Notes to Consolidated Financial Statements

Tsubakimoto Chain Co. and Consolidated Subsidiaries

1. BASIS OF PRESENTING CONSOLIDATED FINANCIAL STATEMENTS

(a) Accounting principles of consolidation

The accompanying consolidated financial statements of Tsubakimoto Chain Co. (the "Company") and Consolidated subsidiaries are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company as required by the Securities and Exchange Law of 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 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").

Consolidated subsidiaries are:

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

(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.

One affiliate, Tianjin Tsubakimoto Conveyor Systems Co., Ltd., has been included in the consolidated financial statements.

Investments in 5 insignificant subsidiaries and 4 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 ¥105.69=$1, the approximate exchange rate prevailing on March 31, 2004.

(e) Cash and cash equivalents

For the purposes of cash flows statements, cash and cash equivalents comprise cash on hand, deposits held at call with banks, net of overdrafts, and all highly liquid investments with original 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 specific identification 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.

Prior service cost is charged to income as incurred.

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.

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, 2004 and 2003, the following assets were pledged as collateral for bank loans and long-term debt:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	**2004**
Property, plant and equipment	**¥57,803**	¥60,250	**$546,911**
Other noncurrent items	**63**	63	**596**
	¥57,866	¥60,313	**$547,507**

8. CONTINGENT LIABILITIES

Contingent liabilities with respect to trade notes discounted and loans guaranteed amounted to ¥2,847 million ($26,937 thousand) and ¥6,101 million at March 31, 2004 and 2003, 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, 2004 and the book value after the revaluation at March 31, 2004, is as follows:

	Millions of Yen	Thousands of U.S. Dollars
	2004	**2004**
Fair value at March 31, 2004	**¥24,274**	**$229,672**
Book value after the revaluation at March 31, 2004	**31,494**	**297,985**
Difference	**¥ 7,220**	**$ 68,313**

10. PER SHARE AMOUNTS

	Yen		U.S. Dollars
	2004	2003	**2004**
Shareholders' equity per share	**¥354.14**	¥319.39	**$ 3.35**
Net income per share	**17.40**	7.92	**0.165**

The basic financial data for the computation of basic net income per share for the year ended March 31, 2004, is as follows:

	Millions of Yen	Thousands of U.S. Dollars
Information on basic net income:		
Net income	¥3,385	$32,028
Deduction from net income:		
Bonuses to directors and statutory auditors	101	956
Adjusted net income allocated in common stock	3,284	31,072
Weighted average number of shares of common stock outstanding during 2004	188,657,512 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 is charged to income as incurred. Research and development costs charged to income for the years ended March 31, 2004 and 2003 are ¥1,092 million ($10,332 thousand) and ¥1,151 million, respectively.

13. RETIREMENT BENEFITS

The following table sets forth the details of benefit obligation, plan assets and funded status of the Companies at March 31, 2004 and 2003:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	**2004**
Benefit obligation at end of year	**¥(17,652)**	¥(28,567)	**$(167,017)**
Fair value of plan assets at end of year	**4,640**	6,931	**43,902**
Funded status:			
Benefit obligation in excess of plan assets	**(13,012)**	(21,636)	**(123,115)**
Unrecognized actuarial loss	**1,458**	3,944	**13,795**
Accrued pension liability recognized in the consolidated balance sheets	**(11,554)**	(17,692)	**(109,320)**

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

On April 1, 2004, the Company introduced a point system under which a set sum is added every year, reflecting the individual employee's performance over that year, and adopted a defined contribution pension plan.

