

FINANCIAL SECTION

FIVE-YEAR SUMMARY

Riken Corporation and Consolidated Subsidiaries
Years ended March 31

CONSOLIDATED	2002	2003	2004	2005	2006
	Millions of yen				
Net sales	¥ 69,249	¥ 71,509	¥ 71,738	¥ 78,429	¥ 88,675
Operating income	5,589	5,951	6,091	6,842	7,857
Net income (loss)	3,344	4,409	3,877	4,998	5,659
Total assets	72,849	72,144	74,459	80,747	88,311
Net assets per share (yen)	245.89	269.53	297.07	337.98	393.83
Net income (loss) per share (yen)	31.81	42.08	37.07	47.86	53.55
Diluted net income per share (yen)	—	—	37.06	47.78	53.43
Capital ratio (%)	35.3	38.9	41.5	43.7	47.1
Net cash provided by operating activities	5,333	8,917	6,529	7,547	8,442
Net cash used in investing activities	(3,314)	(6,120)	(4,283)	(5,427)	(6,241)
Net cash used in financing activities	(4,623)	(3,002)	(2,071)	(2,959)	(2,134)
Cash and cash equivalents at end of year	7,258	6,724	6,520	5,578	6,090
Number of employees	3,850	3,736	3,699	3,723	3,905

NON-CONSOLIDATED	2002	2003	2004	2005	2006
	Millions of yen				
Net sales	¥ 61,740	¥ 62,909	¥ 63,263	¥ 68,483	¥ 76,316
Operating income	4,465	5,427	4,497	4,665	5,572
Net income (loss)	2,639	3,711	2,891	3,245	3,727
Capital	8,573	8,573	8,573	8,573	8,573
Common shares issued (shares)	106,484,667	106,484,667	106,484,667	106,484,667	106,484,667
Total assets	58,574	58,496	60,639	65,460	70,597
Net assets per share (yen)	192.71	219.78	240.12	264.13	292.47
Amount of dividend per share (yen)	7.50	8.50	8.50	10.00	12.00
Net income (loss) per share (yen)	25.12	35.38	27.59	31.00	35.14
Diluted net income per share (yen)	—	—	27.58	30.95	35.06
Capital ratio (%)	34.4	39.1	41.2	42.1	43.8
Number of employees	1,564	1,501	1,466	1,470	1,469

OPERATIONAL REVIEW AND ANALYSIS OF FINANCIAL POSITION

Significant Accounting Policies and Estimates

The consolidated financial statements of the Riken Group are prepared on the basis of accounting standards generally accepted as fair and reasonable in Japan. When compiling these financial statements, estimates that may have influence on the values of assets and liabilities as of the closing day and the values of income and expenses for the year under review are mainly the allowance for doubtful accounts, bonuses, employees' retirement benefits and officers' retirement benefits, and these are subject to continuous assessment.

Our estimates, judgments and assessments are made on the basis of factors that are deemed reasonable in light of past performance and conditions. However, since estimates inevitably involve uncertainties, actual values may differ from estimates.

Operational Review

During the year under review, we made significant efforts to increase group-wide profits in line with the policy of "establishing a truly global operation and expanding Group sales and earnings" — the main theme of our mid-term management plan — while continuously enhancing our corporate value.

As a result of these efforts, consolidated net sales were ¥88,675 million for the year, up 13.1% from the previous year. Gross profit was ¥19,512 million, up 10.5% from the previous year. Operating income increased 14.8% year on year to ¥7,857 million while pre-tax income jumped 23.3% to ¥9,264 million. Net income for the year rose 13.2% to ¥5,659 million.

Net sales increased ¥10,245 million from a year earlier due to a rise in sales of automotive parts and environmental and safety-related equipment.

Gross profit went up compared with the previous year's level, mainly because of the effects of rationalizing the production division, although cost of sales was adversely affected by higher raw material costs for cast iron products.

Non-operating income rose 33.9% year on year to ¥2,571 million, owing chiefly to ¥1,340 million in profits on equity-method investments reflecting the strong performance of equity-method affiliates, including those in Asia. Non-operating expenses decreased 4.2% to ¥879 million.

Extraordinary profit was ¥46 million, down 70.2% from the preceding year, and extraordinary loss was ¥331 million, down 31.7% from the preceding year.

As a result, the Group's operating income, net income before income taxes and net income all marked record highs.

Financial Position

The Group's net assets were ¥88,311 million as of the end of the year under review, up ¥7,563 million from the previous year. This increase is attributable mainly to a ¥1,116 million rise in notes and accounts receivable reflecting increased sales, as well as to a ¥4,180 million climb in tangible fixed assets derived from Riken Automobile Parts (Wuhan) Co., Ltd. that was newly included in the Group.

Total liabilities stood at ¥44,958 million as of the end of the year under review, up ¥717 million. The unsettled amount in notes and accounts payable was up ¥2,426 million. On the other hand, interest-bearing debt declined ¥1,499 million from a year earlier to ¥15,518 million due to the appropriation of funds generated from operating and other activities.

Shareholders' equity was ¥41,596 million as of the end of the year, up ¥6,342 million, chiefly because of a rise in retained earnings of ¥4,571 million and an advance in foreign currency translation adjustments of ¥1,075 million.

As a result, the net worth ratio as of the end of the year reached 47.1%, up 3.4 percentage points from the preceding year. Meanwhile, despite a climb in net income, return on equity (ROE) for the year dropped 0.4 point to 14.7%, due to an increase in foreign currency translation adjustments affected by the yen's depreciation against the dollar.

Shareholders' equity per share based on outstanding shares at the end of the year was ¥393.83, an increase of ¥55.85 from a year earlier.

