

# Interim Report for the First Half of the Fiscal Year Ending March 31, 2007 (Consolidated)

November 15, 2006

Company name: Advanced Media, Inc. Listing: TSE Mothers  
 Code Number: 3773 Headquarters: Tokyo  
 URL: <http://www.advanced-media.co.jp>  
 Representative: Kiyoyuki Suzuki, President and CEO Tel: +81-3-5958-1031  
 Point of contact: Katsumi Tatematsu, Director and General Manager, President's Office  
 Date of the board resolution approving the statement of accounts for the period: November 15, 2006

## 1. Consolidated business results for the interim period ended September 30, 2006 (April 1, 2006 - September 30, 2006)

### (1) Consolidated business results

Note: Figures are rounded down to the nearest million yen.

	Net sales		Operating income		Ordinary income	
	¥ million	%	¥ million	%	¥ million	%
1H ended September 30, 2006	1,584	—	(551)	—	(558)	—
1H ended September 30, 2005	—	—	—	—	—	—
(Reference) FY ended March 31, 2006	2,566	—	(107)	—	(59)	—

	Net income for current interim period		Earnings per share for the current interim period	Diluted earnings per share for the current interim period
	¥ million	%	¥	¥
1H ended September 30, 2006	(627)	—	(5,527.06)	—
1H ended September 30, 2005	—	—	—	—
(Reference) FY ended March 31, 2006	(131)	—	(1,257.27)	—

#### Notes:

#### 1. Gains/losses on equity method investment:

First half ended September 30, 2006: ¥17 million loss

First half ended September 30, 2005: —¥ million

Fiscal year ended March 31, 2006: ¥53 million loss

#### 2. Average number of shares outstanding during the period (consolidated):

First half ended September 30, 2006: 113,461 shares

First half ended September 30, 2005: —shares

Fiscal year ended March 31, 2006: 104,818

#### 3. Change of accounting method: None.

4. Because the preparation of consolidated financial statements commenced with the third quarter of the fiscal year ended March 31, 2006, various figures and comparisons with the first half ended September 30, 2005 are not shown.

## (2) Consolidated financial position

Note: Figures are rounded down to the nearest million yen.

	Total assets	Net assets	Shareholders' equity ratio	Shareholders' equity per share
	¥ million	¥ million	%	¥
1H ended September 30, 2006	6,400	5,021	78.0	43,448.69
1H ended September 30, 2005	—	—	—	—
(Reference) FY ended March 31, 2006	6,822	5,397	79.1	47,917.69

Notes:

## 1. Number of shares outstanding at end of period (consolidated):

First half ended September 30, 2006: 114,892

First half ended September 30, 2005: — shares

Fiscal year ended March 31, 2006: 112,647

## (3) Consolidated cash flows

Note: Figures are rounded down to the nearest million yen.

	Cash flow from operating activities	Cash flow from investing activities	Cash flow from financing activities	Cash and cash equivalents at end of period
	¥ million	¥ million	¥ million	¥ million
1H ended September 30, 2006	(166)	(1,176)	322	1,887
1H ended September 30, 2005	—	—	—	—
(Reference) FY ended March 31, 2006	94	(1,228)	2,939	2,898

## (4) Scope of consolidation and equity method affiliates:

Consolidated subsidiaries: 3

Non-consolidated subsidiaries accounted for by the equity method: None

Equity method affiliates: 1

## (5) Changes in the scope of consolidation and the application of the equity method

Newly consolidated subsidiaries: 1

Removed from the scope of consolidation: 1

Newly included under the equity method: —

Removed from the scope of the equity method: —

## 2. Forecast of performance for the fiscal year ending March,31 2007 (April 1, 2006 - March 31, 2007)

	Net sales	Ordinary income	Net income
	¥ million	¥ million	¥ million
FY ending March 31, 2007	3,780	70	(50)

(Note) Forecast of net earnings per share for the year: - ¥434.72

\* This forecast of net earnings per share for the year is based on the number of shares issued and outstanding as of the date of this document, which is 115,017 shares.

