

HitachiSoft's Offshore Development

Increasing the number of offshore development software engineers to 1,500 by the end of fiscal 2010



Etsuro Mori

Executive Officer,
Project Management Division

Building on the Relationship of Trust with Partners

One of HitachiSoft's greatest advantages is its ability to complete large-scale system development projects for financial or public services systems with the required quality, on time and within budget. As one step in building our product management capabilities, we proactively conducted offshore development operations in China and other Asian countries in the latter half of the 1990s. Today, we have four overseas core system development partners, with respective companies in Beijing, Tianjin and Dalian in China, and one company in Vietnam. Combined, this gave us an offshore development center of approximately 820 people at the end of March 2008.

There were two major reasons behind our decision to strengthen our offshore development operations. One reason was to gain an advantage in terms of assembling large development teams, while the other reason was to take advantage of cost reduction benefits.

Currently, it is extremely difficult in Japan to be able to commission a project requiring several hundred software engineers for just one systems development company. However, our team of offshore development partners gives us the capability to do just that for even large-scale projects. This capability yields significant benefits in systems development in terms of more efficient communications, process management, grasping problems and finding solutions, and other aspects of the project. In turn, these benefits contribute to superior quality and faster delivery. At the same time, because of the substantial production cost benefits

of developing systems in China and other parts of Asia, our offshore development operations are gaining importance in terms of supporting HitachiSoft's cost competitiveness.

One of the initiatives of our medium-term management plan aims to dramatically strengthen our offshore development organization both quantitatively and qualitatively. Under the initiative, we will increase the number of development staff from an average of 750 software engineers in fiscal 2007 to 1,150 people in fiscal 2009, and then to 1,500 people in fiscal 2010.

In the past, strengthening the quality of our offshore development operations has been our area of greatest emphasis. When we first started developing systems overseas, we had to use specification manuals produced in Japan and code them overseas. However, today our overseas operations have progress to the point that they can handle detailed designs and testing. Going forward, I want our overseas operations to become able to handle even more upstream processes, such as requirement definitions and advanced testing. To that end we are aggressively conducting technology training locally and in Japan, transferring the know-how required to achieve total quality assurance.

I view China, Vietnam and other countries in Asia not as bases for systems development, but countries where we can develop large systems development markets in the near future. When that day arrives, our current systems development partners will become our business partners in developing the new markets. At that point, I believe that the solid relationship of trust built over the years between HitachiSoft and our offshore development partners will give us a powerful advantage. As partners with which we share the HitachiSoft Group's strengths in systems development management and quality assurance, I plan to work together with them toward that bright future.



HitachiSoft received a Sao Khue Prize 2008 in recognition as a company contributing to Vietnam's IT industries



FPT Development Center, Hanoi, Vietnam

Financial Review

Revenue Analysis

In fiscal 2007, ended March 31, 2008, the Japanese economy continued its mild expansion. However, signs of stagnation emerged in some sectors due to the slowdown in the U.S. economy, the sharp rise in crude oil and raw material prices, and the progressive appreciation of the yen against the U.S. dollar. In the information service industry, favorable market conditions continued as a result of higher demand for systems development and services, particularly from the financial services and manufacturing industries, and growing demand in new areas, such as SaaS and operating system virtualization¹.

Reflecting these conditions, the HitachiSoft Group's Software and Services business posted sales growth supported by an increase in the sales of the core Systems Development segment. In addition, the high profit-margin Services and Products & Packages segments achieved substantial growth.

As a result, net orders climbed 8.0%, to ¥172,638 million, and net sales increased 9.6% to ¥171,399 million.

● Segment Performance

(Software and Services)

In the Systems Development segment, we recorded sharp growth in sales of mission-critical systems for financial services and manufacturing companies. Moreover, we posted favorable growth in sales of embedded software for storage devices and car navigation systems. In the public service field, we achieved substantial growth in orders and sales by leveraging our specialized know-how in such fields as large-scale systems.

