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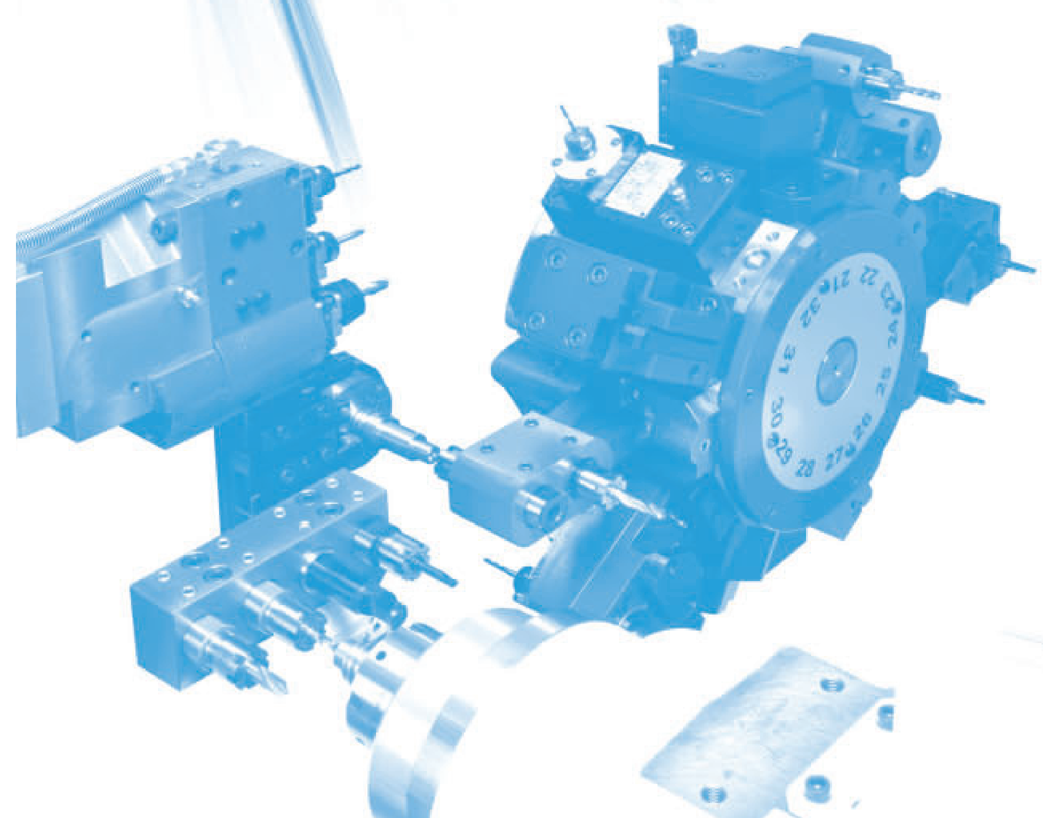
TSUGAMI
ANNUAL REPORT 2007
For the year ended March 31, 2007



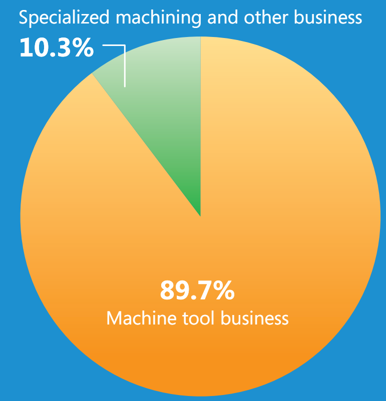
Corporate Profile

Accuracy, Speed and Rigidity
Tsugami is renowned all over the world for its superior precision machine tools.

Tsugami marks the 70th Anniversary in March 2007 since our foundation in 1937. Tsugami as the one of the most experienced machine tool companies in Japan has been supplying “high-accuracy, high-speed and high-rigidity” products as a comprehensive manufacturer of small-sized ultraprecision machine tools.

Tsugami has an advantage in that it can supply many types of machine tools, such as automatic lathes, grinding machines, machining centers and rolling machines, and is capable of proposing a comprehensive production system.

Tsugami supports its customers in various aspects. We can make suggestions to improve a company’s efficiency and reduce its costs using technologies in peripheral devices and tooling. In addition, we offer excellent after-services through our group companies.



Contents

Forward-Looking Statements

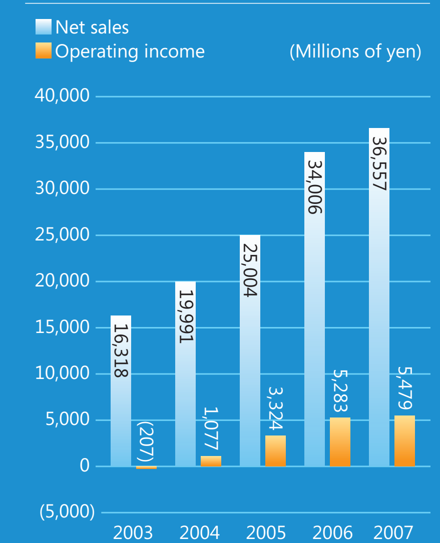
This annual report contains forward-looking statements related to management’s projections about future business conditions. Actual business conditions may differ significantly from management’s expectations and accordingly affect our sales and profitability. Actual results may differ as a result of factors over which we have no control, including unexpected changes in competitive and economic conditions, government regulations, technology and other factors.

Financial Highlights

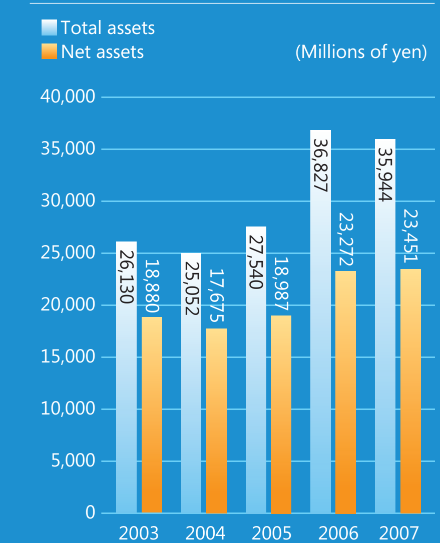
Years ended March 31,	Millions of yen 2006	Millions of yen 2007	Thousands of U.S.dollars 2007
Net sales	¥34,006	¥36,557	$309,676
Operating income	5,283	5,479	46,410
Net income	5,531	3,448	29,204
Operating income to sales ratio (%)	15.5	15.0	15.0
Per share of common stock (Yen or U.S. dollars)			
Net income (Basic)	¥71.38	¥46.36	$0.39
Net assets	306.53	322.67	2.73
At March 31,			
Total assets	¥36,827	¥35,944	$304,481
Net assets	23,272	23,451	198,650
ROA (%)	14.3	15.2	15.2
ROE (%)	26.2	14.8	14.8

Dollar amounts represent translations at the rate of ¥118.05 = U.S.$1, the rate prevailing on March 31, 2007.

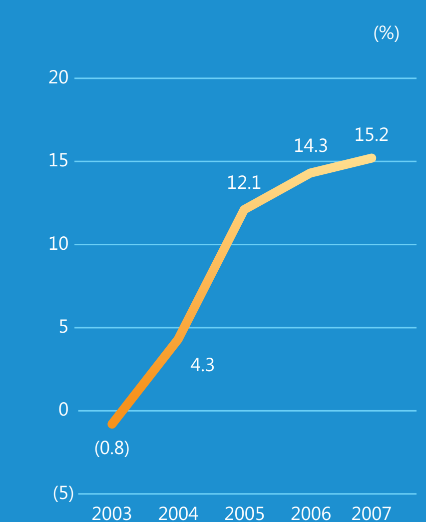
Net sales / Operating income



Total assets / Net assets



ROA



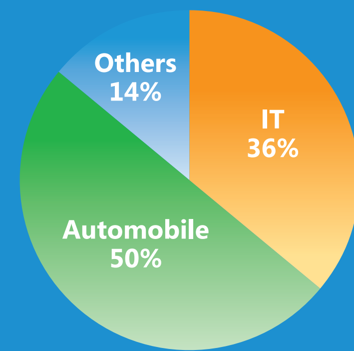
Our Products and Its Superiority

High accuracy and stability even offer 24 hours running operation

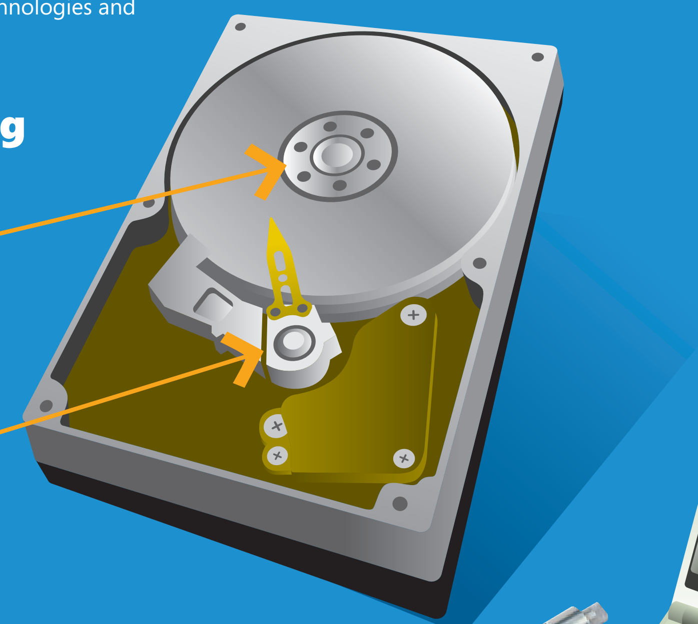
Tsugami's ultraprecise processing technology is so outstanding that it leads the IT industry, an industry in which technology is progressing rapidly. Take the HDDs used in PCs for example, their capacity is increasing year by year while the disks themselves are getting smaller and smaller.

