



YUHO REPORT
Annual

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|-------------------|--------------------------|
| Fiscal Year Ended | December 31, 2013 |
| Traded | JASDAQ |
| Stock Code | 7963 |



KOKEN LTD.

YUHOREPORT

Koken Ltd.

| | |
|-------------------|--------------------------|
| Fiscal Year Ended | December 31, 2013 |
| Traded | JASDAQ-TSE |
| Stock Code | 7963 |

This report is based on the Company's Japanese-language annual filing with the Financial Services Agency and supplemented with materials that facilitate comparison with the Company's peers. The materials from the annual filing with the Financial Services Agency have been edited and reorganized in a format more familiar to the international investment community. All information contained in this report has been obtained from sources believed to be reliable, but the accuracy of the data and the translation and the completeness and timeliness of the information are not warranted by the Company, Pacific Associates, or PRONEXUS. None of the above parties shall be responsible for any error or omission or for results obtained from the use of this information.

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Company Profile

Financial highlights

| Years ended December 31; Thousands of yen | 2009 | 2010 | 2011 | 2012 | 2013 | Change 2013/2009 |
|---|------------|------------|------------|------------|------------|---------------------|
| Net sales | 8,102,194 | 7,358,872 | 8,879,229 | 8,329,921 | 7,476,448 | 92% |
| Ordinary profit | 448,168 | 532,880 | 1,112,847 | 661,983 | 409,703 | 91% |
| Net income | 268,361 | 421,366 | 553,565 | 384,930 | 229,368 | 85% |
| Common stock | 674,265 | 674,265 | 674,265 | 674,265 | 674,265 | 100% |
| Shares outstanding | 5,104,003 | 5,104,003 | 5,104,003 | 5,104,003 | 5,104,003 | 100% |
| Net assets | 7,737,594 | 8,019,514 | 8,466,354 | 8,647,479 | 8,679,298 | 112% |
| Total assets | 16,330,742 | 15,563,206 | 16,262,836 | 15,966,154 | 15,465,283 | 95% |
| Net assets per share (Yen) | 1,522.27 | 1,576.93 | 1,663.78 | 1,703.16 | 1,713.23 | 113% |
| Dividends per share (Yen) | 25.00 | 25.00 | 35.00 | 25.00 | 25.00 | 100% |
| Net income per share (Yen) | 53.06 | 83.31 | 109.46 | 76.07 | 45.45 | 86% |
| Net income per share, fully diluted (Yen) | - | - | 108.79 | 75.77 | 45.00 | |
| Dividend payout ratio (%) | 47.1 | 30.0 | 32.0 | 32.9 | 55.0 | |
| Net cash provided by operating activities | 1,109,749 | 1,092,832 | 630,328 | 1,205,276 | 806,420 | |
| Net cash used in investing activities | (397,396) | (170,094) | (530,507) | (46,337) | (708,352) | |
| Net cash provided by (used in) financing activities | (663,976) | (779,762) | (860,827) | 109,316 | (766,160) | |
| Cash and cash equivalents at end of term | 1,666,031 | 1,809,006 | 1,048,000 | 2,320,852 | 1,652,808 | |
| Employees | 219 | 211 | 215 | 221 | 218 | 100% |

Peer comparisons

| Percent | 2009 | 2010 | 2011 | 2012 | 2013 |
|---------------------------------|--------|------|------|------|-------|
| Net income / net sales (%) | 3.3 | 5.7 | 6.2 | 4.6 | 3.1 |
| Peers | (9.7) | 0.1 | 1.8 | 2.0 | 2.0 |
| Ordinary profit / net sales (%) | 5.5 | 7.2 | 12.5 | 7.9 | 5.5 |
| Peers | (3.1) | 2.2 | 3.4 | 4.0 | 4.1 |
| Net income / equity (%) | 3.5 | 5.3 | 6.6 | 4.5 | 2.7 |
| Peers | (27.4) | 51.3 | 4.9 | 7.2 | (0.9) |
| Net income / assets (%) | 1.6 | 2.7 | 3.5 | 2.4 | 1.5 |
| Peers | (6.0) | 0.6 | 1.9 | 2.6 | 1.8 |
| Ordinary profit / assets (%) | 2.7 | 3.4 | 7.0 | 4.1 | 2.6 |
| Peers | (1.6) | 2.5 | 3.5 | 4.2 | 3.9 |
| Equity / assets (%) | 47.1 | 51.2 | 51.7 | 54.1 | 55.9 |
| Peers | 47.3 | 48.6 | 50.2 | 51.3 | 53.3 |

Peers include 27 companies in the other products sector on the JASDAQ market of the Tokyo Stock Exchange.

Business Overview

Description of business

The corporate group consists of KOKEN LTD. (the Company), one subsidiary and one related party. The Company manufactures and sells particulate respirators, gas masks and other types of protective equipment for occupational health and safety use, as well as equipment and facilities for workplace environments.

The Company rents its corporate headquarters from Sakai Tatemono Ltd., a company with which it has a close relationship.

History

| Year | Month | Event |
|------|-----------|--|
| 1943 | May | Koshinkai Kenkyujo established. |
| 1952 | February | Koshinkai Kenkyujo converted to joint stock company. |
| 1963 | December | Company's production and sales divisions spun off as independent operations; KOKEN LTD. established and Hannou plant constructed in Hannou, Saitama Prefecture. |
| 1967 | April | Hannou Laboratories established in Hannou, Saitama Prefecture. |
| 1968 | December | Hoya plant established in Hoya, Tokyo. |
| 1976 | October | Ashio plant established in Ashio, Tochigi Prefecture. |
| 1977 | January | Logistics center constructed in Ninomiya, Kanagawa Prefecture. |
| 1981 | January | Koken Bosai System established to sell occupational safety and health-protection equipment and to design and construct fire-prevention equipment and workplace environment improvement equipment. |
| 1984 | December | Hoya plant relocated to Tokorozawa, Saitama Prefecture, and reestablished as Tokorozawa plant. |
| 1985 | June | Koshinkai Kenkyujo and Ninomiya Seisakusho acquired. |
| 1986 | December | Company's shares registered with Japan Securities Dealers Association as OTC-traded stock issue. |
| 1987 | July | Koken Bosai System acquired and Sayama Techno-Yard established in Sayama, Saitama Prefecture, with one portion of Hannou Techno-Yard relocated to Sayama Techno-Yard. (Names of plants and factories all changed to Techno-Yard.) |
| 1988 | July | Second phase of Sayama Techno-Yard construction completed, concluding relocation of Hannou Techno-Yard. |
| 1989 | August | New head office building constructed. |
| 1992 | March | New research wing completed for Tokorozawa Laboratories. |
| 1997 | December | Nakai Techno-Yard and Nakai Logistics Center established in Nakai-machi, Kanagawa Prefecture. (Ninomiya Techno-Yard and Ninomiya Logistics Center integrated into newly established facilities of Nakai Techno-Yard and Nakai Logistics Center.) |
| 1999 | January | ISO 9001 certification obtained for entire company (registered on inspection). |
| | June | Gunma Techno-Yard constructed in Kasagake-cho, Gunma Prefecture. |
| 2002 | January | ISO 14001 certification obtained by Gunma Techno-Yard (registered on inspection). |
| 2003 | June | ISO 14001 certification obtained by Nakai Techno-Yard and Nakai Logistics Center (registered on inspection). |
| 2004 | December | Registration for OTC trading with Japan Securities Dealers Association canceled; and shares listed on the JASDAQ Securities Exchange. |
| 2005 | May | ISO 14001 certification obtained by Tokorozawa Techno-Yard (registered on inspection). |
| 2009 | September | Saitama Logistics Center established in Ranzan-machi, Saitama Prefecture. (Nakai Logistics Center integrated into newly established facilities of Saitama Logistics Center.) |
| 2010 | April | Company's shares listed on JASDAQ-OSE integrated market after merger of JASDAQ Securities Exchange into Osaka Securities Exchange. |
| 2011 | March | KOACH showroom opened. |
| | November | KOKEN Super Clean Technical Center opened. |
| 2012 | November | Overseas subsidiary SIAM KOKEN LTD. established in Chonburi Province, Thailand. |
| 2013 | January | Ranzan Techno-Yard established in Ranzan, Saitama Prefecture. |
| | July | Company's shares listed on the JASDAQ Standard market following merger of the Osaka Securities Exchange with the Tokyo Stock Exchange. |

Risk factors

The Company recognizes the following risks or potential risk factors as existing as of December 31, 2013.

All forecasts, projections and other statements regarding the future are based on business plans as of the date of publication of relevant statutory securities filings.

Research and Development

- As an R&D-driven, comprehensive environmental product manufacturing company, the Company invests management resources to bring highly innovative products to the market. Not all R&D will necessarily lead to the development of new products, however, or to growth in earnings. In addition, the Company's performance could be affected by circumstances which leave the Company no choice but to discontinue its R&D activities.
- The Company's product development is based on highly innovative technology, and it has consequently implemented the necessary procedures to protect its intellectual properties and large number of patents. There is, however, only so much laws can do to protect proprietary technology, and the possibility exists that the Company will not be able to prevent a third party from using its intellectual properties to manufacture and sell products similar to the Company's. This could have an impact on the Company's results.

Legal and Regulatory

- The Company's businesses are governed by a number of legal restrictions, as set forth in statutes such as the Industrial Safety and Health Law, the Pharmaceutical Affairs Law, and the Product Liability Act; and it continues to strengthen its compliance capabilities and internal control to ensure its ability to meet the requirements of these laws.
- Despite its best efforts, however, the Company may fail to meet one or more of these regulations, with a resulting recall of its products or other limitations on its businesses. In addition, the enactment of new laws or revision of existing ones could impact the Company's financial performance by requiring it to incur expenses for capital investment or other needs.

Quality Assurance and Quality Management

- Besides being designed for use in harsh environments, Koken's products must be extremely durable and trustworthy to ensure that they protect the health and safety of their users. To assure the highest levels of quality control, the Company has

established quality management systems based on ISO9001 standards and has adopted the following measures:

- a) It maintains an independent quality assurance office, which reports directly to the president; and
- b) It assigns personnel from this office to each of the Company's manufacturing and technical facilities to monitor production and inspection procedures.
- The Ministry of Health, Labour and Welfare conducts tests on protective breathing equipment. In the unlikely event that such tests should reveal defects in the Company's products despite its stringent quality control, the costs incurred in recalling and repairing non-compliant equipment could have a negative impact on the Company's financial performance.

Natural Disasters and Epidemics

- Since the Company's production facilities had previously undergone a seismic risk assessment and formulated appropriate business continuity plans in advance, the Company's production did not suffer any significant disruption due to the Great East Japan Earthquake. Nevertheless potential risks remain that could affect the Company's financial performance: A natural disaster (such as a large, shallow earthquake with a nearby epicenter), accident or other unforeseen event, or an influenza epidemic or other infectious outbreak could stop production or interrupt operations. In preparation for epidemics, the Company has distributed masks to all employees and stocked emergency supplies of masks at all its operating sites.

Environmental Issues

- Soil and groundwater decontamination procedures are continuing at two of the Company's research and manufacturing sites where trichloroethylene pollution was discovered. Although clean-up operations are proceeding according to plan, there could be a material impact on the Company's performance if the decontamination procedures prove lengthier or costlier than anticipated.

Information Security

- The Company's business involves a wealth of confidential information related to technology, sales and other operations. While the Company takes every precaution to manage such information securely, any unauthorized disclosure of such data due to unforeseen circumstances could have a negative impact on the Company's financial performance.

Internal Controls

- The Company has created an effective system of internal controls to promote effective and efficient business administration, reliable financial reporting, full legal and regulatory compliance, and asset security. Given the limitations inherent in internal controls, however, any related failure resulting from unforeseen circumstances could have a negative impact on the Company's financial performance.

Research and development

The Company is committed to research and development in its business domain, “cleanliness, health and safety.” It pursues development of original, creative technologies as well as versatile applications that employ them. A matrix-based R&D structure has been established that includes project teams for basic research on near-future technologies as well as applications.

A total of 71 staff are responsible for research and development, and related expenditures during the year under review totaled 478 million yen.

The Company pursued the following activities during the year under review:

Mask segment

In consideration of its social mission of protecting human health and life in the event of an influenza or other pandemic, Koken has initiated development of consumer-use protective masks and prioritized commercialization of protective masks for children, who are often most susceptible to health hazards. The Company has consequently developed the “Hi-Luck Kids” series of protective masks designed specifically for children.

Existing safety standards for protective masks used in medical or industrial settings, such as the DS2 standard in Japan or the NIOSH N95 standard in the United States, assume usage by adults. After collecting and analyzing data on children's facial dimensions and breathing pattern, Koken applied its expertise to redesign the Hi-Luck 350 series of disposable masks (which conform to the DS2 and N95 standards) for use by children. The result is the “Hi-Luck Kids” series of masks offering a close fit and high level of protection.

In addition to the standard “Hi-Luck Kids” model, Koken has introduced the “Hi-Luck Kids Kakaranzo (with exhalation valve)” model to prevent children from inhaling influenza virus or PM2.5 particles, as well as the “Hi-Luck Kids Utsusanzo (with inhalation valve)” model to prevent any spread of a virus due to coughing.

Other masks developed by Koken during the year under review included the R-5-08 chemical cartridge respirator, which expands the widely used R-5 series (which are popular due to close-fitting facepiece structure and wide varieties of cartridge selection) with the addition of , a fit checker, a convenient monitoring device to ensure that the mask provides a tight fit; and the 1621G replaceable full facepiece chemical cartridge respirator, which features a paint-resistant glass face shield with super paint barrier coating that the user can wipe clean to maintain forward visibility.

Development of the “Cool Blow Wear” CB-1 protective full body suit, the first product of the pro-tech alliance with DuPont Japan and AZEARTH Corp., was also completed. Cooling effect is designed to be accomplished by evaporation of sweat by blowing air directly on the neck of a wearer.

Other businesses segment

During the year under review, Koken introduced the LAMIKOACH J 500-F local ventilation system. Conventional cleanrooms require some time to restore the original level of air cleanliness after contamination occurs within a cleanroom, because dust and other particulates generated and defused inside the room must first pass through the filter several times to be gradually captured and removed. The LAMIKOACH system employs laminar flows to capture contaminants such as particulates before they are defused into the atmosphere, after which they are collected by a filter. After the contaminants are ejected from the clean zone, LAMIKOACH allows fresh air to enter it, significantly accelerating the air-purification process.

Koken has also developed a bench-top version of this KOACH system using “FERENA” nano-fiber filters. The “Table LAMIKOACH” system is easily portable, while still achieving extremely high levels of air purity.

Analysis of financial condition and results of operations

(1) Significant accounting policies and estimates

The financial statements of the Company are prepared in conformity with the Japanese GAAP. Reasonable estimates required in the presentation of these statements are based on the relevant accounting standards.

(2) Financial analysis

Total assets stood at 15,465 million yen as of December 31, 2013, a decrease of 500 million yen from the previous year-end.

