

# Financial Statements for the Fiscal Year Ended March 31, 2006 (Consolidated)

May 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  
 Point of contact: Tetsuo Anzai, Director and General Manager, Administration Department Tel: +81-3-5958-1031  
 Date of the board resolution approving the statement of accounts for the period: May 15, 2006 Interim dividend system in place: Yes  
 Dividend payment commencement date: — Date of ordinary general meeting of shareholders: June 28, 2006  
 Trading unit (*Tangenkabu*) system adopted: No (— shares per trading unit)

1. Consolidated business results for the fiscal year ended March 31, 2006 (April 1, 2005 through March 31, 2006)

(1) Consolidated business results Note: Figures are rounded down to the nearest million yen.

	Net sales		Operating income		Ordinary income	
	¥ million	%	¥ million	%	¥ million	%
FY ended March 31, 2006	2,566	—	(107)	—	(59)	—
FY ended March 31, 2005	—	—	-	—	-	—

	Net income		Earnings per share	Diluted net income per share	Return on equity	Return on assets	Operating income to net sales ratio
	¥ million	%	¥	¥	%	%	%
FY ended March 31, 2006	(131)	—	(1,257.27)	—	(2.4)	(0.9)	(2.3)
FY ended March 31, 2005	—	—	—	—	—	—	—

Notes:

1. Gains/losses on equity method investment:

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

Fiscal year ended March 31, 2005: — ¥ million

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

Fiscal year ended March 31, 2006: 104,818 shares

Fiscal year ended March 31, 2005: — shares

3. Change of accounting method: None

4. Percentages given for net sales, operating income, ordinary income, and net income are calculated in comparison with the figures for the preceding fiscal year.

5. Because preparation of consolidated financial statements commenced in the third quarter of the fiscal year ended March 31, 2006, various figures and comparisons with the fiscal year ended March 31, 2005 are not shown.

(2) Consolidated financial position

	Total assets	Shareholders' equity	Shareholders' equity ratio	Shareholders' equity per share
	¥ million	¥ million	%	¥
FY ended March 31, 2006	6,822	5,397	79.1	47,917.69
FY ended March 31, 2005	—	—	—	—

Notes:

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

Fiscal year ended March 31, 2006: 112,647 shares

Fiscal year ended March 31, 2005: - shares

(3) Consolidated cash flows

	Cash flow from operating activities	Cash flow from investing activities	Cash flow from financing activities	Cash and cash equivalents at end of year
	¥ million	¥ million	¥ million	¥ million
FY ended March 31, 2006	94	(1,228)	2,939	2,898
FY ended March 31, 2005	—	—	—	—

(4) Scope of consolidation and equity method affiliates

Consolidated subsidiaries: 3

Unconsolidated 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: 3

Removed from the scope of consolidation: —

Newly included under the equity method: 1

Removed from the scope of the equity method: —

2. Forecast of performance for the fiscal year ending March 30, 2007 (April 1, 2006 through March 31, 2007)

	Net sales	Operating income	Ordinary income
	¥ million	¥ million	¥ million
Interim period	1,490	(230)	(290)
Fiscal year	3,780	70	(50)

(Note) Forecast of net earnings per share for the year: - ¥443.74.

\* The 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 112,677 shares.

This 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 pages 7 and 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 subsidiary. Principal businesses are as described below.

(1) Speech business

Advanced Media is engaged in the licensing of speech recognition systems built on its *AmiVoice*<sup>®</sup> speech recognition engine, and offers development, consulting, and services related to the use of speech recognition systems.

(2) Telemarketing business

Since November 2005, MC2, Ltd. and Line Support, Inc. have been engaged in the sale of telephone lines and office supplies (Kaunet business) through outbound marketing using telephones.

On April 1, 2006, MC2, Ltd. absorbed Line Support, Inc.