We support this progress in HDD by developing CNC High Precise Automatic Lathes that enable mass processing by the very small unit of less than a micron (submicron). This is how we were able to acquire a large market share in the industry. Demand has been growing in the past few years for the technologies we have cultivated, as measures are sought for automobile engine components to cope with environmental issues, conserve energy and enhance safety. In addition to the above, our strengths include having various peripheral technologies in machine tools, as well as work materials, tooling technologies and tools, which support high precise processing.

Sales Brakedown



HDD FDB parts processing

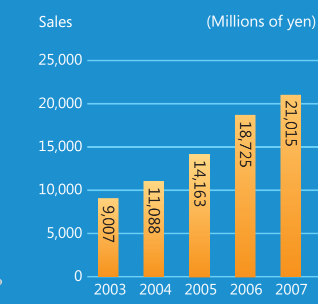


Automotive parts

and more

Main Products

CNC Precision Automatic Lathe

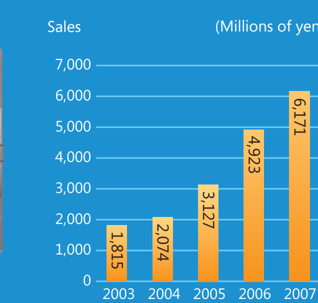


This machine's tools are fitted to minimize any effects resulting from high temperatures, and its cast iron base, with high rigidity, can suppress the vibration that occurs during high-speed processing. Hence, it enables stable and accurate processing for a long time.

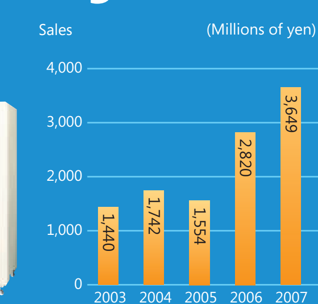
This model is best suited to high-precision mass production of automobile parts, HDD components, office automation equipment, medical and dental equipment, digital cameras, cellular phones and other small parts in a wide range of fields, including optical communications.

CNC Precision Cylindrical Grinding Machine

This machine enables the cylindrical grinding processing of small and medium components in various fields, ranging from unhardened material to highly rigid parts made of hardened steel and ceramics. Equipped with such functions as automatic loading, automatic measuring, and fully automatic processing, the device can handle a variety of items, ranging from single components, such as mold pins, to processed products such as automobile engines, transmissions and oil hydraulic parts, IT-related components and medical and dental equipment. Hence, the machine can meet all the manufacturing needs of our customers.



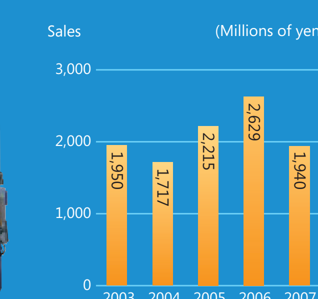
Precision Machining Center



We have a range of machining centers that can carry out various kinds of processing on components, including small aluminum parts for IT-related products such as household electronics and office automation equipment, and steel parts for automobiles and industrial machinery. We will suggest the optimal system for all our models–both the vertical and horizontal types–which have a space-saving design that makes the layout of a plant easy.

Precision Thread Rolling Machine and Other Products

Integrating our own roll dies manufacturing corresponds not only to normal screw or knurl, but also to high-precision lead screws, worms or form rolling.



To Our Shareholders and Other Stakeholders

The Japanese economy remained on a moderate recovery track during the fiscal year under review. This business climate is mainly due to a rise in capital spending reflecting improved corporate earnings, and firmness of consumer spending based on improvement in employment.

In the machine tool industry, the overall level of orders received continued to remain high. Capital spending in the automotive industry, IT companies and general machinery is currently favorable.

Under these circumstances, we achieved record-high sales and profits for the fourth straight business year. Both net sales and ordinary income marked all-time highs in the fiscal year under review.

Business Overview and Results

Q. *Please share with us the overview of earnings for the year ended March 2007.*

A. During fiscal 2006 (the period from April 1, 2006 to March 31, 2007) we released a large quantity of various new products based on our know-how in precision processing, which we have cultivated over many years, and made further efforts to improve productivity and reduce costs. As a result, consolidated net sales for fiscal 2006 increased 7.5% year-on-year to ¥36,557 million. Domestic sales reached ¥21,260 million, up 3.9% year-on-year, and exports grew 12.9% year-on-year to ¥15,297 million. The ratio of exports rose to 41.8% from 39.8% in the previous term.

Operating income increased 3.7% year-on-year to ¥5,479 million, while net income decreased 37.7% year-on-year to ¥3,448 million. The decrease in net income is due to having recorded extraordinary profits on idle land sales in the previous year, as well as being due to having no special tax deductions in the year under review, which means the Company bore the usual tax burden.

Machine tools and Tsugami

Q. *The sales cycle of Tsugami appears to be different from other companies in the machine tool industry. What do you think about it?*

A. What you call machine tools in general have different markets depending on the users. I think that there are different sales cycles for the large, medium and small machine tool markets.

Tsugami belongs to the small machine tool industry, and has expertise in ultraprecision processing. This technology is used in processing electronic parts, with the main market being the ultraprecise parts of personal computers and cellular phones, as well as the precision parts that are needed following the sophistication of automobile engines. Tsugami targets those promising markets in the future, and the Company can be expected to see growing, I believe.

Production System

Q. *Please tell us about your production system and its capacity.*

A. Our production capacity has increased by over 50% compared with the level before the introduction of the new production system. Our existing production facilities can handle output equivalent to annual sales of ¥40-50 billion.

In fiscal 2005, we restructured the production system of the entire Group. We established a new factory in the Nagaoka and Shinshu Plants and in China, introducing state of the art production facilities in five factories altogether. This new production system was completed in November 2005, and integrates the five plants of the group so that they can efficiently operate together with each plant performing the roles assigned to it. Full-scale operations were started in fiscal 2006.

We are making concerted efforts day by day to increase productivity and reduce costs by further pushing forward with in-house production and unit production of parts.

Medium-term Strategies and Measures for Fiscal 2007

Q. *Seeing as the Company completed three company-wide steps–restructuring the group during fiscal 2004, restructuring the production system during fiscal 2005 and releasing a large quantity of new products during fiscal 2006–will you tell us the main measures you plan to implement during fiscal 2007?*

A. Fiscal 2007 will be a year of sales promotion. We have been able to achieve three medium-term targets: restructuring the group through integration and consolidation of consolidated subsidiaries and affiliates, restructuring the production system and releasing a large quantity of new products. The attainment of these goals is one of the points of destination we had envisioned. Ultimately we succeeded in achieving the targets in three years, aided by a strong economy, even though we had once thought it would require about 10 years depending on market conditions.

Our next target is annual sales of 50 billion yen. I believe we will be able to attain the goal in five years, though how many years will be required to achieve the target depends on market conditions. Release of many new products in fiscal 2006 targeted growth fields such as products for automobiles, in which the introduction of information technology (IT) is advancing, FDB and small-sized motors in the electrical machinery industry and high-precision processing of small parts in the telecommunications and medical sectors. What we should do next is expand sales by boosting the sales of such products. In particular, this year we will focus on sales expansion in regions that are expected to grow rapidly from now on.

Q. *Will you tell us the target regions and specific measure of sales expansion?*

A. We will target regions where capital spending is brisk in the precision processing field, mainly the Asian market. In particular, South Korea, where both automotive and IT industries are growing remarkably, is one of the target regions. We set up a branch in Suweon in the southern suburbs of Seoul and started marketing in May 2007. Establishment of an after-sales service is also vital to the sales expansion of machine tools. We station after-sales service personnel in charge of South Korea in Japan, who are ready to fly to South Korea at any time.

In August 2006, we opened in Shanghai an office of Precision Tsugami (China) Corporation, a local unit, to enhance our sales and service systems there.

In Thailand, we raised the number of sales service personnel at Tsugami (Thai) Co., Ltd., an affiliate, to 18 in a bid to enhance our service system for Thailand, Vietnam and other Southeast Asian countries.

In the Philippines, we have concluded a business consignment contract with a local agency concerning after-sales service in the country.

With regard to regions outside Asia, we have concluded a sales contract with a local agency in India, where the automotive industry is expected to grow and the number of inquiries is increasing. We will also continue to stress the European and U.S. markets.

Purchase of Treasury stocks

Q. *Will you tell us about your view of purchase of treasury stocks?*

A. When I took office as president in March 2003, the total number of shares outstanding of Tsugami was approximately 89 million shares.

I thought we would need to improve performance per share since the number of shares outstanding was too large for the sales and asset size of the Company. Therefore, we decided to promote the acquisition of treasury stocks and bought back about 17 million shares from the market, of which 10 million shares were cancelled in November 2006. As a result, we held approximately 7 million shares in treasury as of May 2007 with about 72 million outstanding shares. Since we set the target number of shares outstanding at approximately 70 million as the immediate target, we have almost achieved the target level.

We will flexibly accommodate the number of treasury stocks by watching the status of operations, which are the status of cash flows and capital spending.

