To Our Shareholders and Investors

Our confidence has grown steadily with our positive results. We will tackle outstanding issues with determination until confidence changes into conviction that we are a truly global company.

Takashi Fukunaga
Chairman and
Representative Director

Tatsuhiko Mimoto
President and
Representative Director

Review of Fiscal 2007 (April 2006–March 2007)

Highest-Ever Earnings for Second Consecutive Year

In the second half of fiscal 2007, there was a slackening in the pace of economic expansion, especially in the United States and Japan. Despite this, the Tsubaki Group renewed its highest-ever net sales and ordinary income figures for the second year in a row.

Further Acceleration in Overseas Business Development

Consolidated net sales rose 5.4% year on year, to ¥155.7 billion. Overseas sales increased 8.9% year on year, driving overall growth. In its efforts to promote global development, the Tsubaki Group has focused on Europe and Asia/Oceania, which still have relatively low ratios in the overall sales composition. In fiscal 2007, we were rewarded with strong year-on-year sales growth in both regions, with sales up 24.2% in Europe and 15.7% in Asia/Oceania.

World Market Shares Continue to Expand

In our mainstay Power Transmission Products Segment, sales increased 9.6% year on year. The two core products, industrial-use steel chains and timing chain drive systems for automobiles, both expanded their global market shares. Industrial-use steel chains carved out a 23.5% share of the world market, up 1.9 points, and timing chain drive systems a 34% share, up 1.0 point.

Two Negative Factors Effectively Absorbed and Profitability Increased

In fiscal 2007, two unexpected factors led to a significant negative impact on earnings. However, these were successfully absorbed, and we achieved a 15.7% year-on-year increase in consolidated operating income, to ¥16.0 billion.

The first negative factor was in the Materials Handling Systems Segment. In the United States, installation costs related to an order from the automotive industry rose dramatically due to the effect of a major hurricane, and the segment consequently recorded a significant loss. We responded swiftly, reinforcing the number of key personnel and persevering in tough price negotiations with the installation company. By taking decisive steps to minimize the confusion in the operating situation and to restore profitability, we contained the problem. And, the Materials Handling Systems Segment's operating income margin in fiscal 2007 decreased by only 0.1 point year on year.

The second factor was a dramatic increase in raw materials costs. In response to this situation, we implemented price increases, mainly focused on our highly competitive industrial chains. In addition to transferring a portion of these increased costs to product prices, we reduced costs in our factories through productivity enhancements.

As a result, these two factors, which in total exerted a negative effect of ¥2.6 billion on earnings, were successfully absorbed. In fact, we managed to secure a ¥2.2 billion increase in operating income in fiscal 2007.

Three Types of Confidence Stemming from Stronger Earnings Results

The Group's response to the challenges of the past year has highlighted three types of confidence.

The first type of confidence is in our risk control system and its ability to respond effectively. In any business environment, unforeseen events will occur. The key issue is how a company responds and how it acts to maintain its external commitments. Awareness of this issue is beginning to take root across the entire Group.

The second type of confidence is in our product and manufacturing strength. Our fundamental strategy has always been to grow market share through the quality differentiation that comes from our technology development and manufacturing system. The proof that this strategy is working can be seen in the competitive products that have allowed us to transfer a portion of rising raw materials costs to product prices. In addition, we have achieved cost reductions through productivity enhancements.

The third type of confidence is in our comprehensive strength as a group. Even if an unforeseen event or situation causes business performance to deteriorate in one operating segment, the other operating segments can cover for that downturn. This is the comprehensive strength that makes for sustainable growth.

"Commitment management."
"Growth through differentiated technology development and production."
"Sustainable growth generated by our comprehensive strength."

Initiatives to realize these objectives are taking root throughout the entire Group.

Strategy for Outstanding Issues

Recalling Previous Management Strategy

The Tsubaki Group has implemented various strategy initiatives over the years, but from the mid-1990s, the crucial points were:

1. Build a product portfolio differentiated by our technology development and manufacturing system.
2. Swiftly grasp major trends and structural changes of the era.
3. Create a corporate structure that allows us to turn those trends and structural changes into tail winds for our business operations.

Escaping Influence of Trade Cycles and Focusing on Major Structural Trends

In the mid-1990s, we tried to define the major trends and structural changes of the era. The globalization of the economy was an obvious choice.

The manufacturing sector, and in particular the automotive industry, was accelerating the globalization of both technology development and production. In response to this trend, component manufacturers would clearly have to supply products and develop their own technology on a global basis as well. Globalization would also intensify competition among client companies and increase the demand for quality in components. Our conclusion was that we would need to move beyond the role of a components supplier and enhance our ability in development, system construction, and customization. This would enable us to provide customers with products that would contribute to their productivity, energy-saving, and environmental initiatives.

Real Results – Growth Capacity from Strong Corporate Structure and Differentiation

In order to build the base for global development, we worked diligently to strengthen our financial position and improve our management efficiency. At the same time, we energetically constructed a global production and supply system and invested in technology development.

