

# Japan Vilene Company, Ltd. and Subsidiaries

## Notes to Consolidated Financial Statements Years Ended March 31, 2007 and 2006

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### 1. BASIS OF PRESENTING CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements of Japan Vilene Company, Ltd. (the "Company") and its subsidiaries have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan ("Japanese GAAP"), which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

On December 27, 2005, the Accounting Standards Board of Japan (the "ASBJ") published a new accounting standard for the statement of changes in equity, which is effective for fiscal years ending on or after May 1, 2006.

The consolidated statement of shareholders' equity, which was previously voluntarily prepared in line with the international accounting practices, is now required under Japanese GAAP and has been renamed "the consolidated statement of changes in equity" in the current fiscal year.

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan. In addition, certain reclassifications and rearrangements have been made in the 2006 financial statements to conform to classifications used in 2007.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which the Company is incorporated and operates. The translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥118 to \$1, the approximate rate of exchange at March 31, 2007. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Consolidation**—The consolidated financial statements as of March 31, 2007 include the accounts of the Company and its 15 significant (15 in 2006) subsidiaries (together, the "Companies").

Under the control or influence concept, those companies in which the Company, directly or indirectly, is able to exercise control over operations are fully consolidated, and those companies over which the Companies have the ability to exercise significant influence are accounted for by the equity method.

Investments in 9 (9 in 2006) associated companies are accounted for by the equity method. Investments in the remaining associated companies are stated at cost. If the equity method of accounting had been applied to the investments in these companies, the effect on the accompanying consolidated financial statements would not be material.

The excess of cost of the Company's investments in subsidiaries and associated companies over its equity in the net assets at the respective dates of acquisition is being amortized over 5 years.

The accounts of foreign subsidiaries are included on the basis of their fiscal year end of December 31. All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profits included in assets resulting from transactions within the Companies are eliminated.

**Cash and Cash Equivalents**—Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value. Cash equivalents include time deposits and certificate of deposits, all of which mature or become due within three months of the date of acquisition.

**Inventories**—Inventories of the Company are stated at average cost. Inventories of subsidiaries are stated at the latest purchase cost or at the lower of cost (first-in, first-out) or market.

**Investment Securities**—Investment securities are classified and accounted for, as available-for-sale securities, which are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported as a separate component of equity.

Non-marketable available-for-sale securities are mainly stated at cost determined by the moving-average method. For other than temporary declines in fair value, investment securities are reduced to net realizable value by a charge to income.

**Property, Plant and Equipment**—Property, plant and equipment are stated at cost. Significant renewals and additions are capitalized; maintenance and repairs are charged to income as incurred.

Depreciation of property, plant and equipment is principally computed by the declining-balance method except for buildings. The Company uses the straight-line method for depreciation of buildings. The domestic subsidiaries use the straight-line method for depreciation of buildings acquired after March 31, 1998. The declining-balance method was used for buildings acquired prior to April 1, 1998. Depreciation of property, plant and equipment of foreign subsidiaries is principally computed by the straight-line method.

The ranges of the estimated useful lives of the assets used for the computation of depreciation are as follows:

Buildings and structures	2 to 60 years
Machinery and equipment	2 to 12 years
Vehicles	2 to 7 years
Tools, furniture and fixtures	2 to 20 years

**Long-lived Assets**—The Companies review its long-lived assets for impairment whenever events or changes in circumstance indicate the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.

**Retirement and Pension Plans**—The Company has adopted a cash balance plan, which is a hybrid pension plan based on variable interest rates, enabling the Company to flexibly respond to market interest rate fluctuations.

The provision for retirement benefits to directors is made at the amount which would be paid in accordance with company bylaws if they retired at each balance sheet date. Such plan is not funded.

As mentioned above, prior to the general shareholders meeting held on June 29, 2005, the Company adopted retirement benefits for directors. However, they were abolished at that meeting as part of an amendment of the retirement benefits regulation for directors. As a result, the allowance for retirement benefits for directors as required under the plan has declined drastically. The accumulated amounts, which should be paid to directors in case of their retirement, are included in "Long-term liabilities—other" at March 31, 2007 and 2006.

**Stock Options**—On December 27, 2005, the ASBJ issued ASBJ Statement No. 8, "Accounting Standard for Stock Options" and related guidance. The new standard and guidance are applicable to stock options newly granted on and after May 1, 2006. This standard requires companies to recognize compensation expense for employee stock options based on the fair value at the date of grant and over the vesting period as consideration for receiving goods or services. The standard also requires companies to account for stock options granted to non-employees based on the fair value of either the stock option or the goods or services received. In the balance sheet, the stock option is presented as a stock acquisition right as a separate component of equity until exercised. The standard covers equity-settled, share-based payment transactions, but does not cover cash-settled, share-based payment transactions. In addition, the standard allows unlisted companies to measure options at their intrinsic value if they cannot reliably estimate fair value.

