Hankyu Department Stores, Inc.

FINANCIAL REPORT 2006


New Hakata station building externals image


New Umeda headquarters externals image

Hankyu

Profile

Hankyu Department Stores 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 formed the Hankyu Department Stores Group.

Currently, the Group consists of 37 subsidiaries and 6 affiliates that operate retail business including its core-department store operations, supermarket operations, and shopping center operations.

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General Condition of Business

Ⅰ. Business Performance

The Hankyu Department Stores Group initiated the “GP10 Plan” in the year ended 31st March 2006. The objectives of the GP10 Plan, which runs through March 2015, are to achieve sales of ¥600 billion and operating income of ¥30 billion, both on a consolidated basis, mainly by boosting market share in the Kansai market. Based on the plan, we have expanded the scale of our operations during the reporting term through the opening of a department store in Sanda in Hyogo Prefecture and the opening of new supermarkets. At the same time, we began a large reconstruction project for our flagship store in Umeda with the aim of opening the new store in the spring of 2011.

Although revenues and earnings fell due to the work on the Umeda store, overall performance far exceeded our expectations at the beginning of the term thanks to the improved profitability at each branch store and the expansion of the scale of our foods business.

Operating performance (Reference) Initial forecasts

	Millions of yen	YoY % increase (decrease)	Millions of yen
Net sales	381,285	(1.1)	368,000
Operating income	14,592	(13.6)	10,000
Net income	7,922	(13.0)	6,000

Operating performance (Reference) Initial forecasts

	Thousands of U.S. dollars	YoY % increase (decrease)	Thousands of U.S. dollars
Net sales	3,258,846	(1.1)	3,145,299
Operating income	124,718	(13.6)	85,470
Net income	67,710	(13.0)	51,282

The following is the performance of each business segment:

Department Stores Business

1) Umeda Flagship Store

We began reconstruction of the Umeda store during the term. This work will be completed in two stages so that we do not have to interrupt store operations.

In April 2005 we began preparatory work. Despite negative factors such as the scaling down of sales floor space and the closure of the store for three days to move sales departments, sales for the first half of the year rose by 2.9% year-on-year, due to positive factors such as “special clearance sales before the rebuilding” and other sales promotion initiatives.

The Umeda store was remodeled in September 2005 when the first stage of the construction work was underway. Although the total sales area was reduced to about 70% of that prior to the remodeling, the sales area for fashion, a major source of revenue, was retained at about 87% of that of the previous year. We attempted to create a quality fashion department by enhancing fashion creation capabilities and product leadership. As a result, we maintained our position in the Kansai area as number one in the fashion field, and sales for the second half of the year declined by only 7% year-on-year.

The floor space for the food floor in the basement was scaled down to about 50% of its previous total. However, we allotted relatively large spaces for the popular delicatessen and Western confectionery departments. This proved successful, and sales for the second half declined only 22% year-on-year.

We introduced a Food Point Card in November 2005, in addition to our existing Persona Card, as we believed that a closer relationship with our customers would be important after the sales area was scaled down. At the end of March 2006, about five months after the card’s introduction, the number of card members exceeded 100,000, and revenue from card members accounted for over 20% of in-store sales.

In the autumn of 2005, we assigned 40 new sales floor guides so that the remodeling of the store would not be an inconvenience for our customers. We also began our guide service with specialised staff in a salon for customers.

Thanks to these measures, we did not lose a large number of regular customers after scaling down the sales floor area, a measure which had been a major concern. In addition, the decrease in total sales was limited by strong sales to card-holders. Although the sales floor space was reduced to about 70% of its previous total, sales for the second half declined by only 12% year-on-year, a much smaller reduction than that of the sales floor space. Sales for the whole period declined by only 4.8% year-on-year.

2) Branch Stores and Sales Measures

Each branch store implemented a detailed merchandise policy in accordance with local conditions and tried to retain the loyalty of regular customers by giving them point cards for the branch. As a result, sales for the reporting term ended 31st March 2006 exceeded those for the previous term at six of our eight existing stores.

The operation of the Sanda store, which opened in

General Condition of Business

September 2005, was innovative: Hankyu Department Stores, Inc. managed the fashion division, and Hankyu Oasis, Inc. managed the food division. We think this manner of operation is a prototype for the suburban department stores business, as both companies can take advantage of their strengths and create synergy.

Kobe Hankyu, which was affected by the decline of the Harborland area following the withdrawal of Daiei, a major supermarket chain, adopted a system through which the store could attract customers on its own in an effort to minimize this effect. The Kobe branch is attempting to establish a new image for the department store by introducing a Hankyu Oasis supermarket to attract more customers on weekdays and by reorganising the children's sales department, placing more emphasis on entertainment.

In addition to these measures adopted by each store, the Company made a particular effort to develop human resources to strengthen the response capabilities of the store sales staff.

In April 2006, we opened a school for sales trainers to train those in charge of creating sales departments. In the training sessions, participants learn how to display goods, how to talk to customers, and how to train salespeople. This year we appointed 40 graduates of the school as sales trainers, and these trainers have produced significant results through their creation of attractive sales floors.

We also introduced a mentor system for passing on skills and developing younger staff. We recognised 11 specialists as mentors who will guide customers and deal with specific high-end clients.

Although sales trainers and mentors are not many now, because the relevant systems were just introduced in the reporting term, we believe that we can improve our sales departments by increasing the number of these types of employees.

The following is the performance of the department stores business as a result of these measures.

Department stores business

	Millions of yen	Thousands of U.S. dollars	YoY % increase (decrease)
Net sales	301,048	2,573,060	(1.9)
Operating income	11,658	99,641	(17.6)

Foods Business

In the GP10 Plan, the foods business is our second core business after the department stores business. We are expanding the scale of the foods business to strengthen its foundation in the Kansai area. Together with Sanda Hankyu, Hankyu Oasis, Inc., which has its stores mainly in the suburbs of Kyoto, Osaka, and Kobe, opened a new store in front of Sanda Station in Sanda City. Hankyu Oasis, Inc. also opened a store in the Nigawa district of Takarazuka in Hyogo Prefecture, and a Kobe Hankyu Store in Chuo-ku of Kobe. In addition, Hankyu Family Store Co., Ltd., which has small supermarkets mainly in downtown Osaka, opened three new stores in Osaka: the Kawarayamachi Store in Chuo-ku; the Kyobashi Store in Miyakojima-ku; and the Ueroku Store in Tennoji-ku.

Hankyu Kitchen Yell Co., Ltd., which provides a home delivery service, increased sales and improved profits by continuing to actively acquire new members in the service area.

We began the operation of a fresh groceries distribution center in February 2006 and a chilled food distribution center in April 2006 to improve the infrastructure for the rapid expansion of operations and to procure goods more smoothly.

In addition to the strengthening of the distribution functions, Hankyu Fresh Yell Co., Ltd. unified its purchasing functions, and Hankyu Oasis, Inc. began direct fresh food purchase and sale operation.

Through these measures, the performance of the business as a whole improved greatly.

Foods business

	Millions of yen	Thousands of U.S. dollars	YoY % increase (decrease)
Net sales	55,929	478,026	11.1
Operating income	1,117	9,547	54.8

Property Management Business

Hankyu Shopping Center Development Co., Ltd. improved profitability by efficiently managing entrusted property and by beginning to open its own stores. The Company opened a Can Meet shop, which sells accessories and small fashion items, in the JR Shinagawa Station in Tokyo. Sales at that shop and at another shop opened in Omiya Station in Saitama in March of 2005 have been favorable.

Oi Development Co., Ltd., which manages a hotel, saw an improvement in the occupancy rate through its efforts to attract group travelers on weekends. Consequently, it was able to post its largest-ever revenues and sales.

Mosaic Ginza Hankyu in Tokyo, and Mosaic Dining Shijo Kawaramachi in Kyoto, which opened in 2004, contributed to the improvement of the property management business overall.

As a result of our efforts in the property management business, the business as a whole has increased in both sales and profits.

Property management business

	Millions of yen	Thousands of U.S. dollars	YoY % increase (decrease)
Net sales	9,225	78,846	18.7
Operating income	1,530	13,077	20.0

Other Businesses

Overall sales and profits for other businesses decreased mainly due to the sale of investments in Hankyu Kyoei Pharmacy Co., Ltd. in October 2005. However, each company improved its profitability while it reviewed and clarified its business.

Hankyu Design Systems, Inc. consolidated its scattered studios into one location, thereby enhancing its marketing capabilities and reducing costs. It led to increased revenues and earnings.

Other businesses

	Millions of yen	Thousands of U.S. dollars	YoY % increase (decrease)
Net sales	15,083	128,914	(26.7)
Operating income	302	2,581	(61.5)

(Note) The Company changed its business segmentation during the reporting term. Performance for the reporting term and the previous term are compared after retroactive adjustments are made to the performance of the previous term.

Management Issues to be Resolved

Against a backdrop of social change the Companies are making efforts to expand the scale of its operations so that it can attain the goals of the GP10 Plan. These changes, which include a decreasing and aging population and the polarisation of high-income and low-income earners, will concentrate the population and services in urban areas and increase selective consumption. Consequently, the retail industry is expected to experience tougher times.

In light of these circumstances, the Company started its H06 Medium-Term, 3-Year Action Plan in April 2006 as a first step in achieving the objectives of the GP10 Plan. Because we plan large-scale investments such as the Nishinomiya store in Hyogo, the Hakata store in Fukuoka, and the new Umeda flagship store during the next ten years, improving the management base during the next three years is critical. We will, therefore, establish a management system in line with our growth strategy by opening new department stores and supermarkets and expanding the scale of our operations to strengthen our foundation in the Kansai area. At the same time, we will review the framework of group management, including organisations and systems and continue to improve our enterprise value in the future.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

In the reporting term, the Companies began to implement the GP10 Plan, in which we target net sales of ¥600 billion and operating income of ¥30 billion. We expanded the scale of operations by, for example, opening the Sanda Hankyu store and various supermarkets. We also began to rebuild our flagship store in Umeda so that it can maintain its overwhelming position as the number one store in the area. The grand opening of the new store is scheduled for the spring of 2011.

Because of these measures, although net sales, operating income, and other income fell from the previous year, overall performance was much better than we had expected at the beginning of the year. This positive development was a result of the better than expected performance of the Umeda main store after the scaling down of its sales area, the improved profitability of each department store, and the expanded scale of the foods business.

Operating Performance

Net sales

Net sales for the term decreased by ¥4,390 million ($37,521 thousand) from the previous term to ¥381,285 million ($3,258,846 thousand). This decrease in net sales followed a decrease in the sales area of the Umeda main store to an area about 70% of the previous total due to reconstruction in September. However, sales in the second half of the term decreased by only 12% year-on-year, an amount which was better than expected considering the reduction of the sales area. These positive results are attributable to various measures such as the reorganisation of the sales floors to allocate a greater percentage of the area to fashion and the introduction of a Food Point Card and floor guides. In addition to the success of the Umeda flagship store, the performance of the branch stores was favorable. Two new stores, Sakai Kitahanada Hankyu in Sakai City in Osaka, which opened in October 2004, and Sanda Hankyu in Sanda City in Hyogo, which opened in September 2005, increased revenue. In the foods business, Hankyu Oasis and Hankyu Family Store actively opened new supermarkets, which also contributed significantly to offsetting the decrease in sales at the Umeda store.

