
Payments due within one year .....	¥ 175	103	48	578
Payments due after one year .....	212	81	30	362
Total .....	¥ 387	¥ 184	¥ 78	\$ 940

Rental expenses under such non-capitalised finance leases for the years ended 31st March 2009, 2010 and 2011 were ¥274 million, ¥174 million and ¥107 million (\$1,289 thousand), respectively.

### Operating lease transactions

Future lease payments for non-cancellable operating leases.

The Group as lessee

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Payments due within one year .....	¥ 4,911	¥ 5,905	¥ 9,110	\$ 109,759
Payments due after one year .....	12,365	10,515	62,475	752,711
Total .....	¥ 17,276	¥ 16,420	¥ 71,585	\$ 862,470

The Group as lessor

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Payments due within one year .....	¥ 694	¥ 472	¥ 1,244	\$ 14,988
Payments due after one year .....	4,584	4,911	4,836	58,265
Total .....	¥ 5,278	¥ 5,383	¥ 6,080	\$ 73,253

## 12. Derivative Transactions

The Company enters into interest rate swap contracts to manage risk and reduce exposure to interest rate fluctuations and currency swap contracts to manage risk related to marketable securities denominated in foreign currencies. The Company does not use derivatives for leveraging or speculative purposes.

Derivative transactions involve credit risk and market risk. However, the Company is exposed to minimum credit risk from breach of contract because it deals only with highly rated financial institutions. In addition, the Company enters into interest rate and currency swaps to hedge against risks of market fluctuations in relation to interest rates and its assets and liabilities. Accordingly, although profits or losses are

produced temporarily, no profit or loss will be incurred at the expiration of the contracts.

To maintain adequate risk management, the Board of Directors and other persons in management approve derivative transactions and review them as to purpose, content, counterparty and risk.

The Company evaluates hedge effectiveness by comparing the cumulative changes in cash flows or the changes in fair value of the hedged items and the corresponding changes in the hedging derivative instruments, except in cases of obvious hedge effectiveness.

## 13. Segment Information

Segment information for the years ended 31st March 2009, 2010 and 2011, required to be disclosed by the Financial Instruments and Exchange Law of Japan, was as follows:

As of and for the year ended 31st March 2010 and 2011

### 1. General information about reportable segments

The Company Group's reportable segments are components of the Group whose operating results are regularly reviewed by the Board of Directors when making resource allocation and performance assessment decisions, and for which discrete financial information is available.

The Company Group is expanding its business activities primarily in the department stores business, but also in the supermarkets business, property management ("PM") business, and others businesses. Accordingly, the "Department stores," the "Supermarkets," the "PM" and "Other" have each been made reportable segments.

The "Department stores" is primarily engaged in the sale of clothing, accessories, home furnishings, foods, and

# Notes to the Consolidated Financial Statements

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others. The “Supermarkets” is engaged in supermarket operation and food production. The “PM” is engaged in rental management of commercial facilities, hotels, eating and drinking establishments, remodelling, and others. The “Other” is engaged in membership management, home delivery, temporary staffing, information processing, and others.

2. Basis of measurement about reported segment net sales, segment income or loss, segment assets and other items  
The accounting policies for the reportable segments are basically the same as those described in Note 1. Basis of Presenting Consolidated Financial Statements.

Income by the reportable segments are presented on an operating income basis. Intersegment sales and transfers are recognised based on the current market prices.

3. Information about reported segment net sales, segment income or loss, segment assets and other items

As of and for the year ended 31st March 2010	Millions of yen					
	Department stores	Supermarkets	PM	Other	Adjustments	Total
Net sales						
External customers .....	¥ 357,952	¥ 88,440	¥ 12,886	¥ 11,117	¥ -	¥ 470,395
Intersegment .....	201	4,101	3,156	15,643	(23,101)	-
Total net sales .....	¥ 358,153	¥ 92,541	¥ 16,042	¥ 26,760	¥ (23,101)	¥ 470,395
Segment income .....	¥ 5,815	¥ 1,425	¥ 754	¥ 2,027	¥ (1,997)	¥ 8,024
Segment assets .....	¥ 138,712	¥ 42,849	¥ 25,125	¥ 265,479	¥ (127,465)	¥ 344,700
Other items						
Depreciation and amortisation .....	¥ 5,820	¥ 1,815	¥ 442	¥ 2,320	¥ -	¥ 10,397
Investment expenditures for affiliated company accounted for by the equity method .....	256	-	-	540	-	796
Impairment loss .....	3,363	150	117	-	-	3,630
Increase in property, plant and equipment and intangibles .....	¥ 12,846	¥ 2,882	¥ 3,250	¥ 4,533	¥ -	¥ 23,511

As of and for the year ended 31st March 2011	Millions of yen					
	Department stores	Supermarkets	PM	Other	Adjustments	Total
Net sales						
External customers .....	¥ 350,383	¥ 90,912	¥ 13,489	¥ 10,250	¥ -	¥ 465,034
Intersegment .....	177	4,520	3,440	15,518	(23,655)	-
Total net sales .....	¥ 350,560	¥ 95,432	¥ 16,929	¥ 25,768	¥ (23,655)	¥ 465,034
Segment income .....	¥ 8,228	¥ 1,737	¥ 625	¥ 1,771	¥ (1,806)	¥ 10,555
Segment assets .....	¥ 151,850	¥ 41,390	¥ 34,937	¥ 253,298	¥ (137,287)	¥ 344,188
Other items						
Depreciation and amortisation .....	¥ 5,067	¥ 1,858	¥ 478	¥ 2,419	¥ -	¥ 9,822
Investment expenditures for affiliated company accounted for by the equity method .....	-	-	-	600	-	600
Impairment loss .....	374	200	13	-	-	587
Increase in property, plant and equipment and intangibles .....	¥ 11,929	¥ 1,629	¥ 9,740	¥ 3,382	¥ -	¥ 26,680

As of and for the year ended 31st March 2011	Thousands of U.S. dollars					
	Department stores	Supermarkets	PM	Other	Adjustments	Total
Net sales						
External customers .....	\$ 4,221,482	\$ 1,095,325	\$ 162,518	\$ 123,494	\$ -	\$ 5,602,819
Intersegment .....	2,132	54,458	41,446	186,964	(285,000)	-
Total net sales .....	\$ 4,223,614	\$ 1,149,783	\$ 203,964	\$ 310,458	\$ (285,000)	\$ 5,602,819
Segment income .....	\$ 99,133	\$ 20,928	\$ 7,530	\$ 21,337	\$ (21,759)	\$ 127,169
Segment assets .....	\$ 1,829,518	\$ 498,674	\$ 420,928	\$ 3,051,783	\$ (1,654,060)	\$ 4,146,843
Other items						
Depreciation and amortisation .....	\$ 61,048	\$ 22,385	\$ 5,759	\$ 29,145	\$ -	\$ 118,337
Investment expenditures for affiliated company accounted for by the equity method .....	-	-	-	7,229	-	7,229
Impairment loss .....	4,506	2,410	156	-	-	7,072
Increase in property, plant and equipment and intangibles .....	\$ 143,723	\$ 19,627	\$ 117,349	\$ 40,747	\$ -	\$ 321,446

Notes:

1. Adjustment of segment income were ¥(1,997) million and ¥(1,806) million (\$ (21,759) thousand) for the years ended 31st March, 2010 and 2011, respectively, and were comprised of elimination of intersegment transactions.

Adjustment of assets were ¥(127,465) million and ¥(137,287) million (\$ (1,654,060) thousand), and included a ¥(103,617) million and a ¥(102,907) million (\$ (1,239,843) thousand ) offset elimination of investments and capital, a ¥(22,074) million and a ¥(32,467) million (\$ (391,169) thousand) offset elimination of debts and credits and a ¥(1,786) million and a ¥(1,778) million (\$ (21,422) thousand ) adjustment for unrealized gains and losses on fixed assets for the years ended 31st March, 2010 and 2011 respectively.

2. Segment income is an adjustment of operating income in the consolidated statements of income.

(Additional Information)

Effective from the fiscal year ended 31st March 2011, the Company has adopted “Accounting Standard for Disclosures about Segments of an Enterprise and Related Information” (ASBJ Statement No. 17, issued 27th March 2009) and “Guidance on Accounting Standard for Disclosures about Segments of an Enterprise and Related Information” (ASBJ Guidance No.20, issued 21st March 2008).

As of and the year ended 31st March 2009 segment information have not been prepared to conform to the fiscal year 2011, and therefore reclassifications of the segment figure have not been made.

If we reported segment information for the previous consolidated fiscal year by the segmentation method for reportable segments used in the fiscal year in review, we would get the information as shown in the table above. Heart Dining, Inc., Hankyu Seisakusho Co., Ltd., Hankyu Eyewear Co., Ltd., and NTE Co., Ltd. had previously been segmented in “Other,” but following business restructuring implemented on 1st April 2010, these companies were segmented within the “PM” starting from fiscal 2010. The change is reflected in the table above.

