

Poised for Growth

TDK Corporation Annual Report **2006**

April 2005-March 2006



About TDK

TDK Corporation was established in 1935 as the world's first company to commercialize a magnetic material called ferrite. In the ensuing years, TDK has developed and commercialized a host of other materials and products. This drive is based on the company's founding spirit of "Contribute to culture and industry through creativity."

Looking ahead, TDK is determined to further refine its materials, process, and evaluation & simulation technologies—its core technologies—aiming to be an Exciting Company, a consummate e-material solution provider that delivers with perfect timing products imbuing value that customers want.

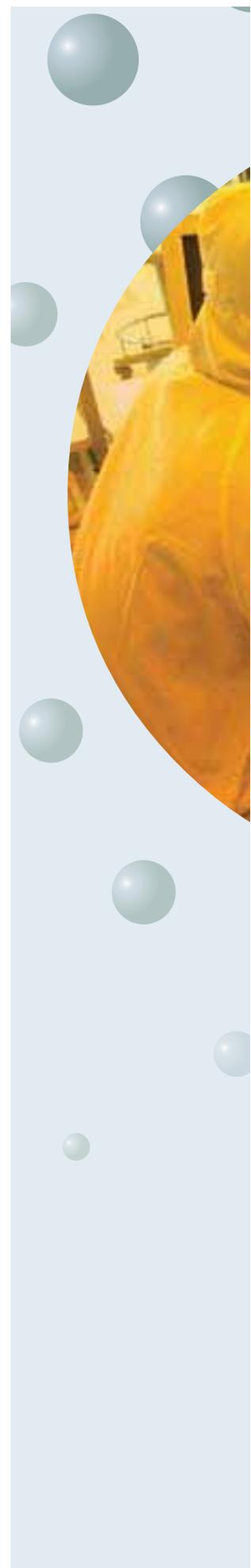
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CAUTIONARY STATEMENTS WITH RESPECT TO FORWARD-LOOKING STATEMENTS

This booklet contains forward-looking statements, including projections, plans, policies, management strategies, targets, schedules, understandings and evaluations, about TDK and its group companies (TDK Group). These forward-looking statements are based on the current forecasts, estimates, assumptions, plans, beliefs and evaluations of TDK Group in light of information currently available to it, and contain known and unknown risks, uncertainties and other factors. TDK Group therefore wishes to caution readers that, being subject to risks, uncertainties and other factors, TDK Group's actual results, performance, achievements or financial position could be materially different from any future results, performance, achievements or financial position expressed or implied by these forward-looking statements, and TDK Group undertakes no obligation to publicly update or revise any forward-looking statements after the issue of this booklet except as provided for in laws and ordinances.

The electronics markets in which TDK Group operates are highly susceptible to rapid changes. Risks, uncertainties and other factors that can have significant effects on TDK Group include, but are not limited to, shifts in technology, fluctuations in demand, prices, interest and foreign exchange rates, and changes in economic environments, conditions of competition, laws and regulations.





Three Core Products to Drive Sustained Growth

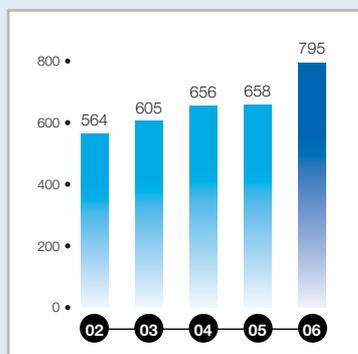
Financial Highlights

| Years ended March 31 | Yen in millions (except per share amounts) | | U.S. dollars in thousands (except per share amounts) | | Change (%) |
|--|---|---------|---|--|------------|
| | 2006 | 2005 | 2006 | | |
| OPERATING RESULTS | | | | | |
| Net sales | ¥795,180 | 657,853 | \$6,796,410 | | 20.9 |
| Electronic materials | 180,766 | 174,800 | 1,545,009 | | 3.4 |
| Electronic devices | 154,680 | 116,387 | 1,322,051 | | 32.9 |
| Recording devices | 315,928 | 234,578 | 2,700,239 | | 34.7 |
| Other electronic components | 36,376 | 19,449 | 310,906 | | 87.0 |
| Electronic materials and components | 687,750 | 545,214 | 5,878,205 | | 26.1 |
| Recording media | 107,430 | 112,639 | 918,205 | | -4.6 |
| (Overseas sales) | 621,522 | 473,828 | 5,312,154 | | 31.2 |
| Net income | 44,101 | 33,300 | 376,932 | | 32.4 |
| Net income per share: | | | | | |
| (basic) | 333.50 | 251.71 | 2.85 | | |
| (diluted) | 333.20 | 251.56 | 2.85 | | |
| Cash dividends per share | 80.00 | 60.00 | 0.68 | | |
| FINANCIAL POSITION | | | | | |
| Total assets | ¥923,503 | 808,001 | \$7,893,188 | | 14.3 |
| Stockholders' equity | 702,419 | 639,067 | 6,003,581 | | 9.9 |
| Long-term debt, excluding current installments | 405 | 81 | 3,462 | | 400.0 |
| PERFORMANCE INDICATORS | | | | | |
| Overseas production/net sales | 61.7 | 59.0 | | | |
| Gross profit margin percentage | 26.3 | 26.4 | | | |
| Operating income ratio | 7.6 | 9.1 | | | |
| Return on equity | 6.6 | 5.5 | | | |
| Price-earnings ratio | 26.6 | 29.2 | | | |

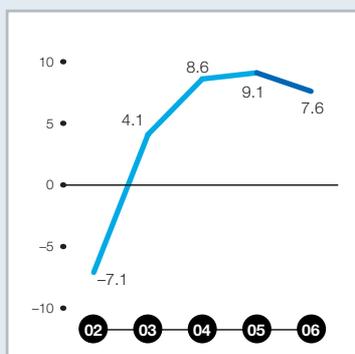
Notes: 1. Yen amounts have been translated into U.S. dollars, for convenience only, at the rate of ¥117=US\$1.

2. Effective from the fiscal year ended March 31, 2006, the "Semiconductors and others" sector and "Recording media & systems" segment were renamed the "Other electronic components" sector and "Recording media" segment, respectively. There were no changes in segment classifications.

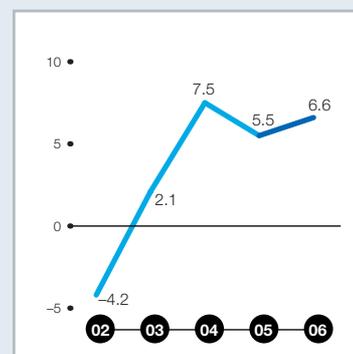
Net Sales
(Yen in billions)



Operating Income Ratio
(%)



Return on Equity
(%)



To Our Stakeholders



Takehiro Kamigama
President and COO

Hajime Sawabe
Chairman and CEO

Four Years of Sales and Earnings Growth

Fiscal 2006, ended March 31, 2006, was our fourth consecutive year of growth in net sales and operating income. We posted consolidated net sales of ¥795,180 million, up 20.9% year on year. In terms of earnings, operating income rose 1.2% to ¥60,523 million and net income climbed 32.4% to ¥44,101 million. We achieved this growth as the digital home appliances market continued its steady expansion and the mobile phone, car electronics and other markets remained robust. Our strong performance also reflects the contributions of two corporate acquisitions during the past year, progress with reforms to our earnings structure and the benefits of other actions we have taken to increase our earnings power and accelerate growth.

TDK's businesses are divided into the electronic materials and components segment and the recording media segment. These segments accounted for 86% and 14% of net sales, respectively. Fiscal 2006 operating results in these segments moved in opposite directions. While the electronic materials and components segment reported much higher sales and earnings, the recording media segment saw both sales and earnings fall.

One of the main contributing factors to the impressive performance in the electronic materials and components segment was growth in two sectors: electronic materials and electronic devices. This growth was driven by a greater-than-expected increase in demand for mobile phones and PCs. These products

have a huge bearing on demand for electronic components included in these two sectors. In the electronic devices sector, results benefited from strong sales of inductors, as well as the inclusion of six months' earnings of the Lambda Power Division in the second half of the past fiscal year. The recording devices sector also performed well. Shipments of hard disk drive (HDD) heads rose sharply on higher demand for HDDs for PCs and other consumer electronics.

In contrast, the recording media segment, which includes audiotapes, videotapes and optical media, failed to improve profitability as planned. This disappointing performance was attributable to discounting of CD-Rs, DVD-Rs and other optical discs as well as a steep rise in materials expenses. On a brighter note, computer data backup tapes continue to make a greater contribution to segment earnings as sales grow. Blue laser discs, which are seen as the next generation of optical media, also possess the potential to contribute to segment earnings once a market for these products emerges.

TDK's Ideal Earnings Structure

Growth at TDK continues to be driven by the rapidly expanding HDD head business. The HDD market continues to grow as applications expand. We are convinced that we will remain a prominent figure in driving this market as one of the leading manufacturers of HDD heads. Our products play a pivotal role

in rapid advances in HDDs in terms of greater compactness and larger capacity.

However, sustained growth at TDK in the future will depend on more than HDD heads. It will depend on making weak businesses stronger. And it will depend on making strong businesses even stronger. In short, we must transform our earnings structure from one excessively reliant on a single product category to one consisting of a balanced portfolio of businesses.

TDK started out 70 years ago by commercializing a magnetic material called ferrite that was developed in Japan. Today, we manufacture a host of distinctive electronic materials and components rooted in the expertise we have acquired in developing materials during these seven decades. Our superior core technologies—materials, process and evaluation & simulation technologies—all originate from thinking about materials, namely ferrite and other ceramics. Products for which TDK has made a name for itself are all derived from these core technologies. This is true of our audio cassette tapes, which took world markets by storm. And the same applies to our HDD heads. There are many more examples.

Even as we enter our 71st year, we are still thinking about materials. Why wouldn't we? After all, materials remain the source of our competitive edge. It's a strength that dates back to our founding. And leveraging our expertise in materials is imperative if we are to achieve sustained growth.

The more we look at our operations today, the more one point stands out—we still have lots to do to approach our ideal earnings structure, one built around consistent growth in earnings from two of our core businesses, namely electronic materials and electronic devices.

Idealism and Reality—Closing the Gap for Sustained Growth Past Initiatives

That's not to say we haven't made progress. Over the past few years, we've advanced structural reforms targeted mainly at the electronic materials and electronic devices sectors.

The results of these initiatives are gradually showing through. While executing these reforms, in the past fiscal year we made two acquisitions to strengthen our core businesses. One is Amperex Technology Limited (ATL), a manufacturer and seller of polymer lithium batteries. The other is the Lambda Power Division, a power supply business. We don't want investors to read into this, however, that we have switched to a policy of putting growth above all else. Our approach has always been, and will remain, one of putting priority on the utilization of internal reserves as a means of achieving business growth. There's



also been no change to our stance that strengthening and growing our core businesses—including electronic materials and electronic devices—will translate into higher corporate value at TDK. We want to make it clear that we don't invest in businesses with a tenuous connection to our core business. Strengthening our internal resources is our highest priority in order to achieve our objectives. But we will look closely at mergers, acquisitions and other options and act where we judge it to be necessary and prudent. The two acquisitions in the past fiscal year were made in line with this thinking. Both businesses are performing precisely as expected and starting to contribute to our overall earnings.

Of the two recent acquisitions, the Lambda Power Division has particularly profound meaning for us. The core component of power supplies is, after all, ferrite. Further, the Lambda Power Division, which specializes in power supply technology, commands the number-one share in the industrial segment of the power supply market. By making the Lambda Power Division a member of the TDK Group, we have created a new vertically integrated business model, one that organically links materials, namely ferrite, to inductors, transformers and finished power supplies. Looking ahead, we plan to launch many power supply products under a unified brand—TDK-Lambda—as we take actions to realize synergistic benefits from this acquisition.

Another recent action concerns the recording media business. We decided to stop manufacturing recordable CD and DVD products within the TDK Group. We have concluded that this is the best course of action for TDK from a medium- and long-term perspective.

Ongoing Preparations for Growth Future Initiatives

So we are making steady progress toward building our ideal earnings structure. We will continue to execute the initiatives implemented to date and enhance these initiatives as we set the stage for sustained growth. And we will do this with a new management team that was formed at the end of June this year.

The following three themes will be important in the interim:

1. Strengthen and Increase Our Workforce

Constant technological development. Building strong relationships with customers. Taking on the challenge of starting new businesses. All these activities depend on people. That's why we believe the skills of individual employees rank above all else in running a company. We put a lot of emphasis on our employees and are determined to help them raise their value.



We intend to demonstrate this stance through many management initiatives. We are convinced that establishing a culture at TDK in which individuals help others to hone their skills will serve as the cornerstone of TDK's growth.

2. Create Three High-Growth Pillars

TDK currently has three main businesses that support its operating results: HDD heads, multilayer ceramic chip capacitors and inductive devices. Naturally, increasing the profitability of these three businesses is an extremely important issue. But in doing this, it is also important to mitigate the risk of fluctuations in TDK results by molding these three pillars into businesses that underpin TDK's earnings in a well-balanced manner.

Our approach for each business differs. With HDD heads, we aim to take full advantage of our position as a company that makes only heads and not drives. We plan to capture a larger market share by leveraging our technological superiority as a specialist in HDD heads and becoming even more cost competitive. In multilayer ceramic chip capacitors, we intend to raise sales mainly by targeting new applications. Regarding inductors, we plan to continue growing by rolling out more new products, timing their introductions to match the emergence of customer demands. In fact, new product launches had a big impact on inductor sales in the past fiscal year.

This doesn't mean that our sole focus is raising profits from these three businesses. Far from it. We are determined to strengthen our operating base by enhancing the profitability of other businesses, too.

3. Become More Customer-centric and Build a Stronger Operating Base

Besides increasing profitability, we will implement the following three initiatives over the medium term to strengthen our operating base.

a. Step Up the Pace of Development

TDK possesses sophisticated technological capabilities. But these skills are only one of the elements required to earn the support of customers. Speed is also important. Development projects tend to take longer the more difficult and important the theme. But slow product commercialization due to this tendency can, in the worst case scenario, result in lost business opportunities. The electronics industry is renowned for dynamic change. There are many instances where short product lifecycles cause unit prices to fall relatively soon after the launch of new electronic components, thus severely impacting earnings. This situation demands a quicker pace of development than in the past to win customer trust. That's exactly what we intend to do—quicken the pace of development by channeling resources into materials and process technologies.

b. Strengthen Manufacturing Capabilities (*Monozukuri*)

Winning customer trust also hinges on optimizing performance at every stage in the product cycle, whether it be development, production or sales. Regarding production, we must meet demands for products that are more compact, offer higher performance and still have competitive prices. This is a major hurdle for us. And with customer needs becoming increasingly sophisticated, this is by no means an easy hurdle to clear. But that's what we are trying to do by clearly identifying the core technologies in individual production processes. This allows us to establish processes with shorter lead times in pursuit of greater rationalization and efficiency.

Our operations are increasingly global. As this global expansion continues, spreading the expertise accumulated at key manufacturing facilities to other production bases worldwide is vital to our success. Factories that launch new products have a "Mother Factory" role to play, such as in ensuring that technological guidance and expertise are transferred to related facilities. This "Mother Factory" approach will be instrumental to enhancing the performance of production facilities on a global scale.

Engendering a mindset change in employees is equally important to strengthening manufacturing capabilities. Rigorous education and training for employees involved in production are essential to accomplishing this. We must also foster pride in our employees as a lynchpin of TDK's *monozukuri*. By

using this approach, we will quickly build production lines that can consistently deliver excellent quality and reliability.

c. Establish a True Supply Chain Management Framework

To maximize production efficiency and meet market demands for a shorter lead time, we must build an integrated system capable of responding immediately to market demands. This requires organically integrating TDK's organizations and functions around the world into one information flow. What we call true global supply chain management (SCM), this integration process entails having a unified framework extending from development through production, sales and distribution. At the same time, it requires an organizational framework that synchronizes the SCM activities of all divisions and functions with market trends. TDK must move with due haste to create such a framework. While establishing a true SCM framework, we will continuously review our manufacturing capabilities to achieve efficient production processes.

Growth That Benefits Stakeholders and TDK

As we stand on the threshold of a full-scale ubiquitous society, electronics are set to play an even more important role in our daily lives. As a manufacturer of electronic components that are at the nucleus of electronics products worldwide, we are acutely aware of our increasing social responsibility.

The growth of a company is proof of society's expectations of and need for it. As a company that seeks to "Contribute to culture and industry through creativity," our level of contribution will earn us the support of various stakeholders, including shareholders, investors and customers. In the unfolding digital network society, we are convinced that TDK can grow in its own unique and dynamic way. Our hope is that the fruits of this growth will benefit all stakeholders. Expect to see TDK continue to set the stage for more growth.

July 2006



Hajime Sawabe
Chairman and CEO



Takehiro Kamigama
President and COO



Hajime Sawabe
Chairman and CEO

A Greeting From Chairman Hajime Sawabe

At the end of June this year, I assumed the office of Chairman and CEO of TDK. The eight years that I served as president of TDK was probably the most tumultuous time in terms of change in our operating environment in its 71-year history. TDK posted a loss in the fiscal year that ended in March 2002 in the aftermath of the collapse of the IT bubble. But we responded to this predicament by unfurling structural reforms based on two key themes: generating profits even without sales growth and raising sales without counting on market growth. I believe that these efforts have produced tangible results, as proven by a recovery in earnings to a near double-digit operating margin in the fiscal year ended March 31, 2006. TDK has now entered a period in which it will endeavor to accelerate growth toward achieving its next goals under the stewardship of a new president in fiscal 2007.

We are determined to redouble our efforts to achieve sustained growth while treasuring a culture of creativity fostered over many years.



Takehiro Kamigama
President and COO

Message From President Takehiro Kamigama

I am pleased to have this opportunity to write to you as TDK's new president and COO. Up to now, I have been responsible primarily for TDK's HDD head business, helping to support TDK as an executive with a technical background. TDK's HDD head business has continued to develop in response to ever-sophisticated customer needs. Today, it is one of the main pillars of TDK's earnings. Having been directly responsible for this business, I'm determined to see it further cement its position as an earnings pillar. At the same time, I recognize the urgency of reforming and strengthening businesses related to ceramic and magnetic materials, where everything began for TDK. I'm committed to tackling these issues head on. I will do my utmost to drive growth at TDK now that I have overall responsibility for its operations.



TDK posted consolidated net sales of ¥795,180 million, up 20.9% from ¥657,853 million.

In the electronics industry, to which the TDK Group belongs, there was growth in the market for digital home appliances such as LCD and plasma flat-screen TVs and DVD recorders during the past fiscal year. The notebook PC, HDD and mobile phone

Electronic Materials and Components



Electronic Materials



Main Products

Multilayer ceramic chip capacitors, ferrite cores for coils and transformers, ferrite and rare-earth magnets

Fiscal 2006 Highlights

Sales rose 3.4% due to a marginal increase in capacitor sales, as falling prices largely negated higher sales to the car electronics market, and to higher sales of metal magnets due to expanding applications for HDDs.



Electronic Devices



Main Products

Coils (inductors), high-frequency components, EMC components, piezoelectric components, sensors, transformers, DC-DC converters, switching power supplies, DC-AC inverters

Fiscal 2006 Highlights

Sales climbed 32.9%, reflecting higher sales of inductors, power supplies and other existing products as well as the inclusion for the first time of operating results of the Lambda Power Division, which TDK acquired on October 1, 2005.



Recording Devices



Main Products

HDD heads, thermal printer heads, optical pickups

Fiscal 2006 Highlights

Sales soared 34.7%, reflecting higher sales of HDD heads on the back of expanding demand for HDDs.



Other Electronic Components



Main Products

Organic EL displays, anechoic chambers, mechatronics

Fiscal 2006 Highlights

Sector sales leapt 87.0% due to higher sales of anechoic chambers and sales growth in new businesses.

Recording Media



Main Products

Audiotapes, videotapes, CD-Rs, MiniDiscs (MDs), DVDs, tape-based data storage media for computers

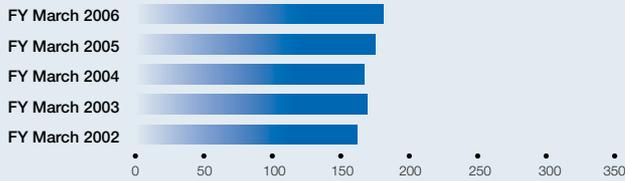
Fiscal 2006 Highlights

Sales declined 4.6%, the result of lower sales of audiotapes and videotapes due to declining demand. Optical discs and data storage tapes saw sales rise.

markets also remained robust. There was rapid expansion, too, in the market for MP3 digital audio players, which store music using semiconductors or HDDs. The market for car electronics also remained firm. Strength in these markets, along with the beneficial effects of an increase in the number of components used in these products, produced solid demand in fiscal 2006

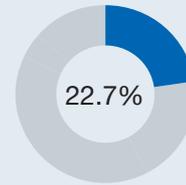
for TDK's electronic components. Amid this operating environment, TDK made two corporate acquisitions and executed reforms to improve its profit structure in the recording media segment. In these and other ways, TDK thus actively invested to accelerate growth and increase its earnings.

