

Trias Company Memo 25-Aug-2010

(Securities Code: 7587 / JASDAQ) PALTEK CORPORATION
Summaries of Business Results Meeting for the Second Quarter
of Fiscal Year ending December 31, 2010 and its Follow-Up Company Visit

On August 10, 2010, PALTEK CORPORATION (hereinafter PALTEK or the Company) held a Business Results Meeting for Q2 FY12/10. (Among the Company officials present were President Tadahito Takahashi; Director Ikuko Tokunaga; and Hiroki Inoue, General Manager of the Operational Service Division.) Following the Meeting, Trias Corporation interviewed President Takahashi, Director Tokunaga and Yoshinori Shibasaki, Manager of Corporate Communications. The following is a summary of the Meeting and follow-up interview.

【Consolidated Business Results for Q2 FY12/10】

Consolidated net sales for Q2 FY12/10 (April-June 2010) rose by 24.5%, to ¥4.24 billion. Demand for PLD used in medical systems, as well as ASSP used in broadband applications, was firm. In addition to increased sales to small- and medium-sized clients that generate higher profit margins, the yen's appreciation drove gross profit margins to improve from 17.2% in Q1 to 17.8% in Q2. While PALTEK's transactions with small- and medium-sized clients began to pick up from Q4 of last fiscal year, the trend became particularly noticeable from Q1 of this fiscal year. Operating income improved from a ¥100 million loss to ¥116 million profit on a year-on-year basis. On a cumulative basis, net sales for Q1 and Q2 rose by 20.2%, while operating income rebounded from a loss of ¥230 million to a profit of ¥147 million y/y.

The changes in net sales by solution and application are shown in Table 1. Firm demand in PLD solutions used in medical systems, analog solutions for small- and medium-sized clients, ASSP for broadband applications and memory for car navigation systems are in clear evidence. Driving growth for Applications was telecom and industrial equipment, which includes telemetry and FA systems, in addition to medical systems. Meaningful data for the sales trends of consumer systems and computer applications could not be discerned.

Table 1: Quarterly Consolidated Sales by Solution

| (¥million) | FY12/09 | | | | FY12/10 | | Q/Q Change | Y/Y Change |
|------------|---------|-------|-------|-------|---------|-------|---------------|---------------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | | |
| PLD | 1,169 | 897 | 1,226 | 1,398 | 1,291 | 1,349 | 4.5% | 50.4% |
| Analog | 661 | 770 | 776 | 809 | 733 | 858 | 17.1% | 11.4% |
| ASSP | 1,122 | 1,372 | 1,542 | 1,498 | 1,353 | 1,516 | 12.0% | 10.5% |
| Memory | 315 | 362 | 388 | 449 | 406 | 511 | 25.9% | 41.2% |
| Total | 3,269 | 3,403 | 3,934 | 4,155 | 3,785 | 4,236 | 11.9% | 24.5% |

* PLD: Programmable Logic Device

ASSP: Application Specific Standard Product

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Table 2: Quarterly Consolidated Sales by Application

| (¥million) | FY12/09 | | | | FY12/10 | | Q/Q | Y/Y |
|---------------|---------|-------|-------|-------|---------|-------|--------|--------|
| | Q1 | Q2 | Q3 | 4Q | 1Q | 2Q | Change | Change |
| Communication | 770 | 963 | 1,101 | 1,232 | 1,062 | 1,225 | 15.3% | 27.2% |
| Industrial | 1,160 | 975 | 1,193 | 1,429 | 1,318 | 1,573 | 19.3% | 61.3% |
| Consumer | 540 | 719 | 768 | 485 | 264 | 323 | 22.3% | -55.1% |
| Computer | 223 | 220 | 228 | 281 | 297 | 339 | 14.1% | 54.1% |
| Others | 576 | 526 | 644 | 729 | 846 | 776 | -8.3% | 47.5% |
| Total | 3,269 | 3,403 | 3,934 | 4,155 | 3,785 | 4,236 | 11.9% | 24.5% |