Current assets: 6,451 million yen (a decrease of 729 million yen)

This mainly reflected decreases in cash and deposits (of 668 million yen) and income taxes receivable (of 153 million yen).

Fixed assets: 9,014 million yen (an increase of 228 million yen)

This mainly reflected an increase of 371 million yen in equity in affiliates and a decrease of 205 million yen due to the depreciation of tangible fixed assets.

Current liabilities: 4,032 million yen (a decrease of 464 million yen)

This primarily reflected decreases in short-term borrowings (of 300 million yen) and the current portion of long-term debt (of 111 million yen).

Long-term liabilities: 2,753 million yen (a decrease of 68 million yen)

This primarily reflected decreases in long-term debt (of 44 million yen) and long-term accounts payable - other (of 44 million yen).

Net assets: 8,679 million yen (an increase of 31 million yen)

This mainly reflected an increase in share subscription rights (of 16 million yen).

The equity capital ratio increased to 55.9% from 54.1%.

(3) Results of operations

| | | |
|-------------------|-------------------|--------------|
| Sales: | 7,476 million yen | (down 10.2%) |
| Operating income: | 466 million yen | (down 37.3%) |
| Ordinary profit: | 409 million yen | (down 38.1%) |
| Net income: | 229 million yen | (down 40.4%) |

Sales:

Sales decreased by 853 million yen compared with the previous year to 7,476 million yen. This primarily reflected declines in sales of protective masks for use in disaster recovery situations and in protecting workers from radiation.

Cost of goods sold:

Reflecting the decrease in sales, the cost of goods sold declined by 401 million yen compared with the previous year to 4,183 million yen.

Selling, general and administrative expenses:

Selling, general and administrative expenses decreased by 173 million yen compared with the previous year to 2,825 million yen.

Operating income:

Operating income decreased by 278 million yen compared with the previous year to 466 million yen. The operating profit margin declined by 2.7 percentage points from 8.9% to 6.2%.

Nonoperating income and expenses:

Nonoperating income decreased by 11 million yen compared with the previous year to 25 million yen. This mainly reflected a year-on-year decrease in refund on cancellation of insurance premiums of 8 million yen.

Nonoperating expenses decreased by 37 million yen compared with the previous year to 82 million yen. This mainly reflected a year-on-year decrease in commission fee of 35 million yen.

Extraordinary income and losses:

Extraordinary losses decreased by 20 million yen compared with the previous year to 1 million yen. This mainly reflected a year-on-year decrease in loss on sales and retirement of fixed assets of 20 million yen.

Corporate governance

(1) Basic philosophy concerning corporate governance

The Company aims to increase its enterprise value and shareholder and investor value. Toward these ends, it is endeavoring to strengthen its corporate governance to ensure the transparency and health of its management. It is also taking steps to build a management organization that achieves increased efficiency through clarified lines of responsibility and that responds rapidly to changes in the operating environment.

The Company also believes that disclosure is an important issue for management. Accordingly, its aim is to continue to disclose information in a timely, prompt, fair and transparent manner hereafter. Toward this end, it is endeavoring to increase opportunities for disclosure, to improve its methods of conveying information, and to add greater value to the information disclosed.

The following information related to corporate governance is as of March 14, 2014 (the publication date of the original Japanese report).

1) Overview of corporate governance structures and the development status of internal control systems

a. Basic explanation of corporate governance structures

- **Board of Directors:** The primary decision-making body of the Company, the Board of Directors meets once a month, as a rule, as provided for under the bylaws of the Board of Directors. In addition to deciding important matters concerning the execution of operations, the Board also oversees those operations. The Board is also prepared to meet on an as-needed basis to deal with issues that require prompt action.
- **Senior Management Meetings:** Senior Management Meetings, whose members consist of the directors, division managers and heads of the respective departments, are convened once a month. Decisions of the Board of Directors are conveyed to the senior management at these meetings, which also provide occasions for divisional managers and heads of sales offices to present sales reports and for senior management to be updated on operations in the various departments. Problem areas and policy responses are also discussed.
- **Board of Corporate Auditors:** The Company has adopted a system of corporate auditors. It elects four auditors (two of whom are outside auditors), who participate in Board of Directors meetings and, in so

doing, monitor the performance of the directors and the Board of Directors.

- b. Overview of corporate governance structures and the development status of internal control systems
 - The Company operates its business through four divisions: the Management Division, the Marketing Division, the Technology Division and the Manufacturing Division. Each division is headed by a general manager, and responsibilities are allocated in a manner that enables each division to act as a check on the others.
 - To enhance efficiency and promote appropriate, rational management, the Company has established a number of internal regulations, which are reviewed regularly by the department heads to assure their compatibility with realities on the ground. The department heads perform the important role of ensuring that operations in their departments are carried out strictly in accordance with the applicable laws and ordinances.
 - The Company continually upgrades its systems to ensure full compliance with laws, regulations and internal rules through various checking procedures. The Company has instituted compliance-related educational and training courses for directors and employees. In addition, the Company has set up the Koken Compliance Help Line as an internal reporting system designed to control and correct any compliance violations at the earliest possible time.
 - As a responsible corporate citizen, the Company maintains no relations with antisocial forces or other organizations that threaten the social order, and it remains resolutely opposed to such forces.
- c. Risk management system development status
 - The Management Division, Marketing Division, Technology Division and Manufacturing Division all have their own systems to manage intra-divisional risks. At the same time, this arrangement is bolstered by a system of mutual checks and balances. Operational audits are conducted to assess the execution status of business processes according to internal auditing regulations. In particular, quality assurance audits are conducted to perform quality checks on product-related processes. The results of internal audits are reported to the president, and systems are in place to facilitate the institution of improvement measures where necessary.

- The executive officer in charge of internal controls assumes overall responsibility for managing risk at the corporate level. While promoting the adoption of any required regulations, he also continues to construct risk management systems with the aim of mitigating projected risks and developing contingency measures against any foreseeable emergency situations.

2) Status of internal audits and auditing by corporate auditors

- Internal audits are the responsibility of the executive officer in charge of internal controls, who directs an individual appointed by the president to audit the Company's operations. The results of this individual's audits are reported to the president, and any necessary measures to resolve problems are adopted and follow-up audits carried out.
- Quality management audits, another facet of the Company's internal audit structure (equivalent to internal audits based on ISO9001 and JIS Q9001), are the responsibility of the head of the Quality Management Office, who also reports the audit results to the president. If an audit uncovers any failure to conform with quality standards, the heads of the departments concerned are requested to correct the problems, and the results of their follow-up measures are checked.
- In line with the initiation of production and sales activities concerned with medical devices whose manufacturing and sale require approval under the Pharmaceutical Affairs Law (notably fully automated systems for washing and sterilizing endoscopes), the Company has constructed quality and safety management systems based on Japanese ministerial ordinances concerning the relevant standards applicable to medical equipment, such as QMS (Quality Management System; manufacturing and quality control), GQP (Good Quality Practice; production-related quality control), and GVP (Good Vigilance Practice; post-marketing safety control). Under this structure, the Company has appointed one person who undertakes management oversight of all quality and safety issues related to the manufacture and sale of medical equipment. Two managers responsible for QC/QA issues and for safety management report to this person. The system involves close cooperation between these managers and the relevant departments. The Company continues to work to strengthen its quality and safety management systems to ensure the production and sale of medical equipment of the highest quality and safety.

- Based on Japanese occupational health and safety legislation, the Company has formulated internal OH&S regulations to ensure the health and safety of employees and to foster the creation of a safe and comfortable working environment. These regulations apply to management of the work, operating environment and health of all employees. Guided by these rules and assisted by a dedicated team of staff, the head of the Safety & Environment Management Office conducts regular and ad hoc OH&S audits of all Company facilities. The results of these audits are reported to the president. If the audits identify any areas of non-compliance, the head of the Safety & Environment Management Office can require the general managers of the relevant audited facilities to implement any requisite corrective measures. Further checks are then carried out to confirm the effectiveness of such measures.
 - As stated above, the Company has four corporate auditors, including two outside auditors. Besides attending meetings of the Board of Directors to audit the execution of directorial duties and Board operations, the corporate auditors also undertake internal audits based on auditing plans formulated by the Board of Corporate Auditors. When necessary, moreover, the corporate auditors seek to improve audit effectiveness based on information exchanged with the independent auditors.
 - Standing Corporate Auditor Etsuo Koyama, who was formerly the general manager of the accounting division, is highly knowledgeable about financial and accounting matters pertaining to the Company's operations.
- 3) Names of certified public accountants participating in audit operations and composition of assistant teams

The Company receives financial auditing services under a contract signed with A&A Partners. Details of the personnel involved in the financial audits conducted under this contract are provided below:

Engagement partner: Yuko Sakamoto, CPA

Engagement partner: Kenji Oka, CPA

Engagement partner: Satoshi Terada, CPA

Number of assistants involved in audits:

CPAs: 5

Other staff: 8

Note: No team member has more than seven years of continuous experience with the financial audits of the Company.

4) Outside directors and outside corporate auditors

Although the Company has not appointed any outside directors, two outside corporate auditors have been appointed to provide an independent, external auditing perspective on the actions of the directors. The Company has also introduced an executive officer system to enhance the separation between decision-making functions and the execution of operations and to clarify the delegation of management authority.

The Company believes its corporate governance systems provide sufficient management oversight and auditing capabilities without the appointment of outside directors.

In accordance with policies determined by the Board of Corporate Auditors, the outside auditors attend meetings of the Board of Directors to provide specialist input as well as participating in auditing of the actions taken by the directors. The corporate auditors work closely with the outside auditors and exchange information with them to achieve continual upgrading of audit functions. The Company believes that its internal audit systems are adequate for corporate governance purposes.

The outside corporate auditors are Hitoshi Emi, a professor emeritus of Kanazawa University, and Hiroyuki Kawai, a lawyer specializing in corporate law. Both bring high levels of specialist knowledge and expertise to their auditing roles. Neither of the outside corporate auditors has any conflict of interest by virtue of special relationships with the Company or related personnel, notwithstanding any ownership of Company stock, as noted below.

Prof. Emi owns 3,800 shares of Company stock. Although the Company has made financial donations to Kanazawa University, these are sufficiently small to be of no concern to shareholders or investors. The Company has nominated Prof. Emi as an independent executive to the Tokyo Stock Exchange.

Mr. Kawai owns 400 shares of Company stock and is a partner in Sakura Kyodo Law Offices. The Company has sought legal advice on occasion from other partners working for this law firm, but has no consulting contract with the firm, nor did the Company have any commercial dealings with the firm during the year under review. The Company has also nominated Mr. Kawai as an independent executive to the Tokyo Stock Exchange.

While the Company does not stipulate standards and other criteria regarding independence in terms of the election of outside corporate auditors, the

Company does refer to the criteria established by the Tokyo Stock Exchange related to the independence of externally appointed executives of publicly listed companies.

In accordance with the provisions of Article 427-1 of the Companies Act, the Company has concluded agreements limiting the liability of both the outside corporate auditors, Hitoshi Emi and Hiroyuki Kawai, with respect to legal compensation claims under Article 423-1 of the Companies Act to the minimum amounts as specified in Article 425-1 of said legislation.

The outside corporate auditors receive reports from relevant directors with respect to financial or accounting matters that the independent auditors may highlight, as well as internal audit system evaluations based on reviews of the Company's internal controls.

5) Directors' compensation

a. Compensation of board members by category; breakdown by type of compensation; and number of board members in each category

| Thousands of yen | Total amounts paid out to board members by type of compensation | | | | | Number of board members in each category |
|----------------------------|---|--------------|---------|---------------|--|--|
| | Amount paid | Compensation | Bonuses | Stock options | Directors' and corporate auditors' retirement allowances | |
| Directors | 181,416 | 131,100 | 16,450 | 4,966 | 28,900 | 8 |
| Corporate auditors | 22,109 | 16,800 | 2,600 | 709 | 2,000 | 2 |
| Outside corporate auditors | 9,809 | 7,200 | 1,100 | 709 | 800 | 2 |
| | 213,335 | 155,100 | 20,150 | 6,385 | 31,700 | 12 |

1. Bonuses include any provisions made during the fiscal year under review in the reserve for directors' and corporate auditors' bonuses. These bonuses were approved at the 51st Annual General Meeting of Shareholders held on March 27, 2014.
2. Directors' and corporate auditors' retirement allowances represent the provisions made in the fiscal year under review in the reserve for directors' and corporate auditors' retirement benefits.

b. Policy regarding amounts paid to board members and the methods of calculating these amounts

Remuneration for directors is set in accordance with their assigned duties and responsibilities. Remuneration for corporate auditors is set in accordance with the relevant duties and responsibilities, which differ between the standing corporate auditors and the outside auditors. Total amounts of remuneration are subject to limits approved by the General Meeting of Shareholders.

Note: Total annual remuneration limit for directors: 180 million yen (approved at the 49th Annual General Meeting of Shareholders held on March 27, 2012)

Total annual remuneration limit for corporate auditors: 30 million yen (approved at the 29th Annual General Meeting of Shareholders held on March 27, 1992)

6) Shareholdings in other companies

a. Investment securities held for purposes other than pure investment

Number of issues: 9

Total value on balance sheet: 76,771,000 yen

b. Equity investment securities held for purposes other than pure investment whose fiscal year-end balance sheet carrying value exceeds 1% of capital (excluding unlisted stocks)

| Thousands of yen | 2012 | | 2013 | | Reason for purchase |
|---|------------------|------------|------------------|------------|---|
| | Number of shares | Book value | Number of shares | Book value | |
| Resona Holdings, Inc. (8308) | 76,835 | 27,583 | 76,835 | 39,493 | To maintain and strengthen business relationships |
| Mizuho Financial Group, Inc. 11th series preferred stock (class 11) | 50,000 | 22,815 | 50,000 | 22,815 | To maintain and strengthen business relationships |
| Nippon Kanryu Industry (1771) | 15,000 | 2,490 | 15,000 | 3,915 | To maintain and strengthen business relationships |
| Mizuho Financial Group, Inc. (8411) | 14,755 | 2,065 | 14,755 | 3,157 | To maintain and strengthen business relationships |
| Mitsubishi UFJ Financial Group, Inc. (8306) | 4,240 | 1,725 | 4,240 | 2,768 | To maintain and strengthen business relationships |
| Nomura Holdings, Inc. (8604) | 1,750 | 689 | 1,750 | 1,375 | To maintain and strengthen business relationships |

7) Limited liability agreements

In accordance with the provisions of Article 427-1 of the Companies Act, the Company has concluded agreements limiting the liability of outside auditors with respect to legal compensation claims under Article 423-1 of said law to the minimum amounts specified in the legislation.

8) Number of directors

The Company's articles of incorporation stipulate 15 as the maximum number of directors.

9) Election of directors

The Company's articles of incorporation stipulate that approval of resolutions to elect directors requires a majority of the votes cast at meetings attended by shareholders representing at least one-third of the total voting rights.

