

To Our Shareholders

Annual Report 2006

Year ended September 30, 2006



Processing Technologies for TomorrowSM

HOSOKAWA MICRON CORPORATION

Table of Contents

A Message to Our Stockholders	-----	2
Summary of Global Operations	-----	3
Summary of the Business by Segments	-----	4
Fiscal Year 2006 Plan and 3-Year Plan	-----	5

Financial Statements for the Years Ended September 30, 2006 and 2005

Consolidated Balance Sheets	-----	6
Consolidated Statements of Income	-----	8
Consolidated Statements of Changes in Net Assets	-----	10
Consolidated Statements of Cash Flows	-----	12
Note to Consolidated Financial Statements	-----	14

Company Profile

Consolidated Performance Evaluation	-----	39
Major Subsidiaries and Divisions	-----	40
Board of Directors	-----	41
Investor Information	-----	42

A Message to Our Shareholders

We were founded in Osaka, Japan in April 18, 1916 and have dedicated ourselves to the advancement of powder sciences and technology since our founding. This year we celebrated our 90th year in business. In fiscal year 2006, we focused on very clear objectives. Our strategy was to create new technologies and to build an even more powerful earnings base under our three year mid-term plan which is themed “Creativity and Enhancement.”

We were able to achieve a remarkable increase in turnover and profit by the sale of high value added new products and technologies. Our strong technological focus and the implementation of various strategies to strengthen our earnings base coupled with growth in capital spending in emerging markets contributed to our success. Our performance resulted in a dividend payment of ¥8.00 per share which is ¥3.00 higher than last fiscal year’s dividend.

We have several key growth initiatives. We are committed to the development of new products/technologies and advanced materials. Our corporation is growing from the traditional designed product and technology business to a larger and broader business. We have expanded our interests into the nano-composite material fields which hold the key for revolutionizing industry for the next generation. Recently, we entered the consumer based business with the promotion of our own brand of cosmetics marketed as “NanoCrysphere” and scalp-care treatment marketed as “NanoImpact.” We are also working to advance the development of materials for fuel cells and DDS (Drug Delivery System) technologies. We are working tirelessly on the development of new materials to expand our portfolio of flagship businesses.

Last, but not least, your continued support of the Corporation and confidence in our future is greatly appreciated.



**President & C.E.O.
Masuo Hosokawa**

Summary of Global Operations

During the fiscal year that ended in September 2006, Japan's economy continued to stage a self-sustaining recovery fueled by the expansion of domestic private sector demand. This economic recovery has surpassed the "Izanagi" boom to become the longest since the Second World War. One reason is continuing growth in consumer spending backed by a rebound in employment and higher wages. The economy is also benefiting from strong growth in capital expenditure spending as corporate earnings climb dramatically.

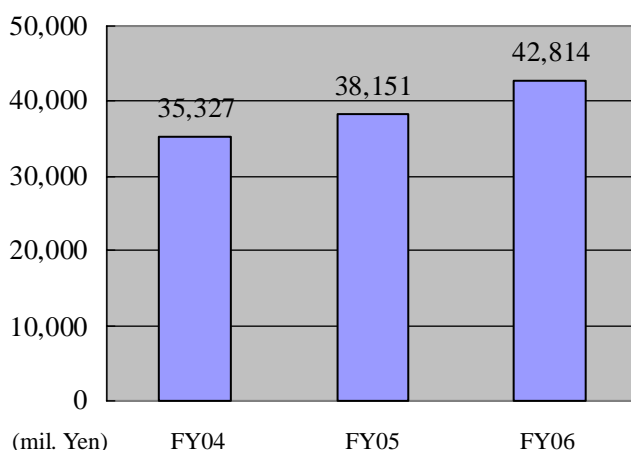
In the United States, the economy continued to expand, although the pace of growth is slowing. Signs of a slowdown are emerging as the housing market weakens and past interest rate hikes begin to affect the economy. Economies in Europe are posting strong growth, particularly in the euro zone where capital spending is high.

In Asia, China is beginning to see the effects of its tighter monetary policy aimed at preventing the economy from overheating, but China's economic growth rate remains high because of the enormous volume of foreign investment. In the ASEAN region, domestic demand is weakening due to the high cost of energy and rising interest rates, but increasing exports of primary products and basic materials continue to fuel economic growth.

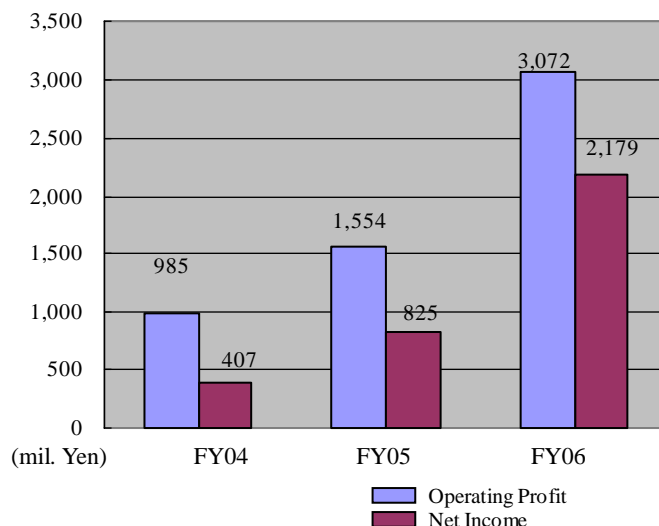
During the fiscal year that ended in September 2006, bookings increased sharply by 22.6%, or 8,764 million yen, to 47,567 million yen. The backlog increased dramatically to 50.7%, or 5,684 million yen, to 16,907 million yen while net sales increased 12.2%, or 4,663 million yen, to 42,814 million yen.

Sales and earnings increased as the Corporation took several actions. Our initiatives included: increasing sales of high value-added new products; raising sales prices of certain products and the implementation of aggressive cost reduction programs. Our cost reduction efforts targeted the cost of sales and selling as well as general and administrative expenses. The result was nearly a double-digit increase in operating profit from 1,554 million yen to 3,072 million yen and nearly 2.3 times an increase in ordinary profit from 1,395 million yen to 3,181 million yen. Net income was affected by extraordinary losses, including the extraordinary depreciation expenses of the current head office building as a result of the construction of our new headquarters. Net income increased more than 2.6 times from 825 million yen to 2,179 million yen.

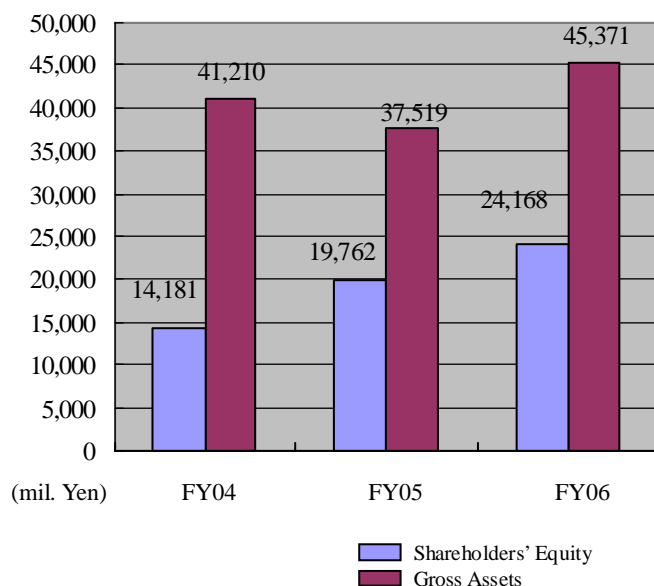
Total Sales Over a Three Year Period



Operating Profit, Net Income



Shareholders' Equity, Gross Assets

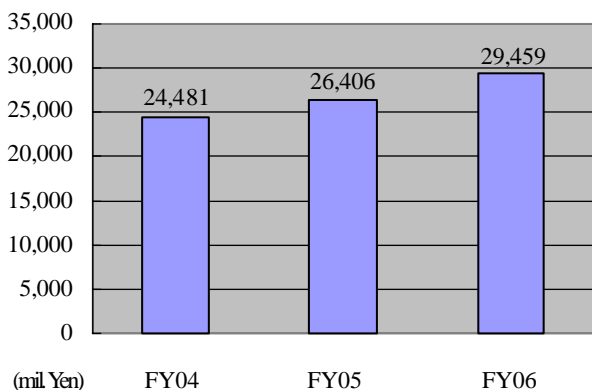


Summary of the Business by Segments

1) Powder and Particle Processing Operations

This segment is the core business of the Group, and includes products and technologies that serve a wide industry base from chemicals to food products and pharmaceuticals. Products and technologies are designed and manufactured for size reduction, classification, mixing, drying, compaction, containment and agglomeration for both full scale and pilot operations. Products in this segment are marketed under the Mikro, Micron, Alpine and Vrieco-Nauta brand names. During the fiscal year, operations in all market segments were strong. Sales of IT applications (electronic materials, toner and magnets), and sales of products for the minerals, chemicals, and foodstuff markets were higher than the previous year. Overall, bookings in this segment increased significantly by 21.1%, or 5,846 million yen, to 33,537 million yen. The backlog increased 60.6%, or 4,597 million yen, to 12,182 million yen and external sales increased 11.6%, or 3,052 million yen, to 29,459 million yen. Operating profit increased sharply by 55.3% to 2,645 million yen.

