HARMONIC DRIVE SYSTEMS INC.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2007

PRICEWATERHOUSECOOPERS

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Report of Independent Auditors

August 23, 2007

To the Board of Directors
of Harmonic Drive Systems Inc.

We have audited the accompanying consolidated balance sheet of Harmonic Drive Systems Inc ("the Company") and its subsidiaries as of March 31, 2007, and the related consolidated statements of income, changes in net assets and cash flows for the year 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 audit.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and its subsidiaries as of March 31, 2007, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in Japan.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2007 are presented solely for convenience. Our audit also included the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 2 to the consolidated financial statements.

PricewaterhouseCoopers Aarata

HARMONIC DRIVE SYSTEMS INC.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

ASSETS

	Thousands of yen		Thousands of U.S. dollars (Note 2)
	March 31,		March 31,
	2006	2007	2007
Assets:			
Current assets -			
Cash and bank deposits (Note 8(a))	¥4,654,297	¥4,744,449	$40,190
Notes and accounts receivable, trade (Notes 5(c) and 16)	4,527,227	5,487,110	46,481
Marketable securities (Notes 8(a) and 10)	530,231	42,355	358
Inventories	963,861	1,199,807	10,163
Deferred income taxes (Note 14)	147,300	195,523	1,656
Other current assets (Note 12)	431,839	690,096	5,845
Allowance for doubtful accounts	-	(3,918)	(33)
Total current assets	11,254,757	12,355,424	104,662
Fixed assets (Note 9) -			
Tangible fixed assets (Note 5(b)):			
Buildings and structures	1,477,448	1,436,478	12,168
Machinery and equipment	298,888	375,836	3,183
Land	803,912	803,912	6,809
Construction in progress	13,401	23,951	202
Other	422,378	540,608	4,579
Total tangible fixed assets	3,016,028	3,180,787	26,944
Intangible fixed assets:			
Software	83,627	97,751	828
Other	7,901	7,651	64
Total intangible fixed assets	91,528	105,402	892
Investment securities and other assets:			
Investment securities (Note 10)	4,877,134	5,076,733	43,004
Investment in affiliated company (Note 5(a))	1,687,810	1,808,988	15,323
Deferred income taxes (Note 14)	21,037	25,249	213
Long-term bank deposits	500,000	500,000	4,235
Others	79,440	79,654	674
Allowance for doubtful accounts	(6,000)	(6,000)	(50)
Total investment securities and other assets	7,159,423	7,484,625	63,402
Total fixed assets	10,266,980	10,770,816	91,239
Total assets	¥21,521,738	¥23,126,240	$195,902

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

HARMONIC DRIVE SYSTEMS INC.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

LIABILITIES AND NET ASSETS

	Thousands of yen		Thousands of U.S. dollars (Note 2)
	March 31,		March 31,
	2006	2007	2007
Liabilities:			
Current liabilities -			
Notes and accounts payable, trade	¥1,588,472	¥1,801,890	$15,263
Short-term borrowings (Note 19(b))	13,200	370,530	3,138
Current portion of long-term debt (Note 19(b))	24,519	24,519	207
Accrued income taxes	768,235	1,224,787	10,375
Accrued bonuses for employees	427,331	552,111	4,676
Accrued bonuses for directors and statutory auditors	-	106,900	905
Other current liabilities	595,200	789,565	6,688
Total current liabilities	3,416,959	4,870,305	41,256
Long-term liabilities -			
Bond (Note 19(a))	2,550,000	-	-
Long-term debt (Note 19(b))	154,504	129,985	1,101
Deferred income taxes (Note 14)	745,273	796,005	6,742
Reserve for retirement allowances for employees (Note 12)	7,459	9,186	77
Reserve for retirement allowances for directors and statutory auditors	376,945	412,938	3,497
Reserve for retirement allowances for executive officers	45,007	70,653	598
Total long-term liabilities	3,879,189	1,418,769	12,018
Total liabilities	7,296,149	6,289,074	53,274
Net assets (Note 17):			
Shareholders' equity (Note 7) -			
Common stock:			
2006 - Authorized: 132,000 shares			
Issued and outstanding: 33,108 shares			
2007 - Authorized: 396,000 shares			
Issued and outstanding: 105,277 shares	666,800	1,610,542	13,642
Capital surplus	3,990,716	5,203,709	44,080
Retained earnings	8,063,190	10,054,225	85,169
Treasury stock, at cost	(393,048)	(2,304,188)	(19,518)
Total shareholders' equity	12,327,658	14,564,289	123,373
Valuation and translation adjustments -			
Net unrealized gains on available-for-sale securities (Note 10)	1,349,845	1,473,278	12,480
Foreign currency translation adjustments	168,982	256,844	2,175
Total valuation and translation adjustments	1,518,827	1,730,123	14,655
Minority interest	379,103	542,753	4,597
Total net assets	14,225,589	16,837,165	142,627
Total liabilities and net assets	¥21,521,738	¥23,126,240	$195,902

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

HARMONIC DRIVE SYSTEMS INC.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

	Thousands of yen		Thousands of U.S. dollars (Note 2)
	For the years ended March 31,		For the year ended March 31,
	2006	2007	2007
Net sales (Notes 15 and 16)	¥14,452,655	¥18,767,977	$158,983
Cost of sales (Notes 6(b) and 15)	7,674,304	10,053,175	85,160
Gross profit	6,778,351	8,714,801	73,822
Selling, general and administrative expenses (Notes 6(a), 6(b), 9, 12 and 15)	3,573,395	4,209,939	35,662
Operating profit	3,204,955	4,504,862	38,160
Other income:			
Interest income	8,509	52,037	440
Equity in income of affiliated company	101,586	195,647	1,657
R&D subsidies	39,688	19,800	167
Income on investment fund	7,956	-	-
Exchange gain	-	50,595	428
Other	36,696	55,073	466
	194,437	373,155	3,160
Other expenses:			
Interest paid	4,986	23,929	202
Charges for credit facility contract	-	30,000	254
R&D cost of subsidies	-	18,371	155
Charges for purchases of treasury stock	-	30,835	261
Loss on investment fund	-	4,281	36
Other	11,196	9,046	76
	16,183	116,464	986
Ordinary income	3,383,209	4,761,553	40,335
Exceptional gains:			
Gain on sales of investment securities (Note 10)	1	0	0
Gain on sales of fixed assets (Note 6(c))	2,083	4,632	39
	2,084	4,632	39
Exceptional losses:			
Loss on sales of fixed assets (Note 6(d))	66	1,494	12
Loss on disposal of fixed assets (Note 6(e))	32,779	21,015	178
Loss on prior period adjustments for a consolidated subsidiary	19,182	-	-
	52,028	22,510	190
Income before income taxes	3,333,265	4,743,676	40,183
Income taxes:			
Current	1,238,664	1,911,908	16,195
Deferred	(36,286)	(82,938)	(702)
	1,202,377	1,828,969	15,493
Minority interest	16,505	103,305	875
Net income (Note 17)	¥2,114,382	¥2,811,401	$23,815

