
LAWSON

ANNUAL REPORT 2004

Year ended February 29, 2004

# The Difference Is Here

# Consolidated Financial Highlights

LAWSON, INC. and Subsidiaries
Years Ended February 29, 2004 and February 28, 2003 and 2002

| | Millions of Yen | | | Percent Change | Thousands of U.S. Dollars[1] |
|---|---|---|---|---|---|
| | **2004** | 2003 | 2002 | 2004/2003 | **2004** |
| **For the Year:** | | | | | |
| Net sales of all stores | **¥1,288,297** | ¥1,294,042 | ¥1,285,557 | (0.4)% | **$11,752,390** |
| Total operating revenues | **245,601** | 250,334 | 256,116 | (1.9) | **2,240,476** |
| Operating income | **38,087** | 34,107 | 36,363 | 11.7 | **347,446** |
| Income before income taxes and minority interests | **32,923** | 17,603 | 29,028 | 87.0 | **300,338** |
| Net income | **18,571** | 8,861 | 16,123 | 109.6 | **169,413** |
| **Per Share Data** (Yen and dollars)**:** | | | | | |
| Net income | **¥ 176** | ¥ 82 | ¥ 146 | 114.6% | **$ 1.61** |
| Cash dividends | **41** | 41 | 41 | – | **0.37** |
| **At Year-End:** | | | | | |
| Total assets | **¥ 354,831** | ¥ 342,599 | ¥ 342,934 | 3.6% | **$ 3,236,918** |
| Total shareholders' equity | **154,317** | 151,864 | 149,827 | 1.6 | **1,407,745** |
| **Store Network:** | | | | | |
| Number of stores[2] | **7,821** | 7,625 | 7,734 | 2.6% | |
| Franchised stores | **7,472** | 7,291 | 7,179 | 2.5 | |
| Company-owned stores | **349** | 334 | 555 | 4.5 | |
| Ratio of liquor-licensed stores (%) | **75.4** | 62.1 | 55.8 | 13.3 | |
| Stores with ATMs | **3,127** | 2,712 | 1,922 | 15.3 | |

*Notes: 1. The U.S. dollar amounts represent translations of Japanese yen at the approximate exchange rate at February 29, 2004, of ¥109.62=$1.*
*2. The number of stores does not include stores of Shanghai Hualian Lawson Co., Ltd.*

## Contents



### Forward-looking Statements

This annual report contains forward-looking statements about the future plans, strategies, beliefs and performance of LAWSON and its subsidiaries. These forward-looking statements are not historical facts. They are expectations, estimates, forecasts and projections based on information currently available to the company and are subject to a number of risks, uncertainties and assumptions, which, without limitation, include economic trends, competition in the Japanese convenience store industry, personal consumption, market demand, the tax system and other legislation. As such, actual results may differ materially from those projected.

“The Japanese convenience store sector is undergoing dramatic change. Until a few years ago, our customers were primarily men in their 20s and 30s. Now our customer base is expanding as the ratio of women, middle-aged men and elderly men using our stores increases.

Amid this change, I decided to review the high-growth management plan we unveiled two years ago as part of our rigorous pursuit of customer satisfaction. Moving forward, LAWSON aims to develop a chain of stores that match the needs of customers in each region, rather than promoting uniform store management and product lineups. And I want everyone in the Lawson family to create greater customer satisfaction by doing the basics right. I believe this will result in future growth in the earnings of franchise owners and LAWSON.

As we make steady progress with our various reforms, I am convinced that Lawson Challenge 2004 is taking us in the right direction. I hope this annual report will help you understand my thinking on customer satisfaction, and show that we are pushing ahead in pursuit of even greater corporate value.”

Takeshi Niinami
President and CEO

# To Shareholders, Other Investors, Customers, Franchise Owners, Store Crew and Employees

"The fact is that the Japanese retail industry remains a difficult market in which to operate. We recorded higher earnings in the fiscal year ended February 29, 2004, but we posted lackluster earnings in the previous two years, the result mainly of actions to deal with unproductive assets. The earnings of franchise owners, our important business partners, drifted slightly lower. For management, prevailing against this stiff competition and driving earnings higher are an extremely important focus."

TAKESHI NIINAMI
*President and CEO*

## A Dynamically Changing Operating Environment

It has been almost three decades since the first convenience store opened in Japan. In the ensuing years, the Japanese convenience store industry has devoted its energies to increasing convenience for customers. Today, the industry faces a wildly changing operating environment and customers' expectations of convenience stores are also in a state of flux.

Let's examine this change. In the past, convenience stores targeted customers in their 20s and 30s. But their number is declining due to Japan's low birthrate and aging population. Increasingly, the major customer group is middle-aged and senior citizens. And, as women play a greater role in all aspects of society, we are also seeing this group become a heavier user of convenience stores. The change in the customer mix has naturally resulted in new demands being placed on the convenience store. In particular, products that respond to heightening health consciousness are in greater demand. Greater levels of customer satisfaction (CS), especially with respect to the quality of service, are in demand, too. These dynamics have ignited more intense competition among convenience stores, most notably in cities. And fueling this competition is the increasing entry of other players into the market, such as supermarkets and drug stores that are open till late. Under these circumstances, convenience stores can no longer hope to gain the patronage of customers using past practices. In fact, these changes are a real threat to companies that persist in operating as they always have. On the other hand, companies such as LAWSON that have embraced this change and are prepared to take up new challenges stand to benefit from growth opportunities.

But there are other challenges. Persistent deflationary trends continue to create an extremely difficult operating environment, particularly for the retail industry. While we recorded higher earnings in the fiscal year ended February 29, 2004, we posted lackluster earnings in the previous two years, the result mainly of actions to deal with unproductive assets. And the earnings of franchise owners, our important business partners, drifted slightly lower. For management, therefore, our highest priorities are to prevail against this stiff competition to drive earnings higher.

## Our Goals

Based on LAWSON's corporate philosophy of "Making life more convenient for customers and contributing to local communities by valuing people and seeking innovative approaches," franchise owners across the country are operating stores with the goal of being "the 'hot' station in the neighborhood." This slogan is our vision of the type of chain we aspire to become. The word "hot" means providing the "hottest" products, information and services to meet the needs of customers in each region, as well as "warm" in the sense that customers find our stores welcoming. "Station" means a place to relax and take a break. Customer satisfaction is essential to realizing this vision, and we believe that it depends on the following three elements. The first is product development capabilities. The second is what we call the Three Challenge Practices: creating stores and store layouts that strike a chord with customers; keeping stores clean; and serving customers with courtesy. Third is convenient locations. Increasing customer satisfaction is thus our main focus.

Customer satisfaction will win the support of customers, which in turn will translate into higher earnings for franchise owners and finally profits for LAWSON. The realization of customer satisfaction and pursuit of profits is by no means antithetical. In fact, the two are connected. If you can't continuously generate profits, you won't be able to continuously satisfy customers. It's like a cycle. Customer satisfaction creates customers that create profits, which allow you to create more customer satisfaction. Our role as managers is to ensure that this cycle is operating properly. In short, we recognize that it is important to generate continuous earnings to deliver customer satisfaction. For this we are implementing more measures and offering more leadership than ever to lift store earnings. And as part of efforts to instill this mindset in LAWSON we have switched to using earnings rather than sales as our key benchmark for the measurement of performance. This applies to performance evaluations of employees, too.

## Building the Lawson Model Convenience Store

In what is a difficult operating environment for convenience stores, I believe the conventional convenience store model, a chain operated in a uniform manner in a drive for efficiency, with everything revolving around Tokyo, has its limits. We are thus aiming to move away from the past model of a convenience store that pursued efficiency above everything else. Our goal is to create a model that is aligned to change in our operating environment and customers' needs.

Those needs differ greatly depending on the region. Existing models cannot cope adequately with this change. Rather than a Tokyo-centered nationwide chain operation, what's required are stores and sales areas fashioned to match the needs of each respective region. The emphasis must be on individuality in store operations and individual stores. This was our motivation for introducing the regional headquarters system in fiscal 2003. Through a process of trial and error, we have attempted to make the most of this system over the past year. While the major benefits from the introduction of this system will come later, it has expedited decision making at a level closer to customers and facilitated smoother communication across our operations, development and product divisions. There have been other benefits as well.

This system has moved us further down the road to creating stores offering greater satisfaction that match regional characteristics.

Toward even higher levels of convenience and with an eye on future change in our operating environment, we are engaged in the continuous development of new formats that add extra value and dimensions to the functions of existing convenience stores, thereby responding to changing customer needs.

But make no mistake, this shouldn't be interpreted as a complete overhaul of our existing model. The new model merely improves on the existing standardized model that has its limits in some respects. The constant, and it's an important point, is that we satisfy customers with the basic convenience store functions. For LAWSON, this is the essence of customer satisfaction.

## Strengthening the Product Lineup

(Offering Safe, Healthy and Tasty Products Customers Can Trust)

Original products are important to setting Lawson apart from other companies. To this end, we have restructured our network of contract manufacturers, concentrating on mega-vendors with the wherewithal to make investments and a strong financial position. This process had largely been completed as planned at the end of February 2004 and, while the benefits won't materialize until fiscal 2004 or thereafter, we are still hopeful that the realignment will produce significant benefits in terms of improved product quality. I have no doubt that the improved productivity and investments in the latest equipment resulting from this realignment will result in more delicious products. Achieving cost savings is important to the strength of our product lineup, too. While procurement costs rose in fiscal 2003 due to a rise in the price of rice as a result of a cool summer, we are seeing the benefits of reviews of purchasing practices conducted by the Raw Materials Procurement Department in the form of lower costs. These savings will be reinvested in improving product quality in fiscal 2004. Our goal is to provide higher-quality products imbuing a sense of value.

In addition to these actions, we have responded to different regional tastes and other preferences. Under the leadership of regional headquarters, we are creating products matched more closely to regions, implementing measures such as the local procurement of regional materials and ingredients that form the basis of these products.

Through these measures, we are pursuing a higher added-value proposition unique to Lawson. There are three watchwords: commitment, authentic and a sense of value.

And to respond to increasing health consciousness, we are progressively eliminating artificial coloring and preservatives from *bento*-boxes, rice balls, prepared breads and other original products and we are restricting the use of food additives to the bare minimum. Moreover, we initiated the Natural Project to communicate these sorts of LAWSON activities and progress we are making with them to customers in an easily understandable manner. Another element of our approach to safe, healthy and tasty foods is the Natural Lawson format. As of February 29, 2004, there were 13 of these stores, mainly in Tokyo and Kanagawa Prefecture.

But all of this is meaningless if customers don't understand the quality of our products, no matter how delicious they might be. Product appearance and image (store and LAWSON brand) have a lot to do with how customers evaluate the taste of products.

“Original products are important to setting Lawson apart from other companies. To this end, we have restructured our network of contract manufacturers, concentrating on mega-vendors with the wherewithal to make investments and a strong financial position. We are also seeing the benefits of reviews of raw material purchasing practices in the form of lower costs. In fiscal 2004, these savings will be reinvested in improving product quality. Our goal is to provide higher-quality products imbuing a sense of value.”

That’s why, as well as raising product quality, we are endeavoring to make store environments more appealing.

## The Three Challenge Practices

LAWSON has a nationwide network of 7,821 stores (as of February 29, 2004) in all 47 prefectures in Japan. But just one store with a low level of awareness of customer satisfaction could undermine a customer’s confidence in the whole Lawson chain—regardless of how hard other stores are trying in this respect. This is the nature of chain operations. Stores with a low awareness of or no interest in customer satisfaction have no place in the Lawson chain. Head Office will monitor these stores and, in certain circumstances, they may be asked to leave the Lawson chain. Nothing less than the firm resolve of all of the Lawson chain in implementing the Three Challenge Practices is acceptable.

The importance I attach to these basics of our business is underscored by them being included as an integral part of Lawson Challenge 2004 from the very outset, and we have been training store supervisors and other line personnel to give them the skills they need to ensure they are realized. Taking this a step further, in fiscal 2004 we plan to put in place an effective system for education and training and hold seminars targeted at franchise owners and crew. At training centers, in addition to skills-based training, we are also fostering a mindset for serving customers at stores in the right way.

We also hold Lawson Seminars twice a year in each region throughout the country at which we assemble franchise owners. In the past, these seminars were used mainly to familiarize attendees with our products every six months. But from this fiscal year we have reconfigured these seminars as study forums for franchise owners and crew to learn what individual stores should do to realize our vision of “the ‘hot’ station in the neighborhood.” The feedback has been encouraging, with many of the participants being extremely impressed, saying that the seminars have improved considerably. Seeing how participants have embraced these seminars fills me with confidence that LAWSON will definitely get better.

Of course, it’s not just franchise owners and store crew that are being required to be more conscious of customer satisfaction.

"I attach great importance to the Three Challenge Principles. This is underscored by them being included as an integral part of Lawson Challenge 2004 from the very outset. We have been training store supervisors and other line personnel to give them the skills they need to ensure these principles are realized. In fiscal 2004, we will take this a step further by holding seminars on these principles for franchise owners and crew as well. In addition to skills-based training, we will foster a mindset for serving customers in the right way."

The same, if not greater, demands are being placed on Head Office personnel. Their performance evaluations depend on it. Qualitatively evaluating measures taken with respect to customer satisfaction is an extremely difficult proposition, but we are trying to quantify this with the introduction of a mystery shopper program to serve as a way of benchmarking our approach to customer satisfaction. The mystery shopper program involves sending a person to specific stores to evaluate service and other aspects of their operations. The key is that this person acts as a customer and the stores have no prior knowledge of the person's visit. This system enables us to look objectively at stores from the customer's perspective and to pinpoint by ourselves areas that need to be improved.

To foster even greater consciousness among employees of customer satisfaction we hold CS sessions at Lawson University, a structured education and training program for employees. I believe that greater awareness of CS among all members of the Lawson family, starting with employees, will lead to customer satisfaction.

I believe that education is extremely important to LAWSON's future and intend to back up this belief by channeling more resources into this area. The benefits of these investments will come in stronger brand equity over the medium and long terms.

## Convenient Locations

LAWSON is not preoccupied with how many stores it has. But we are particular about the profitability of individual stores. That's why instead of applying uniform standards for all stores across the country, we focus on profitability by region and store when opening new stores. In fiscal 2003, while we largely achieved our goal for the number of stores opened, we didn't make the progress we wanted in terms of new store profitability. So, in fiscal 2004 we will step up our focus on profitability to eradicate low-profit store openings. We refuse to be drawn in to setting unrealistic goals for store openings. Instead, our approach will be to conduct more rigorous analysis before deciding to open stores. Raising the productivity of Recruit Field Counselors (RFCs) is part of this. We are trialing a system whereby responsibility for the various aspects of store development is divided among several people. More efficient new store development should be the result. Previously, RFCs handled most aspects of this process. And so that we can more quickly obtain information on possible sites for stores, we are strengthening relationships with leading local companies throughout Japan.

Competition is intense for sites to open new stores. Given this situation, and without clinging to traditional views of what makes a good site for a convenience store, we are opening our eyes to other possibilities through alliances with businesses in other industries. Progress was made in this regard in fiscal 2003. In association with Japan Post, Postal Lawson stores were opened inside some post offices. And we jointly opened stores at Nippon Oil Corporation's ENEOS self-service stations. Stores were also opened at banks, in subway concourses, under an alliance with the Tokyo Metro Co., Ltd. (formerly Teito Rapid Transit Authority), and in association with ALBIREX NIIGATA, a professional football club that plays in the JAPAN PROFESSIONAL FOOTBALL LEAGUE. We are thus opening stores in locations no one has thought of before as we continue to explore the possibilities of convenience stores.

## Lawson Challenge 2004—A Direct Bearing on LAWSON's Future

As I mentioned earlier in this letter, the overarching goal of Lawson Challenge 2004 is to realize our vision of "the 'hot' station in the neighborhood." I believe that our increased focus on customers and stores to improve Lawson has been the correct move. However, if anything, the past two years have taught me that it will take longer than I had expected to execute the reforms needed to make LAWSON more responsive to rapidly changing customer needs and thus deliver customer satisfaction.

Based on our business results in fiscal 2003 we decided to downwardly revise our final-year operating income target for Lawson Challenge 2004 to ¥42.1 billion, from the originally announced ¥50.0 billion. We decided that trying to force growth for the sake of satisfying a preoccupation with a goal set in the past could be detrimental to sustainable growth in the future. At this juncture, we feel that what's best for LAWSON is to build a strong base, as a store and as a company, by first making sure that we are doing the basics right. Our goal is stable, continuous growth that has its roots in relationships with franchise stores and the carefully planned education of employees and store crew. Rapid growth would only put a strain on LAWSON, imposing unrealistic demands. That, in my opinion, is not the way forward. LAWSON has many stakeholders and our relationships with them are based on growing together over the long term, not on a short-term outlook. And the time to forge those lasting relationships is now.

## LAWSON Will Change

Do the basics right. Do what you have to do. If everybody in the Lawson family does this day in and day out, I have no doubt LAWSON will change into an exciting company.