The Company applied the new accounting standard for stock options to those granted on and after May 1, 2006. The effect of adoption of this accounting standard for the year ended March 31, 2007 was to decrease income before income taxes and minority interests by ¥17 million (\$144 thousand).

**Presentation of Equity**—On December 9, 2005, the ASBJ published a new accounting standard for presentation of equity. Under this accounting standard, certain items which were previously presented as liabilities are now presented as components of equity. Such items include stock acquisition rights, minority interests, and any deferred gain or loss on derivatives accounted for under hedge accounting. This standard is effective for fiscal years ending on or after May 1, 2006. The consolidated balance sheet as of March 31, 2007 is presented in line with this new accounting standard.

**Leases**—All leases of the Companies are accounted for as operating leases. Under the Japanese accounting standard for leases, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the lessee's financial statements.

**Bonuses to Directors and Corporate Auditors**—Prior to the fiscal year ended March 31, 2005, bonuses to directors and corporate auditors were accounted for as a reduction of retained earnings in the fiscal year following approval at the general shareholders meeting. The ASBJ issued ASBJ Practical Issues Task Force ("PITF") No. 13, "Accounting Treatment for Bonuses to Directors and Corporate Auditors," which encouraged companies to record bonuses to directors and corporate auditors on the accrual basis with a related charge to income, but still permitted the direct reduction of such bonuses from retained earnings after approval of the appropriation of retained earnings.

The ASBJ replaced the above accounting pronouncement by issuing a new accounting standard for bonuses to directors and corporate auditors on November 29, 2005. Under the new accounting standard, bonuses to directors and corporate auditors must be expensed and are no longer allowed to be directly charged to retained earnings. This accounting standard is effective for fiscal years ending on or after May 1, 2006. The companies must accrue bonuses to directors and corporate auditors at the year end to which such bonuses are attributable.

The Company adopted the new accounting standard for bonuses to directors and corporate auditors from the year ended March 31, 2007. The effect of adoption of this accounting standard was to decrease income before income taxes and minority interests for the year ended March 31, 2007 by ¥69 million (\$585 thousand).

**Income Taxes**—The provision for income taxes is computed based on the pretax income included in the consolidated statements of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

The Company and certain domestic subsidiaries file a tax return under the consolidated corporate-tax system, which allows companies to base tax payments on the combined profits or losses of the parent company and its wholly owned domestic subsidiaries.

**Appropriations of Retained Earnings**—Appropriations of retained earnings are reflected in the financial statements for the following year upon shareholders' approval.

**Translation of Foreign Currency Transactions**—All short-term and long-term monetary receivables and payables denominated in foreign currencies are translated into Japanese yen at the current exchange rate at the balance sheet date. The foreign exchange gains and losses from translation are recognized in the consolidated statements of income to the extent that they are not hedged by forward exchange contracts. Forward exchange contracts are separately accounted for in accordance with the accounting standard for financial instruments.

**Translation of Foreign Currency Financial Statements**—The balance sheet accounts of the foreign subsidiaries are translated into Japanese yen at the current exchange rate at the balance sheet date except for equity, which is translated at the historical rates. Differences arising from such translation were shown as "Foreign currency translation adjustments" in a separate component of equity. Revenue and expense accounts of foreign subsidiaries and associated companies are translated into Japanese yen at the average rates of exchange. The accounts of the consolidated statements of cash flows in foreign currencies are also translated at the average rates of exchange.

**Derivatives and Hedging Activities**—The Company uses derivative financial instruments to manage its exposures to fluctuations in foreign exchange and interest rates. Foreign exchange forward contracts and interest rate swap contracts are utilized by the Company to reduce foreign currency exchange and interest rate risks. The Company does not enter into derivatives for trading or speculative purposes.

Derivative financial instruments and foreign currency transactions are classified and accounted for as follows: (1) all derivatives are recognized as either assets or liabilities and measured at fair value, and gains or losses on derivative transactions are recognized in the statement of income and (2) for derivatives used for hedging purposes, if derivatives qualify for hedge accounting because of high correlation and effectiveness between the hedging instruments and the hedged items, gains or losses on derivatives are deferred until maturity of the hedged transactions.

The foreign currency forward contracts employed to hedge foreign exchange exposures for export sales and import purchases are measured at fair value and the unrealized gains or losses are recognized in income. Forward contracts designated as hedging forecasted (or committed) transactions are also measured at the fair value but the unrealized gains or losses are deferred until the underlying transactions are completed.

The interest rate swap contracts which qualify for hedge accounting and meet specific matching criteria are not remeasured at market value but the differential paid or received under the swap agreements are recognized and included in interest expense or income.

