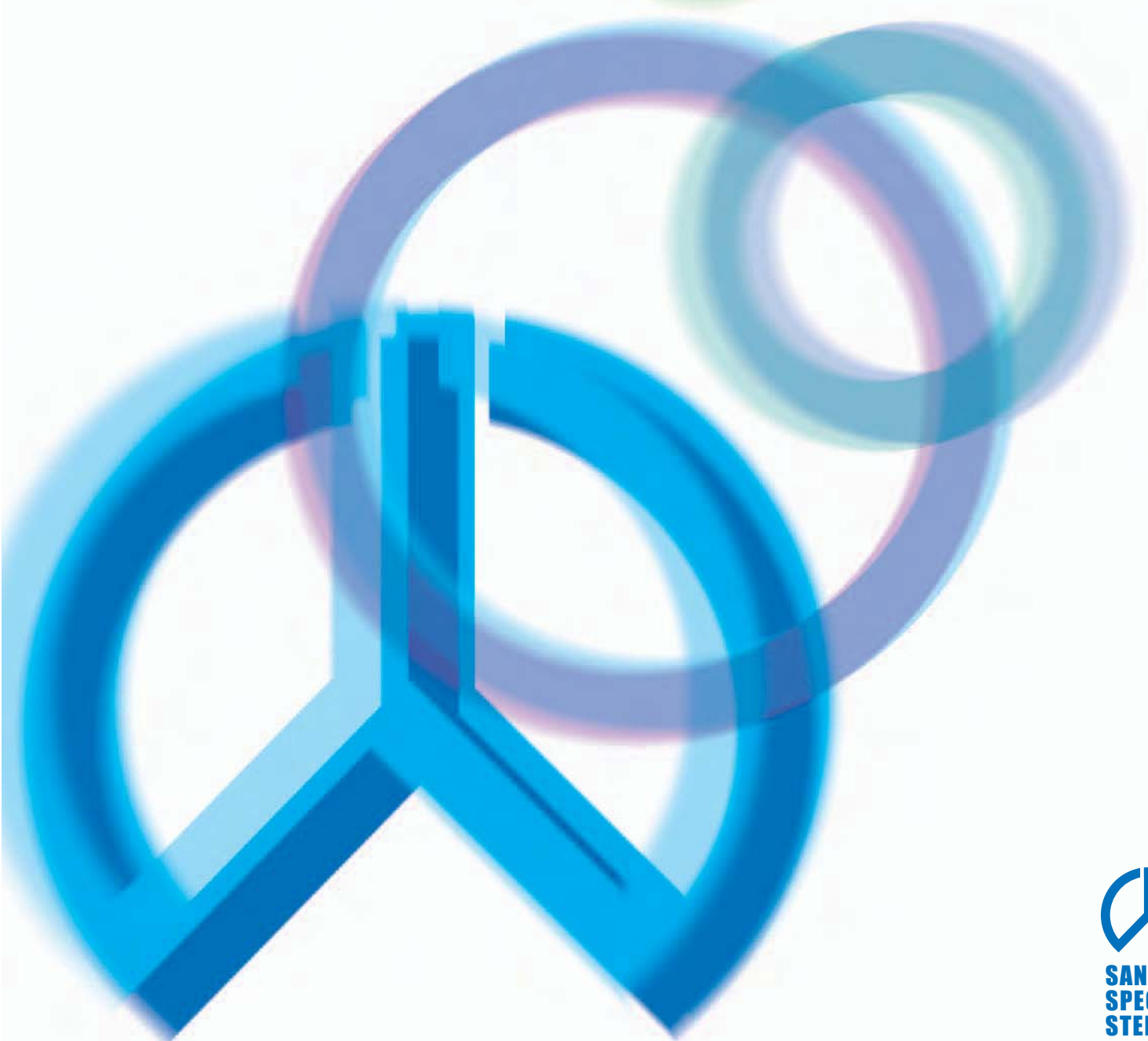


# ANNUAL REPORT

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APRIL 1, 2006 - MARCH 31, 2007  
SANYO SPECIAL STEEL-THE CONFIDENT CHOICE

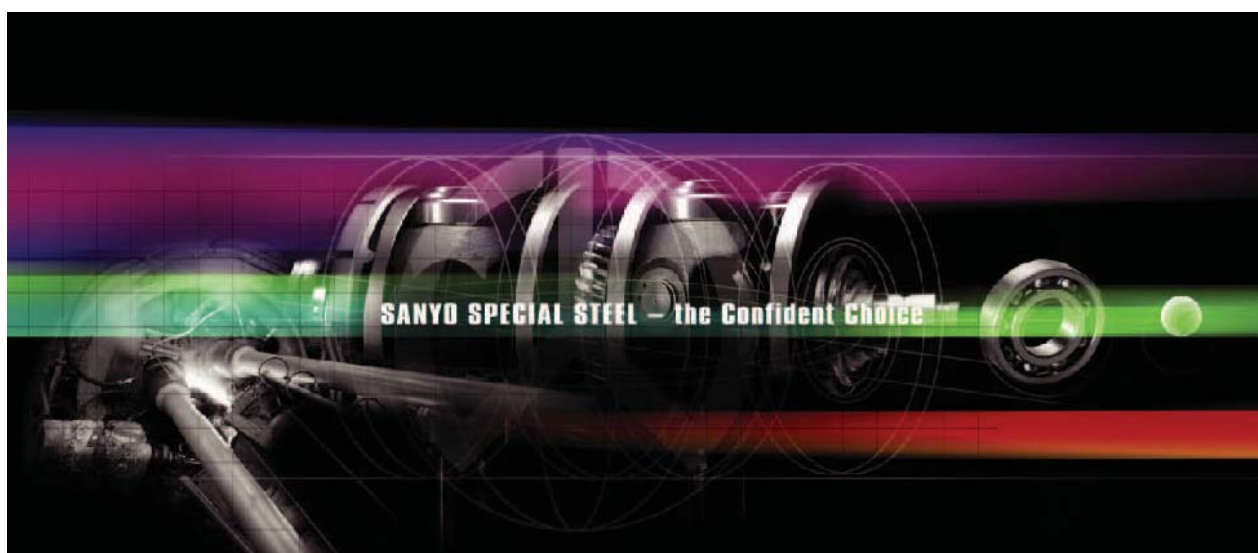


## ■ Profile

Sanyo Special Steel manufactures and distributes steel bars, wire rods, and seamless steel tubes, which are made from special steels such as bearing steel, engineering steel, and stainless steel, formed and fabricated materials, and metal powders. What makes Sanyo Special Steel unique is the fact that it is Japan's only special steel manufacturer that has steel tube manufacturing equipment.

We enjoy a high level of market confidence in every aspect of our undertakings - development, product quality, and stable supply - based on our high cleanliness steel manufacturing technology, which reduces intrasteel impurities to nearly zero.

Featuring superiority in quality characteristics such as fatigue life, cold workability, and impact resistance, our highly reliable steel is put to a broad range of industrial applications, most notably in automobile parts, which require high reliability. Above all, the unmatched quality of our bearing steel means that Sanyo Special Steel is the world's leading bearing steel manufacturer.



## ■ Corporate Philosophy : Confidence-based Management

### Confidence of Society

Through our "high-quality special steel manufacturing" and "harmony with local communities," we aim to acquire the confidence of society by contributing to the realization of an affluent and culturally rich society.

### Confidence of Customers

We aim at acquiring the confidence of customers through our principle "to earnestly seek out customer needs and to solve them with speed and precision."

### Confidence among People

We aim to build the confidence among people by maintaining a corporate culture where individual employees can feel "the joy of creation" and realize job satisfaction.

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# CONSOLIDATED FINANCIAL HIGHLIGHTS

Sanyo Special Steel Co., Ltd. and consolidated subsidiaries  
Years ended March 31

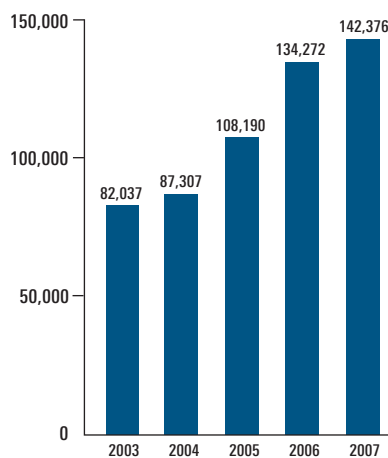
	2005	2006	2007	Change 2007 / 2006	2007
<b>Operating Results(for the year)</b>		(Millions of Yen)		(%)	(Thousands of U.S.Dollars) * 1
Net Sales	¥108,190	¥134,272	¥142,376	6.0	\$1,205,656
Operating income	6,529	18,860	18,189	-3.6	154,027
Ordinary income	5,523	18,959	17,947	-5.3	151,974
Net income	2,682	11,345	8,665	-23.6	73,373
<b>Per share data</b>		(Yen)		(%)	(U.S.Dollars) * 1
Net income	16.49	71.17	53.55	-24.8	0.45
Cash dividends	5.00	11.00	11.00	0.0	0.09
<b>Financial Position(at year-end)</b>		(Millions of Yen)		(%)	(Thousands of U.S.Dollars) * 1
Net assets * 2	63,902	75,607	89,568	18.5	758,473
Total assets	122,663	140,655	152,709	8.6	1,293,158

\* 1 U.S. dollar amounts are converted, for convenience only, at the rate of ¥118.09=U.S.\$1, the approximate rate of exchange on March 31, 2007.

\* 2 Minority interests are presented as a component of net assets.

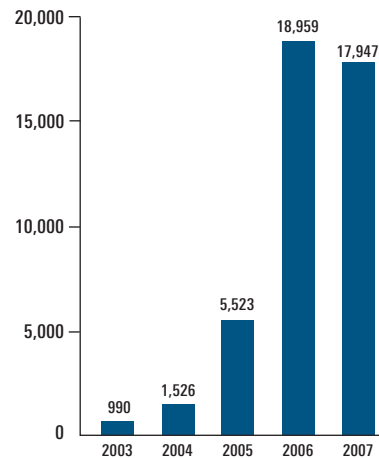
## Net Sales

(Millions of Yen)



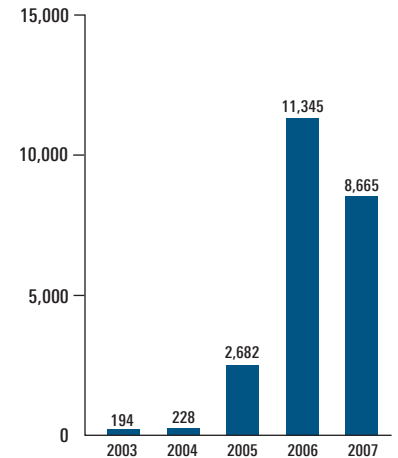
## Ordinary income

(Millions of Yen)



## Net income

(Millions of Yen)





### Fiscal 2006 Overview

During the year ended March 31, 2007 (fiscal 2006), the Company reported growth in sales with a profit decline over the previous year, posting consolidated net sales of ¥142,376 million, ordinary income of ¥17,947 million, and 12.6% ROS (ratio of ordinary income to net sales). This result is primarily due to a decline in sales volume attributable to the unexpectedly prolonged inventory adjustment in customer sectors, and price hikes in raw materials such as scrap iron and nickel caused by the growing worldwide demand for steel, despite some favorable factors including improved product pricing through application of a surcharge system, a better product mix, and a reduction in variable costs.

As for capital expenditure, by year-end we had completed the investment project for productivity improvement in No.2 Steelmaking Plant, expansion of the steel tube manufacturing plant, and installation of a new reheating furnace for open die forging. Completion of these projects set the stage for efficient production as laid out in our sixth Medium-Term Consolidated Business Plan.

Meanwhile, in June 2006, Sanyo Special Steel's treasury stock was sold to Nippon Steel Corporation while the former also acquired the stock of the latter in line with the business alliance formed between the two parties in February 2006. As a result of these deals, Sanyo Special Steel became a Nippon Steel Corporation affiliate, accounted for by the equity method.

### Fiscal 2007 Outlook

While production is expected to remain at a high level in key customer sectors such as automobiles, industrial machinery, construction machinery, and also in the bearing industry that supplies parts to those sectors, prices of main raw materials such as scrap iron and alloy iron are expected to remain high, putting continued heavy pressure on our profits, and casting considerable uncertainty over the future. Against this backdrop, we will strive to improve our product pricing to cope with escalating costs while working to develop a more favorable product mix through expanded sales of high value-added products, and to reduce costs even further by deriving benefits from the expanded steel tube manufacturing plant and the new reheating furnace for open die forging.

Taking all of the above into account, we project consolidated net sales of ¥160,000 million, and ordinary income of ¥14,000 million for fiscal 2007.

## Our future commitments

Under the corporate philosophy of “confidence-based management,” we are currently implementing the sixth Medium-Term Consolidated Business Plan. Fiscal 2007 is its final year. By carrying out the five key action programs set out in the Plan, namely “Create efficient production systems,” “Raise the sales ratio of products with high added value,” “Enhance the brand power of Sanyo Special Steel—the confident choice,” “Stabilize profitability of Formed & Fabricated Materials business,” and “Further promote CSR-conscious management,” we will continue to strive to make our corporate structure even more solid, thereby improving our corporate value.

We will also move ahead with wide-ranging measures to develop a closer business alliance with Nippon Steel Corporation.

