notes to consolidated financial statements

Nikon Corporation and Consolidated Subsidiaries
Years ended March 31, 2005 and 2004

1. BASIS OF PRESENTING CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan. In addition, certain reclassifications have been made in 2004 financial statements to conform to the classification used in 2005.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which Nikon Corporation (the "Company") is incorporated and operates. The translation of Japanese yen amounts into U.S. dollar amounts is included solely for the convenience of readers outside Japan and has been made at the rate of ¥107.39 to U.S.$1, the rate of exchange at March 31, 2005. Such translation should not be construed as representation that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Consolidation

The consolidated financial statements as of March 31, 2005 include the accounts of the Company and its 46 significant subsidiaries (collectively the "Group"). Under the control or influence concept, those companies in which the Company, directly or indirectly, is able to exercise control over operations are fully consolidated, and those companies over which the Company has the ability to exercise significant influence are accounted for by the equity method.

Investments in 2 associated companies (3 associated companies in 2004) are accounted for by the equity method. Investments in the remaining unconsolidated subsidiaries and associated companies are stated at cost. If the equity method of accounting had been applied to the investments in these companies, the effect on the accompanying consolidated financial statements would not be material.

The differences between the cost and underlying net equity of investments in consolidated subsidiaries and associated companies accounted for by the equity method at acquisition ("Goodwill") are charged to income when incurred, if they are small amounts in sum, and the others are being amortized on a straight-line basis over 5 years.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Group is eliminated.

(b) Cash Equivalents

Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value.

Cash equivalents include time deposits, certificates of deposit, commercial paper and mutual funds investing in bonds that represent short-term investments, all of which mature or become due within three months of the date of acquisition.

(c) Marketable and Investment Securities

Marketable and investment securities are classified and accounted for, depending on management's intent, as follows:

i) trading securities, which are held for the purpose of earning capital gains in the near term are reported at fair value, and the related unrealized gains and losses are included in earnings,

ii) held-to-maturity debt securities, which are expected to be held to maturity with the positive intent and ability to hold to maturity, are reported at amortized cost and

iii) available-for-sale securities, which are not classified as either of the aforementioned securities, are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity. Non-marketable available-for-sale securities are stated principally at moving-average cost. For other than temporary declines in fair value, investment securities are reduced to net realizable value by a charge to income.

(d) Inventories

Inventories of the Company and its domestic subsidiaries are stated at cost as determined principally using the average method, except for work in process which is determined by the specific identification method. Inventories of foreign subsidiaries are stated at the lower of cost or market as determined principally using the average method.

(e) Property, Plant and Equipment
Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment of the Company and domestic subsidiaries is principally computed using the declining-balance method, while the straight-line method is applied to buildings (excluding facilities incidental to buildings), and foreign subsidiaries apply the straight-line method, using rates based on the estimated useful lives of the assets. The range of useful lives is principally from 30 to 40 years for buildings and structures, and from 5 to 10 years for machinery and equipment.

(f) Bond Issue Costs
Bond issue costs are charged to income as incurred.

(g) Retirement and Pension Plans
The Company and major subsidiaries have non-contributory funded pension plans covering substantially all of its employees. Certain foreign subsidiaries also have contributory pension plans.

The Group accounted for the liability for retirement benefits based on the projected benefit obligations and plan assets at the balance sheet date. Retirement allowances for officers are recorded to state the liability at the amount that would be required if all officers retired at each balance sheet date.

(h) Retirement Allowances for Directors and Corporate Auditors
Retirement allowances for directors and corporate auditors are recorded to state the liability at the amount that would be required if all directors and corporate auditors retired at each balance sheet date.

(i) Research and Development Costs
The Group is active in research and development, and such costs are charged to income as incurred.

(j) Leases
All leases are accounted for as operating leases by the Company and its domestic subsidiaries. Under Japanese accounting standards for leases, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the lessee's financial statements.

(k) Income Taxes
The provision for income taxes is computed based on the pretax income included in the consolidated statements of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. These deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

(l) Appropriations of Retained Earnings
Appropriations of retained earnings at each year-end are reflected in the consolidated financial statements in the following year upon shareholder's approval.

(m) Foreign Currency Transactions
All short-term and long-term monetary receivables and payables denominated in foreign currencies are translated into Japanese yen at the current exchange rates in effect at each balance sheet date. The foreign exchange gains and losses from transactions are recognized in the statement of income to the extent that they are not hedged by forward exchange contracts.

(n) Foreign Currency Financial Statements
The balance sheet accounts and revenue and expense accounts of the consolidated foreign subsidiaries are translated into Japanese yen at the current exchange rates except for shareholders' equity, which is translated at the historical exchange rates.

Differences arising from such translation are shown as "Foreign currency translation adjustments" in a separate component of Shareholders' equity.

(o) Derivatives and Hedging Activities
The Group enters into derivative financial instruments ("derivatives"), including contracts of foreign exchange forward, currency option, foreign currency swap and interest rate swap to hedge foreign exchange risk and interest rate exposures. The Group does not hold or issue derivatives

for trading or speculative purposes.

Derivative financial instruments and foreign currency transactions are classified and accounted for as follows: (a) all derivatives are recognized principally as either assets or liabilities and measured at fair value, and gains or losses on derivative transactions are recognized in the statements of income and (b) for derivatives used for hedging purpose, if derivatives qualify for hedge accounting because of high correlation and effectiveness between the hedging instruments and the hedged items, gains or losses on derivatives are deferred until maturity of the hedged transactions.