**Per Share Information**—Basic net income per share is computed by dividing net income available to common shareholders, by the weighted-average number of common shares outstanding for the period, retroactively adjusted for stock splits.

Diluted net income per share reflects the potential dilution that could occur if securities were exercised or converted into common stock.

Cash dividends per share presented in the accompanying consolidated statements of income are dividends of the Company applicable to the respective years including dividends to be paid after the end of the year.

### ***New Accounting Pronouncements***

**Measurement of Inventories**—Under Japanese GAAP, inventories are currently measured either by the cost method, or at the lower of cost or market. On July 5, 2006, the ASBJ issued ASBJ Statement No. 9, "Accounting Standard for Measurement of Inventories," which is effective for fiscal years beginning on or after April 1, 2008 with early adoption permitted. This standard requires that inventories held for sale in the ordinary course of business be measured at the lower of cost or net selling value, which is defined as the selling price less additional estimated manufacturing costs and estimated direct selling expenses. The replacement cost may be used in place of the net selling value, if appropriate. The standard also requires that inventories held for trading purposes be measured at the market price.

**Lease Accounting**—On March 30, 2007, the ASBJ issued ASBJ Statement No. 13, "Accounting Standard for Lease Transactions," which revised the existing accounting standard for lease transactions issued on June 17, 1993.

Under the existing accounting standard, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, however, other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the note to the lessee's financial statements.

The revised accounting standard requires that all finance lease transactions should be capitalized. The revised accounting standard for lease transactions is effective for fiscal years beginning on or after April 1, 2008 with early adoption permitted for fiscal years beginning on or after April 1, 2007.

### ***Unification of Accounting Policies Applied to Foreign Subsidiaries for the Consolidated Financial Statements***—

Under Japanese GAAP, a company currently can use the financial statements of foreign subsidiaries which are prepared in accordance with generally accepted accounting principles in their respective jurisdictions for its consolidation process unless they are clearly unreasonable. On May 17, 2006, the ASBJ issued ASBJ PITF No. 18, "Practical Solution on Unification of Accounting Policies Applied to Foreign Subsidiaries for the Consolidated Financial Statements." The new task force prescribes: (1) the accounting policies and procedures applied to a parent company and its subsidiaries for similar transactions and events under similar circumstances should in principle be unified for the preparation of the consolidated financial statements, (2) financial statements prepared by foreign subsidiaries in accordance with either International Financial Reporting Standards or the generally accepted accounting principles in the United States tentatively may be used for the consolidation process, (3) however, the following items should be adjusted in the consolidation process so that net income is accounted for in accordance with Japanese GAAP unless they are not material;

- (1) Amortization of goodwill
- (2) Actuarial gains and losses of defined benefit plans recognized outside profit or loss

- (3) Capitalization of intangible assets arising from development phases
- (4) Fair value measurement of investment properties, and the revaluation model for property, plant and equipment, and intangible assets
- (5) Retrospective application when accounting policies are changed
- (6) Accounting for net income attributable to a minority interest

The new task force is effective for fiscal years beginning on or after April 1, 2008 with early adoption permitted.

### 3. INVESTMENT SECURITIES

Investment securities at March 31, 2007 and 2006, consisted of the following:

	Millions of Japanese Yen		Thousands of U.S. Dollars
	<u>2007</u>	<u>2006</u>	<u>2007</u>
Non-current—Investment securities:			
Marketable equity securities	¥ 873	¥ 794	\$ 7,398
Non-marketable equity securities	<u>227</u>	<u>232</u>	<u>1,924</u>
Total	<u>¥ 1,100</u>	<u>¥ 1,026</u>	<u>\$ 9,322</u>

The carrying amounts and aggregate fair values of marketable and investment securities at March 31, 2007 and 2006, were as follows:

	Millions of Japanese Yen			
	<u>2007</u>			
	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
Securities classified as available-for-sale equity securities	¥ 453	¥ 420		¥ 873
	Thousands of U.S. Dollars			
	<u>2007</u>			
	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
Securities classified as available-for-sale equity securities	\$ 3,839	\$ 3,559		\$ 7,398
	Millions of Japanese Yen			
	<u>2006</u>			
	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
Securities classified as available-for-sale equity securities	¥ 440	¥ 354		¥ 794

Available-for-sale securities whose fair value is not readily determinable as of March 31, 2007 and 2006, were as follows:

	Carrying Amount		
	Millions of Japanese Yen		Thousands of U.S. Dollars
	<u>2007</u>	<u>2006</u>	<u>2007</u>
Securities classified as available-for-sale equity securities	¥ 227	¥ 232	\$ 1,924

Proceeds from sales of available-for-sale securities for the years ended March 31, 2007 and 2006, were ¥9 million (\$76 thousand) and ¥120 million, respectively. Gross realized gains on these sales, computed on the moving average cost basis, were ¥2 million (\$17 thousand) for the year ended March 31, 2007 and ¥73 million for the year ended March 31, 2006.

