Notes to Consolidated Financial Statements

Tsubakimoto Chain Co. and Consolidated Subsidiaries

1. BASIS OF PRESENTING CONSOLIDATED FINANCIAL STATEMENTS

(a) Accounting principles of consolidation

The Company has prepared its consolidated financial statements in accordance with accounting principles and practices generally accepted in Japan, which may differ in some material respects from accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

Certain modifications in format have been made to facilitate understanding by readers outside Japan.

In addition, the notes to the consolidated financial statements include additional information which is not required under accounting principles and practices generally accepted in Japan but is presented herein as additional information.

(b) Consolidated subsidiaries

The consolidated financial statements include the accounts of the parent company and its significant domestic and foreign subsidiaries (the "Companies").

Due to growing significance, beginning with the year ended March 31, 2003, two subsidiaries have been included in the consolidated financial statements.

Consolidated subsidiaries are:

U.S. Tsubaki, Inc. (U.S.A.)
Hokkaido Tsubakimoto Chain Co., Ltd.
Tsubakimoto Custom Chain Co.
Tsubaki of Canada Limited (Canada)
Tsubakimoto Bulk Systems Corporation
Tsubakimoto Machinery Co.
Tsubaki Emerson Co.
Tsubakimoto Sprocket Co.
Tsubaki Conveyor of America, Inc. (U.S.A.)
Taiwan Tsubakimoto Co. (Taiwan)
Ballantine, Inc. (U.S.A.)
Tsubaki Arcs Co.
Tsubakimoto Europe B.V. (Netherlands)
P. Koning B.V. (Netherlands)
Tsubakimoto U.K. Ltd. (U.K.)
Tsubakimoto Singapore Pte. Ltd. (Singapore)
Tsubakimoto Thailand Co., Ltd. (Thailand)
Tsubaki Australia Pty. Limited (Australia)
Tsubakimoto Nishinihon Co., Ltd.
Tsubakimoto Mayfran Inc.
Korea Conveyor Ind. Co., Ltd. (Republic of Korea)
Tsubaki Emerson Gear (Tianjin) Co., Ltd. (China)
Tsubakimoto Iron Casting Co., Ltd.

(c) Unconsolidated subsidiaries and affiliates

Investments in the affiliates over which the Company has the ability to exercise significant influence are accounted for using the equity method.

Due to growing significance, beginning with the year ended March 31, 2003, one affiliate has been included in the consolidated financial statements.

Investments in 6 insignificant subsidiaries and 3 affiliated companies are stated at cost because the Company's equity in the income or losses of these companies is not significant.

(d) Translation into U.S. dollars

The consolidated financial statements presented herein are expressed in Japanese yen and, solely for the convenience of the reader, have been translated into U.S. dollars at the rate of ¥120.20 = $1, the approximate exchange rate prevailing on March 31, 2003.

(e) Cash and cash equivalents

For the purposes of cash flows statements, cash and cash equivalents comprise cash in hand, deposits held at call with banks, net of overdrafts, and all highly liquid investments with maturities of three months or less.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Short-term investments and investments in securities

Held-to-maturity debt securities are stated at their amortized cost adjusted for the amortization of premiums and the accretion of discount to maturity.

Marketable securities classified as other securities are carried at fair value as of the balance sheet date with changes in unrealized holding gain or loss, net of the applicable income taxes, included directly in shareholders' equity. The cost of securities sold is primarily calculated by the moving-average method.

Non-marketable securities classified as other securities are stated at cost primarily determined by the moving-average method.

(b) Inventories

Inventories are stated principally at cost, which is determined by the first-in, first-out (FIFO) method, by the accumulated-cost method or by the moving-average cost method, except for the inventories of 8 subsidiaries, which are valued at the lower of cost or market.

(c) Property, plant and equipment

Property, plant and equipment are carried at cost. Depreciation of property, plant and equipment is computed mainly by the declining-balance method except for buildings for which the straight-line method is applied.

The principal estimated useful lives are as follows:

Buildings and structures	3 to 50 years
Machinery and equipment	4 to 13 years

(d) Computer software

Expenditure relating to computer software developed for internal use is charged to income when incurred, except if it contributes to the generation of income or to future cost savings. Such expenditure is capitalized as an asset and is amortized using the straight-line method over its estimated useful life.

(e) Allowance for doubtful receivables

The allowance for doubtful receivables is computed based on the actual ratio of bad debts in the past and an estimate of certain uncollectible amounts determined after an analysis of specific individual receivables.

(f) Bonuses for employees

Accrued bonuses for employees are calculated based on an estimation of future bonus payments.