Sales by Electronic Materials (Yen in billions)

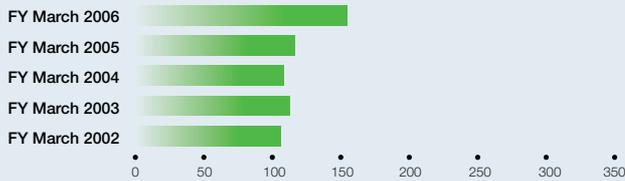


Share of Sales by Electronic Materials

FY March 2006



Sales by Electronic Devices (Yen in billions)

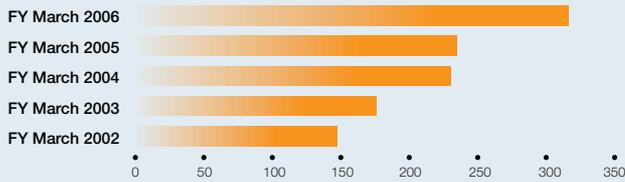


Share of Sales by Electronic Devices

FY March 2006

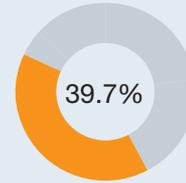


Sales by Recording Devices (Yen in billions)

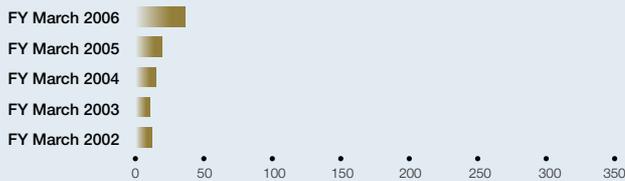


Share of Sales by Recording Devices

FY March 2006



Sales by Other Electronic Components (Yen in billions)

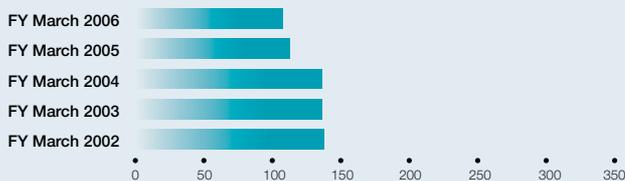


Share of Sales by Other Electronic Components

FY March 2006

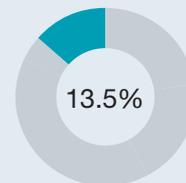


Sales by Recording Media (Yen in billions)



Share of Sales by Recording Media

FY March 2006



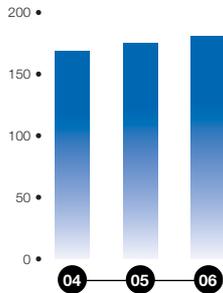
Review of Operations

Electronic Materials and Components

Electronic Materials

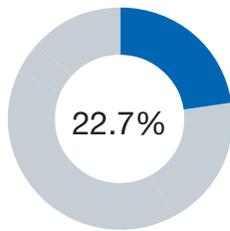
Sales

(Yen in billions)



Share of Sales

FY March 2006



This sector is broken down into two product categories: capacitors and ferrite cores and magnets.

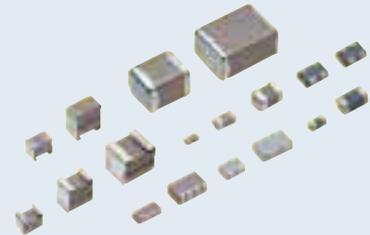
Sales in the electronic materials sector rose 3.4% from ¥174,800 million to ¥180,766 million (U.S.\$1,545,009 thousand).

[Capacitors] Sales increased marginally year on year, as the impact on sales of sluggish demand in the communications market and falling prices was offset by higher sales to the car electronics market. A weaker yen also supported sales.

[Ferrite cores and magnets] Sales of ferrite cores and magnets rose year on year. Sales of ferrite cores were largely unchanged, as higher sales from increasing demand for power supply cores was negated by lower sales of cores used in CRT TVs. Ferrite magnet sales were also largely unchanged, with lower demand stemming from customer inventory cutbacks offset by higher sales of products to the car electronics market. Sales of rare-earth magnets rose on increasing HDD demand.

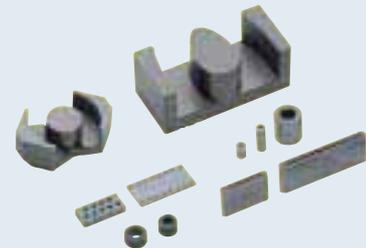
Ceramic Capacitors

Circuit components designed to store electrical energy, ceramic capacitors are made by stacking alternate layers of dielectric material and electrodes, which are then sintered (fired) to form a solid block. Due to their compactness and excellent high-frequency characteristics, ceramic capacitors are used in large quantities in mobile phones, flat-screen TVs and many other products.



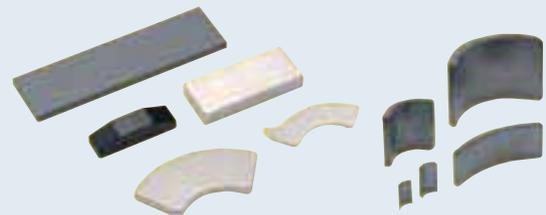
Ferrite Cores

Ferrite cores are widely used to make small cores in power supply transformers and in inductors. Ferrite is a magnetic material made by mixing ferric oxide with manganese, nickel, zinc or other metals. This versatile material is ideal for transformer and inductor cores because it has a minimal power loss even at high signal frequencies.



Magnets

This category is broadly broken down into two products: ferrite magnets and rare-earth magnets. Ferrite magnets are made by forming and sintering a mixture consisting mainly of barium oxide and ferric oxide. Rare-earth magnets, which combine compact size with high magnetic energy, consist mainly of rare-earth elements, such as samarium and neodymium, and iron.

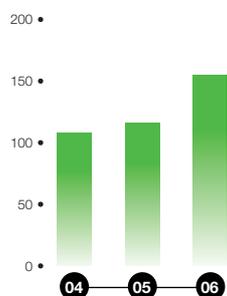


Electronic Materials and Components

Electronic Devices

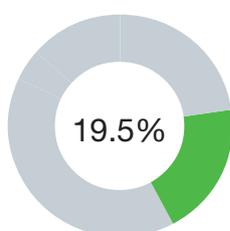
Sales

(Yen in billions)



Share of Sales

FY March 2006



This sector has three product categories: inductive devices, high-frequency components and other products.

Sales in the electronic devices sector leapt 32.9% to ¥154,680 million (U.S.\$1,322,051 thousand), from ¥116,387 million. This growth was mainly due to the inclusion for the first time of the operating results of the Lambda Power Division in the second half of the fiscal year. However, even excluding these sales, existing business in this sector posted year-on-year sales growth.

[Inductive devices] Sales of inductive devices increased mainly due to growth in sales of SMD power line coils for use in mobile phones and HDDs, and in sales of products for use in car electronics.

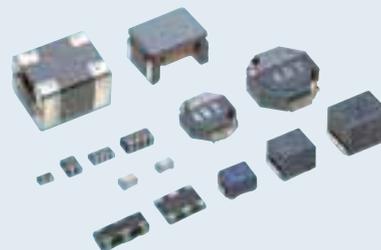
[High-frequency components] Sales of high-frequency components were down year on year. While sales of wireless LAN components rose, total category sales were brought down by further declines in sales prices of some components for mobile phones.

[Other products] Sales of other products rose year on year. The main factors were growth in sales of DC-AC inverters for use in LCD panels and of sensors and actuators for HDDs and mobile phones. The inclusion of six months' sales of the Lambda Power Division in this category also boosted sales.

Inductive Devices

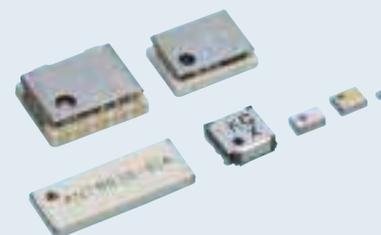
The main products in the inductive devices category are coils (inductors) and EMC components. TDK supplies coils (inductors) made by winding a wire around a ferrite core, multilayer coils (inductors) that are formed by a process similar to printing, and coils (inductors) that are made using thin-film technology.

EMC (Electromagnetic Compatibility) components are electronic components that solve the problem of electromagnetic noise given off by electronic devices.



High-frequency Components

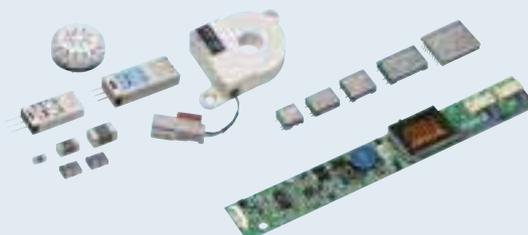
These components are chiefly used in mobile phones and other devices that handle high-frequency signals. TDK boasts an extensive lineup, including isolators, VCOs (voltage-controlled oscillators) and diplexers.



Other Products

The main products in this category are power system products, and sensors and actuators. Power system products include switching power supplies that convert alternating current into direct current, DC-AC inverters that convert direct current into alternating current, DC-DC converters that alter DC voltages, and transformers that step up or down AC voltages.

Sensors and actuators include varistors, which are effective at combating static electricity; sensors for measuring temperature, humidity, toner density and other items; and actuators such as piezoelectric buzzers.

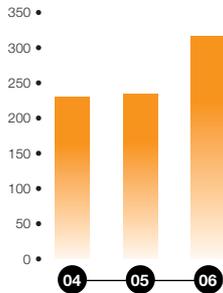


Electronic Materials and Components

Recording Devices

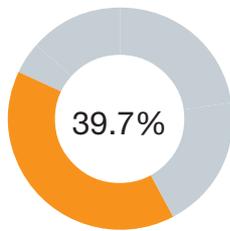
Sales

(Yen in billions)



Share of Sales

FY March 2006



This sector has two product categories: HDD heads and other heads.

Sector sales rose 34.7% from ¥234,578 million to ¥315,928 million (U.S.\$2,700,239 thousand).

[HDD heads] Sales increased year on year. Amid rising demand for HDDs used in PCs and consumer electronics, HDD head shipments increased. This higher volume outweighed a drop in sales prices, resulting in an increase in overall sales.

[Other heads] Sales of other heads declined due to inventory reductions of optical pickups.

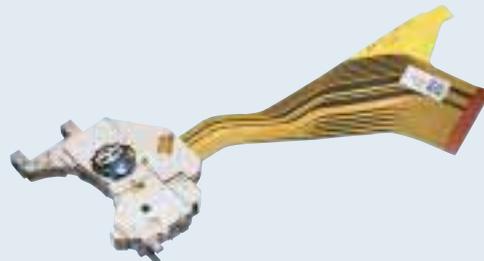
HDD Heads

HDD heads write and read signals on hard disks. GMR (Giant Magnetoresistive) heads for “reading” are gradually giving way to TMR (Tunneling GMR) heads with higher sensitivity as recording density increases. TDK has begun shipments of heads for “writing” that use PMR (Perpendicular Magnetic Recording) technology.



Other Heads

TDK also produces optical pickups for use with DVDs and CDs, thermal printer heads, and magnetic heads used in floppy disk drives (FDDs).

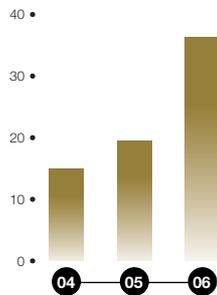


Electronic Materials and Components

Other Electronic Components

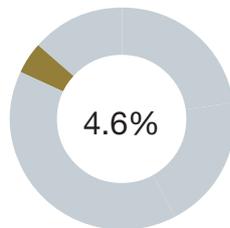
Sales

(Yen in billions)



Share of Sales

FY March 2006



This sector has three product categories: organic EL displays, anechoic chambers and mechatronics.

Sector sales surged 87.0% from ¥19,449 million to ¥36,376 million (U.S.\$310,906 thousand) due to higher sales of anechoic chambers and sales growth in new businesses.

Organic EL Displays

These slender, high-resolution displays use an organic material that emits light when an electric current is applied.



Anechoic Chambers

These chambers block external electromagnetic radiation to permit the precise measurement of electromagnetic noise.

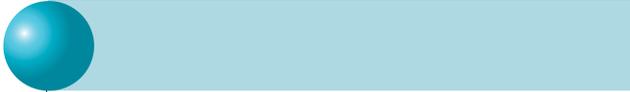


Mechatronics

This category includes external sales of manufacturing equipment. Products include Load Port and Flip Chip Bonder, which are used in the semiconductor manufacturing process.

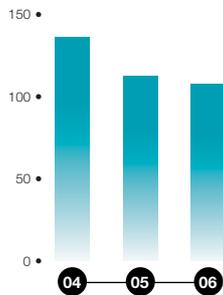


Recording Media



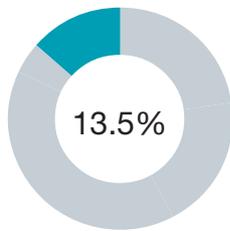
Sales

(Yen in billions)



Share of Sales

FY March 2006



This segment has three product categories: audiotapes and videotapes, optical media and other products.

Segment sales declined 4.6% from ¥112,639 million to ¥107,430 million (U.S.\$918,205 thousand).

[Audiotapes and videotapes] Sales of audiotapes and videotapes declined year on year. While TDK maintained a high market share, demand is declining for these products as a whole.

[Optical media] Sales of optical media increased year on year. CD-R demand has peaked and is declining slowly. However, lower CD-R sales caused by the downturn in demand and discounting pressure were offset by higher sales of DVDs driven by increasing demand.

[Other products] Sales of other products decreased year on year. Sales of LTO-standard* (Linear Tape-Open) tape-based data storage media for computers rose on higher demand. However, sales of recording equipment & accessory products declined as TDK made progress with efforts to create a more tightly focused product lineup.

*Linear Tape-Open, LTO, LTO logo, Ultrium and Ultrium logo are trademarks of HP, IBM and Quantum Corporation in the US and other countries.

Optical Media

TDK supplies several types of optical discs, including write-once CD-Rs and 4.7 gigabyte DVDs that can hold approximately 7 times more data than their CD counterparts, although having the same 12cm diameter. TDK has also commercialized a Blu-ray disc, one of the next generations of optical media.



Other

TDK has commercialized LTO (Linear Tape-Open) standard data storage tapes for computers in response to the rapid growth in electronic data storage needs.

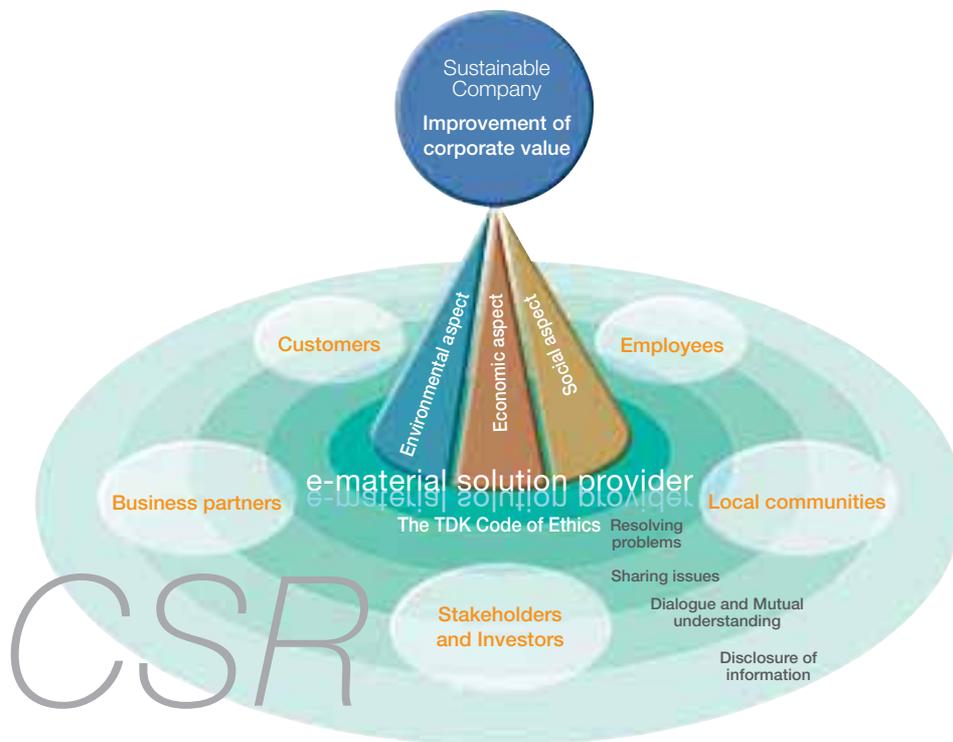


Corporate Social Responsibility (CSR)

TDK is committed to fulfilling its corporate responsibilities to society by upholding the highest standards of corporate ethics and promoting management that has CSR as one of its cornerstones.

TDK believes that a company cannot exist without forging a close relationship with society. True to its founding spirit that aims to “Contribute to culture and industry through creativity,” TDK has always placed great value in coexisting with society. As a corporate citizen, we continue to engage in activities to fulfill our social responsibility to all stakeholders, including our customers,

shareholders, other investors, communities and employees. TDK has a Business Ethics & CSR Committee that leads efforts to ensure ethical standards are upheld throughout the TDK Group and to promote CSR-oriented management. A key element of TDK’s approach to CSR is the TDK Code of Ethics.



Risk Evaluation, Analysis and Countermeasures

At TDK, the corporate officer with responsibility for administration has overall responsibility with respect to risk. The central organizational body relating to risk is the Corporate Risk Countermeasure Promotion Office, part of the General Affairs Department. This office stipulates operational rules for mitigating risk with respect to individual types of risk, such as legal, financial, IT and environmental risks, in companywide regulations and divisional procedures. Furthermore, the executive responsible for each business domain manages risk on a daily basis. Moreover, the Corporate Crisis Management Office oversees a companywide response to risks such as natural disasters and epidemics that could lead to a crisis. Regarding the status of implementation of risk countermeasures, the corporate auditors monitor the directors' performance while the Management Review & Support Department, an internal audit organization, monitors ordinary business activities. Both the corporate auditors and this department offer advice and support for reducing exposure to various risks. In addition, TDK has established a framework that provides access to advice as needed from legal counsel regarding risks associated with the TDK Group's activities.

Product Environmental Management System Assures Quality and Environmental Compliance

In May 2002, TDK formed the Product Environment Committee. This committee was instrumental in completing the process of ensuring that TDK's general-purpose electronic components comply with the RoHS Directive*¹, building a product environmental management system*² and other accomplishments. Looking ahead, the committee will establish product evaluation indicators for resource recycling and energy conservation, not just hazardous chemical substances contained in products. Other themes it will tackle include providing an appropriate response to the EuP (Energy-using Products) Directive*³ and REACH regulations*⁴ that are expected to be enacted in Europe. TDK also plans to raise customer satisfaction through the timely disclosure of environmental information relating to products.

Notes:

*¹RoHS Directive

RoHS is an acronym for "Restriction of the use of certain Hazardous Substances in electrical and electronic equipment." The RoHS Directive regulates the use of certain chemical substances contained in electrical and electronic equipment brought to market in the EU on or after July 1, 2006. RoHS prohibits the use of six substances: lead, mercury, cadmium, hexavalent chromium, polybrominated biphenyls (PBB) and polybrominated diphenyl ethers (PBDE).

*²Product Environmental Management System

This system mainly covers the management of chemical substances contained in products, and requirements for the creation of products that conserve energy and can be recycled. It is part of the maintenance and management system for the creation of environmentally friendly products.

*³EuP Directive

An acronym for "Energy-using Products," the EuP Directive is a framework directive for establishing eco-design requirements for products that use energy that are scheduled for launch onto the market in the EU. Specifically, the EuP Directive obliges companies to submit information concerning products and related products that consume energy when operational, including resource consumption over the product's lifecycle, environmental impact, such as environmental emissions, waste, noise pollution and vibration, and information on reuse and recycling.

*⁴REACH Regulations

REACH is an acronym for "Registration, Evaluation and Authorization of Chemicals." REACH is a proposed regulatory framework that obliges industry to evaluate risk with respect to all chemical substances to be imported to or manufactured and used in the EU. Slated to come into force on January 1, 2009, REACH will be implemented in progressively more stringent stages, beginning with registration of chemical substances, followed by evaluation, authorization and finally restrictions.

Basic Stance on Corporate Governance

Based on the recognition that its existence is dependent on shareholders, customers, suppliers, employees and society, TDK has put in place the following management systems for the purposes of ensuring the legal compliance, transparency and soundness of management and of achieving management goals.

- 1) To strengthen the role of the Board of Directors and increase accountability, TDK has a small number of directors (seven) that includes one outside director, who has no conflicts of interest with TDK. Furthermore, the term of directors is one year.
- 2) The adoption of the corporate officer system expedites business execution by separating management decision-making and oversight from functions involving business execution.
- 3) TDK has adopted the corporate auditor system as provided for by Company Law and, to strengthen the management oversight function, a majority of these corporate auditors (three of the five auditors) are from outside TDK, having no conflicts of interest with the company.
- 4) TDK has established the Business Ethics & CSR Committee, Disclosure Committee and Compensation Advisory Committee as advisory bodies to the Board of Directors. Regarding the Business Ethics & CSR Committee, in July 2005 TDK established a CSR Task Force as a unit of its Business Ethics Committee. The task force is made up of individuals who play various roles in the execution of CSR activities. Due to this change, the committee was renamed the Business Ethics & CSR Committee.

The TDK Code of Ethics can be found on TDK's website at <http://www.tdk.co.jp/teaaa01/aaa06000.htm>. The TDK Code of Ethics provides concrete standards and guidelines for compliance with all laws, regulations and social norms, to be followed by every director, corporate auditor, corporate officer and employee of TDK and its consolidated subsidiaries in conducting business.

The corporate governance rules of the New York Stock Exchange require that foreign private issuers disclose any significant ways in which their corporate governance practices differ from the NYSE domestic corporate governance standards (Section 303A. 11).

TDK complies with this requirement by providing statements in its Form 20-F electronically filed with the United States Securities and Exchange Commission under the heading "Significant differences in corporate governance practices between TDK and U.S. listed companies on the New York Stock Exchange". Copies of the Form 20-F are available at the following URL.

http://www.tdk.co.jp/ir_e/library/lib50000.htm

Directors, Corporate Auditors and Corporate Officers

Directors (*Outside Director)



Hajime Sawabe
Chairman and CEO



Takehiro Kamigama
President and COO



Jiro Iwasaki
Director



Shinji Yoko
Director



Takeshi Nomura
Director



Yasuhiro Hagihara
Director



Seiji Enami
Director

Corporate Auditors (*Outside Corporate Auditor)



Masaaki Miyoshi
Corporate Auditor



Takuma Otsuka
Corporate Auditor



Kazutaka Kubota*
Corporate Auditor



Kaoru Matsumoto*
Corporate Auditor



Ryoichi Ohno*
Corporate Auditor

Corporate Officers



Hajime Sawabe
Chairman and CEO



Takehiro Kamigama
President and COO



Kiyoshi Ito
Senior Executive Vice President



Jiro Iwasaki
Executive Vice President



Shinji Yoko
Senior Vice President



Takeshi Nomura
Senior Vice President



Takaya Ishigaki
Senior Vice President



Minoru Takahashi
Senior Vice President



Michinori Katayama
Senior Vice President



Yukio Hirokawa
Corporate Officer



Masatoshi Shikanai
Corporate Officer



Kenryo Namba
Corporate Officer



Seiji Enami
Corporate Officer



Raymond Leung
Corporate Officer



Shunji Itakura
Corporate Officer



Shiro Nomi
Corporate Officer



Shinichi Araya
Corporate Officer

(As of June 29, 2006)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended March 31, 2006

Commission file number 2-76735

TDK KABUSHIKI KAISHA
(Exact name of Registrant as specified in its charter)

TDK CORPORATION
(Translation of Registrant's name into English)

Japan
(Jurisdiction of incorporation or organization)

13-1, Nihonbashi 1-chome, Chuo-ku, Tokyo 103-8272 Japan
(Address of principal executive offices)

Securities registered pursuant to Section 12(b) of the Act.

| Title of each class | Name of each exchange on which registered |
|-----------------------------------|---|
| <u>American Depositary Shares</u> | <u>New York Stock Exchange</u> |
| <u>Common stock</u> | <u>New York Stock Exchange</u> |

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None
(Title of Class)

Indicate the number of outstanding shares of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

Common stock
Outstanding as of March 31, 2006: 132,266,828 shares (excluding treasury stock)

Indicate by check mark whether if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the securities act.

