

H₂O RETAILING CORPORATION

FINANCIAL REPORT 2009



Profile

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

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

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

Currently, the Group consists of 38 subsidiaries and 6 affiliates that operate retail businesses, including its core-department store operations, supermarket operations and shopping center operations.

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General Business Conditions

I . Business Performance

Following the management integration with Hanshin Department Store, Ltd. in October 2007, the Group relaunched its long-term business plan as The Grand Prix 10 (GP10) Plan ver.2. Under the plan, we are taking various steps to realise our basic strategy of expanding market share in the Kansai business area.

In fiscal 2008, ended March 2009, the Group worked hard to establish an efficient system of management after a comprehensive structural overhaul based on the merger of Hankyu Department Stores, Inc. and Hanshin Department Store, Ltd., and through the merger of five companies in the supermarket business. Among initiatives under GP10 Plan ver.2 were the opening of Nishinomiya Hankyu (Nishinomiya, Hyogo Prefecture) and food supermarket openings and refurbishments, as well as the launch of a redevelopment project near JR Oimachi railway station (Shinagawa Ward, Tokyo).

As a means of ensuring future growth, we reached agreement on 10th October 2008 on an operational and capital alliance, with a view to possible management integration, with Takashimaya Company, Limited. As of the end of February 2009, both companies had acquired 10% of each other's issued shares.

The consumption environment grew significantly more difficult after autumn 2008 when the economic slowdown caused by the financial crisis that began in the United States reached Japan, dimming prospects for the economy as corporate earnings deteriorated and unemployment fears spread. Against this backdrop, the Group's Department Store Business faced increasingly difficult market conditions, particularly for clothing and jewellery, due to dampened consumer sentiment.

As a result, Group sales on a consolidated basis grew 8.0% year-on-year to ¥509,525 million due to inclusion of sales posted by Hanshin Department Store group in the first half. However, operating and net income both fell as economic conditions deteriorated dramatically from the second half.

Results for the term

	Millions of yen	YoY %
Net sales	509,525	108.0
Operating income	13,417	78.4
Net income	6,380	67.5

Below are details of the performance of each business segment.

Department Store Business

After the management integration, Hankyu Department Stores and Hanshin Department Store began the process of integrating the operational and computer systems. Then, in October 2008, both companies effected a full merger and relaunched as Hankyu Hanshin Department Stores, Inc. After the merger, the Hankyu and Hanshin brands were separately maintained, but in November, moves were made to set up a unified operating structure, in the interests of greater efficiency and better business results, through measures such as the integration of the point of sale systems. New sales initiatives such as joint promotional campaigns were also launched.

In the Osaka Umeda area, the Hankyu Department Stores MEN'S Emporium had a good first year since opening in February 2008, winning plaudits from customers for its floor plan with a particular style at each level and its wide range of goods. Other initiatives in the reporting term, such as hot-off-the-catwalk fashion events (September 2008 and February 2009) to build up customer loyalty, helped put earnings on a firm footing.

At the Hankyu Department Stores Umeda Main Store, womenswear and jewellery sales struggled from autumn 2008, as the weak economy took its toll, but sales of cosmetics and food products remained robust throughout the year. As a result, sales at Umeda Main Store of Hankyu Department Stores, including MEN'S Emporium, almost maintained the previous year's level, dipping only 0.1% to ¥172,887 million.

Hanshin Department Store's Umeda Main Store strengthened its participation in joint initiatives with Hankyu Department Stores, for example with a special merger-commemoration ("birthday event") promotion, as well as the traditional Valentine's Day and Christmas sales campaigns. Sales growth was driven by promotional events such as the popular bargain sale for used items and the Hokkaido food promotion and our Relaxia programme of beauty, health and healing services. But sales overall were down at 6.7% year-on-year to ¥94,289 million as fashionable clothing and accessories struggled to attract customers.

At branch stores, food sales at existing stores held up fairly well over the year, but clothing items struggled from the beginning of the second half. Against this backdrop, the grand opening of the Nishinomiya Hankyu (Hyogo Prefecture), with 25,000m² of retail space, took place on 26th November 2008. Sales for the four months after opening totalled ¥7,564 million, in line with expectations, with customers responding warmly to a wide range of high-quality products and a full programme of sponsored events under the store concept of "better living in Nishinomiya."

General Business Conditions

Total sales at branch stores slid 2.7% year-on-year to ¥116,718 million, with a strong performance by Hanshin Mikage (opened March 2008) and Nishinomiya Hankyu (opened November 2008) outweighed by weakness at established stores and the closure at the end of March 2008 of Oi Hankyu Food Hall.

As a result of the foregoing, full-year sales in the Department Store Business increased 10.9% year-on-year to ¥389,792 million, due primarily to inclusion of the first-half earnings of Hanshin Department Store. The sales boost from the openings of Hankyu MEN'S Emporium and Nishinomiya Hankyu (Hankyu Department Stores) also contributed to increased revenues. But this was overshadowed by a poor sales performance by high-end products such as clothing and jewellery. Sales would have declined 3.6% if sales in the previous term had included Hanshin Department Store's first-half figures.

Department Store Business

	Millions of yen	YoY %
Sales	389,792	110.9
Operating income	10,791	79.4

Operating income declined 20.6% year-on-year to ¥10,791 million despite cost-cutting.

Supermarket Business

In October 2008, the Supermarket Business shifted to a more efficient management model with the merger of the former subordinate holding company Hanshoku Co., Ltd. and its four subsidiaries: supermarket operator Hankyu Oasis, Inc., Hankyu Nissho Store, Hankyu Family Store, Co., Ltd., and Hankyu Fresh Yell Co., Ltd., which handled Group purchasing. However, since the end of 2008, sales growth for top-end food products has languished, causing average unit selling prices to fall. As a result, sales at existing stores declined 2.8% year-on-year, causing sales in the Supermarket Business overall to decline 2.9% year-on-year to ¥87,207 million, with operating income falling 17.9% to ¥1,170 million.

We ended the period under review facing very challenging operating conditions, but at the same time took measures to strengthen future competitiveness. In addition to a scrap-and-build policy involving three openings in Osaka (Hankyu Family Stores in Imazato (Higashinari Ward), Miyakojima (Miyakojima Ward) and Higashikagaya (Suminoe Ward)) and one closure, we took measures to strengthen operations at existing stores. We developed a new format for Hankyu Oasis with an enhanced lineup of high-end

products and launched a process of refurbishment centred on Hankyu Nissho stores. At the same time, we launched a store policy focusing on the details, including the refurbishment of some Hankyu Nissho stores with introduction of a low-price policy in certain store locations. In September 2008, we also launched two new private brands, Hankyu Prime Time, with an accent on quality and Hankyu Heartful Days, focusing on pricing. A parallel move was construction of a new delicatessen plant in Ikeda, Osaka Prefecture, with shipments of delicatessen items mainly for Group food supermarkets beginning at the end of 2008.

Supermarket Business

	Millions of yen	YoY %
Sales	87,207	97.1
Operating income	1,170	82.1

Property Management Business

In the Property Management Business, beginning with the current fiscal year in April we began a multi-purpose redevelopment near JR Oimachi Station in Tokyo in which Ours Inn Hankyu, a Group business hotel, will be combined with commercial facilities serving local markets, with completion scheduled for 2014. Hankyu Shopping Center Development Co., Ltd. and Ours Inn Hankyu both suffered declines in revenues and earnings due to the closure of the Hankyu Oimachi Daily Shoppers and the reduction in rental floor space required by the redevelopment project, but performance in the Property Management Business was broadly in line with expectations after take account of the redevelopment factors.

Property Management Business

	Millions of yen	YoY %
Net sales	8,948	92.4
Operating income	1,291	73.9

Other Businesses

Hankyu Kitchen Yell Co., Ltd., which provides a home delivery service, saw revenues grow 12.0% year-on-year to ¥6,267 million. In addition to an increase in product range and an overhaul of catalogs, the company steadily expanded its delivery areas in Osaka and Kyoto city centres from April 2008 as part of an increase in the scale of operations, driving a 4,600 increase in members (subscribers).

We streamlined the restaurant business in October 2008 by merging three Group companies, Humec Foods, Inc., Canteen West Co., Ltd. and Hansel Co., Ltd. which operated cafes, restaurants and employee canteens.

As a result, revenues from Other Businesses increased 13.8% year-on-year to ¥23,578 million, due primarily to the full-term inclusion of revenues posted by subsidiaries of The Hanshin Department Store. Inclusion of revenues of H2O Retailing Corporation since the second half of the previous term was also a contributing factor. Operating income rose 230.7% year-on-year to ¥3,408 million.

Other Businesses

	Millions of yen	YoY %
Sales	23,578	113.8
Operating income	3,408	330.7

Management Issues to be Resolved

In May of 2008, we launched the GP10 Plan ver.2, a long-term business plan aimed at countering the adverse impact on the Group's business performance because of certain factors in our operating environment. Notable among these factors are the growing competition with companies from other industries and companies following different business formats and the effect of social factors like the declining birthrate and the rising average age of the population. Under the GP10 Plan ver.2, we have been pursuing an expansion of our business scale through the opening of new stores, as well as measures to establish a solid earnings base for our existing stores and all Group companies. However, the sharp deterioration of the economy since last autumn has led to a rapid transformation in consumer habits, featuring a stronger focus on value for money and an increased preference for online purchasing and other retail formats. We have thus been obliged to take steps to push through measures under the plan more forcefully. Responding effectively to these changed circumstances is now a crucial issue for the management of H2O Retailing.

In the Department Store Business, work is proceeding on the rebuilding of the Hankyu Department Store Umeda Main Store. Although the Grand Opening of the entire store is scheduled for 2012, we will commence operations at the Phase I Building in September of this year. Work on the renovation of the Umeda Main Store of Hanshin Department Store is also ongoing, as are major new store building projects including a Hanshin department store in Amagasaki and a Hankyu department store in Fukuoka. Through these projects, we intend to realise a new department store business model with enhanced attractiveness for customers and improved profitability.

In the Supermarket Business, we are expanding our business scale in the Kansai region by opening new food supermarkets. We are aiming to create a powerful comprehensive retailing network through close liaison between the Group's supermarkets and department stores, principally through more effective leverage of our department stores' corporate brands and improved competitiveness thanks to our dominant store network in this region. We will also be leveraging fully fledged operations at the delicatessen items processing plant that was completed last autumn, and developing new private-brand items to raise the profitability of the Supermarket Business as a whole.

We have also begun work on the unified operation of our house cards, and this autumn we plan to issue a new point card together with the Hankyu-Hanshin Holdings Group, under the name of the Hankyu Hanshin Emerald STACIA Card. This is aimed at expanding the number of loyal customers of the H2O Retailing Group and further cementing the competitive superiority of the Group in the Kansai region.

While pursuing these various measures under our GP10 ver.2 long-term business plan, we are also laying the groundwork for future growth. In October 2008, we signed a business alliance and capital tie-up agreement with Takashimaya Company, Limited, one of Japan's leading department store operators. We have set up a committee dedicated to oversee this alliance and draw up concrete plans and are currently taking steps to strengthen the management structure of both sides, enabling enhanced competitiveness and sounder financial positions, with a view to eventual full-scale management integration.

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 outside corporate 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 other IR activities.

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

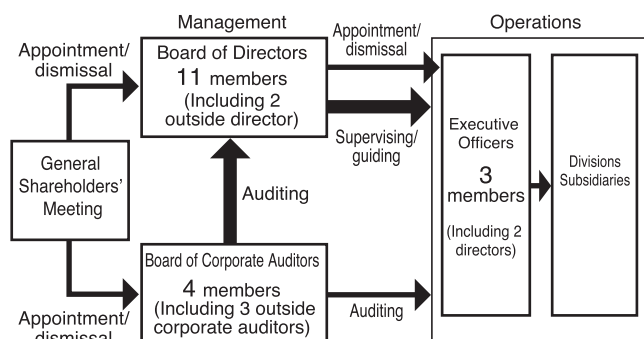
The information below outlines the situation regarding company organisation and internal control systems as of June 2009, when the financial statements were submitted.