The foreign exchange forward contracts and currency option contracts employed to hedge foreign exchange exposures for export sales and purchases are measured at fair value and the related unrealized gains or losses are recognized in income. Forward contracts entered into for forecasted transactions are also measured at fair value, but the unrealized gains or losses on qualifying hedges are deferred until the underlying transactions are completed. The foreign currency swaps used to hedge the foreign currency fluctuations of long-term debt denominated in foreign currencies are measured at fair value and the unrealized gains or losses are included in the carrying amounts of the debt. The interest rate swaps which qualify for hedge accounting are measured at market value at the balance sheet date, and the unrealized gains or losses are deferred until maturity as other liability or asset.

(p) Per Share Information

Basic net income per share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period, retroactively adjusted for stock splits.

Diluted net income per share reflects the potential dilution that could occur if securities were exercised or converted into common stock. Diluted net income per share of common stock assumes full conversion of the outstanding convertible notes and bonds at the beginning of the year (or at the time of issuance) with an applicable adjustment for related interest expense, net of tax and full exercise of outstanding warrants.

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

(q) New Accounting Pronouncements

In August 2002, the Business Accounting Council issued a Statement of Opinion, “Accounting for Impairment of Fixed Assets”, and in October 2003 the Accounting Standards Board of Japan (ASB) issued ASB Guidance No.6, “Guidance for Accounting Standard for Impairment of Fixed Assets”.These new pronouncements are effective for fiscal years beginning on or after April 1, 2005 with early adoption permitted for fiscal year ending on or after March 31, 2004.

The new accounting standard requires an entity to review its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.

The Company expects to adopt these pronouncements as of April 1, 2005 and is currently in the process of assessing the effect of adoption of these pronouncements.

3. ACCOUNTING CHANGES

(a) Inventory Valuation Method

Prior to April 1, 2004, inventories of foreign subsidiaries were stated at the lower of cost or market as determined principally using the first-in, first-out method.

In the year ended March 31, 2005, foreign subsidiaries changed their method of inventory valuation method to principally the average method. This change was made in order to minimize its effect to profit or loss from price changes as a result of re-considering the inventory valuation method due to new inventory management and financial accounting system. Effect of this change to profit or loss is not material.

This change was made during the second half year as re-consideration of inventory valuation method was finalized during the second half period.

Effect of this change to segment information is mentioned in the applicable note.

(b) Retirement Allowances for Directors, Corporate Auditors and Officers

Prior to April 1, 2004, retirement benefits for directors, corporate auditors and officers were charged to expenses when they were paid.

In the year ended March 31, 2005, the Company and certain consolidated subsidiaries changed its method of accounting for such retirement to the method that retirement allowances were recorded to state the liability at the amount that would be required if all directors and corporate auditors retired at each balance sheet date.

The change was made to achieve a more accurate allocation of cost and fiscal health.

The effect of this change was to decrease operating income by ¥177 million ($1,648 thousand) and income before income taxes and minority interests by ¥1,159 million ($10,798 thousand), respectively which included a cumulative effect of ¥983 million ($9,150 thousand) of retroactive year. This cumulative effect was included in other expenses in the 2005 statement of income.

This change was made during the second half period due to the completion of revision of Company's rules for retirement benefits during the second half period.

Effect of this change to segment information is mentioned in the applicable note.

4. INVESTMENT SECURITIES

Investment securities at March 31, 2005 and 2004 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	**2005**
Non-Current :			
Equity securities	**¥ 54,771**	¥ 54,591	**$ 510,015**
Trust bonds, debentures and other	**2**	1	**20**
Total	**¥ 54,773**	¥ 54,592	**$ 510,035**

The carrying amounts and aggregate fair values of investment securities at March 31, 2005 and 2004 were as follows:

	Millions of Yen			
March 31, 2005	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities	**¥ 40,131**	**¥ 12,477**	**¥ 232**	**¥ 52,376**
Debt securities	**1**		**0**	**1**
Total	**¥ 40,132**	**¥ 12,477**	**¥ 232**	**¥ 52,377**

	Millions of Yen			
March 31, 2004	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities	¥ 39,547	¥ 10,603	¥ 332	¥ 49,818
Debt securities	1			1
Total	¥ 39,548	¥ 10,603	¥ 332	¥ 49,819

	Thousands of U.S. Dollars			
March 31, 2005	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities	**$ 373,694**	**$ 116,187**	**$ 2,159**	**$ 487,722**
Debt securities	**5**		**0**	**5**
Total	**$ 373,699**	**$ 116,187**	**$ 2,159**	**$ 487,727**

Carrying amounts of available-for-sale securities whose fair value is not readily determinable as of March 31, 2005 and 2004 were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	**2005**
Available-for-sale:			
Equity securities	**¥ 2,394**	¥ 4,773	**$ 22,293**
Other securities	**2**		**15**
Total	**¥ 2,396**	¥ 4,773	**$ 22,308**

Proceeds from sales of available-for-sale securities for the fiscal years ended March 31, 2005 and 2004 were ¥2,356 million ($21,940 thousand) and ¥15,347 million, respectively. Gross realized gains on these sales for the fiscal year ended March 31, 2005 and 2004 were ¥438 million ($4,078 thousand) and ¥3,418 million, respectively. Gross realized losses on these sales for the fiscal years ended March 31, 2005 and 2004 were ¥11 million ($106 thousand) and ¥486 million, respectively.