Cumulative voting cannot be employed to elect directors.

10) Determination of interim dividends

The Company's articles of incorporation stipulate that an interim dividend may be paid from retained earnings in accordance with Article 454-5 of the Companies Act without shareholder approval by resolution of the Board of Directors. This rule provides the Board with the requisite authority to return profits to shareholders in a proactive and dynamic manner.

11) Acquisitions of treasury stock

The Company's articles of incorporation contain a provision that allows the Company to acquire shares of treasury stock in open market transactions by resolution of the Board of Directors. This enables the Company to undertake share buybacks as a dynamic response to changing business conditions.

12) Special resolutions of the General Meeting of Shareholders

The Company's articles of incorporation stipulate that approval of special resolutions under Article 309-2 of the Companies Act requires a two-thirds majority of the votes cast at meetings attended by shareholders representing at least one-third of the total voting rights. The quorum rule for approval of special resolutions is less strict than these normally applicable to general meetings of shareholders in Japan.

13) Steps taken within the past year to improve corporate governance

- The Board of Directors convened 14 times in the year ended December 2013 to make important management decisions and oversee their execution.
- As its disclosure policy, the Company released explanatory information about its financial results for the year ended December 2012 and its financial results for the interim period of the year ended December 2013 on the Company's website.

(2) Auditors' compensation

1) Compensation paid to CPAs and the Company's auditing firm was as follows:

| Thousands of yen | 2012 | 2013 |
|--------------------------|--------|--------|
| Financial audit services | 22,500 | 22,500 |
| Non-audit services | - | - |

2) Compensation policy for financial audit services

The Company has not established a set policy for determining compensation paid to CPAs and its auditing firm for financial audit services. Fees are set with

the scale and characteristics of the auditing work and the number of days involved taken into consideration.

Directors

(As of March 27 2014)

| Name | Title | Joined company | Previous or current employers/ occupations | Date of birth | Term | Shares owned (Thousand shares) |
|-------------------|---|----------------|--|---------------|---|--------------------------------|
| Masakazu Sakai | Representative Director, Chairman | Aug-67 | Renown Shoji | 22-Aug-41 | 2 years from the General Meeting of Shareholders (GMS) held on March 27, 2014 | 856 |
| Tsutomu Murakawa | Representative Director, President | Apr-89 | | 8-Jan-66 | 2 years from GMS held on March 27, 2014 | 5 |
| Nobuya Horiguchi | Representative Director, Executive Vice President | Apr-82 | | 28-Aug-58 | 2 years from GMS held on March 27, 2014 | 13 |
| Mitsuji Muramatsu | Senior Managing Director | Feb-06 | Mizuho Bank | 21-Feb-56 | 2 years from GMS held on March 27, 2014 | 12 |
| Fumikazu Tanaka | Senior Managing Director | Apr-81 | | 22-Feb-57 | 2 years from GMS held on March 27, 2014 | 6 |
| Toshio Akiyama | Managing Director | Apr-73 | | 2-Apr-49 | 2 years from GMS held on March 27, 2014 | 13 |
| Toshiaki Nagasaka | Director | Apr-82 | | 16-Oct-59 | 2 years from GMS held on March 27, 2014 | 7 |
| Hiroyuki Sakai | Director, Advisor | Apr-67 | | 23-May-43 | 2 years from GMS held on March 27, 2014 | 824 |
| Etsuo Koyama | Standing Corporate Auditor | Jul-81 | Nikkei Aluminium (now Nippon Light Metal) | 21-Sep-42 | 4 years from GMS held on March 27, 2013 | 3 |
| Tadashi Shimosaka | Standing Corporate Auditor | Oct-88 | Dayton Progress Corp. | 3-Jan-43 | 4 years from GMS held on March 25, 2011 | 4 |
| Hitoshi Emi | Corporate Auditor | Apr-03 | Kanazawa University | 12-Nov-37 | 4 years from GMS held on March 25, 2011 | 3 |
| Hiroyuki Kawai | Corporate Auditor | Mar-07 | Attorney at law | 18-Apr-44 | 4 years from GMS held on March 25, 2011 | 0 |
| | | | | | | 1,749 |

Employees

| | Total or average |
|-----------------------------|------------------|
| Number | 218 [168] |
| Average age | 39.5 |
| Average years of service | 14.8 |
| Average annual salary (yen) | 6,740,661 |

The number of employees refers to persons working on a regular basis; temporary employees are shown separately in parentheses.

The average annual salary includes bonuses.

No business segment breakdown of employee numbers is provided, since some employees work in more than one segment.

Union

The Company has no labor union.

Stock option plans

The Company has adopted a stock option system, the principal features of which are based on Articles 236, 238 and 239 of the Companies Act.

1) Share subscription rights based on Articles 236, 238 and 239 of the Companies Act
Resolution passed on March 26, 2010

| | |
|--|--|
| Date of resolution | March 26, 2010 |
| Categories and numbers of persons to be granted rights | 5 directors, 4 corporate auditors and 51 employees |
| Type of shares subject to rights | Common stock |
| Number of shares | 45,500 shares (Note) |
| Amount paid in at time of execution of rights | 704 yen |
| Period for execution of rights | April 1, 2012 - March 31, 2015 |
| Item concerning the assignment of rights | Approval of Board of Directors required. |
| Item concerning the assignment of rights associated with organizational rearrangements | (Note) |

2) Share subscription rights based on Articles 236, 238 and 239 of the Companies Act Resolution passed on March 27, 2013

| | |
|--|--|
| Date of resolution | March 27, 2013 |
| Categories and numbers of persons to be granted rights | 6 directors, 4 corporate auditors and 62 employees |
| Type of shares subject to rights | Common stock |
| Number of shares | 128,000 shares (Note) |
| Amount paid in at time of execution of rights | 2,192 yen |
| Period for execution of rights | April 1, 2015 - March 31, 2018 |
| Item concerning the assignment of rights | Approval of Board of Directors required. |
| Item concerning the assignment of rights associated with organizational rearrangements | (Note) |

(Notes):

1. The number of shares subject to rights shall be adjusted in accordance with the following formula in the event of a stock split or reverse stock split by the Company. The adjustment shall be made to the number of shares subject to rights corresponding to stock options that are unexercised at said time. Any fractional shares arising from such adjustment shall be rounded down.

Adjusted number of shares = Pre-adjusted number of shares × Ratio of split or of reduction in number of shares outstanding

Moreover, if any adjustment of the number of shares subject to rights should be necessitated by the Company acquiring and merging with another firm or else establishing a new company, or by the Company undertaking any related exchange of shares, the Company shall be permitted to undertake any such adjustment as is deemed necessary.

2. In the event of any takeover (limited to any merger in which the Company is not a surviving entity), absorptive split, demerger, establishment of a new firm, or exchange or transfer of shares (collectively hereinafter, "organizational rearrangements"), the Company shall grant stock subscription rights in the Company subject to rearrangement (hereinafter, "rearranged entity") in line with the various provisions 8a–8e of Section 1 of Article 236 of the Companies Act to all holders of rights that had not expired (hereinafter, "outstanding stock options") at the time the organizational rearrangements acquired legal force. In such eventuality, any outstanding stock options shall be cancelled and new stock subscription rights in the rearranged entity shall be issued. However, any such issuance based on the provisions set out below shall be limited to cases in which the issuance of new rights is stipulated in the agreement or plan covering the takeover, absorptive split, demerger, establishment of a new firm or share exchange/transfer.

- 1) Number of rights in rearranged entity to be issued

Based on number of rights owned by outstanding stock option holders, taking into account any adjustments required pursuant to the terms and conditions of the specific organizational rearrangements

- 2) Type of shares in rearranged entity subject to rights

Common stock in the rearranged entity

- 3) Number of shares in rearranged entity subject to rights

Determined in accordance with Note 1 above, taking into account the conditions of the specific organizational rearrangements

- 4) Amount of funds invested to exercise rights

The exercise price, suitably adjusted to take into account the conditions of the specific organizational rearrangements, multiplied by the number of shares in the rearranged entity subject to rights as determined in accordance with item 3) above.

- 5) All other terms and conditions shall be as stipulated in the agreements covering the granting of stock options between the Company and rights holders, based on resolutions approved at the 47th General Meeting of Shareholders and by the Board of Directors.

Cash Flows

Nonconsolidated statement of cash flows

| Years ended December 31; Thousands of yen | 2011 | 2012 | 2013 |
|--|-----------|-----------|-----------|
| Net cash provided by operating activities | | | |
| Net income before taxes and other adjustments | 1,012,520 | 682,549 | 408,387 |
| Depreciation | 526,693 | 577,327 | 560,745 |
| Increase (decrease) in directors' and corporate auditors' retirement allowances | 24,800 | 28,100 | 31,700 |
| Increase (decrease) in reserve for bonuses | 131,000 | (87,000) | (74,000) |
| Increase (decrease) in reserve for directors' and corporate auditors' bonuses | 24,400 | (14,200) | (14,450) |
| Increase (decrease) in allowance for doubtful accounts | 3,000 | - | - |
| Interest income | (207) | (181) | (273) |
| Dividends income | (2,655) | (2,113) | (2,209) |
| Interest expenses | 70,347 | 64,991 | 62,423 |
| Loss on adjustment for changes of accounting standard for asset retirement obligations | 5,231 | - | - |
| Losses (gains) on sales and retirement of fixed assets | 57,419 | 21,531 | 1,315 |
| Losses (gains) on valuation of investments in securities | 34,475 | - | - |
| Foreign exchange losses (gains) | - | (4,596) | (48) |
| Gain on reversal of subscription rights to shares | - | (38,533) | - |
| Decrease (increase) in notes and accounts receivable | (739,693) | 696,417 | (115,547) |
| Decrease (increase) in inventory | (347,685) | 256,095 | 21,351 |
| Increase (decrease) in notes and accounts payable | 66,394 | (33,351) | (32,780) |
| Increase (decrease) in consumption tax payable | 3,778 | (17,184) | 1,508 |
| Increase (decrease) in long-term accounts payable - other | (49,725) | (52,486) | (44,962) |
| Others | 29,618 | (27,998) | (27,368) |
| | 849,712 | 2,049,367 | 775,791 |
| Interest and dividend income | 2,614 | 2,543 | 2,483 |
| Interest expenses | (67,272) | (66,073) | (63,178) |
| Income tax and others | (154,726) | (780,560) | 91,324 |
| | 630,328 | 1,205,276 | 806,420 |

| Years ended December 31; Thousands of yen | 2011 | 2012 | 2013 |
|---|-------------|-------------|-------------|
| Net cash used in investing activities | | | |
| Payments for acquisition of tangible fixed assets | (618,999) | (669,580) | (443,081) |
| Proceeds from sale of tangible fixed assets | 109,968 | 740,272 | 134,696 |
| Purchases of long-term prepaid expenses | (300) | (4,536) | (19,735) |
| Payments for acquisition of intangible fixed assets | (8,734) | (13,365) | (8,873) |
| Proceeds from sales of investment securities | 0 | - | - |
| Payments for loans receivable | - | (1,000) | - |
| Proceeds from collection of loans and advances | 1,536 | 1,856 | 1,526 |
| Purchase of stocks of subsidiaries and affiliates | - | (100,875) | (371,212) |
| Others | (13,977) | 890 | (1,671) |
| | (530,507) | (46,337) | (708,352) |
| Net cash provided by (used in) financing activities | | | |
| Proceeds from increase in short-term borrowings | 4,100,000 | 6,300,000 | 4,000,000 |
| Payments of short-term borrowings | (5,100,000) | (6,100,000) | (4,300,000) |
| Proceeds from increase in long-term debt | 1,500,000 | 1,500,000 | 1,200,000 |
| Payments of long-term debt | (1,205,000) | (1,366,700) | (1,355,400) |
| Proceeds from exercise of stock option | - | 8,448 | 33,440 |
| Repayments of lease obligations | (29,459) | (55,810) | (80,106) |
| Payments for purchase of treasury stock | (14) | (81) | (137,357) |
| Dividends | (126,353) | (176,539) | (126,736) |
| | (860,827) | 109,316 | (766,160) |
| Effect of exchange rate fluctuations on cash and cash equivalents | - | 4,596 | 48 |
| Increase (decrease) in cash and cash equivalents | (761,005) | 1,272,852 | (668,044) |
| Cash and cash equivalents at beginning of term | 1,809,006 | 1,048,000 | 2,320,852 |
| Cash and cash equivalents at end of term | 1,048,000 | 2,320,852 | 1,652,808 |

Relationship between balance of cash and cash equivalents as of term-end and balance sheet items

| Years ended December 31; Thousands of yen | 2011 | 2012 | 2013 |
|--|-----------|-----------|-----------|
| Cash and deposit accounts | 1,048,000 | 2,320,852 | 1,652,808 |
| Time deposits, etc., of 3 months or longer | - | - | - |
| Cash and cash equivalents at end of term | 1,048,000 | 2,320,852 | 1,652,808 |

Capital expenditures

Capital expenditures during the term totaled 451 million yen. Investments targeted the development of highly competitive new products in response to market needs and the establishment of efficient mass-production capabilities.

Major capital expenditures included manufacturing facilities at Nakai Techno-Yard. There were no sales or removals of equipment during the year that exerted a material impact on operations.

Dividend policy

The Company has consistently viewed rewarding shareholders as an important issue for management. In accordance with this view, it has adhered to a basic policy of maintaining a stable and increasing dividend payout.

The Company's articles of incorporation contain the following provision: "An interim dividend may be declared in accordance with the provisions of Article 454-5 of the Companies Act." The level of the final dividend shall be subject to the approval of the General Meeting of Shareholders, while the Board of Directors shall determine the interim dividend.

In accordance with the above policy and based on an overall consideration of the fiscal 2013 results, future business trends and the Company's financial condition, a final dividend for the year ended December 31, 2013 of 25 yen per share, was approved by resolution of the General Meeting of Shareholders held on March 27, 2014. The dividend payout ratio for the year was 55.0%, and the ratio of dividends to net assets was 1.5%.

With the aim of sustaining future growth, the Company plans to appropriate retained earnings to strengthen the business base by investing in research and development of new technologies and products and by applying funds to capital investment projects.