(Related Information)

Amortisation of goodwill and unamortised balance by reportable segment

As of and for the year ended 31st March 2011	Millions of yen					
	Department stores	Supermarkets	PM	Other	Adjustments	Total
Goodwill						
Amortisation .....	¥ 503	¥ 507	¥ -	¥ -	¥ -	¥ 1,010
Unamortised balance .....	¥ 8,305	¥ 7,776	¥ -	¥ -	¥ -	¥ 16,081
Negative Goodwill						
Amortisation .....	¥ -	¥ -	¥ 43	¥ -	¥ -	¥ 43
Unamortised balance .....	¥ -	¥ -	¥ 43	¥ -	¥ -	¥ 43
As of and for the year ended 31st March 2011	Thousands of U.S. dollars					
	Department stores	Supermarkets	PM	Other	Adjustments	Total
Goodwill						
Amortisation .....	\$ 6,060	\$ 6,109	\$ -	\$ -	\$ -	\$ 12,169
Unamortised balance .....	\$ 100,060	\$ 93,687	\$ -	\$ -	\$ -	\$ 193,747
Negative Goodwill						
Amortisation .....	\$ -	\$ -	\$ 518	\$ -	\$ -	\$ 518
Unamortised balance .....	\$ -	\$ -	\$ 518	\$ -	\$ -	\$ 518

# Notes to the Consolidated Financial Statements

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

As of and for the year ended 31st March 2009

Business segment information

As of and for the year ended 31st March 2009	Millions of yen					
	Department stores	Supermarkets	PM	Other	Eliminations	Total
Net sales						
External customers .....	¥ 389,792	¥ 87,207	¥ 8,948	¥ 23,578	¥ -	¥ 509,525
Intersegment .....	94	3,344	582	21,510	(25,530)	-
Total net sales .....	389,886	90,551	9,530	45,088	(25,530)	509,525
Operating costs and expenses .....	379,095	89,381	8,238	41,679	(22,285)	496,108
Operating income .....	¥ 10,791	¥ 1,170	¥ 1,292	¥ 3,409	¥ (3,245)	¥ 13,417
Assets .....	¥ 146,140	¥ 42,129	¥ 23,049	¥ 257,196	¥(145,470)	¥ 323,044
Depreciation and amortisation .....	6,152	1,716	480	1,756	-	10,104
Impairment loss .....	-	178	-	25	-	203
Capital expenditure .....	12,646	3,950	210	3,143	-	19,949

Segment	Commodity and business lines
Department stores	Clothing, accessories, foods, Restaurants and coffee shops, general merchandise, services and others
Supermarkets	Supermarkets, food production, purchasing and other food related business
Property management	Rental management of commercial facilities and hotels
Other	Wholesaling, membership management, home delivery, transportation, interior facilities, restaurants, temporary staffing, inform processing

Geographic segment information for the year ended 31st March 2009 was not disclosed since the proportion of amounts attributable to domestic operations to the total amounts were more than 90% for both the total sales and assets.

Overseas sales segment information was not disclosed since overseas sales of the Companies were less than 10% of consolidated net sales.

## 14. Income Taxes

Income taxes consist of corporation, inhabitants and enterprise taxes.

Significant components of the Companies' deferred tax assets and liabilities as of 31st March 2009, 2010 and 2011 were as follows:

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Deferred tax assets:				
Loss carry forwards .....	¥ 5,244	¥ 4,110	¥ 3,311	\$ 39,891
Provision for redemption of gift certificates .....	724	733	721	8,687
Bonuses to employees .....	1,732	1,817	1,405	16,928
Retirement benefits .....	6,921	6,195	6,282	75,687
Loss on disposal of property, plant and equipment .....	470	432	472	5,687
Depreciation .....	89	53	60	723
Impairment losses .....	1,119	2,398	1,772	21,349
Provision for loss of stores rebuilding .....	1,786	499	657	7,916
Retirement benefit trust assets .....	595	493	496	5,976
Provision for loss on store closing .....	-	314	276	3,325
Asset retirement obligations .....	-	-	111	1,337
Other .....	3,482	4,144	4,071	49,048
	22,162	21,188	19,634	236,554
Valuation allowance .....	(1,241)	(1,540)	(902)	(10,867)
Total deferred tax assets .....	20,921	19,648	18,732	225,687
Deferred tax liabilities:				
Deferred gains on real properties .....	(3,459)	(3,954)	(3,826)	(46,096)
Special appropriation to the deferred gains on real properties .....	(21)	-	-	-
Land revaluation of a consolidated subsidiary .....	(1,920)	(1,919)	(1,920)	(23,133)
Valuation gain on investment securities resulting from conversion of retirement benefit trust assets (equity securities) .....	(4,591)	(4,591)	(4,591)	(55,313)
Unrealised holding gains on securities .....	(2,584)	(6,057)	(360)	(4,337)
Other .....	(368)	(521)	(631)	(7,603)
Total deferred tax liabilities .....	(12,943)	(17,042)	(11,328)	(136,482)
Net deferred tax assets .....	¥ 7,978	¥ 2,606	¥ 7,404	\$ 89,205

Net deferred tax assets as of 31st March 2009, 2010 and 2011 were included in the consolidated balance sheets as follows:

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Current assets .....	¥ 5,025	¥ 3,485	¥ 4,279	\$ 51,554
Other noncurrent assets .....	12,487	12,373	10,624	128,000
Current liabilities .....	(240)	-	(4)	(48)
Long-term liabilities .....	(9,294)	(13,252)	(7,495)	(90,301)
Net deferred tax assets .....	<u>¥ 7,978</u>	<u>¥ 2,606</u>	<u>¥ 7,404</u>	<u>\$ 89,205</u>

Reconciliation of the differences between the statutory tax rate and the effective income tax rate was as follows:

	2009	2010	2011
Aggregate statutory income tax rate	40.0%	40.0%	40.0%
Increase (reduction) in taxes resulting from:			
Non-deductible expenses .....	1.2	1.4	4.3
Tax on inhabitants per capita .....	1.7	2.9	2.7
Gain on extinguishment of tie-in shares .....	5.3	-	-
Retained earnings held by affiliated companies .....	7.8	2.3	-
Permanent differences (including dividends) .....	(3.6)	(2.7)	(2.7)
Net operating loss carry-forwards .....	(20.5)	0.5	(5.0)
Amortisation of consolidated goodwill .....	4.1	6.7	6.6
Others .....	(3.8)	(3.2)	1.6
Effective income tax rate .....	<u>32.2</u>	<u>47.9</u>	<u>47.5</u>

## 15. Net Assets

The Japanese Corporate Law (the "Law") became effective on 1st May 2006, replacing the Japanese Commercial Code (the "Code"). The Law is generally applicable to events and transactions occurring after 30th April 2006 and for fiscal years ending after that date.

Under Japanese laws and regulations, the entire amount paid for new shares is required to be designated as common stock. However, a company may, by a resolution of the Board of Directors, designate an amount not exceeding one half of the price of the new shares as additional paid-in capital, which is included in capital surplus.

Under the Law, in cases where a dividend distribution of surplus is made, the smaller of an amount equal to 10% of the dividend or the excess, if any, of 25% of common stock over the total of additional paid-in capital and legal earnings reserve must be set aside as additional paid-in capital or legal earnings reserve. Legal earnings reserve is included in retained earnings in the accompanying consolidated balance sheets.

Under the Code, companies were required to set aside an amount equal to at least 10% of the aggregate amount of cash dividends and other cash appropriations as legal earnings reserve until the total of legal earnings reserve and additional paid-in capital equaled 25% of common stock.

Under the Code, legal earnings reserve and additional paid-in capital could be used to eliminate or reduce a deficit by a resolution of the shareholders' meeting or could be capitalised by a resolution of the Board of Directors. Under

the Law, both of these appropriations generally require a resolution of the shareholders' meeting.

Additional paid-in capital and legal earnings reserve may not be distributed as dividends. Under the Code, however, on condition that the total amount of legal earnings reserve and additional paid-in capital remained equal to or exceeded 25% of common stock, they were available for distribution by resolution of the shareholders' meeting. Under the Law, all additional paid-in capital and all legal earnings reserve may be transferred to other capital surplus and retained earnings, respectively, which are potentially available for dividends.

The maximum amount that the Company can distribute as dividends is calculated based on the nonconsolidated financial statements of the Company in accordance with the Law.

At the Board of Directors' meeting held on 12th May 2011, the Company resolved cash dividends amounting to ¥1,289 million (\$15,530 thousand). These appropriations have not been accrued in the consolidated financial statements as of 31st March 2011. The appropriations were recognised on 2nd June 2011.

The dividend policy is one of the most important policies of the Company. The Company used to focus on maintaining the dividend amount, now the Company considers the dividend amount based on the progress of GP10 Plan ver.3.

During the period of rebuilding of Umeda Main Store, however, the Company is focused on maintaining a dividend of ¥12.5 per share even if sales decrease temporarily.

# Notes to the Consolidated Financial Statements

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

## Stock Information

Changes in number of shares issued and outstanding during the years ended 31st March 2009, 2010 and 2011 were as follows:

Common stock outstanding	Number of shares		
	2009	2010	2011
Balance at beginning of year .....	206,740,777	206,740,777	<b>206,740,777</b>
Increase due to stock exchange .....	-	-	-
Balance at end of year .....	<u>206,740,777</u>	<u>206,740,777</u>	<u><b>206,740,777</b></u>

Treasury stock outstanding	Number of shares		
	2009	2010	2011
Balance at beginning of year .....	183,302	401,899	<b>425,885</b>
Increase due to additions to treasury stock in preparation for allotment of shares ...	4,000,000	-	-
Increase due to purchase of odd-lot shares .....	258,969	28,297	<b>30,047</b>
Decrease due to sales of the Company's shares on the market by a subsidiary ...	3,950,400	-	-
Decrease due to sales of odd-lot shares .....	89,972	4,311	<b>1,175</b>
Decrease due to exercise of stock options .....	-	-	<b>4,000</b>
Balance at end of year .....	<u>401,899</u>	<u>425,885</u>	<u><b>450,757</b></u>

## 16. Land Revaluation

In accordance with the Law Concerning Revaluation of Land, land used for business owned by two consolidated subsidiaries was revaluated. The unrealised gains and losses, net of deferred taxes, were excluded from the statement of income and reported as "Land revaluation, net of tax" in net assets, and the relevant deferred taxes were shown as "Deferred tax liabilities related to land revaluation" in liabilities at 31st March 2009, 2010 and 2011.

Related information was as follows:

Date of revaluations: 28th February 2002 and 31st March 2002	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Book value of land after revaluation .....	¥ 2,387	¥ 2,387	<b>¥ 2,386</b>	<b>\$ 28,747</b>
Market value of land .....	1,872	1,683	<b>1,619</b>	<b>19,506</b>
Difference .....	¥ 515	¥ 704	<b>¥ 767</b>	<b>\$ 9,241</b>

## 17. Stock Purchase Rights

The details of zero coupon convertible bonds due 2011 were as follows:

Date of issue	16th August 2004
The number of stock purchase rights	4,000
Class and number of stock	20,366,598 shares of common stock
The exercise period of stock purchase rights	From 23rd August 2004 to 9th August 2011
The exercise price of stock purchase rights (convertible price)	¥ 982 per share
The stock issuing price and capitalising amount	¥ 982 per share ¥ 491 per share

The exercise price of stock purchase rights (convertible price) would be adjusted if the Company issued new shares at a price below the market price or in other circumstances.

