

FINANCIAL SECTION

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CONSOLIDATED FINANCIAL SUMMARY IN ACCORDANCE WITH U.S. GAAP

Dentsu Inc. and Consolidated Subsidiaries
Years Ended March 31

	Millions of yen, except per share data					Thousands of U.S. dollars ⁽¹⁾ , except per share data
	2000	2001	2002	2003	2004	2004
For the year:						
Revenue	¥ 259,784	¥ 301,885	¥ 293,920	¥ 282,676	¥ 290,480	\$ 2,679,705
Selling, general and administrative expenses	218,606	240,395	237,801	252,476	251,024	2,315,720
Operating income	41,178	61,490	56,119	30,200	39,456	363,985
Income before income taxes and minority interests	40,910	94,800	53,730	887	43,693	403,072
Net income (loss)	20,617	47,979	27,044	(4,618)	22,562	208,137
At year-end:						
Total assets	¥1,061,355	¥1,139,751	¥1,104,420	¥1,167,922	¥1,167,137	\$10,766,946
Total stockholders' equity	357,073	390,015	426,546	391,305	427,231	3,941,245
Per share data ⁽²⁾:						
Net income (loss):						
Basic	¥ 7,547	¥ 17,563	¥ 9,857	¥ (1,666)	¥ 8,367	\$ 77.19
Diluted	7,547	17,563	9,856	(1,667)	8,366	77.18
Ratios:						
Operating margin ⁽³⁾	15.9%	20.4%	19.1%	10.7%	13.6%	
Return on equity (ROE) ⁽⁴⁾	6.0	12.8	6.6	—	5.5	
Return on assets (ROA) ⁽⁵⁾	4.1	5.6	5.0	2.7	3.4	
Equity ratio ⁽⁶⁾	33.6	34.2	38.6	33.5	36.6	
Other data:						
Net cash provided by (used in) operating activities	¥ 27,573	¥ 38,837	¥ 30,238	¥ (1,197)	¥ 39,319	\$ 362,721
Net cash provided by (used in) investing activities	(76,153)	(56,885)	(35,926)	(77,531)	10,961	101,116
Net cash provided by (used in) financing activities	2,852	40,827	(21,813)	78,815	(55,631)	(513,201)
Cash and cash equivalents at end of year	70,928	93,791	67,691	66,607	60,202	555,369

Notes: (1) U.S. dollar amounts have been translated from yen at the rate of ¥108.4=US\$1, the approximate exchange rate prevailing on the Tokyo Foreign Exchange Market on June 30, 2004.

(2) Per share data has been adjusted for all periods to reflect the two-for-one stock split effective May 20, 2004.

(3) Operating margin = operating income ÷ revenue × 100

(4) ROE = net income ÷ average total stockholders' equity based on total stockholders' equity at the beginning and end of the fiscal year × 100

(5) ROA = operating income ÷ average total assets based on total assets at the beginning and end of the fiscal year × 100

(6) Equity ratio = total stockholders' equity ÷ total assets × 100

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of the Dentsu Group's financial condition and results of operations should be read together with the financial statements and the notes to such statements included in this annual report. Unless otherwise stated, the discussion below is based on the Dentsu Group's U.S. GAAP consolidated financial statements.

Overview

The Dentsu Group derives substantially all of its revenue from marketing and communications services, notably mass media advertising services and related creative services, including the planning and production of advertising. In addition, the Dentsu Group provides:

- sales promotion, including transit advertising;
- new media services, encompassing Internet, mobile and satellite broadcasting advertising;
- event marketing; and
- other services, such as sports and entertainment marketing, public relations, direct marketing, market research and e-solution services.

The advertising services segment accounted for 95.3% of consolidated billings in the fiscal year ended March 31, 2004. References in this annual report to billings are to the Dentsu Group's net sales under Japanese GAAP, the primary component of which is billings to advertisers of the charges for media time and/or space. The balance of billings is attributable to the Dentsu Group's other business segment, which provides such services as the IT management and consulting services provided by Dentsu's subsidiary Information Services International-Dentsu (ISID). The Dentsu Group conducts its business principally in Japan, as well as in Asia, Europe and the Americas, through its worldwide network. In the fiscal year ended March 31, 2004, sales to or in countries and regions other than Japan amounted to 6.9% of the Dentsu Group's billings.

The Dentsu Group's revenue consists principally of commissions received from media companies for the placement of advertising with various forms of media and payments received from advertisers and other clients for the performance of such services as assistance in the production of advertising, including creative services. Commission revenue is recognized when the media placement appears. Other revenue is recognized when the service is completed as specified in the relevant contracts or purchase orders and collection is reasonably assured.

Commissions from the placement of advertising usually represent the commission the Dentsu Group receives from media companies for the sale of media time and/or space to advertisers. In Japan, advertising companies generally purchase media time and/or space from media companies at the request of advertisers and resell the purchased time and/or space to the advertisers at the same prices as those charged by the media companies to the advertising companies. The commissions the Dentsu Group receives for the placement of advertising are typically a percentage, generally negotiated between the Dentsu Group and the relevant media company, of the price advertisers pay for the media time and/or space.

In practice, however, the Dentsu Group, like other advertising companies, generally nets the commission against the payment due to the media company and pays the balance to the media company. For Japanese GAAP purposes, the Dentsu Group records the entire price charged by it to the advertiser for media time and/or space as net sales, and the amount paid to the media company as cost of sales, whereas under U.S. GAAP the Dentsu Group records the difference between the two amounts, which is equivalent to the Dentsu Group's commission, as revenue.

