



# **Annual Report 2006**

**TOKIMEC INC.**

## Description of Business

The TOKIMEC Group is engaged in the manufacture and sale of marine instruments, hydraulic equipment, aerospace and defense equipment, instruments and systems for industrial use.

## Financial Highlights

Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Net sales .....	¥43,438	¥43,804	\$371,265
Operating income .....	2,523	2,207	21,564
Income before income taxes and minority interests .....	2,253	1,739	19,256
Net income .....	1,991	1,474	17,017
Total assets .....	48,797	45,923	417,068
Shareholders' equity .....	15,775	13,223	134,829

  

	Yen		U.S. dollars
	2006	2005	2006
Per share of common stock:			
Net income (Note 2) .....	¥23.35	¥17.29	\$0.20
Cash dividends .....	2.00	2.00	0.02

Notes: 1. Yen amounts are translated, for convenience only, at the rate of ¥117=U.S. \$1.

2. The computations of net income per share of common stock are based on the weighted average number of shares outstanding during each year.

3. Figures for the year 2005 are rounded down to the nearest million yen.

## Sales by Operating Segment

Year ended March 31, 2006

	Millions of yen	% to total	% change (2006/2005)
Marine Systems .....	¥8,578	19.7%	12.5%
Hydraulic and Pneumatic .....	13,189	30.4	0.8
Fluid Measurement .....	1,950	4.5	(7.9)
Defense and Communications .....	15,337	35.3	(7.3)
Others .....	4,384	10.1	(1.1)
Total .....	¥43,438	100.0%	(0.8)%

# To Our Shareholders



## Review of Business Operations

Although the Japanese economy during the consolidated fiscal year was impacted by negative factors such as inventory adjustments in the IT sector and a rise in raw material prices exacerbated by soaring prices for steel and crude oil, business activity gradually recovered in the second half of the fiscal year bolstered by increases in capital investments, improvements in corporate earnings, and an upturn in employment conditions.

Under these circumstances, the TOKIMEC Group established business goals of a higher earnings structure and a further strengthening of its financial position. Specific measures implemented included a reduction of variable costs through cost-cutting efforts a reduction of fixed costs through improvements in operational efficiencies, an improvement of cash flow by reducing inventory, faster collection of receivables, early transition and assumption of the marine transport equipment business from Oki Electric Company, and the expansion of business areas by developing new markets.

As a result of these activities, overall TOKIMEC Group orders for the year were ¥43,717 million, a decline of ¥1,294 million (-2.9%) from the previous consolidated fiscal year. The hydraulic & pneumatic equipment segment and other business segments such as printing inspection equipment & systems, fire extinguishing equipment systems, railway track maintenance inspection equipment, and information systems recorded gains in orders over the last year which were offset by decreases in orders in our defense & communications equipment, marine systems, and fluid measurement equipment segments. Net sales for the Group overall were ¥43,438 million which was a decline of ¥366 million (-0.8%) from the previous year. Sales of marine systems equipment and hydraulic & pneumatic equipment increased compared to the previous year but sales of defense & communications equipment, fluid measurement equipment,

printing inspection equipment & systems, road & tunneling equipment and railway track maintenance inspection equipment decreased during that period.

Regarding profit and loss, despite a decline in sales compared to the previous year, there was major improvement in our cost ratio which can be attributed to improvement efforts and reforms encompassing all areas of manufacturing, sales, engineering, and service. This resulted in operating income of ¥2,523 million, a gain of ¥316 million (14.3%) compared to the previous year and net income of ¥1,991 million, an increase of ¥517 million (35.0%).

Business operations by segments were as follows.

### *Marine Systems Business*

In the commercial vessel market, although the number of ships being built by domestic shipyards remained at a high level, construction of series vessels declined and there was also a drop in large projects involving tank radars. These factors contributed to a significant downturn in orders compared to the previous year. Firm conditions in shipbuilding however, enabled us to post increased sales volumes for gyros and autopilots, exceeding our sales in this market last year. In the coastal vessel market, good conditions for freight relating to steel and automobiles spurred vessel construction and we recorded increases in both orders and sales in this market over the previous year.

In the government vessel market, postponements in construction of large-size patrol vessels for the Japan Coast Guard, training ships, and fisheries survey vessels resulted in a large decline in orders compared to the previous year although there was a slight gain in sales. In the overseas market, shipbuilding by Korean and Chinese shipyards continued at a high level and with increased OEM gyrocompass sales to the US and Europe, orders and sales centering on gyros and autopilots exceeded the previous year. In respect to marine equipment repair and maintenance parts, although there was a decrease in volume of parts for mid-sized gyros, demand increased for sensitive elements for large-size gyros for the commercial market which resulted in increases in both orders and sales over last year.

We completed development of the BR-3440 radar with LCD display (type approved) and automatic identification system (AIS) with target information display function and PR-2000 autopilot with GPS compass compatibility and introduced these products into the market. Development was also completed on a new energy saving adaptive pilot with enhanced yaw checking and course keeping capability which received EU type approval. Our successor MF/HF radio equipment received Ministry of Internal Affairs and Communications type approval in March, 2006 and market launch of this product is planned in the first half of 2006.

Overall sales in this segment were ¥8,578 million which was an increase of ¥956 million (12.5%) over the

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previous year and operating income was ¥390 million, an increase of ¥258 million (195.8%).

### ***Hydraulic and Pneumatic Business***

In the plastics processing machinery market, orders and sales declined from the previous year reflecting soft demand from OEMs and the ongoing trend from hydraulics to electrics. In machine tools, increased production demand for OEM machinery fueled by domestic demand for automobiles, general machinery, and electrical and precision machinery in addition to foreign demand from Asia, North America and Europe enabled us to post gains in orders and sales over the previous year. In the construction machinery market, bolstered by demand for replacements for aerial work platforms and cranes, demand – both domestic and foreign – remained firm resulting in orders and sales which greatly exceeded last year. In the overseas market, China's pervasive policies of investment restraints dampened business conditions causing a decline in sales although orders remained at a level similar to the prior year. In our hydraulic systems market, brisk activity relating to automobiles resulted in increased demand for general industrial machinery and machine tools which led to an increase in orders over last year although sales declined due to a large drop in systems for semiconductor-related equipment.

In respect to product activity, our energy saving direct drive pump control systems which were released in the last fiscal year and market-tailored piston pump series have been increasingly adopted by customers. Our ongoing efforts have been focused on promoting product lineups to related markets.

Overall sales in this segment were ¥13,189 million, an increase of ¥99 million (0.8%) compared to the previous year with operating income of ¥1,701 million which represented an increase of ¥69 million (4.2%) over last year.

### ***Fluid Measurement Equipment Business***

In the public sector market, business relating to small-scale water supply projects remained comparatively steady but with postponements of large-scale programs, deferral of major agricultural water projects and a shift in order placements toward simpler and cheaper water management systems, the business environment has become increasingly difficult. Our efforts during the year were aimed at winning new customers and increasing market share by expanding into new markets and our activities included market introduction of an ultrasonic sewage flowmeter for wastewater applications. Despite these efforts however, orders and sales declined compared to the previous year.

In the private sector market, despite an upswing in demand related to replacement of existing plant facilities, business conditions worsened as price competition escalated resulting in a drop in sales relative to the previous year although orders increased over the same period.

In the overseas market, efforts to expand business relating to ultrasonic flowmeters for water supply distribution and wastewater systems paid off in gains in both orders and sales over last year.

