

Management's Discussion and Analysis of Operations

USS Co., Ltd. and Consolidated Subsidiaries

The USS Group

The USS Group, which comprises the parent company, 15 subsidiaries and one affiliate as of March 31, 2005, engages primarily in the used vehicle auction business. The scope of its operations and Group companies active in each area of business are outlined below. Please note that these business categories are the same as those used for segment information.

Automobile Auction Segment (13 Companies Including the Parent Company)

The parent company and its subsidiaries (eight companies including consolidated subsidiary USS Okayama Co., Ltd.) manage automobile auctions for auction members, consisting predominantly of used vehicle dealers. The parent company also operates a satellite-based remote bidding system and sells special-purpose auction terminals to the users of this system. US Butsuryu Co., Ltd., a consolidated subsidiary, specializes in transportation of submitted and sold vehicles to and from auctions. CAR QUEST Co., Ltd., another consolidated subsidiary, provides used vehicle information services over the Internet. Affiliated company InfoCarry Co., Ltd., operates a mobile phone-based used vehicle information service.

Sales of Used Cars Segment (2 Companies)

Consolidated subsidiary CAR QUEST operates a used vehicle purchasing and sales business. World Automobile Co., Ltd., also a consolidated subsidiary, engages in purchasing and sales of accident-damaged vehicles.

Other Segment (1 Company)

Consolidated subsidiary ARBIZ Co., Ltd., operates a salvage and recycling business for end-of-life vehicles.

Operating Environment

The used vehicle distribution market continued to face a harsh operating climate, as new vehicle registrations grew 0.4%, to 5.85 million units and used vehicle registrations fell 2.4%, to 8.00 million units, compared with the previous calendar year. In the used vehicle auction market, the total number of vehicles put up for auction grew 8.0% from the previous year to 6.98 million units. This result primarily reflected the higher trading volume of reusable vehicles (dated vehicles with high mileage)—a type of vehicle that up to now has not been traded at vehicle auctions—supported by the expansion of export markets against a backdrop of accelerating alliances and consolidation of auction sites. Nevertheless, the contract completion rate stood at 55.7%, down 0.8 percentage point from the previous year, owing to the continued shortage of high-quality used vehicles.

The USS Group responded to this severe operating environment by boosting its operations through such measures as intensification of marketing activities in the automobile auction business, aggressive capital investment, and acquisition of Ryutsu Auto Auction Co, Ltd., an operator of large-scale auction sites. In addition to stepping up purchasing of used vehicles and accident-damaged vehicles, the Group embarked on a recycling business for end-of-life vehicles.

Revenue Overview

In fiscal 2004, consolidated operating revenues increased by ¥8,058 million, or 19.0%, to ¥50,484 million compared with the previous term.

The advance stemmed primarily from a dramatic rise in the number of vehicles put up for auction, which surged 21.2%, to 2.14 million units. By auction site, large auction sites posted a steady gain, with handling

volume at the Tokyo site, which moved to a new location in October 2004, and trading at the Kyushu Gold site rising 18.3%, to 591,000 vehicles and 14.3%, to 186,000 vehicles, respectively. Regional sites also enjoyed across-the-board year-on-year growth, including a 23.0% increase to 103,000 vehicles at the Osaka site and a 15.5% increase to 99,000 vehicles at the Tohoku site. Furthermore, the Yokohama site, which started operation in February 2004, and the USS-R Nagoya site, which opened in June 2004, both recorded higher-than-projected trading volume, handling 157,000 cars and 58,000 cars, respectively. Although the number of contracted vehicles enjoyed a substantial rise of 17.2%, to 1.16 million units, the contract completion rate declined 1.9 percentage points to 54.2%, compared with the previous term.

Within the sales of used cars segment, operating revenues from the Rabbit chain of used vehicle purchasing agencies grew 38.6%, to ¥7,396 million. The increase was driven by the chain's marketing activities tailored to closely match the needs of each local market as well as vigorous advertising, which raised Rabbit brand recognition among consumers. Operating revenues from the business of buying and selling accident-damaged vehicles were up 22.0%, to ¥5,724 million, primarily due to the expansion of operation bases.

The recycling business operated by ARBIZ posted operating revenues of ¥523 million.