■ Three Year Sales History of Powder and Particle Processing Operations



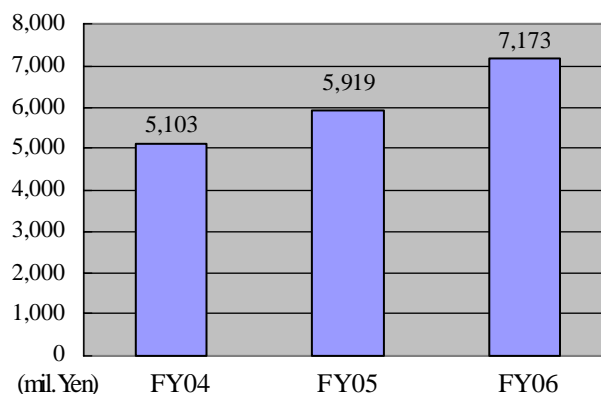
2) Blown Film Processing Operations

Most sales for blown film processing equipment come from the United States and Europe. Alpine brand film processing systems are used on a variety of applications such as the production of: grocery and merchandise bags; institutional and consumer trash bags; industrial packaging film and highly sophisticated multi layer film systems for food and pharmaceutical packaging. Operations in this segment were somewhat challenged by the negative impact on capital expenditures of rapidly increasing prices of feedstock resin triggered by escalating costs of crude oil. In addition, there was a small order backlog at the beginning of the fiscal year. Despite these challenges, the segment achieved solid sales growth due primarily to strong demand in Germany, Spain, Italy, the U.S. and Japan for high value-added multilayer (three to seven layers) film production equipment.

Bookings increased dramatically by 53.1% to 7,281 million yen, and external sales also increased significantly by 21.2% to 7,173 million yen. As a result,

the backlog rose 20.5% to 2,003 million yen. Due to higher sales, operating profit increased considerably by 263.3% to 574 million yen.

■ Three Year Sales History of Blown Film Processing Operations

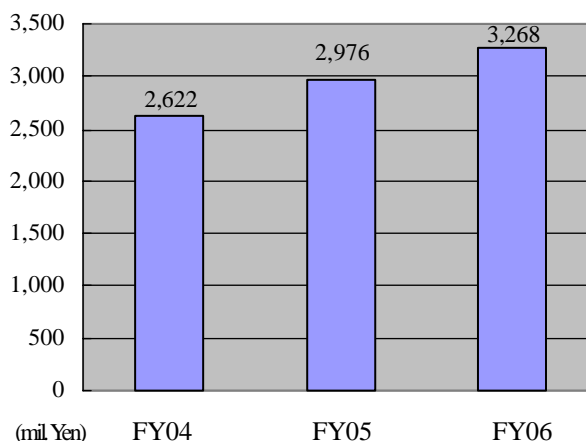


3) Confectionery and Bakery Technology and Systems Operations

This segment is engaged in the design, manufacture, and sale of confectionery (hard candy, chocolate, bars, etc) and bakery production equipment, mainly in Europe and the United States. Sales activities involve consulting-based relationships targeting major U.S. bakery and confectionery companies. This segment works on joint development projects and also provides upgrades of existing equipment to more efficient production lines. The Group focused on developing relationships with confectionery producers in Europe, Asia, and Australia while US core markets remained soft. Sales activities were increased in these new rapidly growing emerging markets. One example is stepped-up sales activities in Russia. The Group also focused on new product development and performance enhancements to integrated systems.

Bookings decreased 11.6% to 3,383 million yen while the backlog climbed 15.4% to 1,614 million yen. External sales increased 9.8% to 3,268 million yen. Operating profit was up a remarkable 20.9% to 231 million yen.

■ Three Year Sales History of Confectionery Production Equipment Operation

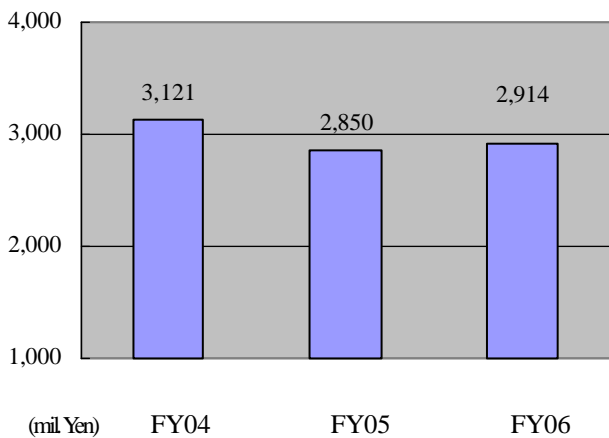


4) Clean Air and Environmental Protection Operations

This business segment is engaged in the manufacture and sale of environmental protection equipment, dust control equipment for product containment and clean air control equipment in Japan. There was no growth in the demand for environmental protection equipment for incinerators, although there was some activity on equipment upgrades in this sector. Sales of dust control equipment for product containment were very strong due to a high level of capital expenditures by manufacturers of chemicals and food products. The overall result was a big increase in segment sales. In the clean air control equipment category, sales were lower as demand for equipment used in pharmaceutical applications was strong but markets and bookings weakened in some sectors of the electronic components industry.

As a result, bookings increased a strong 33.0% to 3,364 million yen and the backlog increased sharply by 92.2% to 1,107 million yen. External sales increased only 2.2% to 2,914 million yen resulting from the smaller backlog at the beginning of the fiscal year, though operating profit was significantly increased by 33.0% to 481 million yen.

■ Three Year Sales History of Clean Air and Environmental Protection Operations

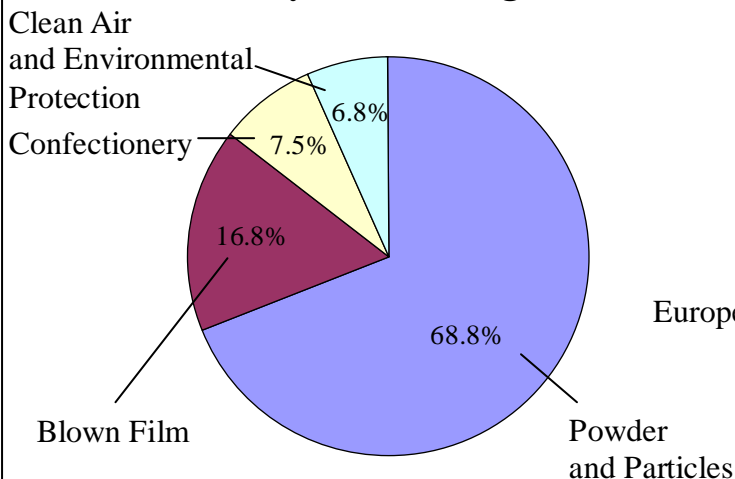


Fiscal Year 2006 Plan and 3-Year Plan

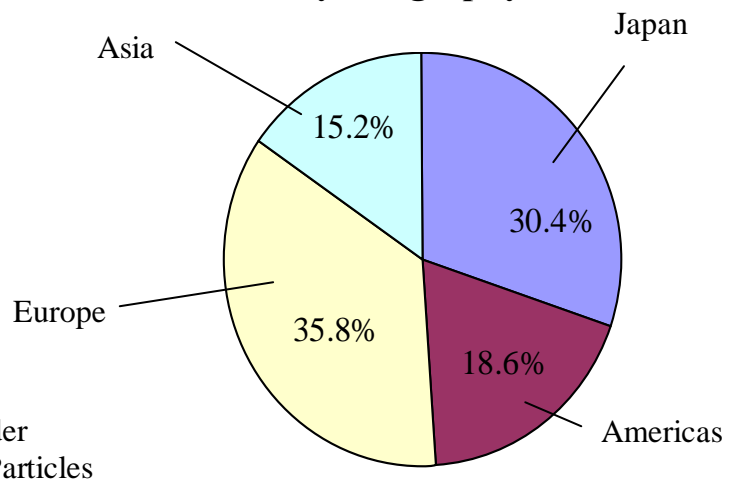
In October 2005, the Hosokawa Micron Group started a new three-year management plan that focuses on enhancing creativity and building a more powerful infrastructure. The Group strives to constantly take on the challenges of creating new technologies and markets, remaining a world leader in innovative powder processing technologies, including nano-particle technologies. Another goal is to establish a materials business that includes the development, manufacture and sale of new materials. Through these activities, the Group is determined to become an organization that excels in every aspect of its operations.

- 1) Use the Group's collective knowledge acquired over the 90 years since its establishment to create new technologies centered on nano-particle technology. Our initiative is to create a constant pipeline of new products and continuously improve the performance of existing products to meet new market needs.
- 2) Maximize the Group's global reach by promoting the transfer of technologies among group companies to build an even more powerful earnings base and create a highly efficient global organization.
- 3) Constantly improve business operations by making strategic investments.
- 4) Broaden the Group's core business and diversify the Group's profit structure by further expansion in the nano materials business.
- 5) Develop and increase the skill sets of our workforce to assure our business goals and financial objectives are met.