【FY12/10 Earnings Forecast】

PALTEK projects that net sales for FY12/10 will total ¥17.2 billion, up 16.5% y/y, while operating income will reach ¥265 million, a turnaround from the ¥182 million-loss in FY12/09. Buoyed by steady net sales growth and an improving gross margin, the Company revised its forecast for H1 upward on July 23 but kept to its initial forecast for H2, limiting the H1 revision only to the FY12/10 full-year forecast. The rebound in transactions with small- and medium-sized clients is believed to continue in H2. Moreover, because several projects that have already been designed in will commence then, net sales of ¥9.18 billion, a y/y gain of 13%, is expected. In contrast, as low-margin volume production projects, including those for telecom infrastructure and broadcasting equipment, will start in H2, gross profit margin is projected to decrease from 17.5% in H1 to 15.6% in H2. The forecast by solution is as follows: PLD sales should reach ¥3.36 billion, up 28% y/y, and with volume production projects expected to start, that should drive sales growth. Sales of Analog Solutions, meanwhile, should increase by some 14% y/y. Nevertheless, the current half-year sales level of some ¥1.8 billion is low when compared to the ¥3 billion levels of the past, when Japanese clients were major players in the mobile telephony and PC fields. The task of recovering current sales to that achieved in the past is a challenge that the Company now faces.

Table 3: Consolidated Business Results Summary for Q2 FY12/09 (Cumulative)

| (¥million) | FY12/09 | | FY12/10 | | Y/Y Growth | | FY12/10 Fcst. | | |
|------------------|---------|--------|---------|--------|------------|-------|---------------|------------|--------|
| | Q2 YTD | Ratio | Q2 YTD | Ratio | Value | Ratio | Old (May) | New (July) | Ratio |
| Sales | 6,672 | 100.0% | 8,021 | 100.0% | 1,349 | 20.2% | 17,000 | 17,200 | 100.0% |
| Gross Profit | 1,088 | 16.3% | 1,406 | 17.5% | 318 | 29.2% | 2,780 | 2,835 | 16.5% |
| SG&A | 1,318 | 19.8% | 1,259 | 15.7% | △ 59 | -4.5% | 2,560 | 2,570 | 14.9% |
| Operating Income | △ 230 | -3.4% | 147 | 1.8% | 377 | n.a. | 220 | 265 | 1.5% |
| Ordinary Income | △ 185 | -2.8% | 186 | 2.3% | 371 | n.a. | 190 | 285 | 1.7% |
| Net Income | △ 84 | -1.3% | 95 | 1.2% | 179 | n.a. | 100 | 155 | 0.9% |

Note: Forecasts for FY12/10 is that announced by PALTEK as of May 12, 2010 and July 23, respectively.

【New Challenge: Reinforcing Smart Energy Solutions】

As new vendors in the field, PALTEK started businesses with two companies—Netlogic Microsystems, the U.S. firm known for its high-performance chips used in telecom network applications, and ADD Semiconductor, the Spanish maker of leading-edge chips used for power line communications (PLC)—in

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H1. The Company is also bolstering its contracted Design Service business by leveraging its strength as a chip supplier with a high degree of engineering expertise. It aims to expand this business not only by supplying chips, but also by developing proprietary DSP evaluation boards and other products designed in-house, to gain greater recognition for its design capabilities.

While the influence of Japanese manufacturers on the digital consumer product market has waned, PALTEK believes there are ample business opportunities for them in such fields as smart grid technologies that contribute to a cleaner environment. Now that the Company has become profitable again, it is now starting to invest in this technology field. For example, PALTEK took part in the Smart Grid Fair 2010 held in June and exhibited a variety of solutions, including low-energy PLC solutions and power management visualization systems. It also participated in the Smart Community Alliance organized by the Japanese government's New Energy Development Organization. The Company is currently collaborating with iD, a design service firm, and Tohoku University in a R&D project on a next-generation energy management system based on a wireless sensor network for factories, which the Ministry of Economy, Trade and Industry is supporting under an initiative to develop strategically important basic advanced technologies. The project aims to develop a power management system designed for factories and other large areas by networking small electric power sensors and wireless communications technologies to carefully monitor power usage at the production equipment level. The system will enable unified management of such renewable energy sources as wind and solar power when combined with storage batteries, and allows operators to "see" and control the process in real-time—making it possible to provide centralized control over diverse air conditioning units, for example. PALTEK is committed to accelerating its involvement in smart energy solutions out of the belief that they will drive even greater business growth in the future.