Revenue from the production of advertising and other advertising services are payments made by advertisers and other clients to the Dentsu Group as compensation for such services. Payments for these services are generally negotiated as a markup on the prices charged to the Dentsu Group for services provided by third parties and/or Dentsu subsidiaries. In some cases, the Dentsu Group may also agree to a fixed fee or other compensation arrangements.

Factors Affecting Results of Operations

Revenue

The primary component of the Dentsu Group's revenue is derived from mass media advertising services and related creative services.

This revenue consists primarily of commissions from media companies on sales of media time and/or space. Commissions for mass media advertising time and/or space through terrestrial television, newspapers, magazines and radio are the Dentsu Group's most important revenue source.

The primary factors affecting revenue from mass media advertising are as follows:

- overall advertising expenditures in Japan, which are determined primarily by general economic conditions and developments affecting specific industries, such as technological advances, deregulation and increased competition;
- the Dentsu Group's competitive position vis-à-vis other advertising companies in Japan, which determines its market share in Japan;
- the rates charged by media companies for media time and/or space; and
- shifts in advertisers' demand for advertising among different media.

There is a close correlation between the growth rate of advertising expenditures and the growth rate of the Japanese economy. For this reason, the Dentsu Group monitors nominal gross domestic product (GDP) as an indicator of trends in advertising expenditures.

Plagued by deflation and recession in recent years, the Japanese economy has finally begun to show signs of recovery. Nominal GDP slipped 1.5% in calendar year 2002, but edged up 0.2% in 2003. Based on Dentsu research, domestic advertising expenditures fell 5.9% in 2002 and slipped 0.3% in 2003. In the January–March quarter of 2003, domestic advertising expenditures remained largely on a par with the first quarter of 2002, bolstered by improving economic conditions. In the April–June quarter, however, expenditures declined sharply, a consequence of the war in Iraq, the outbreak of severe acute respiratory syndrome (SARS), general financial instability and the absence of advertising campaigns related to the 2002 FIFA World Cup™, which had bolstered results in the corresponding quarter of the previous period. The situation improved in the July–September quarter as expenditures were bolstered by economic recovery and rising demand for digital home appliances. In the October–December quarter, expenditures were up from the same period of the previous year, supported by elections to Japan's House of Representatives (the lower house) and the biennial Tokyo Motor Show, as well as by the launch of terrestrial digital broadcasting services.

Recent years have seen an increasing trend among advertisers to consolidate their business with single, large advertising companies, reflecting rising demand for extensive, integrated services, greater cost efficiency and more effective accountability. As a consequence, Dentsu's leading share of the mass media advertising market in Japan—that is, the parent company's share of the billings of the country's top 90 advertising companies—continues to rise steadily. There remains considerable potential for reorganization and mergers within the domestic advertising industry, as seen in the merger of Hakuhodo Co., Ltd. (second in the domestic advertising industry), Daiko Advertising Inc. (fifth) and Yomiko Advertising Inc. (sixth), in 2003. The increasing presence in Japan of “mega-agencies” will also be an important factor going forward.

Rates charged by media companies for time and/or space have generally been stable in Japan in recent years, although rates for certain types of advertisements, such as television spot advertisements, often fluctuate significantly in the short term.

Commission rates vary according to the type of media, with commission rates for television advertising being on average generally higher than for other media. With advertisers anxious to cut costs by maximizing the efficiency of their advertising activities, however, the profitability of mass media advertising services continues to weaken.

The Dentsu Group often provides sales promotion services and other advertising services in conjunction with mass media advertising services. For example, in the case of sales promotion services, advertisers typically combine mass media advertising campaigns with point-of-purchase displays, promotional events and other measures to encourage consumers to buy advertisers' products or services. Factors affecting demand for mass media advertising services also affect demand for these other services, although such demand may fluctuate independently.

The Dentsu Group also earns revenue from sports and entertainment marketing services, although such revenue has not been significant to date. These services include the production, marketing and establishment of marketing tie-ups for, and the selling or brokering of sponsorship, broadcasting and other rights regarding such content as movies, sporting events, popular music and other forms of entertainment. The Dentsu Group's revenue from these services generally consists of net proceeds from, or commissions on brokering, the purchase and sale of content-related rights, returns on rights or interests in content that it holds, as well as payments for services. Revenue from these services is affected by, among other factors: in the case of events, the location and timing of the event; the terms under which the Dentsu Group acquires the relevant rights; the level of consumer demand for, or interest in, the content; and the level of demand from advertisers, broadcasters and others for the related rights.

The Dentsu Group also derives revenue from e-solution services, such as customer relationship management (CRM), Internet strategy consulting services and systems integration services. In addition to factors affecting demand for other advertising services, market trends in expenditures for systems development impact revenue from e-solution services.

The Dentsu Group also earns revenue from advertising services it provides outside Japan. In general, factors similar to those that affect revenue in Japan also affect revenue overseas, so that trends in revenue may differ among the various countries in which the Dentsu Group operates based on such factors as the country's economic condition, developments affecting specific industries, the competitive position of Dentsu Group companies vis-à-vis other advertising companies, market practices regarding compensation for services and shifts in advertiser demand for advertising among different media. The exchange rates between Japanese yen—the Dentsu Group's reporting currency—and the currencies of other countries in which the Dentsu Group operates outside Japan also affect revenue from overseas advertising services.

