

## FINANCIAL SECTION

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# MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

## Overview

Japan's economy was marking time at the start of the fiscal year, with weak activity evident, mainly in exports and output, due to a correction in the IT sector worldwide and other factors. However, economic conditions improved from around the middle of the fiscal year, with exports picking up, particularly to Asia, and a cycle of inventory cutbacks in the IT-related industry coming to an end. Amid this trend, the Japanese economy steadily expanded as a whole, albeit moderately, as it broke out of the doldrums.

Particularly noteworthy was continued growth from the previous

fiscal year in sales volume, mainly outside Japan, in the Japanese automobile industry. Due to this growth, Daido Steel's automotive segment continued to operate at full capacity. Demand was solid in other user segments as well, except for certain categories of electronic material, supporting a high output volume at Daido Steel.

High prices of nickel, molybdenum and other metals used to make alloys persisted throughout the fiscal year, but Daido Steel worked on offsetting these higher costs mainly by lowering costs in other areas, raising sales prices and increasing sales of high-margin products.

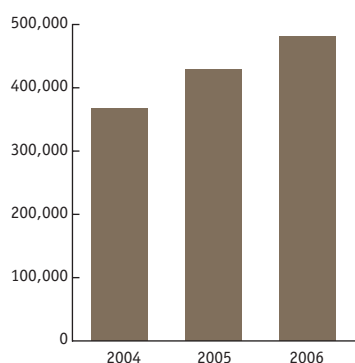
Due to the above factors, consolidated net sales increased ¥51,598 million, or 12.0%, year on year to ¥480,704 million, and operating income rose ¥16,087 million, or 75.0%, to ¥37,543 million. Net income climbed ¥9,811 million, or 86.2%, to ¥21,196 million, also reflecting gains on sales of investment securities and impairment losses on property, plant and equipment.

## Results of Operations

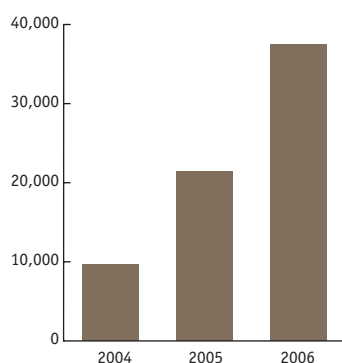
### Specialty Steel

Sales in this segment increased ¥34,180 million, or 14.8%, to ¥265,629 million and operating income surged ¥9,514 million, or

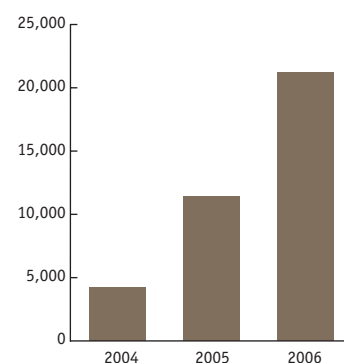
**Net Sales** (Years ended March 31)  
(millions of yen)



**Operating Income** (Years ended March 31)  
(millions of yen)



**Net Income** (Years ended March 31)  
(millions of yen)



96.4%, to ¥19,380 million.

Japanese automakers, the largest source of demand for specialty steel, recorded an increase of 7% year on year in their production volume, reflecting strong growth in exports of knock-down kits in line with higher production and sales in North America, Asia and other overseas areas. Growing private-sector capital expenditures underpinned higher demand from other user segments, with the machine tool sector in particular continuing to see strong growth in demand.

Daido Steel made investments to raise productivity by eliminating bottlenecks at existing plants and to add production capacity. To offset the higher cost of alloys, a cost-linked sales price system was adopted and cost-containment measures were enhanced.

#### **Electronic and Magnetic Materials**

Sales in this segment rose ¥956 million, or 1.9%, year on year to ¥51,696 million, and operating income climbed ¥1,005 million, or 49.9%, to ¥3,016 million.

Negative factors impacting on sales included lackluster first-half sales of IC lead frames and inventory cutbacks by some

manufacturers of office equipment and home appliances.

Positive factors were higher sales of Daido Steel strategic products and increased demand for magnetic materials for HDD applications.

#### **Parts for Automobile & Industrial Equipment**

This segment posted an ¥11,089 million, or 11.9%, increase in sales to ¥104,092 million and operating income rose ¥4,013 million, or 58.4%, year on year to ¥10,878 million.

The automotive parts business performed well, supported by robust motor vehicle production and demand stemming from the imposition of tighter restrictions on emissions of diesel engines used in SUVs, trucks and other commercial vehicles. In addition, sales volume increased in conjunction with extremely high demand for turbochargers, primarily for use in Europe.

Sales of parts for industrial machinery were higher, too. Daido Steel's jet engine shaft production facilities operated at full capacity throughout the fiscal year due to the full-scale rebound in demand for jet aircraft. Daido Steel is the leading supplier of these shafts in terms of market share. Backed by

rising demand, output of marine diesel engine valves and turbine parts for power generators also increased.

#### **Engineering**

Segment sales rose ¥3,205 million, or 10.4%, to ¥33,892 million and operating income surged ¥919 million, or 118.7%, to ¥1,693 million.

Sales of environmental equipment were about the same as one year earlier. On the other hand, in industrial furnaces, heat treatment furnaces performed very well, driven by growth in private-sector capital expenditures, mainly in the automobile industry.

#### **New Materials**

Segment sales grew sharply by ¥3,333 million, or 40.8%, to ¥11,499 million, and operating income rose ¥284 million, or 39.8%, to ¥997 million.

Demand for titanium products used in medical applications and industrial machines remained healthy, but limited supplies of titanium forced the company to decline some orders. However, sales of titanium products increased because of price increases to reflect

the significant rise in the cost of raw material.

Sales of metal powder products rose along with growth in demand, primarily for high-performance materials used to make automotive parts. Demand is expected to continue rising.

#### Trading & Service

Segment sales decreased ¥1,165 million, or 7.7%, to ¥13,896 million because of a decline in sales in the construction materials division at a subsidiary. This reflected intense competition in the market for imported construction materials. Operating income, however, rose ¥350 million, or 28.5%, to ¥1,580 million.

#### Capital Expenditures by Segment

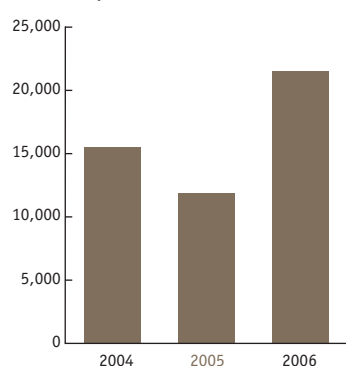
(Years ended March 31)

	Millions of Yen		Change (%)
	2006	2005	
Specialty Steel	<b>¥11,236</b>	¥ 5,468	+105.5
Electronic and Magnetic Materials	<b>895</b>	1,142	(21.6)
Parts for Automobile & Industrial Equipment	<b>7,372</b>	3,660	+101.4
Engineering	<b>67</b>	330	(79.7)
New Materials	<b>408</b>	224	+82.1
Trading & Service	<b>626</b>	758	(17.4)
Total	<b>20,604</b>	11,582	+77.9
Corporate	<b>901</b>	304	+196.4
Consolidated	<b>¥21,505</b>	¥11,886	+80.9

#### Capital Expenditures

Capital expenditures by business segment are shown in the following table. Figures below include intangible fixed assets, in addition to property, plant and equipment.

Capital Expenditures (Years ended March 31)  
(millions of yen)



#### Research and Development

In the past fiscal year, R&D expenditures totaled ¥3,575 million. Expenditures and major objectives and achievements in each business segment were as follows:

##### Specialty Steel

R&D in this segment is performed mainly by Daido Steel. One theme is the development of materials, including automotive structural materials, materials that resist corrosion and heat, tool steel, and connecting materials. Another theme is process improvement extending from melting, refining and solidification to quality assurance for finished products. In the past fiscal year, R&D expenditures in this segment totaled ¥1,741 million.

##### Electronic and Magnetic Materials

Daido Steel and consolidated subsidiary Daido Electronics Co., Ltd. conduct R&D involving magnets. Daido Steel also conducts R&D mainly involving high-performance steel strips and electromagnetic materials. Segment R&D expenditures totaled ¥500 million.

**Parts for Automobile & Industrial Equipment**

R&D in this segment is performed mainly by Daido Steel on engine valves and other automotive parts, as well as parts for various types of industrial machinery. R&D expenditures totaled ¥534 million.

**Engineering**

R&D in this segment is performed mainly by Daido Steel on the development of environmental protection and recycling equipment and a variety of energy-saving industrial furnaces. R&D expenditures totaled ¥15 million.