Returning Profits to Shareholders

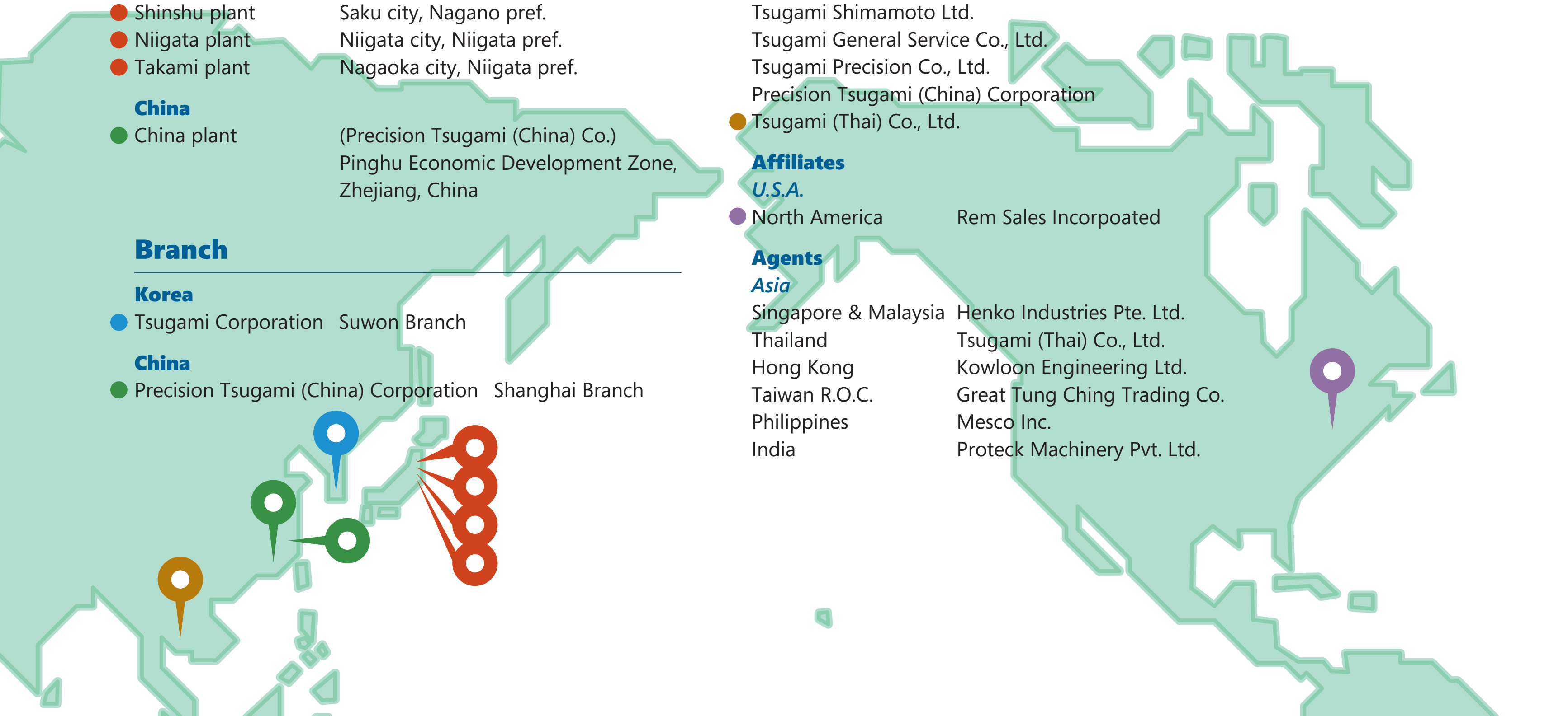
Q. *Please discuss your policy on returning profits to shareholders.*

A. As I described above, we were able to achieve favorable earnings for fiscal 2006, and we paid a dividend of 10 yen per share annually, including a commemorative dividend of 2 yen paid in commemoration of the 70th anniversary of our founding.

For future dividend payments, we will focus not only on making steady dividend payments but also on purchasing common stock in treasury and reinforcing our performance-based dividend policy. I would appreciate continued support and guidance from our shareholders and investors.

Takao Nishijima
Chairman and C.E.O.

Global Network



Plant

Japan

- Nagaoka plant — Nagaoka city, Niigata pref.
- Shinshu plant — Saku city, Nagano pref.
- Niigata plant — Niigata city, Niigata pref.
- Takami plant — Nagaoka city, Niigata pref.

China

- China plant — (Precision Tsugami (China) Co.) Pinghu Economic Development Zone, Zhejiang, China

Branch

Korea

- Tsugami Corporation — Suwon Branch

China

- Precision Tsugami (China) Corporation — Shanghai Branch

Subsidiaries, Affiliates and Agents

Subsidiaries

Tsugami Machinery Co., Ltd.
Tsugami Shimamoto Ltd.
Tsugami General Service Co., Ltd.
Tsugami Precision Co., Ltd.
Precision Tsugami (China) Corporation
Tsugami (Thai) Co., Ltd.

Affiliates

U.S.A.

North America — Rem Sales Incorpoated

Agents

Asia

Singapore & Malaysia	Henko Industries Pte. Ltd.
Thailand	Tsugami (Thai) Co., Ltd.
Hong Kong	Kowloon Engineering Ltd.
Taiwan R.O.C.	Great Tung Ching Trading Co.
Philippines	Mesco Inc.
India	Proteck Machinery Pvt. Ltd.

Nagaoka plant


Shinshu plant


China plant


Niigata plant

Takami plant

Financial Summary

Ten-Year Financial Summary

	Millions of yen										Thousands of U.S. Dollars
Years ended March 31,	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2007
Net sales	20,448	12,035	12,288	21,735	15,577	16,318	19,991	25,004	34,006	36,557	309,676
Operating income (loss)	306	(331)	(631)	1,258	(303)	(207)	1,077	3,324	5,283	5,479	46,410
Operating income (loss) to sales ratio (%)	1.5	(2.7)	(5.1)	5.8	(1.9)	(1.3)	5.4	13.3	15.5	15.0	15.0
Income (loss) before income taxes	(1,999)	(3,190)	(1,166)	1,266	(470)	(856)	(889)	2,934	6,851	5,219	44,209
Net income (loss)	(2,062)	(3,203)	(1,182)	1,180	(427)	(901)	(919)	2,832	5,531	3,448	29,204
At March 31,											
Current assets	22,844	17,319	18,277	22,259	20,207	18,119	17,961	20,498	26,395	25,921	219,574
Current liabilities	6,857	3,260	4,981	9,713	8,042	6,368	6,452	7,646	12,169	11,344	96,100
Total assets	31,402	24,570	25,482	31,481	29,157	26,130	25,052	27,540	36,827	35,944	304,481
Net assets	24,184	20,981	19,719	20,963	19,924	18,880	17,675	18,987	23,272	23,451	198,650

	Yen										U.S. Dollars
Per share of common stock	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2007
Net income (loss)											
Basic	(23.19)	(35.99)	(13.28)	13.28	(4.81)	(10.17)	(10.71)	35.02	71.38	46.36	0.39
Diluted	-	-	-	-	-	-	-	34.99	70.81	46.05	0.39
Cash dividends	-	-	-	-	-	-	-	5.00	8.00	10.00	0.08
Net assets	271.75	235.76	222.74	235.70	224.03	216.12	213.36	243.41	306.53	322.67	2.73

Dollar amounts represent translations at the rate of ¥118.05 = U.S.$1, the rate prevailing on March 31, 2007.

Contents

Financial Review

Business Results

Net sales

Based on the know-how in precision processing that we have cultivated over many years, Tsugami continues to supply high-precision processing machines that are designed to meet the needs of the automotive industry, where measures to cope with environmental issues, conserve energy and enhance safety are required, and likewise to meet the sophisticated needs of IT and other industries. At the same time, the Company introduced various new products to the market. The Company proactively discovered new users and made other sales efforts. As a result, net sales for fiscal 2006 increased 7.5 % year-on-year to ¥36,557 million.

Domestic sales steadily rose 3.9% year-on-year to ¥21,260 million, and exports amounted to ¥15,297 million, up 12.9% year-on-year. As a result, our export ratio grew to 41.8% from 39.8% a year earlier. Sales of the machine tool business increased 12.6% year-on-year to ¥32,775 million. Sales of specialized machining and other business declined 23.0% year-on-year to ¥3,782 million due to the reduction of OEM production.

Profit and loss

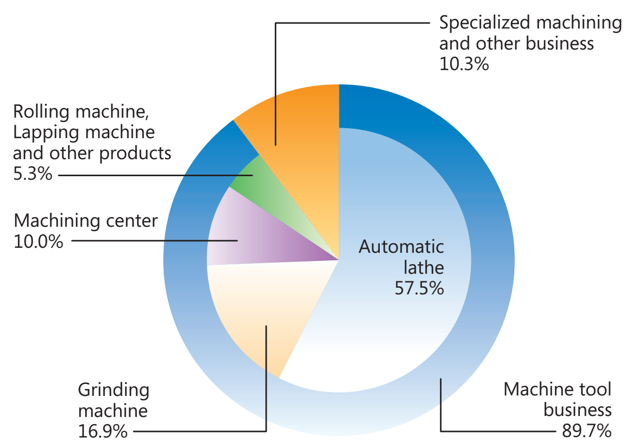
In the year under review, operating income increased 3.7% year-on-year to ¥5,479 million. Net income declined 37.7% year-on-year to ¥3,448 million. The decrease in net income is due to having recorded extraordinary profits on idle land and other sales in the previous year, as well as being due to having no special tax deductions in the year under review, which means the Company bore the usual tax burden.