Overall sales in this segment were ¥1,950 million, a decline of ¥168 million (-7.9%) from the previous year with an operating income of ¥49 million, a decrease of ¥168 million (-77.4%).

### ***Defense and Communications Equipment Business***

In the defense-related market, difficult conditions prevailed with cutbacks in major equipment programs and expenses reflecting the emphasis on effective, flexible, multi-functional defense capabilities as a cornerstone of the new midterm defense buildup program - factors which contributed to a 1.0% decrease in total defense-related expenditures for fiscal 2005. Under these conditions and impacted by phase completions relating to development of radar warning receiver equipment for the C-X next generation large cargo aircraft and FPS-4 ground search radar system programs, ending of the MLRS multiple launch rocket system program, and discontinuation of equipment development for naval vessels, orders declined sharply from the previous year.

There were increases in sales for HLR-108C countermeasures sets for the new patrol helicopter and for repairs related to the FPS-20 ground search radar system and avionic intermediate shop (AIS) for F-15 electronic equipment. However development completion of the advanced APR-X radar warning receiver system for the F-15 and decreases in test equipment for the E-2C early warning aircraft resulted in a decline in sales in this market compared to last year.

In the maritime transport equipment market and in the first year of our assumption of this business, priority was placed on maintaining the previous level of quality of service to customers and our efforts generated results which were consistent with the plan at inception.

In our communications equipment market, the pace of domestic PHS base station replacements was below predictions and there was an ongoing inventory adjustment by set manufacturers in response to curbs on investments by Chinese telecommunications carriers. In addition, subscriber growth for wireless high speed communication microwave modules fell short of expectations contributing to a large decrease in orders and sales compared to the previous year.

Activities in the period included sales releases of advanced amplifier modules for PHS base stations and new products for the automatic identification systems (RFID) market including a new premises entry/exit control system and security control equipment for PCs. In addition, prototypes of 3.8 GHz and 2.0 GHz band amplifiers for WiMAX base stations were completed and we have begun to supply samples to the market.

Overall business results for this segment were sales of ¥15,337 million, a decrease of ¥1,203 million (-7.3%) from the previous year with an operating income of ¥237 million which was an increase of ¥425 million compared to last year.

### ***Other Businesses***

In our printing inspection equipment and systems market, although conditions were favorable with new equipment installations prompted by environmental restrictions in the printing industry and demand for replacements of existing facilities which resulted in an increase in orders over last year, there was a decrease in sales.

Business for fire control equipment for multilevel parking garages remained depressed amid a persistently severe competitive pricing environment precipitated by the prolonged slump in construction. However a partial recovery in fire extinguishing systems for hazardous material and general facilities and an increase in repair projects enabled our fire extinguishing systems equipment segment to post gains in both orders and sales over the previous year.

Business in our road and tunnel equipment segment was impacted by decreased public investments, revised bid tenders, and a fall off in tunnel projects due to postponements and deferrals resulting in declines in both orders and sales compared to last year.

In the aftermath of the tragic JR East (Japan) railway accident and amidst growing demands for improvements in the quality of railway inspection, our railway track maintenance inspection equipment group received an increasing number of requests for collaboration and product development. Business for rail maintenance services and flaw detection equipment was good and orders exceeded the prior year although sales declined due to decreased sales of rail flaw detection cars.

In the information systems segment, orders and sales for development work and contract computing services increased over the previous year.

Overall results of these segments were sales of ¥4,384 million, a decrease of ¥50 million (-1.1%) compared to last year and operating income of ¥146 million which was a decrease of ¥268 million (-64.7%).

### **Status of Cash Flow**

Cash and cash equivalents on a consolidated basis for the fiscal year were ¥8,820 million which was an increase of ¥699 million (8.6%) compared to the previous fiscal year. Cash flow from the various sources and factors involved are as follows.

#### ***Cash Flow from Operating Activities***

Income before income taxes and minority interests was

¥2,253 million, an increase of ¥513 million (29.5%) over the previous year. The increase in payables was ¥818 million, an increase of ¥1,326 million from the previous year. The increase in receivables was ¥816 million an increase of ¥1,126 million from the previous year and the increase in inventories was ¥763 million, an increase of ¥1,802 million from the previous year. As a result, cash flow from operating activities was ¥3,356 million which was decrease of ¥ 432 million (-11.4%) from the previous year.

#### ***Cash Flow from Investing Activities***

Proceeds from sales of property, plant and equipment were ¥546 million, an increase of ¥546 million from the previous year. Purchases of investment securities were ¥254 million, an increase of ¥248 million over last year, purchases of property, plant and equipment were ¥757 million, an increase of ¥224 million (41.9%) compared to the prior year. This resulted in cash used in investing activities of ¥483 million which was an increase of ¥170 million (-54.1%) compared to the previous year.

#### ***Cash Flow from Financing Activities***

Decrease in short-term bank loans-net was ¥4,507 million, a decrease of ¥642 million (-12.5%) from the prior year and proceeds from long-term debt were ¥4,842 million, an increase of ¥1,972 million (68.7%) from last year. Repayments of long-term debt were ¥2,342 million which was a decrease of ¥563 million (-19.4%) from the previous year. As a result, cash used in financing activities was ¥2,183 million for the year, a decrease of ¥ 3,176 million (59.3%) over the previous year.

### **Research and Development Activities**

The basic posture of the Group's R&D effort is the development of original products based on original technology. With its comparatively long range view, TOKIMEC's MRD Center is tasked with fundamental and applications research as well as product developments which involve relatively long timeframes while individual divisions and affiliated subsidiaries carry out shorter term product development. The core technologies of TOKIMEC include microwave, gyroscope, ultrasound, measurement, control, signal and image processing, and actuator technology.

Overall TOKIMEC Group R&D expenditures totaled ¥2,181 million. The principal segments, objectives, and key accomplishments of our research and development efforts and associated R&D expenses are outlined as follows.

#### ***Marine Systems***

The major focus of R&D efforts in this segment involved next generation navigational equipment and marine communications equipment designed to cope with innovations in information technology and activities related to

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revised International Maritime Organization (IMO) international standards. Specifically, research and development was carried out on maritime information display systems, gyrocompasses, autopilots, radars, and marine wireless equipment which resulted in a market release of an LCD type radar and remote electronic chart display system. Type approvals were also obtained for our Track Control System and new adaptive autopilot system.

R&D expenditures related to these activities were ¥385 million.

### ***Hydraulic and Pneumatic Equipment***

Hydraulic and pneumatic equipment and systems and related electronic controls are the focus of R&D efforts in this segment and specific product activities involved various types of pumps and control valves, hydraulic power units, hydraulic control systems, and electronic control equipment. Key concepts driving these efforts are energy savings and reliability improvement and accomplishments included development and market introduction of actuators with integrated hydraulic power source, direct drive pump control systems, low holding power solenoid valves, and various types of controllers for the construction machinery market.

R&D expenditures for these activities were ¥ 316 million.

### ***Fluid Measurement Equipment***

Research and development efforts centered on fluid control measurement equipment and systems for next generation ultrasonic flow meters and microwave level gauges. Major achievements included a new line of ultrasonic flowmeters for sewers which was introduced into the market.

Related R&D expenditures for these activities were ¥160 million.