Expect to see more change in the years ahead as we remain focused on being "the 'hot' station in the neighborhood."

June 2004

Takeshi Niinami
President and CEO

# Corporate Governance

## Basic Policy on Corporate Governance

LAWSON is endeavoring to maximize corporate value, while safeguarding the interests of shareholders and all other stakeholders. We believe that it is important to upgrade corporate governance to increase the soundness and transparency of management. This is achieved through strict compliance, active disclosure and in other ways.

## The Board of Directors, Executive Officer System and Remuneration System

As of May 2004, the Board of Directors had nine members, five of whom are outside directors. We believe that having a majority of outside directors on our Board brings a wide range of insights and opinions to bear on matters that are important in managing the company. This enables us to arrive at fairer, more reasoned judgments.

At the Ordinary Annual General Meeting of Shareholders held in May 2004, two outside directors resigned and were replaced by two new directors. The two new appointees as outside directors are Koji Furukawa, Senior Executive Vice President of Mitsubishi Corporation, LAWSON's leading shareholder and strategic business partner; and Hiroshi Mino, an Executive Officer and Senior Vice President in charge of LAWSON at Mitsubishi Corp. Mr. Furukawa brings experience in a broad range of fields to the Board of LAWSON, having been involved in areas such as finance, personnel, and business reforms at Mitsubishi Corp. The advice of both new appointees will be effective in devising management plans to raise LAWSON's corporate value further.

LAWSON has established various committees to bolster corporate governance. One is the Compensation Committee, which is made up entirely of outside directors. Others are the Private Information Protection Committee, which is chaired by President and CEO Takeshi Niinami, and the Compliance Promotion Committee, which is headed by Executive Vice President and Chief Risk Management Officer (CRO) Katsuhiko Yamasaki. Moreover, in fiscal 2002, we introduced the executive officer system to demarcate management supervision and business execution. As of April 30, 2004, there were 24 executive officers at LAWSON.

Also in the name of compliance we have made around 30% of the remuneration of directors and executive officers contingent upon our business results, thereby clarifying the link between their roles and delivering value for LAWSON's shareholders. For managers, in February 2003, we started using 360-degree evaluations as well as performance-against-target in personal evaluations.

*(Continued on page 10)*

## Expectations of Niinami's Reforms

The reforms initiated by Takeshi Niinami are making steady progress. The first of these is changing LAWSON's corporate culture. The younger top management team has revitalized the organization and sparked greater motivation in employees. The second reform is to ensure that strategic thinking is deeply ingrained. Through alliances with companies in different fields, LAWSON has tapped the resources and outside expertise it needed to take on challenges in new business spheres. The third reform is earning greater recognition from the market. The top management team has actively communicated its vision and strategy in the media, establishing a reputation for LAWSON as an innovative company. LAWSON's reforms can be expected to deliver results in the coming years.

May 12, 2004

HIROSHI TASAKA

*Professor*
*Graduate School of Tama University*
*(Director)*

*From the right*

TAKESHI NIINAMI
*Representative Director, President and CEO*

TERUO AOKI
*Director, Senior Executive Vice President*

KATSUHIKO YAMASAKI
*Director and Executive Vice President*

MASAAKI KOJIMA
*Standing Corporate Auditor*

SADAO SUZUKI
*Standing Corporate Auditor*

YORIHIKO KOJIMA
*Director*

EIICHI TANABE
*Director and Executive Vice President*

YOSHIYUKI SANADA
*Corporate Auditor*

YUKIO UENO
*Director*

HIROSHI TASAKA
*Director*

REIKO OKUTANI
*Director*

TESTUO OZAWA
*Corporate Auditor*

MUNEAKI MASUDA
*Director*

(As of April 30, 2004)

## Audit Function

LAWSON employs the corporate auditor system and three of the four members of the Board of Corporate Auditors come from outside the company. Corporate auditors audit the performance of duties by directors, a process that includes attending Board of Directors and other important meetings, offering opinions from a fair and objective viewpoint and surveying legal and internal controls. In principle, the Board of Corporate Auditors meets once a month.

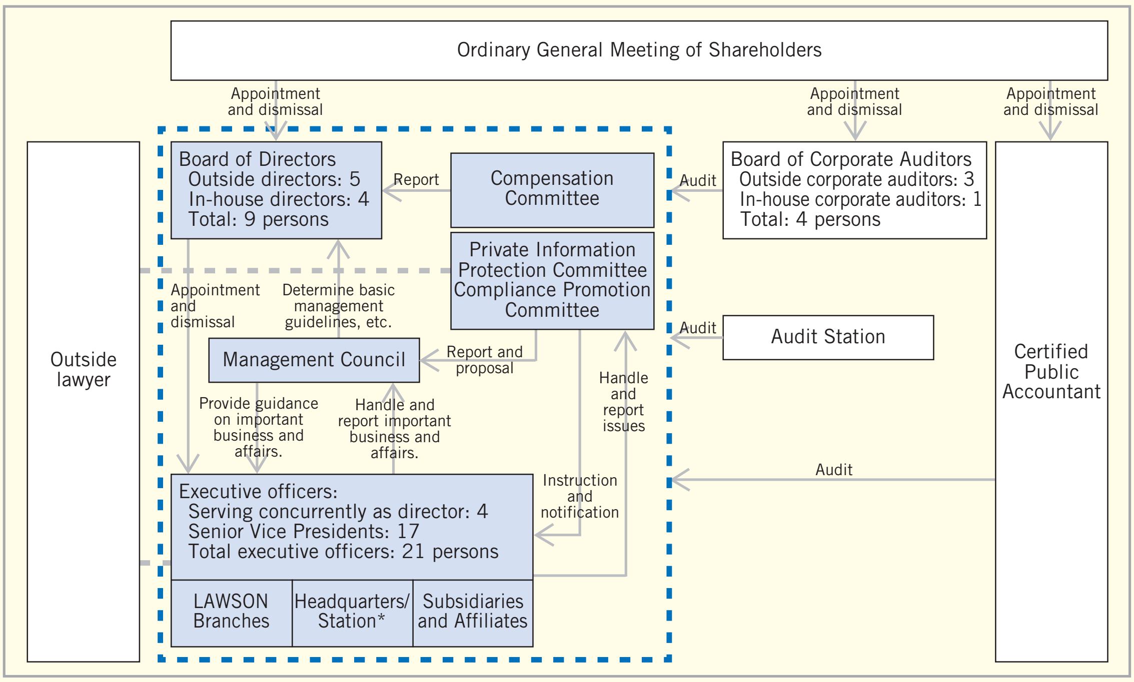
## Active and Fair Disclosure

LAWSON aims to actively disclose information, doing more than merely fulfilling mandatory accountability requirements. This stance extends to releasing a business report every month, making earnings presentation materials available on its website, video streaming the Ordinary Annual General Meeting of Shareholders and other investor relations activities which underscore our commitment to dialogue with all LAWSON stakeholders.

## Compliance

An incident in June 2003 involving the unauthorized disclosure of personal information of one LAWSON PASS cardholder (but not credit information) was a source of concern for customers. In the wake of this incident, we appointed Executive Vice President and CRO Katsuhiko Yamasaki to head corporate compliance and redoubled our efforts to educate employees on compliance. In addition to compliance-related training for all employees at least once a year, we have in place various mechanisms to continuously check the appropriateness of business activities. This includes using a hot line and counseling facility, which is also available to people outside the company, and Audit Station, which audits the legal performance of operations and responses to risk management. We are also receiving feedback from business partners through a third-party organization.

## Corporate Governance and Internal Control Systems (As of February 29, 2004)



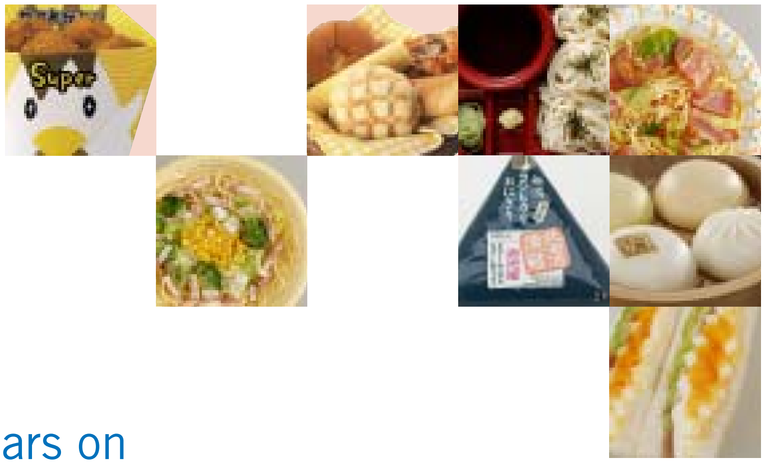

**In May 2002, LAWSON's Head Office was positioned as a Support Station that assists with efforts to realize the vision of "the 'hot' station in the neighborhood." Some Head Office divisions were renamed "stations" in line with this move.*

A Progress Report on Lawson Challenge 2004

Over the past two years, we have steadily executed Lawson Challenge 2004, our medium-term plan for reforming LAWSON and driving growth. The overarching aim is to realize our vision of being "the 'hot' station in the neighborhood." Looking back over this period, I am convinced that turning the company to focus more on customers and frontline operations was indeed the correct decision. But there is still work to be done. The speed of change in our markets has sometimes taken us by surprise, and more time is required for reforms to make LAWSON more responsive to market change. I intend to push ahead with various initiatives, placing emphasis on our intangible assets—customer, employee and organizational—that are so vital to the successful completion of these reforms. That's because I strongly believe that the creation of an operating base that can deliver stable growth is the best way to increase enterprise value. Emphasizing franchised store earnings and customer relationships will build brand equity, ultimately translating into tangible operating results for LAWSON in the future.

## Lawson Challenge 2004:

# Making All the Difference




# Lawson Challenge 2004: Two Years on

## Looking Back on Fiscal 2003

Operating conditions in Japan's retailing industry, LAWSON's operating domain, have become extremely difficult due to protracted deflationary trends, intensifying competition over the past few years that transcends business type and model, and the effect of the coolest summer in a decade in 2003. This is calling into questions companies' ability to respond quickly and flexibly to the market.

Our approach to these market conditions has been to focus on increasing customer satisfaction by raising quality. We have pursued three themes in this respect, motivated by our desire to realize our vision of being "the 'hot' station in the neighborhood." The first of these themes is the Three Challenge Practices: serve customers with courtesy, keep stores and surrounding areas clean, and create stores and store layouts that strike a chord with customers. This also included enhancing leadership in store management. The second theme was to use our improved product development capabilities to quickly develop products under the banner of safe, healthy and tasty products customers can trust. Thirdly, we are developing stores with an emphasis on quality, choosing locations that are convenient for customers. In this section, we look at progress we have made with regard to these three themes.

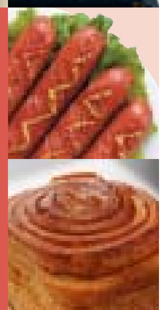
## About the Three Challenge Practices

### LAWSON's Three Challenge Practices

As in the past, we will continue to stress LAWSON's Three Challenge Practices, as we regard them as an important aspect of our operations. Not only are they instrumental to increasing the level of customer satisfaction, but the degree to which they are practiced is a barometer of that change. Underscoring the importance we attach to them, in fiscal 2003, when we extended the results-based performance evaluation system to all employees, we made the quantitative and qualitative measurement of the degree to which the Three Challenge Practices were implemented a key performance metric. This has firmly entrenched them as the main factor for realizing our vision of being "the 'hot' station in the neighborhood." In fiscal 2004, we intend to spotlight people who personify the spirit of the Three Challenge Practices and increase opportunities for people to hone their skills with respect to these practices. This education and training will be given to store owners and crew, not just LAWSON employees. And as part of our approach to education, we will use outside specialists in various fields, such as management, products and store development, to stimulate and invigorate the organization.

## Strengthening the Product Lineup

In our drive to improve quality in respect of products we have focused in particular on the key lines of *bento*-boxes and rice balls. To this end, we have been implementing a plan to reduce the number of vendors and concentrate production on mega-vendors. This process had largely been completed, according to plan, at the end of fiscal 2003. And, ahead of the rest of the country, the latest production equipment has been progressively installed at factories in Tokyo, Nagoya and Osaka, putting in place a framework for delivering products of an even higher quality. These moves have been instrumental to the development of the safe, healthy and tasty products customers can trust that LAWSON is aiming for. One move has been the elimination of preservatives and artificial coloring from Lawson original products, such as *bento*-boxes, rice balls and sandwiches.



*Onigiriya* rice balls are made with the finest ingredients and best production methods. They have continually recorded sales at least 10% above those in the rice ball category as a whole. And, importantly, the proportion of customers citing taste as the reason for choosing to buy rice balls at Lawson and not elsewhere has leapt three times since the launch of the *Onigiriya* series. The *Onigiriya* series is now firmly established as a representative LAWSON brand. The figure on the next page represents cumulative sales of *Onigiriya* rice balls since its launch. Put end to end this would be enough rice balls to circle the globe nearly three times.

# Taste the Difference

# The Pursuit of Safe, Healthy and Tasty Products Customers Can Trust

"The *Totte Oki Sengen* series of original breads is the product of joint efforts with Yamazaki Baking Co., Ltd., one of Japan's top bakers. Our goal was to create bread offering an authentic taste experience. With *Melon Pan* buns, in particular, we succeeded in creating the ideal product, deliciously soft in the middle but delicately firm on the outside without being sticky, as many products have been in the past. This was achieved by finding the perfect mix of flour. *Melon Pan* buns have proved to be a popular addition to our product lineup, ranking among the top sellers since going on sale in September last year."

KAZUYOSHI OHNAKA
*Merchandiser*
*Bakery & Dessert Dept.*
*Merchandizing & Logistics Division*

650,000,

*The total number of rice balls sold at Lawson stores from the launch of the Onigiriya brand through October 2003.*

Ingredients are an important element of a product's value proposition. During fiscal 2003, we experienced a spike in the price of rice due to the effects of a cool summer in 2003. We struggled with how best to manage this situation, but ultimately decided that LAWSON's Head Office would basically bear the brunt of the increase. We had three other choices: ask franchise stores to take the load, pass the increase on to consumers in the form of higher product prices, or use lower-quality rice in our products. Motivated by a desire, first and foremost, not to undermine our relationships with franchise stores and customers over a temporary rise in rice prices, we rejected these options. The strategy we employed was to defer price increases of existing *Onigirya* products made with Niigata Koshihikari rice, and to also use this high-quality rice in some hand-rolled rice balls so as to set the *Onigiriya* brand part from rivals. In fiscal 2004, we plan to leverage the successes of *Onigiriya* as the basis for our product strategy for other products in our lineup, in the process creating popular products that only Lawson can deliver.

## Collaboration With Specialist Manufacturers

Another element of our strategy to strengthen our product lineup has been to collaborate on joint development projects for original products with specialist manufacturers. One example of this approach is the *Totte Oki Sengen* series. Using quality ingredients and a carefully chosen production method in the pursuit of a real taste experience, LAWSON and its development partner came up with *Melon Pan* buns and other hot-selling products that have won high marks from customers. Another product created through joint development is *GU-GU-GU*, a series of instant food products that redefines the term instant. The original brand emphasizes three aspects of the ingredients (*gu* in Japanese)—the superior taste, size and volume of helpings. The lineup features instant noodles, miso soup, cup soup and other instant items, developed jointly with 12 well-known food manufacturers, each using the ingredients and techniques they are most at home with. Joint product development with a single manufacturer is nothing new in the convenience store industry, but a project of this magnitude with 12 companies participating is a first in Japan. The development of original products created in this way and reflecting the "voices" of consumers will be a continuing theme at LAWSON.

## Enhancing Services

Various actions on the service front are contributing to greater convenience for customers, too. Take ATMs. We started a full-scale drive to install ATMs at our stores in October 2001. There are now 3,127 ATMs at Lawson stores in 17 prefectures (as of February 29, 2004), with the recent addition of this facility at stores in Kyoto, Hiroshima, Yamaguchi and Fukuoka prefectures during the fiscal year ended February 29th, 2004. *Loppi* is also offering greater convenience. These in-store multimedia terminals now allow customers to purchase "toto" sports promotion lottery tickets. Through our active support of businesses promoting sports we are building good relations with local communities. This is part of our approach to establish strong relationships with regional societies. LAWSON PASS is another convenient service for customers. Launched in August 2002, and now with around 1.4 million cardholders, LAWSON PASS has steadily won the support of customers with various services, such as the start of a system whereby cardholders can exchange shopping points for shopping vouchers. Regrettably, during fiscal 2003, there was an incident involving the unauthorized disclosure of personal information of a cardholder from a third-party firm to which LAWSON outsources part of its card services. No credit information was disclosed however. Recognizing the serious nature of this incident, we immediately launched a committee made up mostly of outside experts to investigate the reasons for and circumstances of this unauthorized disclosure. At the same time, we are working to establish a stringent in-house system for the safeguarding of information, forming a Private Information Protection Committee to spearhead these efforts. Moving forward, we intend to offer more attractive members-only rewards and a shopping points program while ensuring that information safeguards are followed to the letter so as to continue to enjoy the support of cardholders and shareholders.