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

HARMONIC DRIVE SYSTEMS INC.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31, 2007

	Thousands of yen				
	Shareholders' equity				
	Common stock	Capital surplus	Retained earnings	Treasury stock at cost	Total shareholders' equity
Balance as of March 31, 2006	¥666,800	¥3,990,716	¥8,063,190	(¥393,048)	¥12,327,658
Changes in the period:					
Issuance of ordinary stock	943,742	943,737	-	-	1,887,480
Increase of treasury stock	-	-	-	(2,304,403)	(2,304,403)
Disposal of treasury stock	-	269,255	-	393,264	662,519
Cash dividends (Note)	-	-	(307,906)	-	(307,906)
Cash dividends	-	-	(413,538)	-	(413,538)
Bonuses to directors and statutory auditors (Note)	-	-	(98,922)	-	(98,922)
Net income	-	-	2,811,401	-	2,811,401
Net changes in items except shareholders' equity	-	-	-	-	-
Total changes in the period	943,742	1,212,993	1,991,035	(1,911,139)	2,236,631
Balance as of March 31, 2007	¥1,610,542	¥5,203,709	¥10,054,225	(¥2,304,188)	¥14,564,289

For the year ended March 31, 2007

	Thousands of yen				
	Valuation and translation adjustments				
	Net unrealized gains on other securities	Foreign currency translation adjustments	Total valuation and translation adjustments	Minority interests in consolidated subsidiaries	Total net assets
Balance as of March 31, 2006	¥1,349,845	¥168,982	¥1,518,827	¥379,103	¥14,225,589
Changes in the period:					
Issuance of ordinary stock	-	-	-	-	1,887,480
Increase of treasury stock	-	-	-	-	(2,304,403)
Disposal of treasury stock	-	-	-	-	662,519
Cash dividends (Note)	-	-	-	-	(307,906)
Cash dividends	-	-	-	-	(413,538)
Bonuses to directors and statutory auditors (Note)	-	-	-	-	(98,922)
Net income	-	-	-	-	2,811,401
Net changes in items except shareholders' equity	123,433	87,861	211,295	163,649	374,945
Total changes in the period	123,433	87,861	211,295	163,649	2,611,576
Balance as of March 31, 2007	¥1,473,278	¥256,844	¥1,730,123	¥542,753	¥16,837,165

Note: Approved by the annual shareholders' meeting in June, 2006

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

HARMONIC DRIVE SYSTEMS INC.
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CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31, 2007

	Thousands of U.S. dollars (Note 2)				
	Shareholders' equity				
	Common stock	Capital surplus	Retained earnings	Treasury stock at cost	Total shareholders' equity
Balance as of March 31, 2006	$5,648	$33,805	$68,303	($3,329)	$104,427
Changes in the period:					
Issuance of ordinary stock	7,994	7,994	-	-	15,988
Increase of treasury stock	-	-	-	(19,520)	(19,520)
Disposal of treasury stock	-	2,280	-	3,331	5,612
Cash dividends (Note)	-	-	(2,608)	-	(2,608)
Cash dividends	-	-	(3,503)	-	(3,503)
Bonuses to directors and statutory auditors (Note)	-	-	(837)	-	(837)
Net income	-	-	23,815	-	23,815
Net changes in items except shareholders' equity	-	-	-	-	-
Total changes in the period	7,994	10,275	16,866	(16,189)	18,946
Balance as of March 31, 2007	$13,642	$44,080	$85,169	($19,518)	$123,373

For the year ended March 31, 2007

	Thousands of U.S. dollars (Note 2)				
	Valuation and translation adjustments				
	Net unrealized gains on other securities	Foreign currency translation adjustments	Total valuation and translation adjustments	Minority interests in consolidated subsidiaries	Total net assets
Balance as of March 31, 2006	$11,434	$1,431	$12,865	$3,211	$120,504
Changes in the period:					
Issuance of ordinary stock	-	-	-	-	15,988
Increase of treasury stock	-	-	-	-	(19,520)
Disposal of treasury stock	-		-	-	5,612
Cash dividends (Note)	-	-	-	-	(2,608)
Cash dividends	-	-	-	-	(3,503)
Bonuses to directors and statutory auditors (Note)	-	-	-	-	(837)
Net income	-	-	-	-	23,815
Net changes in items except shareholders' equity	1,045	744	1,789	1,386	3,176
Total changes in the period	1,045	744	1,789	1,386	22,122
Balance as of March 31, 2007	$12,480	$2,175	$14,655	$4,597	$142,627