In the Services business, we continued to win large-scale orders in our SaaS business based on our collaboration with Salesforce.com, inc., and are already providing services to such major customers as the Japan Post Group, trust banks and equipment and device manufacturers. "FINEMAX"²,

our online banking service system for regional banks also registered firm revenue growth. In addition, there was favorable expansion in sales of services for financial services companies provided in cooperation with DACS Co., Ltd., and internal control system services provided in cooperation with Business Brain Showa-ota Inc.

In the Products & Packages business, we acquired large orders for our "JOHMON"[®] security system and for "GeoMation," an operations management and mapping information system. In addition, we worked aggressively to expand orders for our operations control system and for "KATSUBUN," our document control system.

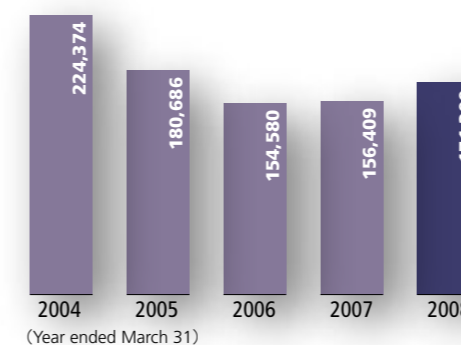
During the fiscal year, we launched sales of "KATSUBUN NAVIstaff," a system for controlling documents to prevent information leakage and "iCOT Assistant," a support system for internal control system operations. We also proceeded with development of our integrated sales and accounting solution, "Fit-ONE"³, and middleware for Blu-ray systems.

Reflecting these efforts, net orders in this segment rose 10.1% to ¥155,427 million, and consolidated net sales advanced 14.2% to ¥155,415 million. Sales in this segment accounted for 90.7% of consolidated net sales, up 3.7 percentage points.

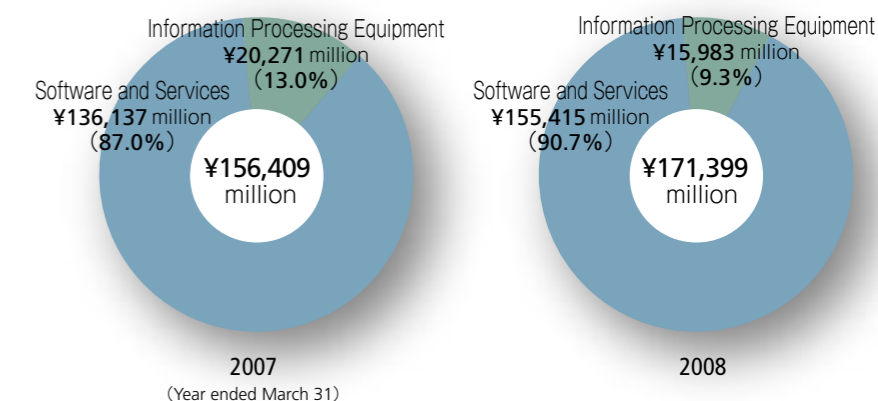
1. Operating system virtualization: Technology enabling multiple operating systems to run on one computer system.
2. "FINEMAX": An online banking service system for regional banks developed by Hitachi, Ltd.
3. "Fit-ONE": A comprehensive sales and finance management solution based on business templates (business program process component product group) customized for different types of business. The service is provided in collaboration with Business Brain Showa-ota Inc.

Net Sales

(¥ Million/Consolidated)



Sales by Segment (Consolidated)



(Note) Beginning with the year ended March 31, 2008, HitachiSoft changed its business segments. Segment sales for the year ended March 31, 2007 is restated in accordance with the change in business segments.

〔Information Processing Equipment〕

In the Information Processing Equipment segment, sales of proprietary products surged, but sales of devices related to systems integration orders decreased, resulting in a year-on-year decline in overall segment sales.

In proprietary products, we endeavored to expand sales of our "StarBoard®" interactive whiteboards as a strategic product in our international business, achieving robust sales mainly in Europe and emerging economies. We also promoted sales of our "JOHMON®" finger vein authentication system by promoting its use as a control system for color copiers, an employee time clock system and other applications.