Needless to say, we cannot implement these commitments without good people. We will enrich our pool of human resources for the future by recruiting high-caliber personnel and developing their capacities on an ongoing basis. And, we will work to carry on our “tradition of technology and expertise.” We aim to realize the “chain of handing down technology and expertise,” through the strong will and sense of mission of our people, both those who pass down the company’s tradition and those who inherit it.

## Promotion of CSR-conscious Management

Promotion of CSR-conscious management, which is one of the key action programs set forth in the sixth Medium-Term Consolidated Business Plan, is an important mission for us to undertake. Sanyo Special Steel Group, as a responsible member of society, will seek to balance its economic activity with good corporate citizenship by fulfilling our social responsibilities, including unflagging commitment to the observance of corporate ethics and steady implementation of global environmental conservation measures.

Toward that end, we have already created the Environmental Management Department to reinforce our organizational structure and enhance our functions for comprehensive environmental management and conservation. We have also set up the Internal Inspection Group in the General Administration Department to further advance our compliance efforts. As for global environmental conservation programs, we have been conducting our business with a view to helping create a resource-recycling society through such approaches as processing electric arc furnace slag into asphalt aggregate, shifting energy sources from heavy oil to liquefied natural gas (LNG), and expanding the dust-collecting capacity of the electric arc furnace.

We will remain actively committed to CSR-conscious management in the future.

## Toward the Next Medium-Term Plan

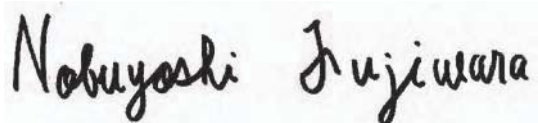
Now, as I mentioned earlier, fiscal 2007 is the final year of the sixth Medium-Term Consolidated Business Plan, and we have already begun our planning process for the seventh Medium-Term Consolidated Business Plan, which will start in fiscal 2008.

The seventh Plan is being developed based on the results of the current Plan while paying close attention to the needs of key customer sectors, global environmental issues, and energy issues, and also carefully assessing the trend of consolidations and realignments in the industry. We will also place high priority on exploring various ways of coping with soaring raw materials procurement costs.

Under the sixth Medium-Term Consolidated Business Plan, we have been working to increase the corporate value of the entire Group by building up a more solid business foundation and bolstering our earning power. Our objective is to grow the company into an entity that can win greater confidence from all stakeholders including shareholders, customers, employees, and community residents. In the next medium-term plan, we will adopt the same perspective and advance toward becoming a special steel manufacturing company with a global presence.

To our shareholders and investors, we would like to ask for your continued support and understanding of the Sanyo Special Steel Group in coming years.

July 2007



Nobuyoshi Fujiwara  
President

## ■ Basic Management Policies

We have been guided by the corporate philosophy of “confidence-based management (confidence of society, confidence of customers, and confidence among people).”

With this corporate philosophy in mind, while maintaining harmony between our high-quality specialty steel manufacturing and local communities, we aim to contribute to the realization of an affluent and culturally rich society, to earnestly seek out customer needs and solve them with speed and precision, and to continue to foster a corporate culture that allows individual employees to enjoy the true “pleasure of creation” and satisfaction in their careers. We also seek to reinforce and enhance our corporate value and the common interests of our shareholders, by mobilizing group-wide efforts to promote our information processing services, as well as special steel products, formed and fabricated materials, and metal powder businesses, thereby meeting the expectations of our customers in a wide range of industry sectors.

## ■ Distribution of Profits

Our basic policy for profit distribution is to reward our shareholders by strengthening our business foundation and expanding profit available for distribution. As for dividend payment, we intend to meet the expectations of our shareholders, primarily through appropriate profit distribution based on periodic business performance, with due attention to both payout ratio and the amount of funds required for investments and other activities to “increase our corporate value.” We also regard repurchase of our own shares as an effective measure for returning profits to shareholders, and we will address this subject, with due consideration to stock price movements, our financial position, and other relevant factors.

We will also utilize internal reserves to strengthen our management base in order to better adapt to our changing business environment.

In order to execute our business in line with the above policies, we are working on the following measures to ensure proper corporate governance and internal control.

## ▶ Commitment to Corporate Governance and Internal Control

The Company makes decisions concerning important issues and supervises the execution of business operations at monthly meetings of the board of directors and at extraordinary meetings of the board of directors as necessary. In order to efficiently make management decisions at meetings of the board of directors and at other opportunities, we have established meetings of managing directors (held four times a month, in principle), in addition to other meetings.

With a view to further ensuring compliance and improving corporate governance, in October 2005 we consolidated in-house committees and meetings, forming them into a total of twenty-two corporate committees and meetings which deliberate upon important business issues, including the Corporate Behavior and Ethics Special Committee, Security & Trade Control Committee, Global Environment Conservation Committee, and Corporate Budget Committee.

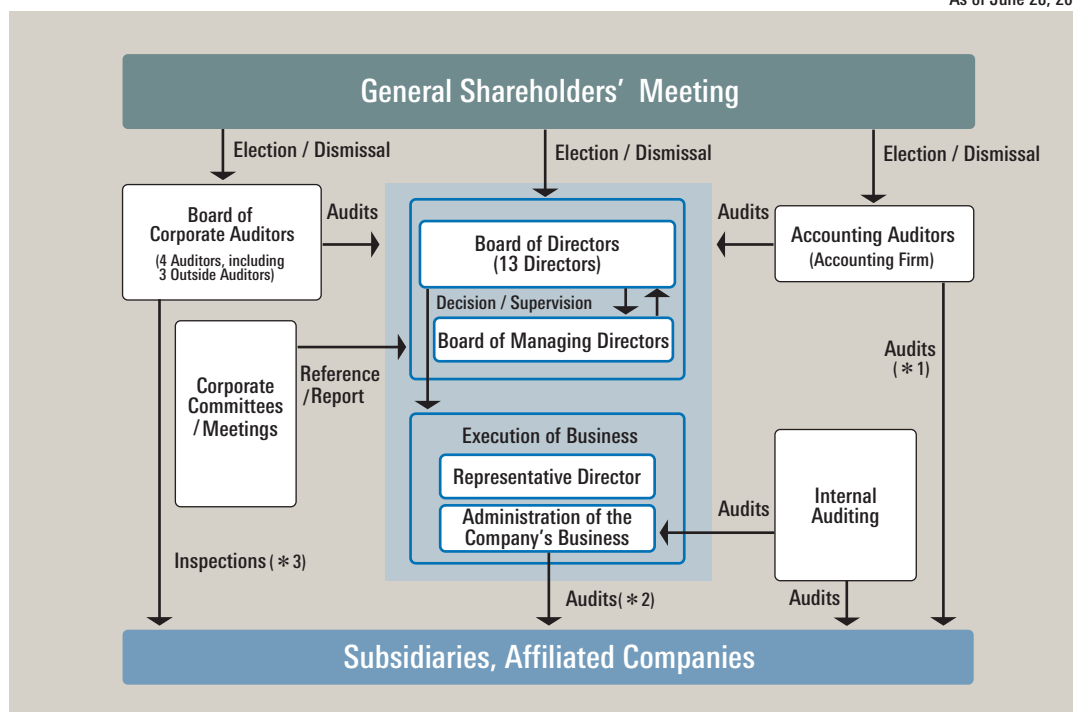
At the board of directors meeting held on May 9, 2006, we settled on a basic policy for the creation of internal control systems in accordance with the Company Law of Japan and relevant laws and ordinances, in order to improve our internal control systems. Based on the understanding that internal control systems help to further improve the appropriateness of our operations and the credibility of our financial statements, we wish to doubly ensure that our business activities comply with related laws and our articles of incorporation as we go about building these systems.

As for risk management, we classified the risks that might influence our business activities into “disaster/accident risk,” “management risk,” and “political/economic/social risk,” based on which we compiled our “Risk Management Manual.” This guides us on how we should respond to a situation in which we are actually exposed to these risks. We will continue addressing this subject in order to develop a more solid risk management system, in line with the above basic policies.

The chart below depicts our organizational structure for corporate governance and internal control (as of June 28, 2007).

## Our organizational structure for corporate governance and internal control (chart)

As of June 28, 2007



(\* 1) Auditing of our subsidiaries and affiliated companies is conducted through the auditing of consolidated financial statements by an accounting firm.

(\* 2) Each of our subsidiaries and affiliated companies has a supervisory department.

(\* 3) Corporate auditors perform inspections as necessary on the operations and asset status of subsidiaries.

Full-time corporate auditors serve concurrently as corporate auditors of Sanyo Special Steel's domestic subsidiaries, and fulfill their responsibilities in that capacity.

### Introduction of Fair Rules for the Acquisition of Substantial Shareholdings

At the board of directors meeting held on April 27, 2007, we decided to introduce the Fair Rules for the Acquisition of Substantial Shareholdings (anti-takeover measure) (hereinafter referred to as the "Fair Rules"), which clearly lay down the specific procedure to be followed by a person contemplating a takeover bid for our company, prior to commencing a specific action for buying shares. The Fair Rules are designed to allow for provision of adequate information and a reasonable period of time for our Board of Directors to discuss a takeover proposal, including possible alternative approaches, thereby ensuring that our shareholders can make an informed judgment on a takeover proposal based on relevant information and a reasonable period for consideration. The rules are also intended to fend off any malicious large-scale purchase of our shares, etc. that could be detrimental to our corporate value and the common interests of our shareholders.

In the situation where a person seeks to purchase 15% or more of our stake (the "Proposer of Purchase"), and the proposed purchase meets the requirements specified in the Fair Rules (relevant information and time for consideration), our shareholders at the time will decide whether or not a free-of-charge allotment of share warrants should be implemented as a defensive measure. Such a free-of-charge allotment of share warrants is executable only when: (1) the Proposer of Purchase has ignored the procedure specified in the Fair Rules, (2) the Proposer of Purchase falls under any of the four cases judged to be malicious by court rulings, and the proposed purchase is considered to be clearly detrimental to the common interests of our shareholders (based on the opinions and advice of internationally respected law firms and investment banks), and (3) our shareholders approve said free-of-charge allotment of share warrants.

However, Nippon Steel Corporation, which holds a stake of 15% or more in Sanyo Special Steel in terms of voting rights and is our affiliated company, is not treated as a purchaser as referred to in the Fair Rules, in light of the business alliance between the two companies.

We have formulated a Medium-term Consolidated Business Plan covering the 3-year period from fiscal 2005. This plan recognizes that it is absolutely imperative for the group to enhance its corporate value by adequately fulfilling the expectations of customers in a wide range of industries through stable supply of high-grade special steel to the market.

## ■ 5 Key Action Programs

In this Medium-term Consolidated Business Plan, we have positioned the following five measures as our key action programs: "Create efficient production systems," "Raise the sales ratio of products with high added value," "Enhance the brand power of 'Sanyo Special Steel – the Confident Choice,'" "Stabilize profitability of the Formed & Fabricated Materials business," and "Further promote CSR-conscious management."

### 1 Create efficient production systems

We will develop efficient production systems with an upwardly flexible capacity (70,000 tons/month (average during the year ended March 31, 2005) →80,000 tons/month) that ensures stable supply of products with a view to helping customers increase their international competitiveness.

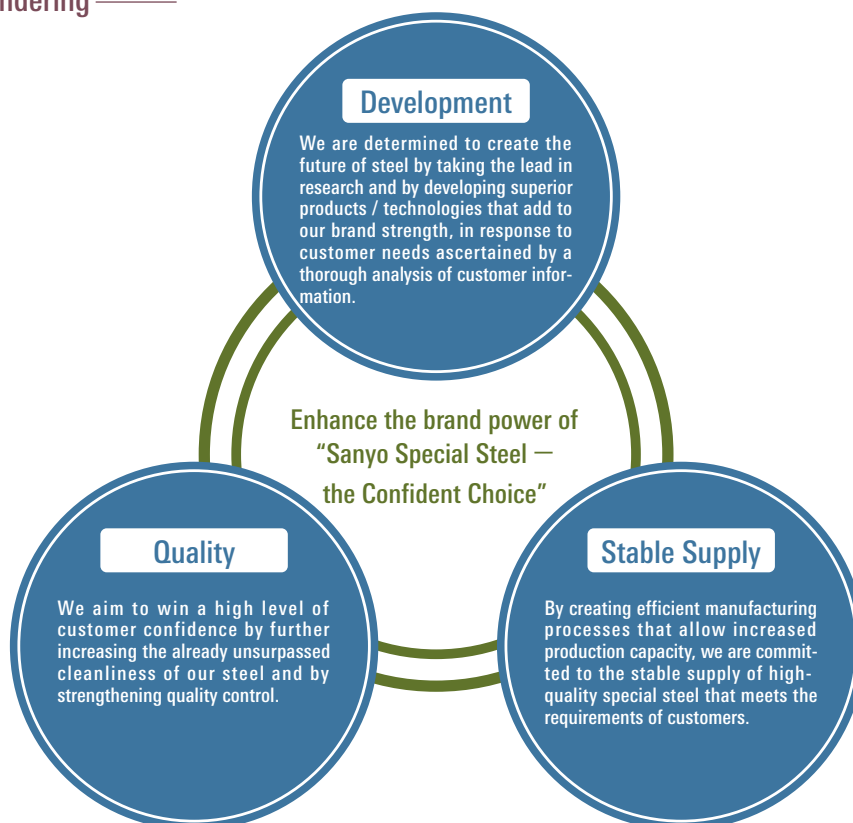
### 2 Raise the sales ratio of products with high added value

We will reinforce sales capabilities through cross-functional coordination between sales, R&D, and engineering, while upgrading facilities and equipment, in order to raise the sales ratio of higher value-added lines, including stainless steel and tool steel types, as well as forms such as steel tubes.

