HARMONIC DRIVE SYSTEMS INC.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2006

Kasumigaseki Bldg. 32nd Floor
3-2-5, Kasumigaseki, Chiyoda-ku,
Tokyo 100-6088, Japan

Report of Independent Auditors

June 23, 2006

To the Shareholders and Board of Directors of
Harmonic Drive Systems Inc.

We have audited the accompanying consolidated balance sheets of Harmonic Drive Systems Inc. and its subsidiaries as of March 31, 2005 and 2006, and the related consolidated statements of income and retained earnings, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated 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 Harmonic Drive Systems Inc. and its subsidiaries as of March 31, 2005 and 2006, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles and practices generally accepted in Japan (see Note 2).

The amounts expressed in U.S. dollars, which are provided solely for the convenience of the readers, have been translated on the basis set forth in Note 3 to the accompanying consolidated financial statements.

ChuoAoyama PricewaterhouseCoopers

HARMONIC DRIVE SYSTEMS INC.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	March 31,		March 31,
	2005	2006	2006
Current assets:			
Cash and bank deposits (Note 4,5)	¥3,386,074	¥4,654,297	$39,621
Marketable securities (Note 6)	60,634	530,231	4,514
Notes and accounts receivable, trade -			
Notes	915,635	719,673	6,127
Accounts	4,153,292	3,807,555	32,413
Allowance for doubtful accounts	(5,210)	-	-
	5,063,717	4,527,228	38,540
Inventories (Note 8)	866,136	963,861	8,205
Deferred income taxes (Note 10)	145,601	147,301	1,254
Prepaid expenses and other current assets (Note 11)	383,508	431,840	3,676
Total current assets	9,905,670	11,254,758	95,810
Property, plant and equipment (Note 9):			
Land	803,913	803,913	6,844
Buildings and structures	3,621,003	3,602,719	30,669
Machinery and equipment	2,571,253	2,636,804	22,447
Construction in progress	1,654	13,401	114
	6,997,823	7,056,837	60,074
Less - Accumulated depreciation	(3,867,195)	(4,040,808)	(34,399)
	3,130,628	3,016,029	25,675
Other assets:			
Investment securities (Note 6)	1,395,894	4,877,135	41,518
Investment in affiliated company (Note 7)	1,730,426	1,687,811	14,368
Software and other intangibles, net	100,841	91,528	779
Deferred income taxes (Note 10)	14,841	21,038	179
Long-term bank deposits	-	500,000	4,257
Others	70,166	73,440	625
	3,312,168	7,250,952	61,726
	¥16,348,466	¥21,521,739	$183,211

The accompanying notes are an integral part of these financial statements.

HARMONIC DRIVE SYSTEMS INC.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

LIABILITIES AND SHAREHOLDERS' EQUITY

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	March 31,		March 31,
	2005	2006	2006
Current liabilities:			
Short term borrowings	¥13,200	¥13,200	$112
Current portion of long-term debt (Note 9)	24,520	24,520	209
Notes and accounts payable, trade	1,534,055	1,588,472	13,522
Accrued income taxes	682,106	768,235	6,540
Accrued bonuses for employees	383,876	427,331	3,638
Other current liabilities	759,246	595,201	5,067
Total current liabilities	3,397,003	3,416,959	29,088
Long-term liabilities:			
Long-term debt (Note 9)	3,179,025	2,704,505	23,023
Reserve for retirement allowances for employees (Note 11)	3,335	7,459	64
Reserve for retirement allowances for directors and statutory auditors	324,421	376,945	3,209
Reserve for retirement allowances for executive officers	34,396	45,008	383
Deferred income taxes (Note 10)	87,211	745,273	6,344
Total long-term liabilities	3,628,388	3,879,190	33,023
Total liabilities	7,025,391	7,296,149	62,111
Minority interest	16,032	379,104	3,227
Shareholders' equity (Note 12):			
Common stock -			
Authorized: 132,000 shares			
Issued and outstanding: 33,108 shares	666,800	666,800	5,677
Capital surplus	3,264,200	3,990,717	33,972
Retained earnings	6,525,119	8,063,190	68,640
Unrealized gains on available-for sale securities	341,866	1,349,846	11,491
Foreign currency translation adjustments	82,607	168,982	1,439
Treasury stock, at cost	(1,573,549)	(393,049)	(3,346)
	9,307,043	13,846,486	117,873
Commitments and contingent liabilities (Notes 17 and 18)	-	-	-
	¥16,348,466	¥21,521,739	$183,211

The accompanying notes are an integral part of these financial statements.