In this segment, net orders decreased 8.0% to ¥17,211 million, and net sales declined 21.2% to ¥15,983 million. Sales in this segment comprised 9.3% of consolidated net sales.

Income Analysis

HitachiSoft registered a 59.2% increase in consolidated operating income to ¥14,370 million, while ordinary income climbed 66.5% to ¥13,502 million. These gains can be attributed to sales growth and continued progress in improving productivity and reducing costs.

Although affected by an extraordinary loss due to the

write off of the unamortized balance of goodwill from INES Corporation, net income expanded 14.4% to ¥3,941 million.

The Company increased annual cash dividends per share by ¥7.00 to ¥34.00.

Analysis of Financial Position

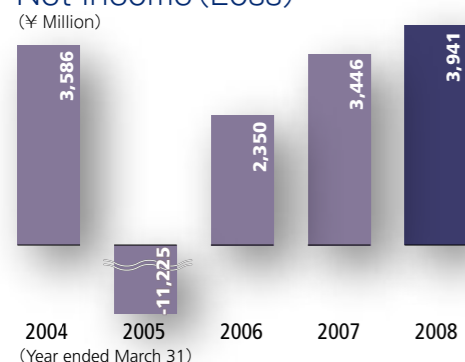
At March 31, 2008, total assets amounted to ¥166,475 million, down ¥3,653 million from a year earlier. Total current assets declined ¥811 million to ¥86,732 million due to a decrease in bank deposits. Fixed assets decreased ¥2,841 million to ¥79,742 million owing to a decrease in investment securities.

Total liabilities decreased ¥5,668 million to ¥52,970 million, while total current liabilities declined ¥7,037 million to ¥37,408 million due to the repayment of last's year current portion of long-term debt amounting to ¥15,000 million. Total long-term liabilities increased ¥1,368 million to ¥15,562 million.

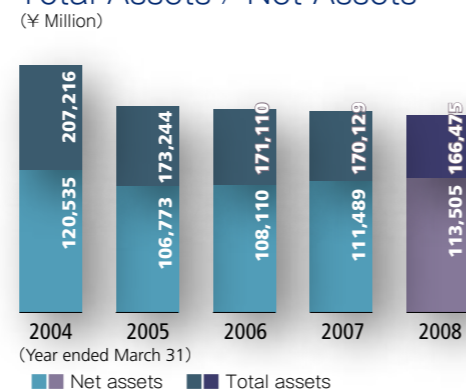
Minority interests totaled ¥5,370 million, comprising the non-equity portion of net assets of a consolidated subsidiary

Total shareholders' equity amounted to ¥108,310 million. The shareholders' equity ratio was 65.0%, and shareholders' equity per share amounted to ¥1,722.26.

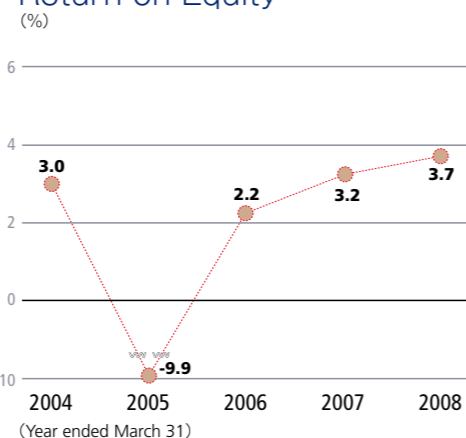
Net Income (Loss)



Total Assets / Net Assets



Return on Equity



Consolidated Financial Statements

Consolidated Statements of Operations

(Millions of yen)

