

# Review of Operations

## SPECIALTY STEEL

### OVERVIEW OF BUSINESS

Accounting for about 55% of consolidated net sales, specialty steel is the core business of Daido Steel. Specialty steel is made by combining steel scrap with alloys and other substances to add value in the form of properties such as resistance to heat, abrasions or rust. Daido Steel is skilled in achieving a variety of desired characteristics by using precise amounts of carefully chosen materials. Customers can thus rely on Daido Steel to develop products that meet the demands of specific applications. The automobile and industrial machinery sectors are the primary users of specialty steel, accounting for about 80% of sales in this business segment.

### RESULTS OF OPERATIONS

Japanese automakers, which are the main source of demand for the Group's specialty steel, increased overall production 4% year on year, as increased exports driven by higher overseas sales outweighed declining Japanese sales. Demand from other areas also remained healthy, particularly the industrial and construction machinery fields.

In this environment, segment performance was generally firm despite lower orders and some reductions in tool steel inventories. During the year under review, thanks to the benefits of capital investment aimed at boosting productivity, Daido Steel established a more flexible and efficient production system. We are also striving to cut costs, as well as optimizing orders and increasing sales prices, in response to soaring prices for nickel and other raw materials.

Due to these factors, sales of specialty steel increased 8.3% to ¥287,754 million.

Looking forward, we plan to respond to demand by reaping the benefits of investment in rationalization. We will also work to overhaul our earnings structure by further reducing costs. Specifically, in response to surging raw materials prices, we will reflect price increases in the cost of our products with the understanding of customers, and in parallel, diversify steel material procurement sources by putting in place new recycling schemes and expanding our alliances.

### MAJOR INITIATIVES OF THE MEDIUM-TERM MANAGEMENT PLAN

#### Upgrade manufacturing capabilities

Increase output capacity and raise productivity for automotive specialty steel products; establish an optimum manufacturing infrastructure with the highest possible output capacity.

#### Establish a variety of alliances

Form alliances for the purposes of raising manufacturing efficiency and better managing risks.

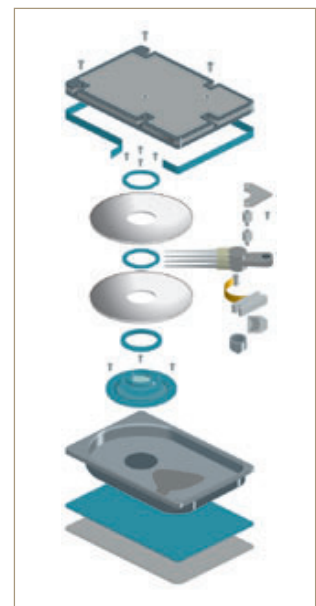
#### Increase sales of number-one products

Between now and the fiscal year ending March 2009, the goal is to raise sales of tool steel by 6% and sales of steel for heat-resistant bolts by 54%.

### Medium-term Management Plan Goals

(Years ended March 31)

	2006	2007	2009 (Target)
Net sales (billions of yen)	265.6	288.8	290.0
Operating income (billions of yen)	19.3	11.7	29.0
ROS (%)	7.3	4.1	10.0



Daido Steel is the world's leading supplier of stainless steel for HDD spindle motors.

## ELECTRONIC AND MAGNETIC MATERIALS (Formerly Electronics)

### OVERVIEW OF BUSINESS

This segment, which accounts for around 12% of consolidated net sales, focuses on the manufacture and sale of electronic and magnetic materials used mainly in computers, automobiles, mobile phones and digital consumer electronics. Notably, Daido Steel is the world's largest supplier of magnets for spindle motors used to rotate the disks in hard disk drives (HDD), with a market share of approximately 60%.

Major electronics products are rare earth magnets, mainly for HDD spindle motors, high alloys, steel strip materials for lead frames, and electromagnetic materials. Demand for these products is climbing in tandem with expansion of global markets for electronics products. Daido Steel is responding to this growth with an extensive new product development program aimed at developing its electronics and magnetic materials into a core business alongside specialty steel.

### RESULTS OF OPERATIONS

Sales volume of nickel alloy steel strips for IC lead frames increased compared to the previous fiscal year due to higher demand from semiconductor and LCD-related fields. We responded to increased nickel prices by optimizing orders, not simply relying on the existing surcharge system. The magnetic materials business suffered from declining sales for digital consumer electronics applications, but enjoyed good performance in sales of materials for servo motors used in factory automation applications. In thin-film deposition and electronic materials, sales of surface hardening films were strong.