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 corporate auditors, and two of the eleven directors are outside directors.

Chart 1 below illustrates the system for operations and management auditing.

(Chart 1)

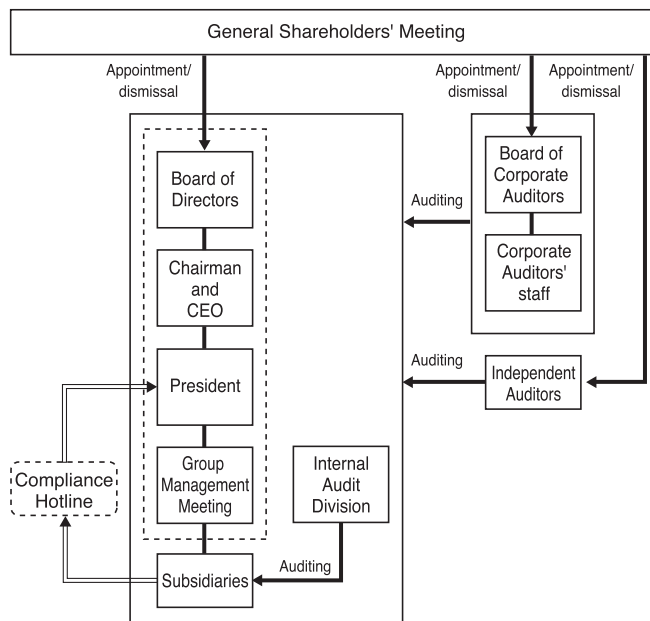


The Company employs the executive officer system. Each director on the Board of Directors individually and the Board of Directors collectively supervise the performance of the executive officers.

Each corporate auditor on the Board of Corporate Auditors individually and the Board of Corporate Auditors collectively monitor the performance of each executive officer, each director and the Board of Directors.

2) Internal Control and Risk Management Systems

(Chart 2)



The H2O RETAILING Group has a code of conduct stipulating basic principles so that executives and employees will act based on the Companies' ethics, laws, rules and regulations. The Companies strive to have the code of conduct embraced by both executives and employees. Lectures are held in each subsidiary to enhance consciousness of compliance and to develop a mastery of the basic knowledge of compliance.

To ensure that the directors and employees of the H2O RETAILING Group act strictly in compliance with the law and the Company's internal regulations, the Company has drawn up the Group Compliance Regulations, which lay down the basic policies and rules to be followed for the implementation of compliance within the Group. The president of H2O RETAILING Corporation has final responsibility for all compliance-related matters at the Group level.

The H2O RETAILING Group has set up the Group Compliance and Risk Management Committee to take the lead in the creation of a system for ensuring compliance throughout the Group. The Group Compliance and Risk Management Committee is chaired by the president of the Company, with whom final responsibility rests for all compliance-related matters.

The Group Compliance and Risk Management Committee designates the president of each Group company as the officer with final responsibility for compliance matters at the company in question, with the exception of H2O RETAILING CORPORATION, Hankyu Hanshin Department Stores, Inc., and Hanshoku Co., Ltd., in whose case the director (or executive officer) in charge of general affairs has final responsibility. Meetings are held with the attendance of officers involved in compliance from all Group companies so as to share information on compliance-related measures and report on progress in the implementation of such measures.

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

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

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

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

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

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

The Company has four corporate auditors. Three are outside corporate auditors and one is a full-time auditor from within the Company. Seven auditors' meetings were held during the term.

All corporate auditors attend Board of Directors' meetings, and the full-time corporate auditor attends monthly "Group Managements" meetings and weekly "830" 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 division (5 members) and Officer in charge of financial reporting as stipulated in the Financial Instruments and Exchange Act (J-SOX)(3 members) are responsible for internal audits. They make proposals for improvements based on regular interviews and regular on-site audits and try 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 Mr. Takashi Yoshida, Mr. Katsuhiko Wakita and Mr. Yusuke Kawasaki. Seven other certified public accountants and 9 other staff assisted them with the audit.

4) Relationships with Outside Director and Outside Corporate Auditors

Outside director Mr. Yosaku Fuji has no special interests in the Company, and Outside director Mr. Atsunori Ando has no special interests in the Company.

Toho Co., Ltd., where outside corporate auditor Mr. Hideyuki Takai is the president and representative director, rents store space for Yurakucho Hankyu in Tokyo to Hankyu Hanshin Department Stores, Inc.

Outside corporate auditor Mr. Takeshi Nakagawa has no special interests in the Company. Outside corporate auditor Mr. Toshihisa Takamura is a lawyer and has no special interests in the Company.

Compensation for Directors and Corporate Auditors

The Company paid a total of ¥262 million (\$2,673 thousand) in compensation to directors and corporate auditors, ¥308 million (\$3,143 thousand) to the directors (¥7 million to the outside director) and ¥45 million (\$459 thousand) to corporate auditors (¥28 million to outside corporate auditors).

The Company paid an audit fee of ¥46 million (\$469 thousand) for the services stipulated in Article 2, Paragraph 1 of the Certified Public Accountant Law to KPMG AZSA & Co.

Five-Year Summary

H₂O RETAILING CORPORATION and Consolidated Subsidiaries

Years ended 31st March	Millions of yen					Thousands of U.S. dollars (Note1)
	2005	2006	2007	2008	2009	2009
For the year:						
Net sales	¥385,675	¥381,285	¥395,950	¥471,617	¥509,525	\$5,199,234
Cost of sales	272,210	268,044	279,365	334,688	364,028	3,714,571
Gross profit	113,465	113,241	116,585	136,929	145,497	1,484,663
Selling, general and administrative expenses	96,582	98,649	101,821	119,815	132,080	1,347,755
Interest expense	338	97	125	72	98	1,000
Income before income taxes	15,650	13,349	14,308	16,905	9,449	96,418
Net income	9,107	7,922	8,100	9,450	6,380	65,102
Per share data (in yen and dollars)						
Net income - basic	48.24	42.28	43.23	50.07	31.02	0.32
Net income - diluted	45.17	38.13	38.99	45.19	28.23	0.29
Cash dividends	12.50	12.50	12.50	12.50	12.50	0.13
At year-end:						
Inventories	¥12,664	¥12,355	¥13,050	¥15,686	¥16,916	\$172,612
Property, plant and equipment (book value)	70,352	66,473	74,788	80,892	87,396	891,796
Total assets	266,119	276,175	282,759	337,778	323,044	3,296,367
Long-term debt	29,677	22,000	23,044	21,159	40,921	417,561
Shareholders' equity	121,835	138,568	143,195	163,897	153,839	1,569,786
Ratio analysis:						
Gross profit / Net sales (%)	29.42	29.70	29.44	29.03	28.56	
Income before income taxes / Net sales (%)	4.06	3.50	3.61	3.58	1.85	
Net income / Net sales (%)	2.36	2.08	2.05	2.00	1.25	
Net income / Total assets (%)	3.62	2.92	2.90	3.05	1.93	
Net income / Shareholders' equity (%)	7.74	6.08	5.75	6.15	4.02	
Shareholders' equity / Total assets (%)	45.78	50.17	50.64	48.52	47.62	
Long-term debt / Shareholders' equity (times)	0.24	0.16	0.16	0.13	0.27	
Net sales / Inventories (times)	30.45	30.86	30.34	30.07	30.12	
Net sales / Total assets (times)	1.45	1.38	1.40	1.40	1.58	

Note 1: U.S. dollar amounts represent translations of yen amounts at the rate of ¥98 = U.S.\$1.00.

2: Effective 1st April 2006, the Company adopted the new accounting standard for presentation of net assets in the balance sheet and related guidance (Accounting Standards Board Statement No. 5, "Accounting Standard for Presentation of Net Assets in the Balance Sheet" and Financial Standards Implementation Guidance No. 8, "Implementation Guidance for Accounting Standard for Presentation of Net Assets in the Balance Sheet"). The prior year amount of shareholders' equity 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.

4: In the five-year summary, Shareholders' equity means Net assets excluding subscription rights to shares and Minority interests in the consolidated subsidiaries.

Consolidated Balance Sheets

As of 31st March, 2007, 2008 and 2009	Millions of yen			Thousands of U.S. dollars (Note1)
	2007	2008	2009	2009
Assets				
Current assets:				
Cash on hand and in banks (Note 7)	¥45,719	¥59,812	¥39,890	\$407,041
Notes and accounts receivable				
Trade	17,824	24,599	20,613	210,337
Other	2,511	3,572	3,738	38,143
Allowance for doubtful receivables	(303)	(278)	(157)	(1,602)
	20,032	27,893	24,194	246,878
Inventories (Note 4)	13,050	15,686	16,916	172,612
Deferred tax assets (Note 14)	3,228	4,113	5,025	51,276
Prepaid expenses and other (Note 3 and 8)	2,836	3,845	3,319	33,866
Total current assets	84,865	111,349	89,344	911,673
Investments and long-term loans:				
Investment securities (Note 3)	65,165	60,565	63,344	646,367
Investments in nonconsolidated subsidiaries and affiliates	1,009	882	820	8,367
Long-term loans	2,592	2,159	1,862	19,000
Long-term loans to employees	130	237	179	1,827
Total investments and long-term loans	68,896	63,843	66,205	675,561
Property, plant and equipment				
Land (Note 7 and 16)	32,747	32,869	32,494	331,571
Buildings and structures (Note 7)	105,535	121,064	124,756	1,273,020
Machinery and equipment	13,552	18,092	19,078	194,674
Construction in progress	196	376	3,785	38,623
	152,030	172,401	180,113	1,837,888
Accumulated depreciation	(77,242)	(91,509)	(92,717)	(946,092)
Total property, plant and equipment	74,788	80,892	87,396	891,796
Other assets:				
Long-term leasehold deposits (Note 5)	36,980	40,743	40,956	417,918
Goodwill (Note 2)	9,774	18,938	17,971	183,378
Intangibles	3,162	5,985	7,180	73,265
Long-term deferred tax assets (Note 14)	3,535	14,084	12,487	127,418
Long-term deferred tax assets related to land revaluation (Note 16)	308	—	—	—
Interest swaps	132	69	—	—
Other assets	502	1,983	1,540	15,715
Allowance for doubtful receivables	(183)	(108)	(35)	(357)
Total other assets	54,210	81,694	80,099	817,337
	¥282,759	¥337,778	¥323,044	\$3,296,367

See accompanying notes.