Sales by Business Segment



Sales by Geography



**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Consolidated Balance Sheets

September 30, 2006 and 2005

Assets	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Current assets:			
Cash and time deposits (Notes 4 and 13)	¥ 7,663	¥ 3,815	\$ 64,996
Trade receivables	12,488	10,395	105,920
Less allowance for doubtful receivables	(149)	(136)	(1,264)
Net trade receivables	12,339	10,259	104,656
Inventories (Note 3)	5,099	4,491	43,249
Short-term investments	151	409	1,281
Deferred tax assets (Note 6)	679	574	5,759
Other current assets	944	557	8,007
Total current assets	26,875	20,105	227,948
Property, plant and equipment (Notes 4 and 9):			
Land	5,015	4,912	42,536
Buildings and structures	12,938	12,202	109,737
Machinery and equipment	10,288	9,720	87,261
Construction in progress	256	32	2,171
	28,497	26,866	241,7058
Less accumulated depreciation	(14,835)	(13,621)	(125,827)
Net property, plant and equipment	13,662	13,245	115,878
Investments and other assets:			
Investments in securities (Note 11)	1,239	833	10,509
Goodwill	3,098	2,834	26,276
Deferred charges (Note 4)	47	36	399
Deferred tax assets (Note 6)	121	121	1,026
Other assets	329	345	2,790
Total investments and other assets	4,834	4,169	41,000
	¥ 45,371	¥ 37,519	\$ 384,826

See accompanying notes to consolidated financial statements.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Consolidated Balance Sheets

September 30, 2006 and 2005

Liabilities and Net Assets	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Current liabilities:			
Short-term borrowings, including current portion of long-term debt (Note 4)	¥ 363	¥ 1,109	\$ 3,079
Trade payables	5,416	4,824	45,937
Accrued expenses	4,191	3,397	35,547
Accrued income taxes (Note 6)	341	396	2,892
Deferred tax liabilities (Note 6)	232	36	1,968
Advances from customers	2,484	1,536	21,069
Other current liabilities	1,369	1,091	11,611
Total current liabilities	14,396	12,389	122,103
Noncurrent liabilities:			
Long-term debt (Note 4)	4,000	3,400	33,927
Retirement and severance benefits (Note 5)	3,921	3,456	33,257
Retirement allowances for directors and statutory auditors	276	356	2,341
Deferred tax liabilities (Note 6)	183	266	1,552
Other liabilities	35	41	297
Total noncurrent liabilities	8,415	7,519	71,374
Net assets (Note 7):			
Shareholders' equity:			
Common stock	14,496	13,193	122,951
Capital surplus	5,206	3,909	44,156
Retained earnings	4,550	2,707	38,592
Treasury stock	(84)	(47)	(712)
Total shareholders' equity	24,168	19,762	204,987
Accumulated gains (losses) on valuation and translation adjustments:			
Net unrealized gains on available-for-sale securities (Note 11)	85	114	721
Net unrealized gains on hedging derivatives (Note 12)	(8)	-	(68)
Foreign currency translation adjustments	(2,016)	(2,578)	(17,099)
Total accumulated gains (losses) on evaluation and translation	(1,939)	(2,464)	(16,446)
Minority interests	331	313	2,808
Total net assets	22,560	17,611	191,349
Contingent liabilities (Note 14)			
	¥ 45,371	¥ 37,519	\$ 384,826

See accompanying notes to consolidated financial statements.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Consolidated Statements of Income

Years ended September 30, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
	2006	2005	2006
Net sales	¥ 42,814	¥ 38,151	\$ 363,138
Cost of sales	27,192	25,171	230,636
Gross profit	15,622	12,980	132,502
Selling, general and administrative expenses (Note 8)	12,550	11,426	106,446
Operating profit	3,072	1,554	26,056
Other income (expenses):			
Interest and dividend income	113	31	958
Interest expense	(113)	(168)	(958)
Equity in earnings (losses) of an affiliate	7	(1)	59
Net gain on sales of securities	40	18	339
Loss on evaluation of securities	-	(186)	-
Net loss on sales or disposals of property, plant and equipment	(112)	(1)	(950)
Net exchange gain (loss)	118	(19)	1,001
Restructuring costs	(10)	(61)	(85)
Environmental remediated costs	-	(56)	-
Settlement costs for indemnification	-	(41)	-
Loss on impairment of property, plant and equipment	(102)	-	(865)
Extraordinary depreciation	(179)	-	(1,518)
Other, net	(54)	(29)	(458)
	(292)	(513)	(2,477)
Income before income taxes and minority interests	2,780	1,041	23,579
Income taxes (Note 6):			
Current	609	463	5,165
Deferred	(22)	(233)	(186)
	587	230	4,979
Income before minority interests	2,193	811	18,600
Minority interests	(14)	14	(118)
Net income	¥ 2,179	¥ 825	\$ 18,482

See accompanying notes to consolidated financial statements.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Consolidated Statements of Income

Years ended September 30, 2006 and 2005

	Yen		U.S. dollars
	2006	2005	(Note 1)
	<u>2006</u>	<u>2005</u>	<u>2006</u>
Net income per share of common stock:			
Basic	¥ 51.31	¥ 20.98	\$ 435.20
Diluted	49.94	19.81	423.58
	Number of shares		
Average number of common shares outstanding (thousands)	42,472	37,906	
Average number of diluted common shares outstanding (thousands)	43,638	40,136	

See accompanying notes to consolidated financial statements.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Consolidated Statements of Changes in Net Assets

Years ended September 30, 2006 and 2005

Number of common stocks issued	2006	2005		
Balance at beginning of year	39,881,640	37,184,434		
Issuance of common stock due to conversion of bonds	3,193,710	2,697,206		
Balance at end of year	43,075,350	39,881,640		
	Millions of yen		Thousands of U.S. dollars (Note 1)	
	2006	2005	2006	
Shareholders' equity:				
Common stock (Note 7):				
Balance at beginning of year	¥ 13,193	¥ 11,991	\$ 111,900	
Issuance of common stock due to conversion of bonds	1,303	1,202	11,051	
Balance at end of year	¥ 14,496	¥ 13,193	\$ 122,951	
Capital surplus (Note 7):				
Balance at beginning of year	¥ 3,909	¥ 2,711	\$ 33,155	
Issuance of common stock due to conversion of bonds	1,297	1,198	11,001	
Balance at end of year	¥ 5,206	¥ 3,909	\$ 44,156	
Retained earnings (Note 7):				
Balance at beginning of year	¥ 2,707	¥ 1,882	\$ 22,960	
Cash dividends	(306)	-	(2,596)	
Bonuses to directors and corporate auditors	(30)	-	(254)	
Net income for year	2,179	825	18,482	
Balance at end of year	¥ 4,550	¥ 2,707	\$ 38,592	
Treasury stock:				
Balance at beginning of year	¥ (47)	¥ (12)	\$ (398)	
Purchases of treasury stock	(37)	(35)	(314)	
Balance at end of year	¥ (84)	¥ (47)	\$ (712)	

See accompanying notes to consolidated financial statements.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Consolidated Statements of Changes in Net Assets

Years ended September 30, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Accumulated gains (losses) on valuation and translation:			
Net unrealized gains on available-for-sale securities:			
Balance at beginning of year	¥ 114	¥ 23	\$ 967
Net changes during the year	(29)	91	(246)
Balance at end of year	¥ 85	¥ 114	\$ 721
Net unrealized losses on hedging derivatives:			
Balance at beginning of year	¥ -	¥ -	\$ -
Net changes during the year	(8)	-	(68)
Balance at end of year	¥ (8)	¥ -	\$ (68)
Foreign currency translation adjustments:			
Balance at beginning of year	(2,578)	(2,414)	\$ (21,866)
Net changes during the year	562	(164)	4,767
Balance at end of year	¥ (2,016)	¥ (2,578)	\$ (17,099)
Minority Interests:			
Balance at beginning of year	¥ 313	¥ 329	\$ 2,655
Net changes during the year	18	(16)	152
Balance at end of year	¥ 331	¥ 313	\$ 2,808

See accompanying notes to consolidated financial statements.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended September 30, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Cash flows from operating activities:			
Income before income taxes and minority interests	¥ 2,780	¥ 1,041	\$ 23,579
Adjustments for:			
Depreciation and amortization	921	892	7,812
Interest and dividend income	(113)	(31)	(958)
Interest expense	113	168	958
Equity in (earnings) loss of an affiliate	(7)	1	(59)
Net gain on sales of securities	(40)	(18)	(339)
Loss on evaluation of securities	-	186	-
Net loss on sales or disposals of property, plant and equipment	112	1	950
Loss on impairment of property, plant and equipment	102	-	865
Extraordinary depreciation	179	-	1,518
(Increase) decrease in net trade receivables	(1,879)	289	(15,937)
(Increase) decrease in inventories	(464)	94	(3,936)
Increase in trade payables	501	71	4,249
Increase (decrease) in advances from customers	662	(69)	5,615
Increase in retirement and severance benefits	299	66	2,536
Bonuses paid to directors and corporate auditors	(30)	-	(254)
Other, net	433	436	3,673
Subtotal	3,569	3,127	30,272
Interest and dividends received	65	31	551
Interest paid	(101)	(178)	(857)
Indemnification costs paid	(116)	-	(984)
Income taxes paid	(722)	(90)	(6,124)
Net cash provided by operating activities	2,695	2,890	22,858
Cash flows from investing activities:			
Purchases of securities	(1,024)	(900)	(8,685)
Proceeds from sales of securities	603	859	5,114
Purchase of investment in an affiliate	-	(30)	-
Capital expenditures	(920)	(393)	(7,803)
Proceeds from sales of property, plant and equipment	59	44	500
Decrease in time deposits	-	800	-
Other, net	-	(1)	-
Net cash (used in) provided by investing activities	(1,282)	379	(10,874)

See accompanying notes to consolidated financial statements.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended September 30, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Cash flows from financing activities:			
Decrease in short-term borrowings	¥ (353)	¥ (4,687)	\$ (2,995)
Proceeds from long-term debt	-	1,300	-
Repayment of long-term debt	(1,200)	(2,059)	(10,178)
Proceeds from issuance of bonds	3,978	4,982	33,740
Repayment of bonds	-	(4,000)	-
Payments for stock issuance costs	(21)	(18)	(178)
Increase in treasury stock	(36)	(35)	(305)
Dividends paid	(306)	-	(2,595)
Net cash provided by (used in) financing activities	2,062	(4,517)	17,489
Effect of exchange rate changes on cash and cash equivalents	85	54	721
Net increase (decrease) in cash and cash equivalents	3,560	(1,194)	30,195
Cash and cash equivalents at beginning of year	4,224	5,418	35,827
Cash and cash equivalents of newly consolidated subsidiaries	30	-	255
Cash and cash equivalents at end of year (Note 13)	¥ 7,814	¥ 4,224	\$ 66,277

See accompanying notes to consolidated financial statements.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(1) Basis of Presenting Consolidated Financial Statements

Hosokawa Micron Corporation (“the Company”) and its domestic consolidated subsidiaries maintain their accounting records in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations and in conformity with accounting principles generally accepted in Japan (“Japanese GAAP”), which are different in certain respects as to the application and disclosure requirements from International Financial Reporting Standards.