Gross Profit

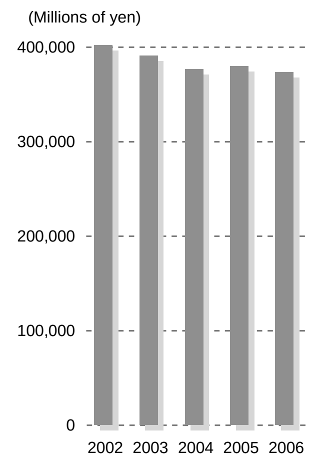
Gross profit decreased by ¥224 million ($1,915 thousand) to ¥113,241 million ($967,872 thousand) due to the decline in sales at the Umeda store. However the gross profit ratio improved by 0.28 of a percentage point to 29.7% because of initiatives to improve profitability, including enhancing the Companies' direct sales activities in department stores and expanding the scale of joint purchasing in the Companies' foods business.

Selling, General and Administrative Expenses and Operating Income

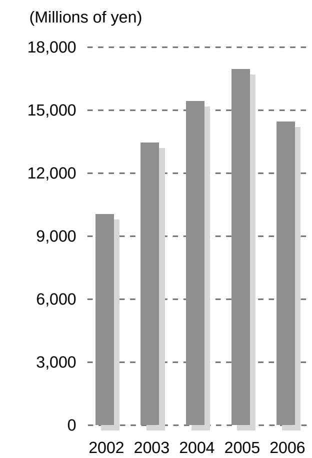
SG&A expenses increased by ¥2,067 million ($17,667 thousand) to ¥98,649 million ($843,154 thousand), mainly because Sakai Kitahanada Hankyu, Sanda Hankyu, and various supermarkets opened during the term. For existing stores, we have been making efforts to review and change the structure of expenses, thereby reducing costs.

Although operating income decreased by ¥2,291 million ($19,581 thousand) to ¥14,592 million ($124,718 thousand), the operating margin remained at the high level of 3.8%.

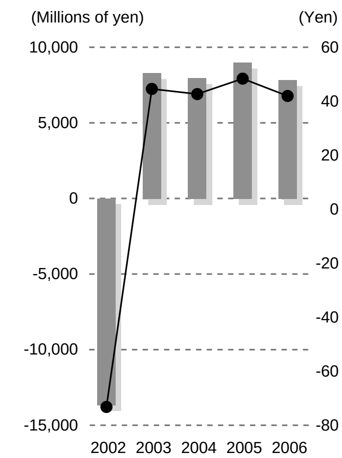
Net Sales



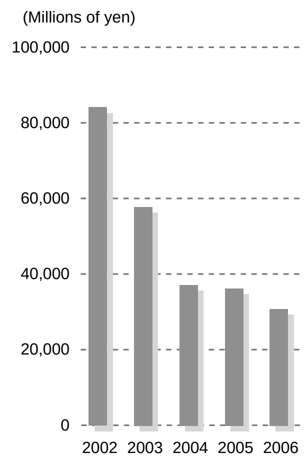
Operating Income



■ Net Income (Loss)
● Net Income per Share



Interest Bearing Debts



Other Income and Expenses

Other income and expenses increased by ¥10 million ($85thousand) from a ¥1,233 million to a ¥1,243 million ($10,624 thousand), net expense.

The net interest income increased ¥370 million ($3,162 thousand) from ¥188 million to ¥558 million ($4,769 thousand). Equity in earnings of affiliated companies improved by ¥22 million ($188 thousand).

Other income includes gains on the sale of investments in the subsidiary Hankyu Kyoei Pharmacy Co., Ltd. Other expenses include a loss on the reconstruction of the Umeda store, impairment losses on Kobe Hankyu, and losses on the restructuring of subsidiaries. We recorded the impairment losses to strengthen the financial status of the Company.

As a result, income before income taxes decreased by ¥2,301 million ($19,667 thousand) to ¥13,349 million ($114,094 thousand).

Net Income

Net income fell by ¥1,185 million ($10,128 thousand) from ¥9,107 million to ¥7,922 million ($67,710 thousand). ROE was 6.1% (7.7 % in the previous term), EPS was ¥42.28 ($0.36) (¥48.24 in the previous term), and fully diluted EPS was ¥38.13 ($0.33) (¥45.17 in the previous term).

Financial Position

Assets, Liabilities and Shareholders Equity

Total assets were ¥276,175 million ($2,360,470 thousand), an increase of ¥10,056 million ($85,949 thousand) from the end of the previous term. Investment securities increased by ¥20,961 million ($179,154 thousand) due to an increase in unrealised gains on shareholdings. Short-term loans receivable and accrued revenue decreased by ¥3,799 million ($32,470 thousand) and ¥3,948 million ($33,744 thousand), respectively.

Total liabilities decreased by ¥6,782 million ($57,966 thousand) to ¥135,790 million ($1,160,598 thousand). This was mainly due to the repayment of ¥6,452 million ($55,145 thousand) in debt. Outstanding interest-bearing liabilities at the end of the year were ¥30,384 million ($259,692 thousand), down ¥5,769 million ($49,308 thousand) from the previous year.

Minority interests in consolidated subsidiaries increased by ¥106 million ($906 thousand) to ¥1,817 million ($15,530 thousand).

Shareholders' equity rose by ¥16,733 million ($143,017 thousand) to ¥138,568 million ($1,184,342 thousand) as a result of net income of ¥7,922 million ($67,710 thousand) and dividends of ¥2,342 million ($20,017 thousand). The shareholders' equity ratio was 50.2%, and shareholders' equity per share was ¥739.55 ($6.32), up ¥89.77 ($0.77) from the previous term.

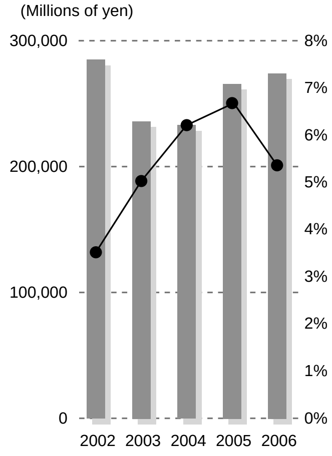
Cash Flows

Cash and cash equivalents at the end of the year were ¥38,928 million ($332,718 thousand), a decrease of ¥1,230 million ($10,513 thousand) from the previous year.

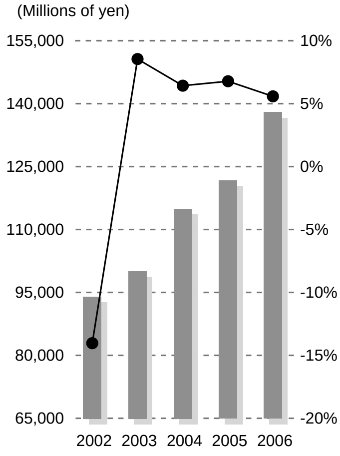
Net cash flow provided by operating activities decreased by ¥3,999 million ($34,179 thousand) to ¥14,963 million ($127,889 thousand). This was mainly because income taxes paid increased by ¥5,570 million ($47,607 thousand), which more than offset an impairment loss of ¥2,664 million ($22,769 thousand) and income before income taxes.

Net cash used in investing activities increased by ¥3,149 million ($26,915 thousand) to ¥7,337 million ($62,710

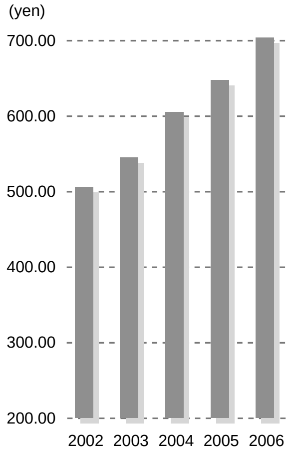
■ Total Assets
● Return on Assets



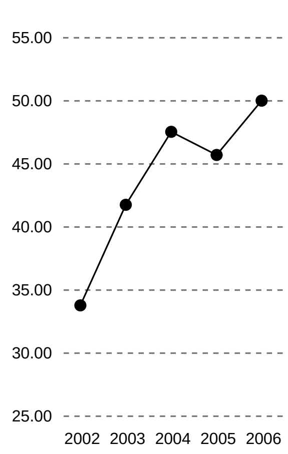
■ Shareholders' Equity
● Return on Equity



Shareholders' Equity Per Share



Shareholders' Equity Ratio



million). Additions to property, plant and equipment increased due to capital expenditure on preparatory work for the rebuilding of the Umeda store and a decline in proceeds from sale of idle land, which more than offset proceeds from the sale of the investment in Hankyu Kyoei Pharmacy Co., Ltd.

Net cash used in financing activities increased by ¥6,301 million ($53,855 thousand) to ¥8,854 million ($75,675 thousand). In the previous term there was a difference of ¥2,961 million ($25,308 thousand) between the ¥20,000 million in proceeds from the issuance of bonds and the ¥17,039 million in payments from the early redemption of bonds. In the reporting term, repayments of debt increased by ¥3,381 million ($28,897 thousand) from the previous term.

Risk Disclosures

The profitability and sales of the Companies could be affected by the following risk factors. These risks, however, do not cover all the risks which could affect the future operations or future financial condition of the Companies. The factors related to the future are what the Companies think could happen as of 31st March, 2005.

(1) Business environment

1. Business environment for retailers

The rising dependency ratio (ageing population with falling birthrate) and increasing competition in the market due to entrants from abroad could change the business environment for retailers, which could affect the profitability of the Companies.

2. Rebuilding of the Umeda main store

The Company began rebuilding its Umeda main store in the term under review. The first phase of reconstruction will be completed for partial opening in autumn 2007, and the full grand opening is scheduled for spring 2011. The new Umeda main store will be one of the biggest stores in Japan and is expected to be much more profitable than the existing store. During the construction period, however, net sales will decrease due to reduction of the sales area. Also, there are a number of other development plans underway in the Umeda area, which will become one of the largest retail zones in Japan. This will make the area more attractive for shopping than other areas, but internal competition could intensify. These background factors could also affect the profitability of the Companies.

(2) Changes in laws, regulations and other government policies

1. Store openings and extensions

In Japan, the law concerning large retail stores governs the opening of new department stores and supermarkets by the Companies. This law requires that new store openings and existing store extensions with sales area of more than 1,000㎡ must undergo inspection by local authorities to avoid affecting the surrounding living environment. This could influence the Companies' future store-opening plans. Other laws and regulations concerning antitrust, environment, recycling or consumer protection could affect the Companies.

2. Consumption tax (Value added tax) rate

A rise in the consumption tax rate could depress personal spending. This could lead to a decrease in the sales of the Companies.

(3) Natural environment and accidents

1. Unusual climate

Cold summers and unseasonably warm winters could influence sales, since fashionable clothes are one of the Companies' mainstay products.

2. Natural disasters and accidents

Natural disasters and accidents including earthquakes, floods, typhoons and fires could damage property of the Companies.