Consolidated Balance Sheets

	Millions of yen			Thousands of U.S. dollars (Note1)
	2007	2008	2009	2009
Liabilities and Net Assets				
Current liabilities:				
Current portion of long-term debt (Notes 6 and 7)	¥2,324	¥1,324	¥238	\$2,429
Notes and accounts payable:				
Trade	26,216	36,385	30,456	310,776
Other	6,897	9,070	6,708	68,449
	33,113	45,455	37,164	379,225
Accrued expenses	5,302	2,524	2,837	28,949
Income and enterprise taxes payable	4,271	5,443	2,886	29,449
Consumption tax payable	395	1,575	623	6,357
Advances received	24,975	34,725	32,989	336,622
Deferred tax liabilities	—	—	240	2,449
Provision for bonuses to employees (Note 2)	—	4,798	4,613	47,071
Provision for bonuses to directors and corporate auditors (Note 2)	72	135	80	816
Provision for loss of stores rebuilding (Note 2)	—	956	3,228	32,939
Provision for business reorganisation of subsidiaries and affiliates (Note 2)	—	—	971	9,908
Other current liabilities	3,080	3,180	2,976	30,368
Total current liabilities	73,532	100,115	88,845	906,582
Long-term debt (Note 6 and 7)	23,044	21,159	40,921	417,561
Long-term deferred tax liabilities (Note 14)	14,105	19,439	9,294	94,837
Long-term deferred tax liabilities related to land revaluation (Note 16)	348	348	348	3,551
Employees' severance and retirement benefits (Note 9)	12,843	17,975	18,292	186,653
Directors' severance and retirement benefits	462	541	101	1,031
Provision for loss of stores rebuilding (Note 2)	5,390	4,272	1,179	12,031
Provision for redemption of gift certificates (Note 2)	—	1,685	1,785	18,214
Long-term payables accrued	75	47	796	8,122
Guarantee deposits	7,877	7,963	7,433	75,847
Other noncurrent liabilities	191	247	55	561
Contingent liabilities (Note 11)				
Total liabilities	137,867	173,791	169,049	1,724,990
Net assets (Note 15)				
Shareholders' equity:				
Common stock:				
Authorised - 300,000,000 shares.				
Issued - 187,688,301 shares in 2007				
Issued - 206,740,777 shares in 2008 and 2009	17,797	17,797	17,797	181,602
Capital surplus	17,580	37,172	37,172	379,306
Retained earnings	86,091	92,388	95,608	975,592
Treasury stock - 345,561 shares in 2007				
- 183,302 shares in 2008	(288)	(192)	(280)	(2,857)
- 401,899 shares in 2009				
Total shareholders' equity	121,180	147,165	150,297	1,533,643
Accumulated gains from revaluation and translation:				
Net unrealised holding gains on securities	22,970	16,840	3,904	39,837
Deferred hedge gains	79	41	—	—
Land revaluation, net of tax (Note 16)	(797)	43	43	439
Foreign currency translation adjustments	(237)	(191)	(405)	(4,133)
Total accumulated gains from revaluation and translation	22,015	16,733	3,542	36,143
Subscription rights to shares	—	—	45	459
Minority interests in consolidated subsidiaries	1,697	89	111	1,132
Total net assets	144,892	163,987	153,995	1,571,377
	¥282,759	¥337,778	¥323,044	\$3,296,367

See accompanying notes.

Consolidated Statements of Income

Years ended 31st March	Millions of yen			Thousands of U.S. dollars (Note1)
	2007	2008	2009	2009
Net sales	¥395,950	¥471,617	¥509,525	\$5,199,234
Cost of sales (Note 25)	279,365	334,688	364,028	3,714,571
Gross profit	116,585	136,929	145,497	1,484,663
Selling, general and administrative expenses	101,821	119,815	132,080	1,347,755
Operating income	14,764	17,114	13,417	136,908
Other income (expenses):				
Interest and dividend income	874	863	897	9,153
Equity in earnings (losses) of affiliated companies	99	(268)	(60)	(612)
Amortisation of negative goodwill	150	75	44	449
Gain on reversal of provision for loss of stores rebuilding	—	228	58	592
Gain on reversal of provision for loss of Umeda Main Store rebuilding	901	—	—	—
A bonus dividend	640	—	—	—
Gain on sales of property, plant and equipment (Note 20)	—	2,391	68	694
Gain on sales of investment securities	—	—	145	1,480
Gain on donations of property, plant and equipment	—	200	—	—
Interest expense	(125)	(72)	(98)	(1,000)
Loss of stores rebuilding (Note 21)	(1,994)	(67)	(173)	(1,765)
Loss on disposal of property, plant, equipment and intangibles (Note 24)	(743)	(812)	(692)	(7,061)
Loss on restructuring of subsidiary business	(597)	—	—	—
Impairment losses (Note 23)	—	(867)	(204)	(2,082)
Outplacement expenses	—	(249)	(1,004)	(10,245)
Expenses for opening new store	—	(418)	(556)	(5,673)
Business reorganisation expenses (Note 22)	—	—	(2,723)	(27,786)
Loss on valuation of investment securities	—	—	(529)	(5,398)
Loss on provision for redemption of gift certificates	—	(882)	(1,058)	(10,796)
Loss on provision for redemption of gift certificates for prior periods	—	(1,131)	—	—
Loss on depreciation of property, plant, equipment and intangibles	—	(354)	—	—
Loss on decrease in investment in affiliated company	—	(57)	—	—
Other-net	339	1,211	1,917	19,560
	(456)	(209)	(3,968)	(40,490)
Income before income taxes	14,308	16,905	9,449	96,418
Income taxes (Note 14) :				
Current	5,645	6,821	3,577	36,500
Deferred	653	628	(533)	(5,439)
	6,298	7,449	3,044	31,061
Minority interests (losses)	(90)	6	25	255
Net income	¥8,100	¥9,450	¥6,380	\$65,102
		Yen		U.S. dollars (Note 1)
Net income per share - basic (Note 28)	¥43.23	¥50.07	¥31.02	\$ 0.32
Net income per share - diluted (Note 28)	¥38.99	¥45.19	¥28.23	\$ 0.29
Cash dividends	¥12.50	¥12.50	¥12.50	\$ 0.13

See accompanying notes.

Consolidated Statements of Changes in Net Assets

	Thousands		Millions of yen								
	Number of shares of common stock	Common stock	Capital surplus	Retained earnings	Treasury stock	Net unrealised holding gains (losses) on securities	Deferred hedge gains	Land revaluation, net of tax (Note 16)	Foreign currency translation adjustments	Subscription rights to shares	Minority interests in consolidated subsidiaries
Years ended 31st March											
Balance at 31st March, 2006	187,688	¥17,797	¥17,577	¥80,340	(¥252)	¥24,546	—	(¥1,112)	(¥328)	—	¥1,817
Cash dividends - ¥12.5 per share	—	—	—	(2,342)	—	—	—	—	—	—	—
Net income	—	—	—	8,100	—	—	—	—	—	—	—
Gain on treasury stock	—	—	3	—	(36)	—	—	—	—	—	—
Land revaluation, net of tax (Note 16)	—	—	—	(7)	—	—	—	315	—	—	—
Decrease resulting from increase in number of consolidated subsidiaries	—	—	—	—	—	—	—	—	—	—	—
Decrease in net unrealised holding gains on securities	—	—	—	—	—	(1,576)	—	—	—	—	—
Deferred hedge gains	—	—	—	—	—	—	79	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	—	—	91	—	—
Minority interests in consolidated subsidiaries	—	—	—	—	—	—	—	—	—	—	(120)
Balance at 31st March, 2007	187,688	¥17,797	¥17,580	¥86,091	(¥288)	¥22,970	¥79	(¥797)	(¥237)	—	¥1,697
Cash dividends - ¥12.5 per share	—	—	—	(2,241)	—	—	—	—	—	—	—
Net income	—	—	—	9,450	—	—	—	—	—	—	—
Gain on treasury stock	—	—	(16)	(29)	95	—	—	—	—	—	—
Stock exchange	19,052	—	19,608	—	1	—	—	—	—	—	—
Land revaluation, net of tax (Note 16)	—	—	—	(840)	—	—	—	840	—	—	—
Decrease resulting from increase in number of consolidated subsidiaries	—	—	—	(43)	—	—	—	—	—	—	—
Decrease in net unrealised holding gains on securities	—	—	—	—	—	(6,130)	—	—	—	—	—
Deferred hedge gains	—	—	—	—	—	—	(38)	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	—	—	46	—	—
Minority interests in consolidated subsidiaries	—	—	—	—	—	—	—	—	—	—	(1,607)
Balance at 31st March, 2008	206,740	¥17,797	¥37,172	¥92,388	(¥192)	¥16,840	¥41	¥43	(¥191)	—	¥90
Cash dividends - ¥12.5 per share	—	—	—	(2,581)	—	—	—	—	—	—	—
Net income	—	—	—	6,380	—	—	—	—	—	—	—
Gain on treasury stock	—	—	—	(579)	(88)	—	—	—	—	—	—
Land revaluation, net of tax (Note 16)	—	—	—	—	—	—	—	—	—	—	—
Decrease resulting from increase in number of consolidated subsidiaries	—	—	—	—	—	—	—	—	—	—	—
Decrease in net unrealised holding gains on securities	—	—	—	—	—	(12,936)	—	—	—	—	—
Deferred hedge gains	—	—	—	—	—	—	(41)	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	—	—	(214)	—	—
Subscription rights to shares	—	—	—	—	—	—	—	—	—	45	—
Minority interests in consolidated subsidiaries	—	—	—	—	—	—	—	—	—	—	21
Balance at 31st March, 2009	206,740	¥17,797	¥37,172	¥95,608	(¥280)	¥3,904	—	¥43	(¥405)	¥45	¥111

Thousands of U.S. dollars (Note 1)

	Common stock	Capital surplus	Retained earnings	Treasury stock	Net unrealised holding gains (losses) on securities	Deferred hedge gains	Land revaluation, net of tax (Note 16)	Foreign currency translation adjustments	Subscription rights to shares	Minority interests in consolidated subsidiaries
Balance at 31st March, 2008	\$181,602	\$379,306	\$942,735	(\$1,959)	\$171,837	\$418	\$439	(\$1,949)	—	\$918
Cash dividends - \$0.13 per share	—	—	(26,337)	—	—	—	—	—	—	—
Net income	—	—	65,102	—	—	—	—	—	—	—
Gain on treasury stock	—	—	(5,908)	(898)	—	—	—	—	—	—
Stock exchange	—	—	—	—	—	—	—	—	—	—
Land revaluation, net of tax (Note 16)	—	—	—	—	—	—	—	—	—	—
Decrease resulting from increase in number of consolidated subsidiaries	—	—	—	—	—	—	—	—	—	—
Decrease in net unrealised holding gains on securities	—	—	—	—	(132,000)	—	—	—	—	—
Deferred hedge gains	—	—	—	—	—	(418)	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	—	(2,184)	—	—
Subscription rights to shares	—	—	—	—	—	—	—	—	459	—
Minority interests in consolidated subsidiaries	—	—	—	—	—	—	—	—	—	214
Balance at 31st March, 2009	\$181,602	\$379,306	\$975,592	(\$2,857)	\$39,837	—	\$439	(\$4,133)	\$459	\$1,132

See accompanying notes.

Consolidated Statements of Cash Flows

Years ended 31st March	Millions of yen			Thousands of U.S. dollars (Note1)
	2007	2008	2009	2009
Cash flows from operating activities:				
Income before income taxes	¥14,308	¥16,905	¥9,449	\$96,418
Depreciation and amortisation	7,038	7,731	10,104	103,102
Loss on disposal of property, plant, equipment and intangible assets	743	812	692	7,061
Impairment loss	—	867	204	2,082
Decrease in allowance for doubtful receivables	(118)	(146)	(193)	(1,969)
Increase (decrease) in provision for bonuses to employees	—	2,516	(185)	(1,888)
Increase (decrease) in provision for bonuses to directors and corporate auditors	—	46	(55)	(561)
Increase (decrease) in provision for retirement benefits	880	146	(123)	(1,255)
Increase (decrease) in provision for loss of stores rebuilding	983	(161)	(822)	(8,388)
Increase in provision for redemption of gift certificates	—	1,685	100	1,020
Increase in provision for business reorganisation of subsidiaries and affiliates	—	—	971	9,908
Interest and dividend income	(874)	(863)	(897)	(9,153)
Interest expense	125	72	98	1,000
Gain on sales of property, plant and equipment	—	(2,391)	(68)	(694)
Gain on sales of investment securities	—	—	(145)	(1,480)
Gain on valuation of investment securities	—	—	529	5,398
Decrease (increase) in notes and accounts receivable	(1,136)	(2,861)	3,985	40,663
Decrease (increase) in inventories	310	582	(1,229)	(12,541)
Increase (decrease) in notes and accounts payable	497	1,540	(5,928)	(60,490)
Increase (decrease) in consumption tax payable	76	1,028	(952)	(9,714)
Bonuses payable to directors and corporate auditors	(60)	—	—	—
Other	317	(1,558)	1,253	12,787
	23,088	25,950	16,788	171,306
Interest and dividends received	920	875	857	8,745
Interest paid	(125)	(76)	(44)	(449)
Income tax paid	(5,050)	(6,642)	(6,470)	(66,020)
Net cash provided by operating activities	18,833	20,107	11,131	113,582
Cash flows from investing activities:				
Net increase in time deposits	5,000	—	100	1,020
Additions to property, plant and equipment	(5,294)	(10,262)	(19,460)	(198,571)
Proceeds from disposal of property, plant and equipment	957	8,119	536	5,469
Additions to intangibles	(831)	(1,447)	(3,394)	(34,633)
Proceeds from disposal of intangibles	82	94	15	153
Investment in securities	(175)	(1,508)	(25,816)	(263,429)
Proceeds from sales of investment securities	11,992	658	1,543	15,745
Payments for the purchase of stock of subsidiary accompanied by a change in the scope of consolidation	(15,370)	21,336	—	—
Proceeds from collection of long-term loans receivable	562	562	321	3,277
Net cash provided by (used in) investing activities	(3,077)	17,552	(46,155)	(470,969)
Cash flows from financing activities:				
Net decrease in short-term debt	(2,800)	—	—	—
Proceeds from long-term debt	—	—	20,000	204,082
Repayments of long-term debt	(3,175)	(2,885)	(1,324)	(13,510)
Payments for redemption of bonds	(5,817)	—	—	—
Dividends paid	(2,366)	(2,264)	(2,585)	(26,378)
Proceeds from sale of treasury stock	54	142	2,267	23,133
Additions to treasury stock	(87)	(18,609)	(2,933)	(29,929)
Other	—	—	(1)	(10)
Net cash provided by (used in) financing activities	(14,191)	(23,616)	15,424	157,388
Foreign exchange differences of cash and cash equivalents	92	46	(222)	(2,266)
Net increase (decrease) in cash and cash equivalents	1,657	14,089	(19,822)	(202,265)
Cash and cash equivalents at beginning of year	38,928	40,595	54,688	558,041
Cash and cash equivalents at beginning of year of newly consolidated subsidiaries	10	4	—	—
Cash and cash equivalents at end of year	¥40,595	¥54,688	¥34,866	\$355,776
Reconciliation to balance sheet:				
Cash and cash equivalents:				
Cash on hand and in banks in the balance sheet	¥45,719	¥59,812	¥39,890	\$407,041
Time deposits with maturities exceeding three months	(5,124)	(5,124)	(5,024)	(51,265)
Total	¥40,595	¥54,688	¥34,866	\$355,776

