

From **Change**
to **Challenge**

Annual Report 2006

For the year ended 31 March 2006



Profile

Since 1973, MARUWA CO., LTD. has specialized in ceramic material technology. Based on this technological expertise and “quality first” policy, MARUWA has been meeting customers’ requirements for three decades by supplying electronic components and ceramics for electronic parts, as well as other innovative products.

Today, MARUWA is expediting the transformation of its core business, increasing competitiveness by prioritizing its key business, and concentrating its management resources on these fields. As part of the business strategy, MARUWA is committed to developing quality-valued products in the rapidly expanding information technology field, while promoting development, production and sales localization through its global operations. The establishment of international operations creates part of the driving force that will enable MARUWA to attain high profitability and growth, in turn, increasing the corporate value.

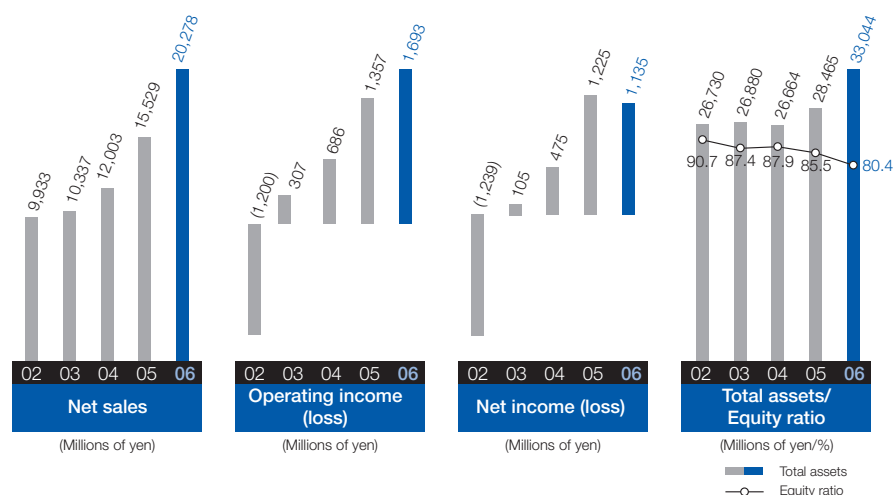
Financial Highlights

MARUWA CO., LTD. and consolidated subsidiaries

For the years ended 31 March 2005 and 2006

	Millions of yen		Thousands of U.S. dollars
	For the years ended 31 March		For the year ended 31 March
	2005	2006	2006
For the year			
Net sales	¥15,529	¥20,278	\$172,623
Operating income.....	1,357	1,693	14,412
Income before income taxes.....	1,180	1,669	14,208
Net income.....	1,225	1,135	9,662
At year-end			
Total shareholders’ equity.....	24,328	26,557	226,075
Total assets.....	28,465	33,044	281,297
Per share amounts			
Net income.....	¥112.40	¥103.82	\$0.88
Cash dividends	15.00	21.00	0.18

Note: U.S. dollar amounts have been converted for convenience only at the rate of ¥117.47=US\$1, the rate of exchange on 31 March 2006.



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Cautionary remarks regarding forward-looking statements

This Annual Report includes forward-looking statements that represent MARUWA’s assumptions and expectation in light of currently available information. These statements reflect industry trends, clients’ situations and other factors, and involve risks and uncertainties which may cause actual performance results to differ from those discussed in the forward-looking statements in accordance with changes in the domestic and overseas business environment.

To Our Shareholders

First of all, I would like to thank you for your sincere support.

In the fiscal year ended 31 March 2006, our efforts to restructure corporate management, which were launched in the year ended March 2003, came to fruition and MARUWA posted increases in both consolidated net sales and operating income, marking the fourth consecutive year of such a trend. We could also solidify our management base.

MARUWA will embark on a new stage of “Challenge” to pursue future growth, departing from the stage of “Change” to restructure its management, aiming to maximize shareholder value.

We appreciate your continued support and understanding.

June 2006

A handwritten signature in white ink that reads "Sei Kanbe". The signature is fluid and cursive, with the first letters of "Sei" and "Kanbe" being capitalized and prominent.

Sei Kanbe
President

Interview with the President

Question

How do you assess the business results for the fiscal year ended 31 March 2006?