HARMONIC DRIVE SYSTEMS INC.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	For the years ended March 31,		For the year ended March 31,
	2005	2006	2006
Net sales	¥14,110,082	¥14,452,655	$123,033
Cost of sales	7,815,669	7,674,304	65,330
Gross profit	6,294,413	6,778,351	57,703
Selling, general and administrative expenses (Note 15)	3,418,137	3,573,395	30,420
Operating profit	2,876,276	3,204,956	27,283
Other income:			
Interest income	2,691	8,510	72
Equity in income of affiliated company	59,049	101,586	865
Rental income	13,080	-	-
Other	84,058	84,341	718
	158,878	194,437	1,655
Other expenses:			
Interest paid	43,262	4,986	42
Rental expense	3,764	-	-
Other	56,107	11,197	95
	103,133	16,183	137
Ordinary income	2,932,021	3,383,210	28,801
Exceptional losses, net (Note 16)	89,997	49,944	426
Income before income taxes and minority interest	2,842,024	3,333,266	28,375
Income taxes (Note 9):			
Current	979,478	1,238,664	10,545
Deferred	8,628	(36,287)	(309)
	988,106	1,202,377	10,236
Minority interest	12,995	16,506	140
Net income	1,840,923	2,114,383	17,999
Retained earnings (Note 12):			
Balance at beginning of year	5,261,424	6,525,119	55,547
Cash dividends	524,470	491,123	4,181
Directors' bonuses	47,758	80,189	683
Statutory auditors' bonuses	5,000	5,000	42
Balance at end of year	¥6,525,119	¥8,063,190	$68,640

	Exact yen		U.S. dollars (Note 3)
Net income per share (Notes 2(n) and 13) - Basic	¥57,895.58	¥65,227.37	$555.27
- Diluted	¥54,891.80	¥60,015.12	$510.90
Cash dividends per share (Notes 2(m) and 13)			
Year-end dividends for preceding year	¥7,800	¥7,200	$61.29
Interim dividends for current year	9,500	9,000	76.62
	¥17,300	¥16,200	$137.91

The accompanying notes are an integral part of these financial statements.

HARMONIC DRIVE SYSTEMS INC.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	For the years ended March 31,		For the year ended March 31,
	2005	2006	2006
Cash flows from operating activities:			
Income before income taxes and minority interest	¥2,842,024	¥3,333,266	$28,375
Adjustments for:			
Depreciation and amortization	513,696	518,770	4,416
Net provision of allowance for doubtful accounts	-	(5,511)	(47)
Net provision of reserve for retirement allowances for employees	954	4,124	35
Net provision of reserve for retirement allowances for directors and statutory auditors	28,857	52,524	447
Net provision of reserve for retirement allowances for executive officers	19,655	10,611	91
Interest income earned	(2,691)	(8,510)	(72)
Interest expense incurred	43,262	4,987	42
Equity in income of affiliated company	(59,048)	(101,586)	(865)
Income on investment fund	(24,333)	(7,956)	(68)
Issuance cost of bonds	20,584	-	-
Charges for credit facility contracts	10,500	-	-
Gain on sales of investment securities	-	(1)	(0)
Gain on sales of fixed assets	(42)	(2,083)	(18)
Loss on sales of fixed assets	6,470	66	1
Loss on disposal of fixed assets	19,923	32,780	279
Cancellation charge for long-term debt contracts	63,647	-	-
Loss on prior period adjustments for a consolidated subsidiary	-	19,182	163
Bonuses for directors and statutory auditors appropriated from retained earnings	(52,758)	(85,189)	(725)
Decrease in trade receivables	90,277	566,253	4,821
Increase in inventories	(3,100)	(78,378)	(667)
Increase (decrease) in trade payables	(156,888)	46,647	397
Other	(53,515)	(96,958)	(825)
Subtotal	3,307,474	4,203,038	35,780
Interest received	10,399	44,646	380
Dividends received from affiliated company	32,665	133,300	1,135
Interest paid	(39,562)	(4,986)	(43)
Income taxes paid	(1,026,502)	(1,152,922)	(9,815)
Net cash provided by operating activities	2,284,474	3,223,076	27,437
Cash flows from investing activities:			
Payments for purchases of fixed assets	(341,238)	(509,877)	(4,340)
Proceeds from sale of fixed assets	10,959	3,753	32
Payments for purchases of software and other intangibles	(26,006)	(40,177)	(342)
Proceeds from sale of investment securities	-	1	0
Payments for long-term bank deposits	-	(500,000)	(4,256)
Payments for purchases of investment securities	(499,757)	(1,834,964)	(15,621)
Acquisition of cash owned by Harmonic Drive L.L.C., net of payment for purchase of subsidiary's shares	-	347,126	2,955
Other	60,957	50,894	433
Net cash used in investing activities	(795,085)	(2,483,244)	(21,139)
Cash flows from financing activities:			
Proceeds from short-term borrowings	3,200	-	-
Payment of long-term debt	(2,824,520)	(24,519)	(209)
Payment of charges for credit facility contract	(10,500)	-	-
Payment of cancellation charge for long-term debt contracts	(63,646)	-	-
Proceeds from long-term debt	2,979,416	-	-
Payments for purchases of treasury stock	-	(556)	(5)
Proceeds from sale of treasury stock	-	1,457,572	12,408
Cash dividends paid	(524,470)	(491,122)	(4,180)
Cash dividends paid to minority shareholders	-	(560)	(5)
Net cash provided by (used in) financing activities	(440,520)	940,815	8,009
Effect of exchange rate changes on cash and cash equivalents	(11,513)	57,173	487

The accompanying notes are an integral part of these financial statements.