As a result, the ratio of net interest-bearing debt to total assets fell from 29.3% in fiscal 2002 to 13.0% in fiscal 2007, signifying a much strengthened financial structure. Over the same period, the ratio of selling, general and administrative expenses to net sales decreased 4.5 points, from 22.2% to 17.7%. This indicated a remarkable increase in efficiency in our marketing and administrative divisions. Our mainstay products achieved major increases in global market share, backed by the technology advantage that differentiates them from competing products. We reinforced a global production and supply system spanning Japan, North America, Europe, China, and Asia/Oceania, and over the past five years the overseas sales ratio has risen 7.4 points, to 37.4%. The result of these endeavors is that in the past five years consolidated net sales have risen slightly less than 1.4 times while operating income has increased more than 2.6 times.

Growth Capacity Enhanced through Tackling Regional and Product Issues

The achievements detailed above belong to the past. A number of unresolved issues remain in the background, and by dealing with these issues we will forge our path to the future.

We first need to look at our marketing power and product strength, which are crucial to determining our capacity for growth. The overall ratio of overseas sales has increased greatly, but the ratios of sales in Europe and Asia/Oceania sales to total sales are still low; for Europe, the figure is 6.3%, while for Asia/Oceania it is 10.4%. In Chain Operations, we find that powerful retailers in these regions have a low Tsubaki product sales ratio. We intend to reinforce the number of our marketing personnel in order to develop initiatives targeted at these retailers. We will positively promote the technology advantage of Tsubaki products, already well-known in Japan and North America.

There are also product issues. In Chain Operations, the growth rate for sales of compact conveyance systems is relatively low compared with other product groups. To strengthen this product group, we are forming a cross-sectional organization, comprising both planning and technology functions, and we will offer solutions-based marketing that goes beyond stand-alone component sales.

Reflecting only on successful experiences will not encourage us to grow. Rather, we will search out issues that are not immediately visible and respond to the challenge. This is the first step to the future.

Toward Greater Profitability and Sustainable Growth

The ordinary income margin increased from 3.5% in fiscal 2002 to 9.3% in fiscal 2007, and we are targeting further increases to 11.1% by fiscal 2010. As the pace of economic expansion slows worldwide, our attempt to build up resistance to economic cycles has begun in earnest.

At our domestic and overseas factories, we will further shorten production lead times and improve productivity. In Chain Operations, at the Kyotanabe Plant, our main plant for industrial-use chains, we have introduced the cell manufacturing method, which is optimal for small-lot, variable-item manufacturing. This step has already achieved cost reductions, and we are now moving onto the second stage, targeting annual productivity increases of 7% over the next three years. In Power Transmission Units and Components Operations, we are attempting to limit the impact of rising raw materials costs by increasing the overseas local procurement ratio to 17% in fiscal 2008 and to more than 20% by fiscal 2010.

On the technology front, we are aware that raising the ratio of new products with differentiating potential can contribute to enhanced profitability. In Automotive Parts Operations, we are accelerating technology development for the next generation of timing systems as well as for power-drive chains for 4WD vehicles. In Power Transmission Units and Components Operations, we are strengthening new product development through the establishment of a specialist project committee that is charged with increasing the ratio of new products from its current level of 15.7% to 25% by fiscal 2010.

Aiming to Simultaneously Raise Growth Capacity, Enhance Profitability, and Attain Sustainable Growth

Acceleration of Investment in Human Resources and Organization

In this brief outline, we have only been able to give a few examples of management strategies, and for further details we recommend turning to the Operating Segments section of this report (pages 15 to 26). Our aim is not just to raise growth capacity; we are also seeking to enhance profitability and attain sustainable growth. As such, we have set the targets of increasing net sales by more than 1.2 times, to ¥188.0 billion, and raising ordinary income by more than 1.4 times, to ¥20.9 billion, by fiscal 2010. To achieve these targets, continuous investment in human resources and organization is necessary, in addition to the strategy that we have just outlined for tackling outstanding issues. In the current fiscal year, we began the Global Management Development (GMD) training program for both domestic and overseas middle management. Through this program, we will nurture a group of executives who are able to work effectively in a global environment.

Toward Management That Truly Engages with Capital Markets and Society

In conjunction with efforts to attain sustainable growth, our priority is to enhance the transparency and flexibility of management while positively integrating the opinions of capital markets and society as a whole into our business operations. In pursuit of this, we will further strengthen our investor relations activities. As a fresh initiative, we scheduled a presentation of management strategy and reception for shareholders directly after our annual meeting of shareholders. This gives an opportunity for shareholders and management to interact and exchange opinions directly. Our intention is to implement management that prioritizes the needs and opinions of all our stakeholders, including shareholders and investors.

The Tsubaki Group will devote its best efforts to the further promotion of the *Global Best strategy* by focusing on the "Three Gs" – Global operational development, Group management reinforcement, and Growth continuation and enhancement. We ask for your continued support and encouragement.

August 2007

Takashi Fukunaga
Chairman and Representative Director

Tatsuhiko Mimoto
President and Representative Director

"Growth that comes from our rich human resources."
"Sustainable growth based on flexible integration of opinion from capital markets and society."

Realizing *Global Best* through these principles.