(g) Retirement benefits

Effective April 1, 2000, the Companies adopted the Accounting Standards for Retirement Benefits which was issued by the Business Accounting Deliberation Council for Small Business Entity. In accordance with the new standards, accrued severance indemnities are provided based on the amount of projected benefit obligation reduced by pension plan assets at fair value at the end of the annual period.

Actuarial gain or loss is proportionally amortized in each year following the year in which the gain or loss is recognized principally by the straight-line method over 10 years, which is within the estimated average remaining years of service of the eligible employees.

Effective April 1, 2002, Tsubaki Emerson Co. and Tsubakimoto Custom Chain Co. changed the method of calculation for retirement benefits obligation from the simplified method, accrual for 100% of the amount required if all employees were to voluntarily terminate their employment as of the balance sheet date, to actuarial calculation which is prescribed by the accounting standards as the principle method.

The effect of the change was to increase income before income taxes and minority interests for the year ended March 31, 2003 by ¥15 million ($124,792 thousand) from the amount which would have been recorded under the method applied in the previous year.

Also, the Company and consolidated domestic subsidiaries record the unfunded retirement benefits for directors and statutory auditors on the accrual basis, which is included in other noncurrent liabilities.

(h) Translation of balances denominated in foreign currencies in domestic financial statements

Receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rates prevailing on the balance sheet date except for amounts fixed by forward exchange contracts.

All gains and losses resulting from the translation of foreign currency balances are included in net income for the year.

(i) Accounting for leases

Finance leases, except for those in which ownership is deemed to be transferred to the lessee, are accounted for by the same method as operating leases.

3. DIFFERENCE BETWEEN COST AND NET EQUITY OF CONSOLIDATED SUBSIDIARIES

The difference between the cost and the underlying net equity in investments in consolidated subsidiaries and affiliates accounted for on an equity basis is allocated to identifiable assets based on their fair value at respective dates of acquisition. Unallocated costs are deferred and amortized by the straight-line method for less than 5 years.

4. INTERCOMPANY TRANSACTIONS

All material intercompany balances and transactions, including unrealized profit in inventories and property, plant and equipment, have been eliminated on consolidation.

5. TRANSLATION OF FOREIGN CURRENCY FINANCIAL STATEMENTS

Assets and liabilities of foreign subsidiaries are translated into Japanese yen at the exchange rates prevailing on the respective balance sheet dates. Revenue and expenses are translated at the average rates of exchange for the respective years. Translation adjustments of foreign currency financial statements are reflected in shareholders' equity and minority interests in the consolidated balance sheets.

6. APPROPRIATIONS OF RETAINED EARNINGS

Appropriations of retained earnings are recorded at the date they are approved at the annual shareholders' meeting.

7. PLEDGED ASSETS

At March 31, 2003 and 2002, the following assets were pledged as collateral for bank loans and long-term debt:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	**2003**
Property, plant and equipment	**¥60,250**	¥45,397	**$501,248**
Other noncurrent items	**63**	63	**524**
	¥60,313	¥45,460	**$501,772**

8. CONTINGENT LIABILITIES

Contingent liabilities with respect to trade notes discounted and loans guaranteed amounted to ¥6,101 million ($50,757 thousand) and ¥7,866 million at March 31, 2003 and 2002, respectively.

9. REVALUATION OF LAND

At March 31, 2002, the land owned by the Company was revaluated under the Land Reappraisal Law, and unrealized losses resulting from the revaluation were debited directly from shareholders' equity as a revaluation surplus after offsetting the related deferred tax assets as stipulated by the law. The revaluation surplus will be credited to gain or loss to be incurred when the related land is sold.

The difference between the fair value at March 31, 2003 and the book value after the revaluation at March 31, 2002, is as follows:

	Millions of Yen	Thousands of U.S. Dollars
	2003	**2003**
Fair value at March 31, 2003	**¥28,094**	**$233,727**
Book value after the revaluation at March 31, 2003	**31,494**	**262,013**
Difference	**¥ 3,400**	**$ 28,286**

10. PER SHARE AMOUNTS

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	**2003**
Shareholders' equity per share	**¥319.39**	¥327.47	**$2.65**
Net income per share	**7.92**	6.27	**0.06**

Effective April 1, 2002, the Company and its consolidated subsidiaries adopted Financial Accounting Standard No. 2, "Accounting Standards for Earnings per Share" and Financial Accounting Standards Implementation Guidance No. 4: "Implementation Guidance for Accounting Standards for Earnings per Share," which were issued by the Accounting Standards Board of Japan.