5. INVENTORIES

Inventories at March 31, 2005 and 2004 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	**2005**
Finished and semi-finished products	**¥ 114,725**	¥108,932	**$1,068,306**
Work in process	**111,042**	112,037	**1,034,007**
Raw materials and supplies	**19,856**	16,537	**184,896**
Total	**¥ 245,623**	¥237,506	**$2,287,209**

6. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

Short-term borrowings at March 31, 2005 and 2004 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	**2005**
Short-term loans, principally from banks:			
2005: 0.3694%-4.0000%			
2004: 0.3675%-6.5000%	**¥ 38,115**	¥ 43,918	**$ 354,926**
Total	**¥ 38,115**	¥ 43,918	**$ 354,926**

Long-term debt at March 31, 2005 and 2004 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	**2005**
Loans, principally from banks and insurance companies:			
2005: 0.50%-5.510% due 2006-2013			
2004: 0.50%-5.510% due 2004-2011	**¥ 11,723**	¥ 11,098	**$ 109,167**
Bonds	**145,500**	165,500	**1,354,875**
Total	**157,223**	176,598	**1,464,042**
Less: Current portion	**(7,090)**	(12,727)	**(66,024)**
Long-term debt, less current portion	**¥ 150,133**	¥163,871	**$1,398,018**

The following was a summary of the terms of bonds which the Company may at any time purchase at any price in the open market or otherwise. The bonds purchased or otherwise acquired by the Company may be held or resold or, at the discretion of the Company, may be canceled (together with any unmatured coupons attached thereto or purchased therewith).

			Millions of Yen		Thousands of U.S. Dollars
	Issued in	Maturity	**2005**	2004	**2005**
2.5% Yen Unsecured Bonds	November, 1997	November, 2007	**¥ 10,000**	¥ 10,000	**$ 93,119**
2.575% Yen Unsecured Bonds	April, 1998	April, 2005		10,000	
1.76% Yen Unsecured Bonds	August, 1999	August, 2004		10,000	
1.0% Yen Unsecured Bonds	April, 2001	April, 2006	**10,000**	10,000	**93,119**
1.3% Yen Unsecured Bonds	December, 2001	December, 2006	**10,000**	10,000	**93,119**
1.7% Yen Unsecured Bonds	December, 2001	December, 2008	**5,000**	5,000	**46,559**
1.15% Yen Unsecured Bonds	February, 2003	February, 2008	**10,000**	10,000	**93,119**
1.4% Yen Unsecured Bonds	February, 2003	February, 2010	**10,000**	10,000	**93,119**
Yen Zero Coupon Convertible Bond	June, 2002	March, 2007	**56,000**	56,000	**521,463**
Yen Zero Coupon Convertible Bond	March, 2004	March, 2011	**34,500**	34,500	**321,258**
Total			**¥ 145,500**	¥165,500	**$1,354,875**

The aggregate annual maturities of long-term debt for the years following March 31, 2005 are as follows:

Year Ending March 31	Millions of Yen	Thousands of U.S. Dollars
2006	¥ 7,090	$ 66,024
2007	77,571	722,326
2008	21,712	202,180
2009	5,900	54,944
2010	10,399	96,832
Thereafter	34,551	321,736
Total	¥ 157,223	$1,464,042

The yen zero coupon convertible bonds were issued with stock acquisition rights to subscribe for shares of common stock of the Company. The stock acquisition rights are exercisable through March 16, 2007 at ¥1,857 per share. The stock acquisition rights outstanding at March 31, 2005 entitled the holders to subscribe for 30,156,165 shares which was computed using the above-mentioned exercise price.

The yen zero coupon convertible bonds were issued with stock acquisition rights to subscribe for shares of common stock of the Company. The stock acquisition rights are exercisable through March 14, 2011 at ¥2,058 per share. The stock acquisition rights outstanding at March 31, 2005 entitled the holders to subscribe for 16,763,848 shares which was computed using the above-mentioned exercise price.

At March 31, 2005, the following assets were pledged as collateral for long-term debt.

	Millions of Yen	Thousands of U.S. Dollars
	2005	2005
Investment securities	¥ 6,808	$ 63,391
Total	¥ 6,808	$ 63,391

Liabilities secured by the above assets were as follows:

	Millions of Yen	Thousands of U.S. Dollars
	2005	2005
Long-term debt, including current portion	¥ 3,651	$ 33,999
Total	¥ 3,651	$ 33,999

As is customary in Japan, the Company maintains substantial deposit balances with banks with which it has borrowings. Such deposit balances are not legally or contractually restricted as to withdrawal.

General agreements with respective banks provide, as is customary in Japan, that additional collateral must be provided under certain circumstances if requested by such banks and that certain banks have the right to offset cash deposited with them against any long-term or short-term debt or obligation that becomes due and, in case of default and certain other specified events, against all other debts payable to the banks. The Group has never been requested to provide any additional collateral.

7. RETIREMENT AND PENSION PLANS

The Company and major domestic subsidiaries have non-contributory funded defined benefit pension plans covering substantially all of its employees. Certain foreign subsidiaries also have contributory defined benefit pension plans. Under the pension plan, employees terminating their employment are, in most circumstances, entitled to pension benefits determined by reference to basic rates of pay at the time of termination, length of service and certain other factors.

Retirement allowances for officers are recorded to state the liability at the amount that would be required if all officers retired at each balance sheet date. On April 1, 2004, the Company revised the pension plan and implemented a defined benefit corporate pension plan (cash balance plan). As a result, the projected benefit obligation is to be decreased by ¥18,004 million ($167,659 thousand) and the amount is being amortized as prior service cost over 10 years as of April 1, 2004.