## 18. Stock Options

In the year ended 31st March 2009

### (1) Outline of stock options

	Subscription rights to shares issued on March 2009 as stock options
Title and number of grantees	5 directors, 1 executive officer of the Company, and 4 directors, 8 executive officers of Hankyu Hanshin Department Stores. Inc.
Number of stock options (a)	92,000 common shares
Date of issue	31st March 2009
Exercise condition	No provisions
Intended service period	No provisions
Exercise period	From 1st April 2009 to 31st March 2039

(a) Number of shares means total shares to be issued upon exercise of subscription rights to shares.

### (2) Scale and changes in stock options

The following describes scale and changes in stock options that existed during the fiscal year ended 31st March 2009.

The number of stock options is translated into number of shares.

Fiscal year ended 31st March 2009:

Number of stock options

	Subscription rights to shares issued on March 2009 as stock options		Subscription rights to shares issued on March 2009 as stock options
Before vested		After vested	
As of March 31, 2008	-	As of March 31, 2008	-
Granted	92,000	Vested	92,000
Forfeited	-	Exercised	-
Vested	92,000	Forfeited	-
Outstanding	-	Outstanding	92,000

Price information

Exercise price	¥ 1
Average exercise price	-
Fair value at the grant date	¥ 493

### (3) Valuation method for estimating per share fair value of stock options

Valuation technique used for valuating fair value of stock options is as follows:

Valuation method used Adjusted Black-Scholes option-pricing model

Principal parameters and estimation method

Expected volatility of the underlying stock (Note 1)	32.80%
Remaining expected life of the option (Note 2)	6 years
Expected dividends on the stock (Note 3)	¥ 12.5 per share
Risk-free interest rate during the expected option term (Note 4)	0.86%

Notes 1. The fair value of stock options was calculated on the basis of the Company's weekly share price movements over the period from 31st March 2003 to 23rd March 2009. This period (313 weeks) corresponds to the estimated remaining life of the stock options.

2. This period has been calculated utilising the average period of service for directors (or executive officers) of the Company, and the average period from appointment as director (or executive officer) to the issuing date of the stock options.

3. Projection as of March 2008

4. This figure has been calculated using the compound interest rate on Japanese Government Bonds whose remaining period is similar to that of the stock options as of 31st March 2009.

### (4) Estimation method for number of vested share subscription rights

All of the share subscription rights were vested when granted.

# Notes to the Consolidated Financial Statements

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

In the year ended 31st March 2010

## (1) Outline of stock options

	Subscription rights to shares issued on March 2009 as stock options
Title and number of grantees	5 directors, 1 executive officer of the Company, and 4 directors, 8 executive officers of Hankyu Hanshin Department Stores. Inc.
Number of stock options (a)	92,000 common shares
Date of issue	31st March 2009
Exercise condition	No provisions
Intended service period	No provisions
Exercise period	From 1st April 2009 to 31st March 2039

	Subscription rights to shares issued on March 2010 as stock options
Title and number of grantees	6 directors, 1 executive officer of the Company, and 4 directors, 16 executive officers of Hankyu Hanshin Department Stores. Inc.
Number of stock options (a)	165,000 common shares
Date of issue	31st March 2010
Exercise condition	No provisions
Intended service period	No provisions
Exercise period	From 1st April 2010 to 31st March 2040

(a) Number of shares means total shares to be issued upon exercise of subscription rights to shares.

## (2) Scale and changes in stock options

The following describes scale and changes in stock options that existed during the fiscal year ended March 31, 2010.  
The number of stock options is translated into number of shares.

Fiscal year ended 31st March, 2010:

Number of stock options

	Subscription rights to shares issued on March 2009 as stock options	Subscription rights to shares issued on March 2010 as stock options
Before vested		
As of March 31, 2009	-	-
Granted	-	165,000
Forfeited	-	-
Vested	-	165,000
Outstanding	-	-
After vested		
As of March 31, 2009	92,000	-
Vested	-	165,000
Exercised	-	-
Forfeited	-	-
Outstanding	92,000	165,000

## Price information

	Subscription rights to shares issued on March 2009 as stock options	Subscription rights to shares issued on March 2010 as stock options
Exercise price	¥ 1	¥ 1
Average exercise price	-	-
Fair value at the grant date	¥ 493	¥ 568

(3) Valuation method for estimating per share fair value of stock options

Valuation technique used for valuating fair value of subscription rights to shares issued on March 2010 as stock options is as follows:

Valuation method used Adjusted Black-Scholes option-pricing model

Principal parameters and estimation method

Expected volatility of the underlying stock (Note 1)	37.30%
Remaining expected life of the option (Note 2)	6 years
Expected dividends on the stock (Note 3)	¥12.5 per share
Risk-free interest rate during the expected option term (Note 4)	0.74%

Notes 1. The fair value of stock options was calculated on the basis of the Company's weekly share price movements over the period from 1st October 2007 to 22nd March 2010 (the period from 31st March 2004 to 22nd March 2010 except the period from 31st March 2004 to 30th September 2007). This period corresponds to the estimated remaining life of the stock options.

2. This period has been calculated utilising the average period of service for directors ( or executive officers ) of the Company, and the average period from appointment as director ( or executive officer ) to the issuing date of the stock options.
3. Projection as of March 2009
4. This figure has been calculated using the compound interest rate on Japanese Government Bonds whose remaining period is similar to that of the stock options as of 31st March 2010.

(4) Estimation method for number of vested share subscription rights

All of the share subscription rights were vested when granted.

In the year ended 31st March 2011

(1) Outline of stock options

	Subscription rights to shares issued on March 2009 as stock options
Title and number of grantees	5 directors, 1 executive officer of the Company, and 4 directors, 8 executive officers of Hankyu Hanshin Department Stores. Inc.
Number of stock options (a)	92,000 common shares
Date of issue	31st March 2009
Exercise condition	No provisions
Intended service period	No provisions
Exercise period	From 1st April 2009 to 31st March 2039

	Subscription rights to shares issued on March 2010 as stock options
Title and number of grantees	6 directors, 1 executive officer of the Company, and 4 directors, 16 executive officers of Hankyu Hanshin Department Stores. Inc.
Number of stock options (a)	165,000 common shares
Date of issue	31st March 2010
Exercise condition	No provisions
Intended service period	No provisions
Exercise period	From 1st April 2010 to 31st March 2040

	Subscription rights to shares issued on March 2011 as stock options
Title and number of grantees	6 directors of the Company, and 10 directors, 7 executive officers of Hankyu Hanshin Department Stores. Inc.
Number of stock options (a)	194,000 common shares
Date of issue	31st March 2011
Exercise condition	No provisions
Intended service period	No provisions
Exercise period	From 1st April 2011 to 31st March 2041

(a) Number of shares means total shares to be issued upon exercise of subscription rights to shares.

# Notes to the Consolidated Financial Statements

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

## (2) Scale and changes in stock options

The following describes scale and changes in stock options that existed during the fiscal year ended March 31, 2011.

The number of stock options is translated into number of shares.

Fiscal year ended 31st March, 2011:

Number of stock options

	Subscription rights to shares issued on March 2009 as stock options	Subscription rights to shares issued on March 2010 as stock options	Subscription rights to shares issued on March 2011 as stock options
Before vested			
As of March 31, 2010	-	-	-
Granted	-	-	194,000
Forfeited	-	-	-
Vested	-	-	194,000
Outstanding	-	-	-
After vested			
As of March 31, 2010	92,000	165,000	-
Vested	-	-	194,000
Exercised	-	4,000	-
Forfeited	-	-	-
Outstanding	92,000	161,000	194,000

## Price information

	Subscription rights to shares issued on March 2009 as stock options	Subscription rights to shares issued on March 2010 as stock options	Subscription rights to shares issued on March 2011 as stock options
Exercise price	¥ 1 (\$ 0.01)	¥ 1 (\$ 0.01)	¥ 1 (\$ 0.01)
Average exercise price	-	¥ 520 (\$ 6)	-
Fair value at the grant date	¥ 493 (\$ 6)	¥ 568 (\$ 7)	¥ 492 (\$ 6)

## (3) Valuation method for estimating per share fair value of stock options

Valuation technique used for valuating fair value of subscription rights to shares issued on March 2011 as stock options is as follows:

Valuation method used Adjusted Black-Scholes option-pricing model

### Principal parameters and estimation method

Expected volatility of the underlying stock (Note 1)	34.60%
Remaining expected life of the option (Note 2)	6 years
Expected dividends on the stock (Note 3)	¥12.5 per share (\$ 0.15 per share)
Risk-free interest rate during the expected option term (Note 4)	0.63%

Notes 1. The fair value of stock options was calculated on the basis of the Company's weekly share price movements over the period from 1st October 2007 to 21st March 2011 (the period from 31st March 2005 to 21st March 2011 except the period from 31st March 2005 to 30th September 2007). This period corresponds to the estimated remaining life of the stock options.

2. This period has been calculated utilising the average period of service for directors ( or executive officers ) of the Company, and the average period from appointment as director ( or executive officer ) to the issuing date of the stock options.

3. Projection as of March 2010

4. This figure has been calculated using the compound interest rate on Japanese Government Bonds whose remaining period is similar to that of the stock options as of 31st March 2011.

## (4) Estimation method for number of vested share subscription rights

All of the share subscription rights were vested when granted.

## 19. Gain on Sales of Property, Plant and Equipment

The gain on sales of property, plant and equipment in the year ended 31st March 2009 was mainly due to the sale of land, buildings and structures of Nishinomiya Distribution Centre operated by Hankyu Foods, Inc. for ¥59 million.

The gain on sales of property, plant and equipment in the year ended 31st March 2010 was due to the sale of land of Tsuruno-cho for ¥1,994 million.

## 20. Gain on reversal of asset retirement obligations

The gain on reversal of asset retirement obligations is the difference between estimated and actual expenses on the fulfilment of asset retirement obligations due to the closing of Shijo Kawaramachi Hankyu.

