SHIMA SEIKI

Ever Onward

Annual Report 2006

Year Ended March 31, 2006

Financial Highlights

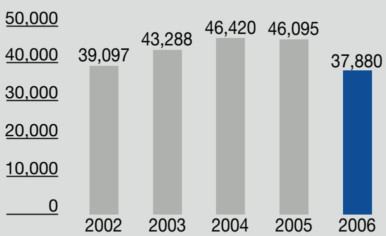
SHIMA SEIKI MFG., LTD. and Consolidated Subsidiaries
Years ended March 31, 2006, 2005 and 2004

	2006	2005	2004	2006	2006
For the Year:	Millions of yen			Thousands of U.S. dollars	Thousands of euros
Net sales	**¥37,880**	¥46,095	¥46,420	**$322,465**	**€265,248**
Operating income	**4,023**	9,258	10,972	**34,247**	**28,170**
Income before income taxes and minority interests	**5,293**	9,518	9,520	**45,058**	**37,063**
Net income	**3,405**	5,930	5,624	**28,986**	**23,843**
At Year-End:					
Total assets	**¥109,302**	¥107,234	¥102,853	**$930,467**	**€765,367**
Shareholders' equity	**95,331**	92,115	87,903	**811,535**	**667,537**
Per Share Data:	Yen			U.S. dollars	Euros
Net income	**¥91.92**	¥159.97	¥150.64	**$0.78**	**€0.64**
Cash dividends applicable to the year	**37.50**	37.50	37.50	**0.32**	**0.26**
Shareholders' equity	**2,599.24**	2,510.71	2,391.63	**22.13**	**18.20**

Notes: Yen amounts have been translated into U.S. dollars and euros, for convenience only, at the rates of ¥117.47=US$1 and ¥142.81=€1, respectively, the approximate Tokyo foreign exchange market rates as of March 31, 2006.

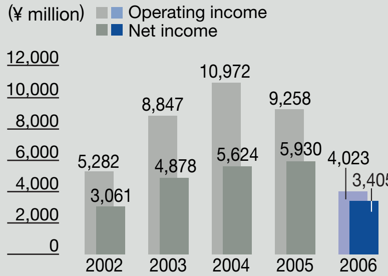
Net sales

(¥ million)



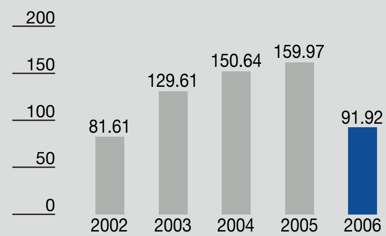
Operating income/Net income

(¥ million)



Net income per share

(¥)



Contents

Forward-looking statements:

Statements contained in this report regarding the Company's plans, strategies, and expectations for future performance fall into the category of "forward-looking statements," which are based on information available to the Company's management at the time of writing. They are therefore subject to a number of uncertainties and unknowable factors, and actual results may thus differ substantially from those projected.

SHIMA SEIKI Spirit

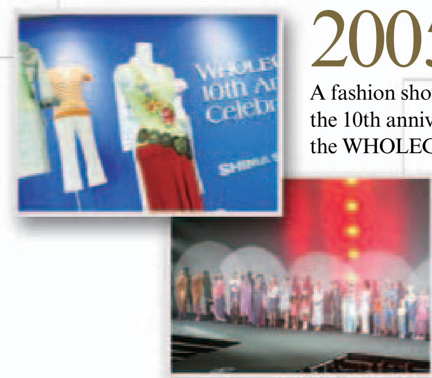
Ever Onward

Based on our corporate motto of "Ever Onward", Shima Seiki has been striving to develop technologies that have never existed before. Moreover as comprehensive mechatronics company, Shima Seiki will provide highly advanced products at economical prices and introduce continuous innovations to the industry.

Shima Seiki was incorporated in 1962 in Wakayama city (cf. p.42) by the current president Masahiro Shima in order to address the difficult challenge of "fully automating the glove knitting machine."

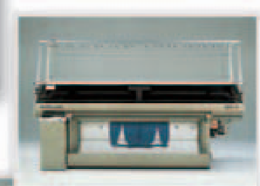
This effort was rewarded three years later with the development of the world's first fully automated glove knitting machine. Later the Company, driven by the aim to "revolutionize apparel knitting machines," overcame numerous technical issues and became the world's frontrunner in the apparel industry. In 1995, the Company launched the WHOLEGARMENT® flat knitting machine, which was capable of seamless, three-dimensional knitting and thus overturned all conventions of the knitting industry. Today Shima Seiki, with its superior cost competitiveness and advanced technology, has grown a leader in the knitwear and apparel industries.

The Company has consistently taken on technological developments from the customers' point of view, and by providing customers with the entire package including design systems, its accumulated know-how and designs, as well as the knitting machines, it has evolved into a business capable of creating its own markets.



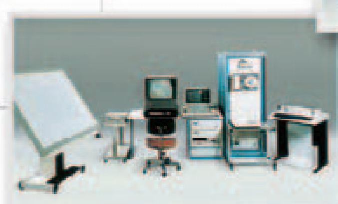
2005

A fashion show was held to commemorate the 10th anniversary of the launch of the WHOLEGARMENT® flat knitting machine



1995

Developed the SWG-series, the world's first seamless, computerized flat knitting machine

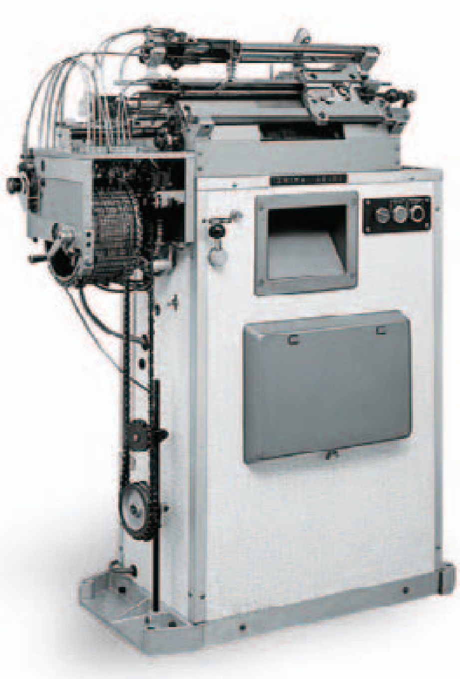


1981

Developed the SDS®-1000 Shimatronic Design System

1978

Developed the SNC Shimatronic computerized jacquard flat knitting machine and pioneered the new field of flat knitting machines with its advanced computer technology



1965

Developed the world's first fully automated glove knitting machine

Shima Seiki technology revolutionizing the world's knitting industry

The WHOLEGARMENT® flat knitting machine, with its unique mechanical technology as well as knitting technology, has revolutionized the industry. By offering total knitting solutions combined with its design system, the Company is shifting the knitting industry from a labor-intensive industry to a knowledge-intensive type of industry.

The world's largest knitting machine trade fair

The company exhibited at IKME, the International Exhibition of Finishing & Knitting Technology, which was held in Milan, Italy in November 2005. Working with the theme of "Fresh, Attractive and Innovative," the Company introduced new models and new functions primarily to the apparel manufacturers of Europe. The innovative solutions offered at the year's exhibit resulted in the increase in the number of product inquiries as compared to the Company's previous exhibit in 2003.

WHOLEGARMENT® Fashion Show

To commemorate the 10th anniversary of the launch of WHOLEGARMENT®, an unparalleled event, intended to stimulate all of the senses, was held in Wakayama City in July 2005. The Company welcomed more than 2,000 members of the industry both from Japan and abroad and attracted wide acclaim for its innovative ideas presented at the show.

WHOLEGARMENT®'s potential to alter the global knitwear production map

"Seamless knitwear" is being adopted by an increasing number of major apparel manufacturers

WHOLEGARMENT® flat knitting machines defy the conventional assumption that knitwear is to be made from separately knitted parts being sewn together and makes it possible to produce "knitwear without seams (seamless knitwear)" through three-dimensional knitting.

Recognizing WHOLEGARMENT®'s wide-reaching potential and its capabilities for manufacturing products with immense appeal, major apparel manufacturers are adopting WHOLEGARMENT® for the production of their major brand name garments.

Although the main reason for WHOLEGARMENT®'s wide appeal may lie in its potential for manufacturing high value-added products for the end user, it has also been valued highly by the industry for its ability to significantly reduce cost, shorten lead-time and manufacture products that immediately respond to the needs of the market.

The Company has been promoting and expanding the sales of WHOLEGARMENT® flat knitting machines, which is considered to be the strategic focal point of its flat knitting machine business, to the world's consumer knitwear markets.

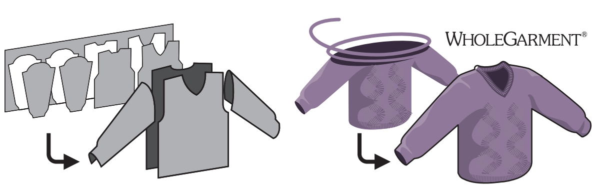
WHOLEGARMENT® 's huge potential

WHOLEGARMENT® offers high-quality design with dress-like flowing silhouettes and because the finished garments are seamless, they have greater elasticity, durability, comfort and lightness. In recognition of these qualities, WHOLEGARMENT® is now widely adopted for the manufacture of sportswear, formal wear and children's clothing.

The pursuit of WHOLEGARMENT®'s vast potential, which enables the creation of attractive knitwear, has only just begun. This is indicated by the fact that WHOLEGARMENT® knitwear are estimated to account for less than 1% of all knitwear being sold globally today.

By promoting these new possibilities to its users, the Company is intent on transforming production in consumer regions from labor-intensive mass production to knowledge-intensive, multi-product/small-lot production.

Difference between WHOLEGARMENT® and conventional knitting methods



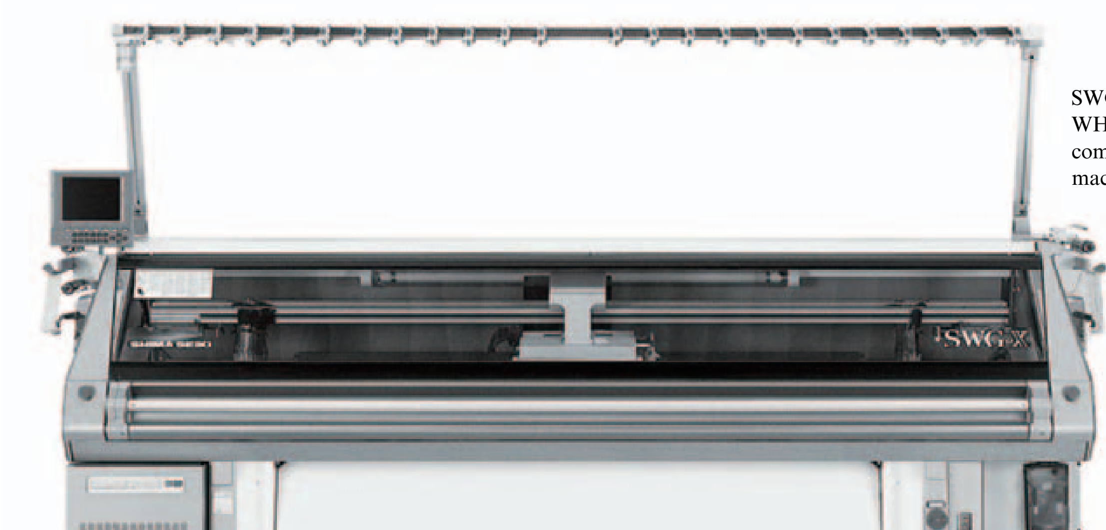
Typically knitted garments are made by first knitting individual parts, including the body panels and sleeves, cutting them along the pattern, and then sewing them together in a detailed sewing process. With WHOLEGARMENT®, on the other hand, it is possible to knit an entire garment in one piece on the knitting machine employing three-dimensional knitting.

Advantages of WHOLEGARMENT®

Advantages for the manufacturer
- Enables quick response
- Reduces cost as a result of drastic shortening of the production process
- Minimum yarn

Advantages for the consumer
- A soft feel and light-weight comfort
- Elasticity
- Flowing silhouette

Advantages in the revitalization of knitwear industries in consumer markets
- Production acutely responsive to consumer trends
- Creation of products with high added-value



SWG-X WHOLEGARMENT® computerized flat knitting machine

Creation of a new business model with the Total Knitting System

SDS®-ONE offers manufacture of high-quality products

SDS®-ONE is an "ALL-in-ONE" design tool, developed by the Company to support the efficient manufacture of high-quality products, and which allows for all operations necessary for production in the apparel field, from product planning through to production management and product promotion, to be integrated into one system.

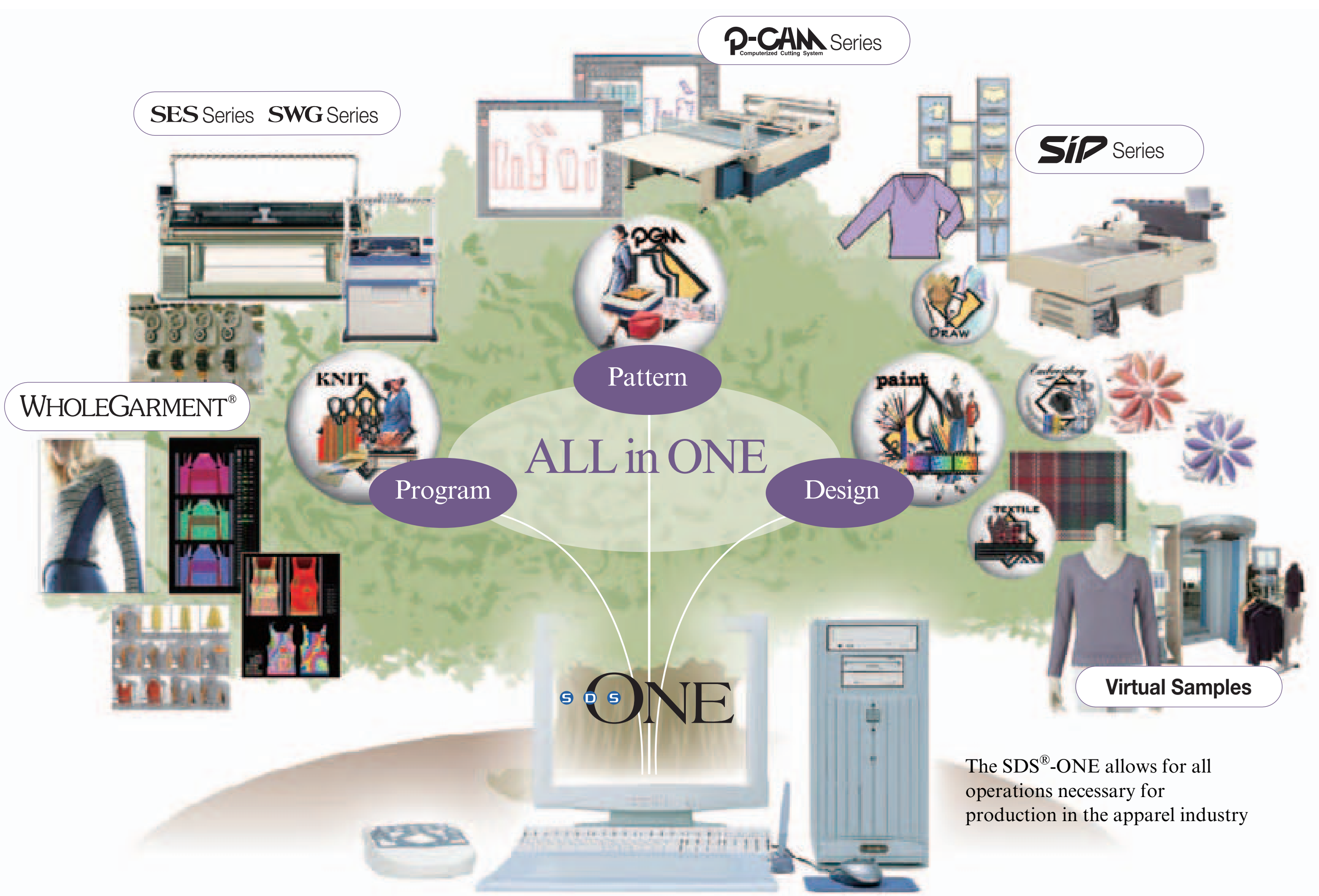
For example, the once time-consuming process of sample production is now carried out on the system, which has significantly shortened lead-time and enabled accurate and waste-free product deliberation. For all practical purposes, this system is equivalent to a computer having a knitting machine inside.

As a focal tool providing business solutions, SDS®-ONE, together with WHOLEGARMENT® flat knitting machines, enables the manufacture of high-quality products.