## Quality—the Focus for Store Development

During fiscal 2003, we actively relocated and closed stores with low daily sales or that were unprofitable, as well as opened stores with a focus on quality, mainly in the Tokyo, Nagoya and Osaka areas. Our efforts were guided by new standards that we introduced last year for the opening of stores, part of our drive to develop higher quality stores in convenient locations for customers. These moves have lifted the quality of our overall chain and also led to higher earnings for the franchise owners of stores that were relocated. And stores have been opened in novel new locations. These include stores such as Metropia in subway concourses, thanks to an alliance with Tokyo Metro Co., Ltd.; hybrid convenience stores in banks; Lawson stores operated at ENEOS self-service stations in a tie-up with Nippon Oil Corporation; and Hospital Lawson shops inside hospital grounds such as the Kyorin University Hospital and Takatsuki Red Cross Hospital.

As a result of these and other developments, the Lawson network in Japan numbered 7,821 stores at the end of February 2004, a net year-on-year increase of 196 stores, following the opening of 625 stores and the closing or relocation of 429 stores. While the net increase was largely as planned, return on investment (ROI) at new


# New Format Stores

> In January 2003, mailboxes were installed in all Lawson stores. Since then, LAWSON and Japan Post have developed and expanded a mutually beneficial business alliance. Activities now include the trial operation of Postal Lawson stores, sales of stamps featuring original photographs, and the handling of "*Furusato Kozutsumi*" small parcels. All initiatives have won the support of delighted customers. More initiatives are planned in fiscal 2004. These will increase convenience for customers and create additional value for both Japan Post and LAWSON.

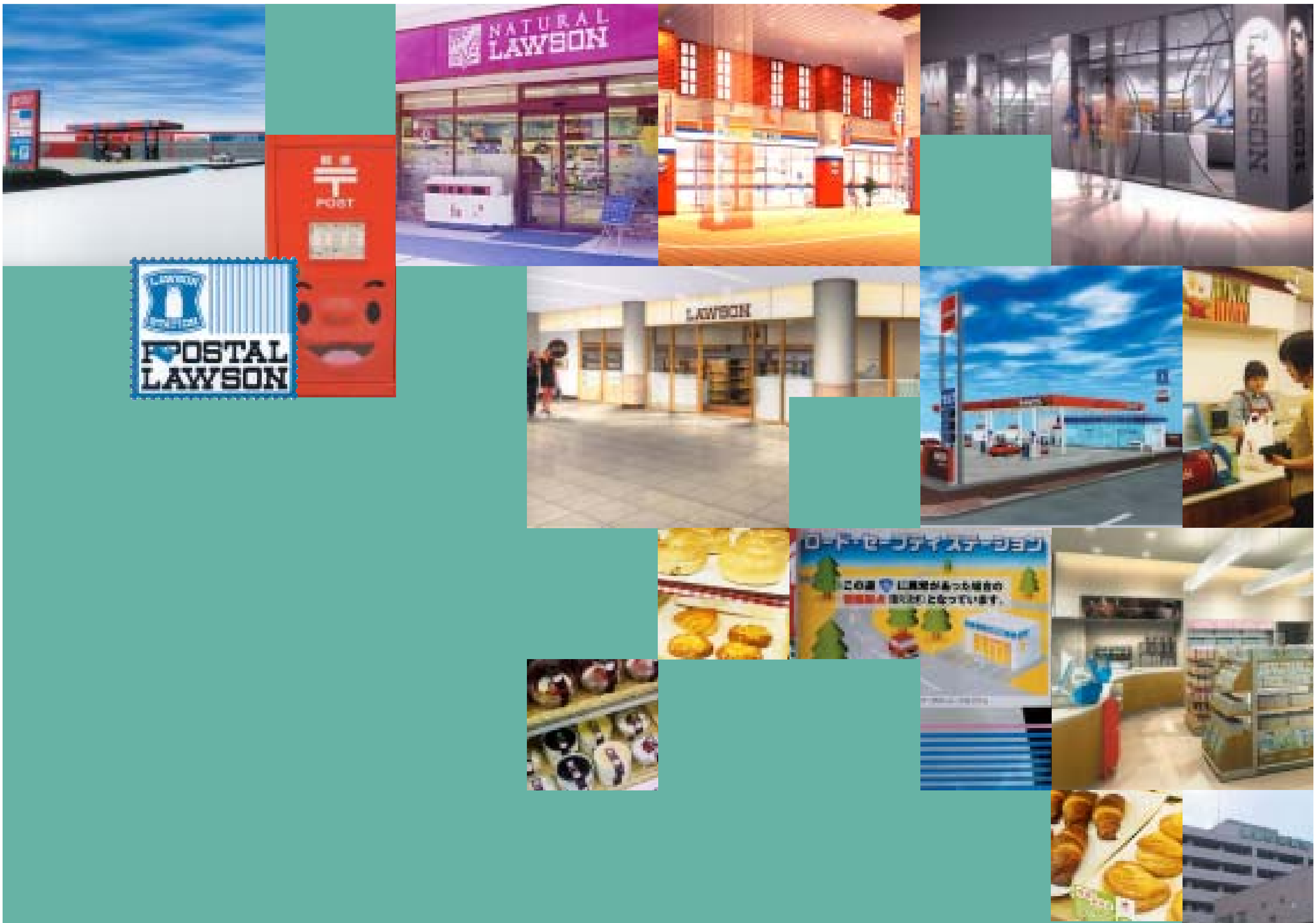
2

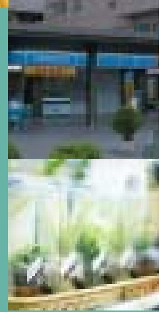
*The number of Postal Lawson stores*

SATOSHI KATAOKA *(Left)*
*General Manager*
*Postal Lawson Project Team*

KAZUYA NODA *(Right)*
*Postal Lawson Project Team*

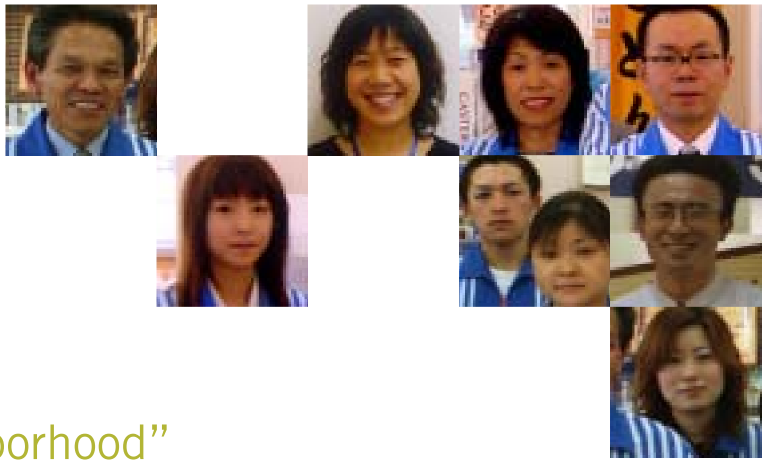
stores was slightly lower than the previous year due to the effects of the cool summer in 2003 and poor performances at stores opened in regional areas of Japan. LAWSON must open higher quality stores from the perspectives of new store earnings and new store ROI. That is why we are now reviewing our store development system, starting with the Kanto area. Our aim is to raise the precision of store opening by dividing responsibilities for corporate development, owner candidate development and sales forecasting, tasks that are crucial in planning quality stores. Previously, these tasks were performed almost entirely by Recruit Field Counselors (RFCs). Lawson's Epoch-making Total Strategic System (LETSS) is a strategic tool in reducing the ratio of stores with low daily sales by increasing the percentage of new store openings in prime locations in each region identified by the "grid point" system. By using its sophisticated mapping and data analysis capabilities, LETSS improves the efficiency of surveys and management of land and commercial districts, such as areas where store openings are planned. Aiming for even higher profits at new stores, we plan to make this system—and details of its success—available to our development corps across the country.



LAWSON is stealing a march on other convenience store chains with various new format stores. One is Natural Lawson, which continues to grow in stature as a brand in its own right. Then there is Hospital Lawson, Postal Lawson, convenience stores in banks, service station-based Lawson stores, and Lawson stores in subway concourses. And that is not to mention regular Lawson stores where customers can eat *Sanuki udon* in store.

# See the Difference



## “The ‘Hot’ Station in the Neighborhood”

“Since 2002, 50 CS (customer satisfaction) sessions have already been held. Originally, mainly for directors and managerial employees, these sessions are now being extended to encompass all employees. Discussions at CS sessions center on how to deal with others in a warm and kind manner. The desire to want to satisfy customers is so important, but customer satisfaction will be elusive without a willingness to show warmth and kindness. We want to be a company that values all people who have dealings with LAWSON: customers, franchise owners, store crew and so on.”

TOMOMI OKADA
*Customer Satisfaction Promotion Office*

Quality is the focus in the development of Lawson stores in China, too. Shanghai Hualian Lawson Co., Ltd., which is developing stores in Shanghai, had 146 stores as of February 29, 2004, an increase of 50 during the 2003 fiscal year. This company is planning to open 100 stores in fiscal 2004 as it advances locally both in name and substance.

*The number of Lawson stores as of February 29, 2004*
*Note: Includes Shanghai Hualian Lawson stores as of December 31, 2003 because this company has a December 31 fiscal year-end.*

### Business Alliances

LAWSON has been actively promoting business alliances. October 2003 saw the launch of a shared shopping rewards program for TSUTAYA card members of Culture Convenience Club Co., Ltd. And we are steadily building a deeper relationship with Japan Post. In addition to opening Postal Lawson stores in some post offices, we started selling stamps commemorating the victory of the Hanshin Tigers professional baseball team and started handling “*Furusato Kozutsumi*” small parcels at Lawson stores. Through these sorts of alliances, we are aiming to encourage new customers to use our stores and increase the visits of existing customers, which should translate into higher profits for franchised stores.

### About CSR (Corporate Social Responsibility)

LAWSON’s basic philosophy regarding environmental protection and social contribution activities is founded on co-existence. Business activities in harmony with the environment and activities that make a positive contribution to society are how we put this philosophy into action. Based on this philosophy, LAWSON continues activities designed to support greenification through the Lawson Green Fund. The number of activities was increased in fiscal 2003. As a result, the Lawson Green Fund has collected ¥1,547,362,695 since being started in 1992. Furthermore, with the aim of upgrading community services and promoting industry, LAWSON has entered into a regional joint business alliance program with Wakayama Prefecture and participated in the beautification activities of the Kobe Citizen Movement. Through these and other activities we are making an even greater contribution to society as a responsible member of the regions in which we are active. Another activity is participation in the Road Safety Station program at the request of Regional Development


LAWSON's vision of "the 'hot' station in the neighborhood" will not be achievable without the efforts, day in and day out, of owners and other frontline members of Lawson in all of Japan's 47 prefectures. Most of the new measures taken at LAWSON originate from the frontline. Realizing our vision, however, means consistently making sure we do the basics right.

# Experience the Difference

Bureaus of the Ministry of Land, Infrastructure and Transport. This program involves Lawson stores along state highways in the Chubu, Chugoku and Shikoku regions informing authorities of any abnormal road conditions. Beyond that it also encompasses cleaning walkways in front of stores and roadsides. LAWSON willingly agreed to participate because the cause matches the thrust of its "Every store can help" campaign launched in 1997.

## Cost Reductions

LAWSON has undertaken a sweeping review of raw materials and packing with suppliers in an effort to cut costs, an important theme at LAWSON. Due to progress made in cutting costs across the company, we are forecasting cost savings of several billion yen in fiscal 2004. These savings will offset increases in raw material prices and be used for procuring higher-quality raw materials and increasing purchased products in an effort to raise product quality. With respect to Head Office costs, we have worked to improve our profit structure by negotiating reduced IT-related expenditures and rent for existing stores. With respect to the regional headquarters system, which was introduced in March 2003, in addition to linking bonuses to results against clear regional headquarter profit targets, we are now better able to control costs as a result of delegating considerable decision-making authority. This, in turn, has sparked a heightened awareness of costs. We are also gradually seeing the results of developing products with a regional flavor.

## Measures in Fiscal 2004

Amid continuing uncertainty in the economic outlook and with no end in sight for deflation, the Japanese retailing industry is likely to experience increasingly intense competition across industries and business models.

As we aim to realize "the 'hot' station in the neighborhood" vision amid these conditions, we will work to raise customer satisfaction on three fronts: (1) the Three Challenge Practices and upgrading store leadership; (2) strengthening the product lineup; and (3) increasing customer satisfaction by increasing convenience. We plan to upgrade training programs not just for employees but also for store owners and crew, whose actions are also key to customer satisfaction on a day-to-day basis. By raising the level of customer satisfaction through the allocation of resources to education, we are aiming to engineer a transformation from a retail business that has stressed sales to one that places greater emphasis on customer satisfaction. We believe that this measure will yield higher earnings at franchise stores and as a result drive up LAWSON's own earnings. By promoting human resource education that highlights people, one of our key intangible assets, we will create a robust organization and establish a stronger LAWSON brand. Expect to see some exciting changes at LAWSON in the years ahead.

# Financial Section

# Consolidated Five-Year Summary

LAWSON, INC. and Consolidated Subsidiaries
Years Ended February

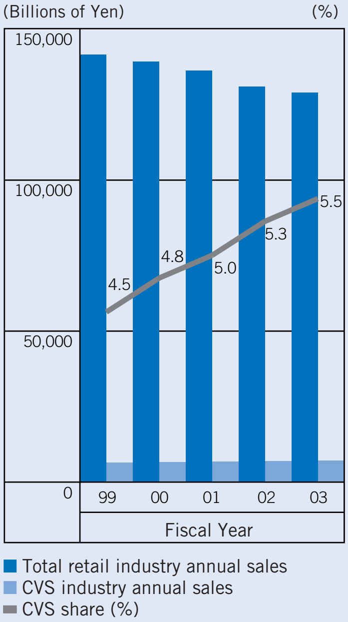
| | Millions of Yen | | | | | Thousands of U.S. Dollars[4] |
|---|---|---|---|---|---|---|
| | **2004** | 2003 | 2002 | 2001 | 2000 | **2004** |
| **For the year:** | | | | | | |
| Operating revenues | | | | | | |
| Franchise commission from franchised stores | **¥ 153,910** | ¥ 149,032 | ¥ 141,621 | ¥ 135,237 | ¥ 124,587 | **$ 1,404,032** |
| Net sales from company-operated stores | **67,479** | 80,954 | 101,353 | 132,921 | 149,458 | **615,572** |
| Other | **24,212** | 20,348 | 13,142 | 12,060 | 17,808 | **220,872** |
| Total operating revenues | **245,601** | 250,334 | 256,116 | 280,218 | 291,853 | **2,240,476** |
| Operating income | **38,087** | 34,107 | 36,363 | 41,279 | 40,185 | **347,446** |
| Net income | **18,571** | 8,861 | 16,123 | 16,368 | 15,011 | **169,413** |
| Cash flows from operating activities | **37,424** | 33,860 | 44,804 | 52,793 | 67,790 | **341,398** |
| Cash flows from investing activities | **(40,621)** | (3,787) | (44,031) | (54,696) | 121,758 | **(370,563)** |
| Cash flows from financing activities | **(14,364)** | (7,247) | (58,236) | 18,707 | (92,521) | **(131,034)** |
| Capital expenditure | **33,968** | 37,712 | 35,571 | 32,651 | 30,703 | **309,870** |
| Depreciation and amortization[1] | **18,499** | 16,071 | 16,328 | 16,021 | 15,017 | **168,756** |
| **At year-end:** | | | | | | |
| Total assets | **¥ 354,831** | ¥ 342,599 | ¥ 342,934 | ¥ 387,236 | ¥ 339,413 | **$ 3,236,918** |
| Total shareholders' equity | **154,317** | 151,864 | 149,827 | 178,448 | 95,932 | **1,407,745** |
| Interest-bearing debt | **–** | – | 3,140 | 23,530 | 71,817 | **–** |
| Ratio of interest-bearing debt (%) | **–** | – | 0.9 | 6.1 | 21.1 | **–** |
| Cash and cash equivalents | **76,389** | 93,994 | 71,269 | 128,655 | 111,753 | **696,853** |
| Total number of stores | **7,967** | 7,721 | 7,824 | 7,749 | 7,432 | |
| Number of employees (Full-time) | **3,148** | 3,462 | 3,817 | 4,170 | 4,234 | |

| | Yen | | | | | U.S. Dollars |
|---|---|---|---|---|---|---|
| **Per share data:** | | | | | | |
| Net income[2] | **¥ 176** | ¥ 82 | ¥ 146 | ¥ 148 | ¥ 143 | **$ 1.61** |
| Cash dividends[2] | **41** | 41 | 41 | 35 | 17 | **0.37** |
| **Financial data:** | | | | | | |
| ROE | **12.1%** | 5.9% | 9.8% | 11.9% | 16.8% | |
| ROA | **5.3** | 2.6 | 4.4 | 4.5 | 4.0 | |
| **Net sales of all stores:** | | | | | | |
| Net sales by store category | | | | | | |
| Franchised stores[3] | **¥1,220,819** | ¥1,213,088 | ¥1,184,204 | ¥1,144,717 | ¥1,073,422 | **$11,136,827** |
| Company-operated stores | **67,479** | 80,954 | 101,353 | 132,921 | 149,458 | **615,572** |
| Net sales by product category[3] | | | | | | |
| Processed foods | **625,031** | 600,508 | 583,712 | 562,777 | 528,188 | **5,701,797** |
| Fast foods | **302,568** | 303,098 | 297,030 | 362,979 | 350,702 | **2,760,153** |
| Daily delivered foods | **139,506** | 138,353 | 150,862 | 90,569 | 89,248 | **1,272,633** |
| Non-food products | **221,192** | 252,083 | 253,953 | 261,313 | 254,742 | **2,017,806** |
| Net sales of all stores | **¥1,288,297** | ¥1,294,042 | ¥1,285,557 | ¥1,277,638 | ¥1,222,880 | **$11,752,390** |