Net increase in cash and cash equivalents	1,037,356	1,737,820	14,794
Cash and cash equivalents at beginning of year	2,409,352	3,446,708	29,341
Cash and cash equivalents at end of year (Note 4)	¥3,446,708	¥5,184,528	$44,135

The accompanying notes are an integral part of these financial statements.

HARMONIC DRIVE SYSTEMS INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED MARCH 31, 2005 AND 2006

1. Nature of operations:

Harmonic Drive Systems Inc. (the "Company") and its consolidated subsidiaries (collectively referred as the "Companies") are engaged in the development, manufacture and sale of harmonic drive gears and related motion control products. The Company's manufacturing facilities are located in Japan and its products are marketed by the Company in Japan, a subsidiary in the United States and an affiliated company in Europe.

2. Summary of significant accounting policies:

The accompanying consolidated financial statements of the Companies are prepared based on the statutory books and records maintained by the Companies in accordance with accounting principles and practices generally accepted in Japan, which are different in certain respects with regard to the application and disclosure requirements from International Financial Reporting Standards. The consolidated financial statements are not intended to present the consolidated financial position, results of operations and cash flows of the Companies in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan. However, certain reclassifications are incorporated in order to present the financial statements in a form which is more familiar to readers outside Japan. Such reclassifications have no effect on net income or retained earnings.

(a) Basis of consolidation and accounting for investment in affiliated company -

The consolidated financial statements include the accounts of the Company and its consolidated subsidiaries. Consolidated subsidiaries for the year ended March 31, 2005 are as follows:

- HD Systems, Inc.
- HD Logistics, Inc.
- Harmonic Precision Inc.
- Harmonic AD, Inc.

Harmonic Drive L.L.C., a 51% owned subsidiary, was established in December 2005. The accounts of Harmonic Drive L.L.C. have been included in the consolidated financial statements together with the four previously-consolidated subsidiaries, effective from the establishment date.

All significant intercompany transactions and accounts and unrealized intercompany profits are eliminated on consolidation.

The Company has a 25% shareholding in a sales distributor in Europe named Harmonic Drive AG. The investment in the shares of Harmonic Drive AG was accounted for by the equity method in the consolidated financial statements for the years ended March 31, 2005 and 2006.

The Company's overseas subsidiary (HD Systems, Inc. and Harmonic Drive L.L.C.) and affiliated company (Harmonic Drive AG) both have a fiscal year end date of December 31, which differs from that of the Company. The consolidation of the overseas subsidiary and the application of the equity method in accounting for the affiliated company are based on the respective financial statements of these entities for the fiscal years ended December 31. Any material transactions occurring in respect of these entities in the period January 1 to March 31 are adjusted for, if appropriate, in these consolidated financial statements.

(b) Cash and cash equivalents -

Cash and cash equivalents include all highly liquid investments, generally with original maturities of three months or less, that are readily convertible to known amounts of cash and are so close to maturity that they present an insignificant risk of changes in value.

(c) Allowance for doubtful accounts -

The allowance for doubtful accounts of the Company and its domestic subsidiaries is computed based on the past bad debt experience ratio for normal receivables, plus the estimated irrecoverable amount of doubtful receivables on an individual account basis.

(d) Marketable securities and investment securities -

Securities are classified into four categories; trading securities, held-to-maturity debt securities, equity securities of unconsolidated subsidiaries and affiliates, and available-for-sale securities. All securities held by the Company and its subsidiaries are classified as available-for-sale securities, with the exception of the investment in an affiliated company which is classified as equity securities of unconsolidated subsidiaries and affiliates.

Held-to-maturity debt securities are expected to be held to maturity and are recognized at amortized cost in the consolidated balance sheets.

Available-for-sale securities with market quotations are stated at fair value, with net unrealized gains or losses being reported as a separate component of shareholders' equity on a net-of-tax basis. Those securities without market quotations are stated at cost, cost being determined by the moving average method.

In cases where the fair value of securities is lower than the carrying value by 30% or more, and recovery of fair value to the carrying value is not deemed possible in the foreseeable future, impairment losses are recognized in the statement of income for that period.

In accordance with recent amendments to the Japanese Securities and Exchange Law, investments in investing business associations have been reclassified and included in "Investment securities" of the "Other assets" section of the consolidated balance sheet at March 31, 2005, while they were included in "Others" in the "Other assets" section at March 31, 2004. The balances of the investments in investing business associations included in "Others" at March 31, 2004 and "Investment securities" at March 31, 2005 were ¥133,882 thousand and ¥118,081 thousand ($1,099 thousand), respectively.

(e) Inventories -

Finished products, work in process and raw materials are stated at cost, cost being determined by the moving average method.

(f) Property, plant and equipment -

Property, plant and equipment, including significant renewals and additions, are capitalized at cost. Maintenance and repairs, as well as minor renewals and improvements, are charged to income as incurred. Depreciation is computed by the declining balance method for the Company and its domestic subsidiaries, except that for buildings acquired on or after April 1, 1998, it is computed using the straight-line method. For the overseas subsidiary, the straight-line method at rates based on the estimated useful lives of the assets is used.