Years ended March 31	2007(A)	2008(B)	(B)-(A)
Net sales	156,409	171,399	14,989
Cost of sales	127,278	134,256	6,977
Gross profit	29,131	37,142	8,011
Selling, general and administrative expenses	20,106	22,772	2,665
Operating income	9,024	14,370	5,345
Non-operating income	470	513	42
Interest and dividend income	308	404	95
Others	161	109	(52)
Non-operating expenses	1,386	1,381	(5)
Interest expenses	292	142	(150)
Loss from investments by equity method	183	676	493
Others	911	563	(347)
Ordinary income	8,108	13,502	5,393
Extraordinary income	—	678	678
Gain on sale of investments in securities	—	678	678
Extraordinary losses	1,122	3,909	2,786
One-time depreciation of changes in investments elimination by equity method	—	2,882	(2,882)
Impairment loss	—	576	(576)
Loss on evaluation of affiliated companies securities	465	383	(110)
Loss on evaluation of other investment securities	219	66	(124)
Amortization of goodwill	437	—	(437)
Income before income taxes and minority interests	6,986	10,271	3,285
Income taxes	1,019	7,679	6,660
Adjustment of income taxes	2,574	(1,693)	(4,268)
Minority interests	(53)	344	397
Net income	3,446	3,941	495

Consolidated Balance Sheets

(Millions of yen)

March 31	2007(A)	2008(B)	(B)–(A)
ASSETS			
Current assets	87,544	86,732	(811)
Cash and deposits	1,453	1,493	39
Notes and accounts receivable	49,269	48,496	(773)
Securities	1,413	1,000	(413)
Inventories	3,942	4,872	929
Due from Parent related to Hitachi group cash management fund	26,696	24,493	(2,202)
Deferred tax assets	4,341	5,040	698
Others	539	1,480	940
Less: Allowance for doubtful accounts	(113)	(143)	(30)
Fixed assets	82,584	79,742	(2,841)
Property, plant and equipment	32,027	31,040	(986)
Property held for leases	118	53	(65)
Buildings and structures	15,123	14,419	(703)
Machinery and vehicles	65	51	(13)
Tools, furniture and fixtures	1,364	1,142	(222)
Land	15,275	15,275	—
Construction in progress	80	98	17
Intangible assets	8,527	7,612	(914)
Software	7,639	6,918	(720)
Others	888	693	(194)
Investments and other assets	42,030	41,089	(940)
Investments in securities	27,566	24,623	(2,942)
Guarantee deposit	3,260	3,458	198
Prepaid pension cost	2,050	2,177	126
Deferred long-term tax assets	5,246	6,487	1,240
Others	4,257	4,642	384
Less: Allowance for doubtful accounts	(351)	(299)	52
Total assets	170,129	166,475	(3,653)

(Millions of yen)

March 31	2007(A)	2008(B)	(B)–(A)
LIABILITIES			
Current liabilities	44,446	37,408	(7,037)
Trade accounts payable	12,337	13,399	1,062
Short-term loans	30	—	(30)
Current portion of bonds	15,000	—	(15,000)
Accrued expenses	8,410	9,002	591
Income taxes payable	1,172	7,778	6,605
Accrued contract losses	903	1,140	236
Others	6,590	6,087	(502)
Long-term liabilities	14,193	15,562	1,368
Retirement and severance benefits	12,942	13,888	945
Retirement allowance for directors	529	532	2
Accrued program product warranties	150	98	(52)
Others	570	1,043	473
Total liabilities	58,639	52,970	(5,668)
NET ASSETS			
Shareholders' equity	106,047	108,310	2,263
Common stock	34,182	34,182	—
Capital surplus	35,235	35,235	—
Retained earnings	41,179	43,409	2,229
Treasury stock	(4,550)	(4,516)	33
Valuation and translation adjustments	316	(175)	(492)
Net unrealized gain on securities held	136	(274)	(410)
Foreign currency translation adjustments	180	98	(81)
Minority interests	5,125	5,370	244
Total net assets	111,489	113,505	2,015
Total liabilities and net assets	170,129	166,475	(3,653)

Corporate Data (as of March 31, 2008)