**New Materials**

R&D in this segment is performed mainly by Daido Steel in the field of new materials, chiefly focusing on functional powders and titanium alloys. R&D expenditures totaled ¥783 million.

**Trading & Service**

There are no R&D activities in this segment.

**Financial Position****Cash Flows**

Cash and cash equivalents as of March 31, 2006 amounted to ¥14,104 million, ¥2,031 million, or

12.6%, less than a year ago. Net cash provided by operating activities of ¥22,081 million and negative investing cash flows of ¥13,579 million resulted in free cash flows of ¥8,502 million. This cash and internal liquidity were used in financing activities, which used cash of ¥10,653 million.

**OPERATING ACTIVITIES**

Net cash provided by operating activities was ¥22,081 million, ¥1,301 million less than one year earlier. Although income before income taxes and minority interests increased significantly by ¥19,396 million to ¥38,433 million, cash was used by an increase in working capital, mostly reflecting higher notes and accounts receivable in line with increased net sales, and a rise in inventories due to a steep increase in the cost of metals used to make alloys.

**INVESTING ACTIVITIES**

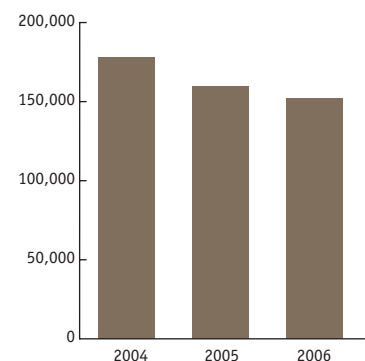
Net cash used in investing activities was ¥13,579 million, ¥2,276 million more than one year earlier. This increase was mainly attributable to increased outflows for the purchase of property, plant and equipment accompanying higher

capital expenditures, offset in part by an increase in inflows from the sale of subsidiaries' shares.

**FINANCING ACTIVITIES**

Net cash used in financing activities was ¥10,653 million, ¥9,786 million less than in the previous fiscal year. Free cash flows resulting from the aforementioned activities and internal liquidity were used to repay loans and pay cash dividends.

**Interest-bearing Debt** (Years ended March 31)  
(millions of yen)



## **Business Risks**

Forward-looking statements in the following list of risks are based on Daido Steel Group's judgments as of March 31, 2006 with regard to significant risk factors.

### **Impact of changes in market conditions on operating results**

The Daido Steel Group's sales and earnings are vulnerable to shifts in the Japanese and foreign economies, public-works expenditures, private-sector capital spending, consumer spending, commodity prices, foreign exchange rates and other factors. The automobile industry is a major source of demand for Daido Steel Group products. Accordingly, of the various operating environments to which it is subject, the Group's operating results may be affected in particular by changes in production levels by automakers in Japan and overseas and the Group's ability to negotiate suitable sales prices.

### **Fluctuations in raw material prices**

Fluctuations in raw materials prices caused by changes in demand for raw materials may affect the Group's operating results. Scrap iron and nickel and other metals

used to make alloys are the primary raw materials used by the Daido Steel Group. Additionally, the Group uses electricity, heavy oil and other energy sources when manufacturing its products. The recent rapid growth in steel output and consumption in China has caused the cost of these raw materials to rise.

### **Interest rate movements**

The Daido Steel Group relies on loans from financial institutions and other external sources to fund part of its capital expenditures and working capital. Although interest rates in Japan have been low for many years, there are currently expectations of a change in interest rates due to economic trends in Japan. Such changes may affect the Group's sales and earnings.

### **Changes in the value of marketable securities held**

Changes in the value of investment securities held by the Daido Steel Group due to poor operating results at portfolio companies and/or deterioration in conditions in the securities market, among other factors, may affect the Group's operating results. Furthermore, changes in the value of marketable securities

forming part of retirement benefit trust assets may also affect operating results.

### **Fluctuations in exchange rates**

The Daido Steel Group conducts transactions denominated in foreign currencies when exporting products and importing raw materials. Some receivables and payables are also denominated in foreign currencies. Accordingly, changes in foreign exchange rates may affect operating results.

### **Natural disasters**

Many of the Daido Steel Group's factories, including the Chita Plant, are located in Aichi Prefecture, a region where there is a possibility of a major earthquake. While the Group is taking preventive measures such as strengthening earthquake resistance at its facilities, a severe earthquake in this region of the magnitude of the Tokai or Tonankai earthquakes may affect the Group's sales and earnings.

### **Equipment malfunctions and worker accidents**

The Daido Steel Group employs electric arc furnaces, forging machines and other steel

production facilities that operate at high temperatures and pressures. The Group also uses chemicals in production processes. Extreme care is exercised to prevent accidents associated with production machinery and processes. However, in the event of a major malfunction or worker accident involving machinery, the Group's production activities may be suspended and sales and earnings may be affected.

#### **Overseas operations**

The Daido Steel Group exports its products to and operates in the United States, China, other Asian countries and other regions. Business operations are therefore vulnerable to political and economic instability, unexpected revisions to laws and regulations, and social unrest. These events could disrupt overseas business operations and affect the Group's sales and earnings.

#### **Environmental regulations**

The Group is dedicated to operating in a manner that complies with all applicable laws and regulations in Japan and overseas, and demonstrates a commitment to environmental responsibility, including

corporate citizenship. However, stricter regulations or rising public demands concerning environmental protection could result in greater restrictions and expenses that could affect the Group's sales and earnings.

#### **Product liability**

The Group has a system for conducting rigorous inspections and quality management in order to manufacture products of a consistently high quality. The Group has also purchased liability insurance. However, in the event that products of inadequate quality reach customers due to unforeseen circumstances, the cost of product returns, replacements and liability claims may affect the Group's sales and earnings.

# CONSOLIDATED BALANCE SHEETS

DAIDO STEEL CO., LTD. AND CONSOLIDATED SUBSIDIARIES  
AS OF MARCH 31, 2006 AND 2005

ASSETS	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2006	2005	2006
<b>Current Assets:</b>			
Cash and cash equivalents (Note 8)	¥ 14,104	¥ 16,135	\$ 120,547
Time deposits	719	586	6,145
Trade notes and accounts receivable	120,752	112,264	1,032,069
Inventories (Note 5)	92,317	78,801	789,034
Deferred tax assets (Note 11)	5,697	5,529	48,692
Prepaid expenses and other current assets (Note 4)	4,524	3,974	38,667
Allowance for doubtful accounts	(971)	(736)	(8,299)
Total current assets	237,142	216,553	2,026,855
<b>Property, Plant and Equipment:</b>			
Land (Notes 6 and 8)	30,043	31,004	256,778
Buildings and structures (Notes 6 and 8)	115,913	114,812	990,709
Machinery and equipment	349,567	346,229	2,987,752
Construction in progress	4,915	2,317	42,009
Total	500,438	494,362	4,277,248
Accumulated depreciation	(347,228)	(342,760)	(2,967,761)
Net property, plant and equipment	153,210	151,602	1,309,487
<b>Investments and Other Assets:</b>			
Investment securities (Notes 4 and 8)	46,337	32,580	396,043
Investments in and advances to non-consolidated subsidiaries and associated companies	27,481	25,657	234,880
Deferred tax assets (Note 11)	1,184	1,068	10,120
Other investments and assets (Note 8)	11,463	8,875	97,974
Total investments and other assets	86,465	68,180	739,017
<b>TOTAL</b>	<b>¥ 476,817</b>	<b>¥ 436,335</b>	<b>\$ 4,075,359</b>

See notes to consolidated financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2006	2005	2006
<b>Current Liabilities:</b>			
Short-term borrowings (Notes 7 and 8)	¥ 65,701	¥ 64,038	\$ 561,547
Current portion of long-term debt (Notes 7 and 8)	13,516	13,768	115,521
Payables:			
Trade notes and accounts	77,278	78,599	660,496
Acquisitions of property, plant and equipment	5,423	2,504	46,350
	82,701	81,103	706,846
Income taxes payable	12,578	4,337	107,504
Accrued expenses	10,551	8,850	90,180
Other current liabilities (Note 8)	6,337	5,080	54,163
Total current liabilities	191,384	177,176	1,635,761
<b>Long-Term Liabilities:</b>			
Long-term debt (Notes 7 and 8)	73,171	81,843	625,393
Liability for employees' retirement benefits (Notes 2(i) and 9)	4,312	4,479	36,855
Deferred tax liabilities (Note 11)	13,737	9,716	117,410
Other long-term liabilities	5,045	5,107	43,120
Total long-term liabilities	96,265	101,145	822,778
<b>Minority Interests</b>	16,521	13,747	141,205
<b>Contingent Liabilities</b> (Note 15)			
<b>Shareholders' Equity</b> (Note 10):			
Common stock:			
Authorized: 1,160,000 thousand shares			
Issued: 434,487 thousand shares in 2006 and 2005	37,172	37,172	317,709
Capital surplus	28,548	28,541	244,000
Retained earnings	87,048	68,639	744,000
Land revaluation surplus (Note 2(f))	1,357	1,357	11,598
Unrealized gain on available-for-sale securities	18,549	9,050	158,539
Foreign currency translation adjustments	152	(411)	1,299
Treasury stock, at cost			
493 thousand shares in 2006 and 383 thousand shares in 2005	(179)	(81)	(1,530)
Total shareholders' equity	172,647	144,267	1,475,615
<b>TOTAL</b>	¥476,817	¥436,335	\$4,075,359