See accompanying notes.

Notes to the Consolidated Financial Statements

H2O RETAILING CORPORATION and Consolidated Subsidiaries

1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements have been prepared in accordance with the provisions set forth in the Japanese Financial Instruments and Exchange Law which took effect on 30th September 2007, replacing 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 from International Financial Reporting Standards.

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

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

The translations of the Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan, using the prevailing exchange rate at 31st March 2009, which was ¥98 to U.S.\$1.00. The translations should not be construed as representations that the Japanese yen amounts have been could have been, or could in the future be converted into U.S. dollars at this or any other rate of exchange.

2. Summary of Significant Accounting Policies

Consolidation and investments in affiliates

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

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

The consolidated financial statements include the accounts of the Company and its 37 (47 in 2008 and 38 in 2007) significant majority owned subsidiaries. All significant inter-company transactions and accounts have been eliminated in consolidation.

In the year ended 31st March 2009, the subsidiaries listed below have been removed from the scope of condition. Hanshin Department Store, Ltd. (attendant on merger with consolidated subsidiary Hankyu Department Stores, Inc. on 1st October 2008)

Hankyu Oasis, Inc.; Hankyu Nissho Store.; Hankyu Family Store Co., Ltd.; Hankyu Fresh Yell Co., Ltd. (attendant on merger with consolidated subsidiary Hanshoku Co., Ltd. on 1st October 2008)

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

Hanshin Gift Service Co., Ltd. (attendant on liquidation with effect from 31st January 2009)

Mosaic Realty Co., Ltd. (attendant on merger with the parent company on 6th February 2009)

The trade name of Hankyu Department Stores, Inc., has been changed to Hankyu Hanshin Department Stores, Inc., while that

of HumeK Foods, Inc. has been changed to Heart Dining, Inc.

In the year ended 31st March 2008, the Company made Hanshin Department Store, Ltd. a subsidiary by a stock-for-stock exchange.

In the year ended 31st March 2007, the Company purchased all the stock of Nissho, a supermarket business. The Company also set up Hanshoku and Hankyu Foods as new subsidiaries and took into account Mameda as a subsidiary.

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

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

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

The equity method has been applied to 6 (7 in 2008 and 6 in 2007) affiliates for the year ended 31st March 2009.

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

Cash flow statements

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

Securities

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

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

Allowance for doubtful receivables

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

Inventories

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

(Change in accounting policies)

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

Property, plant and equipment

Property, plant and equipment excluding lease assets:

Property, plant and equipment excluding lease assets are carried at cost. Depreciation is computed principally by the declining balance method at rates based on the estimated useful life of the assets. Expenditures for maintenance and repairs, including minor replacements and betterments, are charged to income as incurred.

Buildings acquired after 1st April 1998 (excluding peripheral facilities) are depreciated using the straight-line method.

The estimated useful life of the assets are as follows:

Buildings and structures: 3 to 50 years

Machinery and equipment: 4 to 17 years

Other: 3 to 20 years

Lease assets:

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

Goodwill

The difference between the cost of investments in consolidated subsidiaries and the equity in their net assets at the date of acquisition is with minor exceptions, amortised over five to twenty years. The investments in the Hanshin Department Store, Ltd. and the Hankyu Nissho Store are amortised over twenty years.

Software

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

Bonuses to employees

The Companies accrue estimated amounts of employee bonuses based on the estimated amount to be paid in the subsequent period. Provision for bonuses to employees, which was included in “other current liabilities” until the year ended 31st March 2007, is presented separately from the year ended 31st March 2008. As of 31st March 2007, ¥3,978 million was included “accrued expenses” as provision for bonuses to employees.

Bonuses to directors and corporate auditors

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

Retirement benefits

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

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

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

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

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

The Companies have executive officers' severance and retirement benefits. The amount of liability as of 31st March 2007, 2008 and 2009 was ¥123 million, ¥142 million, and ¥27 million (\$265 thousand), respectively.

(Additional Information)

The Company and its subsidiary, Hankyu Hanshin Department Stores, Inc., resolved to abolish the retirement benefits plan for directors at the Board of Directors' meeting, and their Shareholders meeting approved payments to directors and corporate auditors to settle the allowances for retirement benefits for directors and corporate auditors.

Accordingly, ¥417 million (\$4,255 thousand), corresponding to the allowances for retirement benefits for the directors and corporate auditors of the two companies, was posted under "long-term payables accrued."

Derivative and hedge accounting

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

Translation of foreign currencies

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

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

Finance leases

(Change in accounting policies)

Until the fiscal period ended 31st March 2008, finance leases which do not transfer ownership are accounted for in the same manner as operating leases in accordance with Japanese GAAP. Effective from the year ended 31st March 2009, the Company and its domestic consolidated subsidiaries have adopted the new accounting standards, "Accounting Standard for Lease Transactions" (Statement No.13 issued by the Accounting Standards Board of Japan on 30th March 2007) and "the Implementation Guidance for Accounting Standards for Lease Transactions" (the Financial Accounting Standard Implementation Guidance No.16 issued by the Accounting Standards Board of Japan on 30th March 2007). The new standard requires the recording of capital leases as ordinary buying and selling transactions.

Finance lease transactions that are not deemed to transfer ownership of the leased property to the lessee and that were concluded prior to 1st April 2008 will continue to be accounted for by the method applied to ordinary operating leases.

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

Reclassifications

The “Increase (decrease) in provision for loss of store rebuilding” in amount of (¥160) million, previously included in “Other” under “Cash flows from operating activities”, is separately presented retroactively due to its increased materiality.

Provision for loss of stores rebuilding

The Companies made a provision to cover estimated losses arising from the rebuilding of the Umeda Main Store, Hankyu-Oi Building and Oi Development Building. The estimates of these losses were based on historical precedents, the book value of the stores’ property at the time of demolition, and the estimated cost of the demolition work for the year ended 31st March 2008.

With the expansion of the rebuilding plans, the provision for loss of the Umeda Main Store rebuilding is included in the provision for loss of stores rebuilding from the year ended 31st March 2007.

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

Provision for redemption of gift certificates

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

(Change in accounting policies)

For gift certificates not redeemed by customers within a certain time period, the Company previously reversed the liability associated with unredeemed gift certificates and recognised a gain in other nonoperating income, in the same manner as that under Corporate Tax Law. Beginning with the year ended 31st March 2008, the Company records a provision for the unredeemed gift certificates based on the estimated future redemption of those certificates.

The reason for this change in accounting policies is to more accurately present profits and losses for the period and to present a more sound financial position by recording the provision. This is reflective of the concept in the Japanese Institute of Certified Public Accountants Auditing and Assurance Practice Committee Report No. 42, April 13, 2007, “Audit Treatment of Reserves Under the Special Taxation

Measures Law, Allowance and Reserves Under Special Laws, and Reserves for Officers’ Retirement Benefits.”

As of the beginning of the year ended 31st March 2008, the Company recognised a loss of ¥1,130 million related to the provision and change in accounting policy. The Company additionally recorded ¥177 million of provision during the current year. As a result, ordinary income and income before income taxes for the current fiscal year were ¥177 million and ¥1,308 million less, respectively, than the amounts that would have been recorded with the previous accounting policy.

Provision for business reorganisation of subsidiaries and affiliates

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

Bond issue expenses

Bond issue expenses are charged to expenses when incurred.

Per share information

Computations of basic net income per share are based on the weighted average number of shares outstanding during each period. As for diluted net income per share for the years ended 31st March 2007, 2008 and 2009, see Note 28.

Cash dividends per share presented in the accompanying consolidated statements of income are dividends applicable to the respective years including dividends to be paid after the end of the year.

Consumption taxes

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

Notes to the Consolidated Financial Statements

H2O RETAILING CORPORATION and Consolidated Subsidiaries

3. Investment Securities

The following tables summarise acquisition costs and book values (fair values) of available-for-sale securities with available fair values as of 31st March 2007, 2008 and 2009.

Securities with book values exceeding acquisition costs:

	Millions of yen									Thousands of U.S. dollars		
	2007			2008			2009			2009		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥ 20,309	¥ 58,674	¥ 38,365	¥ 19,693	¥ 48,016	¥ 28,323	¥ 21,300	¥ 32,893	¥ 11,593	\$ 217,347	\$ 335,643	\$ 118,296
Government bonds	-	-	-	-	-	-	2,952	3,017	65	30,122	30,785	663
Other	205	208	3	5,690	5,773	83	1,056	1,062	6	10,776	10,837	61
Total	¥ 20,514	¥ 58,882	¥ 38,368	¥ 25,383	¥ 53,789	¥ 28,406	¥ 25,308	¥ 36,972	¥ 11,664	\$ 258,245	\$ 377,265	\$ 119,020

Other securities:

	Millions of yen									Thousands of U.S. dollars		
	2007			2008			2009			2009		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥ 367	¥ 262	(¥ 105)	¥ 1,595	¥ 1,216	(¥ 379)	¥ 25,047	¥ 19,842	(¥ 5,205)	\$ 255,582	\$ 202,469	(\$ 53,113)
Government bonds	10	10	-	-	-	-	75	68	(7)	765	694	(71)
Other	-	-	-	1,145	1,091	(54)	1,353	1,319	(34)	13,806	13,459	(347)
Total	¥ 377	¥ 272	(¥ 105)	¥ 2,740	¥ 2,307	(¥ 433)	¥ 26,475	¥ 21,229	(¥ 5,246)	\$ 270,153	\$ 216,622	(\$ 53,531)

The following table summarises book values of securities with no available fair values as of 31st March 2007, 2008 and 2009:

	Millions of yen			Thousands of U.S. dollars
	2007	2008	2009	2009
	Book value	Book value	Book value	Book value
Non-listed equity securities	¥ 6,011	¥ 5,566	¥ 5,751	\$ 58,684

The following table summarises maturities of available-for-sale securities that have maturities as of 31st March 2009:

	Millions of yen				Thousands of U.S. dollars			
	Within 1 year	Over 1 year but within 5 years	Over 5 years but within 10 years	Over 10 years	Within 1 year	Over 1 year but within 5 years	Over 5 years but within 10 years	Over 10 years
Government bonds	¥ 609	¥ 1,520	¥ 956	-	\$ 6,214	\$ 15,510	\$ 9,755	-
Corporate bonds	-	¥ 107	-	-	-	\$ 1,092	-	-

The following table summarises sales of available-for-sale securities for the years ended 31st March 2007, 2008 and 2009:

	Millions of yen									Thousands of U.S. dollars		
	2007			2008			2009			2009		
	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	¥ 5	¥ 5	-	¥ 1	-	-	¥ 90	¥ 152	-	\$ 918	\$ 1,551	-

4. Inventories

Inventories at 31st March 2007, 2008 and 2009 consisted of the following:

	Millions of yen			Thousands of U.S. dollars
	2007	2008	2009	2009
Merchandise goods and finished goods	¥ 12,109	¥ 15,001	¥ 16,129	\$ 164,581
Work in progress	135	67	102	1,041
Raw materials and supplies	806	618	685	6,990
Total	¥ 13,050	¥ 15,686	¥ 16,916	\$ 172,612

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 bear interest only at a nominal rate.