(g) Accounting for leases -

Lease payments under finance lease contracts are charged to income as incurred. Under Japanese accounting principles, finance leases where ownership of the assets does not transfer to the lessee at the end of the lease period may be accounted for as operating leases with an appropriate footnote disclosure.

(h) Intangibles -

Software and other intangibles are amortized by the straight-line method over the estimated useful lives of the assets.

(i) Accrued severance indemnities for employees -

The severance indemnity regulations, which cover substantially all employees of the Company and its domestic subsidiaries, provide for benefit payments determined by reference to the employee's base amount for severance indemnity, length of service, position in the respective company and conditions under which the termination of employment occurs.

The Company has adopted a non-contributory funded, defined benefit, and tax qualified pension plan to provide the benefit payments established under the severance indemnity regulations for its employees. Under the pension plan, a retiring employee may elect either a lump-sum payment or annuity payments. Contributions to the pension plans include current service costs and past service costs, which are amortized over a period of approximately 3 years. Directors are not covered by the regulations.

A U.S. subsidiary maintains a simplified employee plan (the "SEP Plan"). All employees are eligible to participate in the SEP Plan upon completion of one year of service and after attaining the age of 21. The SEP Plan provides for discretionary contributions by the subsidiary. Participants are fully vested in the subsidiary's contributions based on a percentage of their annual compensation.

The reserve for retirement benefits for employees of the Company and its domestic subsidiaries has been provided at the estimated present value of projected benefit obligations in excess of the fair value of the plan assets, less the unrecognized balance of actuarial differences. In the case that this results in a debit balance, a prepaid pension cost is recorded as an asset. Actuarial differences are amortized on a straight-line basis over 3 years, starting from the year following that in which they occur.

(j) Reserve for retirement allowances for directors, statutory auditors and executive officers -

The reserve for retirement allowances for directors, statutory auditors and executive officers of the Company has been provided at 100% of the amount that would have been payable if all directors, statutory auditors and executive officers had retired at the balance sheet date, in accordance with the Company's "Rule for Retirement Allowances for Directors and Statutory Auditors" and the Company's "Rule for Retirement Allowances for Executive Officers".

(k) Income taxes -

The Company calculates and records income taxes currently payable based on its taxable income, determined in accordance with the applicable tax laws.

(l) Foreign currency translation -

Monetary items denominated in foreign currencies are translated into Japanese yen at the exchange rate prevailing at the balance sheet date, with exchange gains or losses being credited or charged to current income. Assets and liabilities of the foreign subsidiary are translated into Japanese yen at the exchange rate prevailing at the balance sheet date, shareholders' equity accounts of the foreign subsidiary are translated at historical rates, and all income and expense accounts are translated at the average exchange rate during the year.

(m) Appropriations of retained earnings -

Appropriations of retained earnings are recorded in the accompanying consolidated financial statements following approval by the shareholders, as required under Japanese law.

(n) Net income per share -

The computation of net income per share is based on the average number of shares outstanding during each period, with retroactive adjustments to reflect the effect of any stock split subsequently made, if appropriate.

The standard also requires that net income be adjusted by deducting bonuses paid to directors and statutory auditors as well as the payment of dividends to shareholders of preferred stocks to be recognized as an appropriation of retained earnings from net income shown in the consolidated statements of income and retained earnings. The calculation of net income per share be made on that adjusted net income basis.

Diluted net income per share assumes the dilutive effect that could occur if convertible instruments are converted, options or warrants are exercised, or shares are issued upon the satisfaction of specified conditions.

(o) Accounting standard for impairment of fixed assets -

On August 9, 2002, the Business Accounting Council in Japan issued "Accounting Standard for Impairment of Fixed Assets". Further, on October 31, 2003, the Accounting Standards Board of Japan issued Financial Accounting Standards Implementation Guidance No. 6 - "Application Guidance on Accounting Standards for Impairment of Fixed Assets". The standard requires that fixed assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss should be recognized in the statements of income by reducing the carrying amount of impaired assets or a group of assets to the recoverable amount, which is defined as the higher of net selling price and value in use. Whilst the Company had adopted these Standards for the year ended March 31, 2006, there was no impact on the operating results or financial position.

3. U.S. dollar amounts:

U.S. dollar amounts are included solely for convenience and have been translated, as a matter of arithmetical computation only, at the rate of ¥117.47=US$1, the approximate exchange rate prevailing in the Japanese foreign exchange market at March 31, 2006. This translation should not be construed as implying that the yen amounts actually represent, have been or could be converted into U.S. dollars at this or any other rate.

4. Cash and cash equivalents:

Cash and cash equivalents for the purpose of the consolidated statements of cash flows at March 31, 2005 and 2006 comprise the following:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Cash and bank deposits	¥3,386,074	¥4,654,297	$39,621
Highly liquid investments	60,634	530,231	4,514
Cash and cash equivalents	¥3,446,708	¥5,184,528	$44,135

5. Supplemental cash flow information:

In December 2005, the Company acquired 51% shares of Harmonic Drive L.L.C. for ¥361,294 thousand ($3,076 thousand). As a result, assets and liabilities of Harmonic Drive L.L.C. were included in the Company's consolidated financial statements effective from the acquisition date.