The forecast is based on information available as of the date of publication, and reflects the best judgment of the Company's management. However, actual outcome and results are subject to certain risks and uncertainties, and may differ materially from what is expressed. For further information on performance forecasts, see page 8 of the attached document.

## I. The Corporate Group

The Advanced Media Group is composed of Advanced Media, Inc. (“the Company”), three consolidated subsidiaries, and one equity-method affiliate. Principal businesses are as described below.

### (1) Speech business

Advanced Media is engaged in the licensing of speech recognition systems built using its AmiVoice® speech recognition technology, and offers development, consulting, and services related to the use of speech recognition systems.

### (2) Telemarketing business

Since November 2005, MC2, Ltd. (an Advanced Media subsidiary) has been engaged in the sale of telephone lines and office supplies (Kaunet business) through outbound marketing using telephones.

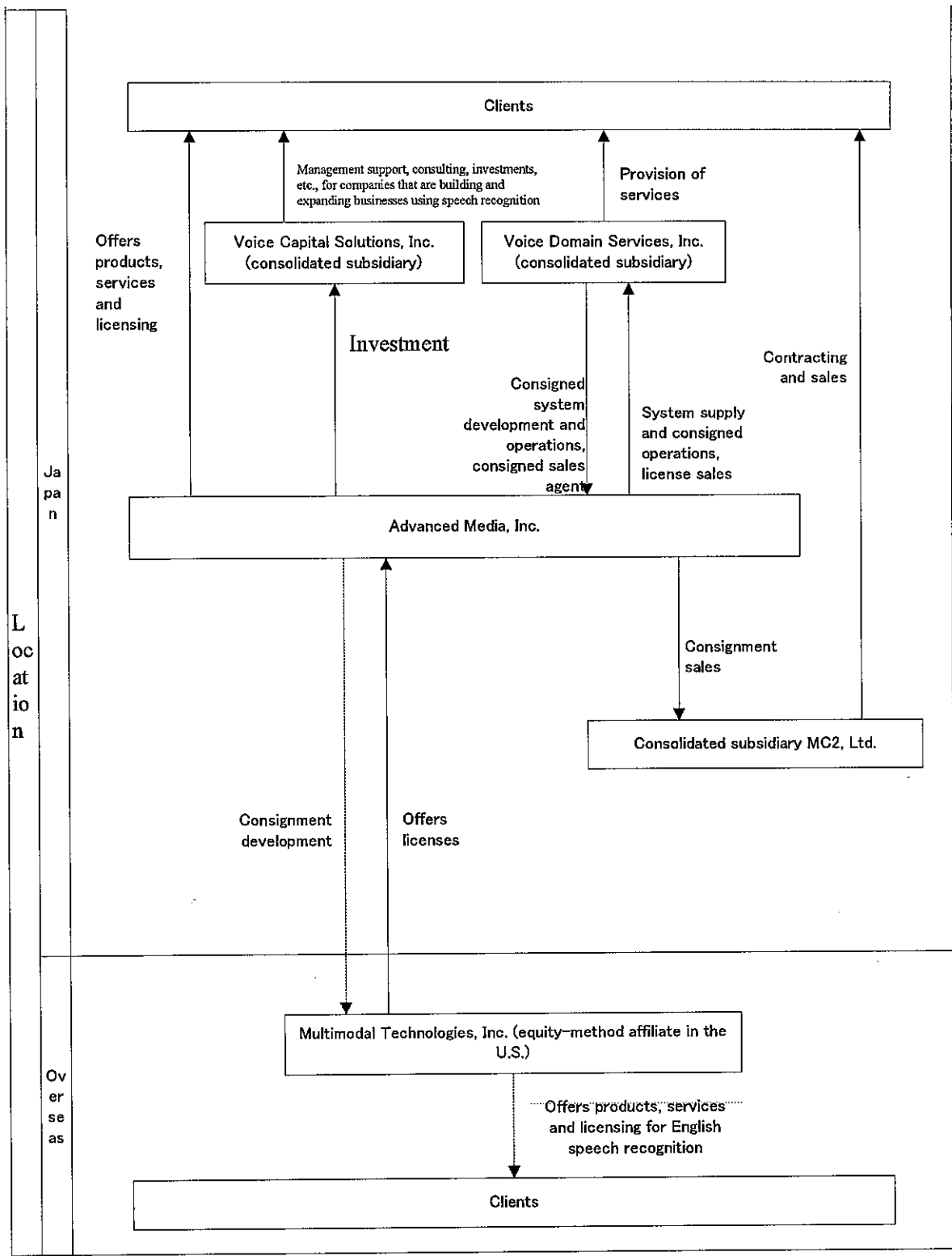
### (3) Other

Voice Domain Service, Inc. (another Advanced Media subsidiary), which is engaged in providing services that allow connection to URLs by voice command over a mobile telephone (voice domain registration and operation services), was established in July 2005 and began full-scale services in March 2006. Then, in August 2006, Voice Capital Solutions Inc. (another subsidiary) was established to support the development of companies that can work with Advanced Media on the commercialization of speech recognition solutions and services.

Business areas of the Advanced Media Group, and the placement of Advanced Media’s subsidiaries and one affiliate within those businesses, are as follows.

	Name	Location	Capitalization (¥ thousand)	Voting rights ownership	Names of business divisions	Business areas
Consolidated subsidiaries	MC2, Ltd.	Shibuya-ku, Tokyo	10,000	Direct 100.0%	Telemarketing business	Telemarketing, etc.
	Voice Domain Service, Inc.	Toshima-ku, Tokyo	94,500	Direct 63.5%	Other	Connection to URLs by voice command
	Voice Capital Solutions, Inc.	Toshima-ku, Tokyo	10,000	Direct 100.0%	Other	Management support, consulting, investments, etc. for companies that are building and expanding businesses using speech recognition
Affiliate (equity- method)	Multimodal Technologies, Inc.	Pittsburgh, Pennsylvania, U. S. A.	US\$3,414 thousand	Direct 30.2%	—	Consignment development of speech recognition engines

The following diagram illustrates the Group’s business relationships.



## II. Management Policies

### 1. Basic management policy

The business objective of the Advanced Media Group is "the realization of Human Communication Integration (HCI)," i.e., building a framework that allows people to enjoy usefulness, convenience, and value through communication in its broadest sense.