The basic financial data for the computation of basic net income per share based on the new aforementioned standards for the year ended March 31, 2003, is as follows:

	Millions of Yen	Thousands of U.S. Dollars
Information on basic net income:		
Net income	¥1,531	$12,737
Deduction from net income:		
Bonuses to directors and statutory auditors	29	241
Adjusted net income allocated in common stock	1,502	12,496
Weighted average number of shares of common stock outstanding during 2003	189,504,012 shares	

11. SHAREHOLDERS' EQUITY

The Commercial Code of Japan (the "Code") requires the Company to transfer an amount equal to at least 10% of appropriations paid in cash to legal reserve. Under the revised Code, effective on October 1, 2001, the Company may not appropriate retained earnings to the legal reserve when the total balance of the legal reserve and additional paid-in capital equals to 25% of common stock. Amounts of the legal reserve and capital surplus in excess of 25% of common stock, subject to shareholders' approval, may be used for dividend distributions.

12. RESEARCH AND DEVELOPMENT

Research and development expenditure charged to income was ¥1,151 million ($9,576 thousand) and ¥1,273 million for the years ended March 31, 2003 and 2002, respectively.

13. RETIREMENT BENEFITS

The following table sets forth the changes in benefit obligation, plan assets and funded status of the Companies at March 31, 2003 and 2002, respectively:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	**2003**
Benefit obligation at end of year	**¥28,567**	¥28,219	**$237,662**
Fair value of plan assets at end of year	**6,931**	7,393	**57,662**
Funded status:			
Benefit obligation in excess of plan assets	**21,636**	20,826	**180,000**
Unrecognized actuarial loss	**3,944**	3,291	**32,812**
Accrued pension liability recognized in the consolidated balance sheets	**17,692**	17,535	**147,188**

Note: Domestic subsidiaries have adopted allowed alternative treatment of the Accounting Standards for Retirement Benefits for Small Business Entities.

Severance and pension costs of the Companies included the following components for the years ended March 31, 2003 and 2002, respectively:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	**2003**
Service cost	**¥1,438**	¥1,417	**$11,963**
Interest cost	**642**	726	**5,341**
Expected return on plan assets	**(158)**	(211)	**(1,314)**
Amortization:			
Actuarial losses	**335**	57	**2,787**
Other	**121**	—	**1,007**
Net periodic benefit cost	**¥2,378**	¥1,989	**$19,784**

Assumptions used in the accounting for the defined benefit plan for the year ended March 31, 2003, are as follows:

Method of attributing benefits to periods of service	straight-line basis
Discount rate	2.5%
Long-term rate of return on fund assets	2.5%
Amortization period for actuarial losses	10 years

14. INCOME TAXES

The Company and its domestic subsidiaries are subject to several taxes based on income, which in the aggregate resulted in statutory tax rates of approximately 42.0% for the years ended March 31, 2003 and 2002. Foreign subsidiaries are subject to income taxes of the countries in which they operate.

The effective rate for the two years ended March 31, 2003, differs from the Company's statutory tax rate for the following reasons:

	2003	2002
Statutory tax rate	**42.0%**	42.0%
Lower tax rates of overseas subsidiaries	**(12.0)**	(2.8)
Expenses not deductible for income tax purposes	**2.4**	2.7
Surplus not additional for income tax purposes	**(0.6)**	(1.4)
Cash dividends from overseas subsidiaries	**4.5**	4.8
Per capita levy	**1.8**	2.0
Other	**0.8**	1.2
Effective tax rate	**38.9%**	48.5%

New legislation was enacted in March 2003 which will change the aggregate statutory tax rate from 42.0% to 40.5% effective for fiscal years beginning after March 31, 2004. The effect of this tax rate change was to decrease deferred tax liabilities (net of deferred tax assets) by ¥0 million ($0 thousand) at March 31, 2003 and to increase income taxes–deferred by ¥38 million ($316 thousand) for the year ended March 31, 2003.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets at March 31, 2003 and 2002, are presented below:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	**2003**
Deferred tax assets:			
Provision for retirement benefits	**¥ 6,248**	¥ 5,952	**$ 51,980**
Accrued bonuses	**680**	367	**5,657**
Allowance for doubtful accounts	**215**	247	**1,789**
Tax loss carryforwards	**145**	561	**1,206**
Loss on valuation of investment securities	**332**	526	**2,762**
Impairment loss on deposits for golf club membership	**164**	203	**1,365**
Other	**1,236**	1,195	**10,283**
Total gross deferred tax assets	**9,020**	9,051	**75,042**
Less valuation allowance	**—**	(166)	**—**
Net deferred tax assets	**9,020**	8,885	**75,042**
Deferred tax liabilities:			
Reserve for deduction entry of property replaced by purchase	**(5,210)**	(5,410)	**(43,345)**
Profit from valuation for the consolidation of capital account	**(372)**	(372)	**(3,095)**
Other	**(2,474)**	(3,111)	**(20,581)**
Total gross deferred tax liabilities	**(8,056)**	(8,893)	**(67,021)**
Net deferred tax assets	**¥ 964**	¥ (8)	**$ 8,021**