【Q&A Session*】

*Note: Session includes questions and answers from the actual interview.

Q1: PALTEK hasn't revised its initial H2 forecast. Weren't the H1 business results taken into account?

A1: They have been taken into account. We did not revise our initial H2 forecast because, despite the fact that order inflow remains sound, some deliveries of semiconductors have been delayed.

Q2: PLD sales in H2 are expected to rise by ¥700 million versus H1. Will the increase consist almost entirely from volume production projects? Please elaborate on this point.

A2: Yes, it will be made up almost entirely of volume production projects, and for that reason, our gross margin will likely decrease. Most of these were delayed as a result of the Lehman Bros. collapse, which included projects to replace PLDs by Altera to those provided by Xilinx in the fields of medical

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and industrial equipment. As for high-volume, low-margin projects in consumer applications, we have sales of security cameras and digital cinema products. In addition, sales of Long Term Evolution (LTE) applications related to measuring systems are also picking up.

Q3: Why has inventory gotten smaller even as sales grew on a year-on-year basis?

A3: We disposed of old stock. In addition, global demand for PLDs and other chips has not been this great and products aren't being delivered to Japan in sufficient quantities, meaning we're operating on the tightest inventory levels since 2000. We now have less than one month's worth of stock—that's far below our order inflow and the shortfall is expected to continue for some time.

Q4: Is the strong yen helping or hurting PALTEK?

A4: It's true that the yen's appreciation is a positive profit driver at the moment. However, there are cases in which we have to sell expensive chips at far less than cost and are stuck with dollar-based debt. A stable exchange rate will thus be better for us in terms of performance.

Q5: When will your smart grid operations begin contributing to your bottom line? And are you mulling the possibility of bringing this business overseas?

A5: Since we just started our smart grid business, there will be no contribution to revenues this year. Our business, after all, was only launched in H2, which is why we are hoping to some impact from around the second half of FY12/11. At the moment, smart grids based on PLCs are becoming increasingly adopted in Europe, while wireless technologies are growing in popularity in the U.S. Some detractors here say because Japan has already installed advanced watt meters, smart grid systems are unnecessary and no clear direction on the issue has been established at this time. For this reason, PALTEK is now pushing research into both PLCs and wireless technologies. We have yet to seriously entertain our overseas options for now because we are basically an enterprise supporting Japanese clients which develop and manufacture products in Japan. ■■

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[Reference] PALTEK CORPOEARION (Securities Code: 7587)
Key Financial Data and Business Results (Consolidated)

| Key Stock Indicators (Consolidated) | |
|-------------------------------------|---------------------|
| No. of Shares Issued | Dec.2009 11,849,899 |
| No. of Treasury Stock | Dec.2009 420,366 |
| Market Value (¥million) | Aug. 24, 2010 3,970 |
| BPS (¥) | Dec.2009 691.7 |
| ROE (%) ※1 | Dec.2009 -0.7 |
| ROA (%) ※2 | Dec.2009 -0.6 |
| PER (times) | FY12/10 est. 24.7 |
| PCFR (times) ※3 | Dec.2009 -136.9 |
| PBR (times) | Dec.2009 0.5 |
| Share Price (¥) | Aug. 24, 2010 335 |
| Unit Share (shares) | Aug. 24, 2010 100 |
| Average Daily Volume (shares) ※4 | Aug. 24, 2010 2,024 |

| Key Financial Data (Consolidated) | |
|---------------------------------------|----------------|
| Total Assets (¥million) | Dec.2009 9,102 |
| Shareholders' Equity (¥million) | Dec.2009 7,905 |
| Interest-Bearing Debt (¥million) | Dec.2009 0 |
| Equity Ratio (%) | Dec.2009 86.8 |
| Ratio of Interest-Bearing Debt (%) ※5 | Dec.2009 0.0 |
| Free Cash Flows (¥million) ※6 | Dec.2009 578 |

