KYB Corporation

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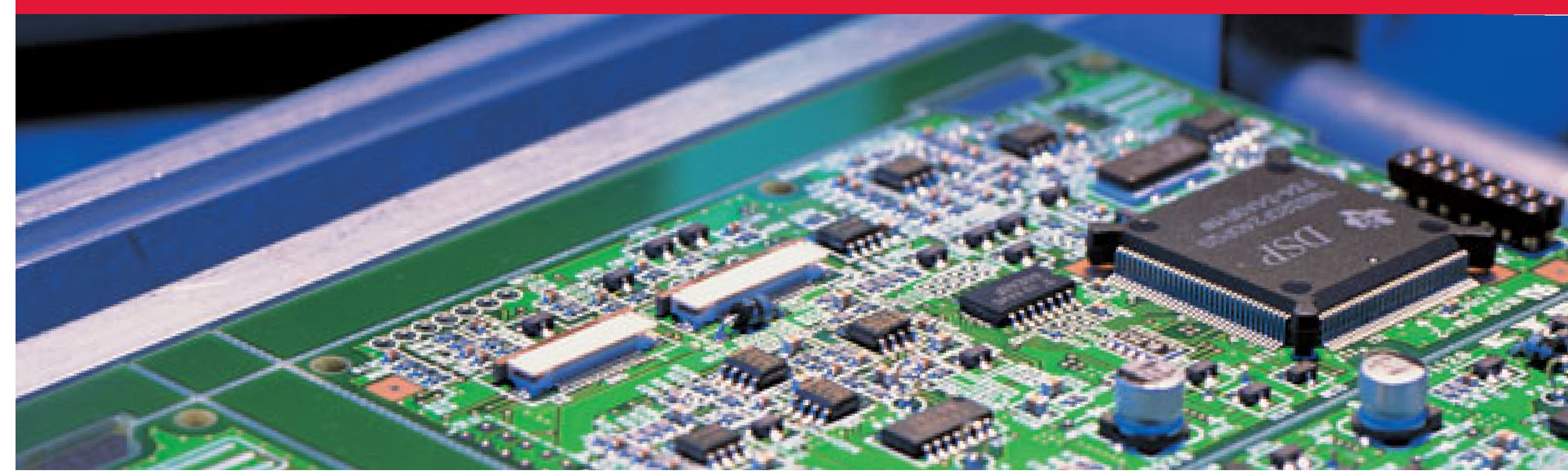
KYB Corporation Annual Report 2006

Our Precision, Your Advantage

Annual Report 2006

Year Ended March 31, 2006



KYB Corporation

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Forward-Looking Statements

This annual report contains forward-looking statements, including KYB's plans and strategies, as well as statements that report historical results. Forward-looking statements involve such known and unknown risks and uncertainties as economic conditions; currency exchange rates; laws, regulations, and government policies; and political instability in principal markets.

Our Value Is...

the KYB Brand

"A world where *monozukuri* (manufacturing expertise) makes people happy"

This is the goal of the KYB Group.

We want to remain a company that supplies customers and markets with valuable ideas. We are also dedicated to supplying new forms of value and achieving even greater customer satisfaction. To accomplish this, we view our mission as "manufacturing that goes the extra yard." To us, the joy of manufacturing is the ability to be recognized for two key strengths. One is "reliable quality," a concept that is rooted in our view that our customers include all end users of our products. The other is the ability to contribute to even more "comfortable living." Backing up these strengths are innovative technologies and a powerful R&D program. This spirit is expressed directly by our new KYB logo and corporate slogan, "our precision, your advantage."

KYB's Brand Platform

We adopted the name KYB Corporation on October 1, 2005, which is now used alongside our official name, Kayaba Industry Co., Ltd. This allows us to use the well-known KYB brand as our company name as well. Additionally, we established the corporate slogan "our precision, your advantage" for use with the new logo.

Vision **The world that KYB brand wants to realize**

A society of smiles through manufacturing

KYB is striving to create a society where the joy of manufacturing underpins the development of society and makes people smile.

Value **The value that KYB brand provides**

Technology for comfortable living

Emotional value: Comfortable living, joy of manufacturing
Functional value: Reliable quality
The value that KYB promises to end users—
"comfortable living" that is a step above, through innovative technology and diligent product development.

The value that KYB promises to the clients—
reliable quality that even considers end users as "patrons."

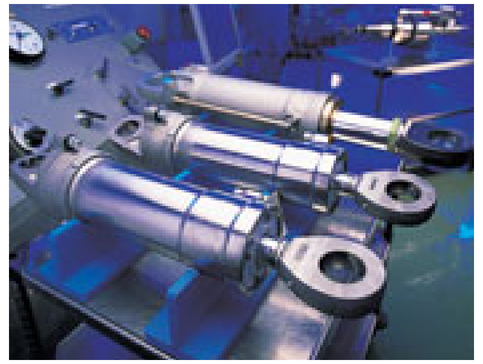
The value that KYB promises to the employees—
the "joy of manufacturing" where each and every individual can actually feel that they are making a difference in society.

Mission **The mission that KYB brand must accomplish**

Manufacturing that goes the extra yard

KYB will continue to be a corporation that can give valuable proposals to clients and markets, making the most of the solid and reliable technology that has been developed over the years.

We will conduct manufacturing that is a step ahead with our own hands to provide new values and unprecedented satisfaction to our customers.








To Our Shareholders

Our Value Is...

Management Quality

KYB has announced a change in its presidency for the purposes of making its organization younger and stronger. KYB's new president and representative director is Satoru Yamamoto, who last served as managing director and general manager of Hydraulic Components Operations. Mr. Yamamoto replaced Tadahiko Ozawa, who now has the title of chairman and representative director.

KYB has also announced its fundamental policy concerning internal controls. Based on this policy, we will continue to strictly adhere to the highest ethical standards while aiming for outstanding quality in our management systems.

Right: Tadahiko Ozawa,
Chairman and Representative Director

Left: Satoru Yamamoto,
President and Representative Director

Profits Fall as Sales Increase in Fiscal 2005

In fiscal 2005, ended March 31, 2006, there were several sources of concern about the Japanese economy, notably the high cost of steel and other basic materials and the steep increase in the price of crude oil. Despite these difficulties, the economy has ended a deflationary period and is now in the midst of a self-sustaining recovery. Supporting the rebound are strong exports to China and the U.S. along with a recovery in capital expenditures and consumer spending. The global economy was generally healthy as well. The U.S. economy was solid due to consumer spending and corporate earnings, which offset the impact of severe hurricane damage and a temporary weakening in housing investments and capital expenditures in the fiscal year's second half. China continued to post a high growth rate as exports and capital expenditures were strong. In Europe, there was moderate economic expansion fueled primarily by exports.

KYB's consolidated net sales rose 7.4%, to ¥290,456 million. Sales growth was due mostly to solid demand for industrial-use hydraulic equipment and automobile shock absorbers in the Hydraulic Products segment.

Profits were lower even though sales increased because of the higher cost of steel, growth in sales of lower-priced products, and a downturn in profitability in the Systems Products segment. The result was a ¥2,919 million drop in operating income, to ¥6,723 million. The bottom line was net income of ¥2,917 million, which was ¥2,584 million less than the previous fiscal year.

A Message to Our Shareholders

Under the new management team, KYB will continue to take the actions needed to raise corporate value by achieving the goals of its medium-term management plan. Returning profits to shareholders in an appropriate manner is a key element of our management policies. For many years, our basic policy has been to maintain a dividend-on-equity (DOE) ratio of at least 2% in each fiscal year. Our policy is to use retained earnings for capital expenditures, overseas manufacturing bases, and R&D activities, as well as to reduce interest-bearing debt.

Reflecting our operating results and basic policy concerning dividends, the dividend applicable to fiscal 2005 is ¥6 per share, the sum of interim and year-end distributions of ¥3 each. To serve our customers, which are rapidly enlarging their operations outside Japan, we are concentrating on expanding our own overseas network. Developing new products is another priority of ours. We will be placing emphasis on increasing earnings for the time being as we execute these business strategies.

Tadahiko Ozawa,
Chairman and Representative Director

Satoru Yamamoto,
President and Representative Director

An Interview with the President

Satoru Yamamoto joined Kayaba Industry (the present KYB Corporation) in September 1967. His career has included assignments as the general manager of the Sagami Plant and as managing director in charge of Hydraulic Components Operations. Mr. Yamamoto became president in June 2006.

In this section, Mr. Yamamoto discusses KYB's basic strategies, progress with regard to the medium-term management plan, and other subjects.

Q ***KYB is planning on a big recovery in earnings in the fiscal year ending in March 2007. What will be the primary sources of this recovery?***

In fiscal 2005, ended March 31, 2006, KYB's sales increased but earnings fell. We formulated our plan for a strong rebound based on an exhaustive analysis of the causes of fiscal 2005's disappointing performance.

We plan to raise sales by 18.1%, to ¥343,000 million. Japanese automobile companies, the primary customers of our hydraulic products, are steadily raising their global market shares. The outlook for hydraulic products for construction machinery is also bright. Construction machinery manufacturers have established very aggressive sales plans. They foresee growth in the established markets of China, North America, and Europe as well as in emerging markets like India and Russia. Our sales forecast takes into account this strength in the automobile and construction machinery industries.

With regard to expenses, KYB plans to work on reflecting the higher cost of steel in its sales prices. The rising cost of steel was a major cause of the earnings decline in the fiscal year under review. We will be particularly resolute concerning price negotiations for hydraulic products used in automobiles and construction machinery. Prices of OEM products are also critical. After some negotiation, our customers have generally gained an understanding of KYB's position regarding price increases for products with low profit margins. In the after-market for shock absorbers, we signed a contract worth about US$50 million with a major distributor. The deal will improve our earnings because this is a sales channel with high profit margins.

Hydraulic pumps for continuously variable transmissions (CVT) have much growth potential. An increasing number of automakers are using these transmissions. We plan to raise production capacity to meet demand. Exporting power steering systems to U.S. and Australian automakers should also contribute to expanding sales. Moreover, Investment on a substantial increase in production capacity for construction machinery hydraulic equipment is in progress. Our own plants can now handle production that had previously been outsourced.

Our forecast also incorporates a recovery at consolidated subsidiaries, which had weak sales and earnings in the fiscal year under review. Kayaba System Machinery, which manufactures and sells systems products, is moving production and marketing activities to optimal facilities by focusing on building-rerated products. Disruptions caused by sudden growth in new orders at KYB Manufacturing North America, the U.S. production base for shock absorbers, due to increasing sales of Japanese automakers have come to an end. The resulting growth in our internal production ratio is raising profit margins. In addition, we are sending people to this company to improve productivity and quality control.

New plants will also generate additional earnings. Our hydraulic cylinder plant for construction machinery in China has started full-scale operations. We plan to ship 6,400 units in the first half of the current fiscal year and 10,400 units in the second half. In Vietnam, where demand for motorcycles is strong, we have built a large new shock absorber plant, replacing a small rented plant.

In light of these developments, we are forecasting operating income of ¥15,300 million, up 127.6%, and net income of ¥7,100 million, up 143.4%, in fiscal 2006, ending March 31, 2007.

CONSOLIDATED FINANCIAL HIGHLIGHTS

KYB Corporation and Consolidated Subsidiaries
Years Ended March 31

	Millions of yen		Change	
	2006	2005	Amount	%
For the year:				
Net sales	¥290,456	¥270,329	20,127	7.4
Costs and expenses	283,733	260,687	23,046	8.8
Net income	2,917	5,501	(2,584)	(47.0)
At year-end:				
Total shareholders' equity	¥ 76,718	¥ 70,656	6,062	8.6
Total assets	247,966	222,224	25,742	11.6
Per share data (in yen):				
Net income	¥ 12.63	¥ 24.15		
Cash dividends applicable to the year	6.00	6.00		

Note: Per share amounts are based on the average number of shares outstanding each year.

Q What is your evaluation of progress regarding KYB's current medium-term management plan?

KYB is executing a medium-term management plan called "Change & Accomplish V10." One target is a return on equity (ROE) of at least 10% in the fiscal year ending March 2008. Although fiscal 2005's performance was disappointing, meeting our goals for an earnings recovery will raise our ROE to about 8% for fiscal 2006. I believe that the fiscal year under review was a time when we built the groundwork for achieving this goal. First of all, we made sweeping changes to our organization. We now have three operational groups: Automotive Components Operations, Hydraulic Components Operations, and Affiliated Business Operations. With these operational groups, we can use our resources more effectively. We can also give greater authority to business decisions while clearly defining accountability for meeting goals. Overseas bases are under the control of these groups. This provides for the efficient management of the entire KYB Group from a global perspective. Along with these moves, we began a brand management program, using the name KYB Corporation and unveiling a new logo. The goal is to firmly establish this unified brand outside the KYB Group as well as at our Group companies worldwide.

Monozukuri (manufacturing expertise) skills at our plants are the source of our ability to compete and win. A "*Monozukuri* Workplace" campaign at the primary KYB plants in Japan has succeeded in further streamlining work processes on the plant floors. These improvements have contributed directly to better quality and productivity. Now that this improvement methodology has proven its worth, we plan to expand the campaign to overseas production bases and affiliated companies. Making our manufacturing activities even more global is the primary goal.