	Thousands of yen	Thousands of U.S. dollars (Note 3)
Current assets	¥708,420	$6,031
Minority interest	(347,126)	(2,955)
Payment for purchase of Harmonic Drive L.L.C. shares	361,294	3,076
Cash and cash equivalents owned by Harmonic Drive L.L.C.	708,420	6,031
Acquisition of cash owned by Harmonic Drive L.L.C., net of payment for purchase of subsidiary's shares	¥347,126	$2,955

The following summary represents significant non-cash activities for the year ended March 31, 2006.

	Thousands of yen	Thousands of U.S. dollars (Note 3)
Decrease in treasury stock due to exercise of warrants	¥266,844	$2,272
Increase in capital surplus (gains on sales of treasury stock) due to exercise of warrants	183,156	1,559
Decrease in bonds with warrants due to exercise of warrants	¥450,000	$3,831

6. Marketable securities and investment securities:

The carrying amount on the balance sheet, gross unrealized gains and losses, and the relevant fair value of held-to-maturity debt securities with market quotations at March 31, 2005 and 2006 are as follows:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Carrying amount	-	¥996,050	$8,479
Gross unrealized gains	-	-	-
Gross unrealized losses	-	(4,940)	(42)
Fair value	-	¥991,110	$8,437

The aggregate cost, gross unrealized gains and losses, and carrying amount on the balance sheet, which were re-valued to the related fair value, of available-for-sale securities with market quotations at March 31, 2005 and 2006 are as follows:

	Thousands of yen			
March 31, 2005:	Cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
Equity securities	¥700,589	¥573,423	-	¥1,274,012
Debt securities	-	-	-	-
Other	-	-	-	-
	¥700,589	¥573,423	-	¥1,274,012

March 31, 2006:	Thousands of yen Cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
Equity securities	¥1,539,514	¥2,267,981	-	¥3,807,495
Debt securities	-	-	-	-
Other	-	-	-	-
	¥1,539,514	¥2,267,981	-	¥3,807,495

March 31, 2006:	Thousands of U.S. dollars (Note 3) Cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
Equity securities	$13,105	$19,307	-	$32,412
Debt securities	-	-	-	-
Other	-	-	-	-
	$13,105	$19,307	-	$32,412

The proceeds from sales of available-for-sale securities for the years ended March 31, 2005 and 2006 are zero and ¥1 thousand, respectively. The gross realized profits and losses on those sales for the year ended March 31, 2006 are ¥1 thousand and zero.

No impairment losses for the years ended March 31, 2005 and 2006 were recognized on available-for-sale securities with market quotations.

The carrying amounts of available-for-sale securities without market quotations at March 31, 2005 and 2006 are as follows:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Equity securities	¥3,800	¥3,800	$32
Money management funds	60,634	30,231	257
Free financial funds	-	500,000	4,257
Investments in investing business associations	118,081	69,790	594
	¥182,515	¥603,821	$5,140

7. Transactions with affiliated company:

Transactions with the affiliated company for the years ended March 31, 2005 and 2006, as well as account balances at the end of the period, are presented below:

	Thousands of yen 2005	Thousands of yen 2006	Thousands of U.S. dollars (Note 3) 2006
Sales to affiliated company	¥1,054,537	¥1,116,172	$9,502
Notes and accounts receivable, trade	349,554	417,060	3,550

8. Inventories:

Inventories at March 31, 2005 and 2006 comprise the following:

	Thousands of yen 2005	Thousands of yen 2006	Thousands of U.S. dollars (Note 3) 2006
Finished products	¥110,751	¥132,422	$1,127
Work in process	344,280	345,197	4,139
Raw materials	411,105	486,242	2,939
	¥866,136	¥963,861	$8,205

9. Long-term debt:

Long-term debt at March 31, 2005 and 2006 is summarized as follows:

	Thousands of yen 2005	Thousands of yen 2006	Thousands of U.S. dollars (Note 3) 2006
Unsecured zero coupon bonds, due 2009 with detachable warrants	¥3,000,000	¥2,550,000	$21,708
Secured loans, principally from banks due from 2007 to 2016 with interest ranging from 1.80% to 3.27%:	203,545	179,025	1,524
Portion due within one year	(24,520)	(24,520)	(209)
	¥3,179,025	¥2,704,505	$23,023

At March 31, 2006, the detachable warrants are exercisable until September 7, 2009 at a strike price of ¥950 thousand.