#### 4. INVENTORIES

Inventories at March 31, 2007 and 2006, consisted of the following:

	Millions of Japanese Yen		Thousands of U.S. Dollars
	<u>2007</u>	<u>2006</u>	<u>2007</u>
	Merchandise	¥ 1,123	¥ 1,037
Finished goods	3,189	3,059	27,025
Work in process	646	509	5,475
Raw materials and supplies	<u>1,687</u>	<u>1,482</u>	<u>14,297</u>
Total	<u>¥ 6,645</u>	<u>¥ 6,087</u>	<u>\$ 56,314</u>

#### 5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at March 31, 2007 and 2006, consisted of the following:

	Millions of Japanese Yen		Thousands of U.S. Dollars
	<u>2007</u>	<u>2006</u>	<u>2007</u>
	Land	¥ 4,271	¥ 4,272
Buildings and structures	21,037	20,671	178,279
Machinery and equipment	33,548	32,648	284,305
Vehicles	379	357	3,212
Tools, furniture and fixtures	5,704	5,512	48,339
Construction in progress	<u>1,013</u>	<u>446</u>	<u>8,585</u>
Total	<u>¥ 65,952</u>	<u>¥ 63,906</u>	<u>\$ 558,915</u>

Depreciation expense amounted to ¥2,068 million (\$17,525 thousand) and ¥1,913 million for the years ended March 31, 2007 and 2006, respectively.

## 6. LONG-LIVED ASSETS

The Companies reviewed its long-lived assets for impairment as of the year ended March 31, 2006 and, as a result, recognized an impairment loss of ¥110 million as other expense for buildings and land held for sale due to a decline of market value, and the carrying amount of these buildings and land was written down to the recoverable amount for the year ended March 31, 2006. The recoverable amount of the buildings and land was measured at net selling price based on tax purpose valuations. No impairment loss was recognized in 2007.

## 7. LEASES

The Companies lease certain office equipment and vehicles under long-term noncancelable lease agreements.

Total rental expenses for the years ended March 31, 2007 and 2006, were ¥745 million (\$6,314 thousand) and ¥749 million, respectively, including ¥30 million (\$254 thousand) and ¥55 million of lease payments under finance leases.

Pro forma information of leased property such as acquisition cost, accumulated depreciation and obligations under finance leases that do not transfer ownership of the leased property to the Companies on an "as if capitalized" basis as of March 31, 2007 and 2006, was as follows:

	Millions of Japanese Yen			Thousands of U.S. Dollars		
	2007			2007		
	Machinery and Equipment	Tools, Furniture and Fixtures	Total	Machinery and Equipment	Tools, Furniture and Fixtures	Total
Acquisition cost	¥ 81	¥ 72	¥ 153	\$ 686	\$ 610	\$ 1,296
Accumulated depreciation	<u>37</u>	<u>27</u>	<u>64</u>	<u>313</u>	<u>229</u>	<u>542</u>
Net leased property	<u>¥ 44</u>	<u>¥ 45</u>	<u>¥ 89</u>	<u>\$ 373</u>	<u>\$ 381</u>	<u>\$ 754</u>
	Millions of Japanese Yen					
	2006					
	Machinery and Equipment	Tools, Furniture and Fixtures	Total			
Acquisition cost	¥ 108	¥ 129	¥ 237			
Accumulated depreciation	<u>48</u>	<u>102</u>	<u>150</u>			
Net leased property	<u>¥ 60</u>	<u>¥ 27</u>	<u>¥ 87</u>			

Future lease payments, including imputed interest, under finance leases that do not transfer ownership of the leased property and long-term noncancelable operating leases as of March 31, 2007 and 2006, were as follows:

	Millions of Japanese Yen				Thousands of U.S. Dollars	
	2007		2006		2007	
	Finance Lease	Operating Lease	Finance Lease	Operating Lease	Finance Lease	Operating Lease
Due within one year	¥ 23	¥ 32	¥ 29	¥ 47	\$ 195	\$ 271
Due after one year	<u>66</u>	<u>58</u>	<u>58</u>	<u>101</u>	<u>559</u>	<u>492</u>
Total	<u>¥ 89</u>	<u>¥ 90</u>	<u>¥ 87</u>	<u>¥ 148</u>	<u>\$ 754</u>	<u>\$ 763</u>

Depreciation expense which was not reflected in the consolidated statements of income, computed by the straight-line method, was ¥30 million (\$254 thousand) and ¥55 million for the years ended March 31, 2007 and 2006, respectively.

## 8. SHORT-TERM BANK LOANS AND LONG-TERM DEBT

Short-term bank loans represented borrowings under bank overdraft agreements and notes, bearing interest at rates ranging from 1.0% to 6.5% and from 0.5% to 5.5% per annum at March 31, 2007 and 2006, respectively.

