

Overview of Operations 2004

The year 2004 witnessed various difficulties on the domestic front such as a contraction in consumption due to high levels of household debt and high unemployment. In addition, exports slowed from the previous year due to increasing oil prices and increased public charges.

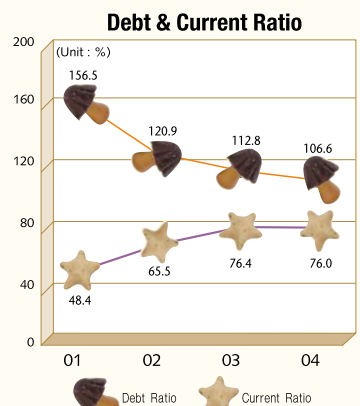
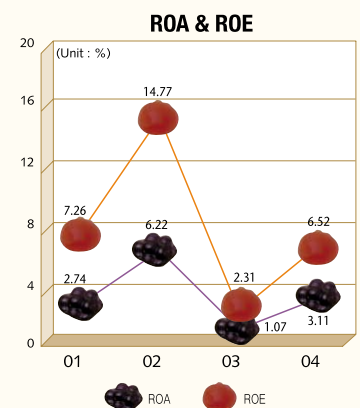
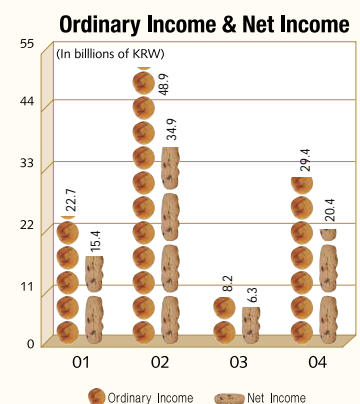
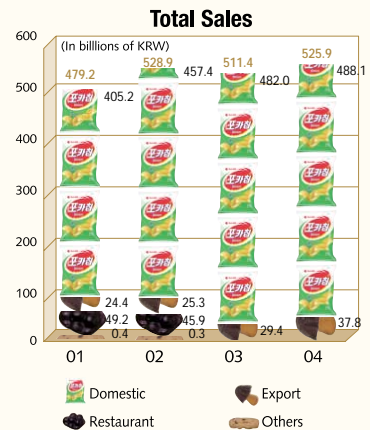
Due to margin pressure caused by increasing competition in the market, and the increasing popularity of a Well-Being trend that highlights the importance of fresh natural products, sales in Korea's confectionery market decreased by 1.8% from 2003. Yet, despite such unfavorable market conditions, Orion's efforts to enhance its brand awareness yielded results with several core products such as Chocopie, Pocachips, improving their performance from 2003. As a result, total sales rose by 2.8% and domestic share grew 0.8%p to 26.1% from the previous year.

The operating income margin for 2004 recorded 8.2% with KRW 43.3 billion, down 1.5%p over 2003, attributable to pressure on expenses caused by rising prices as well as an increase in advertising and promotion expenses related to the relaunching of products after the reacquisition of Pepsico's holding shares in Orion as part of a mid-to long- term strategies initiated at the end of fourth quarter.

Ordinary income for 2004 amounted to KRW 29.4 billion, jumping a staggering 258% or 4.0%p year-on-year due to the fact that net loss improved to KRW 13.0 billion from KRW 40.4 billion in 2003. The heavy net loss in 2003 was due to losses incurred with the introduction of the sports lottery ticket business, Sports TOTO, which, though still operating at a loss in 2004, improved its bottom line dramatically from the previous year. In addition, losses on valuation of securities using the equity method improved to KRW 2.4 billion from KRW 28.3 billion in 2003, due to stellar performances of the entertainment subsidiaries MEDIAPLEX and ON*MEDIA.

Although the total amount of net debt posted at KRW 264.8 billion was up by KRW 45.1 billion compared to the previous year, this was due to the acquisition of Pepsico's share in the joint-venture company of Orion Snack International Corporation. The debt-to-equity ratio edged down to 107% advanced by 6%p due to the rise in operating income compared to the previous year. The long-term borrowings ratio posted 65% representing the Company's solid financial position.

For 2005, despite lingering doubts over the prospects for recovery of the Korean economy, expected growing competition in the market due to Crown Corporation's acquisition of Haetae, and increasing margin pressure from wholesalers, Orion expects to maintain sales growth in 2005, by expanding its core products markets and launching new brands under the management goal of maximizing the Company's brand power. To this end, Orion will hone its competitive edge in every sector by improving the quality of existing products and services, while optimizing management structure and improving cost efficiency. The Company will also provide further training opportunities so as to nurture a targeted 10% of our employees to become top-class talented people in the world. Orion aims for continued growth and the strengthening of its brand value, so as to deliver maximum value to shareholders.



Five-Year Summary

	(In thousands of USD)*		(In millions of KRW)			
	2004	2004	2003	2002	2001	2000
For the year						
Total Sales	503,813	525,880	511,437	528,920	479,164	455,669
Gross Profit	194,800	203,332	205,799	221,220	197,939	184,866
Operating Income	41,464	43,280	49,394	53,659	39,443	32,446
Net Income	19,512	20,366	6,258	34,889	15,403	26,399
At year end						
Total Assets	664,798	693,916	615,000	560,270	560,858	565,027
Current Assets	119,395	124,624	115,075	107,935	121,832	124,430
Non-current Assets	545,403	569,292	499,926	452,336	439,027	440,596
Total Liabilities	342,956	357,978	325,995	306,644	342,177	359,475
Capital Stock	28,159	29,392	27,162	26,956	26,662	26,534
Capital Surplus	120,029	125,286	117,167	116,416	115,344	114,877
Retained Earnings	124,983	130,457	114,813	113,997	80,891	69,194
Shareholders' Equity	321,842	335,938	289,006	253,626	218,681	205,552
Financial Ratio (%)						
Current Ratio		76.0	76.4	65.5	48.4	52.9
Debt Ratio		106.6	112.8	120.9	156.5	174.9
ROA		3.11	1.07	6.22	2.74	4.67
ROE		6.52	2.31	14.77	7.26	12.84

*Accounts in Korean won have been translated into U.S. dollars, solely for the reader's convenience, at ₩ 1,043.80, the prevailing rate on December 31, 2004

Balance Sheets

Assets	Korean won in thousands		U.S.dollars (Note 2)
	2003	2004	2004
Current assets:			
Cash and cash equivalents (Notes 3 and 8)	₩ 10,102,400	₩ 1,224,688	US\$ 1,173,298
Short-term financial instruments (Note 3)	378,530	378,530	362,646
Held-to-maturity securities (Note 6)	9,615	238,245	228,248
Accounts and notes receivable - trade, less allowance for doubtful accounts (Notes 4, 8 and 15)	78,067,439	85,358,528	81,776,708
Accounts receivable - other	477,338	478,743	458,654
Accrued interest income	7,988	747	716
Prepaid expenses	842,619	883,623	846,544
Inventories (Note 5)	24,985,767	35,679,566	34,182,378
Other current assets	203,067	381,652	365,637
Total current assets	115,074,763	124,624,322	119,394,829
Investments and other assets:			
Long-term financial instruments (Note 3)	20,500	20,500	19,640
Held-to-maturity securities (Note 6)	841,510	681,695	653,090
Available-for-sale securities (Note 6)	4,263,180	6,045,422	5,791,744
Securities accounted for by the equity method (Note 6)	260,231,368	335,176,406	321,111,713
Guarantee deposits	6,548,213	6,168,092	5,909,266
Deferred income tax assets (Note 16)	14,947,338	12,140,750	11,631,299
Total investments and other assets	286,852,109	360,232,865	345,116,751
Property, plant and equipment (Note 7):			
Land	103,834,433	103,850,919	99,493,120
Buildings and structures	80,983,983	81,841,388	78,407,155
Machinery and equipment	145,398,097	148,421,607	142,193,530
Vehicles	12,009,588	13,989,626	13,402,592
Tools, furniture and fixtures	26,085,577	27,418,299	26,267,771
Construction in-progress	11,847,972	10,940,369	10,481,289
	380,159,650	386,462,208	370,245,457
Less accumulated depreciation	(167,709,096)	(178,384,653)	(170,899,265)
Property, plant and equipment, net	212,450,554	208,077,555	199,346,192
Intangibles, net of amortization	622,888	981,250	940,075
Total assets	₩ 615,000,314	₩ 693,915,992	US\$ 664,797,846

See accompanying notes.