### ***Defense and Communications Equipment***

Research and development efforts were focused on modernizing defense-related products including electronic warfare equipment, equipment for naval vessels, and defensive systems such as radars as well as on information systems and microwave components which are intended to keep us at the cutting edge of technological innovations. Specific defense-related research and development was carried out on tactical situation display equipment, dead reckoning equipment, and radar indicator systems. Telecommunications-related business research and development focused on modules and amplifiers for wireless communication base stations, switches, RFID-based premise entry/exit control systems, and gyro stabilized camera systems for aircraft. Accomplishments included the sales release of amplifier modules for advanced PHS and WiMAX base stations, new premise entry/exit control systems, and

security equipment for PCs.

R&D expenditures were ¥826 million.

### ***Other Equipment***

Other major business segments of the Group include printing inspection equipment and systems, railway track maintenance equipment, construction machinery equipment, and fire extinguishing systems.

Development efforts related to printing inspection equipment and systems emphasize system upgrades and expanded printing pattern inspection functions. Railway track maintenance equipment is the primary business of our TOKIMEC RAIL TECHNO subsidiary and research and development is devoted to promoting manpower-savings and precision of railway track maintenance measurement equipment and systems. R&D efforts in the road and tunnel-equipment business, the focus of our TOKIMEC CONSTRUCTION SYSTEMS subsidiary, is centered on automation of construction machinery. People-safe and environment-safe extinguishing systems are the focus of research and development of our fire extinguishing systems business segment. Major accomplishments in these segments include the market introduction of new road surface flatness analytical equipment and a new excavation control system for shield tunneling machines.

R&D expenses for these activities were ¥495 million.

## **The Tasks of the Company**

The Group is striving to achieve a stable high earnings structure and further strengthen its financial position. Specific objectives related to these efforts are the attainment of an equity ratio of more than 30% (non-consolidated) and a debt to equity ratio of less than 1.0. The tasks we need to carry out in order to accomplish these goals are as follows.

- 1 Expand business areas and add significant value through the development of new products and markets and establishment of new businesses.
- 2 Promote total lower costs by achieving higher operational efficiencies.

Progress made on issues raised during the previous fiscal year is as follows.

- 1 We achieved a 1.1 point improvement in the cost of sales ratio compared to the previous year by reducing total costs through the joint effort of our production, sales, engineering, and service operations.
- 2 Efforts to improve cash flow resulted in the ¥2 billion repayment of borrowings in fiscal year 2005 which improved our equity capital ratio to 32.3% and debt/equity ratio to 1.15.

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- 3 Since our assumption in April, 2005 of the marine communications business centering on marine navigation monitoring systems and aided by an early and smooth transition of operations, business results have been good and in accordance with the original plan. Efforts are also ongoing in establishing the business for our multi-output, micro-inertial sensor (MESAG) focus strategic product.
- 4 The results of our efforts on new product development are outlined in the section, “Review of Business Operations”.

To our shareholders, customers, employees, distribution partners and other associates, thank you for your continued confidence and support.

A handwritten signature in black ink, appearing to read "H. Katsuki", with a stylized flourish at the end.

Hideaki Katsuki  
President



# Consolidated Balance Sheets

## TOKIMEC INC. and Consolidated Subsidiaries

March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
<b>ASSETS</b>			
<b>Current assets:</b>			
Cash and cash equivalents .....	¥8,820	¥8,120	\$75,385
Receivables—			
Trade notes .....	3,833	3,246	32,761
Trade accounts .....	9,756	9,970	83,385
Associated companies .....	489	89	4,179
Other .....	343	117	2,932
Allowance for doubtful accounts .....	(77)	(95)	(658)
Inventories (Note 4) .....	11,833	11,065	101,137
Deferred tax assets (Note 8) .....	497	834	4,248
Prepaid expenses and other current assets .....	216	299	1,846
<b>Total current assets</b> .....	<u>35,711</u>	<u>33,648</u>	<u>305,222</u>
<b>Property, plant and equipment:</b>			
Land (Note 5) .....	1,927	2,418	16,470
Buildings and structures (Note 5) .....	12,861	12,857	109,923
Machinery and equipment (Note 5) .....	14,568	13,693	124,513
Furniture and fixtures (Note 5) .....	10,354	11,184	88,496
Construction in progress .....	38	181	325
<b>Total</b> .....	<u>39,749</u>	<u>40,334</u>	<u>339,735</u>
Accumulated depreciation .....	(32,087)	(32,031)	(274,248)
<b>Net property, plant and equipment</b> .....	<u>7,662</u>	<u>8,303</u>	<u>65,487</u>
<b>Investments and other assets:</b>			
Investment securities (Note 3) .....	3,712	2,227	31,726
Investments in and advances to associated companies .....	321	210	2,744
Software .....	46	38	393
Goodwill .....	128		1,094
Deposits .....	1,019	1,277	8,709
Deferred tax assets (Note 8) .....	5	32	43
Other assets .....	271	327	2,316
Allowance for doubtful accounts .....	(77)	(142)	(658)
<b>Total investments and other assets</b> .....	<u>5,425</u>	<u>3,971</u>	<u>46,368</u>
<b>Total</b> .....	<u>¥48,797</u>	<u>¥45,923</u>	<u>\$417,068</u>

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current liabilities:</b>			
Short-term bank loans (Note 5) .....	¥9,887	¥14,391	\$84,504
Current portion of long-term debt (Note 5) .....	1,779	2,342	15,205
Payables—			
Trade notes .....	1,241	858	10,607
Trade accounts .....	4,885	4,444	41,752
Associated companies .....		1	
Other .....	377	341	3,222
Income taxes payable (Note 8) .....	148	248	1,265
Accrued bonuses .....	901	762	7,701
Accrued expenses .....	1,204	966	10,291
Other current liabilities .....	336	299	2,872
<b>Total current liabilities</b> .....	<u>20,758</u>	<u>24,655</u>	<u>177,419</u>
<b>Long-term liabilities:</b>			
Long-term debt (Note 5) .....	6,535	3,472	55,855
Liability for retirement benefits (Note 6) .....	4,979	4,048	42,556
Deposits received .....	12	11	103
Deferred tax liabilities (Note 8) .....	608	383	5,197
<b>Total long-term liabilities</b> .....	<u>12,134</u>	<u>7,915</u>	<u>103,709</u>
<b>Minority interests</b> .....	<u>131</u>	<u>127</u>	<u>1,120</u>
<b>Commitments and contingent liabilities</b> (Note 11 and 13)			
<b>Shareholders' equity</b> (Notes 7 and 14):			
Common stock,			
Authorized, 250,000,000 shares			
Issued, 85,382,196 shares in 2006 and 2005 .....	7,218	7,217	61,692
Capital surplus .....	14	13	120
Retained earnings .....	7,163	5,341	61,222
Unrealized gain on available-for-sale securities .....	1,395	662	11,923
Foreign currency translation adjustments .....	1		9
Treasury stock —at cost			
95,825 shares in 2006 and 81,250 shares in 2005 .....	(15)	(10)	(128)
<b>Total shareholders' equity</b> .....	<u>15,775</u>	<u>13,223</u>	<u>134,829</u>
<b>Total</b> .....	<u>¥48,797</u>	<u>¥45,923</u>	<u>\$417,068</u>

See notes to consolidated financial statements.