Long-term debt at March 31, 2007 and 2006, consisted of the following:

	Millions of Japanese Yen		Thousands of U.S. Dollars
	2007	2006	2007
1.1% to 6.7% loans due through 2011:			
Collateralized	¥ 220	¥ 300	\$ 1,865
Unsecured	<u>2,927</u>	<u>2,523</u>	<u>24,805</u>
Total	<u>3,147</u>	<u>2,823</u>	<u>26,670</u>
Less current maturities	<u>(2,206)</u>	<u>(392)</u>	<u>(18,695)</u>
Total	<u>¥ 941</u>	<u>¥ 2,431</u>	<u>\$ 7,975</u>

Maturities of long-term debt at March 31, 2007, were as follows:

Year Ending March 31	Millions of Japanese Yen	Thousands of U.S. Dollars
2008	¥ 2,206	\$ 18,695
2009	157	1,331
2010	781	6,619
2011	<u>3</u>	<u>25</u>
Total	<u>¥ 3,147</u>	<u>\$ 26,670</u>

The carrying amounts of assets pledged as collateral for long-term bank loans of ¥220 million (\$1,865 thousand) at March 31, 2007, were as follows:

	<u>Millions of Japanese Yen</u>	<u>Thousands of U.S. Dollars</u>
Land	¥ 208	\$ 1,763
Buildings and structures	3,528	29,898
Machinery and equipment	2,166	18,356
Vehicles	11	93
Tools, furniture and fixtures	<u>412</u>	<u>3,492</u>
Total	<u>¥ 6,325</u>	<u>\$ 53,602</u>

As is customary in Japan, loan agreements provide, under certain circumstances, that the Company shall provide additional collateral or guarantees for the present and future indebtedness immediately upon the banks' or other lenders' request. Basic agreements with banks also provide that the banks have the right to offset cash deposited with them against loans, or any other indebtedness outstanding, in the case of default or other similar events.

## 9. INCOME TAXES

The Company and its domestic subsidiaries are subject to a number of taxes based on income which, in the aggregate, resulted in a normal effective statutory tax rate of approximately 40.5% for 2007 and 2006. Foreign subsidiaries are subject to income taxes of the countries in which they operate.

The tax effects of significant temporary differences and loss carryforwards which resulted in deferred tax assets and liabilities at March 31, 2007 and 2006, are as follows:

	<u>Millions of Japanese Yen</u>		<u>Thousands of U.S. Dollars</u>
	<u>2007</u>	<u>2006</u>	<u>2007</u>
Deferred tax assets:			
Accrued bonuses	¥ 425	¥ 431	\$ 3,602
Liability for retirement benefits	1,242	1,466	10,525
Loss on write-down of investment securities	142	144	1,203
Loss on revaluation of long-lived assets	35	53	296
Loss on write-down of other investments	19	30	161
Tax loss carryforwards	31	21	263
Other	543	509	4,602
Less valuation allowance	<u>(226)</u>	<u>(192)</u>	<u>(1,915)</u>
Total deferred tax assets	<u>2,211</u>	<u>2,462</u>	<u>18,737</u>
Deferred tax liabilities:			
Unrealized gain on land transacted within the Companies	(163)	(301)	(1,381)
Unrealized gain on available-for-sale securities	(301)	(138)	(2,551)
Undistributed earnings of foreign associated companies	(37)		(314)
Other	<u>(245)</u>	<u>(217)</u>	<u>(2,076)</u>
Total deferred tax liabilities	<u>(746)</u>	<u>(656)</u>	<u>(6,322)</u>
Net deferred tax assets	<u>¥ 1,465</u>	<u>¥ 1,806</u>	<u>\$ 12,415</u>

A reconciliation between the normal effective statutory tax rate and the actual effective tax rates reflected in the accompanying consolidated statements of income for the years ended March 31, 2007 and 2006, is as follows:

	<u>2007</u>	<u>2006</u>
Normal effective statutory tax rate	40.5 %	40.5 %
Expense not deductible for tax purposes	0.8	1.3
Accrued bonuses to directors	0.7	
Valuation allowance		1.4
Deductible loss carryforward of subsidiaries	(3.5)	(0.7)
Equity in earnings of associated companies		(5.5)
Dividend from foreign subsidiaries eliminated for consolidation purpose	1.9	
Lower income tax rate applicable to income in certain foreign countries	(2.1)	
Inhabitant tax—per capita	0.4	0.5
Credit for foreign taxes	(3.0)	(3.4)
Other—net	<u>0.5</u>	<u>(0.2)</u>
Actual effective tax rate	<u>36.2 %</u>	<u>33.9 %</u>

#### 10. LIABILITY FOR RETIREMENT BENEFITS

The Company adopted a cash balance pension plan and a point-method pension plan.