Cash Flows

Overview

Free cash flow, calculated by subtracting "cash flow from investing activities" from "cash flow from operating activities," amounted to ¥2,200 million. As a result of appropriation of funds for the repayment of debt (¥1,569 million) and payment of dividends (¥1,043 million), cash and cash equivalents came to ¥6,090 million at the end of the year under review, up ¥512 million from a year earlier.

Comparison with the Previous Year

Cash flow from operating activities reached ¥8,442 million, up ¥894 million from the preceding year. Net income before income taxes rose ¥1,749 million, while increases in notes and accounts receivable and inventories were ¥1,827 million, down ¥1,895 million. Rise in notes and accounts payable was ¥1,358 million, down ¥696 million. Decrease in allowance for retirement benefits was ¥723 million, down ¥600 million.

Cash flow for investment activities amounted to ¥6,241 million, an increase of ¥814 million from the previous year. This growth was mainly due to the ¥6,373 million acquisition costs of tangible fixed assets relating to capital investments, etc., up ¥2,004 million, and the ¥11 million acquisition costs of investment securities, a decrease of ¥1,178 million.

Cash flow for financing activities totaled ¥2,134 million, down ¥825 million from the previous year. The main factor behind this decrease was the repayment of short- and long-term debt dropping ¥640 million from the previous year to ¥1,569 million.

CONSOLIDATED BALANCE SHEETS

Riken Corporation and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars) (Note 2)
ASSETS			
Current assets:			
Cash and cash equivalents	¥ 6,090	¥ 5,578	\$ 52,051
Time deposits	112	61	957
Notes and accounts receivable	22,299	21,182	190,590
Less allowance for doubtful receivables	(29)	(26)	(248)
Inventories (Note 4)	10,150	9,322	86,752
Deferred tax assets (Notes 1(k) and 7)	1,289	1,000	11,017
Other current assets	724	712	6,188
Total current assets	40,637	37,831	347,325
Non-current assets:			
Property, plant and equipment, at cost (Notes 5 and 6):			
Land	3,337	3,568	28,521
Buildings	9,033	7,210	77,205
Machinery and equipment	17,238	14,074	147,333
Construction in progress	996	1,572	8,513
Property, plant and equipment, net	30,606	26,426	261,590
Investments in unconsolidated subsidiaries and affiliates	6,128	5,978	52,376
Investments in other securities (Notes 1(f) and 3)	3,733	3,373	31,906
Deferred tax assets (Notes 1(k) and 7)	4,908	5,049	41,949
Other non-current assets	2,296	2,088	19,624
Total non-current assets	47,673	42,916	407,462
Total assets	¥88,311	¥80,747	\$ 754,795

The accompanying notes are an integral part of these statements.

CONSOLIDATED BALANCE SHEETS

Riken Corporation and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars) (Note 2)
LIABILITIES, MINORITY INTERESTS AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Notes and accounts payable	¥ 15,726	¥ 13,300	\$ 134,410
Short-term debt (Note 6)	8,170	8,425	69,829
Current portion of long-term debt (Note 6)	1,526	1,200	13,043
Accrued income taxes (Note 7)	2,415	1,050	20,641
Accrued expenses and other current liabilities (Note 8)	7,023	8,113	60,026
Total current liabilities	34,863	32,090	297,974
Long-term liabilities:			
Long-term debt (Note 6)	5,575	7,069	47,650
Deferred tax liabilities (Notes 1(k) and 7)	18	3	154
Accrued retirement benefits (Notes 1(j) and 9)	4,151	4,758	35,479
Accrued retirement benefits to directors and statutory auditors (Notes 1(j) and 9)	280	263	2,393
Excess of net assets acquired over cost	4	16	34
Other long-term liabilities	66	38	564
Total long-term liabilities	10,095	12,150	86,282
Minority interests in consolidated subsidiaries	1,755	1,252	15,000
Shareholders' equity (Note 10):			
Common stock:			
Authorized - 196,525,000 shares			
Issued - 106,484,667 shares at March 31, 2006 and 2005	8,573	8,573	73,274
Capital surplus	6,613	6,608	56,521
Retained earnings	27,182	22,611	232,325
Unrealized holding gain on other securities (Notes 1(f) and 3)	467	260	3,991
Translation adjustments (Note 1(c))	(870)	(1,945)	(7,436)
Less treasury stock, at cost	(369)	(853)	(3,154)
Total shareholders' equity	41,596	35,254	355,521
Contingent liabilities (Note 12)			
Total liabilities, minority interests and shareholders' equity	¥ 88,311	¥ 80,747	\$ 754,795

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF INCOME

Riken Corporation and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars) (Note 2)
Net sales	¥ 88,675	¥ 78,429	\$ 757,906
Cost of sales	69,162	60,776	591,128
Gross profit	19,512	17,652	166,769
Selling, general and administrative expenses	11,654	10,809	99,607
Operating income	7,857	6,842	67,154
Other income (expenses):			
Interest and dividend income	151	116	1,291
Interest expense	(226)	(255)	(1,932)
Equity in earnings of investees	1,340	1,106	11,453
Loss on disposal of inventories	(162)	(100)	(1,385)
Gain on sales of fixed assets	38	101	325
Gain on reversal of allowance for doubtful receivables	7	50	60
Loss on disposal of fixed assets	(145)	(160)	(1,239)
Retirement benefits to directors and statutory auditors	(29)	(209)	(248)
Loss on impairment of assets	(148)	-	(1,265)
Other, net	580	23	4,957
Income before income taxes and minority interests	9,264	7,515	79,179
Income taxes (Notes 1(k) and 7):			
Current	3,439	2,066	29,393
Deferred	(238)	380	(2,034)
	3,201	2,447	27,359
Minority interests in earnings of consolidated subsidiaries	(404)	(70)	(3,453)
Net income (Note 15)	¥ 5,659	¥ 4,998	\$ 48,368