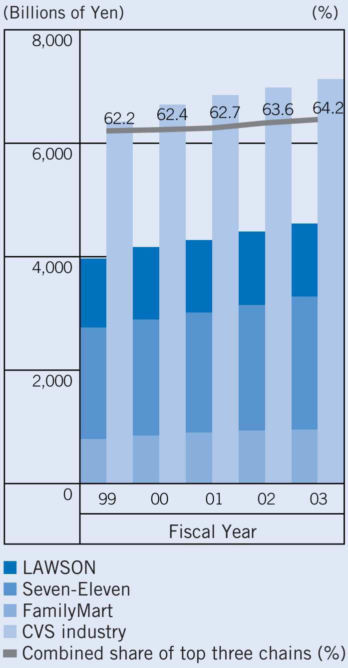
*Notes: 1. Including depreciation and amortization of intangible fixed assets.*
*2. The data has been restated to reflect the 1 to 50 stock split on April 14, 2000.*
*3. These figures, as reported by franchised stores, are unauditied.*
*4. The U.S. dollar amounts represent translations of Japanese yen at the approximate exchange rate at February 29, 2004, of ¥109.62=$1.*

# Management's Discussion and Analysis

## CVS Share of the Total Retail Market




## Share of CVS Market Held by Top Three Chains (Sales)




## Overview

Amid persistent deflationary trends, retailing industry realignment in Japan has accelerated in recent years. This has been driven by intensifying competition transcending businesses and business models in the past few years, and the entry of major foreign retailers to the Japanese market.

Even as the retailing industry as a whole contracts, the Japanese convenience store sector continues to expand, albeit at a slower pace than in the past. Convenience stores continue to account for an increasing share of total retail sales in Japan, with signs of a recovery in year-on-year decline in same-store sales and other factors. Major convenience store chains have been pushing ahead with the closure of unprofitable stores such as those with low daily sales, while at the same time actively relocating stores.

As the networks of large chains grow, the number of stores at other convenience store companies is falling. As a result, the leading industry players are accounting for an increasing share of the market. This trend is expected to continue in the future.

Competition is also expected to escalate in the convenience store industry due to competition from other industries and business models such as supermarkets, which are extending their operating hours, retailers operating around the clock and the restaurant industry. Also fueling competition is an increasing number of stores, the result of expansion of the industry's largest players into new areas and other factors.

In this climate, LAWSON will be required to have the flexibility to adroitly respond to the market and make speedy decisions in response to changing undercurrents in society and customer needs.

## Convenience Store (CVS) Share of the Total Retail Market

(Billions of Yen)

| | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| Total retail industry annual sales | **¥128,871** | ¥130,760 | ¥136,087 | ¥139,132 | ¥141,450 |
| CVS industry annual sales | **7,133** | 6,980 | 6,846 | 6,680 | 6,383 |
| CVS share | **5.5%** | 5.3% | 5.0% | 4.8% | 4.5% |

Based on data in the "Survey of Commerce" published by the Ministry of Economy, Trade and Industry.

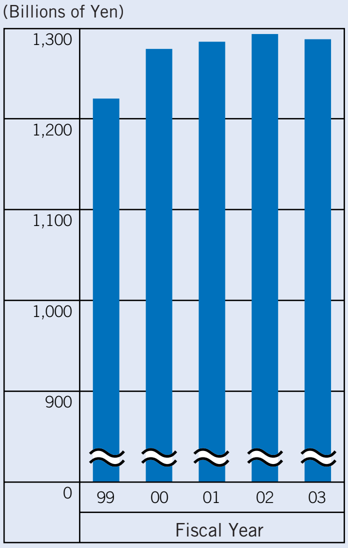
## Share of CVS Market Held by Top Three Chains (Sales)

(Billions of Yen)

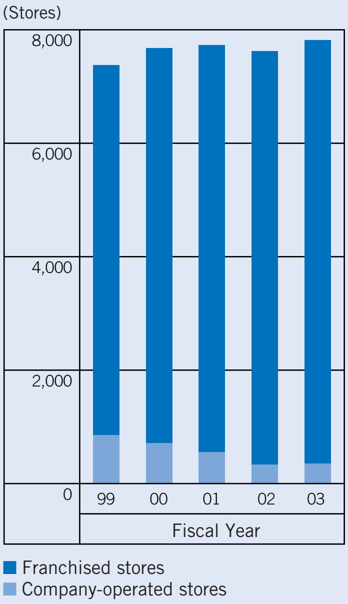
| | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| LAWSON | ***¥1,285** | ¥1,294 | ¥1,282 | ¥1,275 | ¥1,221 |
| Seven-Eleven | **2,343** | 2,213 | 2,114 | 2,047 | 1,964 |
| FamilyMart | **954** | 932 | 899 | 843 | 783 |
| Sales of top three companies | **4,582** | 4,439 | 4,295 | 4,165 | 3,968 |
| Share of top three companies | **64.2%** | 63.6% | 62.7% | 62.4% | 62.2% |
| CVS industry | **7,133** | 6,980 | 6,846 | 6,680 | 6,383 |

*The discontinuation of sales of the high-priced Highway Card series reduced earnings by approximately ¥22.0 billion.

## Total Net Sales (Consolidated)




## Total Number of Stores (Consolidated)




## RISK FACTORS IN THE OPERATING ENVIRONMENT

LAWSON believes the following are the five main risk factors in the convenience store industry.

(1) Trends in Japan: Due to Japan's low birthrate and aging population, the number of people in their twenties and thirties, the original target market for convenience store operators, is dwindling. This is creating a greater need for convenience stores to attract more middle-aged, senior citizen and female customers. As the customer mix changes so too do the demands placed on convenience stores. LAWSON's inability to respond to customer needs, could result in lower sales at Lawson stores adversely affecting earnings.

(2) Greater competition: The restaurant industry, drug stores and other types of businesses and business models are fanning competition in the convenience store industry. As a result, it is becoming more difficult to boost sales with a standard product lineup and by using the same store operation standards uniformly in all convenience stores nationwide. The inability of LAWSON to distinguish itself through products tailored to a particular region and on an "individual store" basis, could result in lower sales at Lawson stores adversely affecting earnings.

(3) Sharp rises in raw material prices: A spike in the price of rice and rising costs of other ingredients due to BSE outbreaks and other problems has affected earnings in mainstay rice dishes, such as rice balls. Sudden rises in the price of ingredients could also adversely affect LAWSON's earnings in other product lines.

(4) Deregulation: With supermarkets extending operating hours, more businesses opening for 24 hours, and other trends, customers are being handed an increasing number of shopping choices, undermining one of the strengths of convenience stores, namely, their convenience. The inability to provide products and services that only LAWSON could offer, could result in lower sales at Lawson stores adversely affecting earnings.

(5) Weather conditions: LAWSON must source products and take other actions in its business based on a sufficient understanding of the weather conditions specific to each region in the country. Furthermore, changes in sales caused by changes in weather patterns, such as a cool summer or mild winter, could adversely affect earnings.

## STORE OPERATION ANALYSIS

### Net Sales

Net sales at all Lawson stores edged down 0.4% to ¥1,288,297 million in the fiscal year ended February 29, 2004. This primarily reflected lower sales during the traditionally busy summer months due to an extended spell of cool weather and the effect of discontinuing sales of the high-priced Highway Card series.

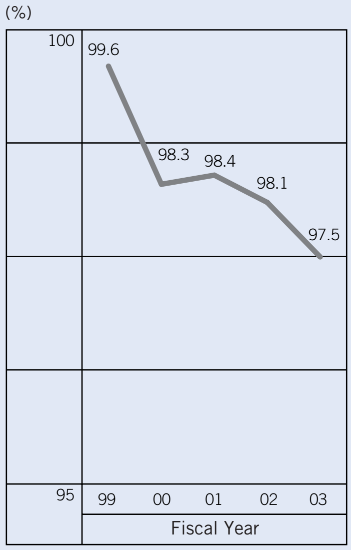
By product category, sales of processed foods and daily delivered foods increased, while sales of fast foods and non-food products decreased.

### Existing Store Sales

Existing store sales declined in the year under review, marking the sixth consecutive year of decline from the fiscal year ended February 28, 1999. Although consumer spending tended toward recovery, an extended period of deflation, intense price and value-based competition from the ready-made food and restaurant industries, changes in the operating environment, such as extended operating hours and the start of 24-hour operations by supermarkets and other retailers, and regional macroeconomic factors all contributed to the sales decline. Through a refined infrastructure that concentrates the production of mainstay rice dishes in a smaller number of vendors, namely mega vendors, LAWSON is attempting to drive sales growth by developing new *bento*-boxes, rice balls and other products in this category.

## Average Number of Customers (Per Day) and Average Transaction Value (Per Customer)


## Existing Store Sales (Compared With Previous Year)




## Sales by Product Category

Sales of processed foods increased 4.0% on growth in sales of LAWSON's series of ¥100 confections and tobacco products. Sales of daily delivered foods edged up 0.8% on strong sales in the bakery category, particularly of the *Totte Oki Sengen* series of original breads. Fast foods sales edged down 0.2% due to lackluster sales of delicatessen items and rice dishes. Nevertheless, total food sales were up 2.4% year on year. Sales of non-food products dipped 12.3% due to the discontinuation of the high-priced Highway Card series and weak sales of magazines and other products, despite strong sales of hardcover books.

### Breakdown of Net Sales by Product Segment

(Millions of Yen)

| | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| Processed foods | ¥ 625,031 | ¥ 600,508 | ¥ 583,712 | ¥ 562,777 | ¥ 528,188 |
| Fast foods | 302,568 | 303,098 | 297,030 | 362,979 | 350,702 |
| Daily delivered foods | 139,506 | 138,353 | 150,862 | 90,569 | 89,248 |
| Total food sales | 1,067,105 | 1,041,959 | 1,031,604 | 1,016,325 | 968,138 |
| Non-food products | 221,192 | 252,083 | 253,953 | 261,313 | 254,742 |
| Net sales at all stores | ¥1,288,297 | ¥1,294,042 | ¥1,285,557 | ¥1,277,638 | ¥1,222,880 |

### Ratio of Net Sales by Product Segment

(%)

| | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| Processed foods | 48.5% | 46.4% | 45.4% | 44.1% | 43.2% |
| Fast foods | 23.5 | 23.4 | 23.1 | 28.4 | 28.7 |
| Daily delivered foods | 10.8 | 10.7 | 11.7 | 7.1 | 7.3 |
| Total food sales | 82.8 | 80.5 | 80.2 | 79.6 | 79.2 |
| Non-food products | 17.2 | 19.5 | 19.8 | 20.4 | 20.8 |
| Net sales at all stores | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

*Effective from the fiscal year ended February 28, 2003, bakery items were reclassified from "fast foods" to "daily delivered foods," while some pickles and some delicatessen items were reclassified from "daily delivered foods" to "fast foods." Figures for the fiscal year ended February 28, 2002 were restated to conform to the fiscal year ended February 28, 2003 classifications to facilitate comparison.

### Gross Profit Ratio by Product Segment

(%)

| | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| Fast foods | 35.6% | 35.7% | 33.7% | 34.3% | 34.1% |
| Daily delivered foods | 32.5 | 32.5 | 35.0 | 34.9 | 34.6 |
| Processed foods | 26.9 | 27.3 | 27.3 | 27.2 | 27.7 |
| Non-food products | 33.4 | 29.9 | 30.5 | 29.6 | 28.8 |

*The gross profit ratio in the fiscal year ended February 28, 2003 was 30.5%, excluding the effect of the Highway Card series.
*The gross profit ratio in the fiscal year ended February 29, 2004 was 30.2%, excluding the effect of the Highway Card series.
*The gross profit for non-food products includes commissions.
*Tobacco is included in processed foods.

## Store Network

In the year under review and continuing on from the previous fiscal year, LAWSON engaged in the pursuit of higher earnings at new stores, placing greater emphasis on returns on investment based on store opening standards specific to each region. While working to open stores in a manner that places priority on profitability, LAWSON actively closed or relocated low-volume and unprofitable stores. As a result, there were 625 store openings in the past fiscal year and 429 store closings, including store relocations. The net increase of 196 in the number of stores meant there were 7,821 Lawson stores in Japan at February 29, 2004.

While LAWSON achieved a net increase in the number of stores in this way, it believes it must pay even closer attention to profitability when opening stores. Placing emphasis on the quality of new stores results in an improvement in same-store sales figures in the following year and a consequential improvement in returns on investment in the Lawson chain as a whole. In the fiscal year ended February 29, 2004, the profitability of new stores declined slightly in regional areas due to the effect of a cool summer and other factors.

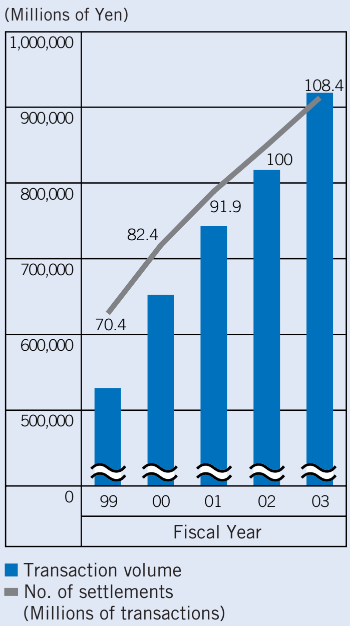
In the People's Republic of China, Shanghai Hualian Lawson Co., Ltd. increased its store network in the Shanghai area by 50 to 146 stores. Including these stores, this gave LAWSON a total network of 7,967 stores.

### Number of Stores in LAWSON Network Years Ended February

| | **2004** | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| Number of stores | **7,967** | 7,721 | 7,824 | 7,749 | 7,432 |
| Openings | **687** | 519 | 626 | 739 | 718 |
| Closings | **441** | 622 | 551 | 422 | 352 |
| Net increase (decrease) | **246** | (103) | 75 | 317 | 366 |

*Shanghai Hualian Lawson Co., Ltd. has a December 31 balance sheet date.

## Third-Party Bill Settlement Service




## Number of Stores by Contract Type

Lawson stores are operated under three different types of contract: FC-B, FC-G and FC-C.

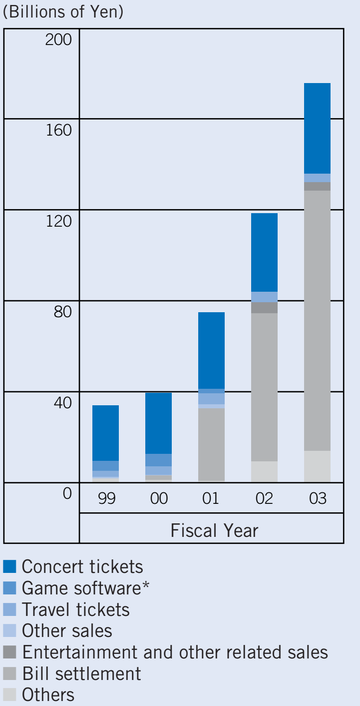
Under FC-B-type contracts, the franchise owner provides the store property and operates the store. The owner is not therefore required to pay LAWSON a guarantee deposit.

Under FC-G and FC-C contracts, LAWSON provides the store property to franchise owners without property, who operate the store on a contract basis. Franchise owners with an FC-G contract must pay a guarantee deposit, but franchise commissions are set lower than for FC-C contracts. Details of each type of contract are shown in the following table.