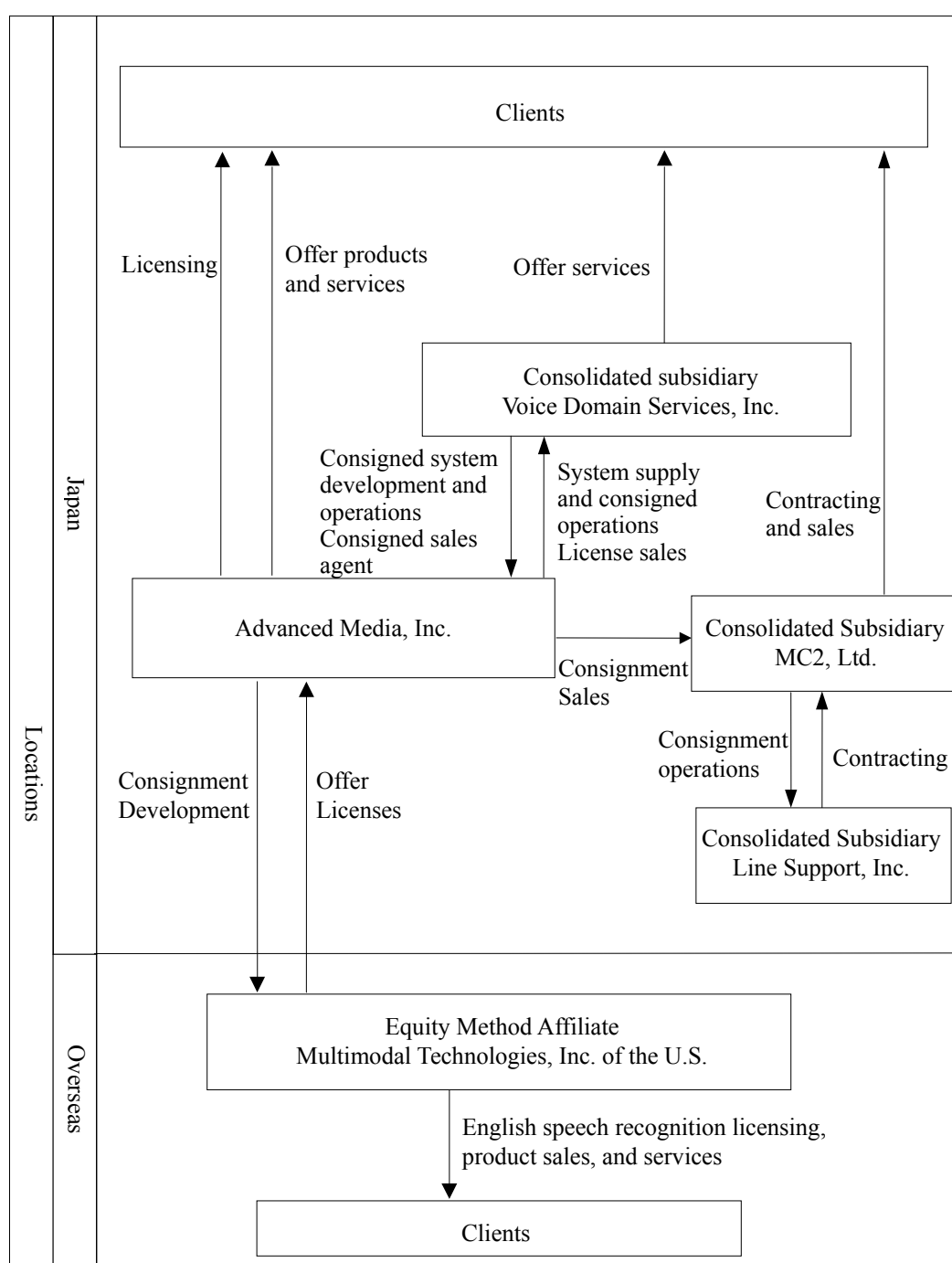
(3) Other

Voice Domain Service, Inc., 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.

Business areas of the Advanced Media Group, and the placement of Advanced Media's subsidiaries and affiliates within those business areas, 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.
	Line Support, Inc.	Shibuya-ku, Tokyo	3,000	Indirect 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
Affiliate (equity-method)	Multimodal Technologies, Inc	Pittsburgh, Pennsylvania, USA	US\$3,312 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 unknown, creative things, 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, it is its policy 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 18,000 (as of March 31, 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 indicators

The management indicators primarily targeted by the Group are net sales and return on equity (ROE).

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 uncovering the latent needs of users, while injecting management resources into the creation of a

speech recognition market targeting private 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 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 consolidated subsidiary Voice Domain Service, Inc. (VDS), and 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 equity-method affiliate with two Advanced Media directors on its board). 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 fiscal year

During the consolidated fiscal year ended March 31, 2006, the Japanese economy benefited from the effects of recovering corporate earnings and the continued growth of private-sector capital investment. In addition, employment figures and consumer spending took a turn for the better, and the recovery in business conditions, though sluggish, continued. At the same time, though, raw materials prices remained at high levels, while the anticipated hike in long-term interest rates and anticipated increase in taxes had 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 in 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 engine.

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.

VDS was established in July 2005 to provide services that allow connection to URLs using voice commands.

To upgrade the Group's agile marketing potential and to contribute to the development of Advanced Media's products and services, telemarketing firm MC2, Ltd. (and its wholly owned subsidiary Line Support, Inc.) became consolidated subsidiaries in October 2005 through the acquisition of their stock.