Balance Sheets (continued)

December 31, 2003 and 2004

Liabilities and Stockholders' Equity	Korean won in thousands		U.S.dollars (Note 2)
	2003	2004	2004
Current liabilities:			
Accounts and notes payable - trade (Notes 8 and 15)	₩ 42,578,400	₩ 42,572,188	US\$ 40,785,771
Short-term borrowings (Notes 8 and 9)	14,057,544	17,753,695	17,008,713
Accounts payable - other	30,298,555	25,197,583	24,140,240
Advances from customers	733,650	485,446	465,076
Income taxes payable	4,177,070	1,739,108	1,666,131
Accrued expenses and other current liabilities	1,372,357	1,721,845	1,649,593
Current portion of long-term debt and bonds, less bond discount (Notes 10 and 11)	57,496,085	74,509,547	71,382,973
Total current liabilities	150,713,661	163,979,412	157,098,498
Long-term liabilities:			
Long-term debt and bonds, less bond discount and current portion (Notes 10 and 11)	157,060,324	172,249,246	165,021,313
Severance and retirement benefits (Notes 12 and 20)	10,214,156	11,087,020	10,621,786
Tenant lease deposits and other	4,643,220	7,060,133	6,763,875
Provision for loss on sales returns	3,363,163	3,601,733	3,450,597
Total long-term liabilities	175,280,863	193,998,132	185,857,570
Total liabilities	325,994,524	357,977,544	342,956,068
Commitments and contingencies (Note 13)			
Stockholders' equity (Note 14):			
Common stock, ₩5,000 par value			
Authorized - 12,000,000 shares			
Issued - 5,432,310 in 2003 and 5,878,356 in 2004	27,161,550	29,391,780	28,158,440
Outstanding - 4,722,373 in 2003 and 5,168,419 in 2004			
Capital surplus	117,167,486	125,286,115	120,028,851
Retained earnings (Note 14)			
Appropriated	108,200,000	108,700,000	104,138,724
Unappropriated	6,612,590	21,756,593	20,843,642
	114,812,590	130,456,593	124,982,365
Capital adjustment account:			
Treasury stock (709,937 in 2003 and 709,937 in 2004) (Note 14)	(16,605,222)	(16,605,222)	(15,908,433)
Gain on valuation of investments (Note 6)	46,082,867	66,410,628	63,623,901
Stock compensation expense (Note 14)	386,519	998,554	956,653
	29,864,164	50,803,960	48,672,121
Total stockholders' equity	289,005,790	335,938,448	321,841,778
Total liabilities and stockholders' equity	₩ 615,000,314	₩ 693,915,992	US\$ 664,797,846

See accompanying notes.

Statements of Income

	Korean won in thousands		U.S.dollars (Note 2)
	2003	2004	2004
Net sales (Notes 15 and 19)	₩ 511,436,672	₩ 525,880,341	US\$ 503,813,318
Costs and expenses:			
Cost of sales (Notes 15 and 19)	305,637,937	322,548,020	309,013,240
Selling, general and administrative expenses (Note 20)	156,404,890	160,051,855	153,335,749
	462,042,827	482,599,875	462,348,989
Operating income	49,393,845	43,280,466	41,464,329
Other income (expenses):			
Interest expense	(14,897,108)	(13,979,712)	(13,393,094)
Interest income	933,568	1,035,669	992,210
Dividend income	103	4,835	4,632
Unrealized foreign currency translation gain (loss), net	(62,554)	288,279	276,182
Realized foreign currency exchange gain (loss), net	(135,620)	866,446	830,088
Gain on disposal of property, plant and equipment, net	153,645	(121,193)	(116,107)
Equity income (loss) on investments			
in affiliated companies, net (Note 6)	(28,285,697)	(2,439,766)	(2,337,388)
Gain (loss) on disposal of investments, net (Note 6)	(191,710)	600,718	575,511
Impairment of investments in securities	(55,350)	-	-
Donations	(304,628)	(253,251)	(242,624)
Miscellaneous	1,658,312	120,719	115,653
	(41,187,039)	(13,877,256)	(13,294,937)
Ordinary income	8,206,806	29,403,210	28,169,392
Extraordinary gain (loss)	-	-	-
Income before income taxes	8,206,806	29,403,210	28,169,392
Provision for income taxes (Note 16):			
Current	9,065,152	6,230,246	5,968,813
Deferred	(7,116,803)	2,806,588	2,688,818
	1,948,349	9,036,834	8,657,631
Net income	₩ 6,258,457	₩ 20,366,376	US\$ 19,511,761
Basic ordinary income per share (Note 17)			
(Korean won and U.S. dollars in units)	₩ 1,331	₩ 4,042	US\$ 3.87
Basic earnings per share (Note 17)			
(Korean won and U.S. dollars in units)	₩ 1,331	₩ 4,042	US\$ 3.87
Diluted ordinary earnings per share (Note 17)			
(Korean won and U.S. dollars in units)	₩ 1,234	₩ 3,970	US\$ 3.80
Diluted earnings per share (Note 17)			
(Korean won and U.S. dollars in units)	₩ 1,234	₩ 3,970	US\$ 3.80

See accompanying notes.

Statements of Appropriations of Unappropriated Retained Earnings

Years ended December 31, 2003 and 2004

	Korean won in thousands		U.S.dollars (Note 2)
	2003	2004	2004
Unappropriated retained earnings at end of year before reversals and appropriations:			
Unappropriated retained earnings carried over from prior year	₩ 1,116,014	₩ 1,390,217	US\$ 1,331,881
Increase (decrease) in retained earnings due to equity method of accounting for investments in affiliated companies (Note 6)	(761,881)	-	-
Net income for the year	6,258,457	20,366,376	19,511,761
	6,612,590	21,756,593	20,843,642
Reversal of reserve for research and manpower development	1,000,000	2,333,334	2,235,422
Reversal of voluntary reserve	4,000,000	-	-
Unappropriated retained earnings available for appropriations	11,612,590	24,089,927	23,079,064
Appropriations:			
Legal reserve	500,000	800,000	766,430
Reserve for financial position improvement	1,000,000	2,400,000	2,299,291
Reserve for business expansion	-	4,000,000	3,832,152
Reserve for research and manpower development	4,000,000	4,000,000	3,832,152
Voluntary reserve	-	3,000,000	2,874,114
Cash dividends (Note 18)	4,722,373	7,752,629	7,427,313
	10,222,373	21,952,629	21,031,451
Unappropriated retained earnings to be carried forward to the next year	₩ 1,390,217	₩ 2,137,298	US\$ 2,047,613

See accompanying notes.

Years ended December 31, 2003 and 2004

Statements of Cash Flows

	Korean won in thousands		U.S.dollars (Note 2)
	2003	2004	2004
Operating activities:			
Net income	₩ 6,258,457	₩ 20,366,376	US\$ 19,511,761
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	13,540,919	12,665,380	12,133,914
Bad debt written off	5,198,505	2,598,351	2,489,319
Provision for severance and retirement benefits	7,439,355	7,867,440	7,537,306
Payments of severance and retirement benefits, net of transfers	(7,231,363)	(6,796,727)	(6,511,523)
Decrease in accumulated prepayments to Korean National Pension Fund	284,983	444,579	425,924
Amortization of discount on bonds	13,248	29,659	28,414
Amortization of intangible assets	239,187	286,679	274,649
Provision for loss on sales returns	116,330	238,571	228,560
Loss (gain) on disposal of investments, net	191,710	(600,717)	(575,510)
Gain on disposal of property, plant and equipment, net	(153,645)	121,192	116,107
Equity income (loss) on investments in affiliated companies, net	28,285,697	2,439,766	2,337,389
Unrealized foreign currency translation loss (gain), net	62,702	(288,438)	(276,335)
Impairment of investments in securities	55,350	-	-
Stock compensation expense	273,154	612,036	586,354
Miscellaneous	-	(25,316)	(24,254)
Changes in operating assets and liabilities:			
Accounts and notes receivable - trade	(4,551,613)	(9,894,086)	(9,478,910)
Accounts receivable - other	(5,962)	(1,405)	(1,346)
Accrued interest income	27,622	7,241	6,937
Prepaid expenses	(188,535)	(41,004)	(39,283)
Other current assets	131,745	(178,586)	(171,092)
Inventories	541,435	(10,693,798)	(10,245,065)
Deferred income tax assets	(6,205,286)	2,806,587	2,688,817
Accounts and notes payable - trade	5,093,897	59,001	56,525
Accounts payable - other	939,967	(5,100,972)	(4,886,925)
Advances from customers	718,431	(248,204)	(237,789)
Income taxes payable	(5,334,722)	(2,437,962)	(2,335,660)
Accrued expenses and other current liabilities	(1,429,947)	349,488	334,822
Tenant lease deposits and other	401,245	2,416,913	2,315,494
Net cash provided by operating activities	₩ 44,712,866	₩ 17,002,043	US\$ 16,288,602

(Continued)

See accompanying notes.

