LAWSON

The Challenge Begins

EXPAND, ENHANCE, BUILD

Annual Report 2006

Year ended February 28, 2006

Consolidated Financial Highlights

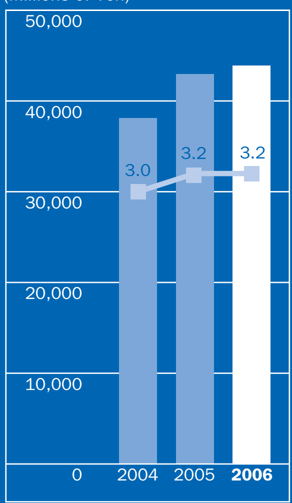
LAWSON, INC. and Subsidiaries
Years Ended February 28, 2006, 2005 and February 29, 2004

	Millions of Yen			Percent Change	Thousands of U.S. Dollars[2]
	2006	2005	2004[1]	2006/2005	**2006**
For the Year:					
Net sales of all stores	**¥1,361,731**	¥1,329,077	¥1,288,297	2.5%	**$11,711,800**
Total operating revenues	**268,058**	254,395	245,601	5.4%	**2,305,479**
Operating income	**43,867**	42,941	38,087	2.2%	**377,286**
Income before income taxes and minority interests	**38,723**	36,040	32,923	7.4%	**333,044**
Net income	**22,025**	20,435	18,571	7.8%	**189,430**
Per Share Data (yen and dollars):					
Net income	**¥ 216**	¥ 198	¥ 176	8.6%	**$ 1.85**
Cash dividends	**90**	70	41	28.6%	**0.77**
At Year-end:					
Total assets	**¥ 375,107**	¥ 356,310	¥ 354,831	5.3%	**$ 3,226,172**
Total shareholders' equity	**175,184**	160,282	154,317	9.3%	**1,506,700**
Financial Data					
Return on equity (ROE)	**13.1%**	13.0%	12.1%	0.1	
Payout ratio (Non-consolidated)	**40.5%**	35.0%	22.8%	5.5	
Store Network:					
Number of stores in Japan	**8,366**	8,077	7,821	3.6%	
Franchised stores	**7,958**	7,731	7,472	2.9%	
Company-owned stores	**408**	346	349	17.9%	

Notes: 1. Figures for 2004 include data for SHANGHAI HUALIAN LAWSON CO., LTD.
2. The U.S. dollar amounts represent translations of Japanese yen at the approximate exchange rate at February 28, 2006, of ¥116.27=$1.

Operating income and Operating income ratio

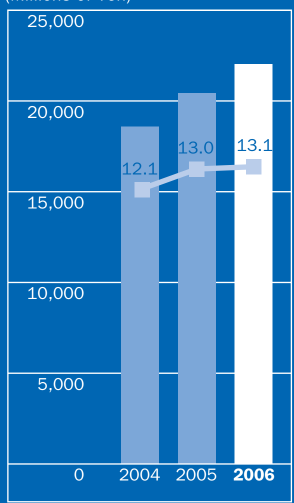
(Millions of Yen)



Operating income
Operating income ratio (%)
*Operating income ratio=Operating income/Net Sales of all stores

Net income and ROE

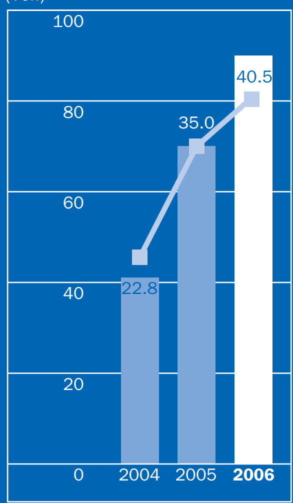
(Millions of Yen)



Net income
ROE (%)

Cash dividends per share and payout ratio (Non-consolidated)

(Yen)



Cash dividends per share
Payout ratio (%) (Non-consolidated)

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.

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A Message to LAWSON Stakeholders

Recently, there is a belief that sales at existing stores are limited due to growing saturation of the convenience store (CVS) sector. This belief is based on a declining birthrate and aging society in Japan, a decline in the purchasing power of men in their twenties and thirties, who have supported the CVS sector up to now, and increasing competition from new openings of conventional convenience stores. However, I firmly believe that the CVS sector can continue to expand. I believe that LAWSON can grow by promoting the development of stores and displays matched to the individual characteristics of each location. And there is room to increase the number of women, senior and other customers who haven't traditionally been our main customers.

We have invested aggressively in the development of two new formats—NATURAL LAWSON and LAWSON STORE100—to that end. This has put us a step ahead of our competitors and gives us a powerful means of expanding our customer base. While our upfront investments will slow earnings growth during fiscal 2006, the year ending February 28, 2007, I believe that these investments will begin making a contribution to earnings in fiscal 2007 and beyond. As outlined in LAWSON Challenge 2007, our medium-term business plan, we expect an increase in the number of customers stemming from expansion of the customer base to lead to growth in franchise owners' profits. In turn, this will lead to corporate earnings growth as this winning formula delivers results.

Our targets under LAWSON Challenge 2007 are average growth in EPS of 10% over the 3 years of the plan, and ROE of 15% at the end of fiscal 2007. As we aim for these goals, we intend to actively return profits to our shareholders.

TAKESHI NIINAMI
President and Chief Executive Officer

Review of fiscal 2005, the first year of LAWSON Challenge 2007

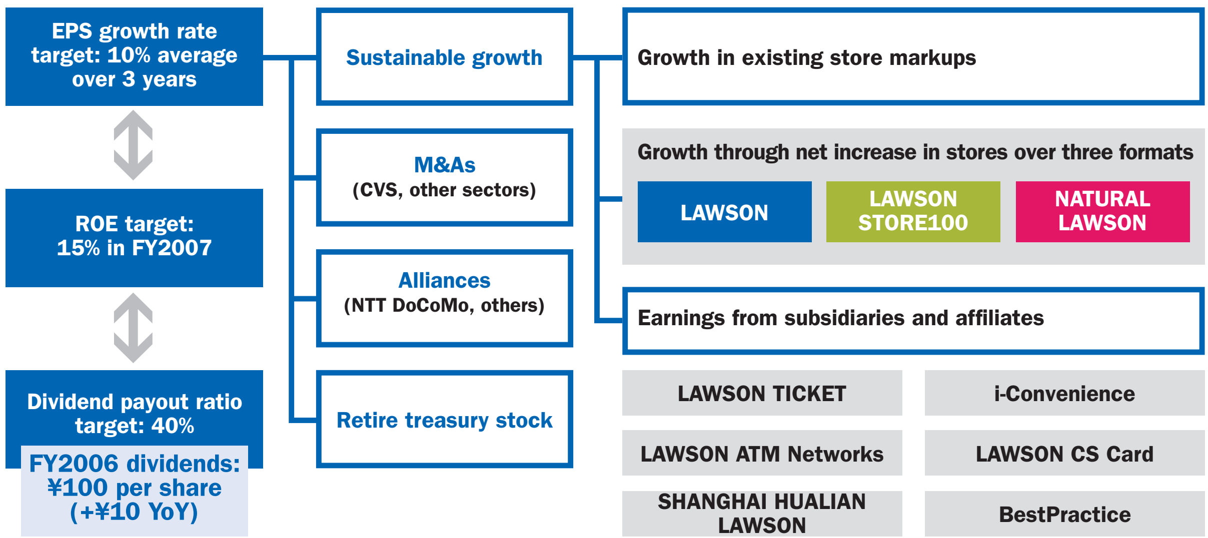
In fiscal 2005, we further promoted the enhancement of quality (Q), service (S), and cleanliness (C) as important management measures, by remaining committed to our Three Challenge Practices—ensuring merchandise assortments tailored to individual locations, courteous service and cleanliness. In particular, franchise owners and LAWSON store supervisors worked together to analyse information regarding the commercial areas surrounding individual stores. In this way, we thoroughly promoted Q matched to customers living in the vicinity of individual stores. At LAWSON, we are evaluating the Q, S and C of stores by using a "Mystery Shopper" program. According to this QSC evaluation, there has been a striking improvement in service and cleanliness. However, an improvement in quality has been slower than we expected, as highlighted by a decline in existing store sales reflecting a decrease in the number of customers in the second half. Based on this, I believe there is an urgent need to adopt measures to minimize opportunity losses in sales.

We regard existing store markups* as an important indicator for managing the company. Equivalent to assumed sales minus cost per existing store, this management benchmark unfortunately was only 98.4% of the level of the previous period in fiscal 2005. A severe winter from November that has scarcely been seen in recent years directly led to a decline in the number of customers in the second half. However, this is a short-term factor. There are crucial challenges that I believe we must fundamentally solve that could have a longer term impact on our performance. These are the declining birthrate and the aging society, as well as a decline per store in the number of men aged in their twenties and thirties, who are the core customer target of the conventional CVS. In other words, it is increasingly vital that we expand our customer base by capturing new customers. I believe that sustained growth as a CVS operator hinges on the implementation of initiatives ahead of competitors to create new customer bases.

*Existing store markups=expected profit (sales minus cost) per existing store

In fiscal 2005, although our earnings growth slowed from the second half, we achieved our full-year profit target thanks to a strong first-half result. Nevertheless, we did not achieve a satisfactory result in terms of increasing our customer base, which is our greatest aim. A discussion of our operating results can be found on page 21 of this report.

Overview of LAWSON Challenge 2007



Action plans in fiscal 2006, the second year of LAWSON Challenge 2007

With continued competition to open new stores from conventional CVS operators and competition in the overall retail industry that transcends business formats, conditions are likely to remain tough. However, we see business opportunities for LAWSON. We are now in an age when disparities in earnings among CVS operators who previously benefited from the growth in the overall CVS sector have become distinctly apparent due to differences in management capabilities and strategies. By implementing the following four action plans in fiscal 2006, we aim to increase the number of customers, our most important theme. I believe this will lead to dramatic growth in fiscal 2007 and beyond.

Improving merchandise assortment by utilizing "store charts"

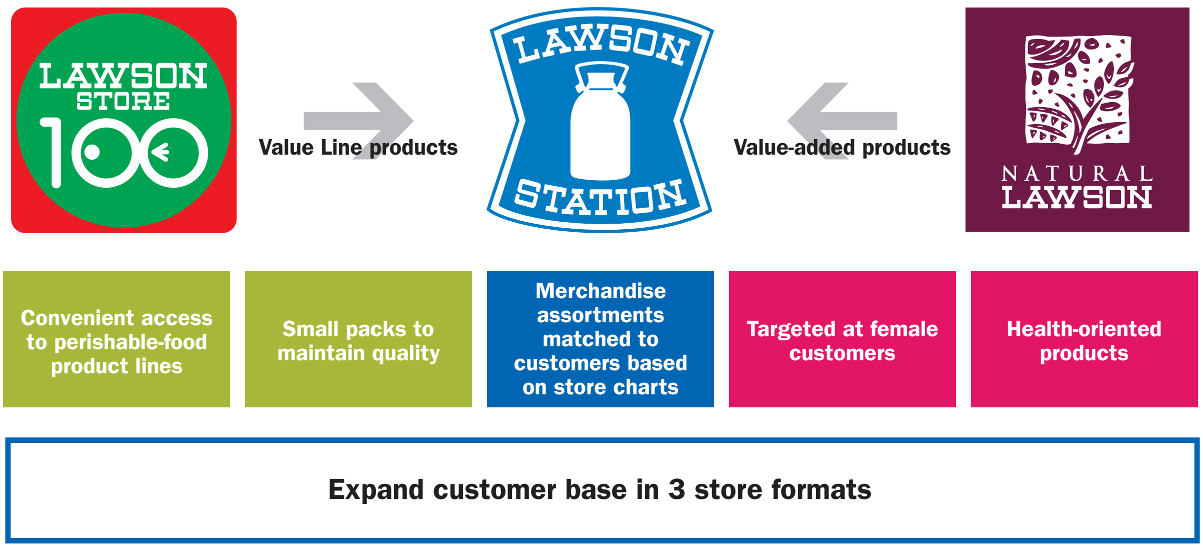
In fiscal 2005, we developed what we call "store charts" (analysis of individual store information*) for all stores as the basis for improving merchandise assortments. In fiscal 2006, by maximizing the use of these charts, we aim to realize merchandise assortments catering to potential customers living in the areas where stores are located. We aim to enhance ordering precision by thoroughly carrying out a process whereby we formulate, execute, and then verify assumptions regarding merchandise for each store.

*Store charts are created by franchise owners under the direction of LAWSON store supervisors. An important tool for making management decisions, they include analysis of marketing and management on an individual store basis.

Improving merchandise assortments by strengthening product proposals

In creating merchandise assortments matched to each location, I believe that it is essential to improve the product categories that haven't been able to cater to the needs of women and seniors in the conventional CVS format. These categories include locally targeted products, health-oriented products, and perishable foods. That's why we have made substantial upfront investments in developing NATURAL LAWSON and LAWSON STORE100 to take the lead over our competitors. I feel that through this action we have established a more dominant position than other CVS operators with regard to strengthening product lines aimed at women and seniors. In fiscal 2006, we will promote further advances in the NATURAL LAWSON and LAWSON STORE100 formats. At the same time, we will introduce at our regular LAWSON stores the expertise we have acquired in product development for these formats as well as products such as health-oriented

A Key Role in Expanding the Customer Base: Applying Know-how From New Formats to Regular LAWSON Stores



foods in the NATURAL LAWSON brand and the private brand *Value Line* of LAWSON STORE100. This will be done as needed based on analysis of store charts. In this way, we aim to maximize the effectiveness of our merchandise assortment.

Increase in customers through acquisition of LAWSON PASS members

LAWSON PASS is also a major strength of LAWSON for winning customers. As of February 28, 2006, LAWSON PASS had at least 2.1 million members. In fiscal 2006, to strengthen the acquisition of LAWSON PASS members at all stores, we will provide attractive points programs and privileges to members in the hope of creating loyal existing customers. Furthermore, we will actively develop our sales strategy by encouraging the utilization of LAWSON PASS by new target customers, such as women who have a strong interest in point cards.

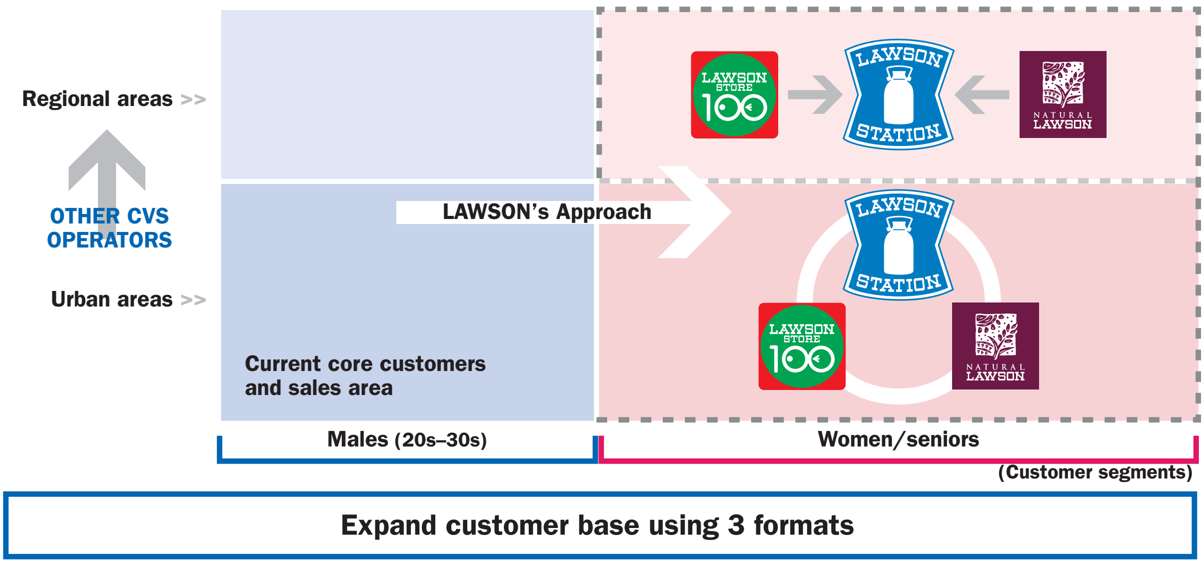
Expand the customer base by utilizing the three formats

As our original core target shrinks because of the declining birthrate and the aging society in Japan, we will be unable to survive if we limit our activities to the same products and services as those of the conventional CVS. In the highly competitive CVS sector, to survive and be a winner we must take up the challenge of creating new markets by expanding our customer base. Having positioned women and seniors as new customer bases, I believe we must substantially change the merchandise assortments to cater to a wider customer profile. We may even have to alter the store format itself in accordance with the location and customer needs.

The NATURAL LAWSON format was launched in July 2001. In fiscal 2005, we made preparations to open these stores on a full-fledged basis. Product development unique to the NATURAL LAWSON format has progressed steadily. We have strengthened our freshly baked bread lineup and improved our range of rice dishes and salads that make abundant use of healthy ingredients. We also actively forged alliances covering distinctive products such as freshly brewed coffee and fresh vegetables.

The first perishable-food LAWSON STORE100 store opened in May 2005. We drew on experience in opening stores in diverse locations to make an early success out of this initiative. For example, in locations where it was difficult to open a conventional CVS and where there were many competitors nearby, we recognized that there was a greater

Strengthening 3 Formats in Urban Areas and Regular LAWSON Stores in Regional Areas



chance to open a LAWSON STORE100 format store. In addition, we succeeded in rapidly launching the *Value Line* private brand by making use of the economies of scale and supply chain of the LAWSON Group. The number of stock keeping units (SKU: the minimum unit handled by POS systems) for this line amounted to around 140 at the end of fiscal 2005, and we are aiming for 400 SKU during fiscal 2006.

As shown in the diagram on page 5, other major CVS operators have aggressively opened conventional convenience stores in major urban areas. As a result, they have little room to move in terms of opening stores and are now turning to openings in regional areas where they have no presence. In contrast, LAWSON has already developed a nationwide chain ahead of other companies, meaning there are still opportunities for us to open stores in major urban areas. Furthermore, the development of two new formats means that we can open any one of three store types to match local customer demographics such as age and gender as well as customer needs. Consequently, we believe there are sufficient expectations for LAWSON to develop stores in the Tokyo metropolitan area and other large-city areas where there appears to still be plenty of available sites for us to open stores. In regional areas as well, we believe it is possible to provide merchandise that suits the customers of particular areas at regular LAWSON stores by introducing the product know-how accumulated from our two new formats. Through the effective development of the three formats, I believe we will be able to expand our customer base by increasing the number of women and senior customers.

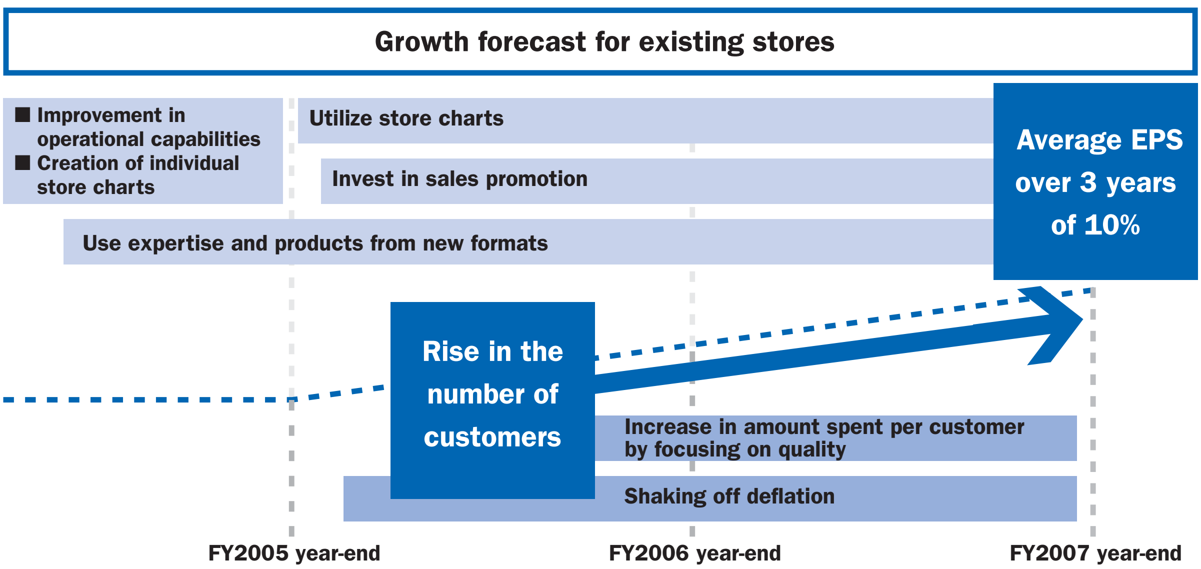
Alliances Based on a Medium- to Long-term Viewpoint

LAWSON concluded a capital and business alliance with NTT DoCoMo, Inc. in March 2006. NTT DoCoMo holds 2% of LAWSON common stock. We expect this business alliance to produce the following benefits:

1) Simplification of the payment process and greater customer convenience from the introduction of NTT DoCoMo's *iD*™* credit card payment service at all stores
2) More efficient sales promotion to LAWSON PASS members based on the linking of NTT DoCoMo's *iD*™ and LAWSON PASS
3) The utilization of the advanced mobile phone technology capabilities possessed by NTT DoCoMo in the infrastructure of next-generation LAWSON stores

*iD™ is a registered trademark of NTT DoCoMo.

