

Overview of Operations

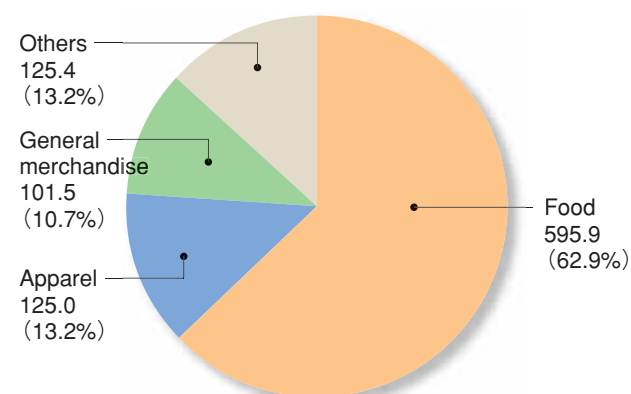
In fiscal 2006, ended December 31, 2006, Seiyu posted consolidated net sales of ¥960,861 million, down 3.6% from the preceding fiscal year, although same-store sales turned around, rising 0.6% to mark the first year-on-year improvement in 15 years. Excluding the impact of subsidiaries sold during the term, sales from existing operations improved. The Company

Retail Sales

Seiyu opened three new stores in fiscal 2006, including two large stores—the Sendai Izumi store in Miyagi Prefecture and the Hitachino-Ushiku store in Ibaraki Prefecture—as well as the Atsuta-Sanbancho store in Aichi Prefecture. After reviewing its operating assets, the Company discontinued operations at 13 unprofitable stores.

During the year, in response to customer input we remodeled 73 stores, substantially more than the 15 stores

Composition of Retail Sales (Billions of yen)



Real Estate

In its real estate operations, Seiyu seeks to generate income by reinvigorating dormant real estate assets and upgrading tenants, as well as disposing of owned assets. During the year,

also performed favorably in terms of income. Operating income increased 161.4%, to ¥3,222 million, and our ordinary loss came to ¥2,614 million, compared with ¥6,160 million in fiscal 2005. During the year, the Company booked impairment losses of ¥49.2 billion, resulting in an extraordinary loss. Consequently, the net loss during the term was ¥55,792 million.

refurbished in fiscal 2005. Our efforts focused on expanding regional product selections, improving layouts, increasing the ease of product selection and creating more comfortable shopping environments. As a result, sales at remodeled stores were strong.

We also responded to customers' requests by expanding our portfolio of 24-hour stores, enhancing lineups of fresh foods and side dishes, and strengthening nighttime product selections. During the year, we increased the number of 24-hour stores by 53, to 262 stores.

Seiyu regularly conducts customer surveys to evaluate various aspects of customers' shopping experiences. The results of our most recent survey were the most positive to date, pointing to our success in embracing customer suggestions. Survey comments regarding product selections and checkout accuracy and speed showed particular improvement.

In August 2006, we began operating an integrated distribution center handling food products, apparel and general merchandise in the city of Misato, Saitama Prefecture. Supported by our business partners, we have begun supplying our stores in the Tokyo metropolitan area from this center.

revenues from real estate operations increased 3.5%, to ¥5,741 million, and operating income expanded 74.6%, to ¥1,973 million.

Consolidated Financial Statements

Consolidated Balance Sheets

(Millions of yen)