Statements of Cash Flows

(continued)

Years ended December 31, 2003 and 2004

	Korean won in thousands		U.S.dollars (Note 2)
	2003	2004	2004
Investing activities:			
Acquisition of long-term held-to-maturity securities	₩ (1,945,806)	₩ (1,884,517)	US\$ (1,805,439)
Proceeds from disposal of available-for-sale securities	-	10,850	10,395
Decrease in short-term financial instruments	670,550	-	-
Decrease in long-term financial instruments	3,000	-	-
Decrease (increase) in guarantee deposits	1,715,707	380,121	364,170
Acquisition of securities accounted for by the equity method	(40,000,000)	(57,159,115)	(54,760,601)
Proceeds from disposal of long-term investment securities	41,057	725,398	694,959
Decrease in deposits for employee's group severance insurance	(122,304)	(642,428)	(615,470)
Acquisition of property, plant and equipment	(13,129,964)	(11,219,849)	(10,749,041)
Proceeds from disposal of property, plant and equipment	2,656,184	2,831,591	2,712,772
Increase in intangible assets	(315,193)	(645,042)	(617,974)
Net cash used in investing activities	(50,426,769)	(67,602,990)	(64,766,230)
Financing activities:			
Increase (decrease) in short-term borrowings	(32,101,947)	-	-
Repayment of current portion of long-term debt	(39,503,490)	(53,582,451)	(51,334,021)
Increase in long-term debt and bonds	90,000,000	89,679,200	85,916,076
Common stock issued for stock warrants	952,880	10,362,570	9,927,735
Stock issuance costs	(1,910)	(13,711)	(13,136)
Payment of cash dividends	(4,681,259)	(4,722,373)	(4,524,212)
Net cash provided by financing activities	14,664,274	41,723,235	39,972,442
Net increase (decrease) in cash and cash equivalents	8,950,371	(8,877,712)	(8,505,185)
Cash and cash equivalents at the beginning of the year	1,152,029	10,102,400	9,678,483
Cash and cash equivalents at the end of the year	₩ 10,102,400	₩ 1,224,688	US\$ 1,173,298
Transactions not involving inflow or outflow of cash:			
Transfer of construction in-progress to appropriate property, plant and equipment accounts	₩ 2,349,601	₩ 2,306,650	US\$ 2,209,858
Transfer of long-term debt to current portion	57,506,475	74,509,547	71,382,973
Depreciation offset against government grants	12,109	12,110	11,602
Transfer of long-term financial instruments to short-term financial instruments	57,506,475	74,509,547	71,382,973

See accompanying notes.

1. Organization and business

Orion Corporation (“the Company”) was incorporated as Tong Yang Confectionery Corporation in 1956, under the laws of the Republic of Korea to engage in the business of manufacturing and selling confectioneries. On September 1, 2001, the Company, together with all its affiliates (Note 6), separated from the Tong Yang Group of companies to establish its own identity as a confectionery, food and entertainment business group. Accordingly, the Company changed its name from Tong Yang Confectionery Corporation to Orion Corporation on August 29, 2003.

As of December 31, 2004, the Company has four manufacturing plants in Korea to produce biscuits, chocolates, pies and gums. The Company also sells merchandise purchased from Orion Snack International Corp., a 100% owned company organized locally.

The Company’s common stock has been listed on the Korea Stock Exchange since June 27, 1975.

2. Basis of financial statements and summary of significant accounting policies

Basis of financial statements | The Company maintains its official accounting records in Korean won and prepares statutory financial statements in the Korean language in conformity with accounting principles generally accepted in the Republic of Korea (“Korean GAAP”). Certain accounting principles applied by the Company that conform with financial accounting standards and accounting principles in the Republic of Korea may not conform with generally accepted accounting principles in other countries. Accordingly, these financial statements are not intended for use by those who are not informed about Korean accounting principles and practices. The accompanying financial statements have been condensed, restructured and translated into English (with certain expanded descriptions) from the Korean language financial statements.

Certain supplementary information included in the statutory Korean language financial statements, but not required for a fair presentation of the Company’s financial position, results of operations and cash flows, is not presented in the accompanying financial statements.

Basis of translating the financial statements | Solely for the convenience of the reader, the 2004 financial statements, expressed in Korean won, have been translated to United States dollar amounts at the exchange rate of ₩1,043.80 to US\$1, the prevailing exchange rate on December 31, 2004. This translation should not be construed as a representation that any or all of the amounts stated in Korean won could have been converted to United States dollars at this or any other rate.

Cash equivalents | Highly liquid trading securities and short-term financial instruments with original maturities of three months or less, and which have no significant risk of loss in value by interest rate fluctuations, are considered as cash equivalents.

Financial instruments | Financial instruments, such as time deposits and restricted bank deposits, which are traded by financial institutions and are held for short-term cash management purposes or which will mature within one year, are accounted for as short-term financial instruments. Financial instruments other than cash equivalents and short-term financial instruments are recorded as long-term financial instruments.

Investment securities | Available-for-sale securities are stated at fair value. The unrealized gains and losses related to changes in the fair value of available-for-sale securities are reported as a separate component of stockholders' equity until realized. Trading securities are stated at fair value, with unrealized holding gains and losses reported as part of net income. Debt securities, classified as held-to-maturity, are stated at the acquisition cost adjusted for the amortization of discount or premium using the effective interest method.

Investment securities are evaluated to determine if they have suffered a loss in value that is other than temporary. The impairment loss is charged to current operations.

Investments in affiliated companies | Investments in affiliated companies over which the Company exercises significant control are stated using the equity method, whereby the Company's initial investment is recorded at acquisition costs and subsequently the carrying value is increased or decreased to reflect the Company's share of the investee's income or loss. If the increase or decrease is derived from changes in the investee's retained earnings, such change is presented as an increase or decrease in the investor's beginning retained earnings. If the increase or decrease is derived from the investee's changes in capital surplus or capital adjustments, then such amount is presented as a valuation gain or loss on investment securities, and is shown in a capital adjustment account within stockholders' equity.

Allowance for doubtful accounts | The Company provides an allowance for doubtful accounts to cover estimated losses that may arise from non-collection of its receivables. The estimate of losses is based on the estimated collectibility of receivables and historical bad debt experience.

Valuation of receivables at present value | Receivables arising from long-term installment transactions are stated at present value. The difference between the carrying amount of receivables and their present value is amortized using the effective-interest-rate method and credited to results of operations over the installment period.

When credit terms (e.g., principal, interest rate, payment period) of receivables from debtors experiencing financial difficulties (e.g., court receivership, debt restructuring, financial workout) are unfavorably changed from the perspective of the Company, such receivables are stated at present value and the difference between the carrying amount of such receivables and their present value is charged to current operations.

Foreign currency translation | The Company's books and records are maintained in Korean won. Transactions conducted in foreign currencies are recorded in Korean won based on the prevailing exchange rates when the transactions are made. Assets and liabilities denominated in foreign currencies are translated into Korean won at the exchange rates in effect at the balance sheet date. The resulting unrealized foreign currency translation gains (losses) are credited (charged) to current operations.