Global dispatch of design information and support for the revitalization of the apparel industry

At Total Design Center, established at the Company's Headquarters, designers plan and produce nearly 60 WHOLEGARMENT® samples every week. These samples are then displayed at the showroom at the Company's Headquarters, while at the same time, the design data are quickly sent to Communication Spaces in Milan, Tokyo, and Osaka, for presentation to apparel companies around the world.

Total Design Center also provides proprietary training courses for SDS®-ONE and WHOLEGARMENT® flat knitting machines for technicians of our customers in order to assist them with design and production, helping to bring out the best in WHOLEGARMENT® and other knitting technologies.



The SDS®-ONE allows for all operations necessary for production in the apparel industry

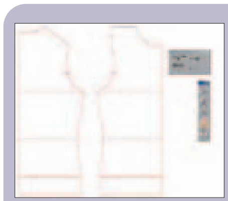
Communicating the designer's vision directly to the consumer

SDS®-ONE is a design tool that not only offers its superior operability and functionality to directly express the designer's creativity but also enables the production of multiple samples in an extremely short amount of time.

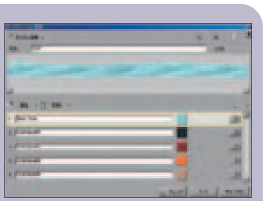
The essence of garment manufacture lies in the ability to shape the designer's creativity into a product, and let its appeal be felt by the consumer. SDS®-ONE is attracting a great deal of interest as a design system which allows the designer's creativity to become reality.

Flow of the design process using SDS®-ONE

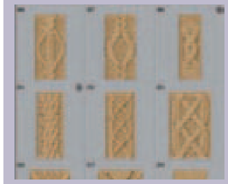
By executing a few essential steps in design, SDS®-ONE will produce a realistic image of the finished product.



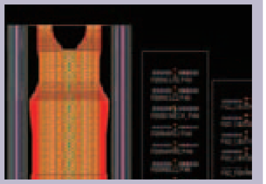
Pattern making



Yarn selection



Knit pattern selection

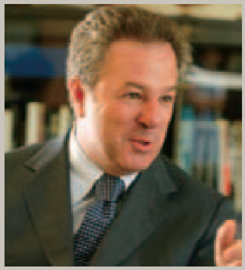


Converting knit pattern into knitting machine data

Product simulation

The WHOLEGARMENT® flat knitting machine then promptly produces knitwear identical with the image.

Shima Seiki, an ally of the Italian fashion industry



CEO of Stefanel S.p.A.*

Giuseppe Stefanel

By introducing 120 Shima Seiki WHOLEGARMENT® flat knitting machines to our plant located in the suburb of Treviso, Italy, we were able to substantially increase our production capacity with its superior functionality. Moreover since the finished products have no seams and come out of the machines in completed form, operations can be completed with a minimum number of personnel.

Through reinforcement of our Italian domestic production structure, we were able to shorten the time required for the entire process from product planning to actual delivery down to one week and shift our production from mass production on a semi-annual basis to small-lot production conducted throughout the year. Because of this innovation, we have been able to expand our brand on a global scale.

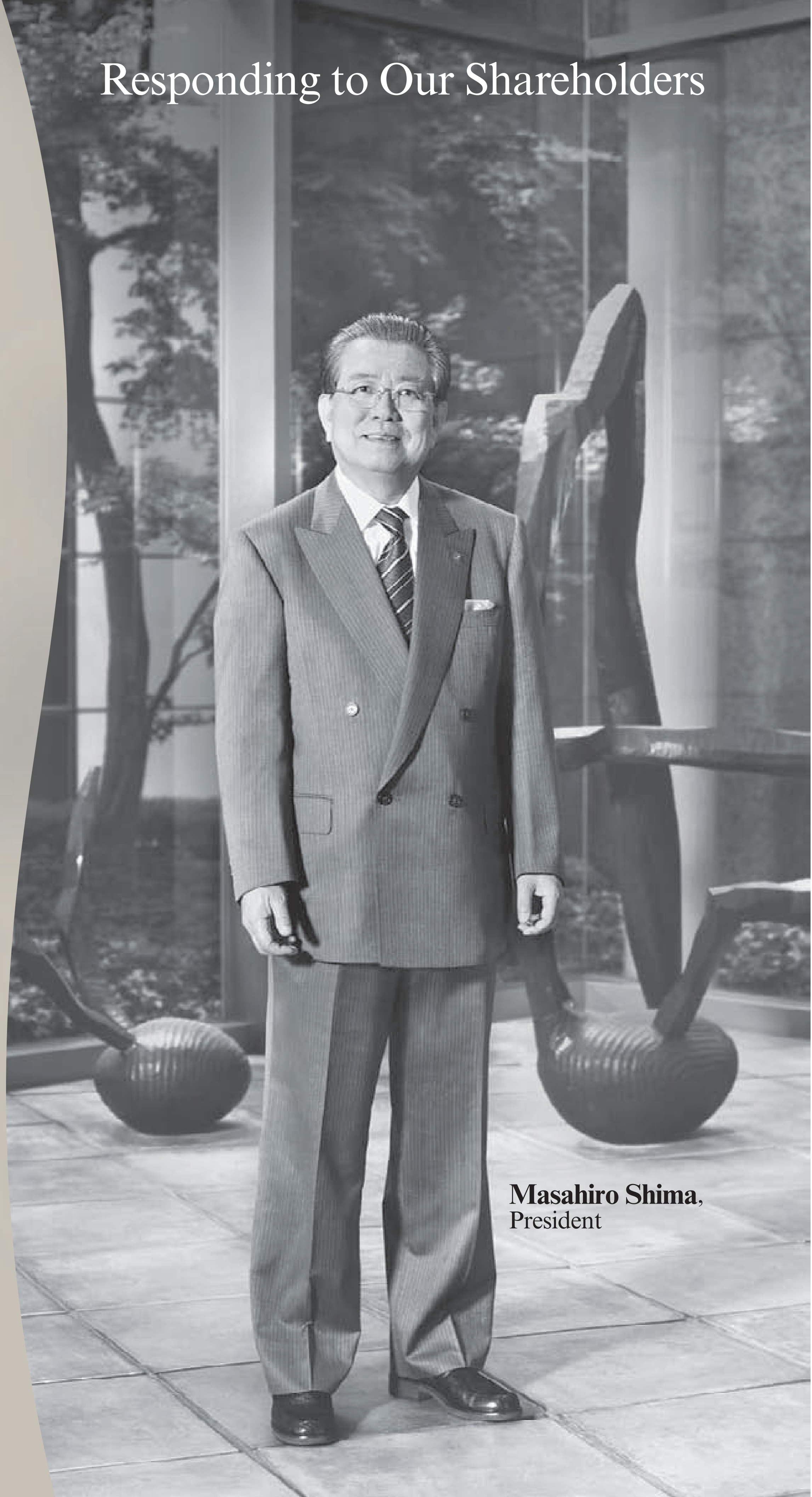
It is a given that Italian manufacturers produce high value-added products with creativity and innovation not seen anywhere else. And WHOLEGARMENT® is a wonderful tool to make that happen.

*Stefanel S.p.A.: Stefanel S.p.A. is a leading fashion brand in Italy. In the apparel industry, where more and more companies are conducting globalization and segmentation of their production base, Stefanel S.p.A., remains an apparel manufacturer that is primarily focused on manufacturing and retail (SPA) reinforcing its brand image and aggressively engaging in overseas business development by keeping its production base in Italy.

Responding to Our Shareholders

The period under review (the year ending in March 2006) witnessed major changes in the global knitwear and apparel industry, as a result of the termination of textile import quotas (quota-free*1). In the market, on the eve of the formation of a new framework for the textiles industry accompanying the rapid growth of the newly industrializing China, cautionary trends for capital investments were discerned, waiting for the outcome of government-level negotiations. Under such a climate, the Company endeavored to enhance its cost competitiveness, while spreading word around the world of the advanced functions and appealing qualities of WHOLEGARMENT® flat knitting machines as well as conventional ones.

*1 Quota-free: Refers to the complete abolition of the limits on the amount of textiles the U.S., Europe and other nations can import from China and other countries (quota), decided by an agreement of the WTO (World Trade Organization) in 1995 which phased it out after a ten-year period.



Masahiro Shima,
President

Business results and dividends for the period

During the period under review, new quota-free conditions had far wider impact than had initially been anticipated by the industry and even ultimately led to governmental talks between Europe & the U.S. and China. Until a textile agreement was reached between the EU and China in September, and the U.S. China Textile Agreement concluded in November, uncertainty prevailed in the capital investment projections in each country. The impact of product imports from China was not only felt in the consumer markets but also in the production markets, such as Turkey in the Middle East, resulting in the stagnation of the global market. Although orders received picked up toward the end of the period, overseas sales as a whole decreased to 32,992 million yen (down by 18.1% year-on-year).

In the domestic market, on the other hand, limited investments in the textiles industry resulted in domestic sales of 4,888 million yen (decrease of 16.1% year-on-year).

As a result, consolidated sales totaled 37,880 million yen (down by 17.8% year-on-year) and operating income was 4,023 million yen (decrease of 56.5% year-on-year) due to the increase in proactive anticipatory investments, including events and participation in fairs and trade shows. As the current period marked the initial year for impairment loss accounting in Japan, the Company recorded a net income of 3,405 million yen (decrease of 42.6% year-on-year), due to the recording of impairment losses on the lands and buildings of its consolidated subsidiaries.

In accordance with the basic policy of "maintaining long-term stable dividends," the Company paid ¥37.50 per share for the full business year (includes the interim dividend of ¥17.50 per share).

Projections for the following period

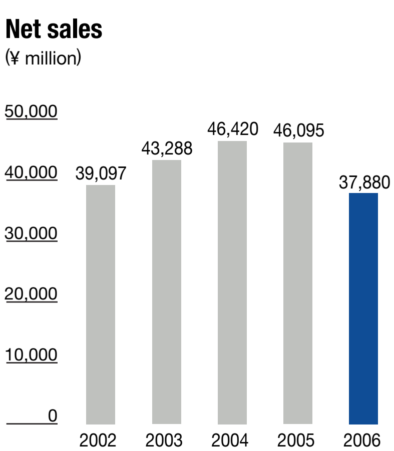
Following the conclusion of the U.S. China Textile Agreement, confusion within the global textile market settled down for the time being and trade of textile products has begun to show signs of stabilizing. Within this new framework, China's role as the world's textile production factory is expected to gain even greater significance. Capital investments in the Chinese and Hong Kong markets, which had temporarily been suspended, are bouncing back and the Group also intends to inject its management resources actively into these markets in order to reinforce its technology/service structure.

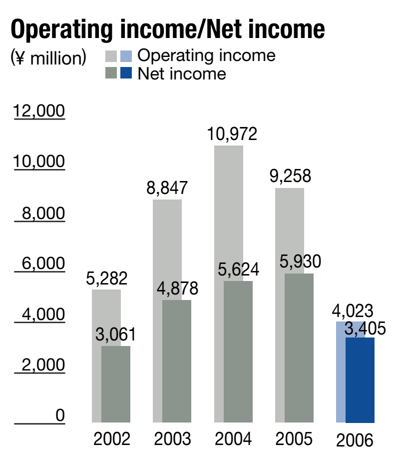
In the European market, which is a consumer market, the Company anticipates growing demand centering around the Italian apparel industry, as a result of the value of WHOLEGARMENT® flat knitting machines being recognized at venues such as IKME*2.

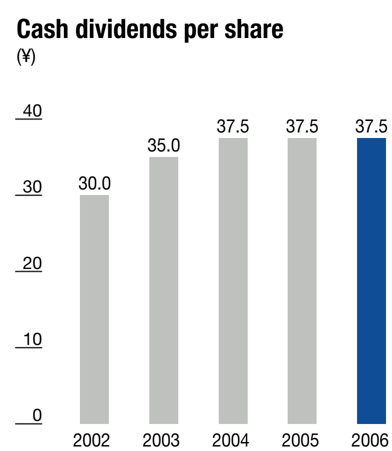
The domestic market, despite brisk retail sales of WHOLEGARMENT® products, is expected to encounter difficulties due to the onslaught of Chinese imports.

Under these circumstances, the Group has predicted for the following period, net sales of 41, 000 million yen, operating income of 6,000 million yen, ordinary income of 6,000 million yen and net income of 4,000 million yen.

*2 IKME: The world's largest international knitting machines trade show, which was held in Milan, Italy, in November 2005.







Q What are the effects that the company's business structure and the lifting of textile quotas have had on the Company's performance?

The flat knitting machine business, which constitutes the Company's main field of business, may be divided into two markets; one may be identified as the production market (China, Hong Kong, Turkey, etc.) and the other as the consumer market (Japan, Europe and the U.S., etc.). During the period under review, the abolition of the quota system caused great confusion in both the garment-producing regions and garment-consuming regions. In the largest consumer markets of Europe and the U.S., the lifting of the quotas altered their industrial structures, and in the Middle East, it resulted in Turkey falling behind in the price war. In China and Hong Kong also, voluntary restrictions were imposed, indicating uncertainty among the textile industry in the future, which in turn inhibited capital investments.

The effects of these developments went far beyond industry predictions and the Company was twice forced to make downward adjustments in its performance forecasts. However, with the conclusion of the U.S. China Textile Agreement in November 2005, the state of confusion that had dominated the industry moved toward resolution, and demand, primarily in the Chinese and Hong Kong markets, began to rise again.

Q What do you predict the market trends will be?

Following the cooling down of the confusion caused by the lifting of quotas, orders for conventional flat knitting machine in the Fourth Quarter from China and Hong Kong began to increase, following their textile agreement. Consequently the Company has stepped up its production structure in order to meet the delivery deadlines of these orders. In the future, we predict that orders from the world's major textile producing countries will steadily increase and we are considering enhancements to flexible manufacturing in order to meet such increases in orders.

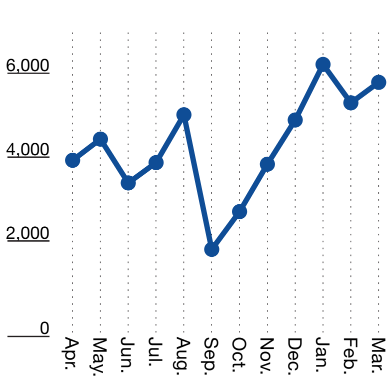
In the consumer nations, on the other hand, it has become evident that, amidst mounting competition, production of high value-added items, not high-volume items, will give apparel manufacturers the much-needed edge to play out this fierce competition.

We believe that the effective application of WHOLEGARMENT® knitting technology suited to each brand image, is the deciding factor between success or failure for European and U.S. apparel manufacturers. Recognition of this fact will eventually penetrate the industry and consequently we anticipate steady improvement in demand for our products.

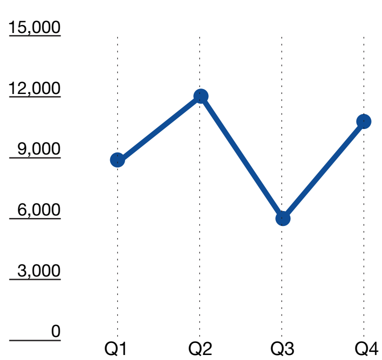
Q What direction do you expect the sales of WHOLEGARMENT® flat knitting machines to take in the future?

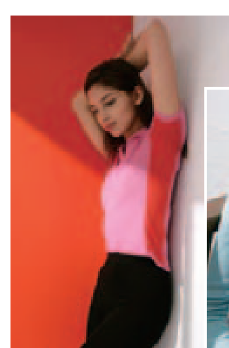
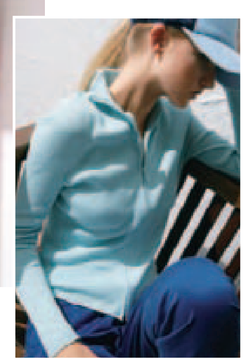
The Company is focusing its attention on the sales of WHOLEGARMENT® flat knitting machines, which

Order Backlog in 2006
(¥ Million)



Quarterly Sales in 2006
(¥ Million)



Collection of WHOLEGARMENT® samples

commemorated its tenth anniversary last year, as the key to sustain its long-term corporate growth. In the European and American markets in the past, the connotations of the term “seamless,” i.e. literally without stitched seams, had led the majority of apparel manufacturers to think of the WHOLEGARMENT® flat knitting machine as a mere cost-reduction device. However, since the Company’s exhibit at last year’s IKME, the idea that WHOLEGARMENT® knitwear present advantages to the end user, such as “fit and comfort” has begun to take hold.

