**Takashi Fukunaga**
Chairman and Representative Director

**Tatsuhiko Mimoto**
President and Representative Director

# To Our Shareholders and Investors

Our pursuit of *Global Best* has borne fruit.
Now, we are striding forward in markets worldwide.

## Fiscal 2006 Business Results

### Reached Targets of Three-Year STEP 07 Medium-Term Management Plan Early and Posted Record Net Sales and Earnings

In fiscal 2006, ended March 31, 2006, the Tsubaki Group achieved its highest-ever consolidated net sales, which were up 14.0% year on year, to ¥147.8 billion. Also, the Group posted new earnings records for the first time since 1990, with year-on-year increases of 32.4% in operating income, 41.7% in ordinary income, and 48.5% in net income. Moreover, net sales surpassed targets set at the beginning of the year by approximately 9%, while earnings exceeded benchmarks by between 26% and 30%. In addition, almost one year ahead of schedule, we reached the fiscal 2007 targets set out in our three-year STEP 07 medium-term management plan, prepared in fiscal 2005.

**Our strong business results were not only due to favorable business conditions but also to our decisive implementation of selection and concentration.**

### All Operational Areas Delivered Higher Revenues and Earnings—Strategic Differentiation of Quality, Technology, and Production Contributes Significantly

All operational areas recorded higher revenues and earnings as well as enhanced operating income margins.

Chain operations were buoyed by stepped-up private-sector capital investment in Japan compared with the previous fiscal year and by the solid growth of economies in North America, Europe, and Asia. However, this solid performance was not entirely attributable to favorable external business conditions. Our differentiated quality and technology broadened our customer base, giving us a 21% share of the worldwide steel chain market. For example, we won a large order from a British food manufacturer and will begin OEM for a major overseas construction machinery manufacturer.

Further, automotive parts operations carved out a 33% share of the world market for automotive timing chain drive systems, which use timing chains and other components to drive engine camshafts. We are now hard on the heels of the timing drive system industry's largest manufacturer. The ongoing shift in global demand from belt to chain drive systems coupled with the increasing international presence of Japanese automakers—our mainstay customers—boosted automotive parts operations. Equally important contributing factors were our international five-point optimal site production system and the enhanced strength and durability of our products, which resulted from continuous efforts to develop technology.

Power transmission units and components operations worked to increase sales of reducers for shredders. Also, underpinned by ever-improving technology development capabilities, this operational area continued to diversify its customer base by launching new high-precision products, including couplings for servo motors and stepping motors. Meanwhile, we steadily exploited technological advances to differentiate materials handling systems operations. For example, we rolled out the recently released Minomi Conveyor System worldwide, which enables automakers to shorten paint shop conveyor lines and enhance productivity. Further, we attracted new customers through the solutions-based marketing of such products as drug discovery support equipment.

## Initiatives to Date and Issues and Basic Strategy Going Forward

### This Is *Global Best*

At Tsubakimoto Chain, our medium-to-long-term goal is to establish ourselves as the *Global Best*. In other words, we aim to enlarge our field of vision beyond the domestic market and offer the best-value products in markets worldwide. Under the STEP 08 medium-term management plan, in fiscal 2009 we target increases compared with fiscal 2006 of 6.4% in consolidated net sales, to ¥178.0 billion, and 12.9% in ordinary income, to ¥18.1 billion, as well as an ordinary income margin of 10.2%, up from 8.5%. Moreover, we are using upwardly revised targets because in fiscal 2006, we reached the numerical targets of the STEP 07 medium-term management plan approximately one year ahead of schedule.

### This Is the Journey—Combining Defensive and Aggressive Strategies on the Way to *Global Best*

Groundless calls for increases in world market share or ever-improving business results are not business plans or targets; they are simply dreams or hopes. To truly be the *Global Best,* we must satisfy certain major preconditions. With that in mind, we would like to review the road we have traveled in recent years.

Over the past five years, we have concentrated efforts on removing our vulnerability to economic fluctuations. A look at business results before fiscal 2001 reveals structural weakness. During the period, such economic indicators as private-sector capital investment in Japan drove our results up or down significantly. One reason was that there was little leeway left for the expansion of our domestic customer base. For example, our chain operations and automotive parts operations account for about 60% and 70% of their target markets in Japan. Clearly, we needed to extend the scope of our operations worldwide. However, that was by no means the only factor that spurred us to develop overseas business.

