

LINK THEORY HOLDINGS CO.,LTD.  
**ANNUAL REPORT 2007**  
**FOR THE YEAR ENDED AUGUST 31, 2007**

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## PROFILE

Theory was founded on the principle that men and women want to feel comfortable and look great in modern clothes. Founded in New York City in 1997, Theory quickly became known for its iconic fit and innovative fabrics, becoming the first clothing company to incorporate stretch as a fundamental element of its collection.

Ricky C. Sasaki, a business associate of Andrew Rosen (Theory founder and current president and co-CEO of Link Theory Holdings (US) Inc.), introduced the Theory brand to the Japanese market in 1999. In 2003, Link International, under the leadership of Mr. Sasaki, acquired Theory to create Link Theory Holdings.

In 2007, Theory celebrates its 10th anniversary with the opening of its flagship store in New York City. Located in New York City's Meatpacking District, the building is an expression of the company's innovative culture and aesthetic. The personality of the Meatpacking District is both historic and visionary, making it the most appropriate location for Theory to celebrate the intersection of its history and future.



t h e o r y

#### **THEORY**

1. THEORY IS A COMPANY, A CONCEPT, A PHILOSOPHY, AN AESTHETIC, A STYLE, AND A PRODUCT. 2. THEORY IS A PHENOMENON THAT SPUN OUT OF GREAT FITTING PANTS. 3. THEORY IS A BRAND THAT DOESN'T LOOK TO THE FUTURE – THEORY CREATES THE FUTURE. 4. THEORY IS PASSION, PEOPLE, PRODUCT, AND PROFITABILITY. 5. THEORY IS A DYNAMIC ENTREPRENEURIAL SPIRIT AND ATTITUDE THAT IS SHARED BY OUR EMPLOYEES, OUR PARTNERS AND OUR CONSUMERS. 6. ASK OUR CUSTOMERS ABOUT THEIR FAVORITE FITTING PANTS, THE PERFECT SHIRT, THE JACKET THEY THROW ON OVER EVERYTHING...THEY'LL TELL YOU "IT'S THEORY".

#### **PASSION**

1. PASSION IS THE FORCE THAT DRIVES US TO EVOLVE OUR BRAND, OUR PRODUCT AND OURSELVES. 2. PASSION KEEPS US TRUE TO OUR BELIEFS IN QUALITY, INNOVATION AND INTELLIGENCE. 3. OUR PASSION IS EXPRESSED IN OUR UNCOMPROMISING COMMITMENT TO OUR PRODUCT, OUR PEOPLE AND OUR MESSAGE. 4. PASSIONATE IS HOW PEOPLE FEEL IN OUR CLOTHES AND ABOUT OUR CLOTHES. 5. OUR CLOTHES CHANGE THE WAY PEOPLE FEEL ABOUT THEMSELVES.

#### **PEOPLE**

1. WE ARE A BRAND OF AESTHETIC INSIDERS. 2. WE LOVE STYLE, LUXURY AND SIMPLICITY. 3. WE ARE VISIONARY, STRATEGIC AND SOMETIMES DELIBERATELY UNCONVENTIONAL. 4. WE INVEST IN PEOPLE'S STRENGTHS, CULTIVATE PERSONAL GROWTH AND CREATE TEAM ENVIRONMENTS WHERE PEOPLE SUCCEED. 5. WE SEEK OUT AND NURTURE TALENT THAT EMBRACES OUR ENTREPRENEURIAL SPIRIT AND ATTITUDE. 6. WE ARE A GLOBAL ORGANIZATION UNITED BY OUR SHARED VALUES AND VISION.

#### **PRODUCT**

1. IT'S ABOUT THE FIT AND THE FABRICS. 2. IT'S ABOUT FEELING SEXY AND CONFIDENT IN CLOTHING THAT FITS YOU. 3. IT'S ABOUT DRESSING WITH A POINT OF VIEW. 4. IT'S ABOUT LUXURY, QUALITY, SIMPLICITY AND INTEGRITY. 5. IT'S ABOUT CLOTHING THAT WORKS INTO EVERY ASPECT OF OUR CUSTOMER'S LIFESTYLE. 6. SEASON AFTER SEASON IT'S ABOUT EVOLVING WHAT WE DO, NOT REINVENTING IT.

#### **PROFITABILITY**

1. IT'S NOT ONLY ABOUT MAKING MONEY, IT'S ABOUT MAKING A DIFFERENCE. 2. THEORY INVESTS IN THE LIVES OF OUR EMPLOYEES, IN OUR RELATIONSHIPS WITH OUR PARTNERS, AND IN OUR CONNECTIONS WITH OUR CUSTOMERS. 3. WE MANAGE OUR RESOURCES WITH DISCIPLINE AND FOCUS ON OUR LONG-TERM OBJECTIVES. 4. WE MEASURE SUCCESS BY RETURNS FOR OUR INVESTORS, SYNERGIES WITH OUR PARTNERS, THE ENTHUSIASM OF OUR EMPLOYEES AND LOYALTY FROM OUR CUSTOMERS.



**IN THEORY, ANYTHING IS POSSIBLE**

## LETTER FROM THE CEO

To our shareholders, customers and employees:

### Performance

Buoyed by the retail expansion of the core Theory brand in the United States, Link Theory Holdings Co., Ltd. (LTH), posted net sales of ¥59.4 billion for the year ended August 31, 2007, up 24.5% from the previous fiscal year. In Europe, the LTH Group recorded healthy sales of the Theory brand, with notable growth in the United Kingdom. Having established a platform from which to operate in Europe, LTH is poised for future expansion in the European market. Despite the strong performance of the core Theory brand, the Group reported a net loss of ¥5.6 billion due to mainly a write-down on the Rosner goodwill, trademark and tangible fixed assets stemming from the underperformance of that business in Europe.

In the United States, the gradual improvement in results was attributable to the continued focus on product development and innovation. LTH increased its brand awareness in the European market by opening its first retail store in Paris. The development of bases in the three key regions of Japan, North America and Europe has positioned the Group for further expansion as a global organization.

### Corporate Value

LTH's corporate value lies in the value of its brands, as well as its people and organization. Our leading brands in the contemporary fashion market, represented by our core Theory brand, enjoy a loyal following in Japan and the United States. One of the key strengths of LTH is its global reach. We firmly believe that the contemporary concept is a global concept, and that the modern, intelligent man or woman exists as much in New York as in London or Tokyo. Our global organization consists of operational headquarters in Japan and the United States. We hold a biannual Theory Global Line Opening in New York, at which managers gather from around the world to learn about new products and new developments in the company, and develop a truly global dialogue within the organization.

### New Medium-Term Plan: LTH2010

In January 2006, the Group announced its "LTH 100 Billion Plan," which focuses on generating ¥100 billion in net sales for the year ending August 31, 2010. However, the impairment loss recorded following the acquisition of Rosner had a significant impact on the earnings of the entire Group, resulting in a net loss for the fiscal year under review. In consideration, we believe that the plan overly emphasizes sales expansion while placing insufficient emphasis on profitability. Consequently, we recently announced a new medium-term plan, "LTH2010," which highlights achievable earnings. Under this new plan, LTH seeks to post ¥80 billion in net sales and ¥6 billion in operating income by the fiscal year ending August 31, 2010.

November 2007



Ricky C. Sasaki  
President & CEO





# t h e o r y

## **Theory Concept: "Contemporary"**

Theory is designed to address the needs of a modern customer, one who has a demanding and versatile lifestyle. This customer is sophisticated, urban and has discriminating taste, but designer companies are not catering to his or her need for comfort and value. This customer represents the contemporary consumer, creating a new segment in the marketplace, one that Theory believes in and views as a growing niche. Since Theory's inception, the contemporary business has become the fastest-growing segment of the American and Japanese fashion markets, and is rapidly on the rise in the European fashion landscape.

## **Theory's Global Culture**

LTH is a multinational company operating in a global market, which continually causes us to focus on our ability to think globally and execute locally. In the past year, the company continued its global evolution, while remaining true to its founding principles—quality, integrity and innovation. We are one company, unified by a set of principles. In theory, great companies are built on such a solid foundation.

# THEORY 10-YEAR TIMELINE | 1997-2007

THEORY CELEBRATES 10 YEARS OF INNOVATING THE CONTEMPORARY MARKETPLACE

## 1997

Theory is founded in New York City on the principles of fit and fabric quality, and ships its first Women's collection for Spring 1997.

## 1999

Theory launches the Men's collection creating a sensation in men's dressing, the Theory Men's flat front trouser becomes a staple in his cool and casual attire.

## 1998

Theory becomes available in Japan. Theory's signature "stretch" revolutionizes the sexy silhouette and becomes the urban women's cult favorite contemporary line and redefines the contemporary market.

## 2000

Men's and women's in urban hubs and suburban cliques depend on Theory to deliver chic, sophisticated clothing with a sexy and city style. Theory begins its global expansion with a distribution deal with Link International in Japan.

## 2001

Theory opens flagship store in Aoyama, Tokyo. Theory's belief that the connection to the customer and their passion for and understanding of the clothing is the cornerstone for Theory's expanding business.

## 2002

Theory begins its retail initiative opening stores in California, Connecticut, Florida, New York and Pennsylvania and officially launches the Women's collection to the European market for Spring 2003.

## 2003

Link International, Theory's Japanese licensee, purchases Theory LLC and Link Theory is formed.

## 2004

Theory becomes available in more than 20 countries around the world and continues to chart its global expansion in Europe and Asia, - opening stores and building businesses in Monaco, South Korea, China and Taiwan. Theory launches Accessories with a focused collection of handbags and shoes.

## 2005

The Theory Icon Project is founded, creating a companywide mission to encourage the development and exposure of iconic ideas, events, initiatives and sponsorships. The Icon Project goes on to honor and collaborate with the Richard Avedon estate, Stacy Peralta, the NRDC\* and the Vogue/CFDA\*\* fashion fund.

## 2006

Theory opens its Global Headquarters in NYC's Meatpacking District at 38 Gansevoort -, a 60,000 square-foot urban design that houses Theory's corporate headquarters, showrooms and flagship store.

## 2007

Theory celebrates its 10 year anniversary with a thriving global business -, remaining true to its roots and principles while continuously evolving. Theory continues to resonate with the modern, contemporary customer. Because in Theory, that's just the first 10 years.

## TOPICS

### Theory Icon Project

The Theory Icon Project is a program of events, exhibitions and sponsorships designed to encourage the development of iconic artists that is mainly led by the U.S. Theory Group. An icon is an individual, organization, artistic expression or concept that symbolizes a time or a philosophy. Proposing a powerful and consistent idea, an icon creates a movement that brings change by appealing to people's emotions. Our icons present society with new perspectives, at times provocatively, at times subtly.

The Theory Icon Project has been developed in accordance with Theory as an iconic fashion brand. It seeks to promote the brand principles of innovation, intelligence, authenticity and provocation.

<http://www.theory.com/#folderId=/iconproject&>

### «Ruth Ro's "Icons of the Meatpacking District"»

This exhibition featured portraits by artist Ruth Ro of about 40 people who play significant roles in creating the character of the Meatpacking District. It was held at the Theory flagship store in New York City.

### «Green Initiative Partnership»

Organized in partnership with the Precipice Alliance and the Natural Resources Defense Council (NRDC), this art installation and event was organized at the Theory flagship store to promote awareness of global warming.

### «High Line, a Photographic Installation by Lisa Kereszi»

The "Icon Wall" in the Theory flagship store featured photographs of the "High Line" by photographer Lisa Kereszi. The High Line is an abandoned, elevated railway track 1.5 miles long that runs along Manhattan's Lower West Side that is currently being revitalized for use as a park. Theory is an underwriter of this effort.

### «Philip Johnson's The Glass House»

The "Icon Wall" of the Theory flagship store featured a photographic exhibition of The Glass House, which was built by architect Philip Johnson in 1949. The pictures are excerpted from a book being published in the spring of 2008, and are the only photographs of its kind that exist. Today, The Glass House is considered one of the icons of modernism. Bequeathed by Mr. Johnson to the National Trust, the site is now open to the public.

### New Brands

LTH added two new brands, Helmut Lang and Premise, in the fiscal year ended August 2007.

#### Helmut Lang

The designer label Helmut Lang revolutionized the fashion world in the 1990s through its concept of minimalism. LTH appointed the husband-wife design team, Michael and Nicole Colovos, to the helm of the Helmut Lang brand. The duo's most recent collections have been well received from both critical and commercial perspectives.

Recognizing the potential to develop Helmut Lang as a major player in the contemporary market, LTH plans to expand this new business, mainly in the United States, with the goal of turning a profit by the year ending August 2010. Wholesale efforts have already been launched in select specialty stores. Distribution will continue to expand by increasing sales channels to premium department stores.