Some domestic subsidiaries have a tax qualified pension plan and a lump-sum retirement benefit plan as their defined benefit pension plan. A foreign subsidiary has a defined contribution pension plan. In certain instances, the Company pays additional retirement benefits for employees. The cash balance plan adopted by the Company is a hybrid pension plan based on variable interest rates, enabling the Company to flexibly respond to market interest fluctuations. In addition, the Company contributes to the DAINIPPON INK pension funds under the cash balance plan.

The retirement benefits for directors are paid subject to the approval of the shareholders. With respect to the Company, the retirement benefits regulation for directors was abolished at the general shareholders meeting held on June 29, 2005. The accumulated amount to be paid in case of their retirement had been reclassified from "Liability for retirement benefits" into "Long-term liabilities—other" at March 31, 2007 and 2006.

Liability for retirement benefits at March 31, 2007 and 2006, consisted of the following:

	Millions of Japanese Yen		Thousands of U.S. Dollars
	<u>2007</u>	<u>2006</u>	<u>2007</u>
Employees' retirement benefit plans	¥ 3,083	¥ 3,634	\$ 26,127
Directors' plan at some of domestic subsidiaries	<u>61</u>	<u>56</u>	<u>517</u>
Total	<u>¥ 3,144</u>	<u>¥ 3,690</u>	<u>\$ 26,644</u>

The liability for employees' retirement benefits at March 31, 2007 and 2006, consisted of the following:

	Millions of Japanese Yen		Thousands of U.S. Dollars
	<u>2007</u>	<u>2006</u>	<u>2007</u>
Projected benefit obligations	¥ 15,656	¥ 15,554	\$ 132,678
Fair value of plan assets	(11,878)	(11,375)	(100,661)
Unrecognized prior service cost	1,034	1,421	8,763
Unrecognized actuarial loss	<u>(1,729)</u>	<u>(1,966)</u>	<u>(14,653)</u>
Net liability	<u>¥ 3,083</u>	<u>¥ 3,634</u>	<u>\$ 26,127</u>

The components of net periodic benefit costs for the years ended March 31, 2007 and 2006, were as follows:

	Millions of Japanese Yen		Thousands of U.S. Dollars
	<u>2007</u>	<u>2006</u>	<u>2007</u>
Service cost	¥ 524	¥ 611	\$ 4,441
Interest cost	305	301	2,585
Expected return on plan assets	(341)	(297)	(2,890)
Actuarial cost	324	413	2,746
Prior service cost	<u>(387)</u>	<u>(387)</u>	<u>(3,280)</u>
Net periodic benefit costs	<u>¥ 425</u>	<u>¥ 641</u>	<u>\$ 3,602</u>

Assumptions used for the years ended March 31, 2007 and 2006, are set forth as follows:

	<u>2007</u>	<u>2006</u>
Discount rate	2.0%	2.0%
Expected rate of return on plan assets	3.0%	3.0%
Recognition period of actuarial gain or loss	10 years	10 years
Amortization period of prior service cost	5 years	5 years

## 11. EQUITY

On and after May 1, 2006, Japanese companies are subject to a new corporate law of Japan (the "Corporate Law"), which reformed and replaced the Commercial Code of Japan (the "Code") with various revisions that are, for the most part, applicable to events or transactions which occur on or after May 1, 2006 and for the fiscal years ending on or after May 1, 2006. The significant changes in the Corporate Law that affect financial and accounting matters are summarized below:

**a. Dividends**

Under the Corporate Law, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the shareholders meeting. For companies that meet certain criteria such as; (1) having the Board of Directors, (2) having independent auditors, (3) having the Board of Corporate Auditors, and (4) the term of service of the directors is prescribed as one year rather than two years of normal term by its articles of incorporation, the Board of Directors may declare dividends (except for dividends in kind) at any time during the fiscal year if the company has prescribed so in its articles of incorporation. The Company meets all the above criteria.

The Corporate Law permits companies to distribute dividends-in-kind (non-cash assets) to shareholders subject to a certain limitation and additional requirements.

Semiannual interim dividends may also be paid once a year upon resolution by the Board of Directors if the articles of incorporation of the company so stipulate. The Corporate Law provides certain limitations on the amounts available for dividends or the purchase of treasury stock. The limitation is defined as the amount available for distribution to the shareholders, but the amount of net assets after dividends must be maintained at no less than ¥3 million.

**b. Increases/Decreases and Transfer of Common Stock, Reserve and Surplus**

The Corporate Law requires that an amount equal to 10% of dividends must be appropriated as a legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus) depending on the equity account charged upon the payment of such dividends until the total of aggregate amount of legal reserve and additional paid-in capital equals 25% of the common stock. Under the Corporate Law, the total amount of additional paid-in capital and legal reserve may be reversed without limitation. The Corporate Law also provides that common stock, legal reserve, additional paid-in capital, other capital surplus and retained earnings can be transferred among the accounts under certain conditions upon resolution of the shareholders.

