

Notes to Consolidated Financial Statements

Nabtesco Corporation

Years ended March 31, 2006 and 2005

1. Description of Business and Basis of Presenting Consolidated Financial Statements

(1) Description of business

Nabtesco Corporation (the "Company"), a Japanese corporation, was established as a holding company on September 29, 2003, through a stock transfer process, by TS Corporation (formerly Teijin Seiki Co., Ltd.) and NABCO Ltd. As a result of the stock transfer, both TS Corporation and NABCO Ltd. became wholly owned subsidiaries of the Company.

The Company has completed its business integration through the acquisition of the two wholly owned subsidiaries on October 1, 2004.

The main products of the Company and its consolidated subsidiaries (the "Companies") include precision equipment, transport equipment, aircraft and oil hydraulic equipment, and industrial equipment.

(2) Basis of presenting consolidated financial statements

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 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 consolidated 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 consolidated financial statements.

The formation of the Company and the stock transfer of the two companies were accounted for using the pooling-of-interests method and, as such, the assets and liabilities of the two companies are combined at book value.

The translation of the Japanese yen amounts into U.S. dollars are included solely for the convenience of readers outside Japan, using the prevailing exchange rate at March 31, 2006, which was ¥117.47 to U.S. \$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

(1) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its 33 significant subsidiaries. All significant inter-company transactions, account balances and unrealized profits are eliminated in consolidation.

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 investments in subsidiaries and the equity in their net assets at the date of acquisition is amortized over a period of five years on a straight-line basis. However the difference is insignificant, it is charged to income as incurred.

Investments in 9 significant affiliated companies (generally 20% to 50% owned), over which the Company has the ability to exercise significant influence over operating and financial policy, are accounted for by the equity method.

(2) Cash and cash equivalents

For the purpose of the consolidated statements of cash flows, cash and cash equivalents consist of cash on hand, deposits with banks drawable on demand and short-term investments which are readily convertible to cash subject to an insignificant risk of changes in value and which were purchased with an original maturity of three months or less. See Note 4 as to reconciliation to cash and time deposits on the balance sheets.

(3) Allowance for doubtful receivables

The allowance for doubtful receivables is provided in amounts management considers sufficient to cover possible losses on collection. The allowance is based on past collection experience and management estimate of the collectibility of individual receivables.

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(4) Allowance for soil quality improvement loss

The allowance for soil quality improvement loss is provided to cover an estimated loss for the improvement in quality of the soil in the land where one of the Company's plants was located.

(5) Securities

The Companies are required to examine the intent of holding each security and classify those securities as (a) securities held for trading purposes (hereafter, "trading securities"), (b) debt securities intended to be held to maturity (hereafter, "held-to-maturity debt securities"), (c) equity securities issued by subsidiaries and affiliated companies, and (d) for all other securities that are not classified in any of the above categories (hereafter, "available-for-sale securities") The Companies had no trading securities and held-to-maturity debt securities at March 31, 2006 and 2005.

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 sale of such securities are computed using the moving-average cost method. Other available-for-sale securities with no available fair market value are stated at moving-average cost.

If the market value of equity securities issued by unconsolidated subsidiaries and affiliated companies, and available-for-sale securities declines significantly, such securities are written down to their fair market value and the difference between fair market value and the carrying amount is recognized as loss in the period of the decline. For equity securities with no available fair market value, if the net asset amount of the investee declines significantly, such securities are written down to the net asset amount with a corresponding charge in the income statement in the period of decline. In these cases, such fair market value or net asset amount will be the carrying amount of the securities at the beginning of the next year.

(6) Inventories

Inventories of the Company and its consolidated domestic subsidiaries are stated at cost, while inventories of its consolidated foreign subsidiaries are principally stated at the lower of cost or market.

The evaluation methods for the cost of finished goods and work in process by segment are as follows:

Segment	Evaluation method
Precision Equipment	Mainly periodic weighted average method
Transport Equipment	Mainly moving average method
Aircraft and Oil Hydraulic Equipment	Mainly periodic weighted average method (however certain finished goods and work in process are determined by the specific identification method)
Industrial Equipment	Mainly moving average method

The cost of raw materials is principally determined by the moving average method.

(7) Property, plant and equipment

Property, plant and equipment are stated at cost. The Company and its consolidated domestic subsidiaries calculate depreciation principally by the declining-balance method over the estimated useful lives of the respective assets, except for the buildings acquired on or after April 1, 1998, and owned by the Company, which are depreciated by the straight-line method over the estimated useful lives of the respective assets. In addition, the Company and its consolidated domestic subsidiaries depreciate machinery and equipment, whose acquisition cost is ¥100 thousand or more but less than ¥200 thousand, over a period of three years on a straight-line basis. The consolidated foreign subsidiaries calculate depreciation principally by the straight-line method over the estimated useful lives of the respective assets.