In addition to the Company’s participation in IKME and fashion show in Japan, the Company has taken advantage of opportunities to introduce WHOLEGARMENT® flat knitting machines and design systems to the U.S. market during the year to demonstrate its use for both inner- and outer-wear and that it can make three-dimensional images of the garment’s silhouettes. Garments knitted with WHOLEGARMENT® flat knitting machines have received much praise, describing their comfort as “second skin,” and we are confident that we have taken our first step in increasing the U.S. industry’s awareness of WHOLEGARMENT® flat knitting machines. In the future, the Company intends to steadily increase penetration of WHOLEGARMENT® into the U.S. market by continuing to dispatch information in New York, where the apparel industry is heavily concentrated.

Q How do you intend to cultivate new markets?

WHOLEGARMENT® flat knitting machines, through the years of progress and improvements since its launch ten years ago, has been understood in the context of its advantages to the consumer, such as “wearer comfort” and “the ability to create a flowing silhouette.” The Company intends to continue to actively promote these advantages to the three major consumer regions of Europe, U.S. and Japan. Among these regions, the Company considers the U.S., with its huge population, to hold particular promise, even though being a latecomer to high-end knitwear consumption, and will continue to provide know-how and expertise to the U.S. market primarily through its Total Design Center.

As a new area for cultivation, the Company, in conjunction with apparel manufacturers and sportswear manufacturers, is utilizing the lightweight comfort of seamless clothing made by WHOLEGARMENT® flat knitting machines to expand into the fields of sportswear, children’s clothing, formal attire and even universal fashion garments and is being acclaimed for its efforts.

In the Chinese and Hong Kong markets, on the other hand, manufacturers are not only utilizing the abundant labor of the region to produce highly cost competitive knitwear intended for export to Europe, the U.S. and Japan, but are also witnessing the rapid emergence of the market for high-end knitwear intended for the affluent classes mainly on the coastal regions. In order to satisfy this domestic demand the Chinese and Hong Kong markets will require the technical skill to provide high-quality knitwear on a stable basis and in this respect, we expect our conventional flat knitting machines to maintain high demand in the future.

The company believes that know-how in technology and design related to design systems, as well as hardware development and sales related to knitting machines, are indispensable factors in sustaining future growth and cultivating new markets.

Masahiro Shima

Masahiro Shima, President

As the leading company in the flat knitting machine industry, Shima Seiki intends to rejuvenate the entire user industry, as well as formulate plans to offer products of higher added value that appeal to end-consumers and give them a distinct edge. At the same time, Shima Seiki will endeavor to further increase its market share, reduce costs, and improve risk management in order to maintain stable growth.

1 Increasing market share in the computerized flat knitting machine industry

Shima Seiki, in addressing the needs of its global customers, intends to further increase its market share in the computerized flat knitting machine industry by reinforcing its product development and sales structure according to customer needs and related sales regions.

In Europe, the U.S., and Japan, where the markets have transitioned toward the manufacture of products offering higher added value, Shima Seiki is resolved to establish a “knowledge-intensive production system” that utilizes the WHOLEGARMENT® flat knitting machine.

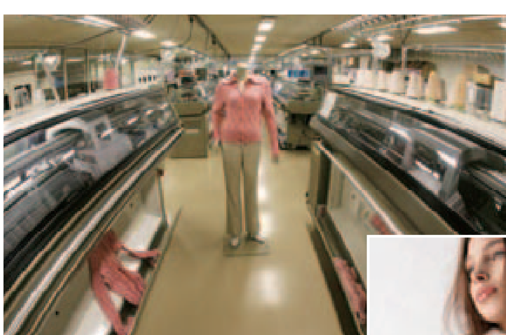
Conversely, in the fiercely competitive markets of Asia and the Middle East, Shima Seiki is determined to penetrate new markets as well as primarily increase existing market share through its conventional flat knitting machines by improving productivity and providing its users with the know-how to produce high-quality, attractive items.

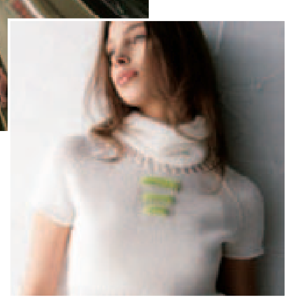
The advantages of the Company’s WHOLEGARMENT® flat knitting machine have been widely recognized through unique planning and promotion campaigns, and a user-support system based on its original know-how. Shima Seiki intends to further link its SDS®-ONE design system and SIP high-resolution printing system to the WHOLEGARMENT® flat knitting machines, thus providing not only the hardware but also the entire package of software, know-how, and design information to distinguish itself from competitors and further expand its sales.

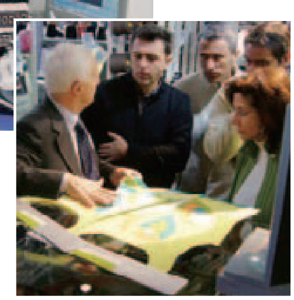
2 Vigorously promoting the SDS®-ONE design system to the apparel industry (covering the entire spectrum from knitwear to textiles)

Shima Seiki, while continuously improving its functionality and operability, has vigorously promoted the SDS®-ONE, which is based on its traditional computer graphics technology, as a “visual communication tool” capable of generating greater profits for the apparel industry.

The SDS®-ONE is a highly functional and economical design tool that enables the entire process from knitting machine programming and pattern making through virtual production of samples under an all-inclusive system. Shima Seiki intends to enhance sales of the SDS®-ONE by further marketing its appeal and promoting it as a comprehensive solution to the issues facing the knitwear and apparel industry, such as market-oriented, manufacturing of a wide variety of products in small quantities, and quick response both in Japan and abroad.







3 Expanding market share in the gloves and socks industry

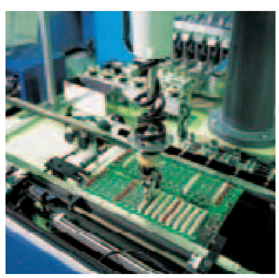
Glove knitting machines, which represents our original starting points and for which the Company holds an overwhelming global market share, are subject to a climate where the wave of capital investments is susceptible to fluctuations in the industries that use the gloves. And more recently, the markets in China for general work gloves have been partially affected by imitation glove knitting machines.

For these reasons, Shima Seiki will not limit itself to the conventional market segments of general work gloves and thermal gloves. Instead, it will offer its user industries the know-how for producing new value-added gloves and socks, including methods of achieving advanced functionality, such as fine-gauge technology for manufacturing gloves to be used in precision manufacturing and medical applications, as well as developing high fashion products, thereby distinguishing itself from competitors and contributing to increased sales. Moreover, given the recent emphasis on health and fitness, “five-toed socks” are receiving wider media attention, consequently fuelling the demand for sock knitting machines.

4 Establishing a high profit structure

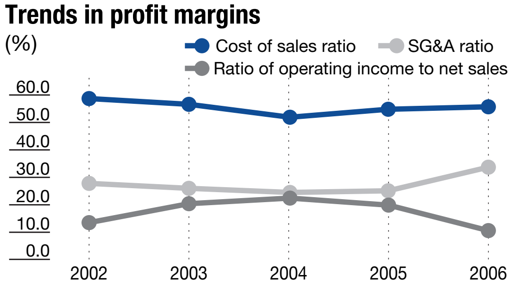
In order to solidify its revenue structure, Shima Seiki will undertake a sweeping reform of its production process from the development design stage up and implement further cuts in manufacturing costs. Shima Seiki will also concentrate on improving its rate of return by shifting its production toward items of high added value, thus differentiating itself from competitors. Efforts will also be made to enhance cost competitiveness by further improving production efficiency and the efficiency of indirect businesses of the entire Group.

By implementing these measures, Shima Seiki is expected to further reinforce its high profit structure.



Assembly of electronic parts

Trends in profit margins

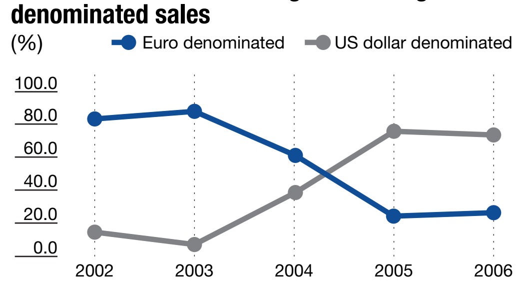


5 Enhancing the risk management system

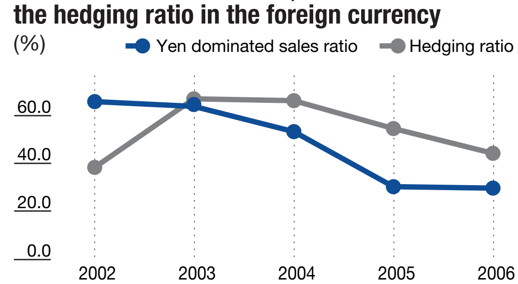
Foreign exchange and credit pose the major risks facing the Company. Shima Seiki actively hedges itself against foreign exchange risks with foreign exchange contract and the liquidation of accounts receivable in order to minimize the impact of sudden fluctuations in exchange rates.

Shima Seiki is also attempting to manage credit risks by closely monitoring the industry trends in each country and region, as well as the business performance and credit standing of its overseas agents, the results of which are reported as needed at the Board of Directors’ Meetings. Moreover, Shima Seiki intends to review the terms and conditions upon which it extends credit to major customers, including methods of financing, collection schemes, and credit lines, thereby dispersing and controlling the concentration of credit risks and ultimately practicing a well-balanced form of risk management.

Changes in the ratio of euro-denominated and US dollar-denominated trading of all foreign currency denominated sales



Changes in the ratio of yen denominated sales of all overseas sales, and the hedging ratio in the foreign currency



Towards new growth—Technology development and intellectual property strategies

Mitsuhiro Shima
Director / General Manager of Graphic System Development Division

Technology development policy and major development projects during the current period

Since the founding of our Company, we have been true to our corporate philosophy of “unique technological developments based upon creativity” and produced products that have generated a high level of customer satisfaction, by combining the advanced technology that we have nurtured as an comprehensive mechatronics company with an abundance of flexible and creative ideas. The Company’s history is also one of relentless technological development that reflects our fundamental stance of “create it yourself if it doesn’t already exist,” as we have developed all the hardware as well as software for our products. Moreover, to ensure thorough quality control, accumulate technical know-how, and improve our quality maintenance, every product, down to individual parts, has been manufactured in-house, resulting in a 75% rate of in-house parts procurement.

Successful development projects undertaken during the period under review include the development of variations of WHOLEGARMENT® flat knitting machines for exhibition at IKME (the International Exhibition of Finishing and Knitting Technology), development of LAPIS™, an evolutionary knitting machine capable of vertical and horizontal knitting, and production of attractive WHOLEGARMENT® samples.

From now on we intend to strike a balance between cost reduction and the accelerated operating speed of our machines as our top-priority development project. Moreover, we have made it our mission to devise and commercialize revolutionary processes that will enable our customers to cut costs while producing apparel of high added value.

Proactive intellectual property strategies resulting in Intellectual Property Award

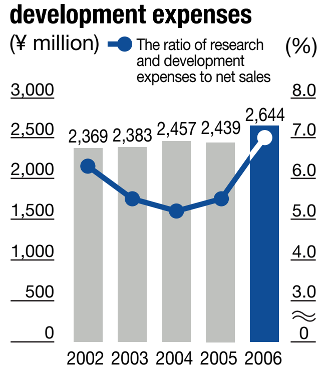
Since its incorporation, Shima Seiki has built up its own database of related technologies in order to construct a technological development structure based on its global business strategies, and devise a set of intellectual property strategies that would fortify such a structure.

Consequently, in April 2006 Shima Seiki received the “Intellectual Property Award from the Ministry of Economy, Trade and Industry” from the Japan Patent Office in recognition of thorough management of its intellectual properties based on technological priorities and proactive deployment of businesses both in Japan and abroad by utilizing its acquired patents.

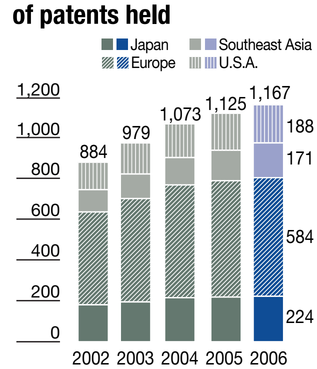
As a means of further enhancing its intellectual property strategies, Shima Seiki intends to actively apply for patents in peripheral and alternative technologies, while at the same time placing greater emphasis on distinguishing and protecting themselves from competitors in terms of products produced by its users who utilize the Company’s products and know-how.

As for the issue of imitation products available in the Chinese market, Shima Seiki is taking firm actions primarily through its Intellectual Property Division to combat patent infringements, though in most cases the Company’s advanced technological developments have rendered such imitations obsolete.

Research and development expenses



Trends in the number of patents held



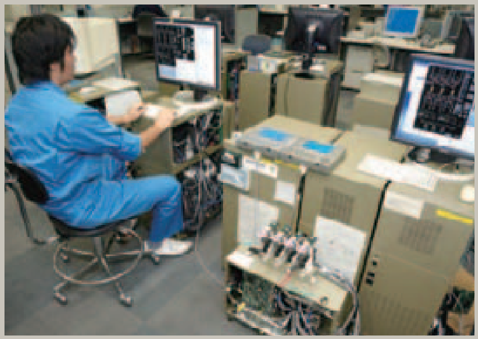
The numbers for Southeast Asia and Europe consist of those of the following major countries and regions only.
Southeast Asia: China, Hong Kong, South Korea and Taiwan
Europe: Germany, U.K., France, Italy and Spain

Mechatronic Development Division:
The Mechatronic Development Division is involved in the design and development of flat knitting machines and glove and sock knitting machines.

During the period under review, the Mechatronic Development Division expanded the variations of the WHOLEGARMENT® flat knitting machines and achieved advanced functionality along with greater knitting efficiency as the priority tasks.

Control System Development Division:
The Control System Development Division, in conjunction with the Mechatronic Development Division, develops the control devices used for knitting machines.

During the period under the review, the Control System Development Division worked on an advanced-functional version of the "i-DSCS® (Digital Stitch Control System with Intelligence), which is a yarn feeding function essential for WHOLEGARMENT® knitting.



The following four divisions conduct research and development activities

Graphic System Development Division:
The Graphic System Development Division is involved in developing every aspect of the design systems-related businesses, covering everything from hardware to software.

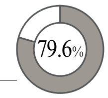
During the period under review, the Graphic System Development Division was engaged in developments to make the SDS®-ONE more expressive and in functional upgrades that allow the SDS®-ONE to function as a total solution.

Total Design Center :
The Total Design Center is involved, among other things, in the planning and development of original samples by primarily using WHOLEGARMENT®, the proposal of efficient business models in manufacturing processes utilizing the design systems, and the development and accumulation of know-how concerning various knitting technologies.

The Group's businesses comprise the main areas of the Flat Knitting Machine Segment, the Design System Segment, the Glove and Sock Knitting Machine Segment and Other Segment, which is engaged in the sales of parts and operations related to the maintenance of each of the other segments. During the period under review, the Group recorded total sales of 37,880 million yen.

The Flat Knitting Machine Segment, which is the Company's core business, is engaged in the development, production and sales of conventional flat knitting machines and WHOLEGARMENT® flat knitting machines and sales from this segment accounted for 79.6% of the total.

Flat Knitting Machine Segment



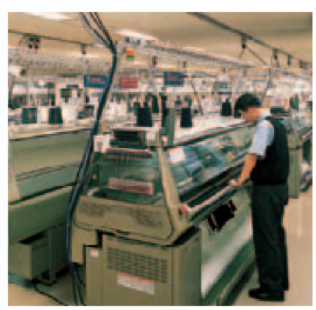
In the Flat Knitting Machine Segment, amidst further polarization of the global market, stagnation resulting from the proceedings of governmental negotiations between China and Europe & the U.S. caused wide-spread uncertainty in China and Hong Kong, the world's greatest production centers among the knitwear production markets. Sales to Turkey in the Middle East, which had been strong in the first half of the year also dropped off significantly during the second half of the year. In spite of our efforts to increase sales through such competitive measures as cost reductions, sales of conventional flat knitting machines fell by 25.2% compared to the previous year to 5,030 units.

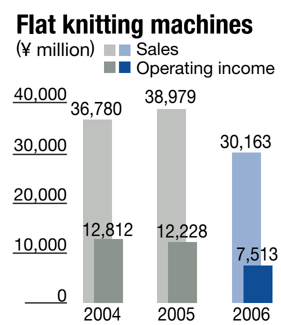
In the future, the Company intends to attain the goal of cost reduction simultaneously with enhanced production, develop high-quality products with consumer appeal, and enhance its user-support system, which includes the provision of the Company's know-how and designs, thereby ultimately increasing its market share.