## 21. Compensation for transfer

Compensation for the transfer is for the Awaji Hankyu Family Store's property transferred due to land readjustment in the area surrounding Hankyu Awaji Station.

## 22. Loss of Store Rebuilding

Loss of store rebuilding in the year ended 31st March 2009 consisted of a loss of ¥173 million for the provision for loss of store rebuilding.

Loss of store rebuilding in the year ended 31st March 2010 consisted of a loss of ¥144 million for the cost from the second stage rebuilding construction of the Hankyu Umeda Main Store and a loss of ¥10 million for the provision for loss of store rebuilding.

Loss of store rebuilding in the year ended 31st March 2011 consisted of a loss of ¥376 million (\$4,530 thousand) for the provision for loss of Hankyu Oimachi Garden opening (Phase II) rebuilding.

## 23. Loss on Store Closing

Loss on store closing in the year ended 31st March 2010 consisted of a loss of ¥762 million for the provision for a loss on store closing and a loss of ¥580 million for the impairment loss on Shijo Kawaramachi Hankyu, Hankyu Hanshin Department Stores, Inc.

Loss on store closing in the year ended 31st March 2011 consisted of a loss of ¥1,066 million (\$12,843 thousand) for closing of Sannomiya Hanshin Food Hall, Hankyu Hanshin Department Stores, Inc. and a loss of ¥1,019 million (\$12,277 thousand) \*for Hanshin Mikage store floor area reduction, Hankyu Hanshin Department Stores, Inc.

\* This amount includes provision for loss on store closing of ¥689 million (\$8,301 thousand).

## 24. Business Reorganisation Expenses

Business reorganisation expenses at 31st March 2009 consisted of the following:

	Millions of yen
	<u>2009</u>
Expenses for mergers within department store business .....	¥ 1,265
Expenses for mergers within supermarket business .....	330
Reorganisation expenses incurred in other businesses .....	<u>1,128</u>
	<u>¥ 2,723</u>

Reorganisation expenses incurred in other businesses consist of provision for business reorganisation of subsidiaries and affiliates.

# Notes to the Consolidated Financial Statements

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

## 25. Impairment Losses

The Companies recorded impairment losses in the year ended 31st March 2009 as follows:

Company	Asset Group	Use	Type of Assets	Location	Millions of yen
Hanshoku Co., Ltd.	Kusatsu store	Store	Buildings and structures, machinery and equipment	Kusatsu City, Shiga Prefecture	¥ 178
Hanshin Shoji Co., Ltd	Yao store and other	Store	Buildings and structures, machinery and equipment	Yao City, Osaka Prefecture and other	¥ 25

Hanshoku Co., Ltd. and Hanshin Shoji Co., Ltd. recognised impairment losses on some of their stores because their operating environments became severe with the growing competition.

The recoverable amounts of the assets are the present values of expected cash flows from on-going utilisation and subsequent disposal of the assets based on a discount rate of 5%. As a result, ¥204 million was recorded as total impairment losses.

The Companies recorded impairment losses in the year ended 31st March 2010 as follows:

Company	Asset Group	Use	Type of Assets	Location	Millions of yen
Hankyu Hanshin Department Stores, Inc.	Shijo Kawaramachi Hankyu Kobe Hankyu and other	Store	Buildings and structures, machinery and equipment	Shimogyo-ku, Kyoto City and other	¥ 3,363
Hanshoku Co., Ltd	Kuzuha store and other	Store	Buildings and structures, machinery and equipment	Hirakata City, Osaka Prefecture and other	¥ 150
Hankyu Shopping Center Development Co., Ltd. and other	Mosaic Box and other	Store	Buildings and structures, machinery and equipment	Kawanishi City, Hyogo Prefecture and other	¥ 117

In light of the store closing plan for Shijo Kawaramachi Hankyu, Hankyu Hanshin Department Stores, Inc. recognised impairment losses on Shijo Kawaramachi Hankyu, and with a view toward improving the financial soundness of Hankyu Hanshin Department Stores, Inc., Hanshoku Co, Ltd. and Hankyu Shopping Center Development Co, Ltd. which were facing a harsh earnings environment resulting from increasing competition, recognised impairment losses on some of their stores.

The recoverable amounts of the assets are the present values of expected cash flows from on-going utilisation and subsequent disposal of the assets based on a discount rate of 5%. As a result, ¥3,630 million was recorded as total impairment losses.

Of that amount, an impairment loss of ¥581 million for the Shijo Kawaramachi Hankyu is shown inclusive of loss on store closing.

The Companies recorded impairment losses in the year ended 31st March 2011 as follows:

Company	Asset Group	Use	Type of Assets	Location	Millions of yen	Thousands of U.S. dollars
Hankyu Hanshin Department Stores, Inc.	Hanshin Mikage Sannomiya Hashin Food Hall and other	Store	Buildings and structures, machinery and equipment	Nada-ku, Kobe City and other	¥ 374	\$ 4,506
Hanshoku Co., Ltd	Fushimi store and other	Store	Buildings and structures, machinery and equipment	Hushimi-ku, Kyoto City and other	¥ 200	\$ 2,410
Hankyu Shopping Center Development Co., Ltd. and other	Canmeet Kawasaki and other	Store	Buildings and structures, machinery and equipment	Kawasaki-ku, Kawasaki City and other	¥ 13	\$ 157

With a view toward improving their financial soundness, the Company recognised impairment losses on Hankyu Hanshin Department Store's Sannomiya and Hanshin Food Hall for its closing, on Hanshin Mikage for a reduction in shop floor space, and some stores of Hanshoku Co., Ltd. and Hankyu Shopping Center Development Co., Ltd. for their harsh earnings environments resulting from increasing competition.

The recoverable amounts of the assets are the present values of expected cash flows from on-going utilisation and subsequent disposal of the assets based on a discount rate of 5%. As a result, ¥587 million (\$7,072 thousand) was recorded as total impairment losses.

Of this amount, the ¥330 million (\$3,976 thousand) for Hanshin Mikage and ¥31 million (\$373 thousand) for Sannomiya Hanshin Food Hall is shown inclusive of loss on store closing and loss on adjustment for changes of accounting standard for asset retirement obligations.

## 26. Loss on Disposal of Property, Plant and Equipment and Intangibles

Loss on disposal of property, plant and equipment and intangibles in the year ended 31st March 2009 consisted of losses of ¥275 million on the disposal of buildings and structures, losses of ¥17 million on the disposal of machinery and vehicles, losses of ¥320 million on the disposal of intangibles and losses of ¥80 million on the disposal of other assets.

Loss on disposal of property, plant, equipment and intangibles in the year ended 31st March 2010 consisted of losses of ¥379 million on disposal of buildings and structures, losses of ¥39 million on disposal of machinery and vehicles, losses of ¥204 million on disposal of losses of intangibles and losses of ¥239 million on disposal of other assets.

Loss on disposal of property, plant, equipment and intangibles in the year ended 31st March 2011 consisted of losses of ¥372 million (\$4,482 thousand) on disposal of buildings and structures, losses of ¥5 million (\$60 thousand) on disposal of machinery and vehicles, losses of ¥10 million (\$120 thousand) on disposal of losses of intangibles and losses of ¥79 million (\$952 thousand) on disposal of other assets.

## 27. Reduction in Book Value of Inventories

Reduction in book value of inventories held for ordinary sale due to a decline in profitability in the year ended 31st March 2009, 2010 and 2011 were as follows:

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Cost of sales .....	¥ 154	¥ 207	¥ 181	\$ 2,181

## 28. Expenses for opening new stores

Expenses for opening new stores in the year ended 31st March 2011 consisted of expenses of ¥1,140 million (\$13,735 thousand) for opening expenses of Hakata Hankyu store and expenses of ¥545 million (\$6,566 thousand) for opening expenses of Hankyu Oimachi Garden (Phase I).

## 29. Cash Flows Information

The reconciliation of cash on hand and in banks shown in the consolidated balance sheets and cash and cash equivalents shown in the consolidated statements of cash flows as of 31st March, 2009, 2010, and 2011 is as follows:

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Cash on hand and in banks .....	¥ 39,890	¥ 45,890	¥ 42,150	\$ 507,831
MMF including securities account .....	-	0	0	0
Total .....	39,890	45,890	42,150	507,831
Time deposits with maturities exceeding three months .....	(5,024)	(10,524)	(10,024)	(120,771)
Cash and cash equivalents .....	¥ 34,866	¥ 35,366	¥ 32,126	\$ 387,060

The important non-cash transactions are as follows:

In the year ended 31st March 2010, the reversal of provision for loss of store rebuilding following the launch of the second stage rebuilding construction of the Hankyu Umeda Main Store offset fixed assets. The amount of offset was ¥3,185 million.

In the year ended 31st March 2011, effective from fiscal 2010, the Company has adopted "Accounting Standard for Asset Retirement Obligations" and "Guidance on Accounting Standard for Asset Retirement Obligations." As a result, at the end of fiscal 2010, buildings and structures increased ¥63 million(\$ 759 thousand) and asset retirement obligations increased ¥271 million(\$3,265 thousand).

# Notes to the Consolidated Financial Statements

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

## 30. Financial Instruments

In the year ended 31st March 2010  
(Additional Information)

In consolidated fiscal 2009, the Company began applying “Accounting Standard for Financial Instruments” (Statement No.10 issued by the Accounting Standards Board of Japan on 10th March 2008) and “the Implementation Guidance for Accounting Standards for the Disclosure of Fair Value, etc. of Financial Instruments” (the Financial Accounting Standard Implementation Guidance No.19, issued by the Accounting Standards Board of Japan on 10th March 2008).

### 1. Matters Related to Financial Instruments

#### (1) Policies for Financial Instruments

In accordance with its capital investment plan, the Group procures needed funds (primarily loans from banks and the issuance of bonds). Temporary surplus funds are invested in highly secure financial assets. Derivative transactions are carried out within confines of real demand according to internal control regulations and no speculative transactions are performed.

#### (2) Financial Instruments and their Risks

Notes and accounts receivable and operating receivables, are subject to credit risk. Securities and investment securities are subject to market price volatility risk.