Because these are all relatively intangible, creative values, time will naturally be required for their achievement, but the Group is working rapidly and effectively.

## 2. Basic earnings distribution policy

Since the Advanced Media Group was established, it has conducted vigorous investment in research and development activities. Because it has not yet posted income that would make distribution of profits through dividends possible, it has not conducted any distribution of profits to shareholders.

For the future, it has designated the return of gains to shareholders as one of its most important management issues, and is striving to realize the return of profits. The Advanced Media Group's business growth is proceeding according to plan, and if it posts continued steady profits, its policy will be to consider the distribution of profits to shareholders, taking into account the balance with financial position and investments in research and development activities necessary to the sustained growth of its business. This term, however, its policy is to forego dividends in favor of increasing retained earnings for the sake of strengthening its financial base and increasing stability.

Advanced Media's policy after the enforcement of Japan's new Company Law will be to pay dividends twice a year as in the past (at the end of the first half and of the fiscal year).

## 3. Position and policy regarding reduction in the size of the trading unit (*tangenkabu*)

Under the Advanced Media Group's equity policy, increasing the number of shareholders and the liquidity of its stock are important issues, and vigorous IR activities have resulted in an increase in the number of shareholders to over 19,000 (as of September 30, 2006). Advanced Media will consider future stock splits and reductions of the stock trading unit in light of the Group's performance, trends in its stock price, and stock market conditions, while carefully considering their cost-effectiveness.

## 4. Target management indicator

The management indicator primarily targeted by the Group is net sales.

Speech recognition is the Advanced Media Group's core technology. Although it has a history that spans over 40 years, the market for speech recognition is not yet fully developed. Therefore, the Advanced Media Group is focused on the creation of the speech recognition market (which means expanding sales). The Advanced Media Group's business model for its speech business began with the consigned development of speech recognition solutions. To this was added licensing, then speech recognition services. The sales growth that resulted from this structural evolution is expected to lead to improved gross profit margins and better return on equity (ROE).