Our medium-term management plan is now in its second year. The central themes are "Change" and "Accomplish." Change refers to the shift from quantity to quality. Accomplish refers to maximizing earnings. In fiscal 2005, we saw earnings drop even as sales increased. KYB must stop pursuing volume alone. Instead, everyone needs to focus on generating earnings by accepting the amount of orders that matches our manufacturing capabilities. We must build the proper manufacturing infrastructure and supply products that we can make with high productivity. I want everyone at the KYB Group to rededicate themselves to doing what is needed to generate earnings with consistency, and to maximize earnings.

Our medium-term management plan has four core elements: fostering individuals who can do their jobs with a global perspective; building a global product and technology development network; establishing a global manufacturing infrastructure; and putting in place a global quality management system. Productivity and quality at Japanese "mother factories" will be the benchmarks. Overseas factories cannot earn the trust of customers unless they meet these standards. Every Group company needs to become more profitable. Through this approach, we intend to raise the profitability of the entire KYB Group. KYB's head office must transform itself into a powerful nucleus for the Group by looking outward rather than focusing on internal matters. Global management, a theme that I have stressed repeatedly, can be executed most efficiently if the head office is positioned at the center. Naturally, I want our head office personnel as well to adopt a global viewpoint when performing their duties.

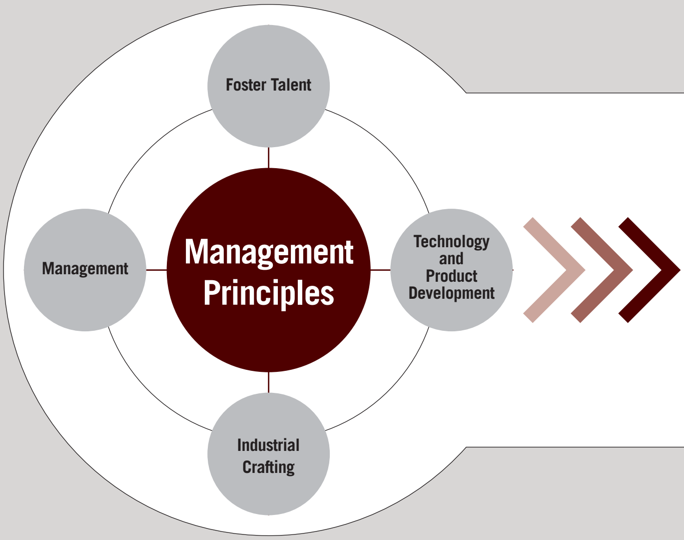
Q Your term as president is starting at a time of enormous change in KYB's markets. What are your plans for overcoming these challenges?

To put it simply, I want to make all our workplaces more powerful. I spent much of my career at KYB plants. However, my goal is not limited to plants; I want to see improvements in sales, development, and administrative workplaces. After all, KYB grew to its present size by focusing on enhancing operations precisely when market conditions were the most challenging. By workplace power, I am referring to the skills of our people. Even outstanding strategies will be meaningless unless we have people who can take the necessary actions. Strategies become meaningful only when we have workplaces that can transform goals into actions. I want our production and sales bases not only in Japan but also worldwide to embrace this concept.

A powerful workplace is one that can deal with many problems on its own. Even after a strategy reaches a particular department or team, there will always be problems to solve. Employees involved need to adapt and act with speed and insight. This is where the energy of our workplaces originates. If we can make this self-reliance an integral part of our organization, KYB will have truly powerful workplaces.

I believe that three qualities are vital to creating powerful workplaces: courage, self-confidence, and pride. Management needs the courage to entrust workplaces with a task. Workplaces need the self-confidence to perform that task. Repeating this process will produce a sense of pride at these workplaces. This is how our operations can constantly become stronger. As the new president, I will always pay attention to our workplaces and I strongly believe that making workplaces stronger will directly lead to the growth of the KYB Group.

Our Management Principles



Foster Talent
To foster the talent to achieve the objectives with a thorough understanding of the principles and the strategy.

Technology and Product Development
To provide products that are impressive, comfortable and reliable to customers throughout the world.

Industrial Crafting—*Monozukuri* (Manufacturing Expertise)
To make our plants enjoyable, dynamic places to work, and at the same time full of discipline based on the field priority doctrine, in order to produce products satisfactory to the customer.

Management
Always keep social responsibilities of the corporation in mind and provide efficient group management.

Our Value Is...

Technology and Product Development

To sustain growth, the KYB Group must preserve outstanding skills involving the creation of innovative technologies and products and the execution of *monozukuri* (manufacturing expertise) at the highest level. Meeting customer needs requires the development of highly distinctive products, the establishment of extremely efficient production lines, and a relentless drive to make products with the best quality in the world. As a *monozukuri* organization, the KYB Group is constantly working on refining the technologies and skills required for excellence in *monozukuri*, and on passing those skills on to new workers.

Hydraulic Products

Major Products

Shock absorbers:
For automobiles, motorcycles, railway vehicles, and all terrain vehicles
Seismic isolation systems and vibration control dampers

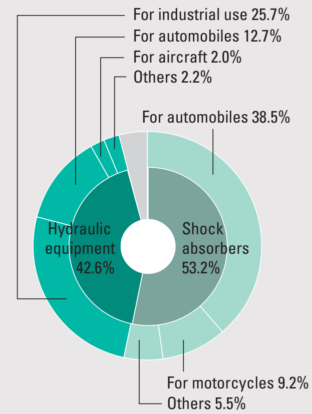
Hydraulic equipment:
For industrial use: Pumps, valves, motors, and cylinders
For automobiles: Hydraulic and electric power steering systems and four-wheel steering systems
For aircraft: Equipment for landing systems, flight control systems, pneumatic/hydraulic systems, and space flight-related equipment

Growth Strategy

Shock absorbers:
Establish a global sales, supply, and development network, including overseas factories, to become more competitive

Hydraulic equipment:
Strengthen the KYB brand and increase the scale of operations, increase global market share by establishing a global production network, and further enhance expertise in technology and new product development

Sales Composition by Product



Systems Products

Major Products

Special-purpose vehicles:
Concrete mixer trucks, granule carriers, and special-function vehicles

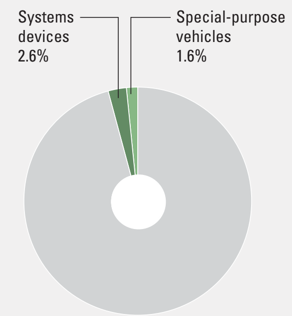
Systems devices:
Motion simulators, control systems, hydraulic systems, auditorium and stage control systems, hydraulic tunnel borers, and ship-based hydraulic equipment

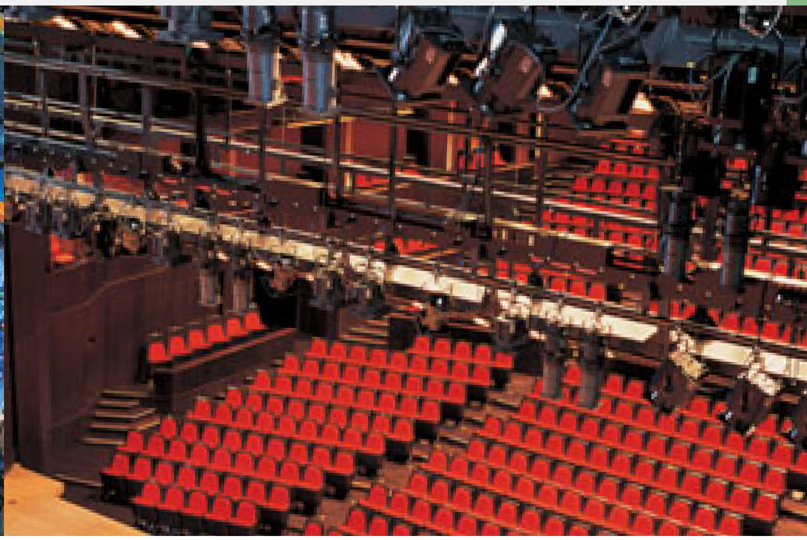
Growth Strategy

Special-purpose vehicles:
Increase market share by developing and introducing products that anticipate emerging market needs; enter new markets by using recycled products and other environment-friendly products

Systems devices:
Increase orders for auditorium and stage control equipment as well as control systems; increase sales activities for environmental equipment and motion simulators

Sales Composition by Product





Hydraulic Products

Performance Summary

Sales in the Hydraulic Products segment increased 7.2%, to ¥278,696 million (US$2,382,017 thousand), but operating income decreased ¥1,964 million, to ¥12,921 million (US$110,436 thousand). Although actions were taken to reflect the higher cost of steel in product prices, earnings were impacted by insufficient increases in selling prices and a further increase in the share of sales of lower-priced products.

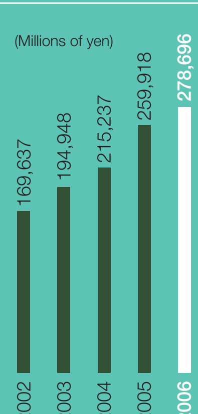
Shock Absorbers

There was an increase in sales of shock absorbers for assembly use, as production of automobiles in Japan increased 2.6%. By having increased also overseas, shock absorber sales rose 3.8%. This was attributable to strong sales at Japanese automakers, the primary buyers of KYB shock absorbers, in North America and other regions as gasoline prices climbed. Sales of motorcycle shock absorbers were up 11.9% due to growth in exports of large motorcycles by companies that are major users of KYB shock absorbers.

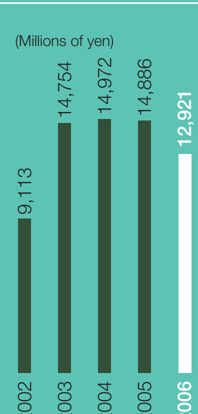
Hydraulic Equipment

Sales of industrial-use hydraulic equipment, which is used mainly in construction machinery, were up 12.9%. In China, there was a gradual recovery in the construction machinery market following a temporary downturn. Demand was higher in North America and Europe, and there was a large increase in exports of construction machinery to India and Russia. In automobile power steering products, sales climbed 8.3% due to substantial growth in sales of electric power steering systems and hydraulic pumps for continuously variable transmissions (CVT). In hydraulic products for aircraft, sales fell 18.9% reflecting a cyclical decline in the development of aircraft for the Japan Defense Agency.