Notes and accounts payable, an operating payable, are almost all subject to payment deadlines of one year or less. Long-term loans and corporate bonds are for the purpose of procuring needed funds mainly for capital investment. Their repayment deadlines are at most five and one-half years after the closing of accounts. Some of them are subject to interest rate risk because of variable interest rates.

Moreover, notes and accounts payable, operating payable, and long-term loans are subject to the liquidity risk of the inability to make payment by the payment due date.

As of the end of the consolidated reporting period, the Group conducted no derivative transactions.

#### (3) Risk Management System for Financial Instruments

##### ① Management of credit risk (risk of customer default of contract)

At Hankyu Hanshin Department Stores, Inc., a consolidated subsidiary, the management of each business unit cooperates with the accounting office concerning notes and accounts receivable, an operating receivables, according to sales management guidelines and routinely monitors the status of key customers by managing due dates and balances for each customer. At the same time, the Company attempts to quickly determine if there are concerns about the collection of payment from the customer due to worsening financial conditions.

Other consolidated subsidiaries also manage in the same way described above.

##### ② Management of interest rate risk

To limit the risk of fluctuation in interest rate payments for long-term debt and corporation bond, the Company conducts interest-rate swap transactions only with major and highly trusted financial institutions according to derivative management guidance.

Consolidated subsidiaries do not conduct interest-rate swap.

##### ③ Management of price volatility risk

The Company and Hankyu Hanshin Department Stores, Inc., invest and properly manage securities and investment securities according to securities management guidance. Other consolidated subsidiaries also manage price volatility risk in the same way described above.

##### ④ Management of liquidity risk

The Company and Hankyu Hanshin Department Stores, Inc., manage liquidity risk for accounts payable and long-term debt following a cash management plan that the financial department prepares and updates based on reports provided by all departments in accordance with accounting rules.

Other consolidated subsidiaries also manage liquidity risk in the same way described above.

### 2. Matters Related to Fair Value of Financial Instruments

The book values recorded in consolidated balance sheet for the fiscal year ended 31st March 2010 (the consolidated closing date for the reporting term), and fair values and differences of them are as follows. Figures for which fair value is not readily determinable are not included in the following chart (See Note 2).

	Millions of yen		
	<b>2010</b>		
	Book value	Fair value	Difference
(1) Cash on hand and in banks .....	¥45,890	¥45,890	¥ -
(2) Notes and accounts receivable-Trade .....	17,595		
Allowance for doubtful receivables .....	(95)		
	<b>17,500</b>	<b>17,500</b>	<b>-</b>
(3) Notes and accounts receivable-Other .....	3,560		
Allowance for doubtful receivables .....	(31)		
	<b>3,529</b>	<b>3,529</b>	<b>-</b>
(4) Securities and investment securities			
Other securities .....	64,426	64,426	-
Total assets .....	<b>131,345</b>	<b>131,345</b>	<b>-</b>
(1) Notes and accounts payable-Trade .....	28,972	28,972	-
(2) Long-term debt - Corporate bonds .....	20,000	19,708	292
(3) Long-term debt - Long-term loans* .....	40,921	40,972	(51)
Total liabilities .....	<b>¥89,893</b>	<b>¥89,652</b>	<b>¥241</b>

\* Figures shown include long-term loans with repayment due dates of one year or less.

Note:

1. Matters related to the method for calculating fair value of financial instruments

#### Assets

(1) Cash on hand and in banks, (2) Notes and accounts receivable-Trade, and (3) Notes and accounts receivable-Other

Because these items have short repayment periods, fair value approximates book value, therefore said book value shall be fair value.

(4) Securities and investment securities

Fair value of these securities depends on their stock market price, while fair value of bonds depends on their stock market price or the price submitted by the correspondent financial institution.

#### Liabilities

(1) Notes and accounts payable-Trade

Because these items have short payment periods, fair value approximates book value, therefore said book value shall be fair value.

(2) Long-term debt - Corporate bonds

Fair value of corporate bonds is their value based on their market value.

(3) Long-term debt - Long-term loans

Fair value of long-term loans is determined by discounting the current value at the assumed applicable interest rates should new loans be taken with the same total principal and interest.

Long-term loans that are based on variable interest rates reflect market interest rates over the short term. In addition, because the Company's credit status has not changed substantially since taking on these loans, and as the fair value approximates book value, said book value shall be fair value.

2. Financial instruments whose fair value is not readily determinable

These financial instruments have no market price and their future cash flow cannot be estimated. Because fair value is not readily determinable, they have not been included in the above table.

	Millions of yen	
	<b>2010</b>	
	Book value	
Unlisted shares .....	¥	<b>6,563</b>
Long-term leasehold deposits .....		<b>54,011</b>
Guarantee deposits .....	¥	<b>7,200</b>

# Notes to the Consolidated Financial Statements

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

## 3. Expected proceeds from redemption after the balance sheet date for monetary claims and securities that have maturities

	Millions of yen			
	Within 1 year	Over 1 year but within 5 years	Over 5 years but within 10 years	Over 10 years
Cash on hand and in banks .....	¥45,890	¥ -	¥ -	¥ -
Notes and accounts receivable-Trade .....	17,595	-	-	-
Notes and accounts receivable-Other .....	3,560	-	-	-
Securities and investment securities .....				
Other securities with maturity (government bonds) .....	190	-	300	-
Other securities with maturity (corporate bonds) .....	-	100	-	-
Total .....	¥67,235	¥100	¥300	¥ -

## 4. Expected proceeds from redemption after the balance sheet date for corporate bonds and long-term loans

	Millions of yen					
	Within 1 year	Over 1 year but within 2 years	Over 2 years but within 3 years	Over 3 years but within 4 years	Over 4 years but within 5 years	Over 5 years
Long-term debt - Corporate bonds ...	¥ -	¥20,000	¥ -	¥ -	¥ -	¥ -
Long-term debt - Long-term loans ...	166	20,166	166	166	20,166	91
Lease obligations .....	65	65	65	63	61	868
Total .....	¥231	¥40,231	¥231	¥229	¥20,227	¥959

In the year ended 31st March 2011

### 1. Matters Related to Financial Instruments

#### (1) Policies for Financial Instruments

In accordance with its capital investment plan, the Group procures needed funds (primarily loans from banks and the issuance of bonds). Temporary surplus funds are invested in highly secure financial assets. Derivative transactions are carried out within confines of real demand according to internal control regulations and no speculative transactions are performed.

#### (2) Financial Instruments and their Risks

Notes and accounts receivable and operating receivables, are subject to credit risk. Securities and investment securities are subject to market price volatility risk.

Notes and accounts payable, an operating payable, are almost all subject to payment deadlines of one year or less. Long-term loans and corporate bonds are for the purpose of procuring needed funds mainly for capital investment. Their repayment deadlines are at most 4 years and 9 month after the closing of accounts. Some of them are subject to interest rate risk because of variable interest rates.

Moreover, notes and accounts payable, operating payable, and long-term loans are subject to the liquidity risk of the inability to make payment by the payment due date.

As of the end of the consolidated reporting period, the Group conducted no derivative transactions.

#### (3) Risk Management System for Financial Instruments

##### ① Management of credit risk (risk of customer default of contract)

At Hankyu Hanshin Department Stores, Inc., a consolidated subsidiary, the management of each business unit cooperates with the accounting office concerning notes and accounts receivable, an operating receivables, according to sales management guidelines and routinely monitors the status of key customers by managing due dates and balances for each customer. At the same time, the Company attempts to quickly determine if there are concerns about the collection of payment from the customer due to worsening financial conditions.

Other consolidated subsidiaries also manage in the same way described above.

##### ② Management of interest rate risk

To limit the risk of fluctuation in interest rate payments for long-term debt and corporation bond, the Company conducts interest-rate swap transactions only with major and highly trusted financial institutions according to derivative management guidance.

Consolidated subsidiaries do not conduct interest-rate swap.

③ Management of price volatility risk

The Company and Hankyu Hanshin Department Stores, Inc., invest and properly manage securities and investment securities according to securities management guidance. Other consolidated subsidiaries also manage price volatility risk in the same way described above.

④ Management of liquidity risk

The Company and Hankyu Hanshin Department Stores, Inc., manage liquidity risk for accounts payable and long-term debt following a cash management plan that the financial department prepares and updates based on reports provided by all departments in accordance with accounting rules.

Other consolidated subsidiaries also manage liquidity risk in the same way described above.

2. Matters Related to Fair Value of Financial Instruments

The book values recorded in consolidated balance sheet for the fiscal year ended 31st March 2011 (the consolidated closing date for the reporting term), and fair values and differences of them are as follows. Figures for which fair value is not readily determinable are not included in the following chart (See Note 2).

	Millions of yen			Thousands of U.S. dollars		
	2011			2011		
	Book value	Fair value	Difference	Book value	Fair value	Difference
(1) Cash on hand and in banks .....	¥42,150	¥42,150	¥ -	\$507,831	\$507,831	\$ -
(2) Notes and accounts receivable-Trade .....	18,995			228,885		
Allowance for doubtful receivables .....	(55)			(662)		
	18,940	18,940	-	228,193	228,193	-
(3) Notes and accounts receivable-Other .....	2,702			32,554		
Allowance for doubtful receivables .....	(2)			(24)		
	2,700	2,700	-	32,530	32,530	-
(4) Securities and investment securities						
Other securities .....	49,014	49,014	-	590,530	590,530	-
Total assets .....	112,804	112,804	-	1,359,084	1,359,084	-
(1) Notes and accounts payable-Trade .....	32,517	32,517	-	391,771	391,771	-
(2) Current portion of Long-term bonds .....	20,000	19,950	50	240,964	240,361	603
(3) Long-term debt - Long-term loans * .....	40,755	40,578	177	491,024	488,892	2,133
Total liabilities .....	¥93,272	¥93,045	¥227	\$1,123,759	\$1,121,024	\$2,735

\* Figures shown include long-term loans with repayment due dates of one year or less.

Note:

1. Matters related to the method for calculating fair value of financial instruments

Assets

(1) Cash on hand and in banks, (2) Notes and accounts receivable-Trade, and (3) Notes and accounts receivable-Other

Because these items have short repayment periods, fair value approximates book value, therefore said book value shall be fair value.