Corporate Name	Hitachi Software Engineering Co., Ltd.
Head Office	4-12-7, Higashishinagawa, Shinagawa-ku, Tokyo 140-0002, Japan
Established	September 21, 1970
Paid-in Capital	34,182,664,471 yen
Number of Employees	5,166 (Non-consolidated)

Business Fields

Business Fields	Mainstay Business/Fields of Expertise
Systems Development	<ul style="list-style-type: none"> Basic Software <ul style="list-style-type: none"> Embedded Software [storage, networking, car navigation] Operating System and Middleware [database, communications control, operational management] Application Software Systems Engineering <ul style="list-style-type: none"> Large-scale Application Systems Development [finance, public works, society, industry, distribution, telecommunications]
	<ul style="list-style-type: none"> Services <ul style="list-style-type: none"> ASP/SaaS Contents Services Maintenance Outsourcing/BPO, etc.
Products & Packages	<ul style="list-style-type: none"> Security ("HIBUN") Electronic Documents ("KATSUBUN") Systems Management, etc.
Information Processing Equipment	<ul style="list-style-type: none"> Proprietary Hardware ("StarBoard"™ Interactive Whiteboard, "JOHMON"™ Finger Vein Authentication System, etc.), Distribution Hardware

Shareholder Information (as of March 31, 2008)

Common Stock	Authorized	227,000,000 shares
	Issued	64,479,381 shares

Number of Shareholders 25,731

Principal Shareholders

Shareholder	Shares held (thousand)	Percentage of total (%)
Hitachi, Ltd.	33,107	51.35
Japan Trustee Services Bank, Ltd.	2,505	3.88
The Master Trust Bank of Japan, Ltd.	1,699	2.63
Hitachi Software Group Employees' Stockholding	1,173	1.82
Trust & Custody Services Bank, Ltd.	1,095	1.70
TAM TWO	1,075	1.67
State Street Bank and Trust Company 505019	1,056	1.64
Millennium	1,036	1.61
Bank of New York GCM Client Accounts ELRG	843	1.31
Morgan Stanley and Company Inc.	472	0.73

Notes:

- The above table excludes HitachiSoft's own shares of 1,692 thousand.
- The above table includes shares held as part of trust operations as follows:

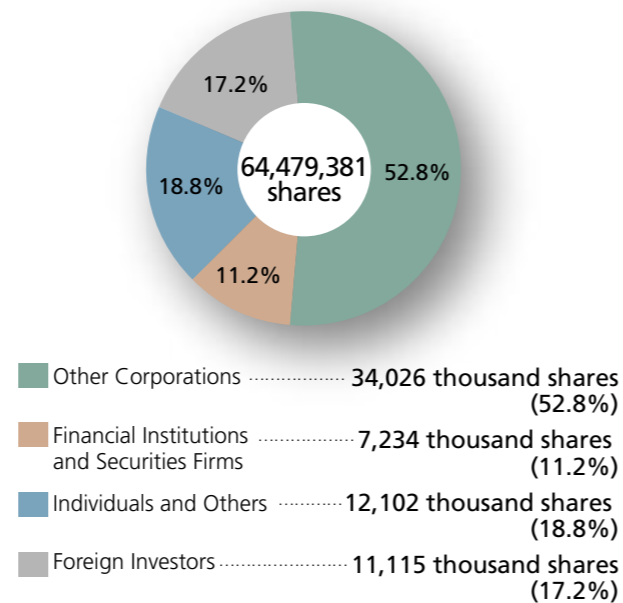
Japan Trustee Services Bank, Ltd.	2,089 thousand shares
The Master Trust Bank of Japan, Ltd.	1,301 thousand shares
Trust & Custody Services Bank, Ltd.	696 thousand shares

Board of Directors and Executive Officers (as of June 25, 2008)

Chairman of the Board	Kotaro Muneoka
Board Director	Isao Ono
Board Director	Hiroshi Kuwahara
Board Director	Shoji Yamamoto
Board Director	Ryouji Akahoshi
Board Director	Masao Terasawa
Board Director	Koichiro Nishikawa