### 3 Enhance the brand power of "Sanyo Special Steel – the Confident Choice"

We will tap into our core technology of high cleanliness steel manufacturing in order to ensure steadfast confidence from the market by taking the correct action in every aspect of our business, including development, quality, and stable supply. Our goal is to enhance the brand power of "Sanyo Special Steel – the Confident Choice"

## Conceptual rendering



#### 4 Stabilize profitability of the Formed & Fabricated Materials business

For the Formed & Fabricated Materials business, we aim to further increase profitability in Japan by boosting productivity, and to improve its profitability in China by establishing at the earliest possible date an integrated process technology that extends from forging to lathing.

#### 5 Further promote CSR-conscious management

As an integral member of society, we aim to achieve a balance between economic efficiency and our social character by fulfilling responsibilities to society through a firm commitment to corporate ethics and the secure implementation of environmental protection.

While steadily carrying out the above key action programs, we aim to improve the corporate value of the entire group by making proactive investments in human resources, facilities, and R&D activities, seeking thereby to become a company that can win a higher level of confidence among customers, society, and our markets.

### ■ Target Management Indicators

We have set forth the following numerical targets in its three-year Medium-Term Consolidated Business Plan ending March 31, 2008, with a view towards establishing a profit structure that stably reaches the company ROS of 10% or over.

(Billions of Yen)

	Year ending March 31, 2008	
	Consolidated	Non-consolidated
Net sales	140.0	130.0
Ordinary income	14.0	13.0
Net income	7.5	7.0
Total assets	135.0	130.0
Interest-bearing debts	23.0	20.0
ROS( *)	10%	10%

(\*) ROS: Ordinary income / Net sales

## Specialty Steel



The Specialty Steel segment is involved in the manufacture and distribution of special steel products that draw upon our high cleanliness steel manufacturing technology. For example, we are Japan's largest producer of bearing steel, as well as manufacturing engineering and stainless steels. Our products come in the form of steel bars, wire rods, and steel tubes.

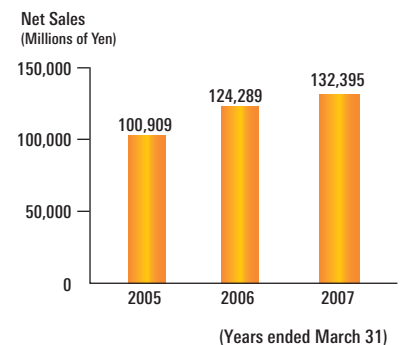
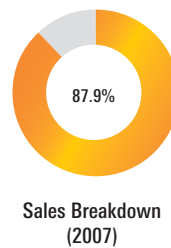
Our steel products have attained the world's highest level of cleanliness, which is supported by highly reliable steelmaking and operational technologies such as the Sanyo New Refining Process ("SNRP"), a steelmaking technology developed based on our unique concept of "controlling the size of the largest inclusion in steel." Moreover we are Japan's only special steel manufacturer that has seamless steel tube manufacturing equipment.

## Overview

Sales volume fell due primarily to the impact of prolonged inventory adjustment in customer sectors. However, net sales increased to ¥132,395 million (up ¥8,105 million year-on-year) due to a steadily improved product mix and more favorable product pricing. We posted operating income of ¥17,389 million (down ¥182 million year-on-year).

Meanwhile, various capital investment projects were progressively completed during fiscal 2006: capital expenditure for productivity improvement in the No.2 Steelmaking Plant; expansion of the steel tube manufacturing plant, including addition of a cold pilger mill; and installation of a new reheating furnace for open die forging. Completion of these projects means that we now possess efficient production systems, and we will boost our marketing efforts for high value-added, strategic products such as high alloy steels and steel tubes.

Also in fiscal 2006, in order to carry out quality improvements, we installed a second, state-of-the-art phased-array across-the-section automatic ultrasonic inspection machine to enhance our inspection systems while establishing mass production technology for high aluminum nitriding steel with multiple continuous casting to ensure stable supply.



Cold pilger mill



Phased-array ultrasonic inspection machine

## Formed & Fabricated Materials



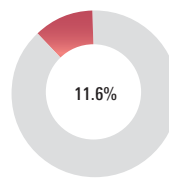
The Formed & Fabricated Materials segment uses an integrated, serial process to manufacture high-quality formed and fabricated materials from “Steel you can count on,” which is produced using our high cleanliness manufacturing technology. Our formed and fabricated materials include cut rings produced by cutting special steel tubes with high precision, forged rings/die forged products/hot rolled rings made from steel bars, and cold roll formed rings made from ring materials.

### Overview

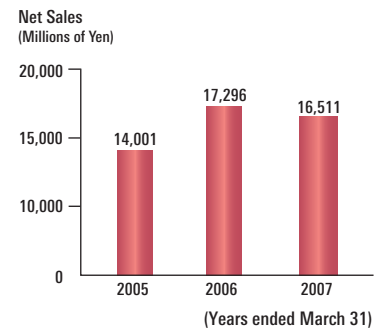
Although product prices improved, sales volume declined due to the effect of inventory adjustment, especially in the bearing industry, which is our major customer. As a result, net sales and operating income both declined, to ¥16,511 million (down ¥786 million year-on-year) and ¥681 million (down ¥396 million year-on-year), respectively.

Meanwhile, we decided to install an additional hot vertical-type forging machine at Ningbo Sanyo Special Steel Products Co., Ltd. (“NSSP”), a Chinese subsidiary for manufacturing formed and fabricated materials, with project completion scheduled for fiscal 2008, in order to cater for expanding automobile production demand in China.

Besides this project, we will continue to address productivity improvement, and cost rationalization for the overall Formed & Fabricated business.



Sales Breakdown (2007)



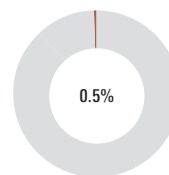
NSSP

## Others

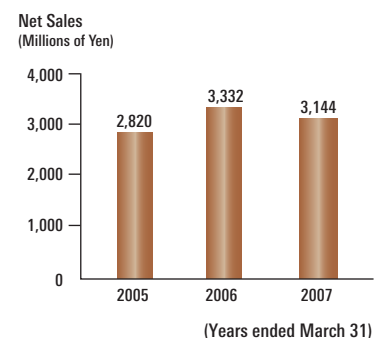
We provide information processing services through our subsidiaries.

### Overview

Net sales declined to ¥3,144 million (down ¥187 million year-on-year) and operating income increased to ¥126 million (up ¥2 million year-on-year).



Sales Breakdown (2007)



### Notes:

Net sales of each business segment include intersegment transactions. However, the sales breakdown is computed based on net sales by each segment to outside customers.

We identify actual customer needs through a thorough analysis of data on social and industrial developments collected through its customer satisfaction-oriented marketing approach and respond to such customer needs with fast-paced research and development. Building on many years of expertise in manufacturing high cleanliness steel, we carry out research and development to improve quality in every area ranging from steel characteristics to stable supply.

## Analytical Technology

- Analysis of inclusions and precipitates
- Rapid analysis of fatigue characteristics
- Advanced CAE simulation ranging from fluid dynamics and thermal analysis to deformation analysis



Ultrasonic fatigue test equipment



Strain distribution of a cold forged gear

## Technological Development

- Steelmaking process
- Manufacturing process
- Forming and fabricating process
- Powder-producing process



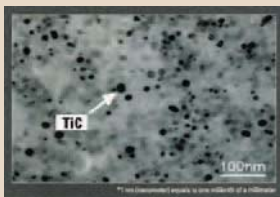
Electric furnace operation



**SANYO SPECIAL STEEL**  
— the Confident Choice

## Materials Development

- Development of state-of-the-art bearing steel
- Development of high-functional engineering steel
- Development of materials related to energy use and the environment
- Development of steel for highly functional dies
- Development of materials for electronics components
- Development of high-functional powder materials



Electron microscopic image of TiC in TMAX steel

## Fundamental Research



High-resolution field emission scanning electron microscope

## ■ Key Products Developed In-House

### ■ Premium Cleanliness Steel

Steel with characteristics improved to the limit

Our premium cleanliness steel was developed from our original concept of “minimizing the size of the largest inclusions within steel,” in order to bring out the utmost in the inherent performance of our flagship products of bearing steel and engineering steel. It satisfies our customers’ needs, especially those in the automobile and industrial machinery sectors, who require “light, small and long-life high-performance parts that are also friendly to the environment.”



Half Toroidal CVT  
(Continuously Variable Transmission)



Bearings

### ■ QCM8 (Tool Steel)

Cold die steel combining high strength and toughness to extend the life of materials

By improving the distribution of carbides in the steel, higher hardness, toughness, fatigue strength and wear resistance than that of SKD11 have been attained. This makes it possible to substantially extend the die life. This steel is an ideal material for cold working tools, and dies used under severe conditions as in cold forging.



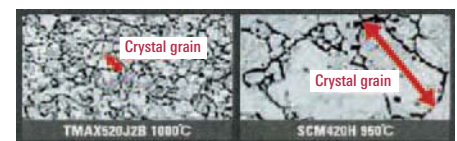
Example of die application

### ■ TMAX Steel (Case Hardening Steel)

Titanium-added case hardening steel improves the higher strength of the material by preventing grain coarsening

TiC (titanium carbide) precipitates are dispersed to provide an excellent pinning effect to prevent grain coarsening during carburization, enabling the simplification of parts manufacturing process due to the shortening of carburizing time by adoption of higher carburizing temperature and the omission of a normalizing treatment after cold forming, as well as the reduction in size and weight of parts due to the higher strength of the material.

Grain growth property of TMAX



TMAX steel

JIS case hardening steel

### ■ INVAR-Z3, INVAR-H3 (New Invar Alloys)

High strength and superior torsional performance helps improve the power transmission efficiency of high voltage lines

These Invar alloys have been specially developed for ultra high voltage power transmission lines, by improving low thermal expanding Invar alloys to achieve superior torsional performance and an unprecedented level of strength.

In addition to high strength, these new alloys also undergo little thermal expansion while transmitting power, thus preventing the lines from sagging during high voltage transmission. Capable of transmitting is approximately twice as much power than ACSR(steel-cored lines), thereby improving power transmission efficiency.



High voltage power transmission lines using Invar alloys

While promoting corporate management with integrity, fairness, and transparency through the practice of our corporate philosophy, “confidence-based management,” we fulfill our economic and social missions in order to gain the confidence of all our stakeholders and build a sustainable relationship with society.

■ Conceptual rendering



# COMPLIANCE STRUCTURE

In order to ensure compliance across the organization, we are working on development, maintenance, and improvement of our systems for familiarizing personnel at all levels with compliance practice.

## Development of Company Rules

- Guidelines for Corporate Behavior** The Guidelines for Corporate Behavior indicate how we should behave as a corporation and underpin all corporate activities.
- Code of Conduct** The Code of Conduct provides “guidance on conduct” in the course of our business activities, based on the Guidelines for Corporate Behavior.
- Corporate Behavior and Ethics Regulations** The Corporate Behavior and Ethics Regulations set forth the rules on promotion of compliance.

## Establishment of Corporate Behavior and Ethics Special Committee

The Committee discusses compliance policies and specific measures based on these policies. If any circumstances or behaviors deviate or are likely to deviate from laws and regulations, etc., the Committee investigates the actual situation and deliberates on appropriate corrective actions.

## Establishment of Whistle-blowing System

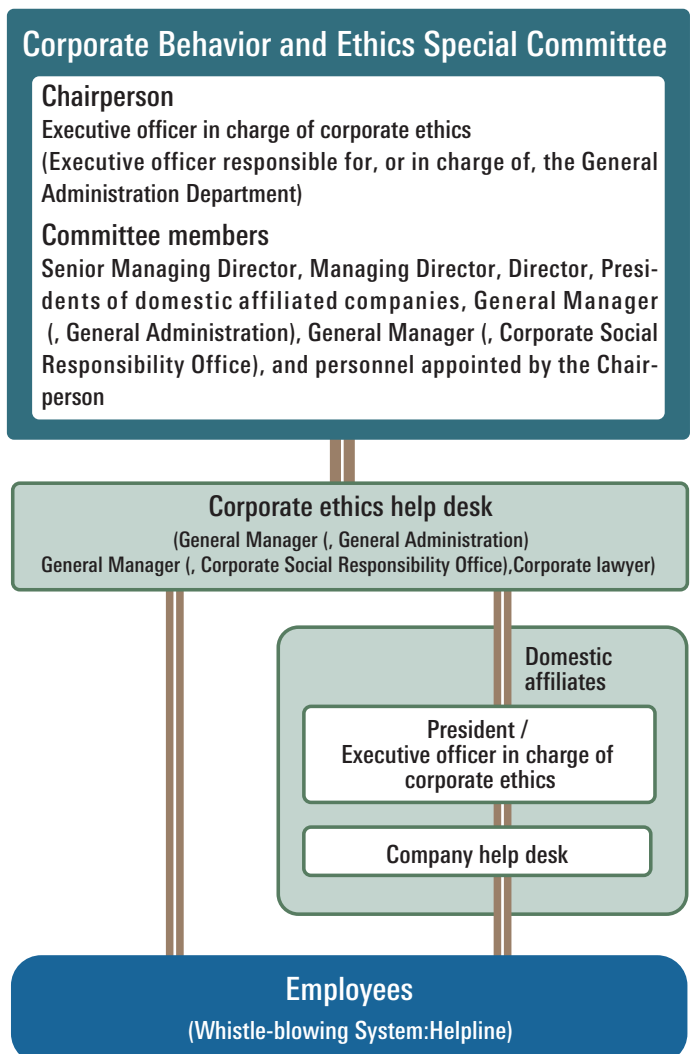
We have initiated “Helpline,” a whistle-blowing system designed to help prevent occurrence and recurrence of misconduct.