Dividend payments out of retained earnings for the fiscal year under review are outlined below.

| Date of decision | Dividend payout | Dividend per share |
|---|------------------------|---------------------------|
| | (Millions of yen) | (Yen) |
| March 27, 2014 | 126 | 25 |
| Resolution by General Meeting of Shareholders | | |

Operations

Nonconsolidated statement of income

| Years ended December 31; Thousands of yen | 2011 | 2012 | 2013 |
|--|-----------|-----------|-----------|
| Sales | | | |
| Net sales | 8,879,229 | 8,329,921 | 7,476,448 |
| | 8,879,229 | 8,329,921 | 7,476,448 |
| Cost of goods sold | | | |
| Finished goods and merchandise inventory, beginning of term | 491,677 | 399,216 | 455,841 |
| Production costs for the term | 4,658,741 | 4,678,431 | 4,234,627 |
| Purchase of merchandise for the term | 16,707 | 48,242 | 30,830 |
| | 5,167,126 | 5,125,889 | 4,721,298 |
| Transfers to other accounts | 95,101 | 84,450 | 33,970 |
| Finished goods and merchandise inventory, end of term | 399,216 | 455,841 | 503,566 |
| | 4,672,809 | 4,585,598 | 4,183,761 |
| Gross profit on sales | 4,206,420 | 3,744,323 | 3,292,687 |
| Selling, general and administrative expenses | | | |
| Packing and shipping expenses | 94,750 | 92,263 | 89,785 |
| Advertising expenses | 211,954 | 216,229 | 171,738 |
| Directors' and corporate auditors' salaries | 137,120 | 148,500 | 155,100 |
| Employees' salaries and allowances | 718,532 | 728,022 | 731,251 |
| Bonuses | 142,091 | 75,646 | 90,306 |
| Provision for bonuses | 170,328 | 142,770 | 99,962 |
| Provision for directors' and corporate auditors' bonuses | 48,800 | 34,600 | 20,150 |
| Provision for directors' and corporate auditors' retirement benefits | 24,800 | 28,100 | 31,700 |
| Retirement benefit expenses | 49,095 | 49,932 | 50,743 |
| Employee benefit expenses | 153,871 | 155,278 | 152,389 |
| Travel and transportation expenses | 99,023 | 102,054 | 96,633 |
| Other office expenses | 80,593 | 103,588 | 106,998 |
| Rental expenses | 198,894 | 205,015 | 197,112 |
| Research expenses | 503,984 | 526,694 | 478,439 |
| Taxes and public dues | 50,650 | 47,587 | 46,554 |
| Depreciation expenses | 84,644 | 104,299 | 100,253 |
| Others | 270,623 | 238,556 | 206,622 |
| | 3,039,755 | 2,999,140 | 2,825,740 |
| Operating income | 1,166,664 | 745,183 | 466,946 |

| Years ended December 31; Thousands of yen | 2011 | 2012 | 2013 |
|--|-----------|---------|---------|
| Nonoperating income | | | |
| Interest income | 207 | 181 | 273 |
| Dividend income | 2,655 | 2,113 | 2,209 |
| Commissions received | 9,462 | 10,987 | 9,361 |
| Rental income | 1,801 | 1,801 | 1,801 |
| Temporary assigned personnel payments received | 3,611 | 4,106 | 4,112 |
| Refund on cancellation of insurance premiums | 11,183 | 8,358 | - |
| Interest on refund | - | - | 4,248 |
| Foreign exchange gains | - | 4,596 | 119 |
| Others | 7,366 | 4,745 | 3,099 |
| | 36,288 | 36,890 | 25,226 |
| Nonoperating expenses | | | |
| Interest expenses | 70,347 | 64,991 | 62,423 |
| Commission fees | - | 35,000 | - |
| Sales discounts | - | 8,910 | 8,939 |
| Others | 19,757 | 11,188 | 11,107 |
| | 90,105 | 120,090 | 82,470 |
| Ordinary profit | 1,112,847 | 661,983 | 409,703 |
| Extraordinary income | | | |
| Gain on reversal of subscription rights to shares | - | 38,533 | - |
| Others | - | 3,563 | - |
| | - | 42,096 | - |
| Extraordinary losses | | | |
| Loss on sales and retirement of fixed assets | 57,419 | 21,531 | 1,315 |
| Loss on valuation of investments in securities | 34,475 | - | - |
| Provision of allowance for doubtful accounts | 3,200 | - | - |
| Loss on adjustment for changes of accounting standard for asset retirement obligations | 5,231 | - | - |
| | 100,326 | 21,531 | 1,315 |
| Net income before taxes and special reserves for the term | 1,012,520 | 682,549 | 408,387 |
| Corporate, inhabitant and enterprise taxes | 589,000 | 143,000 | 160,000 |
| Deferred taxes | (130,044) | 154,618 | 19,019 |
| | 458,955 | 297,618 | 179,019 |
| Net income | 553,565 | 384,930 | 229,368 |

Nonconsolidated statement of changes in net assets

December 2013 term

| Thousands of yen; December 31, 2013 | Shareholders' equity | | | | | | | | Treasury stock | Total shareholders' equity |
|---|----------------------|----------------------------|-----------------------|-----------------------|-------------------------|----------------------------------|-----------------------------------|-----------|----------------|----------------------------|
| | Capital surplus | | | Retained earnings | | | | | | |
| | Common stock | Additional paid-in capital | Other capital surplus | Legal income reserves | Other retained earnings | | | | | |
| | | | | | Special reserve | Reserve for special depreciation | Retained earnings carried forward | | | |
| Balance at beginning of current term | 674,265 | 527,936 | 242 | 168,566 | 6,386,000 | 26,983 | 881,406 | (31,340) | 8,634,060 | |
| Changes in items during the term | | | | | | | | | | |
| Provision for special reserves | | | | | 300,000 | | (300,000) | | - | |
| Reversal of reserve for asset reduction entries | | | | | | (1,264) | 1,264 | | - | |
| Dividends from retained earnings | | | | | | | (126,733) | | (126,733) | |
| Net income | | | | | | | 229,368 | | 229,368 | |
| Exercise of stock option | | | (242) | | | | (34,501) | 74,833 | 40,090 | |
| Purchase of treasury stock | | | | | | | | (137,357) | (137,357) | |
| Other changes in non-shareholders' equity items during the term (net) | | | | | | | | | | |
| Total changes during the term | - | - | (242) | - | 300,000 | (1,264) | (230,602) | (62,523) | 5,367 | |
| Balance at end of current term | 674,265 | 527,936 | - | 168,566 | 6,686,000 | 25,719 | 650,804 | (93,864) | 8,639,427 | |

| Thousands of yen; December 31, 2013 | Valuation/translation gains (losses) | Share subscription rights | Net assets |
|---|---|------------------------------|------------|
| | Unrealized gains (losses) on other securities | | |
| Balance at beginning of current term | (161) | 13,580 | 8,647,479 |
| Changes during the term | | | |
| Provision for special reserves | | | - |
| Reversal of reserve for asset reduction entries | | | - |
| Dividends from retained earnings | | | (126,733) |
| Net income | | | 229,368 |
| Exercise of stock option | | (6,650) | 33,440 |
| Purchase of treasury stock | | | (137,357) |
| Other changes in non-shareholders' equity items during the term (net) | 10,397 | 22,704 | 33,101 |
| Total changes during the term | 10,397 | 16,054 | 31,818 |
| Balance at end of current term | 10,236 | 29,634 | 8,679,298 |

December 2012 term

| Thousands of yen; December 31, 2012 | Shareholders' equity | | | | | | | | | |
|---|----------------------|----------------------------|-----------------------|-----------------------|-------------------------|----------------------------------|-----------------------------------|----------|----------------|----------------------------|
| | Capital surplus | | | Retained earnings | | | | | Treasury stock | Total shareholders' equity |
| | Common stock | Additional paid-in capital | Other capital surplus | Legal income reserves | Other retained earnings | | | | | |
| | | | | | Special reserve | Reserve for special depreciation | Retained earnings carried forward | | | |
| Balance at beginning of current term | 674,265 | 527,936 | 756 | 168,566 | 6,086,000 | 28,264 | 972,206 | (41,901) | 8,416,093 | |
| Changes in items during the term | | | | | | | | | | |
| Provision for special reserves | | | | | 300,000 | | (300,000) | | - | |
| Reversal of reserve for asset reduction entries | | | | | | (1,280) | 1,280 | | - | |
| Dividends from retained earnings | | | | | | | (177,010) | | (177,010) | |
| Net income | | | | | | | 384,930 | | 384,930 | |
| Exercise of stock option | | | | | | | | | | |
| Purchase of treasury stock | | | (514) | | | | | 10,642 | 10,128 | |
| Other changes in non-shareholders' equity items during the term (net) | | | | | | | | (81) | (81) | |
| Total changes during the term | - | - | (514) | - | 300,000 | (1,280) | (90,799) | 10,561 | 217,967 | |
| Balance at end of current term | 674,265 | 527,936 | 242 | 168,566 | 6,386,000 | 26,983 | 881,406 | (31,340) | 8,634,060 | |

| Thousands of yen; December 31, 2012 | Valuation/translation gains (losses) | Share subscription rights | Net assets |
|---|---|------------------------------|------------|
| | Unrealized gains (losses) on other securities | | |
| Balance at beginning of current term | (1,624) | 51,885 | 8,466,354 |
| Changes during the term | | | |
| Provision for special reserves | | | - |
| Reversal of reserve for asset reduction entries | | | - |
| Dividends from retained earnings | | | (177,010) |
| Net income | | | 384,930 |
| Exercise of stock option | | | 10,128 |
| Purchase of treasury stock | | | (81) |
| Other changes in non-shareholders' equity items during the term (net) | 1,463 | (38,305) | (36,842) |
| Total changes during the term | 1,463 | (38,305) | 181,124 |
| Balance at end of current term | (161) | 13,580 | 8,647,479 |

Cost of goods sold

| Years ended December 31; Thousands of yen | 2011 | % | 2012 | % | 2013 | % |
|--|-------------|----------|-------------|----------|-------------|----------|
| Raw materials costs | 2,716,274 | 55.3 | 2,457,539 | 55.3 | 2,285,875 | 54.1 |
| Labor costs | 792,790 | 16.2 | 706,292 | 15.9 | 654,861 | 15.5 |
| Other expenses | 1,400,290 | 28.5 | 1,277,976 | 28.8 | 1,281,947 | 30.4 |
| Total manufacturing overhead | 4,909,355 | 100.0 | 4,441,808 | 100.0 | 4,222,684 | 100.0 |
| Work-in-process inventory, beginning of term | 253,243 | | 503,857 | | 267,235 | |
| | 5,162,599 | | 4,945,666 | | 4,489,920 | |
| Work-in-process inventory, end of term | 503,857 | | 267,235 | | 255,293 | |
| Production costs for the term | 4,658,741 | | 4,678,431 | | 4,234,627 | |
| Major items in other expenses above | | | | | | |
| Subcontracted processing expenses | 396,867 | | 355,698 | | 372,052 | |
| Depreciation expenses | 406,085 | | 436,414 | | 433,381 | |

Results of operations

Year ended December 31, 2013

The Japanese economy recovered in the year under review, supported by economic stimulus measures implemented by the government and heightened expectations of monetary easing by the Bank of Japan, which helped to weaken the yen and push up share prices. Exporters led the recovery in corporate profits, despite emerging risks in the global economy. Signs of a recovery in consumer spending were seen as well.

Demand for protective masks did not benefit significantly from the economic upturn in Japan (demand for safety products is known to lag behind the overall economy by at least six months). Large companies continued to prioritize cost savings. Although Koken received many inquiries concerning the KOACH range of clean technology systems, it became clear that it takes longer than usual time before receiving orders due to the nature of this business, and the sales volume was disappointing as a result. Total sales fell by 10.2% compared with the previous year to 7,476 million yen.

Koken responded to the dip in demand after the strong earthquake-related special demand occurred in the previous fiscal year by cutting costs across the board, but the weaker yen inflated materials costs. With new product development costs also rising, this resulted in a higher cost-of-goods ratio. Reflecting the fall in top-line revenues coupled with increased costs, operating income fell by 37.3% to 466 million yen and net income fell 40.4% to 229 million yen.

Sales in the core mask business segment declined 7.5% to 6,836 million yen. The “Hi-Luck” series of tight-fitting disposable medical masks remained popular, achieving 60% coverage of sales in public health centers in Japan. Koken’s market share also rose further in university research departments, large public hospitals and medical institutions specializing in infectious diseases.

Sales of industrial masks increased only slightly in year-on-year terms, despite the success of the BL-711H powered air-purifying respirator and the 1521 series of full facepiece gas masks, which are designed to provide users with greater safety and comfort at reasonable cost. No new orders were received in the year under review from Tokyo Electric Power Company for protective masks for clean-up efforts at the Fukushima site, although Koken products remained in use at nuclear power facilities across Japan.

In October 2013, Koken launched the first three products in its new “Hi-Luck Kids” series of close-fitting protective masks for children. Designed to protect children who are at high risk from infectious diseases such as influenza, these are being marketed directly to consumers. By targeting concerned mothers, the initial production capacity of 500,000 units per month is set.

Sales in the other businesses segment fell by 32.0% to 640 million yen. Recognizing that it takes an unusually long time to secure orders for such large investments as the KOACH open clean system, Koken changed its sales policy during the year under review to focus on increasing inquiries from prospective customers by developing a network of scientific instruments distributors who have strong sales channels involving universities and research institutions. As a result, the number of inquiries exceeded 650 by the end of 2013, as expected.

Koken expects to supply KOACH systems to customers involved in cutting edge research, including the Center for iPS Cell Research and Application, Kyoto University (CIRA), and the Japan Aerospace Exploration Agency (JAXA), both of whom have expressed high praise for Koken’s clean technology.

Sales of “KAGAMI-NAISHI” fully automated endoscope cleaning/sterilization systems generated steady growth with support from advertising campaigns in specialized medical publications. Orders for air purification systems from customers in the public sector dropped significantly, as demand fell relative to the high levels following the earthquake of 2011.

Year ended December 31, 2012

Conditions remained difficult for Japanese companies during the year under review in an environment of a persistently strong yen, weak stock market, fiscal concerns in Europe, and slowing growth in China. Japanese economic growth was lackluster, despite signs of recovery linked to demand for reconstruction after the earthquake.

Demand for protective masks for use in emergency situations and to protect workers from radiation was significantly lower in year-on-year terms as the boost from the earthquake faded. Koken was able to prevail against low-priced rival products in the industrial mask sector, however, by continuing awareness campaigns to emphasize the importance of a proper mask fit, while steadily gaining share in the medical market. Koken also made significant progress in its clean zone technology business, with key customers such as the Institute for Cosmic Ray Research, the University of Tokyo and Shimane Fujitsu Ltd. buying the “Floor KOACH Ez” system, an open clean zone creator with a guide screen. Total sales declined by 6.2% compared with the previous year to 8,329 million yen.

Despite efforts to cope with the decline in post-disaster demand by reducing the cost-of-goods ratio and cutting selling, general and administrative expenses, operating income fell by 36.1% to 745 million yen and net income by 30.5% to 384 million yen.

By segment, the core mask business recorded an 8.4% decline in sales to 7,388 million yen. Sales of the “Hi-Luck” series of tight-fitting disposable masks grew as customers in the automotive and other industrial sectors adopted them. Usage of these masks also increased in public health centers and in medical institutions to prevent the spread of infection. Total sales of masks for disaster-response applications were lower than initially expected, however, due to delays in debris removal operations and the use of less expensive surgical masks in decontamination operations in an environment of enhanced cost consciousness.