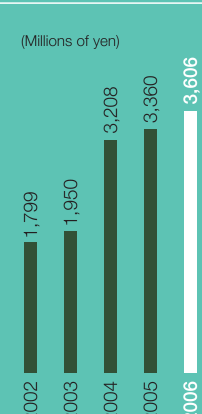
Sales

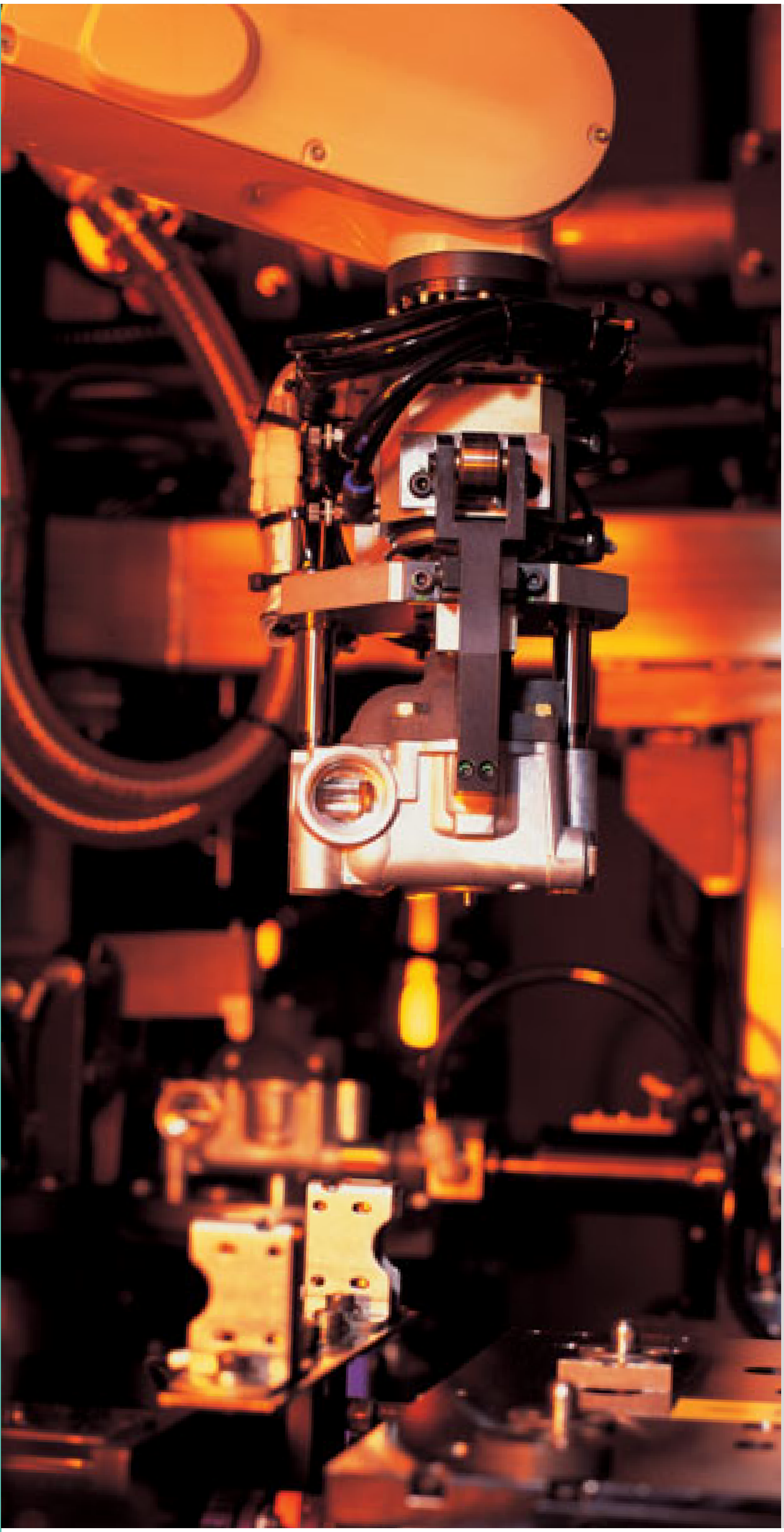


Operating Income



R&D Expenditures





R&D Highlights of the Year

- Developed an accumulator with a damping valve for the Relative Shock Absorber System (REAS) of Audi's RS4. This accumulator is the most critical component of the REAS, which keeps vehicles level and maintains handling stability.
- Developed a chair-ski shock absorber for use at the 2006 Winter Paralympics in Torino. The shock absorber has adjustable damping to match the requirements of each athlete.
- Developed a urethane seal that can withstand temperatures of about 20 degrees higher than conventional urethane seals while retaining the same low-temperature characteristics. The seal was used to make hydraulic cylinders that can operate over a wider temperature range.
- Developed a vane pump for trucks and buses that is compact and light while generating high pressure and high output. The pump, which has an aluminum casing, goes up to 15cm^3/rev, 15MPa, a first in Japan.
- Developed an acceleration sensor for controlling the semi-active suspension of Shinkansen (bullet train) rail cars. The sensor can detect acceleration in two directions and has a malfunction self-diagnosis capability.

Joint Development of CVT Vane Pump

In hydraulic equipment for transmission systems, KYB developed a built-in vane pump for CVT in collaboration with JATCO Ltd. The new pump is compact, more efficient, provides higher pressure, and has a lower noise level, and has won acclaim in the market.

Systems Products

Performance Summary

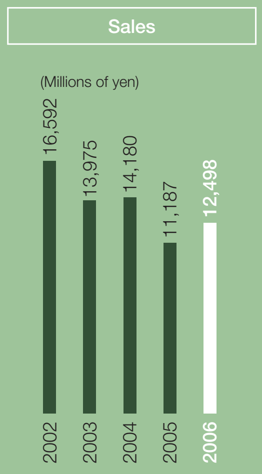
Sales in the Systems Products segment increased 11.7%, to ¥12,498 million (US$106,821 thousand). However, the operating loss increased from ¥230 million to ¥413 million (US$3,530 thousand) because of a provision for the allowance for doubtful accounts.

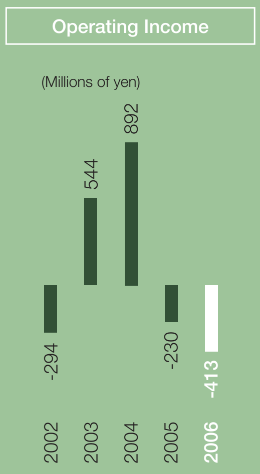
Special-Purpose Vehicles

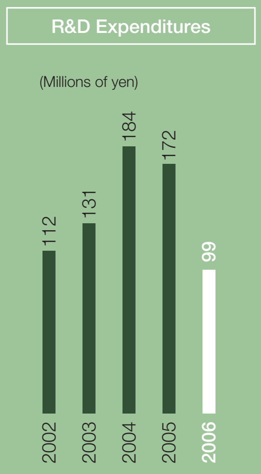
Sales of special-purpose vehicles rose 57.2%. The increase was primarily the result of growth in sales of concrete mixer trucks and powdered materials transport trucks, which are core products of this segment. There was a rush to purchase vehicles prior to the enforcement of new regulations in Japan.

Systems Devices

Sales declined 3.3% due to slower sales of our environment-friendly products and a turndown in demand for hydraulic tunnel borers, reflecting cutbacks in public works projects.







R&D Highlights of the Year

- Developed a dual-axis vibration tester. Used for simulations, this device has a hydrostatic bearing to reduce friction in order to produce rapid vibrations (up to 500Hz) for tests that simulate the high-speed vibrations of engines and other sources.

Seismic Dampers for High-Rise Building in Nagoya

KYB supplied an outrigger oil damper and an inter-building oil damper for a high-rise building now under construction in Nagoya, Japan. The high-rise building will have 96 of the outrigger oil dampers, each 1.65 meters long, on the ceilings of floors 7, 26, and 42. In addition, there are 19 of the inter-building oil dampers on the 7th floors of the high-rise and low-rise buildings at this project. Together, these dampers will allow the buildings to withstand even a major earthquake.

Our Value Is...

Global Quality

The KYB Group has manufacturing bases in North America, South America, Europe, and Asia to supply parts to the manufacturers of automobiles and motorcycles, construction machinery, and industrial vehicles. In China, KYB is increasing the production of automobile shock absorbers and hydraulic cylinder for construction machinery.

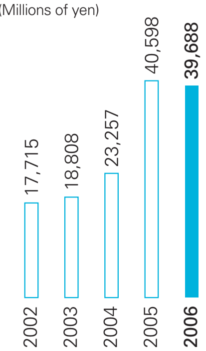
In the fiscal year under review, overseas sales increased ¥2,939 million, or 2.9%, to ¥103,248 million (US$882,462 thousand). Overseas sales as a percentage of total sales decreased 1.6 percentage points year on year, to 35.5%, with international activities still an important part of KYB's operations.

KYB plans to continue to enlarge its global manufacturing network to establish a system where products are manufactured and parts and materials are procured in the optimal locations from a global perspective.

Europe

Countries:
Germany, United Kingdom, Spain, Italy, France

Overseas Sales
(Millions of yen)

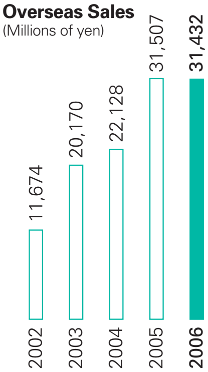


13.6% of total consolidated sales

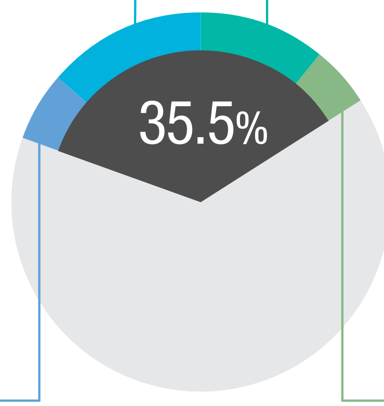
North America

Countries:
United States, Canada

Overseas Sales
(Millions of yen)



10.8% of total consolidated sales

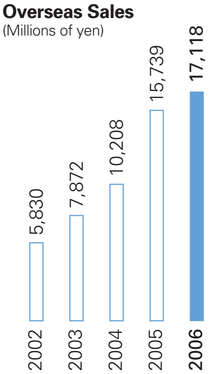


5.9% of total consolidated sales

Southeast Asia

Countries:
Taiwan, Indonesia, Malaysia, Thailand

Overseas Sales
(Millions of yen)

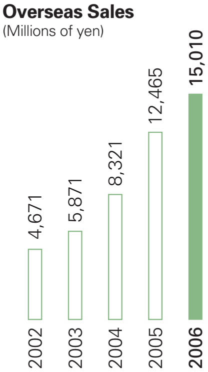


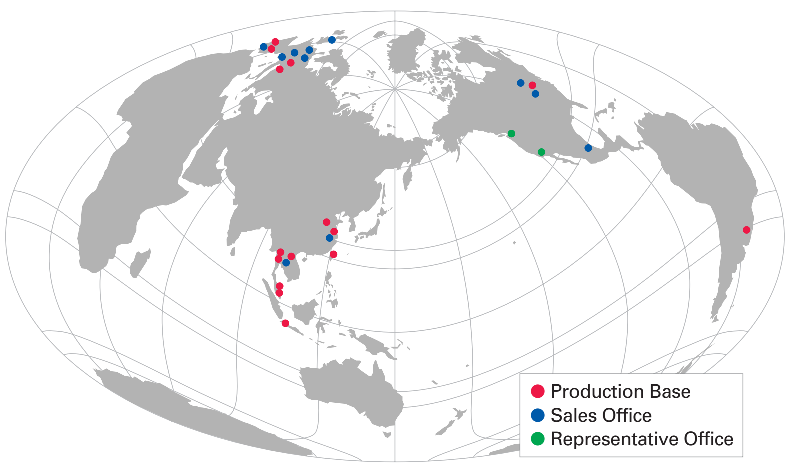
5.2% of total consolidated sales

Other Areas

Countries:
China, South Korea

Overseas Sales
(Millions of yen)





Our Value Is...

Policy for a Better Environment

KYB is devoted to activities to preserve the environment in order to realize a sustainable and better place for all.

Environmental Objectives

KYB has established the basic environmental objectives so that all employees act as a unified team in carrying out environmental activities. (established in July 1992 and revised in March 2003)

Slogan

Protect the green earth and create products gentle to the environment

Basic Environmental Objectives

KYB creates products gentle to both people and the planet. As a company that provides power and comfort, KYB is dedicated to the promotion of environmental activities as an important tool for evaluating management.

(1) Strive to ensure long-term and sustainable operations throughout the entire KYB Group.

(2) Work to promote harmony with society and contribute to the global community as a good corporate citizen.

(3) Clarify every employee's role so that all employees can participate fully.

Activity Plan Related to Environmental Preservation

KYB is promoting activities on a Companywide scale by defining goals every year according to the "Activity Plan Related to Environmental Preservation."

The main results of activities in 2005 are as indicated below.

Activity Results of 2005

Compilation range: Sagami Plant, Kumagaya Plant, Gifu North Plant, Gifu South Plant

Activities		Goal of 2005	Result of 2005	Activity Plan Goal for 2010
Prevention of global warming	CO_2 emission	88,000 ton-CO_2/year or less (0.5% decrease compared to 2004)	93,403 ton-CO_2/year (5.6% increase compared to 2004)	7% decrease of emission (1990 comparison)
Energy saving	Energy usage (Basic unit)	252.9 ℓ/million yen or less (1% decrease compared to 2004)	240.5 ℓ/million yen (5.9% decrease compared to 2004)	6% decrease of basic unit (2004 comparison)
Recycling and recycling rate improvement	Recycling	87.3% recycling rate (2% increase compared to 2004)	84.6% recycling rate (0.8% decrease compared to 2004)	Improvement of recycling and recycling rate
	Zero emission	3% or less landfilled waste	4.4% landfille waste	3% or less landfilled waste
Decrease of waste	General waste	655 tons/year or less (3% decrease compared to 2004)	720 tons/year (6.5% increase compared to 2004)	Decrease of discharge to level of 2004 or less
	Industrial waste	4,032 tons/year or less (3% decrease compared to 2004)	4,731 tons/year (13.8% increase compared to 2004)	Decrease of discharge to level of 2004 or less
	Metal scraps (Basic unit)	97.4 kg/million yen or less (2% decrease compared to 2004)	97.6 kg/million yen (1.8% decrease compared to 2004)	6% decrease of discharge (2004 comparison)

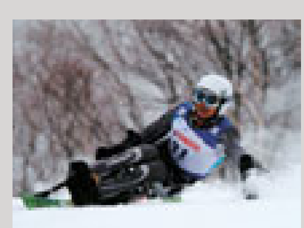
Notes: In line with the changes following 2003 such as closure of plants and establishment of subsidiaries, the activity plan up to 2010 was reviewed based on the 2004 plan. Due to the further expected increase of production in the future, goals are set to keep general and industrial wastes to the level of 2004 or less.

- Assuming discharge generated from production activities of KYB as wastes, such discharge is categorized into standard waste, industrial waste, and metal scraps.
- For energy, electricity and fuel are converted into crude oil equivalent and total values are displayed as total energy.
- Basic units are calculated based on the shipment volume of production.

Welfare Efforts

Chair Skis for Winter Paralympic Games

KYB has been developing and improving shock absorbers for the chair ski, a device that allows wheelchair users to ski, since the 1998 Winter Paralympic Games in Nagano, based on the accumulated technologies of shock absorbers for motorcycles and snowmobiles. In the 2002 Winter Paralympic Games in Salt Lake City, all chair skis used by the Japan team in alpine races were equipped with chair-ski shock absorbers made by KYB. Thus, KYB contributed to the records of the Japan team, including two bronze medals awarded to Ms. Kuniko Obinata. In the 2006 Winter Paralympic Games in Torino, KYB continued working with Ms. Obinata, which resulted in her winning a gold medal.