Helpline is aimed at facilitating prompt detection of apparent or probable circumstances/acts that could be considered inappropriate in light of laws, regulations, social norms, and/or company rules, in order that swift and appropriate measures can be taken to avoid misconduct.

## Implementation of Compliance Education Programs

We conduct lectures to improve compliance awareness and provide e-learning programs for compliance education.

### Compliance Structure



# ENVIRONMENTAL CONSERVATION

We commit ourselves to environmental conservation in host communities and throughout the globe by ensuring that business activities are always in harmony with the environment.

## ■ Environmental policy

### Environmental philosophy

We, Sanyo Special Steel, understand that environmental issues are important to everyone around the world. We are located in a rich environment surrounded by the World Cultural Heritage and national treasure “Himeji Castle” to the north and the “Setonaikai National Park” to the south. Therefore, we strive to help with environmental preservation at both local and global levels.

### Environmental policy

Based on our company mission statements, listed below, we, Sanyo Special Steel, promote environmental management as a producer and seller of special steels and nonferrous metals.

- 1 We contribute the recycling of metal as we manufacture steel products from steel scrap.
- 2 We abide by laws, regulations, and agreements related to the environment, constantly work hard to improve our environmental preservation systems, and strictly control its business activities that may impact the environment.
- 3 We promote resource and energy savings, strive to reduce waste generation, and suppress emission of pollutants in order to prevent environmental pollution.
- 4 We set environmental goals and targets, review these environmental aims at least once a year and make revisions as necessary, in order to accomplish these environmental missions.
- 5 The general manager of Environmental Management Department is designated as the chief administrator of the environmental system, with the purpose of making these environmental missions known to all of our employees and implementing the environmental system surely.
- 6 These company mission statements are disclosed to the public upon request.

## ■ Environmental Management System

Certified for ISO 14001 international environmental standards, Sanyo Special Steel remains aggressive in further improving its environmental management system. Santoku Tech. Co., Ltd., one of our subsidiaries, has also been certified for ISO 14001, and we will continue to support and promote our group companies in obtaining ISO 14001 certification.

### ■ Environmental management system model



## ■ Initiatives to Improve the Environment

In line with action policies for various environmental improvement measures, we establish medium-/long-term plans and annual plans, and implement these plans throughout the company.

### ■ Our Environmental Improvement Efforts

(Measures)	(Policies)
Energy saving and countermeasures against global warming	<ul style="list-style-type: none"> <li>• Reducing energy consumption rate</li> <li>• Converting fuels to city gas</li> </ul>
Management and reduction of materials with severe environmental impact	<ul style="list-style-type: none"> <li>• Reducing materials in the manufacturing process that put stress on the environment</li> </ul>
Reduction and recycling of byproducts	<ul style="list-style-type: none"> <li>• Reducing landfill disposal waste materials</li> </ul>
Promotion of tree-planting on factory sites	<ul style="list-style-type: none"> <li>• Creating onsite green areas</li> <li>• Improving the landscape by planting trees</li> </ul>
Employee education and awareness campaign	<ul style="list-style-type: none"> <li>• Regular environmental training/education for employees</li> <li>• Encouraging employees to obtain environment-related public qualifications</li> </ul>
Promotion of information disclosure	<ul style="list-style-type: none"> <li>• Proactive disclosure to our stakeholders</li> </ul>

## ! Topics

### We are promoting a dramatic reduction in our carbon dioxide emissions to curb global warming.

A distinctive feature of liquefied natural gas (LNG) is that it is more environment-friendly than heavy oil. In particular, the volume of carbon dioxide emissions from the use of LNG is about 30% less than that from the use of heavy oil. LNG is also beneficial in that it does not emit sulfur oxide and smoke. For these reasons, we are actively promoting a changeover from heavy oil to LNG.

For this purpose, we set aside a total budget of ¥1,300 million in our sixth Medium-Term Business Plan, approx. ¥400 million for fiscal 2005 and approx. ¥900 million for fiscal 2006. At the end of fiscal 2004 our ratio of LNG to heavy oil use was roughly fifty-fifty, but today, the LNG proportion is up to around 70%.

As a result of these efforts, we have successfully reduced our carbon dioxide emissions by 20% compared with fiscal 1990. We will continue to move toward a complete changeover to LNG.



A newly installed reheating furnace also runs on LNG.

# SOCIAL CONTRIBUTIONS

We are actively promoting social contribution programs, which include cleaning and landscaping our neighborhoods, holding flea markets open to community residents, as well as other programs implemented by the Sanyo Special Steel Cultural Promotion Foundation that seek to contribute to the development of regional culture including arts, academic research, and sports such as organizing concerts of elementary and junior high school choirs, donating books to local elementary schools, and sponsoring track meets. Through these activities, we strive to gain the strong confidence of all our stakeholders and grow as a corporate citizen.

## ■ Community Activities

### Beautification of the surrounding area

In September 2006, we conducted a cleanup in the area surrounding our plant. We conduct a cleanup of this type every year as part of our community activities. This year, about 270 employees joined in picking up trash in various parts of the area.



### Flea market opened

In November 2006, we organized our fourth flea market. Various entertainments such as refreshment booths, games, and lucky draws added to the fun, and many local residents, employees, and their families joined in the event, and had a great time. Income earned from this event was used to make a social contribution.



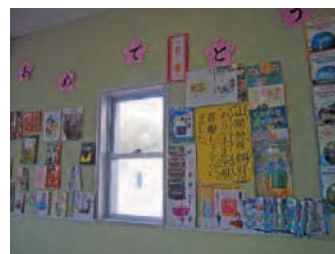
### New Year's concert (Cultural Promotion Foundation program)

The Sanyo Special Steel Cultural Promotion Foundation and the Himeji City board of education co-hosted a New Year's concert in January 2007, inviting choral groups from elementary and junior high schools in Himeji City and surrounding areas. This community program is aimed at providing an opportunity for children to experience the joy of music by exhibiting the results of their daily practice on a big stage. Choral groups from eight schools took part in this, our twelfth contest, and delighted the audience with their beautiful singing voices.



### Donation of books to local elementary schools(Cultural Promotion Foundation program)

The book donation program was started in fiscal 2006 with the hope that reading books will help provide children with opportunities to build a platform for well-rounded personal development. In April 2007, 215 books were donated to a local elementary school.



### Sponsorship of the Himeji Athletic Sports Championship (Cultural Promotion Foundation program)

We sponsored the Himeji Athletic Sports Championship that took place in September 2006. We hope that by participating in and supporting this athletic event, young people will become more interested in sport.



# FINANCIAL SECTION

## Overview

During the year ended March 31, 2007, the Japanese economy continued on a moderate recovery track, supported by a high level of corporate earnings and constantly increasing capital expenditure, despite the weakness observed in personal consumption.

In the special steel industry, production of hot-rolled special steel products remained at a high level, thanks to strong production performance in such key customer sectors as automobiles, which enjoyed good sales in overseas markets, industrial machinery, and construction machinery.

In this business climate, the Sanyo Special Steel Group registered net sales of ¥142,376 million (up ¥8,104 million year-on-year), thanks to improved product pricing and a better product mix, even though sales volume declined due to the impact of prolonged inventory adjustment mainly in automobile-related industries. On the profit front, ordinary income declined, despite a more favorable product mix and cost cuts, to ¥17,947 million (down ¥1,013 million year-on-year), due to such factors as lower sales volume, surging iron scrap prices, price hikes in nickel and other alloy irons (to which a surcharge system is generally applied but in this instance was not sufficiently successful in correcting selling prices for our products), and increased fixed costs.

Net income declined to ¥8,665 million (down ¥2,680 million year-on-year) due to a loss on sale and disposal of fixed assets, etc., provision of a reserve for environmental programs, and an impairment loss on assets of an overseas subsidiary.

The Company paid an annual dividend of ¥11 per share.

## Financial Position

Net cash provided by operating activities was ¥8,237 million (down ¥6,873 million year-on-year). Major factors involved were income before income taxes of ¥15,621 million (down ¥3,359 million year-on-year), depreciation expenses, increased trade accounts payable, increased inventory, and payment of income taxes.

Net cash used in investing activities increased to ¥10,836 million (up ¥3,490 million year-on-year) due to expenditures for productivity improvement, replacement of equipment, and capital expenditure for environmental programs and product quality improvement.

Net cash provided by financing activities was ¥222 million (compared to the net cash outflow of ¥6,172 million for the previous year) because cash inflows from the disposal of treasury stock outweighed cash outflows from payment of dividends and repayment of borrowings.

The balance of cash and cash equivalents as at March 31, 2007 was ¥4,176 million (down ¥2,342 million from the balance at March 31, 2006).

# FINANCIAL SECTION

Sanyo Special Steel Co., Ltd. and Consolidated Subsidiaries

## CONSOLIDATED BALANCE SHEETS

As of March 31, 2006 and 2007

ASSETS	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	2006	2007	2007
<b>Current Assets:</b>			
Cash and bank deposits (Notes 6 and 15)	¥ 6,553	¥ 4,184	\$ 35,434
Notes and accounts receivable, trade (Notes 7 and 18)	31,525	33,688	285,273
Less: Allowance for doubtful accounts	(91)	(244)	(2,067)
Inventories (Note 5)	31,885	38,974	330,034
Deferred income taxes (Note 10)	1,801	1,573	13,320
Other current assets	1,285	852	7,214
Total current assets	72,958	79,027	669,208
<b>Property, Plant and Equipment:</b>			
Land (Note 6)	7,757	7,771	65,805
Buildings and structures (Note 6)	40,321	41,760	353,627
Machinery and equipment (Note 6)	148,897	152,446	1,290,929
Construction in progress	2,667	2,217	18,777
	199,642	204,194	1,729,138
Less: Accumulated depreciation	(144,689)	(148,221)	(1,255,152)
Total property, plant and equipment	54,953	55,973	473,986
<b>Intangibles</b>	976	983	8,326
<b>Investments and Other Assets:</b>			
Investments in securities (Note 4)	7,834	12,744	107,918
Long-term loans receivable	695	410	3,467
Deferred income taxes (Note 10)	183	185	1,563
Prepaid pension cost (Note 9)	2,332	2,439	20,656
Other investments and assets	1,230	1,330	11,267
Less: Allowance for doubtful accounts	(506)	(382)	(3,233)
Total investments and other assets	11,768	16,726	141,638
<b>Total assets</b>	¥ 140,655	¥ 152,709	\$ 1,293,158

These accompanying notes are an integral part of these statements.

<b>LIABILITIES AND NET ASSETS</b>	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	2006	2007	2007
<b>Current Liabilities:</b>			
Short-term loans (Notes 6 and 8)	¥ 9,693	¥ 17,368	\$ 147,077
Current portion of long-term debt (Notes 6 and 8)	11,190	2,519	21,327
Notes and accounts payable, trade (Note 7)	10,957	14,019	118,712
Accounts payable, other	4,094	3,890	32,942
Accrued income taxes (Note 10)	6,267	4,027	34,105
Deferred income taxes (Note 10)	13	13	113
Accrued expenses	6,378	6,976	59,077
Other current liabilities (Note 7)	1,184	624	5,280
Total current liabilities	49,776	49,436	418,633
<b>Long-term Liabilities:</b>			
Long-term debt (Notes 6 and 8)	12,235	9,724	82,347
Accrued employees' retirement benefits (Note 9)	1,345	1,121	9,495
Accrued directors' retirement benefits	436	557	4,711
Provision for environmental measures	—	376	3,184
Deferred income taxes (Note 10)	1,120	1,809	15,320
Other long-term liabilities	136	118	995
Total long-term liabilities	15,272	13,705	116,052
Total liabilities	65,048	63,141	534,685
<b>Net Assets (Note 11)</b>			
<b>Shareholders' Equity:</b>			
Common stock:			
Authorized - 474,392,000 shares			
Issued - 167,124,036 shares	¥ 20,183	¥ 20,183	\$ 170,909
Capital surplus	17,594	22,591	191,300
Retained earnings	36,455	43,085	364,852
Less: Treasury stock, at cost (2006: 9,420,047 shares, 2007: 3,979,082 shares)	(1,467)	(664)	(5,622)
Total shareholders' equity	72,765	85,195	721,439
<b>Valuation, Translation Adjustments and Others:</b>			
Unrealized holding gains on securities, net of taxes	2,687	4,175	35,353
Unrealized losses on hedging derivatives, net of taxes	—	(6)	(49)
Foreign currency translation adjustments	(271)	(51)	(433)
Valuation, Translation Adjustments and Others	2,416	4,118	34,871
<b>Minority Interests</b>	426	255	2,163
Total net assets	75,607	89,568	758,473
<b>Contingent Liabilities (Note 18)</b>			
Total liabilities and net assets	¥ 140,655	¥ 152,709	\$ 1,293,158

These accompanying notes are an integral part of these statements.