(4)Other

1. Safety of items sold

The Companies ensure the high quality of items sold through special quality control committees. Epidemics and other public health related issues such as BSE, however, could depress the domestic consumption of food products and influence sales.

2. Control of customer information

The company has strict internal rules for protecting customer information. Any accidental or criminal leak, however, could damage the Companies' reputation and decrease sales.

3. Systemic risk

Earthquakes, fires, electricity problems and computer viruses could damage the information systems of the Companies and have a negative influence on efficiency and profitability.

Corporate Governance

Fundamental Stance on Corporate Governance

The Company is working to strengthen corporate governance, focusing on management's supervision function and transparency.

We have appointed outside directors and statutory auditors, and the management is reviewed by the Board of Directors and the Board of Corporate Auditors. Management is also reviewed by shareholders and investors through company information willingly disclosed at shareholders' meetings, in business reports, in letters to shareholders and through IR activity.

We introduced an executive officer system in April 2002 and shortened the term of office for directors to one year in June 2002. As a result, the Company has changed to a system in which the responsibility of executive officers for operations and the responsibility of the directors for management and supervision have been clarified.

Company Organisation and Internal Control Systems

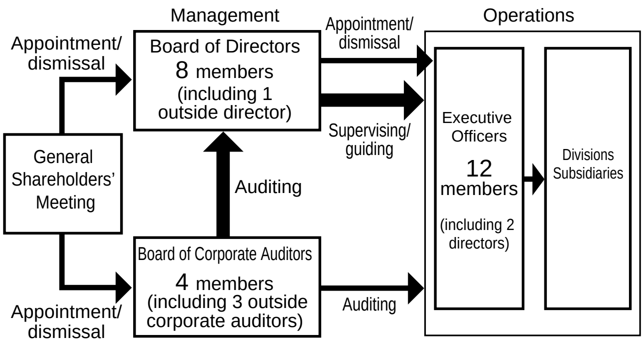
The following outlines the situation as of June 2006, when the financial statements were submitted.

1) Internal Governance Organisation

Regarding corporate governance, the Company employs the corporate auditor system rather than the so-called "committee system". Three of our four corporate auditors are outside auditors, and one of eight directors is an outside director.

The following is the system for operations and management auditing.

(Chart 1)

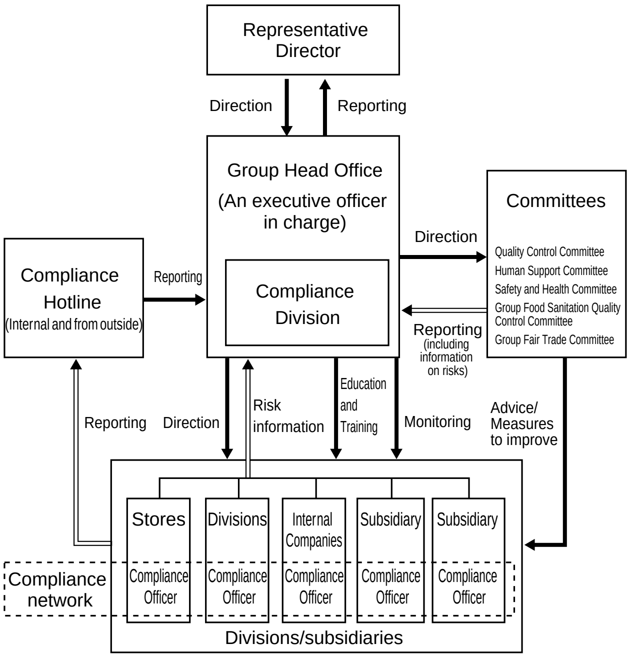


The Company employs the executive officer system. Each director on the Board of Directors as an individual, and the Board of Directors as a collective body, supervise the performance of the executive officers.

Each corporate auditor on the Board of Corporate Auditors as an individual, and the Board of Corporate Auditors as a collective body, monitor the performance of each executive officer, each director and the Board of Directors.

2) Internal Control and Risk Management Systems

(Chart 2)



The Hankyu Department Store Group has a code of conduct stipulating basic principles so that executives and employees will act based on the Companies' ethics, laws, regulations and rules. The Companies have also established risk management regulations, which include guidelines for risk prevention measures, reporting when risks occur and the implementation of measures, thereby stipulating basic policies and rules relating to risk management.

In addition, the Companies have a Compliance Division, which develops compliance and risk management systems and identifies and improves problem areas. There are also various committees that examine and discuss material risks.

Corporate Governance

The Companies have appointed staff for compliance in every subsidiary and division of the Company to promote information gathering, communication and education related to compliance and risk management, thereby building a compliance network. To share knowledge and information, Group compliance meetings are held regularly.

Moreover, a Compliance Hotline, or whistleblower system, has been established with contact points both inside and outside the Companies.

3) Internal Audit, Statutory Auditors Audit, and Accounting Audit

The Company has four corporate auditors. Three are statutory auditors, and one is a full-time auditor from within the Company. Ten auditors' meetings were held in the term.

All corporate auditors attend Board of Directors meetings, and the full-time corporate auditor attends weekly full-time directors' meetings. The corporate auditors express opinions at these meetings as needed and interview staff in subsidiaries and in each division about the performance of their duties. They also review operation audits through reports from the internal audit division and reinforce auditing functions by reviewing reports from independent auditors, as well as exchanging opinions.

The internal audit office, under the direct control of the president, is responsible for internal audits. It makes proposals for improvements based on regular interviews and regular on-site audits and tries to improve the efficiency and quality of audits by reporting the results of internal audits to, and regularly exchanging opinions with, the corporate auditors.

The Company has designated KPMG AZSA & Co. as its accounting auditing firm. The certified public accountants who executed the accounting audit were Takashi Yoshida, Yoshinori Ikeda and Katsuhiro Wakita. Nine other certified public accountants and eight junior accountants assisted them with the audit.

4) Relationships with Outside Director and Outside Corporate Auditors

The Kansai Electric Power Co., Inc., where outside director Yosaku Fuji works as a director, is a corporate customer of the Company, and the Company sells products to Kansai Electric Power Co., Inc.

Outside corporate auditor Tadashi Yamada is a lawyer and has no special interests in the Company.

Toshiba Corporation, where outside corporate auditor Tomohiko Sasaki served as a corporate advisor, is a corporate customer of the Company, and the Company sells products to Toshiba Corporation. Toshiba Corporation holds 61,000 shares of the Company, which account for 0.03% of the Company's outstanding shares. Mr. Sasaki retired from the position of corporate advisor on the 31st of March 2006.

Toho Co., Ltd., where outside corporate auditor Hideyuki Takai is the president and representative director, is a corporate customer of the Company, and the Company sells products to Toho Co., Ltd. Toho Co., Ltd. rents a store space for Yurakucho Hankyu in Tokyo to the Company. Toho Co., Ltd. holds 8,630,000 shares of the Company, which accounts for 4.60% of the Company's outstanding shares.

Compensation for Directors and Corporate Auditors

The Company paid a total of ¥214 million ($1,829 thousand) in compensation, ¥175 million ($1,496 thousand) to the directors and ¥39 million ($333 thousand) to corporate auditors.

The Company paid an audit fee of ¥55 million ($470 thousand) to KPMG AZSA & Co. Of this total, ¥40 million ($342 thousand) was for the services stipulated in Article 2, Paragraph 1 of the Certified Public Accountant Law, and ¥15 million ($128 thousand) was for other services.

Five-Year Summary

Hankyu Department Stores, Inc. and Consolidated Subsidiaries

Years ended 31st March	Millions of yen 2002	2003	2004	2005	2006	Thousands of U.S. dollars (Note1) 2006
For the year:						
Net sales	¥401,475	¥395,029	¥384,556	¥385,675	¥381,285	$3,258,846
Cost of sales	288,229	281,348	271,916	272,210	268,044	2,290,974
Gross profit	113,246	113,681	112,640	113,465	113,241	967,872
Selling, general and administrative expenses	103,279	100,354	97,421	96,582	98,649	843,154
Interest expense	677	647	528	338	97	829
Income (loss) before income taxes	(20,448)	13,060	14,744	15,650	13,349	114,094
Net income (loss)	(13,117)	8,574	8,101	9,107	7,922	67,710
Per share data (in yen and dollars)						
Net income (loss) - basic	(70.62)	45.50	42.89	48.24	42.28	0.36
Net income - diluted	—	45.50	42.89	45.17	38.13	0.33
Cash dividends	12.50	12.50	12.50	12.50	12.50	0.11
At year-end:						
Inventories	¥13,485	¥12,110	¥11,578	¥12,664	¥12,355	$105,598
Property, plant and equipment (book value)	74,419	72,597	71,038	70,352	66,473	568,146
Total assets	279,640	240,600	237,029	266,119	276,175	2,360,470
Long-term debt	57,606	35,852	32,180	29,677	22,000	188,034
Shareholders' equity	94,046	100,673	113,350	121,835	138,568	1,184,342
Ratio analysis:						
Gross profit / Net sales (%)	28.21	28.78	29.29	29.42	29.70	
Income before income taxes / Net sales (%)	—	3.31	3.83	4.06	3.50	
Net income / Net sales (%)	—	2.17	2.11	2.36	2.08	
Net income /Total assets (%)	—	3.30	3.39	3.62	2.92	
Net income / Shareholders' equity (%)	—	8.81	7.57	7.74	6.08	
Shareholders' equity / Total assets (%)	33.63	41.84	47.82	45.78	50.17	
Long-term debt / Shareholders' equity (times)	0.61	0.36	0.28	0.24	0.16	
Net sales / Inventories (times)	29.77	32.62	33.21	30.45	30.86	
Net sales / Total assets (times)	1.44	1.64	1.62	1.45	1.38	

Note 1: U.S. dollar amounts represent translations of yen amounts at the rate of ¥117=U.S.$1.
2: Effective 1st April 2002, the Company adopted the new accounting standard for earnings per share and related guidance (Accounting Standards Board Statement No. 2, "Accounting Standard for Earnings Per Share" and Financial Standards Implementation Guidance No. 4, "Implementation Guidance for Accounting Standard for Earnings Per Share"). The prior year amount of net income (loss) per share has not been restated.
3: 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 year.