The following assets are pledged as collateral to secure long-term debt, including the current portion thereof, at March 31, 2005 and 2006:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Land	¥504,518	¥504,518	$4,295
Buildings	1,302,399	1,213,969	10,334
Structures	5,261	4,242	36
	¥1,812,178	¥1,722,729	$14,665
Secured long-term debt:			
Current portion of long-term loans	-	-	-
Long-term loans	-	-	-
	-	-	-

Included in the above, the following assets are pledged to secure factory founded bonds at March 31, 2005 and 2006:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Land	¥49,168	¥49,168	$419
Buildings	161,501	143,891	1,225
Structures	5,261	4,241	36
	¥215,930	¥197,300	$1,680

The aggregate annual maturities of long-term debt, including the current portion, for each year in the following 5-year period at March 31, 2006 are as follows:

	Thousands of yen	Thousands of U.S. dollars (Note 3)
Year ending March 31,		
2007	24,520	209
2008	24,520	209
2009	21,855	186
2010	2,570,520	21,882
2011	17,980	153
Over 2012	69,630	593
	¥2,729,025	$23,232

On March 25, 2005, the Company entered credit facility contracts totaling ¥2,000,000 thousand with four banks. In the year ended March 31, 2006, the maturity date of these credit facility contracts were extended to March 24, 2007. The entire amount of these credit facilities was unused as at March 31, 2005 and 2006.

10. Income taxes:

The income taxes applicable to the Company and its domestic subsidiaries consist of corporate income tax, inhabitants tax and enterprise tax, which in aggregate result in a normal statutory tax rate of approximately 40.4% and 40.5% for the years ended March 31, 2005 and 2006, respectively.

Deferred tax assets (liabilities) as of March 31, 2005 and 2006 consist of the following:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Deferred tax assets - current:			
Accrued enterprise taxes	¥53,819	¥65,869	$561
Accrued bonuses	131,000	135,988	1,158
Inventory write-down	15,448	6,354	54
Unrealized intercompany profit	48,942	45,978	391
Accrued bonuses for executive officers	24,300	36,855	314
Accrued social expenses	15,615	17,414	148
Prepaid pension costs	(145,170)	(161,157)	(1,372)
Others	1,647	-	-
Net deferred tax assets – current	¥145,601	¥147,301	$1,254
Deferred tax assets – non current			
Reserve for retirement allowances for directors and statutory auditors	¥12,988	¥17,545	149
Other	1,853	3,493	30
Net deferred tax assets - non-current	¥14,841	¥21,038	$179
Deferred tax liabilities - non-current:			
Reserve for retirement allowances for directors and statutory auditors	¥118,281	¥134,899	$1,148
Reserve for retirement allowances for executive officers	13,930	18,228	155
Devaluation of golf club memberships	7,775	7,775	66
Depreciation	528	429	4
Devaluation of investment securities	22,256	22,256	190
Unrealized gains on available-for-sale securities	(232,699)	(918,802)	(7,822)
Undistributed earnings of foreign subsidiary	(11,478)	(8,448)	(72)
Other	1,971	6,165	53
	(79,436)	(737,498)	(6,278)
Valuation allowance	(7,775)	(7,775)	(66)
Net deferred tax liabilities - non-current	(¥87,211)	(¥745,273)	($6,344)

The valuation allowance primarily relates to deferred tax assets recognized in respect of devaluation of golf club memberships for 2005 and 2006.

Reconciliation of the differences between the statutory tax rate and the effective income tax rate for the years ended March 31, 2005 and 2006 is as follows:

	2005	2006
Statutory tax rate	40.4%	40.5%
Increase (decrease) in taxes resulting from:		
Tax credit relating to research and development expenses	(5.8)	(4.3)
Tax effect on undistributed earnings of foreign subsidiary	0.4	0.3
Others, net	(0.2)	(0.4)
Effective income tax rate	34.8%	36.1%

11. Severance indemnities and retirement allowances for employees:

The Company and its domestic subsidiaries have defined benefit retirement plans covering substantially all employees. The prepaid pension cost recorded on the consolidated balance sheets as of March 31, 2005 and 2006 is analyzed as follows:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Projected benefit obligations (PBO)	(¥1,233,542)	(¥1,283,878)	($10,930)
Plan assets	1,635,595	2,098,132	17,861
Excess of plan assets over PBO (Unfunded PBO)	402,053	814,254	6,931
Unrecognized actuarial differences	(46,633)	(423,619)	(3,606)
Sub total	355,420	390,635	3,325
Reserve for retirement allowances for employees	3,335	7,459	64
Prepaid pension cost	¥358,755	¥398,094	$3,389

The net periodic pension cost relating to retirement benefits for the years ended March 31, 2005 and 2006 is as follows:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Service cost	¥70,725	¥75,073	$639
Interest cost	23,006	24,604	209
Expected return on plan assets	(26,334)	(32,712)	(278)
Amortization of unrecognized losses	76,815	14,688	125
Net periodic pension cost	¥144,212	¥81,653	$695

The assumptions used in the above actuarial computations for the years ended March 31, 2005 and 2006 are as follows:

	2005	2006
Discount rate	2.0%	2.0%
Expected rate of return on plan assets	2.0%	2.0%
Method of attributing pension benefits to employee service periods	Straight-line basis	Straight-line basis
Amortization of transition obligation	3 years	3 years
Amortization of unrecognized actuarial differences	3 years	3 years

In addition to the defined benefit retirement plans, the Company enters an industrial multi-employer pension plan. The proportionate share of the plan assets of the multi-employer plan are ¥1,552,579 thousand and ¥1,980,494 thousand ($16,860 thousand) as at March 31, 2005 and 2006, respectively, and contribution to the plan in those years are ¥51,775 thousand and ¥61,654 thousand ($525 thousand), respectively.