Result by business segment

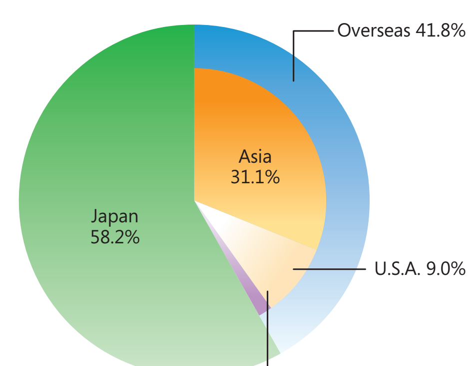
(Millions of yen)

	2005	2006	2007
Machine tool business			
Net sales	21,059	29,097	32,775
Operating income	3,436	4,988	5,653
Specialized machining and other business			
Net sales	3,945	4,909	3,782
Operating income	735	900	585

Sales by business and product



Sales breakdown by region



Cash Flows

Cash and cash equivalents on a consolidated basis for fiscal 2006 decreased 700 million yen from the previous year, and the ending balance was ¥3,497 million.

Cash flows from operating activities

Net cash provided by operating activities increased ¥4,143 million. This was mainly because of an increase in funds due to inflows of ¥5,219 million in income before income taxes, ¥760 million in depreciation and amortization, and a decrease in funds due to an outflow of ¥2,568 million in income tax payments.

Cash flow from investing activities

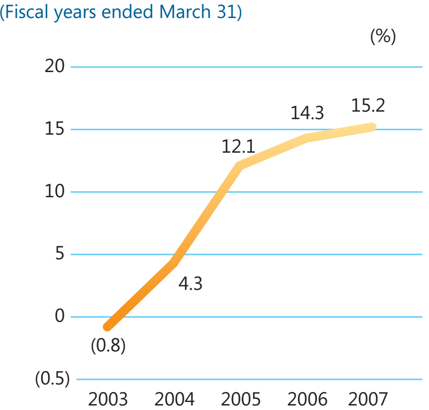
Net cash used in investing activities decreased ¥383 million from the previous year. This was mainly due to an inflow of ¥725 million from sales of properly, plant and equipment and an outflow of ¥1,071 million to fund the purchase of properly, plant and equipment.

Cash flows from financing activities

Net cash used in financing activities decreased ¥3,157 million. This was mainly attributed to an inflow of ¥115 million from sales of common stock in treasury and a decrease in funds due to the outflows of ¥2,595 million and ¥677 million to fund the purchase of common stock in treasury and dividends payments, respectively.

Return on assets

(Fiscal years ended March 31)

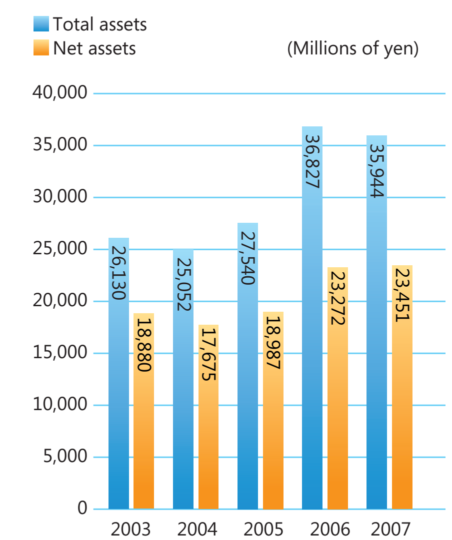


Cash flows indices

	2004	2005	2006	2007
Net worth ratio (%)	70.6	68.9	63.2	65.0
Net worth ratio based on market value (%)	96.9	126.3	195.6	136.5
Number of years for debt redemption	-	-	-	-
Interest coverage ratio	226.26	-	-	-

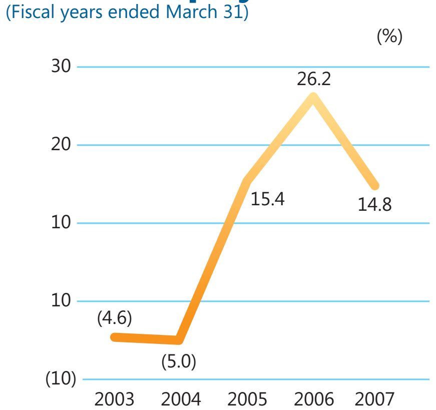
(Notes)
Net worth ratio (%): Net worth/total assets
Net worth ratio on market value (%): Total market capitalization/total assets
Ratio of cash flows to interest-bearing liabilities: Interest-bearing liabilities/cash flows
Interest coverage ratio: Cash flows/interest payment
- All indices were computed using the consolidated financial figures.
- Total market capitalization was computed based on the closing stock price at period-end multiplied by number of outstanding shares at period-end (after deducing treasury stock).
- Cash flows present cash flows from operating activities on the consolidated statements of cash flows. Interest-bearing debts represent all debts on the consolidated balance sheets, including notes receivable discounted, for which interest is paid. In addition, interest payment represents the amount of interest paid on the consolidated statements of cash flows.

Total assets / Net assets



Return on equity

(Fiscal years ended March 31)



Consolidated Balance Sheets

(March 31, 2006 and 2007)

ASSETS

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2007	2007
Current assets:			
Cash and deposits (Note 4)	¥ 2,847	¥ 3,577	$ 30,299
Trade notes and accounts receivable	14,390	14,314	121,258
Inventories (Note 7)	7,935	7,659	64,880
Deferred tax assets (Note 9)	416	385	3,261
Other	886	65	548
Allowance for doubtful accounts	(79)	(79)	(672)
Total current assets	**26,395**	**25,921**	**219,574**
Property, plant and equipment:			
Land	643	598	5,067
Buildings and structures	7,524	7,875	66,710
Machinery and equipment	9,038	8,805	74,583
Other	804	596	11,409
Accumulated depreciation	(10,973)	(10,416)	(94,594)
Net property, plant and equipment	**7,036**	**7,458**	**63,175**
Intangible assets:	17	33	282
Investments and other assets:			
Investment securities (Note 6)	2,628	2,224	18,836
Investments in and advances to unconsolidated subsidiaries and affiliated companies	658	209	1,773
Other	93	99	841
Total investments and other assets	**3,379**	**2,532**	**21,450**
Total fixed assets	**10,432**	**10,023**	**84,907**
Total assets	**¥36,827**	**¥35,944**	**$304,481**

The accompanying notes are an integral part of these financial statements.

LIABILITIES AND NET ASSETS

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2007	2007
Current liabilities:			
Trade notes and accounts payable	¥ 8,975	¥ 9,130	$ 77,337
Income taxes payable	1,760	1,025	8,681
Accrued bonuses	372	345	2,921
Other	1,062	844	7,161
Total current liabilities	**12,169**	**11,344**	**96,100**
Long-term liabilities:			
Deferred tax liabilities (Note 9)	553	270	2,286
Accrued pension and severance costs (Note 8)	695	751	6,360
Retirement benefits for directors and corporate auditors	42	34	289
Other	96	94	796
Total long-term liabilities	**1,386**	**1,149**	**9,731**
Total liabilities	**13,555**	**12,493**	**105,831**
Contingent liabilities (Note 14)			
Net assets (Notes 5, 10, 11, 12 and 19):			
Common stock, no-par-value	10,599	10,599	89,788
Authorized: 320,000,000 shares in 2007 and			
320,000,000 shares in 2006			
Issued: 79,019,379 shares in 2007			
89,019,379 shares in 2006			
Capital surplus	8,011	4,209	35,654
Retained earnings	7,872	10,569	89,529
Shares of common stock in treasury	(4,015)	(2,681)	(22,715)
6,341,667 shares in 2007			
13,099,280 shares in 2006			
Net unrealized gain on investment securities	805	600	5,084
Translation adjustments		61	512
Stock option		94	798
Total net assets	**23,272**	**23,451**	**198,650**
Total liabilities and net assets	**¥36,827**	**¥35,944**	**$304,481**

Consolidated Statements of Income

(Years ended March 31, 2006 and 2007)

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2007	2007
Net sales	¥34,006	¥36,557	$309,676
Cost of sales (Note 15)	25,507	27,326	231,477
Gross profit	8,499	9,231	78,199
Selling, general and administrative expenses (Note 15)	3,216	3,752	31,789
Operating income	5,283	5,479	46,410
Other income (expenses)			
Gain on sales of property, plant and equipment	2,430	121	1,022
Removal expenses of machinery and equipment	(155)	–	–
Loss on disposal of property, plant and equipment	(704)	(88)	(745)
Loss on disposal of inventories	(93)	(55)	(467)
Loss on exchange of bills without L/C	(42)	(71)	(603)
Expenses of lawsuit	–	(87)	(735)
Other	132	(80)	(673)
Income before income taxes	6,851	5,219	44,209
Current income taxes (Note 9)	1,736	1,882	15,945
Deferred	(416)	(111)	(940)
Income Taxes	1,320	1,771	15,005
Net income	¥ 5,531	¥ 3,448	$ 29,204
Per share of common stock (Note 18)	Yen		U.S. dollars (Note 1)
Net assets	¥306.53	¥322.67	$ 2.73
Net income — basic	71.38	46.36	0.39
— diluted	70.81	46.05	0.39
Cash dividends, applicable to earnings of the year	8.00	10.00	0.08

The accompanying notes are an integral part of these financial statements.