Consolidated Balance Sheets

As of 31st March, 2004, 2005 and 2006	Millions of yen 2004	2005	2006	Thousands of U.S. dollars (Note1) 2006
Assets				
Current assets:				
Cash on hand and in banks	¥27,924	¥45,177	¥48,947	$418,350
Notes and accounts receivable (Note 7) :				
Trade	19,407	18,695	16,528	141,265
Other	8,165	5,783	1,836	15,692
Allowance for doubtful receivables	(141)	(306)	(313)	(2,675)
	27,431	24,172	18,051	154,282
Inventories (Note 4)	11,578	12,664	12,355	105,598
Deferred tax assets (Note 14)	1,920	5,176	3,447	29,462
Prepaid expenses and other	2,697	7,516	2,812	24,034
Total current assets	71,550	94,705	85,612	731,726
Investments and long-term loans:				
Investment securities (Note 3)	48,611	58,916	79,738	681,521
Investments in unconsolidated subsidiaries and affiliates	811	787	926	7,915
Long-term loans	6,158	2,872	2,309	19,735
Long-term loans to employees	293	233	172	1,470
Total investments and long-term loans	55,873	62,808	83,145	710,641
Property, plant and equipment (Note 7)				
Land (Note 16)	29,116	28,942	28,833	246,436
Buildings and structures	105,755	105,681	90,967	777,496
Machinery and equipment	11,589	11,845	11,793	100,795
Construction in progress	17	11	12	103
	146,477	146,479	131,605	1,124,830
Accumulated depreciation	(75,439)	(76,127)	(65,132)	(556,684)
Total property, plant and equipment	71,038	70,352	66,473	568,146
Other assets:				
Long-term leasehold deposits (Note 5)	29,624	29,782	33,625	287,393
Intangibles	2,529	3,130	2,807	23,991
Long-term deferred tax assets (Note 14)	4,817	4,285	4,185	35,769
Long-term deferred tax assets related to land revaluation (Note 16)	838	684	–	–
Interest swaps	596	496	227	1,940
Other assets	247	261	310	2,650
Allowance for doubtful receivables	(83)	(384)	(209)	(1,786)
Total other assets	38,568	38,254	40,945	349,957
	¥237,029	¥266,119	¥276,175	$2,360,470

See accompanying notes.

	Millions of yen			Thousands of U.S. dollars (Note1)
	2004	2005	2006	2006
Liabilities, Minority Interests and Shareholders' Equity				
Current liabilities:				
Short-term debt (Note 6)	¥11	¥11	—	—
Current portion of long-term debt (Notes 6 and 7)	3,071	6,465	8,384	71,658
Notes and accounts payable:				
Trade	25,336	26,124	23,407	200,060
Other (Note 7)	7,069	5,737	6,513	55,667
	32,405	31,861	29,920	255,727
Accrued expenses	4,879	4,918	5,089	43,496
Income and enterprise taxes payable	1,711	7,193	3,646	31,162
Consumption tax payable	955	521	274	2,342
Advances received	22,214	22,777	23,624	201,915
Provision for bonuses to directors and corporate auditors (Note 2)	—	—	59	504
Provision for loss of Umeda main store rebuilding (Note 2)	—	4,453	111	949
Other current liabilities	2,406	2,664	2,745	23,461
Total current liabilities	67,652	80,863	73,852	631,214
Long-term debt (Note 6)	32,180	29,677	22,000	188,034
Long-term deferred tax liabilities (Note 14)	5,084	8,034	15,348	131,179
Long-term deferred tax liabilities related to land revaluation (Note 16)	344	344	344	2,940
Employees' severance and retirement benefits (Note 9)	7,695	11,730	11,826	101,077
Directors' severance and retirement benefits	314	315	376	3,214
Provision for loss of Umeda main store rebuilding (Note 2)	—	1,928	4,296	36,718
Long-term accrued payables	308	1,841	773	6,607
Guarantee deposits	7,403	7,044	6,629	56,658
Deferred hedge gains	596	496	227	1,940
Other non-current liabilities	484	301	119	1,017
Contingent liabilities (Note 11)				
Total liabilities	122,060	142,573	135,790	1,160,598
Minority interests in consolidated subsidiaries	1,619	1,711	1,817	15,530
Shareholders' equity (Note 15):				
Common stock:				
Authorised - 300,000,000 shares, Issued - 187,688,301 shares	17,797	17,797	17,797	152,111
Capital surplus	17,573	17,574	17,577	150,231
Retained earnings	68,337	74,824	80,340	686,666
Land revaluation, net of tax (Note 16)	(642)	(429)	(1,112)	(9,504)
Net unrealised holding gains on securities	10,767	12,608	24,546	209,795
Foreign currency translation adjustments	(348)	(326)	(328)	(2,803)
Treasury stock - 193,138 shares in 2004 - 286,314 shares in 2005 - 321,437 shares in 2006	(134)	(213)	(252)	(2,154)
Total shareholders' equity	113,350	121,835	138,568	1,184,342
	¥237,029	¥266,119	¥276,175	$2,360,470

Consolidated Statements of Income

Years ended 31st March	Millions of yen 2004	Millions of yen 2005	Millions of yen 2006	Thousands of U.S. dollars (Note1) 2006
Net sales	¥384,556	¥385,675	¥381,285	$3,258,846
Cost of sales	271,916	272,210	268,044	2,290,974
Gross profit	112,640	113,465	113,241	967,872
Selling, general and administrative expenses	97,421	96,582	98,649	843,154
Operating income	15,219	16,883	14,592	124,718
Other income (expenses):				
Interest and dividend income	521	526	655	5,598
Interest expense	(528)	(338)	(97)	(829)
Loss on disposal of property, plant, equipment and intangibles (Note 24)	(849)	(647)	(1,218)	(10,410)
Loss of Umeda main store rebuilding (Note 22)	—	—	(2,936)	(25,094)
Impairment losses (Note 23)	(2,409)	—	(2,664)	(22,769)
Outplacement expenses	—	—	(719)	(6,145)
Loss on restructuring of subsidiary business	—	—	(621)	(5,308)
Gain on sales of investment securities	240	87	–	–
Gain on sales of investment in consolidated subsidiary (Note 2)	—	—	3,036	25,949
Compensation for moving	—	—	2,028	17,333
Gain on sales of property, plant and equipment (Note 19)	1,891	4,502	189	1,615
Provision for loss of Umeda main store rebuilding (Note 2)	—	(6,381)	–	–
Expenses of debt assumption agreements	—	(1,240)	–	–
Expenses incurred as a result of the revision of the personnel plans (Note 20)	—	(797)	–	–
Loss on business of subsidiaries (Note 21)	—	(652)	–	–
Expenses for opening a new store	—	(340)	–	–
Gain on the revision of employees' severance and retirement benefits plans (Note 9)	—	3,456	–	–
Gain on goodwill sale	319	—	–	–
Special retirement benefits	(458)	—	–	–
Equity in earnings (losses) of affiliated companies	(31)	(0)	22	188
Amortisation of consolidation difference	240	238	238	2,034
Other-net	589	353	844	7,214
	(475)	(1,233)	(1,243)	(10,624)
Income before income taxes	14,744	15,650	13,349	114,094
Income taxes (Note 14)**:**				
Current	1,714	7,307	4,295	36,709
Deferred	4,838	(878)	1,002	8,564
	6,552	6,429	5,297	45,273
Minority interests	91	114	130	1,111
Net income	¥8,101	¥9,107	¥7,922	$67,710

	Yen			U.S. dollars (Note 1)
Net income per share - basic	¥42.89	¥48.24	¥42.28	$0.36
Net income per share - diluted	¥42.89	¥45.17	¥38.13	$0.33
Cash dividends	¥12.50	¥12.50	¥12.50	$0.11

See accompanying notes.

Consolidated Statements of Shareholders' Equity

Years ended 31st March	Thousands	Millions of yen						
	Number of shares of common stock	Common stock	Capital surplus	Retained earnings	Land revaluation, net of tax (Note 16)	Net unrealised holding gains on securities	Foreign currency translation adjustments	Treasury stock
Balance at 31st March, 2003	187,688	¥17,797	¥17,565	¥62,948	(¥982)	¥3,938	(¥378)	(¥215)
Land revaluation, net of tax (Note 16)	—	—	—	(301)	340	—	—	—
Net income	—	—	—	8,101	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	30	—
Increase in net unrealised holding gains on securities	—	—	—	—	—	6,829	—	—
Gain on treasury stock	—	—	8	—	—	—	—	81
Cash dividends - ¥12.5 per share	—	—	—	(2,342)	—	—	—	—
Bonuses to directors and corporate auditors	—	—	—	(89)	—	—	—	—
Decrease resulting from increase in number of consolidated subsidiaries	—	—	—	(1)	—	—	—	—
Increase resulting from increase in number of equity method affiliates	—	—	—	21	—	—	—	—
Balance at 31st March, 2004	187,688	¥17,797	¥17,573	¥68,337	(¥642)	¥10,767	(¥348)	(¥134)
Land revaluation, net of tax (Note 16)	—	—	—	(213)	213	—	—	—
Net income	—	—	—	9,107	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	22	—
Increase in net unrealised holding gains on securities	—	—	—	—	—	1,841	—	—
Gain on treasury stock	—	—	1	—	—	—	—	(79)
Cash dividends - ¥12.5 per share	—	—	—	(2,343)	—	—	—	—
Bonuses to directors and corporate auditors	—	—	—	(64)	—	—	—	—
Balance at 31st March, 2005	187,688	¥17,797	¥17,574	¥74,824	(¥429)	¥12,608	(¥326)	(¥213)
Land revaluation, net of tax (Note 16)	—	—	—	—	(683)	—	—	—
Net income	—	—	—	7,922	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	(2)	—
Increase in net unrealised holding gains on securities	—	—	—	—	—	11,938	—	—
Gain on treasury stock	—	—	3	—	—	—	—	(39)
Cash dividends - ¥12.5 per share	—	—	—	(2,342)	—	—	—	—
Bonuses to directors and corporate auditors	—	—	—	(66)	—	—	—	—
Increase resulting from decrease in number of equity method affiliates	—	—	—	2	—	—	—	—
Balance at 31st March, 2006	187,688	¥17,797	¥17,577	¥80,340	(¥1,112)	¥24,546	(¥328)	(¥252)

	Thousands of U.S. dollars (Note 1)						
	Common stock	Capital surplus	Retained earnings	Land revaluation, net of tax (Note 16)	Net unrealised holding gains on securities	Foreign currency translation adjustments	Treasury stock
Balance at 31st March, 2005	$152,111	$150,205	$639,521	($3,666)	$107,761	($2,786)	($1,821)
Land revaluation, net of tax (Note 16)	—	—	—	(5,838)	—	—	—
Net income	—	—	67,710	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	(17)	—
Increase in net unrealised holding gains on securities	—	—	—	—	102,034	—	—
Gain on treasury stock	—	26	—	—	—	—	(333)
Cash dividends - $0.11 per share	—	—	(20,017)	—	—	—	—
Bonuses to directors and corporate auditors	—	—	(565)	—	—	—	—
Increase resulting from decrease in number of equity method affiliates	—	—	17	—	—	—	—
Balance at 31st March, 2006	$152,111	$150,231	$686,666	($9,504)	$209,795	($2,803)	($2,154)

See accompanying notes.