# FINANCIAL SECTION

Sanyo Special Steel Co., Ltd. and Consolidated Subsidiaries

## CONSOLIDATED STATEMENTS OF INCOME

For the years ended March 31, 2006 and 2007

	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	2006	2007	2007
<b>Net Sales</b>	¥ 134,272	¥ 142,376	\$ 1,205,656
<b>Cost of Sales (Note 12)</b>	104,330	112,820	955,373
Gross profit	29,942	29,556	250,283
<b>Selling, General and Administrative Expenses (Note 12)</b>	11,082	11,367	96,256
Operating income	18,860	18,189	154,027
<b>Other Income:</b>			
Interest and dividends	122	167	1,414
Other	812	421	3,567
	934	588	4,981
<b>Other Expenses:</b>			
Interest	(533)	(501)	(4,242)
Other	(302)	(329)	(2,792)
	(835)	(830)	(7,034)
Ordinary income	18,959	17,947	151,974
<b>Special Items:</b>			
Loss on sale and disposition of property, plant and equipment	(744)	(491)	(4,154)
Loss on impairment of fixed assets (Note 13)	—	(1,454)	(12,311)
Gain on sale of investments in securities and others	23	0	1
Loss on devaluation of investments in securities and others	(2)	(3)	(24)
Allowance for doubtful accounts	—	(2)	(19)
Reversal of allowance for doubtful accounts	26	—	—
Expenses for environmental measures	—	(376)	(3,184)
Gain on transfer to the defined contribution pension plan (Note 9)	719	—	—
	22	(2,326)	(19,691)
Income before income taxes and minority interests	18,981	15,621	132,283
<b>Income Taxes (Note 10):</b>			
Current	6,328	7,030	59,535
Deferred	1,422	117	989
	7,750	7,147	60,524
<b>Minority Interests in Loss of Consolidated Subsidiaries</b>	114	191	1,614
Net income	¥ 11,345	¥ 8,665	\$ 73,373
	Yen		U.S. Dollars (Note 3)
	2006	2007	2007
<b>Per Share:</b>			
Net income (Note 14)	¥ 71.17	¥ 53.55	\$ 0.45
Cash dividends	¥ 11.00	¥ 11.00	\$ 0.09
Net assets	¥ 475.99	¥ 547.44	\$ 4.64

These accompanying notes are an integral part of these statements.

Sanyo Special Steel Co., Ltd. and Consolidated Subsidiaries

## CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31, 2006

	Number of outstanding common shares	Millions of Yen				
		Common stock	Capital surplus	Retained earnings	Treasury stock, at cost	
Balance at March 31, 2005:	167,124,036	¥ 20,183	¥ 17,594	¥ 26,293	¥ (1,369)	
Net income	—	—	—	11,345	—	
Cash dividends paid	—	—	—	(1,105)	—	
Directors' and corporate auditors' bonuses	—	—	—	(78)	—	
Acquisition of treasury stock	—	—	—	—	(98)	
Disposal of treasury stock	—	—	0	—	—	
Other change for fiscal 2005, net	—	—	—	—	—	
Total change for this fiscal 2005	—	—	—	10,162	(98)	
Balance at March 31, 2006:	167,124,036	¥ 20,183	¥ 17,594	¥ 36,455	¥ (1,467)	

	Millions of Yen				
	Unrealized gains on securities, net of taxes	Unrealized losses on hedging derivatives, net of taxes	Foreign currency translation adjustments	Minority interests	Total
Balance at March 31, 2005:	¥ 1,253	¥ —	¥ (427)	¥ 375	¥ 63,902
Net income	—	—	—	—	11,345
Cash dividends paid	—	—	—	—	(1,105)
Directors' and corporate auditors' bonuses	—	—	—	—	(78)
Acquisition of treasury stock	—	—	—	—	(98)
Disposal of treasury stock	—	—	—	—	0
Other change for fiscal 2005, net	1,434	—	156	51	1,641
Total change for this fiscal 2005	1,434	—	156	51	11,705
Balance at March 31, 2006:	¥ 2,687	¥ —	¥ (271)	¥ 426	¥ 75,607

These accompanying notes are an integral part of these statements.

# FINANCIAL SECTION

Sanyo Special Steel Co., Ltd. and Consolidated Subsidiaries

## CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31, 2007

	Number of outstanding common shares	Millions of Yen			
		Common stock	Capital surplus	Retained earnings	Treasury stock, at cost
<b>Balance at March 31, 2006:</b>	<b>167,124,036</b>	<b>¥ 20,183</b>	<b>¥ 17,594</b>	<b>¥ 36,455</b>	<b>¥ (1,467)</b>
Net income	—	—	—	8,665	—
Cash dividends paid	—	—	—	(1,920)	—
Directors' and corporate auditors' bonuses	—	—	—	(115)	—
Acquisition of treasury stock	—	—	—	—	(59)
Disposal of treasury stock	—	—	4,997	—	862
Other change for fiscal 2006, net	—	—	—	—	—
Total change for this fiscal 2006	—	—	4,997	6,630	803
<b>Balance at March 31, 2007:</b>	<b>167,124,036</b>	<b>¥ 20,183</b>	<b>¥ 22,591</b>	<b>¥ 43,085</b>	<b>¥ (664)</b>

	Millions of Yen				
	Unrealized gains on securities, net of taxes	Unrealized losses on hedging derivatives, net of taxes	Foreign currency translation adjustments	Minority interests	Total
<b>Balance at March 31, 2006:</b>	<b>¥ 2,687</b>	<b>¥ —</b>	<b>¥ (271)</b>	<b>¥ 426</b>	<b>¥ 75,607</b>
Net income	—	—	—	—	8,665
Cash dividends paid	—	—	—	—	(1,920)
Directors' and corporate auditors' bonuses	—	—	—	—	(115)
Acquisition of treasury stock	—	—	—	—	(59)
Disposal of treasury stock	—	—	—	—	5,859
Other change for fiscal 2006, net	1,488	(6)	220	(171)	1,531
Total change for this fiscal 2006	1,488	(6)	220	(171)	13,961
<b>Balance at March 31, 2007:</b>	<b>¥ 4,175</b>	<b>¥ (6)</b>	<b>¥ (51)</b>	<b>¥ 255</b>	<b>¥ 89,568</b>

	Number of outstanding common shares	Thousands of U.S. Dollars (Note3)			
		Common stock	Capital surplus	Retained earnings	Treasury stock, at cost
<b>Balance at March 31, 2006:</b>	<b>167,124,036</b>	<b>\$ 170,909</b>	<b>\$ 148,992</b>	<b>\$ 308,713</b>	<b>\$ (12,425)</b>
Net income	—	—	—	73,373	—
Cash dividends paid	—	—	—	(16,257)	—
Directors' and corporate auditors' bonuses	—	—	—	(977)	—
Acquisition of treasury stock	—	—	—	—	(496)
Disposal of treasury stock	—	—	42,308	—	7,299
Other change for fiscal 2006, net	—	—	—	—	—
Total change for this fiscal 2006	—	—	42,308	56,139	6,803
<b>Balance at March 31, 2007:</b>	<b>167,124,036</b>	<b>\$ 170,909</b>	<b>\$ 191,300</b>	<b>\$ 364,852</b>	<b>\$ (5,622)</b>

	Thousands of U.S. Dollars (Note3)				
	Unrealized gains on securities, net of taxes	Unrealized losses on hedging derivatives, net of taxes	Foreign currency translation adjustments	Minority interests	Total
<b>Balance at March 31, 2006:</b>	<b>\$ 22,754</b>	<b>\$ —</b>	<b>\$ (2,298)</b>	<b>\$ 3,607</b>	<b>\$ 640,252</b>
Net income	—	—	—	—	73,373
Cash dividends paid	—	—	—	—	(16,257)
Directors' and corporate auditors' bonuses	—	—	—	—	(977)
Acquisition of treasury stock	—	—	—	—	(496)
Disposal of treasury stock	—	—	—	—	49,607
Other change for fiscal 2006, net	12,599	(49)	1,865	(1,444)	12,971
Total change for this fiscal 2006	12,599	(49)	1,865	(1,444)	118,221
<b>Balance at March 31, 2007:</b>	<b>\$ 35,353</b>	<b>\$ (49)</b>	<b>\$ (433)</b>	<b>\$ 2,163</b>	<b>\$ 758,473</b>

These accompanying notes are an integral part of these statements.

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the years ended March 31, 2006 and 2007

	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	2006	2007	2007
<b>Cash Flows from Operating Activities:</b>			
Income before income taxes and minority interests	¥ 18,981	¥ 15,621	\$ 132,283
Adjustments -			
Depreciation and amortization	5,334	5,933	50,242
Loss on impairment of fixed assets	—	1,454	12,311
(Decrease) Increase in allowance for doubtful accounts	(13)	36	307
Provision for (Reversal of) accrued employees' retirement benefits, less payments	894	(224)	(1,899)
Increase in prepaid pension cost	(2,332)	(108)	(910)
Provision for accrued directors' retirement benefits, less payments	62	121	1,021
Expenses for environmental measures	—	376	3,184
Interest and dividends income	(122)	(167)	(1,414)
Interest expenses	533	501	4,242
Gain on sale of investments in securities	(25)	(0)	(1)
Loss on devaluation of investments in securities	2	0	7
Loss on sale and disposition of property, plant and equipment	744	491	4,154
Payments of directors' and corporate auditors' bonuses	(78)	(115)	(977)
Changes in assets and liabilities:			
Notes and accounts receivable, trade	(6,445)	(2,120)	(17,952)
Inventories	(2,912)	(6,957)	(58,915)
Notes and accounts payable, trade	1,665	3,175	26,888
Other, net	(211)	(82)	(693)
Sub-total	16,077	17,935	151,878
Interest and dividends income received	100	174	1,476
Interest expenses paid	(534)	(502)	(4,254)
Income taxes paid	(533)	(9,370)	(79,344)
Net cash provided by operating activities	15,110	8,237	69,756
<b>Cash Flows from Investing Activities:</b>			
Payments for purchases of property, plant and equipment	(7,122)	(7,711)	(65,295)
Payments for purchases of intangible assets	(176)	(313)	(2,652)
Collections from sale (Payments for purchases) of investments in securities	29	(2,585)	(21,894)
Decrease in long-term loans	99	42	356
Other, net	(176)	(269)	(2,279)
Net cash used in investing activities	(7,346)	(10,836)	(91,764)
<b>Cash Flows from Financing Activities:</b>			
(Decrease) Increase in short-term loans	(4,618)	7,521	63,685
Repayment of long-term debt	(352)	(11,170)	(94,589)
Payments for purchases of treasury stock	(98)	(59)	(496)
Proceeds from sales of treasury stock	0	5,858	49,607
Cash dividends	(1,104)	(1,920)	(16,257)
Cash dividends to minority shareholders	—	(8)	(70)
Net cash (used in) provided by financing activities	(6,172)	222	1,880
<b>Effect of Exchange Rate Changes on Cash and Cash Equivalents</b>	96	34	292
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	1,688	(2,343)	(19,836)
<b>Cash and Cash Equivalents at Beginning of the Year</b>	4,831	6,519	55,200
<b>Cash and Cash Equivalents at End of the Year (Note 15)</b>	¥ 6,519	¥ 4,176	\$ 35,364

Sanyo Special Steel Co., Ltd. and Consolidated Subsidiaries

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. Basis of Presenting Consolidated Financial Statements:

The accompanying consolidated financial statements of Sanyo Special Steel Co., Ltd. (the "Company") and its consolidated subsidiaries (the group referred to herein as "Companies") have been prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to

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.

### 2. Summary of Significant Accounting Policies:

#### (1) Consolidation and investments in affiliates -

##### (a) Scope of consolidation and elimination

The Company has 11 subsidiaries as of March 31, 2007 (12 subsidiaries as of March 31, 2006). The consolidated financial statements include the accounts of the Company and 11 of its significant subsidiaries. The 11 significant subsidiaries that have been consolidated for 2007 are listed below:

Yohkoh Bussan Co., Ltd.  
Santoku Seiken Co., Ltd.  
Santoku Kogyo Co., Ltd.  
Santoku Tech Co., Ltd.  
Santoku Life Co., Ltd.  
Santoku Computer Service Co., Ltd.  
SKJ Metal Industries Co., Ltd.  
P.T. Sanyo Special Steel Indonesia  
Sanyo Special Steel U.S.A., Inc.  
Sanyo Special Steel America Corporation  
Ningbo Sanyo Special Steel Products Co., Ltd.

The differences between the cost of investments in subsidiaries and the underlying equity in net assets of the subsidiaries are amortized on a straight-line basis over 5 years.

The consolidated subsidiaries, except for the 5 foreign consolidated subsidiaries (SKJ Metal Industries Co., Ltd., P.T. Sanyo Special Steel Indonesia, Sanyo Special Steel U.S.A., Inc., Sanyo Special Steel America Corporation and Ningbo Sanyo Special Steel Products Co., Ltd.), use a fiscal year ending on March 31, which is the same as that of the Company. The 5 foreign consolidated subsidiaries use a fiscal year ending on December 31. For these subsidiaries, certain adjustments are made, if appropriate, in preparing the consolidated financial statements to reflect material transactions which occurred during the period from January 1 to March 31.