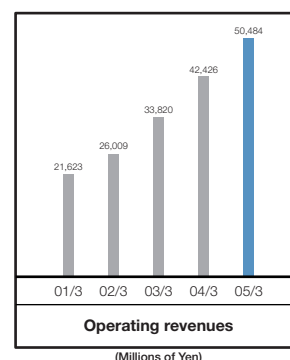
Revenue Breakdown

(1) By Auction Site

Operating revenues from our major auction sites were as follows:

Operating Revenues by Site

	Millions of Yen		Percentage Change 2005/2004
	2005	2004	
For the year:			
Nagoya site	¥6,912	¥6,860	0.8%
Kyushu Gold site	2,357	2,144	9.9
Fukuoka site	655	545	20.0
Tokyo site	9,861	9,048	9.0
Shizuoka site	1,125	1,090	3.1
Okayama site	1,037	981	5.7
Sapporo site	1,579	1,472	7.3
West Tokyo site	781	813	(4.0)
Gunma site	1,420	1,279	11.0
Tohoku site	1,303	1,152	13.1
Osaka site	1,599	1,400	14.3
Yokohama site	2,067	388	433.2
USS-R Nagoya site	589	—	—
Used Car Logistics Services	300	272	10.2
Satellite Auction	3,667	3,670	(0.1)
Internet Information Services	1,592	1,282	24.1
Used Car Purchasing			
Agency Business	7,396	5,335	38.6
Accident-Damaged Car			
Purchasing Agency Business	5,724	4,693	22.0
Recycling Business	524	—	—



The USS Group is pursuing a strategy of aiming for the No. 1 auction site position in each local market by providing services that cater to each region. Thanks to this effort, the Group as a whole posted year-on-year growth, achieving increases in operating revenues.

Among large auction sites, the Tokyo and Kyushu Gold sites enjoyed steady growth from the previous year, with operating revenues expanding to ¥9,861 million, up 9.0%, and ¥2,357 million, up 9.9%, respectively. Regional auction sites also achieved across-the-board year-on-year gains, with operating revenues at the Sapporo site rising 7.3%, to ¥1,579 million and those at the Osaka site increasing 14.3%, to ¥1,599 million.

The Yokohama site, which opened in February 2004, and the USS-R Nagoya site, which started operation in June 2004, both enjoyed higher-than-projected operating revenues, recording ¥2,067 million, up 433.2%, and ¥589 million, respectively.

(2) By Segment

Automobile Auction

Under the leadership of the business development team, the USS Group directed its efforts toward attracting new members and encouraging existing inactive members to participate in USS auctions more regularly. At the same time, we implemented aggressive measures in line with the strategy of making USS action sites No. 1 in every region, to garner a commanding market share in all regions in which we operate.

We put the Yokohama site, which opened in February 2004, on track, and substantially increased the Tokyo site's trading capacity by relocating it to a newly constructed site in October 2004. These measures have strengthened our presence in the greater Tokyo area.

To cope with the increased number of vehicles put up for auction, we expanded and upgraded parking facilities for vehicles put up for auction at the Shizuoka and Sapporo sites. At the same time, we boosted the auction capacity at the Tohoku and Shizuoka sites through the introduction of a two-lane auction system, which allows simultaneous bidding on two vehicles.

Responding to a trend toward higher numbers of dated vehicles with high mileage entering the used vehicle auction market, the USS Group in June 2004 opened the USS-R Nagoya site (an auction site that exclusively handles reusable vehicles) in the city of Nagoya's Minato Ward.

During the consolidated fiscal year under review, the above-mentioned efforts to expand business enabled the USS Group to put up 2.14 million vehicles for auction, a rise of 21.2% from the previous term, and sell 1.16 million vehicles, an expansion of 17.2%.

Consequently, the automobile auction segment generated operating revenues of ¥36,841 million, up 13.7%, and operating income of ¥20,704 million, up 13.0%.

Sales of Used Cars

The Rabbit chain of used vehicle purchasing agencies posted an increase in operating revenues, achieved through region-focused marketing activities and the fostering of staff, with a view to raising the purchase rate. It recorded an operating loss, however, due to a rise in advertising expenses resulting from the continuation of aggressive TV advertising aimed at strengthening Rabbit brand recognition among consumers.