Consolidated Statements of Changes in Net Assets

(Years ended March 31, 2006 and 2007)

	Thousands	Millions of yen									
		Owners' equity					Valuation, translation adjustments and others				
	Number of shares of common stock	Common stock	Capital surplus	Retained earnings	Shares of common stock in treasury	Net assets	Net unrealized profit on investment securities	Translation adjustments	Total valuation, translation adjustments and others	Stock option	Total net assets
Balance at March 31, 2005	**89,019**	**¥10,599**	**¥8,013**	**¥ 2,835**	**¥(2,639)**	**¥18,808**	**¥179**	**¥ –**	**¥179**	**¥ –**	**¥18,987**
Cash dividends paid				(465)		(465)					(465)
Bonuses paid to directors and corporate auditors				(29)		(29)					(29)
Net income				5,531		5,531					5,531
Purchase of treasury stock					(1,376)	(1,376)					(1,376)
Loss on disposal of treasury stock			(2)			(2)					(2)
Net changes of items other than net assets							626		626		626
Total changes during the year	–	–	(2)	5,037	(1,376)	3,659	626	–	626	–	4,285
Balance at March 31, 2006	**89,019**	**10,599**	**8,011**	**7,872**	**(4,015)**	**22,467**	**805**	**–**	**805**	**–**	**23,272**
Cash dividends paid				(678)		(678)					(678)
Bonuses paid to directors and corporate auditors				(38)		(38)					(38)
Decrease due to increase in consolidated subsidiary				(35)		(35)					(35)
Net income				3,448		3,448					3,448
Purchase of treasury stock					(2,588)	(2,588)					(2,588)
Loss on disposal of treasury stock			(32)		152	120					120
Retirement of treasury stock	10,000		(3,770)		3,770	–					–
Net changes of items other than owners' equity							(205)	61	(144)	94	(50)
Total changes during the year	10,000	–	(3,802)	2,697	1,334	229	(205)	61	(144)	94	179
Balance at March 31, 2007	**79,019**	**¥10,599**	**¥4,209**	**¥10,569**	**¥(2,681)**	**¥22,696**	**¥600**	**¥61**	**¥661**	**¥94**	**¥23,451**

	Thousands of U.S. dollars (Note 1)									
	Owners' equity					Valuation, translation adjustments and others				
	Common stock	Capital surplus	Retained earnings	Shares of common stock in treasury	Net assets	Net unrealized profit on investment securities	Translation adjustments	Total valuation, translation adjustments and others	Stock option	Total net assets
Balance at March 31, 2006	**$89,788**	**$67,862**	**$66,680**	**$(34,013)**	**$190,317**	**$6,821**	**$ –**	**$6,821**	**$ –**	**$197,138**
Cash dividends paid			(5,739)		(5,739)					(5,739)
Bonuses paid to directors and corporate auditors			(324)		(324)					(324)
Decrease due to increase in consolidated subsidiary			(292)		(292)					(292)
Net income			29,204		29,204					29,204
Purchase of treasury stock				(21,921)	(21,921)					(21,921)
Loss on disposal of treasury stock		(272)		1,283	1,011					1,011
Retirement of treasury stock		(31,936)		31,936	–					–
Net changes of items other than owners' equity						(1,737)	512	(1,225)	798	(427)
Total changes during the year		(32,208)	22,849	11,298	1,939	(1,737)	512	(1,225)	798	1,512
Balance at March 31, 2007	**$89,788**	**$35,654**	**$89,529**	**$(22,715)**	**$192,256**	**$5,084**	**$512**	**$5,596**	**$798**	**$198,650**

The accompanying notes are an integral part of these financial statements.

Consolidated Statements of Cash Flows

(Years ended March 31, 2006 and 2007)

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2007	2007
Cash flows from operating activities:			
Income before income taxes	¥6,851	¥5,219	$44,209
Depreciation and amortization	581	760	6,436
Loss on disposal of inventories	93	55	468
Expenses of lawsuit	–	87	735
Change in allowance for doubtful accounts	(5)	1	7
Change in accrued pension and severance costs	46	55	468
Interest and dividend income	(30)	(35)	(300)
Interest expense	0	0	0
Gain on sales of property, plant and equipment	(2,430)	(121)	(1,022)
Loss on disposal of property, plant and equipment	704	88	745
Change in trade notes and accounts receivable	(3,879)	(182)	(1,539)
Change in inventories	(2,464)	196	1,665
Change in trade notes and accounts payable	2,468	165	1,397
Bonuses paid to directors and corporate auditors	(29)	(38)	(324)
Other	271	443	3,751
Subtotal	2,177	6,693	56,696
Proceeds from interest and dividend income	30	35	301
Payment of interest	(0)	(0)	(0)
Payment of earthquake disaster loss	(104)	–	–
Payment of expenses of lawsuit	–	(17)	(147)
Payment for dismantlement of buildings	(191)	–	–
Payment of removal expenses of machinery and equipment	(155)	–	–
Payment of income taxes	(206)	(2,568)	(21,757)
Net cash provided by operating activities	1,551	4,143	35,093
Cash flows from investing activities:			
Proceeds from time deposits	40	40	339
Payment for time deposits	(50)	(70)	(593)
Payment for purchase of property, plant and equipment	(2,972)	(1,071)	(9,074)
Proceeds from sales of property, plant and equipment	2,113	725	6,141
Payment for purchase of investment securities	(62)	(205)	(1,741)
Proceeds from sales of investment securities	150	201	1,701
Payment for stock purchases of unconsolidated subsidiaries	(160)	–	–
Payment for loans receivable	(123)	–	–
Proceeds from loans receivable	54	0	4
Other	(10)	(3)	(23)
Net cash used in investing activities	(1,020)	(383)	(3,246)
Cash flows from financing activities:			
Proceeds from sales of shares of common stock in treasury	0	115	977
Payment for purchase of shares of common stock in treasury	(1,381)	(2,595)	(21,981)
Dividends payments	(465)	(677)	(5,739)
Net cash used in financing activities	(1,846)	(3,157)	(26,743)
Effect of translation of cash and cash equivalents	–	(2)	(12)
Net increase (decrease) in cash and cash equivalents	(1,315)	601	5,092
Cash and cash equivalents at beginning of year	4,112	2,797	23,691
Cash and cash equivalents of newly consolidated subsidiary	–	99	838
Cash and cash equivalents at end of year (Note 4)	¥2,797	¥3,497	$29,621

The accompanying notes are an integral part of these financial statements.

Notes to Consolidated Financial Statements

Tsugami Co., Ltd. and Consolidated Subsidiaries

1 BASIS OF PRESENTING CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements of Tsugami Co., Ltd. (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. The accounts of overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles prevailing in the respective countries of domicile. Certain reclassifications have been made to present the accompanying consolidated financial statements in a format which is more familiar outside Japan. In addition, the accompanying notes include additional information which is not required under accounting principles and practices generally accepted in Japan. U.S. dollar amounts in the accompanying consolidated financial statements are included solely for convenience, at ¥118.05=U.S.$1, the exchange rate on March 31, 2007. The translation should not be construed as a representation that yen amounts have been or could be converted into U.S. dollars at that or any other rate.

For comparison, certain amounts reported for the previous financial statements are retrospectively adjusted in accordance with changes in classification.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(1) **Principles of consolidation**

The accompanying consolidated financial statements include the accounts of 5 subsidiaries as of March 31, 2006 and 2007. The remaining 2 subsidiaries and 2 affiliates as of March 31, 2006 and 1 subsidiary and 2 affiliates as of March 31, 2007, whose total assets, net sales and net income are immaterial in relation to the comparable amounts in these statements have been excluded.

All significant inter-company transactions, accounts and unrealized profits have been eliminated. Investments in the affiliate and unconsolidated subsidiaries, not significant in amount, are carried at cost or less. Where there has been permanent impairment in the value of investments, the Company has written down such investments.

(2) **Cash and cash equivalents**

Cash and cash equivalents consist of cash on hand, available funds on deposit and short-term, highly liquid investments that are readily convertible to cash and with original maturities of three months or less, and substantially free from price fluctuation risk.

(3) **Securities**

Available-for-sale securities with determinable market value are stated at market value. Net unrealized profit on investment securities is accounted for as a component of net assets. Cost of securities sold is determined by the moving average method. Available-for-sale securities without determinable market value are stated at cost determined by the moving average method.

(4) **Inventories**

Inventories of the Company and its consolidated subsidiaries are stated at cost determined by the moving average method.

(5) **Property, plant and equipment**

Property, plant and equipment are stated at cost. Depreciation of the Company and its consolidated subsidiaries is principally computed by the declining-balance method over the estimated useful lives of the respective assets. However, buildings purchased on and after April 1, 1998, excluding fitting, equipment and foreign subsidiary, are depreciated on a straight-line basis.

The significant useful lives are summarized as follows:

Buildings and structures 15-38 years
Machinery and equipment 10 years

(6) **Intangible assets**

Intangible assets are stated at cost less accumulated amortization. Capitalized costs of software for internal use and other intangible assets are amortized using the straight-line method over the estimated lives.

(7) **Leases**

Finance leases which do not transfer ownership to lessee are accounted for in the same manner as operating leases in accordance with Japanese GAAP.

(8) **Allowance for doubtful accounts**

Allowance for doubtful accounts is provided in an amount sufficient to cover probable losses on collection. Provision is made based on the historical default rates for non-specific ordinary receivables and in the amount deemed necessary for specific receivables whose recoverability is highly doubtful, after due consideration of recoverability on an individual basis.

(9) **Allowance for employees bonuses**

Provision is made in an amount deemed necessary at the term-end based on the estimated amount of bonus payments.

(10) **Allowance for bonus payments to directors and corporate auditors**

Bonuses to directors and corporate auditors are recorded on an accrual basis which is linked to the company income.

(11) **Accrued pension and severance costs**

Accrued pension and severance costs are provided based on an estimate of the pension and severance obligation and the plan assets at the end of the year.

Net transition obligation in the amount of ¥2,180 million ($18,467 thousand) is amortized to income over 15 years on a straight-line basis.

Actuarial gains and losses are charged to income over 5 years, which are shorter than the averaged remaining service period of employees, on a straight-line basis, beginning with the term following that in which differences were incurred.

