Trias Company Memo 2009-06-12

PALTEK CORPORATION (Securities Code: 7587 JASDAQ)

Summaries of Business Results Meeting for the 1st Quarter of Fiscal Year ending December 31, 2009, Follow-up Company Visit

On May 14, 2009, PALTEK CORPORATION (hereinafter "the Company" or "PALTEK") held a business results meeting for the 1st quarter of the fiscal year ending December 31, 2009. Following the meeting, Trias visited the Company. The resulting Company Memorandum on the meeting and visit is as follows:

Attendees of the results meeting:

Mr. Tadahito Takahashi, Chairman of the Board and President

Ms. Ikuko Tokunaga, Director

Mr. Hiroki Inoue, General Manager of Operational Service Division

Mr. Yoshinori Shibasaki, Manager of Corporate Communication, Administration Group

【Business Results for the 1st Quarter of FY12/09】

Impacted by inventory adjustments undertaken by client-manufacturers, the Company saw sales declined sharply in the 1st quarter, while operating, ordinary and net incomes posted deficits. Two of the largest declines in sales for the quarter came from PALTEK's analog solutions business, which was hit by plummeting demand in the digital consumer devices, and its ASSP solutions business, which had previously been buoyed by robust demand from NTT Corporation's VDSL high speed digital telephone transmission operations. A significant improvement in gross profit margins was achieved through a decrease in commercial production businesses and a better sales mix. SG&A expenses fell as a result of continued low-cost operations, but the decline was marginal due to a one-time cost generated by the Company's merger with its subsidiaries. Outcome from various cost reduction measures are likely to be realized in the 2nd half of the term. In the non-operating category, the surrender value from cancelled insurance policy netted ¥76 million, but suffered ¥37 million in foreign exchange losses. The Company also posted a loss on sales of securities of ¥39 million and a loss of ¥42 million from restructuring costs.

Table 1: Consolidated Business Results Summary for the 1st Quarter of FY 12/09

(¥ Million)	FY12/08		FY12/09		YoY Change	
	1Q	To net sales	1Q	To net sales	Value	Ratio
Net Sales	5,288	100.0%	3,269	100.0%	△ 2,019	-38.2%
Gross Profit	773	14.6%	599	18.3%	△ 174	-22.5%
SG&A Expenses	740	14.0%	728	22.3%	△ 11	-1.6%
Operating Income	33	0.6%	△ 129	-4.0%	△ 162	n.a.
Ordinary Income	145	2.7%	△ 90	-2.8%	△ 236	n.a.
Net Income	68	1.3%	△ 123	-3.8%	△ 192	n.a.

Net sales for the Company's respective solutions businesses are as follows: PLD solutions sales for telecommunications infrastructure is gradually recovering as blue-chip clients regain solid footing, with results likely to have bottomed out in the 1st quarter. Sales to medium-sized clients were sound, but sales to smaller firms showed little improvement. As mentioned above, sales of analog and ASSP solutions slumped dramatically; however, with regards to analog solutions, demand for power supply peripheral circuits has begun to recover. As for ASSP solutions beyond the realm of VDSL, demand for applications related to WiMAX (the next generation high-speed wireless networking technology), including chipset products by GCT Semiconductor, Inc., a chip maker founded in Silicon Valley, is likely to increase.

As for net sales by application, demand for telecommunications and security related applications remain active. The Company is placing particular emphasis on telecom applications such as LTE (Long Term Evolution, a high-speed data communication standard for mobile phones) and HSPA (High Speed Package Access, another mobile phone data communication standard for W-CDMA 3G networks), with design-in marketing activities (which takes place before a client-manufacturer finalizes a product's design specifications) to commence from the 2nd half of the term. PALTEK also expects volume production of security camera systems to recover at that time. In addition, a client-manufacturer based in the Kansai area is expected to resume large-scale production that will require usage of batteries and battery chargers, which represent a core product group for the National Semiconductor Corporation.

Table 2: Consolidated Net Sales by Solutions

(¥ Million)	FY12/08 1Q	FY12/09 1Q	YoY Change	FY12/09 (est.) 1HF	FY12/09 (est.) 2HF
PLD	1,367	1,169	-14.5%	2,100	3,500
Analog	1,887	661	-65.0%	1,500	2,700
ASSP	1,705	1,122	-34.2%	2,000	3,900
Memory	327	315	-3.7%	600	1,200
Total	5,288	3,269	-38.2%	6,200	11,300

※ PLD: Programmable Logic Device
ASSP: Application Specific Standard Product

Table 3: Consolidated Net Sales by Application

(¥ Million)	FY12/08 1Q	FY12/09 1Q	YoY Change
Communication	1,760	770	-56.3%
Industrial	1,443	1,160	-19.6%
Consumer	874	540	-38.2%
Computer	406	223	-45.1%
Others	805	576	-28.4%
Total	5,288	3,269	-38.2%

With regard to consolidated balance sheets, there was a decrease in notes and accounts receivables and consumption tax receivables due to a contraction of business volume, while cash and deposits

increased with the collection of notes and accounts payable-trade. The Company has no short-term loans payable as they have been repaid. Given the net losses posted and dividend payment, net assets decreased, and total liabilities and net assets decreased by ¥856 million.