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

There were no short-term bank loans as of 31st March 2007, 2008 and 2009.

Long-term debt at 31st March 2007, 2008 and 2009 consisted of the following:

	Millions of yen			Thousands of U.S. dollars
	2007	2008	2009	2009
1.07% to 3.17% loans from banks and others, due through 2009	¥ 5,368	¥ 2,483	¥ 21,159	\$ 215,908
Finance lease obligations	-	-	296	3,020
Zero coupon convertible bonds, due 2011	20,000	20,000	20,000	204,082
	<u>25,368</u>	<u>22,483</u>	<u>41,455</u>	<u>423,010</u>
Less amounts due within one year	(2,324)	(1,324)	(261)	(2,663)
	<u>¥ 23,044</u>	<u>¥ 21,159</u>	<u>¥ 41,194</u>	<u>\$ 420,347</u>

In the year ended 31st March 2005, the Company entered into debt assumption agreements with banks for ¥6,800 million (\$57,627 thousand) 3.05% bonds due in 2009.

There were no debt assumption agreements with banks as of 31st March 2009.

The current conversion price of the zero coupon convertible bonds issued by the Company on 16th August 2004 is ¥982 (\$8.30). The convertible bonds are convertible into 20,366,598 shares of common stock as of 31st March 2007.

Annual maturities of long-term debt at 31st March 2009 were as follows:

Year ending 31st March,	Millions of yen	Thousands of U.S. dollars
2010	¥ 261	\$ 2,663
2011	189	1,929
2012	40,189	410,092
2013	188	1,918
2014 and thereafter.....	628	6,408
	<u>¥ 41,455</u>	<u>\$ 423,010</u>

7. Pledged Assets

The following assets were pledged as collateral for the current portion of long-term debt of ¥238 million (\$2,429 thousand) and long-term debt of ¥921 million (\$9,398 thousand) at 31st March 2009:

	Millions of yen	Thousands of U.S. dollars
Time deposits	¥ 5	\$ 51
Buildings	1,898	19,367
Land	890	9,082
	<u>¥ 2,793</u>	<u>\$ 28,500</u>

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8. Deposited Securities

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

	Millions of yen			Thousands of U.S. dollars
	2007	2008	2009	2009
Installment sales transactions	¥ -	¥ 1,955	¥ 1,950	\$ 19,898
Real estate transactions	10	-	-	-
Law on gift certificates	-	2,239	-	-
	<u>¥ 10</u>	<u>¥ 4,194</u>	<u>¥ 1,950</u>	<u>\$ 19,898</u>

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 2007, 2008 and 2009 consisted of the following:

	Millions of yen			Thousands of U.S. dollars
	2007	2008	2009	2009
Projected benefit obligation	¥ 31,423	¥ 42,021	¥ 38,714	\$ 395,041
Unrecognised actuarial differences	(192)	557	(1,932)	(19,714)
Fair value of pension assets	(18,388)	(24,603)	(19,349)	(197,439)
Prepaid pension cost	-	-	859	8,765
Liability for severance and retirement benefits	<u>¥ 12,843</u>	<u>¥ 17,975</u>	<u>¥ 18,292</u>	<u>\$ 186,653</u>

Included in the consolidated statements of income for the years ended 31st March 2007, 2008 and 2009 were severance and retirement benefit expenses that comprised the following:

	Millions of yen			Thousands of U.S. dollars
	2007	2008	2009	2009
Service costs - benefits earned during the year	¥ 1,008	¥ 2,321	¥ 1,620	\$ 16,531
Interest cost on projected benefit obligation	612	828	800	8,163
Expected return on plan assets	(316)	(468)	(438)	(4,469)
Amortisation of prior service cost	-	-	7	71
Amortisation of actuarial differences	(69)	59	15	153
Severance and retirement benefit expenses	<u>1,235</u>	<u>2,740</u>	<u>2,004</u>	<u>20,449</u>
Other	<u>367</u>	<u>322</u>	<u>511</u>	<u>5,214</u>
Total	<u>¥ 1,602</u>	<u>¥ 3,062</u>	<u>¥ 2,515</u>	<u>\$ 25,663</u>

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 were mainly both 2.0% for the years ended 31st March 2007, 2008 and 2009. The estimated amount of all retirement benefits to be paid at future retirement dates is

allocated equally to each service year using the estimated number of total service years. Past service costs are mainly recognised as expenses when incurred, and actuarial gains and losses are recognised in equal amounts mainly over 13 years.

10. Lease Transactions

Finance lease transactions

The Group as lessee

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

(1) Breakdown of lease investment assets

Property, plant and equipment

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

(2) Method of depreciation of leased assets

As described in Note 2 "Summary of Significant Accounting Policies-Finance leases"

Finance lease transactions that are not deemed to transfer ownership of the leased property to the lessee and that were concluded prior to 1st April 2008 are accounted for by the same method as that applied to ordinary operating leases.

Information, as lessee, for non-capitalised finance leases at 31st March 2007, 2008 and 2009 was as follows:

	Millions of yen			Thousands of U.S. dollars
	2007	2008	2009	2009
Original lease obligations (including finance charges)	¥ 2,920	¥ 1,749	¥ 1,088	\$ 11,102
for machinery and equipment				
Payments remaining:	¥ 341	¥ 281	¥ 175	\$ 1,786
Payments due within one year	465	389	212	2,163
Payments due after one year	¥ 806	¥ 670	¥ 387	\$ 3,949

Rental expenses under such non-capitalised finance leases for the years ended 31st March 2007, 2008 and 2009 were ¥441 million, ¥456 million and ¥274 million (\$2,796 thousand), respectively.

Operating lease transactions

Future lease payments for noncancellable operating leases.

The Group as lessee

	Millions of yen		Thousands of U.S. dollars
	2009	2009	2009
Payments due within one year	¥ 4,911		\$ 50,112
Payments due after one year	¥ 12,365		\$ 126,174
Total	¥ 17,276		\$ 176,286

The Group as lessor

	Millions of yen		Thousands of U.S. dollars
	2009	2009	2009
Payments due within one year	¥ 694		\$ 7,082
Payments due after one year	¥ 4,584		\$ 46,775
Total	¥ 5,278		\$ 53,857

11. Contingent Liabilities

Contingent liabilities as of 31st March 2007, 2008 and 2009 were as follows:

	Millions of yen			Thousands of U.S. dollars
	2007	2008	2009	2009
Dept assumption agreements	¥ 6,800	¥ 6,800	¥ -	\$ -

12. Derivative Transactions

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

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

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

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

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

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H2O RETAILING CORPORATION and Consolidated Subsidiaries

13. Business Segment Information

Business segment information for the years ended 31st March 2007, 2008 and 2009, required to be disclosed by the Financial Instruments and Exchange Law of Japan, was as follows:

As of and for the year ended 31st March 2007	Millions of yen					Total
	Department stores	Supermarkets	Property management	Other	Eliminations	
Net sales						
External customers	¥ 291,567	¥ 78,257	¥ 9,284	¥ 16,842	¥ -	¥ 395,950
Intersegment	1,584	4,570	792	14,677	(21,623)	-
Total net sales	293,151	82,827	10,076	31,519	(21,623)	395,950
Operating costs and expenses	281,351	81,827	8,462	31,181	(21,635)	381,186
Operating income	¥ 11,800	¥ 1,000	¥ 1,614	¥ 338	¥ 12	¥ 14,764
Assets	¥ 248,290	¥ 51,819	¥ 22,075	¥ 36,966	¥ (76,391)	¥ 282,759
Depreciation and amortisation	4,569	1,543	580	346	-	7,038
Capital expenditure	3,740	2,774	453	292	-	7,259

Changes in Business Segmentation

The Companies used to classify their businesses into four segments: department stores, foods, property management and other businesses. However, we changed this segmentation in accordance with the increasing importance of the supermarket business. In fiscal year 2007, Hankyu Nissho Store, a supermarket business company, joined the Companies. The Companies also established Hanshoku Co., Ltd. as the intermediate holding company of the supermarket and food manufacturing business subsidiaries to ensure prompt and effective decision-making and implementation of business strategy in the supermarket business. Hanshoku Co., Ltd. controls three functional groups of supermarket business subsidiaries.

These three groups consist of Hankyu Oasis, Inc., Hankyu Family Store Co., Ltd. and Hankyu Nissho Store as the retailing business group, Hankyu Bakery Co., Ltd., Hankyu Foods, Inc., Hankyu Delica, Inc. and Mameda, Inc. as the food manufacturing business group, and Hankyu Fresh Yell Co., Ltd. as the purchasing function group. These three functional groups operate as one group, increasing their scale to make the supermarket business more profitable. This is the reason why we reclassified these subsidiaries related to the supermarket business as 'Supermarket business.' Subsidiaries which used to be in 'Foods business' and are not related to the supermarket business have been reclassified into other businesses since these subsidiaries have no significant impact on sales and operating income.

As of and for the year ended 31st March 2008	Millions of yen					Total
	Department stores	Supermarkets	Property management	Other	Eliminations	
Net sales						
External customers	¥ 351,435	¥ 89,785	¥ 9,686	¥ 20,711	¥ -	¥ 471,617
Intersegment	988	3,770	773	17,257	(22,788)	-
Total net sales	352,423	93,555	10,459	37,968	(22,788)	471,617
Operating costs and expenses	338,836	92,130	8,712	36,937	(22,112)	454,503
Operating income	¥ 13,587	¥ 1,425	¥ 1,747	¥ 1,031	¥ (676)	¥ 17,114
Assets	¥ 154,970	¥ 42,136	¥ 24,031	¥ 268,606	¥ (151,965)	¥ 337,778
Depreciation and amortisation	4,743	1,765	501	721	-	7,730
Impairment loss	-	867	-	-	-	867
Capital expenditure	9,431	1,928	525	1,241	-	13,125

Prior year information for 2007 has been reclassified to conform to the 2008 presentation.