KYB will continue to contribute to the support of people and society in a variety of fields based on technologies and tradition, in pursuit of the ultimate chair ski as requested by the Paralympic competitors.

Board of Directors and Corporate Auditors
(As of June 28, 2006)

Board of Directors

CHAIRMAN AND REPRESENTATIVE DIRECTOR

Tadahiko Ozawa

PRESIDENT AND REPRESENTATIVE DIRECTOR

Satoru Yamamoto

REPRESENTATIVE DIRECTOR AND EXECUTIVE MANAGING DIRECTOR

Yoshitake Yonekubo
Technology, Information Systems
General Manager, Engineering Div. and Affiliated Business Operations

EXECUTIVE MANAGING DIRECTORS

Katsuma Ohara
Gifu Area Liaison Officer
General Manager, Automotive Components Operations

Kenzo Noguchi
Finance, Accounting, Audit, Corporate Planning, Legal, CSR, Sales Administration, General Affairs, and Personal Administration
General Manager, Corporate Planning Div.

MANAGING DIRECTORS

Masahito Kori
Deputy General Manager, Automotive Components Operations,
Chairman and CEO, KYB Manufacturing North America Inc.

Toshio Watanabe
General Manager, Sales & Marketing Headquarters,
Automotive Components Operations

Ken Mizumukai
Production, Purchasing, Quality Control, Environment and Safety Control
General Manager, Quality & Production Div. and Quality Control Dept.

Masao Usui
Deputy General Manager, Hydraulic Components Operations

Kazuhisa Ikenoya
General Manager, Engineering Headquarters,
Automotive Components Operations

DIRECTORS

Kiyoshi Inoue
General Manager, Electronics Div., Affiliated Business Operations

Akiyoshi Tanaka
General Manager, Corporate Planning Dept. and Legal Affairs Dept.,
Corporate Planning Div.

Keiichi Handa
General Manager, Aftermarket Sales Dept.,
Automotive Components Operations

Shigeki Hirokado
General Manager, Gifu South Plant,
Hydraulic Components Operations

Takafumi Shoji
General Manager, Finance & Accounting Dept.

Yasusuke Nakajima
General Manager, Hydraulic Sales Headquarters,
Hydraulic Components Operations

Kazuhiro Ogata
General Manager, Gifu North Plant,
Automotive Components Operations

Hitoshi Nitta
General Manager, Gifu North Motorcycle Plant,
Automotive Components Operations

Corporate Auditors

STANDING CORPORATE AUDITORS

Hidetsune Iseki
Katsuhisa Egawa
Ichiro Akieda

CORPORATE AUDITOR

Hitoshi Fukushima

Financial Section

CONSOLIDATED FIVE-YEAR SUMMARY

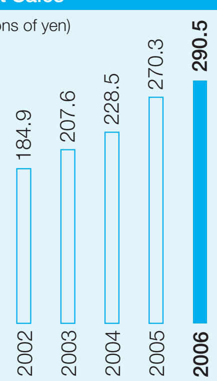
Kayaba Industry Co., Ltd. and Consolidated Subsidiaries Years Ended March 31

	Millions of yen					Thousands of U.S. dollars
	2006	2005	2004	2003	2002	**2006**
For the year:						
Net sales	**¥290,456**	¥270,329	¥228,525	¥207,643	¥184,919	**$2,482,530**
Costs and expenses	**283,733**	260,687	217,406	198,706	182,085	**2,425,068**
Net income (loss)	**2,917**	5,501	6,040	2,663	(735)	**24,932**
Capital expenditures	**15,678**	14,070	10,395	8,398	8,389	**134,000**
At year-end:						
Working capital	**¥ 21,392**	¥ 26,492	¥ 17,918	¥ 24,550	¥ 25,267	**$ 182,838**
Total shareholders' equity	**76,718**	70,656	66,819	59,521	57,956	**655,710**
Total assets	**247,966**	222,224	213,845	194,455	185,868	**2,119,368**
	Yen					U.S. dollars
Per share:						
Net income (loss)	**¥ 12.63**	¥ 24.15	¥ 26.55	¥ 11.47	¥ (3.30)	**$ 0.11**
Cash dividends applicable to the year	**6.00**	6.00	6.00	5.00	—	**0.05**
Net worth	**343.99**	316.64	299.34	266.62	259.92	**2.94**
Number of employees	**8,387**	8,186	7,645	6,105	6,159	

Notes: 1. Unless otherwise indicated, all dollar amounts herein refer to U.S. currency. Yen amounts have been translated into U.S. dollars, for convenience only, at ¥117=US$1, the approximate exchange rate prevailing on March 31, 2006.
2. Per share amounts are based on the average number of shares outstanding each year.

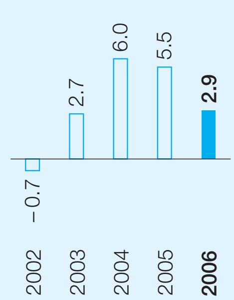
Net Sales

(Billions of yen)



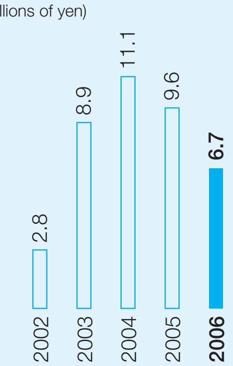
Net Income (Loss)

(Billions of yen)



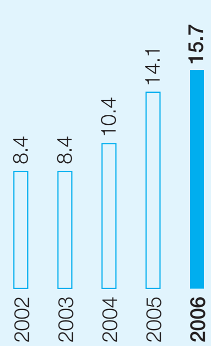
Operating Income

(Billions of yen)



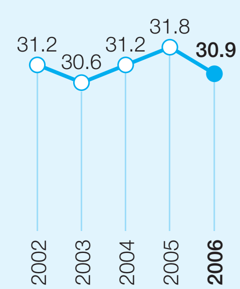
Capital Expenditures

(Billions of yen)



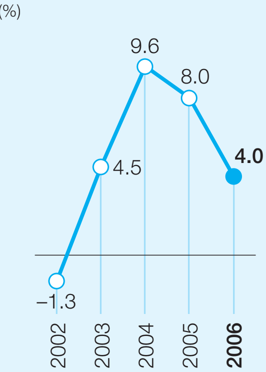
Shareholders' Equity Ratio

(%)



Return on Equity (ROE)

(%)



Summary

Consolidated net sales increased ¥20,127 million, or 7.4%, to ¥290,456 million (US$2,482,530 thousand). The major sources of growth were industrial-use hydraulic equipment and automobile shock absorbers in the Hydraulic Products segment. Cost of sales increased ¥20,724 million, or 9.2%, to ¥246,890 million (US$2,110,171 thousand), and climbed 1.3 percentage points, to 85.0% of sales.

Although sales increased, the higher cost of sales caused gross profit to decline ¥597 million, bringing the gross profit margin down from 16.3% to 15.0%. Operating income was down ¥2,919 million, to ¥6,723 million (US$57,462 thousand), because of the higher cost of steel, an increase in sales of low-priced products, and profit deterioration in the Systems Products segment. Selling, general and administrative (SG&A) expenses increased ¥2,322 million, to ¥36,843 million (US$314,897 thousand), due to packing and transportation charges and higher personnel expenses. SG&A expenses were unchanged as a percentage of sales at 12.7%.

In other income and expenses, interest expense increased ¥205 million because of an increase in debt. However, the foreign exchange gain increased ¥705 million, royalty income increased ¥109 million, and loss on disposal of inventories decreased ¥186 million. Significant components of net other income included a gain of ¥335 million on the sale of investment securities and a loss of ¥370 million on the sale and disposal of property, plant and equipment. The result was net other income of ¥1,286 million (US$10,991 thousand), ¥790 million more than the previous fiscal year.

Income before income taxes and minority interests decreased ¥2,130 million, or 21.0%, to ¥8,009 million (US$68,453 thousand), and net income declined ¥2,584 million, to ¥2,917 million (US$24,932 thousand). Net income was 1.0% of sales. Net income per share was ¥12.63 (US$0.11).

Performance by Segment

Hydraulic Products segment sales increased ¥18,778 million, or 7.2%, to ¥278,696 million (US$2,382,017 thousand). Sales of automobile and motorcycle shock absorbers were higher than the prior year. In the hydraulic equipment category, sales growth was due to a moderate recovery in the Chinese construction machinery market, growth in demand in North America and Europe, where market conditions are strong, and a steep increase in exports to India and Russia. Earnings were impacted by the higher cost of steel. Although actions were taken to reflect these costs in sales prices, the prices of products continued to decline. As a result, segment operating income decreased ¥1,964 million, or 13.2%, to ¥12,921 million (US$110,436 thousand).

Systems Products segment sales increased ¥1,311 million, or 11.7%, to ¥12,498 million (US$106,821 thousand). Sales of special-purpose vehicles rose 57.2%, with growth coming mainly from concrete mixer trucks and powdered materials transport trucks, two core products of this segment. One reason was a rush to purchase vehicles that can still be registered during the grace period prior to the enforcement of new regulations in Japan. Another reason was replacement demand associated with the need to comply with new long-term exhaust emission restrictions. The operating loss increased ¥183 million, or 79.6%, to ¥413 million (US$3,530 thousand) because of a provision for the allowance for doubtful accounts.

In Europe, sales decreased ¥139 million, or 0.4%, to ¥37,750 million (US$322,650 thousand), as lower sales at two manufacturing subsidiaries in Spain outweighed an increase in sales at a shock absorber sales company in Germany. The operating loss improved ¥335 million, or 47.4%, to ¥372 million (US$3,179 million).

In other areas, sales increased ¥6,084 million, or 14.2%, to ¥48,879 million (US$417,769 thousand). Growth was mainly attributable to higher sales at shock absorber manufacturing subsidiaries in North America and Thailand and to the full-scale start of production at a subsidiary in China that manufactures shock absorbers. There was an operating loss of ¥49 million (US$419 thousand), compared with operating income of ¥495 million one year earlier.

Financial Condition

Total assets were ¥247,966 million (US$2,119,368 thousand), an increase of ¥25,742 million, or 11.6%, compared with the previous fiscal year. Total current assets increased ¥16,093 million, or 13.0%, to ¥139,818 million (US$1,195,026 thousand) as trade notes and accounts receivable and inventories increased because of the growth in sales. Net property, plant and equipment increased ¥4,390 million, or 6.0%, to ¥77,718 million (US$664,256 thousand), mainly the result of newly acquired machinery and equipment. Total investments and other non-current assets increased ¥5,259 million, or 20.9%, to ¥30,430 million (US$260,086 thousand). Most of the increase was due to growth in the market values of investment securities.

Total liabilities increased ¥19,098 million, or 12.9%, to ¥167,285 million (US$1,429,786 thousand). This was primarily a reflection of increases in trade notes and accounts payable associated with the growth in production. Interest-bearing debt increased ¥5,145 million, or 9.8%, to ¥57,543 million (US$491,821 thousand), raising the debt-to-equity ratio (interest-bearing debt divided by shareholders' equity) from 74.2% to 75.0%. The current ratio decreased from 1.27 to 1.18.

Total shareholders' equity increased ¥6,062 million, or 8.6%, to ¥76,718 million (US$655,710 thousand), mainly because of growth in net unrealized holding gains on securities. Despite this increase, the shareholders' equity ratio declined 0.9 percentage point, to 30.9%, because of the growth in assets.

Cash Flows

Net cash provided by operating activities increased ¥4,821 million, to ¥13,821 million (US$118,128 thousand). Major sources of cash were income before income taxes and minority interests of ¥8,009 million, depreciation and amortization of ¥10,407 million, and an increase in trade notes and accounts payable of ¥12,806 million. Major uses of cash were a ¥9,004 million increase in trade notes and accounts receivable, ¥3,877 million in income taxes paid, a ¥3,483 million increase in inventories, and a ¥1,071 million decrease in payables—other.

Net cash used in investing activities increased ¥1,182 million, to ¥15,960 million (US$136,410 thousand). The main use of cash was payments of ¥16,166 million for the acquisition of property, plant and equipment.

Net cash provided by financing activities increased ¥2,773 million, to ¥2,965 million (US$25,342 thousand). There were proceeds of ¥6,224 million from long-term debt, an increase in bank loans, net, of ¥2,253 million, repayments of ¥4,024 million for long-term debt, and dividend payments of ¥1,337 million.

The result of the above items was a net increase of ¥1,003 million in cash and cash equivalents at the end of the fiscal year, to ¥14,963 million (US$127,889 thousand).

Business and Other Risks

Hydraulic Products, which account for more than 90% of total consolidated sales, are sold almost entirely to manufacturers of automobiles, motorcycles, construction machinery, and industrial vehicles (finished vehicles) as components for assembly use in those vehicles.