Sales in the other businesses segment advanced by 16.4% to 940 million yen. This mainly reflected growth in sales of Table KOACH, table-top units, with research institutions and precision instrument makers placing more orders for the latter for use in laboratories and assembly lines. Other products generating steady growth in sales included push-pull ventilation systems for industrial use and “KAGAMI-NAISHI” fully automated endoscope cleaning and sterilization systems.

Segment information

1. Segment reporting

Segment reporting is based on financial information gathered for the various separate parts of the Company's business. The Board of Directors reviews the reports regularly for purposes of improving decisions on resources allocation and evaluating performance.

The main business of the Company is the manufacture and sale of particulate respirators and gas masks. The mask segment includes the manufacture and sale of industrial masks and other protective equipment for use in a range of OH&S applications.

2. Method of calculating segment net sales, profits and losses, assets, liabilities, etc.

The accounting methods used in segment reporting are identical to those cited under "Fundamental and Important Matters for the Preparation of Nonconsolidated Financial Statements."

Reported segment earnings are based on operating income.

3. Figures for segment net sales, profits and losses, assets, liabilities, etc.

| Thousands of yen | Segment reporting Mask segment | Other businesses segment | Total | Adjustments | Book value |
|-----------------------|-----------------------------------|-----------------------------|-----------|-------------|------------|
| 2013 | | | | | |
| Net sales | | | | | |
| External customers | 6,836,182 | 640,266 | 7,476,448 | - | 7,476,448 |
| Inter-area | - | - | - | - | - |
| | 6,836,182 | 640,266 | 7,476,448 | - | 7,476,448 |
| Segment profits | 3,023,205 | 269,481 | 3,292,687 | (2,825,740) | 466,946 |
| Segment assets | - | - | - | - | - |
| Other items | | | | | |
| Depreciation expenses | 380,797 | 52,584 | 433,381 | 127,363 | 560,745 |
| 2012 | | | | | |
| Net sales | | | | | |
| External customers | 7,388,943 | 940,978 | 8,329,921 | - | 8,329,921 |
| Inter-area | - | - | - | - | - |
| | 7,388,943 | 940,978 | 8,329,921 | - | 8,329,921 |
| Segment profits | 3,274,558 | 469,765 | 3,744,323 | (2,999,140) | 745,183 |
| Segment assets | - | - | - | - | - |
| Other items | | | | | |
| Depreciation expenses | 418,485 | 17,929 | 436,414 | 140,913 | 577,327 |

(Notes)

1. The "other businesses" segment includes the environment-related business and other operations not reported for the mask segment.
2. The table above contains the following adjustments.
 - (1) The deductions of 2,999,140 thousand yen (December 2012 term) and 2,825,740 thousand yen (December 2013 term) from segment earnings reflect costs incurred across the Company that were not reported for the business segments, principally selling, general and administrative expenses.

(2) Depreciation and amortization costs of 140,913 thousand yen (December 2012 term) and 127,363 thousand yen (December 2013 term) apply to Company assets, but are not reported for any business segment.

3. Segment earnings are adjusted figures based on operating income as reported in the statement of income.

Related information

Information provided by principal customers

| Thousands of yen | Sales | | Segment |
|---------------------|-----------|-----------|-----------------------------------|
| | 2012 | 2013 | |
| Midori Anzen Youhin | 1,293,039 | 1,253,438 | Mask and other businesses segment |
| Ministry of Defense | 1,252,639 | 850,063 | Mask and other businesses segment |

Issues requiring action

Management is focusing the Company's resources on tackling three strategic challenges to ensure the long-term growth of the business.

Challenge 1: Passing on Koken's DNA

Led by founder Yoshiji Sakai, Koken succeeded in establishing its position as the leading manufacturer of industrial masks in Japan. Never resting satisfied with this success, the Company now aims to develop a business base targeting the three areas of cleanliness, health and safety. This will require cultivating a younger generation of managers to lead the next stage of business growth, away from top-down leadership of the founding family.

Management has codified Koken's genetic makeup in terms of three business principles: (1) human resources development; (2) technical development; and (3) development of new markets in the fields of cleanliness, health and safety. The challenge is to pass on the Company's DNA to a new generation of managers.

To link its strength of R&D activities with profit-making, the Company has also established a new Marketing Department to drive the development of new markets by leveraging Koken's strengths in technical development and business planning.

Challenge 2: Establishing the clean zone business and the KOACH brand

Marketed under the KOACH brand, Koken's proprietary "open space" clean room technology, has received critical approval from some of Japan's leading research institutions as a method for creating clean zones within laboratory environments. Since this technology has the clear potential to cause a revolution in cleanroom business and become a pillar of the Company's future growth, Koken is focusing efforts to ensure that KOACH products establish a firm hold in the marketplace.

KOACH systems have the potential to make a social contribution by helping Japanese industry to become more internationally competitive based on the creation of super clean environments at reduced cost. This technology may even be one of the keys to a rebirth of Japan's high-tech and precision industrial sectors.

As of the end of December 2013, the KOACH system inquiry's base had grown to 650 sites. Koken aims to boost this figure to 2,000 to achieve critical mass in the market, thereby developing a second core business on a par with the mask segment.

Challenge 3: Developing masks for medical and consumer markets

Medium-to-long-term growth prospects for industrial mask demand in Japan are weak due to the ongoing decline in the number of people employed in the domestic manufacturing sector. Koken is working to establish a presence in the emerging medical and consumer fields as a means of ensuring the continued growth of this business.

In the medical sector, Koken employs training activities in medical institutions to provide users with information on correct usage and the importance of wearing close-fitting masks such as the "Hi-Luck" series. Over 80,000 professionals in the medical field have now received this training. These products have achieved 60% coverage of sales in public health centers in Japan, and Koken's market share continues to increase among other customers such as university medical departments, large public hospitals and designated medical institutions of specified infection diseases. Koken is continuing to build on these successes with the aim of becoming the largest supplier of medical masks in Japan.

Koken entered the consumer market in October 2013 with the launch of three new products in the "Hi-Luck Kids" series of close-fitting protective masks for children. Marketing efforts mainly target concerned mothers. Koken also plans to build on its reputation for high-quality protection by marketing adult masks for the consumer sector.

Koken has established a local production subsidiary in Thailand to ensure the Company's ability to fulfill its social responsibility as a leading manufacturer of masks in the event of an influenza pandemic. Full-scale production of masks is scheduled to begin at this facility during 2014.

Production and sales

Production

| Thousands of yen | 2013 | |
|---------------------------|-----------|-----------------------------|
| | Amount | Year-on-year comparison (%) |
| Mask segment | 6,714,813 | 90.1 |
| Others businesses segment | 601,251 | 69.6 |
| | 7,316,064 | 88.0 |

Sales

| Thousands of yen | 2013 | |
|--------------------------|-----------|-----------------------------|
| | Amount | Year-on-year comparison (%) |
| Mask segment | 6,836,182 | 92.5 |
| Other businesses segment | 640,266 | 68.0 |
| | 7,476,448 | 89.8 |

Principal customers

| Thousands of yen | 2012 | | 2013 | |
|---------------------|-----------|----------------|-----------|----------------|
| | Amount | % of net sales | Amount | % of net sales |
| Midori Anzen Youhin | 1,293,039 | 15.5% | 1,253,438 | 16.8% |
| Ministry of Defense | 1,252,639 | 15.0% | 850,063 | 11.4% |

Leases

Finance leases that do not transfer ownership (lessee)

1) Nature of lease assets

a. Tangible fixed assets

The primary tangible fixed assets are production facilities.

2) Depreciation method applied to lease assets

Lease terms for years of useful life are employed, assuming a residual value of zero; depreciation is assumed to be on a straight-line basis.

All lease transactions entered into on/before December 31, 2008 related to finance leases that do not transfer ownership continue to be treated as ordinary rental transactions. The details of these transactions are described below.

Pro forma information on leased property is as follows:

| Thousands of yen | 2012 | 2013 |
|--|--------|--------|
| Tools, furniture and fixtures | | |
| Acquisition cost | 50,479 | 50,479 |
| Accumulated depreciation | 47,489 | 50,479 |
| Net leased property | 2,989 | - |
| Total | | |
| Acquisition cost | 50,479 | 50,479 |
| Accumulated depreciation | 47,489 | 50,479 |
| Net leased property | 2,989 | - |
| Future minimum lease payments, including interest portion | | |
| Due within one year | 2,989 | - |
| Due after one year | - | - |
| | 2,989 | - |
| Lease payments and pro forma depreciation expenses | | |
| Lease payments | 10,095 | 2,989 |
| Pro forma depreciation expenses (assuming straight-line method) | 10,095 | 2,989 |

Capital Structure

Nonconsolidated balance sheet: assets

| December 31; Thousands of yen | 2011 | 2012 | 2013 |
|--------------------------------------|-------------|-------------|-------------|
| Current assets | | | |
| Cash and deposits | 1,048,000 | 2,320,852 | 1,652,808 |
| Notes receivable - trade | 1,171,287 | 1,111,250 | 1,154,131 |
| Accounts receivable – trade | 2,787,771 | 2,151,390 | 2,224,057 |
| Merchandise and finished goods | 399,216 | 455,841 | 503,566 |
| Raw materials and supplies | 513,487 | 437,388 | 380,254 |
| Work in process | 503,857 | 267,235 | 255,293 |
| Prepaid expenses | 43,943 | 45,140 | 55,904 |
| Deferred tax assets | 383,246 | 238,219 | 221,070 |
| Income taxes receivable | - | 153,002 | - |
| Others | 7,790 | 4,191 | 8,042 |
| Allowance for doubtful accounts | (4,000) | (4,000) | (4,000) |
| | 6,854,602 | 7,180,514 | 6,451,128 |
| Fixed assets | | | |
| Tangible fixed assets | | | |
| Buildings | 3,498,982 | 3,713,773 | 3,715,843 |
| Accumulated depreciation | (2,154,930) | (2,272,679) | (2,372,467) |
| Buildings, net | 1,344,052 | 1,441,094 | 1,343,376 |
| Structures | 212,945 | 226,043 | 222,817 |
| Accumulated depreciation | (185,400) | (195,307) | (199,318) |
| Structures, net | 27,544 | 30,735 | 23,498 |
| Machinery and equipment | 3,572,307 | 3,870,393 | 4,126,064 |
| Accumulated depreciation | (2,787,942) | (3,039,781) | (3,272,800) |
| Machinery and equipment, net | 784,364 | 830,612 | 853,263 |
| Vehicles and delivery equipment | 1,500 | 1,500 | 1,250 |
| Accumulated depreciation | (1,485) | (1,499) | (1,249) |
| Vehicles and delivery equipment, net | 15 | 0 | 0 |
| Tools, furniture and fixtures | 2,353,315 | 2,338,893 | 2,208,930 |
| Accumulated depreciation | (2,168,293) | (2,165,134) | (2,083,815) |
| Tools, furniture and fixtures, net | 185,021 | 173,759 | 125,115 |
| Land | 5,407,133 | 4,740,386 | 4,740,386 |
| Lease assets | 159,829 | 221,030 | 230,500 |
| Accumulated depreciation | (48,395) | (101,548) | (133,416) |
| Lease assets, net | 111,434 | 119,481 | 97,084 |
| Construction in progress | 349,181 | 131,257 | 78,988 |
| | 8,208,747 | 7,467,326 | 7,261,712 |

| December 31; Thousands of yen | 2011 | 2012 | 2013 |
|---|-------------------|-------------------|-------------------|
| Intangible fixed assets | | | |
| Patents | 21,440 | 28,032 | 27,983 |
| Telephone subscription rights | 9,423 | 9,423 | 9,423 |
| Leaseholds | 1,057 | 1,057 | 1,057 |
| Software | 1,363 | 2,079 | 3,628 |
| Lease assets | - | - | 16,242 |
| Others | 204 | 92 | 21,028 |
| | 33,488 | 40,685 | 79,363 |
| Investments and other assets | | | |
| Investments in securities | 58,342 | 60,616 | 76,771 |
| Stocks of subsidiaries and affiliates | - | 100,875 | 472,087 |
| Long-term loans to employees | 2,582 | 1,726 | - |
| Claims provable in bankruptcy, claims provable in rehabilitation and others | - | 130 | 92 |
| Long-term prepaid expenses | 477 | 3,124 | 15,566 |
| Deferred tax assets | 204,172 | 193,770 | 186,142 |
| Leasing and guarantee deposits | 83,354 | 82,463 | 84,135 |
| Directors' retirement benefit insurance premiums | 821,070 | 838,921 | 842,282 |
| Allowance for doubtful accounts | (4,000) | (4,000) | (4,000) |
| | 1,165,998 | 1,277,627 | 1,673,078 |
| Total fixed assets | 9,408,234 | 8,785,639 | 9,014,154 |
| Total assets | 16,262,836 | 15,966,154 | 15,465,283 |

Nonconsolidated balance sheet: liabilities and net assets

| December 31; Thousands of yen | 2011 | 2012 | 2013 |
|--|-----------|-----------|-----------|
| Current liabilities | | | |
| Accounts payable - trade | 210,903 | 177,551 | 144,770 |
| Short-term borrowings | 2,100,000 | 2,300,000 | 2,000,000 |
| Current portion of long-term debt | 1,244,200 | 1,235,400 | 1,124,200 |
| Lease obligations | - | 57,990 | 70,340 |
| Accounts payable - other | 211,793 | 167,542 | 151,060 |
| Accounts payable - facilities | 179,606 | 36,816 | 36,775 |
| Accrued expenses | 161,491 | 157,169 | 149,873 |
| Income taxes payable | 489,250 | - | 98,166 |
| Consumption taxes payable | 34,459 | 17,274 | 18,782 |
| Advances received | 3 | 24,826 | 2,243 |
| Deposits received | 29,919 | 42,599 | 45,000 |
| Provision for bonuses | 332,000 | 245,000 | 171,000 |
| Provision for directors' and corporate auditors' bonuses | 48,800 | 34,600 | 20,150 |
| | 5,042,427 | 4,496,771 | 4,032,364 |
| Long-term liabilities | | | |
| Long-term debt | 2,070,600 | 2,212,700 | 2,168,500 |
| Lease obligations | 117,005 | 67,465 | 48,652 |
| Long-term accounts payable - other | 139,624 | 87,138 | 42,175 |
| Directors' and corporate auditors' retirement benefits | 416,700 | 444,800 | 476,500 |
| Asset retirement obligations | 7,124 | 6,659 | 14,636 |
| Others | 3,000 | 3,139 | 3,156 |
| | 2,754,054 | 2,821,903 | 2,753,621 |
| Total liabilities | 7,796,481 | 7,318,674 | 6,785,985 |
| Net assets | | | |
| Shareholders' equity | | | |
| Common stock | 674,265 | 674,265 | 674,265 |
| Capital surplus | | | |
| Additional paid-in capital | 527,936 | 527,936 | 527,936 |
| Other capital reserves | 756 | 242 | - |
| | 528,693 | 528,178 | 527,936 |

| December 31; Thousands of yen | 2011 | 2012 | 2013 |
|--|-------------------|-------------------|-------------------|
| Retained earnings | | | |
| Legal income reserves | 168,566 | 168,566 | 168,566 |
| Other legal income reserves | | | |
| Special reserves | 6,086,000 | 6,386,000 | 6,686,000 |
| Reserve for reduction of asset costs due to contributions or subsidies | 28,264 | 26,983 | 25,719 |
| Retained earnings carried forward | 972,206 | 881,406 | 650,804 |
| | 7,255,036 | 7,462,956 | 7,531,090 |
| Treasury stock | (41,901) | (31,340) | (93,864) |
| | 8,416,093 | 8,634,060 | 8,639,427 |
| Valuation/translation gains (losses) | | | |
| Unrealized gains (losses) on other securities | (1,624) | (161) | 10,236 |
| | (1,624) | (161) | 10,236 |
| Share subscription rights | 51,885 | 13,580 | 29,634 |
| Total net assets | 8,466,354 | 8,647,479 | 8,679,298 |
| Total liabilities and net assets | 16,262,836 | 15,966,154 | 15,465,283 |