Our accident-damaged vehicle purchasing and sales business was operated by World Automobile and its two subsidiaries. During the fiscal year under review, the two subsidiaries were merged into the USS Group

to achieve better integration of operation bases. USS succeeded in increasing the number of vehicles put up for auction by expanding its operation bases across Japan and strengthening its marketing capabilities in each region by adopting an area manager system.

Consequently, the sales of used cars segment posted operating revenues of ¥13,120 million, up 30.8%, and an operating loss of ¥51 million, compared with an operating loss of ¥306 million in the previous term.

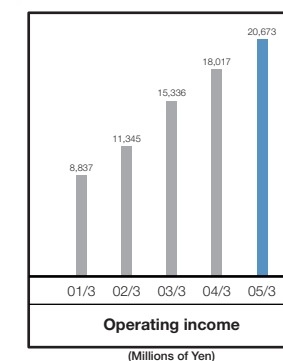
Other Business

Other business represents the recycling business operated by ARBIZ, which started operation in June 2004. In addition to scrapping used vehicles that remained unsold at auctions at the USS-R Nagoya site and thus were judged to have no commercial value, the company sells salvaged auto parts. This segment recorded operating revenues of ¥523 million and an operating loss of ¥21 million, mainly due to amortization costs on capital investment.

Cost of Revenues and Selling, General and Administrative (SG&A) Expenses

Cost of revenues amounted to ¥19,988 million, increasing by ¥4,683 million, or 30.6%, from the previous year. In the wake of expansion in merchandise sales in our used vehicle and accident-damaged vehicle purchasing and sales businesses, costs of revenues rose sharply, while depreciation costs surged due to commencement of operations at the Yokohama and new Tokyo sites.

SG&A expenses grew 7.9%, or ¥719 million, to ¥9,823 million. Advertising expenses were up 16.4%, to ¥218 million, as a result of advertising activities including TV commercials implemented by the Rabbit chain of used vehicle purchasing agencies. Employee salaries and bonuses increased 14.4%, or ¥360 million, primarily due to the hiring of new staff in connection with expansion of World Automobile's network of operation bases.



Operating Income, Other Income (Expenses) and Net Income

Operating income totaled ¥20,673 million, up 14.7%, or ¥2,656 million, compared with the previous year. The increase was attributable to a sharp rise in the number of vehicles put up for auction, which boosted operating revenues in the automobile auction segment. In the sales of used cars segment, operating revenues grew but so did costs, resulting in an operating loss, although the amount

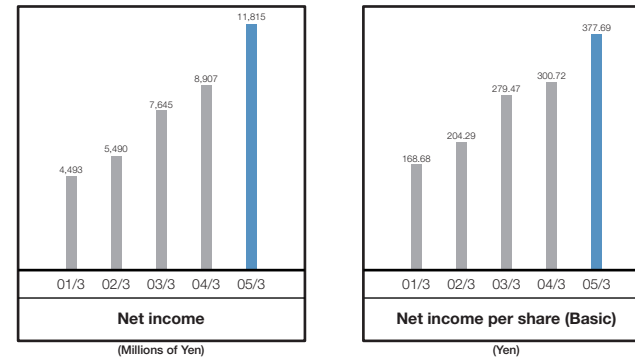
of the loss was small compared to the previous year.

Other expenses "net" declined by ¥1,781 million from the previous year, to ¥61 million. The primary factor responsible for the decrease was recording of an impairment loss of ¥557 million on underutilized real estate.

Income before income taxes and minority interests was ¥20,612 million compared with ¥16,175 million in the previous term. Income taxes amounted to ¥8,603 million, and minority interests in net income of consolidated subsidiaries totaled ¥194 million.

Consequently, net income rose 32.6%, or ¥2,908 million, to ¥11,815 million, marking six consecutive quarters of year-on-year

increases in both operating revenues and net income since we began reporting consolidated financial results. Basic net income per share was ¥377.69, while diluted net income per share was ¥366.03. Cash dividends per share applicable to the year increased to ¥65.00 from ¥50.00 in the previous year.