On the Road to Recovery in FY2007



A Turning Point From Defense to Offence

As I said earlier, to promote management measures more effectively, from the first quarter of fiscal 2006, we will actively allocate expenditure, such as sales promotion expenses, that will lead to an increase in the number of customers.

Fiscal 2006 will mark a major turning point from defense to offence in our policy. During the past several years, we have earnestly undertaken defensive measures for the sake of survival, such as cost cutting, in a deflationary environment. However, while competition is intensifying, we can see signs of an improvement in consumer sentiment stemming from the economy's emergence from deflation. We see this as a sign that the CVS sector has turned the corner. Underpinned by store QSC, which we have improved in a tough environment, and the two new formats, we plan to allocate expenditure to advertising and promotion and various sales promotion campaigns. We will also upgrade products, including improving boxed lunches, and order assistance for stores aimed at improving merchandise assortments based on "store charts."

Focused on Our Goals

In fiscal 2007, the final year of LAWSON Challenge 2007, we aim to achieve our dual targets of a 3-year annual average of 10% EPS growth and ROE of 15%, as a result of various measures to increase the number of customers and an improvement in the earnings of the two new format subsidiaries as well as our finance-related subsidiaries and affiliates. We will also hope to return more profits to shareholders. We are determined to remain a company that is supported by all our customers, shareholders, business partners, franchise owners and store crew (part-time workers), and employees. Furthermore, as a publicly listed company, we will endeavor to further improve our internal control system, as we work to raise shareholder value and maintain growth. LAWSON is committed to meeting your expectations.

July 2006

Takeshi Niinami
President and Chief Executive Officer

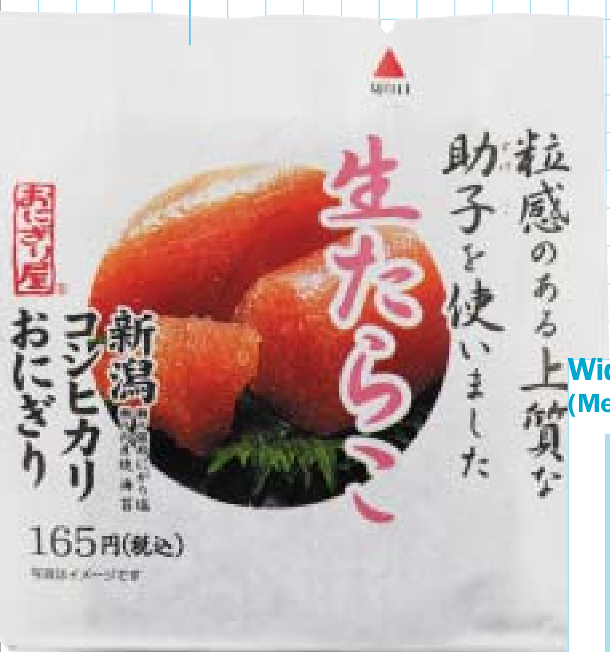
Toward Achieving the Targets of LAWSON Challenge 2007

EXPANDING OPERATIONS

WIDEN

Widen the Product Lineup

Based on the keyword “innovation,” LAWSON aims to achieve differentiation by developing original products. Under the *Gohantei* boxed lunch brand, we developed healthy products such as *Ichiju-Sansai* (one soup and three dishes), which recreates the traditional Japanese meal through the inclusion of a soup in boxed lunch packages, and *Yasai-to-Isshoni* (accompanied by vegetables), which offers a healthy serving of vegetables and staple foods. In the counter products category, we augmented our lineup with the launch of *Fried Chicken* to join *Karaage-kun*, which has been popular with customers since it was launched 20 years ago. This was yet another move designed to differentiate LAWSON by using fryers in stores to prepare freshly cooked food.



***Onigiriya* rice ball**

Widen Breadth of Product Proposals and Improve Quality (Merchandise Assortment) → Increase Customer Numbers

Health-oriented Products
- Leverage NATURAL LAWSON products

Locally Targeted Products
- Increase number of area merchandisers

Reinforce Services/ Entertainment
- Increase convenience for senior customers
- Leverage LAWSON TICKET services

Fresh Products
- Utilize LAWSON STORE100 products and expertise

PRODUCT LINEUPS TAILORED TO LOCAL CUSTOMERS

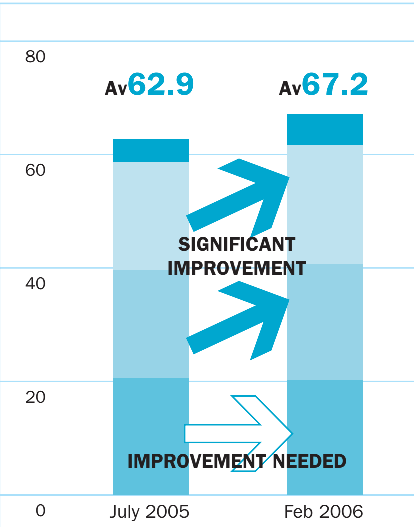
TARGET FEMALE AND SENIORS
Fundamental review of merchandise assortments
← **EXPAND CUSTOMER BASE** →
EMPHASIZE GREATER QUALITY

INCREASE

Increase Earnings for Owners

Increasing the earnings of franchise owners is a cornerstone of LAWSON's management base. Based on our view that earnings will expand if we increase the number of customers by enhancing customer satisfaction, we have endeavored to improve the level of Q, S and C through the "Mystery Shopper" program, which we initiated in fiscal 2004. Service (S) and cleanliness (C), in particular, have improved year by year. We believe that the way to increase the earnings of franchised store owners now is to upgrade Q (quality: merchandise assortment) by stepping up the use of "store charts."

Mystery Shopper QSC Evaluation:



Satisfaction level
C Cleanliness
S Service
Q Quality
(Merchandise assortment)

Note: Graph based on LAWSON Group research. As measurement criteria changed in March 2005, figures have been adjusted using constant standards to secure fairness and consistency.

Cleanliness and Service:	**Improved by focusing on Three Challenge Practices**
Quality:	**Failed to curb ordering due to drop in customers and inadequate ordering support from LAWSON branches**

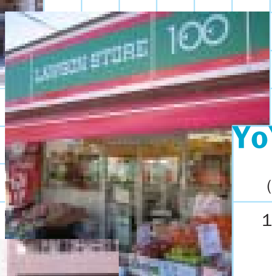
EXTEND

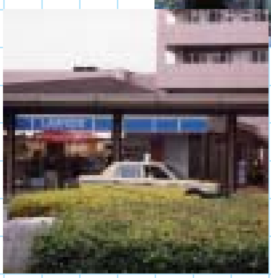
Extend the Customer Base

To increase visits by women and seniors to stores, we will introduce at our regular LAWSON stores throughout Japan the expertise in product development and store displays that we have acquired through the new NATURAL LAWSON and LAWSON STORE100 formats. In addition, we will bolster our lineup of locally targeted products, which reflect the preferences of customers in regional areas. Through these initiatives, we aim to expand the customer base, achieving earnings growth from increased customer numbers. Moreover, by opening stores in locations that are convenient for customers and special locations such as hospitals and subway concourses, we aim to enhance LAWSON's name recognition.

NATURAL LAWSON

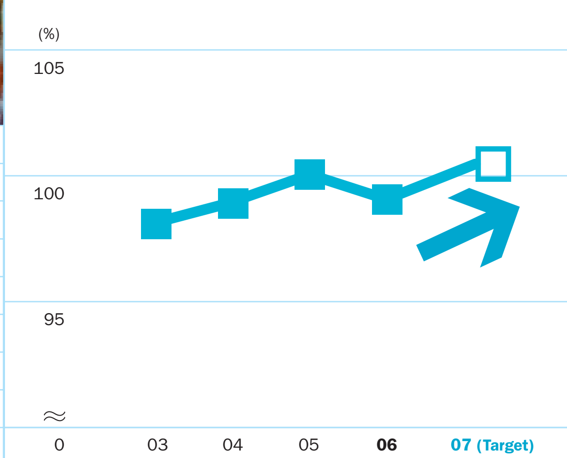
LAWSON STORE100





Hospital LAWSON

YoY Rate on Number of Customers



Note: Fiscal years from 2002 through 2005 are fiscal years ended February the following year, while the 2007 figure is an estimate for the fiscal year ending February 29, 2008.

ENHANCING EARNINGS QUALITY

VALUE-ADDED

“Kayakuzen” *Obento* (boxed lunch)

Supply Value-added Products

The NATURAL LAWSON format, which is based on the key words “beauty and health” and “working women,” has encouraged store visits by women and seniors, thanks to store design that breaks the conventional convenience store mold. For example, stores emphasize white to convey cleanliness, feature a wood tone, and incorporate an in-store bakery. We aim to provide merchandise that customers choose to buy, such as oxygenated mineral water, soap without additives, and organic wine, not just daily necessities and emergency-use products, which are stalwarts of the conventional CVS merchandise assortment. As regards rice dishes, which are a mainstay product line, in particular, we provide high-quality products that take into account nutritional balance and calories by using ingredients with a strong emphasis on health, such as black rice and brown rice.

Initiatives at NATURAL LAWSON

Medium-term Targets:
Markup: 40%
ROI: 30%

Further establish earnings model

FY2006 year-end target: 150 stores

Accelerate store openings
Open stores in business and residential areas

Develop products in tune with NATURAL LAWSON approach

- Increase lineup of freshly baked bread
- Use alliances to develop new products and supply exclusive brands e.g. Vinos Yamazaki and Ef:
- Use alliances in marketing e.g., tie-up with *Hanako* Magazine

Expand franchise network

Accelerate franchise store openings in 2H

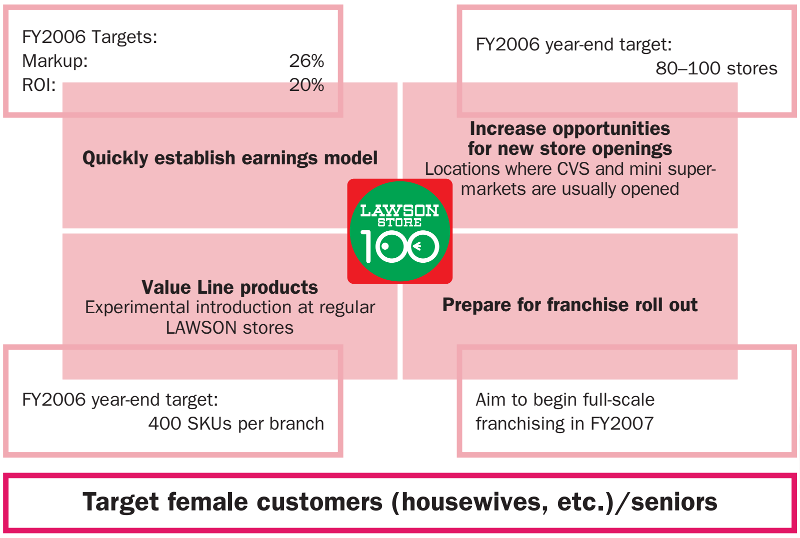
Target health-conscious female customers/seniors

OPTIONS

Offer Economic Options

LAWSON STORE100 targets women and seniors and is founded on the concept of a convenience store plus a mini-supermarket. This format offers the three perishable foods (meat, seafood and vegetables) and daily products, such as *tofu* and *natto* (fermented soy beans), backed by a total commitment to freshness, in small quantities and conveniently sized packages in locations that are within convenient walking distance. These stores respond to the demographic change of a decline in the number of family members in city areas, with senior couples and single people becoming more predominant. In terms of products, we are promoting the development of the private brand *Value Line*, which offers perishable foods produced domestically, beverages, and daily products at a value-for-money price of ¥100 (¥105 including consumption tax). At February 28, 2006, the number of stock keeping units (SKU) for this line had climbed to 140.

Initiatives at LAWSON STORE100



The private brand ***Value Line***

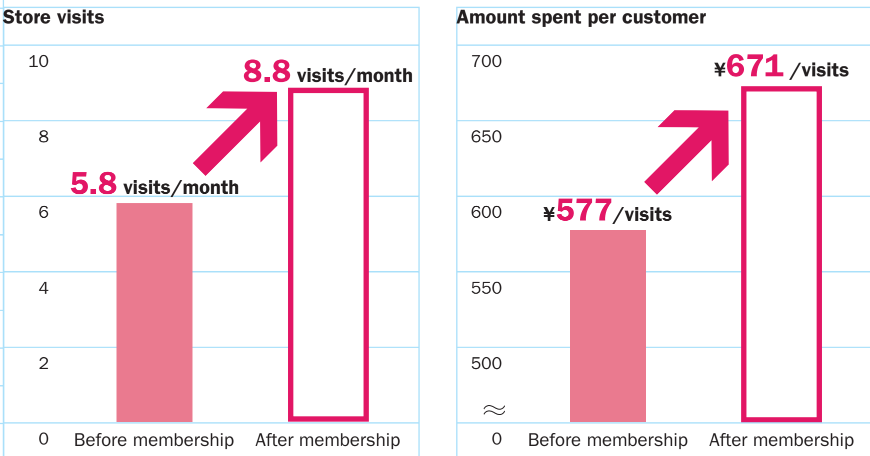
REPEAT

Attract Repeat Customers

At February 28, 2006, the number of members of LAWSON PASS, our original membership card, exceeded 2.1 million, making it one of the largest cardholder bases in the CVS sector. According to a sampling survey, the number of store visits and amount spent per visit by customers who had become LAWSON PASS cardholders had both increased. Going forward, we aim to turn medium-level card users into frequent card users and to increase the number of customers by carrying out sales campaigns limited to members, improving the points program, and reinforcing the merits of advanced reservations linked to LAWSON TICKET.

In March 2006, LAWSON signed a capital and business alliance agreement with NTT DoCoMo, Inc. In addition to promoting the introduction of NTT DoCoMo's *iD*™ mobile phone payment platform at all stores, LAWSON and NTT DoCoMo announced plans to strengthen a cooperative relationship aimed at developing the mobile phone-based business in the future.

Benefits of LAWSON PASS



Note: Based on data for 351 new members

LAWSON PASS encourages more store visits and higher spending per visit

BUILDING
A RESILIENT COMPANY

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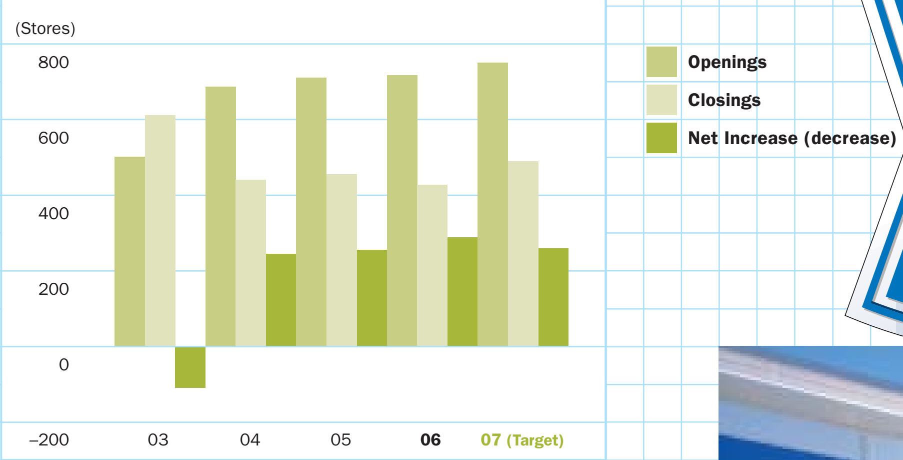
Number of stores



Under LAWSON Challenge 2004, the medium-term management plan that we implemented over a three-year period from fiscal 2002, we closed unprofitable stores. From the viewpoint of asset efficiency, opening highly profitable stores is a key management issue. Thus, when opening stores, we strictly observe our original store opening standards of the “no good (NG) line,” “the grid point system (best location)”, and “return on investment (ROI)”. By firmly adhering to the ROI standard, in particular, we have endeavored to enhance store profitability. Our existing stores have inevitably suffered a decline in income resulting from changes in the external environment, such as competing store openings in nearby areas. However, we are attempting to enhance store earning power by actively relocating franchised stores based on the premise that the “Mystery Shopper” criteria have been fulfilled.

Regular LAWSON

Improve Asset Efficiency

IMPROVE

TRAIN

Train a Better Workforce

At LAWSON, our objective is to improve customer satisfaction and we believe that the "LAWSON family" is important as an intangible asset to realize that objective. The LAWSON family comprises franchise owners, crews (part-time and casual workers), and employees, all of whom support LAWSON. As we aim to enhance the added value of these unseen assets, that is, human resources, we are conducting an educational program for the LAWSON family called LAWSON University. Following the establishment of training centers at all regional headquarters in fiscal 2004, we opened a learning center near the Tokyo Head Office in fiscal 2005. LAWSON University offers various kinds of training based on the principle of customer satisfaction.

LAWSON University

=Corporate-wide human resource development (stores and head office)

Store education	Promotion of ES/CS	LAWSON Basic	Next-generation management education (Selective training)	Training as per job title	Self-enlightenment	Job skills	Job rotation/ evaluation
Training for opening Leader crew candidates training Leader crew course Training of existing store managers *7 training centers throughout Japan	Survey on employees CS session *ES=Employee satisfaction	Basic knowledge to exercise FC business and retail skills	Logical thinking Management strategies Marketing Accounting LAWSON case studies President session	Managerial training New employee training Store manager training Store employee training Training of new store managers	Corres-pondence/ classroom-type education Overseas and external seminars Training tailored for individual needs	Training for store development Merchandiser training IT training Supervisor training	
	Group training						
	e-learning						

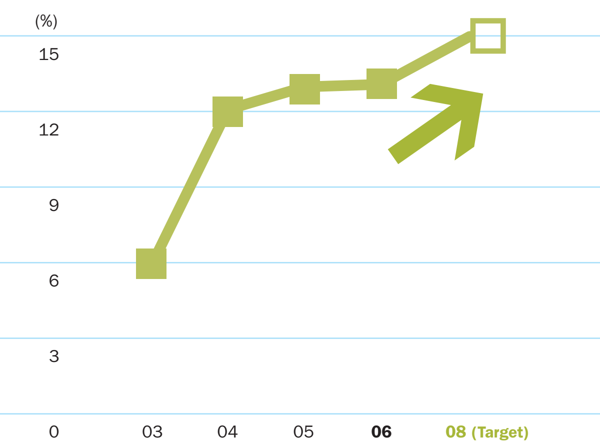
Employee training

RAISE

Raise Capital Efficiency

LAWSON is earnestly striving to enhance capital efficiency. We are targeting average growth in EPS of 10% from fiscal 2005 to fiscal 2007 and ROE of 15% at the end of fiscal 2007. We have also actively returned profits to shareholders. For example, we retired a total of about ¥43.0 billion of treasury stock during the five-year period to fiscal 2005. In fiscal 2004, we raised the annual cash dividend per share by ¥29, and following a further increase of ¥20 in fiscal 2005, we are planning to introduce another increase of ¥10 in fiscal 2006. We will continually aim to enhance capital efficiency to be an attractive company to all our shareholders by seeking an optimal balance between reinvestment in future earnings growth and shareholder returns.