Trade credits

Notes receivable

| Thousands of yen | 2013 |
|-----------------------------|-----------|
| Shimatsu | 100,697 |
| Ohtsuka Brush Manufacturing | 62,097 |
| Simon | 60,886 |
| Yoshikawa Sangyo | 46,417 |
| Tanizawa Seisakusho | 42,498 |
| Others | 841,534 |
| | 1,154,131 |

Accounts receivable — trade

| Thousands of yen | 2013 |
|-----------------------------|-----------|
| Midori Anzen Youhin | 720,723 |
| Ministry of Defense | 678,688 |
| AS ONE Corporation | 52,175 |
| Komatsu Ltd. | 38,624 |
| Mitsubishi Heavy Industries | 37,625 |
| Others | 696,219 |
| | 2,224,057 |

Turnover of accounts receivable

| Thousands of yen | 2013 |
|-----------------------------|-----------|
| Beginning balance | 2,151,390 |
| Increase | 7,842,501 |
| Collected | 7,769,835 |
| Ending balance | 2,224,057 |
| Turnover | 77.8% |
| Average days for collection | 101.8 |

Accounts payable — trade

| Thousands of yen | 2013 |
|----------------------------|---------|
| Takaoka Shoji | 12,229 |
| Tsukuba Chemical | 9,940 |
| Sanwa Sangyo | 8,547 |
| Sanshin Plastic | 7,703 |
| Mitsui & Co. Plastics Ltd. | 5,916 |
| Others | 100,432 |
| | 144,770 |

Securities**Financial instruments****Policies related to financial instruments**

The Company seeks to conduct financing based on market conditions and by maintaining a balance between short-term and long-term instruments. The Company uses safe short-term deposits for operating funds and does not engage in speculative trading.

Nature of financial instruments and management of related risks

The Company manages its exposure to price fluctuation risk on its portfolio of investment securities by assessing market prices on a quarterly basis. With unlisted stocks, the financial situation of the issuing firms is reviewed periodically.

The Company manages its exposure to credit risk from notes and accounts receivable by monitoring the amounts outstanding and due dates for each counterparty.

Trade payables and other operating liabilities are typically due within 60 days. The Company employs mainly short-term borrowings, long-term debt and related financial leases to finance business operations and capital investments. Any related liquidity risk is managed by maintaining certain levels of cash and liquidity at all times.

The Company also uses interest-rate swaps to hedge the risk of interest rate movements on its debt. The Company enters into derivative transactions only with top-rated financial institutions as a means of effectively eliminating related counterparty credit risk. Details of hedging techniques, policies and methods of evaluating the effectiveness of using such derivatives are provided in the section on significant accounting policies.

Additional information on pricing of financial instruments

The values of some financial instruments that do not have market prices are computed using mathematical formulae. The values of these instruments can fluctuate due to changes in the variables, initial conditions or underlying assumptions contained in such formulae.

Items related to current value

| Thousands of yen | 2012 | | | 2013 | | |
|------------------------------------|------------|---------------|------------------------|------------|---------------|------------------------|
| | Book value | Current value | Unrealized gain (loss) | Book value | Current value | Unrealized gain (loss) |
| Cash and deposits | 2,320,852 | 2,320,852 | - | 1,652,808 | 1,652,808 | - |
| Notes receivable - trade | 1,111,250 | 1,111,250 | - | 1,154,131 | 1,154,131 | - |
| Accounts receivable - trade | 2,151,390 | 2,151,390 | - | 2,224,057 | 2,224,057 | - |
| Income taxes receivable | 153,002 | 153,002 | - | - | - | - |
| Investment securities | 34,554 | 34,554 | - | 50,709 | 50,709 | - |
| Total assets | 5,771,051 | 5,771,051 | - | 5,081,707 | 5,081,707 | - |
| Accounts payable - trade | 177,551 | 177,551 | - | 144,770 | 144,770 | - |
| Accounts payable - other | 167,542 | 167,542 | - | 151,060 | 151,060 | - |
| Accounts payable - facilities | 36,816 | 36,816 | - | 36,775 | 36,775 | - |
| Short-term borrowings | 2,300,000 | 2,300,000 | - | 2,000,000 | 2,000,000 | - |
| Current portion of long-term debt | 1,235,400 | 1,238,608 | 3,208 | 1,124,200 | 1,125,849 | 1,649 |
| Income taxes payable | - | - | - | 98,166 | 98,166 | - |
| Short-term leases | 57,990 | 55,448 | (2,541) | 70,340 | 67,938 | (2,402) |
| Long-term accounts payable - other | 87,138 | 86,901 | (236) | 42,175 | 42,078 | (96) |
| Long-term debt | 2,212,700 | 2,222,261 | 9,561 | 2,168,500 | 2,173,286 | 4,786 |
| Long-term leases | 67,465 | 65,678 | (1,787) | 48,652 | 47,315 | (1,336) |
| Total liabilities | 6,342,604 | 6,350,809 | 8,204 | 5,884,642 | 5,887,241 | 2,599 |
| Derivative transactions | - | - | - | - | - | - |

Methods of calculating current value

Cash and deposits; notes receivable - trade; accounts receivable - trade; income taxes receivable: book value

Investment securities: market value

Accounts payable - trade; accounts payable - other; accounts payable - facilities; short-term borrowings: book value

Current portion of long-term debt; long-term debt: discounting at the interest rate that would apply if the Company were to newly borrow the same amount of principal and interest. Interest rate swaps subject to special treatment procedures are accounted for as an inseparable part of the long-term debt that is being hedged; hence, its market value is included as a part of the market value of said long-term debt.

Long-term accounts payable - other: the current value for these liabilities is based on discounting at the risk-free rate for Japanese government bonds with maturities matching the anticipated future payment schedule.

Short-term and long-term leases: the current value is calculated based on the aggregate value of principal and interest for the related liability, discounted at the rates applicable to newly transacted equivalent leases.

Financial instruments with no easily ascertainable current value

| Thousands of yen | 2012 | 2013 |
|------------------------|---------|---------|
| Unlisted stocks | 26,061 | 26,061 |
| Shares in subsidiaries | 100,875 | 472,087 |

Repayment schedule for receivables after accounting date

| Thousands of yen | Up to 1 year | Greater than 1 and up to 5 years | Greater than 5 and up to 10 years | Greater than 10 years |
|-----------------------------|--------------|----------------------------------|-----------------------------------|-----------------------|
| 2013 | | | | |
| Cash and deposits | 1,652,808 | - | - | - |
| Notes receivable - trade | 1,154,131 | - | - | - |
| Accounts receivable - trade | 2,224,057 | - | - | - |
| | 5,030,997 | - | - | - |
| 2012 | | | | |
| Cash and deposits | 2,320,852 | - | - | - |
| Notes receivable - trade | 1,111,250 | - | - | - |
| Accounts receivable - trade | 2,151,390 | - | - | - |
| | 5,583,494 | - | - | - |

Market value of securities

Other quoted securities

| Thousands of yen | 2012 | | | 2013 | | |
|---|------------|---------------------|------------------------|------------|---------------------|------------------------|
| | Book value | Cost of acquisition | Unrealized gain (loss) | Book value | Cost of acquisition | Unrealized gain (loss) |
| Securities valued on the consolidated balance sheet at amounts greater than the purchase cost | | | | | | |
| Shares | 3,179 | 2,303 | 876 | 50,709 | 34,805 | 15,904 |
| | 3,179 | 2,303 | 876 | 50,709 | 34,805 | 15,904 |
| Securities valued on the consolidated balance sheet at amounts not greater than the purchase cost | | | | | | |
| Shares | 31,375 | 32,502 | (1,126) | - | - | - |
| | 31,375 | 32,502 | (1,126) | - | - | - |
| | 34,554 | 34,805 | (250) | 50,709 | 34,805 | 15,904 |

Because unlisted stocks (with a balance sheet value of 26,061 thousand yen) have no market value and are generally considered to be extremely difficult to value at any given time, they are not included in "other securities" above.

Fixed assets

Facilities

The Company maintains plants (techno-yards) in five locations in Japan. It also operates 14 domestic sales offices as well as the Saitama Logistics Center and the Ninomiya Training Center. It conducts research at its Hannou Laboratories.

The Company's principal facilities are as follows:

| Book value; Thousands of yen | Buildings and structures | Machinery, vehicles and delivery equipment | Land | Square meters | Tools, furniture and fixtures | Lease assets | Total book value | Number of employees |
|------------------------------------|--------------------------------|--|-----------|------------------|--|-----------------|---------------------|------------------------|
| Company administration | | | | | | | | |
| Head office | 203,850 | 971 | 1,636,000 | 283.91 | 13,407 | 20,593 | 1,874,822 | 96 |
| Manufacture of dust and gas masks | | | | | | | | |
| Sayama Techno-Yard | 349,343 | 331,838 | 792,433 | 11,430.44 | 9,336 | 15,331 | 1,498,284 | 19 |
| Gunma Techno-Yard | 411,300 | 89,111 | 405,140 | 9,256.83 | 20,479 | 58,696 | 984,729 | 15 |
| Tokorozawa Techno-Yard | 63,687 | 1,800 | 177,214 | 1,915.55 | 8,110 | 16,081 | 266,894 | 9 |
| Nakai Techno-Yard | 123,575 | 329,614 | 325,449 | 1,434.94 | 10,683 | 2,623 | 791,945 | 9 |
| Ranzan Techno-Yard | 34,508 | 77,646 | - | - | - | - | 112,154 | 4 |
| Research activities | | | | | | | | |
| Hannou Laboratories | 30,545 | 6,208 | 31,217 | 3,637.49 | 10,443 | - | 78,414 | 8 |
| Distribution of dust and gas masks | | | | | | | | |
| Saitama Logistics Center | 95,148 | 4,049 | 1,242,116 | 21,336.07 | 3,867 | - | 1,345,181 | 5 |

(Notes)

1. The Ranzan Techno-Yard commenced operations on January 1, 2013.
2. The Ranzan Techno-Yard occupies the same site as the Saitama Logistics Center. The land value for the site is shown under the Saitama Logistics Center.

Fixed assets and depreciation

| Thousands of yen | Beginning of term | Increase | Decrease | End of term | Depreciation | | End of term, net |
|---|-------------------|----------|----------|-------------|--------------|---------|------------------|
| | | | | | Accumulated | Current | |
| Tangible fixed assets | | | | | | | |
| Buildings | 3,713,773 | 30,257 | 28,187 | 3,715,843 | 2,372,467 | 127,062 | 1,343,376 |
| Structures | 226,043 | - | 3,226 | 222,817 | 199,318 | 7,236 | 23,498 |
| Machinery and equipment | 3,870,393 | 263,392 | 7,721 | 4,126,064 | 3,272,800 | 240,422 | 853,263 |
| Vehicles and delivery equipment | 1,500 | - | 250 | 1,250 | 1,249 | - | 0 |
| Tools and fixtures | 2,338,893 | 188,430 | 318,393 | 2,208,930 | 2,083,815 | 102,293 | 125,115 |
| Land | 4,740,386 | - | - | 4,740,386 | - | - | 4,740,386 |
| Lease assets | 221,030 | 70,136 | 60,666 | 230,500 | 133,416 | 68,131 | 97,084 |
| Construction in progress | 131,257 | 443,773 | 496,042 | 78,988 | - | - | 78,988 |
| | 15,243,277 | 995,990 | 914,487 | 15,324,780 | 8,063,067 | 545,146 | 7,261,712 |
| Intangible fixed assets | | | | | | | |
| Patents | - | - | - | 50,908 | 22,924 | 6,325 | 27,983 |
| Telephone subscription rights | - | - | - | 9,423 | - | - | 9,423 |
| Leaseholds | - | - | - | 1,057 | - | - | 1,057 |
| Software | - | - | - | 6,040 | 2,412 | 1,048 | 3,628 |
| Lease assets | - | - | - | 40,804 | 24,561 | 8,160 | 16,242 |
| Usage rights for equipment and facilities | - | - | - | 21,898 | 869 | 63 | 21,028 |
| | - | - | - | 130,132 | 50,768 | 15,598 | 79,363 |
| Long-term prepaid expenses | 4,725 | 19,735 | 6,370 | 18,089 | 2,523 | 1,310 | 15,566 |

Debt

Borrowings

| Thousands of yen | Previous period | Outstanding | Average rate | Maturity |
|---|-----------------|-------------|--------------|--------------|
| Short-term borrowings | 2,300,000 | 2,000,000 | 1.13% | - |
| Current portion of long-term debt | 1,235,400 | 1,124,200 | 1.17% | - |
| Current portion of leasing-related liabilities | 57,990 | 70,340 | - | - |
| Long-term debt (except current portion of long-term debt) | 2,212,700 | 2,168,500 | 1.14% | 2015 to 2018 |
| Leasing-related liabilities (except current portion of leasing-related liabilities) | 67,465 | 48,652 | - | 2015 to 2018 |
| Other interest-bearing liabilities | - | - | - | - |
| | 5,873,555 | 5,411,692 | - | - |

1. Average rates for borrowing shown in the table above are weighted averages of rates paid on loans outstanding as of term-end.

2. Amounts of long-term debt and other debt (excluding debt due in less than one year) scheduled to be repaid over the 5-year period subsequent to the balance sheet date are as follows:

| Thousands of yen | Longer than 1 and up to 2 years | Longer than 2 and up to 3 years | Longer than 3 and up to 4 years | Longer than 4 and up to 5 years |
|-----------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| Long-term debt | 914,000 | 717,000 | 417,500 | 120,000 |
| Leasing-related liabilities | 36,771 | 7,579 | 4,119 | 182 |

Assets provided as collateral

| Thousands of yen | 2012 | 2013 |
|---|-----------|-----------|
| Assets provided as collateral | | |
| Buildings | 828,478 | 789,068 |
| Land | 2,996,037 | 2,996,037 |
| | 3,824,516 | 3,785,105 |
| Liabilities for which collateral is provided | | |
| Long-term debt | 3,298,100 | 3,182,700 |
| | 3,298,100 | 3,182,700 |

Retirement benefits

Outline of retirement benefit system

The Company operates a defined-contribution pension plan for employees.