(8) Leases

Non-cancelable leases are accounted for in the same manner as operating leases (whether such leases are classified as operating or finance leases) except that lease agreements which stipulate the transfer of ownership of the leased assets to the lessee are accounted for as finance leases. Certain consolidated foreign subsidiaries capitalize their assets leased under finance lease contracts in accordance with local accounting principles.

(9) Derivative financial instruments and hedging transactions

The Companies use forward foreign exchange contracts, forward foreign currency options and interest rate swaps as derivative financial instruments only for the purpose of mitigating future risk of fluctuation of foreign currency exchange rates with respect to foreign currency receivables and payables, and future risk of fluctuation of interest rates with respect to borrowings.

The basic policies for executing the derivative transactions are managed by the Board of Directors of the Company. Based on such policies, the finance departments of each company establish the internal regulations which prescribe the specified limits and procedures on the derivative transactions. After execution, each finance department has to report certain information on derivative transactions to the Board of Directors of the Company.

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

Hedging instruments:	Hedged items:
Forward foreign exchange contracts	Foreign currency trade receivables and trade payables
Forward foreign currency option contracts	Foreign currency trade receivables and trade payables
Interest rate swap contracts	Interests on borrowings

The Companies evaluate hedge effectiveness semi-annually by comparing the cumulative changes in cash flows from or the changes in fair value of hedged items and the corresponding changes in fair value of the hedging derivative instruments.

The Companies are required 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 fair value of derivative financial instruments until the related losses or gains on the hedged items are recognized.

However, in cases where forward foreign exchange contracts or forward foreign currency option contracts are used as hedges and meet certain hedging criteria, hedging instruments and hedged items are accounted for in the following manner:

1. When a forward foreign exchange contract or a forward foreign currency option contract is executed to hedge an existing foreign currency receivable or payable,
 - (a) the difference, if any, between the Japanese yen amount of the hedged foreign currency receivable or payable translated using the spot rate at the inception date of the contract and the book value of the receivable or payable is recognized in the income statement in the period which includes the inception date, and
 - (b) the discount or premium on the contract (that is, the difference between the Japanese yen amount of the contract translated using the contracted forward rate and that translated using the spot rate at the inception date of the contract) is recognized over the term of the contract
2. When a forward foreign exchange contract or a forward foreign currency option 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 or the forward foreign currency options are recognized.

Also, if interest rate swap contracts are used as hedge 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 liabilities for which the swap contract is executed.

(10) Amortization

Amortization of intangible assets is computed using the straight-line method, principally over five years. Software is included in intangible assets and amortized using the straight-line method over the estimated useful lives (five years).

(11) Research and development costs

Research and development costs are charged to income as incurred.

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(12) Income taxes

The Companies recognize tax effects of timing differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for tax reporting purpose. Income taxes comprise of corporation tax, enterprise tax and prefectural and municipal inhabitants taxes.

(13) Accrued employees' bonuses

Accrued employees' bonuses are accounted for at the amount of estimated bonuses to be paid and allocated to the current fiscal year.

(14) Translation of foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated into Japanese yen at the year-end rates. Financial statements of consolidated foreign subsidiaries are translated into Japanese yen at the year-end rates, except that shareholders' equity accounts are translated at historical rates and income statement items resulting from transactions with the Company are translated at the rates used by the Company when the transactions occurred. The Company and its domestic subsidiaries report foreign currency translation adjustments in the shareholders' equity and minority interests.

(15) Appropriation of retained earnings

Under the Japanese Company law, the appropriation of retained earnings with respect to a given financial period is made by a resolution of the shareholders at a general meeting held subsequent to the close of such financial period. The accounts for that period do not, therefore, reflect such appropriations. (See Note 17).

(16) Retirement benefits

The Company and certain of its consolidated subsidiaries provide two types of retirement and severance 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 wages and salaries at the time of retirement or termination, length of service and certain other factors.

The Companies provide allowance for employees' severance and retirement benefits at the end of years based on estimated amounts of projected benefit obligations, actuarially calculated using certain assumptions and the fair value of the plan assets at that dates. Prior service costs are recognized in expenses when incurred, and actuarial gains and losses are recognized in expenses using the declining-balance method over a certain period (10 to 14 years) not exceeding the average of estimated remaining service lives, commencing in the following period.