Return on Equity (ROE)



Note: Fiscal years from 2002 through 2005 are fiscal years ended February the following year, while the 2007 figure is an estimate for the fiscal year ending February 29, 2008.

Corporate Governance

7. REIKO OKUTANI
Member of the Board

8. EIICHI TANABE
Member of the Board and CFO

9. KOJI FURUKAWA
Member of the Board

10. HIROSHI KUWATA
Corporate Auditor

11. TAKEHIKO KAKIUCHI
Member of the Board

12. MUNEAKI MASUDA
Member of the Board

13. TORU MORIYAMA
Member of the Board

Basic Policy on Corporate Governance

LAWSON categorizes its stakeholders into seven groups: customers, shareholders, franchise owners, store crew (part-time workers), business partners, employees and society. We are engaged in business activities to maximize our corporate value in order to become a company that has meaning to each of these stakeholder groups. Consequently, there are now more outside directors and corporate auditors than internal appointments to these posts, and we have clearly demarcated responsibilities for management execution and supervision and auditing. At the same time, we believe that it is vital to bolster corporate governance by enhancing the soundness and transparency of management processes. This is achieved through rigorous compliance and proactive disclosure of information.

A diagram illustrating business execution and management supervision flow and showing internal control systems within the overall corporate governance structure is shown on page 16.

Corporate Governance-related Organizations

LAWSON has a Board of Corporate Auditors. At the close of the Ordinary Annual General Meeting of Shareholders on May 26, 2006, there were four corporate auditors, three of whom are from outside LAWSON. Corporate auditors attend Board of Directors' meetings, Executive Committee meetings and other important meetings, offering objective and fair opinions on overall management as well as specific issues. In addition, they audit directors' execution of duties, such as by verifying legality and the condition of internal controls. As a rule, the Board of Corporate Auditors meets once a month.

1. **TETSUO OZAWA**
   Corporate Auditor
2. **TAKESHI NIINAMI**
   President and CEO
3. **HIROSHI TASAKA**
   Member of the Board
4. **MUNEHIKO NAKANO**
   Standing Corporate Auditor
5. **KENJI YAMAKAWA**
   Standing Corporate Auditor
6. **MANABU ASANO**
   Member of the Board and CCO

As of May 26, 2006

As of May 26, 2006, the Board of Directors comprised nine members, five of whom are from outside LAWSON. We believe that this majority representation on the Board provides a wider range of insights and knowledge on significant issues pertaining to corporate management, particularly the formulation of Company-wide management strategies, and reinforces the Board's ability to arrive at fair decisions.

To support the outside directors and outside corporate auditors, staff distributes discussion agenda in advance of Board meetings. Responsible departments also report significant events and incidents immediately to these directors and corporate auditors.

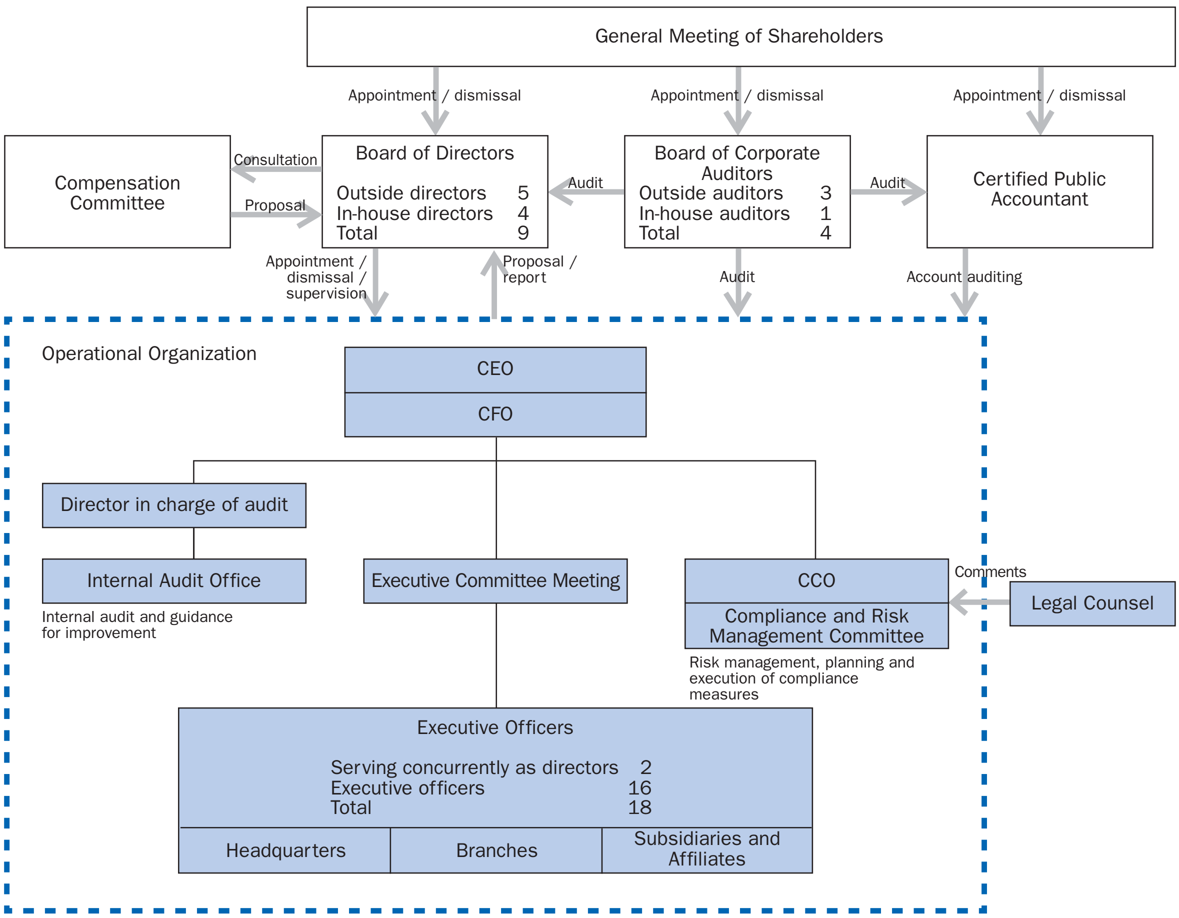
Mitsubishi Corporation, LAWSON's strategic partner, holds 31.7% (32,399 thousand shares) of LAWSON's voting rights, including indirect holdings. LAWSON is treated as an equity-method affiliate by Mitsubishi. Two of the five outside directors and two of the three outside corporate auditors come from Mitsubishi Corporation.

Since fiscal 2002, LAWSON has maintained an executive officer system that separates the functions of management supervision and business execution. As of May 26, 2006, LAWSON had 18 executive officers, 2 of whom also concurrently serve as directors.

Compensation for Directors and Executive Officers

The Compensation Committee, which is made up entirely of outside directors and outside corporate auditors, determines compensation for directors and executive officers. LAWSON has introduced a system whereby approximately 30% of the annual compensation of directors and executive officers is dependent

Corporate Governance System (As of May 26, 2006)



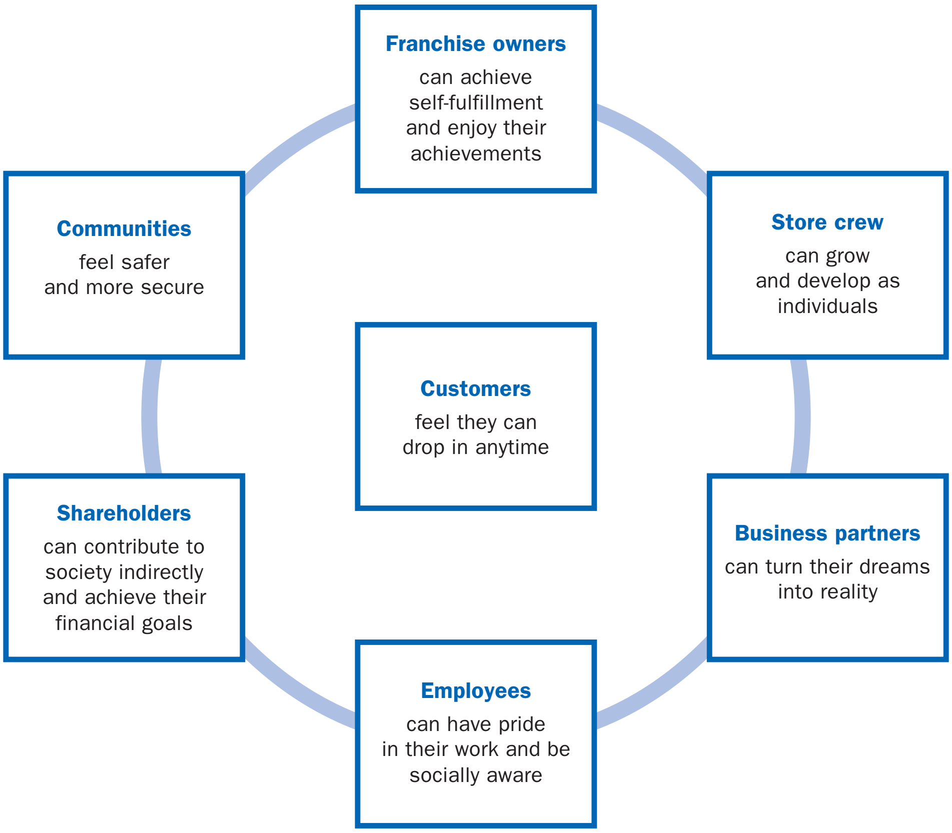
upon business results. This system more clearly incentivizes these executives to improve LAWSON's business results.

Furthermore, the May 27, 2005 Ordinary Annual General Meeting of Shareholders approved a resolution to abolish the conventional retirement benefit system for directors and replace it with stock-compensation-type stock options that can be exercised after a director retires. This is also part of moves by LAWSON to incentivize directors to improve business results.

Active and Fair Disclosure

LAWSON recognizes its obligation to all stakeholders to accurately and fully explain its performance and business results. This obligation extends to disclosing information in a way that is easier to understand. As part of our active efforts to disclose information, we make our monthly business reports and earnings presentation materials available, where possible, on our web site immediately upon their release to the media. Furthermore, to the extent possible, we publish important disclosure materials in English. We also use video streaming (in Japanese only) to bring the Ordinary Annual General Meeting of Shareholders to people unable to attend the meeting in person, further demonstrating our efforts to conduct investor relations activities that encourage dialogue with all stakeholders, both in Japan and overseas. In addition, we have established the LAWSON Customer Center, to handle telephone inquiries from all parties and created an online contact point to field any questions stakeholders may have. Together, these and other initiatives constitute a framework for quickly disclosing information and responding to stakeholders.

We promise to make LAWSON a place where:



LAWSON believes that honoring these commitments to its stakeholders will translate into higher corporate value.

Internal Control Systems

LAWSON believes that it is important to adopt a proactive stance toward compliance and risk management. Regarding the internal control system for ensuring this kind of response, LAWSON maintains internal control functions through the Board of Directors and Board of Corporate Auditors, both of which are made up of a majority of outside directors and outside corporate auditors. Furthermore, LAWSON has established the Internal Audit Office as an internal auditing unit. Audits are performed continuously to ensure that operations are being executed properly, based on prevailing laws and regulations, and that business activities, including risk management measures, are appropriate. LAWSON engages Deloitte Touche Tohmatsu as its independent auditors and has contracts with several law firms to receive legal advice on corporate management and day-to-day operations, and maintain a standby system whereby we can obtain counsel whenever necessary to use as reference in forming management decisions.

To refine and further strengthen the internal control system, we formulated a Basic Policy for Maintaining Internal Control Systems for Fiscal 2006 in February 2006. This policy came into force on March 1, 2006. In addition to the previously mentioned control functions, we have appointed a Chief Compliance Officer (CCO) to handle compliance and risk management, under whom there is full-time staff. At the same time, compliance officers have been appointed at all headquarters departments and our seven regional headquarters nationwide to promote compliance and ensure that it is firmly embedded at LAWSON. In addition, we have a Compliance and Risk Management Committee, which is headed by the CCO. This committee, which meets monthly, is charged with developing and promoting strategies for strengthening risk management and compliance.

Corporate Social Responsibility

Roughly three decades have passed since the first convenience store opened in Japan. During this time, the convenience store industry has grown to occupy an important place in Japanese society as a bona fide industry. At the same time, as its role in society has increased, so too has scrutiny regarding the industry's meaning to society and its corporate social responsibility (CSR) in terms of the environment, ethics and other aspects of business. Until now, the industry has grown by pursuing enhanced customer convenience as its single biggest goal. However, issues about waste, increased energy consumption, nighttime operations and other areas have emerged that must be addressed from the standpoint of social responsibility. LAWSON's mission is to respond proactively to these issues. We must do more than other companies to fulfill our corporate responsibility and only by doing so will we increase our corporate and shareholder value. Signaling our determination to strengthen our approach to CSR, we established a CSR Promotion Office in March 2005 under the direct control of the president.

Fiscal 2005 Activities

LAWSON's biggest contribution to society is supporting the lives of customers and other people in regions where it operates through its chain of about 8,300 stores nationwide. Indeed, we subscribe to the belief that playing a useful role in people's lives is the social responsibility of all companies. In this context, during fiscal 2005, we worked to address four main themes as part of our CSR activities: (1) ascertaining and reducing CO_2 emissions, (2) reducing and recycling waste, (3) running the LAWSON Green Fund and fund-raising campaigns for disaster relief projects, and (4) examining issues relating to late-night convenience store operation.

With regard to theme (1), LAWSON took an active part in Team –6%, a national campaign to help prevent global warming. Specifically, LAWSON initiated concrete measures, including installing energy-efficient equipment, in support of Japan's efforts to comply with its Kyoto Protocol target of reducing CO_2 emissions by 6% between 2008 and 2012 compared with 1990. Progress is being monitored by an ISO 14001-certified environmental management system. In the convenience store industry in particular, reducing the amount of electricity used by stores is one of the most effective ways of reducing CO_2 emissions. Because of this, as part of energy conservation measures at existing stores, LAWSON began introducing Ecopack and Ecomonitor systems in fiscal 2005. Ecopack automatically adjusts and controls freezers, refrigerators, air-conditioning units and other equipment to suitable operating levels, while Ecomonitor automatically monitors and displays total CO_2 emissions, electricity usage and electricity expenses. These initiatives have already won kudos in the industry. In February 2006, LAWSON became the first chain in Japan's convenience store industry to be awarded the Minister of Economy, Trade and Industry Prize for outstanding achievement in the field of energy conservation in fiscal 2005 at a national energy conservation contest sponsored by The Energy Conservation Center, Japan (ECCJ).

To reduce and recycle waste, we implemented an initiative to reduce the number of plastic bags used in stores by asking customers whether they need a bag. Other initiatives include reducing the use of resources by making product packaging thinner and lighter, recycling used edible oils, and using food waste for animal feed and fertilizer. Further, we are trying to reduce food waste by reviewing production and processing systems and devising better distribution and sales approaches. While this will require unprecedented innovation, it will also lead to the creation of a new business model for convenience stores.

In terms of support activities for funds and campaigns, we continue to operate the LAWSON Green Fund, which we launched in 1992. Not only Head Office Staff but also franchise owners and store crew participate in the greening activities supported by this fund, making it a group-wide activity. This is a prime example of how we are giving tangible form to LAWSON's corporate philosophy of "Happiness and Harmony in our Community." LAWSON has also actively undertaken fund-raising campaigns for disaster relief in areas stricken by earthquakes, typhoons and other natural disasters, as well as activities in support of the restoration of these areas such as by providing emergency provisions. As of the end of fiscal 2005, the total amount of money raised by the LAWSON Green Fund and fund-raising campaigns for disaster relief projects since fiscal 1992 was around ¥2.8 billion.

Regarding operating hours, and in particular late-night trading, LAWSON believes that necessity differs from store to store depending on customer needs. In fiscal 2006, LAWSON will continue to examine and make changes to operating hours, conducting trials and taking other actions that it considers will address this issue.

New employees participate in a greening program

LAWSON Green Fund

This poster draws attention to LAWSON's shopping bag-reduction drive

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Consolidated Five-Year Summary

LAWSON, INC. and Consolidated Subsidiaries
Years Ended February 28 and 29

	Millions of Yen					Thousands of U.S. Dollars[1]
	2006	2005	2004	2003	2002	**2006**
For the year:						
Operating revenues						
Franchise commission from franchised stores	**¥ 170,785**	¥ 162,963	¥ 153,910	¥ 149,032	¥ 141,621	**$ 1,468,866**
Net sales from company-operated stores	**66,027**	63,802	67,479	80,954	101,353	**567,876**
Other	**31,246**	27,630	24,212	20,348	13,142	**268,737**
Total operating revenues	**268,058**	254,395	245,601	250,334	256,116	**2,305,479**
Operating income	**43,867**	42,941	38,087	34,107	36,363	**377,286**
Net income	**22,025**	20,435	18,571	8,861	16,123	**189,430**
Cash flows from operating activities	**46,933**	47,329	37,424	33,860	44,804	**403,655**
Cash flows from investing activities	**(55,282)**	(33,297)	(40,621)	(3,787)	(44,031)	**(475,462)**
Cash flows from financing activities	**(7,795)**	(13,836)	(14,364)	(7,247)	(58,236)	**(67,042)**
Capital expenditure[2]	**54,417**	46,873	48,303	75,828	59,810	**468,023**
Depreciation and amortization[3]	**20,896**	19,641	18,499	16,071	16,328	**179,720**
At year-end:						
Total assets	**¥ 375,107**	¥ 356,310	¥ 354,831	¥ 342,599	¥ 342,934	**$ 3,226,172**
Total shareholders' equity	**175,184**	160,282	154,317	151,864	149,827	**1,506,700**
Shareholders' equity ratio	**46.7%**	45.0%	43.5%	44.3%	43.7%	
Interest-bearing debt	**–**	–	–	–	3,140	
Ratio of interest-bearing debt	**–**	–	–	–	0.9%	
Cash and cash equivalents	**60,441**	76,585	76,389	93,994	71,269	**519,833**
Total number of stores[4]	**8,366**	8,077	7,967	7,721	7,824	
Number of employees (full-time)	**3,585**	3,391	3,402	3,462	3,817	

	Yen					U.S. dollars
Per share data:						
Net income	**¥ 216**	¥ 198	¥ 176	¥ 82	¥ 146	**$ 1.85**
Cash dividends	**90**	70	41	41	41	**0.77**
Payout ratio	**40.5%**	35.0%	22.8%	43.0%	27.2%	
Financial data:						
ROE	**13.1%**	13.0%	12.1%	5.9%	9.8%	
ROA	**6.0%**	5.7%	5.3%	2.6%	4.4%	
Net sales of all stores:						
Net sales by store category						
Franchised stores[5]	**¥1,295,704**	¥1,265,275	¥1,220,819	¥1,213,088	¥1,184,204	**$11,143,924**
Company-operated stores	**66,027**	63,802	67,479	80,954	101,353	**567,876**
Net sales by product category[5]						
Processed foods	**¥ 682,006**	¥ 665,687	¥ 625,031	¥ 600,508	¥ 583,712	**$ 5,865,709**
Fast foods	**312,289**	297,369	302,568	303,098	297,030	**2,685,895**
Daily foods	**150,917**	148,134	139,506	138,353	150,862	**1,297,987**
Non-food products	**216,519**	217,887	221,192	252,083	253,953	**1,862,209**
Net sales of all stores	**¥1,361,731**	¥1,329,077	¥1,288,297	¥1,294,042	¥1,285,557	**$11,711,800**

Notes: 1. The U.S. dollar amounts represent translations of Japanese yen at the approximate exchange rate at February 28, 2006, of ¥116.27=$1.
2. Effective from this annual report, the composition of capital expenditure has changed to also include leases, investments and advances, and construction assistance guarantees. Please refer to page 30 for details.
3. Including depreciation and amortization of intangible fixed assets.
4. Shanghai stores are not included because SHANGHAI HUALIAN LAWSON CO., LTD. was excluded from the scope of consolidation from April 2005.
5. These figures, as reported by franchised stores, are unaudited.