Yes No .

Indicate by a check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer .

Indicate by a check mark which financial statement item the registrant has elected to follow.

Item 17 Item 18 .

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No .

All information contained in this Report is as of March 31, 2006 unless otherwise specified. Fiscal 2006, fiscal 2005, fiscal 2004, fiscal 2003 and fiscal 2002 of this Report indicate TDK Corporation's fiscal period of the fiscal years ended March 31, 2006, 2005, 2004, 2003 and 2002, respectively.

The figures in this Report are expressed in yen and, solely for the convenience of the reader, are translated into United States dollars at the rate of ¥117 = U.S.\$1, the approximate exchange rate prevailing on the Tokyo Foreign Exchange Market as of March 31, 2006. (See Note 2 of the Notes to Consolidated Financial Statements.) On July 14, 2006 the noon buying rate for yen cable transfers in New York City as reported by the Federal Reserve Bank of New York was ¥116.33 = \$1. This translation should not be construed as a representation that the amounts shown could be converted into U.S. dollars at such rate.

Forward-Looking Statements

This material contains forward-looking statements, including projections, plans, policies, management strategies, targets, schedules, understandings and evaluations, about TDK Corporation ("TDK") and its group companies (TDK and its group companies are referred to also as "TDK" where the context so requires). These forward-looking statements are based on the current forecasts, estimates, assumptions, plans, beliefs and evaluations of TDK in light of information currently available to it, and contain known and unknown risks, uncertainties and other factors. TDK therefore wishes to caution readers that, being subject to risks, uncertainties and other factors, TDK's actual results, performance, achievements or financial position could be materially different from any future results, performance, achievements or financial position expressed or implied by these forward-looking statements, and TDK undertakes no obligation to publicly update or revise any forward-looking statements after the issue of this material.

The electronics markets in which TDK operates are highly susceptible to rapid changes. Risks, uncertainties and other factors that can have significant effects on TDK include, but are not limited to, shifts in technology, fluctuations in demand, prices, interest and foreign exchange rates, and changes in economic environments, conditions of competition, laws and regulations.

PART 1

Item 1. Identity of Directors, Senior Management and Advisers

A. Directors and senior management

Not applicable.

B. Advisers

Not applicable.

C. Auditors

Not applicable.

Item 2. Offer Statistics and Expected Timetable

A. Offer statistics

Not applicable.

B. Method and expected timetable

Not applicable.

Item 3. Key Information

A. Selected financial data

| | <u>Millions of yen, except per share amounts</u> | | | | | <i>Thousands of U.S. dollars, except per share amounts (1)</i> |
|---|--|-------------|-------------|-------------|-------------|--|
| | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2006</u> |
| Net sales | ¥795,180 | ¥657,853 | ¥655,792 | ¥604,865 | ¥564,286 | \$6,796,410 |
| Cost of sales | 585,780 | 484,323 | 476,407 | 459,552 | 463,331 | 5,006,666 |
| Gross profit | 209,400 | 173,530 | 179,385 | 145,313 | 100,955 | 1,789,744 |
| Selling, general and administrative expenses | 142,052 | 119,886 | 122,875 | 115,569 | 115,696 | 1,214,120 |
| Transfer to the government of the substitutional portion of Employees' Pension Fund: | | | | | | |
| Subsidy from the govern- ment | - | (33,533) | - | - | - | - |
| Loss on settlement | - | 27,347 | - | - | - | - |
| Restructuring cost | 6,825 | - | - | 5,197 | 25,489 | 58,333 |
| Operating income (loss) | 60,523 | 59,830 | 56,510 | 24,547 | (40,230) | 517,291 |
| Income (loss) from conti- nuing operations before income taxes | 66,103 | 60,728 | 55,847 | 20,552 | (40,230) | 564,983 |
| Income (loss) from continuing operations | 44,411 | 36,965 | 43,355 | 13,593 | (23,619) | 379,581 |
| Loss from discontinued operations | 310 | 3,665 | 1,254 | 1,574 | 2,152 | 2,649 |
| Net income (loss) | 44,101 | 33,300 | 42,101 | 12,019 | (25,771) | 376,932 |
| Per Common Share: | | | | | | |
| Income (loss) from continuing operations per share: | | | | | | |
| Basic | ¥335.84 | ¥279.41 | ¥327.27 | ¥102.42 | ¥(177.72) | \$2.87 |
| Diluted | 335.54 | 279.25 | 327.15 | 102.42 | (177.72) | 2.87 |
| Loss from discontinued operations per share: | | | | | | |
| Basic | ¥(2.34) | ¥(27.70) | ¥(9.47) | ¥(11.86) | ¥(16.19) | \$(0.02) |
| Diluted | (2.34) | (27.69) | (9.46) | (11.86) | (16.19) | (0.02) |
| Net income (loss) per share: | | | | | | |
| Basic | ¥333.50 | ¥251.71 | ¥317.80 | ¥90.56 | ¥(193.91) | \$2.85 |
| Diluted | 333.20 | 251.56 | 317.69 | 90.56 | (193.91) | 2.85 |
| Cash dividends | ¥80.00 | ¥60.00 | ¥50.00 | ¥45.00 | ¥60.00 | |
| U.S. Dollar equivalents (2) | \$0.68 | \$0.56 | \$0.47 | \$0.38 | \$0.45 | |

| | <u>Millions of yen, except per share amounts and exchange rate for yen</u> | | | | | <i>Thousands of U.S. dollars (1)</i> |
|---|--|----------------|-----------------|-------------|-------------|--|
| | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2006</u> |
| Net working capital (3) | ¥397,131 | ¥379,746 | ¥360,555 | ¥315,948 | ¥288,865 | \$3,394,282 |
| Total assets | 923,503 | 808,001 | 770,319 | 747,337 | 749,910 | 7,893,188 |
| Short-term indebtedness | 6,427 | 103 | 416 | 1,919 | 2,312 | 54,932 |
| Long-term indebtedness | 405 | 81 | 27 | 94 | 459 | 3,462 |
| Retirement and severance benefits | 26,790 | 28,839 | 73,521 | 84,971 | 49,992 | 228,974 |
| Stockholders' equity | 702,419 | 639,067 | 576,219 | 553,885 | 583,927 | 6,003,581 |
| Number of shares outstanding (in thousands) | 132,267 | 132,245 | 132,409 | 132,625 | 132,860 | |
| Yen exchange rates per U.S. dollar (4) | | <u>Average</u> | <u>Term end</u> | <u>High</u> | <u>Low</u> | |
| Year ended March 31: | | | | | | |
| 2002 | | 125.64 | 132.70 | 134.77 | 115.89 | |
| 2003 | | 121.10 | 118.07 | 133.40 | 115.71 | |
| 2004 | | 112.75 | 104.18 | 120.55 | 104.18 | |
| 2005 | | 107.28 | 107.22 | 114.30 | 102.26 | |
| 2006 | | 113.67 | 117.48 | 120.93 | 104.64 | |
| 2007 (through July 14, 2006) | | 114.22 | 116.33 | 118.66 | 110.07 | |
| January, 2006 | | | | 117.55 | 113.96 | |
| February, 2006 | | | | 118.95 | 115.82 | |
| March, 2006 | | | | 119.07 | 115.89 | |
| April, 2006 | | | | 118.66 | 113.79 | |
| May, 2006 | | | | 113.46 | 110.07 | |
| June, 2006 | | | | 116.42 | 111.66 | |

Notes:

- (1) Translated, except for cash dividend amounts, for convenience of the reader into U.S. dollars at the rate of ¥117 = \$1, the approximate rate on the Tokyo Foreign Exchange Market on March 31, 2006.
- (2) Translated based on the rates specified in Note (4) below on the respective dates of semi-annual payments for each year.
- (3) Net working capital is defined as current assets less current liabilities.
- (4) Based on the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York. The average rates are computed based on the exchange rates on the last day of each month during the year.

B. Capitalization and indebtedness

Not applicable.

C. Reasons for the offer and use of proceeds

Not applicable.

D. Risk factors

Our business is exposed to fluctuations in economic conditions that may adversely affect our business results and financial condition.

The electronics industry, our field of operations, is highly susceptible to economic trends in the U.S., Europe, China and Japan, which are the main markets of end products. In addition, these countries are constantly grappling with various risk factors such as international issues and economic fluctuations. Furthermore, the digital consumer products field is significantly affected by the extremely fast pace of technological innovation and competition in the development of new products as well as changes in economic conditions. Changes in the economic environments from our expectations could significantly affect our business results and financial condition.

Fluctuations in currency exchange rates could adversely affect our business results and financial condition.

We import and export products between different regions of the world as we conduct our business activities in countries around the globe. Sudden changes in foreign currency exchange rates affect company transactions between regions and costs and prices of our products and services at overseas bases, which consequently have effects on our business results such as sales and income. Such fluctuations also give rise to conversion differences with respect to our investments in overseas assets and liabilities, which are converted into Japanese yen in our consolidated financial statements.

Therefore, significant fluctuations in foreign currency exchange rates could have a significant adverse effect on our business results and financial condition.

We are susceptible to risks involved with selling our products in markets outside of Japan.

One of our corporate strategies is to expand in markets outside Japan as we conduct business in countries around the world. Overseas sales account for more than 70 percent of total sales on a consolidated basis.

However, in many of these markets, we may be exposed to international political risks, such as war, terrorism and other events; economic risks, such as fluctuations in foreign currency exchange rates and trade friction; and social risks, including disease, labor problems stemming from differences in cultures and customs. Such risks may give rise to changes of a far greater magnitude than we anticipate. We may also face unexpected barriers in building relationships with trading partners due to differences in commercial and business customs. Manifestation of these risks could lower productivity in manufacturing processes, undermining the competitiveness of products and also hinder sales activities and result in other negative consequences. These outcomes could in turn have a significant adverse effect on our business results and financial condition.

A slow-down of the Chinese economy, adverse changes in political and economic policies of the Chinese government, or other factors in China may reduce our growth and profitability.

We have many production bases in China for mainstay products, such as HDD heads. China is a country in the midst of strong economic growth. We have also established a system for supplying both local companies and customers that have been setting up operations in China. Furthermore, we plan to expand business further in this country.

However, in the event that political factors (such as changes in laws and regulations), economic factors (such as the continuity of high growth, fluctuations in Renminbi (RMB) against U.S. dollars and problems with electric power supply and other infrastructure) and social factors cause unexpected events in China, there could be a material adverse effect on our growth and profitability.

We may not be able to compete effectively with respect to prices, which would have a material adverse effect on our profitability.

We supply products in a broad range of fields in an electronics industry defined by intense competition. These fields include IT and communications devices such as digital home appliances, PCs and mobile phones. In this industry, price is one of the main competitive factors differentiating us from other companies, while leading Japanese companies and Asian companies in South Korea and Taiwan have fueled intense price-based competition.

However, pressure continues to mount from customers for price discounts. In the event that the fall in prices far exceeds our expectations or becomes protracted, there could be a material adverse effect on our profitability.

Rapid changes in technology could adversely affect our business and hurt our competitive position.

We believe that our ability to increase sales by developing appealing, innovative products has an important role to play in our growth. However, it is extremely difficult to predict future demand in the rapidly changing electronics industry and develop new technologies to meet that demand. We may fail to develop and supply in a timely manner attractive, new products with innovative technologies for this industry and our markets. In the event that we misread the industry and market and/or are slow in developing innovative technologies on a cost competitive basis, actual earnings could differ significantly from our forecasts. At the same time, we may cease to be able to compete in markets, resulting in a significant adverse effect on our business results and growth prospects.

Claims of product liability and other issues associated with the quality of our products could adversely affect our business results and brand name.

We manufacture various products at overseas manufacturing bases that we are developing globally in accordance with ISO (International Organization for Standardization) quality management standards (ISO 9001) and the strict standards required by customers in the electronics industry, where technological innovation is remarkable.

We cannot be fully certain, however, that all of our products are defect-free and immune from recalls at some later date. A product recall or a product liability claim against us caused by product defects could result in recall costs or damage claims, lower sales and have a negative impact on our reputation and brand, endangering our continued existence. A situation resulting from poor product quality due to a major product defect could have a materially adverse effect on our business results and brand name.

Our proprietary technology is difficult to protect and unauthorized use of our proprietary technology by third parties may reduce the value of our products and brand and impair our ability to compete effectively.

Our growth depends to a great extent on our ability to obtain patents, licenses and other intellectual property rights covering our products, product designs and manufacturing processes.

However, there are cases where our intellectual property rights cannot be fully protected in a particular region for reasons unique to that region. Furthermore, we may suffer damages resulting from the manufacture by a third party of similar products to our own with the unauthorized use of our intellectual property rights. The failure to protect intellectual property rights of others could reduce the value of our products and brand and impair our ability to compete effectively.

Our business may suffer if we are sued for infringing upon the intellectual property rights of third parties.

There may be cases where it is alleged that our products infringe on the intellectual property rights of third parties. Regarding problems relating to the infringement of such intellectual property rights, we may suffer damages or may be sued for damages. In either case, settlement negotiations and legal procedures would be inevitable and could be expected to be lengthy and expensive. If our assertions are not accepted in such disputes, we may have to pay damages and royalties and suffer losses such as the loss of markets.

The failure to prevent infringement on the rights of others could have a materially adverse effect on our business development and business results and financial condition.

Our success depends on attracting and retaining highly-skilled employees, and we would suffer material adverse effects if we are unable to do so.

To prevail against fierce competition in the electronics industry, we believe that it is necessary to recruit and retain staff possessing advanced technical skills. Regarding personnel with superior management ability, such as with respect to the ability to formulate strategy and organizational management, we believe that it is necessary to upgrade skills at an advanced level.

However, intense competition to recruit such skilled employees is not limited to the industries where we are active. Moreover, in Japan, there is increasing fluidity in the labor market caused by revisions to the life-time employment system and other developments. These and other factors mean there is no guarantee that we will continue to be able to recruit and retain skilled employees. The inability to recruit and train personnel as planned could have a materially adverse effect on our operations, business results and growth prospects.

We are dependent on certain raw materials and other products, and our business will suffer if we are unable to procure such materials.

Our manufacturing system is premised on deliveries of raw materials, components, equipment and other supplies in adequate quality and quantity in a timely manner from many external suppliers. In new product development, we may rely on certain irreplaceable suppliers for materials.

Because of this, there may be cases where supplies of raw materials and other products to us are interrupted by an accident or some other event at a supplier, supply is suspended due to quality or other issues, or there is a shortage of or instability in supply due to a rapid increase in demand for finished products that use certain materials and products. If any of these situations becomes protracted, we may have difficulty finding substitutes in a timely manner from other suppliers, which could have a significant, adverse effect on our production and prevent us from fulfilling our responsibilities to supply products to our customers. Furthermore, if an imbalance arises in the supply-demand equation, there could be a spike in the price of raw materials. In the event of these or other similar occurrences, there could be a material adverse effect on our business results and financial condition.

Increased government regulation of our industry or changes in those regulations, whether in Japan or overseas, may limit our ability to compete effectively.

We are subject to various regulations in Japan and other countries where we conduct business. These include approval for conducting business and making investments, laws and regulations governing the safety of electric and electronic products, laws and regulations relating to national security between nations, and export/import laws and regulations. We are also subject to commercial, antitrust, patent, product liability, environmental, consumer and business taxation laws and regulations.

In the event that these laws and regulations become more stringent in the future, our business development could be affected in no small way and we may incur various additional operating costs. Furthermore, in the event that we are unable to respond appropriately to these laws and regulations, we may be forced to partially withdraw from certain businesses or take other actions.

Government laws and regulations in their various forms may limit our ability to compete effectively.

Fluctuations in interest rates may have an adverse effect on our profitability.

Although we attempt to limit our borrowings from third parties, from time to time, we or our subsidiaries may need to borrow funds from such third parties. To the extent that interest rates increase, we or our subsidiaries may be subject to higher interest expenses. In contrast, a protracted period of low interest rates also may have an adverse effect on us by limiting our interest income from investments. Low interest rates also may require us to make additional contributions to pension benefit funds since the assets of those funds may become under funded. Either of these changes could have a material adverse effect on our business results and financial condition.

We are developing a business strategy whereby we sell to a concentrated number of Original Equipment Manufacturers (OEMs), and are thus susceptible to adverse changes with respect to the business of such OEMs.

We are developing on a global scale an OEM business, whereby we supply mainly electronic components to electronics manufacturers, personal computer (PC) makers and other customers.

However, supplies to these customers are significantly affected by various factors that are beyond our control such as changes in each customer's business results and management strategies. A drop-off in purchasing demand due to poor business results at major customers, changes in customers' purchasing plans and policies, the unexpected termination of contracts and other occurrences could result in our profit margins being reduced due to discounting pressure from customers or our being left holding large amounts of inventory.

During fiscal 2006, Maxtor Peripherals (S) Pte. Ltd., our major customer related to the electronic materials and components business with sales of 11.5 percent of consolidated net sales in 2006, agreed to be acquired by a competitor. The acquisition was completed in May 2006. During the year ended March 31, 2007, TDK will be losing the majority of the sales from this customer that it recorded in the year ended March 31, 2006.

Customers' business results, changes in management strategy or other factors could thus have a material adverse effect on our business results and financial condition.

Our operations depend on facilities throughout the world and are subject to forces of nature that could disrupt our ability to serve our customers.

We have many production sites and R&D facilities in Japan and overseas. These facilities and plants have taken measures to prevent damage caused by natural disasters. However, these facilities and plants could still suffer significant damage due to a force majeure event such as a large earthquake, typhoon or flood that far exceeds any level expected. In the event of interruption to manufacturing, disruption of transportation routes, damage to or disconnection of information and communications infrastructure, our ability to supply our customers could be affected for a long period of time. This situation could have a material adverse effect on our business results and financial condition.

If we are unable to comply with the various environmental laws and regulations to which we are subject, we may have to withdraw from certain business activities, which would have an adverse effect on our brand and business operations.

We are subject to various environmental laws and regulations with respect to industrial waste and emissions into the atmosphere and water from our production processes in Japan and overseas, and specified hazardous chemical substances used in the products. From the perspective of environmental protection, environmental regulations are expected to become increasingly stringent in the future, and expenses are expected to increase for responding to these regulations.

We are engaged in various activities to help protect the environment, including complying with environmental regulations. However, if we have difficulty responding appropriately to these demands and laws and regulations, we may be forced to withdraw from certain business activities impacting our brand name, and in consequence could have a material adverse effect on our business results and financial condition.

Japan's Unit Share System could affect access to Japanese markets by holders of American Depositary Shares ("ADSs"), which could adversely affect the price of our shares.

Pursuant to our Articles of Incorporation, 100 of our shares constitute one unit. A holder who owns ADRs evidencing less than 100 ADSs will indirectly own less than a whole unit of shares of Common Stock. Although, under the unit share system holders of less than a unit have the right to require us to purchase their shares, holders of ADRs evidencing ADSs that represent other than integral multiples of whole units are unable to withdraw the underlying shares of Common Stock representing less than a unit and, therefore, are unable to exercise the rights to require us to purchase such underlying shares at this time. As a result, access to the Japanese markets by holders of ADRs through the withdrawal mechanism will not be available for dispositions of shares of Common Stock in lots less than a unit. The unit share system does not affect the transferability of ADSs, which may be transferred in lots of any size.

Holders of American Depositary Shares have limited rights, which could adversely affect the price of our shares.

The rights of shareholders under Japanese law to take actions, including voting their shares, receiving dividends and distributions, bringing derivative actions, examining our accounting books and records and exercising appraisal rights are available only to shareholders of record. Citibank, N.A., through its custodian agent, is the record holder of the shares underlying the ADSs, and therefore only it can exercise the rights of shareholders in connection with the deposited shares. The depositary has agreed to endeavor to vote the shares underlying ADSs in accordance with the instructions of ADS holders and to pay the dividends and distributions collected from us. However, ADS holders will not be able to bring a derivative action, examine our accounting books and records or exercise appraisal rights through the depositary.

We are incorporated in Japan and a substantial portion of our assets are located outside of the United States (U.S.). As a result, it may be more difficult for investors to enforce against us judgments obtained in U.S. courts predicated upon the civil liability provisions of the Federal securities laws of the United States, including the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, or judgments obtained in other courts outside of Japan. In addition, there is doubt as to the enforceability in Japanese courts, in original actions or in actions for enforcements of judgments of U.S. courts, of civil liabilities based solely upon violation of these Federal securities laws of the United States.

Because we have not yet completed the implementation of the SEC's requirements with respect to internal controls over financial reporting, we might not be aware of weaknesses in our internal controls over financial reporting that could adversely affect our ability to report our financial results timely and accurately.

The Sarbanes-Oxley Act requires that management maintain, evaluate and report on internal controls over financial reporting. As a foreign private issuer, we will be required to comply with this requirement for our fiscal year ending March 31, 2007. Currently, we are engaged in the process of assessing our existing internal controls over financial reporting to ensure our compliance with the new requirements. As a result, we might not be aware of weaknesses that could exist and that might be identified once the evaluation of the effectiveness of our internal controls over financial reporting has been completed. In addition, there is a risk that we may not be able to implement our internal controls and procedures over financial reporting in the time frame allowed by the Sarbanes-Oxley requirements.

Item 4. Information on the Company

A. History and development of the Company

History

TDK Corporation (TDK Kabushiki Kaisha) is a corporation formed under the Commercial Code of Japan. TDK's principal place of business is at 13-1, Nihonbashi 1-chome, Chuo-ku, Tokyo 103-8272 Japan and the telephone number is +81-3-5201-7102. The agent in the U.S. for purposes of this Item 4 is TDK U.S.A. Corporation, 901 Franklin Avenue, P.O. Box 9302, Garden City, New York, NY 11530.