In the fiscal term under review, MARUWA saw both consolidated net sales and operating income increase for four years in a row, achieving the high earnings targets that we had set, and this achievement is something I think highly of. The increase in revenue is attributable mainly to a recovery in the electronic components market and strong demand for products in the EMC Components division. Income rose due to the following factors: reinforcement of the corporate structure through efforts to reduce inventories, shorten lead time, improve quality and yields, and cut costs; restoration of the operations and product lineups obtained through M&A that had been unprofitable; and contribution of newly developed products. Unfortunately, the Lighting Equipment business, which was added to consolidated accounting beginning in the term under review, incurred a loss of ¥27 million. However, this loss amount remains within the level we had originally projected.

Question

How about the earnings outlook for the current fiscal year ending 31 March 2007?

We have a bright outlook for the current term, forecasting that both revenue and profit will post double-digit percentage increases. This bullish projection is based on a likely rise in demand for components used in digital products such as automobiles that increasingly include electronic parts and thin-screen TVs, and our belief that the favorable results of “corporate restructuring,” which we have worked on since the year ended March 2003, will become increasingly clear.

Taking the ordeals it underwent during the IT bubble in 2000 and 2001 as well as its subsequent collapse as a lesson, MARUWA has endeavored to establish a structure that can respond to any change in the market. It advanced into a new field with new products and businesses, which it developed in-house or obtained through M&A activities. In the year ended March 2003, we worked hard to establish a defensive corporate structure that can respond to the rapidly changing market, through a sweeping improvement of corporate management. In the term ended March 2004, on the other hand, we strove to build an offensive structure through the enhancement of development and marketing systems. During the period through March 2005, we further strengthened the corporate structure with an emphasis on cash flows at individual businesses and production sections, reinforced operations acquired through the previous M&A activities, mass-produced newly developed products, and implemented measures for making such new products profitable. In the year under review, which was positioned as the year for the compilation of a series of “management restructuring,” MARUWA strove to strengthen the proprietary management structure with an eye toward operating globally, and achieved excellent results.

For the term ending 31 March 2007, MARUWA will strive to grow not only by creating new products and businesses, but also by acquiring businesses and products through M&A, which is expected to produce a synergy effect when combined with our own materials techniques, elemental technologies and products. Aiming to advance into the Asian market, we will also establish a subsidiary in India, to serve as a manufacturing base for electronic components. This facility, as one of the core bases overseas, is expected to help us to improve our productivity by enhancing its alliance with the Malaysian facility. Furthermore, we aim to enter the automotive components market, which is projected to expand from now on. As for this market, which we regard as a key

Question

What are your capital investment plans for the year through March 2007?

strategic field, we have entered the final stage of developing relevant products through integration of proprietary ceramic materials and processing technologies, preparing for the establishment of a mass-production system for the products in and after the current fiscal year.

For the current fiscal year, MARUWA plans to invest ¥2.5 billion in plant and equipment, up about 44% from the year under review. As part of such investments, we will reinforce the facilities of Naoetsu Plant (Joetsu, Niigata Prefecture) and Toki Plant (Toki, Gifu Prefecture), in response to robust sales of mainstay circuit ceramics and EMC components, which are used in thin-screen TVs and automobile-mounted products. We have already invested about ¥700 million to enhance the facility at Naoetsu Plant, a major plant for manufacturing capacitors and EMC components, aiming for a 20% increase in production capacity there. Toki Plant is scheduled to be expanded in autumn 2006. We will spend ¥250 million on further increasing the production capacity of a plant in India, whose operations have been already launched. Mobile phone manufacturers overseas to which we deliver parts are increasing their sales in China, India and other emerging markets. Meanwhile, demand for components for use in automobiles and digital products such as thin-screen TVs is likely to continue growing. Against this backdrop, we are increasing our amount of investment to set the stage for establishing a system to expand output of such components.

Question

Tell us about the progress of expanding production and sales bases overseas?

In the U.S., MARUWA operates sales bases only in California, but now plans to establish such a base on the East Coast as well. We have increased sales staff in the U.K., our only base in Europe. Meanwhile, in Continental Europe, we will set up a business outlet to bolster sales operations for major local mobile phone manufacturers. On top of that, in China we have established a third sales base in Beijing.