(12) **Retirement benefits for directors and corporate auditors**
Provision is made in the maximum amount stipulated in the internal regulations for certain subsidiaries.
(Additional information)
On April 15, 2005, the Board of Directors passed a resolution to abolish lump-sum payments of allowances to retiring directors and corporate auditors, which was approved at the regular general meeting of shareholders held on June 24, 2005.

Shareholders also approved the payments for directors and corporate auditors at their retirement in the amount corresponding to each service period up to the time of abolition in accordance with internal regulations.

As of March 31, 2006, the Company reversed allowance for retirement of directors and corporate auditors in the full amount and recorded accrued expenses in the amount of ¥49 million ($419 thousand) for the future payments to directors and corporate auditors in other long-term liabilities.

(13) **Foreign currency translation**
In accordance with the accounting standards of Japan for foreign currency transactions, assets and liabilities denominated in foreign currencies of the Company and its consolidated subsidiaries are principally translated into yen at the rate of exchange in effect at the balance sheet dates.

(14) **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.

(15) **Amounts per share of common stock**
Net assets per share is based on the number of shares outstanding at the respective balance sheet dates.

The computation of basic net income per share is based on the weighted average number of share of common stock outstanding during the respective fiscal year. Diluted net income per share is computed based on the weighted average number of shares of common stock outstanding during the respective fiscal year and assuming the exercise of stock option.

Cash dividends per share represent the cash dividends declared as applicable to the respective year together with the interim cash dividends paid.

3 CHANGES IN ACCOUNTING POLICIES AND ADOPTION OF NEW ACCOUNTING STANDARDS

(1) **Directors' bonus**
Effective from the fiscal year ended March 31, 2007, the Company adopted the "Accounting Standard for Directors' Bonus" (Accounting Standard Board of Japan, November 29, 2005, Corporate Accounting Standard No. 4). As a result, operating income and income before income taxes all decreased by ¥15 million ($127 thousand).

(2) **Share-based payment**
Effective from the fiscal year ended March 31, 2007, the Company adopted "Accounting Standard for Share-based Payment" (Accounting Standards Board of Japan, December 27, 2005, Corporate Accounting Standard No. 8) and "Implementation Guidance on Accounting Standards for Share-based Payment" (Accounting Standards Board of Japan, May 31, 2006, Corporate Accounting Standard Implementation Guidance No. 11). As a result, operating income and income before income taxes all decreased by ¥98 million ($832 thousand).

(3) **Presentation of net assets in the balance sheets**
Effective from the fiscal year ended March 31, 2007, the Company adopted the "Accounting Standard for Presentation of Net Assets in the Balance Sheet" (Accounting Standards Board of Japan, December 9, 2005, Corporate Accounting Standard No. 5) and "Implementation Guidance on Accounting Standards for Presentation of Net Assets in the Balance Sheet" (Accounting Standards Board of Japan, December 9, 2005, Corporate Accounting Standard Implementation Guidance No. 8). This amount corresponding to the previous "Net Assets" is ¥23,356 million. Due to amendment of the Financial Statements Regulations, the Company prepares the presentation of net assets in the balance sheet as of March 31, 2007 based on the amended Financial Statements Regulations.

(4) **Partial revision of Accounting Standard for Treasury Stock and Appropriation of Legal Reserves**
Effective from the fiscal year ended March 31, 2007, the Company adopted the revised "Accounting Standard for Treasury stock and Appropriation of Legal Reserves" (Accounting Standards Board of Japan, August 11, 2006, Revised Corporate Accounting Standard No. 1) and "Implementation Guidance on Accounting Standard for Treasury stock and Appropriation of Legal Reserves" (Accounting Standards Board of Japan, August 11, 2006, Revised Corporate Accounting Standard Implementation Guidance No. 2). This change had no impact on the Company's earnings.

4 CASH AND CASH EQUIVALENTS

Reconciliation of cash and time deposits shown in the consolidated balance sheets and cash and cash equivalents shown in the consolidated statements of cash flows as of March 31, 2006 and 2007 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Cash and time deposits	¥2,847	¥3,577	$30,299
Less:Time deposits with maturities exceeding three months	(50)	(80)	(678)
Cash and cash equivalents	¥2,797	¥3,497	$29,621

5 Important non-cash transactions

Retirement of treasury stock: ¥3,770 million ($31,936 thousand)

6 INVESTMENT SECURITIES

The aggregate acquisition cost and fair value of securities with fair value (equity and debt securities) as of March 31, 2006 and 2007 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Acquisition cost	¥1,210	¥1,184	$10,030
Fair value	2,568	2,196	18,603
Unrealized gain	¥1,358	¥1,012	$ 8,573

The aggregate acquisition cost of securities without fair value was ¥43 million as of March 31, 2006 and ¥11 million ($95 thousand) as of March 31, 2007.

Avaliable-for-sale securities sold during the years ended March 31, 2006 and 2007 were as follows:

Millions of yen						Thousands of U.S. dollars		
2006			2007			2007		
Sales amount	Total gain	Total loss	Sales amount	Total gain	Total loss	Sales amount	Total gain	Total loss
¥149	¥54	–	¥201	¥0	–	$1,700	$1	–

7 INVENTORIES

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

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Goods and finished products	¥1,227	¥ 853	$ 7,222
Work in process	5,442	5,306	44,948
Raw materials and supplies	1,266	1,500	12,710
	¥7,935	¥7,659	$64,880

8 ACCRUED PENSION AND SEVERANCE COSTS

The Company and its domestic subsidiaries use a combined funded non-contributory tax-qualified retirement pension plans and lump-sum retirement benefit plans.

(1) **Actuarial present value of projected benefit obligations**

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Actuarial present value of projected benefit obligations	¥(2,491)	¥(2,467)	$(20,895)
Plan assets	262	395	3,350
Net transition obligation	1,262	1,122	9,504
Unrecognized net actuarial loss	272	199	1,681
Accrued pension and severance costs	¥ (695)	¥ (751)	$ (6,360)

Consolidated subsidiaries employ the simplified method for calculation of retirement benefit obligations.

(2) **Components of periodic pension and severance cost**

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Service cost	¥131	¥123	$1,044
Interest cost	36	35	300
Expected return on plan assets	(3)	(5)	(40)
Amortization of net transition obligation	139	140	1,182
Actuarial loss	85	95	803
Periodic pension and severance cost	¥388	¥388	$3,289

Pensions and severance cost of consolidated subsidiaries are included in service cost.

(3) **Major assumptions at the beginning of year**

	2006	2007
Allocation method of pension and severance costs	Straight-line basis	Straight-line basis
Discount rate (%)	1.5	1.5
Expected rate of return on plan assets (%)	2.0	2.0
Period of amortization of net actuarial loss	5 years beginning with the following period when actuarial differences incurred	5 years beginning with the following period when actuarial differences incurred
Period of recognition of transition obligation (year)	15	15

9 INCOME TAXES

The Company and its consolidated subsidiaries are subject to a number of taxes based on income which, in the aggregate, resulted in statutory tax rate of approximately 40.7% in 2006 and 2007, respectively. The effective tax rate reflected in the consolidated statements of income for the years ended March 31, 2006 and 2007 differ from the statutory tax rate for the following reasons:

	2006	2007
Statutory tax rate	40.7%	40.7%
(Reconciliation)		
Decline in valuation allowance	(21.0)	(5.5)
Inhabitants' taxes	0.3	0.4
Tax credit for increased research expenses	(0.7)	(1.3)
Non-deductible expenses such as entertainment expenses	0.6	0.2
Non-taxable income such as dividend income	(0.1)	(0.1)
Other, net	(0.5)	(0.5)
Effective tax rate	19.3%	33.9%

The significant components of deferred tax assets and liabilities as of March 31, 2006 and 2007 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Deferred tax assets:			
Allowance for doubtful accounts	¥ 37	¥ 36	$304
Accrued employees' bonuses	151	140	1,189
Accrued retirement benefits	283	313	2,652
Loss on valuation of investment securities	381	381	3,225
Loss on valuation of inventories	24	13	112
Loss on impairment of fixed assets	214	122	1,031
Accrued enterprise taxes	150	95	801
Other	149	116	984
Gross deferred tax assets	1,389	1,216	10,298
Less valuation allowance	(973)	(689)	(5,833)
Total deferred tax assets	416	527	4,464
Deferred tax liabilities:			
Net unrealized gain on securities	(553)	(412)	(3,489)
Deferred tax liabilities	(553)	(412)	(3,489)
Net deferred tax assets (liabilities)	¥(137)	¥115	$975

10 NET ASSETS

The Japanese New Company Law (the "Law") requires at least 50% of the issue price of new shares to be designated as stated capital as determined by resolution of the Board of Directors. Proceeds in excess of amounts designated as stated capital are credited to additional paid-in capital, which is included in capital surplus.

The Company may transfer portions of additional paid-in capital to stated capital by resolutions of the shareholders. The Company may also transfer a portion of undistributed retained earnings, available for dividends, to stated capital by resolution of the shareholders.

Retained earnings include a legal reserve provided in accordance with the provisions of the Law. This reserve is not available for common stock, but it is available for dividends and may be used to reduce or eliminate a deficit by resolution of the shareholders.

Dividends are determined by resolution of the Board of Directors adccording to the limitation of the Law. In addition, quarterly devidends, semiannual interim devidends may be paid. Cash dividends charged to retained earnings during the fiscal year were year-end cash dividends for the preceding fiscal year and interim cash dividends for the current fiscal year.

The Law provides that an amount equal to at least 10% of the amounts to be disbursed as distributions of earnings be appropriated to the additional paid-in capital or the legal reserve until the sum of the legal reserve and additional paid-in capital equals 25% of the common stock account. The Law 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.