TDK is the world's leading manufacturer of recording media, ferrite products and recording device products, and a major producer of inductor, ceramic capacitor, magnet, HDD head and other components. TDK is a Tokyo-based company founded on December 7, 1935 to commercialize ferrite.

Historically, TDK's growth has been centered on ferrite, a material invented in 1933 by Doctor Yogoro Kato and Doctor Takeshi Takei. Ferrite is indispensable as a magnetic substance in the manufacture of electronic equipment. It is a magnetic material with a ceramic structure composed of iron oxide and other metallic oxides. Its advantages over other magnetic materials include higher resistivity and thus lower eddy current loss while maintaining superior permeability and flux density. Based on its strong materials knowledge and production technology, TDK expanded into ceramic capacitors and magnetic recording tapes in the early 1950s, and ferrite magnets and coil components in the early 1960s. In the early 1980s, TDK began production of a magnetic head, continuing development to its modern day product the "HDD head". Since the 1990s, TDK has promoted the establishment of world-wide research and development organizations and environmental management efforts. TDK has continued to broaden its product development programs by building up expertise in materials technology and new recording-related products.

In the years ended March 31, 2006, 2005 and 2004, TDK's capital expenditures were ¥73.9 billion (\$632 million), ¥61.0 billion and ¥44.5 billion, respectively. For further information of TDK's capital expenditures, see "Capital Expenditures" included in Item 5.B. "Liquidity and capital resources".

TDK is planning capital expenditures of ¥70.0 billion (\$598 million) in fiscal 2007, primarily for the expansion of production facilities and upgrading of facilities. Regarding TDK's capital expenditure plans, TDK's policy is to invest actively in targeted strategic fields to drive growth.

B. Business overview

Sales by product category

TDK's sales are generated by two business segments: electronic materials and components, and recording media. In fiscal 2006, "Semiconductors and others" and "Recording Media and Systems" were renamed "Other electronic components" and "Recording Media", respectively. There were no changes in product classifications.

The following is a breakdown of consolidated net sales of TDK and its consolidated subsidiaries by business segment for fiscal 2006, 2005 and 2004:

| | Years ended March 31 | | | <i>2006</i> <i>(millions of</i> <i>U.S. dollars)</i> |
|--------------------------------------|----------------------|---------------------|---------------------|--|
| | <u>2006</u> | <u>2005</u> | <u>2004</u> | |
| | (millions of yen) | | | |
| | (%) | | | |
| Electronic Materials and Components: | | | | |
| Electronic materials | ¥180,766 (22.7) | ¥174,800 (26.6) | ¥166,818 (25.4) | \$1,545.0 |
| Electronic devices | 154,680 (19.5) | 116,387 (17.7) | 107,999 (16.5) | 1,322.1 |
| Recording devices | 315,928 (39.7) | 234,578 (35.7) | 230,105 (35.1) | 2,700.2 |
| Other electronic components | 36,376 (4.6) | 19,449 (2.9) | 14,870 (2.3) | 310.9 |
| Sub total | 687,750 (86.5) | 545,214 (82.9) | 519,792 (79.3) | 5,878.2 |
| Recording Media | 107,430 (13.5) | 112,639 (17.1) | 136,000 (20.7) | 918.2 |
| Total | ¥795,180 (100.0) | ¥657,853 (100.0) | ¥655,792 (100.0) | \$6,796.4 |

Notes:

The business segment information is required by the Japanese Securities Exchange Law. Segment information is unaudited.

Electronic Materials and Components TDK's electronic materials and components are divided into four principal categories: (i) electronic materials; (ii) electronic devices; (iii) recording devices; and (iv) other electronic components. Overall business results of each category in fiscal 2006 compared to fiscal 2005 are as follows.

(i) Electronic materials The electronics materials sector is broken down into two product categories: capacitors, and ferrite cores and magnets.

Sales of capacitors increased marginally year over year, as the impact on sales of sluggish demand in the communications market and falling prices was offset by higher sales to the car electronics market. A weaker yen also supported sales.

Sales of ferrite cores and magnets rose year over year. Sales of ferrite cores were largely unchanged, as higher sales from increasing demand for power supply cores was negated by lower sales of cores used in CRT TVs. Ferrite magnet sales were also largely unchanged, with lower demand stemming from customer inventory cutbacks offset by higher sales of products to the car electronics market. Sales of rare-earth magnets rose on increasing HDD demand.

(ii) Electronic devices The electronic devices sector has three product categories: inductive devices, high-frequency components and other products.

The growth of sales in this sector was mainly due to the inclusion of the operating results of Lambda Power Business from the second half of the fiscal year. Lambda Power Business was acquired by TDK from U.K.-based Invensys plc. on October 1, 2005. However, even excluding these sales, existing businesses in this sector posted year over year growth.

Sales of inductive devices increased mainly due to growth in sales of power line coils for use in mobile phones and HDDs, and in sales of products for use in car electronics.

Sales of high-frequency components were down year over year. While sales of wireless LAN components rose, total category sales were brought down by further declines in sales prices of some components for mobile phones.

Sales of other products rose year over year. The main factors were growth in sales of DC-AC inverters for use in LCD panels and of sensors and actuators for HDDs and mobile phones. The inclusion of six months' sales of Lambda Power Business in this category also boosted sales.

(iii) Recording devices The recording devices sector has two product categories: HDD heads and other heads.

Sales of HDD heads increased year over year. Amid rising demand for HDDs used in PCs and consumer electronics, HDD head shipments increased. This higher volume outweighed a drop in sales prices, resulting in an increase in overall sales.

Sales of other heads declined due to inventory reductions of optical pickups.

(iv) Other electronic components The other electronic components sector includes all other products in the electronic materials and components segment not included in the three sectors above. The main products are organic EL displays, anechoic chambers and manufacturing equipment.

Sales of this sector surged due to higher sales of anechoic chambers, which block external electromagnetic radiation to permit the measurement of electromagnetic noise, and due to sales growth in new businesses.

Recording Media The recording media segment has three product categories: audiotapes and videotapes, optical media and other products. In March 2006, TDK decided to restructure certain of its recording media business, including the withdrawal from the manufacturing of recordable CD and DVDs. With this decision, TDK shut down the production facilities at its European subsidiary, TDK Recording Media Europe S.A. in Luxembourg in April 2006.

Sales of audiotape and videotapes declined year over year. While TDK maintained a high market share, demand is declining for these products as a whole.

Sales of optical media increased year over year. CD-R demand has peaked and is declining slowly. However, lower CD-R sales caused by the downturn in demand and discounting pressure were offset by higher sales of DVDs driven by increasing demand.

Sales of other products decreased year over year. Sales of LTO-standard* (Linear Tape-Open) tape-based data storage media for computers rose on higher demand. However, sales of recording equipment and accessory products declined as TDK made progress with efforts to create a more tightly focused product lineup.

* Linear Tape-Open, LTO, LTO logo, Ultrium and Ultrium logo are trademarks of HP, IBM and Quantum Corporation in the U.S. and other countries.

Marketing and Distribution

Marketing channels in Japan

TDK markets electronic materials and components in Japan through its sales division, which had approximately 304 sales representatives at March 31, 2006.

In Japan, TDK markets magnetic recording tapes and optical disks through 5 district sales offices with a staff of 88. Approximately 50 percent of domestic sales of TDK brand products are made to approximately 116 distribution agents. These agents in turn sell TDK brand products to over 40,000 retailers in Japan. Remaining TDK brand products are sold directly to approximately 5,500 retail stores in Japan. OEM sales are made to certain manufacturers as well.

Operations outside Japan

TDK has 70 direct and indirect foreign subsidiaries as follows: 29 manufacture various product lines and distribute their products in their country of operation and other countries; 20 are sales subsidiaries which exclusively handle products manufactured by TDK; 1 is a holding company for the administration of TDK's U.S. operations; 1 is a holding company for the administration of TDK's European operations; 1 is a company for research and development in Ireland; 2 are companies for research and development in the U.S.; 1 is a company for engineering service for magnetic heads in Singapore; 1 is a local management company for the administration of TDK's Chinese operations; 1 is a company for engineering service for magnetic heads in China; 1 is a company for engineering service for magnetic heads in Korea; 1 is a holding company for the administration of Lambda's U.S. operations; 1 is a company for the administration in Canada; 1 is a holding company for the administration of Lambda's European operations; 1 is a company for engineering service for switching power supplies; 3 are dormant companies and 5 are companies in the course of liquidation. Principal manufacturing or assembly operations are conducted by subsidiaries in the following countries:

| | |
|---------------|--|
| China | - GMR heads, inductors, ferrite cores, capacitors, transformer, power supplies and ferrite magnets |
| United States | - GMR heads, capacitors, ferrite magnets and power supplies |
| Luxembourg | - Videotapes, CD-Rs and DVDs |
| Taiwan | - Capacitors, ferrite cores and power supplies |
| Philippines | - GMR heads |
| Thailand | - Audiotapes, rare-earth metal magnets and power supplies |
| Malaysia | - Capacitors and high-frequency components |
| Korea | - Capacitors and inductors |
| Hungary | - Capacitors and ferrite cores |
| Hong Kong | - Ferrite cores |

A manufacturing subsidiary in Luxembourg has ceased operation in April 2006.

In addition, TDK has sales subsidiaries in Germany, the United Kingdom, the United States, Hong Kong, Singapore, Australia, Brazil, Poland, China, Philippines, France, Italy and Sweden.

TDK is pursuing a policy of expanding overseas production, which enables TDK to more easily adapt to fluctuating exchange rates and potential trade barriers. Production outside Japan as a percentage of sales outside Japan was 79.0 percent in fiscal 2006, 81.9 percent in fiscal 2005 and 78.9 percent in fiscal 2004.

Outside of Japan, TDK relies on a combination of its sales force, distribution agents, retailers and directed sales efforts to market its products.

Consolidated net sales of TDK and consolidated subsidiaries by geographical area for fiscal 2006, 2005 and 2004 were as follows:

| | Years ended March 31 | | | | | | <u>2006</u> <i>(millions of U.S. dollars)</i> |
|-----------------|----------------------|---|-----------------|----------------|-----------------|----------------|--|
| | <u>2006</u> | <u>2005</u> <i>(millions of yen) (%)</i> | | <u>2004</u> | | | |
| Japan | ¥168,554 | (21.2) | ¥159,487 | (24.2) | ¥161,607 | (24.6) | \$1,440.6 |
| North America | 65,931 | (8.3) | 58,850 | (9.0) | 71,224 | (10.9) | 563.5 |
| Europe | 74,846 | (9.4) | 71,085 | (10.8) | 80,233 | (12.2) | 639.7 |
| Asia and others | <u>485,849</u> | <u>(61.1)</u> | <u>368,431</u> | <u>(56.0)</u> | <u>342,728</u> | <u>(52.3)</u> | <u>4,152.6</u> |
| Total | <u>¥795,180</u> | <u>(100.0)</u> | <u>¥657,853</u> | <u>(100.0)</u> | <u>¥655,792</u> | <u>(100.0)</u> | <u>\$6,796.4</u> |

Notes:

Net sales in each geographic area are based on the location of TDK entities where the external sales are generated.

Patents and Licenses

TDK has a variety of patents in Japan and other countries, and also has licenses from other companies. It believes that expiration of any one of its patents or licenses or related group of patents or licenses would not materially adversely affect its business activities. TDK does not believe that acquisition of new proprietary patents or other companies' patents would have a material effect on operating results in the future.

Competition

In electronic materials and components, rapid technological innovation makes technological improvement a particularly significant competitive factor in the industry. Product performance characteristics, reliability, price, and the diversity of product line-ups are also significant competitive factors. In general, TDK's ferrite and other products compete with similar products made of other materials. For many applications in which specific performance characteristics are required, however, competition with other materials is not significant.

In Japan and elsewhere, the markets in which TDK sells its products are highly competitive. TDK believes that the principal elements of competition in recording media are price, brand recognition, product quality, and marketing strategy. While the Japanese, American and European optical disks markets have grown in terms of volume, they have continued to be plagued by severe price competition. However, TDK has consistently promoted internationalization in manufacturing and marketing and has maintained strategic sales in regions where high profitability is expected. Meanwhile, TDK has implemented further cost-reduction programs and is increasing its competitive strength in other ways, notably through the expansion of overseas production.

Raw Materials and Sources of Supply

TDK purchases a wide variety of raw materials, machines, tools and parts for use in the manufacture of its products. The principal raw materials purchased include plastic resin, used to mould tape cassette shell and in packaging, magnetic powder of iron oxide, base film for magnetic tape and various electronic and mechanical parts. For products manufactured in Japan, TDK purchases such raw materials from approximately 1,900 different sources, primarily in Japan. However, TDK purchases base tape from mainly three suppliers in Japan, although alternative sources of supply exist. Recently TDK increased its purchases from overseas and also increased local procurement of raw materials. No single source accounted for more than 10 percent of total purchases for fiscal 2006.

TDK monitors the availability of raw materials on a regular basis to ensure that it will not encounter any shortages. TDK has not experienced any significant difficulty in obtaining raw materials and believes that it will be able to continue to obtain comparable raw materials in sufficient quantities to meet its manufacturing needs in the future. TDK also believes that the effect of price volatility with respect to raw materials that it uses in manufacturing its products can be managed.

C. Organizational structure

As of March 31, 2006, TDK had 70 overseas subsidiaries and 20 Japanese subsidiaries. See Exhibit 8.1 "List of Significant Subsidiaries" for further information.

D. Property, plants and equipment

TDK's manufacturing operations are conducted primarily at 35 plants in Japan and 28 plants overseas.

The following table sets forth information, as of March 31, 2006, with respect to TDK's manufacturing facilities, approximately 76 percent (in terms of floor space) of which are owned by TDK.

| <u>Location</u> | <u>Number of principal factories</u> | <u>Floor space (thousands of square feet)</u> | <u>Principal products manufactured</u> |
|--------------------------|--------------------------------------|---|--|
| <i><u>Japan</u></i> | | | |
| Akita | 16 | 2,065 | Capacitors, ferrite cores, inductors and high-frequency components |
| Nagano | 4 | 1,150 | GMR heads and optical disks |
| Chiba | 1 | 663 | Rare-earth metal magnets, ferrite cores and power supplies |
| Yamanashi | 3 | 603 | GMR heads and data storage tapes |
| Oita | 1 | 471 | Videotapes |
| Shizuoka | 2 | 465 | Ferrite magnets |
| Yamagata | 3 | 345 | Inductors |
| Iwate | 1 | 298 | Capacitors |
| Ibaraki | 3 | 219 | Display and power supplies |
| Niigata | 1 | 54 | Power supplies |
| <i><u>Overseas</u></i> | | | |
| China | 9 | 4,155 | GMR heads, inductors, ferrite cores, capacitors, transformer, power supplies and ferrite magnets |
| United States of America | 7 | 746 | GMR heads, capacitors, ferrite magnets and power supplies |
| Luxembourg | 1 | 494 | Videotapes, CD-Rs and DVDs |
| Philippines | 1 | 441 | GMR heads |
| Thailand | 2 | 435 | Audiotapes, rare-earth metal magnets and power supplies |
| Malaysia | 2 | 364 | Capacitors and high-frequency components |
| Taiwan | 1 | 345 | Capacitors, ferrite cores and power supplies |
| Korea | 1 | 164 | Capacitors and inductors |
| Hungary | 1 | 160 | Capacitors and ferrite cores |
| England | 1 | 42 | Power supplies |
| Hong Kong | 1 | 42 | Ferrite cores |
| Israel | 1 | 28 | Power supplies |
| Total | 63 | 13,749 | |

TDK considers all of its principal manufacturing facilities and other significant properties to be in good condition and adequate to meet the needs of its operations. TDK owns each of its significant properties.

Though TDK included 1 plant in Luxembourg (494 thousand square feet) in the above table, this plant has ceased operation in April 2006.

In addition, TDK utilizes additional floor space at the above plants and elsewhere for laboratories, office buildings, and employee housing and welfare facilities, with an aggregate floor space of 6,530 thousand square feet, of which approximately 51 percent is owned by TDK and the balance is leased to TDK.

Item 4A. Unresolved Staff Comments

None.

Item 5. Operating and Financial Review and Prospects

Overview

TDK was established in 1935 as the world's first company to commercialize a magnetic material called ferrite. In the ensuing years, TDK has developed and commercialized a host of other materials and products. This drive is based on TDK's founding spirit of "Contribute to culture and industry through creativity."

Looking ahead, TDK is determined to further refine its materials, process, and evaluation & simulation technologies-its core technologies-aiming to be an Exciting Company, a consummate e-material solution provider that delivers products imbuing value that customers want with perfect timing.

TDK's operations are affected by the economies of various regions of the world, including Japan, the United States, Europe and Asia. Looking at economic conditions worldwide during the past fiscal year, the U.S. economy grew on the back of steadily rising consumer spending, which was supported by a strong job market, and higher levels of capital expenditures in the corporate sector. Meanwhile, European economies tended toward recovery due to a strong corporate sector, led by German companies, and the add-on effects of this recovery on employment and consumer spending. In Asia, China maintained a high economic growth rate and economies elsewhere in the region grew as well. Expansion was also evident in the Japanese economy, with capital expenditures rising due to increased production activity in the corporate sector and personal spending increasing as the job market improved.

In the electronics industry, to which TDK belongs, there was growth in the market for digital home appliances such as LCD and plasma flat-screen TVs and DVD recorders during the past fiscal year. The notebook PC, HDD and mobile phone markets also remained robust. There was rapid expansion, too, in the market for MP3 digital audio players, which store music using semiconductors or HDDs. The market for car electronics also remained firm. Strength in these markets, along with the beneficial effects of an increase in the number of components used in these products, produced solid demand in fiscal 2006 for TDK's electronic components. Amid this operating environment, TDK made two corporate acquisitions and executed reforms to improve its profit structure in the recording media segment. In these and other ways, TDK thus actively invested to accelerate growth and increase its earnings.

The electronic components business is constantly subject to two sources of downward pressure on prices. One is price discounting pressure from finished products manufacturers, the customers of electronic component manufacturers. The other is competition among manufacturers of electronic components.

Demands for price discounts are the result of competition among finished product manufacturers being passed on to component manufacturers. As they compete with each other, consumer electronics manufacturers, customers of TDK, are constantly seeking ways to establish a competitive advantage. For example, these companies pursue strategies such as differentiating products by adding new functions to existing products, as well as securing a competitive edge through pricing. This sort of competition involving finished products tends to force companies to compete by launching new products, resulting in shorter product lifecycles and a greater risk of price declines.

TDK's electronic materials and components segment supplies products that are used mainly in digital home appliances, mobile phones and other consumer electronics as well as in automotive electronics. As such, this business is directly exposed to the effects of the competition outlined above. No change is foreseen in discounting pressure from customers in the coming years.

Electronic component manufacturers, as with other industries, compete with peer companies. Consumer electronics manufacturers commonly certify several suppliers so that companies need to compete for orders. A company's pricing strategy is a key element in determining the share of electronic components it supplies to finished product manufacturers. As a consequence, there is constantly downward pressure on prices.

The electronic components business thus requires the constant execution of initiatives to mitigate the effect of these pricing pressures. Actions to reduce costs are an obvious response. But it is also necessary to establish a position as a components manufacturer that can supply key components when customers launch new products. There is no substitute for product development activities aimed at supplying these key components.

Price declines are thus inevitable in the electronic components business, but it is possible to reduce or absorb the effects of lower prices by implementing the above measures appropriately, when required. We believe that these actions are an inherently vital element that will ultimately determine the competitiveness of an electronic components business.

TDK posted consolidated net sales of ¥795,180 million (\$6,796,410 thousand) in fiscal 2006, up 20.9 percent from ¥657,853 million in fiscal 2005. Operating income rose 1.2 percent from ¥59,830 million in fiscal 2005 to ¥60,523 million (\$517,291 thousand) in fiscal 2006. Income from continuing operations before income taxes increased 8.9 percent from ¥60,728 million in fiscal 2005 to ¥66,103 million (\$564,983 thousand) in fiscal 2006. Net income rose 32.4 percent from ¥33,300 million in fiscal 2005 to ¥44,101 million (\$376,932 thousand) in fiscal 2006. Basic net income per common share was ¥333.50 in fiscal 2006, up from ¥251.71 in fiscal 2005.

On October 1, 2005, TDK purchased shares of Lambda Power Business (power supply business) owned by U.K.-based Invensys plc. Consequently, the operating results of 20 companies that form Lambda Power Business have been included in the TDK's consolidated operating results beginning with the second half of fiscal 2006.

TDK's businesses are broadly classified into two business segments: the electronic materials and components segment and the recording media segment.

Electronic Materials and Components Segment is made up of four product sectors: (1) electronic materials, (2) electronic devices, (3) recording devices, and (4) other electronic components, which we previously referred to as semiconductors and others. Segment net sales climbed 26.1 percent to ¥687,750 million (\$5,878,205 thousand) in fiscal 2006, from ¥545,214 million in fiscal 2005, while segment operating income rose 10.1 percent to ¥74,333 million (\$635,325 thousand) in fiscal 2006, from ¥67,520 million in fiscal 2005.

Recording Media Segment, which we previously referred to as Recording Media & Systems, has three product categories: audiotapes and videotapes, optical media and other products. Segment sales declined 4.6 percent from ¥112,639 million in fiscal 2005 to ¥107,430 million (\$918,205 thousand) in fiscal 2006. Operating loss of the recording media segment in fiscal 2006 was ¥13,810 million (\$118,034 thousand), up ¥6,120 million from fiscal 2005. In March 2006, TDK decided to restructure certain of its recording media business, including the withdrawal from the manufacturing of recordable CD and DVDs, and recorded a restructuring cost of ¥6,825 million (\$58,333 thousand).