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Riken Corporation and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars) (Note 2)
Common stock			
Balance at beginning of year	¥ 8,573	¥ 8,573	\$ 73,274
Balance at end of year	¥ 8,573	¥ 8,573	\$ 73,274
Capital surplus			
Balance at beginning of year	¥ 6,608	¥ 6,605	\$ 56,479
Add:			
Gain on sales of treasury stock	4	3	34
Balance at end of year	¥ 6,613	¥ 6,608	\$ 56,521
Retained earnings			
Balance at beginning of year	¥ 22,611	¥ 18,521	\$ 193,256
Add:			
Net income	5,659	4,998	48,368
Other adjustment	3	0	26
Deduct:			
Cash dividends applicable to the year	(1,042)	(883)	(8,906)
Bonuses to directors and statutory auditors	(25)	(25)	(214)
Adjustments for inclusion in or exclusion from consolidation or equity method of accounting	(23)	-	(197)
Balance at end of year	¥ 27,182	¥ 22,611	\$ 232,325
Unrealized holding gain on other securities			
Balance at beginning of year	¥ 260	¥ 141	\$ 2,222
Net change during the year	207	119	1,769
Balance at end of year (Notes 1(f) and 3)	¥ 467	¥ 260	\$ 3,991
Translation adjustments			
Balance at beginning of year	¥ (1,945)	¥ (1,969)	\$ (16,624)
Net change during the year	1,075	23	9,188
Balance at end of year (Note 1(c))	¥ (870)	¥ (1,945)	\$ (7,436)
Treasury stock			
Balance at beginning of year	¥ (853)	¥ (983)	\$ (7,291)
Net change during the year	484	129	4,137
Balance at end of year	¥ (369)	¥ (853)	\$ (3,154)

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Riken Corporation and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars) (Note 2)
Operating activities			
Income before income taxes and minority interests	¥ 9,264	¥ 7,515	\$ 79,179
Depreciation and amortization	4,601	4,194	39,325
Loss on impairment of assets	148	–	1,265
Equity in earnings of investees	(1,340)	(1,106)	(11,453)
(Reversal of) provision for accrued retirement benefits	(723)	(122)	(6,179)
Reversal of allowance for doubtful receivables	0	(17)	0
Gain on sales of fixed assets	(38)	(101)	(325)
Loss on disposal of fixed assets	145	160	1,239
Increase in notes and accounts receivable	(1,154)	(2,039)	(9,863)
Increase in inventories	(673)	(1,684)	(5,752)
Increase in notes and accounts payable	1,358	2,054	11,607
Other, net	(979)	1,511	(8,368)
Subtotal	10,609	10,365	90,675
Interest received	152	116	1,299
Interest paid	(228)	(257)	(1,948)
Income taxes paid	(2,090)	(2,676)	(17,863)
Net cash provided by operating activities	8,442	7,547	72,154
Investing activities			
Increase in property, plant and equipment	(6,373)	(4,368)	(54,470)
Proceeds from sales of property, plant and equipment	406	141	3,470
Increase in investments in securities	(11)	(1,190)	(94)
Proceeds from sales of investments in securities	1	2	9
Other, net	(264)	(12)	(2,256)
Net cash used in investing activities	(6,241)	(5,427)	(53,342)
Financing activities			
Proceeds from short-term bank loans	5,311	5,860	45,393
Repayment of short-term bank loans	(5,664)	(6,859)	(48,410)
Repayment of long-term bank loans	(1,216)	(1,210)	(10,393)
Increase in treasury stock	(58)	(34)	(496)
Proceeds from sales of treasury stock	547	166	4,675
Cash dividends paid	(1,043)	(882)	(8,915)
Other, net	(10)	–	(85)
Net cash used in financing activities	(2,134)	(2,959)	(18,239)
Effect of exchange rate changes on cash and cash equivalents	379	(103)	3,239
Net increase (decrease) in cash and cash equivalents	446	(942)	3,812
Cash and cash equivalents at beginning of year	5,578	6,520	47,675
Increase in cash and equivalents arising from inclusion in consolidation	66	–	564
Cash and cash equivalents at end of year	¥ 6,090	¥ 5,578	\$ 52,051

The accompanying notes are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Riken Corporation and Consolidated Subsidiaries
March 31, 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) BASIS OF PRESENTATION

Riken Corporation (the "Company") and its domestic subsidiaries maintain their books of account in conformity with the financial accounting standards of Japan, and its foreign subsidiaries maintain their books of account in conformity with those of their countries of domicile.

The accompanying consolidated financial statements of the Company and consolidated subsidiaries are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company as required by the Securities and Exchange Law of Japan.

As permitted by the regulations under the Securities and Exchange Law, amounts of less than one million yen have been omitted. As a result, the totals shown in the accompanying consolidated financial statements (both in yen and in U.S. dollars) do not necessarily agree with the sums of the individual amounts.

(b) PRINCIPLES OF CONSOLIDATION AND ACCOUNTING FOR INVESTMENTS IN UNCONSOLIDATED SUBSIDIARIES AND AFFILIATED COMPANIES

The accompanying consolidated financial statements include the accounts of the Company and any significant subsidiaries and affiliates which it controls directly or indirectly. Subsidiaries and affiliates over which the Company exercises significant influence in terms of their operating and financial policies have been included in the consolidated financial statements on an equity basis. All significant intercompany balances and transactions have been eliminated.

The excess of cost over the underlying equity in net assets at the dates of acquisition of the major consolidated subsidiaries is charged to income over a five-year period by the straight-line method.

Investments in unconsolidated subsidiaries and affiliates, not accounted for by the equity method, are stated at cost or less.