The KYB Group is currently concentrating on building a global manufacturing network to respond to the expansion of finished-vehicle assemblers in the global market. The Group is also placing priority on supplying products that are superior to those of competitors in terms of quality and cost. Due to intense price-based competition associated with the volume of global automobile, motorcycle, and construction machinery production, finished-vehicle manufacturers may exert pressure on the Group for cost reductions, price discounts, compensation for damages caused by defective products, and other concessions that could have an impact on KYB's operating results. In addition, as KYB's operations become more global, operating results are becoming vulnerable to changes in demand caused by economic trends in overseas markets, new restrictions and other political uncertainty involving foreign governments, other companies becoming more competitive, losses resulting from foreign exchange rate movements, higher interest rates, and other potential risks. Regarding the procurement of raw materials and parts, operating results are highly susceptible to movements in international commodity markets because the Group may not be able to fully reflect the higher cost of raw materials and other items in the selling prices of its products.

In the Systems Products segment, which sells special-purpose vehicles and stage control systems, operating results are vulnerable to risks associated with external factors such as changes in the volume of construction, revisions to regulations—such as motor vehicle exhaust emission regulations—the financial condition of local governments, and other items.

In addition, the Group may have to temporarily suspend production activities in the event of a fire, leak of hazardous materials, or other accident at a Group factory.

The KYB Group is aware of these risks and is taking adequate steps to avoid the occurrence of these risks.

CONSOLIDATED BALANCE SHEETS

Kayaba Industry Co., Ltd. and Consolidated Subsidiaries   As of March 31, 2006 and 2005

ASSETS	Millions of yen 2006	Millions of yen 2005	Thousands of U.S. dollars (Note 1) 2006
Current assets:			
Cash and time deposits (Note 9)	¥ 10,665	¥ 11,078	$ 91,154
Trade receivables:			
Notes and accounts	82,475	72,774	704,915
Unconsolidated subsidiaries and affiliated companies	3,677	1,922	31,427
Allowance for doubtful accounts	(680)	(197)	(5,812)
Inventories (Note 3)	35,103	30,863	300,026
Deferred tax assets (Note 6)	2,585	2,516	22,094
Short-term loans receivable	5,028	4,008	42,974
Prepaid expenses and other current assets	965	761	8,248
Total current assets	139,818	123,725	1,195,026
Property, plant and equipment (Note 4):			
Land	17,555	19,001	150,043
Buildings	43,029	41,176	367,769
Machinery and equipment	177,956	167,609	1,520,991
Construction in progress	2,736	3,411	23,385
Total	241,276	231,197	2,062,188
Less: Accumulated depreciation	163,558	157,869	1,397,932
Net property, plant and equipment	77,718	73,328	664,256
Investments and other non-current assets:			
Investments in and loans to unconsolidated subsidiaries and affiliated companies (Note 11)	7,719	5,747	65,975
Investment securities (Note 11)	17,868	11,620	152,718
Lease deposits, loans and other long-term receivables	1,419	1,399	12,128
Deferred tax assets (Note 6)	1,437	3,781	12,282
Other assets	2,076	2,717	17,744
Allowance for doubtful accounts	(89)	(93)	(761)
Total investments and other non-current assets	30,430	25,171	260,086
Total assets	¥247,966	¥222,224	$2,119,368

See accompanying notes.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen 2006	2005	Thousands of U.S. dollars (Note 1) 2006
Current liabilities:			
Bank loans (Note 4)	**¥ 20,315**	¥ 17,411	**$ 173,633**
Current maturities of long-term debt (Note 4)	**8,867**	4,026	**75,786**
Trade payables:			
Notes and accounts	**68,626**	54,641	**586,547**
Unconsolidated subsidiaries and affiliated companies	**404**	571	**3,453**
Payables—other	**9,786**	11,053	**83,641**
Accrued expenses	**7,840**	6,578	**67,009**
Income taxes payable	**2,028**	2,316	**17,333**
Other current liabilities	**560**	637	**4,786**
Total current liabilities	**118,426**	97,233	**1,012,188**
Long-term liabilities:			
Long-term debt less current maturities (Note 4)	**28,361**	30,961	**242,402**
Retirement benefits (Note 5)	**15,420**	15,720	**131,795**
Deferred tax liabilities on land revaluation	**4,513**	3,785	**38,572**
Other long-term liabilities	**565**	488	**4,829**
Total long-term liabilities	**48,859**	50,954	**417,598**
Minority interests in consolidated subsidiaries	**3,963**	3,381	**33,872**
Contingent liabilities (Note 8)			
Shareholders' equity (Note 7):			
Common stock:			
Authorized—491,955,000 shares			
Issued—222,984,315 shares	**19,114**	19,114	**163,368**
Capital surplus	**20,249**	20,249	**173,068**
Retained earnings	**27,070**	26,713	**231,368**
Revaluation reserve for land, net of tax	**4,761**	3,658	**40,692**
Net unrealized holding gains on securities	**6,768**	3,591	**57,846**
Foreign currency translation adjustments	**(1,166)**	(2,608)	**(9,966)**
Less: Treasury stock	**(78)**	(61)	**(666)**
Total shareholders' equity	**76,718**	70,656	**655,710**
Total liabilities and shareholders' equity	**¥247,966**	¥222,224	**$2,119,368**

CONSOLIDATED STATEMENTS OF INCOME

Kayaba Industry Co., Ltd. and Consolidated Subsidiaries   Years Ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Net sales (Note 15)	**¥290,456**	¥270,329	**$2,482,530**
Cost of sales (Notes 13 and 15)	**246,890**	226,166	**2,110,171**
Gross profit	**43,566**	44,163	**372,359**
Selling, general and administrative expenses (Notes 13 and 15)	**36,843**	34,521	**314,897**
Operating income (Note 15)	**6,723**	9,642	**57,462**
Other income (expenses):			
Interest and dividend income	**278**	221	**2,376**
Interest expense	**(1,222)**	(1,017)	**(10,445)**
Other, net (Note 14)	**2,230**	1,292	**19,060**
Net other income	**1,286**	496	**10,991**
Income before income taxes and minority interests	**8,009**	10,138	**68,453**
Income taxes (Note 6):			
Current	**3,598**	3,156	**30,752**
Deferred	**898**	883	**7,675**
Income before minority interests	**3,513**	6,099	**30,026**
Minority interests	**596**	598	**5,094**
Net income	**¥ 2,917**	¥ 5,501	**$ 24,932**

	Yen		U.S. dollars (Note 1)
Amounts per share of common stock:			
Net income	**¥ 12.63**	¥ 24.15	**$ 0.11**
Cash dividends applicable to the year	**6.00**	6.00	**0.05**

See accompanying notes.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Kayaba Industry Co., Ltd. and Consolidated Subsidiaries   Years Ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Common stock			
Beginning and end of year	**¥19,114**	¥19,114	**$163,368**
Capital surplus			
Beginning of year	**¥20,249**	¥20,248	**$173,068**
Gain on disposal of treasury stock	**0**	1	**0**
End of year	**¥20,249**	¥20,249	**$173,068**
Retained earnings			
Beginning of year	**¥26,713**	¥22,671	**$228,316**
Net income	**2,917**	5,501	**24,932**
Reversal of revaluation reserve for land, net of tax	**(1,102)**	2	**(9,419)**
Cash dividends paid	**(1,336)**	(1,337)	**(11,419)**
Bonuses to directors and corporate auditors	**(122)**	(124)	**(1,042)**
End of year	**¥27,070**	¥26,713	**$231,368**
Revaluation reserve for land, net of tax			
Beginning of year	**¥ 3,658**	¥ 3,660	**$ 31,265**
Reversal of revaluation reserve for land, net of tax	**1,103**	(2)	**9,427**
End of year	**¥ 4,761**	¥ 3,658	**$ 40,692**
Net unrealized holding gains on securities			
Beginning of year	**¥ 3,591**	¥ 4,195	**$ 30,692**
Net change during the year	**3,177**	(604)	**27,154**
End of year	**¥ 6,768**	¥ 3,591	**$ 57,846**
Foreign currency translation adjustments			
Beginning of year	**¥ (2,608)**	¥ (3,024)	**$ (22,291)**
Net change during the year	**1,442**	416	**12,325**
End of year	**¥ (1,166)**	¥ (2,608)	**$ (9,966)**
Treasury stock			
Beginning of year	**¥ (61)**	¥ (45)	**$ (521)**
Net change during the year	**(17)**	(16)	**(145)**
End of year	**¥ (78)**	¥ (61)	**$ (666)**

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Kayaba Industry Co., Ltd. and Consolidated Subsidiaries   Years Ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Cash flows from operating activities:			
Income before income taxes and minority interests	**¥ 8,009**	¥10,138	**$ 68,453**
Depreciation and amortization	**10,407**	9,997	**88,949**
Loss on sale and disposal of property, plant and equipment, net	**370**	640	**3,162**
Gain on sale of investment securities	**(335)**	(1,515)	**(2,863)**
Amortization of consolidation goodwill	**647**	649	**5,530**
Changes in allowance for doubtful accounts	**472**	(147)	**4,034**
Changes in retirement benefits	**(303)**	1,432	**(2,590)**
Interest and dividend income	**(278)**	(221)	**(2,376)**
Interest expense	**1,222**	1,017	**10,445**
Equity in earnings of unconsolidated subsidiaries and affiliated companies	**(495)**	(481)	**(4,231)**
Changes in trade notes and accounts receivable	**(9,004)**	(4,965)	**(76,957)**
Changes in inventories	**(3,483)**	(3,513)	**(29,769)**
Changes in trade notes and accounts payable	**12,806**	5,073	**109,453**
Changes in payables—other	**(1,071)**	(4,173)	**(9,154)**
Other, net	**(623)**	(32)	**(5,325)**
Subtotal	**18,341**	13,899	**156,761**
Interest and dividends received	**527**	435	**4,504**
Interest paid	**(1,195)**	(1,023)	**(10,214)**
Income taxes paid	**(3,877)**	(4,353)	**(33,137)**
Income taxes refunded	**25**	42	**214**
Net cash provided by operating activities	**13,821**	9,000	**118,128**
Cash flows from investing activities:			
Transfer to time deposits	**(642)**	(993)	**(5,487)**
Transfer from time deposits	**1,127**	831	**9,633**
Payments for acquisition of property, plant and equipment	**(16,166)**	(13,492)	**(138,171)**
Proceeds from sale of property, plant and equipment	**2,070**	127	**17,692**
Payments for acquisition of subsidiaries' stock	**—**	(625)	**—**
Payments for acquisition of investment securities	**(1,068)**	(229)	**(9,128)**
Proceeds from sale of investment securities	**392**	2,311	**3,350**
Payments for loans	**(95)**	(99)	**(812)**
Proceeds from collection of loans	**29**	50	**248**
Other, net	**(1,607)**	(2,659)	**(13,735)**
Net cash used in investing activities	**(15,960)**	(14,778)	**(136,410)**
Cash flows from financing activities:			
Increase (decrease) in bank loans, net	**2,253**	(806)	**19,256**
Proceeds from long-term debt	**6,224**	13,000	**53,197**
Repayments of long-term debt	**(4,024)**	(3,529)	**(34,393)**
Payments for bond redemption	**—**	(7,000)	**—**
Payments for acquisition of treasury stock	**(23)**	(15)	**(197)**
Cash dividends paid	**(1,337)**	(1,337)	**(11,427)**
Cash dividends paid for minority interests	**(128)**	(121)	**(1,094)**
Net cash provided by financing activities	**2,965**	192	**25,342**
Effect of exchange rate changes on cash and cash equivalents	**177**	159	**1,513**
Net increase (decrease) in cash and cash equivalents	**1,003**	(5,427)	**8,573**
Cash and cash equivalents at beginning of year	**13,960**	18,902	**119,316**
Increase in cash and cash equivalents due to change of consolidation scope	**—**	485	**—**
Cash and cash equivalents at end of year (Note 9)	**¥14,963**	¥13,960	**$127,889**

See accompanying notes.

1. Basis of Presenting Consolidated Financial Statements

Kayaba Industry Co., Ltd. (the "Company") and its consolidated domestic subsidiaries (together the "Companies") maintain their official accounting records in Japanese yen, and 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 ("Japanese GAAP"), which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

The accounts of overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles and practices prevailing in the respective countries of domicile.

The accompanying consolidated financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of the statements of shareholders' equity) from the consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law. Some supplementary information included in the statutory Japanese-language consolidated financial statements, but not required for fair presentation, is not presented in the accompanying financial statements.

The translations of the Japanese yen amounts into U.S. dollars are included solely for the convenience of readers, using the prevailing exchange rate at March 31, 2006, which was ¥117 to US$1. The convenience translations should not be construed as representations that the Japanese yen amounts have been, could have been, or could in the future be converted into U.S. dollars at this or any other rate of exchange.

2. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements of the Company include the accounts of the Company and its significant subsidiaries (19 in 2006 and 2005), which are controlled through substantial ownership of majority voting rights or the existence of certain conditions.

Financial statements of certain consolidated subsidiaries which have the fiscal year ending December 31 were consolidated with adjustments made for material transactions which took place in the three-month period between the balance sheet date of such subsidiaries and that of the Company. In the elimination of investments in subsidiaries, the assets and liabilities of the subsidiaries, including the portion attributable to minority shareholders, are evaluated using the fair value at the time the Company acquired control of the respective subsidiaries.