#### Premise

The Premise brand made its debut in the Spring season of 2007 as an adult fashion label that takes inspiration from Theory's core elements. Premise projects elegance while retaining the neutral and minimalist style of Theory.

Sophisticated and chic, Premise addresses the segment of the market that is more mature than the Theory audience, but still wants to look cool and feel good in their clothes. Premise has been developed to leverage an opportunity in the bridge market. With the coming of age of the "baby boomer" generation, the bridge market is poised for major growth. Premise is wholesaled in the United States. The expectation is for Premise to become profitable by the fiscal year ending August 2009 by expanding distribution to premium department stores to target its core customer.

## FUTURE CHALLENGES

developing our growing brands and working to effectively revitalize Rosner, which we view as our turnaround brand.

### Brand definitions

Core brand: Theory

Growing brands: Helmut Lang, Premise, PLS+T and contemporary casual brands in Japan (such as Joie)

Turnaround brand: Rosner

### (2) Achieve profitability in growing and turnaround brands

**Helmut Lang:** LTH believes that Helmut Lang has the potential to become a major contributor to Group sales and prestige. Our goal is to achieve business expansion, primarily in the United States. Following an initial focus on wholesale efforts, the brand now seeks to evolve and develop distribution channels, and increase sales in existing points of sale, in order to achieve profitability by the year ending August 2010.

**Premise:** LTH seeks to increase sales of this brand by expanding distribution to premium department stores. The expectation is for Premise to become profitable by the year ending August 2009.

**Casual Business:** The operating loss in the casual business in Japan narrowed in the fiscal year ended August 2007. We will continue to closely address profitability by brand, considering the possibility of closing unprofitable stores in order to focus our efforts. Our goal is to achieve profitability in the fiscal year ending August 2008.

**Revitalization of Rosner:** Rosner is slated to be profitable by the year ending August 2010. The strategy for profitability is as follows:

1. Restore sales through merchandising enhancements of the Rosner brand, focusing on collections for women in the 40-plus age group, which have been received favorably by wholesale customers.
2. Reduce cost of goods by increasing third-party purchases of finished goods.

### New Medium-Term Plan: LTH2010

As mentioned earlier, LTH's management announced a new medium-term plan, "LTH2010," in the year under review. The fundamental strategy of the new plan is to achieve "growth with sound profitability." LTH is pursuing three initiatives under the plan: (1) optimize the brand portfolio, (2) achieve profitability of growing and turnaround brands and (3) ensure steady growth of Theory. The financial targets for the year ending 2010 are ¥80 billion in net sales, ¥6 billion in an operating income and an operating margin of 7.5%.

### Initiatives to achieve new medium-term plan objectives

#### (1) Optimize the brand portfolio

To optimize our brand portfolio, LTH will maintain a balance among fostering the performance of our core brand, further

3. Reduce expenses through streamlining efforts.

#### (3) Ensure steady growth of Theory

We will aggressively expand the Theory brand as a growth driver in the European market. Theory sales have demonstrated healthy growth, primarily in the United Kingdom, currently our main market in the region. To accelerate this expansion, Theory Europe GmbH & Co. KG will continue to invest in our marketing efforts and further our retail

expansion strategy in the United Kingdom and France in 2008.

In the United States, Theory has maintained steady growth, and we continually seek new opportunities to expand the brand in meaningful arenas.

In Japan, we will continue to maintain the current high level of efficiency at existing stores through store renovation and floor expansion.

### LTH2010 CONSOLIDATED OUTLOOK

¥ 100 million

	FY2007 (RESULT)	FY2008 (FORECAST)	FY2009 (PLAN)	FY2010 (PLAN)
<b>Net sales</b>	<b>¥594</b>	<b>¥660</b>	<b>¥735</b>	<b>¥800</b>
Japan	221	226	240	258
USA	295	350	391	425
Europe	88	96	116	129
Asia except Japan	5	5	7	8
Eliminations	(15)	(17)	(19)	(19)
<b>Gross profit</b>	<b>303</b>	<b>350</b>	<b>392</b>	<b>427</b>
Gross margin	51.1%	53.1%	53.3%	53.4%
<b>Operating income before amortization of goodwill &amp; trademark</b>	<b>20</b>	<b>31</b>	<b>52</b>	<b>72</b>
Japan	16	19	23	27
USA	24	34	41	52
Europe	(15)	(13)	(3)	3
Asia except Japan	(0)	0	0	0
Eliminations, holding company expenses, etc.	(5)	(8)	(9)	(9)
Amortization of goodwill & trademark	15	12	12	12
<b>Operating income</b>	<b>¥ 5</b>	<b>¥ 19</b>	<b>¥ 40</b>	<b>¥ 60</b>
Operating margin	0.8%	2.9%	5.4%	7.5%

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

### PERFORMANCE OVERVIEW

In the year under review, the world economy posted a generally favorable performance, bolstered by growth in the emerging economies, notably BRICs, as well as solid results in the corporate sector. This growth occurred despite soaring raw materials prices, instability stemming from the subprime housing loan problem in the United States and other general factors contributing to certain global uncertainties. By region, all of our major markets—Japan, North America and Europe—remained on a path of stable growth in terms of the overall economy and personal consumption.

Against this backdrop, the LTH Group has improved the value of the Theory brand, which celebrated its 10th anniversary in 2007.

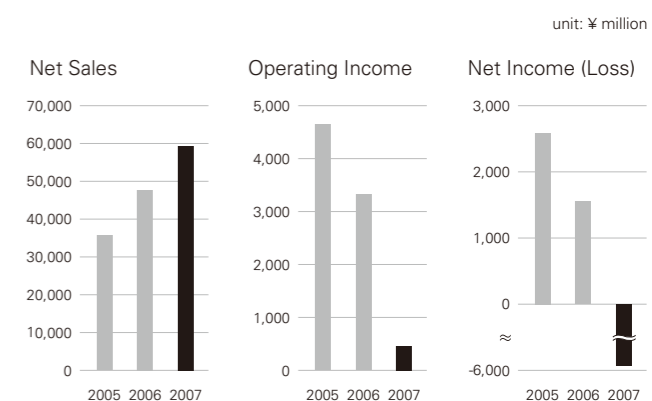
In Japan, sales of Spring and Summer items recovered, and we reported increased sales in our casual clothing business, which is handled by domestic subsidiaries. In the United States, we opened a flagship store in New York and otherwise sought to raise recognition of the Theory brand. Healthy U.S. sales have been reported by our retail division, spurred by the opening of several new stores, and our booming wholesale business. In Europe, our performance was bolstered by the full-year contribution of the Rosner business (which was included in consolidation for only eight months of the previous year). Sales of Theory brand items were also strong, attributable, in part, to the successful opening of the first Theory store in Paris in March 2007.

Although sales in each region increased, the gross margin declined due to higher sales of discounted items in Japan, North America and Europe in the first half of the period. Moreover, selling, general and administrative expenses jumped significantly, due to various factors, including (1) increased up-front outlays associated with establishing the Theory brand in Europe; (2) expenses arising from relocating the headquarters and warehouse, as well as opening new retail stores, in the United States; and (3) higher design costs related to establishing new businesses. In addition, we reported an other expense of ¥4,883 million as an impairment loss at a German

subsidiary, due to the underperforming Rosner business.

As a result, consolidated net sales for the year totaled ¥59,419 million, up 24.5% from the previous corresponding period. Operating income declined 86.0% to ¥466 million, and ordinary income fell 65.7% to ¥1,115 million. The Company posted a net loss of ¥5,617 million compared with net income of ¥1,551 million the previous year.

### Performance Overview



### PERFORMANCE BY BRAND

#### Theory Women's and Theory Men's

In Japan, LTH enhanced the value of the Theory Women's category by improving our per-store efficiency through renovating and expanding the floor space of existing stores, in lieu of opening new stores. We expanded the sales volumes of both Theory Men's and Theory Luxe, a size extension of the Theory Women's line, by emphasizing distribution through new retail stores, centering on prominent department stores.

In North America, we opened the Theory flagship store in New York City. In addition to expanding sales in the wholesale business, we boosted revenue in the retail business by opening 11 new stores in major cities. We have thus made steady progress in raising the Theory brand's profile.

In Europe, Link Theory Holdings (Europe) GmbH leveraged the Rosner infrastructure to operate without the need to distribute all goods from the United States, as was previously the case. During the year, we also opened a store in Paris as our first Theory retail store in Europe, which further bolstered regional sales.

As a result, sales of the Theory Women's segment rose 16.0% to ¥40,845 million from the previous corresponding period, and sales of the Theory Men's segment grew 29.4% to ¥5,410 million from the previous corresponding period.

#### Theory store openings/closings in Japan

	Stores Opened	Stores Renovated	Stores Closed	Number of Stores at Year-end
Theory Women's	5	5	2	49
Theory Men's	3	3	1	30
Theory Luxe	7	3	—	38
Theory Accessories	—	—	5	2
Theory Petit	—	—	2	8

#### Rosner

Rosner GmbH & Co. KG, acquired by LTH in November 2005, was included in the scope of consolidation for 12 months in the year under review compared with just eight months in the previous fiscal year. Segment sales grew 61.0% to ¥7,542 million from the previous corresponding period.

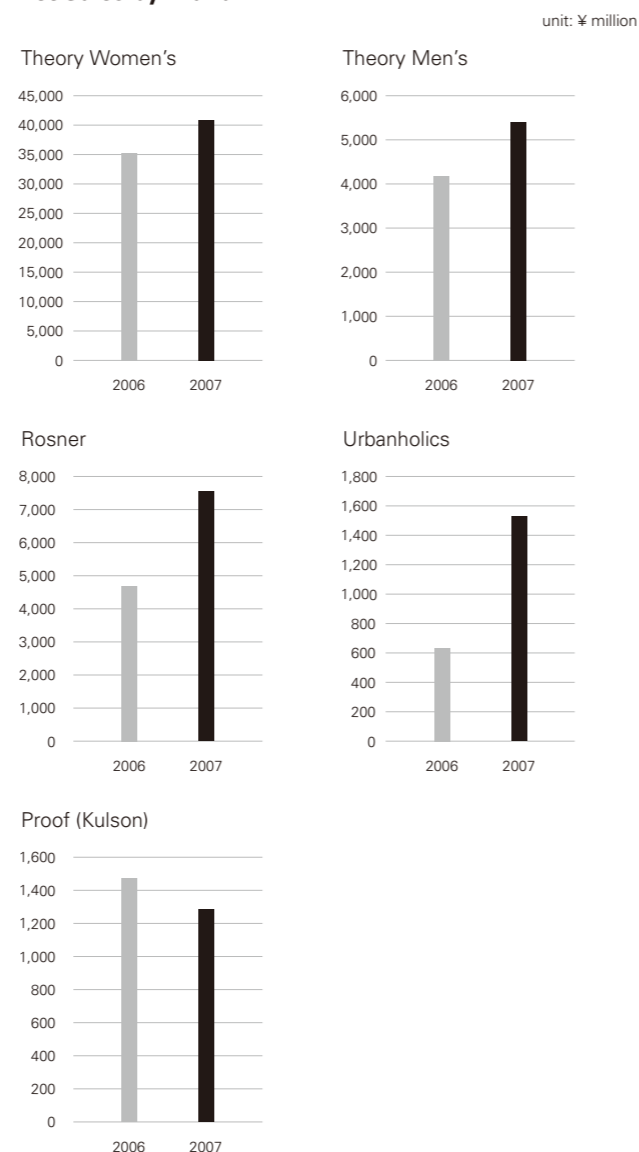
#### Urbanholics

In the year under review, the Urbanholics segment was launched to handle our casual lines, such as Joie and 7 For All Mankind. This was due to the increasing financial importance of our casual business. Sales of the new segment increased steadily in the fiscal year under review, experiencing particular growth in the wholesale category. During the fiscal year, we opened eight new stores and renovated two existing ones, bringing our total stores to 12. Segment sales surged 141.2% to ¥1,530 million from the previous corresponding period.

#### Proof (Kulson)

For the spring and summer seasons of 2007, we reinvented the existing Kulson brand by appointing a new designer and marketing under a new label—Proof. At fiscal year-end, the Proof brand, which inherited our existing Kulson stores, had 14 retail stores. Segment sales totaled ¥1,285 million, down 12.6% from the previous corresponding period.

#### Net Sales by Brand



#### Other

In the year under review, the PLS+T brand performed favorably, boosted by increased sales of original items. We reported steady sales of the Helmut Lang brand, which we launched on a full-scale basis during the fiscal year with the opening of five stores. At the end of the period, there were 17 stores in this segment. Segment sales jumped 83.7% to ¥2,803 million from the previous corresponding period.

