

## Business Climate and Operational Review

During the year under review, the U.S. economy continued steady supported by strong housing and capital investments, despite such negative factors as oil price hikes and higher interest rates. The European economy, which had slowed from the latter half of 2004, started to recover due to a pickup in the German economy. In Asia, the Chinese economy continued to show substantial growth, and ASEAN and NIES saw stable expansion in their economies. The global economy remained steady, in general, due to the relatively stable currency market. Meanwhile, the Japanese economy expanded steadily mainly because of improved corporate earnings, a rise in consumer spending related to better employment and income environments, and an increase in exports.

In the automobile industry, domestic sales totaled about 5.85 million units in calendar year 2005, slightly down from the previous year. Domestic production, however, rose 2.7% year on year to approximately 10.80 million units amid growing exports due to expanding overseas markets.

As for domestic construction and housing industries, new housing starts increased 4.0% from the preceding year to 1.24 million units in calendar year 2005, and construction starts of floor space for non-housing buildings also increased 2.5%.

Under this business climate, the Riken Group made efforts to strengthen the competitiveness of its quality, technology and pricing particularly in its core product areas, including piston rings and camshafts, as well as to develop and sell products that better satisfy the needs of its customers.

During the year under review, automotive parts sales increased and sales of environmental and safety-related equipment were also up. As a result, consolidated net sales climbed 13.1% from the previous year to ¥88,675 million. Although profits were negatively influenced chiefly by falling average sales per item and higher costs of raw materials for casting products, operating income rose 14.8% to ¥7,857 million due to our efforts to rationalize production operations. Net income was ¥5,659 million, up 13.2% from the previous year. Consequently, both operating and net income posted record highs.

Based on these positive results, we increased our annual dividend for the year under review by ¥2.00 per share to ¥12.00.

## Outlook for the Future

The global economy is expected to continue a moderate expansion in the years to come. In the U.S., the economy is forecasted to remain steady despite such negative factors as the effects of high oil prices and excessive housing supply. The recovering European economy is likely to enter an expansion

phase, while the Asian economy is likely to maintain continued high growth led by China and India.

The Japanese economy at present is said to be in the middle of a boom, comparable to the longest postwar growth period, “Izanagi boom,” and is likely to continue expanding for the foreseeable future. This robust forecast is attributable to many favorable factors, such as completion of the round of inventory adjustments, expansion of capital expenditures, growing exports, improving employment conditions, and strong consumer spending. Despite this projected growth, the business environment should be looked at with caution given various unfavorable factors such as oil price hikes, higher costs of pig iron, steel scrap and other raw materials, as well as the yen’s appreciation.

With regards to the automobile industry, earnings at U.S. automakers and leading automotive parts manufacturers are expected to be sluggish, while Japanese automakers are expected to further increase the scale of their global production. With our customers working to enhance their global competitiveness, their requirements regarding quality, technology and price for our products are becoming more and more demanding.

Against this backdrop, the Riken Group will move forward to expand its total Group sales. To this end, we will hone our competitive edge by further improving product quality and technology. We will establish new business bases and proactively implement sales activities, with an emphasis on improved responsiveness to the needs of the global market, while strengthening cooperation among Group companies inside and outside Japan. Finally, to further heighten its corporate value, the Group will redouble its rationalizing efforts to increase production efficiency, lower costs and improve its overall financial standing.

With the aim of strengthening our global piston ring operations, we completed the installation of our improved, innovative and focused steel piston ring operation at the Tsurugi plant in Kashiwazaki, Japan. Furthermore, construction of the Group’s new piston ring manufacturing operations in China, Riken Automobile Parts (Wuhan) Co., Ltd., was completed and mass production started in the first half of the year. We plan to increase production of both piston rings and camshafts in China this year by relocating and expanding the existing manufacturing operations of Xiamen Riken Ind. Co., Ltd.



President

In March 2006, the Riken Group formulated its three-year mid-term management plan “PLAN 2008,” which is to last through fiscal year 2008, aiming to achieve sustainable growth.

The plan prioritizes a thorough enhancement of our technology so as to better respond to the globalization of business activities and technological innovation.

## Riken Group's Mid-Term Management Plan “PLAN 2008”

**Slogan:** Think Big, Aim High, and Do Through.

**Main theme:** “Enhancement of technological development and continued improvement of corporate value through expanded global operations”



## Mid-Term Key Policies

1. Development of advanced technologies that can create new value for our customers

2. Realization of the world's highest and most unified quality

3. Substantial increase in productivity through manufacturing innovation

4. Expansion of global operations

5. Active recruiting and intensive and continuous training of human resources

6. Further promotion of corporate social responsibility (CSR)

The Group will enhance its R&D system to create new products and technologies that help customers solve their problems, while creating innovative production technologies and raising on-site manufacturing capabilities to significantly increase productivity and to realize the world's highest and most unified quality.

In order to expand global operations, we will also continue to strengthen overseas production bases while reinforcing our sales and marketing system and our supply chain management.

Furthermore, we aim to achieve a sustainable growth of corporate value, through the implementation of global operations, strategies and the proactive group-wide promotion of personnel training and CSR.