# CONSOLIDATED STATEMENTS OF INCOME

DAIDO STEEL CO., LTD. AND CONSOLIDATED SUBSIDIARIES  
YEARS ENDED MARCH 31, 2006 AND 2005

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2006	2005	2006
<b>Net Sales</b>	<b>¥480,704</b>	¥429,106	<b>\$4,108,581</b>
<b>Cost of Sales</b>	<b>394,213</b>	359,900	<b>3,369,342</b>
Gross profit	<b>86,491</b>	69,206	<b>739,239</b>
<b>Selling, General and Administrative Expenses</b>	<b>48,948</b>	47,750	<b>418,359</b>
Operating income	<b>37,543</b>	21,456	<b>320,880</b>
<b>Other Income (Expenses):</b>			
Interest and dividend income	<b>1,048</b>	900	<b>8,957</b>
Interest expense	<b>(1,696)</b>	(1,995)	<b>(14,496)</b>
Equity in earnings of non-consolidated subsidiaries and associated companies	<b>2,330</b>	2,390	<b>19,915</b>
Gain on sales of investment securities	<b>1,656</b>	478	<b>14,154</b>
Impairment loss (Notes 2(g) and 6)	<b>(813)</b>	–	<b>(6,949)</b>
Loss on sales and disposals of property, plant and equipment—net	<b>(1,186)</b>	(2,334)	<b>(10,137)</b>
Write-down of investment securities including investments in non-consolidated subsidiaries and associated companies	<b>(50)</b>	(57)	<b>(427)</b>
Extraordinary retirement payments	<b>(1,369)</b>	(2,156)	<b>(11,701)</b>
Other—net	<b>970</b>	355	<b>8,291</b>
Other income (expenses)—net	<b>890</b>	(2,419)	<b>7,607</b>
Income before income taxes and minority interests	<b>38,433</b>	19,037	<b>328,487</b>
<b>Income Taxes (Note 11):</b>			
Current	<b>15,269</b>	5,166	<b>130,504</b>
Deferred	<b>(317)</b>	481	<b>(2,709)</b>
Total income taxes	<b>14,952</b>	5,647	<b>127,795</b>
<b>Minority Interests</b>	<b>2,285</b>	2,005	<b>19,530</b>
Net income	<b>¥ 21,196</b>	¥ 11,385	<b>\$ 181,162</b>

	Yen		U.S. Dollars
<b>Per Share of Common Stock (Note 2(q)):</b>			
Basic net income	<b>¥ 48.19</b>	¥ 25.70	<b>\$ 0.41</b>
Cash dividends applicable to the year	<b>8.00</b>	5.00	<b>0.07</b>

	Thousands	
<b>Weighted Average Number of Shares of Common Stock (Note 2(q))</b>	<b>434,054</b>	434,152

See notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

DAIDO STEEL CO., LTD. AND CONSOLIDATED SUBSIDIARIES  
YEARS ENDED MARCH 31, 2006 AND 2005

	Thousands	Millions of Yen						
	Outstanding Number of Shares of Common Stock	Common Stock	Capital Surplus	Retained Earnings	Land Revaluation Surplus	Unrealized Gain on Available-for-Sale Securities	Foreign Currency Translation Adjustments	Treasury Stock
<b>Balance at April 1, 2004</b>	434,181	¥37,172	¥28,535	¥55,874	¥ 3,642	¥ 7,887	¥(179)	¥ (51)
Net income	-	-	-	11,385	-	-	-	-
Cash dividends, ¥3 per share	-	-	-	(1,303)	-	-	-	-
Bonuses to directors and corporate auditors	-	-	-	(85)	-	-	-	-
Reversal of land revaluation surplus due to sales of land	-	-	-	2,286	(2,285)	-	-	-
Adjustment of retained earnings for newly consolidated subsidiaries	-	-	-	482	-	-	-	-
Net change in unrealized gain on available-for-sale securities	-	-	-	-	-	1,163	-	-
Net change in foreign currency translation adjustments	-	-	-	-	-	-	(232)	-
Gain on sales of treasury stock—net	-	-	6	-	-	-	-	-
Net increase in treasury stock	(77)	-	-	-	-	-	-	(30)
<b>Balance at March 31, 2005</b>	434,104	37,172	28,541	68,639	1,357	9,050	(411)	(81)
Net income	-	-	-	21,196	-	-	-	-
Cash dividends, ¥6 per share	-	-	-	(2,605)	-	-	-	-
Bonuses to directors and corporate auditors	-	-	-	(187)	-	-	-	-
Increase due to merger of a consolidated subsidiary and a non-consolidated subsidiary	-	-	-	5	-	-	-	-
Net change in unrealized gain on available-for-sale securities	-	-	-	-	-	9,499	-	-
Net change in foreign currency translation adjustments	-	-	-	-	-	-	563	-
Gain on sales of treasury stock—net	-	-	7	-	-	-	-	-
Net increase in treasury stock	(110)	-	-	-	-	-	-	(98)
<b>Balance at March 31, 2006</b>	<b>433,994</b>	<b>¥37,172</b>	<b>¥28,548</b>	<b>¥87,048</b>	<b>¥ 1,357</b>	<b>¥18,549</b>	<b>¥ 152</b>	<b>¥(179)</b>

	Thousands of U.S. Dollars (Note 1)						
	Common Stock	Capital Surplus	Retained Earnings	Land Revaluation Surplus	Unrealized Gain on Available-for-Sale Securities	Foreign Currency Translation Adjustments	Treasury Stock
<b>Balance at March 31, 2005</b>	\$317,709	\$243,940	\$586,658	\$11,598	\$ 77,350	\$(3,513)	\$ (692)
Net income	-	-	181,162	-	-	-	-
Cash dividends, \$0.05 per share	-	-	(22,265)	-	-	-	-
Bonuses to directors and corporate auditors	-	-	(1,598)	-	-	-	-
Increase due to merger of a consolidated subsidiary and a non-consolidated subsidiary	-	-	43	-	-	-	-
Net change in unrealized gain on available-for-sale securities	-	-	-	-	81,189	-	-
Net change in foreign currency translation adjustments	-	-	-	-	-	4,812	-
Gain on sales of treasury stock—net	-	60	-	-	-	-	-
Net increase in treasury stock	-	-	-	-	-	-	(838)
<b>Balance at March 31, 2006</b>	<b>\$317,709</b>	<b>\$244,000</b>	<b>\$744,000</b>	<b>\$11,598</b>	<b>\$158,539</b>	<b>\$ 1,299</b>	<b>\$(1,530)</b>

See notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

DAIDO STEEL CO., LTD. AND CONSOLIDATED SUBSIDIARIES  
YEARS ENDED MARCH 31, 2006 AND 2005

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2006	2005	2006
<b>Operating Activities:</b>			
Income before income taxes and minority interests	¥ 38,433	¥ 19,037	\$ 328,487
Adjustments for:			
Income taxes—paid	(6,480)	(3,171)	(55,385)
Depreciation and amortization	16,151	16,422	138,043
Impairment loss	813	—	6,949
Loss on sales and disposals of property, plant and equipment—net	1,173	2,572	10,026
Gain on sales of investment securities—net	(1,663)	(471)	(14,214)
Write-down of investment securities including investments in non-consolidated subsidiaries and associated companies—net	111	104	949
Equity in earnings of non-consolidated subsidiaries and associated companies	(2,330)	(2,390)	(19,915)
Changes in assets and liabilities:			
Increase in notes and accounts receivable	(10,106)	(4,410)	(86,376)
Decrease in allowance for doubtful accounts	(10)	(841)	(85)
Increase in inventories	(14,040)	(8,508)	(120,000)
(Decrease) Increase in notes and accounts payable	(505)	2,299	(4,316)
Increase (Decrease) in liability for employees' retirement benefits	83	(544)	709
Other—net	451	3,575	3,854
Total adjustments	(16,352)	4,345	(139,761)
Net cash provided by operating activities	22,081	23,382	188,726
<b>Investing Activities:</b>			
Increase in time deposits	(358)	(335)	(3,060)
Proceeds from time deposits	246	27	2,102
Proceeds from sales of marketable securities	—	2	—
Purchases of property, plant and equipment	(18,143)	(11,021)	(155,068)
Proceeds from sales of property, plant and equipment	267	790	2,282
Purchases of investment securities and investments in non-consolidated subsidiaries and associated companies	(731)	(114)	(6,248)
Proceeds from sales of investment securities	664	780	5,675
Disbursements for originating loans	(200)	(171)	(1,709)
Proceeds from collection of loans	196	336	1,675
Proceeds from sales of investment in a consolidated subsidiary	5,513	—	47,120
Other—net	(1,033)	(1,597)	(8,829)
Net cash used in investing activities	(13,579)	(11,303)	(116,060)
<b>Financing Activities:</b>			
Net increase in short-term borrowings	1,500	6,131	12,820
Proceeds from long-term borrowings	4,400	17,510	37,607
Proceeds from issuance of bonds	700	—	5,983
Repayments of long-term debt	(14,024)	(42,373)	(119,863)
Dividends paid including payments to minority shareholders of subsidiaries	(3,136)	(1,681)	(26,803)
Other—net	(93)	(26)	(795)
Net cash used in financing activities	(10,653)	(20,439)	(91,051)
<b>Foreign Currency Translation Adjustments on Cash and Cash Equivalents</b>	109	(17)	932
<b>Cash and Cash Equivalents Increased by Merger</b>	11	92	94
<b>Net Decrease in Cash and Cash Equivalents</b>	(2,031)	(8,285)	(17,359)
<b>Cash and Cash Equivalents of a Subsidiary Newly Consolidated, at Beginning of Year</b>	—	492	—
<b>Cash and Cash Equivalents at Beginning of Year</b>	16,135	23,928	137,906
<b>Cash and Cash Equivalents at End of Year</b>	¥ 14,104	¥ 16,135	\$ 120,547
<b>Additional Information</b>			
Details of proceeds from sales of investment in a subsidiary resulting in exclusion in consolidation			
Current assets	¥ 4,123	¥ —	\$ 35,239
Non-current assets	2,847	—	24,333
Current liabilities	(1,613)	—	(13,786)
Non-current liabilities	(305)	—	(2,607)
Unrealized gain on available-for-sales securities	(39)	—	(333)
Gain on sales of a subsidiary	1,355	—	11,581
Proceeds from sales of a consolidated subsidiary	¥ 6,368	¥ —	\$ 54,427
Cash and cash equivalents of a consolidated subsidiary sold	(855)	—	(7,307)
Net proceeds from sale of a consolidated subsidiary	¥ 5,513	¥ —	\$ 47,120

See notes to consolidated financial statements.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DAIDO STEEL CO., LTD. AND CONSOLIDATED SUBSIDIARIES  
YEARS ENDED MARCH 31, 2006 AND 2005

## 1. BASIS OF PRESENTING CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements have been prepared from the accounts maintained by DAIDO STEEL CO., LTD. (the "Company") and its consolidated subsidiaries (together with the Company, hereinafter referred to as the "Group") 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, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

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.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which the Company is incorporated and operates. The translation of Japanese yen amounts into U.S. dollar amounts is included solely for the convenience of readers outside Japan and has been made at the rate of ¥117 to \$1, the approximate rate of exchange at March 31, 2006. Such translation should not be construed as representation that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### (a) Consolidation

The Company had 48 (54 in 2005) majority-owned subsidiaries and 22 (22 in 2005) associated companies at March 31, 2006. The consolidated financial statements include the accounts of the Company and 31 (32 in 2005) significant subsidiaries for the year ended March 31, 2006.

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 Group has ability to exercise significant influence are accounted for by the equity method.

Investments in eight associated companies are accounted for by the equity method for the years ended March 31, 2006 and 2005. Investments in other non-consolidated subsidiaries and 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 have been material.

The fiscal years of the subsidiaries are not necessarily the same as that of the Company. Accounts of those subsidiaries, which have different fiscal years, have been adjusted for significant transactions to properly reflect their financial position at March 31 of each year and the results of operations for the years then ended.

The difference between the cost of an acquisition and the fair value of the net assets of the acquired subsidiary at the date of acquisition is being amortized on a straight-line basis over five years.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Group is eliminated.

### (b) 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, which mature or become due within three months of the date of acquisition.

### (c) Marketable and Investment Securities

Marketable and investment securities are classified and accounted for, depending on management's intent, as follows:

- i) held-to-maturity debt securities, which are expected to be held to maturity with the positive intent and ability to hold to maturity, are reported at amortized cost.
- ii) available-for-sale securities, which are not classified as the aforementioned securities, are reported at fair values. The cost of available-for-sale securities sold is determined based on the moving-average method. A limited partnership investment is accounted for by the equity method.

Non-marketable available-for-sale securities are 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.

### (d) Inventories

Inventories are stated at cost principally determined by the annual average method.

**(e) Property, Plant and Equipment**

Property, plant and equipment are stated at cost, less gains on grants receipts. The acquisition costs of property, plant and equipment have been reduced in the amount of ¥1,207 million (\$10,316 thousand) by March 31, 2006.

Depreciation is computed by the declining-balance method or the straight-line method while the straight-line method is applied to buildings acquired after April 1, 1998 for domestic companies. The range of useful lives is from 7 to 60 years for buildings and structures and from 3 to 17 years for machinery and equipment.

**(f) Land Revaluation**

Under the "Law of Land Revaluation" Nippon Drop Forge Co., Ltd., a consolidated subsidiary, elected a one-time revaluation of its own-use land to a value based on real estate appraisal information at March 31, 1999. The resulting land revaluation surplus represented unrealized appreciation of land and was stated, net of income taxes, as a component of shareholders' equity. There was no effect on the consolidated statements of income. Continuous readjustment is not permitted unless the land value subsequently declines significantly such that the amount of the decline in value should be removed from the land revaluation surplus account and related deferred tax liabilities.

At March 31, 2006, the carrying amount of the land after the above one-time revaluation in the books of the consolidated subsidiary exceeded the market value by ¥3,626 million (\$30,991 thousand).

**(g) Long-lived Assets**

In August 2002, the Business Accounting Council (BAC) issued a Statement of Opinion, *Accounting for Impairment of Fixed Assets*, and in October 2003 the Accounting Standards Board of Japan (ASBJ) issued ASBJ Guidance No. 6, *Guidance for Accounting Standard for Impairment of Fixed Assets*. These new pronouncements were effective for fiscal years beginning on or after April 1, 2005 with early adoption permitted for fiscal years ending on or after March 31, 2004.

The Company and domestic consolidated subsidiaries adopted the new accounting standard for impairment of fixed assets as of April 1, 2005.

The domestic consolidated subsidiaries 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.

As a result of the adoption of this new accounting standard, impairment loss on long-lived assets relating to certain land, buildings and leased assets, in the amount of ¥813 million (\$6,949 thousand) was recognized and the effect of this was to decrease income before income taxes and minority interests for the year ended March 31, 2006 by the same amount. (See Note 6)

**(h) Other Assets**

Intangible assets are amortized by the straight-line method. Research and development costs are charged to income as incurred.

**(i) Liability for Employees' Retirement Benefits**

The Company and its domestic consolidated subsidiaries have unfunded retirement benefit plans and non-contributory funded pension plans. Certain consolidated subsidiaries have defined contribution pension plans and multiemployer plans. The liability for employees' retirement benefits is accounted for based on projected benefit obligations and plan assets at the balance sheet date. Multiemployer plan assets, which were excluded from the balance sheet as of March 31, 2006 and 2005, amounted to ¥4,983 million (\$42,590 thousand) and ¥3,803 million as of March 31, 2006 and 2005, respectively.

The existing accounting standard for employees' retirement benefits prohibited recognition of any excess portion of plan assets exceeding the projected benefit obligation that had arisen due to an excess of the actual return of plan assets over the expected return or a reduction level. This standard was amended in March 2005 to allow recognition of such excess portion of plan assets from the year ended March 31, 2005. In accordance with the amended standard, the Group recognized excess plan assets due to actual return of plan assets exceeding the expected return. Such excess was recognized as actuarial gain and is being recognized over 10 years from the year ended March 31, 2005. The effect of this change was to increase income before income taxes for the year ended March 31, 2005 by ¥446 million.