The liability for employees' retirement benefits at March 31, 2005 and 2004 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	**2005**
Projected benefit obligation	**¥ 100,138**	¥115,743	**$ 932,474**
Fair value of plan assets	**(78,359)**	(71,364)	**(729,669)**
Unrecognized actuarial loss	**(18,867)**	(23,288)	**(175,691)**
Unrecognized prior service cost	**15,666**	(626)	**145,881**
	18,578	20,465	**172,995**
Prepayment of service cost	**113**	545	**1,055**
Net Liability	**¥ 18,691**	¥ 21,010	**$ 174,050**

The components of net periodic benefit costs for the fiscal years ended March 31, 2005 and 2004 were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	**2005**
Service cost	**¥ 3,353**	¥ 5,142	**$ 31,221**
Interest cost	**2,628**	3,041	**24,469**
Expected return on plan assets	**(1,752)**	(1,315)	**(16,316)**
Recognized actuarial loss	**3,049**	4,463	**28,398**
Amortization of prior service cost	**(1,718)**	82	**(16,002)**
Net periodic benefit costs	**¥ 5,560**	¥ 11,413	**$ 51,770**

Assumptions used for the fiscal years ended March 31, 2005 and 2004 were principally set forth as follows:

	2005	2004
Discount rate	**2.5%**	2.5%
Expected rate of return on plans assets	**2.0%**	2.0%
Recognition period of actuarial gain (loss)	**10 years**	10 years
Amortization period of prior service cost	**10 years**	10 years

8. SHAREHOLDERS' EQUITY

Japanese companies are subject to the Japanese Commercial Code (the "Code")

The Code requires that all shares of common stock are recorded with no par value and at least 50% of the issue price of new shares is required to be recorded as common stock and the remaining net proceeds as additional paid-in capital, which is included in capital surplus. The Code permits Japanese companies, upon approval of the Board of Directors, to issue shares to existing shareholders without consideration as a stock split. Such issuance of shares generally does not give rise to changes within the shareholders' accounts.

The Code also provides that an amount at least equal to 10% of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period shall be appropriated as a legal reserve (a component of retained earnings) until such reserve and additional paid-in capital equals 25% of the amount of common stock. The amount of total additional paid-in capital and legal reserve that exceeds 25% of the amount of common stock may be available for dividends by resolution of the shareholders. In addition, the Code permits the transfer of a portion of additional paid-in capital and legal reserve to the common stock by resolution of the Board of Directors.

The Code allows Japanese companies to repurchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The repurchased amount of treasury stock cannot exceed the amount available for future dividend plus amount of common stock, additional paid-in capital or legal reserve to be reduced in the case where such reduction was resolved at the shareholders meeting.

In addition to the provision that requires an appropriation for a legal reserve in connection with the cash payment, the Code imposes certain limitations on the amount of retained earnings available for dividends. The amount of retained earnings available for dividends under the Code was ¥64,126 million ($597,135 thousand) as of March 31, 2005, based on the amount recorded in the parent company's general books of account.

Dividends are approved by the shareholders at a meeting held subsequent to the fiscal year to which the dividends are applicable. Semiannual interim dividends may also be paid upon resolution of the Board of Directors, subject to certain limitations imposed by the Code.

9. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses for the fiscal years ended March 31, 2005 and 2004 principally consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	**2005**
Advertising expenses	**¥ 42,551**	¥ 30,823	**$ 396,230**
Provision of warranty costs	**5,305**	4,005	**49,402**
Employees' salaries	**27,963**	27,502	**260,384**
Employees' retirement benefit plan	**3,256**	5,295	**30,317**
Employees' bonuses and others	**11,926**	11,801	**111,051**
Research and development costs	**33,561**	30,165	**312,514**

10. INCOME TAXES

The Company and its domestic subsidiaries are subject to Japanese national and local income taxes which, in the aggregate, resulted in a normal effective statutory tax rate of approximately 40.6% for the fiscal year ended March 31, 2005 due to the new local tax law, and 42% for the fiscal year ended March 31, 2004.

The tax effects of significant temporary differences and loss carry-forwards which result in deferred tax assets and liabilities at March 31, 2005 and 2004, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	**2005**
Deferred tax assets :			
Write-down of inventories	**¥ 14,345**	¥ 10,490	**$ 133,574**
Warranty reserve	**1,863**	1,375	**17,349**
Liability for employees' retirement benefits	**9,830**	10,573	**91,531**
Depreciation and amortization	**14,225**	12,068	**132,459**
Net operating loss carryforwards	**914**	2,494	**8,513**
Accrued bonus	**3,588**	2,928	**33,410**
Other	**5,921**	3,569	**55,141**
Total	**¥ 50,686**	¥ 43,497	**$ 471,977**
Deferred tax liabilities :			
Deferred gains on sales of property to be replaced	**7,388**	7,192	**68,798**
Unrealized gain on available-for-sale securities	**4,872**	4,061	**45,372**
Undistributed earnings of foreign subsidiaries	**2,693**	2,392	**25,064**
Other	**600**	713	**5,589**
Total	**¥ 15,553**	¥ 14,358	**$ 144,823**
Net deferred tax assets	**¥ 35,133**	¥ 29,139	**$ 327,154**

A valuation allowance of ¥3,012 million ($28,051 thousand) in 2005 and ¥3,228 million in 2004 were deducted from the amounts calculated above, respectively.