In consumer markets, on the other hand, the Company, in response to the high praise received for the WHOLEGARMENT® flat knitting machines at IKME, focused particular attention on the expansion of sales primarily in Italy. However due to the impact of the lifting of textile quotas, overall sales in the consuming markets fell below expectations. Moreover, despite aggressive follow-ups of our customers in the domestic market, the severe business climate resulted in weakened capital investments. As a result, sales of WHOLEGARMENT® flat knitting machines fell by 31.7% compared to the previous year to 420 units.

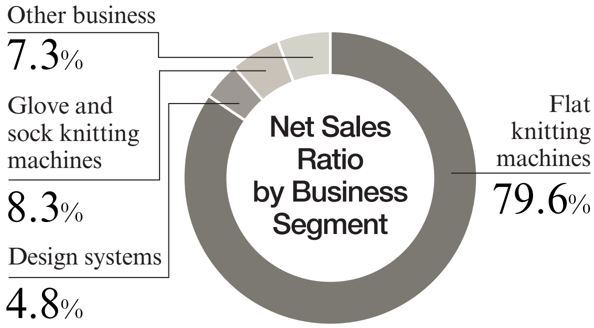
During the year, the entire Flat Knitting Machine Segment recorded sales of 30,163 million yen (22.6% decrease year-on-year), of which overseas sales accounted for 28,195 million yen (21.9% decrease year-on-year) and domestic sales accounted for 1,968 million yen (31.5% decrease year-on-year).

WHOLEGARMENT® sleeveless sweater with fabric that gives a varied impression by using contrasting materials and different knitting techniques





SWG-X WHOLEGARMENT® computerized flat knitting machine



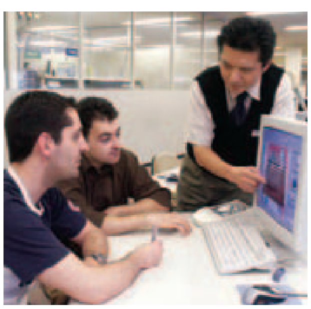
Design System Segment

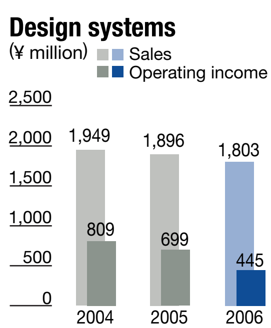
4.8%

The Design System Segment was engaged in the aggressive expansion of its sales through the enhancement of virtual sample functions and other new functions of its SDS®-ONE, the core tool offering total solutions to the knitwear and apparel industries.

In spite of our efforts to communicate the appeal of our expressive designs at the IKME exhibit and through the many samples displayed at the Milan Design Center, the severe business climate caused sales to fall below previous year sales. As a result, the Design System Segment during the period under review recorded sales of 1,803 million yen (4.9% decrease year-on-year).

The Company intends to support its knitwear and apparel manufacturing customers in producing competitive products by providing them with design know-how and samples utilizing the SDS®-ONE, while also offering support, in personnel training by continuing its proprietary training programs in the use of its design systems.





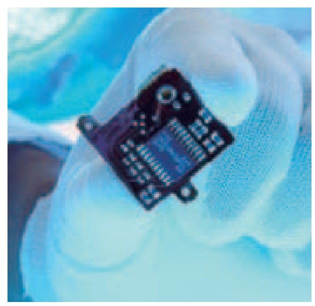
SDS®-ONE apparel design system

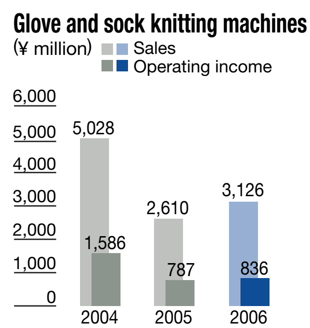
Glove and Sock Knitting Machine Segment

8.3%

The glove and sock knitting machine business, despite the effects of imitation machines on the Chinese market, performed strongly due to the recovery in South Korea, the major market for general work gloves, in addition to the stepped up production in the newly emerging nations of Asia. As a result this segment recorded sales of 3,126 million yen (19.8% increase year-on-year).

The glove and sock knitting machine business is currently engaged in the expansion of glove uses beyond conventional general work and thermal gloves to fine-gauge and highly fashionable gloves. The Company believes that such proactive developments present valid means of dealing with imitation machinery.





NewSFG automatic ultrafine gauge seamless glove flat knitting machine

SPF automatic sock flat knitting machine

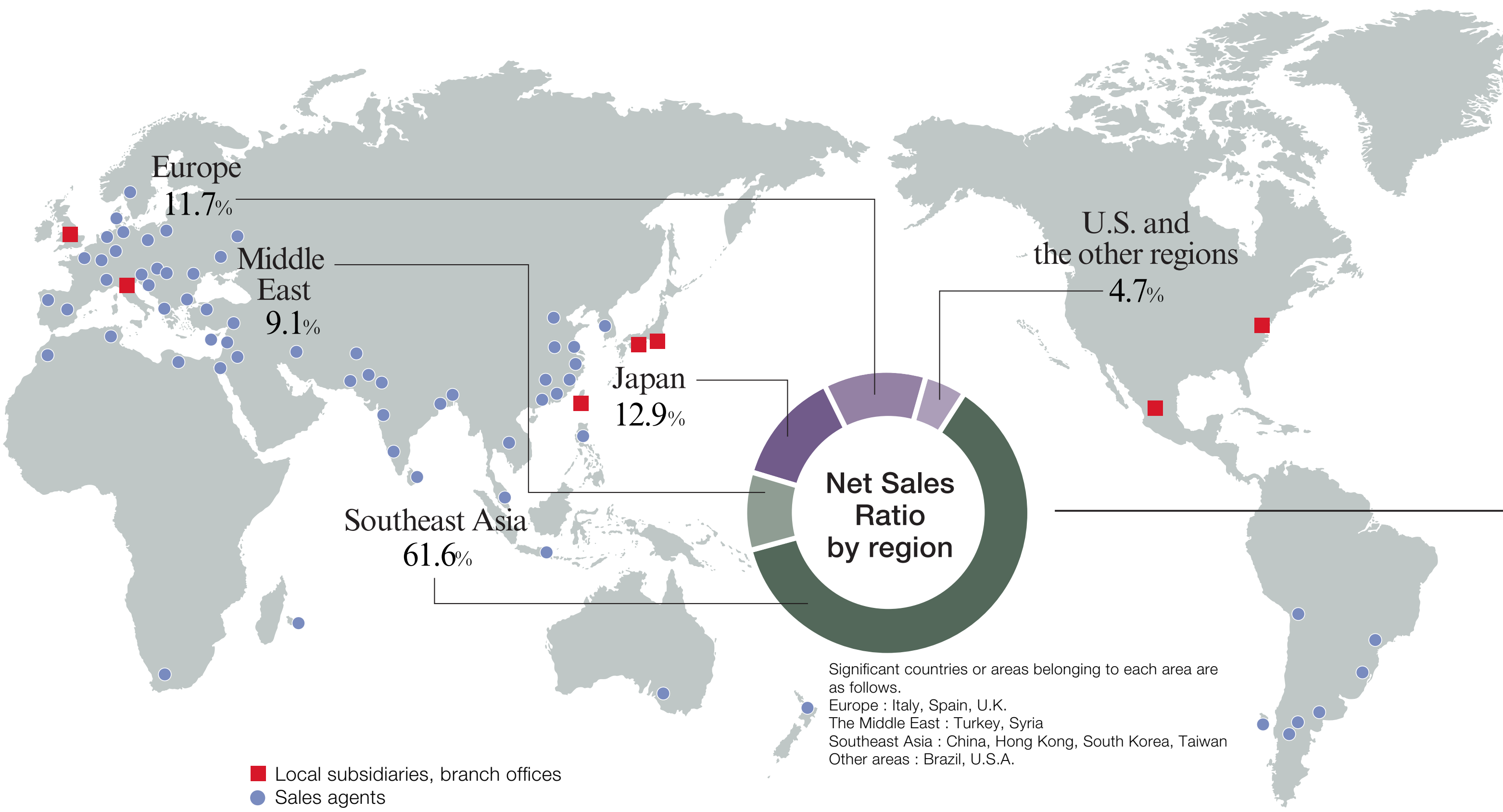
Other Segment

7.3%

Other Segment, which is involved in the sales of parts required for the maintenance of the Company's products, recorded sales of 2,788 million yen (6.8% increase year-to-year).

Sales by Region

In the period under review, the Company's overseas sales accounted for more than 87% of total sales and the Company's markets spread across the entire globe. In the apparel and fashion industry, high-volume products are increasing in production and export, mainly in the Asian region. In the consumer regions of Europe, the U.S. and Japan, on the other hand, manufacture has shifted to the production of high-value added items in order to compete with the onslaught of imports. Similar polarization trends are also becoming evident in the flat knitting machine industry; as the market is divided into the production region market (China, Southeast Asia, including Hong Kong and the Middle Eastern nations including Turkey) and the consumer regions market (Japan, Europe and the U.S.).



Significant countries or areas belonging to each area are as follows.
Europe : Italy, Spain, U.K.
The Middle East : Turkey, Syria
Southeast Asia : China, Hong Kong, South Korea, Taiwan
Other areas : Brazil, U.S.A.

The Company was acclaimed for its excellent cost efficiency and cutting-edge technology at trade shows around the world.

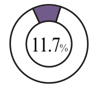
May 2005
Exhibited at the SHANGHAITEX 2005

October 2005
Exhibited at the ITMA ASIA 2005

February 2006
Exhibited at PITTI IMMAGINE FILATI

Knitwear consumer markets

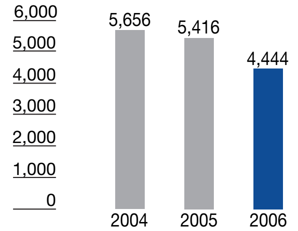
The European market

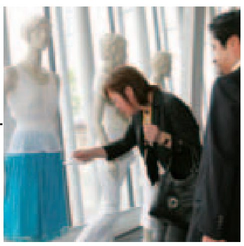


During the period under review, sales to Europe amounted to 4,444 million yen (17.9% decrease year-on-year).

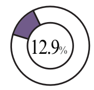
During the year the Company participated in a number of fairs and trade shows, including IKME and PITTI IMMAGINE FILATI. In the European region, including Italy, there has been a noticeable shrinkage of the apparel market. However the Company believes that by utilizing WHOLEGARMENT® flat knitting machines, it will be able to devise a valid strategy with which to survive in the market.

Net Sales in Europe (¥ million)





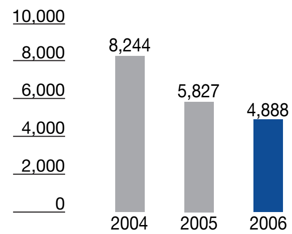
The Japanese market



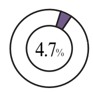
During the period under review, domestic sales amounted to 4,888 million yen (16.1% decrease year-on-year).

During the year, in addition to the WHOLEGARMENT® 10th anniversary commemorative fashion show, the Company participated in the Japan International Apparel Machinery Trade Show (JIAM 2005). Despite the efforts by Japanese knitwear manufacturers to develop higher value-added products using WHOLEGARMENT® flat knitting machines, the climate surrounding the industry remained severe due to the onslaught of imports from China.

Net Sales in Japan (¥ million)



The U.S. and other markets

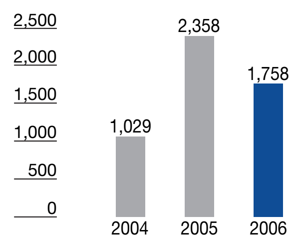


During the period under review, sales to the U.S. and other regions amounted to 1,758 million yen (25.4% decrease year-on-year).

During the year, the Company, following IKME, aggressively engaged in sales activities in the U.S. and communicated the appeal of WHOLEGARMENT® flat knitting machines and design systems to the U.S. knitwear and apparel manufacturing industry.

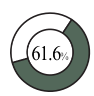
The Company is also considering the possibility of establishing a presence in New York, the center of the apparel industry in the U.S.

Net Sales in U.S. and others
(¥ million)



Knitwear production markets

The Southeast Asian market

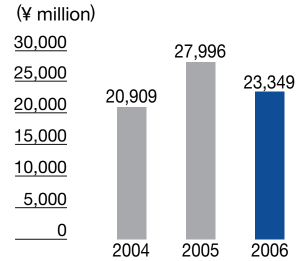


During the period under review, sales to Southeast Asia amounted to 23,349 million yen (16.6% decrease year-to-year).

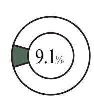
Although capital investments in China and Hong Kong stagnated at the beginning of the term, with the conclusion of the Textile Agreement with the U.S., inquiries and orders have rebounded toward the end of the period.

The Company established a subsidiary, SHIMA SEIKI SHANGHAI, LTD., in Shanghai China in November 2005 and has been offering technology-training programs to its customers.

Net Sales in Southeast Asia
(¥ million)



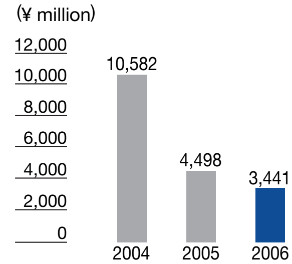
The Middle Eastern market



During the period under review, sales to the Middle East amounted to 3,441 million yen (23.5% decrease year-on-year).

Since the latter half of the year, Turkey experienced a difficult business climate, due to the effects of price competition with China in their exports to Europe and Russia. In order to provide a means to differentiate its products from Chinese products, the Company intends to expand sales of its high quality conventional flat knitting machines to the Middle East.

Net Sales in Middle East
(¥ million)

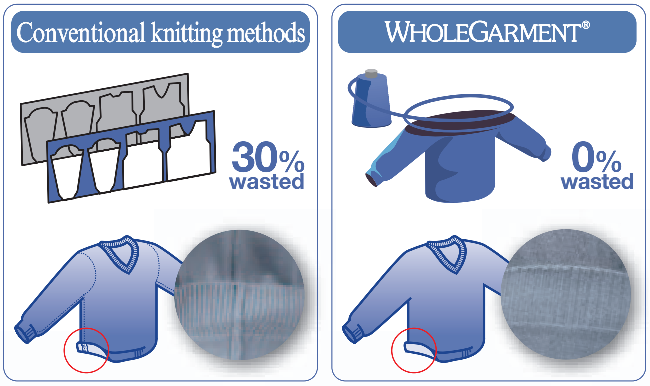


Shima Seiki contributes to society through its business activities, paying special attention to global environment and safety.

WHOLEGARMENT® contributes to the conservation of raw materials

Since the WHOLEGARMENT® flat knitting machine is capable of three-dimensional knitting of each garment, it produces no seams and generates no material loss from cutting. Conventional knitting methods generally result in 30% material loss from cutting and the manufacturing of one sweater involves seam allowance equal to an A4-size sheet of paper. This means that knitting 1,000 sweaters would result in material loss equivalent to the wool yarn collected from 48 sheep.

Moreover, when considering the amount of energy saved that would otherwise be consumed for spinning, processing, and production of materials lost due to cutting, WHOLEGARMENT® may be said to be a truly environment-friendly product.



Conventional knitting methods cannot avoid the cutting loss and seam allowance in the course of cutting and sewing the parts

Environmental considerations in production activities

Shima Seiki considers the reduction of environmental impact as one of its main contributions to society. The factory is certified as a type-1 designated energy management factory and it intends to reduce the annual average consumption of energy by more than 1%. The factory has been reducing its consumption of electricity by such measures as installing a thermal-storage air conditioning system and inverter-controlled light fixtures and recycling the waste heat generated by machine tools.

Efforts are also being made to reduce the final disposal amount of industrial waste through sorting before disposal and recycling expanded polystyrene.

Compliance with the European Environmental Standards

Shima Seiki has been manufacturing all of its electronic

TOPICS

A next-generation factory friendly to both people and the environment commences operations

Operations have begun at the new factory, the "FA Building No. 2," after its construction was completed in December 2005 on the premises of its Headquarters. This factory was built based on the concept of "an energy-saving and user-friendly factory for the next generation of manufacturing with focus on the environment," and features a number of environmentally conscious innovations.

With the commencement of operations at the new factory, Shima Seiki, while complying with the all-important issue of environment conservation, will expand production capacity for its major products including WHOLEGARMENT® flat knitting machines and reinforce its structure for ensuring prompt delivery and uniform high quality.

View of FA (Factory Amenity) No. 2

products in compliance with European Environmental Standards as prescribed by the "Restrictions of Hazardous Substances Directive (RoHS)," which bans the use of six designated chemical substances including lead. In addition, Shima Seiki has also been switching over its procured items to products compliant with the RoHS directive.