The overseas subsidiaries maintain their accounting records in conformity with generally accepted accounting principles in their respective countries of domicile.

The accompanying consolidated financial statements have been compiled in and translated into English from the consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law. Certain supplemental information included in the statutory consolidated financial statements in Japanese, but not required for fair presentation, has not been presented in the accompanying consolidated financial statements.

As discussed in Note 2(t)4, the consolidated statements of changes in net assets for the year ended September 30, 2005 has been prepared for the purpose of inclusion in the accompanying consolidated financial statements, although such statements were not required to be filed with the Local Finance Bureau prior to 2006.

The translation of Japanese yen amounts into U.S. dollars is included solely for the convenience of readers outside Japan, using the prevailing exchange rate at September 30, 2006, which was ¥117.9 to U.S. \$1.00. This translation should not be construed as representation that the Japanese yen amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any other rate of exchange.

(2) Significant Accounting Policies

(a) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and all subsidiaries. All significant inter-company balances and transactions are eliminated in consolidation. An investment in an affiliate is accounted for by the equity method.

(b) Cash and Cash Equivalents (Note 13)

For the purpose of the Consolidated Statements of Cash Flows, cash and cash equivalents consist of cash on hand, deposits at call held with banks and all highly liquid investments with a maturity of three months or less.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(c) *Investments in Securities (Note 11)*

Investments in securities are classified and accounted for, depending on management's intention, as available-for-sale securities. Marketable available-for-sale securities are reported at fair value, with unrealized gains and losses, net of tax, as a separate component of net assets.

Nonmarketable available-for-sale securities are stated at cost determined by the moving average method.

(d) *Allowance for Doubtful Receivables*

Allowance for doubtful receivables of the Company and its domestic subsidiaries is provided principally at an amount computed based on the actual ratio of bad debts in the past and estimated uncollectible amounts based on an analysis of certain individual receivables. The foreign subsidiaries account for the estimated uncollectible amounts based on an analysis of certain individual receivables.

(e) *Inventories (Note 3)*

Finished goods and work in process of the Company and its domestic subsidiaries are stated at cost, principally by the specific identification method. Raw materials and merchandise of the Company and its domestic subsidiaries are stated at cost, principally determined by the moving average method. Supplies of the Company and its domestic subsidiaries are valued at the latest purchase price. Inventories of the Company's foreign subsidiaries are stated at the lower of cost or market, cost being determined by either the specific identification or the average cost method.

(f) *Long-term Construction Type Contracts*

The Company accounts for long-term construction type contracts under the completed contract method.

The foreign subsidiaries account for significant long-term contracts under the percentage-of-completion method and for all other contracts under the completed contract method.

(g) *Property, Plant and Equipment*

Property, plant and equipment are stated at cost. The property, plant and equipment at Tsukuba Technical Development Center, Nara plant, and the Tokyo branch of the Company and buildings (other than leasehold improvements) which were acquired on or after April 1, 1998, are depreciated using the straight-line method over their respective estimated useful lives. Other property, plant and equipment of the Company are depreciated using the declining balance method over their respective estimated useful lives. The domestic subsidiaries compute depreciation primarily using the declining balance method. The

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

foreign subsidiaries compute depreciation primarily using the straight-line method.

The principal estimated useful lives are as follows:

Buildings and improvements	2 to 47 years
Vehicles, furniture, machinery and equipment	2 to 17 years

(h) Goodwill and Other Assets

Goodwill represents the excess of total acquisition cost over the fair market value of the net assets acquired and is recognized related to the acquisition of subsidiaries of Hosokawa Micron International Inc., the United States.

The goodwill is tested for impairment on an annual basis and between annual tests in certain circumstances and written down when impaired, rather than being amortized as previous accounting standards required. Purchased intangible assets other than goodwill are amortized over their respective estimated useful lives, unless these lives are determined to be indefinite.

(i) Computer Software

Expenditure relating to computer software developed for internal use is generally charged to income when incurred. However, if it contributes to the generation of income or to future cost savings, such expenditure is capitalized as an asset and amortized using the straight-line method over its estimated useful life, which is usually 5 years.

(j) Leases (Note 9)

The Company and its subsidiaries lease various facilities and equipment.

The Company and its domestic subsidiaries account for leases as operating leases, except for those in which ownership is deemed to be transferred to the lessee. The foreign subsidiaries account for finance leases as capital leases.

(k) Product Warranty

The Company and its subsidiaries provide for the estimated cost to repair or replace products sold under warranties. Such warranties generally cover a 12-month period.

(l) Retirement and Severance Benefits (Note 5)

Upon retirement or termination of employment, employees of the Company and its domestic subsidiaries are entitled to lump-sum or annuity payments based on the current rate of pay and length of service.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

The Company and its domestic subsidiaries have adopted the Financial Accounting Standard for Retirement Benefits issued by the Business Accounting Deliberation Council. In accordance with this standard, retirement and severance benefits are provided based on the estimated retirement benefit obligation and the pension assets.

Actuarial gains and losses are amortized from the next year in which the actuarial gains and losses are incurred using the straight-line method over 15 years, representing the estimated average remaining service years of employees.

The foreign subsidiaries have pension and supplemental retirement plans covering substantially all employees. Certain of the Company's foreign subsidiaries' unrecognized net transition liability is being amortized over 15 years, and the amortization is presented in the consolidated statements of income.

To supplement the above, the Company and its domestic subsidiaries participate in a multi-employer contributory defined benefit welfare pension plan (the "welfare pension plan") covering substantially all of their employees. The welfare pension plan is funded in conformity with the Japanese Welfare Pension Insurance Law and covers a portion of the governmental welfare pension program and a portion under which contributions are made by the respective companies and their employees.

Regarding the welfare pension plan, contributions made by the Company and most of its domestic subsidiaries are expensed when paid since the pooled fund assets and the entire pension obligation of the welfare pension plan cannot be reasonably determined by each of the participants. The pooled fund assets of the Company and most of its domestic subsidiaries at fair value as of September 30, 2006, amounted to ¥1,709 million (\$14,495 thousand).

(m) Retirement Allowance for Directors and Corporate Auditors

The Company has provided for the estimated unfunded liability for directors' and corporate auditors' retirement and severance benefits in the financial statements.

The Company's foreign subsidiary in the United States has a Supplemental Executive Retirement Plan (SERP) and has provided for executive retirement benefits under the plan.

(n) Appropriations of Retained Earnings

Appropriations of retained earnings are reflected in the financial statements for the following period upon shareholders' approval.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(o) *Income Taxes (Note 6)*

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carried forward. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(p) *Foreign Currency Translation*

The Company and its domestic subsidiaries have adopted the Financial Accounting Standard for Foreign Currency Transactions which was issued by the Business Accounting Deliberation Council. In accordance with this standard, all monetary assets and liabilities denominated in foreign currencies are converted into Japanese yen at the rates of exchange prevailing at the balance sheet date.

Foreign currency financial statements of foreign subsidiaries are translated into Japanese yen at year-end rates for all assets and liabilities and at weighted average rates for income and expense accounts. Adjustments resulting from the translation of financial statements are reflected in foreign currency translation adjustments in net assets.

(q) *Derivatives and Hedging Activities*

The Company has adopted the Financial Accounting Standard on Accounting for Financial Instruments issued by the Business Accounting Deliberation Council. The Company uses derivative financial instruments to manage its exposure to fluctuation in foreign currencies and interest rates on swap transactions.

(r) *Net Income per Share*

Basic net income per share of common stock shown for each year in the accompanying consolidated statements of income is computed based upon the weighted average number of shares of common stock outstanding during the year. Diluted net income per share assumes the full exercise of potentially dilutive securities outstanding at the date of issuance.

(s) *Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(t) New Accounting Pronouncements

1. Accounting standard for directors' bonus

Effective for the year ended September 30, 2006, the Company and its domestic consolidated subsidiaries adopted the new accounting standard, entitled "Accounting Standard for Directors' bonus" (Statement No. 4 issued by the Accounting Standards Board of Japan (ASBJ) on November 29, 2005). As a result of the change, income before income taxes and minority interests decreased by ¥53 million.