Consolidated Statements of Cash Flows

Years ended 31st March	Millions of yen			Thousands of U.S. dollars (Note1)
	2004	2005	2006	2006
Cash flows from operating activities:				
Income before income taxes	¥14,744	¥15,650	¥13,349	$114,094
Depreciation and amortisation	6,694	6,537	6,726	57,487
Loss on disposal of property, plant, equipment and intangible assets	849	647	1,218	10,410
Impairment loss	2,409	-	2,664	22,769
Increase (decrease) in allowance for doubtful receivables	54	466	(164)	(1,402)
Increase in provision for retirement benefits	1,327	4,035	236	2,017
Interest and dividend income	(521)	(526)	(655)	(5,598)
Interest expense	528	338	97	829
Gain on sales of property, plant and equipment	(1,891)	(4,502)	(189)	(1,615)
Gain on sales of investment securities	(240)	(87)	(3,036)	(25,949)
Gain on goodwill sale	(319)	-	-	-
Expenses of dept assumption agreements	-	1,240	-	-
Decrease in notes and accounts receivable	1,264	716	1,485	12,692
Decrease (increase) in inventories	532	(1,087)	(150)	(1,282)
Increase (decrease) in notes and accounts payable	(224)	785	(1,404)	(12,000)
Decrease in consumption tax payable	(453)	(434)	(235)	(2,009)
Bonuses payable to directors and corporate auditors	(91)	(66)	(67)	(572)
Other	(1,978)	(2,738)	2,310	19,744
	22,684	20,974	22,185	189,615
Interest and dividends received	537	598	663	5,667
Interest paid	(540)	(405)	(110)	(940)
Income tax paid	(997)	(2,205)	(7,775)	(66,453)
Net cash provided by operating activities	21,684	18,962	14,963	127,889
Cash flows from investing activities:				
Net decrease (increase) in time deposits	9	(5,009)	(5,000)	(42,735)
Additions to property, plant and equipment	(5,900)	(7,194)	(9,616)	(82,188)
Proceeds from disposal of property, plant and equipment	3,425	4,873	343	2,932
Additions to intangibles	(762)	(1,291)	(1,014)	(8,667)
Proceeds from disposal of intangibles	93	4	12	102
Investment in securities	(6,367)	(498)	(8,576)	(73,299)
Proceeds from sales of investment securities	3,417	5,118	8,503	72,675
Proceeds from the sale of stock of subsidiary accompanied by a change in the scope of consolidation	-	-	3,679	31,444
Payments for long-term loans receivable	(2,953)	(800)	(0)	(0)
Proceeds from collection of long-term loans receivable	-	609	4,332	37,026
Net cash used in investing activities	(9,038)	(4,188)	(7,337)	(62,710)
Cash flows from financing activities:				
Net decrease in short-term debt	(6,015)	0	(11)	(94)
Repayments of long-term debt	(8,835)	(3,071)	(6,441)	(55,051)
Proceeds from issuance of bonds	-	20,000	-	-
Payments for redemption of bonds	-	(17,039)	-	-
Dividends paid	(2,364)	(2,365)	(2,366)	(20,222)
Proceeds from sale of treasury stock	8	18	36	307
Additions to treasury stock	(46)	(96)	(72)	(615)
Net cash used in financing activities	(17,252)	(2,553)	(8,854)	(75,675)
Foreign exchange differences of cash and cash equivalents	36	22	(2)	(17)
Net increase (decrease) in cash and cash equivalents	(4,570)	12,243	(1,230)	(10,513)
Cash and cash equivalents at beginning of year	32,462	27,915	40,158	343,231
Cash and cash equivalents at beginning of year of newly consolidated subsidiaries	23	-	-	-
Cash and cash equivalents at end of year	¥27,915	¥40,158	¥38,928	$332,718
Reconciliation to balance sheet:				
Cash and cash equivalents:				
Cash on hand and in banks in the balance sheet	¥27,924	¥45,177	¥48,947	$418,350
Time deposits with maturities exceeding three months	(9)	(5,019)	(10,019)	(85,632)
Total	¥27,915	¥40,158	¥38,928	$332,718

See accompanying notes.

Notes to the Consolidated Financial Statements

Hankyu Department Stores, Inc. 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 Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards. The accounts of overseas subsidiary are based on their accounting records maintained in conformity with generally accepted accounting principles and practices prevailing in the country of domicile.

Hankyu Department Stores, Inc. (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 and the inclusion of consolidated statements of shareholders' equity) 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 Securities and Exchange Law. Some 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 translation of the Japanese yen amounts into U.S. dollars is included solely for the convenience of readers outside Japan, using the prevailing exchange rate at 31st March 2006, which was ¥117 to U.S. $1.00. The convenience 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 "Companies"), over which the Company has power of control through majority voting right or existence of certain 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 of the investees, are accounted for on the equity method.

The consolidated financial statements include the accounts of the Company and its 34 (35 in 2005 and 33 in 2004) significant majority-owned subsidiaries. All significant inter-company transactions and accounts have been eliminated in consolidation.

In the year ended 31st March 2006, the Company sold the stock of Hankyu Kyoei Pharmacy Co., Ltd., a drugstores subsidiary, and recorded a gain of ¥3,036 million ($25,949 thousand).

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 subsidiaries.

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

The equity method has been applied to 6 (7 in 2005 and 8 in 2004) affiliates for the year ended 31st March 2006.

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

Cash flow statement

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 non-marketable 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 shareholders’ equity. Realised gains and losses on sales of such securities are principally determined 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, such 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, such securities should be written down to the net asset value by charging to income. In these cases, such 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 has been individually estimated.

Inventories

Inventories are stated at cost, which is determined principally by the retail cost method.

Property, plant and equipment

Property, plant and equipment are carried at cost. Depreciation is computed principally by a declining-balance method at rates based on the estimated useful lives of the assets in accordance with the Corporation Tax Law of Japan. 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.

Software

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

Bonuses

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

Bonuses to directors and corporate auditors

Commencing with the year ended 31st March 2006 the Company accrues bonuses for directors and corporate auditors based on estimated payments to be made after the end of the year.

Previously, the Company treated bonuses for directors and corporate auditors as an appropriation of retained earnings at the time of approval by the shareholders. However, the Company now treats bonuses to directors and corporate auditors as an expense at the time of accrual in compliance with the new accounting treatment of bonuses for directors and corporate auditors (Accounting Standards Board of Japan's practical guidance report No. 13, 9th March 2004). As a result, operating income and income before income taxes each decreased by ¥59 million ($504 thousand) compared with the previous method.

Retirement benefits

The Companies provided 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.

On 1st October 2004, the Company adopted a new 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).

Hankyu Oasis, Inc. and 5 other subsidiaries also adopted new retirement benefits plans, which include contributory pension plans.

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

Prior service costs are 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 lives (mainly over 13 years) commencing with the following period.

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

In the year ended 31st March 2004, the Companies adopted executive officers' severance and retirement benefits. The amounts of liabilities, as of 31st March 2004, 2005 and 2006 were ¥61 million, ¥92 million, and ¥105 million ($897 thousand), respectively.

Derivative and hedge accounting

Derivative financial instruments are stated at fair value and changes in fair value are recognised as gains or losses unless 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 gains or losses resulting from changes in fair value of derivative financial instruments until the related losses or gains on the hedged items are recognised.

Translation of foreign currencies

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

As to translation of financial statements of the overseas subsidiary, assets, liabilities, revenues and expenses are translated at current rates at its 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 shareholders' equity.

Finance Leases

Except for leases with covenants transferring ownership of the properties to lessees, the Companies do not capitalise finance leases.

Reclassifications

Certain amounts in prior years have been reclassified to conform to the 2006 presentation. These changes had no impact on previously reported results of operations or shareholders' equity.

Provision for loss of Umeda main store rebuilding

The Companies made a provision to cover estimated losses arising from the rebuilding of the Umeda main store. The estimates of losses were based on historical precedents, the book value of the store property at the time of demolition, and the estimated cost of the demolition work.

Bond issue expenses

Bond issue expenses are charged to expense when incurred.

Net income per share

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 2005 and 2006, see Note 25.

3. Investment Securities

The following tables summarise acquisition costs, book values (fair values) of available-for-sale securities with available fair values as of 31st March 2004, 2005 and 2006:

Securities with book values exceeding acquisition costs:

	Millions of yen									Thousands of U.S. dollars		
	2004			2005			**2006**			**2006**		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥ 4,655	¥ 23,254	¥ 18,599	¥ 16,919	¥ 38,267	¥ 21,348	**¥ 20,267**	**¥ 61,305**	**¥ 41,038**	**$ 173,223**	**$ 523,974**	**$ 350,751**
Government bonds	706	707	1	714	717	3	**701**	**702**	**1**	**5,991**	**6,000**	**9**
Other	683	719	36	7,296	7,584	288	**11,561**	**11,663**	**102**	**98,812**	**99,684**	**872**
Total	¥ 6,044	¥ 24,680	¥ 18,636	¥ 24,929	¥ 46,568	¥ 21,639	**¥ 32,529**	**¥ 73,670**	**¥ 41,141**	**$ 278,026**	**$ 629,658**	**$ 351,632**

Other securities:

	Millions of yen									Thousands of U.S. dollars		
	2004			2005			**2006**			**2006**		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥ 11	¥ 8	(¥ 3)	¥ 214	¥ 192	(¥ 22)	**¥ 184**	**¥ 142**	**(¥ 42)**	**$ 1,573**	**$ 1,214**	**($ 359)**
Government bonds	10	10	(0)	-	-	-	**10**	**10**	**(0)**	**85**	**85**	**(0)**
Other	23,854	23,222	(632)	12,000	11,486	(514)	**-**	**-**	**-**	**-**	**-**	**-**
Total	¥ 23,875	¥ 23,240	(¥ 635)	¥ 12,214	¥ 11,678	(¥ 536)	**¥ 194**	**¥ 152**	**(¥ 42)**	**$ 1,658**	**$ 1,299**	**($ 359)**

The following table summarises book values of securities with no available fair values as of 31st March 2004, 2005 and 2006:

	Millions of yen			Thousands of U.S. dollars
	2004 Book value	2005 Book value	**2006** Book value	**2006** Book value
Non-listed equity securities	¥ 691	¥ 670	**¥ 5,916**	**$ 50,564**

The following table summarises maturities of available-for-sale securities that have maturities as of 31st March 2006:

	Millions of yen		Thousands of U.S. dollars	
	Within 1 year	Over 1 year but within 5 years	Within 1 year	Over 1 year but within 5 years
Government bonds	¥702	¥ 10	$ 6,000	$ 85

The following table summarises sales of available-for-sale securities for the years ended 31st March 2004, 2005 and 2006:

	Millions of yen									Thousands of U.S. dollars		
	2004			2005			**2006**			**2006**		
	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	¥363	¥240	-	¥ 80	-	-	**¥ 1**	**0**	**-**	**$ 9**	**0**	**-**

4. Inventories

Inventories at 31st March 2004, 2005 and 2006 consisted of the following:

	Millions of yen			Thousands of U.S. dollars
	2004	2005	**2006**	**2006**
Merchandise goods and finished goods	¥ 10,585	¥ 11,625	**¥ 11,173**	**$ 95,496**
Work in progress	116	182	**842**	**7,196**
Raw materials and supplies	877	857	**340**	**2,906**
	¥ 11,578	¥ 12,664	**¥ 12,355**	**$ 105,598**

5. 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 interest at a nominal rate.

6. Short-term Bank Loans and Long-term Debt

Short-term bank loans are principally notes payable to banks due in 30-365 days. The average interest rates on these loans, as of 31st March 2004 and 2005 were approximately 1.375% and 1.475%, respectively. There were no short-term bank loans as of 31st March 2006.