**(j) Leases**

All leases are accounted for as operating leases. Under Japanese accounting standards 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.

**(k) Income Taxes**

The provision for current 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.

**(l) Appropriations of Retained Earnings**

Appropriations of retained earnings at each year-end are reflected in the consolidated financial statements for the following year upon shareholders' approval.

**(m) 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 rates 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.

**(n) Foreign Currency Financial Statements**

The balance sheet accounts and revenue and expense accounts of the consolidated foreign subsidiaries are translated into Japanese yen at the current exchange rate as of the balance sheet date except for shareholders' equity, which is translated at the historical rate. Differences arising from such translation are shown as "Foreign currency translation adjustments" in a separate component of shareholders' equity and minority interests.

**(o) Derivatives and Hedging Activities**

The Group uses derivative financial instruments to manage its exposures to fluctuations in foreign exchange and interest rates. Foreign exchange forward contracts and interest rate swaps are utilized by the Group to reduce foreign currency exchange and interest rate risks.

Derivative financial instruments and foreign currency transactions are classified and accounted for as follows: a) 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 consolidated statements of income and b) 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 exchange forward contracts are measured at the fair value and the unrealized gains (losses) are recognized in the consolidated statements of income.

The interest rate swaps 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.

**(p) Revenue Recognition**

Revenue from construction contracts having a contract amount of more than ¥500 million (\$4,274 thousand) and a construction duration of more than one year is recognized based on a percentage-of-completion method, measured by the percentage of direct cost incurred to date to estimated total direct cost for each contract (See Note 3).

**(q) 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 was not disclosed because it was anti-dilutive.

Cash dividends per share presented in the accompanying consolidated statements of income are dividends applicable to the respective years without giving retroactive adjustment for subsequent stock splits.

### **(r) New Accounting Pronouncements**

#### **Business Combination and Business Separation**

In October 2003, the BAC issued a Statement of Opinion, *Accounting for Business Combinations*, and on December 27, 2005 the ASBJ issued *Accounting Standard for Business Separations* and ASBJ Guidance No. 10, *Guidance for Accounting Standard for Business Combinations and Business Separations*. These new accounting pronouncements are effective for fiscal years beginning on or after April 1, 2006.

The accounting standard for business combinations allows companies to apply the pooling of interests method of accounting only when certain specific criteria are met such that the business combination is essentially regarded as a uniting-of-interests. These specific criteria are as follows:

- (a) the consideration for the business combination consists solely of common shares with voting rights,
- (b) the ratio of voting rights of each predecessor shareholder group after the business combination is nearly equal, and
- (c) there are no other factors that would indicate any control exerted by any shareholder group other than voting rights.

For business combinations that do not meet the uniting-of-interests criteria, the business combination is considered to be an acquisition and the purchase method of accounting is required. This standard also prescribes the accounting for combinations of entities under common control and for joint ventures. Goodwill, including negative goodwill, is to be systematically amortized over 20 years or less, but is also subject to an impairment test.

Under the accounting standard for business separations, in a business separation where the interests of the investor no longer continue and the investment is settled, the difference between the fair value of the consideration received for the transferred business and the book value of net assets transferred to the separated business is recognized as a gain or loss on business separation in the statement of income. In a business separation where the interests of the investor continue and the investment is not settled, no such gain or loss on business separation is recognized.

#### **Stock Options**

On December 27, 2005, the ASBJ issued *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 shareholders' 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.

#### **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.

### 3. ACCOUNTING CHANGE

Prior to April 1, 2005, revenue under long-term construction contracts, for which the term of construction was more than one year, with contract amounts exceeding ¥1,000 million (\$8,547 thousand), were recorded under the percentage-of-completion method. On the other hand, construction contracts which do not meet the above condition were accounted for by the completed-contract method. However, the number of projects with smaller contract amounts has increased and the management of the Group believes that this trend would continue in the future.

With the background mentioned above, the Group changed the scope of the application of the percentage-of-completion method to the long-term construction contracts effective from April 1, 2005, for which the term of construction was more than one year, with contract amounts exceeding ¥500 million (\$4,274 thousand).

The effect of this change was to increase net revenue by ¥180 million (\$1,538 thousand), and to increase operating income and income before income taxes and minority interests by ¥12 million (\$103 thousand) for the year ended March 31, 2006.

### 4. MARKETABLE AND INVESTMENT SECURITIES

Investment securities at March 31, 2006 and 2005 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Investment securities:			
Equity securities	¥45,842	¥32,079	\$391,812
Debt securities	6	6	51
Other	495	495	4,231
Total	¥46,343	¥32,580	\$396,094

Debt securities of ¥6 million (\$51 thousand) due within one year was included in other current assets in the accompanying consolidated balance sheet as of March 31, 2006.

Information regarding each category of the securities classified as available-for-sale and held-to-maturity at March 31, 2006 and 2005 was as follows:

March 31, 2006	Millions of Yen			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities	¥7,919	¥29,063	¥22	¥36,960
Debt securities	6	–	–	6

March 31, 2005	Millions of Yen			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities	¥7,697	¥15,560	¥57	¥23,200
Debt securities	6	0	–	6

March 31, 2006	Thousands of U.S. Dollars			Fair Value
	Cost	Unrealized Gains	Unrealized Losses	
Securities classified as:				
Available-for-sale:				
Equity securities	\$67,684	\$248,401	\$188	\$315,897
Debt securities	51	–	–	51

Securities classified as available-for-sale and held-to-maturity whose fair values were not readily determinable at March 31, 2006 and 2005 were as follows:

Available-for-sale:	Carrying Amount		Thousands of U.S. Dollars
	Millions of Yen		
	2006	2005	2006
Equity securities	¥8,882	¥8,879	\$75,915
A limited partnership investment	495	495	4,231
Total	¥9,377	¥9,374	\$80,146

Proceeds from sales of available-for-sale securities for the years ended March 31, 2006 and 2005 were ¥664 million (\$5,675 thousand) and ¥715 million, respectively. Gross realized gains and losses on these sales, computed on the moving average cost basis, were ¥301 million (\$2,673 thousand) and ¥2 million (\$17 thousand), respectively, for the year ended March 31, 2006 and ¥448 million and nil, respectively, for the year ended March 31, 2005.

Contractual maturities for securities classified as available-for-sale at March 31, 2006 were as follows:

	Millions of Yen	Thousands of U.S. Dollars
Due within one year	¥6	\$51

## 5. INVENTORIES

Inventories held by the Group at March 31, 2006 and 2005 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Merchandise	¥14,104	¥12,870	\$120,547
Finished products	7,601	7,244	64,965
Semi-finished products	21,553	16,583	184,214
Work-in-process	22,460	19,990	191,966
Raw materials	19,874	16,026	169,864
Supplies	6,725	6,088	57,478
Total	¥92,317	¥78,801	\$789,034

## 6. LONG-LIVED ASSETS

The Group reviewed its long-lived assets for impairment as of and for the year ended March 31, 2006 and, as a result, recognized an impairment loss of ¥813 million (\$6,949 thousand) as other expense for certain land used for warehouses and certain unused assets due to other-than-temporary decline in market value and the carrying amount of the relevant assets was written down to the recoverable amount. The recoverable amount of that such land and unused assets were measured at its net selling price mainly determined by quotation from a third-party real estate appraiser or assessed by the value of fixed assets.

## 7. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

Short-term borrowings at March 31, 2006 and 2005 consisted of notes to banks, bank overdrafts and ¥7,000 million (\$59,829 thousand) and ¥10,000 million of commercial paper, respectively. The weighted average rates of annual interest applicable to short-term borrowings (excluding the commercial paper) at March 31, 2006 and 2005 were 0.63% and 0.61%, respectively.