Management's Discussion and Analysis

Industry Overview

In the Japanese retail industry, the disparity between companies' earnings has widened based on the quality of management strategies and corporate strength, due to intensifying competition that has transcended industry borders in the past several years.

In the convenience store (CVS) sector, major chains are continuing to open new stores aggressively, while competition with other industries and other sectors is also becoming increasingly fierce. For example, supermarkets are extending their trading hours or increasingly operating round the clock, and there is heightened competition from restaurants, take-out shops, and drugstores. In addition, convenience stores featuring specific merchandise assortments of perishable food targeting consumers, mainly housewives, in small commercial areas have been rapidly expanding and encroaching on the conventional CVS market.

Owing to these changes in the environment, if LAWSON limits its operations to conventional CVS formats, which just provide merchandise assortments and services predominantly for the core target of young male customers, by only pursuing the need to save time and the offering of convenience, it will be forced into a war of attrition with other homogenized convenience stores. We believe this would make it increasingly difficult for us to achieve sustained, stable growth as a company.

CVS Share of the Total Retail Market

(Billions of Yen)

Years ended December 31	2005	2004	2003	2002	2001
Total retail industry annual sales	**¥129,526**	¥128,093	¥128,870	¥131,413	¥136,808
CVS sector annual sales	**7,360**	7,289	7,096	6,980	6,846
CVS share	**5.7%**	5.7%	5.5%	5.3%	5.0%

Source: "Survey of Commerce," Ministry of Economy, Trade and Industry

Share of CVS Market Held by Top Five Chains (Sales)

(Billions of Yen)

February 28 and 29	2006	2005	2004	2003	2002
LAWSON	**¥1,362**	¥1,329	¥1,288	¥1,294	¥1,286
Seven-Eleven Japan	**2,499**	2,441	2,343	2,213	2,114
FamilyMart	**1,032**	998	954	932	899
Circle K	**505**	503	480	485	467
Sunkus	**394**	403	403	406	393
Total	**5,792**	5,674	5,468	5,330	5,159
(Share)	**78.7%**	77.8%	77.0%	76.4%	75.4%
CVS industry	**¥7,360**	¥7,289	¥7,096	¥6,980	¥6,846

Notes: 1. Total figures are for the years ended February 28 and 29.
2. CVS industry figures are for previous calendar years ended December 31.

Management Measures in Fiscal 2005

In this environment, LAWSON inaugurated LAWSON Challenge 2007, a medium-term business plan, which aims to enhance customer satisfaction and increase the earnings of franchised store owners. In addition, we implemented the following management measures in fiscal 2005, ended February 28, 2006:

1. We aimed to enhance customer satisfaction by focusing on the reinforcement of existing stores and the opening of new stores based on a three-pronged approach: enhancing product development capabilities, strengthening store operation capabilities, and improving store development capabilities.
2. By developing LAWSON STORE100, a new format, we endeavored to establish a three-format store system that also includes LAWSON and NATURAL LAWSON stores.
3. To mark our 30th anniversary, we established a new corporate philosophy called "Happiness and Harmony in our Community," and we took actions aimed at the realization of this corporate philosophy in order to be a company that is needed not only by customers, but also society as a whole.

Product Overview

Sales by Product Category (consolidated, total net sales)

Sales of processed foods, which account for half of total sales, struggled, edging up only 2.5%. The rate of growth of total net sales, the total sum of both Company-operated and franchised store sales dropped as a result. In the fast foods category, although sales of rice dishes and cooked noodles were slightly weak, counter products such as *Karaage-kun* crispy Japanese-style fried chicken performed strongly. As a result, sales of fast foods rose 5.0% and drove sales. Sales of daily foods rose only 1.9% due to lackluster sales of bakery items. Sales of non-food products edged down 0.6%. Sales of energy drinks, health care products, and sanitary goods were robust, but the termination of sales of the Highway Card in September 2005 and slower cigarette sales growth had an adverse impact.

Net Sales by Product Segment (consolidated, total net sales)

(Millions of Yen)

Years ended February 28 and 29	2006	2005	2004	2003	2002
Processed foods	¥ 682,006	¥ 665,687	¥ 625,031	¥ 600,508	¥ 583,712
Fast foods	312,189	297,369	302,568	303,098	297,030
Daily foods	150,917	148,134	139,506	138,353	150,862
Total food sales	1,145,212	1,111,190	1,067,105	1,041,959	1,031,604
Non-food products	216,519	217,887	221,192	252,083	253,953
Net sales at all stores	¥1,361,731	¥1,329,077	¥1,288,297	¥1,294,042	¥1,285,557

Breakdown of Net Sales by Product Segment (consolidated, total net sales)

(%)

Years ended February 28 and 29	2006	2005	2004	2003	2002
Processed foods	50.1%	50.1%	48.5%	46.4%	45.4%
Fast foods	22.9	22.4	23.5	23.4	23.1
Daily foods	11.1	11.1	10.8	10.7	11.7
Total food sales	84.1	83.6	82.8	80.5	80.2
Non-food products	15.9	16.4	17.2	19.5	19.8
Net sales at all stores	100.0%	100.0%	100.0%	100.0%	100.0%

Note: Effective from the fiscal year ended February 28, 2003, bakery items were reclassified from "fast foods" to "daily foods," while some pickles and some delicatessen items were reclassified from "daily 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 Margin by Product Segment (parent company)

The overall gross profit margin improved by 0.4 percentage point, roughly in line with our target. The termination of low-margin Highway Card sales from mid-September pushed up the gross profit margin by about 0.2 percentage point on a fiscal year basis. As regards the sales mix, a slowdown in sales growth of low-margin cigarettes and an increase in the sales weighting of high-margin fast foods such as counter products contributed to an improvement in the gross margin. In non-food products, a narrower focus on strong-selling daily necessities produced an improvement in the terms of trade and contributed to an improvement in the gross margin, mainly in the first half.

Gross Profit Margin by Product Segment (parent company)

(%)

Years ended February 28 and 29	2006	2005	2004	2003	2002
Fast foods	36.8%	36.4%	35.6%	35.7%	33.7%
Daily foods	33.6	33.3	32.5	32.5	35.0
Processed foods	26.7	26.7	26.9	27.3	27.3
Non-food products	35.8	34.0	33.4	29.9	30.5

Notes: 1. Gross profit in the non-food products segment includes commission income.
2. The processed foods category includes cigarettes.

Bill Settlement Services (parent company)

Years ended February 28 and 29	2006	2005	2004	2003	2002
Bill settlements (millions of yen)	1,165,255	1,035,936	919,205	817,656	743,482
No. of transactions (millions)	130.6	118.9	108.4	100.0	91.9
No. of companies handled	349	309	283	245	198
Commission income (millions of yen)	7,507	6,768	6,368	5,990	5,689

Merchandising Strategy

In the area of merchandising strategy, while aiming to develop products that suit customer needs, we actively pursued innovation as we attempted to achieve differentiation from other retailers. In the case of the *Gohantei* rice dish brand based on the concept of "surprise" and "innovation," which we launched in 2004, we actively brought out new products at an average rate of two a month. We developed boxed lunches made from ingredients with health conscious consumers in mind, namely, rice steamed with vegetables and steamed barley rice. Examples included *Kani-tama no Kurozuan* (crab bowl with black vinegar sauce over steamed rice) and *Aburi Chashu-don* (grilled roast pork bowl), which went on sale in April 2005. In addition, based on the new concept of including soup in boxed lunches, we launched a new *Gohantei* series that resembles traditional Japanese meals of three dishes, one bowl of soup and a bowl of rice.

Sales in the sushi category, represented by dishes such as *Yakisaba Sushi* (grilled mackerel sushi), performed strongly and were more than 100% higher than a year earlier.

As regards the *Onigiriya* series of rice balls, which we have been marketing for three years, we adopted square packaging for hand-rolled rice balls for the first time in the CVS sector. This wrapping was used in *Shinfukkura Temaki Onigiri*, featuring crispy dried seaweed and fluffy rice. Sales of this product were expanded nationwide in July 2005.

Reflecting calls from working women in their twenties and thirties, who want to eat "a variety of foods in small quantities" and have "a good nutritional balance of vegetables, meat and other items," we launched the *Deli & Pasta* series, which enables customers to enjoy pasta together with side dishes, in October 2005.

In the case of counter products, we introduced new fried chicken products, including a new series of *Karaage-kun*. This move, in combination with active sales promotion at our stores, led sales to increase more than 100% from a year earlier.

In June 2005, we carried out our 30th anniversary commemoration campaign. Based on the concept of "surprise & fun," we launched products for a limited time such as 30th anniversary commemoration boxed lunches.

Store Development

We put in place a framework to open stores in an optimal format matched to their location, by making maximum use of the features of our three formats—LAWSON, NATURAL LAWSON, and LAWSON STORE100—which enable us to respond flexibly to the needs of regional customers. It has become difficult to open only regular LAWSON stores in some locations due to competition with other major CVS chains, but there is now a greater possibility of opening stores based on formats that enable differentiation, namely, NATURAL LAWSON and LAWSON STORE100, in such locations.

By thoroughly adhering to LAWSON's store opening standards, the "no good (NG) line" (a standard indicating store opening is impossible), as well as the grid point system (the best location), and return on investment (ROI), when opening stores mainly in large city areas in the Kanto, Kinki, and Chubu regions, we strove to develop stores that we expect to generate high income.

As part of our strategy aimed at opening stores in diverse locations, we formed a business alliance with Tokyu Corporation in November 2005, and we agreed to develop a new type of business format involving convenience stores in stations, with the aim of opening the first store in the summer of 2006. Furthermore, based on a business alliance with Tokyo Metro Co., Ltd. in February 2006, we endeavored to enhance the recognition and establish the brand image of NATURAL LAWSON by newly opening NATURAL LAWSON stores, in addition to our existing regular LAWSON stores, in subway concourses.

During fiscal 2005, we opened 8 Hospital LAWSON stores, which we expect to generate high income in these special commercial spaces within hospitals, bringing the total number of these stores to 20 at the end of the fiscal year. Anticipating new business opportunities arising from Japan's aging population, we intend to further expand this promising business model. We also steadily implemented measures relating to Postal LAWSON stores, based on our alliance with Japan Post, with an eye on business opportunities likely to occur after privatization. We believe that one of LAWSON's strengths lies in the ability to actively form alliances with diverse partners. Moving forward as well, based on entirely original concepts that break the mold, we will open stores in diverse locations as we pursue the potential of new business opportunities.

As a result of these measures, domestic store openings numbered 717 while store closings reached 428, including relocated stores. At February 28, 2006, LAWSON's domestic network comprised 8,366 stores, including 51 NATURAL LAWSON and 35 LAWSON STORE100 stores, a net increase of 289 from a year earlier.

The network of SHANGHAI HUALIAN LAWSON CO., LTD., an affiliate in the People's Republic of China accounted for under the equity method, reached 283 stores, an increase of 73 stores, as of December 31, 2005.

Number of Stores in the LAWSON Network

February 28 and 29	2006	2005	2004	2003	2002
Number of stores	**8,366**	8,077	7,967	7,721	7,824
Openings	**717**	711	687	519	626
Closings	**428**	455	441	622	551
Net increase (decrease)	**289**	256	246	(103)	75

Note: Figures for SHANGHAI HUALIAN LAWSON CO., LTD. are not included in figures from 2005, as the company became an equity-method affiliate in fiscal 2004.

Number of Stores by FC Contract Type

February 28 and 29	2006	2005	2004	2003	2002	Net increase (decrease) (from 2005 to 2006)
B	**1,674**	1,836	1,992	2,200	2,412	(162)
Share (%)	**20.0**	22.7	25.4	28.8	31.2	
G	**2,272**	2,335	2,415	2,446	2,459	(63)
Share (%)	**27.2**	28.9	30.9	32.1	31.8	
C	**4,012**	3,560	3,065	2,645	2,308	452
Share (%)	**48.0**	44.1	39.2	34.7	29.8	
Franchised stores	**7,958**	7,731	7,472	7,291	7,179	227
Share (%)	**95.1**	95.7	95.5	95.6	92.8	
Company-operated stores	**408**	346	349	334	555	62
Share (%)	**4.9**	4.3	4.5	4.4	7.2	
Total	**8,366**	8,077	7,821	7,625	7,734	289
Share (%)	**100.0**	100.0	100.0	100.0	100.0	

Outline of Store Contracts

<table>
<tr><td colspan="2">Contract type</td><td>C</td><td>G</td><td>B</td></tr>
<tr><td colspan="2">Contract term</td><td colspan="3">10 years from store opening day</td></tr>
<tr><td colspan="2">Owner conditions</td><td colspan="3">At least 20 years old, 2 full-time store workers</td></tr>
<tr><td colspan="2">Land and buildings</td><td colspan="2">Prepared by LAWSON</td><td>Prepared by franchisee</td></tr>
<tr><td colspan="2">Investment in store construction and interior decoration expenses</td><td colspan="2">Borne by LAWSON</td><td>Borne by franchisee</td></tr>
<tr><td colspan="2">Signage and business fixtures</td><td colspan="3">Prepared by LAWSON</td></tr>
<tr><td rowspan="2">Payment by franchisee at time of contract*</td><td>Franchise fee</td><td colspan="3">¥1.5 million (Contract fee, training expenses, and store opening preparation commission, each ¥500,000)</td></tr>
<tr><td>Investment</td><td colspan="3">¥1.5 million (Including payment for some merchandise purchased on behalf of the store)</td></tr>
<tr><td colspan="2">Guarantee deposit provided by franchisee</td><td>Not required</td><td>Average monthly sales x 2 months</td><td>–</td></tr>
<tr><td colspan="2">Head Office income**</td><td>Gross profit x 50%</td><td>Gross profit x 45%</td><td>Gross profit x 34%</td></tr>
<tr><td colspan="2">Burden of utility expenses</td><td colspan="3">Franchisee</td></tr>
<tr><td colspan="2">Minimum guarantee (annual)** (thousands of yen)</td><td>21,000</td><td>22,200</td><td>22,200</td></tr>
</table>

* *Above amount is paid by franchisee to Head Office at time of franchising contract. In addition, the franchisee needs to separately prepare a total of ¥500,000, including float at time of store opening.*

** *Head Office income and minimum guarantee are in case of stores operating on a 24-hour basis*

Scope of Consolidation

The consolidated results for fiscal 2005 include the performances of eight members of the LAWSON Group—six consolidated subsidiaries and two affiliates accounted for under the equity method—and the parent company. These subsidiaries and affiliates are broadly involved in four categories of business: CVS operations, financial services, other services, and overseas business. The business operations and fiscal results of companies included within the scope of consolidation are presented below.

(1) CVS Operations

LAWSON is developing its new CVS formats through two subsidiaries: NATURAL LAWSON, Inc. and VALUE LAWSON Inc.

NATURAL LAWSON, Inc. (Consolidated Subsidiary)

NATURAL LAWSON is a valued-added CVS format targeting mainly working women, based on the key words "beauty" and "health." The first store was opened in July 2001. In April 2004, one business division within the Head Office was spun off as NATURAL LAWSON, Inc., a subsidiary of LAWSON. NATURAL LAWSON, Inc. undertakes the establishment of the business format, product planning and development, and store management guidance for NATURAL LAWSON stores under contract for LAWSON. In fiscal 2005, the company endeavored to achieve further differentiation from the conventional CVS business model by reviewing products handled. In addition, it carried out a radical management review aimed at the full-scale operation of a franchise system, including reform of the management system based on the introduction of individual store information analysis. The company will increase its human resources as it accelerates growth from fiscal 2006 onward.

(Millions of Yen)

	2006	2005	2004	2003	2002
Operating income (loss)	**¥(690)**	¥19	¥(0.4)	¥ 9	¥(0.4)
Net income (loss)	**(723)**	18	5	(1)	5
No. of stores	**51**	28	14	13	3

VALUE LAWSON Inc. (Consolidated Subsidiary)

This consolidated subsidiary operates LAWSON STORE100 perishable food convenience stores. LAWSON STORE100 stores target women and seniors with a concept of "supporting time saving, simplicity, and convenience in everyday life." These stores provide a wide range of products spanning processed foods and daily necessities at a uniform price of ¥100 (excluding consumption tax). The main products comprise fresh fruit and vegetables, handy boxed lunches and side dishes. VALUE LAWSON Inc. was established in April 2005 as a wholly owned subsidiary to establish the LAWSON STORE100 business format, which weds the CVS and mini-supermarket formats, as well as to perform product planning and development for these stores. The company opened its first store in May 2005. The company is actively developing a private brand called *Value Line*. As of February 28, 2006, there were approximately 140 stock keeping units (SKUs) in this brand.

(Millions of Yen)

	2006	2005	2004	2003	2002
Operating loss	**¥(623)**	–	–	–	–
Net loss	**(709)**	–	–	–	–
No. of stores	**35**	–	–	–	–

(2) Financial Services

LAWSON ATM Networks, Inc (Consolidated Subsidiary)

This consolidated subsidiary was established in May 2001 with investments by LAWSON, Mitsubishi Corporation and several banks to run ATM-related operations for LAWSON stores. The company began installing ATMs and started ATM services at some LAWSON stores from October 2001. The company's ATM business installs jointly operated ATMs on a leased basis in LAWSON stores in regions where agreement has been reached with partner banks. It has formed alliances with the major city bank groups and regional banks; partner banks currently number 17.

As of February 28, 2006, the number of ATMs installed stood at 3,812 and the number of prefectures where ATMs are installed was 27, following the addition of Miyagi Prefecture during fiscal 2005. LAWSON held a 59.0% interest in this company as of February 28, 2006.

Number of ATMs Installed

	2006	2005	2004	2003	2002
Number of ATMs installed	**3,812**	3,570	3,127	2,712	1,922

(Millions of Yen)

	2006	2005	2004	2003	2002
Operating revenues	**¥11,311**	¥10,003	¥8,352	¥6,718	¥1,248
Operating income (loss)	**654**	144	(348)	(529)	(303)
Net income (loss)	**675**	266	(350)	(529)	(326)

LAWSON CS Card, INC. (Equity-method Affiliate)

This equity-method affiliate was established in February 2002 by Credit Saison Co., Ltd. (30% shareholding), Mitsubishi Corporation (20% shareholding), and LAWSON (50% shareholding). It issues LAWSON PASS credit cards to LAWSON customers and provides services through Loppi multimedia terminals and other channels. As of February 28, 2006, LAWSON PASS, for which services began in August 2002, had a cardholder base exceeding 2.1 million members. Earnings have improved substantially every year since the February 2004 fiscal year in line with growth in the cardholder base.

Credit Saison undertakes card issuance and credit screening for LAWSON PASS on behalf of LAWSON CS Card.

(Millions of Yen)

	2006	2005	2004	2003	2002
Operating revenues	**¥7,157**	¥ 4,261	¥ 2,551	¥ 858	¥ 0
Operating income (loss)	**270**	(1,230)	(2,255)	(3,935)	(1)
Net income (loss)	**568**	(1,218)	(2,256)	(3,936)	(5)

(3) Other Services

LAWSON TICKET INC. (Consolidated Subsidiary)

This consolidated subsidiary sells tickets to concerts, movies, sporting events and other entertainment productions, primarily through Loppi multimedia terminals at LAWSON stores. It was established as a ticket sales company in 1992 and changed its name to the current one in 1996. Having become a subsidiary of LAWSON in 1997, it formed a business alliance covering ticket sales with Rakuten, Inc., after accepting capital participation from Rakuten in January 2004. LAWSON TICKET listed on the JASDAQ market in October 2004. It ranks second in sales in the ticket sales industry behind PIA Corp. and it is particularly strong in J-POP, sports and theater-related ticketing. LAWSON held a 50.8% interest in this company as of February 28, 2006. In fiscal 2005, profits reached a record high, with operating income surging 13.9% compared to a year earlier.