As a result of expanding our sales bases overseas, we expect to increase production as a Group. In response, we established a new plant (MARUWA Electronic (India) Pvt., Ltd.*) in Chennai, India, as a new foreign manufacturing base, with investments totaling about ¥500 million. We expect the new company to contribute to improving the Group's productivity in the future as one of its core overseas bases for manufacturing EMC components and others.



***MARUWA Electronic (India) Pvt., Ltd.**

Establishment: 2005

Location: Chennai, India

Number of employees: approximately 100 (including temporary employees)

Sales: ¥300 million (estimate for the fiscal year through March 2007)

Products: Electronic components, assembly parts, power inductors, etc.

Question

What is the progress of the newly started Lighting Equipment business?

In April 2005, we launched the Lighting Equipment business through new subsidiary MARUWA SHOMEI Co., Ltd. that is involved mainly in production and sales of lighting for roads and bridges in public works. Sales from this business tend to occur in March, and expenses substantially exceed sales until that month. In the fiscal year under review, MARUWA SHOMEI posted sales of ¥3,650 million and an operating loss of ¥27 million, a notable improvement from the previous year, since we pulled out all the stops to reduce costs, by such measures as reorganizing sales bases. From now on, MARUWA SHOMEI aims to enter a business in which the promising product of an LED is used to illuminate building exteriors, thereby establishing a balanced earnings structure that does not heavily rely on public works.

Question

What is MARUWA's future course of action?

Corporate management requires “destruction and creation.” In order to flexibly respond to rapidly changing technological innovation and an equally changing market environment, a company needs to reform any organization and business structure that has become rigid, and efficiently allocate management resources such as personnel, equipment and capital for in-house use.

* Mini-mini company system

In order to expedite the decision-making process and nurture an open corporate culture, we have established the mini-mini company system while abolishing the division-section system. Each mini-mini company is run by a manager. MARUWA is composed of such mini-mini companies, or cells.

The mini-mini company system*, which we introduced in the year through March 2002, is designed to play just such a role. In establishing the system, we dissolved the vertically-divided, centrally-governed organization, which was directly controlled by the management's immediate staff, into 20 mini-mini companies – a “federal” system. The process from the time of introducing this system to the fiscal year under review may be called “activities to destruct the rigid existing order.” However, through this continuous process of destructive changes, we could transform our organization into one equipped with a solid earnings structure and flexible competitiveness. Now that the stage of destruction, or “Change,” has ended, we recognize the current fiscal year to be the stage of creation, or “Challenge.”

In the next process of creating new corporate value toward growth, we will focus on fostering individual mini-mini companies in a big way. Specifically, we will consider increasing integration among mini-mini companies to accelerate corporate growth. We will integrate mini-mini companies taking into account their strength and the characteristics in the market so that the integrated entity can operate more efficiently and produce a synergy effect. By doing this, we will establish technologies that cannot be copied by other companies, enhance our capability of developing products, and ensure our position as the world's number one niche corporation in each product field. In addition, we will also continue to acquire external effective management resources through M&A, as one of our important options.

We will not only pursue better earnings, but also establish an attractive corporation that meets the expectations of our customers, shareholders, employees, business partners and the community, while further sharing values of MARUWA culture with them and fulfilling corporate social responsibility*. From now on, we will particularly focus on improving employee satisfaction, based on the belief that if employees feel satisfied with their everyday work, customers will also be satisfied and hence corporate value will be raised.

*Efforts to fulfill corporate social responsibility

Environmental protection activities

MARUWA is promoting a zero emissions campaign, aiming to reduce and recycle wastes centering on Toki Plant in Gifu Prefecture, which will achieve a recycling rate of 100% in the year through March 2007.



Toki Plant

Supporting local environmental protection

MARUWA participated in the activity dubbed the Home of the Fireflies in Jokoji, and donated 1.6-hectares land to Seto municipal government in Aichi Prefecture. Currently, the area, including the Home of the Fireflies, is renamed MARUWA's Forest and being improved.



The Home of the Fireflies

Supporting arts and culture activities

Through the Fundación Maruwa Fomento de Baile Español (the Maruwa Foundation for Promotion of Spanish Dancing), MARUWA offers support in developing flamenco in Japan and training young dancers.