	December 31, 2005	December 31, 2006	December 31, 2005	December 31, 2006
Assets				
Current assets:				
Cash on hand and in banks	¥ 114,066	¥ 73,320		
Trade notes and accounts receivable	26,353	18,432		
Inventories	50,626	51,664		
Deferred income taxes	269	325		
Other current assets	25,167	21,698		
Allowance for doubtful accounts	(52)	(48)		
Total current assets	¥ 216,430	¥ 165,392		
Fixed assets:				
Property and equipment:				
Buildings and structures	¥ 143,088	¥ 117,491		
Land	131,843	116,479		
Other property and equipment	13,465	10,791		
Total property and equipment	¥ 288,397	¥ 244,763		
Intangible fixed assets:				
Goodwill	¥ 1,006	¥ 668		
Other intangible fixed assets	8,132	6,446		
Total intangible fixed assets	¥ 9,139	¥ 7,115		
Investments and other assets:				
Investments in securities	¥ 12,476	¥ 11,519		
Long-term loans receivable	48,041	44,674		
Leasehold deposits	67,192	67,961		
Deferred income taxes	1,028	823		
Other investments	13,269	10,735		
Allowance for doubtful accounts	(4,589)	(5,063)		
Total investments and other assets	¥ 137,418	¥ 130,651		
Total fixed assets	¥ 434,955	¥ 382,529		
Liabilities				
Current liabilities:				
Trade notes and accounts payable	¥ 105,515	¥ 102,208		
Short-term borrowings	50,704	32,700		
Current portion of bonds	4,000	2,000		
Commercial paper	54,400	41,400		
Accrued income taxes	1,689	1,677		
Accrued bonus for employees	415	486		
Other current liabilities	26,873	28,188		
Total current liabilities	¥ 243,598	¥ 208,661		
Long-term liabilities:				
Bonds	¥ 2,000	¥ 1,600		
Long-term borrowings	246,690	237,505		
Deferred tax liabilities	1,836	789		
Deferred tax liabilities from revaluation of land	3,498	3,327		
Accrued retirement benefits for employees	15,313	14,490		
Accrued retirement benefits for directors	168	125		
Other long-term liabilities	28,813	27,730		
Total long-term liabilities	¥ 298,320	¥ 285,568		
Total liabilities	¥ 541,919	¥ 494,230		
Minority interests				
Minority interests	¥ 27	¥ —		
Shareholders' equity				
Common and preferred stock	129,895	—		
Capital surplus	77,531	—		
Retained earnings	(95,031)	—		
Excess of land revaluation	(3,223)	—		
Net unrealized gain on other securities	890	—		
Translation adjustments	(374)	—		
Treasury stock	(248)	—		
Total shareholders' equity	¥ 109,439	¥ —		
Total liabilities and shareholders' equity	¥ 651,386	¥ —		
Net assets				
Shareholders' equity				
Common and preferred stock	¥ —	¥ 129,895		
Capital surplus	—	77,706		
Retained earnings	—	(151,930)		
Treasury stock	—	(170)		
Total shareholders' equity	—	55,501		
Valuation and translation adjustments				
Net unrealized gain on other securities	—	452		
Deferred gain (loss) on hedge transactions	—	(172)		
Excess of land revaluation	—	(2,118)		
Total valuation and translation adjustments	—	(1,838)		
Stock options	—	1		
Minority interests	—	27		
Total net assets	¥ —	¥ 53,691		
Total liabilities and net assets	¥ —	¥ 547,922		

Notes: 1. Amounts are rounded down to the nearest million yen.
2. All statements are based on the Generally Accepted Accounting Principles in Japan that correspond to their respective fiscal years.

Non-Consolidated Financial Statements

Consolidated Statements of Income (Millions of yen)

	Year ended December 31, 2005	Year ended December 31, 2006
Net sales	¥ 997,103	¥ 960,861
Cost of sales	751,896	720,260
Total gross profit	¥ 245,206	¥ 240,600
Other operating revenue	¥ 37,483	¥ 35,269
Operating gross profit	¥ 282,689	¥ 275,870
Selling, general and administrative expenses:		
Salaries and bonuses to employees	¥ 95,569	¥ 92,639
Provision for accrued bonuses	1,179	812
Retirement benefit expenses	4,444	3,698
Provision for accrued retirement benefits for directors	62	24
Rental fee	49,952	48,900
Amortization of goodwill	610	338
Other	129,638	126,235
Total selling, general and administrative expenses	¥ 281,456	¥ 272,648
Operating income	¥ 1,233	¥ 3,222
Non-operating income:		
Interest income	¥ 661	¥ 638
Dividend income	113	89
Equity in earnings of unconsolidated subsidiaries and affiliates	—	17
Miscellaneous income	2,800	1,143
Total non-operating income	¥ 3,575	¥ 1,888
Non-operating expenses:		
Interest expenses	¥ 8,682	¥ 7,100
Interest expenses on commercial paper	935	201
Equity in losses of unconsolidated subsidiaries and affiliates	24	—
Miscellaneous losses	1,326	423
Total non-operating expenses	¥ 10,970	¥ 7,725
Ordinary loss	¥ 6,160	¥ 2,614