# Consolidated Statements of Income

## TOKIMEC INC. and Consolidated Subsidiaries

Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
<b>Net sales</b> (Note 9).....	¥43,438	¥43,804	\$371,265
<b>Cost of sales</b> (Note 10) .....	32,445	33,217	277,308
<b>Gross profit</b> .....	10,994	10,586	93,966
<b>Selling, general and administrative expenses</b> (Note 10) .....	8,471	8,378	72,402
<b>Operating income</b> .....	2,523	2,207	21,564
<b>Other income (expenses):</b>			
Interest and dividend income.....	45	34	385
Equity in earnings of associated companies .....	62	26	530
Interest expense.....	(234)	(297)	(2,000)
Gain (loss) on sales and disposals of property, plant and equipment .....	24	(30)	205
Loss on disposals of inventories .....	(236)	(251)	(2,017)
Other-net.....	69	51	589
<b>Other expenses—net</b> .....	(271)	(467)	(2,316)
<b>Income before income taxes and minority interests</b> .....	2,253	1,739	19,256
<b>Income taxes</b> (Note 8):			
Current.....	155	233	1,325
Deferred.....	90	(24)	769
Total.....	245	208	2,094
<b>Minority interests in net income of consolidated subsidiaries</b> .....	16	56	137
<b>Net income</b> .....	¥1,991	¥1,474	\$17,017
<b>Per share of common stock</b> (Note 2):			
	2006	2005	2006
Net income .....	¥23.35	¥17.29	\$0.20
Cash dividends.....	2.00	2.00	0.02

See notes to consolidated financial statements.

# Consolidated Statements of Shareholders' Equity

## TOKIMEC INC. and Consolidated Subsidiaries

Years ended March 31, 2006 and 2005

	Millions of yen						
	Outstanding Number of Shares of Common Stock	Common Stock	Capital Surplus	Retained Earnings	Unrealized Gain on Available-for-sale Securities	Foreign Currency Translation Adjustments	Treasury Stock
<b>Balance at April 1, 2004</b> .....	85,322,483	¥7,217	¥13	¥4,037	¥601	¥2	¥(6)
Net income.....				1,474			
Net increase in unrealized gain on available-for-sale securities .....					61		
Net decrease in foreign currency translation adjustments.....						(3)	
Repurchase of treasury stock .....	21,537						(4)
Cash dividends, ¥2 (\$0.01) per share .....				(170)			
<b>Balance at March 31, 2005</b> .....	85,300,946	7,217	13	5,341	662	(0)	(10)
Net income.....				1,991			
Net increase in unrealized gain on available-for-sale securities .....					732		
Net increase in foreign currency translation adjustments .....						2	
Repurchase of treasury stock.....	14,575						(4)
Cash dividends, ¥2 (\$0.02) per share .....				(171)			
<b>Balance at March 31, 2006</b> .....	<u>85,286,371</u>	<u>¥7,218</u>	<u>¥14</u>	<u>¥7,163</u>	<u>¥1,395</u>	<u>¥1</u>	<u>¥(15)</u>

	Thousands of U.S. dollars(Note 1)					
	Common Stock	Capital Surplus	Retained Earnings	Unrealized Gain on Available-for-sale Securities	Foreign Currency Translation Adjustments	Treasury Stock
Balance at March 31, 2005 .....	\$61,684	\$111	\$45,650	\$5,658	\$(0)	\$(85)
Net income .....			17,017			
Net increase in unrealized gain on available-for-sale securities .....				6,256		
Net increase in foreign currency translation adjustments .....					17	
Repurchase of treasury stock.....						(34)
Cash dividends, ¥2 (\$0.02) per share .....			(1,462)			
Balance at March 31, 2006 .....	\$61,692	\$120	\$61,222	\$11,923	\$9	\$(128)

See notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

## TOKIMEC INC. and Consolidated Subsidiaries

Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
<b>Operating activities:</b>			
Income before income taxes and minority interests .....	¥2,253	¥1,739	\$19,256
Adjustments for:			
Income taxes - paid .....	(214)	(193)	(1,829)
Depreciation .....	875	844	7,479
Increase in accrued bonuses .....	139	22	1,188
Decrease in allowance for doubtful accounts .....	(84)	(196)	(718)
Increase in liability for retirement benefits .....	930	913	7,949
(Loss) Gain on sales and disposals of property, plant and equipment .....	(24)	30	(205)
Changes in assets and liabilities:			
(Increase) decrease in receivables .....	(816)	310	(6,974)
(Increase) decrease in inventories .....	(763)	1,038	(6,521)
Increase (decrease) in payables .....	818	(508)	6,991
Decrease (increase) in other assets .....	62	(143)	530
Increase (decrease) in liabilities .....	231	(36)	1,974
Decrease in interest payable .....	(9)	(30)	(77)
Other-net .....	(42)	(3)	(359)
Total adjustments .....	1,104	2,048	9,436
Net cash provided by operating activities .....	3,356	3,788	28,684
<b>Investing activities:</b>			
Purchases of investment securities .....	(254)	(5)	(2,171)
Purchases of property, plant and equipment .....	(757)	(533)	(6,470)
Proceeds from sales of property, plant and equipment .....	546		4,667
Other-net .....	(19)	225	(162)
Net cash used in investing activities .....	(483)	(313)	(4,128)
<b>Financing activities:</b>			
Decrease in short-term bank loans-net .....	(4,507)	(5,149)	(38,521)
Proceeds from long-term debt .....	4,842	2,870	41,385
Repayments of long-term debt .....	(2,342)	(2,905)	(20,017)
Other-net .....	(176)	(175)	(1,504)
Net cash used in financing activities .....	(2,183)	(5,359)	(18,658)
Foreign currency translation adjustments on cash and cash equivalents .....	9	(2)	77
Net increase (decrease) in cash and cash equivalents .....	699	(1,886)	5,974
Cash and cash equivalents, beginning of year .....	8,121	10,007	69,410
Cash and cash equivalents, end of year .....	¥8,820	¥8,120	\$75,385

See notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

## TOKIMEC INC. and Consolidated Subsidiaries

Years ended March 31, 2006 and 2005

### 1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan. In addition certain reclassifications have been made in the 2005 financial statements to conform to classifications and presentations used in 2006.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which TOKIMEC INC. (the "Company") is incorporated and operates. The translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥117 to \$1, the approximate rate of exchange at March 31, 2006. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate. Figures of year 2005 are rounded down to the nearest million yen.

Amounts of less than one million have been eliminated. As a result, totals may not add up exactly.

### 2. Summary of Significant Accounting Policies

#### **Consolidation**

The consolidated financial statements as of March 31, 2006 include the accounts of the Company and its 9 significant (9 in 2005) subsidiaries (together, the "Group").

Under the control or influence concept, those companies in which the Company, directly or indirectly, is able to exercise control over operations are fully consolidated, and those companies over which the Group has the ability to exercise significant influence are accounted for by the equity method.

Investments in 2 (2 in 2005) associated companies are accounted for by the equity method.

Investments in the remaining associated companies are stated at cost. If the equity method of accounting had been applied to the investments in these companies, the effect on the accompanying consolidated financial statements would not be material.

The excess of the cost of the Group's investments in consolidated subsidiaries and associated companies accounted for by the equity method over its equity in the fair value of the net assets at the respective dates of acquisition, is being amortized over a period of 5 years or charged to income when the effect is immaterial.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Group is eliminated.

#### **Cash Equivalents**

Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value. Cash equivalents include time deposits and certificate of deposits, all of which mature or become due within three months from the date of acquisition.

#### **Allowance for Doubtful Accounts**

The allowance for doubtful accounts is stated in amounts considered to be appropriate based on the Group's past credit loss experience and an evaluation of potential losses in the assets outstanding.

#### **Inventories**

The cost of finished goods and work in process is determined by the job identification cost method. Raw materials and supplies are stated at cost determined by the first-in, first-out method.

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**Marketable and Investment Securities**

Marketable and investment securities are classified as available-for-sale securities.