Note: Approved by the annual shareholders' meeting in June, 2006

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 2)
	For the years ended March 31,		For the year ended March 31,
	2006	2007	2007
Cash flows from operating activities:			
Income before income taxes	¥3,333,265	¥4,743,676	$40,183
Adjustments for -			
Depreciation and amortization	518,770	534,680	4,529
Net provision of allowance for doubtful accounts	(5,510)	3,828	32
Net provision of reserve for retirement allowances for employees	4,123	1,727	14
Net provision of reserve for retirement allowances for directors and statutory auditors	52,523	35,993	304
Net provision of reserve for retirement allowances for executive officers	10,611	25,646	217
Net provision of reserve for bonuses for directors and statutory auditors	-	106,900	905
Interest income earned	(8,509)	(52,037)	(440)
Interest expense incurred	4,986	23,929	202
Equity in income of affiliated company	(101,586)	(195,647)	(1,657)
(Income) loss on investment fund	(7,956)	4,281	36
Charges for credit facility contracts	-	30,000	254
Charges for acquisition of the treasury stock	-	30,835	261
Gain on sales of investment securities	(1)	(0)	(0)
Gain on sales of fixed assets	(2,083)	(4,632)	(39)
Loss on sales of fixed assets	66	1,494	12
Loss on disposal of fixed assets	32,779	21,015	178
Loss on prior period adjustments for a consolidated subsidiary	19,182	-	-
Bonuses for directors and statutory auditors appropriated from retained earnings	(85,189)	(98,922)	(837)
Decrease (increase) in trade receivables	566,253	(953,140)	(8,074)
Increase in inventories	(78,377)	(229,611)	(1,945)
Increase in trade payables	46,646	210,257	1,781
Other	(96,958)	(36,245)	(307)
Subtotal	4,203,037	4,204,027	35,612
Interest received	44,646	86,312	731
Dividends received from affiliated company	133,300	140,820	1,192
Interest paid	(4,986)	(4,478)	(37)
Income taxes paid	(1,152,921)	(1,401,080)	(11,868)
Net cash provided by operating activities	3,223,075	3,025,601	25,629

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

HARMONIC DRIVE SYSTEMS INC.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Continued)

	Thousands of yen For the years ended March 31,		Thousands of U.S. dollars (Note 2) For the year ended March 31,
	2006	2007	2007
Cash flows from investing activities:			
Payments for purchases of marketable securities	-	(11,787)	(99)
Payments for purchases of fixed assets	(509,877)	(641,151)	(5,431)
Proceeds from sale of fixed assets	3,753	12,860	108
Payments for purchases of software and other intangibles	(40,177)	(48,974)	(414)
Payments for purchases of investment securities	(1,834,964)	-	-
Proceeds from sale of investment securities	1	0	0
Payments for long-term bank deposits	(500,000)	-	-
Payments for deposits and long-term loan	(6,864)	(7,128)	(60)
Proceeds from deposits and long-term loan	3,350	3,778	32
Acquisition of cash owned by Harmonic Drive L.L.C., net of payment for purchase of subsidiary's shares	347,125	-	-
Other	54,408	7,727	65
Net cash used in investing activities	(2,483,243)	(684,676)	(5,799)
Cash flows from financing activities:			
Proceeds from short-term borrowings	-	379,140	3,211
Payment of short-term borrowings	-	(30,000)	(254)
Payment of long-term debt	(24,519)	(24,519)	(207)
Payment of charges for credit facility contract	-	(30,000)	(254)
Payments for charges for acquisition of the treasury stock	-	(30,835)	(261)
Payments for purchases of treasury stock	(555)	(2,304,403)	(19,520)
Proceeds from sale of treasury stock	1,457,572	-	-
Cash dividends paid	(491,122)	(721,444)	(6,111)
Cash dividends paid to minority shareholders	(560)	(700)	(5)
Net cash provided by (used in) financing activities	940,815	(2,762,763)	(23,403)
Effect of exchange rate changes on cash and cash equivalents	57,173	12,050	102
Net increase (decrease) in cash and cash equivalents	1,737,820	(409,788)	(3,471)
Cash and cash equivalents at beginning of year	3,446,708	5,184,528	43,918
Cash and cash equivalents at end of year (Note 8)	¥5,184,528	¥4,774,740	$40,446

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

HARMONIC DRIVE SYSTEMS INC.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 Company and its domestic subsidiaries 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.

In the consolidated financial statements, amounts less than ¥1 thousand have been omitted. As a result, the total shown in the consolidated financial statements and notes thereto do not necessarily agree with the sum of the individual account balances.

U.S. dollar amounts are included solely for convenience and have been translated, as a matter of arithmetical computation only, at the rate of ¥118.05 = US$1, the approximate exchange rate prevailing in the Japanese foreign exchange market at March 31, 2007. 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.

(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, 2006 and 2007 are as follows:

- HD Systems, Inc.
- HD Logistics, Inc.
- Harmonic Precision Inc.
- Harmonic AD, Inc.
- Harmonic Drive L.L.C.

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

The Company holds a 25% share in a sales distributor in Europe named Harmonic Drive AG. The investment in the shares of Harmonic Drive AG is accounted for by the equity method in the consolidated financial statements for the years ended March 31, 2006 and 2007.

The Company's foreign subsidiaries (HD Systems, Inc. and Harmonic Drive L.L.C.) and affiliated company (Harmonic Drive AG) both have a year end date of December 31, which differs from that of the Company. The consolidation of the foreign subsidiaries 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 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) Valuation methods for major assets -

① Marketable securities and investment securities:

Securities are classified into two categories.

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

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 net assets on a net-of-tax basis. Those securities without market quotations are stated at cost using the moving average method.

Subscriptions to non-affiliated investment funds that are included in investment securities are accounted for by the equity method based on the recent available financial information.

② Inventories:

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

(c) Depreciation and amortization method of major assets -

① Tangible fixed assets:

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, with the exception of buildings acquired on or after April 1, 1998, which are computed using the straight-line method. For the foreign subsidiaries, depreciation is computed on a straight-line basis over the estimated useful lives of the assets.

② Intangible fixed assets:

Amortization is calculated based on the straight-line method. Software for in-house use is amortized based on the straight-line method over the expected useful life of 5 years.

(d) Treatment of deferred assets -

Stock issuance expense is not capitalized, but expensed as incurred.

(e) Basis of provision -

① Allowance for doubtful accounts -

The allowance for doubtful accounts is comprised of a general reserve based on historical bad debt experience and a specific reserve for amounts considered by management to be irrecoverable.

② Accrued bonuses for employees:

The Company and its domestic subsidiaries provide accrued bonuses for the expected payments of employee bonuses as of the end of the year.

③ Accrued bonuses for directors and statutory auditors:

The Company and its domestic subsidiaries estimate and provide an accrual for bonuses to directors and statutory auditors. The actual amount to be paid will be approved at the shareholders' meeting held subsequent to the end of the year.