Consideration of workplace safety

Shima Seiki has implemented health and safety measures for the purpose of bringing out the best of our employees' ability under a safe environment. Shima Seiki intends to establish a new safety record for consecutive years without an accident in conjunction with the "Safety and Health Committee" that promotes safety with regard to machinery, tools and facilities, as well as safe operational practices, thereby maintaining a workplace that offers a favorable working environment in tune with the mental and physical well-being of its workers.

Meeting to ensure safety and health

Operations with emphasis on safety

Disaster prevention considerations

As we are located in a country vulnerable to earthquakes, the FA Building No. 2 has been built utilizing the latest earthquake-resistant structure. Shima Seiki is also conducting earthquake resistance tests on all its facilities. Moreover, Shima Seiki has implemented risk management measures in response to possible disasters, including the establishment of "Disaster Prevention Committee" to review restoration measures in case of disaster and accidents, and "Corporate Fire Brigade" in case of fire, and the development of a safety confirmation system for our employees upon fire and disaster.

A scene from the emergency drill

Compliance with CE Marking

All products manufactured by the Company comply with the CE Marking Directive (a safety standard required for designated products sold within the EU). Numerous measures have been taken to ensure the safe operation of our products by our customers. For example, protective covers are mounted over the moving parts of our knitting machines to prevent gaps where fingers could get caught. Moreover, the machines are designed to stop automatically whenever such covers are opened.

EMC Center
European Standards-compliant facility to measure electromagnetic emissions

Largest capacity of photovoltaic generation in the nation

The 3,048 solar battery panels installed on the southern roof of the FA Building No.2, combined with existing solar power facilities, will generate 1,134 kW of electricity—the largest single output in the nation for a private facility. The effect of adopting this facility on reducing CO_2 will be equivalent to that of a forest 220 ha in size.

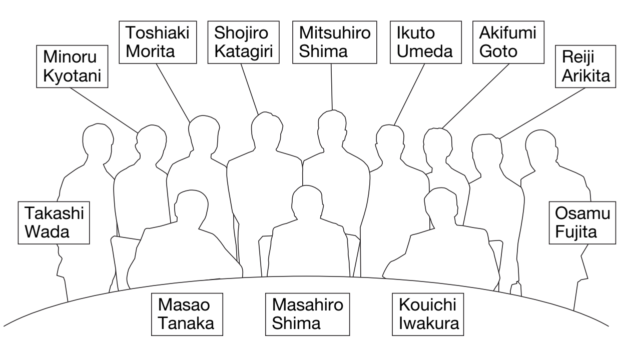
Drastic reduction of running costs

An annual reduction of approximately 35% in the factory's running costs is anticipated through the adoption of photovoltaic power generation, improvements made to heat insulation of the roof and walls, the use of inverter-controlled air conditioning, and heat exchange ventilation.

Creating open spaces

Applying trusses to the top lights and utilizing improved steel of greater strength made higher ceilings and more spacious interiors possible, while at the same time reinforcing earthquake resistance.

Board of Directors and Corporate Auditors



President

Masahiro Shima

Senior Managing Director

Masao Tanaka
General Manager of Accounting Division, overseeing General Affairs Division and Internal Auditing Division

Managing Director

Kouichi Iwakura
General Manager of Corporate Administration Department

Director

Minoru Kyotani
General Manager of Machinery Production Technology Division

Toshiaki Morita
General Manager of Material Purchasing Division

Takashi Wada
General Manager of Manufacturing Division

Akifumi Goto
General Manager of Sales Marketing Division & Total Design Center

Mitsuhiro Shima
General Manager of Graphic System Development Division

Shojiro Katagiri
General Manager of Corporate Planning Division

Ikuto Umeda
General Manager of Export Division

Osamu Fujita
General Manager of General Affairs Division

Reiji Arikita
General Manager of Mechatronic Development Division

Corporate Auditor

Osamu Okawa
Standing Corporate Auditor

Yuuki Matoba
Corporate Auditor

Toshiyuki Okidono
Standing Corporate Auditor

Masatoshi Yasugi
Corporate Auditor

(As of June 29, 2006)

The Structure for Corporate Governance

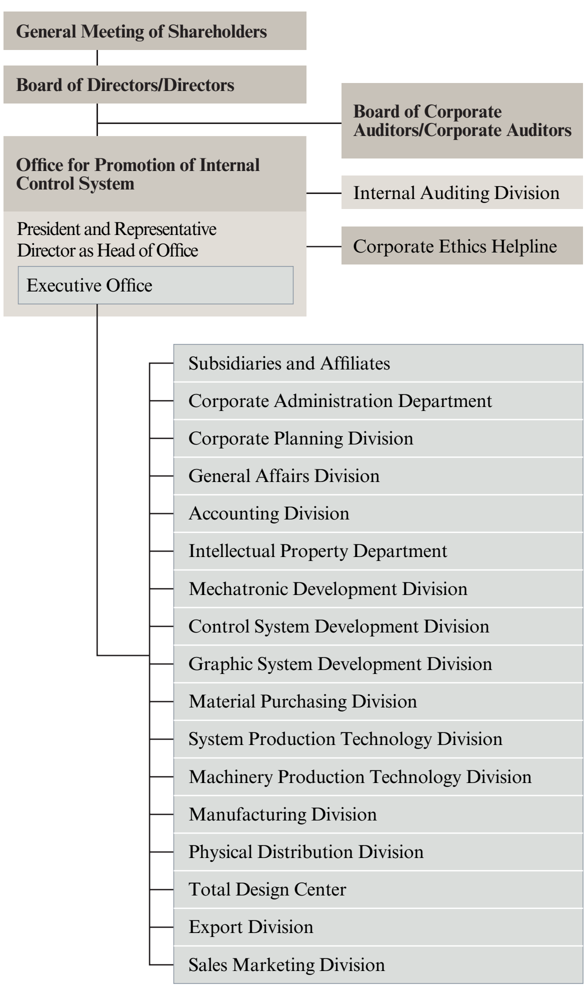
Shima Seiki recognizes the importance of fully utilizing the functions of its various systems, including the Board of Directors system and the auditing system, and the establishment of proper and efficient corporate governance in promoting greater efficiency, soundness, and transparency of management, as well as business management with a high regard for the interests of our stakeholders.

Shima Seiki has adopted a Board of Directors system consisting of 12 Directors, but does not appoint outside board members. In order to accurately grasp the status of its business operations and implement prompt and flexible management decisions, the Board of Directors' Meeting is convened at least once every month to discuss critical management issues, review business performance, and decide management policies. The system allows for each Director to execute his/her duty in a proper and efficient manner in accordance with decision-making rules based on the Company's internal regulations.

Shima Seiki has also adopted an auditing system consisting of four Corporate Auditors (two of whom are outside auditors), who attend board meetings and other important meetings, entailing a proactive collection of information, including the inspection of important documents, and thorough monitoring of the Directors regarding the execution of their duties. By appointing an attorney and a certified tax accountant as outside auditors, Shima Seiki has fortified its checking system on matters of compliance and accounting in general.

Moreover, the Internal Auditing Division (consisting of three members) has also been put into place to enhance internal control through regular contact with the Corporate Auditors, and efficiently conduct internal audits according to audit plans.

Shima Seiki has appointed Ohtemae Audit Corporation as its accounting auditor and ensured the effectiveness of its audit system by undergoing regular accounting audits.



Compliance and Risk Management

Shima Seiki has made efforts to establish the Group's internal control system stemming from its recognition of internal control, as not mere compliance with the law, but as an essential element in fulfilling the Company's corporate philosophy and objectives, which are to be attained through a sweeping revision of current operations and the solidifying of its corporate structure.

During the period under review, Shima Seiki, in order to enhance the effectiveness of its internal control system, set up the Committee for the Promotion of the Internal Control System headed by the President, to deal with the Internal Reporting System (Corporate Ethics Helpline). Shima Seiki has been promoting system improvements for compliance and risk management encompassing the entire Group, and at the Board of Directors Meeting held in May 2006, a resolution was passed to adopt the "Basic Policies related to Improvement of the Internal Control System."

In accordance with these Basic Policies, Shima Seiki intends to implement such measures regarding compliance as the establishment of standards for corporate behavior and the appointment of a Director responsible for ensuring compliance. Furthermore, upon establishing a set of risk management regulations, the Company plans to establish a risk management structure for the entire Group, by means of a system that will enable the continuous monitoring of risks under the direction of a risk management supervisor.

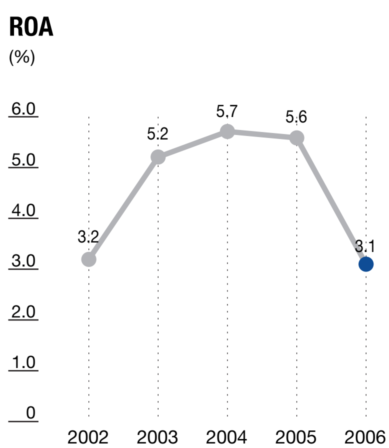
Financial Section

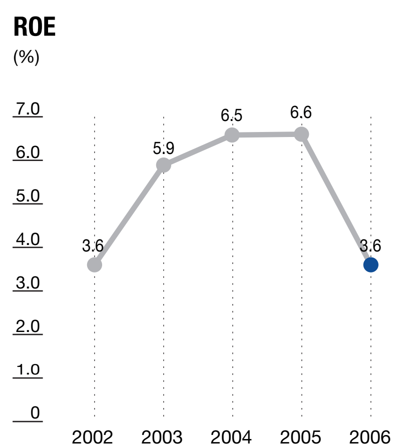
Five-Year Financial Summary

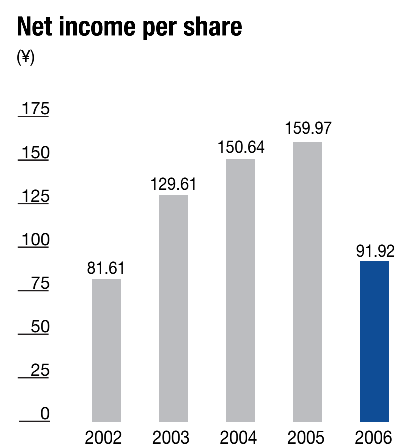
SHIMA SEIKI MFG., LTD. and Consolidated Subsidiaries
Years ended March 31

	Millions of yen					Thousands of U.S. dollars
	2006	2005	2004	2003	2002	**2006**
For the Year:						
Net sales	**¥37,880**	¥46,095	¥46,420	¥43,288	¥39,097	**$322,465**
Cost of sales	**21,100**	25,277	24,074	23,200	22,939	**179,620**
Gross profit	**16,780**	20,818	22,346	20,088	16,158	**142,845**
Selling, general and administrative expenses	**12,757**	11,560	11,374	11,241	10,876	**108,598**
Operating income	**4,023**	9,258	10,972	8,847	5,282	**34,247**
Income before income taxes and minority interests	**5,293**	9,518	9,520	8,801	5,212	**45,058**
Net income	**3,405**	5,930	5,624	4,878	3,061	**28,986**
Depreciation and amortization	**1,026**	997	1,021	1,031	1,088	**8,734**
At Year-End:						
Total assets	**¥109,302**	¥107,234	¥102,853	¥96,220	¥92,549	**$930,467**
Shareholders' equity	**95,331**	92,115	87,903	84,419	81,735	**811,535**
Per Share Data:	Yen					U.S. dollars
Net income	**¥91.92**	¥159.97	¥150.64	¥129.61	¥81.61	**$0.78**
Cash dividends applicable to the year	**37.50**	37.50	37.50	35.00	30.00	**0.32**
Shareholders' equity	**2,599.24**	2,510.71	2,391.63	2,280.85	2,190.16	**22.13**
Ratios:	%					
Return on assets	**3.1%**	5.6%	5.7%	5.2%	3.2%	
Return on equity	**3.6%**	6.6%	6.5%	5.9%	3.6%	
Equity ratio	**87.2%**	85.9%	85.5%	87.7%	88.3%	

Notes: U.S. dollar amounts have been translated from yen, for convenience only, at the rate of ¥117.47=US$1, the exchange rate at 31st March, 2006.







Financial Review

SHIMA SEIKI MFG., LTD. and Consolidated Subsidiaries
Years ended March 31

Overview

The world economy during the current consolidated fiscal year continued to prosper, while our nation's economy also emerged from a period of sluggishness and exhibited steady recovery. In the knitwear and apparel industry, however, production of textile products around the world became engulfed in a state of turmoil following the termination of textile import quotas (quota-free) last January and the ensuing global surge in the imports of Chinese textile products.

Quota-free had far wider impact than had initially been anticipated by the industry and even ultimately led to governmental talks between Europe & the U.S. and China. Until the textile agreement was reached between the EU and China in September, and the U.S. China Textile Agreement concluded in November, uncertainty prevailed in the capital investment projections of each country. The impact of Chinese imports was not only felt in the consumer markets but also in the production markets, such as Turkey in the Middle East as well, resulting in the stagnation of the global market. Nevertheless, orders received from China and Hong Kong picked up somewhat at the end of the period.

Under these circumstances, despite the Company's efforts to enhance the competitiveness of its products by cutting down on costs, consolidated net sales decreased by 8,215 million yen (down by 17.8% year-on-year) compared to the previous year to 37,880 million yen and consolidated net income decreased by 2,525 million yen (down by 42.6% year-to-year) to 3,405 million yen.

In order to enhance shareholder value, maintain sound management, and return profits to the shareholders commensurate with its revenue, the Company had set the management benchmark of achieving net earnings per share (EPS) of 200 yen. However due to uncertain market trends during this period, the Company was only able to achieve consolidated EPS of 91.92 yen.

Net sales

Consolidated net sales during the period totaled 37,880 million yen (down by 17.8% year-on-year).

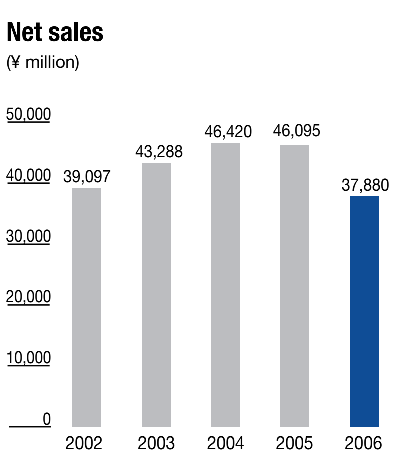
Overseas net sales for the current period decreased by 18.1% to 32,992 million yen. This decrease was mainly due to the global caution exercised toward capital investments in the textiles industry as a result of the lifting of the textile import quotas in January of last year.

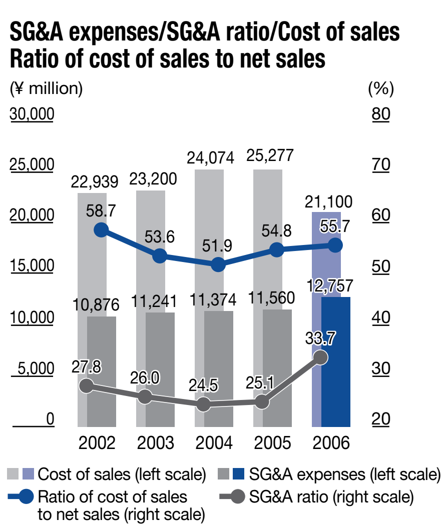
Domestic net sales for the current period decreased by 16.1% compared to previous year to 4,888 million yen. Despite positive factors for consumption and demand in the domestic market, such as the cold spell and the "warm biz" movement, with increasing knitwear imports primarily from China, the industry continued to be enveloped in a harsh climate causing capital investments to drop, resulting in decreased sales for the Company. (Cf. pp.15-18 for segment information)

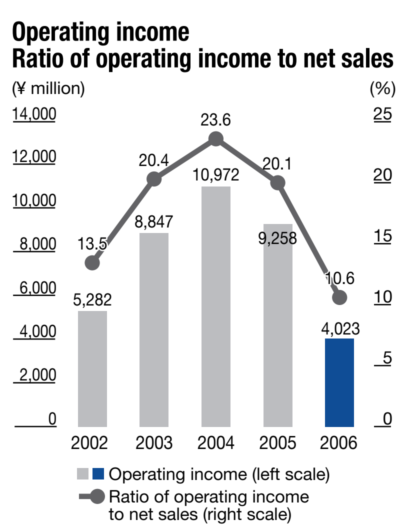
Cost of sales and SG&A expenses

Cost of sales during this period dropped by 16.5% compared to the previous year to 21,100 million yen. And the cost to sales ratio increased by 0.9 points compared to the previous year to 55.7%. This was due mainly to the rise in the fixed charge ratio resulting from the decrease in the number of flat knitting machines produced.

SG&A expenses rose by 10.4% compared to the previous year to 12,757 million yen, resulting in the 8.6 point-rise in the SG&A expenses to sales ratio to 33.7%. This was primarily attributable to the decrease in net sales, as well as to the increase in event participation expenses, such as the expenses for the fashion show held in Japan in July and the Company's participation in IKME (the international knitting machines trade show), which was held in Milan in November, and to the transfer of the allowance for losses on debt guarantees.