As of and for the year ended 31st March 2009	Millions of yen					
	Department stores	Supermarkets	Property management	Other	Eliminations	Total
Net sales						
External customers.....	¥ 389,792	¥ 87,207	¥ 8,948	¥ 23,578	¥ -	¥509,525
Intersegment.....	94	3,344	582	21,510	(25,530)	-
Total net sales.....	389,886	90,551	9,530	45,088	(25,530)	509,525
Operating costs and expenses.....	379,095	89,381	8,238	41,679	(22,285)	496,108
Operating income	¥ 10,791	¥ 1,170	¥ 1,292	¥ 3,409	¥ (3,245)	¥ 13,417
Assets	¥ 146,140	¥ 42,129	¥ 23,049	¥257,196	¥(145,470)	¥323,044
Depreciation and amortisation	6,152	1,716	480	1,756	-	10,104
Impairment loss	-	178	-	25	-	203
Capital expenditure	12,646	3,950	210	3,143	-	19,949
As of and for the year ended 31st March 2009	Thousands of U.S. dollars					
Department stores	Supermarkets	Property management	Other	Eliminations	Total	
Net sales						
External customers.....	\$ 3,977,469	\$ 889,867	\$ 91,306	\$ 240,592	\$ -	\$5,199,234
Intersegment.....	959	34,122	5,939	219,490	(260,510)	-
Total net sales.....	3,978,428	923,989	97,245	460,082	(260,510)	5,199,234
Operating costs and expenses.....	3,868,316	912,051	84,061	425,296	(227,398)	5,062,326
Operating income	\$ 110,112	\$ 11,938	\$ 13,184	\$ 34,786	\$ (33,112)	\$ 136,908
Assets	\$1,491,224	\$ 429,888	\$ 235,194	\$2,624,449	\$(1,484,388)	\$3,296,367
Depreciation and amortisation	62,776	17,510	4,898	17,918	-	103,102
Impairment loss	-	1,816	-	255	-	2,071
Capital expenditure	129,041	40,306	2,143	32,071	-	203,561

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

Geographic segment information for the years ended 31st March 2007, 2008 and 2009 was not disclosed since the proportion of amounts attributable to domestic operations to the total amounts were more than 90% for both the total sales and assets.

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

Notes to the Consolidated Financial Statements

H₂O RETAILING CORPORATION and Consolidated Subsidiaries

14. Income Taxes

Income taxes consist of corporation, inhabitants and enterprise taxes.

Significant components of the Companies' deferred tax assets and liabilities as of 31st March 2007, 2008 and 2009 were as follows:

	Millions of yen			Thousands of U.S. dollars
	2007	2008	2009	2009
Deferred tax assets:				
Loss carryforwards	¥ 498	¥ 818	¥ 5,244	\$ 53,510
Provision for redemption of gift certificates	-	684	724	7,388
Bonuses to employees	1,521	1,923	1,732	17,673
Retirement benefits	5,104	7,224	6,921	70,622
Investments in consolidated subsidiaries	3,038	1,924	-	-
Loss on disposal of fixed assets	549	512	470	4,796
Depreciation	145	153	89	908
Impairment of investment securities and others	142	-	-	-
Impairment losses of fixed assets	1,517	1,150	1,119	11,418
Provision for loss of stores rebuilding	2,156	2,115	1,786	18,225
Unpaid transitional contribution on definite contribution pension plan	301	2	-	-
Retirement benefit trust assets	769	415	595	6,072
Other	1,727	3,649	3,482	35,531
	<u>17,467</u>	<u>20,569</u>	<u>22,162</u>	<u>226,143</u>
Valuation allowance	(390)	(166)	(1,241)	(12,663)
Total deferred tax assets	<u>17,077</u>	<u>20,403</u>	<u>20,921</u>	<u>213,480</u>
Deferred tax liabilities:				
Deferred gains on real properties	(3,020)	(2,941)	(3,459)	(35,296)
Special appropriation to the deferred gains on real properties	-	(664)	(21)	(214)
Land revaluation of a consolidated subsidiary	(1,409)	(1,957)	(1,920)	(19,592)
Valuation gain on investment securities resulting from conversion	(4,591)	(4,591)	(4,591)	(46,847)
of retirement benefit trust assets (equity securities)	(15,347)	(11,288)	(2,584)	(26,367)
Unrealised holding gains on securities	(52)	-	-	-
Deferred hedge gains	-	(204)	(368)	(3,756)
Other	(24,419)	(21,645)	(12,943)	(132,072)
Total deferred tax liabilities	<u>¥ (7,342)</u>	<u>¥ (1,242)</u>	<u>¥ 7,978</u>	<u>\$ 81,408</u>
Net deferred tax assets (liabilities)				

Net deferred tax assets (liabilities) as of 31st March 2007, 2008 and 2009 were included in the consolidated balance sheets as follows:

	Millions of yen			Thousands of U.S. dollars
	2007	2008	2009	2009
Current assets	¥ 3,228	¥ 4,113	¥ 5,025	\$ 51,276
Long-term assets	3,535	14,084	12,487	127,418
Current liabilities	-	-	(240)	(2,449)
Long-term liabilities	(14,105)	(19,439)	(9,294)	(94,837)
Net deferred tax assets (liabilities)	<u>¥ (7,342)</u>	<u>¥ (1,242)</u>	<u>¥ 7,978</u>	<u>\$ 81,408</u>

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

	2009
Aggregate statutory income tax rate	40.0%
Increase (reduction) in taxes resulting from:	
Nondeductible expenses	1.2
Tax on inhabitants per capita	1.7
Gain on extinguishment of tie-in shares	5.3
Retained earnings held by affiliated companies	7.8
Permanent differences (including dividends)	(3.6)
Net operating loss carryforwards	(20.5)
Amortisation of consolidated goodwill	4.1
Others	(3.8)
Effective income tax rate	32.2%

Reconciliation of the differences between the statutory tax rate and the effective income tax rate for 2007 and 2008 is not disclosed since the difference between the statutory tax rate and the effective income tax rate was less than 5% of the aggregate statutory income tax rate.

15. Net Assets

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

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

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

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

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

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

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

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

At the Board of Directors' meeting held on 13th May 2008, the Company resolved cash dividends amounting to ¥1,290 million. These appropriations have not been accrued in the consolidated financial statements as of 31st March 2008. The appropriations were recognised on 3rd June 2008.

The dividend policy is one of the most important policies of the Company. The Company used to focus on maintaining the dividend amount, now the Company considers the dividend amount based on the progress of GP10 plan ver.2.

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

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Stock Information

Changes in number of shares issued and outstanding during the years ended 31st March 2007, 2008 and 2009 were as follows:

Common stock outstanding	Number of shares		
	2007	2008	2009
Balance at beginning of year	187,688,301	187,688,301	206,740,777
Increase due to stock exchange	-	19,052,476	-
Balance at end of year	<u>187,688,301</u>	<u>206,740,777</u>	<u>206,740,777</u>

Treasury stock outstanding	Number of shares		
	2007	2008	2009
Balance at beginning of year	321,437	345,561	183,302
Increase due to additions to treasury stock in preparation for allotment of shares ...	-	-	4,000,000
Increase due to additions to treasury stock in preparation for stock exchange	-	16,257,000	-
Increase due to purchase of odd-lot shares	87,598	90,507	258,969
Increase due to treasury stock held by Hanshin Department Stores, Ltd.	-	20,050	-
Decrease due to stock exchange	-	16,364,000	-
Decrease due to sales of the Company's shares on the market by a subsidiary	-	-	3,950,400
Decrease due to sales of odd-lot shares	7,474	39,816	89,972
Decrease due to exercise of stock options	56,000	126,000	-
Balance at end of year	<u>345,561</u>	<u>183,302</u>	<u>401,899</u>

16. Land Revaluation

In accordance with the Law Concerning Revaluation of Land, land used for business owned by two consolidated subsidiaries was revaluated. The unrealised gains and losses, net of deferred taxes, were excluded from the statement of income and reported as "Land revaluation" in net assets, and the relevant deferred taxes were 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 2007, 2008 and 2009.

Related information was as follows:

Date of revaluations: 28th February 2002 and 31st March 2002	Millions of yen	Thousands of U.S. dollars
	2009	2009
Book value of land after revaluation	¥ 2,387	\$ 24,357
Market value of land at 31st March 2009	¥ 1,872	\$ 19,102
Difference	¥ 515	\$ 5,255

17. Stock Purchase Rights

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

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

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

18. Stock Options

(1) Outline of stock options

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

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

(2) Scale and changes in stock options

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

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

Fiscal year ended 31st March 2009:

Number of stock options

Before vested		After vested	
As of March 31, 2008	-	As of March 31, 2008	-
Granted	92,000	Vested	92,000
Forfeited	-	Exercised	-
Vested	92,000	Forfeited	-
Outstanding	-	Outstanding	92,000

Price information

Exercise price	¥ 1 (\$ 0.01)
Average exercise price	-
Fair value at the grant date	¥ 493 (\$ 5)

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

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

Valuation method used Adjusted Black-Scholes option-pricing model

Principal parameters and estimation method

Expected volatility of the underlying stock Note 1	32.8%
Remaining expected life of the option Note 2	6 years
Expected dividends on the stock Note 3	¥ 12.5 per share (\$ 0.13 per share)
Risk-free interest rate during the expected option term Note 4	0.86%

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

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

3. Projection as of March 2008

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

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

All of the share subscription rights were vested when granted.

Notes to the Consolidated Financial Statements

H₂O RETAILING CORPORATION and Consolidated Subsidiaries

19. Loan Commitments

For efficient procurement of working capital, the Company entered into loan commitment contracts with two financial institutions in 2007, providing the Company with loan commitment facilities in the aggregate amount of ¥5,000 million as of 31st March 2007.

20. Gain on Sales of Property, Plant and Equipment

The gain on sales of property, plant and equipment in the year ended 31st March 2008 was mainly due to the sale of land, buildings and structures of Hankyu Oasis Shioe store for ¥170 million, land, buildings and structures of Kawanishi Mosaic Box for ¥1,674 million and land of Hankyu Nissho Store, the former Ikeda store, for ¥547 million.

The gain on sales of property, plant and equipment in the year ended 31st March 2009 was mainly due to the sale of land, buildings and structures of Nishinomiya Distribution Centre operated by Hankyu Foods, Inc. for ¥59 million (\$602 thousand).

21. Loss of Stores Rebuilding

Loss of stores rebuilding in the year ended 31st March 2007 consisted of a loss of ¥1,994 million for the provision for loss of stores rebuilding.

Loss of stores rebuilding in the year ended 31st March 2008 consisted of a loss of ¥67 million for the provision for loss of stores rebuilding.

Loss of stores rebuilding in the year ended 31st March 2009 consisted of a loss of ¥173 million (\$1,765 thousand) for the provision for loss of stores rebuilding.

22. Business Reorganisation Expenses

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

	Millions of yen	Thousands of U.S. dollars
	2009	2009
Expenses for mergers within department store business	¥ 1,265	\$ 12,908
Expenses for mergers within supermarket business	330	3,367
Reorganisation expenses incurred in other businesses	1,128	11,511
	<u>¥ 2,723</u>	<u>\$ 27,786</u>

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

23. Impairment Losses

The Companies recorded impairment losses in the year ended 31st March 2008 as follows:

Company	Asset Group	Use	Type of Assets	Millions of yen
Hankyu Oasis, Inc.	Kitasenri store	Store	Buildings and structures, machinery and equipment and other	¥ 50
Hankyu Nissho Store	Neyagawa store and other	Store	Buildings and structures, machinery and equipment and other	¥267
Hankyu Family Store Co., Ltd.	Shimpoin store and other	Store	Buildings and structures, machinery and equipment and other	¥264
Hankyu Foods, Inc.	Nishinomiya centre	Logistics centre	Buildings and structures, machinery and equipment	¥286

Hankyu Oasis Inc., Hankyu Nissho Store, and Hankyu Family Store Co., Ltd. recognised impairment losses on some of their stores because their operating environments became severe with the growing competition.

The recoverable amounts of the assets are based on the present values of expected cash flows from the on-going utilisation and subsequent disposal of the assets using a discount rate of 5%.

Hankyu Foods, Inc. classified the Nishinomiya Centre, which was used as a logistics centre, into a separate item and recognised impairment loss for it because it became an idle asset with the restructuring of their facilities. The recoverable amount of the asset is its net realisable value based on the assessed asset value. As a result, ¥867 million was recorded as impairment losses in total.

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

Company	Asset Group	Use	Type of Assets	Millions of yen	Thousands of U.S. dollars
Hanshoku Co., Ltd.	Kusatsu store	Store	Buildings and structures, machinery and equipment	¥ 178	\$ 1,816
Hanshin Shoji Co., Ltd.	Yao store and other	Store	Buildings and structures, machinery and equipment	¥ 25	\$ 255

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

The recoverable amounts of the assets are the present values of expected cash flows from on-going utilisation and subsequent disposal of the assets based on a discount rate of 5%. As a result, ¥204 million (\$2,082 thousand) was recorded as impairment losses in total.