Matters related to retirement benefit expenses

| Thousands of yen | 2012 | 2013 |
|---|--------|--------|
| Expenses related to defined-contribution pension plan | 85,000 | 85,723 |

Reserves

| Thousands of yen | Beginning of term | Increase | Decrease | End of term |
|--|-------------------|----------|----------|-------------|
| Allowance for doubtful accounts | 8,000 | 4,018 | 4,018 | 8,000 |
| Provision for bonuses | 245,000 | 171,000 | 245,000 | 171,000 |
| Provision for directors' and corporate auditors' bonuses | 34,600 | 20,150 | 34,600 | 20,150 |
| Directors' and corporate auditors' retirement benefits | 444,800 | 31,700 | - | 476,500 |

Related Parties

Transactions with related parties: Directors and major independent shareholders

December 2013 term

Subsidiaries and related companies

| December 31; Thousands of yen | Address | Capital | Type of business or occupation | % of voting rights held (held by others) | Relationship with related party | Type of transaction | Value of transactions | Accounting classification | Balance at term-end |
|--|--------------------|-------------|---|---|---|------------------------|--------------------------|------------------------------|------------------------|
| 2013 | | | | | | | | | |
| Companies in which a major shareholder or close relative has unshared decision-making authority over more than half the voting rights | | | | | | | | | |
| SIAM KOKEN LTD. | Chonburi, Thailand | THB 150,000 | Manufacture/ sale of disposable particulate respirators | Owning 100.00 | Capital transactions Interlocking directors | Investment financing | 371,212 | - | - |

Directors and major individual shareholders

| December 31; Thousands of yen | Address | Capital | Type of business or occupation | % of voting rights held (held by others) | Relationship with related party | Type of transaction | Value of transactions | Accounting classification | Balance at term-end |
|--|-------------------|---------|--|---|---|----------------------------|--------------------------|------------------------------|------------------------|
| 2013 | | | | | | | | | |
| Companies in which a major shareholder or close relative has unshared decision-making authority over more than half the voting rights | | | | | | | | | |
| Sakai Tatemono Ltd. | Chiyoda-ku, Tokyo | 228,000 | Real estate leasing, Insurance agency business | Owned 3.29 | Building leasing Interlocking directors | Payment of rental expenses | 39,235 | Accounts payable - other | 1,556 |

December 2012 term

Directors and major individual shareholders

| December 31; Thousands of yen | Address | Capital | Type of business or occupation | % of voting rights held (held by others) | Relationship with related party | Type of transaction | Value of transactions | Accounting classification | Balance at term-end |
|--|-------------------|---------|--|---|---|----------------------------|--------------------------|------------------------------|------------------------|
| 2012 | | | | | | | | | |
| Companies in which a major shareholder or close relative has unshared decision-making authority over more than half the voting rights | | | | | | | | | |
| Sakai Tatemono Ltd. | Chiyoda-ku, Tokyo | 228,000 | Real estate leasing, Insurance agency business | Owning 3.28 | Building leasing Interlocking directors | Payment of rental expenses | 39,201 | Accounts payable - other | 1,533 |

Accounting Policies

Summary of accounting policies – nonconsolidated

| | |
|---|--|
| Basis of presentation | Japanese GAAP; nonconsolidated |
| Marketable securities and investments in securities | <p>Bonds held to maturity: cost amortization method (straight-line)</p> <p>Shares in subsidiaries: valued at cost using the moving-average method</p> <p>Other securities:</p> <p>Quoted securities: current value method based on average market prices in the month prior to the end of the fiscal year (by which all valuation differences are credited directly to net assets, with the cost of securities sold calculated in accordance with the moving-average method)</p> <p>Unquoted securities: valued at cost using the moving-average method</p> |
| Inventories | <p>Finished goods, work in process: cost method computed on a periodic-average basis (method by which the book value is reduced based on declines in the profitability of inventories shown on the balance sheet)</p> <p>Merchandise, raw materials: cost method using the moving-average method (method by which the book value is reduced based on declines in the profitability of inventories shown on the balance sheet)</p> <p>Supplies: cost method using the final-purchase-cost method (method by which the book value is reduced based on declines in the profitability of inventories shown on the balance sheet)</p> |
| Depreciation | <p>Tangible fixed assets (excluding lease assets): declining-balance method</p> <p>Intangible fixed assets: straight-line method</p> <p>Software for internal use is amortized on a straight-line basis (based on the length of useful in-house life).</p> <p>Long-term prepaid expenses: straight-line method</p> <p>Lease assets: lease terms for years of useful life are employed, assuming a residual value of zero; depreciation is assumed to be on a straight-line basis.</p> |
| Allowance for doubtful accounts | The Company recognizes an amount calculated on the basis of a historical bad debt ratio for general accounts receivable, plus an amount for specific accounts for which collection appears doubtful. |
| Provision for bonuses | An amount is reserved based on estimated payments to employees. |
| Directors' and corporate auditors' retirement benefits | An amount that must be paid at term-end is reserved in accordance with the Company rules. |
| Provision for directors' and corporate auditors' bonuses | An amount is reserved based on estimated payments to directors and corporate auditors. |

Significant hedge accounting methods

Method of accounting for hedges:

Hedging is limited to interest-rate swaps, which are undertaken only in exceptional circumstances.

Hedging instruments and risks being hedged:

Hedging instruments: interest rate swaps

Risks being hedged: loans payable

Hedging policy:

Interest-rate swaps linked to borrowings may be used to hedge the risk due to interest rate fluctuations. The target of such hedging transactions varies according to the individual contract.

Method of evaluating the effectiveness of hedging:

The effectiveness of hedging is not evaluated, since interest-rate swaps are used only in exceptional circumstances and, when utilized, these swaps are virtually standardized with respect to the notional principal, contract term and conditions related to receipt or payment of interest (including rates of interest and related dates).

Opinion of independent auditors

Auditors: A&A Partners

Opinion: unqualified

Share-related Information

Shares in issue

| | |
|------------------------------------|-----------------------------|
| Class of shares | Common |
| Number of shares authorized | 20,000,000 |
| Issued | |
| As of December 31, 2013 | 5,104,003 |
| As of March 14, 2014 | 5,104,003 |
| Stock exchange listings | JASDAQ-TSE (Standard) |
| Comments | Trading unit 100-share min. |

Changes in common stock and number of shares outstanding

| | Shares outstanding | | Common stock | | Additional paid-in capital | | Remarks |
|-------------------|----------------------|-----------|----------------------|---------|----------------------------|---------|---------------------------------|
| | Increase or decrease | Balance | Increase or decrease | Balance | Increase or decrease | Balance | |
| | (Shares) | | (Thousands of yen) | | (Thousands of yen) | | |
| December 31, 1999 | 4,611 | 5,104,003 | 2,254 | 674,265 | 2,246 | 527,936 | Conversion of convertible bonds |

Shareholders by type of investor

| Type of investor | Number of shareholders | Units owned (100 shares) | % owned |
|---|------------------------|--------------------------|---------|
| National and local government agencies | - | - | - |
| Financial institutions | 7 | 7,043 | 13.80 |
| Securities companies | 27 | 4,305 | 8.44 |
| Business and other corporations | 19 | 1,915 | 3.75 |
| Non-residents - institutions and corporations | 9 | 253 | 0.5 |
| Non-residents - individuals | - | - | - |
| Individuals and others | 1,292 | 37,503 | 73.51 |
| | 1,354 | 51,019 | 100.00 |
| Shares less than one unit | - | 2,103 | - |

Largest shareholders

| Name | Thousands of shares owned | % of shares outstanding |
|---------------------|---------------------------|-------------------------|
| Masakazu Sakai | 856 | 16.77 |
| Hiroyuki Sakai | 824 | 16.15 |
| Resona Bank | 244 | 4.79 |
| Kaori Sakai | 229 | 4.50 |
| Rie Sakai | 229 | 4.50 |
| Mizuho Bank | 227 | 4.47 |
| Miho Kuboi | 226 | 4.43 |
| Haruna Sakai | 226 | 4.43 |
| Sakai Tatemono Ltd. | 166 | 3.26 |
| Yoshinori Ito | 159 | 3.12 |
| | 3,389 | 66.40 |

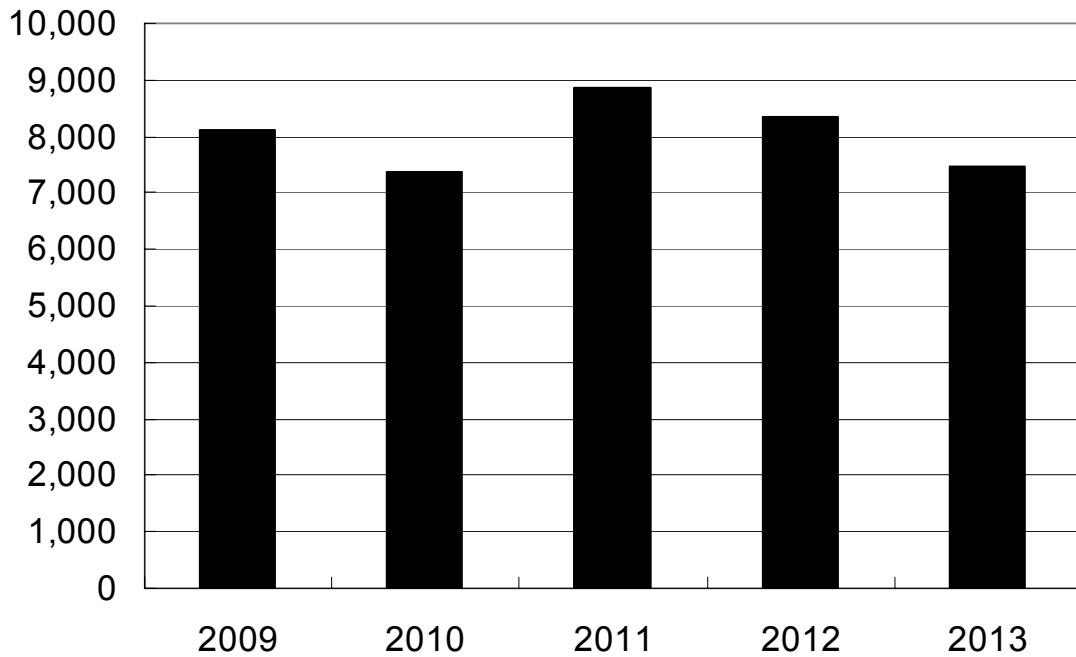
Share information

| | |
|---|---|
| Business year | January 1 to December 31 |
| Ex-rights date | December 31 |
| Date of record for dividends | June 30 and December 31 |
| Annual General Meeting of Shareholders | March |
| Trading unit | 100 shares |
| Transfer agent | Mitsubishi UFJ Trust & Banking, 1-4-5, Marunouchi, Chiyoda-ku, Tokyo |
| Publication of record | The Company's method of public notice shall be by electronic means. In the event of an accident or other unavoidable circumstance, notices shall be published in <i>The Nihon Keizai Shimbun</i> . The address of the Company's website is as follows: http://www.koken-ltd.co.jp/ |