A reconciliation between the normal effective statutory tax rate for the fiscal years ended March 31, 2005 and 2004, and the actual effective tax rates reflected in the consolidated statements of income were as follows:

	Year ended March 31,	
	2005	2004
Normal statutory tax rate	**40.6%**	42%
Tax credit for research and development costs	**(5.7)**	
Consolidated adjustment on unrealizable profits in inventories	**(11.1)**	10.3
Dividends from foreign subsidiaries not applicable to foreign tax credits	**5.2**	6.1
Increase in valuation allowance	**3.0**	5.3
Effect on tax levied based on paid-in capital		5.2
Other-net	**(4.2)**	5.5
Actual effective tax rate	**27.8%**	74.4%

11. RESEARCH AND DEVELOPMENT COSTS

Research and development costs incurred were ¥33,561 million ($312,514 thousand) and ¥30,165 million for the fiscal years ended March 31, 2005 and 2004, respectively.

12. LEASE PAYMENTS

Total lease payments under financing lease arrangements that do not transfer ownership of the leased property to the Company and its domestic subsidiaries were ¥2,596 million ($24,177 thousand) and ¥2,519 million for the fiscal years ended March 31, 2005 and 2004, respectively.

The minimum rental commitments under noncancelable operating leases at March 31, 2005 and 2004 were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	**2005**
Due within one year	**¥ 1,965**	¥ 1,110	**$ 18,294**
Due after one year	**3,915**	1,969	**36,461**
Total	**¥ 5,880**	¥ 3,079	**$ 54,755**

Pro forma information of leased property carried by finance leases that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis as of and for the fiscal years ended March 31, 2005 and 2004 was as follows:

	Millions of Yen			Thousands of U.S. Dollars		
	2005			**2005**		
	Machinery and Equipment	Furniture and Fixtures	Total	Machinery and Equipment	Furniture and Fixtures	Total
Acquisition cost	**¥ 7,312**	**¥ 5,489**	**¥ 12,801**	**$ 68,091**	**$ 51,111**	**$ 119,202**
Accumulated depreciation	**3,568**	**2,898**	**6,466**	**33,229**	**26,981**	**60,210**
Net leased property	**¥ 3,744**	**¥ 2,591**	**¥ 6,335**	**$ 34,862**	**$ 24,130**	**$ 58,992**

	Millions of Yen		
	2004		
	Machinery and Equipment	Furniture and Fixtures	Total
Acquisition cost	¥ 6,510	¥ 6,308	¥ 12,818
Accumulated depreciation	3,076	3,589	6,665
Net leased property	¥ 3,434	¥ 2,719	¥ 6,153

Obligations under finance leases at March 31, 2005 and 2004 were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	**2005**
Due within one year	**¥ 2,141**	¥ 2,238	**$ 19,933**
Due after one year	**4,194**	3,915	**39,059**
Total	**¥ 6,335**	¥ 6,153	**$ 58,992**

The amount of obligations under finance leases includes the imputed interest expense portion.

Depreciation expense, which is not reflected in the accompanying consolidated statements of income, computed by the straight-line method, was ¥2,596 million ($24,177 thousand) and ¥2,519 million for the fiscal years ended March 31, 2005 and 2004, respectively.

13.DERIVATIVES

The Group enters into derivative contracts, including foreign exchange forward contracts, currency option contracts, foreign currency swap contracts and interest rate swap contracts to hedge foreign exchange risk and interest rate exposures. The Group does not hold or issue derivatives for trading purposes. Derivatives are subject to market risk and credit risk. Market risk is the exposure created by potential fluctuations in market conditions, including in changes in interest or foreign exchange rates. Credit risk is the possibility that a loss may result from a counterparty's failure to perform according to the terms and conditions of the contract.

Because the counterparties to those derivative contracts are limited to major international financial institutions, the Group does not anticipate any losses arising from credit risk.

Derivative transactions entered into by the Group have been made in accordance with internal policies which regulate the authorization and credit limit amount.

Derivative contracts outstanding at March 31, 2005 and 2004, were as follows:

	Millions of Yen			Thousands of U.S. Dollars		
	2005			2005		
	Contract or Notional Amount	Fair Value	Net Unrealized Gain (Loss)	Contract or Notional Amount	Fair Value	Net Unrealized Gain (Loss)
Foreign exchange forward contracts :						
Selling USD	**¥ 44,637**	**¥ 45,638**	**¥ (1,001)**	**$ 415,652**	**$ 424,970**	**$ (9,318)**
Selling EUR	**14,482**	**14,715**	**(233)**	**134,853**	**137,026**	**(2,173)**
Buying JPY	**26**	**26**	**0**	**242**	**243**	**1**
Buying USD	**2,928**	**3,003**	**75**	**27,268**	**27,965**	**697**
Buying EUR	**2,870**	**2,861**	**(9)**	**26,724**	**26,644**	**(80)**
Total			**(1,168)**			**(10,873)**
Currency option contracts :						
Selling put EUR	**¥ 2,250**	**¥**	**¥**	**$ 20,952**	**$**	**$**
Option premiums	**12**	**21**	**(9)**	**115**	**198**	**(83)**
Buying call EUR	**2,250**			**20,952**		
Option premiums	**10**	**15**	**5**	**99**	**142**	**43**
Total			**(4)**			**(40)**
Interest rate swaps :						
(fixed rate receipt, floating rate payment)	**¥ 20,000**	**¥ 517**	**¥ 517**	**$ 186,237**	**$ 4,814**	**$ 4,814**
(fixed rate payment, floating rate receipt)	**10,000**	**(462)**	**(462)**	**93,119**	**(4,298)**	**(4,298)**
Total	**¥ 30,000**	**¥ 55**	**¥ 55**	**$ 279,356**	**$ 516**	**$ 516**