As a result, segment sales increased 24.7% to ¥64,453 million.

### Medium-term Management Plan Goals

(Years ended March 31)

	2006	2007	2009 (Target)
Net sales (billions of yen)	51.7	64.5	59.0
Operating income (billions of yen)	3.0	3.4	6.0
ROS (%)	5.8	5.3	10.2

### MAJOR INITIATIVES OF THE MEDIUM-TERM MANAGEMENT PLAN

#### Increase sales of magnets

Between now and the fiscal year ending March 2009, the goal is to raise sales of magnets by 33%. Plans call for increasing sales for automotive applications, a market that is growing and where Daido Steel can effectively use its technologies. Work has been completed on a factory in China to produce magnets for electric power steering system motors. Full-scale production and sales activities commenced in 2006.

#### Develop technology for value-added hot rolled materials with hard workability and begin sales

Daido Steel is expanding applications for steel with hard workability, such as alloys with high nickel content, to fully utilize the attributes of its Steckel Mill. This mill is ideal for producing high-quality alloy strip and flat products with hard workability thanks to a furnace coiler that maintains a stable temperature during rolling. This processing capability is creating new opportunities for Daido Steel at the high end of the electronic materials market.



#### NEOQUENCH-P (NdFeB Polymer-bonded Magnets)

Magnets for precision, high-speed motors used in mobile phones, office automation (OA) equipment and other products; currently the world's most popular magnet for HDD spindle motors.

## PARTS FOR AUTOMOBILE & INDUSTRIAL EQUIPMENT

### OVERVIEW OF BUSINESS

This segment contributes around 20% of consolidated net sales. It focuses on the manufacturing of die forged parts such as crankshafts using specialty steel materials, precision casting parts for use in gears and turbochargers (used in diesel engines to improve fuel efficiency and reduce exhaust gases), engine valves, jet engine shafts and parts for industrial gas turbines. Most of the auto parts sold in this segment use materials that were developed through joint projects with automakers to meet their exacting requirements. These parts can therefore lower processing expenses at customers' factories as well as reduce the weight of finished products.

Many products in this segment have dominant positions in their respective market categories worldwide. Aircraft jet engine shafts and marine diesel engine valves are two examples. Daido Steel has a high market share in numerous other product categories, including automotive engine valves and turbine disks. We will continue to develop and launch new products that differentiate us from competitors and support our position as a provider of advanced products.

The steel materials used in this segment are manufactured in-house

### RESULTS OF OPERATIONS

Demand for automobile parts decreased as demand related to restrictions on emissions from diesel engines used in trucks ran its course and customers cut back inventories. However, strong vehicle production led to robust performances for products such as die forgings and hot precision forgings. In the hot precision

forgings field, we added more high-speed hot formers in Japan and the United States with the aim of becoming more competitive and expanding our operations. Sales of precision cast products grew smoothly on increased production of diesel engine turbochargers in Europe.

In industrial equipment, sales were strong for heavy electric machines, industrial machinery and aerospace- and marine-related products. In particular, production of aircraft jet engine shafts remained at full capacity on the back of continued high demand. As a response to increased prices for raw materials, we increased the cost of our products and promoted a shift to high-value-added products.

As a result of these developments, sales in the segment increased 2.8% to ¥107,046 million.

### MAJOR INITIATIVES OF THE MEDIUM-TERM MANAGEMENT PLAN

#### Make large investments to upgrade production facilities and enhance quality

In 2006, the decision was made to add a large 7,000-ton press forging machine at the Shibukawa Plant. The machine is slated to become operational early in 2008. A U.S. subsidiary has ordered a high-speed precision forging machine that is expected to help increase sales of forged products to customers in North America.

#### Increase sales of number-one products

Between now and the fiscal year ending in March 2009, the goal is to raise sales of jet engine shafts by 60%, gas turbine components by 67% and turbocharger parts by 64%.

### Medium-term Management Plan Goals

(Years ended March 31)

	2006	2007	2009 (Target)
Net sales (billions of yen)	104.1	107.0	119.0
Operating income (billions of yen)	10.9	10.5	13.0
ROS (%)	10.5	9.8	10.9



**Hot, High-speed Precision Forgings**

Daido Steel is one of the largest manufacturers of hot, high-speed precision forgings.