**c. Treasury Stock and Treasury Stock Acquisition Rights**

The Corporate Law also provides for companies to purchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The amount of treasury stock purchased cannot exceed the amount available for distribution to the shareholders which is determined by specific formula.

Under the Corporate Law, stock acquisition rights, which were previously presented as a liability, are now presented as a separate component of equity.

The Corporate Law also provides that companies can purchase both treasury stock acquisition rights and treasury stock. Such treasury stock acquisition rights are presented as a separate component of equity or deducted directly from stock acquisition rights.

**12. COMMITMENTS AND CONTINGENT LIABILITIES**

The amount of capital commitments outstanding at March 31, 2007, for purchases of property, plant and equipment for the purpose of renewal or expansion of production and research facilities was ¥49 million (\$415 thousand).

Contingent liabilities at March 31, 2007, are summarized as follows:

	<u>Millions of Japanese Yen</u>	<u>Thousands of U.S. Dollars</u>
Guarantees and items of a similar nature of related parties' indebtedness	¥ 729	\$ 6,178
Trade notes endorsed	85	720
Export drafts discounted	<u>117</u>	<u>992</u>
Total	<u>¥ 931</u>	<u>\$ 7,890</u>

### 13. STOCK OPTION

The stock option outstanding as of March 31, 2007 is as follows:

<u>Stock Option</u>	<u>Persons Granted</u>	<u>Number of Option Granted</u>	<u>Date of Grant</u>	<u>Exercise Price</u>	<u>Exercise Period</u>
2001 Stock Option	10 directors, 6 deputy directors and 299 managers	633,000 shares	June 28, 2001 and July 1, 2001	¥ 310	From July 1, 2003 to June 30, 2006
2005 Stock Option	8 directors	37,200 shares	June 29, 2005	¥1	From August 1, 2005 to June 29, 2025
2006 Stock Option	7 directors	28,400 shares	September 15, 2006	¥1	From September 16, 2006 to June 29, 2026

The stock option activity is as follows:

	<u>2001 Stock Option</u>	<u>2005 Stock Option (Shares)</u>	<u>2006 Stock Option</u>
<u>For the Year Ended March 31, 2007</u>			
Non-vested:			
March 31, 2006—outstanding			
Granted			
Canceled			
Vested			
March 31, 2007—outstanding			
Vested:			
March 31, 2006—outstanding	42,000	37,200	
Vested			28,400
Exercised	12,000	3,400	
Canceled	30,000		
March 31, 2007—outstanding		33,800	28,400
Exercise price	¥310	¥1	¥1
Average stock price at exercise	¥804	¥776	
Fair value price at grant date			¥615

The Assumptions Used to Measure Fair Value of 2006 Stock Option

Estimate method:	Black-Scholes option pricing model
Volatility of stock price:	47.618%
Estimated remaining outstanding period:	ten and a half years
Estimated dividend:	¥10 per share
Interest rate with risk free:	1.680%

**14. NET INCOME PER SHARE**

Reconciliation of the differences between basic and diluted net income per share ("EPS") for the years ended March 31, 2007 and 2006, is as follows:

	Millions of Japanese Yen	Thousands of Shares	Japanese Yen	U.S. Dollars
<u>Year Ended March 31, 2007</u>	<u>Net Income</u>	<u>Weighted-average Shares</u>		<u>EPS</u>
Basic EPS—Net income available to common shareholders	¥ 2,906	64,932	¥ 44.76	\$ 0.38
Effect of dilutive securities— Stock options	_____	48		
Diluted EPS—Net income for computation	¥ 2,906	64,980	¥ 44.73	\$ 0.38
<u>Year Ended March 31, 2006</u>				
Basic EPS—Net income available to common shareholders	¥ 2,448	64,935	¥ 37.70	
Effect of dilutive securities— Stock options	_____	46		
Diluted EPS—Net income for computation	¥ 2,448	64,981	¥ 37.67	

**15. RELATED PARTY TRANSACTIONS**

Transactions of the Company with associated companies for the years ended March 31, 2007 and 2006, were as follows:

	Millions of Japanese Yen		Thousands of U.S. Dollars
	<u>2007</u>	<u>2006</u>	<u>2007</u>
Sales	¥ 2,655	¥ 2,137	\$ 22,500
Purchases	1,245	1,233	10,551

The balances due to or from these associated companies at March 31, 2007 and 2006, were as follows:

	Millions of Japanese Yen		Thousands of U.S. Dollars
	<u>2007</u>	<u>2006</u>	<u>2007</u>
Trade accounts receivable	¥ 740	¥ 713	\$ 6,271
Prepaid expenses and other current assets	138	173	1,169
Trade accounts payable	212	168	1,797

## 16. RESEARCH AND DEVELOPMENT COSTS

Research and development costs charged to income were ¥1,740 million (\$14,746 thousand) and ¥1,729 million for the years ended March 31, 2007 and 2006, respectively.