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Selling, general and administrative expenses

The largest component of selling, general and administrative expenses is compensation to employees, including salaries, pension and severance costs and welfare expenses. Other significant components of selling, general and administrative expenses include payments to third-party service providers and other business expenses, and depreciation.

In the fiscal year ended March 31, 2003, Dentsu introduced a remuneration system linking a portion of employee compensation to the Company's financial performance, as part of efforts to make its personnel expenses more flexible.

Factors that affect pension and severance costs include changes in the value of pension plan assets, the number of Dentsu Group employees and officers, the level of employee and officer compensation, and the terms of the pension and severance plans. Expenses resulting from the implementation of early retirement incentive programs also affect pension-related expenses. In the fiscal year ended March 31, 2004, Dentsu conducted two early retirement incentive programs. The first led to 29 employees accepting early retirement on June 30, 2003, while 89 employees retired on March 31, 2004, under the second. These employees received an aggregate of ¥2.2 billion in special retirement benefits in addition to their standard entitlements, the cost of which was included in selling, general and administrative expenses for the fiscal year ended March 31, 2004.

Depreciation expenses incurred in connection with the consolidation of Dentsu's offices into its new Head Office building in November 2002 peaked in the fiscal year ended March 31, 2004, and are expected to decline from the fiscal year ending March 31, 2005. Depreciation expenses have been, and will continue to be, partially offset by savings in rent expense resulting from the move as well as rental income from leasing office space in the new Head Office building and an adjacent building.

Strategies and Outlook

The Dentsu Group has defined four target markets—domestic advertising market; advertising-related markets; new markets; and overseas markets—on which it will focus its business development efforts to achieve growth going forward.

The domestic advertising market is undergoing a major transformation due to the evolving needs of advertisers and the digitization of media, while the market for advertising-related services holds great potential for further growth, particularly in such areas as sales promotion, public relations, market research, direct marketing and e-solutions. At the same time, communications techniques in these markets are changing thanks to advances in information technology (IT). Sports marketing, entertainment and other content businesses—collectively referred to by Dentsu as “new” markets—enable the Group to link clients, media-related companies and consumers, and are growing in importance both in Japan and overseas. Driven by economic globalization, a growing number of advertisers are adopting a global perspective when formulating their business strategies. As a result, an effective network covering overseas markets has become a crucial component of the Dentsu Group’s operations.

The Dentsu Group’s competitive edge lies in its various business models, skilled staff and effective management approach, and in its ability to integrate various services in these four markets and provide “one-stop solutions” under the concept of Total Communications Services, thereby creating an overall business model that is unique in the advertising industry.

In conducting marketing and communications activities that link clients, media-related companies and consumers, the Dentsu Group is striving to deliver the best possible solutions. To this end, the Group continues to raise its expertise in each target market and further develop its unique “Dentsu way” of integrating its services in these different markets. In this way, the Dentsu Group is broadening its competitive advantage.

Domestic advertising market

In the domestic advertising market, the Dentsu Group’s basic strategy is to expand its market share by maintaining an accurate grasp of client needs. To this end, it is working to enhance the efficiency of its media services, developing tools and systems for proposing optimal media plans and actively researching the effectiveness of its advertising activities to make the Group more accountable to its clients.

To reinforce the Group’s branding-related service capabilities, it is creating a more versatile management system and a service structure geared toward providing integrated solutions.

The Internet advertising market has excellent potential for future growth. In this market, various members of the Dentsu Group are utilizing their specific expertise and working together to pinpoint new business opportunities.

Advertising-related markets

The Dentsu Group regards advertising-related markets, which are diverse in scope and offer significant growth potential, as “frontier” markets.

The Group is drawing on its specialized expertise, responsiveness to change in digital media and cost competitiveness to further reinforce its “one-stop solution” capabilities and cultivate new businesses with dedicated services based on Groupwide strengths.

Due to advances in Internet, database and other digital technologies, sales promotion and in-store promotion techniques are changing dramatically. Recognizing these changes as opportunities, the Group will actively expand its business in advertising-related markets.

New markets

New markets for the Dentsu Group center on sports marketing, entertainment and other content-related markets. Dentsu has developed a special business model linking producers and rights holders with clients, media companies and consumers that it believes holds great potential for the future.

With sports and entertainment assuming greater importance in its operations, the Group will continue developing more profit-oriented business models and expand the scope of its business in new markets outside Japan. The Group will also seek to maximize synergies with advertising and advertising-related markets, so that new markets become an engine for future growth.

Overseas markets

In overseas markets, Dentsu will reinforce its global account services capabilities in cooperation with Publicis Groupe S.A., as well as strive to expand its business in rapidly growing Asian advertising markets.

Employing its own network throughout Asia, Dentsu will further upgrade its client service capabilities. Having already established a top position in China in terms of billings and revenue, going forward Dentsu will seek to further increase billings and revenue, while expanding the scope of its offerings to include content and advertising-related services.

In North America and Europe, Dentsu will capitalize on its strategic alliance with Publicis Groupe and strengthen its own network to increase accounts from existing clients and secure new business.