(4) Securities and investment securities

Fair value of these securities depends on their stock market price, while fair value of bonds depends on their stock market price or the price submitted by the correspondent financial institution.

Liabilities

(1) Notes and accounts payable-Trade

Because these items have short payment periods, fair value approximates book value, therefore said book value shall be fair value.

(2) Current portion of Long-term bonds

Fair value of corporate bonds is their value based on their market value.

# Notes to the Consolidated Financial Statements

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

## (3) Long-term debt - Long-term loans

Fair value of long-term loans is determined by discounting the current value at the assumed applicable interest rates should new loans be taken with the same total principal and interest.

Long-term loans that are based on variable interest rates reflect market interest rates over the short term. In addition, because the Company's credit status has not changed substantially since taking on these loans, and as the fair value approximates book value, said book value shall be fair value.

## 2. Financial instruments whose fair value is not readily determinable

These financial instruments have no market price and their future cash flow cannot be estimated. Because fair value is not readily determinable, they have not been included in the above table.

	Millions of yen	Thousands of U.S. dollars
	2011	2011
	Book value	Book value
Unlisted shares .....	¥ 6,159	\$ 74,205
Long-term leasehold deposits .....	56,248	677,687
Guarantee deposits .....	¥ 6,268	\$ 75,518

## 3. Expected proceeds from redemption after the balance sheet date for monetary claims and securities that have maturities

	Millions of yen				Thousands of U.S. dollars			
	Within 1 year	Over 1 year but within 5 years	Over 5 years but within 10 years	Over 10 years	Within 1 year	Over 1 year but within 5 years	Over 5 years but within 10 years	Over 10 years
Cash on hand and in banks .....	¥42,150	¥ -	¥ -	¥ -	\$507,831	\$ -	\$ -	\$ -
Notes and accounts receivable-Trade ...	18,995	-	-	-	228,855	-	-	-
Notes and accounts receivable-Other ...	2,702	-	-	-	32,554	-	-	-
Securities and investment securities ...	-	-	300	-	-	-	3,614	-
Other securities with maturity (government bonds) ...	-	100	-	-	-	1,205	-	-
Other securities with maturity (corporate bonds) ...	-	-	-	-	-	-	-	-
Total .....	¥63,847	¥100	¥300	¥ -	\$769,240	\$1,205	\$3,614	\$ -

## 4. Expected proceeds from redemption after the balance sheet date for corporate bonds and long-term loans

	Millions of yen					
	Within 1 year	Over 1 year but within 2 years	Over 2 years but within 3 years	Over 3 years but within 4 years	Over 4 years but within 5 years	Over 5 years
Long-term debt - Corporate bonds ...	¥20,000	¥ -	¥ -	¥ -	¥ -	¥ -
Long-term debt - Long-term loans ...	166	166	166	35,166	5,091	-
Lease obligations .....	65	65	63	61	61	805
Total .....	¥20,231	¥231	¥229	¥35,227	¥5,152	¥805

	Thousands of U.S. dollars					
	Within 1 year	Over 1 year but within 2 years	Over 2 years but within 3 years	Over 3 years but within 4 years	Over 4 years but within 5 years	Over 5 years
Long-term debt - Corporate bonds ...	\$240,964	\$ -	\$ -	\$ -	\$ -	\$ -
Long-term debt - Long-term loans ...	2,000	2,000	2,000	423,687	61,337	-
Lease obligations .....	783	783	759	735	735	9,699
Total .....	\$243,747	\$2,783	\$2,759	\$424,422	\$62,072	\$9,699

### 31. Asset retirement obligations

Fiscal year ended 31st March 2011

Asset retirement obligations that are recorded on the consolidated balance sheets

#### 1. Outline of the asset retirement obligations

The obligation to restore property to its original state due to a real estate lease agreement for store property, etc.

#### 2. Calculation method of asset retirement obligations

An estimated period of use of 3-20 years and a discount rate of 1.3%-2.2% are used to calculate the amount of the asset retirement obligation.

#### 3. Changes in the total amount of the asset retirement obligations for the fiscal year ended 31st March 2011.

	Millions of yen	Thousands of U.S. dollars
	2011	2011
Balance at beginning of year <sup>1</sup> .....	¥ 1,007	\$ 12,133
Increase due to estimate changes .....	79	952
Increase due to acquisition of property, plant and equipment .....	43	518
Adjustments with passage of time .....	5	60
Decrease due to fulfilment of asset retirement obligations <sup>2</sup> .....	(863)	(10,398)
Balance at end of year .....	¥ 271	\$ 3,265

Notes:

1. This was the balance at the beginning of the fiscal year resulting from the Company's adoption from the fiscal year ended 31st March 2011 of "Accounting Standard for Asset Retirement Obligations" (ASBJ Statement No. 18, issued 31st March 2008) and "Guidance on Accounting Standard for Asset Retirement Obligations" (ASBJ Guidance No. 21, issued 31st March 2008).
2. Because the expense for restoring Shijo Kawaramachi Hankyu, a store of Hankyu Hanshin Department Stores, Inc., to its original state has been fixed, the ¥402 million (\$4,843 thousand) difference between the fixed amount and the estimated amount has been transferred to the gain on reversal of asset retirement obligations.

Based on a resolution of the Board of Directors as of 12th May 2011, the lease agreement of the Kobe Hankyu, a store of Hankyu Hanshin Department Stores, Inc., which is set to expire on 30th September 2012, will not be renewed. Although there is an obligation to restore the property to its original state following closure, negotiations are now in progress, and at this juncture, the amount of the asset retirement obligations remains uncertain.

# Notes to the Consolidated Financial Statements

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

## 32. Related Party Transactions

In the year ended 31st March 2009

(Additional Information)

With effect from the year ended 31st March 2009, the Company applies “Accounting Standards for Disclosure of Related Party Transactions” (Statement No.11 issued by the Accounting Standards Board of Japan on 17th October 2006) and “Implementation Guidance on Accounting Standards for Disclosure of Related Party Transactions” (The Financial Accounting Standard Implementation Guidance No.13, issued by the Accounting Standards Board of Japan on 17th October 2006).

As a result of this change, Osaka Chuo Syokuryo, Hankyu Corporation and Hanshin Electric Railway Co., Ltd. have been added to the scope of disclosure of related party transactions.

1 Transactions with related parties

(a) Directors, corporate auditors and major individual shareholders of the reporting entity of the consolidated financial statements

Classification	Name of company or personal name	Location	Capital or investment	Occupation or business lines	Ownership of voting rights (%)
Director or Corporate Auditor	Hideyuki Takai	-	-	Corporate Auditor for the Company; President of TOHO CO., LTD.	7.27% shares of the Company directly held
Companies in which the director, the corporate auditor or his immediate family own a majority of voting rights	Osaka Chuo Syokuryo	Ibaraki City, Osaka	-	Food wholesaling	-

Nature of relationship	Nature of transactions	Value of transactions	Accounting title	Term-end balance
Rental of real estate	Rental fees	¥ 2,139 million	Prepaid expenses	¥ 187 million
	Common service charge	¥ 273 million	-	-
	Fees for display of signs, etc.	¥ 12 million	-	-
	Lease deposit	-	Long-term leasehold deposits	¥ 3,213 million
Materials procurement	Purchase of foodstuffs for processing	¥ 23 million	Notes and accounts payable-Trade	¥ 1 million

Business terms and policies for determination of business terms

Note 1. Transactions are conducted under third-party beneficiary contracts

2. Transaction amounts are exclusive of consumption taxes; term-end balances ( exclusive of guarantee money paid ) include consumption taxes.

3. Rents for buildings are determined on the basis of current market levels.

4. All other matters are determined according to the general terms and conditions.

5. Immediate family members of Senior Managing Director Shigeru Yasukawa of Hankyu Hanshin Department Stores, Inc., a subsidiary of the company, held 100% of voting rights in Osaka Chuo Shokuryo.

(b) Companies whose parent is the same as the parent of the reporting entity or the other related companies

Classification	Name of company or personal name	Location	Capital or investment	Occupation or business lines	Ownership of voting rights (%)
Subsidiaries of companies that have significant stakes in the reporting entity	Hankyu Corporation	Kita-ku, Osaka City	¥ 100 million	Railway operations, real estate rental and dealership operations, stage revues, retailing	-
	HANSHIN ELECTORIC RAILWAY CO., LTD.	Fukushima-ku, Osaka City	¥ 29,384 million	Railway operations; bus operations; real estate rental and dealership operations; sports business; travel business	14.38% of shares held by the Company

Nature of relationship	Nature of transactions	Value of transactions	Accounting title	Term-end balance
Same person serving concurrently as director or corporate auditor for both parties rental of real estate	Rental fees	¥ 5,252 million	Prepaid expenses	¥ 110 million
			Notes and accounts receivable-Other	¥ 90 million
			Notes and accounts payable-Other	¥ 1 million
	Deposit of guarantee money	¥ 548 million	Long-term leasehold deposits	¥ 7,867 million
Return of guarantee money	¥ 160 million			
Same person serving concurrently as director or corporate auditor for both parties rental of real estate	Rental fees	¥ 2,354 million	Accrued expenses	¥ 556 million
	Fees for display of signs, etc.	¥ 9 million	-	-
	Deposit of guarantee money	-	Long-term leasehold deposits	¥ 2,554 million
	Return of guarantee money	¥ 6 million	Other assets	¥ 38 million

Business terms and policies for determination of business terms

Note 1. Transaction amounts are exclusive of consumption taxes; term-end balances (exclusive of guarantee money deposited) include consumption taxes.