2. Accounting standard for impairment of fixed assets

A new accounting standard for the impairment of fixed assets ("Opinion Concerning Establishment of Accounting Standard for Impairment of Fixed Assets" issued by the Business Accounting Deliberation Council on August 9, 2002) and the implementation guidance for the new standard (the Financial Accounting Standard Implementation Guidance No. 6 issued by the ASBJ on October 31, 2003) has been adopted effective for the year ended September 30, 2006. As a result of this change, income before income taxes and minority interests decreased by ¥102 million. Depreciation calculated after implementation of the new standard is included in accumulated depreciation.

3. Accounting standard for presentation of net assets in the balance sheet

Effective for the year ended September 30, 2006, 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 ASBJ on December 9, 2005), and the implementation guidance for the new standard (the Financial Accounting Standard Implementation Guidance No. 8 issued by the ASBJ on December 9, 2005), (collectively, the "New Accounting Standards").

Under the New Accounting Standards, the balance sheets are to be comprised of assets, liabilities and net assets sections. Previously, the balance sheets comprised the assets, liabilities, minority interest and shareholders' equity sections.

The net assets section is to be comprised four subsections, which are shareholders' equity, accumulated gains (losses) on valuation and translation adjustments, subscription rights to shares and minority interests, as applicable.

The net assets section includes items which were not included in the previously presented shareholders' equity section. The accumulated gains (losses) on the valuation and translation adjustments section include unrealized gains (losses) on hedging derivatives, net of taxes.

HOSOKAWA MICRON CORPORATION AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Previously presented shareholders' equity and certain other balance sheet items for fiscal year 2005 have been restated to conform to the 2006 presentation. As a result, minority interests amounting to ¥313 million have been included in the net assets section as of September 30, 2005.

4. Accounting standard for statement of changes in net assets

Effective the year ended September 30, 2006, the Company and its consolidated subsidiaries have adopted a 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 new standard (the Financial Accounting Standard Implementation Guidance No. 9 issued by the ASBJ on December 27, 2005), (collectively, the "New Accounting Standards").

Based on the reclassification of previously presented shareholders' equity and certain other balance sheet items for fiscal year 2005 as discussed in Note 2(t)3 above, the consolidated statement of changes in net assets for fiscal year 2005 have been prepared in accordance with the New Accounting Standards.

(u) *Reclassification and restatement*

Certain prior year amounts have been reclassified to conform to the current year presentation. Also, as described in Notes 2(t)3 and 2(t)4, previously presented shareholders' equity and certain other balance sheet items for fiscal year 2005 and the consolidated statements of shareholders' equity for the year ended September 30, 2005, which was voluntarily prepared for the purpose of inclusion in the 2005 consolidated financial statements, have been restated to conform to the New Accounting Standards adopted in 2006.

These reclassifications and restatements had no impact on previously reported results of operations and cash flows.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(3) Inventories

Inventories at September 30, 2006 and 2005 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Finished goods	¥ 1,867	¥ 1,187	\$ 15,835
Work in process	1,660	1,733	14,080
Raw materials	1,500	1,501	12,723
Supplies	72	70	611
	¥ 5,099	¥ 4,491	\$ 43,249

(4) Long-term Debt and Short-term Borrowings

Long-term debt at September 30, 2006 and 2005 are set forth below:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
The Company and domestic subsidiaries:			
Unsecured convertible bonds with stock acquisition rights with no interest, due February 2008	¥ -	¥ 2,600	\$ -
Unsecured convertible bonds with stock acquisition rights with no interest, due August 2011	4,000	-	33,927
Secured bank loans with interest at 2.24%, due in installments through 2008	-	1,200	-
	4,000	3,800	33,927
Less current portion	-	400	-
	¥ 4,000	¥ 3,400	\$ 33,927

The aggregate annual maturities of long-term debt after September 30, 2006 are as follows:

Year ending September 30,	Millions of yen		Thousands of U.S. dollars
2011	¥	4,000	\$ 33,927

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

At September 30, 2006, assets pledged as collateral for short-term borrowings and long-term debts were summarized as follows:

	<u>Millions of yen</u>	<u>Thousands of U.S. dollars</u>
Land	¥ 4,014	\$ 34,046
Buildings, net of accumulated depreciation	2,577	21,875

As is customary in Japan, short-term and long-term bank loans are made under general agreements which provide that security and guarantees for future and present indebtedness will be given upon request by the bank and that the bank shall have the right as the obligations become due, or in the event of their default, to offset cash deposits against such obligations.

In February 2005, the Company issued unsecured convertible bonds with stock acquisition rights amounting to ¥5,000 million (\$42,409 thousand), all of which were converted to common stock.

In August 2006, the Company issued unsecured convertible bonds with stock acquisition rights amounting to ¥4,000 million (\$33,927 thousand), of which ¥4,000 million (\$33,927 thousand) were outstanding at September 30, 2006. The applicable exercise price for the conversion at September 30, 2006 was ¥1,003 per share.

The Company amortized issuing costs associated with the bonds using the straight-line method over three years. The balance of unamortized issuing costs included in deferred charges at September 30, 2006 and 2005 amounted to ¥7 million (\$59 thousand) and ¥12 million, respectively.

(5) Retirement and Severance Benefits

(a) *The Company and its Domestic Subsidiaries*

The Company has non-contributory qualified funded pension plans for regular employees under Japanese tax regulations. The pension benefits under these plans cover approximately 35% of total benefits in respect of such employees. The remaining balance of the pension benefits is covered by unfunded lump-sum plans.

(b) *Foreign Subsidiaries*

The Company's foreign subsidiaries in the United States have three defined contribution pension plans, which are structured as Section 401(k) type plans under the Internal Revenue Code, covering substantially all employees. Certain of the Company's foreign subsidiaries, other than those in the United States, have noncontributory defined benefit pension plans covering substantially all employees, with varying terms and amounts depending upon their salary level and length of service. The defined benefit plans are funded to accumulate sufficient assets to provide for all accrued benefits.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

The following tables set forth details of the benefit obligation, plan assets and funded status of the Company and its subsidiaries at September 30, 2006 and 2005:

	<u>Millions of yen</u>		<u>Thousands of U.S. dollars</u>
	<u>2006</u>	<u>2005</u>	<u>2006</u>
Benefit obligation at end of year	¥ (5,323)	¥ (4,597)	\$ (45,148)
Fair value of plan assets at end of year	922	560	7,820
Funded status (benefit obligation in excess of plan assets)	(4,401)	(4,037)	(37,328)
Unrecognized actuarial loss	480	566	4,071
Unrecognized net transition liability	-	15	-
Retirement and severance benefits recognized in the consolidated balance sheets	¥ (3,921)	¥ (3,456)	\$ (33,257)

The components of net periodic benefit costs for the years ended September 30, 2006 and 2005 were as follows:

	<u>Millions of yen</u>		<u>Thousands of U.S. dollars</u>
	<u>2006</u>	<u>2005</u>	<u>2006</u>
Service cost	¥ 289	¥ 322	\$ 2,451
Interest cost	196	164	1,662
Expected return on plan assets	(46)	(25)	(390)
Amortization:			
Actuarial losses	19	15	161
Net transition liability	16	6	136
Contribution to defined contribution plans	31	23	263
Net periodic benefit costs	¥ 505	¥ 505	\$ 4,283

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Assumptions used in accounting for retirement benefits for the years ended September 30, 2006 and 2005 were summarized as follows:

	2006	2005
Method of attributing benefit to period of service	straight-line basis	straight-line basis
Discount rate	2.0% ~ 4.5%	2.0% ~ 4.8%
Expected rate of return on plan assets	4.0% ~ 7.0%	4.0% ~ 7.0%
Amortization period for actuarial gains or losses	15 years	15 years
Amortization period for unrecognized net transition liability	15 years	15 years

(6) Income Taxes

The Company and its domestic subsidiaries are subject to a number of taxes based on earnings which, in the aggregate, resulted in an average statutory normal tax rate of approximately 40.7% for both the years ended September 30, 2006 and 2005.

The effective tax rates for the years ended September 30, 2006 and 2005 differed from the normal statutory tax rates for the following reasons:

	2006	2005
Normal statutory tax rate:	40.7 %	40.7 %
No-deductible expenses for tax purposes	0.9	1.7
Per capita taxes	0.6	1.6
Tax rate differentials of overseas subsidiaries	(0.5)	16.0
Change in valuation allowance allocated to income tax expenses	(24.5)	(41.6)
Other	4.0	3.7
Effective tax rates	<u>21.2 %</u>	<u>22.1 %</u>

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

The significant components of deferred tax assets and liabilities at September 30, 2006 and 2005 were summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets:			
Net operating losses	¥ 11,373	¥ 11,989	\$ 96,463
Retirement and severance benefits	871	922	7,388
Reserves, primarily for warranties and inventories	1,131	967	9,593
Gross deferred tax assets	13,375	13,878	113,444
Valuation allowance	(12,258)	(12,865)	(103,970)
Total deferred tax assets	1,117	1,013	9,474
Deferred tax liabilities:			
Accumulated depreciation	347	295	2,943
Percentage of completion	193	106	1,637
Other	192	219	1,629
Total deferred tax liabilities	732	620	6,209
Net deferred tax assets	¥ 385	¥ 393	\$ 3,265

Total deferred tax assets and liabilities shown above include both current and noncurrent elements.