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 2007 consisted of losses of ¥632 million on the disposal of buildings and structures, losses of ¥8 million on the disposal of machinery and vehicles and losses of ¥103 million on the disposal of other assets.

Loss on disposal of property, plant, equipment and intangibles in the year ended 31st March 2008 consisted of losses of ¥652 million on the disposal of buildings and structures, losses of ¥10 million on the disposal of machinery and vehicles, losses of ¥53 million on the disposal of intangibles and losses of ¥97 million on the disposal of other assets.

Loss on disposal of property, plant, equipment and intangibles in the year ended 31st March 2009 consisted of losses of ¥275 million (\$2,806 thousand) on the disposal of buildings and structures, losses of ¥17 million (\$173 thousand) on the disposal of machinery and vehicles, losses of ¥320 million (\$3,265 thousand) on the disposal of intangibles and losses of ¥80 million (\$816 thousand) on the disposal of other assets.

25. Reduction in Book Value of Inventories

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

	Millions of yen	Thousands of U.S. dollars
	2009	2009
Cost of sales	<u>¥ 154</u>	<u>\$ 1,571</u>

26. Consolidated Statements of Cash Flows

Assets and liabilities of newly consolidated subsidiaries by acquisition of shares at the inception of their consolidation, 31 July 2006 and 1 October 2007, were as follows:

	Millions of yen			Thousands of U.S. dollars
	2007	2008	2009	2009
Current assets	¥ 5,049	¥ 22,634	¥ -	\$ -
Fixed assets	16,461	22,625	-	-
Total assets	<u>¥ 21,510</u>	<u>¥ 45,259</u>	<u>¥ -</u>	<u>\$ -</u>
Current liabilities	6,400	16,862	-	-
Long-term liabilities	6,503	5,406	-	-
Total liabilities	<u>¥ 12,903</u>	<u>¥ 22,268</u>	<u>¥ -</u>	<u>\$ -</u>

Notes to the Consolidated Financial Statements

H2O RETAILING CORPORATION and Consolidated Subsidiaries

27. Related Party Transactions

In the year ended 31st March 2009

(Additional Information)

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

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

1 Transactions with related parties

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

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

Nature of relationship	Nature of transactions	Value of transactions	Accounting title	Term-end balance
Rental of real estate	Rental fees	¥ 2,139 million (\$ 21,827 thousand)	Other under current assets (prepaid expenses)	¥ 187 million (\$ 1,908 thousand)
	Common service charge	¥ 273 million (\$ 2,786 thousand)	-	-
	Fees for display of signs, etc.	¥ 12 million (\$ 122 thousand)	-	-
	Lease deposit	-	Guarantee money deposited	¥ 3,213 million (\$ 32,786 thousand)
Materials procurement	Purchase of foodstuffs for processing	¥ 23 million (\$ 235 thousand)	Trade payables	¥ 1 million (\$ 10 thousand)

Business terms and policies for determination of business terms

Note 1 Transactions are conducted under third party beneficiary contracts

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

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

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

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

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

Classification	Name of company or personal name	Location	Capital or investment	Occupation or business lines	Ownership of voting rights (%)
Subsidiaries of companies that have significant stakes in the reporting entity	Hankyu Corporation	Kita-ku, Osaka City	¥ 100 million (\$ 1,020 thousand)	Railway operations, real estate rental and dealership operations, stage revues, retailing	-
	Hanshin Electric Railway Co., Ltd.	Fukushima-ku, Osaka City	¥ 29,384 million (\$ 299,837 thousand)	Railway operations; bus operations; real estate rental and dealership operations; sports business; travel business	14.38% of shares held by the Company

Nature of relationship	Nature of transactions	Value of transactions	Accounting title	Term-end balance
Same person serving concurrently as director or corporate auditor for both parties Rental of real estate	Rental fees	¥ 5,252 million (\$ 53,592 thousand)	Others under current assets (prepaid expenses; accrued revenue)	¥ 200 million (\$ 2,041 thousand)
			Accounts payable	¥ 1 million (\$ 10 thousand)
	Deposit of guarantee money paid	¥ 548 million (\$ 5,592 Thousand)	Guarantee money deposited	¥ 7,867 million (\$ 80,276 thousand)
	Return of guarantee money	¥ 160 million (\$ 1,633 thousand)		
Same person serving concurrently as director or corporate auditor for both parties Rental of real estate	Rental fees	¥ 2,354 million (\$ 24,020 thousand)	Others under current assets (prepaid expenses)	¥ 556 million (\$ 5,673 thousand)
	Fees for display of signs, etc.	¥ 9 million (\$ 92 thousand)	-	-
	Deposit of guarantee money	-	Guarantee money deposited	¥ 2,554 million (\$ 26,061 thousand)
	Return of guarantee money	¥ 6 million (\$ 61 thousand)	Other under investments and other assets	¥ 38 million (\$ 388 thousand)

Business terms and policies for determination of business terms

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

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

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

28. Net Income Per Share

Reconciliation of the difference between basic and diluted net income per share ("EPS") for the years ended 31st March 2007, 2008 and 2009.

	Millions of yen			Thousands of U.S. dollars
	2007	2008	2009	2009
Basic net income per share calculation:				
Income (numerator):				
Net income	¥ 8,100	¥ 9,450	¥ 6,380	\$ 65,102
Amounts not belonging to common stock	-	-	-	-
Net income available to common stockholders	8,100	9,450	6,380	65,102
Shares, thousands (denominator):				
Weighted average number of shares	187,358	188,738	205,665	
Basic EPS (yen and U.S. dollars)	¥ 43.23	¥ 50.07	¥ 31.02	\$ 0.32
Diluted net income per share calculation:				
Income (numerator):				
Net income	¥ 8,100	¥ 9,450	¥ 6,380	\$ 65,102
Amounts not belonging to common stock	-	-	-	-
Net income available to common stockholders	8,100	9,450	6,380	65,102
Effect of dilutive securities-convertible bonds	-	-	-	-
Adjusted net income	8,100	9,450	6,380	65,102
Shares, thousands (denominator):				
Weighted average number of shares	187,358	188,738	205,665	
Assumed conversion of convertible bonds	20,366	20,366	20,367	
Assumed exercise of stock purchase rights	23	-	-	
Adjusted weighed average number of shares	207,747	209,104	226,032	
Diluted EPS (yen and U.S. dollars)	¥ 38.99	¥ 45.19	¥ 28.23	\$ 0.29

29. Business Combinations

(Change in accounting standard for business combinations, etc.)

Effective from the year ended 31st March 2007, the Company applied the “Accounting standard for business combinations” issued by the Business Accounting Council on 31st October 2003, Accounting Standard Board Statement No. 7, the “Accounting Standard for Business Divestitures” issued by the Accounting Standard Board of Japan on 27th December 2005 and the Accounting Standard Board Guidance No. 10, “Guidance for Accounting Standard for Business Combinations and the Accounting Standard for Business Divestitures,” issued by the Accounting Standards Board of Japan on 22nd December 2006. The adoption of the New Accounting Standards had no impact on the consolidated statements of income for the year ended 31st March 2007.

In the year ended 31st March 2007

Purchase Method Application (Purchase of Nissho Corporation)

1. Corporate name and description of business of acquired company, main reason for business combination, date of business combination, legal form of business combination, corporate name after business combination and percentage of voting rights acquired

(1) Corporate name and business of the entity combined

Nissho Corporation - Supermarkets business

(2) Purpose of business combination

The Companies operate in the supermarkets business with originalities as department store group. By combining with Nissho Corporation, which has stores in Hokusetsu (the northern area of Osaka and south-eastern area of Hyogo), the Companies can enhance intra-group synergy through the combination of the strong points of each supermarkets subsidiaries and the complementary effects of the operating areas. The Companies can also enlarge the scale of the supermarkets business and implement the dominant strategy in the Kansai area.

(3) Date of business combination

31st July 2006

(4) Legal form of business combination

Purchase of shares of Nissho Corporation

(5) Corporate name after business combination

Hankyu Department Stores, Inc.

(6) Percentage of total shares outstanding

100%

2. The period of operations of the purchased company included in the consolidated statements of income

From 1st August 2006 to 31st March 2007

3. Acquisition cost

¥18,750 million

4. Amount of goodwill, reason for the generation of goodwill and the method and period of amortisation of goodwill

(1) Amount of goodwill

¥10,143 million

(2) Reason for the generation of goodwill

The goodwill arose from the expected future profitability generated by the increased scale of the supermarkets business.

(3) The method and period of amortisation of goodwill

Equal amortisation over 20 years

5. Assets and liabilities of the combined company as of the date of the combination

	Millions of yen
Current assets	¥ 5,049
Fixed assets	16,461
Total assets	<u>¥ 21,510</u>
Current liabilities	6,400
Long-term liabilities	6,503
Total liabilities	<u>¥ 12,903</u>

6. The estimated influence on the consolidated statement of income for the year ended 31st March 2007 if the business combination had been completed on 1st April 2006

Net sales	¥408,156 million
Operating income	¥14,647 million
Income before income taxes	¥14,203 million
Net income	¥7,969 million
Net income per share	¥42.53

The influence shown above is estimated by adding the sales and income of Nissho Corporation from 1st April 2006 to 31st July 2006 and the amortisation of goodwill for the same period.

In the year ended 31st March 2008

Purchase Method Application

(Management Combination with Hanshin Department Store, Ltd. through share transfer)

The Company integrated its operations with Hanshin Department Store, Ltd., a wholly owned subsidiary of the Company, through a share transfer effective 1st October 2007.

- Corporate name and description of business of acquired company, primary reason for business combination, date of business combination, legal form of business combination, corporate name after business combination, percentage of voting rights acquired.
 - Corporate name and description of operations of acquired company
Hanshin Department Store, Ltd. - Department store operations
 - Primary reason for business combination of operations
In addition to major changes in the operating environment such as the declining birthrate, the aging of the population, competition between different business formats, and a decline in the number of market participants triggered by industry reorganisations, the downtown of Osaka (“Kita”) is expected to become an area of unprecedented business concentration by 2011, creating an exceptionally competitive business environment. Accordingly, the companies, which are ranked as the number one and number two stores in the area, decided to merge in order to build a unified business foundation that can take full advantage of both brand and jointly utilise the business resources of both companies to construct a “super main store” that will give them a competitive advantage and, thereby, improve customer satisfaction and boost shareholder value.
 - Date of business combination
1st October 2007
 - Legal form of business combination
Share transfer whereby Hankyu Department Stores, Inc. became the 100% parent company and Hanshin Department Store, Ltd. became the wholly-owned subsidiary (Note: The Hankyu Department Stores, Inc. changed its trade name to H2O RETAILING CORPORATION as of 1st October 2007.)
 - Corporate name after business combination
H2O RETAILING CORPORATION
 - Percentage of voting rights acquired
99.9%
As a result of the above-mentioned acquisition, Hanshin Department Store, Ltd. became a wholly-owned subsidiary of the Company.
- Period of the business performance of the acquired company contained in the consolidated financial statements
1st October 2007 to 31st March 2008
- Acquisition cost
¥38,144 million

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H2O RETAILING CORPORATION and Consolidated Subsidiaries

4. Share transfer ratio

One common share of the Company was exchanged for one common share of Hanshin Department Store, Ltd. However, this exchange was not applied to twenty thousand (20,000) shares of common stock in Hanshin Department Store, Ltd. that were owned by the Company

5. Calculation method of share transfer ratio

Daiwa Securities SMBC Co. Ltd. calculated the share transfer ratio on behalf of the Company, while Ernst & Young Transaction Advisory Services Co., Ltd. performed the calculation on behalf of Hanshin Department Store, Ltd.

Daiwa Securities SMBC performed a share value appraisal with respect to the Company based on the discounted cash flow method (DCF method) and another method used for a comparison of similar companies. It also performed a share value appraisal with respect to Hanshin Department Store, Ltd. based on the same methods.