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

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Borrowings from banks and other financial institutions, with weighted average interest rates of 1.11% in 2006 and 1.18% in 2005	¥ 65,987	¥ 71,761	\$ 563,991
0.79% unsecured bonds due February 10, 2006	–	3,000	–
1.13% unsecured bonds due October 23, 2008	5,000	5,000	42,735
1.83% unsecured bonds due October 22, 2010	5,000	5,000	42,735
0.96% unsecured bonds due March 16, 2009	5,000	5,000	42,735
1.48% unsecured bonds due March 16, 2011	5,000	5,000	42,735
Unsecured bonds issued by consolidated subsidiaries due serially March 31, 2006	700	–	5,983
Secured bonds issued by the consolidated subsidiary due February 28, 2013	–	850	–
Sub-total	86,687	95,611	740,914
Less: Portion due within one year	(13,516)	(13,768)	(115,521)
Total long-term debt	¥ 73,171	¥ 81,843	\$ 625,393

Annual maturity amounts of long-term debt at March 31, 2006 were as follows:

Year Ending March 31	Millions of Yen	Thousands of U.S. Dollars
2007	¥13,516	\$115,521
2008	18,987	162,282
2009	16,404	140,205
2010	23,270	198,889
2011	12,270	104,872
2012 and thereafter	2,240	19,145
Total	¥86,687	\$740,914

The Group entered into line of credit agreements with three banks. The details of the agreements were as follows:

	Millions of Yen	Thousands of U.S. Dollars
Line of credit amount	¥23,000	\$196,581
Balance used at March 31, 2006	–	–

## 8. PLEDGED ASSETS

The carrying amounts of assets pledged as collateral for short-term borrowings of ¥1,211 million (\$10,350 thousand), long-term debt (including current portion) of ¥2,871 million (\$24,538 thousand) and other current liabilities of ¥5 million (\$43 thousand) at March 31, 2006 were as follows:

	Millions of Yen	Thousands of U.S. Dollars
Cash and cash equivalents	¥ 1	\$ 9
Land	9,119	77,940
Buildings and structures	4,988	42,632
Investment securities	2,366	20,222
<b>Total</b>	<b>¥16,474</b>	<b>\$140,803</b>

Land held for investment, in the amount of ¥103 million (\$880 thousand) included in "Other investments and assets" was pledged as collateral for borrowings of ¥2,547 million (\$21,769 thousand) by Yugen Kaisha Takakura Funding Corporation ("Takakura"). In the event that acceleration of the maturity of the borrowings for Takakura occurs, the Group may repay the balance of the borrowings on behalf of Takakura. The Group entered into an agreement with the lender that the Group shall settle the borrowings by way of a transfer of ownership of the pledged land to the lender with the settlement amount (the difference between the balance of the borrowings and the fair market value of the land) to be returned to the Group, if the Group does not repay the borrowings on behalf of Takakura.

In addition, investment securities of ¥495 million (\$4,231 thousand) and other assets of ¥228 million (\$1,949 thousand) were pledged as collateral for borrowings of ¥8,198 million (\$70,068 thousand) by Takakura, including the above borrowings of ¥2,547 million (\$21,769 thousand).

## 9. RETIREMENT AND PENSION PLANS

Under most circumstances, employees terminating their employment are entitled to retirement benefits determined based on the rate of pay at the time of termination, years of service and certain other factors. Such retirement benefits are made in the form of a lump-sum severance payment from the Company or from certain consolidated subsidiaries and annuity payments from trustees. Employees are entitled to larger payments if the termination is involuntary, by retirement at the mandatory retirement age, by death, or by voluntary retirement at certain specific ages prior to the mandatory retirement age.

The liability for employees' retirement benefits at March 31, 2006 and 2005 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Projected benefit obligation	¥ 60,842	¥ 61,363	\$ 520,017
Fair value of plan assets	(94,397)	(59,948)	(806,812)
Unrecognized prior year service cost	840	-	7,179
Unrecognized actuarial gain	32,161	436	274,880
Prepaid pension cost	4,866	2,628	41,591
<b>Net liability</b>	<b>¥ 4,312</b>	<b>¥ 4,479</b>	<b>\$ 36,855</b>

The components of net periodic employees' retirement benefit costs for the years ended March 31, 2006 and 2005 were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Service cost	¥2,411	¥ 2,532	\$20,607
Interest cost	1,023	1,079	8,744
Expected return on plan assets	(849)	(1,085)	(7,256)
Recognized actuarial loss	313	657	2,675
Amortization of prior service cost	(66)	–	(564)
Contribution to defined contribution plans	68	67	581
Contribution to multiemployer pension plans	180	152	1,538
Additional severance payments	–	22	–
Net periodic employees' retirement benefit costs	¥3,080	¥ 3,424	\$26,325

In addition to the above amount, the Group recorded extraordinary retirement payments in the amount of ¥1,369 million (\$11,701 thousand) and ¥2,156 million for the years ended March 31, 2006 and 2005, respectively.

Assumptions used for the years ended March 31, 2006 and 2005 were set forth as follows:

	2006	2005
Discount rate	Primarily 1.9%	Primarily 1.9%
Expected rate of return on plan assets	1.7 – 2.5%	1.7 – 3.5%
Recognition period of actuarial gain/loss	10 years	10 years
Recognition period of prior year service cost	10 years	–

## 10. SHAREHOLDERS' EQUITY

Through May 1, 2006, Japanese Companies are subject to the Japanese Commercial Code (the "Code").

The Code requires that all shares are recorded with no par value and at least 50% of the issue price of new shares is required to be recorded as common stock and the remaining net proceeds as additional paid-in capital, which is included in capital surplus. The Code permits Japanese companies, upon approval of the Board of Directors, to issue shares to existing shareholders without consideration as a stock split. Such issuance of shares generally does not give rise to changes within the shareholders' accounts.

The Code also provides that an amount at least equal to 10% of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period shall be appropriated as a legal reserve (a component of retained earnings) until such reserve and additional paid-in capital equals 25% of the amount of common stock. The amount of total additional paid-in capital and legal reserve that exceeds 25% of the amount of common stock may be available for dividends by resolution of the shareholders. In addition, the Code permits the transfer of a portion of additional paid-in capital and legal reserve to the common stock by resolution of the Board of Directors.

The Code allows Japanese companies to repurchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The repurchased amount of treasury stock cannot exceed the amount available for future dividends plus the amount of common stock, additional paid-in capital or legal reserve to be reduced in the case where such reduction was resolved at the general shareholders' meeting.

In addition to the provision that requires an appropriation for a legal reserve in connection with the cash payment, the Code imposes certain limitations on the amount of retained earnings available for dividends. The amount of retained earnings available for dividends under the Code was ¥64,282 million (\$549,419 thousand) as of March 31, 2006, based on the amount recorded in the parent company's general books of account.

Dividends are approved by the shareholders at a meeting held subsequent to the fiscal year to which the dividends are applicable. Semi-annual interim dividends may also be paid upon resolution of the Board of Directors, subject to certain limitations imposed by the Code.

On May 1, 2006, a new corporate law (the "Corporate Law") became effective, which reformed and replaced the Code with various revisions that would, for the most part, be 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) if the company has prescribed so in its articles of incorporation.

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. Under the Code, certain limitations were imposed on the amount of capital surplus and retained earnings available for dividends. The Corporate Law also 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 Code, the aggregate amount of additional paid-in capital and legal reserve that exceeds 25% of the common stock may be made available for dividends by resolution of the shareholders. Under the Corporate Law, the total amount of additional paid-in capital and legal reserve may be reversed without limitation of such threshold. 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 a specific formula.

Under the Corporate Law, stock acquisition rights, which were previously presented as a liability, are now presented as a separate component of shareholders' 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 shareholders' equity or deducted directly from stock acquisition rights.

On December 9, 2005, the ASBJ published a new accounting standard for presentation of shareholders' equity. Under this accounting standard, certain items which were previously presented as liabilities are now presented as components of shareholders' equity. Such items include stock acquisition rights, minority interest, 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.

## 11. INCOME TAXES

The Company and its domestic subsidiaries are subject to Japanese national and local income taxes which, in the aggregate, resulted in a normal effective statutory tax rate of approximately 41% for the years ended March 31, 2006 and 2005.