In addition, subject to the shareholders' approval, directors and corporate statutory auditors of the Company and its consolidated domestic subsidiaries are customarily entitled to lump-sum payments under unfunded retirement benefits plans. The provision for retirement allowances for these officers has been made at estimated amounts based on each company's internal rule.

3. Change in accounting policies

Effective October 1, 2004, the Company adopted the straight-line method of depreciation for buildings which had been owned by TS Corporation and depreciated by the declining-balance method. This change was made to provide a more appropriate allocation of the cost of the buildings in consideration that the buildings are stably used for long periods as a result of the review of the depreciation method at the time the Company merged TS Corporation and NABCO Ltd. together. The effect of this change was to decrease depreciation expense by ¥62 million and increase income before income taxes and minority interests by ¥60 million for the year ended March 31, 2005 as compared to the amounts that would have been reported under the prior method.

Effective April 1, 2005, the Company and its consolidated domestic subsidiaries adopted a 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 (the Financial Accounting Standard Implementation Guidance No. 6 issued by the Accounting Standards Board of Japan on October 31, 2003). As a result, there is no impact on consolidated financial statements by application of the new standard.

4. Cash and Cash Equivalents

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:

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Cash and time deposits	¥ 18,841	¥ 14,354	\$ 160,390
Time deposits with maturities extending over three months	(344)	(319)	(2,929)
Total: Cash and cash equivalents	<u>¥ 18,497</u>	<u>¥ 14,035</u>	<u>\$ 157,461</u>

5. Securities

The information on securities of the Companies at March 31, 2006 and 2005 are shown below.

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

(Available-for-sale securities)

(1) Securities with book values exceeding acquisition costs:

Type	2006		
	Acquisition cost	Book value (Millions of yen)	Difference
Equity securities	¥ 4,616	¥ 16,445	¥ 11,829
Bonds	—	—	—
Others	2	3	1
Total	<u>¥ 4,618</u>	<u>¥ 16,448</u>	<u>¥ 11,830</u>

Type	2005		
	Acquisition cost	Book value (Millions of yen)	Difference
Equity securities	¥ 4,181	¥ 9,056	¥ 4,875
Bonds	9	10	1
Others	1	1	0
Total	<u>¥ 4,191</u>	<u>¥ 9,067</u>	<u>¥ 4,876</u>

Type	2006		
	Acquisition cost	Book value (Thousands of U.S. dollars)	Difference
Equity securities	\$ 39,295	\$ 139,993	\$ 100,698
Bonds	—	—	—
Others	17	26	9
Total	<u>\$ 39,312</u>	<u>\$ 140,019</u>	<u>\$ 100,707</u>

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(2) Securities with book values not exceeding acquisition costs:

Type	2006		Difference
	Acquisition cost	Book value (Millions of yen)	
Equity securities	¥ 6	¥ 6	¥ (0)
Bonds	86	73	(13)
Total	¥ 92	¥ 79	¥ (13)

Type	2005		Difference
	Acquisition cost	Book value (Millions of yen)	
Equity securities	¥ 39	¥ 36	¥ (3)
Bonds	86	73	(13)
Total	¥ 125	¥ 109	¥ (16)

Type	2006		Difference
	Acquisition cost	Book value (Thousands of U.S dollars)	
Equity securities	\$ 51	\$ 51	\$ (0)
Bonds	732	622	(110)
Total	\$ 783	\$ 673	\$ (110)

The Companies recognize impairment loss on the securities, whose available fair values decline more than 50% of the carrying amount, based on the Japanese accounting standard for financial instruments and guidelines concerning the accounting for financial instruments.

The following tables summarizes book values of securities with no available fair values as of March 31, 2006 and 2005:

(Available-for-sale securities)

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Non-listed equity securities	¥ 149	¥ 151	\$1,268
Non-listed bonds	0	0	0
Total	¥ 149	¥ 151	\$1,268

Total sales of available-for-sale securities and the related gains and losses in the years ended March 31, 2006 and 2005 were as follows:

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Sales of available-for-sale securities	¥ 11	¥ 61	\$ 94
Gains on sale of available-for-sale securities	0	0	0

The maturity schedule of available-for-sale securities with maturities as of March 31, 2006 and 2005 was as follows:

	2006					
	Due within 1 year	1 to 5 years	Over 5 years	Due within 1 year	1 to 5 years	Over 5 years
	(Millions of yen)			(Thousands of U.S. dollars)		
Bonds						
Corporate bonds	-	-	-	-	-	-
Others	-	-	¥ 100	-	-	\$851
Total	-	-	¥ 100	-	-	\$851