Marketable available-for-sale securities are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity.

Non-marketable available-for-sale securities are stated at cost determined by the average method. For other than temporary declines in fair value, non-marketable available-for-sale securities are reduced to net realizable value by a charge to income.

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost. Depreciation is computed on the declining-balance method while the straight-line method is applied to buildings acquired after April 1, 1998. The range of useful lives is from 8 to 65 years for buildings and structures, from 4 to 11 years for machinery and equipment, and from 2 to 15 years for furniture and fixtures. Although the range of useful lives of buildings for tax purpose was altered in 1998, the Company and its domestic subsidiaries did not alter the useful lives of buildings acquired before April 1, 1998.

Equipment held for leases is depreciated by the straight-line method over the respective lease periods.

**Long-lived assets**

In August 2002, the Business Accounting Council (BAC) issued a Statement of Opinion, Accounting for Impairment of Fixed Assets, and in October 2003 the Accounting Standards Board of Japan (ASBJ) issued ASBJ Guidance No.6, Guidance for Accounting Standard for Impairment of Fixed Assets. These new pronouncements were effective for fiscal years beginning on or after April 1, 2005 with early adoption permitted for fiscal years ending on or after March 31, 2004. The Group adopted the new accounting standard for impairment of fixed assets as of April 1, 2005.

The Group reviews its long-lived assets for impairment whenever events or changes in circumstance indicate the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.

**Goodwill**

Goodwill on the purchase of specific business is amortized on a straight-line basis over 5 years.

**Software**

Purchased software costs are deferred and amortized over their useful lives.

**Accrued Bonuses**

An accrual is provided for bonuses to be paid to employees.

**Retirement and Pension Plans**

The Company has a non-contributory funded pension plan covering substantially all of its employees.

Effective April 1, 2000, the Group adopted a new accounting standard for employees' retirement benefits and accounted for the liability for retirement benefits based on the projected benefit obligations and plan assets at the balance sheet date.

The transitional obligation of ¥ 7,627 million (\$ 65,188 thousand), determined as of the April 1, 2000, is being amortized over 10 years.

Retirement benefits to directors and corporate auditors are provided at the amount which would be required if all directors and corporate auditors retired at the balance sheet date.

**Research and Development Costs**

Research and development costs are charged to income as incurred.

**Leases**

All leases are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the lessee's financial statements.

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### ***Income Taxes***

The provision for income taxes is computed based on the pretax income included in the consolidated statements of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

The Group files a tax return under the consolidated corporate-tax system from the fiscal year ended March 31, 2003, which allows companies to base tax payments on the combined profits or losses of the parent company and its wholly owned domestic subsidiaries. Under the consolidated-tax system, a surcharge tax of 2% of taxable income was levied in addition to the national corporate income tax rate up to the fiscal years ended March 31, 2004, but such surcharge tax is no longer levied for the fiscal year ended March 31, 2005.

### ***Appropriations of Retained Earnings***

Appropriations of retained earnings are reflected in the financial statements for the following year upon shareholders' approval.

### ***Foreign Currency Transactions***

All short-term and long-term monetary receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rates at the balance sheet date. The foreign exchange gains and losses from translation are recognized in the consolidated statements of income to the extent that they are not hedged by forward exchange contracts.

### ***Foreign Currency Financial Statements***

The balance sheet accounts of the consolidated foreign subsidiaries are translated into Japanese yen at the current exchange rate as of the balance sheet date except for shareholders' equity, which is translated at historical rates.

Differences arising from such translation were shown as "Foreign currency translation adjustments" in a separate component of shareholders' equity.

Revenue and expense accounts of consolidated foreign subsidiaries are translated into yen at the current exchange rate as of the balance sheet date.

### ***Derivatives and Hedging Activities***

The Group uses interest rate swaps as a means of hedging exposure to interest rate risks. The Group does not enter into derivatives for trading or speculative purposes.

Derivative financial instruments are classified and accounted for as follows: (a) all derivatives be recognized as either assets or liabilities and measured at fair value, and gains or losses on derivative transactions are recognized in the income statement and (b) for derivatives used for hedging purposes, if derivatives qualify for hedge accounting because of high correlation and effectiveness between the hedging instruments and the hedged items, gains or losses on derivatives are deferred until maturity of the hedged transactions.

The interest rate swaps which qualify for hedge accounting and meet specific matching criteria are not remeasured at market value but the differential paid or received under the swap agreements are recognized and included in interest expense or income.

### ***Per Share Information***

Basic net income per share is computed by dividing net income available to common shareholders, by the weighted-average number of common shares outstanding for the period, retroactively adjusted for stock splits.

Fully diluted net income per share at March 31, 2006 and 2005 are not disclosed in the accompanying consolidated financial statements because bonds with warrants or convertible bonds have not been issued.

### ***New Accounting Pronouncements***

#### ***Business Combination and Business Separation***

In October 2003, the Business Accounting Council (BAC) issued a Statement of Opinion, Accounting for Business Combinations, and on December 27, 2005 the Accounting Standards Board of Japan (ASBJ) issued Accounting Standard for Business Separations and ASBJ Guidance No.10, Guidance for Accounting Standard for Business Combinations and Business Separations. These new accounting pronouncements are effective for fiscal years beginning on or after April 1, 2006.

The accounting standard for business combinations allows companies to apply the pooling of interests method of accounting only when certain specific criteria are met such that the business combination is essentially regarded as a uniting-of-interests. These specific criteria are as follows:

- (a) the consideration for the business combination consists solely of common shares with voting rights,
- (b) the ratio of voting rights of each predecessor shareholder group after the business combination is nearly equal, and
- (c) there are no other factors that would indicate any control exerted by any shareholder group other than voting rights.

For business combinations that do not meet the uniting-of-interests criteria, the business combination is considered to be an acquisition and the purchase method of accounting is required. This standard also prescribes the accounting for combinations of entities under common control and for joint ventures. Goodwill, including negative goodwill, is to be systematically amortized over 20 years or less, but is also subject to an impairment test.

Under the accounting standard for business separations, in a business separation where the interests of the investor no longer continue and the investment is settled, the difference between the fair value of the consideration received for the transferred business and the book value of net assets transferred to the separated business is recognized as a gain or loss on business separation in the statement of income. In a business separation where the interests of the investor continue and the investment is not settled, no such gain or loss on business separation is recognized.

### **Stock options**

On December 27, 2005, the ASBJ issued Accounting Standard for Stock Options and related guidance. The new standard and guidance are applicable to stock options newly granted on and after May 1, 2006.

This standard requires companies to recognize compensation expense for employee stock options based on the fair value at the date of grant and over the vesting period as consideration for receiving goods or services. The standard also requires companies to account for stock options granted to non-employees based on the fair value of either the stock option or the goods or services received. In the balance sheet, the stock option is presented as a stock acquisition right as a separate component of shareholders' equity until exercised. The standard covers equity-settled, share-based payment transactions, but does not cover cash-settled, share-based payment transactions. In addition, the standard allows unlisted companies to measure options at their intrinsic value if they cannot reliably estimate fair value.

### **Bonuses to directors and corporate auditors**

Prior to the fiscal year ended March 31, 2005, bonuses to directors and corporate auditors were accounted for as a reduction of retained earnings in the fiscal year following approval at the general shareholders' meeting. The ASBJ issued ASBJ Practical Issues Task Force (PITF) No.13, Accounting treatment for bonuses to directors and corporate auditors, which encouraged companies to record bonuses to directors and corporate auditors on the accrual basis with a related charge to income, but still permitted the direct reduction of such bonuses from retained earnings after approval of the appropriation of retained earnings.