The net change in the total valuation allowance for the years ended September 30, 2006 and 2005 was a decrease of ¥607 million (\$5,148 thousand) and of ¥402 million, respectively. In assessing the possibility of realizing deferred tax assets, management considers whether it is more likely than not that a certain portion or all of the deferred tax assets will be realized. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making the assessment. Valuation allowances have been established primarily for deferred tax assets relating to future utilization of net operating loss carried forward in various taxing jurisdictions. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income in the periods in which those temporary differences become deductible. Based upon projections for future taxable income in the various taxing jurisdictions, management believes certain portions of the deferred tax assets have not met the more likely than not criteria for realization of these deferred tax assets.

At September 30, 2006, the Company had a net operating loss carryforward available of approximately ¥14,155 million (\$120,059 thousand) expiring in 2010.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

At September 30, 2006, Hosokawa Micron International Inc., a subsidiary of the Company in the United States, had a net operating loss carryforward available of approximately ¥11,646 million (\$98,779 thousand) expiring between 2008 and 2026. Foreign subsidiaries, other than those in the United States, had foreign net operating loss carryforward amounting to ¥3,468 million (\$29,415 thousand) available for local tax purposes, a significant portion of which is not subject to expiration.

(7) Net Assets

As described in Note 2(t)3, net assets comprise the following subsections shareholders' equity, accumulated gains (losses) on valuation and translation adjustments and minority interests.

Japanese Corporate law ("the Law") were into effect on May 1, 2006, replacing the Japanese Commercial Code.

Under the Japanese laws and regulations, the entire amount paid for new share issuances is required to be designated as common stock. However, a company may, by 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 dividend distribution of a surplus is made, the lesser of the 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 Law, appropriations of legal earnings reserve and additional paid-in capital for the elimination or reduction of a deficit generally require a resolution to be approved at the shareholders' meeting.

Additional paid-in capital and legal earnings reserve may not be distributed as dividends. Under the Law, the entire amount of additional paid-in capital and that of legal earnings reserve may be transferred to other capital surplus and retained earnings, respectively, which are potentially available for the payment of dividends.

The maximum amount that the Company can distribute as dividends is calculated based on the nonconsolidated financial statements of the Company in accordance with the Law.

At the annual general shareholders' meeting held on December 21, 2006, the shareholders resolved cash dividends amounting to ¥236 million (\$2,002 thousand). Such appropriations have not been accrued in the consolidated financial statements as of and for the year ended September 30, 2006. Such appropriations are recognized in the period in which they were approved.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(8) Research and Development Costs

Research and development costs are charged to income when incurred. Research and development costs charged to income for the years ended September 30, 2006 and 2005 were summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Research and development costs	¥ 909	¥ 834	\$ 7,710

(9) Leases

The Company and its domestic subsidiaries account for leases as operating leases, except those in which ownership is deemed to be transferred to the lessee.

The following proforma amounts represent the acquisition costs and accumulated depreciation as of September 30, 2006 and 2005 which would have been reflected in the accompanying consolidated balance sheets if finance lease accounting had been applied to these leases:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Machinery and equipment:			
Acquisition cost	¥ 380	¥ 418	\$ 3,223
Accumulated depreciation	(214)	(230)	(1,815)
	166	188	1,408
Furniture and fixtures:			
Acquisition cost	417	342	3,537
Accumulated depreciation	(165)	(201)	(1,400)
	252	141	2,137
	¥ 418	¥ 329	\$ 3,545

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Future minimum lease payments for finance leases other than those which transfer the ownership of the leased property (including the interest portion thereon) subsequent to September 30, 2006 were summarized as follows:

	Millions of yen		Thousands of
	2006	2005	U.S. dollars
Due within one year	¥ 140	¥ 109	\$ 1,187
Due after one year	278	220	2,358
	¥ 418	¥ 329	\$ 3,545

Lease payments and depreciation expenses for the year ended September 30, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of
	2006	2005	U.S. dollars
Lease payments	¥ 123	¥ 126	\$ 1,043
Depreciation expenses	123	126	1,043

(10) Extraordinary Depreciation

In January 2006, the Company decided to replace its head office buildings and shortened the useful lives of the existing head office buildings. As a result, the Company recognized extraordinary depreciation in the amount of ¥179 million, and income before income taxes and minority interests decreased by the same amount accordingly.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(11) Investments in Securities

Marketable equity securities included in investments in securities at September 30, 2006 and 2005 were summarized as follows:

Millions of yen			
2006			
	<u>Carrying amount</u>	<u>Fair value</u>	<u>Unrealized gain, net</u>
Equity securities	¥ <u>987</u>	¥ <u>1,146</u>	¥ <u>159</u>
2005			
	<u>Carrying amount</u>	<u>Fair value</u>	<u>Unrealized gain, net</u>
Equity securities	¥ <u>526</u>	¥ <u>717</u>	¥ <u>191</u>
Thousands of U.S. dollars			
2006			
	<u>Carrying amount</u>	<u>Fair value</u>	<u>Unrealized gain, net</u>
Equity securities	\$ <u>8,371</u>	\$ <u>9,720</u>	\$ <u>1,349</u>

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(12) Foreign Exchange Contracts

Foreign exchange contracts at September 30, 2006 and 2005 were summarized as follows:

		Millions of yen		
		2006		
		<u>Notional amount</u>	<u>Fair value</u>	<u>Unrealized loss, net</u>
Forward:				
To buy foreign currencies	¥	70	¥ 66	¥ 3
To sell foreign currencies		175	178	3
		2005		
		<u>Notional amount</u>	<u>Fair value</u>	<u>Unrealized loss, net</u>
Forward:				
To buy foreign currencies	¥	685	¥ 662	¥ 23
To sell foreign currencies		20	20	0
		Thousands of U.S. dollars		
		2006		
		<u>Notional amount</u>	<u>Fair value</u>	<u>Unrealized loss, net</u>
Forward:				
To buy foreign currencies	\$	594	\$ 559	\$ 25
To sell foreign currencies		1,484	1,509	25

The above amounts exclude contracts entered into in order to hedge foreign currency denominated receivables and payables, which have been translated and reflected at the corresponding contracted rates in the accompanying consolidated balance sheets at September 30, 2006 and 2005.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(13) Supplemental Information to Consolidated Statements of Cash Flows

Reconciliations of cash and time deposits shown in the consolidated balance sheets and cash and cash equivalents shown in the consolidated statements of cash flows as of September 30, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Cash and time deposits	¥ 7,663	¥ 3,815	\$ 64,996
Cash equivalents included in short-term investments	151	409	1,281
Cash and cash equivalents	¥ 7,814	¥ 4,224	\$ 66,277

At September 30, 2006 and 2005, non-cash financing activities were summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Conversion of convertible bonds with stock acquisition rights into common stock and capital surplus	¥ 2,600	¥ 2,400	\$ 22,053

(14) Contingent Liabilities

At September 30, 2006, contingent liabilities for notes discounted with recourse amounted to ¥35 million (\$297 thousand) and for guarantees of loans of affiliates amounted to ¥25 million (\$212 thousand).

Various lawsuits and claims are pending against the Company and its subsidiaries, including product liability suits. Although the outcome of such suits and claims cannot be predicted with certainty, the disposition thereof will not, in the opinion of the management of the Company, result in a material adverse effect on the consolidated financial position of the Company, or its operating results or cash flows.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(15) Segment Information

Information by segment for fiscal years 2006 and 2005 is shown in the tables below:

(a) By Business Segment

		Millions of yen						
		2006						
		Powder processing equipment	Plastic processing equipment	Air pollution control equipment	Confec- tionery equipment	Total	Elimina- tions and corporate items	Consoli- dated total
Sales:								
External sales	¥	29,459	¥ 7,173	¥ 2,914	¥ 3,268	¥ 42,814	¥ -	¥ 42,814
Inter-segment sales		8	4	680	-	692	(692)	-
Total sales		29,467	7,177	3,594	3,268	43,506	(692)	42,814
Operating expenses		26,822	6,603	3,113	3,037	39,575	167	39,742
Operating profit	¥	2,645	¥ 574	¥ 481	¥ 231	¥ 3,931	¥ (859)	¥ 3,072
Identifiable assets	¥	26,322	¥ 8,366	¥ 2,243	¥ 2,840	¥ 39,771	¥ 5,600	¥ 45,371
Depreciation		643	63	97	44	847	253	1,100
Impairment losses		86	-	-	-	86	16	102
Capital expenditure		815	103	-	53	971	215	1,186
		2005						
		Powder processing equipment	Plastic processing equipment	Air pollution control equipment	Confec- tionery equipment	Total	Elimina- tions and corporate items	Consoli- dated total
Sales:								
External sales	¥	26,406	¥ 5,919	¥ 2,850	¥ 2,976	¥ 38,151	¥ -	¥ 38,151
Inter-segment sales		27	-	715	-	742	(742)	-
Total sales		26,433	5,919	3,565	2,976	38,893	(742)	38,151
Operating expenses		24,730	5,760	3,203	2,784	36,477	120	36,597
Operating profit	¥	1,703	¥ 159	¥ 362	¥ 192	¥ 2,416	¥ (862)	¥ 1,554
Identifiable assets	¥	22,379	¥ 7,219	¥ 2,237	¥ 2,837	¥ 34,672	¥ 2,847	¥ 37,519
Depreciation		561	73	104	45	783	70	853
Capital expenditure		320	41	2	11	374	1	375