As a result of the factors described above, consolidated net sales for the fiscal year under review were ¥2,566 million. However, the startup of business at VDS was delayed substantially, and it was not possible to absorb the cost of these initial investments. In addition, equity-method affiliate Multimodal Technologies, Inc. posted an ordinary loss. This resulted in a consolidated operating loss of ¥107 million and a consolidated ordinary loss of ¥59 million. After the higher tax burden of consolidated subsidiary MC2, Ltd., the Group posted a consolidated net loss of ¥131 million.

## (2) Performance by business segment

### i) Speech business

In the medical area, to achieve broader use of speech input in the electronic medical record market, Advanced Media lowered the price of AmiVoice Ex Clinic speech input software for electronic medical records in October 2005, and commenced Internet sales of this package. In addition, it expanded its marketing channels in the area of speech recognition for medical applications through an operational alliance with ASCII Solutions, Inc., which resulted in the expansion of its total installed base to 1,500 institutions nationwide. It continued to promote its drug profile input system that uses speech recognition, and 800 dispensing pharmacies across the country are now using it. The Company will introduce its medical mail package to the market in the coming fiscal year, and began accepting orders in November 2005.

In the Entertainment & Education (E&E) area, the Company achieved healthy sales of sales of AmiVoice CALL – pronunciation, an application that assists Japanese students to correct their English pronunciation. It focused on the sale of package products, including the sale of Japanese-language study applications with audible pronunciation guides to private 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 Assist and AmiVoice CallScriber call-center solutions.

In the business support area, Advanced Media released an upgrade to the AmiReception automated reception system in January 2006, with improved network monitoring and security functions, and worked to increase sales of both this and the AmiVoice Dialer automated internal/external line connector system.

Progress in development of new products and collaboration with business partners was as described below.

- Developed the AmiVoice Mobile Verification voice verification system for mobile telephones, and began offering ASP services.
- Formed a technological alliance with Dream Arts Corporation for product development using speech recognition, and Advanced Media's AmiVoice DSR was incorporated into Dream Arts' Hibiki Sales, a sales support system.
- Introduced an AmiVoice DSR plugin for "desknet's," a Web-based groupware developed by NEOJAPAN, Inc.
- Established a technological alliance with IT News, Inc. regarding their "Keitai de Homepage."
- Commenced sales of AmiVoice Ex Bizmail, text-input software that uses speech recognition technology for the creation of business mail, proven in use at medical institutions.

In the conference proceedings area, the AmiVoice Rewriter conference proceedings creation support system was adopted by a number of local government assemblies, and was also marketed to private companies as a conference proceedings creation support tool. Advanced Media established an operational alliance with IBE, Inc. in the conference proceedings disclosure solutions business, and jointly developed solutions with IBE using integrated management of images, speech, and text, suitable for any committee or assembly, by melding IBE's expertise in advanced digital image compression and management technology with Advanced Media's speech recognition technology.

As a result of the above factors, consolidated net sales in the speech business were ¥1,946 million. However, due to the offset of income arising from intersegment transactions and other factors, the speech business posted an operating loss of ¥62 million.

### ii) Telemarketing business

Performance stayed strong 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), on which the Company is focusing as a stable source of revenue in the future. This segment also commenced sales of products from Advanced Media's speech business.

Because the Company launched its telemarketing business in November 2005, these operations made only a five-month contribution to consolidated performance. The telemarketing business generated net sales of ¥673 million; however, as a result of the consolidation adjustment account write-off and other factors, it posted an operating loss of ¥34 million.

### iii) Other

VDS commenced trial speech recognition services for mobile telephones in November 2005, and launched regular services in March 31, 2006. However, its business did not rise to the level of full-scale operation. Therefore, net sales in this segment were held to ¥1 million, and an operating loss of ¥34 million was posted.

### (3) Outlook for the coming fiscal year

The Advanced Media Group will be pressing forward with and working to expand sales in new businesses, including mobile services and other non-PC platform businesses, the security business (biometrics), and multilingual businesses, in addition to its existing business areas, such as medical, education & entertainment, call center support, and business support. The telemarketing business made only a five-month contribution during this fiscal year, but next year will make a full term's contribution, and is expected to show stable performance. As a result, consolidated net sales for the coming fiscal year are forecast to rise 47.3% to ¥3,780 million.

Despite the consolidation adjustment account write-off and uncertainty with regard to the earnings of consolidated subsidiary VDS and equity-method affiliate Multimodal Technologies, Inc., 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 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.

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. However, selling, general, and administrative expenses are incurred at a constant level year-round, leading to forecasts for the first half of the coming fiscal year of ¥1,490 million in consolidated net sales, a consolidated ordinary loss of ¥230 million, and a consolidated interim net loss of ¥290 million.