Comparison of the Fiscal Year Ended March 31, 2004, with the Fiscal Year Ended March 31, 2003

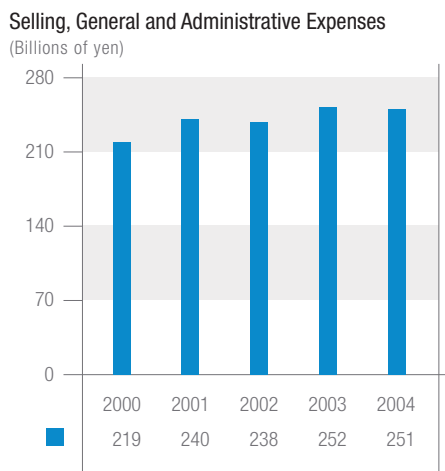
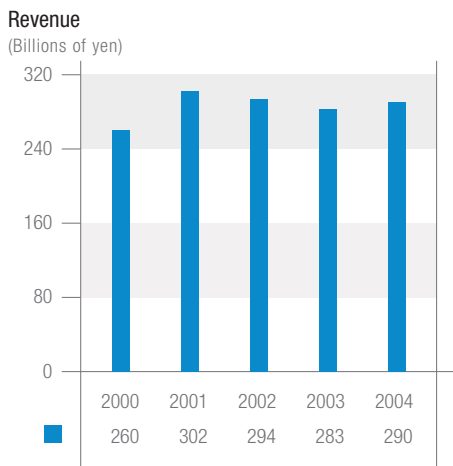
Revenue

The Dentsu Group's revenue was ¥290,480 million in the fiscal year ended March 31, 2004, an increase of ¥7,804 million, or 2.8%, from ¥282,676 million in the previous fiscal period. This rise was mainly attributable to revenue increases at Dentsu West Japan, cyber communications and Beijing Dentsu Advertising as well as to the additional revenue from newly consolidated subsidiaries Geneon Entertainment and Geneon Entertainment (USA), which offset the absence of revenue derived from activities related to the 2002 FIFA World Cup™.

Revenue from the four traditional mass media rose sharply in several key industries, notably Home Electric Appliances/AV Equipment and Information/Communications, which were bolstered by growth in demand for digital home appliances and broadband communications, respectively. Nonetheless, domestic advertising expenditures edged down 0.3% in calendar year 2003, the third consecutive year of decline.

Selling, general and administrative expenses

Selling, general and administrative expenses fell ¥1,452 million, or 0.6%, to ¥251,024 million in the fiscal year ended March 31, 2004, from ¥252,476 million in the previous fiscal period. Reasons for the decrease included a decline in



costs involved in moving to the new Head Office building and renting office space, which more than offset the impact of an increase in the number of consolidated subsidiaries.

Operating income

As a result of the above-mentioned factors, operating income rose ¥9,256 million, or 30.6%, to ¥39,456 million in the fiscal year ended March 31, 2004, from ¥30,200 million in the previous fiscal period. The operating margin (operating income as a percentage of revenue) was 13.6% in the fiscal year ended March 31, 2004, compared with 10.7% in the previous fiscal period.

Other income (expense)

Other income in the fiscal year ended March 31, 2004, was ¥4,237 million, compared with other expense of ¥29,313 million in the previous fiscal period. Primary factors in other expense in the fiscal year ended March 31, 2003, were a ¥21,689 million loss on sales of investment securities associated with the merger of Publicis Groupe and Bcom3 Group and an ¥8,186 million impairment loss on investment securities and others. In contrast, other income in the period under review reflected a ¥4,705 million gain on sales of investment securities and marketable securities.

Income before income taxes and minority interests

Income before income taxes and minority interests for the fiscal year ended March 31, 2004, amounted to ¥43,693 million, up ¥42,806 million from ¥887 million in the previous fiscal period.

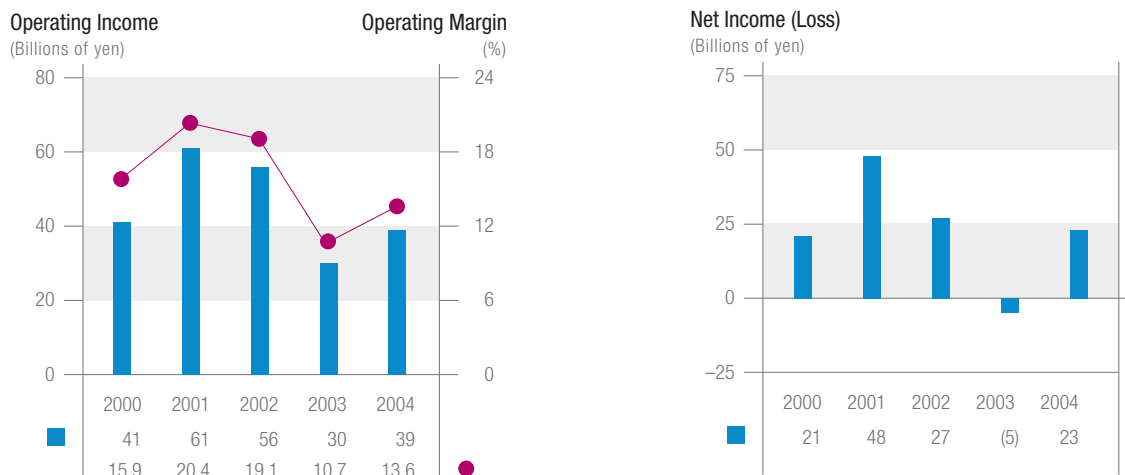
Income taxes

34 Income taxes for the fiscal year ended March 31, 2004, were ¥19,584 million, a ¥14,269 million, or 268.5%, increase from ¥5,315 million in the previous fiscal period.