(c) TRANSLATION OF FOREIGN CURRENCIES

Accounts of foreign consolidated subsidiaries are translated into yen as follows: all assets, liabilities, retained earnings at the end of the year and items, including net income, in the statement of income, at the rate of exchange in effect at the year end; capital stock, at historical rates, and dividends paid, at the rate of exchange in effect when paid.

The Company has presented translation adjustments as a component of shareholders' equity and minority interests in consolidated subsidiaries (instead of as a component of assets or liabilities) in the accompanying consolidated financial statements.

(d) APPROPRIATION OF RETAINED EARNINGS

Cash dividends paid, transfers to the legal reserve and bonuses to directors and statutory auditors are recorded in the financial year in which the proposed appropriations of retained earnings are approved by the Board of Directors and/or shareholders.

(e) CASH EQUIVALENTS

The Company and its consolidated subsidiaries substantially consider all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

(f) SECURITIES

Securities other than those of subsidiaries and affiliates are classified into three categories: trading, held-to-maturity or other securities. Trading securities are carried at fair value and held-to-maturity securities are carried at amortized cost. Marketable securities classified as other securities are carried at fair value with any changes in unrealized gain or loss, net of the applicable income taxes, included directly in shareholders' equity. Non-marketable securities classified as other securities are carried at cost. Cost of securities sold is determined by the moving average method.

(g) INVENTORIES

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

(h) PROPERTY, PLANT AND EQUIPMENT AND DEPRECIATION

Depreciation of buildings and of machinery and equipment is determined primarily by the declining-balance method, except for buildings acquired in Japan subsequent to March 31, 1998 on which depreciation is computed by the straight-line method, at rates based on the estimated useful lives of the respective assets.

(i) LEASES

Noncancelable leases are primarily accounted for as operating leases (whether such leases are classified as operating or finance leases) except that

lease agreements which stipulate the transfer of ownership of the leased assets to the lessee are accounted for as finance leases.

(j) RETIREMENT BENEFITS

Accrued retirement benefits at March 31, 2006 and 2005 have been provided principally at an amount calculated based on the retirement benefit obligation and the fair value of the pension plan assets as of the balance sheet date, as adjusted for unrecognized actuarial gain or loss and unrecognized prior service cost. The retirement benefit obligation is attributed to each period by the straight-line method over the estimated years of service of the eligible employees. Unrecognized actuarial gain and loss are amortized in the year following the year in which the gain or loss is recognized by the straight-line method over periods (principally 10 years) which are shorter than the average remaining years of service of the employees.

In prior years, the Company expensed retirement benefits to directors and statutory auditors when paid. Effective the semiannual period ended September 30, 2004, the Company began accruing retirement benefits to directors and statutory auditors at the full amount which would be

required to be paid if all directors and statutory auditors retired at the balance sheet date based on the Company's internal regulations. This change in method of accounting was made in order to reflect a more appropriate cost allocation to each period and to enhance the Company's financial position. The effect of this change was to decrease net income by ¥250 million and to increase selling, general and administrative expenses by ¥41 million and other expenses by ¥209 million for the year ended March 31, 2005.

See Note 9 for the method of accounting for the corporate portion of the retirement benefit obligation under the Welfare Pension Fund Plan.

(k) INCOME TAXES

Deferred tax assets and liabilities are determined based on the differences between financial reporting and the tax bases of the assets and liabilities and are measured using the enacted tax rates and laws which will be in effect when the differences are expected to reverse.

(l) RESEARCH AND DEVELOPMENT COSTS

Research and development costs are charged to income when incurred.

as a representation that yen have been, could have been, or could in the future be, converted into U.S. dollars at that or any other rate.

2. U.S. DOLLAR AMOUNTS

The translation of yen amounts into U.S. dollar amounts is included solely for convenience and has been made, as a matter of arithmetic computation only, at ¥117 = U.S.\$1.00, the approximate rate of exchange prevailing on March 31, 2006. The translation should not be construed

3. SECURITIES

(a) Information regarding marketable securities classified as other securities at March 31, 2006 is as follows:

March 31, 2006						
	Acquisition cost	Carrying value	Unrealized gain (loss)	Acquisition cost	Carrying value	Unrealized gain (loss)
	(Millions of yen)			(Thousands of U.S. dollars)		
Securities whose carrying value exceeds their acquisition cost:						
Stock	¥ 282	¥ 1,097	¥ 814	\$ 2,410	\$ 9,376	\$ 6,957
Subtotal	282	1,097	814	2,410	9,376	6,957
Securities whose acquisition cost exceeds their carrying value:						
Stock	3	3	(0)	26	26	(0)
Subtotal	3	3	(0)	26	26	(0)
Total	¥ 286	¥ 1,100	¥ 814	\$ 2,444	\$ 9,402	\$ 6,957

(b) Sales of securities classified as other securities and the related aggregate gain and loss at March 31, 2006 were as follows:

March 31, 2006						
	Sales	Aggregate gain	Aggregate loss	Sales	Aggregate gain	Aggregate loss
	(Millions of yen)			(Thousands of U.S. dollars)		
	¥ 1	¥ 0	¥ —	\$ 9	\$ 0	\$ —

(c) The carrying value and details of securities with no determinable fair value at March 31, 2006 are summarized as follows:

	Carrying value	
	(Millions of yen)	(Thousands of U.S. dollars)
Held-to-maturity debt securities:		
Other	¥ —	\$ —
Other securities:		
Unlisted securities (except for securities traded on the over-the-counter market)	2,629	22,470
Others	2	17

(d) Information regarding marketable securities classified as other securities at March 31, 2005 is as follows:

	March 31, 2005		
	Acquisition	Carrying value	Unrealized gain (loss)
	(Millions of yen)		
Securities whose carrying value exceeds their acquisition cost:			
Stock	¥ 251	¥ 727	¥ 476
Subtotal	251	727	476
Securities whose acquisition cost exceeds their carrying value:			
Stock	33	22	(10)
Subtotal	33	22	(10)
Total	¥ 284	¥ 749	¥ 465

(e) Sales of securities classified as held-to-maturity debt securities and the related aggregate cost, gain and loss at March 31, 2005 were as follows:

March 31, 2005		
Sales	Cost	Gain and loss
(Millions of yen)		
¥ 2	¥ 2	¥ —

(f) The carrying value and details of securities not carried at fair value at March 31, 2005 are summarized as follows:

Carrying value	
(Millions of yen)	
Held-to-maturity debt securities:	
Others	¥ —
Other securities:	
Unlisted securities (except for securities traded on the over-the-counter market)	2,620
Others	3

4. INVENTORIES

Inventories at March 31, 2006 and 2005 were as follows:

	March 31,		
	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Finished products	¥ 2,922	¥ 2,750	\$ 24,974
Goods for resale	1,544	1,111	13,197
Work in process	4,064	4,201	34,735
Other	1,620	1,259	13,846
	¥ 10,150	¥ 9,322	\$ 86,752

5. DEPRECIATION

Depreciation of property, plant and equipment for the years ended March 31, 2006 and 2005 amounted to ¥4,448 million (\$38,017 thousand) and ¥4,021 million, respectively.

Accumulated depreciation of property, plant and equipment at March 31, 2006 and 2005 amounted to ¥65,442 million (\$559,333 thousand) and ¥62,883 million, respectively.

6. SHORT-TERM DEBT AND LONG-TERM DEBT

At March 31, 2006 and 2005, short-term debt and the current portion of long-term debt consisted of the following:

	March 31,		
	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Loans, principally from banks	¥ 8,170	¥ 8,425	\$ 69,829
Current portion of long-term debt	1,526	1,200	13,043
	¥ 9,697	¥ 9,625	\$ 82,880

The annual interest rates applicable to short-term debt outstanding at March 31, 2006 and 2005 ranged principally from 0.54 percent to 6.20 percent and from 0.58 percent to 8.17 percent, respectively.

At March 31, 2006 and 2005, long-term debt consisted of the following:

	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Secured loans from banks, insurance companies, due through 2011 at interest rates ranging from 4.40 percent to 4.72 percent	¥ 171	¥ 274	\$ 1,462
Unsecured loans from banks, insurance companies and others due through 2018 at interest rates ranging from 0.23 percent to 6.00 percent	6,930	7,995	59,231
	7,101	8,270	60,692
Less current portion	(1,526)	(1,200)	(13,043)
	¥ 5,575	¥ 7,069	\$ 47,650

The maturities of long-term debt are summarized as follows:

Year ending March 31,

	(Millions of yen)	(Thousands of U.S. dollars)
2007	¥ 1,526	\$ 13,043
2008	1,167	9,974
2009	4,304	36,786
2010 and thereafter	104	889
	¥ 7,101	\$ 60,692

The assets pledged as collateral for short-term debt of ¥588 million (\$5,026 thousand) and long-term debt of ¥171 million (\$1,462 thousand) at March 31, 2006 and 2005 were as follows:

	March 31,		
	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Property, plant and equipment, at net book value	¥ 2,140	¥ 1,964	\$ 18,291
Other	35	25	299
	¥ 2,176	¥ 1,991	\$ 18,598

7. INCOME TAXES

Income taxes applicable to the Company and its domestic subsidiaries comprise corporation tax, inhabitants' taxes and enterprise tax which, in the aggregate, resulted in a statutory tax rate of 40.5 percent for 2006 and 2005.

Income taxes of the overseas subsidiaries are based generally on the tax rates applicable in their countries of incorporation.

The significant components of deferred tax assets and liabilities at March 31, 2006 and 2005 were as follows:

	March 31,		
	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Deferred tax assets:			
Current assets:			
Accrued bonuses	¥ 859	¥ 778	\$ 7,342
Accrued enterprise tax	162	79	1,385
Other, net	353	219	3,017
Valuation allowance	(86)	(76)	(735)
Total deferred tax assets (current)	¥ 1,289	¥ 1,000	\$ 11,017
Non-current assets:			
Accrued retirement benefits	¥ 6,618	¥ 6,595	\$ 56,564
Depreciation	59	63	504
Loss carryforward	—	14	—
Accrued retirement benefits to directors and statutory auditors	113	106	966
Other, net	333	331	2,846
Valuation allowance	(307)	(309)	(2,624)
Elimination of deferred tax liabilities (non-current)	(1,908)	(1,753)	(16,308)
Total deferred tax assets (non-current)	¥ 4,908	¥ 5,049	\$ 41,949
Deferred tax liabilities:			
Current liabilities			
	¥ —	¥ —	\$ —
Non-current liabilities:			
Gain on contribution of securities to retirement benefit trust	¥ (1,497)	¥ (1,472)	\$(12,795)
Depreciation	(60)	(66)	(513)
Other, net	(368)	(217)	(3,145)
Elimination to deferred tax assets (non-current)	1,908	1,753	16,308
Total deferred tax liabilities (non-current)	¥ (18)	¥ (3)	\$ (154)

The effective tax rates reflected in the consolidated statement of income for the years ended March 31, 2006 and 2005 differ from the statutory tax rates for the following reasons:

	2006	2005
Statutory tax rates	40.5%	40.5%
Effect of:		
Expenses not deductible for income tax purposes	0.3	0.3
Dividend income deductible for income tax purposes	(0.4)	(0.6)
Per capita portion of inhabitants' taxes	0.3	0.3
Differences in tax rates applicable to overseas subsidiaries	(1.9)	(1.1)
Equity in earnings of investees	(5.9)	(6.0)
Other, net	1.7	(0.8)
Effective tax rates	34.6%	32.6%

8. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

At March 31, 2006 and 2005, accrued expenses and other current liabilities consisted of the following:

	March 31,		
	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Accrued bonuses	¥ 2,109	¥ 1,921	\$ 18,026
Other	4,914	6,191	42,000
	¥ 7,023	¥ 8,113	\$ 60,026

9. RETIREMENT BENEFIT PLANS

The Company has defined benefit plans, i.e., welfare pension fund plans (WFPF), tax-qualified pension plans and lump-sum payment plans, covering substantially all employees who are entitled to lump-sum or annuity payments, the amounts of which are determined by reference to their basic rates of pay, length of service, and the conditions under which termination occurs. In addition, domestic subsidiaries have primarily defined

benefit plans, funded non-contributory tax-qualified, and lump-sum payments. Certain overseas subsidiaries have defined benefit plans.

The following table sets forth the funded and accrued status of the plans, and the amounts recognized in the consolidated balance sheet at March 31, 2006 and 2005 for the Company's and the subsidiaries' defined benefit plans:

	March 31,		
	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Retirement benefit obligation	¥ (23,709)	¥ (23,177)	\$ (202,641)
Plan assets at fair value	28,893	20,020	246,949
Unfunded retirement benefit obligation	5,183	(3,157)	44,299
Unrecognized actuarial gain or loss	(9,154)	(735)	(78,239)
Unrecognized prior service cost	(180)	(865)	(1,538)
Accrued retirement benefits	¥ (4,151)	¥ (4,758)	\$ (35,479)

On February 1, 2005, the Company received approval from the Minister of Health, Labor and Welfare with respect to its application for exemption from the obligation for benefits related to past employee servic-

es under the substitutional portion of the WFPF. The remaining corporate portion of the WFPF is transferred to a corporate defined benefit pension plan.

The components of retirement benefit expenses for the years ended March 31, 2006 and 2005 are outlined as follows:

	March 31,		
	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Service cost	¥ 682	¥ 1,044	\$ 5,829
Interest cost	320	386	2,735
Amortization of actuarial gain or loss	75	157	641
Past service cost	(89)	66	(761)
Other	41	40	350
Total	¥1,029	¥1,694	\$8,795

The assumptions used in accounting for the above plans were as follows:

	March 31,	
	2006	2005
Discount rates	1.7%	1.7%
Expected rates of return on plan assets	0.0%	0.0%

10. SHAREHOLDERS' EQUITY

The Commercial Code of Japan (the "Code") provides that an amount equal to at least 10% of the amounts to be disbursed as distributions of earnings be appropriated to the legal reserve until the sum of the legal reserve and additional paid-in capital equals 25% of the common stock account. The Code also stipulates that, to the extent that the sum of the additional paid-in capital account and the legal reserve exceeds 25% of the common stock account, the amount

of any such excess is available for appropriation by resolution of the shareholders. Retained earnings also include retained earnings appropriated for special reserves in accordance with the Special Taxation Measures Law and the Commercial Code of Japan. The reserves are deducted from taxable income when provided and are to be reversed to taxable income in subsequent years through direct appropriations of retained earnings.

11. RESEARCH AND DEVELOPMENT COSTS

Research and development costs included in selling, general and administrative expenses and manufacturing costs for the

years ended March 31, 2006 and 2005 amounted to ¥1,466 million (\$12,530 thousand) and ¥1,359 million, respectively.

12. CONTINGENT LIABILITIES

At March 31, 2006 and 2005, the Company and its consolidated subsidiaries had the following contingent liabilities:

	March 31,		
	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
As endorser of trade notes discounted and endorsed	¥ 177	¥ 364	\$ 1,513
As guarantor of transferred accounts receivable	209	197	1,786
As guarantor of indebtedness of employees	126	136	1,077
	¥ 512	¥ 697	\$ 4,376

13. LEASES

The following *pro forma* amounts represent the acquisition costs, accumulated depreciation and net book value of the leased properties at March 31, 2006 and 2005, which

would have been reflected in the consolidated balance sheets if finance lease accounting had been applied to the finance leases currently accounted for as operating leases:

	March 31,		
	2006	2005	2006
	(Millions of yen)		(Thousands of U.S. dollars)
Acquisition costs:			
Machinery and equipment	¥ 1,446	¥ 1,687	\$ 12,359
Other assets	61	95	521
	¥ 1,508	¥ 1,783	\$ 12,889
Accumulated depreciation:			
Machinery and equipment	¥ 972	¥ 1,091	\$ 8,308
Other assets	36	56	308
	¥ 1,010	¥ 1,148	\$ 8,632
Net book value:			
Machinery and equipment	¥ 472	¥ 595	\$ 4,034
Other assets	25	38	214
	¥ 498	¥ 634	\$ 4,256

Lease payments relating to finance leases accounted for as operating leases amounted to ¥216 million (\$1,846 thousand) and ¥253 million for the years ended March 31, 2006 and 2005, respectively which were almost equal to the depreciation expense of the leased assets computed by the straight-

line method over the lease terms,

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2006 for finance leases accounted for as operating leases are summarized as follows:

Year ending March 31,

	(Millions of yen)	(Thousands of U.S. dollars)
2007	¥ 173	\$ 1,479
2008 and thereafter	¥ 324	2,769
Total	¥ 498	\$ 4,256

14. DERIVATIVES

The Company enters into foreign forward exchange contracts to reduce its exposure to adverse fluctuation in foreign exchange rates relating to receivables and payables denominated in foreign currencies. In addition, the Company enters into interest-rate swap agreements to reduce its exposure to

adverse fluctuation in interest rates relating to long-term debt.