④ Reserve for retirement allowances for directors and statutory auditors:

In accordance with the Company's "Rule for Retirement Allowances for Directors and Statutory Auditors," the reserve for retirement allowances for directors and statutory auditors of the Companies is calculated as 100% of the amount that would have been payable if all directors and statutory auditors had retired at the consolidated balance sheet date.

⑤ Reserve for retirement allowances for executive officers:

In accordance with the Company's "Rule for Retirement Allowances for Executive Officers," the reserve for retirement allowances for executive officers of the Companies is calculated as 100% of the amount that would have been payable if all executive officers had retired at the consolidated balance sheet date.

(f) Reserve for retirement allowances for employees -

The reserve for retirement allowances for employees of the Company and its domestic subsidiaries represents the estimated present value of projected benefit obligations in excess of the fair value of the plan assets, net of the unrecognized balance of actuarial differences. As of March 31, 2006 and 2007 this results in debit balances of ¥393,094 thousand and ¥598,692 thousand ($5,071 thousand), respectively, which are recorded as prepaid pension costs in Other current assets in the consolidated balance sheet. Prior service costs are amortized over a period of approximately 3 years from the year in which they occur. Actuarial differences are amortized on a straight-line basis over 3 years, starting from the year following that in which they occur. Certain domestic subsidiaries have adopted a simplified method in the calculation of their retirement benefit obligation and recorded as reserve for retirement allowances for employees in the consolidated balance sheet.

(g) Foreign currency translation -

Assets and liabilities of the foreign subsidiaries are translated into Japanese yen at the exchange rate prevailing at the balance sheet date, net assets accounts are translated at historical rates, and all income and expense accounts are translated at the average exchange rate during the year. Foreign currency translation adjustments resulting from such procedures are recorded in the consolidated balance sheet as a separate component of net assets.

(h) Accounting for leases -

Leases that do not meet the criteria for capitalization are accounted for either as financing or operating leases

(i) Consumption tax -

The consumption tax withheld upon sales of goods and the consumption tax paid by the Companies upon purchases of goods and services are not included in revenue and cost or expense items, respectively, in the accompanying consolidated statements of income.

(j) Valuation method for assets and liabilities of subsidiaries -

Assets and liabilities of the subsidiaries were measured at the fair values of the year in which they were consolidated.

(k) Amortization of goodwill and negative goodwill -

No goodwill or negative goodwill is recognized, as the cost of acquisition is equal to the group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities.

(l) Cash and cash equivalents -

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

3. Accounting changes:

(a) 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 amounts of impaired assets or a group of assets to the recoverable amount, which is defined as the higher of the net selling price or expected future cash flows. While the Companies adopted these standards for the year ended March 31, 2006, there is no impact on the operating results or financial position.

(b) Accounting standard for directors' bonuses -

Accounting Standards Board of Japan Statement No. 4, "Accounting Standard for Directors' Bonuses," issued on November 29, 2005, has been adopted effective for the current year. Due to the adoption of this new accounting standard, bonuses to directors and statutory auditors are expensed when incurred. Prior to the adoption, these bonuses were accounted for as an appropriation from retained earnings, upon resolution at the shareholders' meeting. As a result, operating profit and income before income taxes for the year ended March 31, 2007 are reduced by ¥106,900 thousand ($905 thousand) as compared to what would have been reported under the previous accounting policy. The impact on segment information is discussed in Note 15.

(c) Accounting standard for presentation of net assets in balance sheets -

Accounting Standards Board of Japan Statement No. 5, "Accounting Standard for Presentation of Net Assets in Balance Sheets," issued on December 9, 2005, and Financial Accounting Standards Implementation Guideline No. 8, "Guideline on Accounting Standard for Presentation of Net Assets in Balance Sheets," issued on December 9, 2005, have been adopted effective for the current year. The Companies disclosed net assets in the consolidated balance sheet as of March 31, 2007 using the new standard and guideline. The balance sheet as of March 31, 2006 was reclassified to meet these standard and guideline for convenience.

4. Change in presentation:

Due to its increased materiality for the year ended March 31, 2007, "Exchange gain" has been presented separately from "Other" within Other income. "Exchange gain" in the amount of ¥5,987 thousand ($50 thousand) for the year ended March 31, 2006 is included in "Other."

5. Notes to consolidated balance sheet:

(a) Investment in unconsolidated subsidiaries and affiliates -

Investments in unconsolidated subsidiaries and affiliates at March 31 is as follows:

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Investment in affiliated company	¥1,687,810	¥1,808,988	$15,323

(b) Assets pledged as collateral and liabilities secured by the collateral -

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

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Buildings	¥1,213,969	¥1,141,971	$9,673
Structures	4,241	3,705	31
Land	504,518	504,518	4,273
	¥1,722,728	¥1,650,195	$13,978
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:

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Buildings	¥143,890	¥131,637	$1,115
Structures	4,241	3,705	31
Land	49,168	49,168	416
	¥197,300	¥184,512	$1,562

(c) Treatment of notes receivable at the consolidated balance sheet date -

Notes receivable maturing on the consolidated balance sheet date are treated as though they are settled at the consolidated balance sheet date. Consequently, though March 31, 2007 was a bank holiday, notes receivable due on the consolidated balance sheet date, totaling ¥73,622 thousand ($623 thousand) were treated as settled and excluded in the balance of notes receivable at March 31, 2007.

(d) Credit facility contracts -

On March 26, 2007, the Company entered into credit facility contracts totaling ¥3,000,000 thousand ($25,412 thousand) for 3 years with four banks. As of March 31, 2007, there are no loans outstanding under these contracts.

6. Notes to consolidated statement of income:

(a) Selling, general and administrative expenses -

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

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Salaries and bonuses	¥742,546	¥976,758	$8,274
Provision of reserve for bonuses for employees	226,294	248,831	2,107
Provision of reserve for bonuses for directors and statutory auditors	-	106,900	905
Provision of reserve for retirement allowance for directors and statutory auditors	52,523	38,640	327
Provision of reserve for retirement allowance for executive officers	21,791	25,646	217
Research and development	1,096,027	1,236,738	10,476

(b) Research and development expenditure -

Research and development expenditure, which is charged to income when incurred, and is included in cost of sales and selling, general and administrative expenses, amounted to ¥1,119,725 thousand and ¥1,264,020 thousand ($10,707 thousand) for the years ended March 31, 2006 and 2007, respectively.