A. Operating Results

Results of Operations

| | Years ended March 31 | | | |
|--|----------------------|-------------|-------------|------------------------|
| | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2006</u> |
| | (millions of yen) | | | (thousands of dollars) |
| | | (%) | | |
| Net sales | ¥795,180 | ¥657,853 | ¥655,792 | \$6,796,410 |
| | (100.0) | (100.0) | (100.0) | |
| Cost of sales | 585,780 | 484,323 | 476,407 | 5,006,666 |
| | (73.7) | (73.6) | (72.6) | |
| Gross profit | 209,400 | 173,530 | 179,385 | 1,789,744 |
| | (26.3) | (26.4) | (27.4) | |
| Selling, general and administrative expenses | 142,052 | 119,886 | 122,875 | 1,214,120 |
| | (17.9) | (18.2) | (18.8) | |
| Transfer to the government of the substitutional portion of Employees' Pension Fund: | | | | |
| Subsidy from the government | - | (33,533) | - | - |
| | - | (-5.1) | - | - |
| Loss on settlement | - | 27,347 | - | - |
| | - | (4.2) | - | - |
| Restructuring cost | 6,825 | - | - | 58,333 |
| | (0.8) | - | - | |
| Operating income | 60,523 | 59,830 | 56,510 | 517,291 |
| | (7.6) | (9.1) | (8.6) | |
| Other income (other deductions) | 5,580 | 898 | (663) | 47,692 |
| | (0.7) | (0.1) | (-0.1) | |
| Income taxes and minority interests, net of tax | 21,692 | 23,763 | 12,492 | 185,402 |
| | (2.7) | (3.6) | (1.9) | |
| Loss from discontinued operations | 310 | 3,665 | 1,254 | 2,649 |
| | (0.1) | (0.5) | (0.2) | |
| Net income | ¥44,101 | ¥33,300 | ¥42,101 | \$376,932 |
| | (5.5) | (5.1) | (6.4) | |

Sales by Region

| | Years ended March 31 | | | |
|------------------------------------|----------------------|-------------|-------------|-----------------------|
| | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2006</u> |
| | (millions of yen) | | | (millions of dollars) |
| | | (%) | | |
| Japan | ¥173,658 | ¥184,025 | ¥168,623 | \$1,484,256 |
| | (21.8) | (28.0) | (25.7) | |
| Americas | 90,192 | 77,813 | 88,734 | 770,872 |
| | (11.4) | (11.8) | (13.5) | |
| Europe | 75,895 | 71,702 | 80,710 | 648,675 |
| | (9.5) | (10.9) | (12.3) | |
| Asia (excluding Japan) and Oceania | 451,710 | 321,612 | 314,875 | 3,860,769 |
| | (56.8) | (48.9) | (48.0) | |
| Middle East and Africa | 3,725 | 2,701 | 2,850 | 31,838 |
| | (0.5) | (0.4) | (0.5) | |
| Net sales | ¥795,180 | ¥657,853 | ¥655,792 | \$6,796,410 |
| | (100.0) | (100.0) | (100.0) | |

This summary of sales by region is based on the location of the customer.

Segment Information

The following industry and geographic segment information is required by the Japanese Securities Exchange Law. Segment information is unaudited.

Industry Segment Information

| | <u>Years ended March 31</u> | | | <u>2006</u> <i>(thousands of dollars)</i> |
|--|-----------------------------|-------------|-------------|--|
| | <u>2006</u> | <u>2005</u> | <u>2004</u> | |
| | (millions of yen) | | | |
| ELECTRONIC MATERIALS AND COMPONENTS | | | | |
| Net sales | | | | |
| External sales | ¥687,750 | ¥545,214 | ¥519,792 | \$5,878,205 |
| Intersegment | - | - | - | - |
| Total revenue | 687,750 | 545,214 | 519,792 | 5,878,205 |
| | (100.0%) | (100.0%) | (100.0%) | (100.0%) |
| Operating expenses | 613,417 | 477,694 | 461,077 | 5,242,880 |
| | (89.2%) | (87.6%) | (88.7%) | (89.2%) |
| Operating income | ¥74,333 | ¥67,520 | ¥58,715 | \$635,325 |
| | (10.8%) | (12.4%) | (11.3%) | (10.8%) |
| Identifiable assets | 672,596 | 537,593 | 505,178 | 5,748,684 |
| Depreciation and amortization | 53,599 | 47,409 | 46,293 | 458,111 |
| Capital expenditures | 71,070 | 57,192 | 40,084 | 607,436 |
| RECORDING MEDIA | | | | |
| Net sales | | | | |
| External sales | ¥107,430 | ¥112,639 | ¥136,000 | \$918,205 |
| Intersegment | - | - | - | - |
| Total revenue | 107,430 | 112,639 | 136,000 | 918,205 |
| | (100.0%) | (100.0%) | (100.0%) | (100.0%) |
| Operating expenses | 121,240 | 120,329 | 138,205 | 1,036,239 |
| | (112.9%) | (106.8%) | (101.6%) | (112.9%) |
| Operating income (loss) | ¥(13,810) | ¥(7,690) | ¥(2,205) | \$(118,034) |
| | (-12.9%) | (-6.8%) | (-1.6%) | (-12.9%) |
| Identifiable assets | 79,109 | 84,160 | 97,186 | 676,145 |
| Depreciation and amortization | 4,941 | 5,397 | 4,433 | 42,231 |
| Capital expenditures | 2,841 | 3,813 | 4,387 | 24,282 |
| ELIMINATIONS AND CORPORATE | | | | |
| Corporate assets | ¥171,798 | ¥186,248 | ¥167,955 | \$1,468,359 |
| TOTAL | | | | |
| Net sales | | | | |
| External sales | ¥795,180 | ¥657,853 | ¥655,792 | \$6,796,410 |
| Intersegment | - | - | - | - |
| Total revenue | 795,180 | 657,853 | 655,792 | 6,796,410 |
| | (100.0%) | (100.0%) | (100.0%) | (100.0%) |
| Operating expenses | 734,657 | 598,023 | 599,282 | 6,279,119 |
| | (92.4%) | (90.9%) | (91.4%) | (92.4%) |
| Operating income | ¥60,523 | ¥59,830 | ¥56,510 | \$517,291 |
| | (7.6%) | (9.1%) | (8.6%) | (7.6%) |
| Identifiable and corporate assets | 923,503 | 808,001 | 770,319 | 7,893,188 |
| Depreciation and amortization | 58,540 | 52,806 | 50,726 | 500,342 |
| Capital expenditures | 73,911 | 61,005 | 44,471 | 631,718 |

Geographic Segment Information

| | Years ended March 31 | | | <u>2006</u> <i>(thousands of dollars)</i> |
|-----------------------------------|----------------------|---|-------------|--|
| | <u>2006</u> | <u>2005</u> <i>(millions of yen)</i> | <u>2004</u> | |
| JAPAN | | | | |
| Net sales (1) | ¥360,210 | ¥339,493 | ¥329,782 | \$3,078,718 |
| Operating income | 49,437 | 26,382 | 8,538 | 422,539 |
| Identifiable assets | 347,942 | 305,717 | 316,695 | 2,973,863 |
| AMERICAS | | | | |
| Net sales (1) | 105,979 | 87,594 | 100,971 | 905,803 |
| Operating income | 9,995 | 5,496 | 4,985 | 85,427 |
| Identifiable assets | 100,611 | 70,844 | 65,584 | 859,923 |
| EUROPE | | | | |
| Net sales (1) | 76,240 | 71,682 | 80,641 | 651,624 |
| Operating income (loss) | (9,996) | (5,125) | (115) | (85,436) |
| Identifiable assets | 45,729 | 44,961 | 51,797 | 390,846 |
| ASIA AND OTHERS | | | | |
| Net sales (1) | 531,824 | 400,866 | 380,781 | 4,545,504 |
| Operating income | 12,607 | 33,551 | 42,912 | 107,752 |
| Identifiable assets | 348,008 | 263,621 | 228,058 | 2,974,428 |
| ELIMINATIONS AND CORPORATE | | | | |
| Net sales (1) | 279,073 | 241,782 | 236,383 | 2,385,239 |
| Operating income (loss) | 1,520 | 474 | (190) | 12,991 |
| Identifiable assets | 81,213 | 122,858 | 108,185 | 694,128 |
| TOTAL | | | | |
| Net sales | ¥795,180 | ¥657,853 | ¥655,792 | \$6,796,410 |
| Operating income | 60,523 | 59,830 | 56,510 | 517,291 |
| Identifiable and corporate assets | 923,503 | 808,001 | 770,319 | 7,893,188 |
| OVERSEAS SALES (2) | | | | |
| Americas | ¥90,192 | ¥77,813 | ¥88,734 | \$770,872 |
| Europe | 75,895 | 71,702 | 80,710 | 648,675 |
| Asia and others | 455,435 | 324,313 | 317,725 | 3,892,607 |
| Overseas sales total | ¥621,522 | ¥473,828 | ¥487,169 | \$5,312,154 |
| Percentage of consolidated sales | 78.2% | 72.0% | 74.3% | 78.2% |

Notes:

- (1) Net sales in each geographic area are based on the location of TDK entities where the sales are generated.
- (2) Overseas sales are based on the location of the customers.

Fiscal 2006 Compared to Fiscal 2005

Sales

Consolidated net sales increased 20.9 percent from ¥657.9 billion to ¥795.2 billion (\$6,796.4 million) for the fiscal year ended March 31, 2006.

Looking at economic conditions worldwide during the past fiscal year, the U.S. economy grew on the back of steadily rising consumer spending, which was supported by a strong job market, and higher levels of capital expenditures in the corporate sector. Meanwhile, European economies tended toward recovery due to a strong corporate sector, led by German companies, and the knock-on effects of this recovery on employment and consumer spending. In Asia, China maintained a high economic growth rate and economies elsewhere in the region grew as well. Expansion was also evident in the Japanese economy, with capital expenditures rising due to increased production activity in the corporate sector and personal spending increasing as the job market improved.

In the electronics industry, to which TDK belongs, there was growth in the market for digital home appliances such as LCD and plasma flat-screen TVs and DVD recorders during the past fiscal year. The notebook PC, HDD and mobile phone markets also remained robust. There was rapid expansion, too, in the market for MP3 digital audio players, which store music using semiconductors or HDDs. The market for car electronics also remained firm. Strength in these markets, along with the beneficial effects of an increase in the number of components used in these products, produced solid demand in fiscal 2006 for TDK's electronic components. Amid this operating environment, TDK made two corporate acquisitions and executed reforms to improve its profit structure in the recording media segment. In these and other ways, TDK thus actively invested to accelerate growth and increase its earnings.

As a result, the electronic materials and components segment posted net sales of ¥687.8 billion (\$5,878.2 million), up 26.1 percent from ¥545.2 billion in the previous fiscal year.

Sales in the electronic materials sector rose 3.4 percent from ¥174.8 billion to ¥180.8 billion (\$1,545.0 million). Sales of multilayer chip capacitors, a mainstay of capacitor products, increased marginally year over year, as the impact on sales of sluggish demand in the communications market and falling prices was offset by higher sales to the car electronics market. A weaker yen also supported sales. Sales of ferrite cores and magnets rose year over year. Sales of ferrite cores were largely unchanged, as higher sales from increasing demand for power supply cores was negated by lower sales of cores used in CRT TVs. Ferrite magnet sales were also largely unchanged, with lower demand stemming from customer inventory cutbacks offset by higher sales of products to the car electronics market. Sales of rare-earth magnets rose on increasing HDD demand.

Sales in the electronic devices sector leapt 32.9 percent to ¥154.7 billion (\$1,322.1 million), from ¥116.4 billion. This growth was mainly due to the inclusion of the operating results of Lambda Power Business from the second half of the fiscal year. However, even excluding these sales, existing business in this sector posted 10.8 percent year over year sales growth. Sales of inductive devices increased mainly due to growth in sales of SMD power line coils for use in mobile phones and HDDs, and in sales of products for use in car electronics. Sales of high-frequency components were down year over year. While sales of wireless LAN components rose, total category sales were brought down by further declines in sales prices of some components for mobile phones. Sales of other products rose year over year. The main factors were growth in sales of DC-AC inverters for use in LCD panels and of sensors and actuators for HDDs and mobile phones. The inclusion of six months' sales of Lambda Power Business in this category also boosted sales.

In the recording devices sector, sales rose 34.7 percent from ¥234.6 billion to ¥315.9 billion (\$2,700.2 million). Sales of HDD heads increased year over year. Amid arising demand for HDDs used in PCs and consumer electronics, HDD head shipments increased. This higher volume outweighed a drop in sales prices, resulting in an increase in overall sales. Sales of other heads declined due to inventory reductions of optical pickups.

Maxtor Peripherals (S) Pte. Ltd., TDK's major customer related to electronic materials and components business with sales of 11.5 percent of consolidated net sales for the year ended March 31, 2006, was acquired by a company in the same industry in May 2006. During the year ended March 31, 2007, TDK will be losing the majority of sales from Maxtor Peripherals (S) Pte. Ltd. that it recorded for the year ended March 31, 2006. TDK, however, plans to set off the loss with other businesses in the electronic materials and components segment and to raise its sales further, due mainly to growing demand for digital home appliances and cell phones.

Sales in the other electronic components sector surged 87.0 percent from ¥19.4 billion to ¥36.4 billion (\$310.9 million) due to higher sales of anechoic chambers, which block external electromagnetic radiation to permit the measurement of electromagnetic noise, and due to sales growth in new businesses.

Operating income of the electronic materials and components segment in fiscal 2006 was ¥74.3 billion (\$635.3 million), up ¥6.8 billion from fiscal 2005. In spite of the deep-rooted pressure for sales price discounts, operating income increased due to higher sales of HDD heads and inductive devices, discounts in raw materials and cost improvements by rationalization.

In the recording media segment, sales declined 4.6 percent from ¥112.6 billion to ¥107.4 billion (\$918.2 million). Sales of audiotapes and videotapes declined year over year. While TDK maintained a high market share, demand is declining for these products as a whole. Sales of optical media increased year over year. CD-R demand has peaked and is declining slowly. However, lower CD-R sales caused by the downturn in demand and discounting pressure were offset by higher sales of DVDs driven by increasing demand. Sales of other products decreased year over year. Sales of LTO-standard* (Linear Tape-Open) tape-based data storage media for computers rose on higher demand. However, sales of recording equipment and accessory products declined as TDK made progress with efforts to create a more tightly focused product lineup.

Operating loss of the recording media segment in fiscal 2006 was ¥13.8 billion (118.0 million), up ¥6.1 billion from fiscal 2005. Operating loss increased due to a decline in demand of audiotapes and videotapes as a whole, and continuous drop in sales prices mainly in optical media. In March 2006, TDK decided to restructure certain of its recording media business, including the withdrawal from the manufacturing of recordable CD and DVDs, and recorded a restructuring cost of ¥6.8 billion (\$58.3 million).

*Linear Tape-Open, LTO, LTO logo, Ultrium and Ultrium logo are trademarks of HP, IBM and Quantum Corporation in the U.S. and other countries.

By region, sales in Japan declined 5.6 percent from ¥184.0 billion to ¥173.7 billion (\$1,484.3 million). Overseas sales climbed 31.2 percent from ¥473.8 billion to ¥621.5 billion (\$5,312.2 million). Overseas sales accounted for 78.2 percent of consolidated net sales.

In Japan, sales in the recording devices sector and recording media segment declined, while higher sales were recorded in the electronic materials, electronic devices and other electronic components sectors. Operating income of the electronic materials and components segment increased by ¥24.4 billion to ¥53.4 billion. This increase was mainly due to the payment made by its subsidiary in Asia to TDK in the amount of ¥24.0 billion relating to the assessment of additional tax in fiscal 2005 on prices charged and paid by TDK in connection with sales and purchases of products involving the subsidiary. Recognition of operating expense in the subsidiary resulted in reduction of operating expenses in Japan. Operating loss of the recording media segment increased slightly, resulting in operating loss in fiscal 2006 of ¥4.6 billion, up ¥1.5 billion from fiscal 2005.

In Asia (excluding Japan) and Oceania, sales increased in the electronic materials, electronic devices, recording devices and other electronic components sectors, but sales declined in the recording media segment slightly. The operating income of the electronic materials and components segment decreased by ¥21.3 billion to ¥11.6 billion. This decrease was mainly due to the payment made by its subsidiary in Asia to TDK in the amount of ¥24.0 billion relating to the assessment of additional tax in fiscal 2005 on prices charged and paid by TDK in connection with sales and purchases of products involving the subsidiary. Recognition of operating expense in the subsidiary resulted in increase of operating expenses in recording devices. Operating income of the recording media segment increased slightly, resulting in operating income for fiscal 2006 of ¥0.8 billion, ¥0.1 billion more than fiscal 2005.

In the Americas, sales increased mainly in the electronic devices and recording devices sectors. The lower yen versus the U.S. dollar also led to increased sales in the Americas. The operating income of the electronic materials and components segment increased by ¥3.0 billion to ¥9.0 billion from fiscal 2005 due to increase in sales mainly in the recording devices sector. However, operating income of the recording media segment in fiscal 2006 was ¥0.3 billion, up ¥0.8 billion from fiscal 2005.

In Europe, sales increased in the electronic devices sector and the recording media segment. While operating loss of the electronic materials and components reversed to the operating income of ¥0.3 billion, up ¥0.7 billion from fiscal 2005, operating loss of the recording media segment in fiscal 2006 was ¥10.3 billion, up ¥5.6 billion from fiscal 2005, mainly due to restructuring cost of ¥6.8 billion.

Effect of foreign exchange movements

In fiscal 2006, overseas sales accounted for 78.2 percent of consolidated net sales, up 6.2 percentage points. As a result, fluctuations in foreign exchange rates had a significant effect on TDK's consolidated sales and income. During fiscal 2006, the yen's value declined 5.4 percent against the U.S. dollar and 2.0 percent against the euro, based on TDK's average internal exchange rates. Overall, exchange rate movements had the effect of increasing net sales by approximately ¥31.3 billion and operating income by approximately ¥7.7 billion in fiscal 2006.

By region, foreign exchange fluctuations increased sales in Japan by about ¥8.6 billion, in Asia (excluding Japan) and Oceania by about ¥32.5 billion, in the Americas by about ¥6.0 billion and in Europe by about ¥3.1 billion. The effect of foreign exchange fluctuations on consolidated net sales after the elimination of intersegment transactions was about ¥31.3 billion.

TDK conducts a large share of business activities outside Japan as one way to offset the impact of exchange-rate fluctuations. Such activities include manufacturing and sales, as well as research, design and procurement. In-region production in fiscal 2006 represented 102.2 percent compared with 112.1 percent one year earlier of sales in Asia (excluding Japan) and Oceania, 22.0 percent compared with 20.9 percent one year earlier in the Americas, and 19.1 percent compared with 23.9 percent one year earlier in Europe. Overseas production accounted for 61.7 percent of total sales in fiscal 2006, compared with 59.0 percent one year earlier, and for 79.0 percent of overseas sales, compared with 81.9 percent one year earlier. The rise in the percentage of overseas production in fiscal 2006 is mainly due to higher production in Asia in the electronic materials and components segment.

TDK and certain overseas consolidated subsidiaries hedge exposure to foreign exchange movements by entering into forward foreign exchange contracts and swaps for some foreign currency-denominated obligations. Foreign exchange risk arising in operating activities is hedged by using forward foreign exchange contracts. In principle, TDK's policy is to hedge up to 50 percent of expected foreign currency-denominated accounts receivable for each month for the next six months. Due to the global nature of operations, management realizes that currency movements continue to have the potential to exert a material influence on consolidated performance.

Cost and expenses

The cost of sales increased 20.9 percent from ¥484.3 billion in fiscal 2005 to ¥585.8 billion in fiscal 2006 due primarily to higher sales. Cost of sales increased from 73.6 percent to 73.7 percent of net sales, respectively. This reflected the negative effects on earnings of strong discounting pressure in all segments, which were positively offset by cost reductions from structural reforms and numerous other actions to cut costs, including the receipt of discounts on purchased materials. As a result, gross profit was 26.3 percent in fiscal 2006, compared to gross profit of 26.4 percent in fiscal 2005.

Selling, general and administrative expenses increased ¥22.2 billion from ¥119.9 billion in fiscal 2005 to ¥142.1 billion in fiscal 2006, but decreased from 18.2 percent to 17.9 percent of net sales, respectively. Selling, general and administrative expenses as a percentage of net sales reduced due to a 20.9 percent rise in net sales and to the improvements of sales productivity. The main components of this increase were personnel expenses of ¥4.8 billion, shipping and handling costs of ¥1.9 billion, and loss on disposal of property, plant and equipment of ¥2.0 billion. Research and development expenses included in selling, general and administrative expenses increased by ¥9.2 billion from ¥36.3 billion in fiscal 2005 to ¥45.5 billion in fiscal 2006, and increased from 5.5 percent to 5.7 percent of net sales, respectively.

In addition, TDK decided to restructure certain of its recording media business in March 2006, including the withdrawal from the manufacturing of recordable CD and DVDs, and recorded a restructuring cost of ¥6.8 billion (\$58.3 million).

Other income and deductions

Other income (deductions) improved ¥4.7 billion from the previous fiscal year, reflecting a ¥1.9 billion increase in interest and dividend income due to upturn in overseas interest rates and a ¥1.8 billion increase in foreign exchange gain (loss), as well as other factors.

Income taxes and minority interests

The ratio of income taxes to income from continuing operations before income taxes (the effective tax rate) decreased from 38.3 percent in fiscal 2005 to 31.9 percent in fiscal 2006. The decrease reflects mainly the fact that in fiscal 2005 TDK received a notification and assessment of additional tax from the Tokyo Regional Tax Bureau (Nihonbashi Tax Office) asserting that prices charged and paid by TDK in connection with sales and purchases of products involving its overseas subsidiaries have not been commensurate with the prices of similar transactions involving unrelated third parties. The period of additional assessments covers tax years ending March 1999 through March 2003. The additional tax assessed by the Tokyo Regional Tax Bureau amounted to ¥12.0 billion including interest and penalty, which has been reflected as additional tax expense and other expense, net of deferred income tax benefits, in the accompanying consolidated statements of income for the year ended March 31, 2005. In addition, the residual tax effects of ¥4,571 million previously recorded in accumulated other comprehensive income (minimum pension liability adjustments) were released and recorded as a reduction to income tax expense in the consolidated statements of income as a result of the elimination of the minimum pension liability adjustment for the year ended March 31, 2005.

Net income

TDK posted net income of ¥44.1 billion, resulting in net income per diluted share of ¥333.20, compared with ¥251.56 in the previous fiscal year. Return on Equity, which is net income divided by average total stockholders' equity, increased from 5.5 percent to 6.6 percent. This was mainly due to a ¥10.8 billion increase in net income.

Cash dividends per share paid during the fiscal year totaled ¥80. This dividend is the sum of the June 2005 year-end dividend of ¥40 and the December 2005 interim dividend of ¥40. Shareholders of record on March 31, 2006 received a cash dividend of ¥50 per share at the end of June 2006.