	2005					
	Due within 1 year	1 to 5 years	Over 5 years	Due within 1 year	1 to 5 years	Over 5 years
	(Millions of yen)			(Thousands of U.S. dollars)		
Bonds						
Corporate bonds	¥ 9	-	-	\$84	-	-
Others	-	-	¥ 100	-	-	\$931
Total	¥ 9	-	¥ 100	\$84	-	\$931

6. Inventories

Inventories at March 31, 2006 and 2005 consisted of the followings:

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Finished goods	¥ 2,910	¥ 2,569	\$ 24,772
Works in process	6,653	5,713	56,636
Raw materials	6,417	5,479	54,627
Supplies	383	398	3,260
Total inventories	¥ 16,363	¥ 14,159	\$ 139,295

7. Short-term Bank Loans and Long-term Debt

Short-term bank loans at March 31, 2006 and 2005 represented bank notes at interest rates ranging from 0.25 % to 14.5 % and from 0.35% to 8.1% per annum, respectively.

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

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Loans, principally from banks at interest rates from 0.30% to 5.5%, due through 2009	¥ 10,394	¥ 16,090	\$ 88,482
Total	10,394	16,090	88,482
Less current portion	(6,905)	(5,662)	(58,781)
Long-term debt, net	¥ 3,489	¥ 10,428	\$ 29,701

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The aggregate annual maturities of long-term debt subsequent to March 31, 2006 were summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2007	¥ 6,905	\$ 58,781
2008	485	4,129
2009	3,004	25,572
Total	¥ 10,394	\$ 88,482

The Companies' assets pledged as collateral to secure a portion of the above bank loans in the aggregate amount of ¥164 million (\$1,396 thousand) and ¥328 million at March 31, 2006 and 2005, respectively, are summarized in Note 10.

8. Leases

The following proforma amounts present the acquisition costs, accumulated depreciation and the net book value of the property leased to the Companies as of March 31, 2006 and 2005, which would have been reflected in the balance sheet, had finance leases other than those which transfer the ownership of the leased property to the Companies (which are accounted for in the same manner as operating leases) been capitalized:

	2006		
	Acquisition costs	Accumulated depreciation	Net book value
		(Millions of yen)	
Machinery and equipment	¥ 1,218	¥ 669	¥ 549
Intangible assets	697	464	233
Total	¥ 1,915	¥ 1,133	¥ 782

	2005		
	Acquisition costs	Accumulated depreciation	Net book value
		(Millions of yen)	
Machinery and equipment	¥ 1,594	¥ 970	¥ 624
Intangible assets	647	405	242
Total	¥ 2,241	¥ 1,375	¥ 866

	2006		
	Acquisition costs	Accumulated depreciation	Net book value
		(Thousands of U.S. dollars)	
Machinery and equipment	\$ 10,369	\$ 5,695	\$ 4,674
Intangible assets	5,933	3,950	1,983
Total	\$ 16,302	\$ 9,645	\$ 6,657

Finance lease payments of the Companies for the year ended March 31, 2006 and 2005 were as follows:

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Lease payments	¥ 340	¥ 376	\$2,894

The payments presented above also represent depreciation expense equivalents. Proforma depreciation expense equivalents are computed by the straight-line method over the respective lease periods, assuming no residual value.

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2006 under finance leases other than those which transfer the ownership of the leased property to the Companies and operating leases are summarized as follows:

	2006 (Millions of yen)	2006 (Thousands of U.S.dollars)
Under finance leases:		
Payments due within one year	¥ 306	\$2,605
Payments due after one year	476	4,052
Total	<u>¥ 782</u>	<u>\$6,657</u>
Under operating leases:		
Payments due within one year	¥ 85	\$723
Payments due after one year	212	1,805
Total	<u>¥ 297</u>	<u>\$2,528</u>

9. Income Taxes

The Company and its domestic subsidiaries are subject to a number of taxes based on income which, in the aggregate, resulted in statutory tax rates of approximately 40.7% for both years ended March 31, 2006 and 2005.