(c) Gain on sales of fixed assets -

Gain on sales of fixed assets for the years ended March 31 is comprised of the following:

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Machinery equipment	¥2,083	¥4,632	$39

(d) Loss on sale of fixed assets -

Loss on sales of fixed assets for the years ended March 31 is comprised of the following:

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Furniture and fixtures	¥66	¥ -	$ -
Vehicles	-	1,494	12
	¥66	¥1,494	$12

(e) Loss on disposal of fixed assets -

Loss on disposal of fixed assets for the years ended March 31 is comprised of the following:

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Building and structures	¥12,782	¥6,376	$54
Machinery equipment	5,405	1,725	14
Furniture and fixtures	14,404	12,540	106
Other	-	305	2
Software	188	67	0
	¥32,779	¥21,015	$178

7. Notes to consolidated statement of changes in net assets:

(a) Shares issued -

Share type	March 31, 2006	Increase	Decrease	March 31, 2007
Common stock (shares)	33,108	72,169	-	105,277

The increase in common stock is due to the following:

- 66,216 shares - three-for-one stock split at April 1, 2006
- 5,953 shares - issuance of new stock upon the exercise of warrants

(b) Treasury stock -

Share type	March 31, 2006	Increase	Decrease	March 31, 2007
Common stock (shares)	696.8	4,894.2	2,090.6	3,500.4

The increase in common stock is due to the following:

- 1,393.6 shares - three-for-one stock split at April 1, 2006
- 3,500 shares - purchase of treasury stock at March 22, 2007
- 0.6 shares - purchase of fractional shares upon the exercise of warrants of bonds with detachable warrants

The decrease in common stock is due to the following:

- 2,090.6 shares - treasury stock granted upon the exercise of warrants in place of issuance of new stock

(c) Stock subscription rights -

Company	Harmonic Drive Systems Inc.
Description	Unsecured zero coupon bonds, due 2009 with detachable warrants
Type of shares to be issued	Common stock

	March 31, 2006	Increase	Decrease	March 31, 2007
Number of shares to be issued	2,682	5,365	8,047	-

- The increase in the number of shares to be issued is due to the three-for-one stock split at April 1, 2006. The decrease in the number of shares reflects the exercise of certain warrants.
- The balance of unsecured zero coupon bonds, due 2009 with detachable warrants, is zero at March 31, 2007.
- Number of shares to be issued represents the shares to be exercised.

(d) Dividends -

① Dividends paid during the current year

(i) The following were resolved by the annual shareholders' meeting held on June 23, 2006

Type of shares	Common stock
Total amount of dividends paid in cash	
(Thousands of yen)	¥307,906
(Thousands of U.S. dollars)	($2,608)
Cash dividend per share	
(Yen)	¥9,500
(U.S. dollars)	($80.47)
Record date	March 31, 2006
Effective date	June 23, 2006

(ii) The following were determined by the Board of Directors held on November 17, 2006

Type of shares	Common stock
Total amount of dividends paid in cash	
(Thousands of yen)	¥413,538
(Thousands of U.S. dollars)	($3,503)
Cash dividend per share	
(Yen)	¥4,000
(U.S. dollars)	($33.88)
Record date	September 30, 2006
Effective date	December 14, 2006

② Dividends for the current year that are to be paid after the consolidated balance sheets date

The following have been approved by the annual shareholders' meeting held on June 22, 2007

Type of shares	Common stock
Resource of the dividends to be paid	Retained earnings
The total amount of the dividends in cash paid	
(Thousands of yen)	¥346,040
(Thousands of U.S. dollars)	($2,931)
Cash dividend per share	
(Yen)	¥3,400
(U.S. dollars)	($28.80)
Record date	March 31, 2007
Effective date	June 25, 2007

8. Notes to consolidated statements of cash flows:

(a) Cash and cash equivalents -

Cash and cash equivalents, for the purpose of the consolidated statements of cash flows, at March 31 are comprised of the following:

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Cash and bank deposits	¥4,654,297	¥4,744,449	$40,190
Highly liquid investments	530,231	30,290	256
Cash and cash equivalents	¥5,184,528	¥4,774,740	$40,446

(b) Supplemental consolidated cash flow information -

In December 2005, the HD Systems, Inc. acquired 51% shares of Harmonic Drive L.L.C. for ¥361,294 thousand ($3,060 thousand). As a result, assets and liabilities of Harmonic Drive L.L.C. are included in the Company's consolidated financial statements effective from the acquisition date.

	Thousands of yen	Thousands of U.S. dollars
Current assets	¥708,420	$6,001
Minority interest	(347,125)	(2,940)
Payment for purchase of Harmonic Drive L.L.C. shares	361,294	3,060
Cash and cash equivalents owned by Harmonic Drive L.L.C.	708,420	6,001
Acquisition of cash owned by Harmonic Drive L.L.C., net of payment for purchase of subsidiary's shares	¥347,125	$2,940

(c) Significant non-cash activities -

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

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Decrease in treasury stock due to exercise of warrants	¥266,844	¥393,264	$3,331
Increase in capital surplus (gains on sales of treasury stock) due to exercise of warrants	183,155	269,255	2,280
Increase in common stock due to exercise of warrants	-	943,742	7,994
Increase in capital surplus due to exercise of warrants	-	943,737	7,994
Decrease in bonds with warrants due to exercise of warrants	¥450,000	¥2,550,000	$21,601

9. Finance leases:

Leased assets and related expenses in respect of the Companies' 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, 2006 and 2007 are ¥426,426 thousand and ¥427,363 thousand ($3,620 thousand), respectively. Had these leases been capitalized on the consolidated balance sheet, the following would have been recognized on the consolidated balance sheet and the consolidated statements of income as of March 31 and for the years then ended:

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Machinery and equipment	¥2,256,353	¥2,165,468	$18,343
Tools, furniture and vehicles	85,798	97,674	827
Software	39,930	10,660	90
	2,382,082	2,273,802	19,261
Less - Accumulated depreciation	(1,244,069)	(1,281,040)	(10,851)
	¥1,138,013	¥992,762	$8,409

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Depreciation	¥399,026	¥400,329	$3,391
Interest expense	27,684	24,467	207

Depreciation expense is calculated based on the straight-line method over the lease period, assuming no residual asset value at the end of the lease period. Interest expense is determined as the difference between the acquisition cost and 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 of March 31 are as follows:

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Current portion	¥384,665	¥328,974	$2,786
Long-term obligation	778,059	686,020	5,811
	¥1,162,725	¥1,014,995	$8,598

Future operating lease payments under non-cancelable lease contracts as of March 31 are as follows:

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Current portion	¥24,270	¥117,382	$994
Long-term obligation	28,569	154,992	1,312
	¥52,840	¥272,374	$2,307

There is no impairment loss allocated to leased assets for the years ended March 31, 2006 and 2007.