Disclosure of fair value information for interest-related derivatives positions has been omitted since all derivatives were accounted for as hedges at March 31, 2006 and 2005.

15. AMOUNTS PER SHARE

The computation of basic net income per share is based on the weighted-average number of shares of common stock outstanding during each year. If applicable, diluted net income per share is computed based on the weighted-average number of shares of common stock outstanding each year after giving effect to the dilutive poten-

tial of the shares of common stock to be issued pursuant to the stock option plan.

Cash dividends per share represent dividends declared as applicable to the year.

Net assets per share are based on the number of shares outstanding at the year end.

	2006	2005	2006
	(yen)		(U.S. dollars)
Net income:			
Basic	¥ 53.55	¥ 47.86	\$ 0.458
Diluted	53.43	47.78	0.457
Net assets	393.83	337.98	3.366
Cash dividends applicable to the year	12.00	10.00	0.103

16. SEGMENT INFORMATION

(a) Business segments

Effective the year ended March 31, 2006, the Company and its consolidated subsidiaries have adopted two new business segments, "Automobile and Machinery Parts" and "Other." This change in segmentation was made in order to reflect the increase in sales of piston rings and seal rings for ships and vessels, and construction and farm machinery, and to enhance the control over production of piston rings and seal rings for automobiles and machinery referred to above with the related manufacturing processes.

The business segment information of the Company and its consolidated subsidiaries for the years ended March 31, 2006 and 2005 is summarized as follows:

Year ended March 31, 2006					
	Automobile and machinery parts	Other	Total	Eliminations or corporate	Consolidated
(Millions of yen)					
I. Sales:					
Sales to third parties	¥ 74,255	¥ 14,420	¥ 88,675	¥ —	¥ 88,675
Intersegment sales and transfers	27	1,084	1,111	(1,111)	—
Total	74,282	15,504	89,787	(1,111)	88,675
Operating expenses	68,026	13,782	81,808	(991)	80,817
Operating income	¥ 6,256	¥ 1,721	¥ 7,978	¥ (120)	7,857
II. Assets, depreciation expenses, capital expenditures:					
Assets	¥ 65,654	¥ 11,202	¥ 76,857	¥ 11,454	¥ 88,311
Depreciation expenses	¥ 4,148	¥ 242	¥ 4,391	¥ 189	¥ 4,580
Loss on impairment of assets	¥ 92	¥ 6	¥ 99	¥ 49	¥ 148
Capital expenditures	¥ 7,912	¥ 353	¥ 8,265	¥ 288	¥ 8,554

Year ended March 31, 2006					
	Automobile and machinery parts	Other	Total	Eliminations or corporate	Consolidated
(Thousands of U.S. dollars)					
I. Sales:					
Sales to third parties	\$ 634,658	\$ 123,248	\$ 757,906	\$ —	\$ 757,906
Intersegment sales and transfers	231	9,265	9,496	(9,496)	—
Total	634,889	132,513	767,410	(9,496)	757,906
Operating expenses	581,419	117,795	699,214	(8,470)	690,744
Operating income	\$ 53,470	\$ 14,709	\$ 68,188	\$ (1,026)	\$ 67,154
II. Assets, depreciation expenses, capital expenditures:					
Assets	\$ 561,145	\$ 95,744	\$ 656,897	\$ 97,897	\$ 754,795
Depreciation expenses	\$ 35,453	\$ 2,068	\$ 37,530	\$ 1,615	\$ 39,145
Loss on impairment of assets	\$ 786	\$ 51	\$ 846	\$ 419	\$ 1,265
Capital expenditures	\$ 67,624	\$ 3,017	\$ 70,641	\$ 2,462	\$ 73,111

In prior years, the business segments were "Automobile," "Construction" and "Other." Business segment information based on the prior years' segmentation for the years ended March 31, 2006 and 2005 is summarized as follows:

Year ended March 31, 2006						
	Automobile	Construction	Other	Total	Eliminations or corporate	Consolidated
(Millions of yen)						
I. Sales:						
Sales to third parties	¥ 64,558	¥ 4,265	¥ 19,851	¥ 88,675	¥ —	¥ 88,675
Intersegment sales and transfers	27	0	1,084	1,111	(1,111)	—
Total	64,586	4,265	20,935	89,787	(1,111)	88,675
Operating expenses	60,439	3,870	17,499	81,808	(991)	80,817
Operating income	¥ 4,146	¥ 394	¥ 3,436	¥ 7,978	¥ (120)	¥ 7,857

Year ended March 31, 2006

	Automobile	Construction	Other	Total	Eliminations or corporate	Consolidated
(Millions of yen)						
II. Assets, depreciation expenses, capital expenditures:						
Assets	¥ 58,115	¥ 6,385	¥ 12,355	¥ 76,857	¥ 11,454	¥ 88,311
Depreciation expenses	¥ 3,649	¥ 229	¥ 511	¥ 4,391	¥ 189	¥ 4,580
Loss on impairment of assets	¥ 82	¥ 5	¥ 11	¥ 99	¥ 49	¥ 148
Capital expenditures	¥ 7,048	¥ 343	¥ 872	¥ 8,265	¥ 288	¥ 8,554

Year ended March 31, 2006

	Automobile	Construction	Other	Total	Eliminations or corporate	Consolidated
(Thousands of U.S. dollars)						
I. Sales:						
Sales to third parties	\$ 551,778	\$ 36,453	\$ 169,667	\$ 757,906	\$ —	\$ 757,906
Intersegment sales and transfers	231	0	9,265	9,496	(9,496)	—
Total	552,017	36,453	178,932	767,410	(9,496)	757,906
Operating expenses	516,573	33,077	149,564	699,214	(8,470)	690,744
Operating income	\$ 35,436	\$ 3,368	\$ 29,368	\$ 68,188	\$ (1,026)	\$ 67,154