The following table summarizes the significant differences between the statutory tax rates and the effective tax rates for financial statement purposes for the years ended March 31, 2006 and 2005:

	2006	2005
Statutory tax rate	40.7%	40.7%
Deficits of some consolidated subsidiaries	—	(1.4%)
Equity in earnings of affiliates	0.3%	(1.0%)
Permanent non-deductible expenses	0.6%	1.3%
Others	(1.6%)	(3.4%)
Effective tax rate	<u>40.0%</u>	<u>36.2%</u>

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The tax effects of temporary differences which give rise to a significant portion of the deferred tax assets and liabilities at March 31, 2006 and 2005 are summarized as follows:

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Deferred tax assets:			
Net operating loss carry forwards	¥ 2,047	¥ 2,073	\$ 17,425
Accrued severance and retirement benefits	5,090	4,645	43,330
Accrued employees' bonuses	1,352	1,212	11,509
Other accrued expenses	1,268	678	10,794
Loss on devaluation of inventories	32	20	273
Loss on devaluation of investments in securities	971	971	8,266
Allowance for doubtful receivables	270	29	2,299
Allowance for soil quality improvement loss	472	472	4,018
Others	593	551	5,048
	<u>12,095</u>	<u>10,651</u>	<u>102,962</u>
Less valuation allowance	(2,564)	(2,303)	(21,827)
Total deferred tax assets	<u>9,531</u>	<u>8,348</u>	<u>81,135</u>
Deferred tax liabilities:			
Deferred taxation on government contributions for acquisition of property, plant and equipment	(2,387)	(2,539)	(20,320)
Effect of differences between tax rates in Japan and in other countries on undistributed earnings of foreign subsidiaries	(207)	(165)	(1,762)
Net unrealized holding gains on securities	(4,806)	(1,976)	(40,912)
Others	(108)	(108)	(919)
Total deferred tax liabilities	<u>(7,508)</u>	<u>(4,788)</u>	<u>(63,913)</u>
Deferred tax assets, net	<u>¥ 2,023</u>	<u>¥ 3,560</u>	<u>\$ 17,222</u>

10. Assets Pledged as Collateral

At March 31, 2006 and 2005, assets pledged as collateral for short-term bank loans, long-term debt and guarantees given for business fulfillment were as follows:

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Property, plant and equipment, net of accumulated depreciation	¥ 1,655	¥ 1,689	\$14,089
Investments in securities	—	608	—
Total	<u>¥ 1,655</u>	<u>¥ 2,297</u>	<u>\$14,089</u>

The liabilities and guarantees secured by such collateral at March 31, 2006 and 2005 were as follows:

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Short-term bank loans	¥ 46	¥ 49	\$ 391
Current portion of long-term debt	39	115	332
Long-term debt	79	164	673
Guarantees given for business fulfillment of subsidiaries	—	242	—
Total	<u>¥ 164</u>	<u>¥ 570</u>	<u>\$ 1,396</u>

11. Shareholders' Equity

Under the Japanese Company Law, upon issuance of common stock, the entire amount of the issue price is required to be accounted for as common stock, although companies may, by resolution of the Board of Directors, account for an amount not exceeding one-half of the issue price of the new shares as additional paid-in capital, which is included in capital surplus.

The Japanese Company Law provides that an amount equal to 10% of cash dividends and other cash appropriations shall be appropriated and set aside as a legal earnings reserve until the total amount of legal earnings reserve and additional paid-in capital equals 25% of common stock account. The legal earnings reserve and additional paid-in capital may be used to eliminate or reduce an accumulated deficit by resolution of a shareholders' meeting or may be capitalized by resolution of the Board of Directors. On condition that the total amount of legal earnings reserve and additional paid-in capital remains being equal to or exceeding 25% of common stock, they are available for distribution by the resolution of a shareholders' meeting. Legal earnings reserve is included in retained earnings in the accompanying consolidated financial statements.

The maximum amount that the Company can distribute as dividends is calculated based on the non-consolidated financial statements of the Company in accordance with the Company Law.

12. Contingent Liabilities

The Companies had the following contingent liabilities at March 31, 2006 and 2005:

	2006 (Millions of yen)	2005	2006 (Thousands of U.S. dollars)
As guarantor of indebtedness of affiliated companies	¥ 294	¥ 329	\$2,503
Total	<u>¥ 294</u>	<u>¥ 329</u>	<u>\$2,503</u>

13. Employee's Severance and Retirement Benefits

The liabilities for severance and retirement benefits included in the liability section of the consolidated balance sheets as of March 31, 2006 and 2005 consisted of the following:

	2006 (Millions of yen)	2005	2006 (Thousands of U.S. dollars)
Projected benefit obligation	¥ 23,221	¥ 22,390	\$ 197,676
Less fair value of plan assets	(8,159)	(7,053)	(69,456)
Less unrecognized actuarial losses	(2,461)	(3,130)	(20,950)
Accrued severance and retirement benefits for employees	<u>¥ 12,601</u>	<u>¥ 12,207</u>	<u>\$ 107,270</u>