#### PERFORMANCE BY REGION

##### Japan

In Japan, the Group opened 33 retail stores and closed 17, for a total of 178 stores at fiscal year-end. In the first half of the period, sales of retail stores slipped below projections, due to the weak performance of outerwear, as the result of a warmer climate and fashion trends away from jackets. The Fall season launched favorably at first, although the aforementioned weak sales, combined with excess purchases, resulted in excess inventories. To address this issue, we offered sales discounts and devalued our inventories, leading to a decline in the gross margin for the first half of the period. In the second half, we raised the precision of our ordering procedures, leading to an appropriate level of inventory situation and higher gross profit. For the year, sales in Japan grew 5.5% to ¥22,342 million from the previous corresponding period, and operating income declined 22.8% to ¥2,193 million from the previous corresponding period.

##### North America

In North America, the Group opened 11 retail stores, for a total of 31 stores at fiscal year-end. In the first half of the period, unusually warm weather pushed full-priced sales below our expectations. Meanwhile, discount sales increased, leading to a decline in the gross margin. In the second half of the period, we reported increased expenses due to the New York headquarters' relocation, the opening of new retail stores and higher design costs. However, both sales and gross profit rose considerably owing to

revenue contributions from new business such as Helmut Lang, retail sales spurred on by the opening of new stores and higher sales in the wholesale business. Regional sales jumped 33.6% to ¥29,520 million from the previous corresponding period, and operating income declined 56.6% to ¥1,083 million from the previous corresponding period.

##### Europe

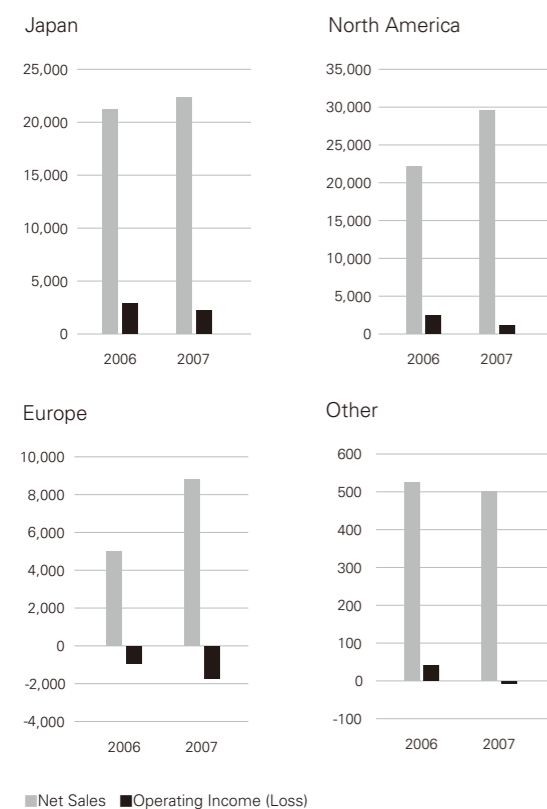
In addition to weakness in the Rosner segment, the Group incurred setup costs in its strategy to establish the Theory business in Europe, including the investment in European infrastructure and the opening of the first Theory retail store in Paris. Furthermore, in light of the weak performance of the Rosner business, we posted an impairment loss on Rosner's goodwill, trademark and tangible fixed assets, which were valued based on the excess earning power of that business when we acquired Rosner GmbH & Co. KG in November 2005. Regional sales surged 77.0% to ¥8,815 million. The Group posted a regional operating loss of ¥1,726 million, expanding 86.9% from the previous corresponding period.

##### Other

Through local subsidiaries, the Group has retail operations in Asia (excluding Japan). During the year, we opened one store each in China and Hong Kong and closed one in Hong Kong. In South Korea and Taiwan, we formed alliances with local companies, which subsequently assumed responsibility for our retail network in those markets. Under the new arrangement, we closed two retail stores in South Korea and two in Taiwan. As a result, there were four retail stores in Asia (excluding Japan) at fiscal year-end, and regional sales slipped 4.6% to ¥500 million. The Group posted a regional operating loss of ¥6 million compared with operating income of ¥41 million in the previous corresponding period.

Performance by Region

unit: ¥ million



FINANCIAL POSITION

At fiscal year-end, the Group had total current assets of ¥20,950 million, down ¥8,255 million from the previous year. Major factors included a decrease in inventories stemming from improved inventory management in Japan and North America, as well as an ¥8,119 million decline in cash and cash equivalents due to the repayment of loans by U.S. and German subsidiaries. Total fixed assets were down ¥2,098 million to ¥23,482 million. Although the purchase of property and equipment by U.S. subsidiaries boosted fixed assets by ¥2,474 million, the Group posted a ¥4,883 million impairment loss on goodwill, trademark and tangible fixed assets related to the Rosner business. As a

result, consolidated total assets stood at ¥44,432 million, down ¥10,354 million from a year earlier.

Total current liabilities amounted to ¥12,793 million at fiscal year-end, down ¥481 million from a year earlier. The decline stemmed mainly from a ¥1,103 million decrease in the current portion of long-term debt owing to the repayment of loans by U.S. and German subsidiaries. Total long-term liabilities fell ¥4,655 million to ¥19,000 million, due primarily to a ¥4,960 million drop in long-term debt as subsidiaries repaid their loans. Consequently, total liabilities declined ¥5,137 million to ¥31,793 million.

Total net assets fell ¥5,216 million to ¥12,638 million, mainly due to the ¥5,617 million net loss and an increase in translation adjustments.

CASH FLOWS

At fiscal year-end, cash and cash equivalents totaled ¥5,672 million, down ¥8,117 million from ¥13,789 million a year earlier.

Net cash provided by operating activities amounted to ¥1,771 million compared with ¥754 million in net cash used in operating activities the previous fiscal year. Major factors included ¥466 million in operating income and a ¥774 million decrease in inventories.

Net cash used in investing activities totaled ¥3,294 million, down 80.3% from the previous fiscal year.

This was mainly due to ¥3,278 million in purchases of property and equipment.

Net cash used in financing activities was ¥6,681 million compared with ¥20,452 million in net cash provided by financing activities in the previous fiscal year. The primary factor was repayment of long-term debt amounting to ¥6,554 million.

**CONSOLIDATED BALANCE SHEETS**

LINK THEORY HOLDINGS CO., LTD. AND CONSOLIDATED SUBSIDIARIES

	August 31,		
	2007	2006	2007
	Millions of yen		Thousands of U.S. dollars (Note 2)
<b>Assets</b>			
Current assets (Note 7):			
Cash and cash equivalents	¥ 5,672	¥ 13,789	\$ 48,870
Time deposits and short-term investments	—	2	—
Notes and accounts receivable	3,997	3,832	34,437
Inventories (Note 3)	8,118	8,852	69,948
Deferred tax assets (Note 8)	1,738	1,223	14,978
Other	1,632	1,553	14,068
Allowance for doubtful accounts	(209)	(48)	(1,805)
Total current assets	20,950	29,205	180,495
Fixed assets (Notes 4 and 7):			
Property and equipment:			
Buildings and structures	5,377	2,967	46,332
Land	—	25	—
Other	3,602	3,055	31,035
	8,979	6,048	77,367
Accumulated depreciation	(3,098)	(2,641)	(26,696)
Total property and equipment, net	5,881	3,407	50,671
Intangible assets:			
Trademarks	6,520	9,471	56,174
Software	305	307	2,631
Goodwill	6,638	8,754	57,196
Other	1	4	11
Total intangible assets	13,465	18,537	116,012
Investments and other assets:			
Investment securities (Note 5)	618	577	5,330
Leasehold deposits paid	1,028	866	8,858
Deferred tax assets (Note 8)	2,223	1,920	19,161
Other	440	441	3,798
Allowance for doubtful accounts	(176)	(170)	(1,519)
Total investments and other assets	4,135	3,636	35,628
Total fixed assets	23,482	25,580	202,311
Total assets	¥ 44,432	¥ 54,786	\$ 382,807

	August 31,		
	2007	2006	2007
	Millions of yen		Thousands of U.S. dollars (Note 2)
<b>Liabilities and net assets</b>			
Current liabilities:			
Accounts payable – trade	¥ 4,834	¥ 4,767	\$ 41,654
Short-term borrowings (Notes 6 and 7)	3,217	3,066	27,721
Current portion of long-term debt (Note 6)	1,196	2,299	10,306
Accounts payable – other	1,831	1,699	15,777
Accrued income taxes (Note 8)	367	424	3,165
Accrued consumption taxes	200	70	1,730
Deferred tax liabilities	2	—	24
Accrued employees' bonuses	548	355	4,723
Allowance for restructuring expenses	280	—	2,416
Other	313	589	2,702
Total current liabilities	12,793	13,274	110,219
Long-term liabilities:			
Convertible bond with warrants (Note 6)	13,258	13,264	114,230
Long-term debt (Note 6)	3,662	8,622	31,551
Deferred tax liabilities (Note 8)	—	539	—
Accrued directors' and statutory auditors' retirement benefits	189	189	1,629
Accrued employees' retirement benefits (Note 9)	694	611	5,981
Other	1,196	428	10,306
Total long-term liabilities	19,000	23,656	163,697
Total liabilities	31,793	36,930	273,915
Net assets:			
Shareholders' equity (Notes 12 and 13):			
Common stock, without par value:			
Authorized: 2007 and 2006 — 456,000 shares			
Issued: 2007 — 151,608 shares	6,369	—	54,874
2006 — 151,096 shares	—	6,335	—
Capital surplus	7,956	7,922	68,545
(Accumulated deficit) retained earnings	(2,008)	3,703	(17,300)
Total shareholders' equity	12,317	17,961	106,119
Valuation, translation adjustments and other:			
Unrealized holding (loss) gain on securities	(0)	0	(2)
Unrealized gain and loss on hedging instruments	10	33	93
Translation adjustments	297	(227)	2,566
Total valuation, translation adjustments and other	308	(194)	2,657
Minority interests	13	88	115
Total net assets	12,638	17,855	108,891
Contingent liabilities (Note 11)			
Total liabilities and net assets	¥ 44,432	¥ 54,786	\$ 382,807

See accompanying notes to consolidated financial statements.

**CONSOLIDATED STATEMENTS OF OPERATIONS**

LINK THEORY HOLDINGS CO., LTD. AND CONSOLIDATED SUBSIDIARIES

	Year ended August 31,			
	2007	2006	2005	2007
	Millions of yen			Thousands of U.S. dollars (Note 2)
Net sales	¥ 59,419	¥47,707	¥35,646	\$ 511,925
Cost of sales (Note 17)	29,076	22,091	16,438	250,505
Gross profit	30,342	25,616	19,207	261,419
Selling, general and administrative expenses (Note 18)	29,876	22,293	14,563	257,401
Operating income	466	3,323	4,644	4,018
Other income (expenses):				
Interest and dividend income	83	64	0	722
Foreign exchange gain	918	171	97	7,909
Rent income	1	2	2	17
Amortization of negative goodwill	—	28	93	—
Interest expense	(319)	(334)	(137)	(2,753)
Stock issuance expenses	(0)	(1)	(43)	(8)
Bond issuance expenses	—	(18)	—	—
Initial public offering expenses	—	—	(32)	—
Gain on sales of property and equipment (Note 19)	4	—	—	40
Gain on sales of investment securities	—	—	0	—
Receipt of cash surrender payment from life insurance policies	—	68	—	—
Loss on sales or disposal of property and equipment (Note 19)	(52)	(120)	(48)	(449)
Loss on write-down of investment securities	—	—	(5)	—
Loss on business restructuring	(172)	—	—	(1,486)
Loss on disposal of finished goods	(2)	(6)	(20)	(18)
Loss on cancellation of lease contracts	(29)	(28)	(47)	(253)
Loss on liquidation of affiliated companies	—	—	(33)	—
Loss on extinguishment of debt financing (Note 21)	(38)	—	(91)	(328)
Loss on allowance for restructuring expenses	(262)	—	—	(2,258)
Impairment loss on fixed assets (Note 20)	(5,032)	—	—	(43,361)
Loss related to lawsuits	(90)	—	—	(780)
Other	(514)	(29)	(36)	(4,433)
(Loss) income before income taxes and minority interests	(5,039)	3,117	4,340	(43,421)
Income taxes (Note 8):				
Current	1,886	2,011	2,425	16,252
Deferred	(1,276)	(453)	(655)	(10,997)
	609	1,557	1,769	5,254
Minority interests	(32)	7	(14)	(279)
Net (loss) income	¥ (5,617)	¥ 1,551	¥ 2,586	\$ (48,395)

See accompanying notes to consolidated financial statements.