## 5. Medium- and long-term management strategy

The Advanced Media Group's strengths are its preeminent technological capabilities in the area of speech recognition, and the ability to serve as a leader in eliciting latent needs to create new markets. On the basis of these two strengths, it is contributing to human convenience by providing active speech recognition by machine, and actually commercializing the technologies that used to be merely symbols of a future society.

Because the business expansion of Advanced Media alone is limited in its ability to achieve dramatic increases in the market permeation of speech recognition solutions, the Advanced Media Group plans to utilize its own capital and human resources, as well as that of external partners, to promote awareness and acceptance of the convenience, usefulness, value, and indispensability of speech recognition.

Over the medium and long term, the Advanced Media Group will pursue research and development primarily in the core technology for communication between people and machinery, and, with its License Business on the front lines, build several corporate alliances to realize and popularize that technology by applying domestic and international capital, while engaging in market cultivation.

## 6. Significant issues facing the Group

### (1) Developing new business areas

Since the Advanced Media Group was founded, it has used its core speech recognition technology to create speech recognition solutions, primarily for the PC platform, in the five areas of medical, education and entertainment, business, conference proceedings, and call center support. As a result, speech recognition has become an indispensable input interface for a number of users, and the full-scale creation of the speech recognition market has begun.

In the future, the Advanced Media Group will move forward with the cultivation of new business areas on the PC platform by ascertaining the latent needs of users, while injecting management resources into the creation of a speech recognition market targeting individual consumers, typified by speech recognition

solutions for mobile telephones. To achieve this, it will be important not merely to wait for users and enterprise users of Advanced Media's products to emerge, but to energetically work to "create" user needs.

(2) Strengthening the organization

Because the Advanced Media Group is a venture enterprise with a short history, and because it operates in the software industry, agile response to change is essential. This means it needs to increase the organizational strength of the sales, development, and management divisions that must respond quickly and flexibly to management strategies and tactics as they are adapted to changes in the business environment.

(3) Upgrading the skills of employees

As a result of the rapid pace of change in network technology and other peripheral technologies, and by extension the environment for use of speech recognition, the Advanced Media Group's business format changes on a daily basis. It is vital to secure and train human resources that can deal successfully with the speed of these changes. The Group is endeavoring to improve the awareness and capabilities of both development and management personnel with regard to these peripheral technologies as well as speech recognition technology.

7. Items to report regarding parent company

None.

8. Other important management information

(1) Conflicts of interest in transactions with Voice Domain Service, Inc.

Advanced Media holds a 63.5% stake in the consolidated subsidiary Voice Domain Service, Inc. (VDS), and also contracts for the development of that company's business systems. Because Advanced Media and VDS have the same President and CEO, and because VDS has not been a wholly owned subsidiary of Advanced Media since September 30, 2005, it has been necessary since that date for the boards of directors of both companies to approve all contracts or other terms of business between Advanced Media and VDS.

(2) Transactions with Multimodal Technologies, Inc. (below, "MTI")

Advanced Media holds a 30.2% stake in MTI (an Advanced Media director and certain employees also serve as directors at MTI). Advanced Media outsources the upgrading and development of the recognition decoder portion of its speech recognition engine and other peripherals to MTI.

### III. Business conditions and financial position

1. Business conditions

(1) Overview of the first half

During the consolidated fiscal year ending March 31, 2007, the Japanese economy is benefiting from the effects of recovering corporate earnings and the continued growth of private-sector capital investment. In addition, employment figures and consumer spending have taken a turn for the better, and the recovery in business conditions, though sluggish, continues. At the same time, the anticipated hike in long-term interest rates and anticipated increase in taxes are having a negative effect on business confidence.

In this environment, the Advanced Media Group is working to make Human Communication Integration (HCI) a reality, advancing further with its existing operations in its core speech business, and demonstrating usable speech recognition. Together with this, the Group is engaged in the development of high-value-added speech recognition solutions using its AmiVoice speech recognition technology.

In addition, to create new business areas, the Group is seeking to forge alliances in the mobile area with mobile telephone content providers (firms pursuing mobile telephone service businesses), mobile telephone communications carriers (firms that provide mobile telephone communications services), and mobile telephone manufacturers.