12. Shareholders' equity:

The balance of capital surplus as of March 31, 2005 and 2006 is analyzed as follows:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Beginning of year	¥3,264,200	¥3,264,200	$27,787
Gains on sales of treasury stock	-	726,517	6,185
End of year	¥3,264,200	¥3,990,717	$33,972

The Company's retained earnings consist of unappropriated retained earnings and legal reserves required by the Commercial Code of Japan. The retained earnings accumulated by the Company are initially recorded as unappropriated retained earnings and later transferred to legal reserve upon approval at the shareholders' meeting.

The Japanese Commercial Code provides that an amount equivalent to a minimum of 10% of cash dividends and bonuses paid to directors and statutory auditors be appropriated as a legal reserve until such reserve reaches a certain limit, which was 25% of the capital stock, less capital reserves. The capital and legal reserves may be used to reduce a deficit following the approval of a shareholders' meeting. In addition, under the Commercial Code, the capital and legal reserves may be transferred to retained earnings and are available for dividends by resolution of the shareholders' meeting, to the extent that the total amount of the capital and legal reserve does not fall below 25% of the capital stock. The legal reserve of the Company is included in retained earnings on the consolidated balance sheets.

Appropriations of retained earnings are recorded in the accounts when the shareholders' approval is obtained. The following appropriations of retained earnings of the Company for the year ended March 31, 2006 were approved at the ordinary general meeting of shareholders held on June 23, 2006.

	Thousands of yen	Thousands of U.S. dollars (Note 3)
Appropriations:		
Cash dividends at ¥9,500 ($80.87) per share	¥307,906	$2,621
Directors' bonuses for service in the year ended March 31, 2006	85,000	724
Statutory auditors' bonuses for service in the year ended March 31, 2006	5,000	43

These appropriations were not recorded in the consolidated financial statements for the year ended March 31, 2006, but will be recorded in those for the year ending March 31, 2007.

The number of treasury stocks at March 31, 2005 and 2006 are 2,791.8 and 696.8, respectively.

13. Net income per share:

Net income used in the computation of net income per share is as follows:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Net income	¥1,840,923	¥2,114,383	$17,999
Less - Net income not attributable to common shareholders:			
Bonuses to directors and statutory auditors recognized as appropriation of retained earnings	(85,749)	(99,622)	(848)
Net income attributable to common shareholders	¥1,755,174	¥2,014,760	$17,151

Weighted average number of shares used in the computation of basic and diluted net income per share are as follows:

	Number of shares	
	2005	2006
Weighted average number of shares	30,316.2	30,888.3
Adjusted – Dilutive potential common shares:		
Bonds with warrants	1,659.0	2,682.6
Diluted net income per share	31,975.2	33,570.9

14. Derivative financial instruments:

The Companies had no derivative financial instruments at March 31, 2005 or 2006.

15. Selling, general and administrative expenses:

The major items included in selling, general and administrative expenses for the years ended March 31, 2005 and 2006 are as follows:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Shipping and transportation	¥127,084	¥127,272	$1,083
Remuneration, salaries, bonuses, fringe benefits, etc.	1,382,644	1,496,998	12,744
Research and development	1,100,685	1,096,028	9,330

16. Exceptional losses, net:

Exceptional losses, net for the years ended March 31, 2005 and 2006 consist of the following:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Exceptional gains on:			
- Gain on sales of investment securities	-	(¥1)	($0)
- Gain on sales of property, plant and equipment	(¥42)	(2,083)	(17)
Exceptional losses on:			
- Disposal of property, plant and equipment	19,923	32,780	279
- Sales of fixed assets	6,470	66	1
- Cancellation charge for long-term debt contracts	63,646	-	-
- Loss on prior period adjustments for a consolidated subsidiary	-	19,182	163
Exceptional losses, net	¥89,997	¥49,994	$426

17. Finance leases:

Leased assets and related expenses in respect of the Company's finance leases, other than those which transfer ownership of the leased assets to the lessee, are accounted for using a method similar to that used for operating leases. Finance lease charges of the Companies for the years ended March 31, 2005 and 2006 were ¥392,925 thousand and ¥426,426 thousand ($3,630 thousand), respectively. Had they been capitalized on the balance sheet, the following items would have been recognized on the balance sheet and the statements of income and retained earnings as at and for the years ended March 31, 2005 and 2006:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Machinery and equipment	¥1,864,709	¥2,256,353	$19,208
Tools, furniture and vehicles	91,174	85,799	730
Software	49,000	39,930	340
	2,004,883	2,382,082	20,278
Less - Accumulated depreciation	(913,172)	(1,244,069)	(10,590)
	¥1,091,711	¥1,138,013	$9,688

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Depreciation	¥345,650	¥399,027	$3,397
Interest expense	22,510	27,685	236

Depreciation costs are calculated based on the straight-line method over the lease period, with no residual asset value at the end of the lease period. The interest expense portion is determined by subtracting an amount equivalent to the acquisition cost from the total lease fee. Total interest payments over the lease period are allocated to each period by the "interest method."