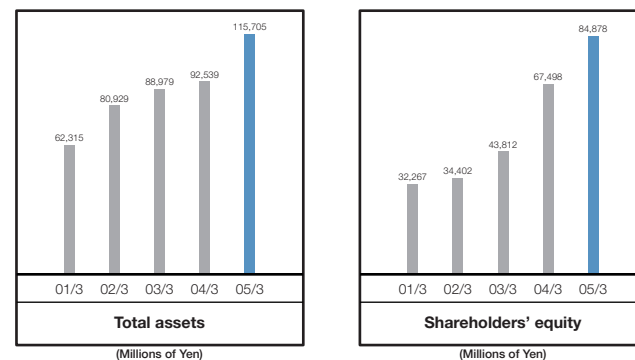


Financial Position

At year-end, total assets stood at ¥115,705 million on a consolidated basis. Total shareholders' equity amounted to ¥84,878 million, and the equity ratio stood at 73.4%.

Total assets increased by ¥23,166 million, or 25.0%, compared with the previous year, to ¥115,705 million. Current assets rose by ¥4,422 million, or 19.2%, mainly due to an increase of 65.6%, or ¥3,504 million, in receivables due from member dealers at auction (reflecting the fact that the final day of the consolidated fiscal year fell on a Thursday, the day of the week on which receivables due from member dealers at auction see a relative increase). Property and equipment, less accumulated depreciation, expanded by ¥14,033 million, or 22.8%, primarily due to acquisition of land for the Kobe auction site. Intangible fixed assets rose ¥2,818 million, or 283.9%, reflecting an increase in the consolidating adjustment account as a result of the conversion of RAA Co., Ltd., into a subsidiary.

Total shareholders' equity totaled ¥84,878 million, up 25.7%, or ¥17,380 million, from the previous year. Paid-in capital rose by ¥1,979 million, or 12.7%, and capital surplus by ¥5,166 million, or 26.4%. Other factors included an increase of ¥9,904 million, or 26.6%, in retained earnings, conversion of convertible bonds and issuance of stocks associated with the conversion of RAA into a subsidiary through a stock swap.



As a result, shareholders' equity per share of common stock amounted to ¥2,652.32, up ¥463.30 from ¥2,189.02 at the previous year-end, and the equity ratio rose to 73.4% from 72.9%.

Cash Flows

At end of the consolidated fiscal year under review, cash and cash equivalents (hereafter referred to as cash) totaled ¥15,673 million, up 3.7%, or ¥554 million.

Cash Flow Provided by Operating Activities

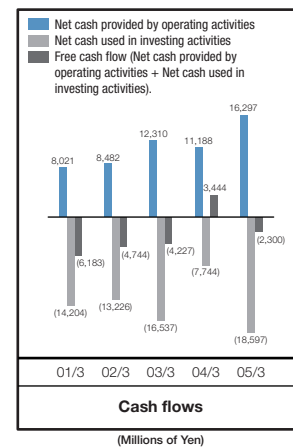
Net cash provided by operating activities amounted to ¥16,297 million, increasing 45.7%, or ¥5,109 million. This was primarily a result of increases in cash due to higher income before taxes and minority interests of ¥20,612 million, up 27.4% from the previous year, and depreciation and amortization of ¥2,969 million, up 61.6%. These increases were partially offset by a decrease in cash due to income taxes paid, which grew to ¥8,753 million, up 9.1%.

Cash Flow Used in Investing Activities

Net cash used in investing activities totaled ¥18,597 million, up 140.2% from the previous year. This was mainly attributable to a decrease in cash due to expenditures incurred in the purchase of property and equipment for the construction of the new Tokyo and Kobe auction sites, which amounted to ¥18,766 million, up 5.3% from the previous year.

Cash Flow Provided by Financing Activities

Net cash provided by financing activities totaled ¥2,383 million, compared with net cash used of ¥3,401 million the previous year. This was primarily due to increases in cash, which consisted proceeds from long-term debt of ¥4,000 million, up 3,900.0%, to finance the construction of the Kobe auction site and proceeds of ¥1,057 million, down 15.3%, from the issuance of common stock due to the exercise of stock options. These were partially offset by decreases in cash, which represented ¥1,827 million, down 48.9%, in scheduled repayment of long-term debt, and dividends paid of ¥1,702 million, up 30.0%.



Risk Factors

The following is a summary of potential risk factors that may affect the future growth of the USS Group. This list is not exhaustive and new factors may arise as the result of external events.