**Patient, farsighted garnering of world-beating capabilities is crucial.**

First, we felt we had to construct an unshakable financial base and earnings structure that could withstand aggressive management. Second, we wanted to differentiate our quality, technology development, and production system. To those ends, we undertook multifaceted reforms.

For example, by consolidating plants and withdrawing from unprofitable lineups, we reformed the structure of power transmission units and components operations and materials handling systems operations, which were competitively weaker than chain operations and automotive parts operations. Meanwhile, in chain operations, we heightened our technological superiority and the competitiveness of pricing through bold forward-looking investment that included the construction of a large state-of-the-art plant in Kyotanabe, Kyoto Prefecture, Japan. We knew that if we wanted to switch to more aggressive management at some point we had to upgrade the structure and core content of our operations—based on differentiated quality, technology, and production—rather than simply pursuing cost reductions and personnel rationalization. That prescient strategy underpinned our favorable business results in fiscal 2006 and has dramatically improved our profitability. For example, in fiscal 1998 and in fiscal 2005, net sales were roughly the same: ¥128.3 billion and ¥129.6 billion. In ordinary income, however, in fiscal 1998, we posted ¥5.5 billion, while in fiscal 2005, we recorded ¥8.9 billion. And, in fiscal 2006, ordinary income amounted to ¥12.6 billion.

**Simultaneously pursuing defensive and aggressive management enhanced our profitability and financial position.**

Meanwhile, we honed the efficiency of our administrative organization through operational outsourcing and other initiatives. Consequently, selling, general and administrative expenses as a percentage of net sales have fallen steadily, from 21.7% in fiscal 1998 to 18.9% in fiscal 2005 and 17.2% in fiscal 2006. Looking at our financial position, due to major investments for the Kyotanabe Plant, interest-bearing debt spiked to ¥78.7 billion in fiscal 2001, compared with ¥41.6 billion in fiscal 1998. However, interesting-bearing debt was down to ¥39.0 billion at the end of fiscal 2006.

### Analysis of Immediate Business Conditions

We are not excessively optimistic about current worldwide economic expansion. Nevertheless, several long-term structural trends in the global economy and in competition will likely give us a tail wind in the immediate future.

**We are not overly optimistic about the economic climate. We are focusing on long-term structural trends in the global economy and in competition.**

To take chain operations as one example, our main customers, manufacturers, are increasingly concerned with total life cycle costs. Therefore, demand is stronger than ever for enhanced quality and technology, particularly with respect to strength, durability, and drive performance. Among suppliers, however, there is a large gap between those that have the resources to invest in development and facilities along with the know-how to meet the emerging needs of manufacturers, and those that have not. This trend benefits well for the Group because Tsubakimoto Chain is the largest manufacturer of chain products in the world and stands well above its competitors in terms of quality and financial strength.

Further, automotive parts operations are witnessing a shift from the use of belts to chains in timing drive systems—the component that drives an engine's camshaft—because the additional strength and durability of chains makes them better suited to the high-powered, compact engines that are becoming increasingly prevalent. In particular, Europe, which has lagged behind other regions, will likely see stepped-up use of chain systems. Other positive factors include accelerating globalization in the design, development, and procurement of automotive parts and the increasing share of worldwide markets held by Japanese automakers, our mainstay customers. Such trends also benefit materials handling systems operations. Similarly, a shift from hydraulic to electro-mechanical linear actuators, which we call Power Cylinders, is helping our power transmission units and components operations, which produce more than half of the electro-mechanical cylinders sold in Japan.