**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**

LINK THEORY HOLDINGS CO., LTD. AND CONSOLIDATED SUBSIDIARIES

	Shareholders' equity			
	Common stock	Capital surplus	(Accumulated deficit) retained earnings	Total shareholders' equity
	Millions of yen			
Balance as of August 31, 2006	¥ 6,335	¥ 7,922	¥ 3,703	¥ 17,961
Changes during the year:				
Issuance of common stock	33	33	—	67
Cash dividends paid	—	—	(94)	(94)
Net loss	—	—	(5,617)	(5,617)
Net changes in items other than those in shareholders' equity	—	—	—	—
Total changes during the year	33	33	(5,711)	(5,644)
Balance as of August 31, 2007	¥ 6,369	¥ 7,956	¥ (2,008)	¥ 12,317

	Valuation, translation adjustments and other					
	Unrealized holding (loss) gain on securities	Unrealized gain and loss on hedging instruments	Translation adjustments	Total valuation, translation adjustments and other	Minority interests	Total net assets
	Millions of yen					
Balance as of August 31, 2006	¥ 0	¥ 33	¥ (227)	¥ (194)	¥ 88	¥ 17,855
Changes during the year:						
Issuance of common stock	—	—	—	—	—	67
Cash dividends paid	—	—	—	—	—	(94)
Net loss	—	—	—	—	—	(5,617)
Net changes in items other than those in shareholders' equity	(0)	(22)	525	503	(75)	427
Total changes during the year	(0)	(22)	525	503	(75)	(5,216)
Balance as of August 31, 2007	¥ (0)	¥ 10	¥ 297	¥ 308	¥ 13	¥ 12,638

**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS (CONTINUED)**

LINK THEORY HOLDINGS CO., LTD. AND CONSOLIDATED SUBSIDIARIES

	Shareholders' equity			
	Common stock	Capital surplus	(Accumulated deficit) retained earnings	Total shareholders' equity
	Thousands of U.S. dollars (Note 2)			
Balance as of August 31, 2006	<b>\$54,584</b>	<b>\$68,256</b>	<b>\$ 31,909</b>	<b>\$154,749</b>
Changes during the year:				
Issuance of common stock	<b>289</b>	<b>289</b>	<b>—</b>	<b>579</b>
Cash dividends paid	<b>—</b>	<b>—</b>	<b>(814)</b>	<b>(814)</b>
Net loss	<b>—</b>	<b>—</b>	<b>(48,395)</b>	<b>(48,395)</b>
Net changes in items other than those in shareholders' equity	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>
Total changes during the year	<b>289</b>	<b>289</b>	<b>(49,209)</b>	<b>(48,630)</b>
Balance as of August 31, 2007	<b>\$54,874</b>	<b>\$68,545</b>	<b>\$ (17,300)</b>	<b>\$106,119</b>

	Valuation, translation adjustments and other					
	Unrealized holding (loss) gain on securities	Unrealized gain and loss on hedging instruments	Translation adjustments	Total valuation, translation adjustments and other	Minority interests	Total net assets
	Thousands of U.S. dollars (Note 2)					
Balance as of August 31, 2006	<b>\$ 1</b>	<b>\$ 285</b>	<b>\$ (1,963)</b>	<b>\$ (1,678)</b>	<b>\$ 767</b>	<b>\$153,838</b>
Changes during the year:						
Issuance of common stock	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>579</b>
Cash dividends paid	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>(814)</b>
Net loss	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>(48,395)</b>
Net changes in items other than those in shareholders' equity	<b>(3)</b>	<b>(192)</b>	<b>4,530</b>	<b>4,335</b>	<b>(651)</b>	<b>3,683</b>
Total changes during the year	<b>(3)</b>	<b>(192)</b>	<b>4,530</b>	<b>4,335</b>	<b>(651)</b>	<b>(44,947)</b>
Balance as of August 31, 2007	<b>\$ (2)</b>	<b>\$ 93</b>	<b>\$ 2,566</b>	<b>\$ 2,657</b>	<b>\$ 115</b>	<b>\$108,891</b>

	Shareholders' equity			
	Common stock	Capital surplus	Retained earnings	Total shareholders' equity
	Millions of yen			
Balance as of August 31, 2005	¥6,314	¥7,901	¥2,333	¥16,549
Changes during the year:				
Issuance of common stock	20	20	—	41
Cash dividends paid	—	—	(91)	(91)
Bonuses to directors	—	—	(90)	(90)
Net income	—	—	1,551	1,551
Net changes in items other than those in shareholders' equity	—	—	—	—
Total changes during the year	20	20	1,370	1,412
Balance as of August 31, 2006	¥6,335	¥7,922	¥3,703	¥17,961

	Valuation, translation adjustments and other					
	Unrealized holding gain on securities	Unrealized gain and loss on hedging instruments	Translation adjustments	Total valuation, translation adjustments and other	Minority interests	Total net assets
	Millions of yen					
Balance as of August 31, 2005	¥ 0	¥ 16	¥(302)	¥(286)	¥ 6	¥16,269
Changes during the year:						
Issuance of common stock	—	—	—	—	—	41
Cash dividends paid	—	—	—	—	—	(91)
Bonuses to directors	—	—	—	—	—	(90)
Net income	—	—	—	—	—	1,551
Net changes in items other than those in shareholders' equity	0	16	74	91	82	174
Total changes during the year	0	16	74	91	82	1,586
Balance as of August 31, 2006	¥ 0	¥33	¥(227)	¥(194)	¥88	¥17,855

**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS (CONTINUED)**

LINK THEORY HOLDINGS CO., LTD. AND CONSOLIDATED SUBSIDIARIES

	Shareholders' equity			
	Common stock	Capital surplus	Retained earnings (accumulated deficit)	Total shareholders' equity
	Millions of yen			
Balance as of August 31, 2004	¥2,542	¥2,457	¥ (115)	¥ 4,883
Changes during the year:				
Issuance of common stock	3,772	5,444	—	9,216
Cash dividends paid	—	—	(71)	(71)
Bonuses to directors and statutory auditors	—	—	(65)	(65)
Net income	—	—	2,586	2,586
Net changes in items other than those in shareholders' equity	—	—	—	—
Total changes during the year	3,772	5,444	2,449	11,665
Balance as of August 31, 2005	¥6,314	¥7,901	¥2,333	¥16,549

	Valuation, translation adjustments and other					
	Unrealized holding gain on securities	Unrealized gain and loss on hedging instruments	Translation adjustments	Total valuation, translation adjustments and other	Minority interests	Total net assets
	Millions of yen					
Balance as of August 31, 2004	¥—	¥ 8	¥(309)	¥(301)	¥—	¥ 4,582
Changes during the year:						
Issuance of common stock	—	—	—	—	—	9,216
Cash dividends paid	—	—	—	—	—	(71)
Bonuses to directors and statutory auditors	—	—	—	—	—	(65)
Net income	—	—	—	—	—	2,586
Net changes in items other than those in shareholders' equity	0	8	7	15	6	21
Total changes during the year	0	8	7	15	6	11,687
Balance as of August 31, 2005	¥ 0	¥16	¥(302)	¥(286)	¥ 6	¥16,269

See accompanying notes to consolidated financial statements.

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

LINK THEORY HOLDINGS CO., LTD. AND CONSOLIDATED SUBSIDIARIES

	Year ended August 31,			
	2007	2006	2005	2007
	Millions of yen			Thousands of U.S. dollars (Note 2)
<b>Cash flows from operating activities</b>				
(Loss) income before income taxes and minority interests	¥ (5,039)	¥ 3,117	¥ 4,340	\$ (43,421)
Depreciation	989	561	340	8,526
Amortization of (negative) goodwill	432	245	(93)	3,726
Increase in accrued directors' and statutory auditors' retirement benefits	—	37	46	—
Increase (decrease) in accrued employees' bonuses	171	(55)	274	1,476
Increase in allowance for doubtful accounts	143	71	18	1,241
(Decrease) increase in accrued employees' retirement benefits	(0)	96	—	(0)
Increase in allowance for restructuring expenses	262	—	—	2,258
Interest and dividend income	(83)	(64)	(0)	(722)
Interest expense	319	334	137	2,753
Foreign exchange (gain) loss	(796)	(202)	20	(6,863)
Amortization of trademarks	1,061	864	595	9,142
Stock issuance expenses	0	1	43	8
Bond issuance expenses	—	18	—	—
Initial public offering expenses	—	—	32	—
Gain on sales of investment securities	—	—	(0)	—
Receipt of cash surrender payment from life insurance policies	—	(68)	—	—
Loss on disposal of finished goods	2	6	20	18
Gain on sales of property and equipment	(4)	—	—	(40)
Loss on sales or disposal of property and equipment	52	120	48	449
Loss on write-down of investment securities	—	—	5	—
Loss on business restructuring	172	—	—	1,486
Loss on cancellation of lease contracts	29	28	47	253
Loss on liquidation of affiliated companies	—	—	33	—
Loss on extinguishment of debt financing	38	—	91	328
Impairment loss on fixed assets	5,032	—	—	43,361
Loss related to lawsuits	90	—	—	780
Loss on write-downs of supplies	351	—	—	3,025
Decrease (increase) in accounts receivable	46	(127)	(674)	396
Decrease (increase) in inventories	774	(2,816)	(178)	6,670
(Decrease) increase in accounts payable — trade	(138)	1,447	(154)	(1,193)
(Decrease) increase in accounts payable — other	(77)	(553)	81	(667)
Increase (decrease) in accrued expenses	7	204	(43)	61
Increase (decrease) in accrued consumption taxes	212	(173)	23	1,830
Bonuses paid to directors and statutory auditors	—	(90)	(65)	—
Other	446	(230)	388	3,844
Subtotal	4,494	2,774	5,381	38,724
Interest and dividends received	86	60	0	749
Interest paid	(351)	(286)	(133)	(3,025)
Receipt of life insurance cash surrender payment	—	68	—	—
Loss on cancellation of lease contracts	(51)	(27)	(40)	(442)
Income taxes paid	(2,048)	(3,087)	(1,785)	(17,648)
Other	(359)	(256)	(96)	(3,095)
Net cash provided by (used in) operating activities	¥ 1,771	¥ (754)	¥ 3,325	\$ 15,263

**CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)**

LINK THEORY HOLDINGS CO., LTD. AND CONSOLIDATED SUBSIDIARIES

	Year ended August 31,			2007
	2007	2006	2005	
	Millions of yen			Thousands of U.S. dollars (Note 2)
<b>Cash flows from investing activities</b>				
Decrease (increase) in time deposits	¥ 2	¥ —	¥ (1)	\$ 22
Purchases of property and equipment	(3,278)	(2,022)	(517)	(28,247)
Proceeds from sales of property and equipment	88	102	16	760
Purchases of intangible assets	(164)	(2,819)	(122)	(1,420)
Proceeds from sales of intangible assets	0	—	—	3
Purchases of investment securities	(1)	(1)	(2,543)	(10)
Proceeds from sales of investment securities	—	—	2,004	—
Purchases of its own stock by a subsidiary	—	(6,896)	—	—
Purchases of stock in a subsidiary	—	(18)	—	—
Short-term loans made	—	(0)	(4)	—
Collection of loans receivable	—	4	1	—
Proceeds from sales of (acquisition of) golf-club memberships	1	10	(13)	11
Purchases of a subsidiary's stock resulting in changes in scope of consolidation	—	(5,018)	—	—
Proceeds from reduction in purchase price of a subsidiary's stock	154	—	—	1,334
Other	(96)	(98)	(108)	(832)
Net cash used in investing activities	(3,294)	(16,760)	(1,288)	(28,380)
<b>Cash flows from financing activities</b>				
(Decrease) increase in short-term borrowings	(99)	2,542	(355)	(857)
Proceeds from long-term debt	—	9,964	4,056	—
Repayment of long-term debt	(6,554)	(5,250)	(5,585)	(56,467)
Proceeds from issuance of convertible bond with warrants	—	13,247	—	—
Proceeds from issuance of common stock	66	40	9,170	570
Cash dividends paid	(94)	(90)	(71)	(811)
Proceeds from issuance of common stock of subsidiaries to minority shareholders	—	—	6	—
Payment for initial public offering expenses	—	—	(32)	—
Net cash (used in) provided by financing activities	(6,681)	20,452	7,189	(57,566)
<b>Effect of exchange rate changes on cash and cash equivalents</b>				
	86	33	(154)	748
<b>Net change in cash and cash equivalents</b>	<b>(8,117)</b>	<b>2,971</b>	<b>9,070</b>	<b>(69,934)</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>13,789</b>	<b>10,818</b>	<b>1,700</b>	<b>118,804</b>
<b>Increase in cash and cash equivalents resulting from changes in scope of consolidation</b>				
	—	—	47	—
<b>Cash and cash equivalents at end of year</b>	<b>¥ 5,672</b>	<b>¥ 13,789</b>	<b>¥ 10,818</b>	<b>\$ 48,870</b>

See accompanying notes to consolidated financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** August 31, 2007

LINK THEORY HOLDINGS CO., LTD. AND CONSOLIDATED SUBSIDIARIES

**1. Summary of Significant Accounting Policies****a. Basis of Presentation**

The accompanying consolidated financial statements of LINK THEORY HOLDINGS Co., Ltd. (the "Company") and its consolidated subsidiaries (collectively, the "Group") are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards and are compiled from the consolidated financial statements prepared by the Company as required by the Financial Instruments and Exchange Law of Japan. The accounts of overseas subsidiaries and other affiliates, such as Link Theory Holdings (US) Inc. and its 45 subsidiaries, Link Theory Holdings (Europe) GmbH and its 8 subsidiaries, LK International (H.K.) Ltd., Theory Korea Co., Ltd., Theory Shanghai International Trading Co., Ltd. and Theory Taiwan Co., Ltd., are based on their accounting records maintained in conformity with accounting principles generally accepted in their respective countries of domicile.