The tax effects of significant temporary differences and loss carryforwards which resulted in deferred tax assets and liabilities at March 31, 2006 and 2005 were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Deferred Tax Assets:			
Accrued bonuses	¥ 2,910	¥ 2,361	\$ 24,872
Retirement benefits	1,992	2,527	17,025
Allowance for doubtful accounts	349	421	2,983
Write-down of securities and other assets	2,124	2,136	18,154
Unrealized gain on property, plant and equipment	371	375	3,171
Net loss carried forward	1,210	1,561	10,342
Unrealized gain on inventories	861	719	7,359
Enterprise tax	1,065	–	9,102
Other	1,797	1,962	15,359
Valuation allowance	(4,192)	(3,510)	(35,829)
Total deferred tax assets	¥ 8,487	¥ 8,552	\$ 72,538
Deferred Tax Liabilities:			
Deferred gain on sales of property, plant and equipment	¥ 3,202	¥ 3,391	\$ 27,367
Land revaluation surplus	1,694	1,694	14,479
Unrealized gain on securities	10,192	6,342	87,111
Other	255	244	2,179
Total deferred tax liabilities	15,343	11,671	131,136
Net Deferred Tax Liabilities	¥ (6,856)	¥ (3,119)	\$(58,598)

A reconciliation between the normal effective statutory tax rates for the years ended March 31, 2006 and 2005, and the actual effective tax rates reflected in the accompanying consolidated statements of income were as follows:

	2006	2005
Normal effective statutory tax rates	41.0%	41.0%
Expenses not deductible for income tax purposes	0.8	1.8
Revenues not recognized for income tax purposes	(2.1)	(3.1)
Per capita tax	0.3	0.7
Net change in valuation allowance	(2.3)	(13.9)
Effects of elimination of dividend for consolidation purpose	2.4	3.4
Effect of accounting for equity methods	(2.5)	–
Effect of undistributed retained earnings in a consolidated subsidiary sold to the third party	5.6	–
Tax rate difference in foreign consolidated subsidiaries	(1.3)	–
Tax credits	(1.8)	–
Other—net	(1.2)	(0.2)
Actual effective tax rates	38.9%	29.7%

## 12. RESEARCH AND DEVELOPMENT COSTS

Research and development costs charged to income were ¥3,575 million (\$30,556 thousand) and ¥3,094 million for the years ended March 31, 2006 and 2005, respectively.

## 13. LEASES

### (As lessee)

The Company and certain consolidated subsidiaries lease machinery, equipment, vehicles, tools, furniture and fixtures and software as a lessee. Finance lease expenses were ¥1,001 million (\$8,556 thousand) and ¥979 million for the years ended March 31, 2006 and 2005, respectively.

Pro forma information of leased property such as acquisition cost, accumulated depreciation, obligations under finance leases and depreciation expense of finance leases that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2006 and 2005 was as follows:

	Millions of Yen			
	Machinery, Equipment and Vehicles	Tools, Furniture and Fixtures	Software	Total
<b>2006</b>				
Acquisition cost	¥897	¥1,773	¥1,022	¥3,692
Accumulated depreciation	401	883	640	1,924
Impairment loss	17	–	–	17
Net leased property	¥479	¥ 890	¥ 382	¥1,751

	Millions of Yen			
	Machinery, Equipment and Vehicles	Tools, Furniture and Fixtures	Software	Total
<b>2005</b>				
Acquisition cost	¥1,029	¥2,326	¥975	¥4,330
Accumulated depreciation	410	1,611	525	2,546
Net leased property	¥ 619	¥ 715	¥450	¥1,784

	Thousands of U.S. Dollars			
	Machinery, Equipment and Vehicles	Tools, Furniture and Fixtures	Software	Total
<b>2006</b>				
Acquisition cost	\$7,667	\$15,154	\$8,735	\$31,556
Accumulated depreciation	3,427	7,547	5,470	16,444
Impairment loss	146	–	–	146
Net leased property	\$4,094	\$ 7,607	\$3,265	\$14,966

Obligations under finance leases at March 31, 2006 and 2005, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Due within one year	¥ 756	¥ 662	\$ 6,462
Due after one year	1,012	1,122	8,649
Total	¥1,768	¥1,784	\$15,111

Depreciation expense, which was not reflected in the accompanying consolidated statements of income, computed by the straight-line method, was ¥1,001 million (\$85,556 thousand) and ¥979 million for the years ended March 31, 2006 and 2005, respectively.

Impairment loss on leased assets was ¥24 million (\$205 thousand) for the year ended March 31, 2006. Reversal of allowance for impairment loss on leased assets was ¥6 million (\$51 thousand) for the year ended March 31, 2006.

The amounts of acquisition cost and obligations under finance leases include the imputed interest expense portion.

Obligations under operating leases at March 31, 2006 and 2005 were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Due within one year	¥ 57	¥19	\$ 487
Due after one year	188	50	1,607
Total	¥245	¥69	\$2,094

#### (As lessor)

A consolidated subsidiary leases machinery, equipment, vehicles, tools, furniture and fixtures as a lessor. Finance lease revenues were ¥91 million (\$778 thousand) and ¥75 million for the years ended March 31, 2006 and 2005, respectively.

Leased property whose ownership does not transfer to the lessee during or at the completion of the lease term at March 31, 2006 and 2005 was as follows:

	Millions of Yen		
	Machinery, Equipment and Vehicles	Tools, Furniture and Fixtures	Total
2006			
Acquisition cost	¥375	¥15	¥390
Accumulated depreciation	225	3	228
Net leased property	¥150	¥12	¥162

	Millions of Yen		
	Machinery, Equipment and Vehicles	Tools, Furniture and Fixtures	Total
2005			
Acquisition cost	¥342	¥6	¥348
Accumulated depreciation	188	3	191
Net leased property	¥154	¥3	¥157

	Thousands of U.S. Dollars		
	Machinery, Equipment and Vehicles	Tools, Furniture and Fixtures	Total
2006			
Acquisition cost	\$3,205	\$128	\$3,333
Accumulated depreciation	1,923	26	1,949
Net leased property	\$1,282	\$102	\$1,384

Expected revenues from finance leases at March 31, 2006 and 2005 were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Due within one year	¥ 89	¥ 78	\$ 760
Due after one year	144	150	1,231
<b>Total</b>	<b>¥233</b>	<b>¥228</b>	<b>\$1,991</b>

Depreciation expense, which was reflected in the accompanying consolidated statements of income, was ¥74 million (\$632 thousand) and ¥73 million for the years ended March 31, 2006 and 2005 respectively. The amounts of expected revenues under finance leases include the imputed interest revenue portion.

#### 14. DERIVATIVES

The Group enters into foreign exchange forward contracts, interest rate options and interest rate swaps. The Group does not hold or issue derivatives for trading or speculative purposes. Derivative transactions entered into by the Group have been made in accordance with internal policies which regulate hedge policy, authorization, credit limit and reporting to the management. Each derivative transaction is periodically reported to the management, where evaluation and analysis of derivatives are made.

The Group had the following derivative contracts outstanding at March 31, 2006 and 2005:

	Millions of Yen			Thousands of U.S. Dollars		
	Contract or Notional Amount	Fair Value	Unrealized Gains (Losses)	Contract or Notional Amount	Fair Value	Unrealized Gains (Losses)
<b>2006</b>						
Forward Exchange Contracts:						
Selling:						
U.S. Dollar	¥3,352	¥3,379	¥(27)	\$28,650	\$28,880	\$(230)
H.K. Dollar	10	10	(0)	85	85	(0)
Singapore Dollar	1	1	(0)	9	9	(0)
Euro	0	0	0	0	0	0
Buying:						
U.S. Dollar	430	435	5	3,675	3,718	43
H.K. Dollar	1	1	0	9	9	0
Euro	0	0	0	0	0	0
<b>2005</b>						
Forward Exchange Contracts:						
Selling:						
U.S. Dollar	¥2,518	¥2,581	¥(63)			
H.K. Dollar	10	10	(0)			
Buying:						
Japanese Yen	209	207	(2)			
U.S. Dollar	200	199	(1)			
Euro	26	27	1			
H.K. Dollar	1	1	(0)			
Interest rate options:						
Buying:						
Interest rate cap	¥ 380	—	—			
<Option premiums>	<5>	—	(5)			

Option premiums were reflected in brackets (< >) under the contracted amounts. The contract or notional amounts of derivatives which are shown in the above table do not represent the amounts exchanged by the parties and do not measure the Group's exposure to credit or market risk. Foreign currency forward contracts which qualify for hedge accounting for the years ended March 31, 2006 and 2005 and such amounts which are assigned to the associated assets and liabilities and recorded on the balance sheets at March 31, 2006 and 2005, are excluded from disclosure of market information. Interest rate caps which qualify for hedge accounting for the year ended March 31, 2005 are excluded from disclosure of market information.

## 15. CONTINGENT LIABILITIES

At March 31, 2006, the Group had contingent liabilities for notes trusted with recourse in the course of assets liquidation in the amount of ¥580 million (\$4,957 thousand).

At March 31, 2006, the Group was contingently liable for ¥3,665 million (\$31,325 thousand) for guarantees of loans and payables for non-consolidated subsidiaries, associated and other companies and employees. Additionally, the Group was jointly and severally liable for ¥300 million (\$2,564 thousand) for guarantee of loans of a company of which the Group's proportionate liability was ¥30 million (\$256 thousand).