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Thousands of U.S. dollars							
2006							
	Powder processing equipment	Plastic processing equipment	Air pollution control equipment	Confec- tionery equipment	Total	Elimina- tions and corporate items	Consoli- dated total
Sales:							
External sales	\$ 249,864	\$ 60,840	\$ 24,716	\$ 27,718	\$ 363,138	\$ -	\$ 363,138
Inter-segment sales	68	34	5,768	-	5,870	(5,870)	-
Total sales	249,932	60,874	30,484	27,718	369,008	(5,870)	363,138
Operating expenses	227,498	56,005	26,404	25,759	335,666	1,416	337,082
Operating profit	<u>\$ 22,434</u>	<u>\$ 4,869</u>	<u>\$ 4,080</u>	<u>\$ 1,959</u>	<u>\$ 33,342</u>	<u>\$ (7,286)</u>	<u>\$ 26,056</u>
Identifiable assets	\$ 223,257	\$ 70,958	\$ 19,025	\$ 24,088	\$ 337,328	\$ 47,498	\$ 384,826
Depreciation	5,454	534	823	373	7,184	2,146	9,330
Impairment losses	729	-	-	-	-	136	865
Capital expenditure	6,913	874	-	449	8,236	1,823	10,059

(b) By Geographical Location

Millions of yen							
2006							
	Location					Elimina- tions and corporate items	Consoli- dated total
	Japan	Americas	Europe	Asia	Total		
Sales:							
External sales	¥ 15,050	¥ 5,882	¥ 21,779	¥ 103	¥ 42,814	¥ -	¥ 42,814
Inter-segment sales	85	207	3,290	153	3,735	(3,735)	-
Total sales	15,135	6,089	25,069	256	46,549	(3,735)	42,814
Operating expenses	12,751	6,146	23,476	217	42,590	(2,848)	39,742
Operating profit (loss)	<u>¥ 2,384</u>	<u>¥ (57)</u>	<u>¥ 1,593</u>	<u>¥ 39</u>	<u>¥ 3,959</u>	<u>¥ (887)</u>	<u>¥ 3,072</u>
Identifiable assets	¥ 14,030	¥ 3,489	¥ 19,910	¥ 228	¥ 37,657	¥ 7,714	¥ 45,371

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Millions of yen							
2005							
Location					Total	Eliminations and corporate items	Consolidated total
Japan	Americas	Europe	Asia				
Sales:							
External sales	¥ 15,199	¥ 5,309	¥ 17,527	¥ 116	¥ 38,151	¥ -	¥ 38,151
Inter-segment sales	84	58	3,006	60	3,208	(3,208)	-
Total sales	15,283	5,367	20,533	176	41,359	(3,208)	38,151
Operating expenses	13,240	5,583	19,884	177	38,884	(2,287)	36,597
Operating profit (loss)	¥ 2,043	¥ (216)	¥ 649	¥ (1)	¥ 2,475	¥ (921)	¥ 1,554
Identifiable assets	¥ 13,602	¥ 3,147	¥ 16,341	¥ 78	¥ 33,168	¥ 4,351	¥ 37,519

Thousands of U.S. dollars							
2006							
Location					Total	Eliminations and corporate items	Consolidated total
Japan	Americas	Europe	Asia				
Sales:							
External sales	\$ 127,650	\$ 49,890	\$ 184,724	\$ 874	\$ 363,138	\$ -	\$ 363,138
Inter-segment sales	721	1,755	27,905	1,298	31,679	(31,679)	-
Total sales	128,371	51,645	212,629	2,172	394,817	(31,679)	363,138
Operating expenses	108,151	52,128	199,118	1,841	361,238	(24,156)	337,082
Operating profit (loss)	\$ 20,220	\$ (483)	\$ 13,511	\$ 331	\$ 33,579	\$ (7,523)	\$ 26,056
Identifiable assets	\$ 118,999	\$ 29,593	\$ 168,872	\$ 1,934	\$ 319,398	\$ 65,428	\$ 384,826

(c) *Overseas Sales*

Millions of yen					
2006					
	Americas	Europe	Asia	Total	
Overseas sales	¥ 7,978	¥ 15,337	¥ 6,513	¥ 29,828	
Percentage of overseas sales to total consolidated sales	18.6%	35.8%	15.2%	69.6%	

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

		Millions of yen						
		2005						
		Americas	Europe	Asia	Total			
Overseas sales	¥	7,360	¥	12,856	¥	4,690	¥	24,906
Percentage of overseas sales to total consolidated sales		19.3%		33.7%		12.3%		65.3%

		Thousands of U.S. dollars						
		2006						
		Americas	Europe	Asia	Total			
Overseas sales	\$	67,667	\$	130,085	\$	55,242	\$	252,986
Percentage of overseas sales to total consolidated sales		18.6%		35.8%		15.2%		69.6%

Note: (1) Overseas sales are sales to countries outside of Japan by the Company and its consolidated subsidiaries.

(16) Related Party Transactions

Transactions of the Company and Hosokawa Powder Technology Research Institute (HPTRI) with related parties are shown in the table below.

(a) Transactions of the Company

		Millions of yen			
Name of Related Parties		Transactions made during the year ended September 30, 2006		Resulting account balance	
• Status	• Equity ownership percentage held by the Company	Description of transactions	Amount	Account	Amount
Juno International Inc.					
100% of voting rights was held by the close relations of the president		Rent of warehouse and offices	¥ 4	-	¥ -
6.95%		Expense reimbursement	¥ 7	Other receivable	¥ 1

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Name of Related Parties • Status • Equity ownership percentage held by the Company	Millions of yen			
	Transactions made during the year ended September 30, 2006		Resulting account balance	
	Description of transactions	Amount	Account	Amount
Hosokawa Enterprise Co., Ltd. 100% of voting rights was held by Juno International Inc. 0%	Purchase of coffee beans, etc.	¥ 4	Other payable	¥ 0
	Lease of cars and equipment	¥ 126	Other payable	¥ 10
	Expense reimbursement	¥ 14	-	¥ -

Name of Related Parties • Status • Equity ownership percentage of the Company	Thousands of U.S. dollars			
	Transactions made during the year ended September 30, 2006		Resulting account balance	
	Description of transactions	Amount	Account	Amount
Juno International Inc. 100% of voting rights was held by the close relations of the president 6.95%	Rent of warehouse and offices	\$ 34	-	\$ -
	Expense reimbursement	\$ 59	Other receivabl e	\$ 8
	Purchase of coffee beans, etc.	\$ 34	Other payable	\$ 0
Hosokawa Enterprise Co., Ltd. 100% of voting rights was held by Juno International Inc. 0%	Lease of cars and equipment	\$ 1,009	Other payable	\$ 85
	Expense reimbursement	\$ 119	-	\$ -

Toho Sangyo Corp. changed its name to Juno International Inc. effective February 1, 2006.

Management believes that the above transactions were at arm's length and for terms that would have been obtained from unaffiliated third parties.

Millions of yen

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

Name of Related Parties • Status • Equity ownership percentage of the Company	Transactions made during the year ended September 30, 2005		Resulting account balance	
	Description of transactions	Amount	Account	Amount
Masuo Hosokawa President of Hosokawa Micron Corporation 9.81%	Redemption of Bond	¥ 800	-	¥ -
Masuo Hosokawa Chairman of Hosokawa Powder Technology Foundation 0%	Redemption of Bond	¥ 1,200	-	¥ -
Toho Sangyo Corp. 100% of voting rights was held by the president and his close relations 7.52%	Rent of warehouse and offices	¥ 3	-	¥ -
	Expense reimbursement	¥ 5	Other receivable	¥ 0
	Purchase of coffee beans, etc.	¥ -	Other Payable	¥ 0
Hosokawa Enterprise Co., Ltd. 100% of voting rights was held by Juno International Inc. 0%	Lease of cars and equipment	¥ 138	Other Payable	¥ 11
	Expense reimbursement	¥ 13	-	¥ -
Juno International Co., Ltd. 100% of voting rights was held by the close relations of the president 0%	Purchase of coffee beans, etc.	¥ 1	-	¥ -

Juno International Co., Ltd. was liquidated at August 29, 2005, and its business was transferred to the food sales division of Toho Sangyo Corp.

Management believes that the above transactions were at arm's length and for terms that would have been obtained from unaffiliated third parties.

**HOSOKAWA MICRON CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(b) The transaction of HPTRI

Name of Related Parties • Status • Equity ownership percentage held by HPTRI	Millions of yen			
	Transactions made during the year ended September 30, 2006		Resulting account balance	
	Description of transactions	Amount	Account	Amount
Juno International 100% of voting rights was held by the close relations of the president 0.82%	Sales of beauty and hair-care products	¥ 165	Trade Receivable	¥ 170
Hosokawa Enterprise Co., Ltd 100% of voting rights held by Juno International Inc. 0%	Lease of cars and equipment	¥ 69	Other payable	¥ 7

Name of Related Parties • Status • Equity ownership percentage held by HPTRI	Thousands of U.S. dollars			
	Transactions made during the year ended September 30, 2006		Resulting account balance	
	Description of transactions	Amount	Account	Amount
Juno International 100% of voting rights was held by the close relations of the president 0.82%	Sales of beauty and hair-care products	\$ 1,399	Trade Receivable	\$ 1,442
Hosokawa Enterprise Co., Ltd 100% of voting rights was held by Juno International Inc. 0%	Lease of cars and equipment	\$ 585	Other payable	\$ 59

Management believes that the above transactions were at arm's length and for terms that would have been obtained from unaffiliated third parties.