10. Marketable securities and investment securities:

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

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Carrying amount	¥996,050	¥998,023	$8,454
Gross unrealized gains	-	-	-
Gross unrealized losses	(4,940)	(2,043)	(17)
Fair value	¥991,110	¥995,980	$8,436

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

	Thousands of yen			
March 31, 2006:	Cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
Equity securities	¥1,539,513	¥2,267,981	-	¥3,807,495

	Thousands of yen			
March 31, 2007:	Cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
Equity securities	¥1,539,513	¥2,471,086	-	¥4,010,599

	Thousands of U.S. dollars			
March 31, 2007:	Cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
Equity securities	$13,041	$20,932	-	$33,973

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. No impairment losses for the years ended March 31, 2006 and 2007 are recognized on available-for-sale securities with market quotations.

The proceeds from sales of available-for-sale securities for the years ended March 31, 2006 and 2007 are ¥1 thousand and ¥0 thousand ($0 thousand), respectively. The gross realized gains and losses on these sales for the years ended March 31, 2006 and 2007 are ¥1 thousand and zero, and ¥0 thousand ($0 thousand) and zero, respectively.

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

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Equity securities	¥3,800	¥15,864	$134
Money management funds	30,231	30,290	256
Free financial funds	500,000	-	-
Subscriptions to investment funds	69,789	64,309	544
	¥603,821	¥110,464	$935

The redemption schedule for “Other securities” with maturity dates, and “Held-to-maturity debt securities” at March 31 are as follows:

	Thousands of yen			
	March 31, 2006			
	Due Within 1 year	Due After 1 year within 5 years	Due After 5 years within 10 years	Due After 10 years
Bonds:				
Government bonds, Municipal bonds, etc.	¥ -	¥1,000,000	¥ -	¥ -
Corporate bonds	-	-	-	-
Other	-	-	-	-
Others:				-
Mutual funds	-	-	-	-
	¥ -	¥1,000,000	¥ -	¥ -

	Thousands of yen			
	March 31, 2007			
	Due Within 1 year	Due After 1 year within 5 years	Due After 5 years within 10 years	Due After 10 years
Bonds:				
Government bonds, Municipal bonds, etc.	¥ -	¥1,000,000	¥ -	¥ -
Corporate bonds	-	-	-	-
Other	-	-	-	-
Others:				-
Mutual funds	-	-	-	-
	¥ -	¥1,000,000	¥ -	¥ -

	Thousands of U.S. dollars			
	March 31, 2007			
	Due Within 1 year	Due After 1 year within 5 years	Due After 5 years within 10 years	Due After 10 years
Bonds:				
Government bonds, Municipal bonds, etc.	$ -	$8,470	$ -	$ -
Corporate bonds	-	-	-	-
Other	-	-	-	-
Others:				-
Mutual funds	-	-	-	-
	$ -	$8,470	$ -	$ -

11. Derivative financial instruments:

The Company had no derivative financial instruments at March 31, 2006 and 2007.

12. Retirement benefits and reserve for employees:

Severance indemnity regulations, which cover substantially all employees of the Company and its domestic subsidiaries, provide for benefit payments based on the employee's eligible salary, length of service, position in the respective company and conditions under which the termination of employment occurs.

The Company has established a non-contributory funded, defined benefit, and tax qualified pension plan for 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.

Foreign subsidiaries maintain 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 subsidiaries. Participants vest in the subsidiaries' contributions based on their annual compensation and length of service.

The prepaid pension cost recorded in the consolidated balance sheet as of March 31 is calculated as follows:

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Projected benefit obligations (PBO)	(¥1,283,877)	(¥1,338,349)	($11,337)
Plan assets	2,098,131	2,240,435	18,978
Excess of plan assets over PBO	814,254	902,086	7,641
Unrecognized actuarial differences	(423,619)	(306,468)	(2,596)
Unrecognized prior service cost	-	3,078	26
Sub total	390,634	598,695	5,071
Reserve for retirement allowances for employees	7,459	9,186	77
Prepaid pension cost	¥398,094	¥607,881	$5,149

- Domestic subsidiaries have adopted a simplified method in the calculation of their retirement benefit obligation.

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

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Service cost	¥75,072	¥76,617	$649
Interest cost	24,604	25,528	216
Expected return on plan assets	(32,711)	(41,962)	(355)
Amortization of unrecognized losses	14,687	(171,120)	(1,449)
Amortization of unrecognized prior service cost	-	1,539	13
Net periodic pension cost	¥81,652	(¥109,398)	($926)

- Retirement benefit expenses for domestic subsidiaries adopting the simplified method are included in "Service cost."

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

	2006	2007
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 unrecognized actuarial Differences	3 years	3 years
Amortization of unrecognized prior service cost	-	3 years

In addition to the defined benefit retirement plans, the Company participates in an industrial multi-employer pension plan. The proportionate share of the plan assets of the multi-employer plan are ¥1,198,799 thousand and ¥1,289,632 thousand ($10,924 thousand) as of March 31, 2006 and 2007, respectively. Contributions to the plan for the years ended March 31, 2006 and 2007 are ¥61,653 thousand and ¥66,170 thousand ($560 thousand), respectively.

13. Stock options:

No stock options were granted during the years ended March 31, 2006 and 2007.