11 Matters related to the type and total number of shares outstanding and the type and number of treasury stock were as follows:

	Thousands of shares			
	Number of shares as of March 31,2006	Increase in the number of shares during the year ended March 31,2007	Decrease in the number of shares during the year ended March 31,2007	Number of shares as of March 31,2007
Nuber of shares outstanding				
Common stock	89,019	-	10,000	79,019
Total	89,019	-	10,000	79,019
Treasury stock				
Common stock	13,099	3,680	10,438	6,341
Total	13,099	3,680	10,438	6,341

The decrease of 10,000 thousand in the number of common shares outstanding resulted from retirement of shares.

The increase of 3,680 thousand in the number of common shares of treasury stock is due to an increase of 18 thousand resulting from the purchase of less-than-one-unit shares and to acquisition of 3,662 thousand common shares in treasury stock by the Company.

The decrease of 10,438 thousand in the number of common shares of treasury stock is attributed to a decrease of 438 thousand resulting from the exercise of stock options and a decline of 10,000 thousand due to retirement.

12 STOCK OPTION PLANS

(1) Outline of stock options

The following table summarized terms and conditions of stock option plans:

	The maximum number of shares to be issued	Exercisable period of the stock option	Exercise price per share	Issue price per share when exercise	Paid-in capital per share
Stock option I (stock purchase right)	230,000	From July 1, 2006 to June 30, 2009	¥286 $2.42	¥286 $2.42	¥143 $1.21
Stock option II (stock purchase right)	360,000	From July 1, 2007 to June 30, 2010	¥575 $4.87	¥575 $4.87	¥288 $2.44
Stock option III (based compensation plan)	180,000	From July 1, 2005 to June 30, 2025	¥1 $0.01	¥1 $0.01	¥1 $0.01
Stock option IV (stock purchase right)	340,000	From July 4, 2008 to June 30, 2011	¥759 $6.43	¥935 $7.92	¥468 $3.96
Stock option V (based compensation plan)	78,000	From July 21, 2006 to July 20, 2026	¥1 $0.01	¥609 $5.16	¥305 $2.58
Stock option VI (based compensation plan)	59,000	From July 21, 2006 to July 20, 2026	¥1 $0.01	¥609 $5.16	¥305 $2.58

A part of each stock option cannot be exercised. Provide the condition of other execution of rights in "New stock reservation right allocation contract" concluded among the Company and the object people.

In order to transfer stock option, the approval of board of directors is required.

(2) Valuation technique used for valuating fair value of stock options

Stock option IV, Stock option V and Stock option VI granted in the fiscal year ended March 31, 2007 were valuated using the following valuation technique.

(a) Valuation technique: Black-Scholes option-pricing model

(b) Principal parameters used in the option-pricing model

	Expected volatility (*1)	Average expected life (*2)	Expected dividends (*3)	Risk-free interest rate (*4)
Stock option IV (stock purchase right)	33.480%	3.5 years	8 yen per share	1.169%
Stock option V (based compensation plan)	58.947%	10.0 years	8 yen per share	1.818%
Stock option VI (based compensation plan)	58.947%	10.0 years	8 yen per share	1.818%

(*) 1. Stock option IV is calculated based on the closing stock price at the last trading day of each month during the 3.5 years from January 4, 2003 to July 3, 2006. Stock option V and Stock option VI is calculated based on the closing stock price at the last trading day of each month during the 10 years from June 1996 to June 2006.

2. The average expected life could not be estimated rationally due to insufficient amount of data. Therefore, it was estimated assuming that the options were exercised at the mid point of the exercise period.

3. The actual dividends on common stock for the fiscal year ended March 31, 2006.

4. Japanese government bond yield corresponding to the average expected life.

(3) Method of estimating number of stock options vested

Only the actual number of forfeited stock options is reflected because it is difficult to rationally estimate the number of stock options that will be forfeited in the future.

13 LEASE INFORMATION

Finance leases which do not transfer ownership are as follows:

(1) Acquisition costs, accumulated depreciation and balance

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Machinery and equipment			
Acquisition costs	¥73	¥43	$365
Accumulated depreciation	57	26	223
Balance	16	17	142
Other tangible fixed assets			
Acquisition costs	169	96	816
Accumulated depreciation	114	54	457
Balance	55	42	359
Intangible assets			
Acquisition costs	25	32	267
Accumulated depreciation	12	20	167
Balance	¥13	¥12	$100

Acquisition costs are calculated using the interest method, as the ratio of the term-end balance of future lease rental payments to the term-end balance of tangible fixed assets is low.

(2) Future lease rental payments of finance leases

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Current portion	¥29	¥29	$243
Non-current portion	54	42	359
Total	¥83	¥71	$602

Future lease rental payments are calculated including interest, as the ratio of the term-end balance of future lease rental payments to the term-end balance of tangible fixed assets is low.

(3) Lease rental payments and depreciation

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Lease payments	¥38	¥33	$281
Estimated depreciations expense	38	33	281

(4) Calculation of depreciation

The amounts equivalent to depreciation are calculated by assuming leasing periods as useful lives and residual value as zero on a straight-line basis.

14 CONTINGENT LIABILITIES

Contingent liabilities were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Bills of exchange without L/C	¥2,406	¥2,688	$22,766
Trade notes receivable discounted	–	1,000	8,471
Transfer of notes for endorsement	65	54	453

15 RESEARCH AND DEVELOPMENT COSTS

Research and development costs included in cost of sales and general and administrative expenses were ¥511 million and ¥636 million ($5,389 thousand) for the years ended March 31, 2006 and 2007, respectively.

16 SEGMENT INFORMATION

The Company and its consolidated subsidiaries (the "Group") are primarily engaged in the sales and manufacture of products in two major segments.
1) Machine tool: CNC precision automatic lathes, CNC cylindrical grinding machines, precision machining centers, precision turning centers, and precision thread rolling machines.
2) Specialized machining and other business: specialty equipment, gauge blocks, roll dies, and screw inserts
Business segments and overseas sales of the group for the years ended March 31 2006 and 2007 are as follows:

(a) **Business segments**

Year ended March 31, 2006	Millions of yen				
	Machine tool business	Specialized machining and other business	Total	Corporate and elimination	Consolidation
Sales and operating income:					
Sales to third parties	¥29,097	¥4,909	¥34,006	¥ –	¥34,006
Intersegment sales and transfer	–	–	–	–	–
Total sales	29,097	4,909	34,006	–	34,006
Cost of revenue from operations	24,109	4,009	28,118	605	28,723
Operating income	¥ 4,988	¥ 900	¥ 5,888	¥ (605)	¥ 5,283
Assets, depreciation and capital expenditure:					
Assets	¥26,830	¥4,442	¥31,272	¥5,555	¥36,827
Depreciation	437	104	541	40	581
Capital expenditure	2,874	660	3,534	–	3,534

Year ended March 31, 2007	Millions of yen				
	Machine tool business	Specialized machining and other business	Total	Corporate and elimination	Consolidation
Sales and operating income:					
Sales to third parties	¥32,775	¥3,782	¥36,557	¥ –	¥36,557
Intersegment sales and transfer	–	–	–	–	–
Total sales	32,775	3,782	36,557	–	36,557
Cost of revenue from operations	27,122	3,197	30,319	759	31,078
Operating income	¥ 5,653	¥ 585	¥ 6,238	¥ (759)	¥ 5,479
Assets, depreciation and capital expenditure:					
Assets	¥26,334	¥3,665	¥29,999	¥5,945	¥35,944
Depreciation	574	163	737	23	760
Capital expenditure	782	172	954	–	954

Year ended March 31, 2007	Thousands of U.S. dollars				
	Machine tool business	Specialized machining and other business	Total	Corporate and elimination	Consolidation
Sales and operating income:					
Sales to third parties	$277,634	$32,042	$309,676	$ –	$309,676
Intersegment sales and transfer	–	–	–	–	–
Total sales	277,634	32,042	309,676	–	309,676
Cost of revenue from operations	229,751	27,087	256,838	6,428	263,266
Operating income	$ 47,883	$ 4,955	$ 52,838	$ (6,428)	$ 46,410
Assets, depreciation and capital expenditure:					
Assets	$223,073	$31,047	$254,120	$50,361	$304,481
Depreciation	4,866	1,381	6,247	189	6,436
Capital expenditure	6,620	1,457	8,077	–	8,077

(b) **Overseas sales**

Overseas sales, which include export sales of the Company and its domestic consolidated subsidiaries, are as follows:

Year ended March 31, 2006	Millions of yen			
	Asia	North America	Europe	Total
Overseas sales	¥10,683	¥2,273	¥589	¥13,545
Consolidated sales				34,006
Ratio of overseas sales to consolidated sales	31.4%	6.7%	1.7%	39.8%

Year ended March 31, 2007	Millions of yen			
	Asia	North America	Europe	Total
Overseas sales	¥11,361	¥3,297	¥639	¥15,297
Consolidated sales				36,557
Ratio of overseas sales to consolidated sales	31.1%	9.0%	1.7%	41.8%

Year ended March 31, 2007	Thousands of U.S. dollars			
	Asia	North America	Europe	Total
Overseas sales	$96,236	$27,927	$5,416	$129,579
Consolidated sales				309,676
Ratio of overseas sales to consolidated sales	31.1%	9.0%	1.7%	41.8%

17 RELATED PARTIES

Significant transactions and balances with related parties as of and for the years ended March 31, 2006 and 2007 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
TOKYO SEIMITSU CO., LTD.			
Sales	¥3,172	¥1,877	$15,899
Trade notes and accounts receivable	1,866	437	3,701
Purchases	75	103	870
Trade notes and accounts payable	34	26	218
Payment for purchase of property, plant and equipment	9	15	129
Notes payable – equipment	–	10	81
TOSEI ENGINIEERING CORP.			
Sales	40	–	–
Trade notes and accounts receivable	43	–	–

We disclose the transaction with Tokyo Seimitsu Co., Ltd. because Kazuo Fujimori, a corporate auditor of Tsugami Co., Ltd., serves as a representative director of Tokyo Seimitsu.
We also disclose the transaction with Tosei Engineering Corporation, because Shigeru Umenaka, a director of Tsugami Corporation, serves as representative director of Tosei Engineering Corporation.