As a result, since August 2006 the Company has been marketing the AmiVoice<sup>®</sup> Mobile Tools – Biz Pack for M1000 for the NTT DoCoMo FOMA<sup>®</sup> M1000. This is a business integration tool that uses speech recognition. By providing tools capable of speech input using distributed speech recognition (DSR), Advanced Media is laying a base for the broad acceptance of its DSR technologies.

Perceiving a need to create and foster speech recognition markets in new business areas, Advanced Media established Voice Capital Solutions, Inc. (VCS) in August 2006, to assist in the commercialization of Advanced Media's speech recognition solutions and services, and to support the development of firms that can collaborate with Advanced Media. The role of VCS is to serve as an incubator for Advanced Media's speech

recognition solutions and services, to accelerate the creation and development of speech recognition markets.

As a result of the factors described above, consolidated net sales for the first half were ¥1,584 million. However, the healthy sales of subsidiary MC2, Ltd. were offset by an increase in selling, general and administrative expenses. In addition, since VDS's business model calls for the energetic expansion of its business and the creation of markets, more time is required for its services to gain broad acceptance. Further, equity-method affiliate MTI posted a recurring loss. As a result of these and other factors, the Group posted a consolidated operating loss of ¥551 million, and a consolidated recurring loss of ¥558 million. After the higher tax burden of the consolidated subsidiary MC2, Ltd., the Group posted a consolidated net loss for the half of ¥627 million.

## 2. Performance by business segment

### i) Speech Recognition business

In the medical area, the Company released an upgrade to its AmiVoice<sup>®</sup> Ex speech recognition software series for medical uses in July 2006. Customer feedback resulted in the expansion of the dictionary of medical terms from 50,000 to 300,000 terms, making the software even easier to use. As a result, 235 new medical facilities adopted this software during the first half, bringing the Company's nationwide installed base to a total of approximately 1,800 facilities. Building on the success of its speech input software for medical and pharmaceutical use, the Company is advancing into the area of dentistry. The AmiVoice<sup>®</sup> Ex Dental speech input package for electronic dental records was released in September 2006.

In the Entertainment & Education (E&E) field, the Company achieved healthy sales of AmiVoice<sup>®</sup> CALL – pronunciation, an application that assists Japanese students to correct their English pronunciation. In July 2006, Sega Music Networks Co., Ltd. released four new game software titles that incorporate Advanced Media's world-leading speech recognition technology for their new Candoone karaoke game machine. The Company also provided speech recognition technology for the trial version of "Parent and Child – Speech Recognition – Kyoto-Style Training" by Uedahonsha Co., Ltd., which operates "KyotoRyuu" (<http://kyotostyle.jp/>), a support site for the Kyoto Tourist and Culture Certification Test (commonly known as the "Kyoto Certification") and the Junior Test of Japanese Culture Learned from the Historical City of Kyoto (commonly known as the "Junior Kyoto Certification"). The Company also focused on the sale of package products, including the sale of Japanese-language study applications with audible pronunciation guides to individual consumers through its business partners, and the licensing of interactive English conversation practice applications and pronunciation training software that improves aural comprehension.

In the computer telephony integration (CTI) area, the Company worked to win more enterprise users of its next-generation AmiVoice<sup>®</sup> Assist and AmiVoice<sup>®</sup> CallScriber call-center solutions. The Bank of Tokyo-Mitsubishi UFJ, Ltd. is using these solutions as strategic IT tools in its Customer Consultation Department to raise the level of customer satisfaction.

In the business support area, the Company has formed an operational alliance with Meiwajisyo Co., Ltd. and Union Corporation to build a condominium entryway security system, and in July 2006 installed a voice verification system in the Clio Funabori condominium. This system controls access to the building by identifying residents through their voice prints. Then, in September 2006, the Company commenced sales of the AmiVoice<sup>®</sup> SceneDirector, which is a meeting-room control system operated through voice commands. AmiVoice<sup>®</sup> Ex BizMail was launched in March 2006. This speech input package software for the creation of business mail text comes with a dictionary specialized by field and makes full use of the high speech recognition accuracy of AmiVoice<sup>®</sup>. Of course, no initial voice training or voice registration is needed. The Company also released an upgrade to the AmiReception<sup>®</sup> automated reception system in January 2006, with improved network monitoring and security functions, and worked throughout the half to increase sales of both this and the AmiVoice<sup>®</sup> Dialer automated internal/external line connector system.