As for consolidated cash flows, net cash used in both operating and investing activities was positive, while that used in financing activities was negative despite repayment of loans due to payment of dividends. As a result, cash and cash equivalents increased by ¥991 million.

At the conclusion of the Meeting, the Company provided a progress report on its merger with two subsidiaries that specialize in analog solutions, Alpha Electronics, Inc. (hereinafter Alpha) and NS Microelectronics Co., Ltd. (hereinafter NSM), which was announced on December 8, 2008. On April 1, 2009, the Company restructured its consolidated group into three corporate entities under integrated management, led by PALTEK CORPORATION itself, together with Spinnaker Systems, Inc. and ALPHA ELECTRON (HK) Co., Ltd. In Japan, three sales branches were closed or absorbed by the tripartite network of the Head Office, the West Japan Branch and Machida Logistics/Program Center. Internationally, the Company closed its Shanghai Branch, leaving the Singapore operation and ALPHA ELECTRON (HK). The impact of these organizational restructurings on lower SG&A related costs is expected to emerge from the 3rd quarter and beyond, when the Company will commence a full-court press of management initiatives both externally and internally.

【Earnings Forecast for FY12/09】

Based on the assumption that business has bottomed out in the 1st quarter and will gradually recover from the 2nd quarter onwards, the Company has not made any alterations to its full-year forecast announced on February 12, 2009. (Please see the Reference data on Page 6 regarding PALTEK's earnings forecast for the 2nd half and full year.)

【Q&A】

Q1: Why does PALTEK believe business has bottomed out in the 1st quarter and will recover from the 2nd quarter onward?

A1: If we break it down, 20-30% of our belief stems from a moderate recovery of the economy itself; another 20-30% lies with the fact that we can mount aggressive sales activities with potential clients that could not be approached before due to the depressed economic climate; and 50% is due to specific projects which will most likely commence in the 2nd half. These projects include telecommunications infrastructure related applications such as WiMAX and LTE, security-related and battery/power supply related applications; PLD solutions by Xilinx, Inc., analog solutions by National Semiconductor Corporation, next-generation wireless standard solutions by picoChip, network access solutions by Wintegra, and those involving GCT Semiconductor products.

(Concludes Memo on Business Results Meeting for FY12/09 1Q)

Following the Business Results Meeting, we traveled to the Head Office and met with President Takahashi, Director Tokunaga and Mr. Shibasaki, who heads investor relations, to discuss the new management reorganization announced on February 27, 2009.

Q1: Under the reorganization, your management team has become significantly younger. What prompted PALTEK to do so and what direction will you take?

A1: The reorganization has both negative and positive elements to it. First, the negative: When the previous management team retired, the Company lost an immense base of information on the industry and a host of personal connections as well. On the other hand, there are a number of positive attributes. For starters, supervisors with a great deal of field experience and expertise were able to join the management team, allowing for faster decision-making. Moreover, the reorganization of the consolidated group under single management enabled us to eliminate many of the constraints that had become institutionalized. In fact, the removal of such constraints was a paramount objective of the initiative to unify our management structure. For example, our engineers—while highly skilled and proficient—tended to pursue technologies on a tightly focused basis. This tendency was as ingrained at PALTEK with our PLD solutions as it was at NSM and Alpha with their analog solutions. But this very preoccupation diluted our corporate culture, when it should have been able to see issues on a broader, more encompassing basis. That was why a key goal for the management reorganization was to break down these internal barriers. Among the challenges that lie ahead is to create a corporate culture that fosters experts with the ability to see issues on a big-picture basis. Incidentally, the average age of the new management team is 15-20 years younger than the outgoing team, and why we should be able to tackle our day-to-day management duties with far greater relish. The previous management team will also provide an invaluable service, backing us up in marketing and other areas requiring strong personal networks.

Q2: How will the management reorganization enhance the Company's business performance?

A2: At the end of FY12/08, there were 232 employees on a consolidated basis versus 220 today. The decrease resulted from the elimination and absorption of the Osaka offices, branches and logistics centers. Moreover, we reduced the number of directors, including those at our group of companies, by six. This move led to a reduction of annual compensation extended to directors of ¥65 million, accompanied by a marginal decrease in salaries and allowances. We estimate the total cost reduction after the 2nd quarter to reach ¥100 million, including the ¥30 million savings from the closure of offices, branches and logistics center. We are also in the process of integrating PALTEK with NSM and Alpha under a single management system, which is scheduled to launch in FY12/11. It not only calls for the systems integration of PALTEK with NSM, but a renewal of PALTEK's main system as well. The new system, which includes the consolidation of logistics with corporate operations, will dramatically enhance the productivity of our back-office operations.