The ASBJ replaced the above accounting pronouncement by issuing a new accounting standard for bonuses to directors and corporate auditors on November 29, 2005. Under the new accounting standard, bonuses to directors and corporate auditors must be expensed and are no longer allowed to be directly charged to retained earnings. This accounting standard is effective for fiscal years ending on or after May 1, 2006. The companies must accrue bonuses to directors and corporate auditors at the year end to which such bonuses are attributable.

## **3. Investment Securities**

Investment securities as of March 31, 2006 and 2005, consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Non-current:			
Marketable equity securities.....	¥3,697	¥2,217	\$31,598
Trust fund investments and other .....	15	10	128
Total.....	¥3,712	¥2,227	\$31,726



The carrying amounts and aggregate fair values of marketable and investment securities at March 31, 2006 and 2005 were as follows:

March 31, 2006	Millions of yen			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities .....	¥1,322	¥2,372	¥29	¥3,665
Other .....	13	2		15
March 31, 2005				
Securities classified as:				
Available-for-sale:				
Equity securities .....	¥951	¥1,116		¥2,068
Other .....	12		¥2	10

March 31, 2006	Thousands of U.S. dollars			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities .....	\$11,299	\$20,273	\$248	\$31,325
Other .....	111	17		128

Available-for-sale securities whose fair value is not readily determinable as of March 31, 2006 and 2005 were as follows:

	Carrying amount		
	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Available-for-sale:			
Equity securities .....	¥32	¥148	\$274

#### 4. Inventories

Inventories at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Finished goods .....	¥798	¥826	\$6,821
Work in process .....	7,002	6,090	59,846
Raw materials and supplies .....	4,033	4,148	34,470
Total .....	¥11,833	¥11,065	\$101,137

## 5. Short-term Bank Loans and Long-term Debt

The annual weighted-average interest rate applicable to the short-term bank loans was 1.02% and 1.31% at March 31, 2006 and 2005, respectively.

Long-term debt at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Loans from banks and insurance companies due serially to 2010 with weighted-average interest of 1.30% (2006) and 1.65% (2005) .....	¥8,314	¥5,814	\$71,060
Less current portion .....	(1,779)	(2,342)	(15,205)
Long-term debt, less current portion .....	<u>¥6,535</u>	<u>¥3,472</u>	<u>\$55,855</u>

Annual maturities of long-term debt at March 31, 2006 were as follows:

Year ending March 31	Millions of yen	Thousands of U.S. dollars
2007 .....	¥1,779	\$15,205
2008 .....	1,500	12,821
2009 .....	3,723	31,821
2010 .....	892	7,624
2011 .....	420	3,590
Total .....	<u>¥8,314</u>	<u>\$71,060</u>

The carrying amounts of assets pledged as collateral for the current portion of long-term debt of ¥831 million (\$7,103 thousand) and the above collateralized long-term debt of ¥277 million (\$2,368 thousand) at March 31, 2006, were as follows:

	Millions of yen	Thousands of U.S. dollars
Buildings and structures .....	¥2,128	\$18,188
Other (Land, Machinery and equipment, Furniture and fixtures) .....	1,955	16,709
Total .....	<u>¥4,083</u>	<u>\$34,897</u>

## 6. Retirement and Pension Plans

The Company and its certain consolidated subsidiaries have severance payment plans for employees, directors and corporate auditors.

Under most circumstances, employees terminating their employment are entitled to retirement benefits determined based on the rate of pay at the time of termination, years of service and certain other factors. Such retirement benefits are made in the form of a lump-sum severance payment or annuity payment both from a trustee for the Company and are made in a form of severance payment from certain consolidated subsidiaries. Employees are entitled to larger payments if the termination is involuntary, by retirement at the mandatory retirement age, by death, or by voluntary retirement at certain specific ages prior to the mandatory retirement age. The liability for retirement benefits at March 31, 2006 for directors and corporate auditors is ¥202 million (\$1,726 thousand). The retirement benefits for directors and corporate auditors are paid subject to the approval of the shareholders.

The liability for employees' retirement benefits at March 31, 2006 and 2005 consisted of the followings:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Projected benefit obligation .....	¥11,372	¥11,244	\$97,197
Fair value of plan assets .....	(3,404)	(2,802)	(29,094)
Unrecognized actuarial loss .....	(177)	(787)	(1,513)
Unrecognized transitional obligation .....	(3,015)	(3,768)	(25,769)
Net liability .....	<u>¥4,777</u>	<u>¥3,886</u>	<u>\$40,829</u>

The components of net periodic benefit costs for the year ended March 31, 2006 and 2005 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Service Cost .....	¥535	¥513	\$4,573
Interest Cost .....	253	249	2,162
Recognized actuarial loss .....	162	213	1,385
Amortization of transitional obligation .....	754	753	6,444
Net periodic benefit costs .....	<u>¥1,704</u>	<u>¥1,729</u>	<u>\$14,564</u>

Assumptions used for the year ended March 31, 2006 and 2005 are set forth as follows:

	2006	2005
Discount rate .....	2.3%	2.3%
Expected rate of return on plan assets .....	0.0%	0.0%
Recognition period of actuarial gain / loss .....	10 years	10 years
Amortization period of transitional obligation .....	10 years	10 years

## 7. Shareholders' Equity

Through May 1, 2006, Japanese companies are subject to the Commercial Code of Japan (the "Code").

The Code requires that all shares of common stock be issued with no par value and at least 50% of the issue price of new shares is required to be recorded as common stock and the remaining net proceeds are required to be presented as additional paid-in capital, which is included in capital surplus. The Code permits Japanese companies, upon approval of the Board of Directors, to issue shares to existing shareholders without consideration by way of a stock split. Such issuance of shares generally does not give rise to changes within the shareholders' accounts.

The Code also provides that an amount of 10% or more of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period (such as bonuses to directors) shall be appropriated as a legal reserve (a component of retained earnings) until the total of such reserve and additional paid-in capital equals 25% of common stock. The amount of total legal reserve and additional paid-in capital that exceeds 25% of the common stock may be available for dividends by resolution of the shareholders after transferring such excess in accordance with the Code. In addition, the Code permits the transfer of a portion of additional paid-in capital and legal reserve to the common stock by resolution of the Board of Directors.

The Code allows Japanese companies to purchase treasury stock and dispose of such treasury stock upon resolution of the Board of Directors. The aggregate purchased amount of treasury stock cannot exceed the amount available for future dividends plus the amount of common stock, additional paid-in capital or legal reserve that could be transferred to retained earnings or other capital surplus other than additional paid-in capital upon approval of such transfer at the annual general meeting of shareholders.

In addition to the provision that requires an appropriation for a legal reserve in connection with the cash outlays, the Code also imposes certain limitations on the amount of capital surplus and retained earnings available for dividends. The amount of capital surplus and retained earnings available for dividends under the Code was ¥4,457 million (\$ 38,094 thousand) as of March 31, 2006, based on the amount recorded in the parent company's general books of account.

Dividends are approved by the shareholders at a meeting held subsequent to the end of the fiscal year to which the dividends are applicable. Semi-annual interim dividends may also be paid upon resolution of the Board of Directors, subject to certain limitations imposed by the Code.