In fiscal 2006, consolidated net income included loss from discontinued operations of ¥310 million related to TDK Semiconductor Corporation (“TSC”). See discussion at Discontinued Operations.

Fiscal 2005 Compared to Fiscal 2004

Sales

Consolidated net sales rose 0.3 percent from ¥655.8 billion to ¥657.9 billion in fiscal 2005, the year ended March 31, 2005.

TDK's operations are affected by the economies of various regions of the world, including Japan, the United States, Europe and China. Despite rising crude oil prices and other factors that restricted growth, the U.S. economy generally expanded steadily due in part to an upturn in capital expenditures and improvements in employment statistics and household incomes. European economies, while resilient in the first half of fiscal 2005, suffered a slowdown in the second half due to the effects of a strengthening euro, rising crude oil prices and other negative factors. China, meanwhile, maintained a high economic growth rate. In comparison, the Japanese economy slowed due to a drop-off in exports, the result of second-half production cutbacks by manufacturers of IT and digital products, despite strength in capital expenditures that was supported by strong corporate earnings.

In the electronics industry in the first half of fiscal 2005, demand for digital home appliances, such as LCD and plasma TVs and DVD recorders, was boosted by the Summer Olympic Games in Athens and other factors. This resulted in strong demand for the TDK's electronic components in the first half. However, demand for these components began to cool in the second half in line with production cutbacks of finished products that use them.

In this business environment, TDK continued to implement cost structure reforms, for example, the improvement of variable expenses by reviewing terms of supply and requesting discounts from purchased materials vendors. TDK also actively made investments to drive growth, such as by ramping up production capacity of capacitors and forging a strategic alliance in HDD heads.

As a result, the electronic materials and components segment posted net sales of ¥545.2 billion, up 4.9 percent from ¥519.8 billion in the previous fiscal year.

Sales in the electronic materials sector rose 4.8 percent from ¥166.8 billion to ¥174.8 billion. Sales of multilayer chip capacitors, a mainstay of capacitor products, increased year over year. In the first half of fiscal 2005, the Athens Olympics propelled demand for digital home appliances higher, which had an add-on effect for components used in them. In the second half, however, demand for components cooled, this time the result of cutbacks in the production of digital home appliances, and prices also dropped. But, against this market backdrop, TDK absorbed the sales price declines and the effect of unfavorable foreign exchange movements through improvements to its product mix. In ferrite cores, sales declined from the previous fiscal year, despite higher demand for general-purpose power supply cores for digital home appliances and cores for communications equipment. This decrease was due to a reduction in output of deflection yoke cores and flyback transformer cores used in CRT TVs. Magnet sales increased year over year, the result of steadily rising demand for use in automotive and HDD applications.

Sales in the electronic devices sector increased 7.8 percent from ¥108.0 billion to ¥116.4 billion. Inductive devices, the largest product category in this sector, posted higher sales, despite lower sales prices and the negative effect of foreign exchange movements. This increase was attributable to higher demand spurred by acceleration in the pace at which automobiles are incorporating electronics and the increasing sophistication of mobile phones, as well as by new product launches. Sales of high-frequency components declined marginally year over year because higher sales volume and an improved product mix failed to completely offset persistently strong discounting pressure from mobile phone handset manufacturers, the main customer for these components. In power systems, sales of DC-DC converters and DC-AC inverters were healthy. Sensors and actuators recorded higher sales due to growth in demand for use in PCs and peripherals and communications equipment.

In the recording devices sector, sales rose 1.9 percent from ¥230.1 billion to ¥234.6 billion. Sales of HDD heads, the main product in this sector, rose year over year. However, TDK had to overcome the loss of business from a major customer that started producing heads in house in 2004, as well as the impact of falling sales prices and unfavorable foreign exchange movements. Cutbacks in HDD inventories at customers in the first half of fiscal 2005 also affected the sector's performance. However, demand for HDD heads rose in the second half of the fiscal year following the end of these cutbacks. Sales of other heads declined year over year due to sluggish sales of optical pickups.

Sales in the other electronic components sector climbed 30.8 percent from ¥14.9 billion to ¥19.4 billion. TDK recorded slightly higher sales of anechoic chambers for electromagnetic noise control and equipment used in these chambers. There was also growth in external sales of manufacturing equipment due to higher investments in semiconductor facilities and equipment by customers.

Operating income of the electronic materials and components segment in fiscal 2005 was ¥67.5 billion, up ¥8.8 billion from fiscal 2004. In spite of the deep-rooted pressure for sales price discounts, operating income increased due to higher sales of capacitors and inductive devices, discounts in raw materials and cost improvements by rationalization.

In the recording media segment, sales declined 17.2 percent from ¥136.0 billion to ¥112.6 billion. Sales of audiotapes and videotapes declined year over year. While TDK maintained a high market share, demand is declining for these products as a whole. Sales of optical media increased, with higher DVD sales volume offsetting a sharp fall in DVD prices and lower CD-R sales. Sales of other products decreased year over year. There was an increase in sales of LTO-standard* (Linear Tape-Open) tape-based data storage media for computers. However, a decline in sales caused by the sale in the previous fiscal year of a U.S. software development subsidiary and lower sales of recording equipment brought overall sales of other products down year over year.

Operating loss of the recording media segment in fiscal 2005 was ¥7.7 billion, up ¥5.5 billion from fiscal 2004. Operating loss increased due to a decline in demand of audiotapes and videotapes as a whole, decrease in sales as a result of sale of a subsidiary in the United States of America in fiscal 2004, and continuous drop in sales prices mainly in optical media.

*Linear Tape-Open, LTO, LTO logo, Ultrium and Ultrium logo are trademarks of HP, IBM and Quantum Corporation in the U.S. and other countries.

By region, sales in Japan rose 9.1 percent from ¥168.6 billion to ¥184.0 billion. Overseas sales declined 2.7 percent from ¥487.2 billion to ¥473.8 billion. Overseas sales accounted for 72.0 percent of consolidated net sales.

In Japan, sales in the electronic devices sector and recording media segment declined, while higher sales were recorded in the electronic materials, recording devices and other electronic components sectors. The electronics materials and components segment saw its operating income increase by ¥17.6 billion due to increase in operating ratio, discount in raw materials and decrease in cost by rationalization. Although operating loss of the recording media segment increased slightly, operating income in fiscal 2005 was ¥25.8 billion, up ¥16.9 billion from fiscal 2004.

In Asia (excluding Japan) and Oceania, sales declined in the recording devices sector and recording media segment, but sales increased in the electronic materials and electronic devices sectors. The operating income of the electronic materials and components segment decreased by ¥8.8 billion. This decrease is due to a significant decline in sales prices mainly in recording devices and capacitors. Operating income of the recording media segment also decreased slightly, resulting in operating income for fiscal 2005 of ¥33.6 billion, ¥9.5 billion less than fiscal 2004.

In the Americas, sales decreased in the electronic materials and recording devices sectors as well as the recording media segment. The higher yen versus the U.S. dollar also impacted sales in the Americas. The operating income of the electronic materials and components segment decreased by ¥0.9 billion from fiscal 2004. However, operating income in fiscal 2005 was ¥5.5 billion, up ¥0.9 billion from fiscal 2004, due to decrease in operating loss of the recording media segment as a result of sale of a subsidiary engaged in software development.

In Europe, lower sales were recorded in the electronic materials and other electronic components sectors as well as the recording media segment. While operating loss of the electronic materials and components decreased, operating loss of the recording media segment in fiscal 2005 reversed from operating income in fiscal 2004 to operating loss of ¥4.7 billion by decrease of ¥5.8 billion, due to a significant decline in sales prices mainly in optical media. As a result, operating loss in fiscal 2005 was ¥5.1 billion, ¥5.0 billion up from fiscal 2004.

Effect of foreign exchange movements

In fiscal 2005, overseas sales accounted for 72.0 percent of consolidated net sales, down 2.3 percentage points. As a result, fluctuations in foreign exchange rates have a significant effect on TDK's consolidated sales and income. During fiscal 2005, the yen appreciated 5.0 percent in relation to the U.S. dollar and depreciated 1.9 percent in relation to the euro, based on TDK's average internal exchange rates. Overall, TDK estimates that each ¥1 movement in the exchange rates during fiscal 2005 had the effect of reducing net sales by about ¥4.0 billion and operating income by about ¥1.0 billion, in relation to the prior fiscal year.

By region, foreign exchange fluctuations reduced sales in Japan by about ¥3.8 billion, in Asia (excluding Japan) and Oceania by about ¥23.6 billion and in the Americas by about ¥5.5 billion, but increased sales in Europe by about ¥1.4 billion. The effect of foreign exchange fluctuations on consolidated net sales after the elimination of intersegment transactions was about ¥20.6 billion.

TDK conducts a large share of business activities outside Japan as one way to offset the impact of exchange-rate fluctuations. Such activities include manufacturing and sales, as well as research, design and procurement. In-region production in fiscal 2005 represented 112.1 percent compared with 111.6 percent one year earlier of sales in Asia (excluding Japan) and Oceania, 20.9 percent compared with 22.5 percent one year earlier in the Americas, and 23.9 percent compared with 23.8 percent one year earlier in Europe. Overseas production accounted for 59.0 percent of total sales in fiscal 2005, compared with 58.6 percent one year earlier, and for 81.9 percent of overseas sales, compared with 78.9 percent one year earlier. The rise in the percentage of overseas production in fiscal 2005 is mainly due to higher production in Asia in the electronic materials and components segment.

TDK and certain overseas consolidated subsidiaries hedge exposure to foreign exchange movements by entering into forward foreign exchange contracts and swaps for some foreign currency-denominated obligations. Foreign exchange risk arising in operating activities is hedged by using forward foreign exchange contracts. In principle, TDK's policy is to hedge up to 50 percent of expected foreign currency-denominated accounts receivable for each month for the next six months. Due to the global nature of operations, management realizes that currency movements continue to have the potential to exert a material influence on consolidated performance.

Cost and expenses

The cost of sales increased 1.7 percent from ¥476.4 billion in fiscal 2004 to ¥484.3 billion in fiscal 2005 due to higher sales. Cost of sales increased from 72.6 percent to 73.6 percent of net sales, respectively. This reflected the negative effects on earnings of strong discounting pressure in all segments and foreign exchange movements, mainly the appreciation of the yen relative to the U.S. dollar. These factors outweighed positive influences such as cost reductions from structural reforms and numerous other actions to cut costs, including the receipt of discounts on purchased materials. As a result, gross profit was 26.4 percent in fiscal 2005, compared to gross profit of 27.4 percent in fiscal 2004.

Selling, general and administrative expenses decreased ¥3.0 billion from ¥122.9 billion in fiscal 2004 to ¥119.9 billion in fiscal 2005, and decreased from 18.8 percent to 18.2 percent of net sales, respectively. Selling, general and administrative expenses decreased despite a 0.3 percent rise in net sales due to efforts to strictly manage fixed expenses, such as by lowering personnel expenses through greater operational efficiency. The main components of this decrease were personnel expenses of ¥3.1 billion and marketing expenses of ¥1.3 billion. Research and development expenses included in selling, general and administrative expenses increased ¥3.4 billion from ¥32.9 billion in fiscal 2004 to ¥36.3 billion in fiscal 2005, and increased from 5.0 percent to 5.5 percent of net sales, respectively.

In addition, pursuant to the newly enacted Contributed Benefit Pension Plan Law, TDK received an exemption from the Minister of Health, Labor and Welfare, effective September 25, 2003, from the obligation to pay benefits related to future employee services with respect to the substitutional portion of its Employees' Pension Fund (EPF). TDK was also granted an exemption from the obligation to pay benefits in relation to past employee services in October 2004 with respect to the substitutional portion of its domestic contributory plan. The transfer of the substitutional portion of TDK's EPF liabilities to the government was completed on January 31, 2005. As a result of the transfer, TDK recognized as a subsidy from the Japanese government an amount equal to the difference between the fair value of the obligation deemed "settled" with the Japanese government and the assets required to be transferred to the government. The subsidy that TDK recognized amounted to ¥33.5 billion. In addition, TDK recognized a settlement loss in an amount equal to the product of (i) the ratio of the obligation settled to the total EPF obligation outstanding immediately prior to settlement, both of which exclude the effect of future salary progression relating to the substitutional portion of the EPF obligation, and (ii) the net unrecognized gain/loss immediately prior to settlement, which amounted to ¥27.3 billion. This gain and loss is included in operating income in the accompanying consolidated statements of income for the year ended March 31, 2005.

Other income and deductions

Other income (deductions) improved ¥1.6 billion from the previous fiscal year, reflecting a ¥2.2 billion decline in foreign exchange losses and a ¥1.0 billion decrease in loss on securities, net, as well as other factors.

Income taxes and minority interests

The ratio of income taxes to income from continuing operations before income taxes (the effective tax rate) increased from 21.7 percent in fiscal 2004 to 38.3 percent in fiscal 2005. The increase reflects mainly the fact that TDK received a notification and assessment of additional tax from the Tokyo Regional Tax Bureau (Nihonbashi Tax Office) asserting that prices charged and paid by TDK in connection with sales and purchases of products involving its overseas subsidiaries have not been commensurate with the prices of similar transactions involving unrelated third parties. The period of additional assessments covers tax years ending March 1999 through March 2003. The additional tax assessed by the Tokyo Regional Tax Bureau amounted to ¥12.0 billion including interest and penalty, which has been reflected as additional tax expense and other expense, net of deferred income tax benefits, in the accompanying consolidated statements of income for the year ended March 31, 2005.

Net income

TDK posted net income of ¥33.3 billion, resulting in net income per diluted share of ¥251.56, compared with ¥317.69 in the previous fiscal year. Return on Equity, which is net income divided by average total stockholders' equity, decreased from 7.5 percent to 5.5 percent. This was due to an approximate ¥62.8 billion increase in stockholders' equity, which reflected a decrease of about ¥38.7 billion in accumulated other comprehensive loss due to such factors as a decrease of about ¥32.9 billion in minimum pension liability adjustments following the transfer of the substitutional portion of EPF liabilities, as well as an increase in retained earnings.

Cash dividends per share paid during the fiscal year totaled ¥60. This dividend is the sum of the June 2004 year-end dividend of ¥30 and the December 2004 interim dividend of ¥30. Shareholders of record on March 31, 2005 received a cash dividend of ¥40 per share at the end of June 2005.

In fiscal 2005, consolidated net income included loss from discontinued operations of ¥3,665 million related to TSC. See discussion at Discontinued Operations.

Discontinued Operations

On March 31, 2005, TDK entered into an agreement to sell all outstanding stock of its wholly owned subsidiary, TSC for \$14,028 thousand to Golden Gates Capital (“Buyer”). The sale of TSC is part of TDK’s continuing shift away from non-core products and technologies. The sale agreement also includes earn-out payments, to be made by the Buyer to TDK, of up to \$32,500 thousand. No earn-out payments were made through March 31, 2006. The payments are contingent upon certain milestones being met related to future revenue targets extending through 2007. The transaction was completed on April 8, 2005. TDK has accounted for the sale of TSC as a discontinued operation pursuant to FASB Statement No. 144, “Accounting for the impairment or Disposal of Long-Lived Assets”, as TSC meets the definition of a “component of an entity”. The results of operations for this subsidiary have been reported as discontinued operations for all periods presented and selected financial information for the years ended March 31, 2006, 2005 and 2004 for the discontinued operations, are summarized as follows:

| | Yen (Millions) | | | U.S. Dollars (Thousands) |
|---|----------------|---------|--------|-----------------------------|
| | 2006 | 2005 | 2004 | 2006 |
| Net sales | ¥45 | 2,242 | 3,070 | \$385 |
| Loss from operations before income taxes (including loss on disposal of ¥224 million in 2006) | 310 | 3,509 | 244 | 2,650 |
| Income tax expense | - | 156 | 1,010 | - |
| Loss from discontinued operations | ¥310 | 3,665 | 1,254 | \$2,650 |
| Loss from discontinued operations per share: | | | | |
| Basic | ¥(2.34) | (27.70) | (9.47) | \$(0.02) |
| Diluted | (2.34) | (27.69) | (9.46) | (0.02) |

See Note 21 to the Consolidated Financial Statements for further discussion.

B. Liquidity and capital resources

Operating capital requirements

TDK's requirements for operating capital primarily are for the purchase of raw materials and parts for use in the manufacture of its products. These purchases are booked as manufacturing costs and selling, general and administrative expenses. The payment of payroll expenses, marketing expenses accompanying sales activities, and distribution-related expenses account for a significant portion of operating expenses. Personnel expenses account for a significant portion of R&D expenses. The necessary funds for these expenses are provided from cash generated by operations.

Capital Expenditures

In fiscal 2006, capital expenditures on a cash basis rose ¥12.9 billion from ¥61.0 billion to ¥73.9 billion (\$631.7 million). This was the result of aggressive investment in IT home electronics appliances; high-speed, large-capacity networks; and car electronics, which are fields TDK regards as strategically important for growth.

In the electronic materials and components segment, capital expenditures totaled ¥71.1 billion. The bulk of the capital expenditures were for facilities to develop and produce HDD heads with higher areal density mainly in China, the U.S. and the Philippines, and for facilities to increase production and rationalize operations for multilayer chip capacitors mainly in Japan and China.

In the recording media segment, capital expenditures totaled ¥2.8 billion, mainly for facilities to increase production of LTO-standard tapes.

In principle, the funds for these capital expenditures are provided from cash generated by operations. In addition, TDK paid ¥32.9 billion to acquire Lambda Power Business and Amperex Technology Limited. The funds for these acquisitions were also provided from cash generated by operations.

Capital expenditures for fiscal 2005, which are described in detail below, increased by ¥16.5 billion, from ¥44.5 billion for fiscal 2004 to ¥61.0 billion.

In the electronic materials and components segment, capital expenditures in 2005 totaled ¥57.2 billion. TDK invested in the expansion of production capacity of HDD heads, facilities for rationalizing these activities and the development of technology for coping with increasing areal density. These investments centered mainly on China, the U.S. and the Philippines. Furthermore, investments were made to increase production and rationalize operations in multilayer chip capacitors and inductors, where growth in sales is expected due to acceleration in the pace at which electronics are being incorporated in automobiles, the increasingly sophisticated nature of mobile phones and other factors. These investments were made mainly in Japan and China.

In the recording media segment, capital expenditures totaled ¥3.8 billion, mainly for facilities to increase LTO production.

Capital expenditures for fiscal 2004, which are described in detail below, increased by ¥3.5 billion, from ¥41.0 billion for fiscal 2003 to ¥44.5 billion.

In the electronic materials and components segment, due to the expansion of the market for recording devices, TDK made investments principally in Asia, but also in the Americas and Japan, to increase production and rationalization for its recording devices. Other major expenditures include investments to increase production and rationalization for electronic materials and electronic devices (principally capacitors), and investments into the development of new products. Capital expenditures of this segment increased by ¥1.7 billion from ¥38.4 billion to ¥40.1 billion.

In the recording media segment, investments have been made in Europe and Japan to increase production and develop optical media products, whose market was expanding. Capital expenditures of this segment increased by ¥1.8 billion from ¥2.6 billion to ¥4.4 billion.

Financial Management

Operating capital and capital expenditures are, in principle, funded by cash generated through operating activities. To improve capital efficiency, to the extent possible, TDK centralizes financial management in the Head Office, having introduced a cash management system (CMS) in Japan, the U.S. and Europe. Surplus funds are invested with an emphasis on low risk and liquidity. Funds from within the group will be utilized, to the extent possible, to extend financing to subsidiaries that cannot procure operating capital or funds for capital expenditures themselves.

Cash flows for fiscal 2006, 2005 and 2004 are summarized as follows:

| | Years ended March 31 | | | <u>2006</u> <i>(millions of dollars)</i> |
|--|----------------------|---|-----------------|---|
| | <u>2006</u> | <u>2005</u> <i>(millions of yen)</i> | <u>2004</u> | |
| Income from continuing operations | ¥44,411 | ¥36,965 | ¥43,355 | \$379.6 |
| Adjustments to reconcile net income to net cash provided by operating activities | <u>44,707</u> | <u>58,284</u> | <u>70,664</u> | <u>382.1</u> |
| Net cash provided by operating activities | <u>89,118</u> | <u>95,249</u> | <u>114,019</u> | <u>761.7</u> |
| Net cash used in investing activities | (104,782) | (62,359) | (37,647) | (895.6) |
| Net cash used in financing activities | (7,125) | (9,629) | (9,860) | (60.9) |
| Net cash provided by (used in) discontinued operations | (414) | (1,625) | 761 | (3.5) |
| Effect of exchange rate changes on cash and cash equivalents | <u>10,712</u> | <u>2,717</u> | <u>(10,669)</u> | <u>91.5</u> |
| Net change in cash and cash equivalents | <u>¥(12,491)</u> | <u>¥24,353</u> | <u>¥56,604</u> | <u>\$(106.8)</u> |

Fiscal 2006 cash and cash equivalents decreased ¥12.5 billion from ¥251.5 billion to ¥239.0 billion (\$2,043 million). Operating activities provided net cash of ¥89.1 billion (\$761.7 million), ¥6.1 billion less than in fiscal 2005. Income from continuing operations rose ¥7.4 billion to ¥44.4 billion (\$380 million) and depreciation and amortization increased ¥5.7 billion to ¥58.5 billion (\$500 million) mainly due to increase in the recording devices segment. In terms of changes in assets and liabilities, the increase in trade receivables climbed ¥9.5 billion, changes in inventories increased ¥3.7 billion, changes in trade payables increased ¥6.9 billion, and changes in accrued expenses increased ¥14.8 billion, while changes in income taxes payables, net declined ¥25.1 billion.

Regarding research and development expenses, TDK's policy is to focus investments in the strategic fields of IT home electronic appliances, high-speed and large-capacity networks and car electronics. Funds for research and development are appropriated from internal funds.

Investing activities used net cash of ¥104.8 billion (\$896 million), ¥42.4 billion more than the ¥62.4 billion used in the previous fiscal year. TDK used ¥73.9 billion for capital expenditures, ¥12.9 billion more than in fiscal 2005, as a result of making aggressive investments to drive growth. Furthermore, acquisition of businesses, net of cash acquired increased ¥31.4 billion and proceeds from sale and maturity of investments in securities increased ¥2.5 billion year over year, respectively.