Inventories | Inventories are stated at the lower of cost or net realizable value. Cost is determined by specific identification for materials in transit, and the moving average method for all other inventories.

Property, plant and equipment and depreciation | Property, plant and equipment are stated at cost, except for assets which were revalued in accordance with the Korean Assets Revaluation Law.

Depreciation of property, plant and equipment has been provided using the declining balance method (straight-line method for buildings and structures acquired after January 1, 1995) over the following estimated useful lives:

	Useful lives of assets acquired from January 1, 1995	Useful lives of assets acquired before January 1, 1995
Building and structures	50	2~60
Machinery and equipment	10	2~10
Vehicles	5	2~15
Tools, furniture and fixtures	5	2~54

The Company has provided for depreciation on assets acquired after January 1, 1995 without retaining a 10% residual value in its accounts. Assets acquired prior to January 1, 1995 have been and will continue to be depreciated up to 90% of their acquisition costs, recognizing a 10% residual value to be disposed at equal amounts for three years after accumulated depreciation reaches 90% of their acquisition costs.

Maintenance and repairs are expensed in the year in which they are incurred. Expenditures that enhance the value or extend the life of an asset are capitalized as additions to property, plant and equipment. Interest expenses and financing charges on borrowings related to the construction or acquisition of property, plant and equipment are capitalized as part of the cost of the assets during construction period.

Leased assets | Property, plant and equipment acquired under capital leases and the related lease obligations are recorded at the discounted present value of non-cancelable lease payments. Assets acquired under capital leases are depreciated using the same method as that provided for other assets acquired through purchase or construction. Rental expenses incurred for assets leased under operating leases are charged to current operations.

Intangible assets | Intangible assets are amortized using the straight-line method over 5 years.

Discount (or premium) on bonds | The difference between proceeds received from bonds (less bond issue and other related costs) and the face value of bond is presented as a deduction (or addition) from (to) the face value of the bonds and is amortized using the effective interest rate method over the life of the bonds.

Consideration for stock warrants of bonds | Interest expense on bonds with stock warrants is recognized using the effective interest rate which equalizes the issued amount of bonds to the present value of the future cash outflow of bonds with stock warrants. Accordingly, the differences between accrued interest and interest paid are presented as an addition to the nominal value of the bonds as a long-term accrued interest account.

Severance and retirement benefits | In accordance with the Korean Labor Standards Law and the Company's regulations, employees and directors with more than one year of service are entitled to severance and retirement benefits upon termination of their employment based on years of service, rates of pay in effect at the time of termination and certain other factors. The annual provision is sufficient to state the estimated obligation arising from services performed to and at rates of pay in effect at the end of year. Funding of this liability is not required by Korean law.

Notes to Financial Statements

(continued)

December 31, 2003 and 2004

The lesser of 10% of annual payroll expense or 40% of the accumulated severance and retirement benefits provision is deductible for corporate income tax reporting purposes, unless benefits are actually paid or the non tax-deducted portion is deposited with financial institutions. Accordingly, the Company had deposited the required portion of its severance and retirement benefits obligation with life insurance companies.

Since the Company's employees are individually nominated as the vested beneficiaries of these deposits, such deposits have been offset against the Company's liability for severance and retirement benefits at December 31, 2003 and 2004 (Note 12).

In accordance with the Korean National Pension Law prior to revision, the Company had prepaid a portion of its severance and retirement benefits obligation to the Korean National Pension Corporation ("KNPC") at a certain rate of payroll expense, up through March 31, 1999. Such accumulated prepayments have been offset against the Company's liability for severance and retirement benefits as of balance sheet dates. In accordance with the revised Korean National Pension Law, addition to such prepayments were no longer required effective April 1, 1999.

Revenue recognition | The Company recognizes revenue from sale of finished products and merchandise at the time of delivery.

Income taxes | Korean GAAP requires the recognition of deferred tax assets and liabilities arising from temporary differences between the financial reporting and tax reporting bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates which are expected to be applied to taxable income in the period such temporary differences are expected to be recovered or settled.

Earnings per share | Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share measures the performance of the Company over the reporting period while giving effect to all potential common shares, such as options, warrants and convertible debt, that were dilutive and outstanding during the period.

Use of estimates | The preparation of financial statements in conformity with Korean GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Korean GAAP revisions for 2005 | The Korean Accounting Standards Board has issued new accounting standards with the intention to revise Korean GAAP and disclosure rules to meet international practices. The revised accounting standards include changes in the areas of equity method of accounting for investments, corporation income taxes, contingent liabilities and contingent assets, and provisions. Korean companies should apply such revised accounting standards for the first fiscal year starting after December 31, 2004. Early adoption of the revised accounting standards is allowed with the exception of the accounting for discontinued operations. The cumulative effect on prior years of the changes in accounting standards will be primarily charged or credited to opening retained earnings with disclosures made on the effect of the changes.

Reclassifications | Certain amounts in the 2003 financial statements have been reclassified to confirm with the 2004 presentation. Such reclassifications had no effect on the Company's net income and retained earnings as previously reported.

3. Cash and cash equivalents, and financial instruments

Cash and cash equivalents, and financial instruments as of December 31, 2003 and 2004 consisted of the following (Korean won in thousands):

	2003		
	Cash and cash equivalents	Short-term financial instruments	Long-term financial instruments
Cash on hand	₩ 9,799,837	₩ -	₩ -
Checking accounts	302,563	-	-
Time deposits - Korean won denominated	-	378,530	-
Restricted deposits	-	-	20,500
	₩ 10,102,400	₩ 378,530	₩ 20,500

	2004		
	Cash and cash equivalents	Short-term financial instruments	Long-term financial instruments
Cash on hand	₩ 809,979	₩ -	₩ -
Checking accounts	414,709	-	-
Time deposits - Korean won denominated	-	378,530	-
Restricted deposits	-	-	20,500
	₩ 1,224,688	₩ 378,530	₩ 20,500
U. S. dollars (Note 2)	US\$ 1,173,298	US\$ 362,646	US\$ 19,640

The restricted deposits of ₩20,500 thousand as of December 31, 2003 and ₩20,500 thousand as of December 31, 2004 represent amounts with banks as guarantee deposits for the maintenance of checking accounts.

4. Accounts and notes receivable - trade

Accounts and notes receivable - trade at December 31, 2003 and 2004 consisted of the following:

	Korean won in thousands		U. S. dollars (Note2)
	2003	2004	2004
Accounts receivable	₩ 50,213,670	₩ 57,853,234	US\$ 55,425,593
Notes receivable	29,882,409	29,897,375	28,642,819
	80,096,079	87,720,609	84,068,413
Allowance for doubtful accounts	(2,028,640)	(2,392,081)	(2,291,705)
	₩ 78,067,439	₩ 85,358,528	US\$ 81,776,708

Notes to Financial Statements

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December 31, 2003 and 2004

5. Inventories

Inventories as of December 31, 2003 and 2004 consisted of the following:

	Korean won in thousands		U. S. dollars (Note2)
	2003	2004	2004
Merchandise	₩ 5,105,202	₩ 11,612,087	US\$ 11,124,820
Finished goods	8,969,683	9,301,328	8,911,025
Work in-process	1,317,749	1,067,673	1,022,872
Raw materials	6,007,693	6,343,178	6,077,005
Supplies and parts	1,126,528	855,380	819,487
Raw materials in-transit	2,458,912	6,499,919	6,227,169
	₩ 24,985,767	₩ 35,679,566	US\$ 34,182,378

6. Investments in securities

Investments in securities at December 31, 2003 and 2004 consisted of the following (Korean won in thousands) :

Description	Investee	Cost at December 31, 2004	Market or net asset value at Dec. 31, 2004	Carrying value	
				Dec. 31, 2004	Dec. 31, 2003
Held-to-maturity	Public bonds	₩ 845,980	₩ 845,980	₩ 845,980	₩ 777,165
	Fantasy CBO	200,000	73,960	73,960	73,960
		1,045,980	919,940	919,940	851,125
Current portion		(364,285)	(238,245)	(238,245)	(9,615)
Total		₩ 681,695	₩ 681,695	₩ 681,695	₩ 841,510

						Equity
Available-for-sale	Orion Reports Corp.	2,150,000	2,006,551	2,150,000	2,150,000	86.00%
	Orion Beverage Corp.	100,000	168,578	100,000	100,000	100.00%
	Korea Investment Corp.	58,800	13,524	18,522	18,522	0.08%
	Haitai Store Co., Ltd.	166,480	83	5,369	5,369	0.12%
	Orion Food (Rus) Co., Ltd.	3,716,085	3,561,812	1,912,416	1,912,416	100.00%
	Others	52,170	65,730	76,873	76,873	-
Total		₩ 6,243,535	₩ 5,816,278	₩ 6,045,422	₩ 4,263,180	

The 2003 impairment loss on the Fantasy CBO amounted to ₩55,350 thousand. Orion Reports Corp. and Orion Beverage Corp. are small-sized companies with total assets less than ₩7,000,000 thousand as of December 31, 2003 and 2004, and therefore, the equity method of accounting was not applied.