In the conference proceedings area, the AmiVoice<sup>®</sup> Rewriter Conference proceedings creation support system was adopted by four local government assemblies, and was also marketed to private companies as a conference proceedings creation support tool.

As a result of the foregoing, consolidated net sales in the speech business for the half were ¥688 million. However, because selling, general and administrative expenses were higher than forecast at the beginning of the fiscal year, the speech business posted an operating loss of ¥450 million.

### ii) Telemarketing business

Performance stayed strong from the previous fiscal year in this segment's core operations, the sale of telephone circuits. In addition, steady progress was made in the mail-order sales of office supplies (Kaunet business), one of the Company's focuses as a stable source of revenue in the future. This segment also commenced sales of

products from Advanced Media's speech business.

As a result, consolidated net sales in the telemarketing business for the half were ¥882 million. However, because selling, general and administrative expenses exceeded initial forecasts for the amortization of goodwill, etc., the telemarketing business posted an operating loss of ¥91 million.

### iii) Other

VDS launched regular services in March 2006. Popularization of the service is expected to take some time, however, as the number of registered companies increases along with the spread of DSR. VCS commenced its business in August 2006, and did not reach full-scale operation in the half. Therefore, net sales in this segment were held to ¥12 million, and an operating loss of ¥40 million was posted.

### (3) Outlook for the fiscal year

In the speech business, the first half saw the Company add a number of new businesses to its existing business areas of medical, education & entertainment, CTI, and business applications. These include non-PC platform businesses such as mobile services, the security business (voice verification), and the multilingual development business, which the Company pursued with energy and focus. Advanced Media will be working to expand sales in these businesses in the second half. Advanced Media has been marketing speech recognition solutions primarily in the software area, but is now moving into speech recognition solutions linked to hardware. In the medical area, in addition to the existing product lineup, the Company is commencing the full-scale marketing of speech input packages for electronic dental records. In the area of Education & Entertainment, the Company released applications from allied mobile phone firms, and is scheduled to commence sales of licenses. In the CTI area, Advanced Media markets primarily to users in the financial industry, and is developing IP telephone solutions (information retrieval, telephone directory search, IVR). In the conference proceedings area, the Company is working to have its products adopted by the management committees of private companies. In the business area, the Company is marketing AmiVoice® SceneDirector, launched during the first half, to medical facilities, schools, and hotels, and is emphasizing it as an advertising tool for AmiReception®. In the security business (voice verification), the Company is installing systems in condominiums, hotels, and office buildings, and is working to introduce them for attendance management and online information security. In the mobile devices area, it is working to persuade carrier firms to install business integration tools using DSR for enterprise users in their terminals. Business integration tools using DSR speech recognition are also used in other environments.

The telemarketing business is expected to show continuous stable performance throughout the fiscal year.

In other businesses, DSR-ready terminals will become more common in the future, and the Group is engaged in the development of various corporate services and mobile affiliate advertising to prepare the business environment for VDS. In addition, VCS commenced operations.

As a result, consolidated net sales for the fiscal year are forecast to rise 47.2% to ¥3,780 million.

Despite the amortization of goodwill and uncertainty with regard to the earnings of consolidated subsidiary VDS and equity-method affiliate MTI, the companies of the Group will be improving their cost of sales ratios and working to reduce selling, general, and administrative expenses. As a result, consolidated ordinary income for the fiscal year is forecast at ¥70 million.

However, the tax burden of consolidated subsidiary MC2, Ltd. is expected to result in a consolidated net loss of ¥50 million for the fiscal year.

In the speech business, shipments to clients and acceptance inspections tend to be concentrated in September and March every year. For this reason, net sales and income tend to be concentrated in the second half, and in the fourth quarter in particular.