**HOSOKAWA MICRON CORPORATION
AND SUBSIDIARIES**

Consolidated Performance Evaluation

September 30, 2006, 2005, 2004, 2003 and 2002

Index	Fiscal Year		2003	2004	2005	2006
	Unit	2002				
Sales	Millions of yen	36,452	28,564	35,327	38,151	42,814
Net income(loss) for the year	Millions of yen	(5,061)	(5,099)	407	825	2,179
Net assets (= Shareholders' Equity)	Millions of yen	12,005	7,594	14,181	17,298	22,560
Gross assets	Millions of yen	48,091	40,072	41,210	37,519	45,371
Net asset worth	Yen	441.71	279.90	381.59	433.66	517.23
Net income(loss) worth	Yen	(184.54)	(187.80)	14.52	20.98	51.31
Adjusted net income worth	Yen	-	-	14.11	19.81	49.94
Pre tax income(loss) to sales ratio	%	(14.1)	(14.2)	0.7	2.7	6.5
Stockholder's equity to total capital ratio	%	25.0	19.0	34.4	46.1	49.0
Net income to shareholder's equity ratio	%	-	-	3.7	5.2	11.1
Net income to stock price ratio	Yen	-	-	34.9	43.1	17.5
Current assets	Millions of yen	21,477	21,773	23,260	20,105	26,875
Current liabilities	Millions of yen	28,471	22,171	19,315	12,389	14,396
Current ratio	%	75.4	98.2	120.4	162.3	186.7
Noncurrent liabilities	Millions of yen	7,552	10,153	7,385	7,519	8,415
Debt ratio	%	300.1	425.7	188.3	115.1	101.1
Cash flows from operating activities	Millions of yen	2,335	(271)	2,465	2,890	2,695
Cash flows from investing activities	Millions of yen	(1,327)	(306)	2,252	379	(1,282)
Cash flows from financial activities	Millions of yen	(1,957)	(1,163)	(2,012)	(4,517)	2,062
Cash and cash equivalent at end of year	Millions of yen	4,551	2,726	5,418	4,224	7,814
Employee	Persons	1,836	1,327	1,617	1,522	1,520

Major Subsidiaries and Divisions

(As of October 1, 2006)

Country	Name	Principal Business
Japan	Hosokawa Powder Technology Research Institute	Research of Nano Particle Technology, Development of Powder Processing System, Measurement and Toll Processing
	Wagner Hosokawa Micron Ltd.	Sales of powder coating equipment
	Hosokawa Alpine AG Japan Branch	Sales of blown film equipment / systems
Asia		
China	Hosokawa Micron (Shanghai) Powder Machinery Co., Ltd.	Sales of powder processing equipment / systems
Korea	Hosokawa Micron (Korea) Ltd.	Sales of powder processing equipment / systems
Malaysia	Hosokawa Micron (Malaysia) Sdn. Bhd.	Sales of powder processing equipment / systems
Americas		
U.S.A.	Hosokawa Micron International Inc.	
(Division)	(Hosokawa Micron Powder Systems)	Manufacture and sales of powder processing equipment / systems
	(Hosokawa Alpine American)	Sales of blown film processing equipment / systems
	(Hosokawa Polymer Systems)	Manufacture and sales of plastic granulating equipment
Canada	Hosokawa Micron Ltd.	Sales of powder processing equipment / systems
Mexico	Hosokawa Micron de Mexico SA de CV	Sales of powder and thermal processing systems
Europe		
Germany	Hosokawa Alpine AG	Manufacture and sales of powder processing equipment / systems and blown film processing equipment / systems
	Hosokawa Micron Powders GmbH	Toll processing of powder material
	Hosokawa Bepex GmbH	Manufacture and sales of powder processing / systems and confectionery equipment/systems
Netherlands	Hosokawa Finance International B.V.	Financing
	Hosokawa Micron B.V.	Manufacture and sales of powder and thermal processing Equipment / systems
	Hosokawa Ter Braak B.V.	Manufacture and sales of confectionery equipment / systems
U.K.	Hosokawa Micron Ltd.	Manufacture and sales of powder processing equipment and containment systems
Spain	Hosokawa Micron Espana S.A.	Sales of powder processing equipment / systems

Board of Directors
(As of December 21, 2006)

Hosokawa Micron Corporation

President

Masuo Hosokawa * Chief Executive Officer

Vice President

Kiyomi Miyata * Chief Operating Officer

Directors

Kiyoshi Nogi Chief Technology Officer
(Director of “Hosokawa Powder Technology Research Institute”)
(Professor, Joining and Welding Research Institute of Osaka University)

Hitoshi Kihara Director of International Operations and Division Director of
International Management and Sales Division

Tadamichi Fukunaga Director of Japan Operation

Shouzo Maede Division Director of Powder Processing Systems Division

Yoshihiro Nakamura Chief Financial Officer and Division Director of Accounting Division

Haruo Shiraya Division Director of General Affairs Division

Makio Naito (Director of “Hosokawa Powder Technology Research Institute”)
(Professor, Smart Processing Research Center, Joining and Welding Research
Institute of Osaka University)

Outside Director

Ichiro Chibata (Ph. D.)

Standing Auditor

Shuntaro Ukita

Auditors

Kiichi Kokubu

Keiichiro Azuta

Executive Officers

Yasuo Takagi Assistant Division Director of General Affairs Division

Tetsuya Inoue Assistant Division Director of Accounting Division

Mitsuru Imachi Division Director of After Sales Service Division

Arata Yokoyama Division Director of Purchasing Division

Tadami Hanakawa Assistant Division Director of Powder Processing System Division

Yoshinori Uchida President of Americas Operation and Assistant Division Director of
International Management and Sales Division

Kouichi Ishii Division Director of Clean Air and Environmental Protection Division

Mitsuhiko Sato General Manager of Tokyo Branch

*Representative Director



HOSOKAWA MICRON CORPORATION

Investor Information
(As of September 30, 2006)

Year of Incorporation

1916

Common Stock

¥ 14,495 Million

Common Stock

Par Value ¥50
Authorized 99,347,000 shares
Issued 43,075,350 shares

Number of Shareholders

8,924

Securities Traded

Tokyo Stock Exchange (First Section)
Osaka Securities Exchange (First Section)

Independent Auditors

Shin Nihon & Co.
AZUSA & Co.

Transfer Agent

The Mitsubishi UFJ Trust & Banking Co., Ltd

Further Information

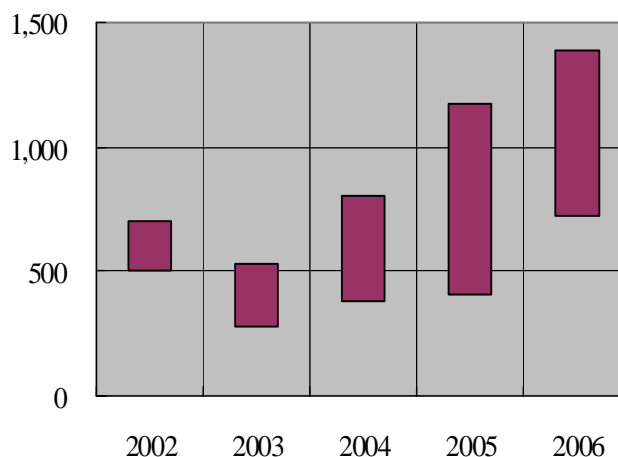
For further information, please contact Accounting Division of Hosokawa Micron Corporation

Address: 9, 1-chome, Shoudai Tajika, Hirakata-shi, Osaka 573-1132, Japan

Telephone: 81-72-855-2225

URL: <http://www.hosokawamicron.co.jp/>

Common Stock Price Range
FY2002-2006



Fiscal Year	2002	2003	2004	2005	2006
Highest	705	538	802	1,174	1,388
Lowest	499	280	380	407	730

(Yen)

HOSOKAWA MICRON CORPORATION and Representative Offices Directory

Hirakata Head Office & Hirakata Plant

9, 1-chome, Shoudai Tajika, Hirakata-shi,
Osaka 573-1132, Japan
Tel: 81-72-855-2226
Fax: 81-72-855-2410

Tokyo Branch

Itabashi Center Bldg., 9-7, 3-chome, Itabashi,
Itabashi-ku, Tokyo, 173-0004, Japan
Tel: 81-3-5248-5730
Fax: 81-3-5248-5737

Nara Plant

9-3 Nara Industrial Estimate, Techno-Park-Nara,
Sumikawa-cho, Gojo-shi, Nara 637-0014, Japan
Tel: 81-7472-6-3960
Fax: 81-7472-6-3970

Kashiwa Office

472, Nakatoyofuta, Kashiwa-shi, Chiba
277-0873, Japan
Tel: 81-4-7131-6612
Fax: 81-4-7132-2516

Tsukuba Technical Development Center

2345-1, Higashida, Shinozaki, Tsukuba-shi,
Ibaraki 300-0873, Japan
Tel: 81-298-64-3961
Fax: 81-298-64-8822

Other Sales Offices (Japan)

Tokai, Shimonoseki, Fukuoka



HOSOKAWA MICRON CORPORATION

Hosokawa Micron Corporation is a member of the Hosokawa Micron Group, responding to global needs through emphasis on materials science and engineering. The Group is an international provider of equipment and technology for powder and particle processing, plastic processing and confectionery products. The Group maintains facilities for research, engineering, manufacturing and service in each of the world's major industrial market.

(0610PC1)