Operating income

Operating income fell by 56.5% compared to the previous year to 4,023 million yen, primarily due to the 17.8% decrease in net sales, the 0.9 point rise in the cost to sales ratio, and the 10.4 % rise in SG&A expenses.

As far as operating income by segment is concerned, the Flat Knitting Machine Segment recorded a net decrease of 4,715 million yen (a 38.6% decrease year-on-year), the Design System Segment recorded a net decrease of 254 million yen (a 36.3% decrease year-on-year), while the Glove and Sock Knitting Machine Segment recorded a net increase of 49 million yen (a 6.2% increase year-on-year), while other segments contended with a net decrease of 96 million yen (a 36.2% decrease year-on-year).

Other income and expenses

Other income exceeded other expenses by 1,270 million yen, resulting in an increase of 1,010 million yen compared to the previous year. Increases were attributable to the recording of 1,151 million yen in exchange gains (179 million yen exchange losses were recorded in the previous year), while decreases were mainly attributable to the 272 million yen loss recorded as a result of impairment accounting, which began this period and also to the fact that a 215 million gain was recorded on capital gains from investments in securities in the previous year, which was not recorded this year.

Net income

Consolidated income before income taxes and minority interests for the period under review decreased by 44.4% to 5,293 million yen.

2,202 million yen was paid in corporate income, residential and enterprise taxes, representing a decrease of 538 million yen (a 19.6% decrease year-on-year). Moreover, corporate income tax adjustments for the period under review were minus 303 million yen, representing a 1,117 million yen decrease from the 814 million yen of the previous year. As a result, the Company's tax payment decreased by 1,655 million yen to 1,899 million yen after the application of deferred tax accounting. This made the rate of our tax payment for taxes including corporate income taxes 35.9% after the application of deferred tax accounting, which constitutes a figure below our effective statutory tax rate of 40.4%. The difference between the rate of the Company's tax payment for taxes including corporate income taxes and its effective tax rate is attributable mainly to tax benefits, including tax credits for experiment and research expenses. Minority interests resulted in minus 11 million yen profit, which is a decrease of 45 million yen compared to the previous year.

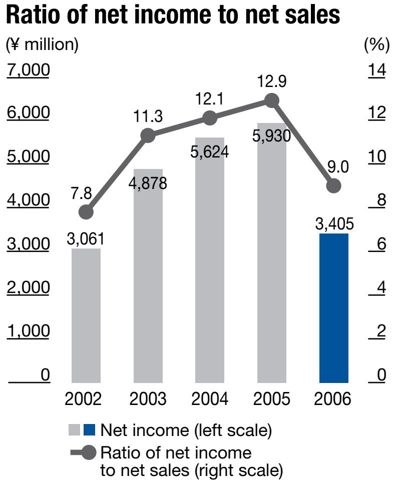
As a result, the consolidated net income for the current year amounted to 3,405 million yen (a 42.6% decrease year-on-year).

Liquidity and capital resources

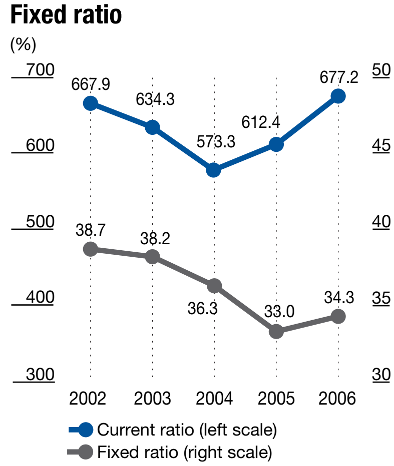
Cash and cash equivalents at the end of the period under review increased by 112 million yen compared to the previous year to 9,110 million yen (a 1.2% increase year-on-year). This increase was due mainly to the fact that cash flows from operating activities provided net cash income, while decreases were due to the net cash expended in investment activities and financing activities.

Cash flows from operating activities generated a net income of 4,754 million yen (a 42.0% increase year-on-year). This increase in income is mainly attributable to the 2,066 million yen decrease in accounts receivable (a 6,017 million decrease year-on-year) reflecting the Company's efforts in liquidating its accounts receivable and its prompt collection and the 2,627 million decrease in the payment of taxes including corporate income taxes (a 1,761 million yen decrease year-on-year), while decreases in income were due mainly to the 5,293 million yen consolidated income before income taxes and minority interests (a

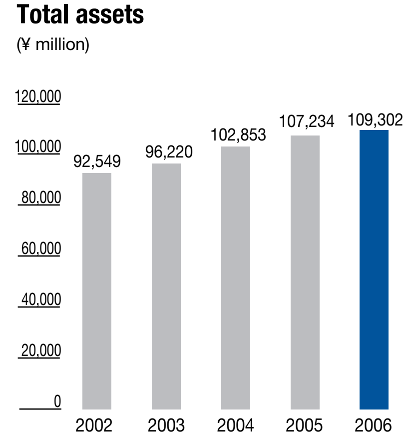
Net income
Ratio of net income to net sales



Current ratio
Fixed ratio



Total assets



4,225 million yen decrease), the 1,195 million yen decrease in accounts-payable trade (a 1,811 million yen increase year-on-year) and the 1,153 million yen increase in inventories (a 701 million yen increase year-on-year).

Cash flows from investing activities resulted in a 3,513 million yen expenditure (a 328.9% increase year-on-year). This was due primarily to the 2,495 million yen acquisition of property, plant and equipment (a 1,177 million yen increase year-on-year), including the FA Building No. 2 at the Company's Headquarters premises and the 1,832 million yen acquisition of investments in securities (a 1,831 million yen increase year-on-year), while sales of investments in securities amounted to 1,548 million yen (a 1,127 million yen increase year-on-year).

Cash flows from financing activities resulted in a 1,386 million yen expenditure (a 68.0% increase year-on-year). This was due to factors such as the payment of 1,374 million yen in cash dividends (a 0.2% decrease year-on-year).

Assets, liabilities and shareholders' equity

Consolidated total assets at the end of the March 2006 period rose by 2,068 million yen compared to the previous year to 109,302 million yen.

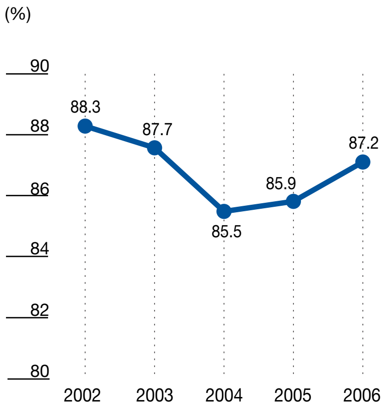
In terms of short-term assets and liabilities, current assets decreased by 289 million yen, which represents a 0.4% decrease from the previous year. Major reasons for the change include the decrease of 1,957 million yen in notes receivable and accounts receivable-trade reflecting the efforts by the Company to liquidate and implement prompt collection of its accounts receivable, the 1,199 million yen increase in inventories and the 656 million yen increase in the allowance for bad debt. Current liabilities, on the other hand, decreased by 1,244 million yen, a decrease of 9.9% compared to the previous year. The main reason for this decrease was the 1,199 million yen decrease in the trade account and notes payable. As a result, the current ratio for the current consolidated fiscal year surpassed the previous year's ratio by an impressive 64.8 points to achieve 677.2%, which is well above the 200% said to be needed to ensure soundness.

As far as long-term assets and liabilities are concerned, in the assets section, property, plant and equipment increased by 1,245 million yen compared to the previous year to 19,450 million yen (a 6.8% increase year-on-year) and investments and other assets increased by 1,112 million yen compared to the previous year to 13,279 million yen (a 9.1% increase year-on-year). These increases were due mainly to the fact that buildings and structures increased by 1,254 million yen to 6,708 million yen as a result of the construction of the new factory and the increase of 1,481 million yen in long-term assets to 5,731 million yen resulting from the acquisition of investments in securities. Long-term liabilities increased by 89 million yen compared to the previous year to 2,473 million yen (a 3.7% increase year-on-year).

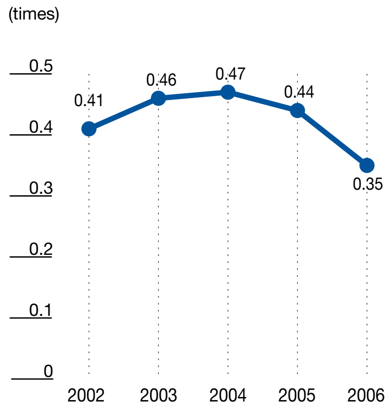
Shareholders' equity increased by 3,216 million yen from the end of the previous fiscal year to 95,331 million yen (a 3.5% increase year-on-year). A factor making a positive contribution to shareholders' equity was the 3,405 million yen in net income, while negative factors include the payment of 1,375 million yen in cash dividends. As a result, the equity-to-assets ratio rose by 1.3 points to 87.2% compared to the previous year, and the ratio of fixed assets to equity capital, which represents a proportion of shareholder's equity to sources of capital in fixed assets, decreased by 1.3 points to 34.3%, thereby marking a slight improvement in the Company's financial stability compared to the previous year.

Moreover the ROA (return on assets) dropped from 5.6% to 3.1% as a result of the decrease in the consolidated income before income taxes and minority interests, while the ROE (return on equity) also fell from 6.6% to 3.6%.

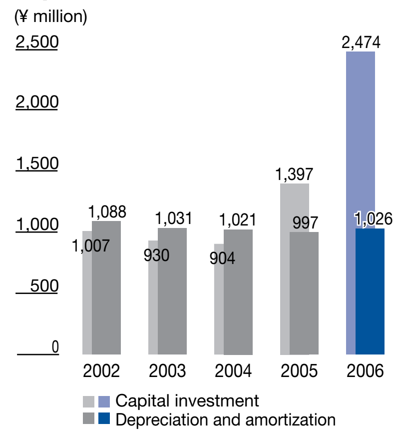
Equity ratio



Total assets turnover



Capital investment
Depreciation and amortization



Business Risks and Uncertainties

The major items that the Group recognizes as possible risk factors in its operations, and which may affect the management performance and financial position of the Group are as follows:

(1) Risks associated with fluctuations in currency exchange rates

Since the Group sells products worldwide, some transactions are conducted in denominations other than the yen. Although the Group employs foreign exchange contract and other hedges to minimize foreign exchange risks, it is possible that sales activities may not be conducted according to plan as a result of declining price competitiveness due to the rising value of the yen. Since such situations could easily occur, sharp fluctuations in exchange rates could affect the performance and financial position of the Group.

(2) Risks of dependency on particular business partners

The Group mainly conducts export sales through direct sales to its overseas agents. Consequently, there has been a marked trend in the rising percentage of sales and accounts receivable to a small number of overseas agents who control the major sales territories of Hong Kong, China, Turkey, and Italy, among others, as compared to total sales and total accounts receivable. Despite the preparations made by the Group to take swift action, through the gathering of information regarding the market trends of each country and region, and the business performance and credit standing of each overseas agent, changes in existing economic situations may occur, thus affecting the financial position of the agents, and affecting the performance and financial position of the Group.

(3) Risks of dependency on particular overseas markets

Export sales account for more than 85% of the Group's total sales, with sales to the Southeast Asian region accounting for approximately 70% of export sales. Consequently, economic and political changes in this region could affect the performance and financial position of the Group.

(4) Risks associated with social and institutional changes in business areas and force majeure

The Group's deployment of business encompasses not only Japan but spans the entire world. Therefore, the areas where the Group conducts business pose the following inherent risks that could affect the performance and financial position of the Group:

a) Stagnant demand resulting from deteriorating economic conditions
b) Unforeseen changes in laws and regulations
c) Social turmoil due to terrorism, war, political upheaval, deteriorating civil order, and other causes
d) Natural disasters including earthquakes

(5) Risks associated with changes in consumer apparel spending and unseasonable weather

The Group's products are sold primarily to apparel and knitwear manufacturers in Japan and overseas. Moreover, department and discount store sales tend to be influenced by individual apparel preferences and fashion trends. Unseasonable weather events such as heat waves and warm winters, coupled with damage caused by strong winds and flooding, constitute another major factor that could influence market trends in the apparel industry, and thus affect the performance and financial position of the Group.

(6) Risks associated with the protection of intellectual property rights

In some countries and regions, it is virtually impossible or possible only to a limited extent to completely protect the Group's proprietary technology and know-how in terms of its intellectual property rights due to a lack of awareness concerning legal compliance. Consequently, the Group may not be able to effectively prevent a third party from illegally using the Group's intellectual property rights and producing imitation products that would affect the performance and financial position of the Group.

Consolidated Balance Sheets

SHIMA SEIKI MFG., LTD. and Consolidated Subsidiaries
March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
ASSETS			
Current assets:			
Cash and cash equivalents	**¥9,110**	¥8,998	**$77,552**
Time deposits	**866**	1,190	**7,372**
Short-term investments (Note 4)	**565**	220	**4,810**
Trade accounts and notes receivable:			
Unconsolidated subsidiaries	**137**	38	**1,166**
Other	**53,488**	55,544	**455,334**
Inventories (Note 5)	**12,133**	10,934	**103,286**
Deferred tax assets (Note 12)	**1,904**	1,452	**16,208**
Prepaid expenses and other current assets	**1,279**	739	**10,888**
Less: allowance for doubtful accounts	**(2,909)**	(2,253)	**(24,764)**
Total current assets	**76,573**	76,862	**651,852**
Investments and other assets:			
Investments in unconsolidated subsidiaries and an affiliate	**1,729**	1,773	**14,719**
Investments in securities (Note 4)	**5,731**	4,250	**48,787**
Long-term loans receivable	**658**	258	**5,601**
Deferred tax assets (Note 12)	**797**	945	**6,785**
Deferred tax assets for land revaluation (Note 6)	**3,050**	3,485	**25,964**
Other	**2,456**	2,431	**20,907**
Less: allowance for doubtful accounts	**(1,142)**	(975)	**(9,722)**
Total investments and other assets	**13,279**	12,167	**113,041**
Property, plant and equipment:			
Land	**10,645**	10,611	**90,619**
Buildings and structures	**20,523**	18,819	**174,708**
Machinery and equipment	**3,698**	3,607	**31,480**
Tools, furniture and fixtures	**5,582**	5,450	**47,519**
Construction in progress	**122**	86	**1,039**
	40,570	38,573	**345,365**
Less: accumulated depreciation	**(21,120)**	(20,368)	**(179,791)**
Property, plant and equipment, net	**19,450**	18,205	**165,574**
Total assets	**¥109,302**	¥107,234	**$930,467**

See the accompanying notes to the consolidated financial statements.

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Short-term loans (Note 7)	**¥2,515**	¥2,520	**$21,410**
Trade accounts and notes payable:			
Unconsolidated subsidiaries	**—**	37	**—**
Other	**4,231**	5,393	**36,017**
Accrued expenses	**1,072**	1,001	**9,126**
Accrued income taxes	**1,025**	1,385	**8,726**
Other current liabilities	**2,464**	2,215	**20,975**
Total current liabilities	**11,307**	12,551	**96,254**
Long-term liabilities:			
Allowance for retirement benefits (Note 8)	**1,548**	1,498	**13,178**
Allowance for directors' and statutory auditors' retirement benefits	**925**	886	**7,874**
Total long-term liabilities	**2,473**	2,384	**21,052**
Minority interests	**191**	184	**1,626**
Contingent liabilities (Note 9)			
Shareholders' equity:			
Common stock:			
Authorized— 142,000,000 shares			
Issued— 37,600,000 shares	**14,860**	14,860	**126,500**
Capital surplus	**21,725**	21,725	**184,941**
Retained earnings (Notes 11 and 16)	**65,009**	63,381	**553,409**
Land revaluation difference (Note 6)	**(4,493)**	(5,135)	**(38,248)**
Net unrealized holding gain on securities	**913**	155	**7,772**
Foreign currency translation adjustments	**5**	(190)	**43**
Treasury stock, at cost (936,623 shares in 2006 and 934,443 shares in 2005)	**(2,688)**	(2,681)	**(22,882)**
Total shareholders' equity	**95,331**	92,115	**811,535**
Total liabilities and shareholders' equity	**¥109,302**	¥107,234	**$930,467**

See the accompanying notes to the consolidated financial statements.