14. Income taxes:

Deferred tax assets and liabilities as of March 31 consist of the following:

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Deferred tax assets - current:			
Accrued enterprise taxes	¥65,868	¥95,462	$808
Accrued bonuses	172,843	223,125	1,890
Inventory write-down	6,353	9,299	78
Supplies write-down	-	23,665	200
Unrealized intercompany profit	45,978	58,794	498
Accrued social expenses	17,413	22,724	192
Prepaid pension costs	(161,157)	(242,049)	(2,050)
Other	-	4,501	38
Net deferred tax assets – current	¥147,300	¥195,523	$1,656
Deferred tax assets – non current:			
Reserve for retirement allowances for directors and statutory auditors	¥17,544	¥20,643	174
Other	3,493	4,605	39
Net deferred tax assets - non-current	¥21,037	¥25,249	$213
Deferred tax liabilities - non-current:			
Reserve for retirement allowances for directors and statutory auditors	¥134,898	¥146,338	$1,239
Devaluation of golf club memberships	7,775	7,775	65
Depreciation	428	425	3
Devaluation of investment securities	22,256	22,256	188
Loss on investment fund	8,716	7,129	60
Reserve for retirement allowances for executive officers	18,228	28,614	242
Unrealized gains on available-for-sale securities	(918,802)	(1,002,820)	(8,494)
Undistributed earnings of foreign subsidiary	(8,447)	(1,965)	(16)
Other	(2,552)	4,015	34
	(737,497)	(788,230)	(6,677)
Valuation allowance	(7,775)	(7,775)	(65)
Net deferred tax liabilities - non-current	(¥745,273)	(¥796,005)	($6,742)

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

	2006	2007
Statutory tax rate	40.5%	40.5%
Increase (decrease) in taxes resulting from:		
Tax credit relating to research and development expenses	(4.3)	(2.4)
Reserve for directors' bonus	-	0.8
Others, net	(0.1)	(0.3)
Effective income tax rate	36.1%	38.6%

15. 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 the businesses.

(b) Geographic area information and export sales information -

	Thousands of yen				
	Japan	North America	Combined	Elimination and /or Corporate	Consolidated
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	1,083,753	11,481,098	(233,399)	11,247,699
Operating profit	¥3,543,107	¥78,821	¥3,621,928	(¥416,972)	¥3,204,955
At March 31, 2006:					
Total Assets	¥14,018,012	¥1,273,787	¥15,291,800	¥6,229,938	¥21,521,738

	Thousands of yen				
	Japan	North America	Combined	Elimination and /or Corporate	Consolidated
For the year ended March 31, 2007:					
Sales:					
Third party	¥15,562,087	¥3,205,889	¥18,767,977	¥ -	¥18,767,977
Intersegment	939,355	-	939,355	(939,355)	-
Total	16,501,442	3,205,889	19,707,332	(939,355)	18,767,977
Operating expenses	11,737,444	3,000,178	14,737,622	(474,508)	14,263,114
Operating profit	¥4,763,998	¥205,711	¥4,969,709	(¥464,847)	¥4,504,862
At March 31, 2007:					
Total Assets	¥15,650,255	¥2,076,266	¥17,726,522	¥5,399,718	¥23,126,240

	Thousands of U.S. dollars				
	Japan	North America	Combined	Elimination and /or Corporate	Consolidated
For the year ended March 31, 2007:					
Sales:					
Third party	$131,826	$27,157	$158,983	$ -	$158,983
Intersegment	7,957	-	7,957	(7,957)	-
Total	139,783	27,157	166,940	(7,957)	158,983
Operating expenses	99,427	25,414	124,842	(4,019)	120,822
Operating profit	$40,355	$1,742	$42,098	($3,937)	$38,160
At March 31, 2007:					
Total Assets	$132,573	$17,588	$150,161	$45,740	$195,902

- Countries and areas are segmented based on their geographical proximity.
- Major countries and areas which belong to segments other than Japan are as follows:

  (1) North America …… The United States

- Operating expenses amounting to ¥429,408 thousand and ¥452,328 thousand ($3,831 thousand) for the years ended March 31, 2006 and 2007, respectively, which cannot be allocated to any particular geographical area, are included in the "Elimination and/or Corporate" column. These represent expenses incurred for research and development activities, and certain expenses incurred by corporate departments, such as the General Affairs and Accounting Department.

- Assets of ¥6,505,614 thousand and ¥5,704,330 thousand ($48,321 thousand) as of March 31, 2006 and 2007, 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.

- Effective from the year ended March 31, 2007, the Companies changed accounting policies as stated in Note 3(b) Accounting standard for directors' bonuses. As a result of these changes, operating expenses included in the "Elimination and /or Corporate" and "Japan" columns for the year ended March 31, 2007 increased by ¥4,800 thousand ($40 thousand) and ¥102,100 thousand ($864 thousand), respectively, while operating profit decreased by the same amount.

(c) Export sales -

Export sales by major area for the years ended March 31 are as follows:

	Thousands of yen			
	March 31, 2006			
	Europe	North America	Other	Total
Overseas sales	¥1,116,163	¥1,162,575	¥59,592	¥2,338,330
Consolidated sales:				14,452,655
Overseas sales as a ratio of consolidated sales (%)	7.7	8.0	0.4	16.2

	Thousands of yen			
	March 31, 2007			
	Europe	North America	Other	Total
Overseas sales	¥1,418,596	¥3,205,889	¥105,716	¥4,730,202
Consolidated sales:				18,767,977
Overseas sales as a ratio of consolidated sales (%)	7.6	17.1	0.6	25.2

	Thousands of U.S. dollars			
	March 31, 2007			
	Europe	North America	Other	Total
Overseas sales	$12,016	$27,157	$895	$40,069
Consolidated sales:				158,983
Overseas sales as a ratio of consolidated sales (%)	7.6	17.1	0.6	25.2

- Countries and areas are segmented based on their geographical proximity.
- Major countries and areas which belong to segments other than Japan are as follows:

  (1) Europe ……………German

  (2) North America ……The United States

- Export sales consist of export sales of the Company and its domestic subsidiaries and sales (other than exports to Japan) of the foreign subsidiaries.