On May 1, 2006, a new corporate law (the "Corporate Law") became effective, which reformed and replaced the Code with various revisions that would, for the most part, be applicable to events or transactions which occur on or after May 1, 2006 and for the fiscal years ending on or after May 1, 2006. The significant changes in the Corporate Law that affect financial and accounting matters are summarized below;

### (a) Dividends

Under the Corporate Law, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the shareholders' meeting. For companies that meet certain criteria such as; (1) having the Board of Directors, (2) having independent auditors, (3) having the Board of Corporate Auditors, and (4) the term of service of the directors is prescribed as one year rather than two years of normal term by its articles of incorporation, the Board of Directors may declare dividends (except for dividends in kind) if the company has prescribed so in its articles of incorporation. The Corporate Law permits companies to distribute dividends-in-kind (non-cash assets) to shareholders subject to a certain limitation and additional requirements.

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Semi-annual interim dividends may also be paid once a year upon resolution by the Board of Directors if the articles of incorporation of the company so stipulate. Under the Code, certain limitations were imposed on the amount of capital surplus and retained earnings available for dividends. The Corporate Law also provides certain limitations on the amounts available for dividends or the purchase of treasury stock. The limitation is defined as the amount available for distribution to the shareholders, but the amount of net assets after dividends must be maintained at no less than ¥ 3 million.

(b) Increases / decreases and transfer of common stock, reserve and surplus

The Corporate Law requires that an amount equal to 10% of dividends must be appropriated as a legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus) depending on the equity account charged upon the payment of the such dividends until the total of the aggregate amount of legal reserve and additional paid-in capital equals 25% of the common stock. Under the Code, the aggregate amount of additional paid-in capital and legal reserve that exceeds 25% of the common stock may be made available for dividends by resolution of the shareholders. Under the Corporate Law, the total amount of additional paid-in capital and legal reserve may be reversed without limitation of such threshold. The Corporate Law also provides that common stock, legal reserve, additional paid-in capital, other capital surplus and retained earnings can be transferred among the accounts under certain conditions upon resolution of the shareholders.

(c) Treasury stock and treasury stock acquisition rights

The Corporate Law also provides for companies to purchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The amount of treasury stock purchased can not exceed the amount available for distribution to the shareholders which is determined by specific formula.

Under the Corporate Law, stock acquisition rights, which were previously presented as a liability, are now presented as a separate component of shareholders' equity.

The Corporate Law also provides that companies can purchase both treasury stock acquisition rights and treasury stock. Such treasury stock acquisition rights are presented as a separate component of shareholders' equity or deducted directly from stock acquisition rights.

On December 9, 2005, the ASBJ published a new accounting standard for presentation of shareholders' equity. Under this accounting standard, certain items which were previously presented as liabilities are now presented as components of shareholders' equity. Such items include stock acquisition rights, minority interest, and any deferred gain or loss on derivatives accounted for under hedge accounting. This standard is effective for fiscal years ending on or after May 1, 2006.

## 8. Income Taxes

The Company and its domestic subsidiaries are subject to Japanese national and local income taxes which, in the aggregate, resulted in a normal effective statutory tax rate of approximately 40.5% for the years ended March 31, 2006 and 2005.

The tax effects of significant temporary differences and tax loss carryforwards which resulted in deferred tax assets and liabilities at March 31, 2006 and 2005 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets:			
Allowance for doubtful accounts .....	¥37	¥53	\$316
Accrued bonuses .....	365	309	3,120
Pension and severance costs .....	2,006	1,628	17,145
Tax loss carryforwards .....		3,640	
Offset against deferred tax liabilities .....	(342)		(2,923)
Other .....	484	432	4,137
Less valuation allowance .....	(2,047)	(5,195)	(17,496)
Total .....	503	867	4,299
Deferred tax liabilities:			
Unrealized gain on available-for-sale securities .....	(950)	(453)	(8,120)
Offset against deferred tax assets .....	342	70	2,923
Total .....	(608)	(383)	(5,197)
Net deferred tax (liabilities) assets .....	¥(105)	¥483	\$(897)

A reconciliation between the normal effective statutory tax rate and the actual effective tax rates reflected in the accompanying consolidated statements of income for the year ended March 31, 2006 and 2005 is as follows:

	2006	2005
Normal effective statutory tax rate .....	40.5%	40.5%
Valuation allowance .....	(30.2)	(26.5)
Expenses not deductible for income tax purposes .....	0.8	1.1
Per capita levy of local taxes .....	1.6	2.2
Other-net .....	(1.8)	(2.1)
Actual effective tax rate .....	10.9%	15.2%

## 9. Transactions with Associated Companies

Sale and purchase transactions with associated companies for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Sales .....	¥968	¥970	\$8,274

## 10. Research and Development Costs

Research and development costs charged to income were ¥2,181 million (\$18,641 thousand) and ¥2,188 million for the years ended March 31, 2006 and 2005, respectively.

## 11. Leases

The Group leases certain machinery, computer equipment and other assets. Total rental expense for the years ended March 31, 2006 and 2005 were ¥1,070 million (\$9,145 thousand) and ¥1,060 million, respectively, including ¥117 million (\$1,000 thousand) and ¥119 million of lease payments under finance leases.

Pro forma information of leased property such as acquisition cost, accumulated depreciation, obligations under finance leases, depreciation expense, and interest expense of finance leases that do not transfer ownership of leased property to the lessee on a "as if capitalized" basis for the years ended March 31, 2006 and 2005 was as follows:

	Millions of yen					
	2006			2005		
	Machinery and Equipment	Furniture and Fixtures	Total	Machinery and Equipment	Furniture and Fixtures	Total
Acquisition cost .....	¥8	¥547	¥555	¥11	¥529	¥540
Accumulated depreciation .....	7	284	291	8	176	185
Net leased property .....	¥1	¥263	¥264	¥2	¥352	¥355

  

	Thousands of U.S. dollars		
	2006		
	Machinery and Equipment	Furniture and Fixtures	Total
Acquisition cost .....	\$68	\$4,675	\$4,744
Accumulated depreciation .....	60	2,427	2,487
Net leased property .....	\$9	\$2,248	\$2,256

Obligations under finance leases as of March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Due within one year .....	¥112	¥106	\$957
Due after one year .....	161	257	1,376
Total .....	¥273	¥363	\$2,333

The imputed interest expense portion which is computed using the interest method is excluded from the above obligations under finance leases.

Depreciation expense and interest expense, which are not reflected in the accompanying statements of income, determined by the straight-line method and the interest method, respectively for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Depreciation expense .....	¥109	¥111	\$932
Interest expense .....	9	11	77

The minimum rental commitments under noncancellable operating leases at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Due within one year .....	¥504	¥577	\$4,308
Due after one year .....	4,536	570	38,769
Total .....	¥5,040	¥1,148	\$43,077

## 12. Derivatives

It is the Group's policy to use derivatives only for the purpose of reducing market risks associated with assets and liabilities.

Derivatives are subject to market risk. Market risk is the exposure created by potential fluctuations in market conditions, including interest.

Because the counterparties to those derivatives are limited to major international financial institutions, the Group does not anticipate any losses arising from credit risk.

The basic policies for the use of derivatives are made in accordance with internal policies which regulate the authorization and credit limit amount.

## 13. Commitments and Contingent Liabilities

Contingent liabilities at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Trade notes discounted .....	¥813	¥1,740	\$6,949
Guarantees of bank loans .....	200	201	1,709

## 14. Subsequent Event

The shareholders' meeting of the Company held on June 29, 2006 approved the following appropriations of retained earnings.