The public bonds and investment bonds as of December 31, 2004 will mature as follows (Korean won in thousands):

Year	Public bonds	Investment bonds
2005	₩ 164,285	₩ 73,960
2006 to 2010	628,170	-
2011 and after	53,525	-
	₩ 845,980	₩ 73,960

Investments in securities accounted for by the equity method at December 31, 2003 and 2004 consisted of the following (Korean won in thousands):

2003	Korean won in thousands			
	Acquisition Cost	Proportionate share in net asset value or market value	Carrying value in balance sheet	Equity ratio (%)
Orion Snack International Corp. (Formerly, Orion Frito-Lay Corp.)	₩ 2,703,346	₩ 33,492,477	₩ 30,866,822	50.00
Buy The Way Inc.	25,393,012	26,038,078	25,969,079	54.59
Orion Food Co., Ltd.	11,370,316	16,015,443	15,988,698	80.26
Orion Food (Shanghai) Co., Ltd.	22,890,134	18,945,497	18,815,168	100.00
On Media Corp.	110,380,527	103,899,663	72,095,795	60.38
Zemiro Inc. (*)	999,000	-	-	-
Mediaplex Corp.	17,999,000	29,643,613	29,582,359	84.16
riseON Inc.	32,754,002	28,776,040	25,591,120	88.83
Tiger Pools International Co., Ltd.	10,000,000	-	-	24.67
Sports Toto Co., Ltd.	30,000,000	-	41,322,327	48.16
	₩ 264,489,337	₩ 256,810,811	₩ 260,231,368	

(*) Zemiro Inc. was merged with riseON Inc. in 2003.

2004	Korean won in thousands			
	Acquisition Cost	Proportionate share in net asset value or market value	Carrying value in balance sheet	Equity ratio (%)
Orion Snack International Corp. (Formerly, Orion Frito-Lay Corp.)	₩ 48,409,990	₩ 57,072,886	₩ 79,221,498	100.00
Buy The Way Inc.	25,524,016	28,282,500	28,094,762	54.59
Orion Food Co., Ltd.	13,088,067	17,056,531	16,984,649	82.16
Orion Food (Shanghai) Co., Ltd.	22,890,134	16,526,162	16,440,425	100.00
On Media Corp.	110,380,527	111,634,850	81,645,909	45.39
Mediaplex Corp.	17,999,000	33,256,183	33,221,347	84.16
riseON Inc.	33,753,002	27,414,649	24,864,457	88.83
Tiger Pools International Co., Ltd.	10,003,717	-	-	32.01
Sports Toto Co., Ltd.	38,809,580	-	54,703,359	40.98
	₩ 320,858,033	₩ 291,243,761	₩ 335,176,406	

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December 31, 2003 and 2004

Changes in investments in securities accounted for by the equity method at December 31, 2003 and 2004 are summarized as follows:

2003	Korean won in thousands					
	Carrying value at Dec. 31, 2002	Additional acquisition costs	Equity income (loss) on investments	Gain (loss) on valuation of investments	Retained Earnings	Carrying value at Dec.31, 2003
Orion Frito-Lay Corp. (Formerly, Orion Frito-Lay Corp.)	₩ 26,672,537	₩ -	₩ 4,194,285	₩ -	₩ -	₩ 30,866,822
Buy The Way Inc.	24,821,130	-	1,147,949	-	-	25,969,079
Orion Food Co., Ltd.	15,174,202	-	841,665	(27,169)	-	15,988,698
Orion Food (Shanghai) Co., Ltd.	20,416,135	-	(1,235,310)	(365,657)	-	18,815,168
On Media Corp.	69,436,936	-	4,617,978	(1,230,995)	(728,124)	72,095,795
Zemiro Inc.	2,659	-	(2,659)	-	-	-
Mediaplex Corp.	28,973,921	-	(264,932)	902,230	(28,860)	29,582,359
riseON Inc.	30,445,381	-	301,303	(5,150,667)	(4,897)	25,591,120
Tiger Pools International Co., Ltd.	-	10,000,000	(10,000,000)	-	-	-
Sports Toto Co., Ltd.	-	30,000,000	(27,885,976)	39,208,303	-	41,322,327
	₩215,942,901	₩40,000,000	₩(28,285,697)	₩33,336,045	₩(761,881)	₩260,231,368

2004	Korean won in thousands					
	Carrying value at Dec. 31, 2003	Additional acquisition costs	Equity income (loss) on investments	Gain (loss) on valuation of investments	Disposition costs	Carrying value at Dec.31, 2004
Orion Frito-Lay Corp. (Formerly, Orion Frito-Lay Corp.)	₩ 30,866,822	₩45,706,644	₩ 2,648,032	₩ -	₩ -	₩ 79,221,498
Buy The Way Inc.	25,969,079	131,004	1,995,357	(678)	-	28,094,762
Orion Food Co., Ltd.	15,988,698	1,717,751	1,488,974	(2,210,774)	-	16,984,649
Orion Food (Shanghai) Co., Ltd.	18,815,168	-	60,492	(2,435,235)	-	16,440,425
On Media Corp.	72,095,795	-	6,612,238	2,937,876	-	81,645,909
Mediaplex Corp.	29,582,359	-	3,730,444	(91,456)	-	33,221,347
riseON Inc.	25,591,120	-	(726,663)	-	-	24,864,457
Tiger Pools International Co., Ltd.	-	3,717	(3,717)	-	-	-
Sports Toto Co., Ltd.	41,322,327	9,600,000	(18,244,923)	23,253,757	(1,227,802)	54,703,359
	₩260,231,368	₩57,159,116	₩(2,439,766)	₩21,453,490	₩(1,227,802)	₩ 335,176,406

7. Property, plant and equipment

Changes in property, plant and equipment during 2004 and depreciation expenses for 2004 and 2003 are as follows (Korean won in thousands):

	Cost			Depreciation		
	Jan.1, 2003	Additions	Disposals	Dec.31, 2004	2004	2003
Land	₩103,834,433	₩ 30,886	₩ (14,400)	₩103,850,919	₩ -	₩ -
Buildings	76,307,402	1,426,600	(556,970)	77,177,033	(2,281,059)	(2,345,352)
Structures	4,676,581	25,000	(37,225)	4,664,356	(177,674)	(203,070)
Machinery and equipment	145,398,097	4,098,320	(1,074,810)	148,421,607	(6,619,460)	(7,803,031)
Vehicles	12,009,588	2,846,810	(866,772)	13,989,626	(2,476,172)	(2,111,906)
Furniture and fixtures	26,085,577	1,398,386	(65,665)	27,418,299	(1,123,124)	(1,089,670)
Construction in-progress	11,847,972	3,700,496	(4,608,098)	10,940,369	-	-
	₩380,159,650	₩13,526,498	₩(7,223,940)	₩386,462,208	₩(12,677,489)	₩(13,553,029)

Property, plant and equipment have been provided as collaterals to the extent of ₩52,954,400 thousand and US\$40,937,000 as of December 31, 2003 and ₩52,954,400 thousand and US\$40,937,000 as of December 31, 2004, for short-term borrowings, long-term debt and bonds, and other current liabilities.

Property, plant and equipment are insured against fire and other casualty losses for up to ₩134,543,228 thousand as of December 31, 2004 (₩134,584,470 thousand as of December 31, 2003).