As permitted by the Financial Instruments and Exchange Law, amounts of less than one million yen have been omitted. Consequently, the totals shown in the accompanying consolidated financial statements (both in yen and U.S. dollars) do not necessarily agree with the sum of the individual amounts.

In addition, for the convenience of readers outside Japan, the accompanying consolidated financial statements, including the notes thereto, contain additional information which is not required under accounting principles generally accepted in Japan.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make certain estimates and assumptions which affect the reported amounts of the assets and liabilities and the disclosure of contingent assets and liabilities at the

date of the financial statements and the reported amounts of revenues and expenses during each reporting period. The actual results could differ from these estimates.

Effective the year ended August 31, 2006, the Company adopted a new accounting standard for the presentation of net assets in the balance sheet and the related implementation guidance. In this connection, the financial statements for the year ended August 31, 2005 have been restated to conform to the presentation of the financial statements for the year ended August 31, 2006.

Effective the year ended August 31, 2007, in line with the revision of the Corporation Tax Law of Japan, the Company and domestic consolidated subsidiaries have changed their method of depreciation for tangible fixed assets acquired on or after April 1, 2007 based on the revised Corporation Tax Law. The impact of this change in method of depreciation was immaterial for the year ended August 31, 2007.

In addition, certain reclassifications have been made to present the accompanying consolidated financial statements in a format which is familiar to readers outside Japan.

**b. Basis of Consolidation**

The consolidated financial statements include the accounts of the Company and 62 subsidiaries over which the Company exerts control through substantial ownership of majority voting rights.

The Company's major subsidiaries are Link International Co., Ltd., Link Theory Holdings (US) Inc., Theory LLC, Urbanholics Co., Ltd., Link Sales Corporation Co., Ltd., LK International (H.K.) Ltd., Theory Shanghai International Trading Co., Ltd., Link Theory Holdings (Europe) GmbH, Rosner GmbH & Co. KG, Theory Europe GmbH & Co. KG and Helmut Lang LLC.

All significant intercompany accounts and transactions have

been eliminated in consolidation.

After allocation to the respective assets based on the fair value of such assets at their dates of acquisition, the difference (goodwill) between the cost of acquisition and the underlying equity in the net assets acquired from subsidiaries is amortized by the straight-line method over the period during which the effect of the investments is considered to be maintained if such goodwill is material. If it is difficult to estimate reasonably the period during which goodwill will be useful in generating additional income, it is charged to income as other expense. Goodwill is tested for impairment whenever there are indications that impairment may exist such as when the subsidiary's fair value is lower than its book value.

The consolidated financial statements of the Company as of and for the years ended August 31, 2007 and 2006 include the accounts of Link Theory Holdings (US) Inc. including its subsidiaries and Link Theory Holdings (Europe) GmbH including its subsidiaries as of June 30, and LK International (H.K.) Ltd. and two other subsidiaries as of May 31, their respective fiscal year-end dates. Similarly, the consolidated financial statements of the Company as of and for the years ended August 31, 2007 and 2006 include the accounts of Theory Shanghai International Trading Co., Ltd. as of June 30, the end of its interim period. All significant transactions which would materially affect the Company's and consolidated subsidiaries' consolidated financial position and results of operations entered into by these subsidiaries during the period from June 1 or July 1 to August 31 have been eliminated in consolidation.

Goodwill represents the difference between the excess of acquisition cost over the net amounts of the related assets and liabilities at fair value. Such costs are expensed as incurred due to the absence of a reasonable basis on which to estimate the period during which the economic benefit of an investment is expected to have an effect on business operations. However, certain amounts determined by the Company to be insignificant are amortized at one time

during the year in which they were incurred.

Thirteen subsidiaries of Link Theory Holdings (US) Inc. and three subsidiaries of Link Theory Holdings (Europe) GmbH were established and became consolidated subsidiaries of the Company during the year ended August 31, 2007.

The Company does not have any subsidiaries or affiliates which are accounted for by the equity method.

#### **c. Cash and Cash Equivalents**

For the purposes of the consolidated statements of cash flows, the Company considers cash and cash equivalents to include cash on hand, readily available deposits and all highly liquid investments with only an insignificant risk of any changes in their value, and with maturities generally of three months or less when purchased.

#### **d. Investments in Securities**

In applying the accounting standard for financial instruments, securities with a determinable fair market value (other than investments in an affiliated company) are classified into one of three categories and are accounted for as follows:

Trading securities, which are debt and equity securities which the Company holds for the purpose of earning profit on short-term movements in their fair market value, are reported at fair market value with unrealized holding gain and loss included in earnings. The Company and its consolidated subsidiaries held no trading securities at August 31, 2007 and 2006.

Held-to-maturity securities, which are debt securities which the Company has the positive intent and ability to hold to maturity, are reported at amortized cost.

Available-for-sale securities, which are debt and equity securities with determinable fair market value and which are classified neither as trading securities nor as held-to-maturity securities, are reported at fair market value.

Unrealized holding gain and loss on available-for-sale securities are excluded from earnings and are reported as "unrealized holding (loss) gain on securities," net of the related tax effect, in a separate component of net assets until realized. In computing the realized gain or loss, the cost of available-for-sale securities is determined principally by the moving-average method.

Other securities with no determinable fair market value are stated at moving-average cost.

Investments in limited liability partnerships and other similar partnerships (which are defined as securities under Article 2-2 of the Financial Instruments and Exchange Law) are stated at their respective net asset value based on the corresponding percentages of shares held by the Company or its consolidated subsidiaries as reported in the financial statements of such partnerships as of the most recent available date.

#### **e. Allowance for Doubtful Accounts**

An allowance for doubtful accounts, including trade notes and accounts receivable and loans, is provided for probable future losses on collection. The Company designates certain accounts as highly doubtful and provides a specific allowance for these accounts based on management's detailed credit analyses. Other than for these identified accounts, the Company provides an additional allowance for doubtful accounts based on the Company's historical experience with write-offs of doubtful accounts.

#### **f. Inventories**

Inventories are stated at cost determined principally by the following methods:

Merchandise: Moving-average method for the Company and its domestic consolidated subsidiaries; moving-average method or first-in, first-out method for overseas consolidated subsidiaries.

Supplies: Last purchase price method for the Company and its domestic consolidated subsidiaries; moving-average

method or first-in, first-out method for overseas consolidated subsidiaries.

Merchandise and supplies carried over from one season to the corresponding season in the following year are stated at net realizable value.

#### **g. Property and Equipment and Depreciation**

Property and equipment is stated at cost. Depreciation is computed by the declining-balance method for the Company and its domestic consolidated subsidiaries except for buildings acquired by the Company or certain domestic consolidated subsidiaries prior to April 1, 1998, to which the straight-line method is applied. Depreciation is computed by the straight-line method for overseas subsidiaries. The estimated useful lives of buildings and structures range from 8 to 47 years.

Maintenance and minor repairs are charged to income as incurred; major renewals and improvements are capitalized.

#### **h. Accounting Standard for Impairment of Fixed Assets**

Effective the year ended August 31, 2006, the Company adopted a new accounting standard for the impairment of fixed assets which requires that tangible and intangible fixed assets be carried at cost less depreciation or amortization, and be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Companies are required to recognize an impairment loss in their statement of income if certain indicators of asset impairment exist and if the book value of an asset exceeds the undiscounted sum of its future cash flows. The standard states that impairment losses should be measured as the excess of the book value over the higher of (1) the fair market value of the asset, net of disposition costs, and (2) the present value of future cash flows arising from ongoing utilization of the asset and from its disposal after use. The standard covers land, factories, buildings and other forms of property, plant and equipment, as well as intangible assets. Fixed assets are to be grouped at the lowest level for which there is

identifiable cash flows that are independent of the cash flows from other groups of assets.

As a result of the adoption of this accounting standard, an impairment loss on fixed assets of ¥5,032 million and nil was recognized for the years ended August 31, 2007 and 2006, respectively.

#### **i. Intangible Assets**

Intangible assets are amortized by the straight-line method. Trademarks are amortized by the straight-line method over a period of 10 years. Software intended for internal use is amortized by the straight-line method over its estimated useful life, which is generally 5 years.

#### **j. Leases**

Non-cancelable leases of the Company and its domestic consolidated subsidiaries are accounted for as operating leases (whether such leases are classified as operating or finance leases), except that lease agreements which stipulate the transfer of ownership of the leased assets to the lessee are accounted for as finance leases. However, leases of the overseas consolidated subsidiaries are generally classified as either finance or operating leases and accounted for accordingly.

#### **k. Deferred Assets**

Deferred assets such as costs associated with the issuance of new shares and bonds and the incorporation of subsidiaries are charged to income as incurred.

#### **l. Retirement Benefits**

Certain overseas consolidated subsidiaries have recognized accrued employees' retirement benefits at August 31, 2007.

In addition, subject to shareholders' approval, the directors and statutory auditors of the Company and certain consolidated subsidiaries are customarily entitled to lump-sum payments under their respective unfunded severance benefit plans. A provision for the indemnity for severance

benefits for these directors and statutory auditors has been made at an estimated amount.

The Company has not recorded the additional provision since a resolution for the discontinuance of severance benefits was approved at a Board of Directors' meeting of the Company held in August 2006. The balance of the provision to be paid in the future is estimated at the amount funded prior to the approval of the discontinuance.

#### **m. Bonuses**

The Company and its consolidated subsidiaries provide accrued employees' and directors' bonuses at the end of each fiscal year at an estimated amount of the bonuses to be paid.

Effective the year ended August 31, 2006, the Company changed the method of accounting for directors' bonuses. The impact of this change in method of accounting was immaterial for the year ended August 31, 2006.

#### **n. Restructuring Expenses**

Certain consolidated subsidiaries provide an allowance for restructuring expenses at the end of the fiscal year at an estimated amount of the expenses to be paid.

#### **o. Income Taxes**

Deferred tax assets and liabilities are determined based on the differences between financial reporting and the tax bases of the assets and liabilities, and are measured using the enacted tax rates and laws which will be in effect when the differences are expected to reverse.

#### **p. Revenue Recognition**

The Company recognizes revenue on the sale of merchandise to customers on a shipping basis.

#### **q. Derivatives**

The Company and certain consolidated subsidiaries enter into derivative transactions in order to manage certain risk arising from adverse fluctuation in foreign currency

exchange rates. Derivatives are carried at fair value with any changes in unrealized gain or loss deferred as an asset or a liability.

The Company records foreign currency trade payables, future anticipated transactions and capital increases denominated in foreign currencies hedged by forward foreign exchange contracts at the corresponding contracted forward foreign exchange rates and no related gain or loss is recognized.

The Company manages the risk associated with adverse fluctuation in foreign currency exchange rates by utilizing forward foreign exchange contracts and fixes the amount in yen of the capital increase to the subsidiary. The Company does not hold or issue derivative financial instruments for speculative trading purposes. The Company has implemented hedging policies to control various aspects of its derivatives positions including their execution, management and monitoring. Under these policies, all derivative

transactions are entered into only after approval by the President of the Company and after having been examined and approved by the directors responsible.

#### **r. Foreign Currency Translation**

Current and non-current monetary accounts denominated in foreign currencies are translated into yen at the current exchange rates.

The balance sheet accounts of the overseas consolidated subsidiaries are translated into yen at the rates of exchange in effect at the balance sheet date except for the components of net assets excluding minority interests which are translated at their historical exchange rates.

#### **s. Appropriation of Retained Earnings**

The statements of changes in net assets are prepared based on the appropriations from retained earnings as determined during each year.

## **2. U.S. Dollar Amounts**

The translation of yen amounts into U.S. dollar amounts is included solely for the convenience of readers outside Japan and has been made, as a matter of arithmetic computation only, at ¥116.07 = U.S. \$1.00, the approximate rate

of exchange in effect on August 31, 2007. This translation should not be construed as a representation that yen have been, could have been or could in the future be converted into U.S. dollars at the above or any other rate.