Long-term debt at 31st March 2004, 2005 and 2006 consisted of the following:

	Millions of yen			Thousands of U.S. dollars
	2004	2005	**2006**	**2006**
0.115% to 4.81% loans from banks and others, due through 2007	¥ 14,097	¥ 11,027	**¥ 4,500**	**$ 38,461**
3.0% bonds, due 2006	9,000	-	**-**	**-**
2.32% to 5.60% Euro dollar bonds, due 2006	5,354	5,115	**5,884**	**50,291**
3.05% bonds, due 2009	6,800	-	**-**	**-**
Zero coupon convertible bonds, due 2011	-	20,000	**20,000**	**170,940**
	35,251	36,142	**30,384**	**259,692**
Less amounts due within one year	(3,071)	(6,465)	**(8,384)**	**(71,658)**
	¥ 32,180	¥ 29,677	**¥ 22,000**	**$ 188,034**

In the year ended 31st March 2005, the Company entered into debt assumption agreements with banks for the ¥9,000 million ($76,923 thousand) 3.0% bonds due 2006 and the ¥6,800 million ($58,120 thousand) 3.05% bonds due 2009.

The Company remains contingently liable, however, on the amounts assumed by the banks.

The current conversion price of the zero coupon convertible bonds issued by the Company on 16th August 2004 is ¥982 ($8.4). The convertible bonds are convertible into 20,366,598 shares of common stock as of 31st March 2005.

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

Year ending 31st March,	Millions of yen	Thousands of U.S. dollars
2007	**¥ 8,384**	**$ 71,658**
2008	**2,000**	**17,094**
2009	**-**	**-**
2010	**-**	**-**
2011 and thereafter	**20,000**	**170,940**
	¥ 30,384	**$ 259,692**

7. Pledged Assets

The following assets are pledged as collateral for current portion of long-term debt of ¥645 million at 31st March 2004:

	Millions of yen
Property, plant and equipment, net of accumulated depreciation	¥ 507

Accounts receivable of ¥1,500 million are pledged as collateral for other short-term accounts payable of ¥1,500 million at 31st March 2004.

8. Deposited Securities

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

	Millions of yen			Thousands of U.S. dollars
	2004	2005	**2006**	**2006**
Installment sales transactions	¥ 2	¥ 707	**¥ 702**	**$ 6,000**
Real estate transactions	10	10	**10**	**85**
	¥ 12	¥ 717	**¥ 712**	**$ 6,085**

9. Employees' Severance and Retirement Benefits

The liabilities for severance and retirement benefits included in the liability section of the consolidated balance sheets as of 31st March 2004, 2005 and 2006 consist of the following:

	Millions of yen			Thousands of U.S. dollars
	2004	2005	**2006**	**2006**
Projected benefit obligation	¥ 43,209	¥ 29,440	**¥ 28,726**	**$ 245,521**
Unrecognised actuarial differences	(3,817)	(76)	**204**	**1,744**
Fair value of pension assets	(31,697)	(17,634)	**(17,104)**	**(146,188)**
Liability for severance and retirement benefits	¥ 7,695	¥ 11,730	**¥ 11,826**	**$ 101,077**

Included in the consolidated statements of income for the years ended 31st March 2004, 2005 and 2006 are severance and retirement benefit expenses comprised of the following:

	Millions of yen			Thousands of U.S. dollars
	2004	2005	**2006**	**2006**
Service costs-benefits earned during the year	¥ 1,586	¥ 1,475	**¥ 1,058**	**$ 9,043**
Interest cost on projected benefit obligation	968	716	**577**	**4,932**
Expected return on plan assets	(500)	(186)	**(279)**	**(2,385)**
Amortisation of actuarial differences	767	217	**8**	**68**
Severance and retirement benefit expenses	2,821	2,222	**1,364**	**11,658**
Other	-	-	**1,515**	**12,949**
Total	¥ 2,821	¥ 2,222	**¥ 2,879**	**$ 24,607**

Retirement benefit expenses of 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 are mainly 2.0% and 2.0% for the year ended 31st March 2005 and 2006 and 2.0% and 4.0% for the year ended 31st March 2004, respectively. 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 recognised as expenses when incurred, and actuarial gains /losses are recognised in equal amounts mainly over 13 years.

Employees of Japanese companies are compulsorily included in the Welfare Pension Insurance Scheme operated by the government. Employers are legally required to deduct employees' welfare pension insurance contributions from their payroll and to pay them to the government together with employers' own contributions. For companies that have established their own Employees' Pension Fund which meets certain legal requirements, it is possible to transfer a part of their welfare pension insurance contributions (referred to as the "substitutional portion" of the government's Welfare Pension Insurance Scheme) to their own employees' pension fund under the government's permission and supervision.

Based on the newly enacted Defined Benefit Corporate Pension Law, the Company decided to restructure its Employees' Pension Fund and was permitted by the Minister of Health, Labor and Welfare on 14th March 2003 to be released from its future obligation for payments for the substitutional portion of the Welfare Pension Insurance Scheme. Pension assets for the substitutional portion maintained by the Employees' Pension Fund were transferred back to the government's scheme.

The Company applied the transitional provisions as prescribed in paragraph 47-2 of the JICPA Accounting Committee Report No. 13, "Practical Guideline for Accounting of Retirement Benefits (Interim Report)", and the effect of transferring the substitutional portion was recognised on the date permission was received from the Ministry of Health, Labor and Welfare. As a result, in the year ended 31st March, 2003, the Company recorded a gain on the release from the substitutional portion of the government's Welfare Pension Insurance Scheme amounting to ¥1,295 million, which was calculated based on the amount of the substitutional portion of the projected benefit obligation as of the permission date, the related pension assets determined pursuant to the government formula, and the related unrecognised items.

The amount of pension plan assets expected to be transferred back to the government approximated ¥17,430 million at 31st March 2003. The final amount was determined and the pension plan transferred the assets to the government at 31st March 2005.

On 1st October 2004, the Company adopted a new 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).

Hankyu Oasis, Inc. and 5 other subsidiaries also adopted new retirement benefits plans, which includes contributory pension plans.

The Companies recorded a gain of ¥3,456 million on the revision of the employees' severance and retirement benefits plan, which consists of a gain on the transition to the new retirement benefits plan amounting to ¥3,150 million and a gain on return of substitutional portion of welfare pension plan amounting to ¥306 million.

10. Finance Leases

Information, as lessee, under non-capitalised finance leases at 31st March 2004, 2005 and 2006 is as follows:

	Millions of yen			Thousands of U.S. dollars
	2004	2005	**2006**	**2006**
Original lease obligations (including finance charges) for machinery and equipment	¥ 5,307	¥ 4,957	**¥ 3,837**	**$ 32,795**
Payments remaining:				
Payments due within one year	¥ 704	¥ 534	**¥ 427**	**$ 3,650**
Payments due after one year	1,178	889	**710**	**6,068**
Total	¥ 1,882	¥ 1,423	**¥ 1,137**	**$ 9,718**

Rental expenses under such non-capitalised finance leases for the years ended 31st March 2004, 2005 and 2006 were ¥946 million, ¥756 million and ¥393 million ($3,359 thousand), respectively.

11. Contingent Liabilities

Contingent liabilities are as follows as of 31st March 2004, 2005 and 2006.

	Millions of yen			Thousands of U.S. dollars
	2004	2005	**2006**	**2006**
Guarantees for employees' housing loans	¥ 1	¥ -	¥ -	$ -
Dept assumption agreements	-	15,800	15,800	135,043
Total	¥ 1	¥ 15,800	¥ 15,800	$135,043

12. Derivative Transactions

The Companies enter 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 Companies do not use derivatives for leveraging or speculative purposes.

Derivative transactions involve credit risk and market risk. However, the Companies are exposed to minimum credit risk from breach of contract, because they deal only with highly rated financial institutions. In addition, the Companies enter 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 the management approve derivative transactions and review them as to purpose, content, counter-party and risk.

The Companies evaluate hedge effectiveness semi-annually by comparing the cumulative changes in cash flows or the changes in fair value of hedged items and the corresponding changes in the hedging derivative instruments except for in cases of obvious hedge effectiveness.

13. Business Segment Information

Business segment information for the years ended 31st March 2004, 2005 and 2006, as required to be disclosed by the Securities and Exchange Law of Japan, is as follows:

Industry segment information As of and for the year ended 31st March 2004	Millions of yen					
	Department stores	Foods	Property management	Other	Eliminations	Total
Net sales						
External customers	¥ 312,955	¥ 44,970	¥ 7,079	¥ 19,552	¥ -	¥ 384,556
Inter-segment	747	6,758	1,090	17,179	(25,774)	-
Total net sales	313,702	51,728	8,169	36,731	(25,774)	384,556
Operating costs and expenses	300,458	51,642	7,073	35,797	(25,633)	369,337
Operating income	¥ 13,244	¥ 86	¥ 1,096	¥ 934	¥ (141)	¥ 15,219
Assets	¥ 179,861	¥ 22,964	¥ 23,392	¥ 55,340	¥ (44,528)	¥ 237,029
Depreciation and amortisation	4,506	801	624	763	-	6,694
Capital expenditure	4,960	1,237	344	1,401	-	7,942

As of and for the year ended 31st March 2005	Millions of yen: Department stores	Foods	Property management	Other	Eliminations	Total
Net sales						
External customers	¥ 306,985	¥ 50,351	¥ 7,769	¥ 20,570	¥ -	¥ 385,675
Inter-segment	1,213	6,603	1,153	15,597	(24,566)	-
Total net sales	308,198	56,954	8,922	36,167	(24,566)	385,675
Operating costs and expenses	294,053	56,232	7,647	35,382	(24,522)	368,792
Operating income	¥ 14,145	¥ 722	¥ 1,275	¥ 785	¥ (44)	¥ 16,883
Assets	¥ 212,455	¥ 24,077	¥ 22,018	¥ 52,816	¥ (45,247)	¥ 266,119
Depreciation and amortisation	4,515	969	621	432	-	6,537
Capital expenditure	4,662	2,087	513	349	-	7,611

As of and for the year ended 31st March 2006	Millions of yen: Department stores	Foods	Property management	Other	Eliminations	Total
Net sales						
External customers	**¥ 301,048**	**¥ 55,929**	**¥ 9,225**	**¥ 15,083**	**¥ -**	**¥ 381,285**
Inter-segment	**1,623**	**5,350**	**761**	**14,940**	**(22,674)**	**-**
Total net sales	**302,671**	**61,279**	**9,986**	**30,023**	**(22,674)**	**381,285**
Operating costs and expenses	**291,013**	**60,162**	**8,456**	**29,721**	**(22,659)**	**366,693**
Operating income	**¥ 11,658**	**¥ 1,117**	**¥ 1,530**	**¥ 302**	**¥ (15)**	**¥ 14,592**
Assets	**¥ 227,620**	**¥ 23,750**	**¥ 21,955**	**¥ 40,413**	**¥ (37,563)**	**¥ 276,175**
Depreciation and amortisation	**4,626**	**1,123**	**622**	**355**	**-**	**6,726**
Capital expenditure	**9,226**	**1,455**	**314**	**393**	**-**	**11,388**

As of and for the year ended 31st March 2006	Thousands of U.S. dollars: Department stores	Foods	Property management	Other	Eliminations	Total
Net sales						
External customers	**$ 2,573,060**	**$ 478,026**	**$ 78,846**	**$ 128,914**	**$ -**	**$ 3,258,846**
Inter-segment	**13,872**	**45,726**	**6,504**	**127,693**	**(193,795)**	**-**
Total net sales	**2,586,932**	**523,752**	**85,350**	**256,607**	**(193,795)**	**3,258,846**
Operating costs and expenses	**2,487,291**	**514,205**	**72,273**	**254,026**	**(193,667)**	**3,134,128**
Operating income	**$99,641**	**$9,547**	**$13,077**	**$2,581**	**$(128)**	**$124,718**
Assets	**$ 1,945,470**	**$ 202,991**	**$ 187,650**	**$ 345,410**	**$ (321,051)**	**$ 2,360,470**
Depreciation and amortisation	**39,538**	**9,598**	**5,316**	**3,035**	**-**	**57,487**
Capital expenditure	**78,855**	**12,436**	**2,684**	**3,358**	**-**	**97,333**

Prior year information for 2004 and 2005 has been reclassified to conform to the 2006 presentation.