Consolidated Statements of Income

SHIMA SEIKI MFG., LTD. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Net sales	**¥37,880**	¥46,095	**$322,465**
Cost of sales	**21,100**	25,277	**179,620**
Gross profit	**16,780**	20,818	**142,845**
Selling, general and administrative expenses (Note 13)	**12,757**	11,560	**108,598**
Operating income	**4,023**	9,258	**34,247**
Other income (expenses):			
Interest and dividend income	**460**	333	**3,916**
Interest expense	**(32)**	(19)	**(272)**
Other, net	**842**	(54)	**7,167**
Income before income taxes and minority interests	**5,293**	9,518	**45,058**
Income taxes (Note 12)**:**			
Current	**2,202**	2,740	**18,745**
Deferred	**(303)**	814	**(2,579)**
	1,899	3,554	**16,166**
Income before minority interests	**3,394**	5,964	**28,892**
Minority interests in losses (gain) of consolidated subsidiaries	**11**	(34)	**94**
Net income	**¥3,405**	¥5,930	**$28,986**

	Yen		U.S. dollars
Per share:			
Net income	**¥91.92**	¥159.97	**$0.78**
Cash dividends applicable to the year	**37.50**	37.50	**0.32**

See the accompanying notes to the consolidated financial statements.

Consolidated Statements of Shareholders' Equity

SHIMA SEIKI MFG., LTD. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	Thousands	Millions of yen						
	Number of shares of common stock issued	Common stock	Capital surplus	Retained earnings	Land revaluation difference	Net unrealized holding gain (loss) on securities	Foreign currency translation adjustments	Treasury stock
Balance at April 1, 2004	37,600	¥14,860	¥21,724	¥60,409	¥(6,658)	¥240	¥(236)	¥(2,436)
Net income	—	—	—	5,930	—	—	—	—
Cash dividends	—	—	—	(1,377)	—	—	—	—
Bonuses to directors and statutory auditors	—	—	—	(58)	—	—	—	—
Land revaluation difference	—	—	—	(1,523)	1,523	—	—	—
Net unrealized holding loss on securities	—	—	—	—	—	(85)	—	—
Foreign currency translation adjustments	—	—	—	—	—	—	46	—
Treasury stock	—	—	1	—	—	—	—	(245)
Balance at March 31, 2005	37,600	14,860	21,725	63,381	(5,135)	155	(190)	(2,681)
Net income	—	—	—	3,405	—	—	—	—
Addition of a consolidated subsidiary	—	—	—	300	—	—	—	—
Cash dividends	—	—	—	(1,375)	—	—	—	—
Bonuses to directors and statutory auditors	—	—	—	(60)	—	—	—	—
Land revaluation difference	—	—	—	(642)	642	—	—	—
Net unrealized holding gain on securities	—	—	—	—	—	758	—	—
Foreign currency translation adjustments	—	—	—	—	—	—	195	—
Treasury stock	—	—	0	—	—	—	—	(7)
Balance at March 31, 2006	37,600	¥14,860	¥21,725	¥65,009	¥(4,493)	¥913	¥5	¥(2,688)

	Thousands of U.S. dollars						
	Common stock	Capital surplus	Retained earnings	Land revaluation difference	Net unrealized holding gain on securities	Foreign currency translation adjustments	Treasury stock
Balance at March 31, 2005	$126,500	$184,941	$539,551	$(43,713)	$1,319	$(1,617)	$(22,822)
Net income	—	—	28,986	—	—	—	—
Addition of a consolidated subsidiary	—	—	2,553	—	—	—	—
Cash dividends	—	—	(11,705)	—	—	—	—
Bonuses to directors and statutory auditors	—	—	(511)	—	—	—	—
Land revaluation difference	—	—	(5,465)	5,465	—	—	—
Net unrealized holding gain on securities	—	—	—	—	6,453	—	—
Foreign currency translation adjustments	—	—	—	—	—	1,660	—
Treasury stock	—	0	—	—	—	—	(60)
Balance at March 31, 2006	$126,500	$184,941	$553,409	$(38,248)	$7,772	$43	$(22,882)

See the accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

SHIMA SEIKI MFG., LTD. and Consolidated Subsidiaries
Year ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Cash flows from operating activities:			
Income before income taxes and minority interests	**¥5,293**	¥9,518	**$45,058**
Adjustments to reconcile income before income taxes and minority interests to net cash provided by operating activities:			
Depreciation and amortization	**1,026**	997	**8,734**
Increase in allowance for doubtful accounts	**796**	690	**6,776**
Increase (decrease) in allowance for retirement benefits	**48**	(38)	**409**
Increase (decrease) in allowance for directors' and statutory auditors' retirement benefits	**39**	(35)	**332**
Interest and dividend income	**(460)**	(333)	**(3,916)**
Interest expense	**32**	19	**272**
Loss on sales and disposal of property, plant and equipment, net	**41**	60	**349**
Loss (Gain) on sales of investment securities	**5**	(215)	**43**
Decrease (Increase) in trade receivables	**2,066**	(3,951)	**17,587**
Increase in inventories	**(1,153)**	(452)	**(9,815)**
Increase (decrease) in trade payables	**(1,195)**	616	**(10,173)**
Other	**405**	547	**3,448**
Subtotal	**6,943**	7,423	**59,104**
Interest and dividend income received	**470**	327	**4,001**
Interest expense paid	**(32)**	(15)	**(272)**
Income taxes paid	**(2,627)**	(4,388)	**(22,363)**
Net cash provided by operating activities	**4,754**	3,347	**40,470**
Cash flows from investing activities:			
Decrease (increase) in time deposits, net	**401**	(231)	**3,414**
Purchases of short-term investments	**(2,500)**	(4,019)	**(21,282)**
Proceeds from sales of short-term investments	**2,220**	4,085	**18,898**
Purchases of property, plant and equipment	**(2,495)**	(1,318)	**(21,240)**
Proceeds from sales of property, plant and equipment	**129**	590	**1,098**
Purchases of investments in securities	**(1,832)**	(1)	**(15,595)**
Proceeds from sales of investments in securities	**1,548**	421	**13,178**
Decrease (increase) in long-term loans receivable, net	**(401)**	48	**(3,414)**
Other	**(583)**	(394)	**(4,963)**
Net cash used in investing activities	**(3,513)**	(819)	**(29,906)**
Cash flows from financing activities:			
Increase (Decrease) in short-term loans, net	**(5)**	800	**(42)**
Decrease in long-term loans, net	**—**	(3)	**—**
Purchases of treasury stock	**(9)**	(247)	**(77)**
Proceeds from sales of treasury stock	**2**	2	**17**
Cash dividends paid	**(1,374)**	(1,377)	**(11,697)**
Net cash used in financing activities	**(1,386)**	(825)	**(11,799)**
Effect of exchange rate changes on cash and cash equivalents	**160**	26	**1,363**
Net increase in cash and cash equivalents	**15**	1,729	**128**
Cash and cash equivalents at beginning of year	**8,998**	7,269	**76,598**
Increase in cash and cash equivalents due to a newly consolidated subsidiary	**97**	—	**826**
Cash and cash equivalents at end of year	**¥9,110**	¥8,998	**$77,552**

See the accompanying notes to the consolidated financial statements.

1. Basis of presenting consolidated financial statements

SHIMA SEIKI MFG., LTD. (the "Company") and its domestic subsidiaries maintain their accounts and records in accordance with the provisions set forth in the Commercial Code of Japan (the "Code") and the Securities and Exchange Law of Japan, and in conformity with accounting principles and practices generally accepted and applied in Japan, which are different from the accounting and disclosure requirements of International Accounting Standards.

The Company's foreign subsidiaries maintain their accounts and records in conformity with generally accepted accounting principles and practices prevailing in their respective countries of domicile.

The accompanying consolidated financial statements are prepared based on the consolidated financial statements of the Company and its significant subsidiaries (the"Group"), which were filed with the Director of Kanto Local Finance Bureau as required by the Securities and Exchange Law.

In preparing the accompanying consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside of Japan.

The translation of the Japanese yen amounts into U.S. dollars is included solely for the convenience of the readers, using the exchange rate prevailing at March 31, 2006, which was ¥117.47 to US$1.00. These convenience translations should not be construed as representations 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. Summary of significant accounting policies

(a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its significant subsidiaries. All significant intercompany balances and transactions are eliminated.

Unconsolidated subsidiaries, whose combined assets, net sales, net income and retained earnings in aggregate are not significant in relation to those of the consolidation with the Group.

Investments in unconsolidated subsidiaries and an affiliate are stated at cost, since those companies' combined net income and retained earnings in aggregate are not significant in relation to those of consolidation with the Group.

(b) Translation of foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated into yen at the rate of exchange in effect at the balance sheet date, except for those hedged by forward foreign exchange contracts which are translated at the contracted rates. Resulting translation gains or losses are charged to income in the year in which they are incurred, except for those arising from forward foreign exchange contracts pertaining to monetary assets, which are deferred and amortized over the periods of the respective contracts. Revenue and expenses are translated at the rates of exchange prevailing when transactions are recorded.

Assets and liabilities of foreign subsidiaries are translated into Japanese yen at the exchange rates in effect at the respective balance sheet dates. Shareholders' equity is translated at historical rates. Revenue and expenses accounts of foreign subsidiaries are translated at the exchange rates in effect at the respective balance sheet dates.

Translation adjustments resulting from translation of foreign currency financial statements are reported as "Foreign currency translation adjustments" in a separate component of the shareholders' equity.

(c) Cash and cash equivalents

Cash and cash equivalents are comprised of cash in hands, deposits held at call with banks, net of overdrafts and all highly liquid investments with maturities within three months.

(d) Short-term investments and investments in securities

Held-to-maturity securities are either amortized or accumulated to face value. Other securities with quoted market prices are carried at market value. The difference between the acquisition costs and the carrying value of other securities, including unrealized gains and losses, is recognized as a component of shareholders' equity and is reflected as "Net unrealized holding gain on securities." The cost of other securities sold is computed by the moving average method. Other securities without quoted market prices are stated at cost based on the average method.

(e) Inventories

Inventories are stated at the lower of cost or market. The cost of finished goods, work in process and raw materials is determined principally by the moving-average method. The cost of purchased goods held by foreign consolidated subsidiaries is determined by the specific method. The cost of supplies is determined by the first-in first-out method.

(f) Property, plant and equipment and depreciation

Property, plant and equipment are stated at cost. Depreciation of the Company and domestic consolidated subsidiaries are computed principally by the declining-balance method based on the estimated useful lives of assets, except that the straight-line method is applied to buildings, but not to fixtures attached to the buildings, acquired after April 1, 1998. Depreciation of foreign consolidated subsidiaries are computed by the straight-line method on the estimated useful lives of assets.

The principal estimated useful lives are as follows:

Buildings and structures	3 to 50 years
Machinery and equipment	3 to 12 years
Tools, furniture and fixtures	2 to 20 years

(g) Allowance for doubtful accounts

The allowance for doubtful accounts is provided in amounts sufficient to cover possible losses on collection. The allowance for doubtful accounts of the Company and its domestic consolidated subsidiaries are calculated based on their past credit loss experience and on an estimate of the individual uncollectible amounts. The allowance for doubtful accounts of foreign consolidated subsidiaries is calculated based on an estimate of the individual uncollectible amounts.

(h) Allowance for retirement benefits

The Company and its certain domestic consolidated subsidiaries have retirement benefit plans for their employees. Such benefits are provided through the unfunded lump-sum severance indemnity plan and the funded noncontributory pension plan. The amount of retirement benefits are determined on the basis of length of service, basic salary and certain other factors at the time of termination of employment.

Allowance for retirement benefits has been provided for employees' retirement benefits, based on the amount of projected benefit obligation reduced by pension plan assets at fair value at the balance sheet date. The actuarial gains and losses recognized in the fiscal year under review is being amortized over a ten-year period by the straight-line method from the year subsequent to the year in which such gains and losses are incurred.

(i) Leases

All leases are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that are deemed to transfer the ownership of the leased property to lessees are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the lessee's financial statements.

(j) Research and development costs

Research and development costs are charged to income as incurred.

(k) Income taxes

Deferred income taxes are recognized by the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are determined based on difference of between financial reporting and the tax basis of the assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

(l) Derivatives and hedging activities

The Company and its consolidated subsidiaries have entered into derivatives transactions in order to manage the risk arising from adverse fluctuation in foreign currency exchange rates.

Derivatives are carried at fair value with any changes in unrealized gain or loss charged or credited to income, except for those which meet the criteria for deferral hedge accounting under which unrealized gain or loss is deferred as an asset or a liability. Receivables hedged by qualified forward foreign exchange contracts are translated at the corresponding contract rates.

(m) Appropriation of retained earnings

Cash dividends, transfers to legal reserve and bonuses to directors and statutory auditors are recorded in the financial year in which a proposed appropriation of retained earnings is approved by shareholders.

(n) Per share information

Basic net income per share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding in each period. Diluted net income per share is not disclosed because there were no dilutive potential common shares that were outstanding during each of the two years in the period ended March 31, 2006.

Cash dividends per share presented in the accompanying consolidated statements of income are dividends applicable to the respective years including dividends to be paid after the end of year.

3. Change in accounting policies

Effective April 1, 2005, the Company and its consolidated subsidiaries adopted the new Japanese accounting standard for impairment of fixed assets. The new standard requires that the book value of fixed assets should be devalued to the recoverable amount. The effect of this adoption was to decrease income before income taxes by ¥267 million ($2,273 thousand).

4. Short-term investments and investments in securities

Other securities with quoted market prices at March 31, 2006 and 2005 were as follows:

	Millions of yen		
	2006		
	Acquisition costs	Amount recorded in the balance sheet	Difference
Other securities whose market values recorded in the balance sheet exceed their acquisition costs:			
Equity securities	¥2,381	¥3,803	¥1,422
Bond	297	305	8
Other	137	146	9
Subtotal	¥2,815	¥4,254	¥1,439
Other securities whose market values recorded in the balance sheet do not exceed their acquisition costs:			
Equity securities	¥15	¥14	¥(1)
Other	850	820	(30)
Subtotal	¥865	¥834	¥(31)
Total	¥3,680	¥5,088	¥1,408

	Millions of yen		
	2005		
	Acquisition costs	Amount recorded in the balance sheet	Difference
Other securities whose market values recorded in the balance sheet exceed their acquisition costs:			
Equity securities	¥958	¥1,347	¥389
Other	50	50	0
Subtotal	¥1,008	¥1,397	¥389
Other securities whose market values recorded in the balance sheet do not exceed their acquisition costs:			
Equity securities	¥681	¥548	¥(133)
Other	112	95	(17)
Subtotal	¥793	¥643	¥(150)
Total	¥1,801	¥2,040	¥239

	Thousands of U.S. dollars		
	2006		
	Acquisition costs	Amount recorded in the balance sheet	Difference
Other securities whose market values recorded in the balance sheet exceed their acquisition costs:			
Equity securities	$20,269	$32,374	$12,105
Bond	2,528	2,596	68
Other	1,166	1,243	77
Subtotal	$23,963	$36,213	$12,250
Other securities whose market values recorded in the balance sheet do not exceed their acquisition costs:			
Equity securities	$128	$119	$(9)
Other	7,236	6,981	(255)
Subtotal	$7,364	$7,100	$(264)
Total	$31,327	$43,313	$11,986

Other securities without quoted market prices at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	Amount recorded in the balance sheet		
	2006	2005	2006
Held-to-maturity securities			
Debt securities	¥500	¥220	$4,256
Other securities			
Unlisted equity securities	¥707	¥2,210	$6,019

5. Inventories

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

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Finished goods	¥7,745	¥6,996	$65,932
Work in process	923	755	7,857
Raw materials	2,936	2,623	24,994
Supplies and others	529	560	4,503
	¥12,133	¥10,934	$103,286

6. Land revaluation

Under the "Law of Land Revaluation", the Company elected a one-time revaluation of their own-use land to a value based on real estate appraisal information as of March 31, 2002. The resulting land revaluation difference represents the net unrealized depreciation of land values and is stated, net of income taxes, as a component of shareholders' equity. There was no effect on the statement of income. The details of the one-time revaluation for land remaining as of March 31, 2006 were as follows.