Financing activities used net cash of ¥7.1 billion (\$60.9 million), a decrease of ¥2.5 billion from the ¥9.6 billion used in fiscal 2005. Dividends paid increased ¥2.6 billion due to a ¥20 per common share increase in the year-end dividend. On the other hand, there were an increase of ¥4.0 billion in increase (decrease) in short-term debt, net mainly in newly consolidated subsidiaries, and a decrease of ¥0.7 billion in cash paid to acquire treasury stock for stock options.

Regarding financing costs, TDK has long-term corporate credit ratings of AA- and A1 from Standard & Poor's and Moody's, respectively. Furthermore, Standard & Poor's gives TDK their highest short-term credit rating, A-1+. These ratings allow TDK to procure funds if needed at relatively low interest rates.

TDK's fundamental treasury management policy is to give consideration to a consistent increase in dividends based on factors such as the return on equity (ROE), dividends as a percentage of equity (DOE) and TDK's results of operations on a consolidated basis. Funds for paying dividends are allocated from internal funds.

In the dynamically changing electronics industry, it is necessary to make well-timed investments. Given this need, and the possibility that unstable financial conditions will continue in Japan, TDK's policy is to maintain an adequate level of liquidity, considering risk factors as well as a capital requirement forecast. Based on the current liquidity, TDK does not have immediate plans of repurchasing its stock for the purpose of extinguishment.

TDK estimates that operating cash flows and other internal resources will provide adequate liquidity in fiscal 2007. Regarding cash flows for the fiscal years ending March 31, 2007 and onward, TDK expects to provide the necessary funds from operating cash flows by increasing profitability and improving the return on assets.

Fiscal 2005 cash and cash equivalents increased ¥24.3 billion from ¥227.2 billion to ¥251.5 billion in the previous fiscal year. Operating activities provided net cash of ¥95.2 billion, a year-on-year decrease of ¥18.8 billion. The major component of cash provided by operating activities was depreciation and amortization of ¥52.8 billion, up ¥2.1 billion. In terms of changes in assets and liabilities, inventories decreased ¥11.3 billion, the result of efforts to reduce inventories, while retirement and severance benefits declined ¥6.8 billion due to the transfer of the substitutional portion of EPF liabilities and changes to the pension system. In addition, the decrease in changes in trade payables and accrued expenses decreased ¥8.0 billion and ¥11.4 billion, respectively, and income taxes payables, net increased ¥8.8 billion.

Investing activities used net cash of ¥62.4 billion, ¥24.7 billion more than the ¥37.6 billion used in the previous fiscal year. TDK used ¥61.0 billion for capital expenditures, ¥16.5 billion more than in fiscal 2004, as a result of making aggressive investments to drive growth. Furthermore, payment for purchase of investments in securities increased ¥2.4 billion year over year.

Financing activities used net cash of ¥9.6 billion, a decrease of ¥0.2 billion from the ¥9.8 billion used in fiscal 2004. There was an increase of ¥1.3 billion in dividends paid due to the increase in the dividend. On the other hand, there was a decline in the repayment of debt because debt has been virtually eliminated.

Fiscal 2004 cash and cash equivalents increased ¥56.6 billion to ¥227.2 billion from ¥170.6 billion in the previous fiscal year. Operating activities provided net cash of ¥114.0 billion, a year-on-year increase of ¥8.1 billion. This reflected mainly a ¥30.1 billion increase in net income to ¥42.1 billion and a ¥6.4 billion decrease in depreciation and amortization to ¥50.7 billion, as well as decreases in changes in trade receivables and inventories of ¥5.0 billion and ¥21.4 billion, respectively. Regarding the shortfall in pension assets, TDK planned to take action in response to certain recent reforms to the pension system, including transferring the substitutional portion of Employees' Pension Fund ("EPF") liabilities.

Investing activities used net cash of ¥37.6 billion, a decrease of ¥8.6 billion from ¥46.2 billion in the previous fiscal year. The main factor was a ¥6.2 billion decrease in payment for purchase of other investments to ¥0.4 billion.

Financing activities used net cash of ¥9.8 billion, ¥1.9 billion more than the ¥7.9 billion in cash used in the previous fiscal year. This mainly represented an increase of ¥0.8 billion in repayments of short-term debt and a ¥0.7 billion increase in dividends paid.

Capital resources as of March 31, 2006, 2005 and 2004 are summarized as follows:

| | Years ended March 31 | | | <i>2006</i> (millions of dollars) |
|---|----------------------|---|---------------------|--------------------------------------|
| | <u>2006</u> | <u>2005</u> (millions of yen) (%) | <u>2004</u> | |
| Short-term debt | ¥4,469 (0.6) | ¥ - (-) | ¥315 (0.1) | \$ 38.2 |
| Current installments of long term debt | 1,958 (0.3) | 103 (0.0) | 101 (0.0) | 16.7 |
| Long-term debt, excluding current installments | 405 (0.1) | 81 (0.0) | 27 (0.0) | 3.5 |
| Stockholders' equity | 702,419 (99.0) | 639,067 (100.0) | 576,219 (99.9) | 6,003.6 |
| Total capital | ¥709,251 (100.0) | ¥639,251 (100.0) | ¥576,662 (100.0) | \$6,062.0 |

TDK currently has no capital market debt outstanding. However, TDK maintains long-term corporate credit ratings of AA- and A1 from Standard & Poor's and Moody's, respectively. Furthermore, Standard & Poor's gives TDK their highest short-term credit rating, A-1+.

Total assets amounted to ¥923.5 billion (\$7,893 million) as of March 31, 2006, up ¥115.5 billion from ¥808.0 billion at the previous fiscal year-end. As of March 31, 2006, trade receivables were ¥189.1 billion (\$1,616 million), ¥41.1 billion higher than ¥148.0 billion and inventories were ¥89.0 billion (\$760 million), ¥14.1 billion more than ¥74.9 billion a year ago, respectively. Property, plant and equipment increased ¥26.7 billion from ¥217.0 billion to ¥243.7 billion (\$2,083 million), investments in securities increased ¥6.1 billion from ¥22.7 billion to ¥28.8 billion (\$246 million). In addition, goodwill increased ¥10.3 billion from ¥9.2 billion to ¥19.5 billion (\$166 million) and intangible assets increased ¥16.3 billion from ¥13.2 billion to ¥29.5 billion (\$252 million) due to the acquisition of businesses.

Total liabilities increased ¥43.3 billion from ¥163.8 billion to ¥207.1 billion (\$1,770 million). Income taxes payables decreased ¥10.1 billion from ¥19.3 billion to ¥9.2 billion (\$78 million), while trade payables rose ¥22.6 billion from ¥62.1 billion to ¥84.7 billion (\$724 million), accrued expenses increased ¥12.4 billion from ¥31.1 billion to ¥43.5 billion (\$372 million), and deferred income taxes increased ¥4.5 billion from ¥0.8 billion to ¥5.3 billion (\$45 million).

Total stockholders' equity increased ¥63.3 billion from ¥639.1 billion to ¥702.4 billion (\$6,004 million). Retained earnings increased ¥32.7 billion from ¥585.6 billion to ¥618.3 billion (\$5,284 million) and accumulated other comprehensive loss decreased ¥29.7 billion from ¥51.7 billion to ¥21.9 billion (\$188 million).

Total assets amounted to ¥808.0 billion as of March 31, 2005, up ¥37.7 billion from ¥770.3 billion at the previous fiscal year-end. As of March 31, 2005, cash and cash equivalents were ¥251.5 billion, ¥24.3 billion higher than ¥227.2 billion a year ago. Trade receivables were ¥148.0 billion, ¥9.7 billion higher than ¥138.3 billion a year ago. Property, plant and equipment increased ¥8.1 billion from ¥208.9 billion to ¥217.0 billion and noncurrent deferred income taxes decreased ¥25.5 billion from ¥34.1 billion to ¥8.6 billion.

Total liabilities decreased ¥27.0 billion from ¥190.8 billion to ¥163.8 billion. Trade payables rose ¥2.2 billion from ¥59.9 billion to ¥62.1 billion, and income taxes payables increased ¥14.6 billion from ¥4.7 billion to ¥19.3 billion. However, retirement and severance benefits declined ¥44.7 billion from ¥73.5 billion to ¥28.8 billion due to the transfer of the substitutional portion of EPF liabilities and changes to the pension system. Accrued expenses decreased ¥2.4 billion from ¥33.4 billion to ¥31.0 billion.

Total stockholders' equity increased ¥62.9 billion from ¥576.2 billion to ¥639.1 billion. Retained earnings increased ¥24.8 billion from ¥560.8 billion to ¥585.6 billion and accumulated other comprehensive loss decreased ¥38.7 billion from ¥90.4 billion to ¥51.7 billion.

Total assets amounted to ¥770.3 billion as of March 31, 2004, up ¥23.0 billion from ¥747.3 billion at the previous fiscal year-end. As of March 31, 2004, cash and cash equivalents were ¥227.2 billion, ¥56.6 billion higher than ¥170.6 billion a year ago. However, property, plant and equipment decreased ¥17.0 billion to ¥208.9 billion from ¥225.9 billion, and noncurrent deferred income taxes decreased ¥9.8 billion to ¥34.1 billion from ¥43.9 billion.

Total liabilities increased ¥0.7 billion, from ¥190.1 billion to ¥190.8 billion. Trade payables increased ¥2.9 billion, from ¥57.0 billion to ¥59.9 billion, accrued expenses increased ¥5.3 billion from ¥28.1 billion to ¥33.4 billion, and income taxes payables increased ¥3.6 billion, from ¥1.1 billion to ¥4.7 billion. Retirement and severance benefits decreased ¥11.5 billion, from ¥85.0 billion to ¥73.5 billion.

Total stockholders' equity increased ¥22.3 billion, from ¥553.9 billion to ¥576.2 billion. Retained earnings rose ¥34.9 billion, from ¥525.9 billion to ¥560.8 billion, while accumulated other comprehensive loss rose ¥11.6 billion, from ¥78.8 billion to ¥90.4 billion.

TDK has various pension plans covering its employees. The unfunded amount as of March 31, 2006 was ¥20.4 billion (\$175 million). As of March 31, 2006, ¥26.8 billion was accrued on the balance sheet as retirement and severance benefits, ¥2.0 billion less than a year ago.

TDK's policy is to utilize group funds for the development of its business, and to use loans from banks or other sources, if necessary, as a secondary method of financing.

Regarding TDK's capital expenditure plans, TDK's policy is to invest actively in targeted strategic fields to drive growth. Capital expenditures will be funded using internally generated funds.

TDK is planning capital expenditures of ¥70.0 billion in fiscal 2007, primarily for the expansion of production facilities and upgrading of facilities. Actual capital expenditures could differ from this forecast as a result of factors such as shifts in technology, demand, prices, competition, economic environments and foreign exchange rates.

Restructuring Costs

During the year ended March 31, 2006, TDK was fundamentally restructuring the recording media business. While reviewing the progress of the restructuring and future strategies of the recording media business, TDK looked for ways to re-strengthen the manufacturing of recordable CD & DVD foundations from various perspectives. However, a sharp drop in market prices of recordable CD & DVDs as well as the increased cost of natural resources has a material impact on the recording media business of TDK. Following further study, at a board meeting held on March 8, 2006, TDK management decided to withdraw from the manufacturing of recordable CD & DVDs, which should lead to an improvement and reform of its recording media business.

TDK accelerated its ODM business model for the current generation of recordable CD & DVD products and the third-party supply of such products following TDK's withdrawal. TDK also continued its R&D and manufacturing activities in Japan of the blue laser disc, a highly value-added product expected to grow in the near future. TDK has also concentrated its resources on strengthening data storage tape business, which is another core business.

With this decision, TDK shut down the production facilities at its European subsidiary, TDK Recording Media Europe S.A. in Luxembourg in April 2006. TDK recorded a restructuring charge of ¥6,825 million (\$58,333 thousand) which included a charge of ¥3,309 million (\$28,282 thousand) relating to employee termination benefits. As a result of the restructuring, a total of 350 regular employees were terminated through May 31, 2006. In addition, TDK recorded a restructuring charge of ¥2,594 million (\$22,171 thousand) relating to an impairment on property, plant and equipment in connection with the decision to shut down production facilities at its European subsidiary.

For a discussion of financial instruments, see Note 14 “Risk Management Activities and Derivative Financial Instruments”, Note 15 “Fair Value of Financial Instruments” and Note 6 “Short-Term and Long-Term Debt” in Item 17 “Financial Statements”.

C. Research and development, patents and licenses, etc.

R&D expenditures amounted to ¥45.5 billion (\$389 million), 5.7 percent of net sales in fiscal 2006; ¥36.3 billion, 5.5 percent of net sales in fiscal 2005; and ¥32.9 billion, 5.0 percent of net sales in fiscal 2004.

In its R&D activities, TDK continues to work on strengthening and expanding development of new products that respond to diversification in the electronics market. In particular, TDK is concentrating on next-generation recording-related products, micro electronics modules for mobile communications-related applications, and energy-efficient, environmentally friendly devices based on materials and design technologies. Furthermore, TDK is using its reservoir of technologies to conduct efficient R&D activities concentrating in three strategic areas: IT home electronic appliances; high-speed and large-capacity networks and car electronics.

In the electronic materials and components field, development themes include commercialization of Polymer PTC thermistor with TDK’s materials technologies, commercialization of 130Gbps PMR heads for HDDs and 100Gbps TMR heads for mobile communications applications. In the recording media field, TDK has made progress with research on post DVD generation products, including commercialization of Blu-ray discs. Furthermore, TDK commercialized thin-film Common-mode Filter with TDK’s thin-film technologies.

R&D at TDK is conducted by the Materials R&D Center, Advanced Process Technology Center, Devices Development Center, Production Engineering Development Center, Materials Analysis Center, Application Center, SQ Research Center and the R&D functions of each operating group. Each facility is developing new products and technologies in its respective area of responsibility. The Application Center devises the necessary application technologies with the aim of keeping TDK in step with market trends and customer needs. The Materials R&D Center is responsible for research in magnetic and dielectric materials that use powder metallurgy. The Advanced Process Technology Center facilitates the use of cutting-edge process technologies. The Devices Development Center conducts research in next-generation recording and communications technologies as well as new devices.

In terms of overseas R&D activities, TDK is conducting R&D in collaboration with leading universities in the U.S. and U.K., and overseas R&D subsidiaries are making use of local technological resources. In China, where TDK is aiming to establish and develop an operating base capable of supporting growth, R&D activities are being carried out in the area of electronic components and materials. In addition, consolidated subsidiary Headway Technologies, Inc. is developing next-generation HDD heads.

Although TDK has a variety of patents in Japan and other countries, and licenses from other companies, it believes that expiration of any one of its patents or licenses or related group of patents or licenses would not materially adversely affect its business activities. Total income from patents and licenses was ¥0.1 billion (\$1 million) in fiscal 2006, ¥0.5 billion in fiscal 2005 and ¥0.1 billion in fiscal 2004. TDK paid ¥7.1 billion (\$60 million) in fiscal 2006, ¥9.3 billion in fiscal 2005 and ¥8.1 billion in fiscal 2004 for patents and licenses, mainly royalties for licenses related to the recording devices business. TDK does not believe that acquisition of new proprietary patents or other companies' patents would have a material effect on operating results in the future.

D. Trend information

Economic environment

While the world economy is expected to continue growing for the medium-term, it is relatively unstable for the short-term, largely influenced by the U.S., where the economy continues to grow despite the backdrop of a burdensome current account deficit, and China, which continues to implement a high-growth policy. Among these risk factors are the specter of inflation caused by persistently high crude oil prices and raw materials costs, trade imbalances among major countries and volatile foreign exchange rates.

Under these economic circumstances, from a medium-term perspective, the electronics industry is expected to see the growth of digital home appliances; the convergence of information and communications, as typified by the increasingly diverse functions offered by mobile phones and advances in portable devices; and the greater use of electronics in motor vehicles. These trends are expected to result in a continued increase in demand for electronics components. TDK believes that this increase will create a large number of opportunities for its electronic components business and potential for growth.

The electronic components business is constantly subject to two sources of downward pressure on prices. One is price discounting pressure from finished products manufacturers, the customers of electronic component manufacturers. The other is competition among manufacturers of electronic components.

Demands for price discounts are the result of competition among finished product manufacturers being passed on to component manufacturers. As they compete with each other, consumer electronics manufacturers, customers of TDK, are constantly seeking ways to establish a competitive advantage. For example, these companies pursue strategies such as differentiating products by adding new functions to existing products, as well as securing a competitive edge through pricing. This sort of competition involving finished products tends to force companies to compete by launching new products, resulting in shorter product lifecycles and a greater risk of price declines.

TDK's electronic materials and components segment supplies products that are used mainly in digital home appliances, mobile phones and other consumer electronics as well as in automotive electronics. As such, this business is directly exposed to the effects of the competition outlined above. No change is foreseen in discounting pressure from customers in the coming years.

Electronic component manufacturers, as with other industries, compete with peer companies. Consumer electronics manufacturers commonly certify several suppliers so that companies need to compete for orders. A company's pricing strategy is a key element in determining the share of electronic components it supplies to finished product manufacturers. As a consequence, there is constantly downward pressure on prices.

The electronic components business thus requires the constant execution of initiatives to mitigate the effect of these pricing pressures. Actions to reduce costs are an obvious response. But it is also necessary to establish a position as a components manufacturer that can supply key components when customers launch new products. There is no substitute for product development activities aimed at supplying these key components.

Price declines are thus inevitable in the electronic components business, but it is possible to reduce or absorb the effects of lower prices by implementing the above measures appropriately, when required. We believe that these actions are an inherently vital element that will ultimately determine the competitiveness of an electronic components business.

Critical accounting policies

Critical accounting policies are those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

The following is not intended to be a comprehensive list of all of TDK's accounting policies. TDK's significant accounting policies are more fully described in Note 1 to the Consolidated Financial Statements. In many cases, the accounting treatment of a particular transaction is specifically dictated by U.S. generally accepted accounting principles, with no need for management's judgment in their application. There are also areas in which management's judgment in selecting an available alternative would not produce a materially different result.

TDK has identified the following as critical accounting policies: impairment of long-lived assets, valuation of inventories, goodwill and other intangible assets, pension benefit costs, and deferred tax assets.

Impairment of long-lived assets

As of March 31, 2006 and 2005, the aggregate of TDK's property, plant and equipment and amortized intangible assets was ¥270.3 billion (\$2,310 million) and ¥229.6 billion, which accounted for 29.3 percent and 28.4 percent of the total assets, respectively. TDK believes that impairment of long-lived assets are critical to TDK's financial statements because the recoverability of the amounts or lack thereof, could significantly affect its results of operations.

TDK's long-lived assets and certain identifiable intangibles are reviewed for impairment when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. This review is performed using estimates of future cash flows. If the carrying amount of the asset is considered to be impaired, an impairment charge is recorded for the amount by which the carrying value of an asset exceeds its fair value. Management believes that the estimates of future cash flows and fair values are reasonable; however, changes in estimates resulting in lower future cash flows and fair value due to unforeseen changes in business assumptions could negatively affect the valuation of those long-lived assets and significantly affect TDK's financial position and results of operations. TDK makes investments with due prudence, taking sufficiently into consideration the future profitability of products and the recoverability of investments.

Valuation of inventories

Inventories are stated at the lower of cost or market, with cost determined on the average cost method. The carrying value of inventory is reduced for estimated obsolescence by the difference between its cost and the estimated market value based upon assumptions about future demand. TDK evaluates the inventory carrying value for potential excess and obsolete inventory exposures by analyzing historical and anticipated demand. In addition, known and anticipated engineering change orders are evaluated against on-hand quantities for their potential obsolescence affects. As fluctuations in estimates, which become a standard in recognizing adjustments in the carrying values of inventory for expected obsolescence, are influential to business results of TDK, we conclude it as a critical accounting policy. If actual demand were to be substantially lower than estimated, additional inventory adjustments for excess or obsolete inventory may be required, which could have a material adverse effect on TDK's business, financial condition and results of operations.

Regarding the appropriateness of estimates in the past, TDK does not use a method based on various scenarios, but a method to reconsider every quarter by comparing estimate and actual results. For example, in the operation management of product sector with rapid development in technological innovation such as the recording devices sector, TDK revises the estimates of valuation of obsolete inventories arising from the timely response to customers' demands for high-efficiency products on a quarterly basis.

Purchase Accounting

We account for acquired businesses using the purchase method of accounting which requires that the assets acquired and liabilities assumed be recorded at the date of acquisition at their respective fair values. The judgments made in determining the estimated fair value assigned to each class of assets acquired, as well as asset lives, can materially impact net income of the periods subsequent to the acquisition through depreciation and amortization, and in certain instances by impairment charges, if the asset becomes impaired in the future.

In determining the estimated fair value for intangible assets, we typically utilize the income approach, which employs discounting of the projected future net cash flow using an appropriate discount rate that reflects the risk factors associated with the cash flow streams.

Determining the useful life of an intangible asset also requires judgment as different types of intangible assets will have different useful lives and certain assets may even be considered to have indefinite useful lives. Intangible assets determined to have an indefinite useful life have been reassessed periodically based on the factors prescribed in SFAS No. 142 including, but not limited to, the expected use of the asset by us, legal or contractual provisions that may affect the useful life or renewal or extension of the asset's contractual life without substantial cost, and the effects of demand, competition and other economic factors.

Goodwill and other intangible assets

Goodwill and other intangible assets that are determined to have an indefinite life are not amortized and are tested for impairment on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of these assets below their carrying amount. Fair value for these assets is determined using a discounted cash flow analysis, which is based on an authorized business plan. Management believes that the estimates of future cash flows and fair value are reasonable; however, changes in estimates resulting in lower future cash flows and fair value due to unforeseen changes in business assumptions could negatively affect the valuations.

Pension benefit costs

Employee pension benefit costs and obligations are dependent on assumptions used by actuaries in calculating such amounts. These assumptions include discount rates, retirement rates and mortality rates which are based upon current statistical data, as well as salary growth, long-term return on plan assets and other factors. Actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect TDK's recognized expense and recorded obligation in future periods. While TDK believes that its assumptions used are appropriate, differences in actual experience or changes in assumptions may affect TDK's benefit obligations and future expense.

In preparing its financial statements for fiscal 2006, TDK established a discount rate of 2.2 percent and an expected long-term rate of return of 2.7 percent on plan assets. In estimating the discount rate, TDK uses available information about rates of return on long-term corporate bonds currently available and expected to be available during the period to the maturity of the pension benefits. TDK established the expected long-term rate of return on plan assets based on management's expectations in respect of the long-term returns of the various plan asset categories in which it invests. Management developed expectations with respect to each plan asset category based on actual historical returns and its current expectations for future returns.