	Millions of Yen		
	2004		
	Contract or Notional Amount	Fair Value	Net Unrealized Gain (Loss)
Foreign exchange forward contracts :			
Selling USD	¥ 19,523	¥ 19,202	¥ 321
Selling EUR	19,787	19,088	699
Buying JPY	2,583	2,673	90
Buying USD	580	574	(6)
Buying EUR	4,656	4,539	(117)
Total			987
Interest rate swaps :			
(fixed rate receipt, floating rate payment)	¥ 20,000	549	549
(fixed rate payment, floating rate receipt)	10,000	(535)	(535)
Total	¥ 30,000	¥ 14	¥ 14

Derivatives which qualified for hedge accounting and related amounts are included with the associated assets and liabilities, and were excluded from disclosure of market value information in the preceding table.

14. CONTINGENT LIABILITIES

Contingent liabilities at March 31, 2005 were as follows:

	Millions of Yen	Thousands of U.S. Dollars
	2005	**2005**
As the endorser of trade notes receivable discounted with banks	**¥ 12**	**$ 116**
As the guarantor of bank loans and indebtedness, principally of employees, unconsolidated subsidiaries and associated companies	**6,200**	**57,734**
Total	**¥ 6,212**	**$ 57,850**

The following debt was assumed by Bank of Tokyo Mitsubishi:

	Millions of Yen	Thousands of U.S. Dollars
2.575%Yen Unsecured Bonds (Maturity: April 1, 2005)	**¥ 10,000**	**$ 93,119**

Note: The above debt is not reported in the Liabilities section of the consolidated balance sheet. Although, the liability to the bond holders will remain with the Company until maturity.

15. NET INCOME PER SHARE

Reconciliation of the differences between basic and diluted net income per share ("EPS") for the fiscal years ended March 31, 2005 and 2004 were as follows:

	Yen in millions	Thousands of shares	Yen	U.S.Dollars
	Net income	Weighted average Shares	EPS	
For the year ended March 31, 2005:				
Basic EPS				
Net income available to common shareholders	**¥ 24,079**	**369,352**	**¥65.19**	**$ 0.61**
Effect of Dilutive Securities				
Warrants		**22**		
Convertible bonds		**46,920**		
Diluted EPS				
Net income for computation	**¥ 24,079**	**416,294**	**¥57.84**	**$ 0.54**

	Yen in millions	Thousands of shares	Yen	U.S.Dollars
	Net income	Weighted average Shares	EPS	
For the year ended March 31, 2004:				
Basic EPS				
Net income available to common shareholders	¥ 2,410	369,361	¥ 6.52	$ 0.062
Effect of Dilutive Securities				
Warrants		40		
Convertible bonds		30,935		
Diluted EPS				
Net income for computation	¥ 2,410	400,336	¥ 6.02	$ 0.057

16. SUBSEQUENT EVENTS

At the general shareholders' meeting held on June 29, 2005, The Company's shareholders approved the following stock option plan for the Company's directors and administrative directors and appropriation of Retained Earnings.

(a) Stock option plan

The plan provides for granting options to directors and administrative directors to purchase up to 178 thousand shares of the Company's common stock in the period from June 30, 2007 to June 29, 2015. The options will be granted at an exercise price of 105% of the fair market value of the Company's common stock at the prior month of the date of option grant.

(b) Appropriations of Retained Earnings

The Company's shareholders approved appropriation of retained earnings as follows:

	Millions of Yen	Thousands of U.S. Dollars
Year-end cash dividends, ¥4.00 ($0.04) per share	**¥ 1,478**	**$ 13,761**
Bonuses to directors and corporate auditors	**63**	**583**

17. SEGMENT INFORMATION

Information about industry segments, geographic segments and sales to foreign customers of the Group for the fiscal years ended March 31, 2005 and 2004, was as follows:

(a) Industry Segments

	Millions of Yen						
	Precision Equipment	Imaging Products	Instruments	Other	Total	(Eliminations) or corporate	Consolidated
For the year ended March 31, 2005							
Net sales							
Outside customers	**¥ 212,471**	**¥ 354,181**	**¥ 50,657**	**¥ 21,159**	**¥ 638,468**	**¥**	**¥ 638,468**
Intersegment sales/transfer	**1,855**	**1,308**	**1,527**	**23,094**	**27,784**	**(27,784)**	
Total	**214,326**	**355,489**	**52,184**	**44,253**	**666,252**	**(27,784)**	**638,468**
Operating expenses	**202,939**	**338,648**	**49,358**	**44,900**	**635,845**	**(27,922)**	**607,923**
Operating income (loss)	**¥ 11,387**	**¥ 16,841**	**¥ 2,826**	**¥ (647)**	**¥ 30,407**	**¥ 138**	**¥ 30,545**
Assets	**¥ 249,904**	**¥ 182,772**	**¥ 36,386**	**¥ 57,573**	**¥ 526,635**	**¥ 106,791**	**¥ 633,426**
Depreciation and amortization	**8,897**	**5,833**	**969**	**4,006**	**19,705**		**19,705**
Capital expenditures	**8,679**	**11,184**	**751**	**1,845**	**22,459**		**22,459**