The difference between the cost of an investment and equity in its net assets at the date of acquisition is being amortized over five years.

Equity method

Investments in four affiliated companies in 2006 and 2005 (20% to 50% owned and certain others less than 20% owned) are accounted for by the equity method and, accordingly, are stated at cost adjusted for equity in undistributed earnings and losses from the date of acquisition.

Investments in the other affiliated companies and unconsolidated subsidiaries are stated at cost or less.

Impairment of fixed assets

Effective April 1, 2005, the Companies adopted the new accounting standard for impairment of fixed assets ("Opinion Concerning Establishment of Accounting Standard for Impairment of Fixed Assets" issued by the Business Accounting Deliberation Council on August 9, 2002) and the implementation guidance for the accounting standard for impairment of fixed assets (Financial Accounting Standard Implementation Guidance No. 6 issued by the Accounting Standards Board of Japan on October 31, 2003).

The adoption of this standard and its related implementation guidance had no impact on the consolidated financial statements for the year ended March 31, 2006.

Foreign currency translation

Receivables and payables denominated in foreign currencies are translated into Japanese yen at the year-end rates with the resulting gain or loss included in the current statements of income.

The balance sheets of consolidated overseas subsidiaries are translated into Japanese yen at the year-end rates except for shareholders' equity accounts, which are translated at the historical rates. The income statements of consolidated overseas subsidiaries are translated at average rates.

The resulting foreign currency translation adjustments are presented in shareholders' equity and minority interests in the consolidated balance sheets.

Cash and cash equivalents

In preparing the consolidated statements of cash flows, cash on hand, readily available deposits and short-term highly liquid investments with maturities not exceeding three months at the time of purchase are considered to be cash and cash equivalents.

Inventories

Inventories are stated at cost by the periodic-average method.

Securities

Under the accounting standard for financial instruments, the Companies examine the intent of holding each security and classify those securities as (a) securities held for trading purposes, (b) debt securities intended to be held to maturity, (c) equity securities issued by subsidiaries and affiliated companies and (d) all other securities that are not classified in any of the above categories (hereafter, "available-for-sale securities").

Equity securities issued by subsidiaries and affiliated companies which are not consolidated or accounted for using the equity method are stated at moving-average cost.

Available-for-sale securities with available fair market values are stated at fair market value. Unrealized gains and losses on these securities are reported, net of applicable income taxes, as a separate component of shareholders' equity. Realized gains and losses on sales of such securities are computed using moving-average cost.

Securities with no available fair market value are stated at moving-average cost.

Derivative transactions and hedge accounting

The accounting standard for financial instruments requires companies to state derivative financial instruments at fair value and to recognize changes in the fair value as gains or losses unless derivative financial instruments are used for hedging purposes.

If derivative financial instruments are used as hedges and meet certain hedging criteria, the Companies defer recognition of gains or losses resulting from changes in the fair value of derivative financial instruments until the related losses or gains on the hedged items are recognized.

However, if a forward foreign exchange contract is executed to hedge a future transaction denominated in a foreign currency, the future transaction will be recorded using the contracted forward rate and no gains or losses on the forward foreign exchange contract are recognized.

Also, if interest rate swap contracts are used as hedges and meet certain hedging criteria, the net amount to be paid or received under the interest rate swap contract is added to or deducted from the interest on the assets or liabilities for which the swap contract was executed.

Property, plant and equipment

Property, plant and equipment are carried at cost except for certain land used for business operations. Depreciation is computed by the declining-balance method at rates based on the estimated useful lives, except for buildings acquired after March 31, 1998, which are depreciated using the straight-line method. Overseas consolidated subsidiaries mainly use the straight-line method over the estimated useful lives.

Land revaluation

Pursuant to the Law Concerning Revaluation of Land enacted on March 31, 1998, land owned by the Company for business operations was revalued at fair value as of March 31, 2002. Due to the revaluation, the related unrealized gain, net of applicable income taxes, was reported as “Revaluation reserve for land” in shareholders’ equity. The revaluation reserve for land in shareholders’ equity is not available for dividends under the law.

According to the revised law, the Company is not permitted to revalue the land at any time, even if the fair value of the land declines. Such unrecorded revaluation loss amounted to ¥4,889 million (US$41,786 thousand) as of March 31, 2006.

Research and development

Expenses relating to research and development activities are charged to income as incurred.

Certain lease transactions

Finance leases, except for those leases for which the ownership of the leased assets is considered to be transferred to lessees, are accounted for as operating leases.

Retirement benefits

(1) Employees’ severance and retirement benefits

The Company and certain consolidated subsidiaries provide two types of employees’ severance and retirement benefit plans, unfunded lump-sum payment plans and funded non-contributory pension plans, under which all eligible employees are entitled to benefits based on the level of wage and salary at the time of retirement or termination, length of service and certain other factors. Some subsidiaries have pension plans of their own.

The liabilities and expenses for employees’ severance and retirement benefits are determined based on the amounts obtained by actuarial calculations.

The Companies recognize the liabilities for employees’ severance and retirement benefits based on the amounts of projected benefit obligation and the fair value of the plan assets as of each balance sheet date.

Actuarial gains and losses are recognized in the consolidated statements of income in equal amounts over the average of the estimated remaining service lives (14 to 15 years), commencing with the succeeding period.

(2) Severance and retirement allowance for directors and corporate auditors

The directors and corporate auditors of the Company and certain subsidiaries receive lump-sum payments upon termination of their services under unfunded termination plans. The full amount of such retirement benefits for directors and corporate auditors is accrued in accordance with the internal rules. The payments to directors and corporate auditors are subject to shareholders’ approval.

Income taxes

Income taxes comprise corporation, enterprise and inhabitants taxes.

The Company and its consolidated subsidiaries recognize the tax effects of timing differences between the financial statement basis and the tax basis of assets and liabilities.

Amounts per share

In computing net income per share of common stock, the average number of shares outstanding during each fiscal year has been used. Diluted net income per share is not presented since the Company had no securities with dilutive effect. Cash dividends per share represent cash dividends declared applicable to the respective years.

Reclassifications

Certain prior year amounts have been reclassified to conform to the 2006 presentation. These changes had no impact on previously reported results of operations or shareholders’ equity.

3. Inventories

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

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Finished products	**¥15,132**	¥12,644	**$129,333**
Work in process	**14,098**	13,163	**120,496**
Raw materials and supplies	**5,873**	5,056	**50,197**
	¥35,103	¥30,863	**$300,026**

4. Bank Loans and Long-Term Debt

Bank loans as of March 31, 2006 and 2005 were represented by short-term notes, generally 90 days, bearing annual interest rates ranging from 0.51% to 5.60% and from 0.50% to 5.22%, respectively.

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

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Loans from banks and others, due through 2015 with interest rates ranging from 0.95% to 4.70%:			
Secured	**¥ 400**	¥ 757	**$ 3,419**
Unsecured	**36,828**	34,230	**314,769**
Total	**37,228**	34,987	**318,188**
Less: Current maturities	**(8,867)**	(4,026)	**(75,786)**
	¥28,361	¥30,961	**$242,402**

As is customary in Japan, security may have to be given if requested by a lending bank, and such bank has the right to offset cash deposited with it against any debt or all obligations that become due and, in the case of default or certain other specified events, against all debts payable to the bank. The Company has never received such a request.

As of March 31, 2006, the following assets were pledged as collateral for notes and long-term bank loans:

	Millions of yen	Thousands of U.S. dollars
Property, plant and equipment, less accumulated depreciation	¥13,227	$113,051

The aggregate annual maturities of long-term debt were as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2007	¥ 8,867	$ 75,786
2008	3,370	28,804
2009	3,110	26,581
2010	1,134	9,692
2011	2,104	17,983
Thereafter	18,643	159,342
	¥37,228	$318,188

5. Retirement Benefits

Retirement benefits included in the liabilities section of the consolidated balance sheets as of March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Projected benefit obligation	**¥38,042**	¥38,593	**$325,146**
Unrecognized actuarial differences	**5,611**	(1,561)	**47,957**
Less: Fair value of plan assets	**(28,800)**	(21,882)	**(246,154)**
Liability for employees' severance and retirement benefits	**14,853**	15,150	**126,949**
Severance and retirement allowance for directors and corporate auditors	**567**	570	**4,846**
Total retirement benefits	**¥15,420**	¥15,720	**$131,795**

Included in the consolidated statements of income for the years ended March 31, 2006 and 2005 were employees' severance and retirement benefit expenses comprising the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Service costs—benefits earned during the year	**¥1,762**	¥1,850	**$15,060**
Interest cost on projected benefit obligation	**758**	820	**6,479**
Expected return on plan assets	**(220)**	(203)	**(1,880)**
Amortization of net transition obligation	**—**	863	**—**
Amortization of actuarial differences	**199**	462	**1,701**
Special payment of extra retirement benefits	**8**	24	**68**
Severance and retirement benefit expenses	**¥2,507**	¥3,816	**$21,428**

The estimated amount of all employees' retirement benefits to be paid at the future retirement date is allocated equally to each service year using the estimated number of total service years.

The discount rate and the rate of expected return on plan assets used by the Companies were 2.0% to 2.5% and 1.0% to 2.5%, respectively, for the years ended March 31, 2006 and 2005.

6. Income Taxes

Income taxes applicable to the Company and its domestic consolidated subsidiaries are comprised of corporation taxes, inhabitants taxes and enterprise taxes. Income taxes of the foreign consolidated subsidiaries are based generally on the tax rates applicable in their countries of incorporation. The aggregate statutory tax rate for the years ended March 31, 2006 and 2005 was 39.8%.

The following table summarizes the significant differences between the statutory tax rate and the actual effective tax rate.

Statutory tax rate	39.8%
Valuation allowance	16.6
Amortization of consolidation goodwill	3.2
Non-deductible expenses (entertainment expense, etc.)	2.5
Equity in earnings of the affiliated companies	(2.5)
Tax credit	(3.9)
Other	0.4
Effective tax rate	56.1%

Significant components of the deferred tax assets and liabilities as of March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Deferred tax assets:			
Provision for employees' severance and retirement benefits	**¥10,399**	¥10,257	**$ 88,880**
Loss carried forward	**3,888**	2,676	**33,231**
Accrued bonuses	**1,434**	1,342	**12,256**
Inventories	**543**	599	**4,641**
Software	**285**	265	**2,436**
Allowance for doubtful accounts	**285**	—	**2,436**
Provision for retirement benefits for directors and corporate auditors	**227**	218	**1,940**
Enterprise taxes	**179**	212	**1,530**
Other	**974**	957	**8,325**
Total deferred tax assets	**18,214**	16,526	**155,675**
Less: Valuation allowance	**(4,833)**	(3,007)	**(41,307)**
	13,381	13,519	**114,368**
Deferred tax liabilities:			
Unrealized holding gains on securities	**(4,495)**	(2,391)	**(38,419)**
Securities contributed to employees' retirement benefit trust	**(3,917)**	(3,979)	**(33,479)**
Tax allowable reserves for deduction of fixed assets	**(530)**	(636)	**(4,530)**
Undistributed earnings of overseas subsidiaries	**(274)**	(185)	**(2,342)**
Other	**(143)**	(31)	**(1,222)**
Total deferred tax liabilities	**(9,359)**	(7,222)	**(79,992)**
Net deferred tax assets	**¥ 4,022**	¥ 6,297	**$ 34,376**

7. Shareholders' Equity

Under the Commercial Code of Japan (the "Code"), at least 50% of the issue price of new shares is required to be credited to common stock. The portion which is to be credited to common stock is determined by resolution of the Board of Directors. Proceeds in excess of the amounts credited to common stock are credited to additional paid-in capital, which is included in capital surplus.

The Code provides that an amount at least equal to 10% of the aggregate amount of cash dividends and certain other cash payments which are made as an appropriation of retained earnings applicable to each fiscal period shall be appropriated and set aside as a legal earnings reserve until the total of the legal earnings reserve and additional paid-in capital equals 25% of stated capital. If the total of the legal earnings reserve and additional paid-in capital exceeds 25% of stated capital, the excess can be transferred to retained earnings by resolution of the shareholders.

The Code permits the Company to transfer a portion of additional paid-in capital and legal earnings reserve to stated capital by resolution of the Board of Directors. The Code also permits the Company to transfer portions of unappropriated retained earnings, available for dividends, to stated capital by resolution of the shareholders. The legal earnings reserve is included in retained earnings in the accompanying financial statements.

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

The maximum amount that the Company can distribute as dividends is calculated based on the unconsolidated financial statements of the Company and in accordance with the Code.

8. Contingent Liabilities

As of March 31, 2006, the Company and its consolidated subsidiaries were contingently liable for trade notes receivable discounted amounting to ¥23 million (US$197 thousand) and trade notes receivable endorsed amounting to ¥487 million (US$4,162 thousand).

The Company was also contingently liable under guarantees of indebtedness of unconsolidated subsidiaries and affiliated companies amounting to ¥2,382 million (US$20,359 thousand) and of employees' loans for their own houses amounting to ¥20 million (US$171 thousand) as of March 31, 2006.