2. Rents for buildings are determined on the basis of current market levels.

3. All other matters are determined according to general terms and conditions.

In the year ended 31st March 2010

1 Transactions with related parties

(1) Transactions between the reporting entity of the consolidated financial statements and related parties; None

(2) Transactions between subsidiaries of the reporting entity of the consolidated financial statements and related parties

(a) Directors, corporate auditors and major individual shareholders of the reporting entity of the consolidated financial statements

Classification	Name of company or personal name	Location	Capital or investment	Occupation or business lines	Ownership of voting rights (%)
Director or Corporate Auditor	Hideyuki Takai	-	-	Corporate Auditor for the Company; President of TOHO CO., LTD.	7.32% shares of the Company directly held
Companies in which the director, the corporate auditor or his immediate family own a majority of voting rights	Osaka Chuo Syokuryo	Ibaraki City, Osaka	¥ 10 million	Food wholesaling	-

# Notes to the Consolidated Financial Statements

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

Nature of relationship	Nature of transactions	Value of transactions	Accounting title	Term-end balance
Rental of real estate	Rental fees	¥ 2,122 million	Prepaid expenses	¥ 172 million
	Common service charge	¥ 271 million	-	-
	Fees for display of signs, etc.	¥ 10 million	-	-
	Lease deposit	-	Long-term leasehold deposits	¥ 3,213 million
Materials procurement	Purchase of foodstuffs for processing	¥ 19 million	Notes and accounts payable-Trade	¥ 2 million

Business terms and policies for determination of business terms

Note 1. Transactions are conducted under third-party beneficiary contracts

2. Transaction amounts are exclusive of consumption taxes; term-end balances ( exclusive of guarantee money paid ) include consumption taxes.
3. Rents for buildings are determined on the basis of current market levels.
4. All other matters are determined according to the general terms and conditions.
5. Immediate family members of Director Shigeru Yasukawa of H<sub>2</sub>O RETAILING CORPORATION and Hankyu Hanshin Department Stores, Inc., a subsidiary of the company, held 100% of voting rights in Osaka Chuo Shokuryo.

(b) Companies whose parent is the same as the parent of the reporting entity or the other related companies

Classification	Name of company or personal name	Location	Capital or investment	Occupation or business lines	Ownership of voting rights (%)
Subsidiaries of companies that have significant stakes in the reporting entity	Hankyu Corporation	Kita-ku, Osaka City	¥ 100 million	Railway operations, real estate rental and dealership operations, stage revues, retailing	-
	HANSHIN ELECTORIC RAILWAY CO., LTD.	Fukushima-ku, Osaka City	¥ 29,384 million	Railway operations; bus operations; real estate rental and dealership operations; sports business; travel business	14.40% of shares held by the Company

Nature of relationship	Nature of transactions	Value of transactions	Accounting title	Term-end balance
Same person serving concurrently as director or corporate auditor for both parties rental of real estate	Rental fees	¥ 4,781 million	Prepaid expenses	¥ 109 million
			Notes and accounts receivable-Other	¥ 115 million
			Accrued expenses	¥ 65 million
	Deposit of guarantee money	¥ 15,001 million	Long-term leasehold deposits	¥ 22,780 million
Return of guarantee money	¥ 143 million			
Same person serving concurrently as director or corporate auditor for both parties rental of real estate	Rental fees	¥ 4,960 million	Prepaid expenses	¥ 1 million
			Accrued expenses	¥ 559 million
	Fees for display of signs, etc.	¥ 18 million	-	-
	Deposit of guarantee money	¥ 6 million	Long-term leasehold deposits	¥ 2,560 million

Business terms and policies for determination of business terms

- Note 1. Transaction amounts are exclusive of consumption taxes; term-end balances ( exclusive of guarantee money deposited ) include consumption taxes.
2. Rents for buildings are determined on the basis of current market levels.
  3. All other matters are determined according to general terms and conditions.

In the year ended 31st March 2011

1 Transactions with related parties

(1) Transactions between the reporting entity of the consolidated financial statements and related parties; None

(2) Transactions between subsidiaries of the reporting entity of the consolidated financial statements and related parties

(a) Directors, corporate auditors and major individual shareholders of the reporting entity of the consolidated financial statements

Classification	Name of company or personal name	Location	Capital or investment	Occupation or business lines	Ownership of voting rights (%)
Director or Corporate Auditor	Hideyuki Takai	-	-	Corporate Auditor for the Company; President of TOHO CO. LTD.	7.33% shares of the Company directly held
Companies in which the director, the corporate auditor or his immediate family own a majority of voting rights	Osaka Chuo Syokuryo	Ibaraki City, Osaka	¥ 10 million (\$ 120 thousand)	Food wholesaling	-

Nature of relationship	Nature of transactions	Value of transactions	Accounting title	Term-end balance
Rental of real estate	Rental fees	¥ 2,010 million (\$ 24,217 thousand)	Prepaid expenses	¥ 181 million (\$ 2,181 thousand)
	Common service charge	¥ 271 million (\$ 3,265 thousand)	-	-
	Fees for display of signs, etc.	¥ 10 million (\$ 120 thousand)	Prepaid expenses	¥ 0 million (\$ 0 thousand)
	Lease deposit	-	Long-term leasehold deposits	¥ 3,266 million (\$ 39,349 thousand)
Materials procurement	Purchase of foodstuffs for processing	¥ 18 million (\$ 217 thousand)	Notes and accounts payable-Trade	¥ 2 million (\$ 24 thousand)

Business terms and policies for determination of business terms

Note 1. Transactions are conducted under third-party beneficiary contracts

2. Transaction amounts are exclusive of consumption taxes; term-end balances ( exclusive of guarantee money paid ) include consumption taxes.

3. Rents for buildings are determined on the basis of current market levels.

4. All other matters are determined according to general terms and conditions.

5. Immediate family members of Director Shigeru Yasukawa of H<sub>2</sub>O RETAILING CORPORATION and Hankyu Hanshin Department Stores, Inc., a subsidiary of the company, held 100% of voting rights in Osaka Chuo Shokuryo.

(b) Companies whose parent is the same as the parent of the reporting entity, or the other related companies

Classification	Name of company or personal name	Location	Capital or investment	Occupation or business lines	Ownership of voting rights (%)
Subsidiaries of companies that have significant stakes in the reporting entity	Hankyu Corporation	Kita-ku, Osaka City	¥ 100 million (\$ 1,205 thousand)	Railway operations, real estate rental and dealership operations, stage revues, retailing	-
	HANSHIN ELECTORIC RAILWAY CO., LTD.	Fukushima-ku, Osaka City	¥ 29,384 million (\$ 354,024 thousand)	Railway operations; real estate rental and dealership operations; sports business; travel business	14.40% of shares held by the Company

# Notes to the Consolidated Financial Statements

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

Nature of relationship	Nature of transactions	Value of transactions	Accounting title	Term-end balance
Same person serving concurrently as director or corporate auditor for both parties rental of real estate	Rental fees	¥ 4,330 million (\$ 52,169 thousand)	Prepaid expenses	¥ 122 million (\$ 1,470 thousand)
			Notes and accounts payable-Other	¥ 11 million (\$ 133 thousand)
			Accrued expenses	¥ 189 million (\$ 2,277 thousand)
	Deposit of guarantee money	¥ 5 million (\$ 60 thousand)	Long-term leasehold deposits	¥ 22,639 million (\$ 272,759 thousand)
	Return of guarantee money	¥ 147 million (\$ 1,771 thousand)		
Same person serving concurrently as director or corporate auditor for both parties rental of real estate	Rental fees	¥ 5,024 million (\$ 60,530 thousand)	Prepaid expenses	¥ 1 million (\$ 12 thousand)
			Accrued expenses	¥ 558 million (\$ 6,723 thousand)
	Fees for display of signs, etc.	¥ 18 million (\$ 217 thousand)	-	-
	Deposit	-	Long-term leasehold deposits	¥ 2,560 million (\$ 30,843 thousand)

Business terms and policies for determination of business terms

Note 1. Transaction amounts are exclusive of consumption taxes; term-end balances ( exclusive of guarantee money deposited ) include consumption taxes.

2. Rents for buildings are determined on the basis of current market levels.
3. All other matters are determined according to general terms and conditions.

### 33. Net Income Per Share

Reconciliation of the difference between basic and diluted net income per share ("EPS") for the years ended 31st March 2009, 2010 and 2011.

	Millions of yen			Thousands of U.S. dollars
	2009	2010	2011	2011
Basic net income per share calculation:				
Income (numerator):				
Net income .....	¥ 6,380	¥ 3,017	¥ 3,110	\$ 37,470
Amounts not belonging to common stock .....	-	-	-	-
Net income available to common stockholders .....	6,380	3,017	3,110	37,470
Shares, thousands (denominator):				
Weighted average number of shares .....	205,665	206,327	206,305	
Basic EPS (yen and U.S. dollars) .....	¥ 31.02	¥ 14.62	¥ 15.07	\$ 0.18
Diluted net income per share calculation:				
Income (numerator):				
Net income .....	¥ 6,380	¥ 3,017	¥ 3,110	\$ 37,470
Amounts not belonging to common stock .....	-	-	-	-
Net income available to common stockholders .....	6,380	3,017	3,110	37,470
Effect of dilutive securities - convertible bonds .....	-	-	-	-
Adjusted net income .....	6,380	3,017	3,110	37,470
Shares, thousands (denominator):				
Weighted average number of shares .....	205,665	206,327	206,305	
Assumed conversion of convertible bonds .....	20,367	20,367	20,367	
Assumed exercise of stock purchase rights .....	-	92	255	
Adjusted weighted average number of shares .....	226,032	226,786	226,927	
Diluted EPS (yen and U.S. dollars) .....	¥ 28.23	¥ 13.30	¥ 13.70	\$ 0.17

### 34. Business Combinations

In the year ended 31st March 2009

#### Procedures and Other Relationships Under Common Control

(Mergers of department store operation subsidiaries)

Hankyu Department Stores, Inc. and Hanshin Department Store, Ltd., both wholly-owned subsidiaries, were merged effective from 1st October 2008.

1. Names of companies prior to business combination and their lines of business, legal form of business combination, corporate name after business combination and summary of transactions, including their purpose.

(1) Names of companies prior to business combination and their lines of business

Hankyu Department Stores, Inc. - department store business

Hanshin Department Store, Ltd. - department store business

(2) Legal form of business combination

Absorption of Hanshin Department Stores by Hankyu Department Stores, Inc. as the surviving entity.

(3) Corporate name after business combination

Hankyu Hanshin Department Stores, Inc.