Changes in Business Segmentation

The Companies used to classify their businesses into four segments: department stores, supermarkets, real estate, and other businesses. However, in accordance with the revision of business segments and changes in the organisational structure under “the GP10 Plan” that was developed in 2004, our long-term strategy centred on the remodeling of the flagship store and that commenced in earnest in 2006. The following are the main changes made in the year ended 31st March 2006:

(1) The businesses of subsidiaries associated with the department stores business, including the business Hankyu Tomonokai Co., Ltd., were reclassified into other businesses. As a result, the department stores business segment consists only of Hankyu Department Stores, Inc.

(2) A foods business segment was created that includes the supermarket business of Hankyu Oasis, Inc. and food-related businesses such as food delivery by Hankyu Kitchen Yell Co., Ltd. and food processing by Hankyu Foods Industry Co., Ltd.

(3) It was decided to develop the real estate business, which includes the property management services of Hankyu Shopping Center Development Co., Ltd. etc., as the property management business. The property management business also includes the hotel business run by Oi Development Co., Ltd.

As a result, the department stores business has become a segment consisting only of the parent company. Hankyu Quality Control Center Co., Ltd, which was included in the department stores business, and Hankyu Kitchen Yell Co., Ltd., Hankyu Foods Industry Co., Ltd., and Hankyu Bakery Co., Ltd., which were included in the other businesses, were reclassified as foods business. Hankyu Tomonokai Co., Ltd., With System Co., Ltd., Hankyu Maintenance Services Co., Ltd., Humekfoods, Inc., and seven other companies, which were previously included in the department stores business, and Hankyu Kyoei Pharmacy Co., Ltd. (the investments in of which were sold during the year), which was in the supermarket business, were reclassified as other businesses. HD Planning West Corporation, which was previously included in the department stores business, and Oi Development Co., Ltd., which was included in other businesses, were reclassified to the property management business.

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

Geographic segment information for the years ended 31st March 2004, 2005 and 2006 is not disclosed since the proportion of domestic operations to the total amounts is more than 90 %, for both the total sales and assets.

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

14. Income Tax

Significant components of the Companies' deferred tax assets and liabilities as of 31st March 2004, 2005 and 2006 are as follows:

	Millions of yen			Thousands of U.S. dollars
	2004	2005	**2006**	**2006**
Deferred tax assets:				
Loss carry forwards	¥ 512	¥ 419	**¥ 540**	**$ 4,616**
Bonuses to employees	1,316	1,567	**1,580**	**13,504**
Retirement benefits	5,146	4,697	**4,707**	**40,231**
Loss on disposal of fixed assets	739	650	**598**	**5,111**
Depreciation	1,315	1,270	**1,218**	**10,410**
Loss on revaluation of land	1,561	1,561	**1,561**	**13,342**
Impairment losses of fixed assets	1,011	861	**1,861**	**15,906**
Provision for loss of Umeda main store rebuilding	-	2,539	**1,763**	**15,068**
Unpaid transitional contribution on definite contribution pension plan	-	929	**609**	**5,205**
Retirement benefit trust assets	-	1,439	**1,134**	**9,692**
Other	1,534	2,345	**2,032**	**17,368**
	13,134	18,277	**17,603**	**150,453**
Valuation allowance	(252)	(282)	**(132)**	**(1,128)**
Total deferred tax assets	12,882	17,995	**17,471**	**149,325**
Deferred tax liabilities:				
Reverse of amortisation of prior service cost	(1,376)	-	**-**	**-**
Gain on return of the substitutional portion of welfare pension plan	(518)	-	**-**	**-**
Deferred gains on real properties	(1,223)	(2,656)	**(3,252)**	**(27,794)**
Land revaluation of a consolidated subsidiary	(793)	(793)	**(793)**	**(6,778)**
Valuation gain on investment securities resulting from conversion of retirement benefit trust assets (equity securities)	-	(4,591)	**(4,591)**	**(39,239)**
Unrealised holding gains on securities	(7,235)	(8,493)	**(16,551)**	**(141,462)**
Other	(84)	(35)	**-**	**-**
Total deferred tax liabilities	(11,229)	(16,568)	**(25,187)**	**(215,273)**
Net deferred tax assets	¥ 1,653	¥ 1,427	**¥ (7,716)**	**$(65,948)**

Net deferred tax assets as of 31st March 2004, 2005 and 2006 were included in the consolidated balance sheets as follows:

	Millions of yen			Thousands of U.S. dollars
	2004	2005	**2006**	**2006**
Current assets	¥ 1,920	¥ 5,176	**¥ 3,447**	**$ 29,462**
Long-term assets	4,817	4,285	**4,185**	**35,769**
Long-term liabilities	(5,084)	(8,034)	**(15,348)**	**(131,179)**
Net deferred tax assets	¥ 1,653	¥ 1,427	**¥ (7,716)**	**$(65,948)**

The aggregate statutory income tax rate was reduced for the years commencing on 1st April 2004 and later due to the revised local tax law.

Reconciliations of the differences between the statutory tax rate and the effective income tax rate is as follows:

	Millions of yen	
	2004	2006
Aggregate statutory income tax rate	42.0%	42.0%
Increase (reduction) in taxes resulting from:		
Non-deductive expenses	0.8	1.6
Tax on inhabitants per capita	0.4	0.5
Net operating losses in subsidiaries	1.8	1.3
Permanent differences (including dividends)	(0.5)	(1.8)
Amortisation of consolidated goodwill	(0.5)	(0.6)
Valuation allowance	1.1	(1.1)
Others	(0.7)	(2.2)
Effective income tax rate	44.4%	39.7%

Reconciliation of the differences between the statutory tax rate and the effective income tax rate for 2005 is not disclosed since the difference between the statutory tax rate and the effective income tax rate is less than 5% of aggregate statutory income tax rate.

15. Shareholders' Equity

Under the Commercial Code of Japan, the entire amount of the issue price of shares is required to be accounted for as capital, although a company may, by resolution of its Board of Directors, account for an amount not exceeding one-half of the issue price of the new shares as additional paid-in capital, which is included in capital surplus. Amounts exceeding one-half the issue price of shares may be credited to capital surplus in certain circumstances such as exchanges of shares.

The Commercial Code provides that an amount equal to at least 10% of cash dividends and other cash appropriations shall be appropriated and set aside as a legal earnings reserve until the total amount of legal earnings reserve and additional paid-in capital, included in capital surplus, equals 25% of common stock. The total amount of legal earnings reserve and additional paid-in capital of the Company has reached to 25% of common stock, and therefore the Company is not required to provide any more legal earnings reserve. The legal earnings reserve and additional paid-in capital may be used to eliminate or reduce a deficit by resolution of the shareholders' meeting or may be capitalised by resolution of the Board of Directors. On condition that the total amount of legal earnings reserve and additional paid-in capital remains being equal to or exceeding 25% of common stock, they are available for distribution by the resolution of shareholders' meeting. Legal earnings reserve is included in retained earnings in the accompanying financial statements.

The maximum amount that the Company can distribute as dividends is calculated based on the non-consolidated financial statements of the Company in accordance with the Commercial Code.

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" in shareholders' equity, and the relevant deferred tax is shown as "Long-term deferred tax liabilities related to land revaluation" in liabilities and "Long-term deferred tax assets related to land revaluation" in assets at 31st March 2004, 2005 and 2006.

Related information is as follows:

Date of revaluations	28th February 2002 and 31st March 2002
Book value of land after revaluation	¥3,636 million
Market value of land at 31st March 2006	¥2,832 million
Difference	¥804 million

17. Stock Options (stock purchase rights)

By special resolution at the general shareholders' meeting held on 27th June 2002, the Company introduced a stock option plan in accordance with Article 280-21 of the Commercial Code in Japan, and granted stock purchase rights at advantageous terms to 8 directors, 4 executive officers, 38 employees and 48 directors of subsidiaries.

The stock purchase rights can be exercised at a price of ¥843 per share in the period from 1st September 2004 to 31st August 2007, and a total of 244,000 shares of common stock could be issued by the exercise of these rights. The exercise price of stock purchase rights would be adjusted, if the Company issued new shares at a price below the market price or in other circumstances.

18. Loan Commitments

For efficient procurement of working capital, the Company has entered into loan commitment contracts with three financial institutions, which provides the Company with loan commitment facilities in the aggregate amount of ¥10,000 million as of 31st March 2005 and 2006.

The amount of ¥10,000 million ($85,470 thousand) is still unused as of 31st March 2006.

19. Gain on Sales of Property, Plant and Equipment

Gain on sales of property, plant and equipment in the year ended 31st March 2005 is mainly due to the sales of unused dormitory land in Osaka of ¥4,358 million and unused dormitory building and land in Hyogo Prefecture of ¥140 million.

The gain on sales of property, plant and equipment in the year ended 31st March 2006 is mainly due to the sale of an unused Hankyu Department Stores dormitory building and land in Takarazuka for ¥88 million ($752 thousand), and the sale of the former Ikeda Distribution Center building and land for ¥99 million ($846 thousand).

20. Expenses Incurred as a Result of the Revision of the Personnel Plans

Expenses incurred as a result of the revision of the personnel plans in the year ended 31st March 2005 consist of ¥517 million incurred for the revision of personnel plans for part-time employees of the Company and ¥280 million incurred for the revision of bonus payments of Hankyu Oasis, Inc.

21. Loss on Business of Subsidiaries

Loss on business of subsidiaries in the year ended 31st March 2005 consists of loss of ¥458 million on loans to an affiliated company and a loss of ¥194 million for the restructuring of the credit card business.

22. Loss of Umeda Main Store Rebuilding

Loss of Umeda main store rebuilding in the year ended 31st March 2006 consists of loss of ¥2,479 million ($21,188 thousand) on provision for loss of Umeda main store rebuilding and loss of ¥457 million ($3,906 thousand) on disposal of fixed assets etc..