•Laws and regulations affecting the auto auction industry

The USS Group, as an operator of auto auctions and through its other businesses involving the purchase and sale of used vehicles, is subject to various laws and regulations covering such activities. These regulations include the requirement for the USS Group to obtain specific licenses for the operation of these activities, which are subject to cancellation, should the Group infringe regulations or fail to meet licensee minimum requirements. If regulations change, the Group may be forced to modify its operations in a way that is disadvantageous to the Group's auction members.

•Related party transactions

Certain directors of companies within the USS Group, or members of these directors' respective families, have management and/or equity interests in used vehicle dealerships. In the period immediately following the establishment of the Group, such relationships helped bolster the number of vehicles put up for auction at USS sites. Should such directors sever ties from the Group, the number of vehicles put up for auction at USS sites may fall as a result.

•Attracting and maintaining a sufficient membership of auction participants

Strategies designed to attract new auction members and maintain sufficient active members are a key part of the USS Group's business. In certain circumstances, such strategies may be rendered ineffective. These include such scenarios as: competitors offering services, facilities or membership benefits not provided by the USS Group; a fall in the number of vehicles put up for auction at USS sites and/or the contract completion rate falling to levels below that of its competitors; the actions of USS staff or directors causing damage to the Group's reputation; and large-volume vehicle consignors deciding, for whatever reason, to use alternative selling methods.

•Attracting sufficient vehicles put up for auction

The USS Group's business is highly reliant on attracting sufficient vehicles put up for auction. This includes a certain level of dependence on vehicles put up for auction by large-volume used car purchasing agencies. In the fiscal year ended March 31, 1999, the Group began offering commission discounts to such high-volume customers. Future changes in the Group's commission system may affect the number of vehicles put up for auction by these customers.

•Limitations to the expansion of existing auction facilities

When expanding existing auction facilities, significant limitations exist on the amount of vehicle parking space that can be added. Such limitations may arise from the Group's ability to acquire or lease suitable land and/or construct multi-level parking facilities. In or near large Japanese cities, the availability of suitable space with the appropriate usage zoning for auto auctions is severely limited, which may impact on the Group's expansion plans.

•Risks relating to the construction and acquisition of new facilities

The USS Group expands its business through the construction of new auction facilities and the acquisition of existing auction sites from other operators. Such expansion includes such risks as: the inability to attract sufficient vehicles put up for auction or sufficient auction members to such new or acquired auction sites; various uncertain factors as contingent liabilities, off-balance-sheet liabilities, management problems and flawed rights arising from merger or acquisition transactions; increasing management complexity owing to a larger organization; the inability to secure all necessary regulatory permission related to auction facilities expansion or transfer to a new site; and foreign exchange risk, difficulty in adapting to local business practices, political risk and local cyclical economic risk when expanding outside Japan.

•Auto auction market growth limitations

The Japanese used car industry is a mature market with relatively low growth prospects. Vehicle ownership growth rates have also declined in recent years. The USS Group's business rests on its ability to sell the merits of its system to optimize the flow of used vehicles through the market. If the Group is unable to sustain its competitive advantage to expand its market share, its profitability and growth rate may decline.

•Competitive factors

Until now, the USS Group has maintained high market share in each geographical region in which it operates auto auctions. However, competitor firms have expanded their operations and increased their scale through alliances and mergers, which may result in these firms offering services or benefits to auction participants that the USS Group is unable to match. Furthermore, automaker-affiliated used car dealers may emerge in the future as significant competitors to the services offered by the Group. Such intensified competition may affect the Group's profitability and growth, including through downward pressure on commissions and other fees.

•Rapid technological innovation

Rapid technological innovation has had a profound impact on the auto auction market, affecting traditional auction sites, satellite-based auctions and Internet-based auction information services. Such rapid change may affect the future competitiveness of the USS Group. The Group may also need to carry out large-scale capital expenditure to keep pace with such developments, and there is no guarantee that the Group would be able to sustain its current competitive advantages despite the execution of such an investment strategy.

•Managing auto auction member information

As of March 31, 2005, the USS Group had an auction membership of 34,420 firms, a satellite auction membership of 6,768 firms and an Internet-based information membership of 12,286 firms. Should confidential information relating to the members be leaked to third parties, the Group would suffer a loss of market confidence and operating results would likely decline correspondingly.