	Millions of Yen						
	Precision Equipment	Imaging Products	Instruments	Other	Total	(Eliminations) or corporate	Consolidated
For the year ended March 31, 2004							
Net sales							
Outside customers	¥ 156,572	¥ 283,347	¥ 46,705	¥ 19,754	¥ 506,378		¥ 506,378
Intersegment sales/transfer	1,482	1,366	1,287	19,889	24,024	¥ (24,024)	
Total	158,054	284,713	47,992	39,643	530,402	(24,024)	506,378
Operating expenses	178,860	259,491	45,307	42,875	526,533	(23,830)	502,703
Operating income (loss)	¥ (20,806)	¥ 25,222	¥ 2,685	¥ (3,232)	¥ 3,869	¥ (194)	¥ 3,675
Assets	¥ 236,542	180,213	¥ 35,218	¥ 58,818	¥ 510,791	¥ 95,722	¥ 606,513
Depreciation and amortization	9,685	5,063	1,132	4,333	20,213		20,213
Capital expenditures	5,134	13,381	1,840	1,912	22,267		22,267

	Thousands of U.S. Dollars						
	Precision Equipment	Imaging Products	Instruments	Other	Total	(Eliminations) or corporate	Consolidated
For the year ended March 31, 2005							
Net sales							
Outside customers	**$1,978,494**	**$3,298,087**	**$ 471,711**	**$ 197,032**	**$5,945,324**	**$**	**$5,945,324**
Intersegment sales/transfer	**17,278**	**12,177**	**14,219**	**215,043**	**258,717**	**(258,717)**	
Total	**1,995,772**	**3,310,264**	**485,930**	**412,075**	**6,204,041**	**(258,717)**	**5,945,324**
Operating expenses	**1,889,740**	**3,153,435**	**459,617**	**418,102**	**5,920,894**	**(260,001)**	**5,660,893**
Operating income (loss)	**$ 106,032**	**$ 156,829**	**$ 26,313**	**$ (6,027)**	**$ 283,147**	**$ 1,284**	**$ 284,431**
Assets	**$2,327,073**	**$1,701,947**	**$ 338,822**	**$ 536,110**	**$4,903,952**	**$ 994,422**	**$5,898,374**
Depreciation and amortization	**82,841**	**54,318**	**9,020**	**37,307**	**183,486**		**183,486**
Capital expenditures	**80,818**	**104,142**	**6,997**	**17,177**	**209,134**		**209,134**

Precision Equipment : IC steppers, LCD steppers, etc.
Imaging Products : Cameras, Interchangeable camera lenses, Digital cameras, etc.
Instruments : Microscopes, Measuring instruments, Inspection equipment etc.
Other : Sport optics products, Ophthalmic frames, Surveying instruments, etc.

Notes: 1. Amortization of Goodwill is included in "Depreciation and amortization" for the year ended March 31, 2005 and 2004.

2. As described in Note 3(a), in the year ended March 31, 2005, foreign subsidiaries changed their method of inventory valuation method to principally the average method. This change was made in order to minimize its impact to profit or loss from price changes as a result of re-considering the inventory valuation method due to new inventory management and financial accounting system. Effect of this change to profit or loss is not material.
This change was made during the second half year as re-consideration of inventory valuation method was finalized during the second half period.

3. As described in Note 3(b), in the year ended March 31, 2005, the Company and certain consolidated subsidiaries changed its method of accounting for such retirement to the method that retirement allowances were recorded to state the liability at the amount that would be required if all directors and corporate auditors retired at each balance sheet date. The change was made to achieve a more accurate allocation of cost and fiscal health.
The effect of this change was to decrease operating income by ¥177 million ($1,648 thousand) in Other segment.
This change was made during the second half period due to the completion of revision of Company's rules for retirement benefits during the second half period.

(b) Geographic Segments

	Thousands of U.S. Dollars						
	Japan	North America	Europe	Asia	Total	(Eliminations) or corporate	Consolidated
For the year ended March 31, 2005							
Net sales							
Outside customers	**¥ 275,992**	**¥ 165,085**	**¥ 142,143**	**¥ 55,248**	**¥ 638,468**	**¥**	**¥ 638,468**
Intersegment sales	**282,026**	**2,895**	**111**	**78,779**	**363,811**	**(363,811)**	
Total	**558,018**	**167,980**	**142,254**	**134,027**	**1,002,279**	**(363,811)**	**638,468**
Operating expenses	**540,180**	**162,372**	**139,392**	**128,902**	**970,846**	**(362,923)**	**607,923**
Operating income	**¥ 17,838**	**¥ 5,608**	**¥ 2,862**	**¥ 5,125**	**¥ 31,433**	**¥ (888)**	**¥ 30,545**
Assets	**¥ 478,739**	**¥ 70,328**	**¥ 57,865**	**¥ 45,776**	**¥ 652,708**	**¥ (19,282)**	**¥ 633,426**

	Thousands of U.S. Dollars						
	Japan	North America	Europe	Asia	Total	(Eliminations) or corporate	Consolidated
For the year ended March 31, 2004							
Net sales							
Outside customers	¥ 196,562	¥ 148,696	¥ 124,134	¥ 36,986	¥ 506,378		¥ 506,378
Intersegment sales	238,627	3,121	629	18,904	261,281	¥ (261,281)	
Total	435,189	151,817	124,763	55,890	767,659	(261,281)	506,378
Operating expenses	439,011	146,207	123,900	53,742	762,860	(260,157)	502,703
Operating income (loss)	¥ (3,822)	¥ 5,610	¥ 863	¥ 2,148	¥ 4,799	¥ (1,124)	¥ 3,675
Assets	¥ 468,545	¥ 58,828	¥ 53,040	¥ 33,151	¥ 613,564	¥ (7,051)	¥ 606,513