16. Transactions with related parties:

Category	Affiliate company
Entity name	Harmonic Drive AG
Location	Land Hessen, Germany
Capital or investment in capital	Euro 1,550 thousand
Description of business	Manufacturing and sales of precision speed reducers
The group's interest in entity	25.0% directly owned
Description of relationship	
- Shared director	-
- Business relationship	Seller of the Company's products in Europe, Middle and Near East, Africa, India and South America
Business relationship	Seller of the Company's products

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Sales to the affiliated company	¥1,116,172	¥1,418,596	$12,016
Outstanding balance of notes and accounts receivable, trade	417,059	497,316	4,212

Transactions are made at arm's-length, at prices that are considered to be equivalent to market prices.

17. Earnings per share information:

The computation of earnings per share is based on the weighted-average number of common shares outstanding during each year. Treasury stocks held during these years are excluded.

	Yen		U.S. dollars
	2006	2007	2007
Net assets per share	¥424,139.30	¥160,099.80	$1,356.20
Earnings per share	65,227.37	27,643.96	234.17
Diluted net earnings per share	60,015.12	-	-

- The following is a reconciliation of basic earnings per share to diluted earnings per share.

	Thousands of yen		Thousands of U.S. dollars
	2006	2007	2007
Net income	¥2,114,382	¥2,811,401	$23,815
Less - Net income not attributable to common shareholders:			
Bonuses to directors and statutory auditors recognized as appropriation of retained earnings	(99,622)	-	-
Net income attributable to common shareholders	¥2,014,760	¥2,811,401	$23,815

The weighted average number of shares used in the computation of basic and diluted earnings per share are as follows:

	Number of shares	
	2006	2007
Weighted average number of shares as basic	30,888.3	101,700.4
Adjusted – Dilutive potential common shares:		
Bonds with warrants	2,682.6	-
Weighted average number of shares as adjusted	33,570.9	101,700.4

The Company split the stock for three-for-one at April 1, 2006. Assuming the stock split had been made on April 1, 2005, pro forma information of net assets equity per share, earnings per share and diluted earnings per share for the year ended March 31, 2006 are ¥141,379.77, ¥21,742.46 and ¥20,005.04, respectively.

18. Subsequent events:

(a) Conclusion on the business alliance -

In accordance with the resolution of the Board of Directors dated April 27, 2007, the Company entered into a business alliance contract with K.K. Winbel and purchase 50% of K.K. Winbel's stock on May 25, 2007 pursuant to the contract dated May 16, 2007. K.K. Winbel will be a consolidated subsidiary of the Company.

The purpose of the contract is the collaboration of the development, designing, trial, and production of the various motors.

The details of the capital transaction are as follows:

(1)	Numbers of new shares issued by K.K. Winbel	Common stock 400 shares
(2)	Issue price	¥125,000 ($1,058) per share
(3)	The total payment	¥50,000,000 ($423,549)
(4)	Ratio of shareholding	50%

(b) Purchase of treasury stock of Harmonic Precision Inc. -

Harmonic Precision Inc. (HPI), a 65% owned subsidiary, purchased its treasury stock from Akahane Koki Y.K. on June 20, 2007 in accordance with the resolutions of the shareholders' and Board of Directors meetings on May 28, 2007. HPI substantially became a wholly owned subsidiary of the Company.

The objective of the purchase was to enable the Company to make group business decisions related to HPI in a timely manner.

The details of the purchase of the treasury stock are as follows:

(1)	Seller	Akahane Koki Y.K.
(2)	Shares	Common stock 70 Shares (35%)
(3)	Share price	¥500,000 ($4,235) per share
(4)	The total payment	¥35,000,000 ($296,484)

19. Consolidated supplemental schedules:

(a) Schedules of bonds payable -

Company	Harmonic Drive Systems Inc.
Description	Unsecured zero coupon bonds, due 2009 with detachable warrants
Date of issuance	September 21, 2004
Balance at prior year-end (Thousands of yen)	¥2,550,000
(Thousands of U.S. dollars)	($21,601thousand)
Balance at year-end (Thousands of yen) (Thousands of U.S. dollars)	-
Interest rate (%)	-
Collateral	None
Maturity	September 21, 2009

- The details of bonds with stock subscription rights are as follows:

Type of shares to be issued upon exercise of stock subscription rights	Common stock
Issue price (Yen) / (U.S. dollars)	-
Exercise price (Yen) / (U.S. dollars)	-
Exercise price total (Thousands of yen)	¥3,000,000
(Thousands of U.S. dollars)	($25,412)
Upon exercise of the stock subscription rights, total exercise price to be credited to common stock (Thousands of Yen)	¥3,000,000
(Thousands of U.S. dollars)	($25,412)
Ratio (%)	100%
Exercise period	From October 5, 2004 To September 7, 2009
Substitutive deposits	Note

When holders request to exercise stock subscription rights, the exercise price is deemed to be paid from the maturity payment, based on Article 341-3 (1) (vii) and (viii) of the former Commercial Code of Japan.

(b) Schedules of borrowing -

Category	Thousands of yen Balance at March 31, 2006	Thousands of yen Balance at March 31, 2007	Average interest rate (%)	Maturity
Short-term borrowings	¥13,200	¥370,530	5.3	-
Current portion of long-term debt	24,519	24,519	2.5	-
Long-term debt (excluding current portion)	154,504	129,985	2.4	2008-2016
Total	¥192,224	¥525,034	-	-

Category	Thousands of U.S. dollars Balance at March 31, 2006	Thousands of U.S. dollars Balance at March 31, 2007	Average interest rate (%)	Maturity
Short-term borrowings	$111	$3,138	5.3	-
Current portion of long-term debt	207	207	2.5	-
Long-term debt (excluding current portion)	1,308	1,101	2.4	2008-2016
Total	$1,628	$4,447		

- Aggregate annual maturities of long-term debt for the 5 years subsequent to March 31, 2007 are as follows:

	Thousands of yen			
	March 31, 2007			
	Due after 1 year but within 2 years	Due after 2 years within 3 years	Due after 3 years within 4 years	Due after 4 years within 5 years
Long-term debt	¥21,855	¥20,520	¥17,980	¥14,160

	Thousands of U.S. dollars			
	March 31, 2007			
	Due after 1 year but within 2 years	Due after 2 years within 3 years	Due after 3 years within 4 years	Due after 4 years within 5 years
Long-term debt	$185	$173	$152	$119

- The average interest rate represents the weighted-average rate applicable to the year-end balance.