(4) Summary of transactions, including their purpose

Prior to the merger, Hankyu Department Stores, Inc. and Hanshin Department Store, Ltd. had firstly engaged in the integration of their infrastructures, including their computer systems, and also arranged for the shared use of their facilities and common procurement of fittings and fixtures. In the second stage of integration, the human resources departments of the two companies were reorganised and steps were taken to synchronise

# Notes to the Consolidated Financial Statements

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

administrative work processes. The two companies were then merged, based on the management's judgment that full integration through merger would be the most effective means of ensuring wholehearted collaboration in the integration process, thereby enabling the speeding up of final integration and the achievement of the maximum synergistic effect.

## 2. Summary of accounting procedures performed

Accounting procedures for common control transactions were applied in line with the "Accounting Standards for Business Combinations" and the "Application Guidance for Accounting Standards for Business Combinations and Accounting Standards for Business Divestitures."

This merger has had no material effect on the consolidated financial statements.

(Merger of subsidiaries in the supermarket operation business)

Effective from 1st October 2008 the following five subsidiaries were merged: Hanshoku Co., Ltd., Hankyu Oasis, Inc., Hankyu Nissho Store, Hankyu Family Store Co., Ltd. and Hankyu Fresh Yell Co., Ltd.

## 1. Names of companies prior to business combination and their lines of business, legal form of business combination, corporate name after business combination and summary of transactions, including their purpose.

### (1) Names of companies prior to business combination and their lines of business

Hanshoku Co., Ltd.

Supervision of food business companies and management of business activities

Hankyu Oasis, Inc

Management of food supermarkets

Hankyu Nissho Store

Management of food supermarkets

Hankyu Family Store Co., Ltd.

Management of food supermarkets

Hankyu Fresh Yell Co., Ltd

Procurement and wholesaling of food products

### (2) Legal form of business combination

Absorption of four companies by Hanshoku Co., Ltd. as the surviving company

### (3) Corporate name after business combination

Hanshoku Co., Ltd.

### (4) Summary of transactions, including their purpose

In addition to the active pursuit of new store openings in the food supermarket business, the Company made Hankyu Nissho Store into a subsidiary as part of a broad plan to expand the scale of its operations in July 2006.

In September 2006, the Company reorganised Hanshoku Co., Ltd. as an intermediate holdings company for supermarket operations. Since then, it has been working to prepare the necessary infrastructure to support a rapid expansion in business scale, including centralisation of administrative and procurement functions, integration of computer systems, and creation of a comprehensive marketing system, among other matters. This merger (of Hanshoku Co., Ltd. with the food supermarket operating companies Hankyu Oasis, Inc., Hankyu Nissho Store, and Hankyu Family Store Co., Ltd., as well as the merchandise procurement company Hankyu Fresh Yell Co., Ltd.) was decided on after the determination that this infrastructure was largely in place, and was aimed at realising further improvements in business efficiency.

## 2. Summary of accounting procedures performed

Accounting procedures for common control transactions were applied in line with the "Accounting Standards for Business Combinations" and the "Application Guidance for Accounting Standards for Business Combinations and the Accounting Standards for Business Divestitures." This merger has had no material effect on the consolidated financial statements.

## 35. Subsequent Events

(Closure of the Kobe Hankyu Store of Hankyu Hanshin Department Stores, Inc.)

The Company decided to close the Kobe Hankyu store of Hankyu Hanshin Department Stores, Inc. following a resolution passed at the Board of Directors' meeting of 12th May 2011.

### 1. Reason for closure

The Kobe Hankyu store was popular with local customers in Kobe ever since it opened as the core commercial facility of the Kobe Harborland area in October 1992.

However, with consumption patterns having drastically changed, it was determined that the continuation of its operation as a department store would be difficult, and therefore the lease agreement, which is set to expire on 30th September 2012, will not be renewed.

### 2. Store summary

(1) Store: Kobe Hankyu store of Hankyu Hanshin Department Stores, Inc.

(2) Location: 1-7-2 Higashi-Kawasaki-cho, Chuo-ku, Kobe, Hyogo Prefecture

(3) Floors: One underground and six above ground

(4) Floor space: 33,278m<sup>2</sup>

(5) Opened: 1st October 1992

(6) Sales in the fiscal year ended 31st March 2011: ¥9,144 million (\$110,169 thousand) (fiscal year ended 31st March 2011)

### 3. Scheduled closing date

In 2012 (actual closing date undecided)

### 4. Impact on consolidated business performance

The closure will have no material impact on sales, operating income, etc.

Although we expect to incur expenses to restore the property to its original state following its closure, the timing and its associated costs are unclear at this juncture as negotiations are now in progress.

(Reorganisation of the Personnel System of Hankyu Hanshin Department Stores, Inc.)

As a part of improving the competitiveness at Hankyu Hanshin Department Stores, Inc., the Company's subsidiary, the specialized sales employment system that is focused on sales was reorganized so that each employee in a general position can choose to transfer out of general work and into a specialized position. As an option for the employees' future career path, we have enhanced our early retirement offer with a system that helps employees design their own career path.

Details are as follows.

(1) Target	Employees in general positions (The career path design support system can also be used by employees in specialized positions)
(2) Offer period	May 16 - 31st May 2011
(3) Number of employees transferred to specialized positions	1,069
Number of employees accepting early retirement	76
(4) Expected loss from program implementation	¥5,300 million (\$63,855 thousand)
(5) Period in which loss will be recorded	First quarter of the fiscal year ending 31st March 2012

The aforementioned amounts and numbers of people are a best estimates at this point in time.

# Independent Auditors' Report

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

To the Board of Directors of  
H<sub>2</sub>O RETAILING CORPORATION:

We have audited the accompanying consolidated balance sheets of H<sub>2</sub>O RETAILING CORPORATION and its consolidated subsidiaries as of 31st March, 2009, 2010 and 2011, and the related consolidated statements of income, changes in net assets and cash flows for each of the three years in the period ended 31st March 2011, and the related consolidated statements of comprehensive income for each of the two years in the period ended 31st March 2011, expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently 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 H<sub>2</sub>O RETAILING CORPORATION and its consolidated subsidiaries as of 31st March, 2009, 2010 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended 31st March 2011, in conformity with accounting principles generally accepted in Japan.

Without qualifying our opinion, we draw attention to the following.

In Note 35 to the consolidated financial statements, there are descriptions about closure of the Kobe Hankyu store and reorganisation of the Personnel System of Hankyu Hanshin Department Stores, Inc..

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended 31st March 2011 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 1 to the consolidated financial statements.

Osaka, Japan  
23rd June, 2011

KPMG AZSA LLC

# Corporate Data

H<sub>2</sub>O RETAILING CORPORATION and Consolidated Subsidiaries

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## Board of Directors and Corporate Auditors

### Chairman, Representative Director and CEO

Shunichi Sugioka

### President and Representative Director

Jun Wakabayashi

### Representative Director

Nobuaki Nitta

### Directors

Yohsaku Fuji, Kazuo Sumi, Kazutoshi Senno, Keiji Uchiyama, Shigeru Yasukawa

### Director, Executive Officer

Tadatsugu Mori, Katsuhiro Hayashi

### Standing Corporate Auditor

Toshimitsu Konishi

### Corporate Auditors

Hideyuki Takai, Takeshi Nakagawa, Toshihisa Takamura

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## Outline of the Company

<b>Date of Establishment :</b>	March 1947
<b>Stated Capital :</b>	¥17,797 million
<b>Authorised Shares :</b>	300,000,000
<b>Issued and Outstanding Shares :</b>	206,740,777
<b>Shareholders :</b>	15,873
<b>Employees :</b>	49

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## Principal Shareholders :

Hankyu Hanshin Department Stores Kyoekai  
HANSHIN ELECTRIC RAILWAY CO., LTD.  
Takashimaya Company, Limited  
Hankyu Hanshin Holdings, Inc.  
Japan Trustee Services Bank, Ltd. (trust account)  
The Bank of Tokyo-Mitsubishi UFJ, Ltd.  
The Master Trust Bank of Japan, Ltd. (trust account)  
Juniper  
Sumitomo Mitsui Banking Corporation  
H<sub>2</sub>O Retailing Group employee stock ownership

# Corporate Data

H2O RETAILING CORPORATION and Consolidated Subsidiaries

## Principal Consolidated Subsidiaries

Company name	Stated capital (Millions of yen)	Annual sales (Millions of yen)	Direct (indirect) holding by the company (%)	Principal business
Hankyu Hanshin Department Stores, Inc.	¥ 200	¥ 350,560	100.0	Operation of department stores
Hanshoku Co., Ltd.	100	89,868	100.0	Operation of supermarkets
Hankyu Delica, Inc.	10	7,099	100.0	Manufacture and sale of prepared food and sushi
Hankyu Foods, Inc.	10	2,415	(100.0)	Manufacture and sale of food products
Hankyu Bakery Co., Ltd.	10	2,319	(100.0)	Manufacture and sale of food products
Mameda, Inc.	10	1,090	100.0	Manufacture and sale of inarizushi
Oi Development Co., Ltd.	100	435	100.0	Supervision of property management business
Hankyu Shopping Center Development Co., Ltd.	50	4,703	100.0	Developer
Hankyu Seisakusho Co., Ltd.	20	5,521	(100.0)	Manufacture and sale of furniture and furnishings
Heart Dining Inc.	10	3,460	(100.0)	Management of cafe, restaurants and company cafeteria
Hankyu Design Systems Co., Ltd.	10	2,921	100.0	Sale of sales promotion materials and printings
Hankyu Maintenance Service Co., Ltd.	10	2,174	100.0	Operation of office maintenance service
Hankyu Kitchen Yell Kansai, Inc.	10	1,686	100.0	Food delivery service
Hankyu Job Yell Co., Ltd.	10	1,448	100.0	Temporary employment agency
With System Corporation	100	1,276	81.0	Data processing and systems development
Hankyu Tomonokai Co., Ltd.	50	679	100.0	Membership organisation for customer service
Hankyu Wedding	50	433	100.0	Costume salon for bridal use
Hanshin Midorikai	20	138	100.0	Membership organisation for customer service
Hankyu Department Stores Europe B.V.	EUR.220 thousands	EUR.431 thousands	100.0	Fund-raising and fund management related to overseas business

**H<sub>2</sub>O RETAILING CORPORATION**

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