Public performance of flamenco at "Expo 2005 Aichi"

Question

What are your measures for improving shareholder value?

For the fiscal year under review, we will pay a year-end dividend of ¥12 per share, resulting in an annual payout of ¥21, of which ¥9 was paid as an interim dividend, up ¥6 from a year earlier. We plan to raise the full-year dividend payment for the year ending March 2007 by ¥3 per share year on year to ¥24, including an interim dividend of ¥12 and a year-end dividend of ¥12. We are striving to increase dividend payment from the level of a year earlier with the emphasis on returning profits to shareholders, while securing internal reserves for strategic investments that are needed to continuously expand our core businesses. We will make every effort to further enhance our investor relation activities so that shareholders can understand more appropriately the management status of MARUWA.

Ceramic Components Business



Circuit Ceramics

The Circuit Ceramics division produces ceramic substrates for chip resistors essential for a wide range of electronics and electric products, glazed substrates for thermal printer heads (TPHs) used in fax machines and bar code label printers, large-size ceramic substrates for hybrid ICs, and Aluminum Nitride substrates for power modules and automotive components.

Fiscal 2006 results

Total sales of this division were ¥6,345 million in the fiscal term under review, up 2.1% from the previous year, reflecting recovered demand for mobile phones, personal computers and other products in the information and communications field. In the third quarter, demand for ceramic substrates for chip resistors decreased in Asia, but after the fourth quarter such demand picked up, particularly for multi-array type substrates.



Looking ahead and key strategy

For the current year through March 2007, we will strive to further increase the market share for alumina substrates by establishing a system for increasing production, given an expected growth in demand in the Asian markets.

By leveraging ceramic material and multi-layer technologies, which we have built up for years, we are working on the development and commercialization of multi-layer ceramic substrates that are widely used in many industrial fields. Among targeted products include automotive module substrates, radio frequency components and radio frequency modules. In the fiscal term under review, we made efforts not only to develop technologies that heighten the density level and facilitate making products multi-functional, but also to expand the lineup of products to cover various sectors as well as establishing mass-production technology. As some of the products are already being mass-produced, we will proactively increase new customers. We expect sales from the Circuit Ceramics division to be ¥6,950 million for the current year, up 9.5% from the year under review.

Technology:

Sheet casting technology

Product line:

- Ceramic substrates for chip resistors
- Ceramic rods for fixed resistors
- Glazed substrates for thermal printer heads (TPH)
- Large substrates for hybrid ICs
- Aluminum Nitride

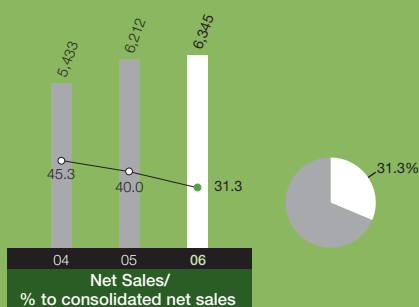
Applications:

- Ceramics for resistors

Electronic devices, PCs, digital cameras, game console, mobile phones, components for automobiles.

- Aluminum Nitride

Hybrid/electric vehicles, DVDs, semiconductor equipment.



Machinery Ceramics

The Machinery Ceramics division manufactures products that require high precision process technology, including quartz glass components mainly for semiconductor equipment, ceramics for supporting magnetic heads for personal computers, and ceramic valves for water faucets.

Fiscal 2006 results

The section of mainstay quartz glass products saw sales and profits increase in the previous year, thanks to strong demand from the semiconductor equipment field amid rising sales of digital home appliances and the reinforcement of the business foundation through reorganization of production sections. In the year under review, however, orders from major customers weakened after the fourth quarter.

To cope with this situation, we further strengthened our business foundation by improving production lines to ensure profits, and expediting the development of materials and products that respond to the growing trend toward large wafers. Despite these efforts, sales of this division were ¥4,444 million in the fiscal period under review, down 15.4% from the previous year.

Looking ahead and key strategy

The Machinery Ceramics division is still suffering the effects of weak demand, which began in the fiscal year under review, but domestic demand is recovering. In this situation, we aim to improve profitability. To this end, we will streamline operational efficiency of the administrative sector by taking advantage of the merger of MARUWA QUARTZ Co., Ltd. and MARUWA TFG Co., Ltd., which was conducted in the term under review, reorganize the production process, enhance the techniques for customized products, and advance into overseas markets.