9. Cash and Cash Equivalents

The reconciliation of cash and time deposits shown in the consolidated balance sheets and cash and cash equivalents shown in the consolidated statements of cash flows as of March 31, 2006 and 2005 was as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Cash and time deposits	**¥10,665**	¥11,078	**$ 91,154**
Less: Time deposits with maturities exceeding three months	**(665)**	(1,117)	**(5,684)**
Add: Commercial paper with maturity less than three months	**4,963**	3,999	**42,419**
Cash and cash equivalents	**¥14,963**	¥13,960	**$127,889**

10. Lease Information

Finance leases which do not transfer ownership to lessees are not capitalized and are accounted for in the same manner as operating leases.

A summary of assumed amounts of acquisition cost, accumulated depreciation and net book value of buildings, machinery and equipment and other assets as of March 31, 2006 and 2005 is as follows:

	Millions of yen						Thousands of U.S. dollars		
	2006			2005			**2006**		
	Acquisition cost	Accumulated depreciation	Net book value	Acquisition cost	Accumulated depreciation	Net book value	Acquisition cost	Accumulated depreciation	Net book value
Buildings	**¥1,573**	**¥ 486**	**¥1,087**	¥1,170	¥ 402	¥ 768	**$13,445**	**$ 4,154**	**$ 9,291**
Machinery and equipment	**1,109**	**512**	**597**	856	472	384	**9,479**	**4,376**	**5,103**
Other assets	**3,423**	**1,532**	**1,891**	3,298	1,760	1,538	**29,256**	**13,094**	**16,162**
Total	**¥6,105**	**¥2,530**	**¥3,575**	¥5,324	¥2,634	¥2,690	**$52,180**	**$21,624**	**$30,556**

Future minimum lease payments 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	**¥1,005**	¥ 850	**$ 8,590**
Due after one year	**2,570**	1,840	**21,966**
	¥3,575	¥2,690	**$30,556**

Lease payments and the assumed depreciation charge for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Lease payments	**¥1,053**	¥997	**$9,000**
Assumed depreciation charge	**1,053**	997	**9,000**

The assumed depreciation charge is computed using the straight-line method over lease terms assuming no residual value.

Since the portion of the future minimum lease payments is minor compared to the balance of property, plant and equipment as of March 31, 2006 and 2005, interest expense has been included in acquisition costs and depreciation expense.

Future minimum lease payments under operating leases, inclusive of interest, as of March 31, 2006 and 2005 were ¥744 million (US$6,359 thousand) and ¥93 million, respectively, including ¥121 million (US$1,034 thousand) and ¥44 million, respectively, due within one year.

11. Securities

A. The following tables summarize acquisition costs, book values and the fair value of securities with available fair values as of March 31, 2006 and 2005.

Available-for-sale securities: Securities with book values exceeding acquisition costs

	Millions of yen						Thousands of U.S. dollars		
	2006			2005			**2006**		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	**¥3,801**	**¥15,109**	**¥11,308**	¥3,335	¥9,343	¥6,008	**$32,487**	**$129,137**	**$96,650**

Available-for-sale securities: Other securities

	Millions of yen						Thousands of U.S. dollars		
	2006			2005			**2006**		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	**¥516**	**¥508**	**¥(8)**	¥32	¥27	¥(5)	**$4,410**	**$4,342**	**$(68)**

B. The following table summarizes the book values of securities with no available fair values as of March 31, 2006 and 2005.

Equity securities issued by subsidiaries and affiliated companies and available-for-sale securities:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Non-listed equity securities	**¥2,251**	¥2,250	**$19,239**
Unconsolidated subsidiaries and affiliated companies' equity securities	**3,107**	2,580	**26,556**

C. Proceeds from sales of available-for-sale securities in the year ended March 31, 2006 amounted to ¥393 million (US$3,359 thousand) and the related gains and losses amounted to ¥335 million (US$2,863 thousand) and ¥1 million (US$9 thousand), respectively.

Proceeds from sales of available-for-sale securities in the year ended March 31, 2005 amounted to ¥2,315 million and the related gains amounted to ¥1,515 million.

12. Derivative Financial Instruments

The Company and certain consolidated subsidiaries have entered into forward exchange contracts with banks as hedges against receivables denominated in foreign currencies and interest rate swap agreements for certain assets with fixed interest rates and certain liabilities with variable interest rates to hedge their exposure to fluctuations of interest rates.

These derivative financial transactions are utilized solely for hedging purposes under the internal control rules and the supervision of the Board of Directors. The Companies do not anticipate any credit loss from non-performance by the counterparties to forward exchange contracts and interest rate swap agreements.

The following summarizes the hedging derivative financial instruments used by the Companies and the items hedged:

Hedging instruments:

Forward foreign exchange contracts, interest rate swap contracts

Hedged items:

Foreign currency transactions, bank loans

An evaluation of hedge effectiveness during the years ended March 31, 2006 and 2005 was omitted as hedge accounting has been applied to derivative transactions.

13. Research and Development Costs

Research and development costs charged to the cost of sales and selling, general and administrative expenses for the years ended March 31, 2006 and 2005 were ¥3,706 million (US$31,675 thousand) and ¥3,533 million, respectively.

14. Other Income (Expenses)—Other, Net

Other, net, included in other income (expenses) for the years ended March 31, 2006 and 2005 comprises the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Royalty income	**¥ 585**	¥ 476	**$ 5,000**
Equity in earnings of unconsolidated subsidiaries and affiliated companies	**495**	481	**4,231**
Loss on disposal of inventories	**(140)**	(326)	**(1,196)**
Foreign exchange gain, net	**922**	217	**7,880**
Loss on sale and disposal of property, plant and equipment, net	**(370)**	(640)	**(3,162)**
Gain on sale of investment securities	**335**	1,515	**2,863**
Reversal of allowance for uncollectibles	**13**	85	**111**
Severance and retirement benefit expenses (Note 5)	**—**	(897)	**—**
Others	**390**	381	**3,333**
	¥2,230	¥1,292	**$19,060**

15. Segment Information

Business segments

The Company and its consolidated subsidiaries operate primarily in the production and sale of hydraulic products and systems products. Refer to the "Review of Operations" and "Financial Review" for more information about the major products of each segment.

Business segment information for the years ended March 31, 2006 and 2005 is as follows:

	Millions of yen				
Year ended March 31, 2006:	Hydraulic products	Systems products	Total	Elimination or unallocation	Consolidated
Sales:					
Outside customers	¥278,282	¥12,174	¥290,456	¥ —	¥290,456
Intersegment	414	324	738	(738)	—
Total sales	278,696	12,498	291,194	(738)	290,456
Operating expenses	265,775	12,911	278,686	5,047	283,733
Operating income	¥ 12,921	¥ (413)	¥ 12,508	¥ (5,785)	¥ 6,723
Identifiable assets	¥203,708	¥10,884	¥214,592	¥33,374	¥247,966
Depreciation and amortization	9,765	398	10,163	87	10,250
Capital expenditures	15,248	355	15,603	75	15,678

	Millions of yen				
Year ended March 31, 2005:	Hydraulic products	Systems products	Total	Elimination or unallocation	Consolidated
Sales:					
Outside customers	¥259,639	¥10,690	¥270,329	¥ —	¥270,329
Intersegment	279	497	776	(776)	—
Total sales	259,918	11,187	271,105	(776)	270,329
Operating expenses	245,032	11,417	256,449	4,238	260,687
Operating income	¥ 14,886	¥ (230)	¥ 14,656	¥ (5,014)	¥ 9,642
Identifiable assets	¥180,398	¥13,853	¥194,251	¥27,973	¥222,224
Depreciation and amortization	9,454	284	9,738	42	9,780
Capital expenditures	13,893	137	14,030	40	14,070

	Thousands of U.S. dollars				
Year ended March 31, 2006:	Hydraulic products	Systems products	Total	Elimination or unallocation	Consolidated
Sales:					
Outside customers	$2,378,479	$104,051	$2,482,530	$ —	$2,482,530
Intersegment	3,538	2,770	6,308	(6,308)	—
Total sales	2,382,017	106,821	2,488,838	(6,308)	2,482,530
Operating expenses	2,271,581	110,351	2,381,932	43,136	2,425,068
Operating income	$ 110,436	$ (3,530)	$ 106,906	$ (49,444)	$ 57,462
Identifiable assets	$1,741,094	$ 93,026	$1,834,120	$285,248	$2,119,368
Depreciation and amortization	83,461	3,402	86,863	744	87,607
Capital expenditures	130,325	3,034	133,359	641	134,000

Geographic segments

Geographic segment information for the years ended March 31, 2006 and 2005 is as follows:

	Millions of yen					
Year ended March 31, 2006:	Japan	Europe	Other areas	Total	Elimination or unallocation	Consolidated
Sales:						
Outside customers	**¥205,600**	**¥36,870**	**¥47,986**	**¥290,456**	**¥ —**	**¥290,456**
Intersegment	**20,388**	**880**	**893**	**22,161**	**(22,161)**	**—**
Total sales	**225,988**	**37,750**	**48,879**	**312,617**	**(22,161)**	**290,456**
Operating expenses	**214,077**	**38,122**	**48,928**	**301,127**	**(17,394)**	**283,733**
Operating income	**¥ 11,911**	**¥ (372)**	**¥ (49)**	**¥ 11,490**	**¥ (4,767)**	**¥ 6,723**
Identifiable assets	**¥181,758**	**¥26,444**	**¥37,851**	**¥246,053**	**¥ 1,913**	**¥247,966**

	Millions of yen					
Year ended March 31, 2005:	Japan	Europe	Other areas	Total	Elimination or unallocation	Consolidated
Sales:						
Outside customers	¥190,647	¥37,620	¥42,062	¥270,329	¥ —	¥270,329
Intersegment	16,520	269	733	17,522	(17,522)	—
Total sales	207,167	37,889	42,795	287,851	(17,522)	270,329
Operating expenses	192,857	38,596	42,300	273,753	(13,066)	260,687
Operating income	¥ 14,310	¥ (707)	¥ 495	¥ 14,098	¥ (4,456)	¥ 9,642
Identifiable assets	¥169,631	¥22,650	¥28,018	¥220,299	¥ 1,925	¥222,224

	Thousands of U.S. dollars					
Year ended March 31, 2006:	Japan	Europe	Other areas	Total	Elimination or unallocation	Consolidated
Sales:						
Outside customers	**$1,757,265**	**$315,128**	**$410,137**	**$2,482,530**	**$ —**	**$2,482,530**
Intersegment	**174,256**	**7,522**	**7,632**	**189,410**	**(189,410)**	**—**
Total sales	**1,931,521**	**322,650**	**417,769**	**2,671,940**	**(189,410)**	**2,482,530**
Operating expenses	**1,829,718**	**325,829**	**418,188**	**2,573,735**	**(148,667)**	**2,425,068**
Operating income	**$ 101,803**	**$ (3,179)**	**$ (419)**	**$ 98,205**	**$ (40,743)**	**$ 57,462**
Identifiable assets	**$1,553,488**	**$226,017**	**$323,512**	**$2,103,017**	**$ 16,351**	**$2,119,368**

Overseas sales

Overseas sales by geographic area for the years ended March 31, 2006 and 2005 are as follows:

	Millions of yen				
Year ended March 31, 2006:	Europe	North America	Southeast Asia	Other areas	Total
I. Overseas sales	**¥39,688**	**¥31,432**	**¥17,118**	**¥15,010**	**¥103,248**
II. Consolidated sales	**—**	**—**	**—**	**—**	**290,456**
III. Ratio of overseas sales (%)	**13.6%**	**10.8%**	**5.9%**	**5.2%**	**35.5%**

	Millions of yen				
Year ended March 31, 2005:	Europe	North America	Southeast Asia	Other areas	Total
I. Overseas sales	¥40,598	¥31,507	¥15,739	¥12,465	¥100,309
II. Consolidated sales	—	—	—	—	270,329
III. Ratio of overseas sales (%)	15.0%	11.7%	5.8%	4.6%	37.1%

	Thousands of U.S. dollars				
Year ended March 31, 2006:	Europe	North America	Southeast Asia	Other areas	Total
I. Overseas sales	**$339,214**	**$268,649**	**$146,308**	**$128,291**	**$ 882,462**
II. Consolidated sales	**—**	**—**	**—**	**—**	**2,482,530**
III. Ratio of overseas sales (%)	**13.6%**	**10.8%**	**5.9%**	**5.2%**	**35.5%**

Overseas sales included those of the Company and its consolidated subsidiaries.

16. Subsequent Events

(1) Share purchase

On April 27, 2006, the Company acquired 137,434 shares of Takako Industries Inc. (Takako) for ¥1,856 million (US$15,863 thousand). As a result, the Company owns 62.5% of the issued shares of Takako. In addition, the Company plans to make Takako a fully consolidated subsidiary through a stock swap. Takako has outstanding skills in precision processes required to manufacture hydraulic products and electronic products. Exemplifying Takako's expertise is its strength in piston ASSY (assemblies), a critical component of hydraulic piston pumps used in construction and industrial machinery, and Takako's share of those products in Japan's market exceeds 50%. The Company plans to expand Hydraulic Components Operations and to enhance the corporate value of the KYB Group.