The value of the Company's land, as determined by the Government of the Republic of Korea for tax administration purposes, was ₩96,826,052 thousand as of December 31, 2004 (₩84,925,839 thousand as of December 31, 2003).

The Company leases certain machinery and equipment under operating lease agreements. A schedule of future minimum lease payments as of December 31, 2004 in connection with these leases is summarized as follows:

Year	Korean won in thousands	U. S. dollars (Note 2)
2005	277,701	266,048
	₩277,701	US\$266,048

8. Assets and liabilities denominated in foreign currencies

Assets and liabilities (other than foreign convertible bonds, as noted in Note 11) denominated in foreign currencies as of December 31, 2003 and 2004 are summarized as follows:

	2003		2004	
	Foreign Currencies	Korean won equivalent (in thousands)	Foreign Currencies	Korean won equivalent (in thousands)
Assets:				
Cash and cash equivalents	US\$ 785,452	₩ 940,815	US\$ 590,607	₩ 616,476
Accounts receivable	US\$ 982,826	1,177,229	US\$ 1,002,548	1,046,460
		₩ 2,118,044		₩ 1,662,936
Liabilities:				
Accounts and notes payable - trade	US\$ 1,993,016	₩ 2,387,235	US\$ 5,631,911	₩ 5,878,588
Short-term borrowings	US\$ 3,088,662	3,699,599	US\$ 3,820,416	3,987,750
	EUR 238,220	357,945	EUR 220,625	313,940
		₩ 6,444,779		₩ 10,180,278

9. Short-term borrowings

The Company borrowed operating funds of ₩14,057,544 thousand and ₩17,753,695 thousand (US\$17,008,713) as of December 31, 2003 and 2004, respectively, with annual interest rates ranging from 2.36% to 5.13% in 2004.

10. Long-term debt

Long-term debt as of December 31, 2003 and 2004 consisted of the following:

Bank	Korean won in thousands		U.S. dollars (Note 2)	Annual interest rate (%)
	2003	2004	2004	as of Dec.31, 2004
Korean won denominated:				
KDB	₩ 16,875,000	₩ 14,375,000	US\$ 13,771,795	6.3~7.50
Kookmin Bank	20,691,799	685,324	656,566	3.0~7.50
Korea First Bank	17,000,000	17,000,000	16,286,645	7.1
Hana Bank	10,000,000	-	-	6.98
CHB	20,000,000	20,000,000	19,160,759	5.99~6.23
	84,566,799	52,060,324	49,875,765	
Less current portion:	(32,506,475)	(29,509,547)	(28,271,266)	
	₩ 52,060,324	₩ 22,550,777	US\$ 21,604,499	

Scheduled repayments of the long-term debt outstanding at December 31, 2004 are summarized as follows:

	Korean won in thousands	U. S. dollars (Note 2)
2005	₩ 29,509,547	US\$ 28,271,266
2006	11,887,713	11,388,880
2007	15,979	15,308
2008	10,019,342	9,598,910
2009 and after	627,743	601,401
	₩ 52,060,324	US\$ 49,875,765

11. Bonds

Bonds (non-guaranteed) as of December 31, 2003 and 2004 consisted of the following:

Series	Korean won in thousands		U.S. dollars (Note 2)	Annual interest rate	Maturity
	2003	2004	2004		
59 th	10,000,000	-	-	6.41%	Aug.17.2004.
60 th	5,000,000	-	-	7.05%	Aug.28.2004.
61 st	10,000,000	-	-	7.25%	Oct.25.2004.
62 nd	10,000,000	10,000,000	9,580,379	7.60%	Mar.15.2005.
63 rd	10,000,000	10,000,000	9,580,379	5.55%	Mar.16.2005.
65 th	10,000,000	10,000,000	9,580,379	5.17%	May.8.2005.
66 th	5,000,000	5,000,000	4,790,190	7.35%	Aug.22.2005.
68 th	20,000,000	20,000,000	19,160,759	6.12%	Mar.26.2006.
69 th	10,000,000	10,000,000	9,580,379	6.21%	Apr.28.2006.
70 th	10,000,000	10,000,000	9,580,379	6.51%	May.2.2006.
71 st	10,000,000	10,000,000	9,580,379	6.14%	May.9.2006.
72 nd	10,000,000	10,000,000	9,580,379	6.20%	Jun.13.2005.
73 rd	10,000,000	10,000,000	9,580,379	6.15%	Sep.30.2006.
74 th	-	20,000,000	19,160,759	6.70%	Jan.15.2007.
75 th -1	-	20,000,000	19,160,759	4.11%	Oct.29.2006
75 th -2	-	50,000,000	47,901,897	4.22%	Oct.29.2007
	130,000,000	195,000,000	186,817,396		
Current portion	(24,989,610)	(45,000,000)	(43,111,707)		
Discount	(10,390)	-	-		
	₩ 105,000,000	₩ 150,000,000	US\$ 143,705,689		

Overseas bonds with detachable warrants, denominated in U.S. dollars and with coupon interest rate of 3%, were issued in May 1999 to Euro market investors originally for the total amount of US\$ 15,000,000. The bond holders can exercise their warrants during the period from June 16, 1999 through April 30, 2004, at ₩23,232 per share of common stock, and starting on May 1, 2004, the holders may also ask the Company to redeem the bonds, with a guaranteed interest rate of 7.7%. The bondholders had exercised their put-option on May 31, 2000, and accordingly, the US\$15,000,000 was redeemed by the Company in full. In 2003, the bondholders had exercised detachable warrants by acquiring 41,014 shares of common stocks amounting to US\$800,000. In 2004, the bond holders exercised detachable warrants by acquiring 446,046 shares of common stocks amounting to US\$ 8,700,000. Exercise period of detachable warrants expired in 2004, no detachable warrants remain outstanding as of December 31, 2004.

Scheduled repayments of the bonds outstanding at December 31, 2004 are summarized as follows:

	Korean won in thousands	U. S. dollars (Note 2)
2005	₩ 45,000,000	US\$ 43,111,707
2006	80,000,000	76,643,035
2007	70,000,000	67,062,654
	₩ 195,000,000	US\$ 186,817,396

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(continued)

December 31, 2003 and 2004

12. Severance and retirement benefits

Changes in severance and retirement benefits for the years ended December 31, 2003 and 2004 are summarized as follows:

	Korean won in thousands		U. S. dollars (Note2)
	2003	2004	2004
Beginning of year	₩ 26,785,083	₩ 26,993,075	US\$ 25,860,390
Provision during the year	7,439,355	7,867,440	7,537,306
Transferred from affiliated companies	-	90,114	86,333
Payments during the year	(7,231,363)	(6,886,841)	(6,597,855)
End of year	₩ 26,993,075	₩ 28,063,788	26,886,174
Deposits for severance and retirement benefits	(16,195,845)	(16,838,273)	(16,131,704)
Accumulated prepayments to the KNPC	(583,074)	(138,495)	(132,684)
Net balance	₩ 10,214,156	₩ 11,087,020	US\$ 10,621,786

13. Commitments and contingencies

In 2000, the KT&G Corporation (formerly, KTC) invested the amount of ₩26,000,000 thousand in Buy The Way INC. an affiliate of the Company. In relation to this investment, the Company made a commitment under a contract with KT&G, to redeem KT&G's investment in Buy The Way Inc. any time after 2004, at KT&G's option. Also the Company was contingently liable for payment guarantees totaling ₩14,400,000 thousand issued for issuing privately placed conversion bonds by Mediaplex Inc. from October 15, 2003 to October 15, 2005.

The company maintains lines of credit in an aggregate amount of ₩47,000,000 thousand (US\$ 45,027,783) with various financial institutions at December 31, 2004 related to bank overdraft facilities. The Company has also entered into L/C opening and usance credit line with banks up to US\$22,800,000 and ₩4,000,000 thousand (US\$ 3,832,152).