### Issues and Countermeasures

The Group faces several hurdles that it must clear. In chain operations, we have to extend the lead that our products have in quality. At the same time, no matter how much customers value quality, enhancing the competitiveness of our pricing remains critical. With respect to quality, for example, in June 2006, we marketed seventh generation RS Roller Chains that have the highest quality in the world. Their wear elongation, or durability, is twice that of the previous generation and four times that of competitors' offerings. Further, a review of our optimal site production system resulted in the transfer of some production of conveyor chains, Lambda Chains, and other products to overseas plants. Meanwhile, in automotive parts, we are taking steps to address various issues, including the early development of new mainstay lineups to succeed timing chains and the improvement of overseas subsidiaries' profitability. Also, in power transmission units and components, we need to expand our overseas customer base, and, in materials handling systems, we must manage project profitability stringently while targeting customers in a greater variety of industries. (For further details on issues and countermeasures, please see pages 14 to 19 for overviews of each operational area.)

**We are dealing with key issues to become *Global Best*.**

## Our Basic Approaches to Management Systems and Returns to Shareholders

Our endeavors to be the *Global Best* are not limited to product quality, pricing, and business development. We also aim for world-class governance and compliance. Specifically, irrespective of how high we grow earnings, we could lose corporate value in a moment due to a compliance-related incident. Although this is an unlikely scenario, we strengthen compliance measures for systems and personnel every year through such initiatives as the establishment of an ethics helpline. Furthermore, rather than simple "one-way" distribution of information to investors and analysts, we seek ongoing feedback on management from our stakeholders, and we reflect those opinions in management through a range of measures. (For further information on the management system of the Tsubaki Group, please see pages 22 and 23.)

Pursuing the highest returns to shareholders, our goal is to grow earnings steadily to maximize corporate value and raise market capitalization. Further, we aim to pay stable dividends based on consideration of business results. To those ends, as far as possible, we will continue paying annual dividends of ¥6.00 per share while linking the distribution of profits to consolidated business results. For fiscal 2006, the Company paid an annual dividend of ¥9.00 per share (including a 90th anniversary commemorative dividend of ¥2.00 per share), up ¥2.00 from the previous fiscal year.

**Tsubakimoto Chain targets *Global Best* in products, business, and management.**

## This Is Tsubakimoto Chain

The Tsubaki Group will redouble pursuit of its *Global Best* strategy by focusing on the "Three Gs"—Global operational development, Group management reinforcement, and Growth continuation and enhancement. We ask our shareholders and investors for their further support as we pursue those strategies.

August 2006

Takashi Fukunaga
Chairman and Representative Director

Tatsuhiko Mimoto
President and Representative Director

# Three-Year STEP 08 Medium-Term Management Plan

## Numerical Targets (Consolidated)

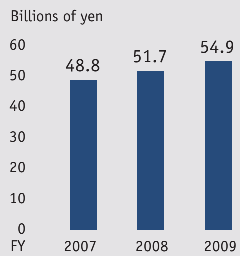
| Billions of yen | | FY 2007 | | FY 2008 | | FY 2009 | |
|---|---|---|---|---|---|---|---|
| Consolidated | Net sales | ¥157.0 | | ¥170.0 | | ¥178.0 | |
| | Operating income | 15.5 | (9.9%) | 17.6 | (10.4%) | 19.7 | (11.1%) |
| | Ordinary income | 13.5 | (8.6%) | 16.1 | (9.5%) | 18.1 | (10.2%) |
| | Net income | 6.8 | (4.3%) | 8.7 | (5.1%) | 9.8 | (5.5%) |

( ) indicates percentage of net sales

## Priority Measures and Sales Targets of Business Units

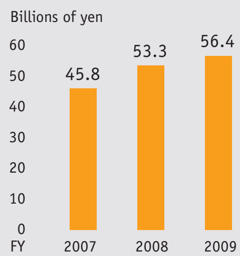
### Chain Operations

① Increase sales of new G7 RS Roller Chain
② Expand conveyor chain business
③ Increase market share of plastic chains in Asia and Oceania




### Automotive Parts Operations

① Strengthen consolidated management (enhance consolidated income margins)
② Pursue global initiatives to achieve upgraded, uniform quality
③ Develop next-generation timing chain systems




### Power Transmission Units and Components Operations

① Hone priority lineups
② Increase support for overseas operations, raise export ratios
③ Advance new product development


### Materials Handling Systems Operations

① Continue seeking orders for Minomi Conveyor System
② Develop overseas after-sales service
③ Strengthen development of drug discovery related products and other new products