Land before revaluation	¥16,337 million
Land after revaluation	¥8,794 milion
Land revaluation difference	¥4,493 million (net of deferred tax assets of ¥3,050 million)

7. Short-term loans

Short-term loans at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Short-term loans:			
0.36% unsecured loans from banks	**¥2,515**	¥2,520	**$21,410**

8. Allowance for retirement benefits

The allowance for retirement benefits at March 31, 2006 and 2005 consisted of the following:

Retirement benefit obligation at March 31, 2006 and 2005:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Projected benefit obligation	**¥(4,345)**	¥(4,303)	**$(36,988)**
Fair value of plan assets	**3,242**	2,635	**27,598**
Benefit obligation in excess of plan assets	**(1,103)**	(1,668)	**(9,390)**
Unrecognized actuarial loss	**(116)**	343	**(987)**
Obligation recognized in the consolidated balance sheets	**(1,219)**	(1,325)	**(10,377)**
Prepaid pension cost	**329**	173	**2,801**
Allowance for retirement benefits	**¥(1,548)**	¥(1,498)	**$(13,178)**

Components of net periodic benefit cost for the year ended March 31, 2006 and 2005:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Service cost	**¥269**	¥218	**$2,290**
Interest cost	**86**	98	**732**
Expected return on plan assets	**(30)**	(25)	**(255)**
Amortization:			
Actuarial loss	**41**	25	**349**
Net periodic benefit cost	**¥366**	¥316	**$3,116**

Assumption used in the accounting for the defined benefit plans for the year ended March 31, 2006 and 2005 is as follows:

	2006	2005
Method of attributing benefit to periods of service	**straight-line basis**	straight-line basis
Discount rate	**2.0%**	2.0%
Expected rate of return on fund assets	**1.15%**	1.15%
Amortization period for actuarial gain (loss)	**10years**	10years

9. Contingent liabilities

Contingent liabilities at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Trade notes discounted	**¥2,382**	¥2,310	**$20,277**
Guarantees of customers' loans and lease obligations	**6,099**	6,633	**51,920**
	¥8,481	¥8,943	**$72,197**

10. Derivatives

The Company and its consolidated subsidiaries are exposed to market risk arising from forward foreign exchange contracts. The Company and its consolidated subsidiaries are also exposed to the risk of credit loss in the event of nonperformance by the counterparties to these forward foreign exchange contract; however, they do not anticipate nonperformance by any of the counterparties, all of whom are financial institutions with high credit ratings.

Summarized below are the contract amounts and the estimated fair value of the derivatives positions outstanding at March 31, 2006 and 2005.

Currency—related transactions

	Millions of yen		
	2006		
	Contract amounts	Fair value	Unrealized loss
Forward foreign exchange contracts:			
Sell:			
US$	**¥1,396**	**¥1,408**	**¥(12)**
Euro	**481**	**507**	**(26)**
Total	**¥1,877**	**¥1,915**	**¥(38)**

	Millions of yen		
	2005		
	Contract amounts	Fair value	Unrealized loss
Forward foreign exchange contracts:			
Total	¥8,236	¥8,484	¥(248)

	Thousands of U.S. dollars		
	2006		
	Contract amounts	Fair value	Unrealized loss
Forward foreign exchange contracts:			
Sell:			
US$	**$11,884**	**$11,986**	**$(102)**
Euro	**4,095**	**4,316**	**(221)**
Total	**$15,979**	**$16,302**	**$(323)**

11. Retained earnings

The Code provides that an amount equal to at least 10% of the amounts to be disbursed as distributions of earnings be appropriated to the legal reserve until such reserve and additional paid-in capital equals 25% of the common stock account. The Code also stipulates that, to the extent that the sum of the additional paid-in capital and the legal reserve exceeds 25% of the common stock account, the amount of any such excess is available for appropriation by resolution of the shareholders.

The retained earnings account in the accompanying consolidated financial statements at March 31, 2006 included the Company's legal reserve of ¥2,124 million ($18,081 thousand).

12. Income Taxes

The Company and its domestic subsidiaries are subject to several taxes based on income, which in the aggregate resulted in a normal effective statutory tax rates of approximately 40.4% for the years ended March 31, 2006 and 2005.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Deferred tax assets:			
Allowance for doubtful accounts	**¥1,384**	¥921	**$11,782**
Allowance for retirement benefits	**471**	458	**4,010**
Allowance for director's and statutory auditors' retirement benefits	**374**	358	**3,184**
Accrued bonuses to employees	**316**	287	**2,690**
Impairment loss on fixed assets	**251**	—	**2,137**
Intercompany profit	**135**	199	**1,149**
Tax loss carryforwards	**107**	140	**911**
Accrued enterprise tax	**102**	129	**868**
Other	**425**	255	**3,617**
Total gross deferred tax assets	**3,565**	2,747	**30,348**
Less valuation allowance	**(183)**	(190)	**(1,558)**
Net deferred tax assets	**3,382**	2,557	**28,790**
Deferred tax liabilities:			
Unrealized holding gain on securities	**(621)**	(106)	**(5,286)**
Tax deductible reserves	**(42)**	(33)	**(358)**
Other	**(18)**	(21)	**(153)**
Total gross deferred tax liabilities	**(681)**	(160)	**(5,797)**
Net deferred tax assets	**¥2,701**	¥2,397	**$22,993**

13. Research and development costs

Research and development costs charged to income were ¥2,644 million ($22,508 thousand) and ¥2,439 million for the years ended March 31, 2006 and 2005, respectively.

14. Lease

Total lease payments under finance leases that are not deemed to transfer ownership of the leased property to the lessee were ¥ 745 million ($6,342 thousand) and ¥727 million for the years ended March 31, 2006 and 2005, respectively.

Pro forma information of leased property under finance leases that are not deemed to transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen			Thousands of U.S. dollars
	2006			**2006**
	Acquisition cost	Accumulated depreciation	Net leased property	Net leased property
Machinery and equipment	**¥4,778**	**¥2,171**	**¥2,607**	**$22,193**
Tools, furniture and fixtures	**139**	**74**	**65**	**553**
Total	**¥4,917**	**¥2,245**	**¥2,672**	**$22,746**

	Millions of yen		
	2005		
	Acquisition cost	Accumulated depreciation	Net leased property
Machinery and equipment	¥4,479	¥2,210	¥2,269
Tools, furniture and fixtures	184	91	93
Total	¥4,663	¥2,301	¥2,362

Obligations under such finance leases as of March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Due within one year	**¥650**	¥634	**$5,533**
Due after one year	**2,051**	1,768	**17,460**
Total	**¥2,701**	¥2,402	**$22,993**

Depreciation expense and imputed interest expense for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Depreciation expense	**¥707**	¥679	**$6,019**
Imputed interest expense	**¥26**	¥33	**$221**

15. Segment information

Business segment information of the Company and its consolidated subsidiaries for the years ended March 31, 2006 and 2005 was as follows:

	Millions of yen						
	2006						
	Flat knitting machines	Design systems	Glove and sock knitting machines	Other	Total	Corporate / elimination	Consolidated
Sales and operating income:							
Sales to customers	**¥30,163**	**¥1,803**	**¥3,126**	**¥2,788**	**¥37,880**	**—**	**¥37,880**
Intersegment sales	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Total	**30,163**	**1,803**	**3,126**	**2,788**	**37,880**	**—**	**37,880**
Operating costs and expenses	**22,650**	**1,358**	**2,290**	**2,619**	**28,917**	**¥4,940**	**33,857**
Operating income	**¥7,513**	**¥445**	**¥836**	**¥169**	**¥8,963**	**¥(4,940)**	**¥4,023**
Assets, depreciation and capital expenditures:							
Assets	**¥72,704**	**¥4,834**	**¥3,278**	**¥4,469**	**¥85,285**	**¥24,017**	**¥109,302**
Depreciation	**551**	**13**	**46**	**54**	**664**	**362**	**1,026**
Impairment loss on fixed assets	**—**	**—**	**—**	**85**	**85**	**187**	**272**
Capital expenditures	**1,932**	**33**	**158**	**153**	**2,276**	**198**	**2,474**

	Millions of yen						
	2005						
	Flat knitting machines	Design systems	Glove and sock knitting machines	Other	Total	Corporate / elimination	Consolidated
Sales and operating income:							
Sales to customers	¥38,979	¥1,896	¥2,610	¥2,610	¥46,095	—	¥46,095
Intersegment sales	—	—	—	—	—	—	—
Total	38,979	1,896	2,610	2,610	46,095	—	46,095
Operating costs and expenses	26,751	1,197	1,823	2,345	32,116	¥4,721	36,837
Operating income	¥12,228	¥699	¥787	¥265	¥13,979	¥(4,721)	¥9,258
Assets, depreciation and capital expenditures:							
Assets	¥74,845	¥4,022	¥2,888	¥4,166	¥85,921	¥21,313	¥107,234
Depreciation	515	11	26	39	591	406	997
Capital expenditures	1,002	27	50	80	1,159	238	1,397

	Thousands of U.S. dollars						
	2006						
	Flat knitting machines	Design systems	Glove and sock knitting machines	Other	Total	Corporate / elimination	Consolidated
Sales and operating income:							
Sales to customers	**$256,772**	**$15,349**	**$26,611**	**$23,733**	**$322,465**	**—**	**$322,465**
Intersegment sales	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Total	**256,772**	**15,349**	**26,611**	**23,733**	**322,465**	**—**	**322,465**
Operating costs and expenses	**192,815**	**11,561**	**19,494**	**22,295**	**246,165**	**$42,053**	**288,218**
Operating income	**$63,957**	**$3,788**	**$7,117**	**$1,438**	**$76,300**	**$(42,053)**	**$34,247**
Assets, depreciation and capital expenditures:							
Assets	**$618,915**	**$41,151**	**$27,905**	**$38,044**	**$726,015**	**$204,452**	**$930,467**
Depreciation	**4,691**	**111**	**392**	**459**	**5,653**	**3,081**	**8,734**
Impairment loss on fixed assets	**—**	**—**	**—**	**723**	**723**	**1,592**	**2,315**
Capital expenditures	**16,447**	**281**	**1,345**	**1,302**	**19,375**	**1,686**	**21,061**

Notes: Main products of each segment are as follows.
Flat knitting machines: Computerized flat knitting machine, computerized semi-jacquard flat knitting machine
Design systems: Computer graphic apparel design system, knitting CAD system, apparel CAD / CAM system
Glove and sock knitting machines: Computerized seamless glove and sock knitting machine
Other: Parts for flat knitting machines and design systems, yarn for glove knitting machines, machine repair and maintenance, hotel business

Geographical segment information of the Company and its consolidated subsidiaries for the years ended March 31, 2005 was as follows:
The statement of Geographical information of the Company and its consolidated subsidiaries for the years March 31, 2006 is abbreviated, because the rate of Japan goes over 90% against total sales amount and total assets amount.

	Millions of yen					
	2005					
	Japan	Europe	North America	Total	Corporate / elimination	Consolidated
Sales and operating income:						
Sales to customers	¥43,526	¥421	¥2,148	¥46,095	—	¥46,095
Intersegment sales	1,379	15	6	1,400	¥(1,400)	—
Total	44,905	436	2,154	47,495	(1,400)	46,095
Operating costs and expenses	31,207	532	1,828	33,567	3,270	36,837
Operating income (loss)	¥13,698	¥(96)	¥326	¥13,928	¥(4,670)	¥9,258
Assets	¥83,563	¥478	¥1,759	¥85,800	¥21,434	¥107,234

Notes: Significant country or area belonging to each segment is as follows.
Europe : U.K.
North America : U.S.A

Overseas sales of the Company and its consolidated subsidiaries for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen				
	2006				
	Europe	The Middle East	Southeast Asia	Other areas	Total
Overseas sales	**¥4,444**	**¥3,441**	**¥23,349**	**¥1,758**	**¥32,992**
Total sales					**¥37,880**
Ratio of overseas sales to total sales	**11.7%**	**9.1%**	**61.6%**	**4.7%**	**87.1%**

	Millions of yen				
	2005				
	Europe	The Middle East	Southeast Asia	Other areas	Total
Overseas sales	¥5,416	¥4,498	¥27,996	¥2,358	¥40,268
Total sales					¥46,095
Ratio of overseas sales to total sales	11.8%	9.8%	60.7%	5.1%	87.4%

	Thousands of U.S. dollars				
	2006				
	Europe	The Middle East	Southeast Asia	Other areas	Total
Overseas sales	**$37,831**	**$29,293**	**$198,766**	**$14,965**	**$280,855**
Total sales					**$322,465**
Ratio of overseas sales to total sales	**11.7%**	**9.1%**	**61.6%**	**4.7%**	**87.1%**

Notes: Significant countries or areas belonging to each area are as follows.
Europe : Italy, Spain, U.K.
The Middle East : Turkey, Syria
Southeast Asia : China, Hong Kong, South Korea, Taiwan
Other areas : Brazil, U.S.A.

16. Subsequent events

Shareholders approved the following appropriation of retained earning at the annual meeting held on June 29, 2006.

	Millions of yen	Thousands of U.S. dollars
Cash dividends	¥733	$6,240
Bonuses to directors and statutory auditors	30	255

Report of Independent Certified Public Accountants

To the Board of Directors of
SHIMA SEIKI MFG., LTD.

We have audited the accompanying consolidated balance sheets of SHIMA SEIKI MFG., LTD. and its consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of SHIMA SEIKI MFG., LTD. and its consolidated subsidiaries as of March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

Supplemental information
As described in Note 3, effective April 1, 2005, the Company and its consolidated subsidiaries adopted a new accounting standard for impairment of fixed assets.

The United States dollar amounts shown in the accompanying consolidated financial statements have been translated solely for convenience. We have reviewed this translation and, in our opinion, the consolidated financial statements expressed in Japanese yen have been translated into United States dollars on the basis described in Note 1.

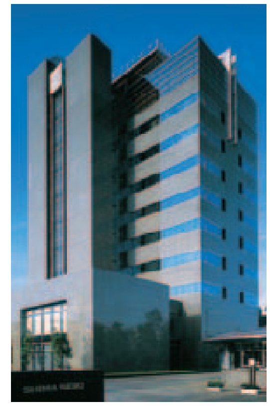
Osaka, Japan
June 29, 2006

Ohtemae Audit Co.
Ohtemae Audit Corporation

Corporate Data

Corporate Information (As of March 31, 2006)

Company Name	SHIMA SEIKI MFG., LTD.
Headquarters	85 Sakata, Wakayama-city, Wakayama 641-8511, Japan Telephone: +81-73-471-0511 Facsimile: +81-73-474-8267
Date of Establishment	February 4, 1962
Capital	¥14,859,800,000
Total Number of Employees	Consolidated 1,316 Non-consolidated 1,051
URL	http://www.shimaseiki.co.jp
Consolidated Subsidiaries	SHIMA FINE PRESS CO., LTD. KNITMAC CO., LTD. TSM Industrial CO., LTD. KAINAN SEIMITSU CO., LTD. TSUKADA SHIMA SEIKI CO., LTD. MARQUISE CO., LTD. SHIMA SEIKI EUROPE LTD. SHIMA SEIKI U.S.A. INC.



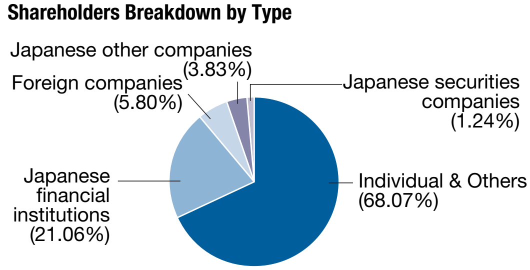
*Wakayama city:
Population, approximately 375 thousand (2005). Capital of Wakayama prefecture, which is located in central Japan and includes the registered UNESCO World Heritage Sites of the Kii Mountain Range and the surrounding Sacred Sites and Pilgrimage Routes. Wakayama city, which encompasses an excellent natural harbor, flourished as a textile industry center since the Meiji era. It enjoys abundant greenery and a mild climate year round.

Investor Information (As of March 31, 2006)

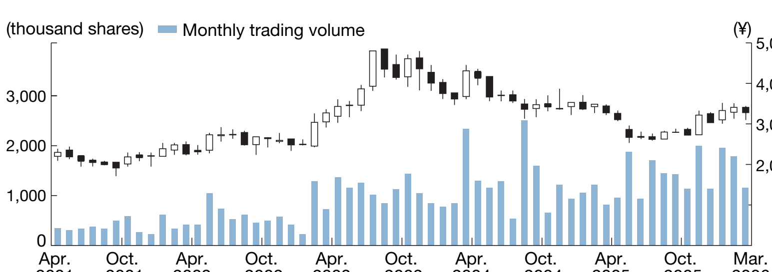
Accounting	Year-End March 31
Month of General Shareholders' Meeting	June
Authorized Common Stocks	142,000,000
Issued Common Stocks	37,600,000
Number of Shareholders	17,533
Stock Exchange Listing	The First Section of Tokyo Stock Exchange The First Section of Osaka Securities Exchange
Auditing Corporation	Ohtemae Audit Corporation

Stock Ownership

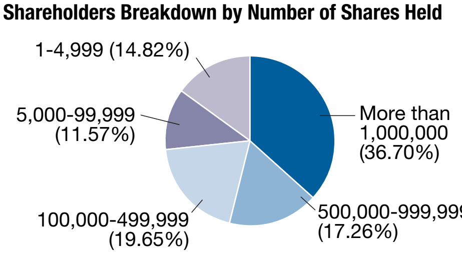
Shareholders Breakdown by Type



Share price and trading volume on the Osaka Securities Exchange



Shareholders Breakdown by Number of Shares Held



SHIMA SEIKI

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