(Millions of Yen)

	2006	2005	2004	2003	2002
Operating revenues	**¥6,259**	¥6,288	¥6,218	¥5,425	¥5,119
Operating income	**821**	721	644	788	508
Net income	**487**	411	387	387	275

i-Convenience, Inc (Consolidated Subsidiary)

This consolidated subsidiary was established in October 2000 with the aim of expanding business in the e-commerce sector, based on joint investment by LAWSON (51% shareholding), Mitsubishi Corporation (18%), Matsushita Electric Industrial Co., Ltd. (18%), and NTT DoCoMo, Inc. (13%). It operates the official "iLAWSON" i-mode Internet site, and in addition to online merchandise sales and provision of related services and information, it manages the LAWSON web site.

(Millions of Yen)

	2006	2005	2004	2003	2002
Operating revenues	**¥ 427**	¥ 308	¥ 333	¥ 213	¥ 103
Operating loss	**(64)**	(114)	(241)	(383)	(473)
Net loss	**(137)**	(155)	(663)	(489)	(470)

BestPractice Inc. (Consolidated Subsidiary)

This wholly owned subsidiary implements "Mystery Shopper" on-site inspections of convenience stores to determine the status of operations and offers advice and proposals to improve LAWSON stores at the operational level. Through this program, a disguised researcher who is a company employee with a thorough knowledge of convenience store operation and merchandise assortments, objectively and quantitatively evaluates LAWSON stores from a customer's perspective. The results are fed back to LAWSON's Head Office and franchise owners.

(Millions of Yen)

	2006	2005	2004	2003	2002
Operating revenues	**¥892**	¥628	–	–	–
Operating income (loss)	**62**	(2)	–	–	–
Net income (loss)	**34**	(2)	–	–	–

(4) Overseas Business

SHANGHAI HUALIAN LAWSON CO., LTD. (Equity-method Affiliate)

This company, which became an equity-method affiliate in fiscal 2004, is involved in the development of a chain of LAWSON stores in Shanghai, the People's Republic of China. The change from consolidated subsidiary to equity-method affiliate represents LAWSON's agreement to foster expansion through operation by local partners. Therefore, in May 2004, LAWSON relinquished 21.0% of its 70.0% equity interest in the company to partner Hualian Group Corporation, leaving LAWSON with a stake of 49.0%. At the end of December 2005, there were 283 stores in operation, of which 191 were franchised stores.

(Millions of Yen)

	2006	2005	2004	2003	2002
Operating loss	**¥ (7)**	¥ (13)	¥ (81)	¥(191)	¥(183)
Net income (loss)	**3**	0	(71)	(190)	(146)
No. of stores	**283**	210	146	96	90

Note: SHANGHAI HUALIAN LAWSON CO., LTD. closes its accounts in December. It also changed from a consolidated subsidiary to an equity-method affiliate in 2004.

Overview of Earnings Figures (Consolidated)

Total Net Sales

Aggregate net sales of LAWSON stores in fiscal 2005, ended February 28, 2006, rose 2.5%, to ¥1,361,731 million. In the first half, although new popular *Gohantei* products and the June 30th anniversary commemoration campaign bore fruit, unfavorable weather conditions in July had an adverse impact, leading only to a 3.8% increase in total net sales. At the start of the second half, the termination of Highway Card sales pushed down sales growth by about 1 percentage point, while customer numbers declined sharply in response to a historically severe winter from November. Furthermore, sales promotion campaigns by competitors in the CVS sector also had a negative impact. As a result, total net sales edged up only 1.1%.

By product category, sales of fast foods grew in response to sales efforts by store crews and the continued launch of new products. However, sales of processed foods, which saw a slump in demand for beverages and instant noodles, and daily foods, which suffered stagnant demand for bakery items, increased only slightly. Sales of non-food products decreased, reflecting the termination of Highway Card sales.

Existing Store Sales

Existing store sales fell for the eighth consecutive year, marking a steady downward trend since fiscal 1998. Consumers appeared more inclined to spend, but customer numbers fell due to the severest Japanese winter in 20 years, according to an announcement by the Japan Meteorological Agency on March 1, 2006. We believe that existing store sales were weak due to a number of factors. The opening of a large number of conventional convenience stores had an adverse impact, and as we were slow to respond to demographic changes, the declining birthrate and aging of society also had a negative impact. In addition, sales were depressed by the termination of Highway Card sales, there was competition from department stores and large-scale shopping centers when consumer sentiment was recovering, and consumer spending shifted from the purchase of foods to apparel.

(%)

	2006	2005	2004	2003	2002
Existing store sales (year on year)	**97.5**	99.7	97.5	98.1	98.4
No. of customers and amount spent per customer (year on year)					
No. of customers	**99.1**	100.1	99.0	98.2	–
Amount spent per customer	**98.3**	99.7	100.2	99.9	–

Income and Expenses

Operating Revenues

Total operating revenues comprise net sales from Company-operated stores, franchise commission from franchised stores, and other operating revenues.

Total operating revenues climbed ¥13,663 million, or 5.4%, to ¥268,058 million. The improvement was largely the result of higher franchise commission from franchised stores, arising from a net increase in the number of stores, and higher ATM fees at consolidated subsidiary LAWSON ATM Networks. The rate of total operating revenue growth was higher than total net sales growth because franchise commission from franchised stores has tended to rise at a faster pace than growth in the number of stores, as the weighting of Company-operated stores has declined every year and the share of C-type stores, which pay a high rate of franchise commissions, among new stores has risen in recent years.

Selling, General and Administrative (SG&A) Expenses

SG&A expenses rose ¥11,259 million, or 6.8%, to ¥175,894 million. This increase was mainly due to a ¥4,451 million, or 9.5%, rise in store rents associated with an increase in the opening of mainly C-type franchised stores, and a ¥1,336 million, or 3.9%, increase in personnel expenses stemming from an increase in personnel associated with more store openings by NATURAL LAWSON, Inc. and VALUE LAWSON Inc.

Owing to the application of accounting standards for impairment losses on fixed assets, depreciation and amortization expenses relating to applicable assets decreased ¥132 million, which pushed up operating income by an equivalent amount.

In addition, because of the introduction of the pro forma standard taxation system, SG&A expenses increased ¥741 million compared to the pre-introduction standard, and income taxes decreased by almost the same amount for the same reason.

Breakdown of Main SG&A Expenses

(Millions of Yen)

	2006	2005	2004	2003	2002
Personnel expenses	**¥ 35,450**	¥ 34,114	¥ 33,803	¥ 36,885	¥ 39,073
Advertising and promotional expenses	**9,177**	9,704	11,188	12,505	15,405
Store rents	**51,236**	46,785	42,679	40,035	36,731
Equipment leasing charges	**16,734**	16,263	15,726	14,316	7,745
Depreciation and amortization expenses*	**15,859**	15,059	18,499	16,071	16,328
Other	**47,436**	42,708	35,561	36,526	29,241
Total	**¥175,894**	¥164,635	¥157,456	¥156,338	¥144,523

**Includes depreciation and amortization of intangible fixed assets.*

Composition of SG&A Expenses

(%)

	2006	2005	2004	2003	2002
Personnel expenses	**20.2%**	20.7%	21.5%	23.6%	27.0%
Advertising and promotional expenses	**5.2**	5.9	7.1	8.0	10.7
Store rents	**29.1**	28.4	27.1	25.6	25.4
Equipment leasing charges	**9.5**	9.9	10.0	9.2	5.4
Depreciation and amortization expenses*	**9.0**	9.1	11.7	10.3	11.3
Other	**27.0**	25.9	22.6	23.4	20.2
Total	**100.0%**	100.0%	100.0%	100.0%	100.0%

**Includes depreciation and amortization of intangible fixed assets.*

Operating Income

As a result, operating income rose ¥926 million, or 2.2%, to ¥43,867 million. Excluding the impact of the change to pro forma taxation standards, operating income is estimated to have increased 3.9%. Existing store sales growth and franchise commission from franchised stores, which accounts for the majority of total operating revenues, were below target, but as SG&A expenses were curbed more than projected, operating income was about ¥167 million above target.

Income Before Income Taxes and Minority Interests

Income before income taxes and minority interests grew ¥2,683 million, or 7.4%, to ¥38,723 million mainly for the following reasons. Owing to improved earnings at equity-method affiliate LAWSON CS Card, Inc., equity in gains of associated companies improved by ¥895 million. In addition, LAWSON posted gains on sales of investment in securities of ¥989 million, due mainly to the sale of shares following the public listing of ECONTEXT, INC. and gains on the sale of shares of Volks Co., Ltd.

Net Income

Net income was ¥22,025 million, an increase of ¥1,590 million, or 7.8%. Net income per share increased 8.6% to ¥215.50.

Financial Position (Consolidated)

Current Assets

Total current assets increased ¥1,249 million, or 1.0%, to ¥129,842 million, marking almost flat growth.

Property and Store Equipment, Investments and Other Assets

Net property and store equipment rose ¥7,106 million, or 7.7%, to ¥99,272 million. Owing to an increase in the opening of C-type stores prepared by LAWSON among newly opened franchised stores, there was a rise of ¥14,843 million in buildings. Investments and other assets increased ¥10,442 million to ¥145,993 million, up 7.7% from a year ago, mainly the result of increases in long-term loans receivable and software. The principal reason for the increase in software was higher systems investment to prepare for next-generation IT investment.

Current Liabilities

Total current liabilities rose ¥3,310 million, or 2.4%, to ¥141,241 million. The main contributing factor was a ¥4,345 million increase in money held as agent.

Long-term Liabilities
Total long-term liabilities grew ¥252 million, or 0.5%, to ¥54,859 million. This was because allowance for employees' retirement benefits rose ¥1,010 million, whereas guarantee deposits received from franchised stores declined ¥1,056 million due to a decrease in the number of franchised stores operating under franchise agreements requiring the payment of a guarantee deposit.

Shareholders' Equity
Shareholders' equity rose ¥14,902 million, or 9.3%, to ¥175,184 million. This change mainly came about because retained earnings grew ¥11,635 million on the back of net income of ¥22,025 million, which offset outlays of ¥8,174 million used to pay dividends. Consequently, the equity ratio was 46.7%, up 1.7 percentage points.

Special Account Items on the Balance Sheet
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 28, 2006, this asset account was ¥10,762 million, ¥430 million higher than a year ago. There was thus no substantial change in this account.

(2) **Accounts Receivable—Other:** Other accounts receivable such as income due from vendors is included in "Other" in "Accounts receivable" on the balance sheet. The constituent elements of this item stood at ¥21,578 million at February 28, 2006, an increase of ¥2,852 million from a year ago. Accrued income due from vendors and credit card companies is included in "Prepaid expenses and other current assets."

(3) **Long-Term Loans Receivable:** This account mainly represents money paid to landlords (owners of land and buildings for stores) to help with construction and investments and finance from Head Office to franchised stores. As of February 28, 2006, this account was ¥3,822 million higher than a year ago at ¥20,631 million, due to an increase in money paid to landlords to help with construction.

(4) **Lease Deposits:** This account represents leasehold deposits paid to landlords equivalent to several months' rent under store lease agreements at LAWSON. As of February 28, 2006, this account was ¥89,928 million, a decrease of ¥37 million.

(5) **Due to Franchised Stores:** This account represents Head Office obligations to franchised stores. All franchised stores make remittances of cash proceeds from daily sales to the Head Office. 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 28, 2006, this account was ¥3,417 million, down ¥566 million from a year ago.

(6) **Money Held as Agent:** This account mainly comprises money held on behalf of third-party companies for which LAWSON provides bill settlement services, including public utility charges. There was an increase in money held as agent due to a rise in the number of transactions and the number of companies for which settlement services were provided. As a reflection of this, the balance of payments to third-party companies increased, leading to a rise of ¥4,345 million to ¥44,615 million in this account at February 28, 2006.

(7) **Guarantee Deposits Received From Franchised Stores:** This represents guarantee deposits received by LAWSON from store owners operating under FC-G-type contracts. As of February 28, 2006, this account was ¥50,466 million, ¥1,056 million less than a year ago due to a decline in the number of FC-G-type contract stores.

Capital Expenditure
In fiscal 2005, capital expenditure totaled ¥54,417 million, an increase of ¥7,544 million. Investments in new stores rose ¥4,352 million to ¥26,047 million, due to the opening of stores in the new formats, NATURAL LAWSON and LAWSON STORE100, as well as the aggressive opening of regular LAWSON stores. Systems-related investments rose ¥6,319 million to ¥9,084 million, mainly due to the fact that upfront investment at the preparation stage for next-generation IT systems used cash of approximately ¥6,000 million.

Capital Expenditure

(Millions of Yen)

	2006	2005	2004	2003	2002
New store investments	**¥26,047**	¥21,695	¥19,614	¥14,663	¥18,651
Existing store investments	**6,592**	8,175	10,432	12,028	8,863
Systems-related investments	**9,084**	2,765	2,191	9,133	10,045
Other	**1,615**	4,186	377	1,149	126
Investments and advances	**1,250**	(1,000)	6,250	3,550	380
Leases	**9,829**	11,052	9,439	35,305	21,745
Total	**¥54,417**	¥46,873	¥48,303	¥75,828	¥59,810

Cash Flows

Net cash provided by operating activities totaled ¥46,933 million, ¥396 million lower than in fiscal 2004. The decrease is mainly attributable to an increase in payments of accounts receivable, accrued income and income taxes paid, although there were increases in accounts payable and money held as agent.

Net cash used in investing activities amounted to ¥55,282 million, ¥21,985 million more than in the previous period. This change is mainly attributable to an increase in outflows for purchases of property and store equipment, primarily store-related buildings, an increase in outflows for purchases of marketable securities (maturity date of more than three months) for the purpose of short-term funds investment, and a decrease in proceeds from redemption of marketable securities.

As a result of changes in cash flows from operating and investing activities, free cash flow—the difference between the two figures—declined ¥22,381 million, to a negative ¥8,349 million. However, this was mainly due to net outflows of ¥11,633 million associated with the purchase of marketable securities.

Net cash used in financing activities amounted to ¥7,795 million, a decrease of ¥6,041 million from the previous period. This change is mainly attributable to the Company's shareholder return policy in fiscal 2005 of emphasizing increased dividends rather than the purchase of treasury stock, as a result of a change in capital policy. Consequently, while cash dividends paid rose ¥2,413 million, cash applied to the purchase of treasury stock declined ¥8,796 million.

As a result, cash and cash equivalents at the end of the fiscal year totaled ¥60,441 million, ¥16,144 million less than a year earlier.

Capital Policy: Dividends and Purchase of Treasury Stock

LAWSON regards returning profits to shareholders as one of its most important management policies. At the same time, it sees capital efficiency, such as ROE, as an important management indicator aimed at carrying out business that counterbalances high capital costs. Accordingly, we pursue optimal capital efficiency by looking at a balance between the distribution of profits through dividends and the purchase and cancellation of treasury stock. At the same time, we comprehensively take into account financial conditions, profit levels, and dividend payout ratios while securing internal reserves needed for future business expansion.

During the four-year period from 2002 to fiscal 2005, LAWSON cancelled approximately ¥43.0 billion of treasury stock. As regards cash dividends, in fiscal 2004, we increased the annual cash dividend per share by ¥29 to ¥70, and in fiscal 2005 we raised it by ¥20 to ¥90. Thus, we have actively returned profits to shareholders. In fiscal 2006, we intend to introduce another increase of ¥10, bringing the annual cash dividend per share to ¥100. We are targeting a dividend payout ratio of around 40%, which is close to the global standard as we continue to strive to return profits to shareholders.

Business Cooperation and Alliances

In January 2000, LAWSON formed a comprehensive tie-up, including a capital alliance, with Mitsubishi Corporation. Since then, the two firms have built a cooperative relationship in the areas of personnel resources, store development, new businesses, and product development.

In March 2006, LAWSON also signed a business alliance agreement, including a capital alliance, with NTT DoCoMo, Inc. The main elements of the alliance are as follows:

NTT DoCoMo acquired 2,092,000 shares of LAWSON common stock owned by LAWSON as treasury stock, or 2% of total issued shares, for about ¥9,000 million. The business alliance comprises:

- The introduction of settlement services based on *iD*™* at all LAWSON stores
  * *iD*™ is a mobile phone-based credit card payment service enabling shopping, etc., via NTT DoCoMo's *Osaifu-Keitai*® wallet services.
- The introduction of information services utilizing *ToruCa*™* at all LAWSON stores
  * *ToruCa*™ is a system for capturing information such as coupons just by holding NTT DoCoMo's *Osaifu-Keitai*® mobile phones over reader/writers at stores.
- Going forward, the two companies will hold regular meetings to continue discussions regarding future fields of collaboration
  * *iD*™, *ToruCa*™ and *Osaifu-Keitai*™ are trademarks or registered trademarks of NTT DoCoMo.

Outlook

Although the Japanese economy appears to be recovering moderately, competition transcending the boundaries of the retail industry is becoming increasingly fierce, and customer needs are becoming increasingly diverse.

With regard to the CVS sector, if LAWSON focuses only on the conventional CVS business format, which just provides merchandise assortments and services centered on the past core target of young male customers, by only pursuing the need to save time and the offering of convenience, it will be forced into a war of attrition with other homogenized CVS shops in a mature market. Moreover, in an aging society where the birthrate is also declining, it is expected to become increasingly difficult for companies to achieve sustained, stable growth.

In this environment, we believe that LAWSON needs to aim to become a more advanced company by pursuing innovation in all kinds of areas, without being bound by conventional thinking of the CVS sector, in order to achieve growth over the medium to long term. Based on this rationale, we initiated the medium-term management plan LAWSON Challenge 2007 in fiscal 2005. LAWSON Challenge 2007 features four key themes that are the key words of our medium-term management strategy: 1) driving innovation; 2) improving customer satisfaction and employee satisfaction; 3) improving productivity; and 4) emphasizing corporate social responsibility (CSR). We will thoroughly undertake these four challenges. More specifically, we will pursue management measures that focus on the following three core elements:

1. Enhancing our product development capabilities mainly in the area of rice dishes and counter products through innovation
2. Strengthening store operation capabilities, chiefly by reducing lost opportunities to sell hot-selling products, based on improved order precision from information collection and analysis
3. Improving the ability to develop stores with high projected earnings, by strictly observing our proprietary store opening standards.

In fiscal 2006, in addition to the above measures, we will further cement the position of the NATURAL LAWSON and LAWSON STORE100 formats, which we created to fulfill the needs of women and seniors. To this end, we will actively open new stores and develop products that ensure differentiation.

Furthermore, based on the expertise acquired from these new formats, we will actively introduce products that suit the needs of women and seniors, as part of merchandise tailored to individual stores, in the core regular LAWSON format, which comprises a chain of more than 8,000 stores.

Through these measures, we aim to expand our customer base and increase customer numbers as a result of an increase in customer visits by the new target group, namely, women and seniors.

By strengthening existing stores, developing new stores with high ROI, establishing new formats and steadily implementing other management measures, we will attempt to enhance customer satisfaction. Our goal is to improve corporate earnings and expand the earnings of franchised store owners by expanding the customer base as a result of these actions.

In fiscal 2006, we estimate that operating income will increase 3.3% to ¥45.3 billion, and that net income will rise 5.8% to ¥23.3 billion.

Business Risk Factors

The main risks that may impact on LAWSON's performance and financial position are described on the following page. Sufficiently aware that these risks may occur, LAWSON conducts risk management and is also building and reinforcing an internal control system so as to respond in the best manner possible should a risk materialize. Nevertheless, these risks are only within the range of what can be forecast based on information currently available to the Company, and we do not believe that they cover all potential risks relating to LAWSON's business operations.

(1) Risks relating to changes in the business environment

Because LAWSON's main business is the operation of convenience stores, changes in consumer expenditure produced by changes in the economic environment, business cycle trends, or the social structure in Japan and overseas countries where the Company operates, as well as changes in competition with other companies in the CVS sector or different retail sectors, and deregulation such as revision of the Large-Scale Retail Store Location Law may impact LAWSON's earnings and financial conditions.

(2) Risks relating to food safety and hygiene management

In the CVS business, LAWSON's main business, the Company sells food products to customers. From the manufacturing process to stores, in cooperation with suppliers, LAWSON strictly observes quality standards by performing thorough hygiene management and also performs rigorous hygiene management within stores. However, loss of customer trust in the unlikely event of a serious incident such as food poisoning or contamination by foreign matter could have an impact on the Company's performance and financial position. Should such an incident occur, the Company intends to make the utmost effort to minimize the effect on customers by making a public announcement as quickly as possible through the mass media and other channels.