For the purpose of preparing the consolidated financial statements, all significant inter-company transactions, account balances and unrealized profits among the Companies have been eliminated.

Santoku Foods Co., Ltd., which was not a consolidated subsidiary, was dissolved in March, 2007.

##### (b) Investments in affiliates

Investments in affiliates in which the Companies have significant influence are accounted for under the equity method.

Investments in Advanced Green Components, LLC is accounted for under the equity method.

The equity method has not been applied to the investments in another affiliate in the consolidated financial statements since the equity method of accounting for the investments in the affiliate would not have a material effect on the consolidated net income and retained earnings of the Companies.

#### (2) Foreign currency translation -

Foreign currency transactions are translated into Japanese yen at the exchange rates prevailing at the respective transaction dates. All monetary assets and liabilities denominated in foreign currencies, whether long-term or short-term, are translated into Japanese yen at the exchange rates prevailing at the balance sheet date. Resulting gains and losses are included in net profit or loss for the period.

All assets and liabilities of the foreign subsidiaries are translated into Japanese yen at the exchange rates prevailing at the balance sheet date. All income and expense accounts for the year are also translated at those rates. These differences are recorded as a separate component of net assets.

#### (3) Securities -

The accounting standard for financial instruments requires that securities be classified into three categories: trading securities, held-to-maturity debt securities or other securities. All of the securities held by the Companies are classified as other securities.

Under the standard, marketable securities classified as other securities are carried at fair value with changes in unrealized holding gain or loss, net of the applicable income taxes, are included directly in net assets. Non-marketable securities classified as other securities are carried at cost. Declines in the value of other securities are reflected in current income unless deemed to be temporary. Cost of securities sold is determined by the moving average method.

#### (4) Derivative Transactions -

The Company and its subsidiaries use foreign exchange forward contracts and interest rate swap to reduce its exposure to market risks from fluctuations in foreign currency and interest rates. The Company does not hold or issue financial derivative instruments for trading purpose.

With regards to foreign exchange forward contracts, unrealized gains/losses of derivative transactions are recognized in the consolidated statements of income.

With regards to interest rate swap transactions, the Company and its subsidiaries use the deferral method based on the short-cut method assuming that there is no ineffectiveness in the hedging relationship between hedged items and hedging instruments, if the criteria for short-cut method are met. If the criteria for hedge accounting are met, even though those for short-cut method are not met, the Company and its subsidiaries use the deferral method for interest rate swap transactions. Notional amounts, fair value and unrealized gains/losses of derivative transactions are not required to be disclosed due to the adoption of hedge accounting.

#### (5) Inventories -

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

(6) Depreciation and amortization -

Depreciation of buildings, structures, machinery, equipment, vehicles and tools at No. 2 Melt Shop and No. 2 Bar, Wire Rod and Wire Mill Shop is computed on the straight-line method, based on their estimated useful lives. In addition the Company has computed the depreciation using the straight-line method for buildings (excluding leasehold improvements and auxiliary facilities attached to buildings), which have been acquired on or after April 1, 1998. Depreciation of property, plant and equipment other than those described above, is computed on the declining-balance method.

The cost of property, plant and equipment retired or otherwise disposed of and the related accumulated depreciation are eliminated from the respective accounts, and the resulting profit or loss is reflected in income. Repairs and maintenance, including minor renewals and betterments, are charged to income as incurred.

Amortization of capitalized software costs for internal use is computed on the straight-line method, based on the useful lives estimated to be 5 years. Amortization of other intangible assets are computed on the straight-line method.

(7) Research and development costs -

Research and development costs are charged to income as incurred.

(8) Allowance for doubtful accounts -

The allowance for doubtful accounts is provided at the amount, which is calculated based on the past loss experience, plus the amount estimated to be uncollectible on an individual account basis.

(9) Employees' retirement benefits -

Employees whose service with the Company and its principal consolidated subsidiaries are terminated, under most circumstances, are entitled to retirement benefits determined by reference to current basic rates of pay, length of service and conditions under which the terminations occur.

Accrued employees' retirement benefits are based on the actuarial valuation of projected benefit obligations and the fair value of the plan assets. Prior service costs are amortized on a straight-line basis over the period of 10 years from the year when they arise. Actuarial differences are amortized on a straight-line basis over the period of 10 years from the year next to the year when they arise.

Following the enactment of the Defined Contribution Pension Law, the Company changed its pension plan from a non-contributory defined benefit pension plan (a tax-qualified pension plan) to defined contribution pension plan in January 2006. The Company recognized a gain on transfer to the defined contribution pension plan of ¥ 719 million (\$6,118 thousand) for the year ended March 31, 2006.

(10) Directors' retirement benefits -

As is a customary practice in Japan, the Company provides for lump-sum payments to retiring directors and corporate auditors, the amount of which is determined by reference to the Company's internal rules. The amounts of such retirement payments are subject to approval by the shareholders at the time of an individual director's or corporate auditor's resignation or retirement.

(11) Provision for Environmental Measures

The provision for environmental measures for obligatory PCB

treatment is stated as an estimated cost at the end of the fiscal year.

(12) Income taxes -

The Company and its consolidated subsidiaries adopt deferred tax accounting for preparation of consolidated financial statements. Income taxes are determined using the asset and liability method, where deferred tax assets and liabilities are recognized for temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements.

(13) Revenue recognition -

Sales are generally recognized at the time the goods are delivered or shipped to the customers.

(14) Finance leases -

Finance leases, other than those where ownership of the leased assets are transferred to the lessee, are accounted for as operating leases.

(15) Net income and cash dividends per share -

Net income per share is computed by dividing net income available for distribution to shareholders of common stock by the weighted-average number of shares of common stock outstanding during the year.

Cash dividends per share shown for each year in the consolidated statements of income represent dividends declared as applicable to the respective years rather than those paid during the years.

(16) Cash and cash equivalents -

Cash and cash equivalents in the consolidated statements of cash flows are composed of cash on hand, bank deposits able to be withdrawn on demand and short-term investments with an original maturity of three months or less and which represent a minor risk of fluctuations in value.

(17) Consumption tax -

In Japan, a consumption tax, with certain exemptions, is imposed on domestic consumption of goods and services at the rate of 5%. The consumption tax imposed on the Company and its domestic subsidiaries sales to customers is withheld at the time of sale and is subsequently paid to the national government. The consumption tax withheld upon sale is not included in the amount of "net sales" in the consolidated statements of income but is recorded as liabilities. The consumption tax imposed on the purchases of products, merchandise and services from vendors borne by the Company and its domestic subsidiaries, is not included in the amounts of costs and expenses but is recorded as assets. The balance of consumption tax withheld, netted of consumption tax paid, is included in "Other current liabilities" in the consolidated balance sheets.

(18) Accounting standard for presentation of net assets in the balance sheet -

Effective from the year ended March 31, 2007, the Company and its consolidated subsidiaries adopted the new accounting standard, "Accounting Standard for Presentation of Net Assets in the Balance Sheet" (Statement No.5 issued by the Accounting Standards Board of Japan on December 9, 2005), and the implementation guidance for the accounting standard for presentation of net assets in the balance sheet (the Financial Accounting Standard Implementation Guidance No. 8 issued by the Accounting Standards Board of Japan on December 9, 2005), (collectively, the "New Accounting Standards").

Under the New Accounting Standards, the balance sheet

comprises three sections, which are the assets, liabilities and net assets sections. Previously, the balance sheet comprised the assets, liabilities, minority interests, as applicable, and the shareholders' equity sections.

**(19) Accounting standard for statement of changes in net assets -**

Effective from the year ended March 31, 2007, the Company and its consolidated subsidiaries adopted the new accounting standard, "Accounting Standard for Statement of Changes in Net Assets" (Statement No.6 issued by the Accounting Standards Board of Japan on December 27, 2005), and the implementation guidance for the accounting standard for statement of changes in net assets (the Financial Accounting Standard Implementation Guidance No. 9 issued by the Accounting Standards Board of Japan on December 27, 2005), (collectively, the "Additional New Accounting Standards"). Accordingly, the Company prepared the statements of changes in net assets for the year ended March 31, 2007 in accordance with the Additional New Accounting Standards. Also, the Company voluntarily prepared the consolidated statement of changes in net assets for 2006 in

accordance with the Additional New Accounting Standards. Previously, consolidated statements of shareholders' equity were prepared for the purpose of inclusion in the consolidated financial statements although such statements were not required under Japanese GAAP.

**(20) Reclassifications and restatement -**

Certain prior year amounts have been reclassified to conform to the current year presentation.

Also, as described in Note 2 (18), and Note 2 (19), the consolidated balance sheet for 2006 has been adapted to conform to new presentation rules of 2007. Also, in lieu of the consolidated statement of shareholders' equity for the year ended March 31, 2006, which was prepared on a voluntary basis for inclusion in the 2006 consolidated financial statements, the Company prepared the consolidated statement of changes in net assets for 2006 as well as for 2007.

These reclassifications had no impact on previously reported results of operations or retained earnings.

### 3. U.S. Dollar Amounts:

The U.S. dollar amounts stated in the consolidated financial statements are included solely for the convenience of readers outside Japan. These translations should not be construed as representations that the Japanese yen amounts actually represent, or have been or could be converted into U.S. dollars. The rate of ¥118.09 = U.S.\$1, the approximate rate of exchange as at March 31, 2007, has been used for the purpose of such translations.

### 4. Securities:

(1) The aggregate acquisition cost and fair value (carrying value) of marketable securities classified as other securities as of March 31, 2006 and 2007 are as follows:

	Millions of Yen						Thousands of U.S. Dollars		
	2006			2007			2007		
	Acquisition cost	Fair value (Carrying value)	Unrealized gain	Acquisition cost	Fair value (Carrying value)	Unrealized gain	Acquisition cost	Fair value (Carrying value)	Unrealized gain
Securities whose carrying value exceeds their acquisition cost:									
Stock	¥ 2,126	¥ 6,649	¥ 4,523	¥ 4,587	¥ 11,401	¥ 6,814	\$ 38,840	\$ 96,548	\$ 57,708
Total	¥ 2,126	¥ 6,649	¥ 4,523	¥ 4,587	¥ 11,401	¥ 6,814	\$ 38,840	\$ 96,548	\$ 57,708

The Companies recognize impairment losses on other securities when the market value declines by more than 50 percent, or the market value declines by more than 30 percent but less than 50 percent and the Companies' management determines the decline to be other than temporary. Impairment losses were not recognized for the year ended March 31, 2006 and 2007.

(2) For the years ended March 31, 2006, and 2007 sales of other securities amounted to ¥30 million and ¥0 million (\$2 thousand) with gross realized gains on those sales of ¥25 million and ¥0 million (\$1 thousand).

(3) Carrying values of other securities without quoted market prices as of March 31, 2006 and 2007 are summarized as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2007	2007
Other securities			
Unlisted securities	¥ 501	¥ 625	\$ 5,292

Impairment losses recognized for the year ended March 31, 2006 and 2007 were ¥2 million and ¥1 million (\$7 thousand), respectively.

### 5. Inventories:

Inventories held by the Companies at March 31, 2006 and 2007 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2007	2007
Merchandise	¥ 1,410	¥ 1,045	\$ 8,844
Finished products	4,628	5,729	48,516
Raw materials	9,268	10,048	85,091
Work-in-process	13,493	18,801	159,208
Supplies	3,086	3,351	28,375
Total	¥ 31,885	¥ 38,974	\$ 330,034

## 6. Assets Pledged as Collateral:

A breakdown of assets pledged as collateral and the related secured liabilities as of March 31, 2006 and 2007 are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2007	2007
Assets pledged as collateral:			
Cash and bank deposits	¥ 27	¥ —	\$ —
Land	4,748	4,595	38,908
Buildings and structures	8,007	6,385	54,066
Machinery and equipment	11,248	10,026	84,904
	<u>¥ 24,030</u>	<u>¥ 21,006</u>	<u>\$ 177,878</u>
Secured liabilities:			
Short-term loans	¥ 319	¥ —	\$ —
Long-term debt (including those due within one year)	22,478	11,525	97,595
	<u>¥ 22,797</u>	<u>¥ 11,525</u>	<u>\$ 97,595</u>

## 7. Accounting treatment for notes receivable/payable maturing at year-end

Notes receivable/payable maturing at year-end are treated as if they were settled at the clearing date of notes. Consequently, as the current year's year-end date was a holiday for banking institutions, the following notes receivable/payable maturing at March 31, 2007 are included in the ending balance of notes receivable/payable and other current liabilities:

	Millions of Yen	Thousands of U.S. Dollars
Notes receivable	¥ 847	\$ 7,174
Notes payable	¥ 523	\$ 4,426
Other current liabilities	¥ 49	\$ 415

## 8. Short-term Loans and Long-term Debt:

Short-term loans at March 31, 2006 and 2007 represent bank overdrafts bearing with a weighted-average interest rate of 1.63% and 1.28%, respectively. It is normal business custom in Japan for short-term borrowings to be rolled over each year. The Company has entered into line of credit agreements for short-term financing arrangements with 3 financial institutions for an aggregated maximum amount of ¥5,000 million (\$42,341 thousand). At March 31 2007, there were unused credit lines of ¥5,000 million (\$42,341 thousand).