The Dentsu Group is subject to a number of different taxes in Japan, including corporate income tax, enterprise tax and resident income taxes, which, in the aggregate, amounted to a normal income tax rate of 42.0% in both the fiscal year ended March 31, 2004, and the previous fiscal period.

Net income

As a result of the above-mentioned factors, after accounting for minority interests, the Dentsu Group recorded net income of ¥22,562 million in the fiscal year ended March 31, 2004, compared with a net loss of ¥4,618 million in the previous fiscal period.



Comparison of the Fiscal Year Ended March 31, 2003, with the Fiscal Year Ended March 31, 2002

Revenue

The Dentsu Group's revenue was ¥282,676 million in the fiscal year ended March 31, 2003, a decrease of ¥11,244 million, or 3.8%, from ¥293,920 million in the previous fiscal period. This decrease was mainly attributable to decreased revenue from mass media advertising, particularly television and newspaper advertising, as well as from creative services, although the decline was partially offset by increased revenue derived from activities related to the 2002 FIFA World Cup™. In other businesses, ISID also recorded lower revenue as companies in the systems integration market reduced IT-related investments.

Domestic advertising expenditures decreased 5.9% in calendar year 2002, largely due to growing uncertainty about the future of the Japanese economy and lower advertising expenditures by many corporations. Expenditures in the Information/Communications industry continued to decline significantly, while expenditures in the Beverages/Cigarettes industry also fell considerably.

Selling, general and administrative expenses

Selling, general and administrative expenses increased ¥14,675 million, or 6.2%, to ¥252,476 million in the fiscal year ended March 31, 2003, from ¥237,801 million in the previous fiscal period. Principal reasons for the increase included costs involved in moving to the new Head Office building, which was completed in November 2002, and the payment of special retirement benefits in connection with early retirement programs. These expenses were significantly greater than savings made in other areas, such as a decline in payments of bonuses due to the adoption of a performance-linked remuneration system, and a decline in amortization of goodwill. Pursuant to the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets," from the fiscal year ended March 31, 2003, Dentsu no longer amortizes goodwill, but instead tests goodwill for impairment. As a result of such test, Dentsu recorded no impairment losses in the fiscal year ended March 31, 2003.

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Operating income

As a result of the above-mentioned factors, operating income declined ¥25,919 million, or 46.2%, to ¥30,200 million in the fiscal year ended March 31, 2003, from ¥56,119 million in the previous fiscal period. The operating margin (operating income as a percentage of revenue) was 10.7% in the fiscal year ended March 31, 2003, compared with 19.1% in the previous fiscal period.

Other income (expense)

Other expense in the fiscal year ended March 31, 2003, was ¥29,313 million, up ¥26,924 million from ¥2,389 million in the previous fiscal period. Primary factors in other expense were a ¥21,689 million loss on sales of investment securities associated with the merger of Publicis Groupe and Bcom3 Group as well as an ¥8,186 million impairment loss on investment securities and others, primarily attributable to declines in share prices, particularly those of Japanese financial institutions. The impairment loss in the fiscal year ended March 31, 2003, was ¥1,453 million, or 21.6%, higher than the previous fiscal year.

Income before income taxes and minority interests

Income before income taxes and minority interests for the fiscal year ended March 31, 2003, decreased ¥52,843 million, or 98.3%, to ¥887 million, from ¥53,730 million in the previous fiscal period.

Income taxes

Income taxes for the fiscal year ended March 31, 2003, were ¥5,315 million, a ¥19,385 million, or 78.5%, decrease from ¥24,700 million in the previous fiscal period.

The Dentsu Group is subject to a number of different taxes in Japan, including corporate income tax, enterprise tax and resident income taxes, which, in the aggregate, amounted to a normal income tax rate of 42.0% in both the fiscal year ended March 31, 2003, and the previous fiscal period. Income taxes exceeded income before income taxes and minority interests, owing to a significant amount of nondeductible expenses that contributed to the decline in income before income taxes and minority interests. Another factor affecting the rate was a reappraisal of the Dentsu Group's deferred tax assets due to the impending adoption of a new enterprise tax on the revenue of large corporations.

Net income

As a result of the above-mentioned factors, after accounting for minority interests, net loss in the fiscal year ended March 31, 2003, was ¥4,618 million, compared with net income of ¥27,044 million in the previous fiscal period.

Liquidity, Capital Resources and Capital Requirements

Assets, liabilities and stockholders' equity

Despite a decline in net property, plant and equipment, which was largely a result of increased accumulated depreciation and amortization, and a decline in deferred income taxes, total assets fell just ¥785 million as higher billings boosted net trade receivables. Total liabilities declined ¥37,795 million, as a result of a decline in accrued pension and severance cost—owing to increases in the fair value of pension plan assets and the establishment of an additional retirement benefit trust—as well as the redemption of commercial paper. Total stockholders' equity rose ¥35,926 million, as a result of net income of ¥22,562 million and the aforementioned increase in the fair value of pension plan assets, which prompted a decline in the minimum pension liability.