(3) Risks relating to handling of personal information

In the process of business operations, LAWSON handles personal information of customers, suppliers, franchise owners and other parties. The Company recognizes that the leakage of personal information or improper access to personal information are serious risks. Consequently, we have devised the best possible information security measures and formulated a policy to protect personal information. We have also ensured that personnel within the Company are thoroughly aware of these matters. However, should customer information be leaked or divulged outside the Company under whatever circumstances, LAWSON's performance or financial position may be affected.

(4) Legal and regulatory risks

LAWSON operates numerous stores in various regions throughout Japan and overseas, and the majority of stores operate 24 hours a day. Because of this, in operating its business, the Company must comply with various laws and regulations regarding store development, operating hours, hygiene management, product transactions, environmental protection, and other matters in Japan and overseas, and must obtain various permits and licenses from administrative authorities. Therefore, should events arise such as an unforeseen change in laws or regulations or a change in the enforcement methods of administrative authorities, new compliance costs could arise, which could have an impact on LAWSON's performance or financial position.

(5) Risks relating to franchise operations

In the CVS business, LAWSON's main business, the Company has adopted the franchise system. Based on franchise agreements concluded with franchised stores, LAWSON operates a chain of stores via store brand names that are owned by LAWSON. Therefore, if the brand image of the overall chain is affected by illegal or improper actions at a franchised store, there may be an impact on LAWSON's performance or financial position.

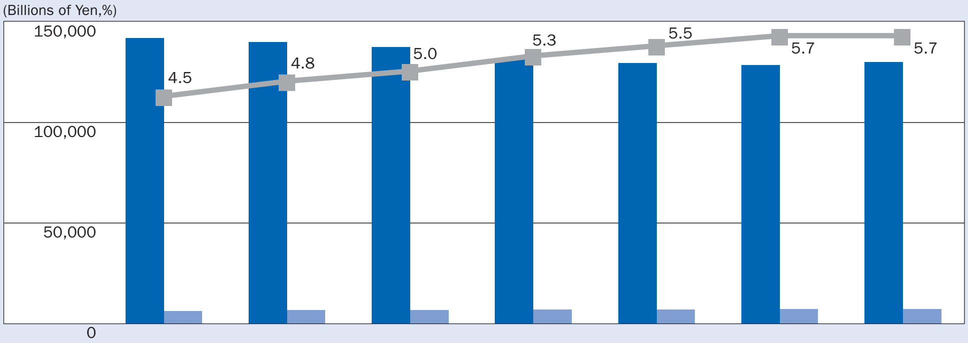
Furthermore, the franchise system is designed to encourage improved business performance for both franchised stores and the Company, based on a relationship of mutual trust. If this relationship of trust between LAWSON and franchised stores is damaged for any reason, and, as a consequence, many franchise agreements are cancelled, there may be an impact on LAWSON's performance or financial position.

(6) Risks relating to unseasonable weather or disasters

Substantial differences in climate and temperatures from the average year could have an impact on LAWSON's performance. Moreover, as LAWSON is a national chain with stores located throughout Japan's 47 prefectures and other administrative divisions, there is a risk that performance will fluctuate due to natural disasters in regions where snowfalls are heavy or typhoons often occur.

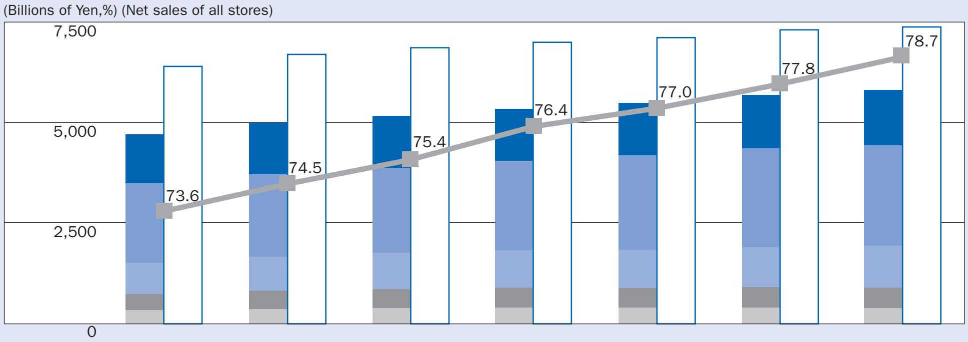
Overview of the CVS Sector

CVS Share of the Total Retail Market



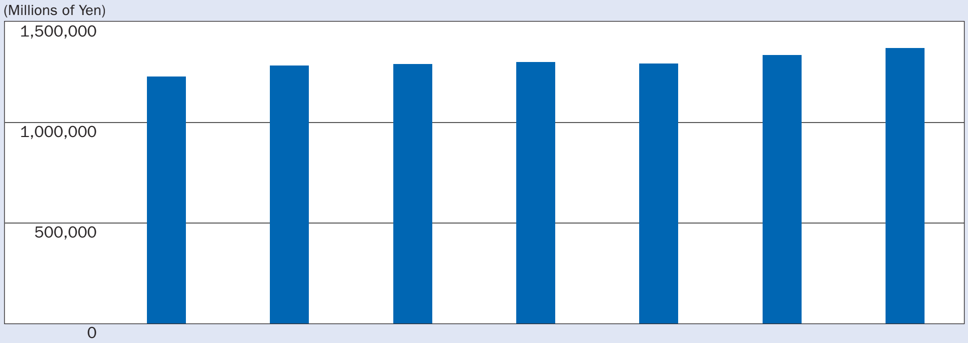
Years ended December 31	1999	2000	2001	2002	2003	2004	**2005**
Total retail industry annual sales	¥141,450	¥139,434	¥136,808	¥131,413	¥128,870	¥128,093	**¥129,526**
CVS sector annual sales	6,383	6,680	6,846	6,980	7,096	7,289	**7,360**
CVS share (%)	4.5%	4.8%	5.0%	5.3%	5.5%	5.7%	**5.7%**

Share of CVS Market Held by Top Five Chains (Sales)



February 28 and 29	2000	2001	2002	2003	2004	2005	**2006**
LAWSON	¥1,221	¥1,275	¥1,286	¥1,294	¥1,288	¥1,329	**¥1,362**
Seven-Eleven Japan	1,964	2,047	2,114	2,213	2,343	2,441	**2,499**
FamilyMart	783	843	899	932	954	998	**1,032**
Circle K	391	447	467	485	480	503	**505**
Sunkus	342	366	393	406	403	403	**394**
Total	4,701	4,978	5,159	5,330	5,468	5,674	**5,792**
(Share) (%)	73.6%	74.5%	75.4%	76.4%	77.0%	77.8%	**78.7%**
CVS industry	¥6,383	¥6,680	¥6,846	¥6,980	¥7,096	¥7,289	**¥7,360**

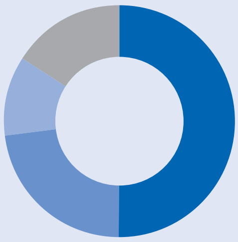
Net Sales of All Stores (Consolidated)



February 28 and 29	2000	2001	2002	2003	2004	2005	**2006**
Net sales of all stores (consolidated)	¥1,222,880	¥1,277,638	¥1,285,557	¥1,294,042	¥1,288,297	¥1,329,077	**¥1,361,731**

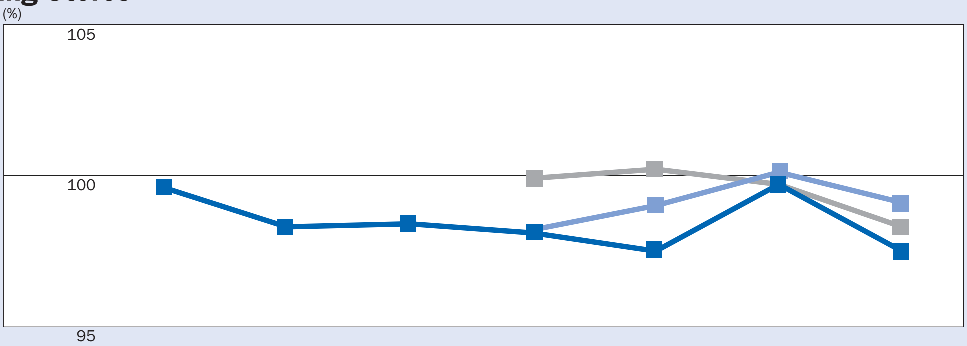
Selected Financial Data

Breakdown of Net Sales by Product Segment



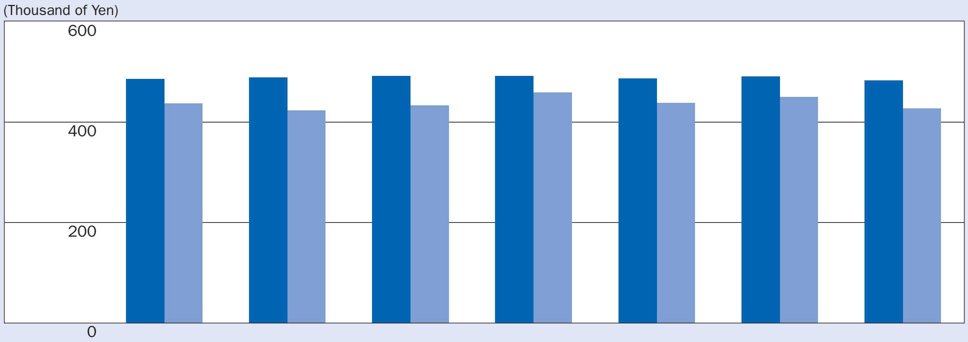
(%)	Year ended February 28, 2006
Breakdown of net sales by product segment	100.0
Processed foods	50.1
Fast foods	22.9
Daily foods	11.1
Non-food products	15.9

YoY Rate on Existing Store Sales, Average Number of Customers and Average Purchase Value per Customer in Existing Stores



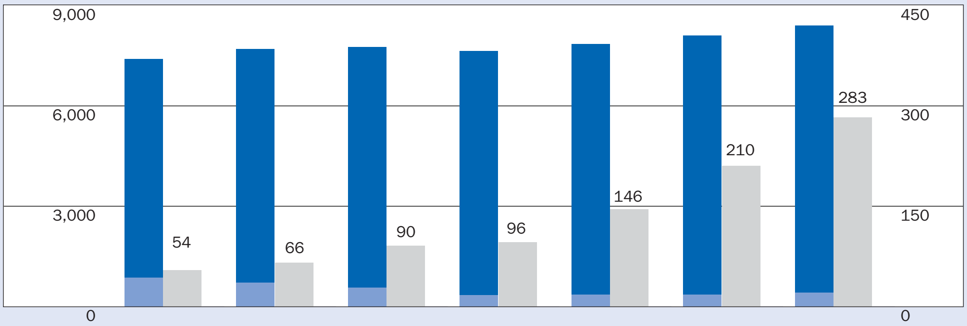
	2000	2001	2002	2003	2004	2005	2006
YoY rate on existing store sales	99.6	98.3	98.4	98.1	97.5	99.7	97.5
Average number of customers and average purchase value per customer in existing stores							
Number of customers	–	–	–	98.2	99.0	100.1	99.1
Average purchase value per customer	–	–	–	99.9	100.2	99.7	98.3

Average Daily Sales per Store (Non-consolidated)



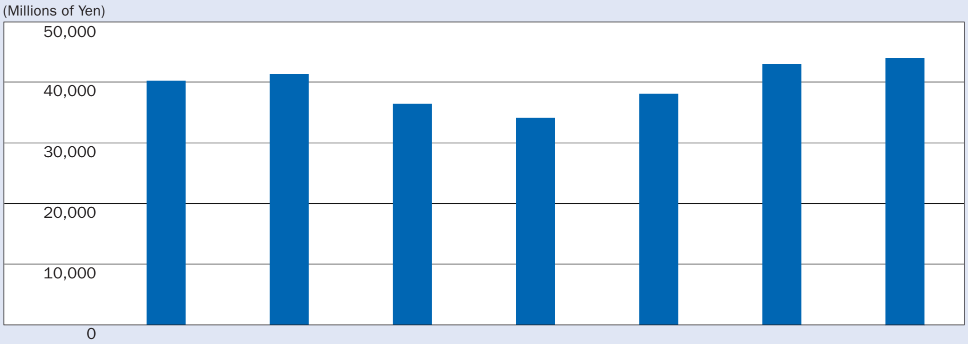
	2000	2001	2002	2003	2004	2005	2006
Total stores	¥483	¥486	¥489	¥489	¥484	¥488	¥480
New stores	435	421	431	457	436	448	426

Number of Stores



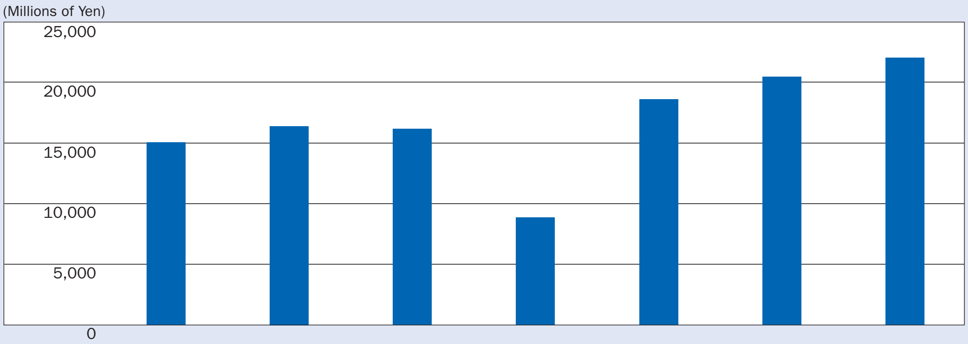
	2000	2001	2002	2003	2004	2005	**2006**
Number of stores (Japan)	7,378	7,683	7,734	7,625	7,821	8,077	**8,366**
■ Franchised stores	6,526	6,972	7,179	7,291	7,472	7,731	**7,958**
■ Company-operated stores	852	711	555	334	349	346	**408**
■ Number of overseas stores (Shanghai, China)	54	66	90	96	146	210	**283**

Operating Income



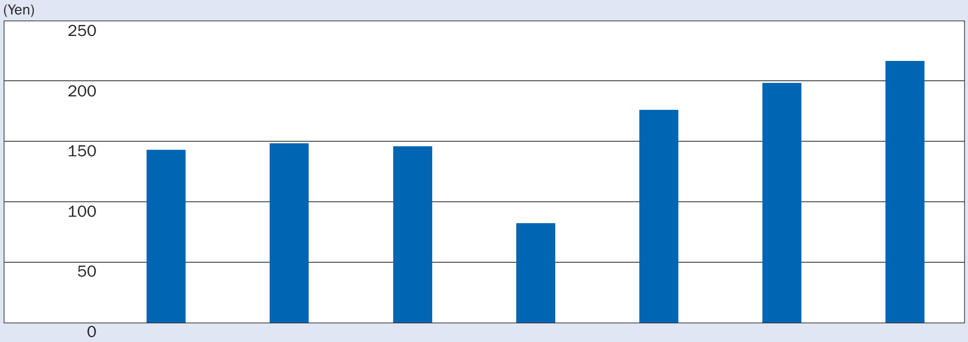
	2000	2001	2002	2003	2004	2005	**2006**
■ Operating income	¥40,185	¥41,279	¥36,363	¥34,107	¥38,087	¥42,941	**¥43,867**

Net Income



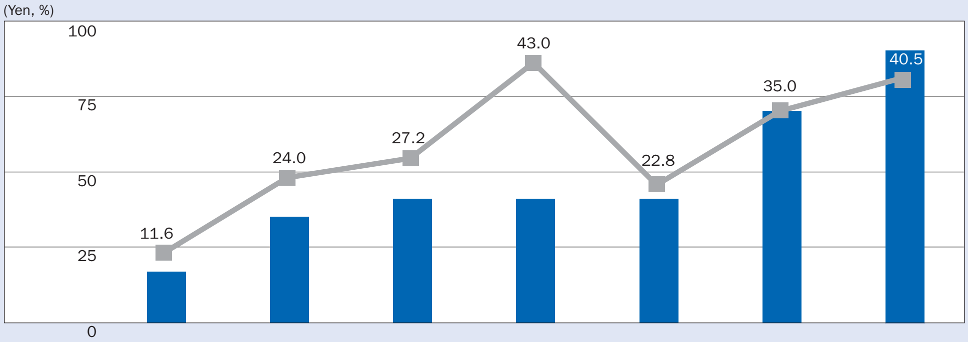
	2000	2001	2002	2003	2004	2005	**2006**
■ Net income	¥15,011	¥16,368	¥16,123	¥8,861	¥18,571	¥20,435	**¥22,025**

Net Income per Share



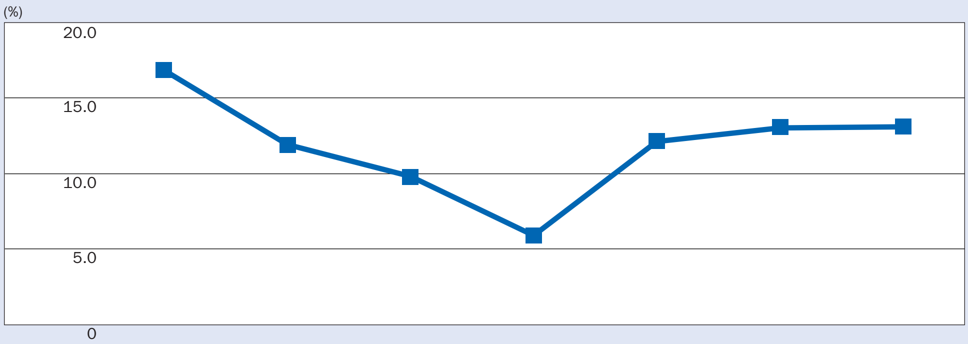
	2000	2001	2002	2003	2004	2005	**2006**
Net income per share	¥143	¥148	¥146	¥82	¥176	¥198	**¥216**

Cash Dividends per Share and Payout Ratio (Non-consolidated)



	2000	2001	2002	2003	2004	2005	**2006**
Cash dividends per share	¥17	¥35	¥41	¥41	¥41	¥70	**¥90**
Payout ratio (%)	11.6%	24.0%	27.2%	43.0%	22.8%	35.0%	**40.5%**

Return on Equity (ROE)



	2000	2001	2002	2003	2004	2005	**2006**
ROE	16.8%	11.9%	9.8%	5.9%	12.1%	13.0%	**13.1%**

Consolidated Balance Sheets

LAWSON, INC. and Subsidiaries
February 28, 2006 and 2005

ASSETS	Millions of Yen 2006	Millions of Yen 2005	Thousands of U.S. Dollars (Note 1) 2006
CURRENT ASSETS:			
Cash and cash equivalents	¥ 60,441	¥ 76,585	$ 519,833
Marketable securities (Note 5)	19,652	8,019	169,020
Accounts receivable:			
Due from franchised stores (Notes 3 and 10)	10,762	10,332	92,560
Other	21,578	18,726	185,585
Allowance for doubtful accounts	(81)	(81)	(697)
Inventories	1,573	1,376	13,529
Short-term loan to associated company (Note 16)	6,250	5,000	53,754
Deferred tax assets (Note 14)	3,189	3,241	27,428
Prepaid expenses and other current assets	6,478	5,395	55,716
Total current assets	129,842	128,593	1,116,728
PROPERTY AND STORE EQUIPMENT (Notes 4 and 6)**:**			
Land (Note 7)	5,237	5,644	45,042
Buildings	130,108	115,265	1,119,016
Furniture, fixtures and equipment (Note 6)	60,410	58,124	519,567
Total	195,755	179,033	1,683,625
Accumulated depreciation	(96,483)	(86,867)	(829,819)
Net property and store equipment	99,272	92,166	853,806
INVESTMENTS AND OTHER ASSETS:			
Investment securities (Note 5)	1,962	1,173	16,875
Investments in associated companies	1,087	728	9,349
Long-term loans receivable	20,631	16,809	177,440
Lease deposits (Note 8)	89,928	89,965	773,441
Deferred tax assets (Note 14)	11,046	8,291	95,003
Deferred tax assets for land revaluation (Note 7)	3,331	4,828	28,649
Software (Note 6)	15,807	12,307	135,951
Other assets	6,663	5,588	57,306
Allowance for doubtful accounts	(4,462)	(4,138)	(38,376)
Total investments and other assets	145,993	135,551	1,255,638
TOTAL	¥375,107	¥356,310	$3,226,172