Long-term debt at March 31, 2006 and 2007, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2007	2007
Loans from banks and other financial institutions due 2006 to 2010 with interest rates ranging from 0.80% to 7.75% at March 31, 2006 and due 2007 to 2010 with interest rates ranging from 1.26% to 4.59% at March 31, 2007	¥ 23,216	¥ 12,051	\$ 102,046
Other payables due 2006 to 2021 with interest rate ranging from 1.80% to 4.05% at March 31, 2006 and due 2007 to 2021 with interest rate ranging from 2.02% to 4.05% at March 31, 2007	209	192	1,628
	<u>23,425</u>	<u>12,243</u>	<u>103,674</u>
Less: Portion due within one year	<u>(11,190)</u>	<u>(2,519)</u>	<u>(21,327)</u>
	<u>¥ 12,235</u>	<u>¥ 9,724</u>	<u>\$ 82,347</u>

The annual maturities of long-term debt outstanding at March 31, 2007 are as follows:

Year ending at March 31,	Millions of Yen	Thousands of U.S. Dollars
2008	¥ 2,519	\$ 21,327
2009	9,356	79,229
2010	117	994
2011	119	1,006
2012 and thereafter	132	1,118
	<u>¥ 12,243</u>	<u>\$ 103,674</u>

## 9. Retirement benefits:

The Company has a severance indemnity plan and defined contribution pension plan. The Company changed a certain of its pension plan from a non-contributory defined benefit pension plan (a tax qualified pension plan) to the defined contribution pension plan in January 2006. Certain consolidated subsidiaries have severance indemnity plans.

(1) Funded status of retirement benefit obligation at March 31, 2006 and 2007 are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2007	2007
Projected benefit obligation	¥ (8,219)	¥ (8,331)	\$ (70,547)
Plan assets at fair value	13,059	13,288	112,523
Unfunded projected benefit obligation	4,840	4,957	41,976
Unrecognized actuarial loss	(3,510)	(3,345)	(28,326)
Unrecognized prior service costs	(343)	(294)	(2,489)
Net of Accrued employees' retirement benefits recognized in the consolidated balance sheets	987	1,318	11,161
Prepaid pension cost	2,332	2,439	20,656
Accrued employees' retirement benefits recognized in the consolidated balance sheets	¥ (1,345)	¥ (1,121)	\$ (9,495)

Consolidated subsidiaries have adopted a simplified method to calculate their projected benefit obligation, which is permitted under the accounting standard for retirement benefits in Japan.

(2) Components of net retirement benefit expenses for the years ended March 31, 2006 and 2007 are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2007	2007
Service cost	¥ 453	¥ 347	\$ 2,940
Interest cost	283	221	1,873
Expected return on plan assets	(165)	(168)	(1,422)
Amortization of prior service costs	(65)	(49)	(415)
Amortization of actuarial loss	228	(242)	(2,048)
Gain on transfer to the defined contribution pension plan	(719)	—	—
Payments for the defined contribution pension plan	39	165	1,393
Total	¥ 54	¥ 274	\$ 2,321

Consolidated subsidiaries adopt a simplified method to calculate their projected benefit obligation. These costs are also included in service costs above.

(3) Assumptions used in the calculation of retirement benefit obligations, for the years ended March 31, 2006 and 2007 are as follows:

	2006	2007
Discount rate	2.8%	2.8%
Expected rate of return on plan assets	1.6%	1.3%
Method of attributing the projected benefits to periods of service	Straight-line basis	Straight-line basis
Amortization period for unrecognized prior service costs	10 years	10 years
Amortization period for unrecognized actuarial differences	10 years	10 years

## 10. Income Taxes:

The Company is subject to a number of different income taxes which, in the aggregate, resulted in a statutory income tax rate in Japan of approximately 40.6% for the years ended March 31, 2006 and 2007, respectively. At March 31, 2006 and 2007, significant components of deferred tax assets and liabilities are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2007	2007
Deferred tax assets:			
Amortization of transition obligations corresponding to contribution of certain marketable securities to employee retirement benefit trust	¥ 2,961	¥ 2,961	\$ 25,077
Accrued bonuses	879	878	7,434
Devaluation loss on marketable securities	754	754	6,386
Accrued employees' retirement benefits	626	573	4,855
Tax losses carried forward	246	318	2,692
Business tax payable	497	318	2,688
Unrealized intercompany profit eliminated in consolidation	239	231	1,958
Accrued directors' retirement benefits	177	225	1,909
Allowance for doubtful accounts	182	162	1,369
Provision for environmental measures	—	153	1,293
Other	501	689	5,837
Gross deferred tax assets	7,062	7,262	61,498
Less: Valuation allowance	(103)	(341)	(2,888)
Total deferred tax assets	¥ 6,959	¥ 6,921	\$ 58,610
Deferred tax liabilities:			
Unrealized holding gains on securities	¥ (1,836)	¥ (2,640)	\$ (22,354)
Gain on contribution of certain marketable securities to employee retirement benefit trust	(1,597)	(1,597)	(13,527)
Reserve for postponement of taxation on capital gains from property, plant and equipment	(1,371)	(1,323)	(11,206)
Prepaid pension cost	(947)	(990)	(8,387)
Reserve for special depreciation	(52)	(38)	(321)
Other	(306)	(398)	(3,365)
Gross deferred tax liabilities	(6,109)	(6,986)	(59,160)
Net deferred tax assets (liabilities)	¥ 850	¥ (65)	\$ (550)

The reconciliation between the statutory income tax rate and the effective income tax rate for the year ended March 31, 2006, was not required to be disclosed due to the insignificance of the differences. The reconciliation between the statutory income tax rate and the effective income tax rate for the years ended March 31, 2007 is as follows:

Statutory income tax rate	40.6%
Add (Deduct)	
Non deductible expenses, including entertainment expenses	0.8
Non taxable income, including dividend income	(0.2)
Equalization tax	0.1
Increase in valuation allowance	1.5
Other	3.0
Effective income tax rate	45.8%

## 11. Net Assets:

The Japanese Corporate Law (“the Law”) became effective on May 1, 2006, replacing the Japanese Commercial Code (“the Code”). The Law is generally applicable to events and transactions occurring after April 30, 2006 and for fiscal years ending after that date.

Under Japanese laws and regulations, the entire amount paid for new shares is required to be designated as common stock. However, a company may, by a resolution of the Board of Directors, designate an amount not exceeding one-half of the price of the new shares as additional paid-in capital, which is included in capital surplus. Under the Law, in cases where a dividend distribution of surplus is made, the smaller of an amount equal to 10% of the dividend or the excess, if any, of 25% of common stock over the total of additional paid-in-capital and legal earnings reserve must be set aside as additional paid-in-capital or legal earnings reserve. Legal earnings reserve is included in retained earnings in the accompanying consolidated balance sheets.

Under the Code, companies were required to set aside an amount equal to at least 10% of the aggregate amount of cash dividends and other cash appropriations as legal earnings reserve until the total of legal earnings reserve and additional paid-in capital equaled 25% of common stock.

Under the Code, legal earnings reserve and additional paid-in capital could be used to eliminate or reduce a deficit by a

resolution of the shareholders' meeting or could be capitalized by a resolution of the Board of Directors. Under the Law, both of these appropriations generally require a resolution of the shareholders' meeting.

Additional paid-in capital and legal earnings reserve may not be distributed as dividends. Under the Code, however, on condition that the total amount of legal earnings reserve and additional paid-in capital remained equal to or exceeded 25% of common stock, they were available for distribution by resolution of the shareholders' meeting. Under the Law, all additional paid-in-capital and all legal earnings reserve may be transferred to other capital surplus and retained earnings, respectively, which are potentially available for dividends.

The maximum amount that the Company can distribute as dividends is calculated based on the non-consolidated financial statements of the Company in accordance with Japanese laws and regulations.

At the annual shareholders' meeting held on June 28, 2007, the shareholders approved cash dividends amounting to ¥979 million (\$8,289 thousand). Such appropriations have not been accrued in the consolidated financial statements as of March 31, 2007. Such appropriations are recognized in the period in which they are approved by the shareholders.

## 12. Research and Development Costs:

Research and development costs charged to manufacturing costs and selling, general and administrative expenses for the years ended March 31, 2006 and 2007 totaled ¥1,055 million and ¥1,242 million (\$10,519 thousand), respectively.

## 13. Loss on Impairment of Fixed Assets

Impairment loss on fixed assets recorded in the consolidated statements of income for the year ended March 31, 2007 was as follows:

Location	Uses of assets	Assets type	Loss on impairment	
			Millions of Yen	Thousands of U.S. Dollars
China	Property for business	Machinery and equipment	¥ 1,186	\$ 10,041
China	—	Goodwill	268	2,270
			¥ 1,454	\$ 12,311

The companies set asset groups mainly by the business segments. Certain assets in China were devaluated to their recoverable values, due to downturn in China market.

The recoverable values were measured as utility values, calculated by discounting future cash flows with 10% discount rate.

## 14. Net income per share:

Basis for calculations of net income per share for the years ended March 31, 2006 and 2007 are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2007	2007
Net income	¥ 11,345	¥ 8,665	\$ 73,373
Bonuses to directors and corporate auditors	(116)	—	—
Net income for common stockholders	¥ 11,229	¥ 8,665	\$ 73,373

	Thousands of shares	
	2006	2007
The weighted-average number of shares of common stock	157,773	161,807

	Yen		U.S. Dollars
	2006	2007	2007
Net income per share	¥ 71.17	¥ 53.55	\$ 0.45

The Companies have no dilutive securities for the years ended March 31, 2006 and 2007.

## 15. Cash and Cash Equivalents:

Cash and cash equivalents at March 31, 2006 and 2007 consisted of:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2007	2007
Cash and bank deposits	¥ 6,553	¥ 4,184	\$ 35,434
Time deposits with deposit term of over 3 months	(34)	(8)	(70)
Cash and cash equivalents	¥ 6,519	¥ 4,176	\$ 35,364

## 16. Accounting for Leases:

### (1) Finance lease -

#### As a lessee

As described in note 2(14), finance leases of the Companies as lessee, other than those where ownership of the leased assets are transferred to the lessee, are accounted as operating leases. Periodic lease charges to the Companies, as a lessee, which were charged to income for the years ended March 31, 2006 and 2007 are ¥397 million and ¥380 million (\$3,216 thousand).

The leased assets under financial leases, if capitalized, at March 31, 2006 and 2007 comprise the following:

	Millions of Yen				Thousands of U.S. Dollars	
	2006		2007		2007	
	Machinery and vehicles	Other	Machinery and vehicles	Other	Machinery and vehicles	Other
Acquisition cost	¥ 1,891	¥ 750	¥ 1,894	¥ 750	\$ 16,042	\$ 6,354
Accumulated depreciation	449	389	657	445	5,563	3,769
Net book value	¥ 1,442	¥ 361	¥ 1,237	¥ 305	\$ 10,479	\$ 2,585

Depreciation expenses of those leased assets for the years ended March 31, 2006 and 2007, which are computed by the straight line method over the periods of those finance leases with no residual value, were ¥397 million and ¥380 million (\$3,216 thousand), respectively.

The amounts of outstanding future lease payments due at March 31, 2006 and 2007, which included the portion of interest thereon, are summarized as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2007	2007
	Due within one year	¥ 368	¥ 328
Due after one year	1,436	1,215	10,288
Total	¥ 1,804	¥ 1,543	\$ 13,064

### (2) Non-cancelable operating leases -

#### As a lessee

The amounts of outstanding future lease payments under non-cancelable operating leases at March 31, 2006 and 2007, are summarized as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2007	2007
	Due within one year	¥ 28	¥ 19
Due after one year	32	36	308
Total	¥ 60	¥ 55	\$ 468

## 17. Derivatives:

The contracted amount, fair value and unrealized gains/losses of the forward exchange contract recognized for the year ended March 31, 2006 is as follows:

	Millions of Yen		
	Contract Amount	Fair value	Unrealized Gains/losses
Forward exchange contract:			
Buying			
U.S. Dollars	¥ 179	¥ 178	¥ (1)
Japanese Yen	55	55	(0)
Total	¥ 234	¥ 233	¥ (1)

The contracted amount, fair value and unrealized gains/losses of the forward exchange contract recognized for the year ended March 31, 2007 is as follows:

	Millions of Yen			Thousands of U.S. Dollars		
	Contract Amount	Fair value	Unrealized Gains/losses	Contract Amount	Fair value	Unrealized Gains/losses
Forward exchange contract:						
Selling						
Japanese Yen	¥ 36	¥ 35	¥ 1	\$ 306	\$ 298	\$ 8
Total	¥ 36	¥ 35	¥ 1	\$ 306	\$ 298	\$ 8
Buying						
U.S. Dollars	¥ 118	¥ 117	¥ (1)	\$ 998	\$ 988	\$ (10)
Japanese Yen	50	49	(1)	419	414	(5)
Total	¥ 168	¥ 166	¥ (2)	\$ 1,417	\$ 1,402	\$ (15)

The contracted amount, fair value and unrealized gains/losses of interest rate swap for the years ended March 31, 2006 and 2007, are not required to be disclosed due to the adoption of hedge accounting.