# ENGINEERING

## OVERVIEW OF BUSINESS

Major activities in this segment, which accounts for about 7% of consolidated net sales, are the manufacture of steelmaking equipment, industrial furnaces and associated equipment. This segment also supplies environmental equipment for the treatment of wastewater, gas emissions and waste materials, mainly to public-sector clients with incinerated ash melting systems for urban waste, and machine tools.

In environmental equipment, in particular, the operation and engineering technologies we have fostered over the years support our cutting-edge engineering business with its finger constantly on the pulse of market needs.

The new types of equipment and technologies that this segment has created contribute to environmental preservation and energy reduction in a wide variety of settings.

Operations also include maintenance and management of this machinery and equipment.

## RESULTS OF OPERATIONS

Sales of environmental equipment declined as public-sector demand cooled. Industrial furnaces, however, performed well, boosted by solid private-sector capital investment. Heat treatment furnaces, including dust collection systems and short-time cycle (STC) heat treatment furnaces performed particularly well.

Due to these factors, segment sales increased 9.8% to ¥37,200 million.

## MAJOR INITIATIVES OF THE MEDIUM-TERM MANAGEMENT PLAN

### Develop new products and markets

Continue work on developing new products and markets by collaborating with heat treatment companies and other users of this segment's products and services.

## MAIN PRODUCTS

### Sewage Sludge Carbonizing System

Sewage sludge is thermally decomposed into a carbonized form using oxygen-free or low-oxygen environments. Carbonized sludge can be utilized as ameliorant for soil or as a biomass energy resource. Heat is recovered and used during the treatment.

### Daido Arc Process (DAP)

The Daido Arc Process (DAP) is the world's first municipal solid waste incinerated ash melting system. DAP breaks down dioxin into less polluting substances and makes it possible to reduce and recycle burnt ash.

## Medium-term Management Plan Goals

(Years ended March 31)

	2006	2007	2009 (Target)
Net sales (billions of yen)	33.9	37.2	34.0
Operating income (billions of yen)	1.7	2.3	2.0
ROS (%)	5.0	6.2	5.9



Daido Arc Process (DAP)

## NEW MATERIALS

### OVERVIEW OF BUSINESS

Accounting for about 3% of consolidated net sales, this segment supplies mainly titanium products for engine valves and turbine wheels, shape-memory alloys, and high-performance metal powders used to make valve sheets and magnetic materials.

### RESULTS OF OPERATIONS

Demand for titanium products remained high, centered on medical and factory applications. Going forward, we will add more specialized melting furnaces to cope with further increases in demand. We also took steps to reflect the climbing cost of titanium, the segment's main raw material, in our product prices. Sales volume of metal powder products increased 47.5% year on year thanks to striking growth in demand related to automobiles and industrial machines and our continued efforts to develop overseas markets. We also increased production capacity.

These factors led to an increase in segment sales of 20.5% to ¥13,858 million.

### MAJOR INITIATIVES OF THE MEDIUM-TERM MANAGEMENT PLAN

#### Increase sales of number-one products

Between now and the fiscal year ending March 2009, the goal is to raise sales of metal powder products by 61% and sales of titanium products by 46%.

### Invest in strategic businesses (number-one products)

Major projects are expansion of water atomization capability at the metal powder plant and increased capacity for titanium melting furnaces at the Hoshizaki Plant.

## TRADING & SERVICE

### OVERVIEW OF BUSINESS

The major activities in this segment, which represents about 2% of consolidated net sales, are the sale of products made by group companies, employee benefit services, real estate and insurance services, operation of golf courses, an analysis business, and the sale of software to external customers.

### RESULTS OF OPERATIONS

There were no significant changes in overall operating results compared with the prior fiscal year. Segment sales, however, decreased 11.4% to ¥12,309 million because of intense competition in the market for imported materials affecting the construction materials divisions of a subsidiary.

### Medium-term Management Plan Goals

(Years ended March 31)

	2006	2007	2009 (Target)
Net sales (billions of yen)	11.5	13.9	15.0
Operating income (billions of yen)	1.0	2.3	2.0
ROS (%)	8.7	16.5	13.3



**Crankset (Mountain Bike Component)**

World's first use of a new lightweight beta-titanium alloy with high levels of strength and hardness, known as "CaTi," in a superior-quality mountain bike crankset.