See notes to consolidated financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of Yen 2006	Millions of Yen 2005	Thousands of U.S. Dollars (Note 1) 2006
CURRENT LIABILITIES:			
Accounts payable:			
Trade (Notes 9 and 16)	¥ 63,170	¥ 62,554	$ 543,304
Due to franchised stores (Note 10)	3,417	3,983	29,388
Other	14,344	14,017	123,368
Income taxes payable (Note 14)	10,324	11,718	88,793
Money held as agent	44,615	40,270	383,719
Accrued expenses and other current liabilities	5,371	5,389	46,195
Total current liabilities	141,241	137,931	1,214,767
LONG-TERM LIABILITIES:			
Allowance for employees' retirement benefits (Note 11)	2,817	1,807	24,228
Allowance for retirement benefits to executive officers and corporate auditors	318	305	2,735
Guarantee deposits received from franchised stores	50,466	51,522	434,041
Lease deposits from lessees	870	813	7,483
Allowance for impairment loss on leased property (Note 15)	140		1,204
Other	248	160	2,133
Total long-term liabilities	54,859	54,607	471,824
MINORITY INTERESTS	3,823	3,490	32,881
CONTINGENT LIABILITIES (Note 17)			
SHAREHOLDERS' EQUITY (Notes 12 and 19):			
Common stock—authorized, 409,300,000 shares in 2006 and 2005; issued, 104,600,000 shares in 2006 and 2005	58,507	58,507	503,199
Capital surplus	41,520	41,523	357,100
Retained earnings	88,356	76,721	759,921
Land revaluation difference (Note 7)	(4,855)	(7,038)	(41,756)
Net unrealized gain on available-for-sale securities	696	110	5,986
Foreign currency translation adjustments	105	34	903
Treasury stock—at cost, 2,313,932 shares in 2006 and 2,422,809 shares in 2005	(9,145)	(9,575)	(78,653)
Total shareholders' equity	175,184	160,282	1,506,700
TOTAL	¥375,107	¥356,310	$3,226,172

Consolidated Statements of Income

LAWSON, INC. and Subsidiaries
Years Ended February 28, 2006 and 2005

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2006	2005	**2006**
OPERATING REVENUES:			
Franchise commission from franchised stores	**¥170,785**	¥162,963	**$1,468,866**
Net sales from Company-operated stores	**66,027**	63,802	**567,876**
Other	**31,246**	27,630	**268,737**
Total	**268,058**	254,395	**2,305,479**
COST AND OPERATING EXPENSES:			
Cost of sales for Company-operated stores	**48,297**	46,819	**415,387**
Selling, general and administrative expenses (Notes 11 and 15)	**175,894**	164,635	**1,512,806**
Total	**224,191**	211,454	**1,928,193**
Operating income	**43,867**	42,941	**377,286**
OTHER INCOME (EXPENSES):			
Interest income—net	**386**	343	**3,320**
Equity in gains (losses) of associated companies	**286**	(609)	**2,460**
Gain on sales of investment in securities	**989**		**8,506**
Reversal of allowance for doubtful accounts	**263**		**2,262**
Loss on disposal of property and store equipment	**(3,014)**	(3,635)	**(25,922)**
Impairment of long-lived assets (Note 6)	**(2,708)**		**(23,291)**
Provision for allowance for doubtful accounts		(2,182)	
Other—net	**(1,346)**	(818)	**(11,577)**
Other expenses—net	**(5,144)**	(6,901)	**(44,242)**
INCOME BEFORE INCOME TAXES AND MINORITY INTERESTS	**38,723**	36,040	**333,044**
INCOME TAXES (Note 14)**:**			
Current	**17,823**	17,313	**153,290**
Deferred	**(1,606)**	(1,945)	**(13,813)**
Total	**16,217**	15,368	**139,477**
MINORITY INTERESTS IN NET INCOME	**(481)**	(237)	**(4,137)**
NET INCOME	**¥ 22,025**	¥ 20,435	**$ 189,430**

	Yen		U.S. Dollars
	2006	2005	**2006**
PER SHARE OF COMMON STOCK (Notes 2.o and 18)**:**			
Net income — basic	**¥215.50**	¥198.47	**$1.85**
Net income — diluted	**215.46**		**1.85**
Cash dividends	**90.00**	70.00	**0.77**

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

LAWSON, INC. and Subsidiaries
Years Ended February 28, 2006 and 2005

	Thousands of Shares/Millions of Yen								
	Common Stock					Net Unrealized Gain on Available-for-sale Securities	Foreign Currency Translation Adjustments	Treasury Stock	
	Shares	Amount	Capital Surplus	Retained Earnings	Land Revaluation Difference			Shares	Amount
BALANCE, MARCH 1, 2004	107,600	¥58,507	¥41,521	¥72,769	¥(7,067)	¥ 53	¥ 68	(3,283)	¥(11,534)
Net income				20,435					
Year-end cash dividends, ¥21 per share				(2,191)					
Interim cash dividends, ¥35 per share				(3,584)					
Reversal of land revaluation difference				(5)	5				
Change in effective tax rate					24				
Net increase in unrealized gain on available-for-sale securities						57			
Net decrease in foreign currency translation adjustments							(34)		
Treasury stock—at cost:									
Purchase of treasury stock								(2,155)	(8,798)
Retirement of treasury stock	(3,000)			(10,703)				3,000	10,703
Exercise of stock options			2					15	54
BALANCE, FEBRUARY 28, 2005	104,600	58,507	41,523	76,721	(7,038)	110	34	(2,423)	(9,575)
Net income				**22,025**					
Year-end cash dividends, ¥35 per share				**(3,576)**					
Interim cash dividends, ¥45 per share				**(4,598)**					
Reversal of land revaluation difference				**(2,183)**	**2,183**				
Net increase in unrealized gain on available-for-sale securities						**586**			
Net increase in foreign currency translation adjustments							**71**		
Treasury stock—at cost:									
Purchase of treasury stock								**(1)**	**(2)**
Exercise of stock options			**(3)**	**(33)**				**110**	**432**
BALANCE, FEBRUARY 28, 2006	**104,600**	**¥58,507**	**¥41,520**	**¥88,356**	**¥(4,855)**	**¥696**	**¥105**	**(2,314)**	**¥ (9,145)**

	Thousands of U.S. Dollars (Note 1)						
	Common Stock	Capital Surplus	Retained Earnings	Land Revaluation Difference	Net Unrealized Gain on Available-for-sale Securities	Foreign Currency Translation Adjustments	Treasury Stock
BALANCE, FEBRUARY 28, 2005	$503,199	$357,126	$659,852	$(60,531)	$ 946	$292	$(82,351)
Net income			**189,430**				
Year-end cash dividends, $0.30 per share			**(30,756)**				
Interim cash dividends, $0.39 per share			**(39,546)**				
Reversal of land revaluation difference			**(18,775)**	**18,775**			
Net increase in unrealized gain on available-for-sale securities					**5,040**		
Net increase in foreign currency translation adjustments						**611**	
Treasury stock—at cost:							
Purchase of treasury stock							**(17)**
Exercise of stock options		**(26)**	**(284)**				**3,715**
BALANCE, FEBRUARY 28, 2006	**$503,199**	**$357,100**	**$759,921**	**$(41,756)**	**$5,986**	**$903**	**$(78,653)**

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

LAWSON, INC. and Subsidiaries
Years Ended February 28, 2006 and 2005

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2006	2005	**2006**
OPERATING ACTIVITIES:			
Income before income taxes and minority interests	**¥ 38,723**	¥ 36,040	**$ 333,044**
Adjustments for:			
Income taxes paid	**(19,217)**	(15,605)	**(165,279)**
Depreciation and amortization	**20,896**	19,641	**179,720**
Impairment of long-lived assets	**2,708**		**23,291**
Provision for allowance for doubtful accounts	**324**	2,342	**2,787**
Loss on disposal of property and store equipment	**1,846**	2,447	**15,877**
Equity in (gains) losses of associated companies	**(286)**	609	**(2,460)**
Gain on sales of investment securities	**(989)**	(92)	**(8,506)**
Other—net	**1,825**	1,648	**15,694**
Changes in assets and liabilities:			
(Increase) decrease in accounts receivable	**(2,908)**	7,378	**(25,011)**
Increase in prepaid expenses and other current assets	**(588)**	(473)	**(5,057)**
Increase in inventories	**(197)**		**(1,694)**
Increase (decrease) in accounts payable	**376**	(2,940)	**3,234**
Increase (decrease) in money held as agent	**4,345**	(3,476)	**37,370**
Increase in accrued expenses and other liabilities	**52**	267	**457**
Increase in allowance for retirement benefits to employees and executive officers and corporate auditors	**1,022**	577	**8,790**
Decrease in guarantee deposits received from franchised stores	**(1,056)**	(1,047)	**(9,082)**
Increase in lease deposits from lessees	**57**	13	**490**
Total adjustments	**8,210**	11,289	**70,611**
Net cash provided by operating activities	**46,933**	47,329	**403,655**
INVESTING ACTIVITIES:			
Purchases of marketable securities	**(44,709)**	(34,319)	**(384,527)**
Proceeds from redemption of marketable securities	**33,076**	35,545	**284,476**
Proceeds from sales of investment securities	**1,705**	216	**14,664**
Purchases of property and store equipment	**(28,631)**	(26,710)	**(246,246)**
Decrease in lease deposits	**37**	623	**318**
(Increase) decrease in short-term loan	**(1,250)**	1,250	**(10,751)**
Increase in long-term loan	**(3,821)**	(3,700)	**(32,863)**
Payment for acquisition of goodwill		(1,685)	
Other	**(11,689)**	(4,517)	**(100,533)**
Net cash used in investing activities	**(55,282)**	(33,297)	**(475,462)**
FINANCING ACTIVITIES:			
Cash dividends paid	**(8,188)**	(5,775)	**(70,422)**
Proceeds from issuance of shares upon exercise of stock option	**395**	56	**3,397**
Purchase of treasury stock	**(2)**	(8,798)	**(17)**
New shares issued to subsidiary's minority shareholders		681	
Net cash used in financing activities	**(7,795)**	(13,836)	**(67,042)**
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	**(16,144)**	196	**(138,849)**
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	**76,585**	76,389	**658,682**
CASH AND CASH EQUIVALENTS, END OF YEAR	**¥ 60,441**	¥ 76,585	**$ 519,833**

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

LAWSON, INC. and Subsidiaries
Years Ended February 28, 2006 and 2005

1. Basis of Presenting Consolidated Financial Statements

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

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

Certain reclassifications have been made in the 2005 financial statements to conform to the 2006 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 ¥116.27 to $1, the approximate rate of exchange at February 28, 2006. 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") owned 32,399 thousand shares of common stock of the Company (including indirect holdings) as of February 28, 2006, which represented 31.7% 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 equal to twice the average monthly sales amounts of the respective store 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 the "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 for 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 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 7). 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. Long-lived Assets—In August 2002, the Business Accounting Council ("BAC") issued a Statement of Opinion, "Accounting for impairment of Fixed Assets," and in October 2003 the Accounting Standards Board of Japan ("ASBJ") issued ASBJ Guidance No. 6, "Guidance for Accounting Standard for impairment of Fixed Assets." These new pronouncements were effective for fiscal years beginning on or after April 1, 2005 with early adoption permitted for fiscal years ending on or after March 31, 2004.

The Companies adopted the new accounting standard for impairment of fixed assets as of March 1, 2005.

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

The effect of adoption of the new accounting standard for impairment of fixed assets (see Note 6) was to increase operating income by ¥132 million ($1,135 thousand) and to decrease income before income taxes by ¥1,854 million ($15,946 thousand) for the year ended February 28, 2006.

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

i. Employees' Retirement Benefits—The Company and a certain domestic subsidiary have defined benefit, lump-sum severance indemnity plans which cover substantially all of their employees. The Company established a trust fund for its lump-sum severance indemnity plan.

The Companies account for the liability for retirement benefits based on the projected benefit obligations and plan assets at the balance sheet date.

In addition to the lump-sum severance indemnity plan, the Company has a defined contribution plan for severance payments. The Company recognizes expenses in the period when the contribution was called for.

j. Allowance for Retirement Benefits to Executive Officers and Corporate Auditors—The provisions are calculated to state the liability at 100% of the amount that would be required if all executive officers and corporate auditors resigned as of each balance sheet date. At the general shareholders' meeting held on May 27, 2005, the Company abolished the conventional retirement benefit system for directors.

k. 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.

l. 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.

m. 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.

n. Foreign Currency Financial Statements—The balance sheet accounts of an associated company denominated in foreign currencies 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 an affiliated company denominated in foreign currencies are translated into yen at the current exchange rate.

o. 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 102,202,000 shares for 2006 and 102,962,000 shares for 2005.

Diluted net income per share for the year ended February 28, 2006 is computed by using the weighted-average number of common shares outstanding adjusted to include the potentially dilutive effect of stock options that were outstanding during the year. Diluted net income per share for the year ended February 28, 2005 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 year.

p. New Accounting Pronouncements

Business combination and business separation

In October 2003, the BAC issued a Statement of Opinion, "Accounting for Business Combinations," and on December 27, 2005 the ASBJ issued "Accounting Standard for Business Separations" and ASBJ Guidance No. 10, "Guidance for Accounting Standard for Business Combinations and Business Separations." These new accounting pronouncements are effective for fiscal years beginning on or after April 1, 2006.

The accounting standard for business combinations allows companies to apply the pooling of interests method of accounting only when certain specific criteria are met such that the business combination is essentially regarded as a uniting of interests. These specific criteria are as follows:

(a) the consideration for the business combination consists solely of common shares with voting rights,

(b) the ratio of voting rights of each predecessor shareholder group after the business combination is nearly equal, and

(c) there are no other factors that would indicate any control exerted by any shareholder group other than voting rights.

For business combinations that do not meet the uniting-of-interests criteria, the business combination is considered to be an acquisition and the purchase method of accounting is required. This standard also prescribes the accounting for combinations of entities under common control and for joint ventures. Goodwill, including negative goodwill, is to be systematically amortized over 20 years or less, but is also subject to an impairment test.

Under the accounting standard for business separations, in a business separation where the interests of the investor no longer continue and the investment is settled, the difference between the fair value of the consideration received for the transferred business and the book value of net assets transferred to the separated business is recognized as a gain or loss on business separation in the statement of income. In a business separation where the interests of the investor continue and the investment is not settled, no such gain or loss on business separation is recognized.

The Company will adopt the new standard for all transactions of business combination/separation effective March 1, 2007.

Stock options

On December 27, 2005, the ASBJ issued “Accounting Standard for Stock Options” and related guidance. The new standard and guidance are applicable to stock options newly granted on and after May 1, 2006.

This standard requires companies to recognize compensation expense for employee stock options based on the fair value at the date of grant and over the vesting period as consideration for receiving goods or services. The standard also requires companies to account for stock options granted to non-employees based on the fair value of either the stock option or the goods or services received. In the balance sheet, the stock option is presented as a stock acquisition right as a separate component of shareholders’ equity until exercised. The standard covers equity-settled, share-based payment transactions, but does not cover cash-settled, share-based payment transactions. In addition, the standard allows unlisted companies to measure options at their intrinsic value if they cannot reliably estimate fair value.

The Company will adopt the new standard for stock options newly granted after May 1, 2006.

The adoption of this standard is not expected to have a material impact on the consolidated financial statements in the year ending February 28, 2007.

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 28, 2006 and 2005, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	**2006**
Used by franchised stores:			
Land	**¥ 1,423**	¥ 1,347	**$ 12,239**
Buildings	**118,297**	104,908	**1,017,434**
Furniture, fixtures and equipment	**51,404**	49,563	**442,109**
Total	**171,124**	155,818	**1,471,782**
Accumulated depreciation	**84,850**	75,888	**729,767**
Net	**86,274**	79,930	**742,015**
Used by Company-operated stores and other:			
Land	**3,814**	4,297	**32,803**
Buildings	**11,811**	10,357	**101,582**
Furniture, fixtures and equipment	**9,006**	8,561	**77,458**
Total	**24,631**	23,215	**211,843**
Accumulated depreciation	**11,633**	10,979	**100,052**
Net	**12,998**	12,236	**111,791**
Net property and store equipment—total	**¥ 99,272**	¥ 92,166	**$ 853,806**

5. Marketable and Investment Securities

Marketable and investment securities as of February 28, 2006 and 2005, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	**2006**
Current—Bonds	**¥19,652**	¥8,019	**$169,020**
Non-current—Marketable and other equity securities	**1,464**	1,173	**12,592**
Non-current—Bonds	**498**		**4,283**

The costs and aggregate fair values of marketable and investment securities at February 28, 2006 and 2005, were as follows:

	Millions of Yen			
February 28, 2006	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as:				
Held-to-maturity	**¥16,012**	**¥ 1**	**¥3**	**¥16,010**
Available-for-sale—equity securities	**288**	**1,175**		**1,463**
Bonds	**4,141**		**3**	**4,138**
February 28, 2005				
Securities classified as:				
Held-to-maturity	¥ 8,019		¥2	¥ 8,017
Available-for-sale—equity securities	947	¥ 188	2	1,133

February 28, 2006	Cost	Unrealized Gains	Unrealized Losses	Fair Value
	Thousands of U.S. Dollars			
Securities classified as:				
Held-to-maturity	**$137,714**	**$ 9**	**$26**	**$137,697**
Available-for-sale—equity securities	**2,477**	**10,106**		**12,583**
Bonds	**35,615**		**26**	**35,589**

Available-for-sale securities whose fair value is not readily determinable as of February 28, 2006 and 2005, were as follows:

	Carrying Amount		
	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	**2006**
Available-for-sale—Equity securities	**¥1**	¥40	**$9**

Proceeds from sales of available-for-sale securities for the years ended February 28, 2006 and 2005 were ¥1,705 million ($14,664 thousand) and ¥216 million, respectively. Gross realized gains and losses on these sales, computed on the moving-average cost basis, were ¥989 million ($8,506 thousand) and ¥0 million ($0 thousand), respectively, for the year ended February 28, 2006, and ¥0 million and ¥14 million, respectively, for the year ended February 28, 2005.

6. Long-lived Assets

The Companies recognized an impairment loss mainly for each store as the smallest cash generating unit, which declined in value due mainly to continuous operating losses. The carrying amount of those assets was written down to the recoverable amount and was recorded in special losses in the statement of income.

The Companies recognized impairment loss on the following asset categories during this fiscal year:

Category	Related Assets	Location	Millions of Yen	Thousands of U.S. Dollars
Stores	Buildings and	Tokyo	**¥ 272**	**$ 2,339**
	furniture, fixtures	Osaka	**183**	**1,574**
	and equipment	Others	**1,870**	**16,084**
Others	Land	Kyoto, etc.	**316**	**2,718**
	Software, etc.	Tokyo	**67**	**576**
Total			**¥2,708**	**$23,291**

The above assets consist of land of ¥316 million ($2,718 thousand), buildings of ¥1,676 million ($14,415 thousand), leased property of ¥204 million ($1,755 thousand), and other of ¥512 million ($4,403 thousand).

The recoverable amounts of those assets were measured based on net selling price or value in use. The net selling price of land was calculated based on the appraised value by a real estate appraiser or expected contract price. The value in use was calculated by discounting estimated future cash flows to which the 6.0% discount rate was applied.

7. 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.

8. 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 28, 2006 and 2005, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	**2006**
Lease deposits for franchised stores	**¥74,856**	¥74,354	**$643,812**
Lease deposits for Company-operated stores and other	**15,072**	15,611	**129,629**
Total	**¥89,928**	¥89,965	**$773,441**

9. Accounts Payable—Trade

The balances of "Accounts payable—trade" 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 as of February 28, 2006 and 2005, were summarized below:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	**2006**
Accounts payable—trade for franchised stores	**¥59,795**	¥59,457	**$514,277**
Accounts payable—trade for Company-operated stores	**3,375**	3,097	**29,027**
Total	**¥63,170**	¥62,554	**$543,304**

10. 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."