The information for Takako for the year ended March 31, 2006 is as follows:

President and Representative Director:	Yoshitomo Ishizaki
Head Office:	Seika-cho, Souraku-gun, Kyoto, Japan
Common Stock:	¥234 million (US$2,000 thousand)
Net Sales:	¥7,500 million (US$64,103 thousand)

(2) Appropriations for retained earnings

On June 28, 2006, the shareholders of the Company authorized the following appropriations of retained earnings as of March 31, 2006:

	Millions of yen	Thousands of U.S. dollars
Cash dividends, ¥3 (US$0.03) per share	¥668	$5,709
Bonuses to directors and corporate auditors	68	581

INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of KAYABA INDUSTRY Co., Ltd.:

We have audited the accompanying consolidated balance sheets of KAYABA INDUSTRY Co., Ltd. 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, expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently 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 KAYABA INDUSTRY Co., Ltd. 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.

Without qualifying our opinion, we draw attention to the following.
(1) As discussed in Note 16 to the consolidated financial statements, on April 27, 2006, KAYABA INDUSTRY Co., Ltd. acquired a majority stake in Takako Industries, INC. and Takako Industries, INC. became the subsidiary of KAYABA INDUSTRY Co., Ltd.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 1 to the consolidated financial statements.

KPMG AZSA & Co.

Tokyo, Japan
June 28, 2006

Major Subsidiaries and Affiliates

(As of July 1, 2006)

Japan

Kayaba System Machinery Co., Ltd.

—Manufacturing and sales of systems products

Sumitomo-Fudosan Shiba Daimon Bldg., 5-5, Shibadaimon 2-chome, Minato-ku, Tokyo 105-0012, Japan
Tel: 81-3-5733-9441 Fax: 81-3-5733-9504

KYB Engineering and Service Co., Ltd.

—Sales of shock absorbers and hydraulic equipment

Shuwa Shiba Park Bldg., A, 8F, 4-1, Shiba Kouen 2-chome, Minato-ku, Tokyo 105-0011, Japan
Tel: 81-3-5777-7501 Fax: 81-3-5401-3362

KYB Trondule Co., Ltd.

—Manufacturing and sales of electronic equipment

3909 Ura, Nagaoka City, Niigata 949-5406, Japan
Tel: 81-258-92-6903 Fax: 81-258-92-6901

Japan Analysts Ltd.

—Analysis and evaluation of lubricating oil

Matsunaga Bldg., 1-17, Hamamatsu-cho 2-chome, Minato-ku, Tokyo 105-0013, Japan
Tel: 81-3-3436-5660 Fax: 81-3-3436-1077

KK Hydraulics Co., Ltd.

—Sales and after-service of hydraulic equipment

World Trade Center Bldg., 4-1, Hamamatsu-cho 2-chome, Minato-ku, Tokyo 105-6111, Japan
Tel: 81-3-3578-1197 Fax: 81-3-3578-1198

Yanagisawa Seiki MFG Co., Ltd.

—Manufacturing and sales of shock absorbers and hydraulic equipment

7001 Oaza-Sakaki, Sakaki-machi, Hanishina-gun, Nagano 389-0601, Japan
Tel: 81-268-82-2850 Fax: 81-268-82-2857

KYB Kanayama Co., Ltd.

—Manufacturing of shock absorbers and hydraulic equipment

4350-130 Tobe, Kanayama-cho, Gero City, Gifu 509-1605, Japan
Tel: 81-576-35-2201 Fax: 81-576-35-2877

MacGREGOR-Kayaba Ltd.

—Manufacturing and sales of hatch covers for ships

Suzue Baydium, 15-1, Kaigan 1-chome, Minato-ku, Tokyo 105-0022, Japan
Tel: 81-3-5403-1951 Fax: 81-3-5403-1953

Takako Industries, Inc.

—Manufacturing and sales of hydraulic pump components and electronic machine parts

1-32-5, Housono-Nishi, Seika-cho, Souraku-gun, Kyoto 619-0240, Japan
Tel: 81-774-95-3336 Fax: 81-774-95-3337

North America and South America

KYB Manufacturing North America, Inc.

—Manufacturing and sales of shock absorbers

2625 North Morton, Franklin, Indiana 46131, U.S.A.
Tel: 1-317-736-7774 Fax: 1-317-736-4618

KYB America LLC

—Sales of shock absorbers and hydraulic equipment

140 North Mitchell Court, Addison, Illinois 60101, U.S.A.
Tel: 1-630-620-5555 Fax: 1-630-620-8133

KYB do Brasil Fabricante de Autopeças Ltda.

—Manufacturing and sales of shock absorbers

Francisco Ferreira da Cruz 3000, Fazenda Rio Grande Parana, CEP 83820-000, Brazil
Tel: 55-41-2102-8200 Fax: 55-41-2102-8210

KYB Latinoamerica, S.A. de C.V.

—Sales of shock absorbers

Paseo de Las Palmas 731, Piso 14 Col. Lomas de Chapultepec, Mexico D.F. C.P. 11000
Tel: 52-55-5282-5770 Fax: 52-55-5282-5661

Europe

KYB Europe GmbH

—Sales of shock absorbers

Kimpler Strasse 336, D-47807 Krefeld, Germany
Tel: 49-2151-931430 Fax: 49-2151-9314320

KYB Steering Spain, S.A.

—Manufacturing and sales of hydraulic equipment

Poligono Industrial de Ipertegui No. 2, Nave 12, 31160, Orcoyen Navarra, Spain
Tel: 34-948-321004 Fax: 34-948-321005

KYB Suspensions Europe, S.A.

—Manufacturing and sales of shock absorbers

Ctra. Irurzun S/No, 31171, Ororbia Navarra, Spain
Tel: 34-948-421700 Fax: 34-948-322338

KYB Manufacturing Czech s.r.o.

—Manufacturing and sales of shock absorbers

U Panasonicu 277, Stare Civice, 53006 Pardubice, Czech Republic

KYB Middle East f.z.e.

—Sales of shock absorbers

LOB 16-302, Jebel Ali Free Zone, Dubai, United Arab Emirates
P.O. Box: 261819
Tel: 971-4-887-2448 Fax: 971-4-887-2438

Asia

KYB Steering (Thailand) Co., Ltd.
—Manufacturing and sales of hydraulic equipment
700/460 Moo 7, Tambol Don Hua Roh, Amphur Muang,
Chonburi 20000, Thailand
Tel: 66-38-454-315 Fax: 66-38-454-313

KYB Industrial Machinery (Zhenjiang) Ltd.
—Manufacturing and sales of shock absorbers
Jing 12 Lu, Zhenjiang New Zone, New & High-Tech Industry
Development Park, Zhenjiang, Jiangsu 212009,
People's Republic of China
Tel: 86-511-889-1008 Fax: 86-511-888-6848

KYB Hydraulics Industry (Zhenjiang) Ltd.
—Manufacturing and sales of hydraulic equipment
Jing 12 Lu, Zhenjiang New Zone, New & High-Tech Industry
Development Park, Zhenjiang, Jiangsu 212009,
People's Republic of China
Tel: 86-511-889-7200 Fax: 86-511-889-7222

KYB Trading (Shanghai) Co., Ltd.
—Sales of shock absorbers
Huamin Empire Plaza 5-L, 728 Yanan Road West,
Shanghai 200050, People's Republic of China
Tel: 86-21-6211-9299 Fax: 86-21-5237-9001

KYB Technical Center (Thailand) Co., Ltd.
—Engineering services
700/363 Moo 6, Amata Nakorn Industrial Estate, Bangna-Trad
Road, K.M. 57, Tambol Don Hua Roh, Amphur Muang,
Chonburi 20000, Thailand
Tel: 66-38-468-251 Fax: 66-38-468-252

KYB Asia Co., Ltd.
—Sales of shock absorbers
Block A1-A2, No. 40-114-115 Bangna-Trad Road, Km 16.5,
Bangcha-long Sub-District, Bangplee District,
Samutprakarn 10540, Thailand
Tel: 66-2-740-7920 Fax: 66-2-740-7924

KYB Manufacturing Vietnam Co., Ltd.
—Manufacturing and sales of shock absorbers
Plot 10-11-12, Thang Long Industrial Park,
Dong Anh District, Hanoi, Vietnam
Tel: 84-4-8812773 Fax: 84-4-8812774

KYB (Thailand) Co., Ltd.
—Manufacturing and sales of shock absorbers
380 Moo 2, Sukhumvit Road, T. Bangpoo Mai, Amphur Muang,
Samutprakarn 10280, Thailand
Tel: 66-2-323-9035 Fax: 66-2-323-9037

KYB Manufacturing (Taiwan) Co., Ltd.
—Manufacturing and sales of shock absorbers and hydraulic equipment
No. 493, Kuang Hsing Road, Pa-Teh City,
Tao Yuan Hsien, Taiwan
Tel: 886-3-368-3123 Fax: 886-3-368-3369

KYB-UMW Malaysia Sdn. Bhd.
KYB-UMW Steering Malaysia Sdn. Bhd.
—Manufacturing and sales of shock absorbers and hydraulic equipment
Lot 8, Jalan Waja 16, Telok Panglima Garang, 42500 Kuala Langat,
Selangor Darul Ehsan, Malaysia
Tel: 60-3-31226222 Fax: 60-3-31226677

P.T. Kayaba Indonesia
—Manufacturing and sales of shock absorbers
JL. Rawaterate 1/4, Pulogadung Industrial Estate,
Jakarta Timur 13930, Indonesia
Tel: 62-21-4615020 Fax: 62-21-4600048

Husco-Kayaba Hydraulics (Shanghai), Ltd.
—Manufacturing and sales of hydraulic equipment
No. 235, Jiangtian Road, East Songjiang Industry Zone,
Shanghai 201600, People's Republic of China
Tel: 86-21-5774-6468 Fax: 86-21-3774-0186

KK Hydraulics Sales (Shanghai) Co., Ltd.
—Sales and after-service of hydraulic equipment
B-908 Far East International Plaza, 317 Xianxia Road,
Shanghai 200051, People's Republic of China
Tel: 86-21-6235-1606 Fax: 86-21-6295-7080

Corporate Information

(As of March 31, 2006)

Company Data

Head Office:
World Trade Center Bldg., 4-1,
Hamamatsu-cho 2-chome, Minato-ku,
Tokyo 105-6111, Japan
Tel: 81-3-3435-3511
Fax: 81-3-3436-6759
URL: http://www.kyb.co.jp

Date of Establishment:
November 25, 1948

Fiscal Year:
April 1 to March 31

Paid-in Capital:
¥19,114 million

Number of Employees:
8,387 (Consolidated basis)

Securities Traded:
Tokyo Stock Exchange (First Section)

Plants:
Sagami, Kumagaya,
Gifu North, Gifu South

R&D Centers:
Basic Technology R&D Center,
Production Technology R&D Center

Sales Branches:
Nagoya, Osaka, Fukuoka, Sapporo,
Sendai, Hamamatsu, Hiroshima

Overseas Offices:

Europe Branch
Kimpler Str. 336,
47807 Krefeld, Germany
Tel: 49-2151-9314350
Fax: 49-2151-9314330

California Representative Office
5790 Katella Ave., Cypress,
CA 90630, U.S.A.
Tel: 1-562-799-3862
Fax: 1-562-799-3863

Seattle Representative Office
700 5th Ave., Suite 5900,
Seattle, WA 98104, U.S.A.
Tel: 1-206-386-5625
Fax: 1-206-621-9448

Shareholder Information

Common Stock Issued:
222,984,315 shares

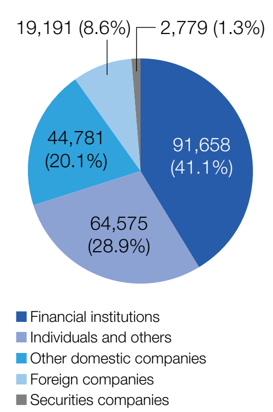
Number of Shareholders:
21,069

Transfer Agent and Registrar:
Mizuho Trust & Banking Co., Ltd.
2-1, Yaesu 1-chome, Chuo-ku,
Tokyo 100-0005, Japan

Major Shareholders:

Name	Shareholdings (Thousands)	Percent of Total Shares Issued
Toyota Motor Corporation	19,654	8.81
UBS AG London—IPB Client Account	10,392	4.66
Meiji Yasuda Life Insurance Company	10,046	4.51
The Master Trust Bank of Japan, Ltd. (Trust Account)	8,998	4.04
Bridgestone Corporation	7,952	3.57
Sompo Japan Insurance Inc.	7,811	3.50
Japan Trustee Services Bank, Ltd. (Trust Account)	7,563	3.39
Mizuho Corporate Bank, Ltd.	7,091	3.18
Trust & Custody Services Bank, Ltd. (Mizuho Corporate Bank, Ltd., Retirement Benefit Trust Account re-entrusted by Mizuho Trust & Banking Co., Ltd.)	6,904	3.10
Japan Trustee Services Bank, Ltd. (Trust Account 4)	6,757	3.03
Total	93,168	41.78

Composition of Shareholders:
(Thousands)



Monthly Stock Price Range (Tokyo Stock Exchange)