Cash flows

Years ended March 31,	Millions of yen		
	2002	2003	2004
Net income (loss)	¥ 27,044	¥ (4,618)	¥ 22,562
Net cash provided by (used in) operating activities	30,238	(1,197)	39,319
Net cash provided by (used in) investing activities	(35,926)	(77,531)	10,961
Net cash provided by (used in) financing activities	(21,813)	78,815	(55,631)
Net decrease in cash and cash equivalents	(26,100)	(1,084)	(6,405)
Cash and cash equivalents at beginning of year	93,791	67,691	66,607
Cash and cash equivalents at end of year	67,691	66,607	60,202

The Dentsu Group had cash and cash equivalents totaling ¥60,202 million as of March 31, 2004, representing a decrease of ¥6,405 million from ¥66,607 million as of March 31, 2003.

In the fiscal year ended March 31, 2004, net cash provided by operating activities was ¥39,319 million, compared with net cash used in operating activities of ¥1,197 million in the fiscal year ended March 31, 2003. The principal factor contributing to this change was the recording of net income compared with a net loss in the previous period.

Net cash provided by investing activities amounted to ¥10,961 million in the fiscal year ended March 31, 2004, compared with net cash used in investing activities of ¥77,531 million in the fiscal year ended March 31, 2003. This change reflected proceeds from sales of investment securities and the refund of guaranty money deposited. Net cash used in investing activities in the fiscal year ended March 31, 2003, included ¥82,096 million in payments for purchase of investment securities, mainly for additional investments in Bcom3 Group prior to its consolidation with Publicis Groupe, and ¥35,911 million in payments for purchase of property, plant and equipment related to the new Head Office building. The Dentsu Group has no current plans for additional significant capital expenditures.

Net cash used in financing activities in the fiscal year ended March 31, 2004, was ¥55,631 million, compared with net cash provided by financing activities of ¥78,815 million in the fiscal year ended March 31, 2003. Net cash provided by financing activities in the fiscal year ended March 31, 2003, was primarily attributable to ¥9,400 million in proceeds from long-term debt related to loans from the Development Bank of Japan; a further ¥50,000 million in proceeds from long-term debt to fund additional investments in the Company's stake in Bcom3 Group; and a ¥45,958 million increase in short-term loans due primarily to issuances of commercial paper. Net cash used in financing activities in the fiscal year ended March 31, 2004, reflected a decrease in short-term loans of ¥37,625 million and payments of long-term debt of ¥8,686 million, down from the previous period.

Capital requirements

The Dentsu Group's principal capital requirements are payments for the purchase of advertising time and/or space and the production of advertisements, and personnel costs and other selling, general and administrative expenses.

Financing policy

The Dentsu Group satisfies its capital financing requirements using internal reserves, as well as through the issuance of commercial paper and short-term loans. The Group is committed to maintaining a positive working capital (current assets minus current liabilities) position. In the fiscal years ended March 31, 2003 and 2004, the Group's working capital amounted to ¥85,760 million and ¥92,174 million, respectively.

To meet its short-term liquidity needs, the Dentsu Group has established a ¥70,000 million commitment line with a syndicate of banks. To improve its cash management, the Group has also introduced a group finance system whereby almost all domestic consolidated subsidiaries that require funding may borrow funds that Dentsu has borrowed for this purpose from other domestic consolidated subsidiaries with excess cash.

Standard & Poor's currently gives Dentsu's long-term debt a rating of AA- and its short-term debt a rating of A-1+. Japanese rating agency Rating and Investment Information (R&I), has assigned a rating of AA to Dentsu's long-term debt and a rating of a-1+ to its short-term debt.

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Market Risk

The Dentsu Group is exposed to market risk from changes in foreign currency exchange rates and interest rates. The Dentsu Group uses derivative financial instruments, primarily foreign exchange forward contracts, currency option contracts, interest rate swap agreements and coupon swap agreements, to manage those risks. The Dentsu Group is also exposed to equity price and interest rate risk with respect to its investment securities.

A description of the Dentsu Group's accounting policies for derivative instruments is included in Note 1 to the consolidated financial statements included herein. Further disclosure is provided in Note 4 of the notes to consolidated financial statements.

The Dentsu Group assesses foreign currency exchange rate risk and interest rate risk by continually monitoring changes in these exposures and evaluating hedging opportunities. The Dentsu Group principally uses derivative instruments for hedging purposes, although as of March 31, 2004, it held ¥1,000 million in notional amount of credit-linked bonds with embedded derivatives for investment purposes.

The Dentsu Group is also exposed to credit-related losses in the event of default by counterparties to derivative financial instruments. However, the Dentsu Group's counterparties are highly reputable international financial institutions.

Foreign currency exchange rate risk

The Dentsu Group has assets and liabilities which are exposed to foreign currency exchange rate risk and, as a result, enters into forward exchange contracts and currency option contracts for the purpose of hedging these risk exposures.

The Dentsu Group principally uses forward exchange contracts and currency option contracts to manage foreign currency exchange exposures arising from the exchange of Japanese yen into U.S. dollars. These contracts are primarily used to fix future net cash flows or limit future net cash outflows principally from trade payables recognized, as well as forecasted transactions, which are denominated in foreign currencies. The Dentsu Group measures the volume and due date of future net cash flows by currency every month. In accordance with its policy, a certain portion of measured net cash flows is covered using forward exchange contracts and currency option contracts, which principally mature within one year. As of March 31, 2004, the Dentsu Group's principal foreign exchange exposure was forward exchange contracts to buy an aggregate of ¥7,324 million in foreign currencies, principally U.S. dollars.