15. SEGMENT INFORMATION

Information by business segment and geographical segment for the years ended March 31, 2003, 2002 and 2001, is as follows:

(a) Business segment	Millions of Yen 2003	2002	2001	Thousands of U.S. Dollars 2003
Net sales:				
Power transmission products:				
Customers	**¥ 86,774**	¥ 83,760	¥ 87,388	**$ 721,913**
Intersegment	**1,383**	1,484	1,298	**11,506**
Total	**88,157**	85,244	88,686	**733,419**
Materials handling systems:				
Customers	**29,452**	29,547	26,329	**245,025**
Intersegment	**111**	201	184	**923**
Total	**29,563**	29,748	26,513	**245,948**
Others:				
Customers	**444**	434	489	**3,694**
Intersegment	**847**	1,227	1,147	**7,047**
Total	**1,291**	1,661	1,636	**10,741**
Eliminations	**(2,341)**	(2,912)	(2,629)	**(19,476)**
Consolidated total	**¥116,670**	¥113,741	¥114,206	**$ 970,632**
Operating income (loss):				
Power transmission products	**¥ 7,526**	¥ 6,563	¥ 8,711	**$ 62,612**
Materials handling systems	**2,463**	2,278	750	**20,491**
Others	**13**	163	230	**108**
Corporate and eliminations	**(2,651)**	(2,966)	(2,729)	**(22,055)**
Consolidated total	**¥ 7,351**	¥ 6,038	¥ 6,962	**$ 61,156**
Total assets:				
Power transmission products	**¥124,213**	¥127,378	¥129,295	**$1,033,386**
Materials handling systems	**23,986**	26,183	21,189	**199,551**
Others	**2,216**	2,748	2,733	**18,436**
Corporate and eliminations	**32,845**	45,246	55,660	**273,253**
Consolidated total	**¥183,260**	¥201,555	¥208,877	**$1,524,626**
Depreciation:				
Power transmission products	**¥ 5,891**	¥ 4,824	¥ 3,719	**$ 49,010**
Materials handling systems	**456**	432	407	**3,794**
Others	**12**	12	17	**100**
Corporate and eliminations	**377**	343	178	**3,136**
Consolidated total	**¥ 6,736**	¥ 5,611	¥ 4,321	**$ 56,040**
Capital expenditures:				
Power transmission products	**¥ 2,635**	¥ 13,573	¥ 8,573	**$ 21,922**
Materials handling systems	**222**	290	295	**1,847**
Others	**8**	7	6	**66**
Corporate and eliminations	**77**	2,324	1,377	**641**
Consolidated total	**¥ 2,942**	¥ 16,194	¥ 10,251	**$ 24,476**

(b) Geographical segment	Millions of Yen 2003	2002	2001	Thousands of U.S. Dollars 2003
Net sales:				
Japan:				
Customers	**¥ 81,768**	¥ 83,267	¥ 86,394	**$ 680,266**
Intersegment	**9,921**	9,223	7,047	**82,537**
Total	**91,689**	92,490	93,441	**762,803**
North America:				
Customers	**25,965**	22,617	20,497	**216,015**
Intersegment	**213**	271	246	**1,772**
Total	**26,178**	22,888	20,743	**217,787**
Europe:				
Customers	**3,811**	3,178	2,807	**31,705**
Intersegment	**4**	6	3	**33**
Total	**3,815**	3,184	2,810	**31,738**
Asia and Oceania:				
Customers	**5,126**	4,679	4,508	**42,646**
Intersegment	**685**	657	658	**5,699**
Total	**5,811**	5,336	5,166	**48,345**
Eliminations	**(10,823)**	(10,157)	(7,954)	**(90,041)**
Consolidated total	**¥116,670**	¥113,741	¥114,206	**$ 970,632**
Operating income:				
Japan	**¥ 7,938**	¥ 7,903	¥ 8,239	**$ 66,040**
North America	**951**	813	981	**7,912**
Europe	**329**	189	57	**2,737**
Asia and Oceania	**479**	374	398	**3,985**
Corporate and eliminations	**(2,346)**	(3,241)	(2,713)	**(19,518)**
Consolidated total	**¥ 7,351**	¥ 6,038	¥ 6,962	**$ 61,156**
Total assets:				
Japan	**¥122,001**	¥125,790	¥127,131	**$1,014,983**
North America	**22,351**	24,572	20,042	**185,948**
Europe	**3,505**	3,341	2,835	**29,160**
Asia and Oceania	**6,491**	6,406	5,851	**54,002**
Corporate and eliminations	**28,912**	41,446	53,018	**240,533**
Consolidated total	**¥183,260**	¥201,555	¥208,877	**$1,524,626**