## **3. Inventories**

Inventories at August 31, 2007 and 2006 consisted of the following:

	2007	2006	2007
	Millions of yen		Thousands of U.S. dollars
Merchandise	¥7,137	¥7,747	\$61,496
Supplies	980	1,104	8,451
Total	¥8,118	¥8,852	\$69,948

#### 4. Depreciation

Depreciation expense for the years ended August 31, 2007, 2006 and 2005 amounted to ¥989 million (\$8,526 thousand), ¥561 million and ¥340 million, respectively.

#### 5. Securities

a. Marketable securities classified as other securities at August 31, 2007 and 2006 are summarized as follows:

	August 31, 2007					
	Acquisition cost	Carrying value	Unrealized loss	Acquisition cost	Carrying value	Unrealized loss
	Millions of yen			Thousands of U.S. dollars		
Securities whose acquisition cost exceeds their carrying value:						
Stock	¥2	¥2	¥(0)	\$23	\$19	\$(4)
Total	¥2	¥2	¥(0)	\$23	\$19	\$(4)

	August 31, 2006		
	Acquisition cost	Carrying value	Unrealized gain (loss)
	Millions of yen		
Securities whose carrying value exceeds their acquisition cost:			
Stock	¥1	¥1	¥ 0
Securities whose acquisition cost exceeds their carrying value:			
Stock	0	0	(0)
Total	¥1	¥1	¥ 0

b. Sales of securities classified as other securities for the years ended August 31, 2007, 2006 and 2005 are summarized as follows:

	August 31,			Thousands of U.S. dollars
	2007	2006	2005	
	Millions of yen			
<b>Proceeds from sales</b>	¥—	¥—	¥ 2,004	<b>\$—</b>
Gain on sales	—	—	0	—
Loss on sales	—	—	—	—

c. The book value of securities with no determinable fair value at August 31, 2007 and 2006 was as follows:

	August 31,		
	2007	2006	2007
	Millions of yen		Thousands of U.S. dollars
(1) Held-to-maturity debt securities whose fair value was not readily determinable:			
Unlisted foreign bonds	¥ 0	¥ 0	\$ 1
(2) Available-for-sale securities whose fair value was not readily determinable:			
Unlisted stocks	—	—	—
Investments in limited partnerships	616	576	5,310
Total	¥616	¥576	\$5,311

d. The redemption schedule for securities with maturity dates classified as other securities at August 31, 2007 is summarized as follows:

	August 31, 2007					
	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due in one year or less	Due after one year through five years	Due after five years through ten years
	Millions of yen			Thousands of U.S. dollars		
Government bonds	¥—	¥0	¥—	\$—	\$1	\$—
Total	¥—	¥0	¥—	\$—	\$1	\$—

## 6. Short-Term Borrowings and Long-Term Debt

Short-term borrowings consisted of bank borrowings, ¥246 million of which was secured. The weighted-average interest rates applicable to such bank borrowings were 4.9% and 4.6% at August 31, 2007 and 2006, respectively.

Long-term debt at August 31, 2007 and 2006 consisted of the following:

	2007	2006	2007
	Millions of yen		Thousands of U.S. dollars
Bonds without collateral:			
Convertible bond with warrants attached due 2018 in Japanese yen	¥ 13,258	¥ 13,264	\$ 114,230
Long-term loans from banks with interest rates			
at 2.9% and 3.4% as of August 31, 2007 and 2006, respectively:			
Without collateral	4,858	10,922	41,857
	18,117	24,186	156,087
Current portion	(1,196)	(2,299)	(10,306)
Total	¥ 16,920	¥ 21,887	\$ 145,781

The annual maturities of long-term debt subsequent to August 31, 2007 are summarized as follows:

Year ending August 31,	Millions of yen	Thousands of U.S. dollars
2008	¥ 1,196	\$ 10,306
2009	1,799	15,504
2010	964	8,310
2011	896	7,726
2012 and thereafter	1	11
Total	¥ 4,858	\$ 41,857

## 7. Pledged Assets

The following assets were pledged as collateral for short-term borrowings at August 31, 2007 and 2006:

	2007	2006	2007
	Millions of yen		Thousands of U.S. dollars
Total assets of six subsidiaries of Link Theory Holdings (US) Inc.	¥ 21,508	¥ —	\$ 185,309
Total assets of Link Theory Holdings (US) Inc.	—	21,502	—

## 8. Income Taxes

The Company and its domestic consolidated subsidiaries are subject to a number of taxes based on income which, in the aggregate, resulted in a statutory tax rate of 40.7% for the years ended August 31, 2007, 2006 and 2005. Income taxes of the overseas consolidated subsidiaries are based generally on the tax rates applicable in their respective countries of incorporation.

The effective tax rate reflected in the consolidated statement of income for the year ended August 31, 2006 differs from the statutory tax rate for the following reasons:

	2006
Statutory tax rate	40.7%
Effect of:	
Permanent differences	0.6
Residence tax	1.0
Valuation allowance	3.2
Amortization of goodwill	2.2
Amortization of trademarks	1.2
Different tax rates applied to income of overseas consolidated subsidiaries	2.4
Other, net	(1.3)
Effective tax rate	50.0%

The presentation of a reconciliation between the statutory tax rate and the effective tax rates as a percentage of (loss) income before income taxes and minority interests has been omitted for the years ended August 31, 2007 and 2005 because loss before income taxes and minority interests was recorded and the differences were immaterial, respectively.

The significant components of deferred tax assets and liabilities at August 31, 2007 and 2006 were as follows:

	2007	2006	2007
	Millions of yen		Thousands of U.S. dollars
Deferred tax assets:			
Accrued employees' bonuses	¥ 144	¥ 105	\$ 1,241
Accrued directors' and statutory auditors' retirement benefits	76	76	663
Allowance for doubtful accounts	52	54	456
Loss on revaluation of inventories	1,264	812	10,898
Depreciation	209	—	1,804
Amortization of (negative) goodwill	2,041	1,930	17,593
Tax loss carryforwards	2,814	567	24,249
Impairment loss on fixed assets	75	—	654
Other	670	355	5,778
Gross deferred tax assets	7,351	3,903	63,336
Valuation allowance	(2,987)	(99)	(25,735)
Total deferred tax assets	4,364	3,803	37,601
Deferred tax liabilities:			
Amortization of trademarks	—	(1,026)	—
Foreign exchange gain	(362)	(85)	(3,127)
Other	(41)	(86)	(359)
Total deferred tax liabilities	(404)	(1,198)	(3,486)
Net deferred tax assets	¥ 3,959	¥ 2,604	\$ 34,114

## 9. Retirement Benefit Plans

The Company and its domestic consolidated subsidiaries have no retirement benefit plans. Most overseas consolidated subsidiaries have various retirement benefit plans which are primarily defined contribution pension plans. Certain overseas consolidated subsidiaries in Europe have defined benefit pension plans.

The following table sets forth the funded and accrued status of the plans and the amounts recognized in the consolidated balance sheets at August 31, 2007 and 2006 for certain overseas consolidated subsidiaries' defined benefit pension plans:

	2007	2006	2007
	Millions of yen		Thousands of U.S. dollars
Retirement benefit obligation	¥694	¥611	\$ 5,981
Plan assets at fair value	—	—	—
Unfunded retirement benefit obligation	694	611	5,981
Unrecognized actuarial gain or loss	—	—	—
Unrecognized prior service cost	—	—	—
Accrued employees' retirement benefits	¥694	¥611	\$ 5,981

The components of retirement benefit expenses for the years ended August 31, 2007, 2006 and 2005 are outlined as follows:

	2007	2006	2005	2007
	Millions of yen			Thousands of U.S. dollars
Service cost	¥ 0	¥81	¥—	\$ 3
Interest cost	25	11	—	219
Expected return on plan assets	—	—	—	—
Amortization of prior service cost	—	—	—	—
Amortization of actuarial gain or loss	—	—	—	—
Total	¥25	¥93	¥—	\$222

The assumptions used in accounting for the above plans were as follows:

	2007	2006	2005
Discount rate	6%	6%	—
Expected rate of return on plan assets	—	—	—

## 10. Lease Transactions

### Lessees' Accounting

The following *pro forma* amounts represent the acquisition costs, accumulated depreciation, accumulated impairment loss and net book value of the leased assets at August 31, 2007 and 2006, which would have been reflected in the consolidated balance sheets if finance lease accounting had been applied to the finance leases currently accounted for as operating leases:

	August 31, 2007							
	Acquisition costs	Accumulated depreciation	Accumulated impairment loss	Net book value	Acquisition costs	Accumulated depreciation	Accumulated impairment loss	Net book value
	Millions of yen				Thousands of U.S. dollars			
Buildings	¥1,085	¥468	¥—	¥617	\$ 9,356	\$4,037	\$—	\$5,319
Machinery and equipment	91	44	—	47	790	385	—	406
Furniture	161	86	—	75	1,395	748	—	647
Software	116	32	—	84	1,004	280	—	725
Total	¥1,456	¥632	¥—	¥823	\$12,546	\$5,450	\$—	\$7,096

	August 31, 2006			
	Acquisition costs	Accumulated depreciation	Accumulated impairment loss	Net book value
	Millions of yen			
Buildings	¥1,000	¥436	¥—	¥564
Machinery and equipment	89	38	—	51
Furniture	225	86	—	138
Software	84	10	—	74
Total	¥1,399	¥571	¥—	¥828

Lease payments relating to finance leases accounted for as operating leases in the accompanying consolidated financial statements amounted to ¥458 million (\$3,953 thousand), ¥411 million and ¥294 million for the years ended August 31, 2007, 2006 and 2005, respectively. *Pro forma* depreciation, which is determined by the straight-line method over the lease terms assuming a nil salvage value, amounted to ¥441 million (\$3,802 thousand), ¥389 million and ¥283 million for the years ended August 31, 2007, 2006 and 2005, respectively. In addition, *pro forma* interest expense, which is computed by the interest method, amounted to ¥19 million (\$167 thousand), ¥24 million and ¥13 million for the years ended August 31, 2007, 2006 and 2005, respectively.

Future minimum lease payments (including the interest portion thereon) for finance leases accounted for as operating leases subsequent to August 31, 2007 are summarized as follows:

Year ending August 31,	Millions of yen	Thousands of U.S. dollars
2008	¥416	\$3,590
2009 and thereafter	429	3,703
Total	¥846	\$7,293
Accumulated impairment loss on leased assets	¥ -	\$ -

Future minimum lease payments for operating leases subsequent to August 31, 2007 are summarized as follows:

Year ending August 31,	Millions of yen	Thousands of U.S. dollars
2008	¥ 1,643	\$ 14,160
2009 and thereafter	14,835	127,818
Total	¥16,479	\$141,978

## 11. Contingent Liabilities

At August 31, 2007 and 2006, the Company and its consolidated subsidiaries had no contingent liabilities.

## 12. Shareholders' Equity

Until May 1, 2006, Japanese companies were subject to the Commercial Code of Japan (the "Code"). The Code requires that an amount equal to at least 10% of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period (such as bonuses to directors) be appropriated to the legal reserve until the sum of the legal reserve and additional paid-in capital equals 25% of the common stock account.

The Code also stipulates that, to the extent that the sum of the legal reserve and the additional paid-in capital account exceeds 25% of the common stock account, the amount

of any such excess is available for the appropriation of dividends by resolution of the shareholders. In addition, the Code permits the transfer of a portion of the additional paid-in capital account and the legal reserve to the common stock account by resolution of the Board of Directors.

The Corporation Law of Japan (the "Law"), which superseded most of the provisions of the Code, went into effect on May 1, 2006. The provisions of the Law are for the most part applicable to events and transactions occurring on or subsequent to May 1, 2006 and to fiscal years ending on or subsequent to May 1, 2006. The significant effects of the

Law on financial and accounting matters are summarized below:

### a. Dividends

Under the Law, companies can pay dividends at any time during the fiscal year in addition to the year-end dividends by approving a resolution at a meeting of the shareholders. For a company that meets certain criteria such as (1) having a Board of Directors, (2) having independent auditors, (3) having a Board of Statutory Auditors, and (4) prescribing one year, rather than two years, as the normal length of service for its directors in its Articles of Incorporation, the Board of Directors may declare dividends (except for dividends in kind) if the company's Articles of Incorporation permit it. The Company has not amended its Articles of Incorporation to allow for the payment of dividends by resolution of its Board of Directors, except for the payment of semiannual interim dividends.

In addition, the Law permits companies to distribute dividends in kind to shareholders subject to certain restrictions and additional requirements.