23. Impairment Losses

Accounting Change

In the year ended 31st March 2004, the Company adopted early the new accounting standard for impairment of fixed assets (“Opinion Concerning Establishment of Accounting Standard for Impairment of Fixed Assets” issued by the Business Accounting Deliberation Council on 9th August 2002) and the implementation guidance for accounting standard for impairment of fixed assets (the Financial Standard Implementation Guidance No. 6) issued by the Accounting Standards Board of Japan on 31st October 2003. As a result, income before income taxes for the year ended 31st March 2004 decreased by ¥2,409 million compared with what would have been reported if the new accounting standard had not been adopted early. Accumulated impairment losses are directly deducted from the acquisition costs.

The Companies grouped their fixed assets based on the relationship in terms of operating activities, and recognised impairment losses of ¥2,409 million for the following groups of fixed assets in the year ended 31st March 2004:

Company	Use	Type of assets	Millions of yen
Hankyu Department Stores, Inc.	Idle assets	Land, etc.	¥ 155
Hankyu Oasis, Inc.	Store	Buildings and structures	1,819
Persona Co., Ltd.	Software	Intangible assets	435

The Company recognised the impairment loss for the idle land, of which the carrying amount may not be recoverable. The recoverable amounts of the lands are their net realisable values based on the bank assessed land values.

Hankyu Oasis, Inc. recognised the impairment loss for one of its stores because of the decline of market values and the growing competitiveness in the near future. 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%.

Persona Co., Ltd. recognised the impairment loss for the software, which it no longer plans to utilise. The recoverable amounts of the assets are their net realisable values, in this case zero. The impairment loss in this case was the asset carrying value.

The Company recorded impairment losses in the year ended 31st March 2006 as described below.

Location	Asset group	Use	Type of assets	Millions of yen	Thousands of U.S. dollars
Chuo-ku, Kobe	Kobe Hankyu	Store	Buildings and structures	¥ 2,211	$ 18,897
Kita-ku, Kobe	Rokko-Kita Sports Centre	Former recreation facility	Land	453	3,872

The Companies classify assets into groups under the accounting rules for impairment losses on fixed assets in the following way.

(1) Stores and other accounting units of a similar nature for which revenue and expenditure are continuously ascertained as a group

(2) An idle asset or an asset to be sold as a separate item

An impairment loss in Kobe Hankyu was recognised because a large adjacent supermarket closed at the end of November 2005. The closing caused a deterioration in the operating environment of the Kobe Harborland area, where the store is located, and this is expected to have a negative influence on its operating profit or loss.

Since the Rokko-kita Sports Centre, which was used as a recreational facility and grouped into common property, was closed in January 2006, it was reclassified as a separate asset and an impairment loss was recognised.

As a result, the book values of the two properties in question were reduced to net selling prices or recoverable values, and the reduced amount, ¥2,664 million ($22,769 thousand), was recorded as an impairment loss under special losses.

Appraisal value provided by a trust and banking company was used as the net selling price for Kobe Hankyu and an estimated selling price was used as the net selling price of the Rokko-kita Sports Centre.

24. Loss on Disposal of Property, Plant, Equipment and Intangibles

Loss on disposal of property, plant, equipment and intangibles in the year ended 31st March 2006 consists of losses of ¥970 million ($8,291 thousand) on disposal of buildings and structures, losses of ¥26 million ($222 thousand) on disposal of machinery and vehicles and losses of ¥222 million ($1,897 thousand) on disposal of other assets.

25. Net Income per Share

Reconciliation of the difference between basic and diluted net income per share ("EPS") for the years ended 31st March, 2004, 2005 and 2006.

	Millions of yen			Thousands of U.S. dollars
	2004	2005	**2006**	**2006**
Basic net income per share calculation:				
Income(numerator):				
Net income	¥ 8,101	¥ 9,107	¥ 7,922	$ 67,710
Amounts not belonging to common stock	64	66	-	-
(bonuses to directors from retained earnings)	(64)	(66)	(-)	(-)
Net income available to common stockholders	8,037	9,041	7,922	67,710
Shares, thousands (denominator):				
Weighted average number of shares	187,362	187,447	187,380	
Basic EPS (yen and U.S. dollars)	¥ 42.89	¥ 48.24	¥ 42.28	$ 0.36
Diluted net income per share calculation:				
Income(numerator):				
Net income	¥ 8,101	¥ 9,107	¥ 7,922	$ 67,710
Amounts not belonging to common stock	64	66	-	-
(bonuses to directors from retained earnings)	(64)	(66)	(-)	(-)
Net income available to common stockholders	8,037	9,041	7,922	67,710
Effect of dilutive securities-convertible bonds	-	-	-	-
Adjusted net income	8,037	9,041	7,922	67,710
Shares, thousands (denominator):				
Weighted average number of shares	187,362	187,447	187,380	
Assumed conversion of convertible bonds	-	12,722	20,366	
Assumed exercise of stock purchase rights	-	-	10	
Adjusted weighed average number of shares	187,362	200,169	207,756	
Diluted EPS (yen and U.S. dollars)	¥ -	¥ 45.17	¥ 38.13	$ 0.33

As for the years ended 31st March 2004 and 2005, stock purchase rights did not have diluted effects and were not taken into account in the calculation of diluted net income per share.

26. Subsequent Events

(The new store in the new Hakata Station building)
The Company agreed with Kyushu Railway Company on 3rd April 2006 on opening a new department store in the new Hakata Station building, which is going to be opened in the spring of 2011.

(Purchase of Nissho Corporation)
The Company decided to purchase all the stock of Nissho Corporation, a supermarket company, at the Board of Directors' meeting on 23rd June 2006 and made a contract with Nipro Corporation, which is the owner of Nissho Corporation.
Detailed information is as follows;

1. The outline of Nissho Corporation
(1) Company name　Nissho Corporation
(2) Address　9-3 Honjo-nishi 3, Kita-ku, Osaka, Japan
(3) Representative　Mr. Eiichi Kawashima
(4) Capital　¥2,000 million ($17,094 thousand)
(5) Business　Supermarkets
(6) Sales and Profit
(In the year ended 31st March 2006)
Sales　¥39,424 million ($336,957 thousand)
Net profit (loss)　¥ (209) million ($(1,786) thousand)
(7) Assets, Liabilities and Shareholder's Equity
(As of 31st March 2006)
Assets　¥21,133 million ($180,624 thousand)
Liabilities　¥11,899 million ($101,701 thousand)
Shareholders' Equity　¥9,234 million ($78,923 thousand)

2. The number of shares to be purchased:　40,000 shares

3. The purchase price　¥18,750 million ($160,256 thousand)

4. Shareholding ratio　100%

5. The Company is going to pay for the stock on 31st July with no financing activities.

Independent Auditors' Report

To the Shareholders and Board of Directors of
Hankyu Department Stores, Inc.:

We have audited the accompanying consolidated balance sheets of Hankyu Department Stores, Inc. and consolidated subsidiaries as of 31st March 2004, 2005 and 2006, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended 31st March 2006, 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 consolidated financial position of Hankyu Department Stores, Inc. and subsidiaries as of 31st March 2004, 2005 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended 31st March 2006, in conformity with accounting principles generally accepted in Japan.

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

(1) As discussed in Note 23 to the consolidated financial statements, in the year ended 31st March 2004, Hankyu Department Stores, Inc. adopted early the new accounting standard for impairment of fixed assets.
(2) As discussed in Note 13 to the consolidated financial statements, Hankyu Department Stores, Inc. and subsidiaries used to classify its business into four segments: department stores, supermarkets, real estate, and other businesses. However, effective 1st April 2005 Hankyu Department Stores, Inc. and subsidiaries changed this segmentation to department stores, foods, property management and other businesses.
(3) As discussed in Note 26 to the consolidated financial statements, on 23rd June 2006, Hankyu Department Stores, Inc. agreed to acquire the all shares of Nissho Corporation.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended 31st March 2006 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
28th June 2006

KPMG AZSA & Co.

KPMG AZSA & Co.

Corporate Data

Board of Directors and Corporate Auditors

Chairman and Representative Director
Shunichi Sugioka
President and Representative Director
Nobuaki Nitta
Representative Director, Senior Managing Executive Officer
Jun Wakabayashi
Director, Senior Managing Executive Officer
Kohei Yanagisawa
Director
Kazutoshi Senno
Director, Executive Officer
Tadatsugu Mori
Directors
Kohei Kobayashi, Yosaku Fuji
Managing Executive Officers
Akira Maekawa, Kimihiko Kitabe
Executive Officers
Keiji Uchiyama, Satoshi Kouchi
Makoto Namimatsu, Naoya Araki
Toshifumi Okajima, Atsushi Suzuki
Norifumi Morii
Standing Corporate Auditor
Toshimitsu Konishi
Corporate Auditors
Tadashi Yamada, Tomohiko Sasaki
Hideyuki Takai

(As of 28th June 2006)

Outline of the Company

Date of Establishment :	March 1947
Stated Capital :	¥17,797 million
Authorised Shares :	300,000,000
Issued and Outstanding Shares :	187,688,301
Shareholders :	17,988
Employees :	2,975

Principal Shareholders :

Hankyu Department Stores Kyoeikai
Japan Trustee Services Bank, Ltd. (Trust account)
Toho Co., Ltd.
The Bank of Tokyo-Mitsubishi UFJ, Ltd.
Hankyu Holdings, Inc.
Daido Life Insurance Company
The Master Trust Bank of Japan, Ltd. (Trust account)
Sumitomo Mitsui Banking Corporation
Nippon Life Insurance Company
Deutsche Bank AG London PB Irish Residents

Principal Consolidated Subsidiaries

Company Name	Stated capital (Millions of yen)	Annual sales (Millions of yen)	Direct holding by the company (Per cent.)	Principal business
Hankyu Oasis, Inc.	¥ 100	¥ 38,870	100.0	Operation of supermarkets
Hankyu Family Store Co., Ltd.	100	9,339	100.0	Operation of supermarkets
Hankyu Kitchen Yell Co., Ltd.	50	4,869	100.0	Food delivery service
Hankyu Foods Industry Co., Ltd.	50	7,076	100.0	Manufacture and sales of food products
Hankyu Bakery Co., Ltd.	50	2,085	100.0	Sales of food products
Hankyu Shopping Center Development Co., Ltd.	50	6,269	100.0	Developer
Oi Development Co., Ltd.	550	2,305	67.2	Hotel
Hankyu Seisakusho Co., Ltd.	20	5,136	100.0	Manufacture and sales of furniture and furnishings
Hankyu Design Systems, Inc.	10	2,419	100.0	Sales of sales promotion materials and printings
Hankyu Department Stores Europe B.V.	EUR.220 thousand	EUR.3,124 thousand	100.0	Fund-raising and fund management related to overseas business
Hankyu Home Styling Co., Ltd.	10	450	100.0	Sales of furniture
Esaka Logistics Services Co., Ltd.	20	5,232	100.0	Transportation
Persona Co., Ltd.	20	592	100.0	Credit card business
Hankyu Maintenance Services Co., Ltd.	10	2,607	100.0	Operation of office maintenance service
With System Co., Ltd.	100	2,121	80.0	Data processing and systems development
Hankyu Job Yell Co., Ltd.	40	2,059	100.0	Temporary employment agency
Hankyu Tomonokai Co., Ltd.	50	1,039	100.0	Membership organization for customer service

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