	Year ended December 31, 2005	Year ended December 31, 2006
Special gains:		
Gains on sales of fixed assets	¥ 36	¥ 2
Gains on sales of investment securities	1,765	49
Profit on cancellation loans	—	1,100
Other special gains	228	198
Total special gains	¥ 2,031	¥ 1,351
Special losses:		
Losses on sales of fixed assets	¥ 303	¥ 61
Loss on disposal of fixed assets	937	814
Provision for allowance for doubtful accounts	336	514
Amortization of net retirement benefit obligation at transition	3,128	—
Loss on write down of merchandise	2,094	—
Impairment loss	—	49,289
Other special losses	1,348	2,967
Total special losses	¥ 8,148	¥ 53,647
Loss before income taxes	¥ 12,278	¥ 54,911
Income taxes—current	¥ 2,271	¥ 1,650
Income taxes—deferred	¥ 3,174	¥ (769)
Income applicable to minority interests	¥ 49	¥ 0
Net loss	¥ 17,774	¥ 55,792

Notes: 1. Amounts are rounded down to the nearest million yen. 2. All statements are based on the Generally Accepted Accounting Principles in Japan that correspond to their respective fiscal years.

Consolidated Statements of Cash Flows (Millions of yen)

	Year ended December 31, 2005	Year ended December 31, 2006
Net cash (used in) provided by operating activities	¥ 9,866	¥ 17,597
Net cash used in investing activities	¥ (14,968)	¥ (14,840)
Net cash provided by financing activities	¥ 25,562	¥ (41,255)
Effect of exchange rate changes on cash and cash equivalents	¥ 725	¥ 1
Increase (decrease) in cash and cash equivalents	¥ 21,185	¥ (38,496)
Cash and cash equivalents at beginning of the year	¥ 88,247	¥ 109,433
Cash and cash equivalents at end of the year	¥ 109,433	¥ 70,937

Notes: 1. Amounts are rounded down to the nearest million yen. 2. All statements are based on the Generally Accepted Accounting Principles in Japan that correspond to their respective fiscal years.

Consolidated Statements of Changes in Shareholders' Equity (Year ended December 31, 2006) (Millions of yen)

	Shareholder's equity				Valuation and translation adjustments							Total net assets	
	Common and preferred stock	Capital surplus	Retained earnings	Treasury stock	Total shareholders' equity	Net unrealized gain (loss) on other securities	Deferred gain (loss) on hedge transactions	Excess of land revaluation	Translation adjustments	Total valuation and translation adjustments	Stock options		Minority interests
Balance as of December 31, 2005	¥ 129,895	¥ 77,531	¥ (95,031)	¥ (248)	¥ 112,147	¥ 890	¥ —	¥ (3,223)	¥ (374)	¥ (2,707)	¥ —	¥ 27	¥ 109,467
Changes during the period													
Distribution of earnings to executive bonuses			(2)		(2)								(2)
Net income (loss)			(55,792)		(55,792)								(55,792)
Reversal of excess of land revaluation			(1,104)		(1,104)								(1,104)
Purchase of treasury stock				(15)	(15)								(15)
Sale of treasury stock		175		93	268								268
Net changes of items other than shareholders' equity						(438)	(172)	1,104	374	868	1	0	870
Total changes during the period	—	175	(56,898)	77	(56,645)	(438)	(172)	1,104	374	868	1	0	(55,775)
Balance as of December 31, 2006	¥ 129,895	¥ 77,706	¥ (151,930)	¥ (170)	¥ 55,501	¥ 452	¥ (172)	¥ (2,118)	¥ —	¥ (1,838)	¥ 1	¥ 27	¥ 53,691

Notes: 1. Amounts are rounded down to the nearest million yen.
2. All statements are based on the Generally Accepted Accounting Principles in Japan that correspond to their respective fiscal years.