### Outline of Store Contracts

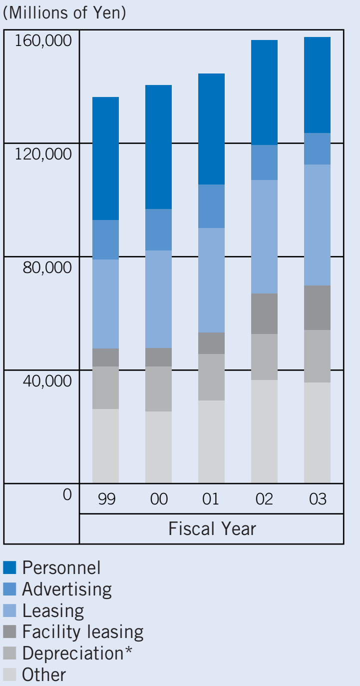
| Contract type | FC-G | FC-C | FC-B |
|---|---|---|---|
| Contract term | 10 years from store opening day | | |
| Contract store | Stores already opened or slated to open | | Own property |
| Franchise fee | ¥1.5 million (Contract fee ¥0.5 million, training expenses ¥0.5 million, store opening preparation commission ¥0.5 million) | | |
| Investment | ¥1.5 million (Incl. payment for some merchandise purchased on behalf of the store) | | |
| Opening preparation expenses | ¥0.5 million (Till cash and application for permission to open, etc.) | | |
| Guarantee deposit | Average monthly sales x 2 months | Not required | – |
| Franchisee income | Gross profit×55% | Gross profit×50% | Gross profit×66% |

## Loppi (Multimedia Terminal) Transaction Volume




*From fiscal 2002, sales of game software are inclued in entertainmenrt and other related sales.

## Breakdown of Selling, General and Administrative Expenses




*Including depreciation and amortization of intangible fixed assets.

## Number of Stores by Contract Type Years Ended February

| | **2004** | 2003 | 2002 | YoY Changes |
|---|---|---|---|---|
| FC-B | **1,992** | 2,200 | 2,412 | (208) |
| FC-G | **2,415** | 2,446 | 2,459 | (31) |
| FC-C | **3,065** | 2,645 | 2,308 | 420 |
| Franchised stores | **7,472** | 7,291 | 7,179 | 181 |
| Company-operated stores | **349** | 334 | 555 | 15 |
| Total | **7,821** | 7,625 | 7,734 | 196 |

### Store Opening Strategy

In the fiscal year ending February 28, 2005, LAWSON's store openings will continue to be centered on large metropolitan areas, namely Tokyo, Nagoya and Osaka. Store openings will focus on areas with demand, with Tokyo being a particular focus. New store profitability and ROI, rather than daily sales, will be the benchmark for the opening of high-quality stores.

### Placement of ATMs in Stores

Since October 2001, LAWSON and subsidiary LAWSON ATM Networks, Inc. have been placing ATMs in Lawson stores. LAWSON has ATM alliances with city banks, including all four of Japan's major banking groups, as well as large regional banks. In the fiscal year ended February 29, 2004, LAWSON installed ATMs in 17 prefectures, adding Kyoto, Hiroshima, Yamaguchi and Fukuoka. In the year ending February 28, 2005, LAWSON plans to strengthen alliances with regional banks and take other actions so as to have around 3,500 ATMs installed in its stores by the end of the fiscal year.

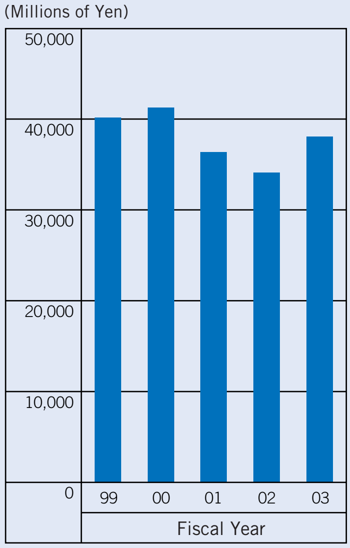
Since March 2004, holders of postal savings cards have been able to use all ATMs in Lawson stores, increasing convenience for customers. As of February 29, 2004, a total of 3,127 ATMs were operating at Lawson stores.

### New Format Stores

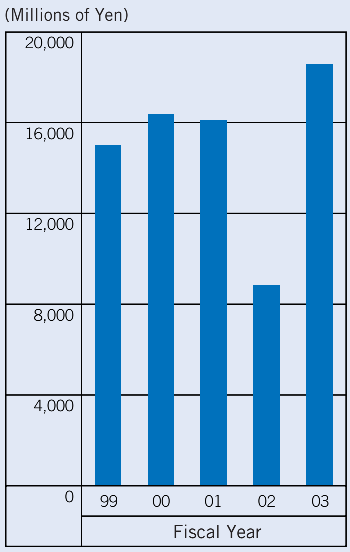
In February 2001, LAWSON launched a new format store called Natural Lawson. Aiming to move from an R&D phase to the full-scale opening of multiple stores, LAWSON in April 2004 separated Natural Lawson from the company to expedite the opening of stores and raise profitability.

LAWSON is also developing what it calls Hospital Lawson, of which there were seven stores at February 29, 2004. Eyeing new business opportunities created by Japan's ageing society, LAWSON intends to expand this new format in future years. And through alliances with other companies, LAWSON is entering other new trading spheres and locations. In an alliance with Japan Post, for example, LAWSON has opened Postal Lawson stores, and a tie-up with Tokyo Metro Co., Ltd. has led to the opening of Metropia stores in subway concourses. Furthermore, LAWSON has opened stores inside the premises of financial institutions and a deal with Nippon Oil Corporation has led to the establishment of convenience stores at ENEOS self-service stations. LAWSON is determined to continue looking for new sites to establish stores as it pursues innovative store development and new business opportunities.

## Operating Income




## Net Income




## INCOME AND EXPENSES

Operating revenues decreased ¥4,733 million, or 1.9%, to ¥245,601 million. There were increases in franchise commissions due to higher sales at franchised stores and in ATM fees at subsidiary LAWSON ATM Networks. However, this growth was outweighed by sales decreases resulting from a decline in the number of business days at company-operated stores.

Operating income increased ¥3,980 million, or 11.7%, to ¥38,087 million. This reflected a ¥9,831 million decrease in the cost of sales for company-operated stores and LAWSON's success in holding selling, general and administrative expenses to an increase of ¥1,118 million; this increase was attributable to higher ATM operating expenses, store rents and other factors.

Income before income taxes and minority interests rose ¥15,320 million, or 87.0%, to ¥32,923 million. This reflected the absence of higher severance benefit payments recorded in the previous fiscal year and a ¥5,884 million decrease in loss on disposal of property and store equipment due to the steady progress that has been made since the start of Lawson Challenge 2004 in dealing with unprofitable assets. Other main factors behind the net result were a ¥1,006 million decrease in equity in losses of associated companies related to LAWSON CS Card, INC. and a ¥11,340 million decrease in other expenses—net. Net income increased ¥9,710 million, or 109.6%, to ¥18,571 million, and net income per share was ¥176.

## Regional Headquarters

| | Hokkaido | Tohoku | Kanto | Chubu | Kinki | Chugoku & Shikoku | Kyusyu | Total |
|---|---|---|---|---|---|---|---|---|
| Total sales (Millions of Yen) . . . . | ¥66,723 | ¥101,167 | ¥360,560 | ¥171,924 | ¥293,160 | ¥139,468 | ¥146,257 | ¥1,279,259 |
| Share (%) . . . . . . . | 5.2% | 7.9% | 28.2% | 13.4% | 22.9% | 10.9% | 11.4% | |
| Existing store sales YoY (%) . . . . . . . . . . | 97.8% | 98.1% | 99.7% | 99.6% | 97.9% | 99.2% | 98.7% | 99.2% |
| No. of stores . . . . . . . | 485 | 646 | 2,108 | 1,071 | 1,756 | 827 | 900 | 7,793* |
| Share (%) . . . . . . . | 6.2% | 8.3% | 27.1% | 13.7% | 22.5% | 10.6% | 11.5% | |

*The 28-store difference from the 7,821 store total at February 29, 2004 represents company-operated stores.

## Subsidiaries

The consolidated financial statements include four consolidated subsidiaries and one equity-method affiliate. The LAWSON group of companies is primarily engaged in convenience store operations, ticket sales, e-commerce and financial services. The operating results of consolidated subsidiaries were as follows.

## Profiles

### *Lawson Tickets Co., Ltd. (Consolidated subsidiary)*

Sales of tickets to concerts, sporting events, movies and other events, mainly through *Loppi* multimedia terminals at Lawson stores.

### *Shanghai Hualian Lawson Co., Ltd. (Consolidated subsidiary)*

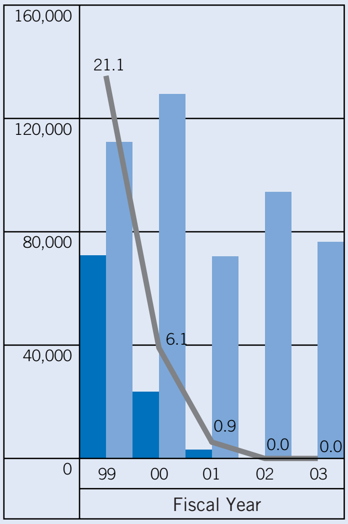
This consolidated subsidiary is developing a chain of Lawson stores in Shanghai, the People's Republic of China. In June 2004, LAWSON sold 21.0% of its 70.0% equity interest in Shanghai Hualian Lawson Co., Ltd. to Hualian Group Corporation, leaving it with a stake of 49.0%.

### *i-Convenience, Inc. (Consolidated subsidiary)*

Operation of the official "iLAWSON" i-mode Internet site, including merchandise sales and the provision of services and information.

## Interest-bearing Debt, Cash and Cash Equivalents and Ratio of Interest-bearing Debt

(Millions of Yen) (%)




■ Interest-bearing debt
■ Cash and cash equivalents
■ Ratio of interest-bearing debt

## Return on Equity Return on Assets

(%)


■ Return on Equity
■ Return on Assets

### *LAWSON ATM Networks, Inc. (Consolidated subsidiary)*

Placement, management and operation of jointly operated ATMs in Lawson stores; outsourcing of clerical tasks for partner banks involving financial services such as deposits, withdrawals and fund transfers performed through these ATMs.

### *LAWSON CS Card, INC. (Equity-method affiliate)*

Issues credit cards to Lawson customers and extends card-based services through *Loppi* terminals and other channels.

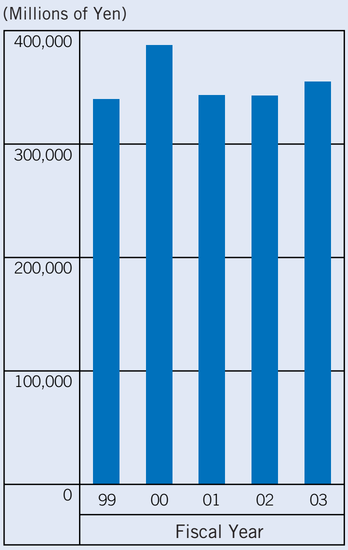
## Operating Results of Group Companies

(Millions of Yen)

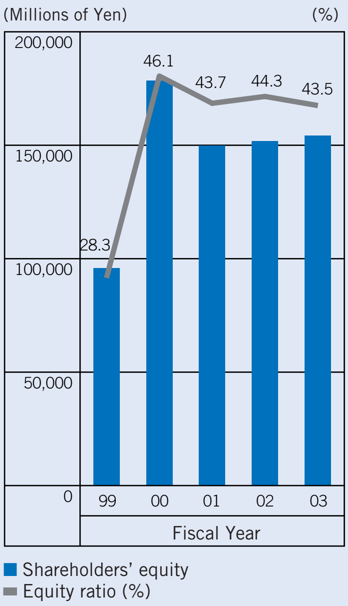
| | Lawson Tickets Co., Ltd. | Shanghai Hualian Lawson Co., Ltd.* | LAWSON ATM Networks, Inc. | i-Convenience, Inc. | LAWSON CS Card, INC. |
|---|---|---|---|---|---|
| | Consolidated subsidiary | Consolidated subsidiary | Consolidated subsidiary | Consolidated subsidiary | Equity-method affiliate |
| 2001 | | | | | |
| Operating revenues . . . . . . . . . . . | ¥4,514 | ¥2,292 | ¥ – | ¥ 0 | ¥ – |
| Operating income (loss) . . . . . . . | 510 | (149) | – | (58) | – |
| Net income (loss) . . . . . . . . . . . . | 642 | (168) | – | (70) | – |
| 2002 | | | | | |
| Operating revenues . . . . . . . . . . . | ¥5,119 | ¥3,033 | ¥1,248 | ¥ 103 | ¥ 0 |
| Operating income (loss) . . . . . . . | 508 | (183) | (303) | (473) | (1) |
| Net income (loss) . . . . . . . . . . . . | 275 | (146) | (326) | (470) | (5) |
| 2003 | | | | | |
| Operating revenues . . . . . . . . . . . | ¥5,425 | ¥2,642 | ¥6,718 | ¥ 213 | ¥ 858 |
| Operating income (loss) . . . . . . . | 788 | (191) | (529) | (383) | (3,935) |
| Net income (loss) . . . . . . . . . . . . | 387 | (190) | (529) | (489) | (3,936) |
| **2004** | | | | | |
| Operating revenues . . . . . . . . . . . | **¥6,187** | **¥2,024** | **¥8,352** | **¥ 333** | **¥ 2,551** |
| Operating income (loss) . . . . . . . | **644** | **(81)** | **(348)** | **(241)** | **(2,255)** |
| Net income (loss) . . . . . . . . . . . . | **387** | **(71)** | **(350)** | **(663)** | **(2,256)** |

*Shanghai Hualian Lawson Co., Ltd. has a December 31 balance sheet date.

## Total Assets




## Shareholders' Equity and Equity Ratio




## SPECIAL FEATURES OF LAWSON'S FINANCIAL STATEMENTS

The following items are special features of LAWSON's financial statements.

(1) Due From Franchised Stores: LAWSON purchases in bulk products ordered by all franchised stores and calculates and pays amounts payable for such to the vendors on the stores' behalf as the stores' representative. LAWSON records the cost of the merchandise in the "Accounts receivable—Due from franchised stores" account since such costs are recovered from franchised stores. Due from franchised stores represents mainly the obligations of franchised stores to Head Office for these amounts at the balance sheet date. As of February 29, 2004, this asset account was ¥18,628 million, ¥11,589 million higher than a year ago, the result of an increase in unremitted sales and other amounts as the fiscal year-end fell on a Sunday.

(2) Accounts Receivable—Other: This account mainly represents accrued income due from Lawson Tickets and credit card companies. As of February 29, 2004, this account was ¥18,028 million, ¥2,064 million higher than a year ago because of an increase in the volume of transactions and other factors.

(3) Long-Term Loans Receivable: This account mainly represents money paid to landlords to help with construction and investments and finance from Head Office to franchised stores. As of February 29, 2004, this account was ¥13,109 million, an increase of ¥4,151 million due to an increase in money paid to landlords to help with construction.

(4) Lease Deposits: This account represents leasehold deposits equivalent to several months' rent under lease agreements at LAWSON. As of February 29, 2004, this account was ¥90,496 million, an increase of ¥997 million due to a net increase of 196 in the number of stores in Japan.

(5) Due to Franchised Stores: This account represents Head Office obligations to franchised stores. If franchised store remittances of cash proceeds from daily sales to the Company exceed the balance of "Accounts receivable—Due from franchised stores," the excess will be shown on the balance sheet as "Accounts payable—Due to franchised stores." As of February 29, 2004, this amount was ¥1,402 million, down ¥3,397 million from a year ago.

(6) Money Held as Agent: This is money held on behalf of third-party companies for which LAWSON provides bill settlement services. As of February 29, 2004, this account was ¥43,745 million, ¥10,715 million higher than a year ago due mainly to the delayed payment of this money to third-party companies because the fiscal year-end fell on a Sunday.

(7) Guarantee Deposits Received From Franchised Stores: This represents guarantee deposits received by LAWSON from stores owners operating under FC-G-type contracts. As of February 29, 2004, this account was ¥52,574 million, ¥1,633 million less than a year ago due to a decline in the number of FC-G-type contract stores.

## FINANCIAL POSITION

Current assets increased ¥6,714 million, or 5.1%, to ¥137,662 million. There was a ¥6,751 million decrease in cash and bank deposits due to the repurchase of treasury stock and other factors. On the other hand, there was a ¥11,589 million increase in "Due from franchised stores" due to the fiscal year-end falling on a Sunday, and the recording of ¥6,250 million as short-term loans receivable.

Property and store equipment increased ¥5,699 million, or 7.3%, to ¥83,272 million, the result of an ¥11,096 million increase in buildings, which was in line with the increase in the number of stores. Furniture, fixtures and equipment increased ¥2,772 million, mainly representing purchases of fixtures.

Investments and other assets decreased ¥181 million to ¥133,897 million. The main reason was a decrease of ¥2,368 million in software.