We forecast that sales of this division will be ¥5,630 million for the current year, up 26.7% from the year under review.



Technology:

Precision processing technology

Product line:

- Slider ceramics
- Ferrite
- Ceramic valves for water faucets
- Quartz glass products

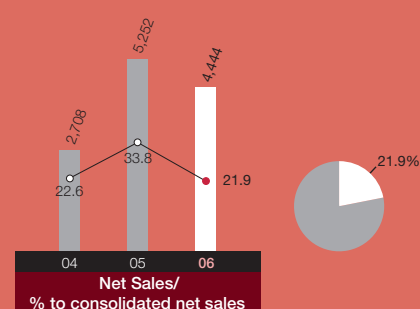
Applications:

- Slider ceramics/ferrite

Floppy disk drives & hard disk drives for PCs

- Ceramic valves for water faucets

Dual (cold and hot) faucets, single faucets



Ceramic Components Business



Radio Frequency Products

The Radio Frequency Products division manufactures device products, mainly bandpass filters (BPF) used in mobile phones, base stations and other items in the wireless communication field, dielectric filters used chiefly in the mobile communication field, and thin-film substrates for use in optical information and communication equipment.

Fiscal 2006 results

Sales of this division were ¥1,589 million in the fiscal period under review, up 45.0% from the previous year, due to strong demand from the communications and digital home appliances sector. As for device products, sales increased substantially reflecting high demand in Asia for products used in mobile phones, commercial-use wireless equipment, and base stations. Sales of thin-film substrates expanded thanks to strong demand in the DVD-related field.

Looking ahead and key strategy

With respect to the radio frequency production, sales have been rising since the latter half of the term under review. Capitalizing on this situation, we are working hard to establish a system for producing a wide range of products in small lots that respond to changes in market needs, as well as expand the sales market by developing new products.

The thin-film production carries out all processes of production, from raw material right through to the finished product, and it has also satisfactorily established mass production of Aluminum Nitride substrates with thin-film that have high thermal conductivity. In addition, the development and mass production of thin-film products that use dielectric materials has progressed favorably and we expect to sell products in the radio frequency market from now on.

The device production has also started product development of radio frequency modules that meet the needs of the market. We are also focusing on the development of products that use our proprietary ceramic technology, such as dielectric filters for base stations, and have started mass production in some of these products. From now on, we will explore markets for these products in the U.S. and the EU.

For the current fiscal year, we project sales from this segment to increase 23.3% year on year to ¥1,960 million.

Technology:

Electronic device technology

Product line:

- BPF
- Dielectric ceramics
- Thin film products
- Multi-layer ceramic substrates

Applications:

- Devices

Mobile phones, wireless LAN, other wireless communications equipment.

- Dielectric ceramics

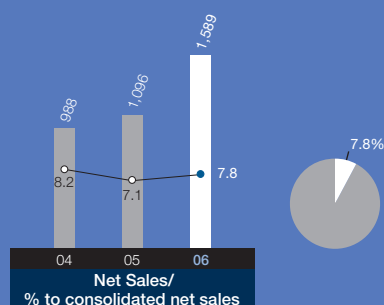
Base stations & terminals for mobile phones, GPS, Bluetooth technology.

- Thin film products

Mobile communication devices, CD/DVD-RW, Optical network.

- Multi-layer ceramic substrates

Mobile communication devices, automobiles.



EMC Components

The EMC Components division produces EMI filters, chip varistors, chip beads and inductors, which are increasingly needed to control noise and electrical surges in electronic equipment, including: digital cameras; liquid crystal backlights; high-voltage, high capacitance multi-layer ceramic capacitors mainly for the power supply part of electronic devices; information/communication equipment such as mobile phones and personal computers; digital home appliances; amusement-related machines; and automotive electronic devices.

Fiscal 2006 results

In the fiscal year under review, sales from this division jumped 43.1% from the preceding year to ¥4,250 million, due to a recovery in the electronic components market and strong demand for the lineup of new products.