The Group had an obligation to invest additionally in Takakura via an anonymous association contract with an upper limit of ¥525 million (\$4,487 thousand) in the event that buildings owned by Takakura are destroyed or impaired by natural disaster.

The Group transferred all stocks of one of its consolidated subsidiaries, Tokuhatsu Co., Ltd., held by the Group, to NHK Spring Co., Ltd. in January 2006. Under the agreement with NHK Spring Co., Ltd., the Group would owe a defect liability against NHK Spring Co., Ltd. at the maximum ¥3,200 million (\$27,350 thousand) for 10 years starting on the date of transfer. The Group agreed to owe the defect liability such as product liability and remedy cost for land pollution, which would be caused by the events occurred prior to the date of transfer. As a result of the due diligence process between the Group and NHK Spring Co., Ltd., the management of the Group believes that the possibility of exposures to loss would be remote.

## 16. SUBSEQUENT EVENT

### a. Appropriations of Retained Earnings

The following appropriations of retained earnings at March 31, 2006 were approved at the Company's shareholders' meeting held on June 29, 2006:

	Millions of Yen	Thousands of U.S. Dollars
Year-end cash dividends, ¥5 (\$0.04) per share	¥2,171	\$18,556
Bonuses to directors and corporate auditors	110	940
Total	¥2,281	\$19,496

## 17. SEGMENT INFORMATION

The Group operates in the following segmentation under the headings of "Specialty Steel," "Electronic and Magnetic Materials," "Parts for Automobile & Industrial Equipment," "Engineering," "New Materials" and "Trading & Service." The Electronics segment was renamed the Electronic and Magnetic Materials segment in the year under review.

### (a) Industry Segments

(1) A summary of net sales, costs and expenses and operating income (loss) by industry segments for the years ended March 31, 2006 and 2005, was as follows:

Millions of Yen									
2006	Specialty Steel	Electronic and Magnetic Materials	Parts for Automobile & Industrial Equipment	Engineering	New Materials	Trading & Service	Total	(Elimination)	Consolidated
Net sales:									
Outside customers	¥265,629	¥51,696	¥104,092	¥33,892	¥11,499	¥13,896	¥480,704	¥ -	¥480,704
Intersegment transactions	24,846	746	19,950	2,255	1,077	9,638	58,512	(58,512)	-
Total	290,475	52,442	124,042	36,147	12,576	23,534	539,216	(58,512)	480,704
Costs and expenses	271,095	49,426	113,164	34,454	11,579	21,954	501,672	(58,511)	443,161
Operating income (loss)	¥ 19,380	¥ 3,016	¥ 10,878	¥ 1,693	¥ 997	¥ 1,580	¥ 37,544	¥ (1)	¥ 37,543

Millions of Yen									
2005	Specialty Steel	Electronics	Parts for Automobile & Industrial Equipment	Engineering	New Materials	Trading & Service	Total	(Elimination)	Consolidated
Net sales:									
Outside customers	¥231,449	¥50,740	¥ 93,003	¥30,687	¥8,166	¥15,061	¥429,106	¥ -	¥429,106
Intersegment transactions	23,009	820	18,110	630	871	9,389	52,829	(52,829)	-
Total	254,458	51,560	111,113	31,317	9,037	24,450	481,935	(52,829)	429,106
Costs and expenses	244,592	49,549	104,248	30,543	8,324	23,220	460,476	(52,826)	407,650
Operating income (loss)	¥ 9,866	¥ 2,011	¥ 6,865	¥ 774	¥ 713	¥ 1,230	¥ 21,459	¥ (3)	¥ 21,456

Thousands of U.S. Dollars									
2006	Specialty Steel	Electronic and Magnetic Materials	Parts for Automobile & Industrial Equipment	Engineering	New Materials	Trading & Service	Total	(Elimination)	Consolidated
Net sales:									
Outside customers	\$2,270,334	\$441,846	\$ 889,675	\$289,675	\$ 98,282	\$118,769	\$4,108,581	\$ -	\$4,108,581
Intersegment transactions	212,359	6,376	170,513	19,274	9,205	82,376	500,103	(500,103)	-
Total	2,482,693	448,222	1,060,188	308,949	107,487	201,145	4,608,684	(500,103)	4,108,581
Costs and expenses	2,317,051	422,444	967,214	294,479	98,966	187,641	4,287,795	(500,094)	3,787,701
Operating income (loss)	\$ 165,642	\$ 25,778	\$ 92,974	\$ 14,470	\$ 8,521	\$ 13,504	\$ 320,889	\$ (9)	\$ 320,880

(2) Assets, depreciation, capital expenditures and impairment loss for the years ended March 31, 2006 and 2005, were as follows:

Millions of Yen									
2006	Specialty Steel	Electronic and Magnetic Materials	Parts for Automobile & Industrial Equipment	Engineering	New Materials	Trading & Service	Total	Corporate	Consolidated
Assets	¥247,156	¥35,864	¥96,343	¥22,513	¥9,599	¥20,487	¥431,962	¥44,855	¥476,817
Depreciation	8,523	1,408	4,448	323	175	832	15,709	358	16,067
Capital expenditures	11,236	895	7,372	67	408	626	20,604	901	21,505
Impairment loss	570	56	28	66	16	77	813	-	813

Millions of Yen									
2005	Specialty Steel	Electronics	Parts for Automobile & Industrial Equipment	Engineering	New Materials	Trading & Service	Total	Corporate	Consolidated
Assets	¥220,239	¥38,323	¥93,308	¥19,915	¥6,503	¥13,438	¥391,726	¥44,609	¥436,335
Depreciation	8,257	1,559	4,832	266	190	825	15,929	400	16,329
Capital expenditures	5,468	1,142	3,660	330	224	758	11,582	304	11,886

Thousands of U.S. Dollars									
2006	Specialty Steel	Electronic and Magnetic Materials	Parts for Automobile & Industrial Equipment	Engineering	New Materials	Trading & Service	Total	Corporate	Consolidated
Assets	\$2,112,444	\$306,530	\$823,444	\$192,419	\$82,043	\$175,103	\$3,691,983	\$383,376	\$4,075,359
Depreciation	72,846	12,034	38,017	2,761	1,496	7,111	134,265	3,060	137,325
Capital expenditures	96,034	7,650	63,009	573	3,487	5,350	176,103	7,701	183,804
Impairment loss	4,872	479	239	564	137	658	6,949	-	6,949

As discussed in Note 2 (g), the Group adopted the new accounting standard for impairment of long-lived assets as of April, 2005. As a result of the adoption of this new accounting standard, impairment loss in the amount of ¥813 million (\$6,949 thousand) was recognized for the year ended March 31, 2006.

#### (b) Geographical Segments

Geographical segment information for the years ended March 31, 2006 and 2005, was not disclosed as net sales and assets in Japan were more than 90 percent of the consolidated net sales and assets of all segments.

#### (c) Export Sales

A summary of export sales information to foreign customers for the Group for the fiscal years ended March 31, 2006 and 2005 was as follows:

Millions of Yen				
2006	North America	Asia	Others	Total
Export sales	¥14,324	¥43,315	¥3,876	¥ 61,515
Net sales				480,704
Ratio of export sales to net sales	3.0%	9.0%	0.8%	12.8%

Millions of Yen				
2005	North America	Asia	Others	Total
Export sales	¥10,614	¥35,175	¥4,326	¥ 50,115
Net sales				429,106
Ratio of export sales to net sales	2.5%	8.2%	1.0%	11.7%

Thousands of U.S. Dollars				
2006	North America	Asia	Others	Total
Export sales	\$122,427	\$370,214	\$33,128	\$ 525,769
Net sales				4,108,581
Ratio of export sales to net sales	3.0%	9.0%	0.8%	12.8%

# INDEPENDENT AUDITORS' REPORT

# Deloitte.

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To the Board of Directors of  
DAIDO STEEL CO., LTD.:

We have audited the accompanying consolidated balance sheets of DAIDO STEEL CO., LTD. (the "Company") and consolidated subsidiaries (together, the "Group") as of March 31, 2006 and 2005, the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of DAIDO STEEL CO., LTD. and consolidated subsidiaries as of March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

As discussed in Note 2 (g) to the consolidated financial statements, effective April 1, 2005, the consolidated financial statements have been prepared in accordance with the new Accounting Standard for Impairment of Fixed Assets.

As discussed in Note 3 to the consolidated financial statements, effective April 1, 2005, the Group changed the scope of the application of percentage completion method to the long-term construction contracts.

Our audits also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 1. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.



June 29, 2006

**Member of**  
**Deloitte Touche Tohmatsu**