Interest rate risk

The Dentsu Group is subject to market risk from exposure to changes in interest rates based on its financing, investing and cash management activities, particularly its incurrence of debt. These debt obligations expose the Dentsu Group to variability in the future cash outflow on interest payments due to changes in interest rates.

Equity security price risk

The Dentsu Group holds investments in various marketable equity securities classified as available-for-sale securities, which are subject to price risk. As of March 31, 2003, and March 31, 2004, the fair value of these investments was approximately ¥32,307 million and ¥36,043 million, respectively. In addition, Dentsu obtained ordinary shares, the bare legal title to additional ordinary shares and other securities of Publicis Groupe in connection with the merger of Bcom3 Group, which became a wholly owned subsidiary of Publicis Groupe. The value of the ordinary shares, *obligations remboursable en actions* (ORA) and the warrant portion of *obligations à bon de souscription d'actions* (OBSA) that Dentsu owned on March 31, 2004, based on closing prices on that date, were approximately €708 million, €152 million and €79 million, respectively. Based on an exchange rate of €1.00=¥128.88, the approximate exchange rate prevailing on March 31, 2004, these amounts translate to approximately ¥91,222 million, ¥19,574 million and ¥10,139 million, respectively.

Operating and Other Risks

The operating results, share price and financial position of the Dentsu Group are subject to various risks, as described below. Any forward-looking statements in the following discussion are based on management's assumptions and beliefs in light of information available as of March 31, 2004.

Current operating risk

(i) Industry-related risk

Fluctuations in the economic and business environments—The financial results of the Dentsu Group and other companies in the advertising industry are greatly influenced by economic and business conditions because many advertisers consider advertising as a variable cost to be adjusted in response to changes in these conditions.

The Dentsu Group has taken steps, such as diversifying the types of services it provides, to reduce its exposure to the impact of fluctuations in the economic and business environment. Nonetheless, as billings in Japan account for more than 90% of the Dentsu Group's total billings, its financial results may be influenced by domestic macroeconomic

trends and fluctuations in the operating environment of key domestic industry sectors having significant advertising expenditures.

Risk related to common business practices in Japan—In Japan, the common practice is for advertising companies to purchase time and/or space from media companies on their own behalf, rather than on the behalf of advertisers. Accordingly, the Dentsu Group is liable for the payment to media companies regardless of whether it receives payment from the advertiser. This practice exposes the Dentsu Group to the risk of default should an advertiser client's business fail.

The nature of the advertising business in Japan is such that sudden changes in advertising proposals and actual advertisements are a frequent occurrence. Moreover, work for client advertisers is not traditionally subject to formal contracts. The Dentsu Group strives to preclude problems related to work for clients by encouraging the conclusion of basic written contracts. However, because many clients are not comfortable with this practice, the Dentsu Group is exposed to the risk of unforeseen incidents or disputes with clients.

Overseas, especially in Europe and the Americas, relationships between advertisers and advertising companies are usually exclusive within a particular industry. In Japan, however, these relationships are typically less exclusive. Accordingly, the Dentsu Group, like other advertising companies in Japan, may handle multiple clients in a single industry. If the practice in Japan were to change in favor of exclusive relationships, however, and if the Dentsu Group's efforts to respond to this change were ineffective, its financial results could be adversely affected.

(ii) Competition-related risk

Risk related to competition with other advertising companies—Competition among Japan's top advertising companies is intense. In recent years, reorganization and mergers among domestic companies and the entry into the market of overseas-based "mega-agencies" have significantly altered the structure of Japan's advertising industry. Going forward, the Dentsu Group's financial results could be adversely affected by increased competition to secure clients if its efforts to respond to changes in the structure of the industry and in standard business practices prompted by the entry of multinational advertising companies are ineffective.

Risk related to competition from new market entrants from adjacent industries—The rapid expansion and diversification of the advertising field is giving rise to competition from an increasing number of companies in adjacent industries, including general trading and consulting companies. The Internet advertising field is also seeing a sharp increase in the number of new market entrants—companies with which it competes in the development and expansion of new businesses. If the Dentsu Group's efforts to respond to the challenges inherent in these new fields are ineffective, its financial results could be adversely affected.

Risk related to competition in new media advertising markets—The advent and spread of the Internet and other new methods of communication have given rise to a number of new advertising media. Believing that these new media complement traditional mass media and will contribute to the future growth of the advertising market as a whole, the Dentsu Group is striving to cultivate new business opportunities. If such new media were to displace traditional mass media as the preferred method of communication, however, and demand for mass media advertising, which currently accounts for more than half of the Dentsu Group's total billings, were to decline, the Dentsu Group's financial results could be adversely affected.

(iii) Risk related to advertisers and media companies

The Dentsu Group provides advertising services for many major advertisers in Japan and has maintained stable, long-term relationships with a large majority of its current clients. In the fiscal year ended March 31, 2004, billings to the Dentsu Group's top 10 clients (in terms of billings) accounted for approximately 20% of its total billings.

The Dentsu Group has established a strong business foundation by assisting the operations and sales activities of Japan's media companies. This enables it to serve as an effective link between media companies and advertisers.

There is no assurance, however, that the Dentsu Group will be able to maintain its beneficial relationships with current and future clients and media companies. The Dentsu Group's financial results may be adversely affected if it is unable to meet the needs of these companies, its relationships with these companies are terminated or dissolved, accounts decline or the nature of these relationships changes.