	Millions of yen	Thousands of U.S. dollars
Cash dividends, ¥3 (\$0.03) per share .....	¥256	\$2,188
Transfer to legal reserve .....	26	222
Total .....	¥281	\$2,402



## 15. Segment Information

Information with respect to operations in different business segments, geographical segments and sales to foreign customers of the Group for the years ended March 31, 2006 and 2005, is as follows:

### (1) Operations in Different Business Segments

#### a. Sales and Operating Income

Millions of yen							
2006							
	Marine Systems	Hydraulic and Pneumatic	Fluid Measurement	Defense and Communications	Others	Eliminations/ Corporate	Consolidated
Sales to customers .....	¥8,578	¥13,189	¥1,950	¥15,337	¥4,384		¥43,438
Intersegment sales .....	99	106	1	88	1,374	¥(1,668)	
Total sales .....	8,677	13,296	1,951	15,425	5,759	(1,668)	43,438
Operating expenses .....	8,287	11,595	1,901	15,188	5,613	(1,668)	40,915
Operating income .....	¥390	¥1,701	¥49	¥237	¥146		¥2,523

#### b. Assets, Depreciation and Capital Expenditures

Millions of yen							
2006							
	Marine Systems	Hydraulic and Pneumatic	Fluid Measurement	Defense and Communications	Others	Eliminations/ Corporate	Consolidated
Assets .....	¥5,043	¥10,082	¥1,455	¥17,371	¥7,410	¥7,436	¥48,797
Depreciation .....	35	222	14	570	34		875
Capital expenditures .....	54	229	11	325	133		752

#### a. Sales and Operating Income

Thousands of U.S. dollars							
2006							
	Marine Systems	Hydraulic and Pneumatic	Fluid Measurement	Defense and Communications	Others	Eliminations/ Corporate	Consolidated
Sales to customers .....	\$73,316	\$112,726	\$16,667	\$131,085	\$37,470		\$371,265
Intersegment sales .....	846	906	9	752	11,744	\$(14,256)	
Total sales .....	74,162	113,641	16,675	131,838	49,222	(14,256)	371,265
Operating expenses .....	70,829	99,103	16,248	129,812	47,974	(14,256)	349,701
Operating income .....	\$3,333	\$14,538	\$419	\$2,026	\$1,248		\$21,564

#### b. Assets, Depreciation and Capital Expenditures

Thousands of U.S. dollars							
2006							
	Marine Systems	Hydraulic and Pneumatic	Fluid Measurement	Defense and Communications	Others	Eliminations/ Corporate	Consolidated
Assets .....	\$43,103	\$86,171	\$12,436	\$148,470	\$63,333	\$63,556	\$417,068
Depreciation .....	299	1,897	120	4,872	291		7,479
Capital expenditures .....	462	1,957	94	2,778	1,137		6,427

**a. Sales and Operating Income**

Millions of yen							
2005							
	Marine Systems	Hydraulic and Pneumatic	Fluid Measurement	Defense and Communications	Others	Eliminations/ Corporate	Consolidated
Sales to customers .....	¥7,621	¥13,090	¥2,118	¥16,539	¥4,433		¥43,804
Intersegment sales .....	106	82	1	79	1,475	¥(1,744)	
Total sales .....	7,727	13,173	2,119	16,619	5,909	(1,744)	43,804
Operating expenses .....	7,596	11,540	1,902	16,806	5,495	(1,744)	41,596
Operating income(loss) .....	¥131	¥1,632	¥217	¥(187)	¥414		¥2,207

**b. Assets, Depreciation and Capital Expenditures**

Millions of yen							
2005							
	Marine Systems	Hydraulic and Pneumatic	Fluid Measurement	Defense and Communications	Others	Eliminations/ Corporate	Consolidated
Assets.....	¥4,869	¥8,589	¥1,490	¥17,139	¥8,123	¥5,710	¥45,923
Depreciation.....	19	172	8	307	336		844
Capital expenditures.....	3	159	4	221	175		563

**(2) Geographical Segments**

Since domestic sales and total assets held domestically of the Group for the years ended March 31, 2006 and 2005, are more than 90% of the consolidated sales and assets, segment information by geographic area is not presented.

**(3) Sales to Foreign Customers**

Sales to foreign customers for the years ended March 31, 2006 and 2005 amounted to ¥5,392 million (\$46,085 thousand) and ¥5,445 million, respectively.

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of  
TOKIMEC INC.:

We have audited the accompanying consolidated balance sheets of TOKIMEC INC. and consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of TOKIMEC INC. and consolidated subsidiaries as of March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

Our audits also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 1. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.



June 29, 2006

# Directors and Auditors of the Company

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## President

Hideaki KATSUKI

## Executive Directors

Chiaki TAKANASHI

Kenji WASHINO

Kenichi WAKI

## Directors

Yoshisuke AKITA

Noriyuki AKABA

Hidemitsu YAMADA

Kazuteru SATO

Junichi MAEZAWA

## Executive Officer

Hiroshi EBINUMA

Motoshi MITOBE

Kazushige MURABAYASHI

## Corporate Auditors

Noboru ISHIBASHI

Hiroshi TOHSE

Yasuhiro HARA

Masanori YONEDA

(As of June 29, 2006)

# Corporate Data of the Company

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## Head office:

2-16-46, Minami-Kamata, Ohta-ku, Tokyo 144-8551, Japan

Tel: +81-3-3732-2111

Fax: +81-3-3736-0261

[www.tokimec.co.jp](http://www.tokimec.co.jp)

## Date of Establishment:

May 1, 1896

## Common Stock:

Authorized—250,000,000 shares

Issued — 85,382,196 shares

## Number of Shareholders:

10,471

## Stock Listing:

Tokyo Stock Exchange (Code:7721)

## Number of Employees:

1,097

## Offices:

Sapporo, Sendai, Nagano, Kanazawa, Sano,  
Shizuoka, Nagoya, Osaka, Kobe, Hiroshima,  
Yamaguchi, Imabari, Kitakyushu, Nagasaki

## Plants:

Nasu, Yaita, Sano, Tanuma (Tochigi Prefecture)  
Hanno (Saitama Prefecture)

(As of March 31, 2006)

# Companies of the TOKIMEC Group

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## **TOKIMEC AVIATION INC.**

2-1-1 Misugi-dai, Hanno-shi,  
Saitama 357-0041  
Phone:+81-429-71-0550 Fax:+81-429-71-0554

## **JYONAN UNYU CO., LTD.**

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## **TECS INC.**

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Tokyo 144-8551  
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## **MORIOKA TOKKI CORPORATION**

1-15-8 Kami-lioka, Morioka-shi,  
Iwate 020-0854  
Phone:+81-19-638-5211 Fax:+81-19-637-1015

## **TOKIMEC POWER SYSTEMS INC.**

168 Tada-cho, Sano-shi,  
Tochigi 327-0311  
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## **TOKIMEC KOREA POWER CONTROL CO., LTD.**

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3ga, Yeongdeungpo-gu, Seoul , KOREA  
Phone:+82-2-2670-4631 Fax:+82-2-2672-5712

## **TOKIMEC INFORMATION SYSTEMS INC.**

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## **TECHNOPORT INC.**

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## **TOKIMEC CONSTRUCTION SYSTEMS INC.**

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## **TOKIMEC RAIL TECHNO INC.**

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## **TOKIMEC U.S.A., INC.**

445 South Figueroa St. Suite 3770  
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Phone:+1-213-689-4747 Fax:+1-213-689-0303



**TOKIMEC INC.**