II. Assets, depreciation expenses, capital expenditures:

Assets	\$ 496,709	\$ 54,573	\$ 105,598	\$ 656,897	\$ 97,897	\$ 754,795
Depreciation expenses	\$ 31,188	\$ 1,957	\$ 4,368	\$ 37,530	\$ 1,615	\$ 39,145
Loss on impairment of assets	\$ 701	\$ 43	\$ 94	\$ 846	\$ 419	\$ 1,265
Capital expenditures	\$ 60,239	\$ 2,932	\$ 7,453	\$ 70,641	\$ 2,462	\$ 73,111

Year ended March 31, 2005

	Automobile	Construction	Other	Total	Eliminations or corporate	Consolidated
(Millions of yen)						
I. Sales:						
Sales to third parties	¥ 55,745	¥ 5,337	¥ 17,345	¥ 78,429	¥ —	¥ 78,429
Intersegment sales and transfers	—	—	—	—	(—)	—
Total	55,745	5,337	17,345	78,429	(—)	78,429
Operating expenses	51,710	4,913	14,962	71,586	(—)	71,586
Operating income	¥ 4,035	¥ 424	¥ 2,383	¥ 6,842	¥ (—)	¥ 6,842

II. Assets, depreciation expenses, capital expenditures:

Assets	¥ 51,107	¥ 5,861	¥ 12,349	¥ 69,318	¥ 11,428	¥ 80,747
Depreciation expenses	¥ 3,380	¥ 217	¥ 516	¥ 4,115	¥ 58	¥ 4,173
Capital expenditures	¥ 5,127	¥ 158	¥ 411	¥ 5,697	¥ —	¥ 5,697

(b) Geographical segments

The geographical segment information for the Company and its subsidiaries for the years ended March 31, 2006 and 2005 is summarized as follows:

Year ended March 31, 2006

	Japan	Other geographic areas	Total	Eliminations and corporate	Consolidated
(Millions of yen)					
Sales to third parties	¥ 72,005	¥ 16,669	¥ 88,675	¥ —	¥ 88,675
Interarea sales and transfers	7,685	512	8,198	(8,198)	—
Total	79,691	17,182	96,873	(8,198)	88,675
Operating expenses	72,721	16,244	88,965	(8,148)	80,817
Operating income	¥ 6,969	¥ 938	¥ 7,908	¥ (50)	¥ 7,857
Total assets	¥ 62,328	¥ 15,017	¥ 77,345	¥ 10,965	¥ 88,311

Year ended March 31, 2006

	Japan	Other geographic areas	Total	Eliminations and corporate	Consolidated
(Thousands of U.S. dollars)					
Sales to third parties	\$ 615,427	\$ 142,470	\$ 757,906	\$ —	\$ 757,906
Interarea sales and transfers	65,684	4,376	70,068	(70,068)	—
Total	681,120	146,855	827,974	(70,068)	757,906
Operating expenses	621,547	138,838	760,385	(69,641)	690,744
Operating income	\$ 59,564	\$ 8,017	\$ 67,590	\$ (427)	\$ 67,154
Total assets	\$ 532,718	\$ 128,350	\$ 661,068	\$ 93,718	\$ 754,795

Year ended March 31, 2005

	Japan	Other geographic areas	Total	Eliminations and corporate	Consolidated
(Millions of yen)					
Sales to third parties	¥ 65,615	¥ 12,813	¥ 78,429	¥ —	¥ 78,429
Interarea sales and transfers	6,512	470	6,982	(6,982)	—
Total	72,128	13,284	85,412	(6,982)	78,429
Operating expenses	65,962	12,688	78,650	(7,063)	71,586
Operating income	¥ 6,165	¥ 595	¥ 6,761	¥ 80	¥ 6,842
Total assets	¥ 59,644	¥ 9,674	¥ 69,318	¥ 11,428	¥ 80,747

(c) Overseas sales

Overseas sales, which include export sales of the Company and its domestic subsidiaries and sales (other than exports to Japan) of the foreign subsidiaries, for the years ended March 31, 2006 and 2005 are summarized as follows:

Year ended March 31, 2006

	Asia	Other	Total
(Millions of yen)			
Overseas sales	¥ 14,562	¥ 13,227	¥ 27,789
Consolidated net sales			¥ 88,675
Overseas sales as a percentage of consolidated net sales	16.4%	14.9%	31.3%

Year ended March 31, 2006

	Asia	Other	Total
(Thousands of U.S. dollars)			
Overseas sales	\$ 124,462	\$ 113,051	\$ 237,513
Consolidated net sales			\$ 757,906
Overseas sales as a percentage of consolidated net sales	16.4%	14.9%	31.3%

Year ended March 31, 2005

	Asia	Other	Total
(Millions of yen)			
Overseas sales	¥ 9,292	¥ 13,060	¥ 22,352
Consolidated net sales			¥ 78,429
Overseas sales as a percentage of consolidated net sales	11.8%	16.7%	28.5%

REPORT OF INDEPENDENT AUDITORS

The Board of Directors

Riken Corporation

We have audited the accompanying consolidated balance sheets of Riken Corporation and consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in yen.

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Riken Corporation and consolidated subsidiaries at 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.

Supplemental Information

As described in Note 16(a), Riken Corporation and its consolidated subsidiaries changed their methods of business segments for the year ended March 31, 2006.

As described in Note 1(j), Riken Corporation changed its method of accounting for retirement benefits to directors and statutory auditors for the year ended March 31, 2005.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 2.

Ernst & Young ShinNihon

June 29, 2006