Severance and retirement benefit expenses, included in the consolidated statements of income for the years ended March 31, 2006 and 2005, were comprised of the following:

	2006 (Millions of yen)	2005	2006 (Thousands of U.S. dollars)
Service costs	¥ 1,069	¥ 1,386	\$ 9,100
Interest cost on projected benefit obligation	441	476	3,754
Expected return on plan assets	(211)	(159)	(1,796)
Amortization of actuarial losses	559	709	4,759
Amortization of prior service cost	—	56	—
Severance and retirement benefit expenses	<u>¥ 1,858</u>	<u>¥ 2,468</u>	<u>\$ 15,817</u>

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Assumptions used for the years ended March 31, 2005 and 2004 were set forth as follows:

	2006	2005
Discount rate:		
Domestic companies	2.0%	2.0%
Foreign companies	4.7%	5.8%
Expected return on plan assets:		
Domestic companies	2.0~3.0%	1.0~2.8%
Foreign companies	8.0%	8.0%
Amortization of actuarial losses	10~14 years	10~14 years
Amortization period of prior service cost	1 year	1 year

14. Research and Development Costs

Research and development costs included in cost of sales and selling, general and administrative expenses for the years ended March 31, 2006 and 2005, in the aggregate, amounted to ¥3,635 (\$30,944 thousand) and ¥3,706 million, respectively.

15. Derivative Financial Instruments

According to the accounting standard for derivative financial instruments, forward foreign exchange contracts, forward foreign currency options and interest rate swap contracts which qualify for hedge accounting and such amounts of which are assigned to hedged assets or liabilities and are recorded on the balance sheets at March 31, 2006 and 2005, are not subject to disclosure of market value information.

There was no derivative financial instruments, for which hedge accounting was not applied, and therefore there was no derivative financial instruments subject to disclosure of market value information as of March 31, 2006.

16. Segment Information

The following tables present information by business segment and geographic area and the overseas sales of the Companies for the years ended March 31, 2006 and 2005 :

(1) Information by business segment

Operations of the Companies are classified into four business segments as follows:

Segment	Main products	Main customers and industries
Precision Equipment	Precision reduction gear and actuators, wafer transfer unit, vacuum pumps, vacuum valves, vacuum devices, rapid prototyping systems, heating pipes	Industrial robots, machine tools, factory automation systems, electronic devices, semiconductor manufacturing equipment, and automobiles, home electronic appliances
Transport Equipment	Automatic door drive unit, automobile air break system, automatic testing and training equipment, remote control systems for marine	Railroad vehicle, automobile, marine vessels
Aircraft and Oil Hydraulic Equipment	Flight control systems, various types of actuators, oil hydraulic drive motors, actuation units for wind turbine, and various types of motors for winches	Aircraft, space, construction equipment, agricultural and other vehicles
Industrial Equipment	Automatic door systems, prosthetic products, automatic measuring and packing machines, multi-forming machines, constant velocity joint processing machines, and oxygen concentrators	Building and general industry, welfare, food, medicine, cleaning material, chemicals, precision equipment, automobiles, and home electronic appliances

2006

	Precision Equipment	Transport Equipment	Aircraft and Oil Hydraulic Equipment	Industrial Equipment	Total	Eliminations and general corporate assets	Consolidated
(Millions of yen)							
I. Sales and operating income							
External sales	¥ 34,242	¥ 37,525	¥ 39,572	¥ 36,089	¥ 147,428	¥ -	¥ 147,428
Intersegment sales	43	505	736	336	1,620	(1,620)	-
Total sales	34,285	38,030	40,308	36,425	149,048	(1,620)	147,428
Operating expenses	28,515	34,505	38,060	33,140	134,220	(1,620)	132,600
Operating income	¥ 5,770	¥ 3,525	¥ 2,248	¥ 3,285	¥ 14,828	¥ -	¥ 14,828
II. Total assets, depreciation and capital expenditures							
Total assets	¥ 20,381	¥ 31,553	¥ 32,145	¥ 27,413	¥ 111,492	¥ 35,403	¥ 146,895
Depreciation	1,168	989	1,412	700	4,269	307	4,576
Capital expenditures	1,882	592	1,450	426	4,350	107	4,457