## 17. DERIVATIVES

The Company enters into foreign exchange forward contracts to hedge foreign exchange risk associated with certain assets and liabilities. The Company also enters into interest rate swap contracts as a means of managing its interest rate exposure on certain liabilities. All derivative transactions are entered into in order to hedge interest and foreign currency exposures associated with its business. Accordingly, interest and currency risks associated with these derivatives are basically offset by opposite movements in the value of hedged assets and liabilities. Because the counterparties to these derivatives are limited to major international financial institutions, the Company does not anticipate any losses arising from credit risk. Derivative transactions entered into by the Company have been made in accordance with internal policies, which regulate the authorization and credit limit amount.

The Company had the following derivatives contracts outstanding at March 31, 2007:

	Millions of Japanese Yen		Thousands of U.S. Dollars	
	<u>Contract or Notional Amount</u>	<u>Fair Value</u>	<u>Contract or Notional Amount</u>	<u>Fair Value</u>
Forward exchange contracts—Buying U.S.\$	¥ 26	¥ 26	\$ 220	\$ 220

## 18. SEGMENT INFORMATION

### (1) Operations by Industry Segment

Information has not been provided because the Companies operated principally in the "non-woven fabrics" industry in 2007 and 2006.

(2) *Operations by Geographical Segment*

Operations of the Companies by geographical segment for the years ended March 31, 2007 and 2006, were as follows:

	Millions of Japanese Yen					Thousands of U.S. Dollars				
	2007					2007				
	Japan	North America	Asia	Eliminations	Consolidated	Japan	North America	Asia	Eliminations	Consolidated
Sales:										
Sales to customers	¥ 43,048	¥ 13,212	¥ 54		¥ 56,314	\$ 364,814	\$ 111,966	\$ 457		\$ 477,237
Intersegment sales	211	224	569	¥ (1,004)		1,788	1,898	4,822	\$ (8,508)	
Total sales	43,259	13,436	623	(1,004)	56,314	366,602	113,864	5,279	(8,508)	477,237
Operating cost and expenses	40,883	11,999	660	(993)	52,549	346,466	101,686	5,593	(8,415)	445,330
Operating income or loss	¥ 2,376	¥ 1,437	¥ (37)	¥ (11)	¥ 3,765	\$ 20,136	\$ 12,178	\$ (314)	\$ (93)	\$ 31,907
Assets	¥ 50,374	¥ 7,031	¥ 1,181	¥ (226)	¥ 58,360	\$ 426,898	\$ 59,585	\$ 10,008	\$ (1,915)	\$ 494,576
	Millions of Japanese Yen									
	2006									
	Japan	North America	Asia	Eliminations	Consolidated					
Sales:										
Sales to customers	¥ 43,487	¥ 8,377	¥ 1		¥ 51,865					
Intersegment sales	169	402	189	¥ (760)						
Total sales	43,656	8,779	190	(760)	51,865					
Operating cost and expenses	41,312	7,935	279	(772)	48,754					
Operating income or loss	¥ 2,344	¥ 844	¥ (89)	¥ 12	¥ 3,111					
Assets	¥ 48,809	¥ 5,677	¥ 1,074	¥ (222)	¥ 55,338					

(3) *Sales to Foreign Customers*

Sales to foreign customers of the Companies for the years ended March 31, 2007 and 2006, were as follows:

	Millions of Japanese Yen				Thousands of U.S. Dollars			
	2007				2007			
	Asia	North America	Other	Total	Asia	North America	Other	Total
Sales to foreign customers	¥ 5,649	¥ 13,403	¥ 414	¥ 19,466	\$ 47,873	\$ 113,585	\$ 3,508	\$ 164,966
Consolidated sales				56,314				477,237
Ratio of sales to foreign customers to consolidated sales				34.6%				34.6%

	<u>Millions of Japanese Yen</u>			
	<u>2006</u>			
	<u>Asia</u>	<u>North America</u>	<u>Other</u>	<u>Total</u>
Sales to foreign customers	¥ 5,507	¥ 8,477	¥ 352	¥ 14,336
Consolidated sales				51,865
Ratio of sales to foreign customers to consolidated sales				27.6%

## 19. SUBSEQUENT EVENT

At its meeting held on May 30, 2007, the Board of Directors approved the following appropriations of retained earnings:

	<u>Millions of Japanese Yen</u>	<u>Thousands of U.S. Dollars</u>
Cash dividends, ¥6.0 (\$0.05) per share	¥ 390	\$ 3,305

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