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

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

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

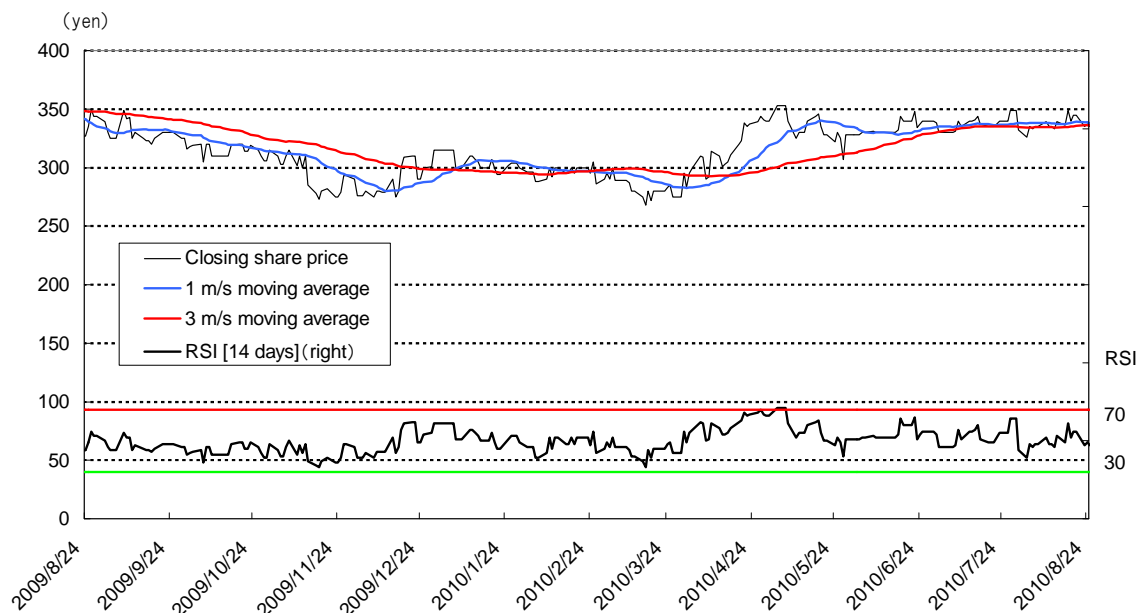
※4 Average Daily Volume=Average Daily Volume for previous 12 months

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

※6 Free Cash Flows=Operating CF+Investment CF

| Consolidated (¥million) | Net Sales | Operating Income | Ordinary Income | Net Income | EPS (¥) | Dividend per Share (¥) |
|-------------------------|-----------|------------------|-----------------|------------|---------|------------------------|
| FY12/06 | 14,729 | △ 412 | △ 42 | △ 36 | △ 3.10 | 10.00 |
| FY12/07 | 20,655 | △ 300 | △ 222 | △ 258 | △ 22.10 | 10.00 |
| FY12/08 | 20,726 | 131 | 286 | 59 | 5.10 | 10.00 |
| FY12/09 | 14,762 | △ 182 | △ 103 | △ 60 | △ 5.17 | 5.00 |
| Q2 (cumulative) FY12/10 | 8,021 | 147 | 186 | 95 | 8.37 | 0.00 |
| FY12/10 fcst. | 17,200 | 265 | 285 | 155 | 13.56 | 5.00 |

Note: FY12/10 forecasts announced on Aug.10, 2010

Stock Price Charts and RSI


Source: Prepared by Trias Corp. with Bloomberg L.P. data.

Note: RSI (Relative Strength Index) is the index representing the ratio of overbought or oversold share prices. In general, over 70 in RSI shows overbought share price range, while 30 shows oversold share price range.

RSI= averaged share price appreciation for N days ÷ (averaged share price appreciation for N days + averaged share price decline for N days) x100

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