Representative Executive Officer, President, Chief Executive Officer	Isao Ono
Executive Vice President and Executive Officer	Hiroshi Kuwahara
Senior Vice President and Executive Officer	Shoji Yamamoto
Senior Vice President and Executive Officer	Shinji Moroshima
Vice President and Executive Officer	Kenryu Nagano
Vice President and Executive Officer	Hiroyuki Maezawa
Vice President and Executive Officer	Toru Shimizu
Vice President and Executive Officer	Toshikazu Shiro
Executive Officer	Tsuneaki Ogawa
Executive Officer	Yosuke Tsuyuki
Executive Officer	Junichiro Sato
Executive Officer	Etsuro Mori
Executive Officer	Akira Uemura
Executive Officer	Hideji Yamazaki
Executive Officer	Kanji Kurihara

Composition of Shareholders (as of March 31, 2008)



Company History

Era	Trends in Business Activities	Month/Year	Company	Businesses
1970	Operating Systems Development Systems Software Development/Systems Engineering Package Software Development Information Processing Equipment Creation of New Business Fields Promotion of Internationalization	September 1970	Hitachi Software Engineering Co., Ltd. was established as the first software company in the Hitachi Group.	Started development of operating systems for Hitachi, Ltd.'s mainframe computers.
		1971		Developed bank online systems. Started development of systems for public, financial, industry and communication fields for mainframe computers.
		1976		Started package software businesses.
1980		1981		Entered into information processing products business by introducing COMDESIGN interactive computer-aided design system.
		March 1981	Relocated head office to Onoe-cho, Naka-ku, Yokohama-city.	
		1985		Entered into life science business by introducing DNASIS genetic analysis software.
		1986	Established International Business Division.	
		1989		Entered into geographic information systems business by introducing CADCore drawing management system.
1990		October 1990	Listed on the Second Section of the Tokyo Stock Exchange.	
		1991	Established Hitachi Software Engineering America, Ltd. (HISAL) in San Francisco, CA (U.S.A.).	
		September 1992	Listed on the First Section of the Tokyo Stock Exchange.	
		1996		Introduced "HIBUN"™ confidential information leakage prevention software addressing growing security needs.
		1997		Introduced an interactive whiteboard that enables users to write on a computer display projected onto a whiteboard and to use computer functions directly from that interface.
		1999		Introduced satellite imagery services.
		2000	Changed into ongoing business segments · Systems Development · Services · Products & Packages · Information Processing Equipment	
2001		2001	Opened the Life Science Research Center in Tsurumi-ku, Yokohama city.	
		2002	Relocated Head Office to Shinagawa-ku, Tokyo.	
		2006		Launched internal control reconfiguration solution businesses to support Japanese SOX Law Compliance Solution utilizing HitachiSoft's know-how in internal control system reconfiguration.
		2007		Entered into SaaS businesses through a business alliance with Salesforce.com, inc.

Development of Key Systems by HitachiSoft

<ul style="list-style-type: none"> Commercial banks, government-affiliated financial institutions, accounting systems Accounting systems for local banks (joint center) Securities companies, stock exchange related systems Main systems of insurance companies Internet banking systems 	<ul style="list-style-type: none"> Fixed phone order management systems Mobile phone billing systems Next-generation network (NGN) systems System management/supervisor control
<ul style="list-style-type: none"> Integrated tax management systems Comprehensive tax online systems Emergency disaster relief systems Facility reservation systems 	<ul style="list-style-type: none"> Development of embedded software (automobiles, mobile phones, information appliances, storage, network equipment) Embedded middleware products (databases, Java, etc.) Embedded software development support package products Consulting for improvement of development processes
<ul style="list-style-type: none"> Electric power fee calculation systems Equipment management mapping systems 	<ul style="list-style-type: none"> Mission-critical Systems (production management) Mission-critical Systems (sales, accounting) SaaS-based SFA/CRM systems Mobile Suica security server systems