11. Employees' Retirement Benefits

The Company and a certain domestic subsidiary each have defined benefit lump-sum severance indemnity plans.

Under the plans, employees terminating their employment are entitled to retirement benefits determined based on the rate of pay, years of service and certain other factors at the time of termination. Such retirement benefits are made in the form of a lump-sum severance payment from the Company or from certain subsidiaries. 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 28, 2006 and 2005, was as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	**2006**
Projected benefit obligation	**¥10,710**	¥ 9,898	**$ 92,113**
Fair value of plan assets	**(5,536)**	(5,536)	**(47,613)**
Unrecognized prior service cost	**(1,406)**	(1,582)	**(12,093)**
Unrecognized actuarial loss	**(951)**	(973)	**(8,179)**
Net liability	**¥ 2,817**	¥ 1,807	**$ 24,228**

The components of net periodic benefit costs for the years ended February 28, 2006 and 2005, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	**2006**
Service cost	**¥ 812**	¥ 659	**$ 6,984**
Interest cost	**197**	175	**1,694**
Amortization of prior service cost	**176**	176	**1,514**
Recognized actuarial loss	**119**	72	**1,023**
Contribution to defined contribution plan	**248**	245	**2,133**
Net periodic benefit costs	**¥1,552**	¥1,327	**$13,348**

Assumptions used for the years ended February 28, 2006 and 2005, were as follows:

	2006	2005
Discount rate	**2.0%**	2.0%
Expected rate of return on plan assets	**0%**	0%
Amortization period of prior service cost	**10 years**	10 years
Recognition period of actuarial gain/loss	**10 years**	10 years

12. Shareholders' Equity

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

The Code requires that all shares of common stock be issued 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 are required to be presented as additional paid-in capital, which is included in capital surplus. The Code permits Japanese companies, upon approval of the Board of Directors, to issue shares to existing shareholders without consideration by way of a stock split. Such issuance of shares generally does not give rise to changes within the shareholders' accounts.

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

The Code allows Japanese companies to purchase treasury stock and dispose of such treasury stock upon resolution of the Board of Directors. The aggregate purchased 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 that could be transferred to retained earnings or other capital surplus other than additional paid-in capital upon approval of such transfer at the annual general meeting of shareholders.

In addition to the provision that requires an appropriation for a legal reserve in connection with the cash outlays, the Code also imposes certain limitations on the amount of capital surplus and retained earnings available for dividends. The amount of capital surplus and retained earnings available for dividends under the Code was ¥78,054 million ($671,317 thousand) as of February 28, 2006, based on the amount recorded in the parent company's general books of account.

Dividends are approved by the shareholders at a meeting held subsequent to the end of 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.

On May 1, 2006, a new corporate law (the "Corporate Law") became effective, which reformed and replaced the Code with various revisions that would, for the most part, be applicable to events or transactions which occur on or after May 1, 2006 and for the fiscal years ending on or after May 1, 2006. The significant changes in the Corporate Law that affect financial and accounting matters are summarized below:

a. Dividends

Under the Corporate Law, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the shareholders' meeting. For companies that meet certain criteria such as: (1) having a Board of Directors (2) having independent auditors (3) having a Board of Corporate Auditors and (4) the term of service of the directors is prescribed as one year rather than two years of normal term by its articles of incorporation, the Board of Directors may declare dividends (except for dividends in kind) if the company has prescribed so in its articles of incorporation.

The Corporate Law permits companies to distribute dividends-in-kind (non-cash assets) to shareholders subject to a certain limitation and additional requirements.

Semiannual interim dividends may also be paid once a year upon resolution by the Board of Directors if the articles of incorporation of the company so stipulate. Under the Code, certain limitations were imposed on the amount of capital surplus and retained earnings available for dividends. The Corporate Law also provides certain limitations on the amounts available for dividends or the purchase of treasury stock. The limitation is defined as the amount available for distribution to the shareholders, but the amount of net assets after dividends must be maintained at no less than ¥3 million.

b. Increases/Decreases and Transfer of Common Stock, Reserve and Surplus

The Corporate Law requires that an amount equal to 10% of dividends must be appropriated as a legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus) depending on the equity account charged upon the payment of such dividends until the total of the aggregate amount of legal reserve and additional paid-in capital equals 25% of the common stock. Under the Code, the aggregate amount of additional paid-in capital and legal reserve that exceeds 25% of the common stock may be made available for dividends by resolution of the shareholders. Under the Corporate Law, the total amount of additional paid-in capital and legal reserve may be reversed without limitation of such threshold. The Corporate Law also provides that common stock, legal reserve, additional paid-in capital, other capital surplus and retained earnings can be transferred among the accounts under certain conditions upon resolution of the shareholders.

c. Treasury Stock and Treasury Stock Acquisition Rights

The Corporate Law also provides for companies to purchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The amount of treasury stock purchased cannot exceed the amount available for distribution to the shareholders, which is determined by specific formula.

Under the Corporate Law, stock acquisition rights, which were previously presented as a liability, are now presented as a separate component of shareholders' equity.

The Corporate Law also provides that companies can purchase both treasury stock acquisition rights and treasury stock. Such treasury stock acquisition rights are presented as a separate component of shareholders' equity or deducted directly from stock acquisition rights.

On December 9, 2005, the ASBJ published a new accounting standard for presentation of shareholders' equity. Under this accounting standard, certain items which were previously presented as liabilities are now presented as components of shareholders' equity. Such items include stock acquisition rights, minority interest, and any deferred gain or loss on derivatives accounted for under hedge accounting. This standard is effective for fiscal years ending on or after May 1, 2006.

13. Stock Option

The Company has a stock option plan as an incentive plan for directors, executive officers and selected employees.

In accordance with approval at the general meetings of shareholders on May 26, 2006, the Company granted stock subscription rights to the Company's directors and selected employees. Also, in accordance with approval at the general meeting of shareholders, the Company granted stock acquisition rights to the Company's directors, executive officers and selected employees. A summary of information regarding the Company's stock option plans is as follows:

						Thousands of Shares				
						Exercised				
Date of Shareholders' Meeting	Exercise Price		Exercisable Period	Number of Options Granted		2004	2005	2006	Canceled or Expired	Outstanding at February 28, 2006
May 26, 2000	¥7,500	$64.51	From May 27, 2002 to May 25, 2007	The Company's directors and selected employees	1,773				756	1,017
May 29, 2002	3,680	31.65	From December 1, 2002 to May 31, 2007	The Company's directors, executive officers and selected employees	313	5	15	66	103	124
May 27, 2003	3,517	30.25	From July 3, 2005 to July 2, 2008	The Company's directors and executive officers	92			44		48
May 28, 2004	4,320	37.15	From June 10, 2006 to June 9, 2009	The Company's directors and executive officers	99					99
May 27, 2005	4,160	35.78	From October 12, 2007 to December 31, 2010	The Company's directors and executive officers	114					114
May 27, 2005	1	0.01	From October 13, 2005 to May 31, 2025	The Company's directors and executive officers	22					22

14. 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 normal effective statutory tax rates of approximately 40.7% and 42.0% for the years ended February 28, 2006 and 2005, respectively.

The tax effects of significant temporary differences and tax loss carryforwards which resulted in deferred tax assets and liabilities at February 28, 2006 and 2005, are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	**2006**
Deferred tax assets:			
Accrued enterprise tax	**¥ 833**	¥ 1,117	**$ 7,164**
Accrued employees' bonuses	**1,144**	1,249	**9,839**
Excess of depreciation	**3,320**	2,298	**28,554**
Excess of amortization of software	**930**	975	**7,999**
Employees' retirement benefits	**3,255**	2,709	**27,995**
Allowance for doubtful accounts	**1,772**	1,654	**15,240**
Tax loss carryforward	**1,425**	1,108	**12,256**
Impairment loss	**2,197**		**18,896**
Other	**1,527**	1,496	**13,134**
Less valuation allowance	**(1,690)**	(998)	**(14,535)**
Total	**14,713**	11,608	**126,542**
Deferred tax liabilities—Unrealized gain on available-for-sale securities	**478**	76	**4,111**
Total	**478**	76	**4,111**
Net deferred tax assets	**¥14,235**	¥11,532	**$122,431**

As of February 28, 2006, certain subsidiaries have tax loss carryforwards aggregating approximately ¥3,502 million ($30,120 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
2007	¥ 456	$ 3,922
2010	483	4,154
2011	415	3,569
2012	622	5,350
2013 and thereafter	1,526	13,125
Total	¥3,502	$30,120

15. 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 28, 2006 and 2005, were ¥16,900 million ($145,351 thousand) and ¥16,133 million, respectively.

For the year ended February 28, 2006, the Companies recorded an impairment loss and a related allowance for impairment loss on leased property, in the amount of ¥204 million ($1,755 thousand) on certain leased property held under finance leases, that do not deem to be transferred ownership and accounted for as operating lease.

Pro forma information of leased property such as acquisition cost, accumulated depreciation, accumulated impairment loss, obligations under finance leases, depreciation expense, interest expense and impairment loss 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 28, 2006 and 2005 was as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	**2006**
Leased to franchised stores:			
Furniture, fixtures and equipment			
Acquisition cost	**¥68,378**	¥67,597	**$588,097**
Accumulated depreciation	**38,352**	33,019	**329,853**
Accumulated impairment loss	**158**		**1,359**
Net leased property	**¥29,868**	¥34,578	**$256,885**
Obligations under finance leases:			
Due within one year	**¥11,972**	¥11,445	**$102,967**
Due after one year	**18,898**	23,992	**162,536**
Total	**¥30,870**	¥35,437	**$265,503**

Allowance for impairment loss on leased property of ¥126 million ($1,084 thousand) as of February 28, 2006 is included in obligations under finance leases.

	Millions of Yen		
	2006		
	Furniture, Fixtures and Equipment	Software	Total
Used by Company-operated stores and other:			
Acquisition cost	**¥17,073**	**¥734**	**¥17,807**
Accumulated depreciation	**10,311**	**196**	**10,507**
Accumulated impairment loss	**17**		**17**
Net leased property	**¥ 6,745**	**¥538**	**¥ 7,283**

	Millions of Yen		
	2005		
	Furniture, Fixtures and Equipment	Software	Total
Used by Company-operated stores and other:			
Acquisition cost	¥16,604	¥782	¥17,386
Accumulated depreciation	7,987	39	8,026
Net leased property	¥ 8,617	¥743	¥ 9,360

	Thousands of U.S. Dollars		
	2006		
	Furniture, Fixtures and Equipment	Software	Total
Used by Company-operated stores and other:			
Acquisition cost	**$146,839**	**$6,313**	**$153,152**
Accumulated depreciation	**88,682**	**1,686**	**90,368**
Accumulated impairment loss	**145**		**145**
Net leased property	**$ 58,012**	**$4,627**	**$ 62,639**

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	**2006**
Obligation under finance leases:			
Due within one year	**¥3,378**	¥3,461	**$29,053**
Due after one year	**4,469**	6,114	**38,436**
Total	**¥7,847**	¥9,575	**$67,489**

Allowance for impairment loss on leased property of ¥14 million ($120 thousand) as of February 28, 2006 is included in obligations under finance leases.

The imputed interest expense portion which is computed using the interest method is excluded from the above obligations under finance leases depreciation expense, interest expense and other information under finance leases:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	**2006**
Depreciation expense	**¥15,782**	¥15,181	**$135,736**
Interest expense	**1,090**	1,063	**9,375**
Reversal of allowance for impairment loss	**37**		**318**
Impairment loss	**204**		**1,755**

Depreciation expense and interest expense, which are not reflected in the accompanying consolidated statements of income, are computed by the straight-line method and the interest method, respectively.

The minimum rental commitments under noncancelable operating leases at February 28, 2006 were as follows:

	Millions of Yen	Thousands of U.S. Dollars
	2006	2006
Due within one year	¥ 663	$ 5,702
Due after one year	5,231	44,990
Total	¥5,894	$50,692

16. Related Party Transactions

Balances to LAWSON CS Card, INC. (an associated company) as of February 28, 2006 were as follows:

	Millions of Yen	Thousands of U.S. Dollars
	2006	2006
Short-term loan receivable	¥6,250	$53,754
Guarantee for bank loans	9,925	85,362

Mitsubishi became a direct principal shareholder when it purchased all shares in the Company held by their wholly owned subsidiary in December 2004.

Since then, Mitsubishi has been treated as an affiliated company of the Company. Therefore, the Company discloses transactions with subsidiaries of Mitsubishi, including those transactions related to the franchised stores.

Balances and transactions with subsidiaries of the principal shareholder as of and for the year ended February 28, 2006 were as follows:

	Millions of Yen	Thousands of U.S. Dollars
	2006	2006
RYOSHOKU LIMITED:		
Accounts payable—trade	¥ 5,569	$ 47,897
Purchases	70,064	602,597
Food Service Network Co., Ltd.:		
Accounts payable—trade	15,570	133,912
Purchases	211,486	1,818,921

17. Contingent Liabilities

As of February 28, 2006, the Company guaranteed an associated company's bank loan in the amount of ¥9,925 million ($85,362 thousand).

18. Net Income per Share

Reconciliation of the differences between basic and diluted net income per share ("EPS") for the year ended February 28, 2006 is as follows:

	Millions of Yen	Thousands of Shares	Yen	U.S. Dollars
Year Ended February 28, 2006	Net Income	Weighted-average Shares		EPS
Basic EPS—Net income available to common shareholders	¥22,025	102,202	¥215.50	$1.85
Effect of dilutive securities—Stock options		20		
Diluted EPS—Net income for computation	¥22,025	102,222	¥215.46	$1.85

Diluted net income per share for the year ended February 28, 2005 is not disclosed because the Company did not have stock options which would have resulted in a dilutive effect.

19. Subsequent Events

a. The following appropriation of retained earnings was approved at the general shareholders' meeting held on May 26, 2006:

	Millions of Yen	Thousands of U.S. Dollars
Cash dividends, ¥45 ($0.39) per share	¥4,603	$39,589

b. At the general shareholders' meeting held on May 26, 2006, the Company's shareholders approved the stock option plan for the Company's directors. The plan provides for granting options to directors to purchase within an upper limit of 50 thousand shares of the Company's common stock. The exercisable period of the stock options shall be three years computed from the day after two years following the date of granting.

c. In addition to b. above, at the general shareholders' meeting held on May 26, 2006, the Company's shareholders approved the stock option plan as compensation for the Company's directors.
The Company intends to abolish the conventional retirement benefit system for directors and instead allocate stock-compensation-type stock options without charge.
The plan provides for granting options to directors to purchase within an upper limit of 27 thousand shares of the Company's common stock. The exercisable period of the stock options shall be 20 years computed from the day following the date when the stock options are granted.

d. As of March 28, 2006, the Company entered into agreements with NTT DoCoMo, Inc., regarding a business alliance and a capital alliance. Accordingly, the Company decided to transfer 2,092,000 shares of treasury stock (which corresponds to 2.0% of the total shares issued and outstanding) at a value of ¥9,021 million ($77,584 thousand).

Independent Auditors' Report

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

Tel: +81 (3) 3457 7321
Fax: +81 (3) 3457 1694
www.deloitte.com/jp

To the Board of Directors of LAWSON, INC.:

We have audited the accompanying consolidated balance sheets of LAWSON, INC. and subsidiaries (together the "Companies") as of February 28, 2006 and 2005, 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 generally accepted 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 the Companies as of February 28, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

As discussed in Note 2.g to the consolidated financial statements, the Companies adopted the new accounting standard for impairment of fixed assets as of March 1, 2005.

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 26, 2006

Member of
Deloitte Touche Tohmatsu

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 SENIOR EXECUTIVE VICE PRESIDENT	Toru Moriyama	General Manager, Merchandizing & Logistics Division
MEMBER OF THE BOARD AND SENIOR VICE PRESIDENT	Manabu Asano	Chief Compliance Officer (CCO); in charge of General Affairs; in charge of Internal Audit
MEMBERS OF THE BOARD	Hiroshi Tasaka	Professor, Graduate School of Tama University
	Reiko Okutani	President, The R Co., Ltd.
	Muneaki Masuda	President and Representative Director, Culture Convenience Club Co., Ltd.
	Koji Furukawa	Senior Adviser to the President, Mitsubishi Corporation
	Takehiko Kakiuchi	General Manager, Living Essentials Group CEO Office, Mitsubishi Corporation
STANDING CORPORATE AUDITORS	Kenji Yamakawa	
	Munehiko Nakano	
CORPORATE AUDITORS	Tetsuo Ozawa	Lawyer
	Hiroshi Kuwata	Manager, Risk Management Dept., Mitsubishi Corporation
EXECUTIVE VICE PRESIDENT	Susumu Hasegawa	Chief Information Officer (CIO); General Manager, Information Systems Station
SENIOR VICE PRESIDENTS	Ichiro Okuda	General Manager, Kinki LAWSON Branch
	Takatoshi Kawamura	General Manager, Next-Generation Business Development Division
	Konoshin Deguchi	General Manager, Store Development Planning Division
	Shigeru Niikura	General Manager, Integration Office
	Kiyoteru Suzuki	General Manager, Services Development Division
	Yoshio Shinozaki	General Manager, CSR Promotion Office
	Shigeaki Kawahara	Executive Assistant to CEO
	Katsuyuki Imada	General Manager, Corporate Planning Office
	Kenji Morimoto	General Manager, Finance & Accounting Office; General Manager, Management Services Office
	Itsuo Iga	General Manager, Quality Control Division
	Takaki Mizuno	General Manager, Chubu LAWSON Branch
	Norikazu Nishiguchi	General Manager, Kanto LAWSON Branch
	Jyun Miyazaki	General Manager, PR, Corporate Communications Office
	Masatoshi Okada	President & CEO, NATURAL LAWSON, Inc.
	Satoshi Matsubara	Deputy General Manager, Merchandizing & Logistics Division

(As of May 26, 2006)

Corporate Data

ENGLISH 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

NUMBER OF EMPLOYEES
3,585 (Consolidated) (As of February 28, 2006)

BUSINESS ACTIVITIES
Development of LAWSON convenience store franchise chain

NET SALES OF ALL STORES
¥1,361.7 billion (Consolidated) (Fiscal 2005)

NUMBER OF STORES
8,366 (Consolidated) (As of February 28, 2006)

OPERATING AREA
All 47 prefectures in Japan; Shanghai, PRC (Joint Venture)

ESTABLISHED
April 15, 1975

CAPITAL
¥58,506,644,000

AUTHORIZED SHARES
409,300,000

SHARES ISSUED
104,600,000

SHAREHOLDERS
45,036

MAJOR SHAREHOLDERS

	Number of Shares Held	Percentage of Total Shares Held
1. Mitsubishi Corporation	32,089,300	30.7
2. Japan Trustee Services Bank, Ltd. (Trust Account)	6,601,200	6.3
3. Marubeni Foods Investment Co., Ltd.	5,939,500	5.7
4. The Master Trust Bank of Japan, Ltd. (Trust Account)	4,688,400	4.5
5. State Street Bank and Trust Company 505103	2,428,701	2.3
6. The Chase Manhattan Bank, N.A. London	1,782,003	1.7
7. Mitsui Asset Trust and Banking Company, Limited (Account 1)	1,241,000	1.2
8. Mitsubishi UFJ Trust and Banking Corporation (Trust Account)	1,183,300	1.1
9. Mellon Bank, N.A., as Agent for its Client Mellon Omnibus US Pension	1,160,168	1.1
10. BBH Boston Pftc Putnam Intl Growth Fund	1,072,400	1.0

Note: Excluding 2,313,932 shares that LAWSON, INC owns as of end of February 2006

STOCK EXCHANGE LISTINGS
Tokyo Stock Exchange (1st Section)
Osaka Securities Exchange (1st Section)

STOCK TRANSFER AGENT
Mitsubishi UFJ Trust and Banking Corporation
4-5, Marunouchi, 1-chome, Chiyoda-ku, Tokyo 100-8212, Japan

(As of February 28, 2006)

LAWSON

LAWSON, INC.

Corporate Planning Office,
East Tower, Gate City Osaki
11-2, Osaki 1-chome, Shinagawa-ku,
Tokyo 141-8643, Japan
http://www.lawson.co.jp/
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