The present values of future lease payments of the Companies as at March 31, 2005 and 2006 are as follows:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Current portion	¥338,200	¥384,666	$3,275
Long-term obligation	756,692	778,059	6,623
	¥1,094,892	¥1,162,725	$9,898

Future operating lease payments under non-cancelable lease contracts as at March 31, 2005 and 2006 are as follows:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Current portion	¥33,411	¥24,271	$207
Long-term obligation	92,799	28,569	243
	¥126,210	¥52,840	$450

18. Contingent liabilities:

The Companies had no contingent liabilities as at March 31, 2005 or 2006.

19. Related party transactions:

The Company sells its products to Harmonic Drive AG. Transactions with Harmonic Drive AG for the years ended March 31, 2005 and 2006 are ¥1,054,538 thousand and ¥1,116,172 thousand ($9,502 thousand) in sales, respectively. The outstanding balance of notes and accounts receivable, trade at March 31, 2005 and 2006 are ¥349,554 thousand and ¥417,060 thousand ($3,550 thousand), respectively. Transactions with Harmonic Drive AG are conducted on an arm's length basis.

20. Segment information:

(a) Industry segment information -

The Companies' business operations fall within a single business segment, based on similarities in the type and nature of business. Accordingly, segment information on operating revenue, operating expenses, operating profit and identifiable assets, depreciation and capital investment, etc., has been omitted.

(b) Geographic area information and export sales information -

	Thousands of yen				
	Japan	United States	Combined	Elimination and /or Corporate	Consolidated
I. For the year ended March 31, 2005:					
Sales -					
Third party	¥13,025,496	¥1,084,586	¥14,110,082	¥ -	¥14,110,082
Intersegment	546,153	-	546,153	(546,153)	-
Total	13,571,649	1,084,586	14,656,235	(546,153)	14,110,082
Operating expenses	10,340,920	1,002,286	11,343,206	(109,400)	11,233,806
Operating profit	¥3,230,729	¥82,300	¥3,313,029	(¥436,753)	2,876,276
II. At March 31, 2005:					
Total Assets	¥14,123,627	¥755,849	¥14,879,476	¥1,468,990	¥16,348,466

	Thousands of yen				
	Japan	United States	Combined	Elimination and /or Corporate	Consolidated
I. For the year ended March 31, 2006:					
Sales -					
Third party	¥13,290,080	¥1,162,575	¥14,452,655	-	¥14,452,655
Intersegment	650,372	-	650,372	(¥650,372)	-
Total	13,940,452	1,162,575	15,103,027	(650,372)	14,452,655
Operating expenses	10,397,345	1,083,754	11,481,099	(233,400)	11,247,699
Operating profit	¥3,543,107	¥78,821	¥3,621,928	(¥416,972)	3,204,956
II. At March 31, 2006:					
Total Assets	¥14,018,012	¥1,273,788	¥15,291,800	¥6,229,939	¥21,521,739

	Thousands of U.S. dollars				
	Japan	United States	Combined	Elimination and /or Corporate	Consolidated
I. For the year ended March 31, 2006:					
Sales -					
Third party	$113,136	$9,897	$123,033	-	$123,033
Intersegment	5,536	-	5,536	($5,536)	-
Total	118,672	9,897	128,569	(5,536)	123,033
Operating expenses	88,510	9,226	97,736	(1,986)	95,750
Operating profit	$30,162	$671	$30,833	($3,550)	$27,283
II. At March 31, 2006:					
Total Assets	$119,333	$10,843	$130,176	$53,035	$183,211

Note 1: Operating expenses amounting to ¥422,227 thousand and ¥429,408 thousand ($3,655 thousand) for the years ended March 31, 2005 and 2006, respectively, which cannot be allocated to any particular geographical area, are included in the "Elimination and/or Corporate" column. These represent expenses incurred for primary research and development activities, plus certain expenses incurred by corporate departments, such as the General Affairs and Accounting Department.

Note 2: Assets of ¥1,738,195 thousand and ¥6,505,614 thousand ($55,381 thousand) as at March 31, 2005 and 2006, respectively, which cannot be allocated to any particular geographical area, are included in the "Elimination and/or Corporate" column. These assets represent excess cash at banks, long-term investments such as investment securities, other investments and other assets and those used by corporate departments.

(c) Export sales -

Export sales by major area for the years ended March 31, 2005 and 2006 are as follows:

	Thousands of yen		Thousands of U.S. dollars (Note 3)
	2005	2006	2006
Europe, mainly Germany	¥1,054,537	¥1,116,163	$9,502
North America, mainly the United States	1,084,586	1,162,575	9,897
Other	46,339	59,592	507
Total export sales	¥2,185,462	¥2,338,330	$19,906