Ernst & Young made similar calculations with respect to the Company based on the market stock price method, DCF method, the other method used for the comparison of similar companies, and the net asset method. After comprehensively considering these results, the market stock price method and the DCF method were adopted to calculate the stock value per share. For valuation of Hanshin Department Store, Ltd., Ernst & Young adopted the DCF method and calculated the stock value per share after comprehensively considering the calculation results based on the DCF method, the method used for the comparison of similar companies and the net asset method.

Based on the results of these calculations, and after considering the respective financial situations, business performance trends, and so on of both companies, and after extensive discussions between the two companies, it was finally agreed that the above-mentioned share transfer ratio was appropriate.

6. Number of shares delivered and appraised value

Number of shares delivered: 35,416,476 shares of common stock

Appraised value: ¥38,144 million

With respect to 16,364,000 shares of the above-mentioned stock, shares in treasury stock were allocated for delivery.

7. Amount of goodwill, reason, method of amortisation, and period for amortisation

(1) Amount of goodwill: ¥10,066 million

(2) Reason

Goodwill arose in connection with the anticipated future profitability resulting from improvements in the competitive predominance of the department store business as well as cost reductions achieved through integration of the business infrastructure.

(3) Method of amortisation and period for amortisation

Equal amounts over a twenty-year period

8. Amount of assets received and liabilities assumed on the date of business combination and breakdown thereof

(1) Amount of assets

Current assets: ¥22,634 million

Noncurrent assets: ¥22,624 million

(2) Amount of liabilities

Current liabilities: ¥16,862 million

Long-term liabilities: ¥5,405 million

9. Estimated effect on consolidated income statements for the reporting term assuming that the business combination is completed on the date of the commencement of the reporting period

Sales and profit and loss information

Net sales: ¥527,206 million

Operating income: ¥17,967 million

Income before income taxes: ¥18,110 million

Net income: ¥10,017 million

Net income per share: ¥48.85

(Calculation method of estimated amounts and important prerequisites)

The sales and profits and losses of Hanshin Department Store, Ltd. and five subsidiaries for the 2007 fiscal year were totaled and calculated after assuming the estimated amounts of eliminations for consolidation adjustment and goodwill amortisation expenses.

Procedures and Other Relationships Under Common Control

(Changeover to holding company system through corporate split of department store business)

The department store business of the Company was taken over by the new company that was established by the corporate split on 1st October 2007. The Company itself was transformed into a holding company.

1. Name and description of target business, legal form of business combination, name of business after combination and summary of transactions, including purpose of transaction

In order to change to a holding company system, the Company carried out a corporate split to establish a new company, which took the department store business (including the departments of the headquarters, such as personnel, general affairs, management, development, etc. related to the department store business, and internal companies) of the Company. The new company was named Hankyu Department Stores, Inc. Simultaneously, the Company changed its trade name to H2O RETAILING CORPORATION.

2. Summary of accounting procedures performed

As of 30th September 2007, the assets and liabilities of The Hankyu Department Stores, Inc. were divided into department store-related assets and liabilities and holding company-related assets and liabilities. Thereafter, the assets and liabilities related to the department store business were transferred to the newly established company through a corporate split in consideration for which the Company acquired shares of the new company.

(1) Amounts of transferred assets and liabilities and breakdown thereof

1. Amount of assets

Current assets: ¥41,099 million

Noncurrent assets: ¥44,359 million

2. Amount of liabilities

Current liabilities: ¥34,609 million

Long-term liabilities: ¥16,438 million

(2) Number of shares and calculation basis of the shares of the new company

1. Number of shares: 100,000 shares

2. Calculation basis

We determined the number of shares to be issued by the new company to realise efficient management, taking into consideration the amount of its paid-in capital.

In addition, notwithstanding the number of shares issued or allocated, the net assets of H2O RETAILING CORPORATION remain unchanged.

(3) Paid-in capital and description of business of the new company

Paid-in capital: ¥5 million

Line of business: Department store operations

The corporate split has no effect on the consolidated financial statements as the procedure comes under the category of common control.

(Establishment of intermediate holding company (development of Oi Development Co., Ltd.) through corporate split of property management business)

In order to achieve speedy and efficient expansion of the property management business, at the Board of Directors' meeting held on 1st October 2007, the Company resolved to establish Oi Development Co., Ltd. as an intermediate holding company to take over the property management business planning operations of the H2O RETAILING Group through a corporate split and established an intermediate holding company on 22nd October 2007.

Notes to the Consolidated Financial Statements

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1. Name and description of target business, legal form of business combination, name of business after business combination, and summary of procedures, including their purpose

Oi Development Co., Ltd., as a holding company which controls the property management (PM) business of the H2O RETAILING Group to optimise the Group's entire PM business, conducts strategic planning related primarily to the redevelopment of the JR Oimachi Station area (in Tokyo), and promotes the further acceleration of the growth strategy. For this purpose, the operations of the PM Business Planning Department of the Company (drafts the strategic planning for the PM Business segment) were taken over by Oi Development Co., Ltd., the newly established intermediate holding company.

2. Summary of accounting procedures performed

Among the assets and liabilities of H2O RETAILING CORPORATION as 22nd October 2007, the assets and liabilities related to the redevelopment of the JR Oimachi Station area were transferred to the newly established company, in consideration for which the shares of the newly established company were acquired by H2O RETAILING CORPORATION.

Amounts of transferred assets and liabilities and breakdown thereof

- (1) Amount of assets

Current assets: ¥34 million

Noncurrent assets: ¥9,969 million

- (2) Amount of liabilities

Long-term liabilities: ¥145 million

The corporate split has had no effect on the consolidated financial statements as the procedure comes under the category of common control.

In addition, Oi Development Co., Ltd. (the intermediate holding company of the PM Business) and Ours Inn Hankyu (its trade name was changed as of 22nd October 2007 from Oi Development Co., Ltd.), which operates a hotel near JR Oimachi Station, passed a resolution at the Board or Directors' meeting of both companies held on 25th October 2007 to approve the business transfer agreement, stating that the business related to the redevelopment of the JR Oimachi Station area would be transferred from Ours Inn Hankyu to Oi Development Co. Ltd. The transfer agreement was implemented on 1st December 2007.

In the year ended 31st March 2009

Procedures and Other Relationships Under Common Control

(Mergers of department store operation subsidiaries)

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

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

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

Hankyu Department Stores, Inc. - department store business

Hanshin Department Store, Ltd. - department store business

- (2) Legal form of business combination

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

- (3) Corporate name after business combination

Hankyu Hanshin Department Stores, Inc.

(4) Summary of transactions, including their purpose

Prior to the merger, Hankyu Department Stores, Inc. and Hanshin Department Store, Ltd. had firstly engaged in the integration of their infrastructures, including their computer systems, and also arranged for the shared use of their facilities and common procurement of fittings and fixtures. In the second stage of integration, the human resources departments of the two companies were reorganised and steps were taken to synchronise administrative work processes. The two companies were then merged, based on the management's judgment that full integration through merger would be the most effective means of ensuring wholehearted collaboration in the integration process, thereby enabling the speeding up of final integration and the achievement of the maximum synergistic effect.

2. Summary of accounting procedures performed

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

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

(Merger of subsidiaries in the supermarket operation business)

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

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

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

Hanshoku Co., Ltd.

Supervision of food business companies and management of business activities

Hankyu Oasis, Inc.

Management of food supermarkets

Hankyu Nissho Store

Management of food supermarkets

Hankyu Family Store Co., Ltd.

Management of food supermarkets

Hankyu Fresh Yell Co., Ltd.

Procurement and wholesaling of food products

(2) Legal form of business combination

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

(3) Corporate name after business combination

Hanshoku Co., Ltd.

(4) Summary of transactions, including their purpose

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

2. Summary of accounting procedures performed

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

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

Independent Auditors' Report

To the Board of Directors of
H2O RETAILING CORPORATION:

We have audited the accompanying consolidated balance sheets of H2O RETAILING CORPORATION (formerly Hankyu Department Stores, Inc.) and consolidated subsidiaries as of 31st March, 2007, 2008, and 2009, and the related consolidated statements of income, changes in net assets and cash flows for each of the three years in the period ended 31st March 2009, expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of H2O RETAILING CORPORATION and subsidiaries as of 31st March, 2007, 2008 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended 31st March 2009, in conformity with accounting principles generally accepted in Japan.

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

- (1) As discussed in Note 13 to the consolidated financial statements, effective 1st April 2006, the Company and subsidiaries changed its segmentation.
- (2) As discussed in Note 2 to the consolidated financial statements, effective 1st April 2007, the Company and subsidiaries changed the accounting policy of provision for redemption of gift certificates.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended 31st March 2009 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
24th June 2009

KPMG AZSA & Co.

Board of Directors and Corporate Auditors

Chairman, Representative Director and CEO

Shunichi Sugioka

President and Representative Director

Jun Wakabayashi

Representative Director

Nobuaki Nitta

Directors

Yosaku Fuji, Kazuo Sumi, Kazutoshi Senno

Director, Executive Officer

Tadatsugu Mori

Directors

Atsunori Ando, Keiji Uchiyama, Shigeru Yasukawa

Director, Executive Officer

Katsuhiko Hayashi

Executive Officer

Junichi Ono

Standing Corporate Auditor

Toshimitsu Konishi

Corporate Auditors

Hideyuki Takai, Takeshi Nakagawa, Toshihisa Takamura
(as of 24th June 2009)

Outline of the Company

Date of Establishment :	March 1947
Stated Capital :	¥17,797 million
Authorised Shares :	300,000,000
Issued and Outstanding Shares :	206,740,777
Shareholders :	16,037
Employees :	60

Principal Shareholders :

Hankyu Hanshin Department Stores Kyoeikai
Hanshin Electric Railway Co., Ltd.
Takashimaya Company, Limited
Hankyu Hanshin Holdings, Inc.
Japan Trustee Services Bank, Ltd. (Trust account)
Japan Trustee Services Bank, Ltd. (Trust account 4G)
The Bank of Tokyo-Mitsubishi UFJ, Ltd.
The Master Trust Bank of Japan, Ltd. (Trust account)
Japan Trustee Services Bank, Ltd. (Trust account 4)
Sumitomo Mitsui Banking Corporation

Principal Consolidated Subsidiaries

Company name	Stated capital (Millions of yen)	Annual sales (Millions of yen)	Direct holding by the company (%)	Principal business
Hankyu Hanshin Department Stores, Inc.	¥ 5,000	¥ 389,892	100.0	Operation of department stores
Hanshoku Co., Ltd.	100	85,654	100.0	Operation of supermarkets
Hankyu Kitchen Yell, Inc.	50	6,267	100.0	Food delivery service
Hankyu Foods, Inc.	50	2,534	100.0	Manufacture and sale of food products
Hankyu Bakery Co., Ltd.	50	1,657	100.0	Manufacture and sale of food products
Oi Development Co., Ltd.	100	327	100.0	Supervision of property management business
Hankyu Shopping Center Development Co., Ltd.	50	5,789	100.0	Developer
Ours Inn Hankyu	100	2,138	100.0	Hotel
Heart Dining Inc.	10	4,614	100.0	Management of cafe, restaurants and company cafeteria
Hankyu Seisakusho Co., Ltd.	20	5,310	100.0	Manufacture and sale of furniture and furnishings
Hankyu Design Systems Co., Ltd.	10	2,797	100.0	Sale of sales promotion materials and printings
Hankyu Department Stores Europe B.V.	EUR 220 thousands	EUR 562 thousands	100.0	Fund-raising and fund management related to overseas business
Hankyu Home Styling Co., Ltd.	10	665	100.0	Sale of furniture
Esaka Logistics Service Co., Ltd.	20	4,586	100.0	Transportation
Persona Co., Ltd.	20	767	100.0	Credit card business
Hankyu Maintenance Service Co., Ltd.	10	2,540	100.0	Operation of office maintenance service
With System Corporation	100	2,268	81.0	Data processing and systems development
Hankyu Job Yell Co., Ltd.	40	2,081	100.0	Temporary employment agency
Hankyu Tomonokai Co., Ltd.	50	372	100.0	Membership organisation for customer service

H₂O RETAILING CORPORATION

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