14. Stockholders' equity

Capital surplus | Capital surplus at December 31, 2003 and 2004 consisted of the following :

	Korean won in thousands		U. S. dollars (Note2)
	2003	2004	2004
Paid-in capital in excess of par value	₩ 44,815,797	₩ 52,934,426	US\$ 50,713,188
Asset revaluation surplus	71,675,867	71,675,867	68,668,200
Other capital surplus	675,823	675,823	647,463
	₩ 117,167,486	₩ 125,286,115	US\$ 120,028,851

The stockholders of the Company at December 31, 2004 are as follows:

	Shares	Rate (%)
Hwa Kyung Lee	865,204	14.72
Chul Kon Tam	770,626	13.11
Others	4,242,526	72.17
	5,878,356	100.00

Changes in common stock and paid-in capital in excess of par value in 2003 and 2004 are as follows:

	No. of shares	Common stock	Paid-in capital in excess of par value
January 1, 2003	5,391,296	₩ 26,956,480	₩ 44,069,897
Change in 2002			
Exercise of stock warrants	41,014	205,070	745,900
December 31, 2003	5,432,310	27,161,550	44,815,797
Change in 2004			
Enrollment commission			(13,711)
Exercise stock of warrants	446,046	2,230,230	8,132,340
December 31, 2004	5,878,356	₩ 29,391,780	₩ 52,934,426

The paid-in capital in excess of par value and the asset revaluation surplus may not be utilized for cash dividends but may only be used to offset a deficit, if any, or be transferred to capital.

Appropriated retained earnings at December 31, 2003 and 2004 consisted of the following:

	Korean won in thousands		U. S. dollars (Note2)
	2003	2004	2004
Legal reserve	₩ 5,400,000	₩ 5,900,000	US\$ 5,652,424
Reserve for business rationalization	7,700,000	7,700,000	7,376,892
Reserve for financial position improvement	19,100,000	20,100,000	19,256,563
Reserve for business expansion	35,000,000	35,000,000	33,531,328
Reserve for research and manpower development	16,000,000	19,000,000	18,202,720
Voluntary reserve	25,000,000	21,000,000	20,118,797
	₩ 108,200,000	₩ 108,700,000	US\$104,138,724

The Company purchased 144,460 and 565,577 shares of treasury stock for the purpose of stabilizing the Company's stock price in 1996 and 2001 in accordance with the Korean Securities and Exchange Act, and the Company paid 100 shares to employees as special bonus in 2003.

Legal reserve | In accordance with the Korean Commercial Code, an amount equal to at least 10% of cash dividends is required to be appropriated as a legal reserve until the reserve equals 50% of paid-in capital. The legal reserve may not be utilized for cash dividends but may only be used to offset a deficit, if any, or be transferred to capital.

Reserve for financial position improvement | The Korean Financial Control Regulations for listed companies require that an amount equal to at least 10% of net income, and 50% of net gain, if any, on disposal of property, plant and equipment, after deduction of any applicable tax, be appropriated as a reserve for financial position improvement until ratio of stockholders' equity to total assets equals 30%. At December 31, 2004, the Company's ratio of stockholder's equity to total assets was 48.4% (47.0% at December 31, 2003).

Reserve for research and manpower development | Under the TILL, the Company is allowed to deduct amounts provided as a reserve for research and manpower development from taxable income through appropriations of retained earnings. The reserve is added back to taxable income over three years after a two year grace period.

Notes to Financial Statements

(continued)

December 31, 2003 and 2004

Voluntary reserve | The voluntary reserve including business expansion reserve is unrestricted.

Stock-option | In accordance with a resolution of the board of directors at their meeting held on January 31, 2002, January 30, 2003 and January 30, 2004, the Company adopted a stock option plan ("the Plan"), whereby 22,291, 19,318 and 21,407 shares of common stock are reserved for issuance at ₩36,546, ₩57,130, and ₩78,400 per share, respectively to certain officers of the Company. As defined in the Plan, the options are exercisable within seven years, starting from January 31, 2005, January 30, 2006 and January 30, 2007. The total compensation cost recognized in the income statement for stock-based employee compensation awards for the year ended December 31, 2004 amounted to ₩612,036 thousand (₩265,003 thousand in 2003).

The Black Scholes option-pricing model was used to value the stock options. Significant assumptions used to estimate the value of the options are as follows:

	2002	2003	2004
• Volatility	45.25%	47.34%	46.96%
• Risk-free interest rate	7.11%	5.19%	5.50%
• Dividend yield	1.36%	1.10%	0.88%
• Expected rate of cancellation	0.00%	3.11%	2.34%

15. Related party transactions

Transactions with related parties for the years ended December 31, 2003 and 2004 and outstanding balances as of December 31, 2003 and 2004 arising from such transactions are summarized as follows:

2003	Korean won in thousands			
	Sales	Purchases	Accounts receivable and prepayments	Accounts payable
Orion Snack International Corp. (Formerly, Orion Frito-Lay Corp.)	₩ 1,046,005	₩ 106,716,612	₩ 195,778	₩ 25,278,028
Orion Food Co., Ltd.	281,011	14,277,499	59,765	1,855,763
Buy The Way Inc.	2,670,970	299,406	639,525	90,000
Orion Food (Shanghai) Co., Ltd.	74,596	3,727,762	25,024	531,471
	₩ 4,072,582	₩ 125,021,279	₩ 920,092	₩ 27,755,262

2004	Korean won in thousands			
	Sales	Purchases	Accounts receivable and prepayments	Accounts payable
Orion Snack International Corp. (Formerly, Orion Frito-Lay Corp.)	₩ 1,068,483	₩ 111,018,492	₩ 201,342	₩ 26,657,628
Orion Food Co., Ltd.	308,800	17,431,670	36,282	1,266,763
Buy The Way Inc.	3,240,799	450,309	471,614	92,200
Orion Food (Shanghai) Co., Ltd.	108,498	5,072,568	7,760	579,608
	₩ 4,726,580	₩ 133,973,039	₩ 716,998	₩ 28,596,199
	US\$ 4,528,243	US\$ 128,351,254	US\$ 686,911,286	US\$ 27,396,244

16. Income taxes

The Company is subject to corporate income taxes, including resident surtax, at the aggregate rates of 16.5% on taxable income up to ₩100,000,000 and 29.7% on taxable income in excess of ₩100,000,000. Effective from 2005, the aggregate tax rates will be reduced to 14.3% on taxable income up to ₩100,000,000 and 27.5% on taxable income in excess of ₩100,000,000.

Reconciliation of income before income taxes for financial reporting purposes and taxable income for corporate income tax reporting purposes are summarized as follows (2004 amounts are preliminary and 2003 amounts are final based on the Company's corporate income tax return filed in March 2004):

	Korean won in thousands		U. S. dollars (Note2)
	2003	2004	2004
Income before income taxes per the accompanying statements of income	₩ 8,206,806	₩ 29,403,209	US\$ 28,169,390
Permanent differences:			
Taxes and dues	115,696	119,275	114,270
Entertainment expenses	86,499	135,839	130,139
Stock option	265,004	612,036	586,354
Investments in securities	(761,881)	-	-
Other	-	873,443	836,792
	(294,682)	1,740,593	1,667,554
Temporary differences:			
Allowance for doubtful accounts	(202,601)	184,228	176,497
Provision for loss on sales returns	116,330	238,570	228,559
Reserve for technology development	(3,000,000)	(1,666,666)	(1,596,729)
Depreciation	673,648	278,883	267,180
Accrued interest income	27,622	7,242	6,938
Equity income on investments in affiliates	28,285,697	(8,120,549)	(7,779,794)
Investments in securities	761,881	-	-
Impairment of investment in securities	55,350	-	-
Other	48,223	2,226	2,133
	26,766,150	(9,076,066)	(8,695,216)
Taxable income	₩ 34,678,274	₩ 22,067,736	US\$ 21,141,728

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for corporate income tax reporting purposes. Significant changes in cumulative temporary differences for the years ended December 31, 2003 and 2004 are as follows:

2003	Korean won in thousands		
	Opening balance	Net increase (decrease)	Ending balance
Temporary differences			
Allowance for doubtful accounts	₩ 1,876,611	₩ (202,601)	₩ 1,674,010
Accrued interest income	(35,610)	27,622	(7,988)
Reserve for technology development	(6,000,000)	(3,000,000)	(9,000,000)
Equity income on investment in affiliates	20,243,851	29,042,271	49,286,122