Notes to Consolidated Financial Statements

Nabtesco Corporation

Years ended March 31, 2006 and 2005

2005							
	Precision Equipment	Transport Equipment	Aircraft and Oil Hydraulic Equipment	Industrial Equipment	Total	Eliminations and general corporate assets	Consolidated
(Millions of yen)							
I. Sales and operating income							
External sales	¥ 32,648	¥ 35,807	¥ 34,273	¥ 35,233	¥ 137,961	¥ -	¥ 137,961
Intersegment sales	41	314	1,171	566	2,092	(2,092)	-
Total sales	32,689	36,121	35,444	35,799	140,053	(2,092)	137,961
Operating expenses	27,590	33,944	34,660	32,572	128,766	(2,092)	126,674
Operating income	¥ 5,099	¥ 2,177	¥ 784	¥ 3,227	¥ 11,287	¥ -	¥ 11,287
II. Total assets, depreciation and capital expenditures							
Total assets	¥ 24,119	¥ 30,483	¥ 29,469	¥ 29,920	¥ 113,991	¥ 19,611	¥ 133,602
Depreciation	1,163	1,041	1,161	611	3,976	514	4,490
Capital expenditures	1,534	652	2,139	687	5,012	183	5,195
2006							
	Precision Equipment	Transport Equipment	Aircraft and Oil Hydraulic Equipment	Industrial Equipment	Total	Eliminations and general corporate assets	Consolidated
(Thousands of U.S. dollars)							
I. Sales and operating income							
External sales	\$ 291,496	\$ 319,443	\$ 336,869	\$ 307,219	\$ 1,255,027	\$ -	\$ 1,255,027
Intersegment sales	366	4,299	6,265	2,860	13,790	(13,790)	-
Total sales	291,862	323,742	343,134	310,079	1,268,817	(13,790)	1,255,027
Operating expenses	242,743	293,734	323,997	282,115	1,142,589	(13,790)	1,128,799
Operating income	\$ 49,119	\$ 30,008	\$ 19,137	\$ 27,964	\$ 126,228	\$ -	\$ 126,228
II. Total assets, depreciation and capital expenditures							
Total assets	\$173,499	\$ 268,605	\$ 273,644	\$ 233,362	\$ 949,110	\$ 301,379	\$ 1,250,489
Depreciation	9,943	8,419	12,020	5,959	36,341	2,613	38,954
Capital expenditures	16,021	5,040	12,344	3,626	37,031	911	37,942

"Eliminations and general corporate assets" in the "Total assets" column of the above schedules includes corporate assets of ¥ 36,771 million (\$313,025 thousand) and ¥ 20,589 million at March 31, 2006 and 2005, respectively, which consisted principally of cash, time deposits and investments in securities.

As described in Note 3, the Company changed the method of depreciation for buildings, which TS Corporation had owned, from the declining-balance method to the straight-line method in the year ended March 31, 2005.

As a result of this change, operating income increased in the Precision Equipment segment by ¥19 million and in the Aircraft and Oil Hydraulic Equipment segment by ¥16 million.

(2) Information by geographic area

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

		2006						
		Japan	Asia	North America	Europe	Total	Eliminations and general corporate assets	Consolidated
		(Millions of yen)						
I.Sales and operating income								
External sales		¥ 122,790	¥ 7,934	¥ 8,851	¥ 7,853	¥ 147,428	¥ -	¥ 147,428
Intersegment sales		12,084	686	1,129	46	13,945	(13,945)	-
Total sales		134,874	8,620	9,980	7,899	161,373	(13,945)	147,428
Operating expenses		121,532	7,979	9,364	7,670	146,545	(13,945)	132,600
Operating income		¥ 13,342	¥ 641	¥ 616	¥ 229	¥ 14,828	¥ -	¥ 14,828
II.Total assets		¥ 104,072	¥ 5,829	¥ 4,210	¥ 3,244	¥ 117,355	¥ 29,540	¥ 146,895
		2005						
		Japan	Asia	North America	Europe	Total	Eliminations and general corporate assets	Consolidated
		(Millions of yen)						
I.Sales and operating income								
External sales		¥ 117,226	¥ 6,848	¥ 7,167	¥ 6,720	¥ 137,961	¥ -	¥ 137,961
Intersegment sales		10,150	559	746	48	11,503	(11,503)	-
Total sales		127,376	7,407	7,913	6,768	149,464	(11,503)	137,961
Operating expenses		117,152	7,001	7,433	6,591	138,177	(11,503)	126,674
Operating income		¥ 10,224	¥ 406	¥ 480	¥ 177	¥ 11,287	¥ -	¥ 11,287
II.Total assets		¥ 108,866	¥ 4,567	¥ 3,653	¥ 2,316	¥ 119,402	¥ 14,200	¥ 133,602
		2006						
		Japan	Asia	North America	Europe	Total	Eliminations and general corporate assets	Consolidated
		(Thousands of U.S. dollars)						
I.Sales and operating income								
External sales		\$ 1,045,288	\$ 67,541	\$ 75,347	\$ 66,851	\$ 1,255,027	\$ -	\$ 1,255,027
Intersegment sales		102,869	5,839	9,611	392	118,711	(118,711)	-
Total sales		1,148,157	73,380	84,958	67,243	1,373,738	(118,711)	1,255,027
Operating expenses		1,034,579	67,923	79,714	65,294	1,247,510	(118,711)	1,128,799
Operating income		\$ 113,578	\$ 5,457	\$ 5,244	\$ 1,949	\$ 126,228	\$ -	\$ 126,228
II.Total assets		\$ 885,945	\$ 49,621	\$ 35,839	\$ 27,616	\$ 999,021	\$ 251,468	\$ 1,250,489