## 13. Stock-Based Compensation Plans

The Company has several stock option plans. On July 31, 2002, the shareholders of the Company approved the issuance of stock options for the directors of the Company. The issued stock options are exercisable from August 1, 2004 to July 31, 2012. The number of shares of common stock of the Company to be issued upon the exercise of the outstanding stock options as of August 31, 2007 was 7,280 shares. The options were issued at an exercise price of ¥7,000 (\$60.31) per share of the Company's common stock at the grant date.

On September 30, 2002, the shareholders of the Company approved the issuance of stock options for the director of the Company's subsidiary and certain employees. The

### b. Increase (decrease) and transfer of common stock, legal reserve and capital surplus

The Law requires that an amount equal to 10% of dividends be appropriated to the legal reserve or to the additional paid-in capital account depending on the equity account charged upon the payment of dividends until the sum of the legal reserve and the additional paid-in capital account equals 25% of the common stock account.

Under the Code, to the extent that the sum of the additional paid-in capital account and the legal reserve exceeds 25% of the common stock account, the amount of any such excess is available for the appropriation of dividends by resolution of the shareholders. Under the Law, the sum of the additional paid-in capital account and the legal reserve may be reversed to retained earnings irrespective of any such excess. The Law also provides that amounts in the common stock account, the legal reserve, the additional paid-in capital account and other capital surplus and retained earnings accounts may be transferred between and among such accounts under certain conditions by resolution of the shareholders.

issued stock options are exercisable from October 1, 2004 to September 30, 2012. The number of shares of common stock of the Company to be issued upon the exercise of the outstanding stock options as of August 31, 2007 was 120 shares. The options were issued at an exercise price of ¥7,000 (\$60.31) per share of the Company's common stock at the grant date.

On October 17, 2003, the shareholders of the Company approved the issuance of stock options for the director of the Company's subsidiary. The issued stock options are exercisable from September 11, 2005 to September 10, 2013. The number of shares of common stock of the Company to be issued upon the exercise of the outstanding

stock options as of August 31, 2007 was 2,400 shares. The options were issued at an exercise price of ¥131,250 (\$1,130.78) per share of the Company's common stock at the grant date.

On August 25, 2004, the shareholders of the Company approved the issuance of stock options for the directors of the Company's subsidiary and certain employees. The issued stock options are exercisable from August 26, 2006 to August 24, 2014. The number of shares of common stock of the Company to be issued upon the exercise of the outstanding stock options as of August 31, 2007 was 1,224 shares. The options were issued at an exercise price of ¥131,250 (\$1,130.78) per share of the Company's common stock at the grant date.

On November 29, 2005, the shareholders of the Company approved the issuance of stock options for the directors

of the Company's subsidiaries and certain employees. The maximum number of shares of common stock of the Company to be issued upon the exercise of the outstanding stock options as of August 31, 2007 was 650 shares. Of the 650 shares, 625 shares are options exercisable from February 14, 2009 to February 13, 2012. These options were issued at an exercise price of ¥741,300 (\$6,386.66) per share of the Company's common stock at the grant date. The remaining 25 shares are options exercisable from April 19, 2009 to April 18, 2012. These options were issued at an exercise price of ¥704,000 (\$6,065.31) per share of the Company's common stock at the grant date.

The number of shares of common stock issuable by the Company, which was previously approved by its shareholders, has decreased due to the exercise of stock options or the resignation of directors.

#### 14. Supplementary Cash Flow Information

##### Supplemental Disclosures of Cash Flow Information

	2007	2006	2007
	Millions of yen		Thousands of U.S. dollars
Cash and cash equivalents as per the consolidated balance sheets	¥5,672	¥13,789	\$48,870
Cash and cash equivalents as per the consolidated statements of cash flows	¥5,672	¥13,789	\$48,870

The following is a summary of the assets and liabilities of subsidiaries which were initially included in consolidation upon acquisition of their shares of common stock for the years ended August 31, 2007, 2006 and 2005:

	2007	2006	2005	2007
	Millions of yen			Thousands of U.S. dollars
Current assets	¥ —	¥3,620	¥ —	\$ —
Non-current assets	—	261	—	—
Total assets	¥ —	¥3,882	¥ —	\$ —
Current liabilities	¥ —	¥2,211	¥ —	\$ —
Non-current liabilities	—	490	—	—
Total liabilities	¥ —	¥2,701	¥ —	\$ —

#### 15. Segment Information

##### a. Business Segments

Business segment information has not been presented because the apparel segment accounted for more than 90% of the Company's consolidated net sales, operating income and total assets as of and for the years ended August 31, 2007, 2006 and 2005.

##### b. Geographical Segments

Geographical segment information, which is classified by location of the Group's entities, for the years ended August 31, 2007, 2006 and 2005 is summarized as follows:

	2007						
	Japan	North America	Europe	Other	Total	Eliminations and/or corporate	Consolidated
	Millions of yen						
Net sales:							
External customers	¥22,045	¥28,057	¥ 8,815	¥ 500	¥59,419	¥ —	¥59,419
Inter-segment	297	1,463	—	—	1,760	(1,760)	—
Total	22,342	29,520	8,815	500	61,179	(1,760)	59,419
Operating expenses	20,149	28,437	10,542	506	59,635	(682)	58,952
Operating income (loss)	¥ 2,193	¥ 1,083	¥(1,726)	¥ (6)	¥ 1,544	¥(1,077)	¥ 466
Total assets	¥ 7,970	¥28,373	¥ 3,980	¥272	¥40,597	¥ 3,834	¥44,432

	2007						
	Japan	North America	Europe	Other	Total	Eliminations and/or corporate	Consolidated
	Thousands of U.S. dollars						
Net sales:							
External customers	\$189,934	\$241,729	\$ 75,953	\$4,308	\$511,925	\$ —	\$511,925
Inter-segment	2,560	12,609	—	—	15,169	(15,169)	—
Total	192,494	254,338	75,953	4,308	527,093	(15,169)	511,925
Operating expenses	173,596	245,001	90,829	4,363	513,789	(5,883)	507,906
Operating income (loss)	\$ 18,898	\$ 9,337	\$(14,876)	\$ (55)	\$ 13,304	\$(9,286)	\$ 4,018
Total assets	\$ 68,671	\$244,451	\$ 34,296	\$2,349	\$349,767	\$ 33,040	\$382,807

Note 1: Segments have been determined according to geographical proximity.

Note 2: "North America" includes primarily the United States, "Europe" includes primarily Germany, and "Other" includes primarily South Korea, China (including Hong Kong) and Taiwan.

Note 3: Operating expenses, which cannot be allocated to a particular segment and are reported under "Eliminations and/or corporate", amounted to ¥1,067 million (\$9,193 thousand) and principally consisted of administrative expenses such as accounting, human resources and general affairs.

Note 4: Corporate assets included under "Eliminations and/or corporate" of ¥4,265 million (\$36,746 thousand) principally consisted of funds for the management of surplus funds (cash and deposits) for the Company, Link Theory Holdings (US) Inc. and Link Theory Holdings (Europe) GmbH.

	2006						Consolidated
	Japan	North America	Europe	Other	Total	Eliminations and/or corporate	
	Millions of yen						
Net sales:							
External customers	¥21,054	¥21,146	¥ 4,981	¥ 524	¥47,707	¥ —	¥ 47,707
Inter-segment	122	950	—	—	1,072	(1,072)	—
Total	21,176	22,097	4,981	524	48,780	(1,072)	47,707
Operating expenses	18,335	19,600	5,905	483	44,324	59	44,384
Operating income (loss)	¥ 2,840	¥ 2,497	¥ (923)	¥ 41	¥ 4,455	¥(1,132)	¥ 3,323
Total assets	¥ 9,853	¥28,374	¥10,098	¥ 388	¥48,714	¥ 6,071	¥ 54,786

Note 1: Segments have been determined according to geographical proximity.

Note 2: "North America" includes primarily the United States, "Europe" includes primarily Germany, and "Other" includes primarily South Korea, China (including Hong Kong) and Taiwan.

Note 3: Operating expenses, which cannot be allocated to a particular segment and are reported under "Eliminations and/or corporate", amounted to ¥1,152 million and principally consisted of administrative expenses such as accounting, human resources and general affairs.

Note 4: Corporate assets included under "Eliminations and/or corporate" of ¥6,778 million principally consisted of funds for the management of surplus funds (cash and deposits) for the Company, Link Theory Holdings (US) Inc. and Link Theory Holdings (Europe) GmbH.

	2005					Consolidated
	Japan	North America	Other	Total	Eliminations and/or corporate	
	Millions of yen					
Net sales:						
External customers	¥18,094	¥17,238	¥ 313	¥35,646	¥ —	¥ 35,646
Inter-segment	176	898	—	1,074	(1,074)	—
Total	18,270	18,136	313	36,720	(1,074)	35,646
Operating expenses	14,970	15,786	341	31,098	(96)	31,002
Operating income (loss)	¥ 3,299	¥ 2,349	¥ (27)	¥ 5,622	¥ (978)	¥ 4,644
Total assets	¥11,764	¥11,857	¥ 253	¥23,875	¥ 4,383	¥ 28,258

Note 1: Segments have been determined according to geographical proximity.

Note 2: "North America" includes primarily the United States, and "Other" includes primarily South Korea, China (including Hong Kong) and Taiwan.

Note 3: Operating expenses, which cannot be allocated to a particular segment and are reported under "Eliminations and/or corporate", amounted to ¥951 million and principally consisted of administrative expenses such as accounting, human resources and general affairs.

Note 4: Eliminations of payables and receivables between the consolidated companies included under "Eliminations and/or corporate" amounted to ¥8,666 million, and corporate assets included under "Eliminations and/or corporate" of ¥9,179 million principally consisted of funds for the management of surplus funds (cash and deposits) for the Company and Theory Holdings Inc.

### c. Overseas Sales

Overseas sales information, which is classified by location of the Group's customers, for the years ended August 31, 2007, 2006 and 2005 is summarized as follows:

	2007			
	North America	Europe	Other	Total
	Millions of yen			
Overseas sales	¥28,041	¥8,832	¥634	¥37,508
Consolidated net sales	—	—	—	59,419
Overseas sales as a percentage of consolidated net sales (%)	47.2	14.8	1.1	63.1

Note 1: Segments have been determined according to geographical proximity.

Note 2: "North America" includes primarily the United States and Canada, "Europe" includes primarily Germany, the Netherlands and Sweden, and "Other" includes primarily South Korea, China (including Hong Kong) and Taiwan.

Note 3: Overseas sales include sales of the Company and its consolidated subsidiaries which occurred in countries or areas outside Japan.

	2007			
	North America	Europe	Other	Total
	Thousands of U.S. dollars			
Overseas sales	\$241,587	\$76,095	\$5,470	\$323,152
Consolidated net sales	—	—	—	511,925
Overseas sales as a percentage of consolidated net sales (%)	47.2	14.8	1.1	63.1

	2006			
	North America	Europe	Other	Total
	Millions of yen			
Overseas sales	¥20,636	¥5,492	¥524	¥26,653
Consolidated net sales	—	—	—	47,707
Overseas sales as a percentage of consolidated net sales (%)	43.3	11.5	1.1	55.9

Note 1: Segments have been determined according to geographical proximity.

Note 2: "North America" includes primarily the United States and Canada, "Europe" includes primarily Germany, the Netherlands and Sweden, and "Other" includes primarily South Korea, China (including Hong Kong) and Taiwan.

Note 3: Overseas sales include sales of the Company and its consolidated subsidiaries which occurred in countries or areas outside Japan.

Note 4: "Europe" was included in "Other" for the year ended August 31, 2005, but was reclassified as a separate line item because sales in "Europe" increased in significance. Sales in "Europe" for the year ended August 31, 2005 amounted to ¥465 million.

	2005		
	North America	Other	Total
	Millions of yen		
Overseas sales	¥16,772	¥795	¥17,567
Consolidated net sales	—	—	35,646
Overseas sales as a percentage of consolidated net sales (%)	47.1	2.2	49.3

Note 1: Segments have been determined according to geographical proximity.

Note 2: "North America" includes primarily the United States and Canada, and "Other" includes primarily Europe, South Korea, China (including Hong Kong) and Taiwan.

Note 3: Overseas sales include sales of the Company and its consolidated subsidiaries which occurred in countries or areas outside Japan.

## 16. Transactions with Related Parties

### a. Directors and Principal Individual Shareholders

#### 2007

Category	Director	
Name	Makoto Hata	
Address	—	
Capital investment (millions of yen)	—	
Operation or occupation	Director of the Company	
Voting rights owned (%)	Direct 2.93	
Relationship:		
Directors holding offices concurrently	—	
Actual relation	—	
Transaction	Sales of the Company's property*	Rent of the Company's property*
Transaction value (millions of yen)	¥43	¥2
Balance at end of year (millions of yen)	—	—

\*Policy for determining the terms of the transactions: Determined with reference to the rent of neighboring properties.