## 18. Contingent Liabilities:

Guarantees against bank loans of employee and an affiliate at March 31, 2006 and 2007 are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2007	2007
Employee	¥ 155	¥ 132	\$ 1,114
Advanced Green Components, LLC	—	729	6,173
Total	¥ 155	¥ 861	\$ 7,287

Notes-discounted with banks and notes-endorsed, as of March 31, 2006 and 2007, stood at ¥244 million and ¥446 million (\$3,777 thousand), respectively. Notes-discounted with banks and notes-endorsed are netted against "Notes and accounts receivable, trade" in the consolidated balance sheets.

## 19. Segment Information:

### (1) Industry segment information -

The industry segment information for the years ended March 31, 2006 and 2007 are as follows:

	For the year ended March 31, 2006					
	Millions of Yen					
	Specialty Steel	Formed & Fabricated Materials	Other	Total	Elimination and corporate assets	Consolidated total
(a) Sales and operating income:						
Net sales						
Outside customers	¥ 116,425	¥ 17,062	¥ 785	¥ 134,272	¥ —	¥ 134,272
Intersegment transactions	7,864	234	2,547	10,645	(10,645)	—
Total	124,289	17,296	3,332	144,917	(10,645)	134,272
Costs and expenses	106,719	16,218	3,208	126,145	(10,733)	115,412
Operating income (loss)	¥ 17,570	¥ 1,078	¥ 124	¥ 18,772	¥ 88	¥ 18,860

### (b) Assets, depreciation and capital expenditures:

Assets	¥ 107,424	¥ 18,948	¥ 1,649	¥ 128,021	¥ 12,634	¥ 140,655
Depreciation	4,448	724	59	5,231	(12)	5,219
Capital expenditures	8,087	577	25	8,689	3	8,692

	For the year ended March 31, 2007					
	Millions of Yen					
	Specialty Steel	Formed & Fabricated Materials	Other	Total	Elimination and corporate assets	Consolidated total
(a) Sales and operating income:						
Net sales						
Outside customers	¥ 125,173	¥ 16,511	¥ 692	¥ 142,376	¥ —	¥ 142,376
Intersegment transactions	7,222	—	2,452	9,674	(9,674)	—
Total	132,395	16,511	3,144	152,050	(9,674)	142,376
Costs and expenses	115,006	15,830	3,018	133,854	(9,667)	124,187
Operating income	¥ 17,389	¥ 681	¥ 126	¥ 18,196	¥ (7)	¥ 18,189

### (b) Assets, depreciation, loss on impairment of fixed assets and capital expenditures:

Assets	¥ 124,478	¥ 14,676	¥ 1,589	¥ 140,743	¥ 11,966	¥ 152,709
Depreciation	¥ 4,887	¥ 916	¥ 56	¥ 5,859	¥ (8)	¥ 5,851
Loss on impairment of fixed assets	¥ —	¥ 1,454	¥ —	¥ 1,454	¥ —	¥ 1,454
Capital expenditures	¥ 7,963	¥ 370	¥ 13	¥ 8,346	¥ (13)	¥ 8,333

	Thousands of U.S. Dollars					
	Specialty Steel	Formed & Fabricated Materials	Other	Total	Elimination and corporate assets	Consolidated total
	(a) Sales and operating income:					
Net sales						
Outside customers	\$ 1,059,984	\$ 139,814	\$ 5,858	\$ 1,205,656	\$ —	\$ 1,205,656
Intersegment transactions	61,151	—	20,766	81,917	(81,917)	—
Total	1,121,135	139,814	26,624	1,287,573	(81,917)	1,205,656
Costs and expenses	973,886	134,045	25,559	1,133,490	(81,861)	1,051,629
Operating income	\$ 147,249	\$ 5,769	\$ 1,065	\$ 154,083	\$ (56)	\$ 154,027

### (b) Assets, depreciation, loss on impairment of fixed assets and capital expenditures:

Assets	\$ 1,054,094	\$ 124,278	\$ 13,454	\$ 1,191,826	\$ 101,332	\$ 1,293,158
Depreciation	\$ 41,382	\$ 7,762	\$ 474	\$ 49,618	\$ (67)	\$ 49,551
Loss on impairment of fixed assets	\$ —	\$ 12,311	\$ —	\$ 12,311	\$ —	\$ 12,311
Capital expenditures	\$ 67,428	\$ 3,133	\$ 110	\$ 70,671	\$ (106)	\$ 70,565

## (2) Geographical segment information -

As Japan, which consisted of Sanyo Special Steel Co., Ltd. and its domestic consolidated subsidiaries, represented more than 90% of the Companies' combined assets as of March 31, 2006 and 2007, and combined sales for the years then ended, the Companies are not required to disclose the geographical segment information.

## (3) Overseas sales -

Overseas sales information for the years ended March 31, 2006 and 2007 are as follows:

	For the year ended March 31, 2006				
	Millions of Yen				
	Asia	North America	Europe	Others	Total
Overseas sales (A)	¥ 12,144	¥ 3,669	¥ 2,588	¥ 138	¥ 18,539
Consolidated sales (B)	—	—	—	—	¥ 134,272
(A) / (B)	9.1%	2.7%	1.9%	0.1%	13.8%

	For the year ended March 31, 2007				
	Millions of Yen				
	Asia	North America	Europe	Others	Total
Overseas sales (A)	¥ 15,782	¥ 4,624	¥ 2,269	¥ 191	¥ 22,866
Consolidated sales (B)	—	—	—	—	¥ 142,376
(A) / (B)	11.1%	3.3%	1.6%	0.1%	16.1%

	Thousands of U.S. Dollars				
	Asia	North America	Europe	Others	Total
	Overseas sales (A)	\$ 133,643	\$ 39,156	\$ 19,213	\$ 1,623
Consolidated sales (B)	—	—	—	—	\$ 1,205,656
(A) / (B)	11.1%	3.3%	1.6%	0.1%	16.1%

Note to overseas sales:

Principal countries in each area where customers are located are as follows:

Asia	:	Taiwan, Korea, China, Thailand
North America	:	U.S.A.
Europe	:	Germany, Norway, Turkey

## 20. Related Party Transactions:

Information of related party transaction for the year ended March 31, 2007 is as follows:

Attribute	Name of Related party	Common Stock	Nature of operations	Equity ownership percentage	Relationship		Transaction	Amount	At March 31,2007
					Number of concurrent directors	Description of the business relationship			
Other Relative company	Nippon Steel Corporation	¥419,524 millions (\$3,552,578 Thousands)	Manufacture and sales of steel, engineering	Directory 15.03 % Indirectory 0.10 %	1	Business alliance	Sales of treasury stock	¥5,852 millions (\$49,555 Thousands)	—

Note:

- (1) The price of sales was decided based on the average of price of the Company's common stock at the Tokyo Stock Exchange during the period from April 28 to May 30, 2006.
- (2) As result of above, the Company became an affiliate company of Nippon Steel Corporation.

## 21. Subsequent Events:

The following appropriations of retained earnings at March 31, 2007 were approved at the Company's Board of Directors held on May 8, 2007 as follows:

	Millions of Yen	Thousands of U.S. Dollars
Cash dividends of ¥6 (\$0.05) per share	¥ 978	\$ 8,289

Independent Auditors' Report

To the Shareholders and Board of Directors of  
Sanyo Special Steel Co.,Ltd.

We have audited the accompanying consolidated balance sheet of Sanyo Special Steel Co.,Ltd. and consolidated subsidiaries as of March 31, 2007, and the related consolidated statements of income, changes in net assets and cash flows for the year 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 audit.

We conducted our audit 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides 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 Sanyo Special Steel Co.,Ltd. and subsidiaries as of March 31, 2007, and the consolidated results of their operations and their cash flows for the year 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 3 to the consolidated financial statements.

*KPMG AZSA & Co.*

KPMG AZSA & Co.  
Tokyo, Japan

June 28, 2007

*Misuzu Audit Corporation*

Misuzu Audit Corporation  
Tokyo, Japan

June 28, 2007

## Report of Independent Auditors

To the Board of Directors and Shareholders of  
Sanyo Special Steel Co., Ltd.

We have audited the accompanying consolidated balance sheets of Sanyo Special Steel Co., Ltd. and its subsidiaries as of March 31, 2006, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese Yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated 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 Sanyo Special Steel Co., Ltd. and its subsidiaries as of March 31, 2006, 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 amounts expressed in U.S. dollars, which are provided solely for the convenience of the reader, have been translated on the basis set forth in Note 3 to the accompanying consolidated financial statements.

*Misuzu Audit Corporation*

Misuzu Audit Corporation  
(formerly ChuoAoyama PricewaterhouseCoopers)

Tokyo, Japan

June 29, 2006



Complete View of our Head Office / Works

## Corporate Data

(As of March 31,2007)

Corporate Name	Sanyo Special Steel Co., Ltd.
Head Office	3007, Nakashima, Shikama-ku, Himeji, Hyogo 672-8677 Japan phone (+81) 79-235-6003
URL	<a href="http://www.sanyo-steel.co.jp/english/index.html">http://www.sanyo-steel.co.jp/english/index.html</a>
Established	January 11,1935
Paid-in Capital	20,182,680,000 yen
Register of Shareholders	Daiko Clearing Services Corporation
Total Number of Shares Authorized to be issued	474,392,000
Total Number of Shares Issued	167,124,036
Stock Listings	Tokyo Securities Exchange, Osaka Stock Exchange (1st Section, loanable stock)
Book Closing	March 31
Number of Shareholders	25,629
Branches and Offices	Tokyo Regional Office, Osaka Branch, Nagoya Branch, Hiroshima Branch, Kyusyu Sales Office, Shanghai Office

## Consolidated Subsidiaries and Equity-Method Affiliates

(As of March 31,2007)

Corporate Name	Business Content
<b>Consolidated Subsidiaries</b>	
Yohkoh Bussan Co., Ltd.	Trading of special steel products, steelmaking raw materials, and other materials
Santoku Seiken Co., Ltd.	Manufacturing and marketing of special steel products
Santoku Kogyo Co., Ltd.	Processing of special steel, machinery maintenance
Santoku Tech Co., Ltd.	Manufacturing of special steel products (formed & fabricated materials)
Santoku Life Co., Ltd.	Insurance, nursing care, and other lifestyle-related services
Santoku Computer Service Co., Ltd.	Construction, operation, and consulting services for information systems
SKJ Metal Industries Co., Ltd. (Thailand)	Manufacturing and marketing of special steel products
PT.SANYO SPECIAL STEEL INDONESIA (Indonesia)	Manufacturing and marketing of special steel products
SANYO SPECIAL STEEL U.S.A., Inc. (U.S.A.)	Trading of special steel products
SANYO SPECIAL STEEL AMERICA CORPORATION (U.S.A.)	Stockholding company for subsidiaries in the U.S.A.
Ningbo Sanyo Special Steel Products Co., Ltd. (China)	Manufacturing and marketing of special steel products (formed & fabricated materials)
<b>Equity-Method Affiliates</b>	
Advanced Green Components, LLC (U.S.A.)	Manufacturing of special steel products (formed & fabricated materials)

## Board of Directors

(As of June 28,2007)

President, Representative Director	Nobuyoshi Fujiwara		
Senior Managing Director	Koji Kishimoto	Tetsuo Kiriyaama	Kazuya Kodama
Managing Director	Seiji Tsutsumi	Kiyoshi Yabuki	Yutaka Tsukamoto
Director and Senior Adviser	Hiroki Sasaki		
Director	Nobuyuki Tanaka Ichiro Sato	Hiroaki Kimura Tatsuro Isomoto	Hideki Nakamura
Corporate Auditor	Tetsuji Shigemori Masatoshi Tsugita	Hideyuki Sasaki Takeshi Yoshii	

## Principal Shareholders

(As of March 31,2007)

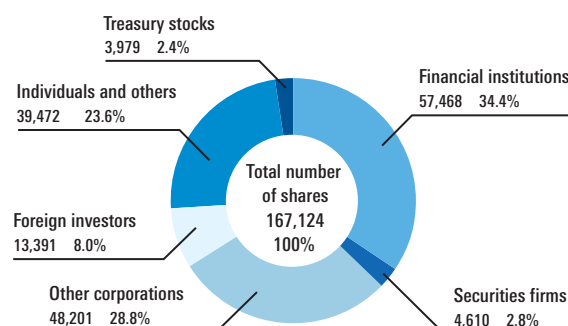
Name of Shareholder	Number of Shares Held (Thousands of shares)	Percentage of Voting Rights (%)
Nippon Steel Corporation	24,256	15.03
Japan Trustee Services Bank, Ltd. (trust account)	11,352	7.04
The Master Trust Bank of Japan, Ltd. (trust account)	9,635	5.97
NSK, Ltd.	7,470	4.63
Company's Kyoekai Association	6,990	4.33
The Nomura Trust and Banking Co., Ltd. (trust account)	4,916	3.05
Sumitomo Mitsui Banking Corporation	4,696	2.91
Mizuho Corporate Bank, Ltd.	3,642	2.26
The Bank of Tokyo-Mitsubishi UFJ, Ltd.	2,849	1.77
Marubeni-Itochu Steel Inc.	2,532	1.57

Notes: The number of shares omits fractions of less than 1,000 shares.

The company's 3,979 treasury stocks are not shown on the list of principal shareholders listed above.

Shareholder Composition

(Thousands of shares)





**SANYO SPECIAL STEEL CO., LTD.**

3007, NAKASHIMA, SHIKAMA-KU  
HIMEJI, JAPAN

<http://www.sanyo-steel.co.jp/>