Current liabilities increased ¥13,512 million, or 10.5%, to ¥142,598 million. This was due mainly to a ¥3,397 million decrease in "Due to franchised stores" and a ¥10,715 million increase in money held as agent as the payment of the proceeds of bill settlement services on behalf of third-party companies was held over until the following month because the fiscal year-end fell on a Sunday.

Long-term liabilities decreased ¥4,395 million, or 7.4%, to ¥55,024 million. This was mainly due to a ¥2,642 million decrease in liability for employees' retirement benefits due to the voluntary disaffiliation from the Daiei Employees' Pension Fund and a ¥1,633 million decline in guarantee deposits received from franchised stores due to a decrease in the number of stores operating under franchise agreements requiring the payment of a guarantee deposit.

Shareholders' equity increased ¥2,453 million, or 1.6%, to ¥154,317 million. The repurchase of treasury stock lowered shareholders' equity by ¥11,532 million while net income of ¥18,571 million bolstered retained earnings. As a result, the equity ratio decreased by 0.8 of a percentage point to 43.5%.

In light of a forecast for stable growth and other factors, the company has decided to raise the total annual dividend from ¥41 to ¥70 per share. Based on its stance of returning profits to shareholders in a stable manner, the company is targeting a payout ratio of around 35%.

LAWSON will operate a flexible corporate finance policy moving forward, continuing to efficiently use its strong balance of cash and reducing equity through dividends, retirement of treasury stock and in other ways from the perspective of returning profits to shareholders.

## CAPITAL EXPENDITURE

Capital expenditure in the fiscal year ended February 29, 2004 was ¥33,968 million, ¥3,744 million less than in the previous fiscal year. In the year under review, LAWSON concentrated its energies on opening stores in conformity with new standards emphasizing profitability. While this approach resulted in the decrease in total capital expenditure, investment in new stores increased ¥2,789 million year on year to ¥14,296 million. The main components of capital expenditure are shown in the following table.

### Capital Expenditure

(Millions of Yen)

| | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| New store investments ........ | **¥14,296** | ¥11,507 | ¥15,807 | ¥21,300 | ¥21,380 |
| Existing store investments ...... | **10,432** | 12,028 | 8,863 | 5,919 | 6,009 |
| Systems-related investments .... | **2,191** | 9,133 | 10,045 | 4,794 | 1,925 |
| Investments and advances ..... | **6,250** | 3,550 | 380 | – | – |
| Other .................... | **799** | 1,494 | 476 | 638 | 1,389 |
| Total .................... | **¥33,968** | ¥37,712 | ¥35,571 | ¥32,651 | ¥30,703 |

## CASH FLOWS

Net cash provided by operating activities increased ¥3,564 million to ¥37,424 million. While there was an increase of ¥10,968 million in increase in accounts receivable, income before income taxes and minority interests increased ¥15,320 million.

Net cash used in investing activities increased ¥36,834 million to ¥40,621 million. There was a ¥7,435 million decrease in payments for intangible fixed assets due to lower investments in store systems. However, the net result of purchase of and proceeds from redemption of marketable securities was a ¥28,692 million decrease in cash provided from the previous fiscal year. There was also a ¥8,297 million decrease in proceeds from sale of investment securities, and there were cash outflows of ¥25,960 million for the purchase of property and store equipment and intangible fixed assets.

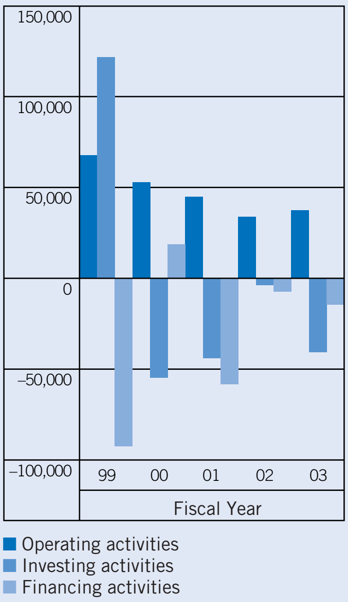
Free cash flows, the sum of operating and investing cash flows, decreased ¥4,578 million to ¥602 million, excluding gains on securities.

Net cash used in financing activities increased ¥7,117 million to ¥14,364 million. Proceeds from minority shareholders increased ¥1,241 million due to an increase in capital via private placement at consolidated subsidiary Lawson Tickets. This was exceeded by an increase of ¥11,548 million in cash used for the repurchase of treasury stock.

The net result of these cash flows was a ¥17,605 million decrease in cash and cash equivalents to ¥76,389 million.

## Cash Flows

(Millions of Yen)



# Consolidated Balance Sheets

LAWSON, INC. and Subsidiaries
February 29, 2004 and February 28, 2003

| ASSETS | Millions of Yen 2004 | Millions of Yen 2003 | Thousands of U.S. Dollars (Note 1) 2004 |
|---|---|---|---|
| **CURRENT ASSETS:** | | | |
| Cash and cash equivalents | ¥ 76,389 | ¥ 93,994 | $ 696,853 |
| Time deposits | 4 | 150 | 36 |
| Marketable securities (Note 5) | 9,244 | 5,445 | 84,328 |
| Accounts receivable: | | | |
| Due from franchised stores (Notes 3 and 9) | 18,628 | 7,039 | 169,932 |
| Other | 18,028 | 15,964 | 164,459 |
| Allowance for doubtful accounts | (132) | (93) | (1,204) |
| Inventories | 1,497 | 1,492 | 13,656 |
| Short-term loans receivable to associated company (Note 14) | 6,250 | | 57,015 |
| Deferred tax assets (Note 12) | 2,818 | 2,445 | 25,707 |
| Prepaid expenses and other current assets | 4,936 | 4,512 | 45,028 |
| Total current assets | 137,662 | 130,948 | 1,255,810 |
| **PROPERTY AND STORE EQUIPMENT** (Note 4)**:** | | | |
| Land (Note 6) | 4,938 | 6,178 | 45,047 |
| Buildings | 99,812 | 88,716 | 910,526 |
| Furniture, fixtures and equipment | 57,437 | 54,665 | 523,965 |
| Total | 162,187 | 149,559 | 1,479,538 |
| Accumulated depreciation | (78,915) | (71,986) | (719,896) |
| Net property and store equipment | 83,272 | 77,573 | 759,642 |
| **INVESTMENTS AND OTHER ASSETS:** | | | |
| Investment securities (Note 5) | 1,064 | 975 | 9,706 |
| Investments in associated company | 651 | 1,779 | 5,939 |
| Long-term loans receivable | 13,109 | 8,958 | 119,586 |
| Lease deposits (Note 7) | 90,496 | 89,499 | 825,543 |
| Deferred tax assets (Note 12) | 6,804 | 8,918 | 62,069 |
| Deferred tax assets for land revaluation (Note 6) | 4,808 | 5,009 | 43,861 |
| Software | 14,216 | 16,584 | 129,684 |
| Other assets | 4,500 | 3,784 | 41,051 |
| Allowance for doubtful accounts | (1,751) | (1,428) | (15,973) |
| Total investments and other assets | 133,897 | 134,078 | 1,221,466 |
| TOTAL | ¥354,831 | ¥342,599 | $3,236,918 |

*See notes to consolidated financial statements.*

| LIABILITIES AND SHAREHOLDERS' EQUITY | Millions of Yen 2004 | Millions of Yen 2003 | Thousands of U.S. Dollars (Note 1) 2004 |
|---|---|---|---|
| **CURRENT LIABILITIES:** | | | |
| Accounts payable: | | | |
| Trade for Company-operated and franchised stores (Note 8) | ¥ 63,322 | ¥ 63,860 | $ 577,650 |
| Due to franchised stores (Note 9) | 1,402 | 4,799 | 12,790 |
| Other (Note 8) | 19,318 | 15,348 | 176,227 |
| Income taxes payable (Note 12) | 10,009 | 7,615 | 91,306 |
| Money held as agent | 43,745 | 33,030 | 399,060 |
| Accrued expenses and other current liabilities | 4,802 | 4,434 | 43,806 |
| Total current liabilities | 142,598 | 129,086 | 1,300,839 |
| **LONG-TERM LIABILITIES:** | | | |
| Liability for employees' retirement benefits (Note 10) | 1,144 | 3,786 | 10,436 |
| Liability for directors' and corporate auditors' retirement benefits | 218 | 223 | 1,989 |
| Guarantee deposits received from franchised stores | 52,574 | 54,207 | 479,602 |
| Lease deposits from lessees | 799 | 782 | 7,289 |
| Other | 289 | 421 | 2,636 |
| Total long-term liabilities | 55,024 | 59,419 | 501,952 |
| **MINORITY INTERESTS** | 2,892 | 2,230 | 26,382 |
| **SHAREHOLDERS' EQUITY** (Notes 11 and 15): | | | |
| Common stock—authorized, 412,300,000 shares in 2004 and 2003; issued, 107,600,000 shares in 2004 and 2003 | 58,507 | 58,507 | 533,726 |
| Capital surplus | 41,521 | 41,520 | 378,772 |
| Retained earnings | 72,769 | 58,608 | 663,830 |
| Land revaluation difference (Note 6) | (7,067) | (6,917) | (64,468) |
| Net unrealized gain (loss) on available-for-sale securities | 53 | (2) | 483 |
| Foreign currency translation adjustments | 68 | 150 | 620 |
| Treasury stock—at cost, 3,283,384 shares in 2004 and 565 shares in 2003 | (11,534) | (2) | (105,218) |
| Total shareholders' equity | 154,317 | 151,864 | 1,407,745 |
| TOTAL | ¥354,831 | ¥342,599 | $3,236,918 |

# Consolidated Statements of Income

LAWSON, INC. and Subsidiaries
Years Ended February 29, 2004 and February 28, 2003

| | Millions of Yen | | Thousands of U.S. Dollars (Note 1) |
|---|---|---|---|
| | 2004 | 2003 | 2004 |
| **OPERATING REVENUES:** | | | |
| Franchise commission from franchised stores | ¥153,910 | ¥149,032 | $1,404,032 |
| Net sales from Company-operated stores | 67,479 | 80,954 | 615,572 |
| Other | 24,212 | 20,348 | 220,872 |
| Total | 245,601 | 250,334 | 2,240,476 |
| **COST AND OPERATING EXPENSES:** | | | |
| Cost of sales for Company-operated stores (Note 13) | 50,058 | 59,889 | 456,650 |
| Selling, general and administrative expenses (Notes 10 and 13) | 157,456 | 156,338 | 1,436,380 |
| Total | 207,514 | 216,227 | 1,893,030 |
| Operating income | 38,087 | 34,107 | 347,446 |
| **OTHER INCOME (EXPENSES):** | | | |
| Interest income—net | 282 | 200 | 2,573 |
| Gain on sales of investments securities | 2 | 5,778 | 18 |
| Premium severance benefit | | (4,322) | |
| Loss on disposal of property and store equipment | (3,807) | (9,691) | (34,729) |
| Equity in losses of associated companies | (1,128) | (2,134) | (10,290) |
| Other—net (Note 10) | (513) | (6,335) | (4,680) |
| Other expenses—net | (5,164) | (16,504) | (47,108) |
| **INCOME BEFORE INCOME TAXES AND MINORITY INTERESTS** | 32,923 | 17,603 | 300,338 |
| **INCOME TAXES** (Note 12)**:** | | | |
| Current | 12,992 | 7,852 | 118,519 |
| Deferred | 1,725 | 1,339 | 15,736 |
| Total | 14,717 | 9,191 | 134,255 |
| **MINORITY INTERESTS IN NET INCOME** | 365 | 449 | 3,330 |
| **NET INCOME** | ¥ 18,571 | ¥ 8,861 | $ 169,413 |

| | Yen | | U.S. Dollars |
|---|---|---|---|
| | 2004 | 2003 | 2004 |
| **PER SHARE OF COMMON STOCK** (Notes 2.n and 15)**:** | | | |
| Net income | ¥ 176 | ¥ 82 | $ 1.61 |
| Cash dividends | 41 | 41 | 0.37 |

*See notes to consolidated financial statements.*

# Consolidated Statements of Shareholders' Equity

LAWSON, INC. and Subsidiaries
Years Ended February 29, 2004 and February 28, 2003

| | Shares/Millions of Yen | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Common Stock | | Capital Surplus | Retained Earnings | Land Revaluation Difference | Net Unrealized Gain (Loss) on Available-for-sale Securities | Foreign Currency Translation Adjustments | Treasury Stock | |
| | Shares | Amount | | | | | | Shares | Amount |
| BALANCE, MARCH 1, 2002 | 107,600,000 | ¥58,507 | ¥41,520 | ¥55,649 | ¥(8,407) | ¥ 2,323 | ¥236 | (171) | ¥ (1) |
| Net income | | | | 8,861 | | | | | |
| Annual cash dividends, ¥21 per share | | | | (2,260) | | | | | |
| Interim cash dividends, ¥20 per share | | | | (2,152) | | | | | |
| Reversal of land revaluation difference | | | | (1,490) | 1,490 | | | | |
| Net decrease in unrealized gain on available-for-sale securities | | | | | | (2,325) | | | |
| Net decrease in foreign currency translation adjustments | | | | | | | (86) | | |
| Treasury stock—at cost—purchase of treasury stock | | | | | | | | (394) | (1) |
| BALANCE, FEBRUARY 28, 2003 | 107,600,000 | 58,507 | 41,520 | 58,608 | (6,917) | (2) | 150 | (565) | (2) |
| Net income | | | | 18,571 | | | | | |
| Annual cash dividends, ¥21 per share | | | | (2,260) | | | | | |
| Interim cash dividends, ¥20 per share | | | | (2,120) | | | | | |
| Reversal of land revaluation difference | | | | (30) | 30 | | | | |
| Change of effective tax rate (Note 12) | | | | | (180) | | | | |
| Net increase in unrealized gain on available-for-sale securities | | | | | | 55 | | | |
| Net decrease in foreign currency translation adjustments | | | | | | | (82) | | |
| Treasury stock—at cost: | | | | | | | | | |
| Purchase of treasury stock | | | | | | | | (3,287,819) | (11,549) |
| Exercise of stock options | | | 1 | | | | | 5,000 | 17 |
| **BALANCE, FEBRUARY 29, 2004** | **107,600,000** | **¥58,507** | **¥41,521** | **¥72,769** | **¥(7,067)** | **¥ 53** | **¥ 68** | **(3,283,384)** | **¥(11,534)** |

| | Thousands of U.S. Dollars (Note 1) | | | | | | |
|---|---|---|---|---|---|---|---|
| | Common Stock | Capital Surplus | Retained Earnings | Land Revaluation Difference | Net Unrealized Gain (Loss) on Available-for-sale Securities | Foreign Currency Translation Adjustments | Treasury Stock |
| BALANCE, FEBRUARY 28, 2003 | $533,726 | $378,763 | $534,647 | $(63,100) | $ (18) | $1,368 | $ (18) |
| Net income | | | 169,413 | | | | |
| Annual cash dividends, $0.19 per share | | | (20,616) | | | | |
| Interim cash dividends, $0.18 per share | | | (19,340) | | | | |
| Reversal of land revaluation difference | | | (274) | 274 | | | |
| Change of effective tax rate (Note 12) | | | | (1,642) | | | |
| Net increase in unrealized gain on available-for-sale securities | | | | | 501 | | |
| Net decrease in foreign currency translation adjustments | | | | | | (748) | |
| Treasury stock—at cost: | | | | | | | |
| Purchase of treasury stock | | | | | | | (105,355) |
| Exercise of stock options | | 9 | | | | | 155 |
| **BALANCE, FEBRUARY 29, 2004** | **$533,726** | **$378,772** | **$663,830** | **$(64,468)** | **$483** | **$ 620** | **$(105,218)** |