Thanks to an expansion of the Asian market, we won substantial orders for EMI filters from manufacturers in the region of thin-screen TVs, DVD equipment and other digital home appliances. Sales of chip varistors rose due to an increase in demand from the automotive parts sector.

Looking ahead and key strategy

With the digitization of TV broadcasting, the switch to thin-screen TVs is progressing, which accelerates the higher speed and multi-functioning of large-scale integrated (LSI) circuits. For this trend, demand is growing for more sophisticated and advanced EMC (electromagnetic compatibility measures to prevent electromagnetic interference). As for the EMC business, we are striving to meet such market needs through the expansion of our product lineups for various coils, capacitors and LC filters, advanced EMI filters and chip varistors that combine these elements, as well as enhancing our EMC technology. In doing so, we are using proprietary technologies for dielectric and magnetic ceramic materials and printing, multi-layering and baking techniques, which we have cultivated, while pursuing better noise/surge absorption, space-saving surface mounting, radio frequency compliance, competitive pricing and environmental considerations.

For the current year through March 2007, we forecast that earnings will increase due to an expansion in sales by manufacturers of digital home appliances, whose business is doing well at home and abroad. We will intensify marketing activities to win more orders for such components as ceramic capacitors, EMI filters and inductors, centering on the Asian market. Sales from this division are estimated to be ¥5,970 million for the current year, up 40.5% from a year earlier.



Technology:

Multi-layer technology

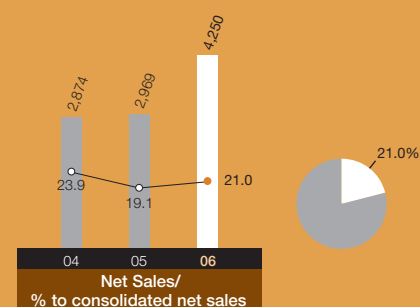
Product line:

- Multi-layer ceramic capacitors
- EMI filters
- Multi-layer ceramic varistors
- Power inductors

Applications:

- EMC Components

Digital cameras, PCs, mobile phones, automobiles



Lighting Equipment Business



Lighting Equipment

This business involves the manufacture and sales of lighting equipment for use in roads, bridges and tunnels, which are constructed as public works projects. We will expand the business domain into a field that includes LED illumination of building exteriors.

Fiscal 2006 results

In the Lighting Equipment Business, which was launched in the fiscal year under review, MARUWA posted sales of ¥3,650 million in the year, and an operating loss of ¥27 million.

As the business handles lighting equipment for roads and bridges in the public works field, sales tend to occur at the end of the fiscal term. (The government also closes its accounts on 31 March of each year.) Throughout the year under review, we reviewed operational bases of this business and implemented measures to reduce cost and purchase expenses. As a result, we failed to become profitable, but were able to reduce losses from this business compared with the beginning of the year.

Looking ahead and key strategy

MARUWA is promoting the research and development of streetlights that are eco-friendly and lighting fixtures for the bridge railing that use LEDs, the next-generation light source. It is unlikely that sales from this business will increase, given a reduction in the budget for public investment and intense price-cutting competition. Despite such severe circumstances, we project that sales will rise 10.1% year on year to ¥4,020 million for the current fiscal year, due to development and sales of outdoor lighting fixtures that use LEDs as their light source.

Main products:

- Lighting fixtures for roads, bridges and tunnels
- Lighting apparatus for streets and squares, and hybrid solar lighting
- Floodlights
- Signboards

Industry's first LED-based footbridge lighting fixture developed and commercialized

MARUWA SHOMEI's brand "Luster μ"

MARUWA SHOMEI Co., Ltd., the Group's consolidated subsidiary engaged in the lighting equipment business, has succeeded in developing and commercializing a footbridge lighting fixture that uses LEDs, the first time such a product has been seen in the industry. By improving optical control and power circuits, MARUWA SHOMEI overcame the issues of brightness and light conversion efficiency and developed an LED module that is more efficient than ordinary 40W fluorescent tubes. LED lamps have longer lives, are smaller in size, and consume less power. As

next-generation lighting that consumes less energy and is friendly to the environment, LED lighting may replace electric bulbs and fluorescent tubes. The newly developed lighting is expected to be a strategic product that will expand the sales of the Lighting Equipment business from the public sector into the private sector.