18 NET INCOME PER SHARE

A reconciliation of the numerators and denominators between basic and diluted net income per share for the years ended March 31, 2006 and 2007 is as follows:

	Millions of yen		Thousands of U.S. dollars
Year ended March 31	2006	2007	2007
Net income	¥5,531	¥3,448	$29,204
Net income unavailable to common shareholders (bounuses paid to directors)	39	–	–
Net income available to common shareholders and assumed conversions	¥5,492	¥3,448	$29,204

	Thousands of shares	
Year ended March 31	2006	2007
Weighted-average number of shares of common stock outstanding for the year	76,947	74,365
Incremental shares from assumed conversions of dilutive stock option	616	499
Weighted-average number of shares of diluted common stock outstanding for the year	77,563	74,864

	Yen		U.S. dollars
Year ended March 31	2006	2007	2007
Net income per share of common stock:			
-Basic	¥71.38	¥46.36	$0.39
-Diluted	70.81	46.05	0.39

19 SUBSEQUENT EVENT

(1) The following appropriations of retained earnings of the Company, which have not been reflected in the accompanying consolidated financial statements for the year ended March 31, 2007, were approved by the Board of Directors at a meeting held on May 18, 2007.

	Millions of yen	Thousands of U.S. dollars
Year-end cash dividends (¥10 = U.S.$0.08 per share)	¥436	$3,694

(2) Stock option
On June 22, 2007, the reporting entity passed a resolution for issuance of share warrants at the general meeting of shareholders.

Independent Auditors' Report

To the Board of Directors of
Tsugami Co., Ltd.:

We have audited the accompanying consolidated balance sheets of Tsugami Co., Ltd. and consolidated subsidiaries as of March 31, 2006 and 2007, and the related consolidated statements of income, change in net assets and cash flows for the years then ended, expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently 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 Tsugami Co., Ltd. and consolidated subsidiaries as of March 31, 2006 and 2007, 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.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2007 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 1 to the consolidated financial statements.

KPMG AZSA & Co.

Tokyo, Japan
June 22, 2007

Corporate Data / Corporate Governance

As of March 31, 2007

Corporate Name	Tsugami Corporation
Established	March 15, 1937
Head Office	9-10, Horidome-cho 1-chome, Nihombashi, Chuo-ku, Tokyo
Paid-in Capital	10,599 million yen
Number of Employees	425
Directors and Auditors	
Chairman and C.E.O.	Takao Nishijima
Directors	Yoshiharu Kikuchi
	Tadashi Narisawa
	Kazunori Miyamoto
Standing statutory auditor	Ikuo Oomiya
Statutory auditors	Kyouji Umeoka
	Kouichiro Watanabe
	Kazuo Fujimori

Head Office and Plants

Head Office:
9-10, Horidome-cho 1-chome, Nihonbashi, Chuo-ku, Tokyo
Nagaoka Plant:
1-1, Higashizao 1-chome, Nagaoka-shi, Niigata
Shinshu Plant:
3600 Nakagomi, Saku-shi, Nagano

Sales Network

East Japan Marketing Division (Tokyo)
North Kanto Marketing Division (Omiya)
Suwa Marketing Division (Suwa)
Central Japan Marketing Division (Nagoya)
West Japan Marketing Division (Osaka)
Sendai Office
Takasaki Office
Nagaoka Office
Hitachi Office
Shinshu Office
Hamamatsu Office
Hiroshima Office
Fukuoka Office

Group Companies

Tsugami Machinery Co., Ltd.
Tsugami Shimamoto Ltd.
Tsugami General Service Co., Ltd.
Tsugami Precision Co., Ltd.
Precision Tsugami (China) Corporation
Tsugami (Thai) Co., Ltd.

Corporate Governance

The basis of the management of the Company is to contribute to society by always anticipating the needs of the market and to create new value based on precision technologies, which we have been cultivating since our founding. Under this basic policy, we will strive to further enhance legal compliance and aim at sound and transparent management in order to properly execute duties and continue to grow over the long term.

1. Corporate governance system

The Company has adopted the corporate auditor system, consisting of the Board of Directors and the Board of Statutory Auditors. The Board of Directors and the Board of Statutory Auditors are our basic structure of corporate governance.

The Board of Directors of the Company is comprised four directors, with no outside directors, as of June 22, 2007. The term of directors is set at one year to better clarify management responsibility.

The Board of Statutory Auditors is made up of four statutory auditors, including three outside statutory auditors. The statutory auditors always attend the meetings of the Board of Directors and other major meetings, and audit the execution of duties by directors as well as company-wide business and financial conditions.

2. Status of establishment of internal control system and risk management system

The Company is striving to drive home the observance of laws and corporate ethics to all employees of the group companies. To that end, we set up "Compliance Committee," chaired by the president of the Company, and established the "Tsugami Group Code of Conduct" in November 2004.

The Company introduced an internal report system in August 2006 and set up counters where employees can report and seek advice.

The Company is doing its utmost to build an internal audit system by establishing "Internal Audit Office" under the direct control of the President.

With regard to security and trade management, the Company enhanced the in-house export management regulations (CP) in August 2005 and placed "Export Management Office" under the direct control of the president.

With regard to quality, the Company is making the most of the ISO 9001 quality management system by establishing "Product Quality Improvement Committee" and its substructures, which are the "Safety and Health Committee" and the "Business Improvement Committee."

As for the environment, the Company regards environmental conservation as one of the important indicators of quality not only for products but also for all production activities of Tsugami, and utilizes the ISO 14001 environmental management system.

Stock Information

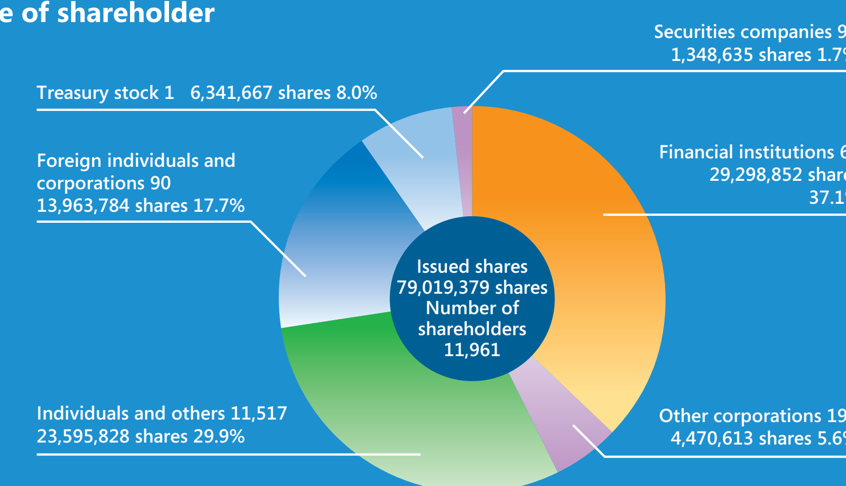
As of March 31, 2007

Authorized shares	320,000,000 shares
Issued shares	79,019,379 shares
Number of shareholders	11,961
Major shareholders	

Shareholders	Investment in the Company		Investment in shareholders	
	Number of shares held	Ownership ratio	Number of shares held	Ownership ratio
	Thousands	%	Thousands	%
The Master Trust Bank of Japan, Ltd. (Trust account)	7,314	9.25	–	–
Mizuho Trust and Banking Co., Ltd. (Pension trust account for Tokyo Seimitsu Co., Ltd.)	4,592	5.81	–	–
Japan Trustee Services Bank, Ltd. (Trust account)	3,047	3.85	–	–
Morgan Stanley & Co. International Limited	2,283	2.88	–	–
Morgan Stanley and Company, Inc.	2,098	2.65	–	–
Mori Seiki Co., Ltd.	2,000	2.53	100	0.09
Bank of New York Europe Limited Luxembourg 131800	1,898	2.40	–	–
The Dai-Ichi Mutual Life Insurance Company	1,800	2.27	–	–
The Hokuetsu Bank, Ltd.	1,484	1.87	466	0.18
The Chase Manhattan Bank 385032	1,313	1.66	–	–

Notes:
1. The figures for ownership percentage are truncated to two decimal places.
2. The 4,592 thousand shares held by Mizuho Trust & Banking Co., Ltd. (pension trust account for Tokyo Seimitsu Co., Ltd.) are held in a pension trust account for Tokyo Seimitsu, which reserves the right to instruct on how to exercise voting rights for these shares. The Company holds 65 thousand shares (0.16%) in Tokyo Seimitsu.
3. In addition to the shares in the table above, there are 6,341 thousand treasury stocks.

Shareholder composition by type of shareholder



Stock price and volume (from April 2006 to March 2007)

Year / month Stock price / volume		2006									2007		
		4	5	6	7	8	9	10	11	12	1	2	3
Stock price	High (yen)	979	961	785	779	745	750	725	707	775	771	766	693
	Low (yen)	878	720	655	634	667	650	605	625	666	724	640	645
Volume (thousands of shares)		8,930	15,255	17,466	16,132	13,365	11,757	15,529	11,899	12,009	10,286	13,011	11,305