The Company attributes external sales to individual countries in each region based on where product are sold and services are provided, and attributes total assets based on where assets are located.

"Eliminations and general corporate assets" in the "Total assets" column of the above schedules includes corporate assets of ¥36,771 million (\$313,025 thousand) and ¥20,589 million at March 31, 2006 and 2005, respectively, which consisted principally of cash, time deposits and investments in securities.

As described in Note 3, the Company changed the method of depreciation for buildings, which TS Corporation had owned, from the declining-balance method to the straight-line method in the year ended March 31, 2005.

As a result of this change, operating income increased in Japan by ¥35 million.

Notes to Consolidated Financial Statements

Nabtesco Corporation

Years ended March 31, 2006 and 2005

(3) Overseas sales

Overseas external sales for the years ended March 31, 2005 and 2004 were as follows:

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Asia	¥ 14,413	¥ 14,048	\$ 122,695
North America	10,756	8,609	91,564
Europe	9,733	8,451	82,855
Other areas	439	153	3,737
Overseas sales (A)	¥ 35,341	¥ 31,261	\$ 300,851
Consolidated net sales (B)	¥ 147,428	¥ 137,961	\$ 1,255,027
(A)/(B) (%)	24.0%	22.7%	24.0%

Overseas external sales include foreign subsidiaries' sales to overseas third parties as well as the Company's and domestic subsidiaries' export sales to third parties.

17. Amounts per Share

The computation of basic net income per share is based on the weighted average number of shares of common stock outstanding during the year.

Diluted net income per share assumes dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, or resulted into issuance of common stock.

Amounts per share of net assets are based on the number of shares of common stock outstanding at the year-end.

Cash dividends per share include interim dividends of the Company proposed by the Board of Directors in addition to year-end dividends approved by shareholders at the annual meeting held subsequent to the end of each fiscal year.

	2006	2005	2006
	(Yen)		(U.S. dollars)
Basic net income	¥ 64.05	¥ 43.70	\$ 0.55
Diluted net income	63.95	43.69	0.54
Net assets	505.59	412.75	4.30
Cash dividends applicable to the year	12.00	7.00	0.10

18. Related Party Transactions

The company owns 25.12% of outstanding shares of NABCO systems Co., Ltd. which sells products related to industrial equipment business.

The account balances and transactions with NABCO systems Co., Ltd. as of and for the years ended March 31, 2006 and 2005 were as follows:

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Net sales	¥ 4,664	¥ -	\$ 39,704
Trade notes and account receivable	1,987	-	16,915

Terms of transactions:

Terms of sales to NABCO systems Co., Ltd. are determined under general market conditions.

19. Subsequent Events

The following appropriation of retained earnings on a non-consolidated basis, which has not been reflected in accompanying consolidated financial statements, was approved at the shareholders' meeting held on June 27, 2006:

	(Millions of yen)	(Thousands of U.S. dollars)
Cash dividends (¥7= \$0.06 per share)	¥ 888	\$ 7,559

Independent Auditors' Report

Nabtesco Corporation

To the Board of Directors of Nabtesco Corporation

We have audited the accompanying consolidated balance sheets of Nabtesco Corporation 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 Nabtesco Corporation and 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 3 to the consolidated financial statements, effective October 1, 2004, Nabtesco Corporation changed the accounting method of depreciation for property, plant and equipment.

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.

Tokyo, Japan
June 27, 2006

KPMG AZSA & Co.
(KPMG AZSA & Co.)