The impact of the transfer of projected benefit obligation and pension assets under the tax qualified non-contributory defined benefit plan to a point system and the defined contribution pension plan at March 31, 2004, is as follows:

	Millions of Yen	Thousands of U.S. Dollars
Decrease in benefit obligation	¥ 9,751	$ 92,260
Plan assets transferred to the defined contribution pension plan	(2,679)	(25,348)
Unrecognized actuarial loss	(420)	(3,974)
Unrecognized prior service cost	(844)	(7,985)
Decrease in retirement benefit	5,808	54,853
Amount not yet transferred to the defined contribution pension plan	(4,692)	(44,394)
Net gain on the modification of retirement benefit plan	¥(1,116)	$(10,559)

The total amounts to be transferred to the defined contribution pension plan within eight years is ¥7,371 million ($69,742 thousand), of which ¥587 million ($5,554 thousand) is in other of current liabilities and ¥4,105 million ($38,840 thousand) is included in other of noncurrent liabilities.

The Company adopted Financial Accounting Standards Implementation Guidance No. 1 "Accounting for Transfers between Retirement Benefit Plans" issued by the Accounting Standards Board of Japan on January 31, 2002.

The components of net periodic benefit costs for the years ended March 31, 2004 and 2003, are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	**2004**
Service cost	**¥ 1,355**	¥1,438	**$ 12,820**
Interest cost	**645**	642	**6,103**
Expected return on plan assets	**(157)**	(158)	**(1,485)**
Net gain on the modification of retirement benefit plan	**(1,116)**	—	**(10,559)**
Amortization:			
Actuarial losses	**434**	335	**4,106**
Other	**—**	121	**—**
Net periodic benefit cost	**¥ 1,161**	¥2,378	**$ 10,985**

Assumptions used in the accounting for the defined benefit plan for the year ended March 31, 2004, are as follows:

Method of attributing benefits to period of service	straight-line basis
Discount rate	2.5%
Expected rate of return on plan assets	2.5%
Amortization period for actuarial losses	10 years
Amortization period of prior service cost	1 year

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, 2004 and 2003. Foreign subsidiaries are subject to income taxes of the countries in which they operate.

The effective tax rate for the year ended March 31, 2003 differs from the Company's statutory tax rate for the following reason.

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

Differences between the statutory tax rate and the effective tax rate for the year ended March 31, 2004 are insignificant and not presented.

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 tax effects of temporary differences that give rise to significant portions of the deferred tax assets at March 31, 2004 and 2003, are presented below:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	**2004**
Deferred tax assets:			
Provision for retirement benefits	**¥ 4,075**	¥ 6,248	**$ 38,556**
Transfer to defined contribution pension plan	**1,905**	—	**18,025**
Accrued bonuses	**801**	680	**7,579**
Allowance for doubtful accounts	**131**	215	**1,239**
Tax loss carryforwards	**58**	145	**549**
Loss on valuation of investment securities	**329**	332	**3,113**
Impairment loss on deposits for golf club membership	**159**	164	**1,504**
Other	**1,258**	1,236	**11,902**
Total gross deferred tax assets	**8,716**	9,020	**82,467**
Deferred tax liabilities:			
Reserve for deduction entry of property replaced by purchase	**(5,182)**	(5,210)	**(49,030)**
Profit from valuation for the consolidation of capital account	**(372)**	(372)	**(3,520)**
Other	**(6,158)**	(2,474)	**(58,264)**
Total gross deferred tax liabilities	**(11,712)**	(8,056)	**(110,814)**
Net deferred tax assets	**¥ (2,996)**	¥ 964	**$ (28,347)**

15. SEGMENT INFORMATION

Information by business segment and geographical segment for the years ended March 31, 2004, 2003 and 2002, is as follows:

(A) BUSINESS SEGMENT	Millions of Yen			Thousands of U.S. Dollars
	2004	2003	2002	**2004**
Net sales:				
Power transmission products:				
Customers	**¥ 90,081**	¥ 86,774	¥ 83,760	**$ 852,313**
Intersegment	**1,371**	1,383	1,484	**12,972**
Total	**91,452**	88,157	85,244	**865,285**
Materials handling systems:				
Customers	**28,426**	29,452	29,547	**268,956**
Intersegment	**123**	111	201	**1,164**
Total	**28,549**	29,563	29,748	**270,120**
Others:				
Customers	**634**	444	434	**5,999**
Intersegment	**1,836**	847	1,227	**17,371**
Total	**2,470**	1,291	1,661	**23,370**
Eliminations	**(3,330)**	(2,341)	(2,912)	**(31,507)**
Consolidated total	**¥119,141**	¥116,670	¥113,741	**$1,127,268**
Operating income (loss):				
Power transmission products	**¥ 8,630**	¥ 7,526	¥ 6,563	**$ 81,654**
Materials handling systems	**1,882**	2,463	2,278	**17,807**
Others	**84**	13	163	**794**
Corporate and eliminations	**(2,645)**	(2,651)	(2,966)	**(25,026)**
Consolidated total	**¥ 7,951**	¥ 7,351	¥ 6,038	**$ 75,229**
Total assets:				
Power transmission products	**¥115,011**	¥124,213	¥127,378	**$1,088,192**
Materials handling systems	**21,955**	23,986	26,183	**207,730**
Others	**2,393**	2,216	2,748	**22,642**
Corporate and eliminations	**36,073**	32,845	45,246	**341,309**
Consolidated total	**¥175,432**	¥183,260	¥201,555	**$1,659,873**
Depreciation:				
Power transmission products	**¥ 5,324**	¥ 5,891	¥ 4,824	**$ 50,374**
Materials handling systems	**409**	456	432	**3,870**
Others	**6**	12	12	**56**
Corporate and eliminations	**344**	377	343	**3,255**
Consolidated total	**¥ 6,083**	¥ 6,736	¥ 5,611	**$ 57,555**
Capital expenditures:				
Power transmission products	**¥ 3,148**	¥ 2,635	¥ 13,573	**$ 29,785**
Materials handling systems	**182**	222	290	**1,722**
Others	**14**	8	7	**132**
Corporate and eliminations	**162**	77	2,324	**1,533**
Consolidated total	**¥ 3,506**	¥ 2,942	¥ 16,194	**$ 33,172**

(B) GEOGRAPHICAL SEGMENT

	Millions of Yen			Thousands of U.S. Dollars
	2004	2003	2002	**2004**
Net sales:				
Japan:				
Customers	**¥ 84,840**	¥ 81,768	¥ 83,267	**$ 802,725**
Intersegment	**9,608**	9,921	9,223	**90,907**
Total	**94,448**	91,689	92,490	**893,632**
North America:				
Customers	**23,291**	25,965	22,617	**220,370**
Intersegment	**253**	213	271	**2,394**
Total	**23,544**	26,178	22,888	**222,764**
Europe:				
Customers	**4,719**	3,811	3,178	**44,649**
Intersegment	**4**	4	6	**38**
Total	**4,723**	3,815	3,184	**44,687**
Asia and Oceania:				
Customers	**6,292**	5,126	4,679	**59,533**
Intersegment	**526**	685	657	**4,977**
Total	**6,818**	5,811	5,336	**64,510**
Eliminations	**(10,392)**	(10,823)	(10,157)	**(98,325)**
Consolidated total	**¥119,141**	¥116,670	¥113,741	**$1,127,268**
Operating income:				
Japan	**¥ 8,385**	¥ 7,938	¥ 7,903	**$ 79,336**
North America	**865**	951	813	**8,184**
Europe	**340**	329	189	**3,217**
Asia and Oceania	**795**	479	374	**7,522**
Corporate and eliminations	**(2,434)**	(2,346)	(3,241)	**(23,030)**
Consolidated total	**¥ 7,951**	¥ 7,351	¥ 6,038	**$ 75,229**
Total assets:				
Japan	**¥113,927**	¥122,001	¥125,790	**$1,077,935**
North America	**18,085**	22,351	24,572	**171,114**
Europe	**4,103**	3,505	3,341	**38,821**
Asia and Oceania	**6,585**	6,491	6,406	**62,305**
Corporate and eliminations	**32,732**	28,912	41,446	**309,698**
Consolidated total	**¥175,432**	¥183,260	¥201,555	**$1,659,873**