#### 2006

Category	Director	
Name	Chikara Sasaki	Makoto Hata
Address	—	—
Capital investment (millions of yen)	—	—
Operation or occupation	President and Representative Director	Director of the Company
Voting rights owned (%)	Direct 20.91	Direct 2.94
	Indirect 12.71	
Relationship:		
Directors holding offices concurrently	—	
Actual relation	—	
Transaction	Sales of the Company's property*	Rent of the Company's property*
Transaction value (millions of yen)	¥87	¥3
Balance at end of year (millions of yen)	—	—

\*Policy for determining the terms of the transactions: Determined with reference to the rent of neighboring properties.

#### 2005

Category	Director	
Name	Makoto Hata	
Address	—	
Capital investment (millions of yen)	—	
Operation or occupation	Director of the Company	
Voting rights owned (%)	Direct 1.89	
Relationship:		
Directors holding offices concurrently	—	
Actual relation	—	
Transaction	Rent of the Company's property*	
Transaction value (millions of yen)	¥3	
Balance at end of year (millions of yen)	—	

\*Policy for determining the terms of the transaction: Determined with reference to the rent of neighboring properties.

## 17. Cost of Sales

Loss on revaluation of inventories included in cost of sales for the years ended August 31, 2007, 2006 and 2005 was ¥1,929 million (\$16,620 thousand), ¥2,155 million and ¥1,103 million, respectively.

## 18. Selling, General and Administrative Expenses

The major items included in selling, general and administrative expenses for the years ended August 31, 2007, 2006 and 2005 were as follows:

	2007	2006	2005	2007
	Millions of yen			Thousands of U.S. dollars
Directors' and statutory auditors' salaries	¥ 349	¥ 248	¥ 193	\$ 3,013
Employees' salaries and bonuses	9,536	7,171	4,531	82,158
Accrued employees' bonuses	812	349	379	6,998
Accrued employees' retirement benefit expenses	25	93	—	222
Accrued directors' and statutory auditors' retirement benefit expenses	—	37	46	—
Allowance for doubtful accounts	191	27	—	1,646
Depreciation	989	561	340	8,526
Amortization of goodwill	432	273	—	3,726
Rent expenses	2,931	2,118	1,154	25,252
Sample expenses	1,467	1,081	955	12,642
Amortization of trademarks	1,061	864	595	9,142
Outsourcing fees	1,066	1,091	1,348	9,189

## 19. Sales or Disposal of Property and Equipment

Gain on sales of property and equipment for the years ended August 31, 2007, 2006 and 2005 consisted of the following:

	2007	2006	2005	2007
	Millions of yen			Thousands of U.S. dollars
Buildings and structures	¥ 0	¥ —	¥ —	\$ 0
Machinery and equipment	0	—	—	2
Vehicles	4	—	—	36
Furniture	0	—	—	2
Software	0	—	—	0
Total	¥ 4	¥ —	¥ —	\$ 40

Loss on sales or disposal of property and equipment for the years ended August 31, 2007, 2006 and 2005 consisted of the following:

	2007	2006	2005	2007
	Millions of yen			Thousands of U.S. dollars
Buildings and structures	¥39	¥ 54	¥43	\$341
Vehicles	6	—	1	52
Furniture	5	18	3	47
Software	0	47	—	8
Total	¥52	¥120	¥48	\$449

Vehicles and furniture are stated as "other" in property and equipment in the accompanying consolidated balance sheets.

## 20. Fixed Assets

The Group reviewed its fixed assets for impairment during the year ended August 31, 2007 and, as a result, recognized an impairment loss of ¥5,032 million as other expense for certain trademarks, goodwill and tangible fixed assets due to the incurrence of continuous operating losses. The carrying amounts of the relevant assets were written down to their respective recoverable amounts.

The following table summarizes impairment losses on fixed assets incurred for the year ended August 31, 2007:

		Millions of yen	Thousands of U.S. dollars
1. Rosner business	Trademarks	¥2,367	\$20,398
	Goodwill	2,229	19,212
	Tangible fixed assets	286	2,467
2. Jean-Michel Cazabat business	Trademarks and other	148	1,283

Fixed assets are grouped based on the minimum units for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities.

The recoverable amount is determined based on the net selling price or value in use. The net selling price is determined based on the appraisal value with reasonable adjustments, whereas value in use is determined based on the sum of the projected future net cash flows discounted at a rate of 11.7% for Rosner business and 8.0% for Jean-Michel Cazabat business.

## 21. Extinguishment of Debt Financing

Expenses paid to finance debt are recorded as long-term prepaid expenses and are amortized over the financing period. Loss on extinguishment of debt financing in other expenses of the accompanying consolidated statements

of operations for the years ended August 31, 2007 and 2005 consisted of write-offs of the remaining balances of the related debt as a result of early repayment of such debt.

## 22. Amounts per Share

	2007	2006	2005	2007
		Yen		U.S. dollars
Net (loss) income:				
Basic	¥ (37,111.17)	¥10,444.04	¥ 40,654.62	\$(319.73)
Diluted	—	9,600.96	39,472.92	—
	2007	2006		2007
		Yen		U.S. dollars
Net assets	¥83,278.00	¥117,587.41		\$ 717.48

Basic net (loss) income per share is computed based on the net (loss) income available for distribution to shareholders of common stock and the weighted-average number of shares of common stock outstanding during each year. The Company implemented a four-for-one stock split and a two-for-one stock split on March 11, 2005 and October 20, 2005, respectively. The weighted-average number of shares of common stock outstanding during each year was computed assuming that these stock splits had occurred at the beginning of each year. Diluted net income per share is computed based on the net income available for distribution to the shareholders and the weighted-average number of shares of common stock outstanding during

each year after giving effect to the dilutive potential of shares of common stock to be issued upon the conversion of convertible bonds and the exercise of stock options. The potential dilutive impact of 13,045 shares of common stock has been included in the computation of the weighted-average number of shares for the year ended August 31, 2006. Diluted net income per share for the year ended August 31, 2007 has not been computed because a net loss was recorded.

Net assets per share are based on the number of shares of common stock outstanding at each balance sheet date.

## 23. Subsequent Events

### a. Distribution Receipt

Link Theory Holdings (US) Inc. (LTH (US)), a subsidiary of the Company, had invested \$5 million in connection with an acquisition by Bear Sterns Merchant Banking (BSMB) of a 50% equity stake in Seven For All Mankind, LLC. On August 31, 2007, BSMB completed the sale of its entire equity stake in Seven For All Mankind, LLC to a third party investor. As a result of the sale, LTH (US) has received a distribution of \$8.77 million for its investment and a repayment of \$5 million for the initial investment.

As a result, the Company will record receipt of this distribution as other income attributable to the sale for the fiscal year ending August 31, 2008.

### b. Transfer from Capital Surplus to Retained Earnings

A resolution for the transfer of an amount from capital surplus to retained earnings was approved at a shareholders' meeting of the Company held on November 28, 2007 as described below.

#### (1) Purposes

To increase distributable funds (i.e., retained earnings) to shareholders in accordance with the Corporation Law of Japan and to enhance the flexibility of the Company's future financial strategies.

#### (2) Reduction of capital surplus

Capital surplus: ¥3,525,000,000

#### (3) Details of the transfer

The Company transferred an amount from capital surplus of ¥3,525,000,000 to retained earnings in order to eliminate its accumulated deficit.

#### (4) Schedule of the transfer

Approval of resolution at the Board of Directors' meeting:  
October 25, 2007

Approval of resolution at the shareholders' meeting:  
November 28, 2007

Effective date of the transfer:  
November 28, 2007

#### 24. Additional Information

##### Partial Dismissal of the Litigation against the Company

On October 24, 2006, a written complaint was served to the Company, two of its subsidiaries and other related entities and persons as follows:

Plaintiffs, Mr. Elie Tahari and the Elie Tahari 2003 Grantor Retained Annuity Trust, filed a lawsuit against the Company, two of its subsidiaries, Link International Co., Ltd. and LTH (US), Chikara Sasaki and other related entities and persons for breach of fiduciary duty, fraud, unjust enrichment and breach of contract related to the sale of the interest in Theory LLC and certain affiliated entities to the Company in September 2003. The plaintiffs argued that the damages they incurred amounted to no less than \$182 million.

The New York State Court (the "Court"), in a ruling issued on June 18, 2007, dismissed most of the claims brought

by the plaintiffs against the Company and certain of its officers and subsidiaries. In the ruling, the Court dismissed, with prejudice, six of seven causes of action alleged in the complaint, including breach of fiduciary duty, fraud and unjust enrichment claims.

The only claim that the Court permitted to go forward and proceed to discovery was the breach of contract claim against the Company and LTH (US) in which the plaintiffs allege that the Company and LTH (US) owe approximately \$2 million for unpaid royalties that were accrued prior to the sale of Theory LLC to the Company. The plaintiffs have appealed to a higher court against this dismissal.

The Company continues to believe that this breach of contract claim is totally without merit, and the Company will vigorously defend itself against that claim and will assert all available defenses.

### Report of Independent Auditors

The Board of Directors and Shareholders  
LINK THEORY HOLDINGS Co., Ltd.

We have audited the accompanying consolidated balance sheets of LINK THEORY HOLDINGS Co., Ltd. and consolidated subsidiaries as of August 31, 2007 and 2006, and the related consolidated statements of operations, changes in net assets and cash flows for each of the three years in the period ended August 31, 2007, all expressed in yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of LINK THEORY HOLDINGS Co., Ltd. and consolidated subsidiaries as of August 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended August 31, 2007 in conformity with accounting principles generally accepted in Japan.

#### *Supplemental Information*

1. As described in Note 23, "Subsequent Events," the Company has received a distribution for an investment and a repayment for the initial investment on August 31, 2007.
2. As described in Note 23, a resolution for the transfer of an amount from capital surplus to retained earnings was approved at a shareholders' meeting of the Company held on November 28, 2007.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended August 31, 2007 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 2.

*Ernst & Young ShinNihon*

November 28, 2007

## CORPORATE AND SHAREHOLDER INFORMATION

(As of August 31, 2007)

### Corporate Information

Name	Link Theory Holdings Co., Ltd.
Head Office	4-35, Minami-Aoyama 5-chome, Minato-ku, Tokyo 107-0062, Japan
	Telephone: +81-3-3407-7502
Established	December 1998
Paid-in Capital	¥6,369 million

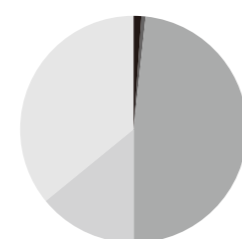
### Board of Directors and Auditors (as of Nov. 28, 2007)

Chairman	Tadashi Yanai
President & CEO	Ricky C. Sasaki
Director	Makoto Hata
Director & Group CFO	Hidetsugu Onishi
Director	Masa Matsushita
Standing Statutory Auditor	Akio Samejima
Standing Statutory Auditor	Shinji Ueno
Auditor	Takaharu Yasumoto
Auditor	Kenzo Takai

### Principal Shareholders

Name	Number of Shares	Percentage of Shares Outstanding
Ricky C. Sasaki	31,600	20.8%
Fast Retailing Co., Ltd.	23,200	15.3%
Global Retailing Co., Ltd.	23,200	15.3%
RS Investment Co., Ltd.	19,200	12.7%
Goldman Sachs and Company (Regular Account)	8,842	5.8%
Global Investment Co., Ltd.	4,960	3.3%
Makoto Hata	4,440	2.9%
Hidetsugu Onishi	4,440	2.9%
Morgan Stanley and Company, Inc.	3,203	2.1%
Mitsubishi Corporation	2,400	1.6%

### Shareholder Breakdown



### Common Stock

Number of shares authorized	456,000
Number of issued and outstanding shares	151,608
Number of shareholders	4,120

### Fiscal Year-End

August 31

### Transfer Agent and Registrar

Stock Transfer Agency Department  
Mizuho Trust & Banking Co., Ltd.  
2-1, Yaesu 1-chome, Chuo-ku, Tokyo 103-8670, Japan

### Independent Auditors

Ernst & Young ShinNihon

### Forward-Looking Statements

Statements in this annual report with respect to plans, strategies, forecasts and other statements of Link Theory Holdings that are not historical facts are forward-looking statements. Such statements, which are based on management's assumptions and beliefs, are derived from information currently available and involve risks and uncertainties. Factors that could cause actual results to differ materially from such statements include, without limitation, global economic conditions, demand for and competitive pricing pressure on products and services, Link Theory Holdings' ability to continue winning acceptance for its products and services in highly competitive markets, and currency exchange rate fluctuations.

## CORPORATE STRUCTURE



### Additional copies of this annual report and other information may be obtained by contacting:

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LTH