*See notes to consolidated financial statements.*

# Consolidated Statements of Cash Flows

LAWSON, INC. and Subsidiaries
Years Ended February 29, 2004 and February 28, 2003

| | Millions of Yen | | Thousands of U.S. Dollars (Note 1) |
|---|---|---|---|
| | 2004 | 2003 | 2004 |
| **OPERATING ACTIVITIES:** | | | |
| Income before income taxes and minority interests | ¥ 32,923 | ¥ 17,603 | $ 300,338 |
| Adjustments for: | | | |
| Income taxes paid | (10,598) | (10,782) | (96,679) |
| Depreciation and amortization | 18,499 | 16,071 | 168,756 |
| Provision for allowance for doubtful accounts | 362 | 508 | 3,302 |
| Loss on disposal of property and store equipment | 2,603 | 7,842 | 23,746 |
| Gain on sales of investments securities | (2) | (5,778) | (18) |
| Equity in losses of associated companies | 1,128 | 2,134 | 10,290 |
| Other—net | 217 | 3,897 | 1,979 |
| Changes in assets and liabilities: | | | |
| Increase in accounts receivable | (14,033) | (3,065) | (128,015) |
| (Increase) decrease in inventories | (15) | 596 | (137) |
| (Increase) decrease in prepaid expenses and other current assets | (425) | 753 | (3,877) |
| Increase (decrease) in accounts payable | 77 | (493) | 702 |
| Increase in money held as agent | 10,715 | 5,164 | 97,747 |
| Increase in accrued expenses and other liabilities | 236 | 373 | 2,153 |
| (Decrease) increase in employees', directors' and corporate auditors' retirement benefits | (2,647) | 703 | (24,147) |
| Decrease in guarantee deposits received from franchised stores | (1,633) | (1,599) | (14,897) |
| Increase (decrease) in lease deposits from lessees | 17 | (67) | 155 |
| Total adjustments | 4,501 | 16,257 | 41,060 |
| Net cash provided by operating activities | 37,424 | 33,860 | 341,398 |
| **INVESTING ACTIVITIES:** | | | |
| Purchases of marketable securities | (28,270) | (25,532) | (257,891) |
| Proceeds from redemption of marketable securities | 24,471 | 50,425 | 223,235 |
| Proceeds from sale of investments securities | 3 | 8,300 | 27 |
| Purchases of property and store equipment | (23,832) | (22,543) | (217,406) |
| Increase in lease deposits | (1,002) | (1,382) | (9,141) |
| Increase in short-term loans receivable | (6,250) | | (57,015) |
| Other | (5,741) | (13,055) | (52,372) |
| Net cash used in investing activities | (40,621) | (3,787) | (370,563) |
| **FINANCING ACTIVITIES:** | | | |
| Repayment of long-term debt | | (3,140) | |
| Cash dividends paid | (4,380) | (4,412) | (39,956) |
| New shares issued to a subsidiary's minority shareholders | 1,547 | 306 | 14,112 |
| Purchase of treasury stock | (11,549) | (1) | (105,355) |
| Other | 18 | | 165 |
| Net cash used in financing activities | (14,364) | (7,247) | (131,034) |
| **FOREIGN CURRENCY TRANSLATION ADJUSTMENTS ON CASH AND CASH EQUIVALENTS** | (44) | (101) | (401) |
| **NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS** | (17,605) | 22,725 | (160,600) |
| **CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR** | 93,994 | 71,269 | 857,453 |
| **CASH AND CASH EQUIVALENTS, END OF YEAR** | ¥ 76,389 | ¥ 93,994 | $ 696,853 |

*See notes to consolidated financial statements.*

# Notes to Consolidated Financial Statements

LAWSON, INC. and Subsidiaries
Years Ended February 29, 2004 and February 28, 2003

## 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 and practices generally accepted in Japan, which are different from International Financial Reporting Standards in certain respects as to application and disclosure requirements. The consolidated financial statements are not intended to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

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.

Certain reclassifications have been made in the 2003 financial statements to conform to the 2004 presentation.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which LAWSON, INC. (the "Company") is incorporated and operates. The translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥109.62 to $1, the approximate rate of exchange at February 29, 2004. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

Mitsubishi Corporation ("Mitsubishi") indirectly owned 32,399 thousand shares of common stock of the Company as of February 29, 2004 which represented 31.1% of the total voting rights of the Company. Accordingly, Mitsubishi is a principal shareholder.

## 2. Summary of Significant Accounting Policies

***a. Consolidation***—The consolidated financial statements include the accounts of the Company and its subsidiaries (together the "Companies").

Under the control or influence concept, those entities in which the Company, directly or indirectly, is able to exercise control over operations are fully consolidated, and those entities over which the Companies have the ability to exercise significant influence are accounted for by the equity method.

The excess of the cost of the Company's investments in consolidated subsidiaries and associated companies over the fair value of the net assets at the dates of acquisition is being amortized over a period of 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 Companies is eliminated.

***b. Franchise Agreement and Basis of Recognizing Franchise Commission***—The Company operates principally in a single industry commonly classified as the convenience store business with its own stores and franchised stores. The Company allows each independent franchisee to operate relatively small-sized convenience stores using specific designs and the Lawson brand names, and provides related managerial or technical know-how under a franchise agreement. Under the agreement, all franchised stores are provided with a variety of services and advice on the operation of convenience stores from the Company as the franchisor. In return, such franchised stores are required to pay continuing franchise commissions to the Company based on certain percentages of the respective franchised store's annual gross margin. As the franchisor, the Company accounts for franchise commissions on an accrual basis by reference to the annual gross margin earned by each franchised store and the applicable commission percentage. According to the franchise agreement, a franchised store may pay additional guarantee deposits twice the average monthly sales amounts of respective stores and pay a lower commission percentage.

The term of a franchise agreement is effective for 10 years from the commencement date of a new store's operation as a franchised store, and may be extended or renewed upon expiration subject to renegotiation of contract terms between the Company and the franchisee.

The franchise agreement usually provides that the franchised store shall make a cash payment to the Company in the amount of ¥3 million upon commencement. Upon receipt of such payment, ¥1.5 million is credited to income of the Company as "Operating revenues—franchise commission from franchised stores" for services related to the opening of the Lawson store. The remaining amount received by the Company is credited to "Due to franchised stores" account and then applied to working capital for purchases of merchandise and supplies for the franchised store.

As part of the contractual obligations of the franchisor under the agreement, the Company generally provides franchisees with furniture, fixtures and equipment designed for the Lawson stores. In some cases, franchisees may also be provided with the land or buildings of the stores. However, the Company does not require the franchisees to make lease payments related to the stores. Instead, a higher percentage applicable to the gross margin would be used as the basis for determining the franchise commissions. The portion of franchise commission attributable to property and store equipment leases is not separately accounted for by the Company.

***c. Cash and Cash Equivalents—***Cash and cash equivalents include cash on hand, demand deposits and short-term investments, which mature or become due within three months of the date of acquisition and which are readily convertible into cash and are exposed to insignificant risk of changes in value.

***d. Inventories—***Inventories are stated at cost determined by the retail method as generally applied in the retail industry.

***e. Marketable and Investment Securities—***Marketable and investment securities are classified and accounted for, depending on management's intent, as follows: (1) 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 (2) available-for-sale securities, which are not classified as the aforementioned securities, are stated at fair value based on market quotation. Unrealized gains and losses with net of applicable taxes are reported in a separate component of shareholders' equity. The cost of securities sold is determined based on the moving-average method.

Non-marketable available-for-sale securities are stated at cost determined by the moving-average method. For other than temporary declines in fair value, non-marketable available-for-sale securities are reduced to net realizable value by a charge to income.

***f. Property and Store Equipment—***Property and store equipment are stated at cost except for land (see Note 6). Depreciation is computed by the declining-balance method at rates based on the estimated useful lives of the assets. The range of useful lives is principally from 10 to 34 years for buildings and structures and from 5 to 8 years for furniture, fixtures and equipment.

***g. Software—***Software used by the Companies is amortized using the straight-line method based on the estimated useful life (mainly 5 years).

***h. Employees' Retirement Benefits—***The Companies accounted for the liability for retirement benefits based on the projected benefit obligations and plan assets at the balance sheet date.

The Company participated in a Japanese government welfare pension fund program (the Daiei Employees' Pension Fund) and also has a lump-sum severance indemnitied plan, both of which are defined benefit plans. The Company voluntarily disaffiliated from the Daiei Employees' Pension Fund as of March 31, 2003 and started a defined contribution plan system from May 2003. For a lump-sum severance indemnitied plan, the Company set up a trust fund.

***i. Liability for Directors' and Corporate Auditors' Retirement Benefits***—The provisions are calculated to state the liability at 100% of the amount that would be required if all directors and corporate auditors resigned as of each balance sheet date.

***j. Leases***—All leases are accounted for as operating leases. 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 consolidated financial statements.

***k. Income Taxes***—The Companies provide for income taxes applicable to all items included in the consolidated statements of income regardless of when such taxes are payable. Deferred income taxes are recorded to reflect the impact of temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. 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 financial statements for the following year upon shareholders' approval.

***m. Foreign Currency Financial Statements***—The balance sheet accounts of the consolidated foreign subsidiary are translated into Japanese yen at the current exchange rate as of the balance sheet date except for shareholders' equity, which is translated at the historical rate. Differences arising from such translation are shown as "Foreign currency translation adjustments" in a separate component of shareholders' equity. Revenue and expense accounts of the consolidated foreign subsidiary are translated into yen at the current exchange rate.

***n. 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.

The number of shares used in computing net income per share was 105,651 thousand shares for 2004 and 107,600 thousand shares for 2003.

Diluted net income per share for the years ended February 29, 2004 and February 28, 2003 is not disclosed because the Company did not have stock options which would have resulted in a dilutive effect.

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.

## 3. Accounts Receivable—Due From Franchised Stores

Under the franchise agreement, the Company is responsible for providing architectural and designing services with respect to the franchised stores' facilities, for training of the franchisees' personnel, and for the centralized processing of invoices from suggested vendors of merchandise and subsequent payments of amounts payable to such vendors.

The EDP system of the Company generates a record of merchandise purchased by each franchised store and accumulates the amounts payable to respective vendors. Under the franchise agreement, the Company, as a representative for all franchised stores, pays amounts payable to the vendors on the stores' behalf. When the merchandise is received by each franchised store, the Company records the cost of the merchandise in the "Accounts receivable—Due from franchised stores" account since such costs shall be subsequently recovered from respective franchised stores.

The "Accounts receivable—Due from franchised stores" account represents net amounts recoverable from the franchised stores.

## 4. Property and Store Equipment

Property and store equipment as of February 29, 2004 and February 28, 2003, consisted of the following:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | 2004 | 2003 | 2004 |
| Used by franchised stores: | | | |
| Land | ¥ 1,092 | ¥ 938 | $ 9,962 |
| Buildings | 89,946 | 79,358 | 820,525 |
| Furniture, fixtures and equipment | 48,340 | 44,531 | 440,978 |
| Total | 139,378 | 124,827 | 1,271,465 |
| Accumulated depreciation | 67,366 | 60,061 | 614,541 |
| Net | 72,012 | 64,766 | 656,924 |
| Used by Company-operated stores and other: | | | |
| Land | 3,846 | 5,240 | 35,085 |
| Buildings | 9,866 | 9,358 | 90,001 |
| Furniture, fixtures and equipment | 9,097 | 10,134 | 82,987 |
| Total | 22,809 | 24,732 | 208,073 |
| Accumulated depreciation | 11,549 | 11,925 | 105,355 |
| Net | 11,260 | 12,807 | 102,718 |
| Net property and store equipment—total | ¥ 83,272 | ¥ 77,573 | $ 759,642 |

## 5. Marketable and Investment Securities

Marketable and investment securities as of February 29, 2004 and February 28, 2003, which represent carrying amounts, consisted of the following:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | 2004 | 2003 | 2004 |
| Current—Government and corporate bonds | ¥9,244 | ¥5,445 | $84,328 |
| Non-current—Marketable and other equity securities | 1,064 | 975 | 9,706 |

The costs and aggregate fair values of marketable and investment securities at February 29, 2004 and February 28, 2003, were as follows:

| | Millions of Yen | | | |
|---|---|---|---|---|
| February 29, 2004 | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Securities classified as: | | | | |
| Held-to-maturity | ¥9,244 | | ¥1 | ¥9,243 |
| Available-for-sale—equity securities | 935 | ¥91 | 2 | 1,024 |
| February 28, 2003 | | | | |
| Securities classified as: | | | | |
| Held-to-maturity | 5,445 | 1 | 2 | 5,444 |
| Available-for-sale—equity securities | 936 | 1 | 3 | 934 |

| | Thousands of U.S. Dollars | | | |
|---|---|---|---|---|
| February 29, 2004 | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Securities classified as: | | | | |
| Held-to-maturity | $84,328 | | $ 9 | $84,319 |
| Available-for-sale—equity securities | 8,529 | $830 | 18 | 9,341 |

Available-for-sale securities and held-to-maturity securities whose fair value is not readily determinable as of February 29, 2004 and February 28, 2003, were as follows:

| | Carrying Amount | | |
|---|---|---|---|
| | Millions of Yen | | Thousands of U.S. Dollars |
| | 2004 | 2003 | 2004 |
| Available-for-sale—equity securities | ¥40 | ¥41 | $365 |

Proceeds from sales of available-for-sale securities for the years ended February 29, 2004 and February 28, 2003 were ¥3 million ($27 thousand) and ¥8,300 million, respectively. Gross realized gains and losses on these sales, computed on the moving average cost basis, were ¥2 million ($18 thousand) and ¥0 million ($0 thousand), respectively, for the year ended February 29, 2004, and ¥5,764 million and ¥51 million, respectively, for the year ended February 28, 2003.

## 6. Land Revaluation

Under the "Law of Land Revaluation," promulgated on March 31, 1998 and revised on March 31, 1999 and 2001, the Company chose a one-time revaluation of its own-use land to a value based on real estate appraisal information as of February 28, 2002.

The resulting land revaluation difference represents unrealized depreciation of land and is stated, net of income taxes, as a component of shareholders' equity. There was no effect on the consolidated statements of income. Continuous readjustment is not permitted unless the land value subsequently declines significantly.

As at February 29, 2004, the carrying amount of the land after the above one-time revaluation exceeded the market value by ¥1,005 million ($9,168 thousand).

## 7. Lease Deposits

Under certain circumstances, the Company leases land and/or buildings, as a lessee, for its offices and Company-operated stores or for franchisees to operate as franchised stores. The leases are based on long-term, cancelable lease agreements with owners. In connection with such agreements, the lessor requires leasehold deposits equivalent to approximately several months' rent, which are non-interest bearing and refundable only when the leases are terminated.

Lease deposits as of February 29, 2004 and February 28, 2003, consisted of the following:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | 2004 | 2003 | 2004 |
| Lease deposits for franchised stores | ¥74,436 | ¥74,525 | $679,037 |
| Lease deposits for Company-operated stores and other | 16,060 | 14,974 | 146,506 |
| Total | ¥90,496 | ¥89,499 | $825,543 |

## 8. Accounts Payable—Trade for Company-Operated and Franchised Stores and Other

The balances of "Accounts payable—Trade for Company-operated and franchised stores" represent the amounts payable to vendors for merchandise purchased by Company-operated stores and franchised stores. The Company centralizes all merchandise purchasing procedures both for Company-operated stores and franchised stores and makes collective payments to vendors (see Note 3).

Accounts payable—trade for Company-operated and franchised stores and other as of February 29, 2004 and February 28, 2003, were summarized below:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | **2004** | 2003 | **2004** |
| Accounts payable—trade for franchised stores | **¥60,041** | ¥60,269 | **$547,719** |
| Accounts payable—trade for Company-operated stores and other | **22,599** | 18,939 | **206,158** |
| Total | **¥82,640** | ¥79,208 | **$753,877** |

## 9. Accounts Payable—Due to Franchised Stores

The cost of merchandise supplied to the franchised stores is recorded as "Accounts receivable—Due from franchised stores" as described in Note 3.

All franchised stores make remittances of cash proceeds from daily sales to the Company. In certain instances, the remittance from a franchised store exceeds the balance of "Accounts receivable—Due from franchised stores." In the accompanying consolidated balance sheets, such excess balances are presented as "Accounts payable—Due to franchised stores."

## 10. Employees' Retirement Benefits

Prior to March 31, 2003, most of the employees of the Companies were covered by two defined benefit plans, a Japanese government welfare pension fund program (the Daiei Employees' Pension Fund) and also a lump-sum severance indemnitied plan, both of which are defined benefit plans.

The Company voluntarily disaffiliated from the Daiei Employees' Pension Fund as of March 31, 2003 and started a defined contribution plan system from May 2003. For a lump-sum severance indemnitied plan, the Company established a trust fund.

Under most circumstances, employees terminating their employment are entitled to retirement benefits determined based on the rate of pay at the time of termination, years of service and certain other factors. Such retirement benefits are made in the form of a lump-sum severance payment from the Company or from certain subsidiaries and on annuity payment from a trustee. Employees are entitled to larger payments if the termination is involuntary, by retirement at the mandatory retirement age, by death, or by voluntary retirement at certain specific ages prior to the mandatory retirement age.