(continued)

Notes to Financial Statements

(continued)

December 31, 2003 and 2004

2003	Korean won in thousands		
	Opening balance	Net increase (decrease)	Ending balance
Temporary differences			
Depreciation	5,840,995	673,648	6,514,643
Provision for loss on sales returns	3,246,833	116,330	3,363,163
Other, net	1,192,758	103,573	1,296,331
	₩ 26,365,438	₩26,760,843	₩ 53,126,281
Tax rate	29.7%		28.1%
Deferred income tax-asset	₩ 7,830,535		₩ 14,947,338

2004	Korean won in thousands		
	Opening balance	Net increase (decrease)	Ending balance
Temporary differences			
Allowance for doubtful accounts	₩ 1,674,010	₩ 184,228	₩ 1,858,238
Accrued interest income	(7,988)	7,242	(746)
Reserve for technology development	(9,000,000)	(1,666,667)	(10,666,667)
Equity income on investment in affiliates	49,286,122	(8,022,582)	41,263,540
Depreciation	6,514,643	278,883	6,793,526
Provision for loss on sales returns	3,363,163	238,570	3,601,733
Other, net	1,296,331	2,226	1,298,557
	₩ 53,126,281	₩ 8,978,100	₩ 44,148,181
Tax rate	28.1%		27.5%
Deferred income tax-asset	₩ 14,947,338		₩ 12,140,750

The effective income tax rates for the years ended December 31, 2003 and 2004 are as follows:

	Korean won in thousands	
	2003	2004
Provision for income taxes	₩ 1,948,349	₩ 9,036,834
Income before income taxes	8,206,806	29,403,209
Effective income tax rates	23.74%	30.73%

17. Per share amounts

17-1. Per share amounts for the year ended December 31, 2003

The Company's basic and diluted EPS for the year ended December 31, 2003 were computed as follows (Korean won in thousands, except for per share amounts):

	Denominator			Numerator		Per share amounts	
	Share(A)	Number of days(B)	(A)x(B)/365	Net income	Ordinary income	Net income	Ordinary income
Net income/ordinary income				₩6,258,457	₩6,258,457		
Basic EPS							
Beginning balance	5,391,296	365	5,391,296				

(continued)

	Denominator			Numerator		Per share amounts	
	Share(A)	Number of days(B)	(A)x(B)/365	Net income	Ordinary income	Net income	Ordinary income
Exercise of stock warrants	15,380	198	8,343				
"	25,634	190	13,344				
Treasury stock	(710,037)	365	(710,037)				
"	100	120	33				
			4,702,979			₩1,331	₩1,331
Effective of dilutive securities							
Outstanding stock warrants	356,085	365	356,085				
Exercise of stock warrants	10,173	167	4,654				
"	16,956	175	8,130				
			368,869				
Diluted EPS			5,071,848			₩1,234	₩1,234

17-2. Per share amounts for the year ended December 31, 2004

The Company's basic earnings per share ("EPS") for the year ended December 31, 2004 was computed as follows (Korean won in thousands, except for per share amounts):

	Denominator			Numerator		Per share amounts	
	Share(A)	Number of days(B)	(A)x(B)/366	Net income	Ordinary income	Net income	Ordinary income
Net income/ordinary income				₩20,366,376	₩20,366,376		
Basic EPS							
Beginning balance	5,432,310	366	5,432,310				
Exercise of stock warrants	446,046	260	316,863				
Treasury stock	(709,937)	366	(709,937)				
			5,039,236			₩4,042	₩4,042
Effective of dilutive securities							
Exercise of stock warrants	313,242	106	90,720				
			90,720				
Diluted EPS			5,129,956			₩3,970	₩3,970

18. Dividends

Cash dividends for the years ended December 31, 2003 and 2004 are as follows:

2003	Outstanding shares	Dividend per share	Korea won in thousands	
Approved cash dividends	4,722,373	₩ 1,000	₩ 4,722,373	

2004	Outstanding shares	Dividend per share	Korea won in thousands	U. S. dollars (Note2)
Accrued cash dividends	5,168,419	₩ 1,500	₩7,752,629	US\$7,427,313

19. Segment information

The following table presents sales and other financial information by business segment for the years ended December 31, 2002 and 2003:

2002	Korean won in thousands		
	Products	Merchandise	Total
Net sales	₩ 336,839,297	₩ 192,081,414	₩ 528,920,711
Cost of sales	174,736,550	132,963,751	307,700,301
Gross profit	₩ 162,102,747	₩ 59,117,663	₩ 221,220,410

2003	Korean won in thousands		
	Products	Merchandise	Total
Net sales	₩ 294,401,253	₩ 217,035,419	₩ 511,436,672
Cost of sales	154,598,513	151,039,424	305,637,937
Gross profit	₩ 139,802,740	₩ 65,995,995	₩ 205,798,735

The Company's business was broken down into two segments: manufacturing and selling confectioneries and the family restaurant business. The family restaurant business was spun-off on September 30, 2002.

20. Added value information

The accounts and amounts which are required to be disclosed in connection with the calculation of the added value of the Company's operations for the years ended December 31, 2003 and 2004 are as follows:

	Korean won in thousands		U. S. dollars (Note2)
	2003	2004	2004
Labor costs	₩ 74,476,449	₩ 76,118,326	US\$ 72,924,244
Severance and retirement benefits	7,439,356	7,867,440	7,537,306
Employee benefits	14,775,235	15,566,661	14,913,452
Rental expense	1,087,158	1,380,001	1,322,093
Taxes and dues	1,891,738	2,337,769	2,239,671
Depreciation	13,540,919	12,665,379	12,133,914
	₩ 113,210,855	₩ 115,935,576	US\$ 111,070,680

21. Spin-off

The family restaurant business division was spun off into a new company, which was incorporated as riseON Inc., a wholly owned subsidiary, as approved by stockholders' resolution at their meeting held on August 26, 2002.

22. Subsequent events

In accordance with a resolution of the board of directors at their meeting held on January 28, 2005, the Company adopted a stock option plan ("the Plan"), whereby 15,669 shares of common stock are reserved for issuance at ₩113,100 per share to certain officers of the Company. As defined in the Plan, the options are exercisable within seven years, starting from January 29, 2008.

23. Approval of 2004 financial statements

The Company's 2004 financial statements will be approved by the Company's board of directors and general meeting of shareholders to be held on March 25, 2005.

Independent Auditors Report



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The Stockholders and Board of Directors
Orion Corporation

We have audited the accompanying balance sheets of Orion Corporation as of December 31, 2003 and 2004, and the related statements of income, appropriations of retained earnings and cash flows for the years then ended, all expressed in Korean won. 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 the Republic of Korea. 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 expressed in Korean won, present fairly, in all material respects, the financial position of Orion Corporation as of December 31, 2003 and 2004, and the results of its operations, appropriations of retained earnings and cash flows for the years then ended in conformity with accounting principles generally accepted in the Republic of Korea.


As described in Note 15, the Company has had transactions with subsidiaries and affiliated companies.

As described in Note 22, the board of directors resolved on January 28, 2005 that the Company adopt a stock option plan ("the Plan"), in which 15,669 shares of common stock are reserved for issuance at W113,100 per share to certain designated officers of the Company. As defined in the Plan, the options are exercisable within seven years, starting from January 29, 2008.

We have also reviewed the translation of the 2004 Korean won financial statements mentioned above into United States dollar amounts on the basis described in Note 2. In our opinion, such statements have been properly translated on such basis.

Accounting principles and auditing standards and their application in practice vary among countries. The accompanying financial statements are not intended to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries other than the Republic of Korea. In addition, the procedures and practices utilized in the Republic of Korea to audit such financial statements may differ from those generally accepted and applied in other countries. Accordingly, this report and the accompanying financial statements are for use by those who are knowledgeable about Korean accounting principles and auditing standards and their application in practice.

February 18, 2005

吳 贊 錫 

This audit report is effective as of February 18, 2005, the auditors' report date. Accordingly, certain material subsequent events or circumstances may have occurred during the period from the auditors' report date to the time this audit report is used. Such events and circumstances could significantly affect the accompanying financial statements and may result in modifications to this report.