In recent years, an increasing number of advertisers have sought to consolidate their media service activities with one advertising company to increase the efficiency of their advertising spending and to reduce costs. As a result, the profitability of mass media advertising is declining. If this trend persists, it could have a negative impact on the Dentsu Group's financial results.

(iv) Risk related to legal or regulatory changes

Advertising companies in Japan, including the Dentsu Group, are subject to a number of laws. These include laws to prevent delays in payments to subcontractors and protect personal information as well as regulations applicable specifically to advertising companies. The Group does not anticipate that these laws and regulations will have any material impact on its business. However, the financial results of the Dentsu Group and other advertising companies could be adversely affected by (1) the strengthening of existing laws or regulations affecting the advertising activities of advertisers or the format or content of advertisements, (2) the introduction of new such laws or regulations, or (3) the reinterpretation of existing such laws or regulations.

Future operating risk

(i) Risk related to efforts to reinforce domestic service capabilities

The Dentsu Group is currently developing a computer-based system to evaluate the effectiveness of its clients' advertising and marketing activities, and building a database as part of efforts to cultivate latent demand and increase its share of the domestic advertising market. However, it is unclear when these efforts will lead to the development and introduction of new services. It is possible that such new services will be deemed obsolete—a casualty of the changing needs of advertisers—or too technologically difficult and, as a consequence, not live up to initial expectations.

To reinforce its position in new media markets, the Dentsu Group has made investments in Internet, telecommunications and satellite broadcasting companies, as well as in related research and development programs, and is currently considered the leader in the market for advertising for the Internet and satellite broadcasting. However, if demand for new media advertising declines or competition in the new media advertising market intensifies, profits and business results may not be commensurate with investments in research and development and commercialization.

As a part of its diversification program, the Dentsu Group has recently taken steps to expand its e-solution businesses, such as CRM, e-marketing, systems design and other services. However, if demand for these services falls short of expectations, or the Dentsu Group is unable to respond appropriately to orders from clients or maintain competitiveness against other e-solutions providers, diversification efforts may not be as effective as planned.

The Dentsu Group is stepping up efforts to expand orders in industries where deregulation or intensifying competition has prompted advertisers to step up advertising spending. To this end, the Group is hiring and training individuals to ensure the specialized expertise necessary to respond to the marketing needs of potential clients in these industries. There is no assurance, however, that these efforts will result in increased accounts.

(ii) Risk related to efforts to adapt businesses to a changing market structure

The Dentsu Group has invested in a new business developing and supplying content, a market that continues to grow quickly as a result of the increasing importance of the Internet, mobile phones and satellite broadcasting. However, it is possible that efforts to develop and commercialize new Internet-related and other technologies or to commercialize services will not yield the expected results or will yield the expected results but require an extended period of time to do so.

The Dentsu Group invests actively in the acquisition of rights to and the production of films, television programs, sporting events and music, and generates profits from the production, distribution and licensing, as well as the sale and brokerage of sponsorship and broadcasting rights, of films and other content. However, planning may take several years and require a considerable financial commitment. Moreover, the success of the Group's content business may depend on the reaction of consumers, which can be difficult to predict. Therefore, there can be no assurance that the Dentsu Group will realize the benefits expected or that the Group's financial results will not be negatively affected.

(iii) Risk related to efforts to build a global business portfolio

The Dentsu Group conducts its business outside Japan through its own network and by establishing activities in overseas markets through alliances with other companies. In the fiscal year ended March 31, 2004, billings in markets outside Japan accounted for 6.9% of the Dentsu Group's total billings. The Group recognizes that building a global business portfolio is essential to its future growth and is thus working to expand its business in overseas markets. However, if these efforts are unsuccessful, the Group's financial results may be adversely affected.

In line with its determination to expand its operations in Europe, the Americas and Oceania, in 2002 Dentsu invested in Publicis Groupe and established a strategic alliance with the organization in the advertising services and other fields. In 2003, the Dentsu Group, together with Publicis Groupe, established joint venture iSe International Sports and Entertainment (iSe), with the aim of expanding its sports marketing business in global markets. However, there is no assurance that this alliance will be successful, and unforeseeable events could adversely affect the Group's financial results. Also, because Dentsu is a minority shareholder in Publicis Groupe, with approximately 15% of voting rights, its ability to influence the management of Publicis Groupe is limited, and there may, as a result, be instances in which Publicis Groupe's business directions and strategies are not beneficial to the Dentsu Group. Moreover, if the price of shares in Publicis Groupe were to decline sharply, Dentsu would be required to write off the value of its investment. The Dentsu Group has long had its own extensive network in Asia through which it has provided services to local markets. In particular, the Group's established position as one of the leading companies in the Chinese advertising market positions it well to capitalize on rapid market growth. The Dentsu Group will continue to focus on expanding its operations in China and elsewhere in Asia. However, as the advertising industries in many countries in Asia remain underdeveloped, political, economic, legal and other factors may hamper the Dentsu Group's efforts to expand its advertising business in the region and prevent it from achieving its intended results.

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Other risk

Risk of litigation

As of March 31, 2004, the Dentsu Group is not subject to any litigation that could have a significant impact on its financial results. However, the Dentsu Group may from time to time become involved in litigation brought against it directly or indirectly, including claims by clients, regulatory bodies, consumers or owners of intellectual property. Such claims may relate to the content or creative aspect of advertisements.