The funded status of these plans as of February 29, 2004 and February 28, 2003, were as follows:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | **2004** | 2003 | **2004** |
| Projected benefit obligation | **¥ 7,247** | ¥ 23,535 | **$ 66,110** |
| Fair value of plan assets | **(5,523)** | (14,111) | **(50,383)** |
| Unrecognized prior service cost | | 955 | |
| Unrecognized actuarial loss | **(580)** | (6,593) | **(5,291)** |
| Net liability | **¥ 1,144** | ¥ 3,786 | **$ 10,436** |

The components of net periodic benefit costs for the years ended February 29, 2004 and February 28, 2003, were as follows:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | 2004 | 2003 | 2004 |
| Service cost | ¥ 870 | ¥2,521 | $ 7,937 |
| Interest cost | 126 | 502 | 1,149 |
| Expected return on plan assets | | (214) | |
| Amortization of prior service cost | | (106) | |
| Recognized actuarial loss | 71 | 555 | 648 |
| Premium severance benefit | | 4,322 | |
| Contribution to defined contribution plan | 205 | | 1,870 |
| Net periodic benefit costs | ¥1,272 | ¥7,580 | $11,604 |

Assumptions used for the years ended February 29, 2004 and February 28, 2003, were set forth as follows:

| | 2004 | 2003 |
|---|---|---|
| Discount rate: | | |
| The unfunded retirement benefits plan | 2.0% | 2.0% |
| The group employees' pension plan | | 2.5 |
| Expected rate of return on plan assets | 0 | 4.5 |
| Amortization period of prior service cost | 10 years | 10 years |
| Recognition period of actuarial gain/loss | 10 | 10 |

When the Company disaffiliated from the Daiei Employees' Pension Fund, the Company recorded in other income ¥812 million ($7,407 thousand) by reversing allowance for employees' retirement benefits, which was determined after reflecting recognition of all remaining actuarial loss and prior service cost attributable to this benefit plan, and a special contribution to the Fund for the purpose of disaffiliation.

## 11. Shareholders' Equity

Japanese companies are subject to the Japanese Commercial Code (the "Code") to which various amendments became effective from October 1, 2001.

The Code was revised whereby common stock par value was eliminated resulting in all shares being 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. 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 revised 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 common stock. The amount of total additional paid-in capital and legal reserve that exceeds 25% of the 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 revised Code eliminated restrictions on the repurchase and use of treasury stock allowing Japanese companies to repurchase treasury stock by a resolution of the shareholders at the general shareholders meeting 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 dividends plus the amount of common stock, additional paid-in capital or legal reserve to be reduced in the case where such reduction was resolved at the general shareholders' meeting.

The amount of retained earnings available for dividends under the Code was ¥57,037 million ($520,316 thousand) as of February 29, 2004, based on the amount recorded in the parent company's general books of account. 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.

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.

***Stock Option***

The Company has stock option plans. The stock option plans which were approved at the general shareholders' meetings provide options for purchases of the Company's common stock for the directors, executive officers and key employees of the Company.

The date of grant, the outstanding number of shares granted by the options, exercise price and exercisable period were as follows:

| Date of Grant | Number of Options Granted (Thousands of Shares) | | Exercise Price | | Exercisable Period |
|---|---|---|---|---|---|
| May 26, 2000 | The Company's directors and key employees | 1,116 | ¥7,500 | $68.42 | From May 27, 2002 to May 25, 2007 |
| May 29, 2002 | The Company's directors, executive officers and key employees | 273 | 3,680 | 33.57 | From December 1, 2002 to May 31, 2007 |
| May 27, 2003 | The Company's directors and executive officers | 92 | 3,517 | 32.08 | From July 3, 2005 to July 2, 2008 |
| | Total | 1,481 | | | |

None of the options were exercisable at February 29, 2004 and February 28, 2003.

## 12. Income Taxes

The Company and its domestic subsidiaries are subject to a number of different taxes based on income, which in the aggregate, resulted in a normal effective statutory tax rate of approximately 42.0% for both 2004 and 2003.

The tax effects of significant temporary differences and tax loss carryforwards which resulted in deferred tax assets and liabilities at February 29, 2004 and February 28, 2003, are as follows:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | **2004** | 2003 | **2004** |
| Deferred tax assets: | | | |
| Marketable securities | **¥ 543** | ¥ 446 | **$ 4,953** |
| Accrued enterprise tax | **936** | 734 | **8,539** |
| Accrued employees' bonuses | **1,005** | 928 | **9,168** |
| Excess of depreciation | **1,868** | 1,420 | **17,041** |
| Excess of amortization of software | **1,059** | 1,039 | **9,661** |
| Employees' retirement benefits | **2,210** | 5,752 | **20,161** |
| Tax loss carryforward | **1,516** | 1,211 | **13,829** |
| Other | **2,049** | 1,819 | **18,691** |
| Less valuation allowance | **(1,528)** | (1,224) | **(13,939)** |
| Total | **9,658** | 12,125 | **88,104** |
| Deferred tax liabilities: | | | |
| Gain on securities contributed to employees' retirement benefit trusts | | 749 | |
| Unrealized gain on available-for-sale securities | **36** | | **328** |
| Other | | 13 | |
| Total | **36** | 762 | **328** |
| Net deferred tax assets | **¥ 9,622** | ¥11,363 | **$ 87,776** |

A reconciliation between the normal effective statutory tax rates and the actual effective tax rates reflected in the accompanying consolidated statements of income for the years ended February 29, 2004 and February 28, 2003, is as follows:

| | **2004** | 2003 |
|---|---|---|
| Normal effective statutory tax rate | **42.0%** | 42.0% |
| Increase (decrease) in tax rate resulting from: | | |
| Permanently nondeductible expenses | **0.6** | 1.5 |
| Inhabitants' taxes—per capita | **0.7** | 1.3 |
| Operating losses of certain subsidiaries | **1.4** | 3.1 |
| Equity in losses of associated companies | **1.4** | 4.7 |
| Gain on increase in a subsidiary's net equity resulting from its allocation of new shares | **(0.7)** | |
| Reduction on deferred tax assets based on the change in enterprise tax rate | **0.8** | |
| Other—net | **(1.5)** | (0.4) |
| Actual effective tax rates | **44.7%** | 52.2% |

On March 31, 2003, a tax reform law concerning enterprise tax was enacted in Japan which changed the normal effective statutory tax rate from 42% to 40.5%, effective for years beginning on or after April 1, 2004. The effect of this change was a decrease in deferred tax assets (net of deferred tax liabilities) by ¥247 million ($2,253 thousand) and a corresponding increase in the provision for income taxes of ¥248 million ($2,262 thousand), and a decrease in deferred tax assets for land revaluation and a corresponding decrease in land revaluation difference of ¥180 million ($1,642 thousand) in the consolidated financial statements for the year ended February 29, 2004. The deferred tax assets and liabilities which are realizable on or after March 1, 2005 are measured at the effective tax rate of 40.5% at February 29, 2004.

As of February 29, 2004, certain subsidiaries have tax loss carryforwards aggregating approximately ¥3,382 million ($30,852 thousand) which are available to be offset against taxable income of such subsidiaries in future years. These tax loss carryforwards, if not utilized, will expire as follows:

| Year Ending February 28 or 29 | Millions of Yen | Thousands of U.S. Dollars |
|---|---|---|
| 2005 | ¥ 181 | $ 1,651 |
| 2006 | 234 | 2,135 |
| 2007 | 928 | 8,466 |
| 2008 | 1,203 | 10,974 |
| 2009 and thereafter | 836 | 7,626 |
| Total | ¥3,382 | $30,852 |

## 13. Leases

The Companies lease certain store facilities, machinery, computer equipment, office space and other assets.

Total lease payments under finance leases for the years ended February 29, 2004 and February 28, 2003, were ¥15,133 million ($138,050 thousand) and ¥13,675 million, respectively.

Pro forma information of leased property such as acquisition cost, accumulated depreciation, obligations under finance leases, depreciation expense and interest expense for finance leases that do not transfer ownership of the leased property to the lessee on an “as if capitalized” basis for the years ended February 29, 2004 and February 28, 2003 was as follows:

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | **2004** | 2003 | **2004** |
| Leased to franchised stores: | | | |
| Furniture, fixtures and equipment: | | | |
| Acquisition cost | **¥63,748** | ¥63,303 | **$581,536** |
| Accumulated depreciation | **25,654** | 21,443 | **234,026** |
| Net leased property | **¥38,094** | ¥41,860 | **$347,510** |
| Obligations under finance leases: | | | |
| Due within one year | **¥10,825** | ¥10,401 | **$ 98,750** |
| Due after one year | **28,036** | 32,045 | **255,756** |
| Total | **¥38,861** | ¥42,446 | **$354,506** |

| | Millions of Yen | | Thousands of U.S. Dollars |
|---|---|---|---|
| | 2004 | 2003 | 2004 |
| Used by Company-operated stores and other: | | | |
| Furniture, fixtures and equipment: | | | |
| Acquisition cost | ¥14,468 | ¥14,421 | $131,983 |
| Accumulated depreciation | 5,056 | 3,225 | 46,123 |
| Net leased property | ¥ 9,412 | ¥11,196 | $ 85,860 |
| Obligation under finance leases: | | | |
| Due within one year | ¥ 2,838 | ¥ 2,698 | $ 25,889 |
| Due after one year | 6,670 | 8,570 | 60,847 |
| Total | ¥ 9,508 | ¥11,268 | $ 86,736 |

The imputed interest expense portion which is computed using the interest method is excluded from the above obligations under finance leases.

Depreciation expense, which is not reflected in the accompanying consolidated statements of income, computed by the straight-line method was ¥14,186 million ($129,411 thousand) and ¥12,775 million for the years ended February 29, 2004 and February 28, 2003, respectively.

Interest expense, which is not reflected in the accompanying consolidated statements of income, computed by the interest method was ¥1,160 million ($10,582 thousand) and ¥1,149 million for the years ended February 29, 2004 and February 28, 2003, respectively.

The minimum rental commitments under noncancelable operating leases at February 29, 2004 were as follows:

| | Millions of Yen | Thousands of U.S. Dollars |
|---|---|---|
| | 2004 | 2004 |
| Due within one year | ¥ 736 | $ 6,714 |
| Due after one year | 5,814 | 53,038 |
| Total | ¥6,550 | $59,752 |

## 14. Related Party Transactions

Transactions with and balances to LAWSON CS Card, INC. (an associated company) for the year ended February 29, 2004 were as follows:

| | Millions of Yen | Thousands of U.S. Dollars |
|---|---|---|
| | 2004 | 2004 |
| Short-term loans receivable | ¥6,250 | $57,015 |
| Accrued interest | 34 | 310 |
| Interest received | 6 | 55 |

## 15. Subsequent Events

a. The following appropriation of retained earnings as of February 29, 2004 was approved at the general shareholders' meeting held on May 28, 2004:

| | Millions of Yen | Thousands of U.S. Dollars |
|---|---|---|
| Cash dividends, ¥21 ($0.19) per share | ¥2,191 | $19,987 |

b. At the general shareholders' meeting held on May 28, 2004, the Company's shareholders approved the stock option plan for the Company's directors and executive officers. The plan provides for granting options to directors and executive officers to purchase up to 120 thousand shares of the Company's common stock in the period from May 28, 2006 to December 31, 2009.

# Independent Auditors' Report

Deloitte.

Deloitte Touche Tohmatsu
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4-13-23 Shibaura
Minato-ku, Tokyo 108-8530
Japan

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Fax: +81(3)3457 1694
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To the Board of Directors of LAWSON, INC.:

We have audited the accompanying consolidated balance sheets of LAWSON, INC. and subsidiaries as of February 29, 2004 and February 28, 2003, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards, procedures and practices generally accepted and applied in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of LAWSON, INC. and subsidiaries as of February 29, 2004 and February 28, 2003, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles and practices generally accepted in Japan.

Our audits also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 1. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

Deloitte Touche Tohmatsu

May 28, 2004

# Directors, Corporate Auditors and Executive Officers

| | | |
|---|---|---|
| PRESIDENT AND CEO | Takeshi Niinami | |
| MEMBER OF THE BOARD AND SENIOR EXECUTIVE VICE PRESIDENT | Eiichi Tanabe | Chief Financial Officer (CFO); in charge of Corporate Planning Office |
| MEMBER OF THE BOARD AND EXECUTIVE VICE PRESIDENT | Katsuhiko Yamasaki | Chief Risk Officer (CRO); General Manager, Line Support Division, in charge of Corporate Ethics, in charge of Human Resources |
| MEMBERS OF THE BOARD | Teruo Aoki | President, LAWSON CS Card, INC. |
| | Hiroshi Tasaka | Professor, Graduate School of Tama University |
| | Reiko Okutani | President, The R Co, Ltd. |
| | Muneaki Masuda | President and CEO, Culture Convenience Club Co., Ltd. |
| | Koji Furukawa | Senior Executive Vice President, Mitsubishi Corporation |
| | Hiroshi Mino | Executive Vice President; General Manager, Consumer Business Division; Lawson Business Unit; Mitsubishi Corporation |
| STANDING CORPORATE AUDITORS | Masaaki Kojima | |
| | Kenji Yamakawa | |
| CORPORATE AUDITORS | Yoshiyuki Sanada | General Manager, Group Controller, New Business Initiative Group, Mitsubishi Corporation |
| | Tetsuo Ozawa | Lawyer |
| EXECUTIVE VICE PRESIDENTS | Susumu Hasegawa | Chief Information Officer (CIO), General Manager, Information Systems Office, in charge of Overseas Projects Office |
| | Taketoshi Kunisaki | General Manager, Line Support Division |
| SENIOR VICE PRESIDENTS | Shigeru Kiyota | General Manager, Hokkaido & Tohoku Lawson Branches |
| | Ichiro Okuda | General Manager, Chugoku & Shikoku Lawson Branches |
| | Isamu Ochiai | General Manager, Shanghai Hualian Lawson Co., Ltd. |
| | Yoshio Shinozaki | General Manager, Kinki Lawson Branch |
| | Kiyoteru Suzuki | Postal Lawson Project Team |
| | Sadayuki Nobayashi | General Manager, Kyusyu Lawson Branch |
| | Takatoshi Kawamura | Next-Generation Format Project Team |
| | Manabu Asano | General Manager, Chubu Lawson Branch |
| | Jyosuke Kishimoto | President, LAWSON ATM Networks, Inc. |
| | Shigeaki Kawahara | General Manager, Marketing Division |
| | Tadanao Watanabe | General Manager, Kanto Lawson Branch |
| | Katsuyuki Imada | General Manager, Corporate Planning Office |
| | Kenji Morimoto | General Manager, Finance & Accounting Office, in Charge of Management Services Office |
| | Hiromichi Ogawa | General Manager, Merchandizing & Logistics Division |
| | Itsuo Iga | General Manager, Quality Control Division |
| | Konoshin Deguchi | Head, Store Development Support, Line Support Division |
| | Satoshi Matsubara | Deputy Head, Merchandizing & Logistics Division |
| | Yukimasa Shimohata | Deputy General Manager, Merchandizing & Logistics Division |
| | Tappei Shimizu | Assistant to CIO and Executive Assistant to CEO |

(As of May 28, 2004)

# Corporate Data

## COMPANY NAME

LAWSON, INC.

## ADDRESS

Tokyo Headquarters:

East Tower, Gate City Osaki

11-2, Osaki 1-chome, Shinagawa-ku, Tokyo 141-8643, Japan

Osaka Headquarters:

9-1, Toyotsu-cho, Suita-shi, Osaka 564-0051, Japan

## EMPLOYEES

3,148 (Consolidated)

## BUSINESS ACTIVITIES

Franchise chain development of
Lawson convenience stores

## NET SALES OF ALL STORES

¥1,288.2 billion (Consolidated) (Fiscal 2003)

## NUMBER OF STORES

7,821 (Consolidated, as of February 29, 2004)

## OPERATING REGION

All 47 Japanese prefectures; Shanghai,
PRC (joint venture)

## ESTABLISHED

April 15, 1975

## CAPITAL

¥58,506,644,000

## AUTHORIZED SHARES

412,300,000

## SHARES ISSUED

107,600,000

## SHAREHOLDERS

48,156

## MAJOR SHAREHOLDERS

| Shareholder | Shareholdings (Shares) | Shareholdings (%) |
|---|---|---|
| 1. M.C. Retail Investment Co., Ltd. | 32,089,300 | 30.8 |
| 2. Japan Trustee Services Bank, Ltd. (Trust account) | 8,618,100 | 9.4 |
| 3. Marubeni Foods Investment Co., Ltd. | 5,939,500 | 5.7 |
| 4. The Master Trust Bank of Japan, Ltd. (Trust account) | 5,326,200 | 5.1 |
| 5. NOMURA SECURITIES CO., LTD. | 3,607,900 | 3.5 |
| 6. Nintendo Co., Ltd. | 3,447,000 | 3.3 |
| 7. BNP Paribas Securities (Japan) Limited | 1,570,800 | 1.5 |
| 8. Mitsui Asset Trust and Banking Company, Limited (Trust Account) | 1,509,500 | 1.4 |
| 9. The Chase Manhattan Bank, NA London Secs Lending Omnibus Account | 1,256,800 | 1.2 |
| 10. Mellon Bank Treaty Clients Omnibus | 1,252,757 | 1.2 |

*Note: The 3,283,384 shares of treasury stock held by Lawson are not included in the above table.*

## STOCK EXCHANGE LISITNGS

Tokyo Stock Exchange (1st Section)

Osaka Securities Exchange (1st Section)

## STOCK TRANSFER AGENT

The Mitsubishi Trust and Banking Corporation

1-4-5, Marunouchi, Chiyoda-ku, Tokyo, Japan

(As of February 29, 2004)

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11-2, Osaki 1-chome, Shinagawa-ku,
Tokyo 141-8643, Japan
URL http://www.lawson.co.jp/

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