Non-Consolidated Balance Sheets (Millions of yen)

	December 31, 2005	December 31, 2006
Assets		
Current assets:		
Cash on hand and in banks	¥ 101,399	¥ 60,314
Trade notes and accounts receivable	21,773	14,264
Inventories	37,944	39,540
Other current assets	99,401	82,634
Total current assets	¥ 260,520	¥ 196,753
Fixed assets:		
Total property and equipment	¥ 168,357	¥ 155,996
Total intangible fixed assets	7,612	6,319
Total investments and other assets	162,349	145,351
Total fixed assets	¥ 338,320	¥ 307,667
Total assets	¥ 598,840	¥ 504,420
Liabilities		
Total current liabilities	¥ 213,474	¥ 177,507
Total long-term liabilities	275,378	265,022
Total liabilities	¥ 488,853	¥ 442,530
Shareholders' equity		
Common and preferred stock	¥ 129,895	¥ —
Capital surplus		
Additional paid-in capital	76,236	—
Retained earnings		
Undisposed accumulated deficit	92,713	—
Excess of land revaluation	(3,591)	—
Net unrealized gain (loss) on securities	315	—
Treasury stock	(154)	—
Total shareholders' equity	¥ 109,987	¥ —
Total liabilities and shareholders' equity	¥ 598,840	¥ —
Net assets		
Shareholders' equity		
Common and preferred stock	¥ —	¥ 129,895
Capital surplus		
Additional paid-in capital	—	76,236
Retained earnings		
Retained earnings brought forward	—	(141,592)
Treasury stock	—	(170)
Total shareholders' equity	¥ —	¥ 64,369
Valuation and translation adjustments		
Net unrealized gain (loss) on other securities	¥ —	¥ 179
Deferred gain (loss) on hedge transactions	—	(172)
Excess of land revaluation	—	(2,486)
Total valuation and translation adjustments	¥ —	¥ (2,479)
Stock options	¥ —	¥ 1
Total net assets	¥ —	¥ 61,890
Total liabilities and net assets	¥ —	¥ 504,420

Notes: 1. Amounts are rounded down to the nearest million yen.
2. All statements are based on the Generally Accepted Accounting Principles in Japan that correspond to their respective fiscal years.

Non-Consolidated Statements of Income (Millions of yen)

	Year ended December 31, 2005	Year ended December 31, 2006
Net sales	¥ 685,035	¥ 685,268
Cost of sales	518,532	520,066
Total gross profit	¥ 166,503	¥ 165,201
Other operating revenues	¥ 40,462	¥ 38,548
Operating gross profit	¥ 206,966	¥ 203,750
Selling, general and administrative expenses	¥ 207,641	¥ 202,022
Operating income (loss)	¥ (675)	¥ 1,727
Non-operating income	¥ 4,003	¥ 4,123
Non-operating expenses	10,210	7,535
Ordinary loss	¥ 6,882	¥ 1,683
Special gains	¥ 4,579	¥ 1,284
Special losses	12,351	47,149
Loss before income taxes	¥ 14,653	¥ 47,549
Income taxes—current	¥ 396	¥ 396
Income taxes—deferred	2,658	(170)
Net loss	¥ 17,707	¥ 47,774
Accumulated deficit carried forward from prior year	¥ 74,950	¥ —
Reversal of excess of land revaluation	(54)	—
Undisposed accumulated deficit at end of period	¥ 92,713	¥ —

Notes: 1. Amounts are rounded down to the nearest million yen.
2. All statements are based on the Generally Accepted Accounting Principles in Japan that correspond to their respective fiscal years.