Q3: Please share some of the details regarding the new management initiatives that are intended to aggressively accelerate the Company in the 2nd half onward.

A3: Underlying the Company's initiatives to integrate management system and revamp our management team was the recognition that a sales framework was necessary not only for our products, but for our solutions as well. Because we've brought these initiatives to a successful conclusion and completed preparations to launch our renewed operations in the 1st half, we are now planning to initiate a major organizational restructuring in order for us to get really aggressive in the 2nd half. At the moment, the sales organizations of PALTEK, NSM and Alpha have yet to be integrated and remain vertically structured. From the 2nd half of the term, however, we will be positioning people who will act as "producers" and serve as lateral links between the three vertical sales organizations to service our blue-chip clients. We envision the final version of this aggressive management organization as one that can provide a detailed oversight of our businesses through a client/solution matrix. At present, an organizational infrastructure that is capable of supporting such matrices is being evaluated, and the trial-and-error process of converting the databases of respective clients and projects for our PLD, analog and ASSP solutions that exist today, into a single database for the entire company. We've also begun developing a new business model. Our existing business model is based on product/sales activities, which, while we could provide engineering services at the design stage, did not always lead to sales at the commercial production stage. In way of improvement, we converted our engineering services into a contracted designing business, and it has since managed to generate sales of several hundreds of million yen annually. We are currently looking to expand sales by offering design services that exploit the knowledge base of our engineers specializing in PLD. This is a business that our competitors are also seeking either to exploit as a new market or taking steps to reinforce their existing position. We therefore intend to develop the business by focusing on our strengths.

Q4: What will be some of the highlights of the Company in the future?

A4: The PLD is an engineering tool commonly employed during a prototype development phase. It allows us to incorporate a client company's circuitry at an early stage and offer system proposals that make effective use of analog and memory solutions. We have successfully made such proposals in the telecommunications field, which ranks among our core competences. We are planning to expand our product lineup even further, encompassing not only telecom infrastructure applications, but also direct even greater effort to develop new markets in such fields as industrial applications of broadcasting, medical and calibration systems, another area of strength for us. In view of mounting international competition, moreover, it is now vital that we reevaluate the merits of maintaining a production base in Japan. Strategic initiatives—such as those enabling Japanese companies to focus on areas in which they can succeed, or direct manufacturers to achieve greater

market superiority—are imperative. We believe one of our biggest challenges is to find ways to strike an optimal balance of engineering expertise and the minimum level of business scale necessary to remain profitable.

(Concludes Company Visit Memo)

【Reference】

(7587) PALTEK CORPORATION

Key Financial Data and Business Results (Consolidated)

Key Stock Indicators (Consolidated)		
No. of Shares Issued	Mar.09	11,849,899
No. of Treasury Stock	Mar.09	189,668
Market Value (¥million)	Jun. 11, 2009	4,183
BPS (¥)	Mar.09	678.6
ROE (%) ※1	Mar.09	−1.5
ROA (%) ※2	Mar.09	−1.2
PER (times)	FY12/09 est.	3,922.2
PCFR (times) ※3	Mar.09	−36.4
PBR (times)	Mar.09	0.5
Share Price (¥)	Jun. 11, 2009	353

Key Financial Data (Consolidated)		
Total Assets (¥million)	Mar.09	9,465
Shareholders' Equity (¥million)	Mar.09	7,911
Interest-Bearing Debt (¥million)	Mar.09	550
Equity Ratio (%)	Mar.09	78.8
Ratio of Interest-Bearing Debt (%) ※4	Mar.09	7.0
Free Cash Flows (¥million) ※5	Mar.09	1,641

※1 ROE=Current Net Income÷Averaged Shareholders' Equity of beginning of term and term end

※2 ROA=Cureent Net Income÷Averaged Total Assets of beginning of term and term end

※3 PCFR=Maket Value÷(Current Net Income+Depreciation)

※4 Ratio=Interest-Bearing Debts÷Shareholders' Equity

※5 Free Cash Flows=Operating CF +Investment CF

Consolidated (¥million)	Net Sales	Operating Income	Ordinary Income	Net Income	EPS (¥)	Dividend per Share (¥)
FY12/05	17,946	541	373	243	20.5	10.00
FY12/06	14,729	−412	−42	−36	−3.1	10.00
FY12/07	20,655	−300	−222	−258	−22.1	10.00
FY12/08	20,726	131	286	59	5.1	10.00
FY12/09 1HF f.	6,200	−325	−335	−215	−18.4	0.00
FY12/09 f.	17,500	50	30	1	0.1	5.00

Note: FY12/09 f. is the Company's forecast announced on Feb. 12, 2009.