Performance in Graphs

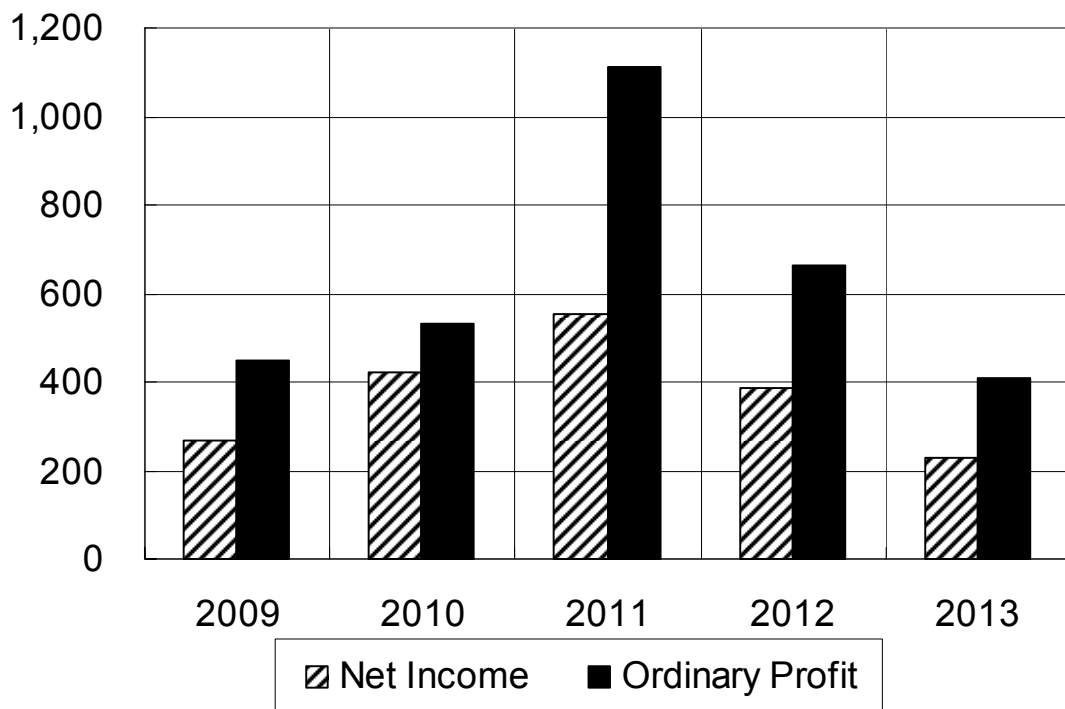
Net Sales

Millions of Yen

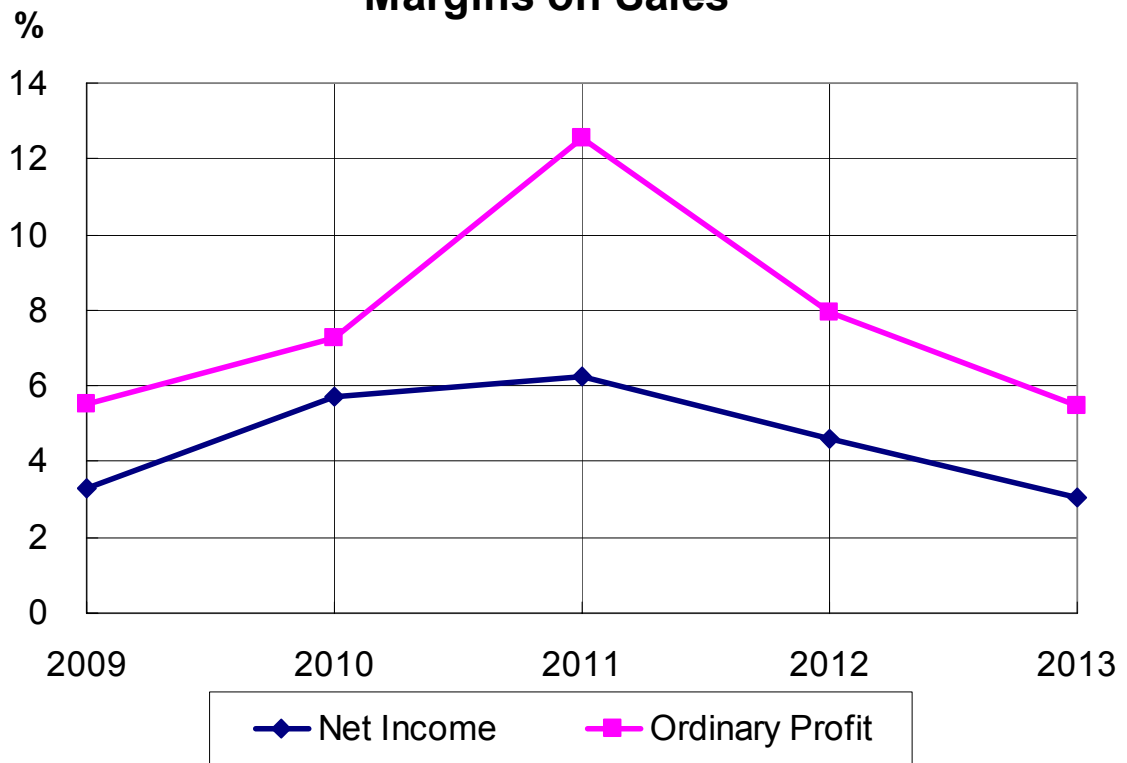


Net Income and Ordinary Profit

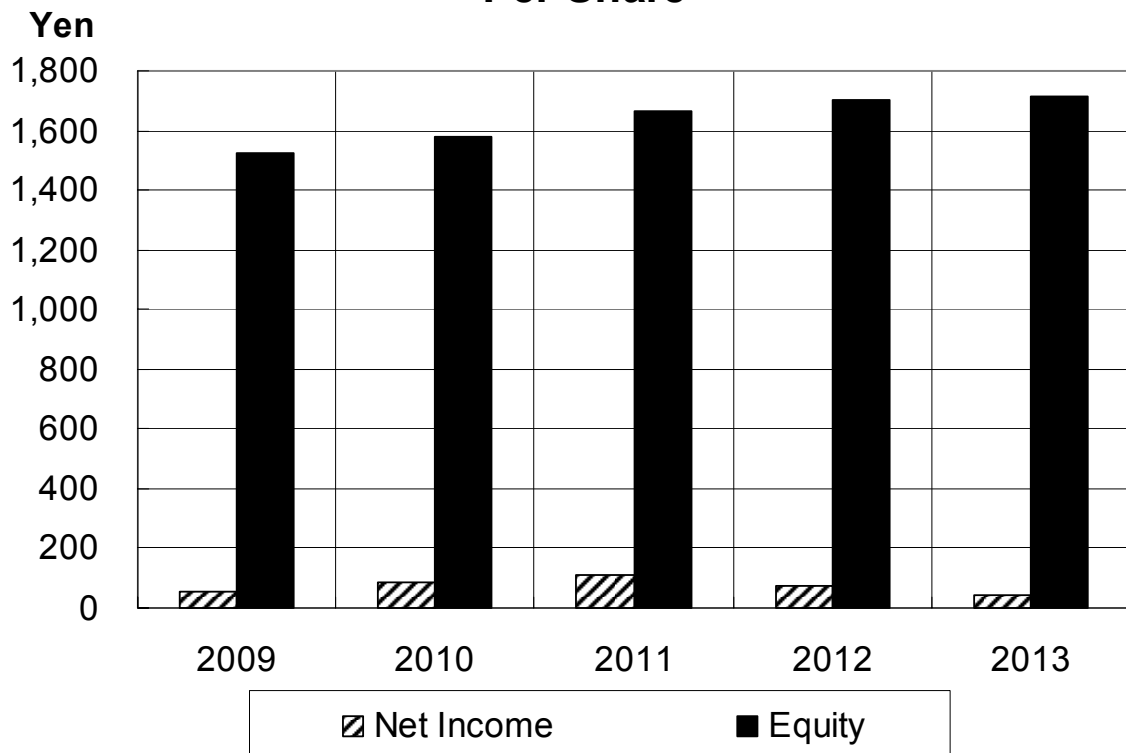
Millions of Yen



Margins on Sales

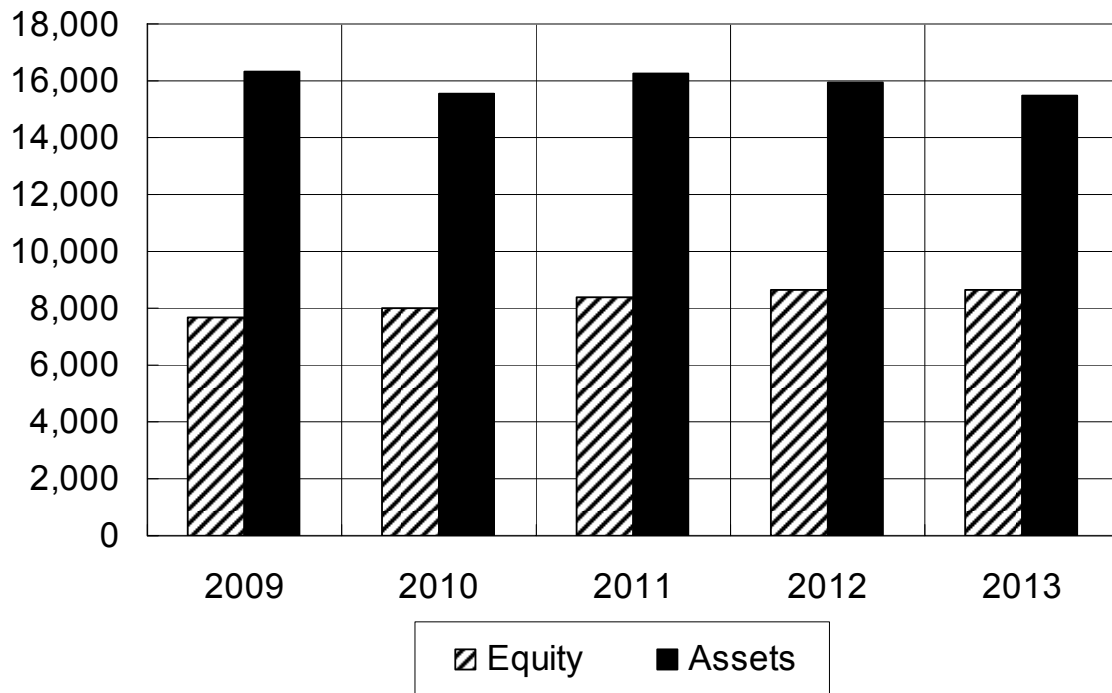


Per Share

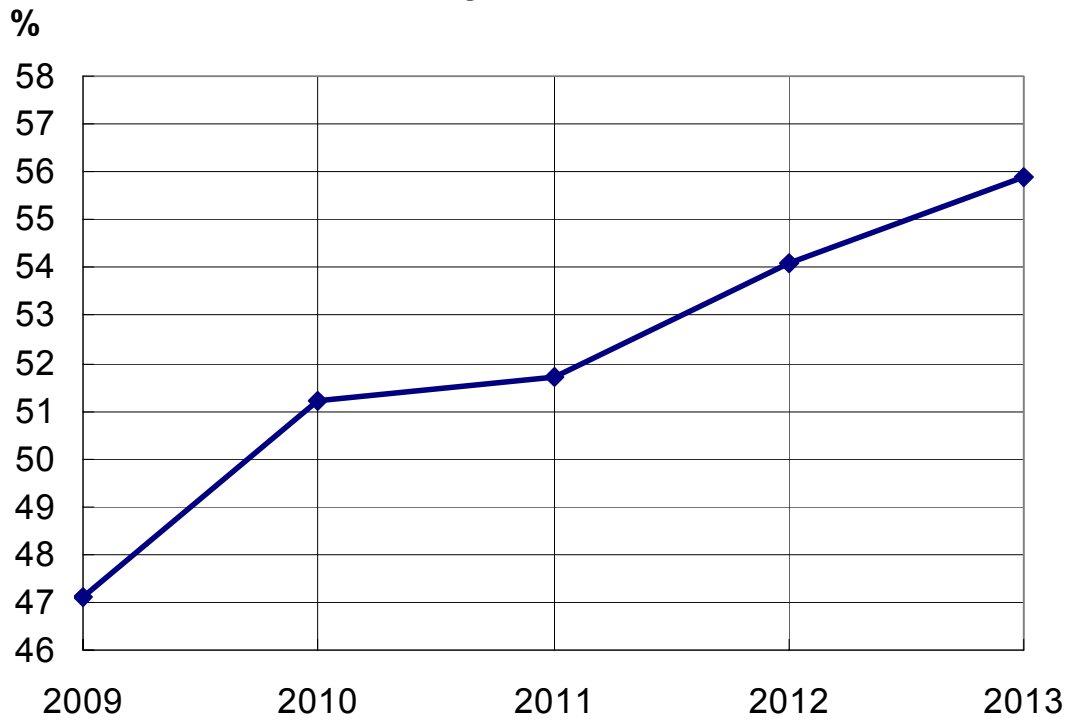


Equity and Assets

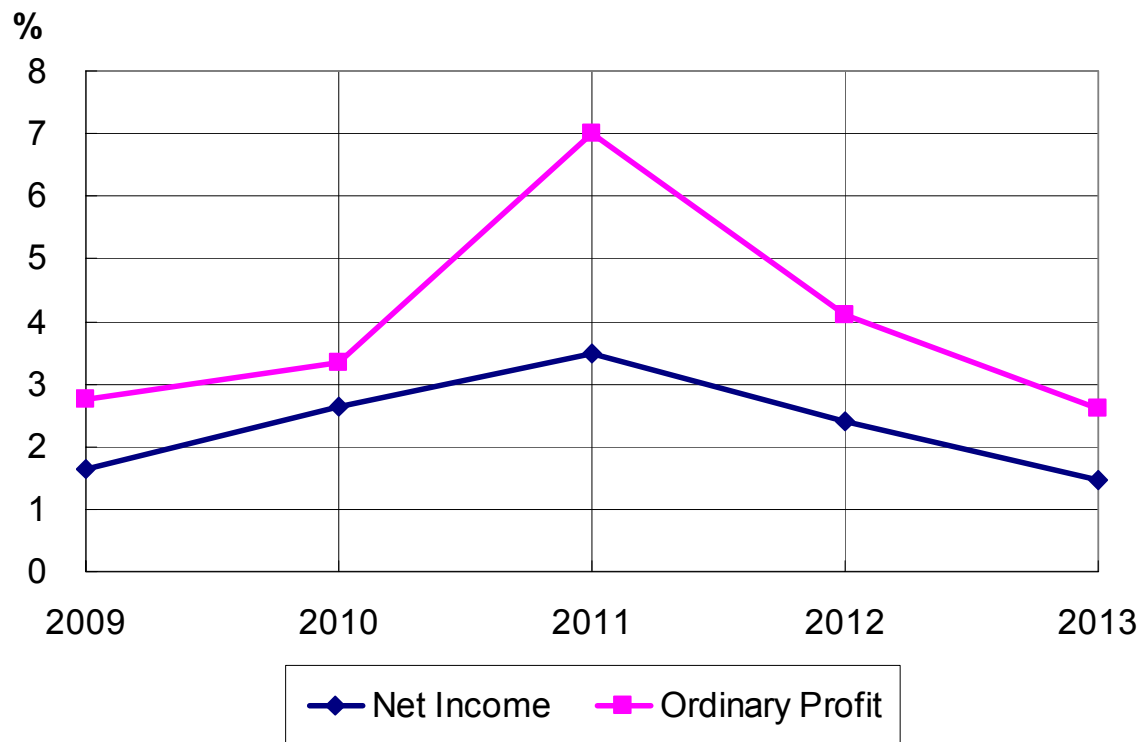
Millions of Yen



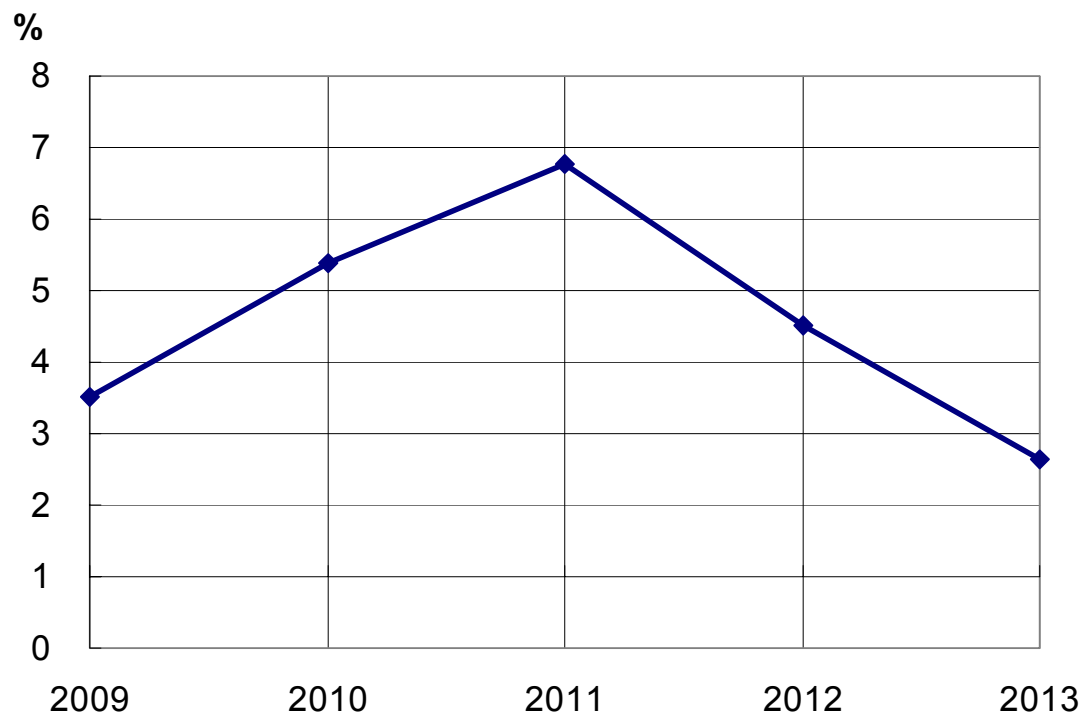
Equity / Assets



Return on Assets



Return on Equity



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