	Thousands of U.S. Dollars						
	Japan	North America	Europe	Asia	Total	(Eliminations) or corporate	Consolidated
For the year ended March 31, 2005							
Net sales							
Outside customers	**$ 2,569,998**	**$ 1,537,251**	**$ 1,323,610**	**$ 514,465**	**$ 5,945,324**	**$**	**$ 5,945,324**
Intersegment sales	**2,626,186**	**26,955**	**1,035**	**733,576**	**3,387,752**	**(3,387,752)**	
Total	**5,196,184**	**1,564,206**	**1,324,645**	**1,248,041**	**9,333,076**	**(3,387,752)**	**5,945,324**
Operating expenses	**5,030,078**	**1,511,985**	**1,298,002**	**1,200,318**	**9,040,383**	**(3,379,490)**	**5,660,893**
Operating income	**$ 166,106**	**$ 52,221**	**$ 26,643**	**$ 47,723**	**$ 292,693**	**$ (8,262)**	**$ 284,431**
Assets	**$ 4,457,944**	**$ 654,887**	**$ 538,833**	**$ 426,261**	**$ 6,077,925**	**$ (179,551)**	**$ 5,898,374**

Notes: 1. As described in Note 3(a), in the year ended March 31, 2005, foreign subsidiaries changed their method of inventory valuation method to principally the average method. This change was made in order to minimize its impact to profit or loss from price changes as a result of re-considering the inventory valuation method due to new inventory management and financial accounting system. Effect of this change to profit or loss is not material.
This change was made during the second half year as re-consideration of inventory valuation method was finalized during the second half period.

2. As described in Note 3(b), in the year ended March 31, 2005, the Company and certain consolidated subsidiaries changed their method of accounting for such retirement to the method that retirement allowances were recorded to state the liability at the amount that would be required if all directors and corporate auditors retired at each balance sheet date. The change was made to achieve a more accurate allocation of cost and fiscal health.
The effect of this change was to decrease operating income by ¥177 million ($1,648 thousand) in Japan.
This change was made during the second half period due to the completion of revision of Company's rules for retirement benefits during the second half period.

(c) Export Sales
For the years ended March 31, 2005 and 2004

	Millions of Yen, %				Thousands of U.S. Dollars
	2005	**(A)/(B)**	2004	(A)/(B)	**2005**
Export sales (A)					
North America	**¥ 160,840**	**25.2%**	¥146,624	29.0%	**$1,497,722**
Europe	**138,793**	**21.7**	122,583	24.2	**1,292,418**
Asia	**175,193**	**27.5**	96,726	19.1	**1,631,375**
Other Area	**6,929**	**1.1**	3,770	0.7	**64,520**
Total	**¥ 481,755**	**75.5%**	369,703	73.0%	**$4,486,035**
Net sales (B)	**¥ 638,468**		¥506,378		**$5,945,324**

Note: "Other Area" consists principally of South and Central America and Oceania.

18. TRADE MATTERS
Nikon Corporation (Nikon), ASML HOLDING N.V. (ASML) and Carl Zeiss SMT AG (SMT) have signed on December 10, 2004, a final agreement (Final Agreement) for comprehensive settlement of legal proceedings and cross-licensing of patents related to lithography equipment used to manufacture semiconductor devices in accordance with a Memorandum of Understanding entered into on September 29, 2004 (MOU).

(a) Legal Proceedings of Settlement
On December 21, 2001, Nikon Corporation and its wholly-owned subsidiaries, Nikon Precision Inc. and Nikon Research Corporation of America filed a complaint in the US International Trade Commission (the "ITC") against ASM Lithography Holding N.V., and ASM Lithography B.V. (both Netherlands corporations) and ASM Lithography, Inc., a U.S. sales subsidiary of ASM Lithography Holding N.V. ("ASML") for an exclusion order from the ITC to prevent any further importation of stepper and scanner machines (both lithography equipment used to manufacture semiconductor devices) that were infringing Nikon's patents in the U.S.

The ITC dismissed Nikon's request for an exclusion order. Subsequently, Nikon Corporation, Nikon Precision Inc. and Nikon Research Corporation of America filed a Notice on May 12, 2003 in the Court of Appeales of the Federal Circuit appealing the ITC decision.

Nikon Corporation and its subsidiaries then filed suit for patent infringement against ASM Lithography B.V., ASM Lithography Inc., ASML Netherlands B.V. and its affiliated companies in the Federal District Court of the Northern District of California (NDCA), and in the Tokyo District, Seoul District and Suwon District Courts.

As a result of several settlement discussions, Nikon basically agreed to settle the case since it concluded that its goal has been accomplished in principle. The NDCA allowed SMT to join in the case, and therefore, they are party to the Memorandum of Understanding.

(b) Description of Settlement
The Final Agreement includes payment to Nikon by ASML and SMT. ASML and SMT will pay Nikon a total of US $145 million. An initial payment of US $100 million was made in November 2004, and the remaining US $45 million will be paid in equal installments in 2005, 2006 and 2007. The total amount of ¥15,879 million (equivalent of US$145 million) payable by ASML to Nikon is treated for accounting purposes as Special Gains for the period ended March 31, 2005.

The Final Agreement also includes the cross-license between ASML and SMT of patents related to lithography equipment used to manufacture semiconductor devices.

In consideration for such payment to Nikon and the cross-license, Nikon, ASML and SMT withdrew all patent disputes pending between the parties in Asia and the U.S. in November 2004.