A decrease in the discount rate leads to an increase in actuarial pension benefit obligations that could lead to an increase in net periodic pension cost through amortization of unrecognized actuarial gain or losses. A 50 basis point decrease in the discount rate would increase the projected benefit obligation by approximately 10 percent.

An increase in the expected return on plan assets may decrease net periodic pension cost in the current year. For fiscal 2006, a 50 basis point decrease in the long-term rate of return would increase net benefit cost by approximately ¥0.9 billion. However, the difference between the expected return and the actual return on those assets could negatively affect net income in future years.

Deferred tax assets

TDK has significant deferred tax assets, which are subject to realizability assessment. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the planned reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes that it is more likely than not that all of the deferred tax assets less valuation allowance, will be realized. However, in the event future projections for income are not realized or are realized in lesser amounts, or in cases where management revises the assessment of the potential for realization of deferred tax assets based on other factors, deferred tax assets may be determined not to be realizable, which then would require TDK to increase a valuation allowance against the deferred tax assets resulting in additional income tax expenses.

New accounting pronouncements

New Accounting Standards

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151 (“SFAS 151”), “Inventory Costs – an amendment of Accounting Research Bulletin No. 43 (“ARB 43”), Chapter 4”. SFAS 151 amends the guidance in ARB 43, Chapter 4, “Inventory Pricing”, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS 151 requires that items such as idle facility expense, excessive spoilage, double freight and rehandling costs be recognized as current-period charges regardless of whether they meet the criterion of “so abnormal” as stated in ARB 43. In addition, SFAS 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred in fiscal periods beginning after June 15, 2005. TDK does not expect the adoption of SFAS 151 to have a material effect on TDK’s consolidated financial position and results of operations.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), “Share Based Payment” (“SFAS 123R”). SFAS 123R is a revision of SFAS 123, “Accounting for Stock Based Compensation”, and supersedes APB 25. SFAS 123R requires TDK to measure the cost of employee services received in exchange for equity awards based on the grant date fair value of the awards. The cost will be recognized as compensation expense over the vesting period of the awards. In April 2005, the Securities and Exchange Commission deferred the effective date of SFAS 123R to the beginning of the first annual period after June 15, 2005. TDK adopted SFAS 123R in the first quarter of fiscal 2007 and will continue to evaluate the impact of SFAS 123R on TDK’s consolidated financial position and results of operations. The pro forma information presented in Note 1(j) and Note 10 presents the estimated compensation charges under SFAS 123. TDK’s assessment of the estimated compensation charges is affected by TDK’s stock price as well as assumptions regarding a number of complex and subjective variables and the related tax impact. These variables include, but are not limited to, TDK’s stock price volatility and employee stock option exercise behaviors. TDK will recognize the compensation cost for stock-based awards issued after April 1, 2006 on a straight-line basis over the requisite service period for the entire award. In addition, TDK will recognize the unvested portion of the grant date fair value of awards issued prior to adoption based on the fair values previously calculated for disclosure purposes. At March 31, 2006, the aggregate value of unvested options, as determined using a Black-Scholes option pricing model, was ¥227 million. Upon adoption of SFAS 123R, this amount will be recognized over the remaining vesting period of these options.

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154 (“SFAS 154”), “Accounting Changes and Error Corrections – a replacement of Opinion of the Accounting Principle Board No. 20 (“APB 20”) and Statement of Financial Accounting Standards No. 3 (“SFAS 3”)”. SFAS 154 replaces APB 20, “Accounting Changes” and SFAS 3, “Reporting Accounting Changes in Interim Financial Statements”, and provides guidance on the accounting for and reporting of accounting changes and error corrections. SFAS 154 establishes retrospective application, or the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

In July 2006, the FASB issued FASB Interpretation No. 48 (“FIN 48”), “Accounting for Uncertainty in Income Taxes”. FIN 48 establishes the threshold for recognizing the benefits of tax-return positions in the consolidated financial statements as “more-likely-than-not” to be sustained by the taxing authority, and prescribes a measurement methodology for those positions meeting the recognition threshold. FIN 48 is effective the fiscal year beginning after December 15, 2006. TDK is currently evaluating the effect that the adoption of FIN 48 will have on TDK’s consolidated financial position and results of operations.

E. Off-Balance Sheet Arrangements

As part of its ongoing business, TDK does not conduct transactions with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which have been established for the purpose of facilitating off-balance sheet arrangements or other limited purposes.

F. Tabular Disclosure of Contractual Obligations

On March 31, 2006, commitments outstanding for the purchase of property, plant and equipment approximated ¥13.1 billion (\$112 million). TDK has entered into several purchase agreements with certain suppliers whereby TDK is committed to purchase a minimum amount of raw materials to be used in the manufacture of its products. Future minimum purchases remaining under the agreements approximated ¥4.5 billion (\$39 million) at March 31, 2006. Contingent liabilities for guarantees of loans of TDK's employees and affiliates amounted to approximately ¥5.7 billion (\$49 million).

Contractual obligations on March 31, 2006 are summarized as follows:

| | Payments Due by Period (Yen in millions) | | | | |
|---|--|---------------------|-----------------|-----------------|------------------|
| | Total | Less than 1 year | 1 to 3 years | 3 to 5 years | After 5 years |
| Contractual obligations: | | | | | |
| Long-term debt | ¥2,363 | 1,958 | 323 | 67 | 15 |
| Operating leases | 11,584 | 2,499 | 3,331 | 1,881 | 3,873 |
| Contributions to defined benefit plans | 6,315 | 6,315 | - | - | - |
| Purchase commitment of raw materials | 4,539 | 4,061 | 231 | 204 | 43 |
| Purchase commitment of property, plant and equipment | 13,088 | 13,088 | - | - | - |
| T o t a l | 37,889 | 27,921 | 3,885 | 2,152 | 3,931 |

G. Safe Harbor

This material contains forward-looking statements, including projections, plans, policies, management strategies, targets, schedules, understandings and evaluations, about TDK Corporation ("TDK") and its group companies (TDK and its group companies are referred to also as "TDK" where the context so requires). These forward-looking statements are based on the current forecasts, estimates, assumptions, plans, beliefs and evaluations of TDK in light of information currently available to it, and contain known and unknown risks, uncertainties and other factors. TDK therefore wishes to caution readers that, being subject to risks, uncertainties and other factors, TDK's actual results, performance, achievements or financial position could be materially different from any future results, performance, achievements or financial position expressed or implied by these forward-looking statements, and TDK undertakes no obligations to publicly update or revise any forward-looking statements after the issue of this material.

The electronics markets in which TDK operates are highly susceptible to rapid changes. Risks, uncertainties and other factors that can have significant effects on TDK include, but are not limited to, shifts in technology, fluctuations in demand, prices, interest and foreign exchange rates, and change in economic environments, conditions of competition, laws and regulations.

Item 6. Directors, Senior Management and Employees

A. Directors and senior management

Directors, corporate officers and corporate auditors of TDK as of June 29, 2006 and their respective business experience are listed below.

Directors

| <u>Name (Date of birth)</u> | <u>Position, responsibility and brief personal record</u> |
|--------------------------------------|--|
| Hajime Sawabe (Jan. 9, 1942) | Representative Director, Chairman and CEO – since June 2006 - Director of TDK since June 1996 - Appointed Representative Director, President and CEO in June 1998 |
| Takehiro Kamigama (Jan. 12, 1958) | Representative Director, President and COO – since June 2006 - Appointed General Manager of Data Storage Components Business Group in October 2001 - Corporate Officer of TDK since June 2002 - Appointed Senior Vice President of TDK in June 2003 - Appointed General Manager of Data Storage and Thin Film Technology Components Business Group in June 2003 - Appointed Director, Executive Vice President in June 2004 |
| Jiro Iwasaki (Dec. 6, 1945) | Director, Executive Vice President – since June 2006 In charge of General Manager of Administration Group and Environment - Director of TDK since June 1996 - General Manager of Administration Group and Environment since June 2002 - Appointed Senior Vice President in June 2002 |
| Shinji Yoko (Jan. 2, 1948) | Director, Senior Vice President – since June 2002 In charge of General Manager of Electronic Components Sales and Marketing Group - Director of TDK since June 1998 - Appointed Deputy General Manager of Electronic Components Business Group, General Manager of High Frequency Devices Division in April 2000 - General Manager of Electronic Components Sales and Marketing Group since June 2002 |

- Takeshi Nomura
(Mar. 8, 1952)
- Director, Senior Vice President – since June 2002
In charge of General Manager of Ferrite and Magnet Products Business Group
- Director of TDK since 1998
 - Appointed General Manager of Materials Research Center, General Manager of Intellectual Properties Center in July 2002
 - Appointed General Manager of Materials Research Center, General Manager of Intellectual Properties Center, General Manager of Information Technology Research Center and Technology in July 2003
 - Appointed General Manager of Technology Group, General Manager of Intellectual Properties Center and Technology in January 2004
 - Appointed General Manager of Technology Group, General Manager of Intellectual Properties Center, General Manager of Devices Development Center and Technology in July 2004
 - General Manager of Ferrite and Magnet Products Business Group since April 2005
- Yasuhiro Hagihara
(Oct. 19, 1937)
- Director* – since June 2002
- Admitted to the bar in Washington D.C., U.S.A. in April 1971
 - Elected Partner of Graham & James L.L.P. in January 1979
 - Partner of Squire, Sanders & Dempsey L.L.P. since July 2000
 - Partner of Squire Sanders Gaikokuho Kyodo Jigyo Horitsu Jimusho since April 2005
- Seiji Enami
(Sep. 14, 1947)
- Director and CFO– since June 2005
In charge of General Manager of Finance and Accounting Department
- Appointed General Manager of Recording Media and Systems Business Group Industrial Sales Department in April 2000
 - General Manager of Finance and Accounting Department since April 2001
 - CFO of TDK since June 2004

Corporate Officers

| <u>Name (Date of birth)</u> | <u>Position, responsibility and brief personal record</u> |
|--------------------------------------|--|
| Kiyoshi Ito (May 28, 1944) | Corporate Officer, Senior Executive Vice President – since June 2006 In charge of General Manager of SCM Group and Production - Appointed General Manager of Electronic Components Business Group Capacitors Division in March 1999 - Appointed Director of TDK in June 2000 - Appointed General Manager of Circuit Devices Business Group in October 2001 - Appointed Corporate Officer, Senior Vice President of TDK in June 2002 - Appointed General Manager of Circuit Devices Business Group, General Manager of Ceramic Material Products Division in June 2002 - Appointed Executive Vice President in June 2004 - General Manager of SCM Group and Production since April 2005 |
| Takaya Ishigaki (Apr. 10, 1953) | Corporate Officer, Senior Vice President – since June 2005 In charge of General Manager of Circuit Devices Business Group, Capacitor Group Senior Manager - Appointed Deputy General Manager of Circuit Devices Business Group, Capacitor Group Senior Manager, General Manager of Multilayer Ceramics Manufacturing Department in October 2001 - Appointed Corporate Officer of TDK in June 2003 - General Manager of Circuit Devices Business Group, Capacitor Group Senior Manager since April 2005 |
| Minoru Takahashi (Feb. 12, 1948) | Corporate Officer, Senior Vice President – since June 2005 In charge of General Manager of Technology Group, General Manager of Devices Development Center and Technology, Intellectual Properties - Appointed General Manager of Sensors and Actuators Business Division, General Manager of Business Promotions Department in April 2002 - Appointed Corporate Officer of TDK in June 2003 - Appointed General Manager of Sensors and Actuators Business Group in November 2004 - General Manager of Technology Group, General Manager of Devices Development Center and Technology, Intellectual Properties since April 2005 |
| Michinori Katayama (Dec. 9, 1946) | Corporate Officer, Senior Vice President – since June 2006 In charge of General Manager of Corporate Communications Department - General Manager of Corporate Communications Department since January 1999 - Appointed Corporate Officer in June 2002 |

- Yukio Hirokawa
(Feb. 19, 1947)
- Corporate Officer – since June 2002
In charge of General Manager of Network Devices Business Group
- Appointed Associate Director, Electronic Components Sales and Marketing Group East Japan Sales Department Senior Manager in June 2000
 - Appointed Associate Director, CRM Group Strategic Sales Department Senior Manager in April 2001
 - Appointed Associate Director, Deputy General Manager of Network Devices Business Group in October 2001
 - General Manager of Network Devices Business Group since January 2002
- Masatoshi Shikanai
(Oct. 3, 1949)
- Corporate Officer – since June 2002
In charge of General Manager of Recording Media and Solutions Business Group
- Appointed General Manager of Recording Media and Systems Business Group Europe Division in April 2000
 - Appointed Deputy General Manager of Recording Media and Systems Business Group in February 2001
 - General Manager of Recording Media and Solutions Business Group since October 2001
- Kenryo Namba
(Jan. 6, 1947)
- Corporate Officer – since June 2002
In charge of Deputy General Manager of Technology Group, General Manager of Material Analysis Center and Organic Materials
- Appointed General Manager of Corporate Research and Development Center in April 2001
 - Appointed Deputy General Manager of Technology Group, General Manager of Devices Development Center, General Manager of Material Analysis Center in January 2004
 - Deputy General Manager of Technology Group, General Manager of Material Analysis Center and Organic Materials since July 2004
- Raymond Leung
(Apr. 18, 1956)
- Corporate Officer – since June 2004
In charge of General Manager of China Operation Group, Vice Chairman of SAE Magnetics (H.K.) Ltd.
- Appointed President of SAE Magnetics (H.K.) Ltd. in October 2000
 - Appointed Deputy General Manager of Data Storage and Thin Film Technology Components Business Group in June 2004
 - General Manager of China Operation Group, Vice Chairman of SAE Magnetics (H.K.) Ltd. since April 2005
- Shunji Itakura
(Nov. 15, 1947)
- Corporate Officer – since June 2005
In charge of General Manager of Display Business Department
- Appointed President of TDK (Malaysia) Sdn. Bhd. in January 1999
 - General Manager of Display Business Department since April 2001

Shiro Nomi
(May 8, 1949)

Corporate Officer – since June 2005

In charge of General Manager of Corporate Strategy Corporate Planning Department

- Appointed General Manager of Corporate Planning Department in October 2000
- General Manager of Corporate Strategy Corporate Planning Department since October 2001
- General Manager of Corporate Strategy Management Review & Support Department since April 2006

Shinichi Araya
(Mar. 7, 1952)

Corporate Officer – since June 2005

In charge of Deputy General Manager of Circuit Devices Business Group, Inductor Group Senior Manager

- Appointed General Manager of Mechatronics Division in January 1999
- Appointed General Manager of Mechatronics Division, General Manager of Production Engineering Development Department in April 2000
- Appointed Deputy General Manager of Production Engineering Development Center in April 2001
- Appointed General Manager of Production Engineering Development Department in October 2001
- Deputy General Manager of Circuit Devices Business Group, Inductor Group Senior Manager since April 2002

Corporate Auditors

| <u>Name (Date of birth)</u> | <u>Position, responsibility and brief personal record</u> |
|------------------------------------|--|
| Masaaki Miyoshi (Sep. 3, 1947) | Corporate Auditor – since June 2003 - Appointed President of Korea TDK Co., Ltd. in July 2000 |
| Takuma Otsuka (Feb. 23, 1944) | Corporate Auditor – since June 2000 - Appointed Director of TDK in June 1998 |
| Kazutaka Kubota (Oct. 11, 1942) | Corporate Auditor* – since June 2003 - Appointed Vice President of Asahi Bank, Ltd. in June 2000 - Appointed President of Asahigin Research Institute, Ltd. and Corporate Auditor of Saitama Railway Corporation in June 2002 |
| Kaoru Matsumoto (Dec. 8, 1947) | Corporate Auditor* – since June 2003 - Registration as a Certified Public Accountant in March 1976 - Establishment of Kaoru Matsumoto & Co. since November 1977 |
| Ryoichi Ohno (Nov. 3, 1958) | Corporate Auditor* – since June 2004 - Registration as a U.S. Certified Public Accountant in November 1988 - Appointed Senior Vice President and Chief Financial Officer of The Gibraltar Life Insurance Co., Ltd. in September 2001 - Finance Vice President of Prudential Financial Inc. since September 2001 - Executive Vice President and Chief Financial Officer of The Gibraltar Life Insurance Co., Ltd. since July 2005 |

Notes(*)

All of TDK's Directors (except Yasuhiro Hagihara), Corporate Officers and Corporate Auditors (except Kazutaka Kubota, Kaoru Matsumoto and Ryoichi Ohno) have been engaged on a full-time basis.

All Directors and Corporate Auditors are elected by the general meeting of shareholders. The term of office of Directors is one year. The current term of all Directors expires in June 2007. The term of office of Corporate Auditors is four years. The current terms for Mr. Miyoshi, Mr. Otsuka, Mr. Kubota, Mr. Matsumoto and Mr. Ohno expire in June 2007.

There are no family relationships between any Director or Corporate Officer or Corporate Auditor and any other Director or Corporate Officer or Corporate Auditor of TDK.

B. Compensation

- (1) The aggregate direct remuneration, including bonuses but excluding retirement allowances, paid by TDK during the years ended March 31, 2006 and 2005 to all Directors and Corporate Auditors of TDK who served during each of those years was approximately ¥250 million (\$2,137 thousand) and ¥254 million, respectively. During fiscal 2006, TDK's Directors and Corporate Officers as of June 29, 2006 received 126 and 130 stock acquisition rights as stock options, respectively. Each right represents an option to purchase 100 shares of common stock of TDK. Further details regarding the grants are listed below. For a discussion of other material terms of the issuance of these stock acquisition rights, please see Item 6.E. "Share ownership". TDK does not disclose individual remuneration for each Director and Corporate Auditor and aggregate direct remuneration for Corporate Officers except for compensation in the form of stock acquisition rights, because such disclosure is not required under Japanese regulations. Corporate Auditors do not receive stock acquisition rights.

| <u>Name</u> | <u>Position</u> | <u>Number of stock acquisition rights granted individually during fiscal 2006</u> |
|---------------------------|--|---|
| <u>Directors</u> | | |
| Hajime Sawabe | Representative Director, Chairman and CEO | 35 |
| Takehiro Kamigama | Representative Director, President and COO | 26 |
| Jiro Iwasaki | Director, Executive Vice President | 19 |
| Shinji Yoko | Director, Senior Vice President | 17 |
| Takeshi Nomura | Director, Senior Vice President | 17 |
| Yasuhiro Hagihara | Director (outside) | 2 |
| Seiji Enami | Director and CFO | 10 |
| | | <hr/> 126 |
| <u>Corporate Officers</u> | | |
| Kiyoshi Ito | Corporate Officer, Senior Executive Vice President | 24 |
| Takaya Ishigaki | Corporate Officer, Senior Vice President | 16 |
| Minoru Takahashi | Corporate Officer, Senior Vice President | 16 |
| Michinori Katayama | Corporate Officer, Senior Vice President | 10 |
| Yukio Hirokawa | Corporate Officer | 9 |
| Masatoshi Shikanai | Corporate Officer | 9 |
| Kenryo Namba | Corporate Officer | 9 |
| Raymond Leung | Corporate Officer | 10 |
| Shunji Itakura | Corporate Officer | 9 |
| Shiro Nomi | Corporate Officer | 9 |
| Shinichi Araya | Corporate Officer | 9 |
| | | <hr/> 130 |

- (2) When a Director or Corporate Auditor retires, a proposal to pay a lump sum retirement allowance is submitted to the general meeting of shareholders for approval. If shareholder approval is obtained, the amount of the retirement allowance for a Director or Corporate Auditor is determined in the case of the Director by the Board of Directors, and in the case of the Corporate Auditor by the Corporate Auditors, and generally reflects his/her prior positions, the length of his/her service as a Director or Corporate Auditor and his/her contribution to TDK's performance. The aggregate amount set aside as lump sum retirement allowance by TDK during fiscal 2006 and fiscal 2005 for Directors and Corporate Auditors of TDK totaled approximately ¥14 million (\$120 thousand) and ¥14 million, respectively. In June 2002, TDK introduced a Corporate Officer system to improve management efficiency and expedite decision-making. With the introduction of a Corporate Officer system (See Item 6.C. "Board practices"), the remuneration system at large was reviewed and a lump sum retirement allowance for Directors was abolished.

On June 27, 2002 the Board of Directors resolved that the retirement bonus remuneration system for Directors should be abolished from the date of the resolution and that the retirement bonus reserves which had been made for, and had not been paid to, the Directors who are reappointed at the general meeting of shareholders held on June 27, 2002, should be frozen until their respective retirements. The payment of any frozen retirement bonuses upon the retirement of a director shall be subject to the consent of a general meeting of shareholders.

TDK has a stock option plan for Directors, Corporate Officers and all other employees. See Item 6.E. "Share ownership".

C. Board practices

TDK's Articles of Incorporation provide for a Board of Directors of not more than ten members. Directors are elected at the general meeting of shareholders for a term of office of one year and may serve any number of consecutive terms. The Board of Directors has the ultimate responsibility for the administration of the affairs of TDK.

The Board of Directors may appoint from among the Directors referred to above one or more Representative Directors. Each of the Representative Directors has the authority to represent TDK generally in the conduct of its affairs.

TDK introduced a Corporate Officer system in June 2002 to improve management efficiency and expedite decision making. Corporate Officers are elected at the meeting of the Board of Directors held immediately after the ordinary general meeting of shareholders, for a term of one year, but may serve any number of terms upon appointment of the Board of Directors each time following the expiration of the term. The Board of Directors may elect from among Corporate Officers one or more Executive Vice Presidents, Senior Vice Presidents and Corporate Senior Officers. Each of the Corporate Officers has the authority individually to operate businesses of which he/she is in charge, under the control of the Board of Directors.

The Corporate Auditors of TDK, who are elected at the general meeting of shareholders and whose number must not exceed five, are not required to be certified public accountants. One or more Standing Corporate Auditor is required to be elected from among the Corporate Auditors. Each Corporate Auditor has the statutory duty to audit the financial statements and business reports to be submitted by the Representative Director to the ordinary general meeting of shareholders and also to audit the administration by the Directors. Each of the Corporate Auditors is required to attend and, if necessary, express his or her opinion at meetings of the Board of Directors, but is not entitled to vote. TDK established a Board of Corporate Auditors (at least half of which must be from outside TDK) and the term of each Corporate Auditor is four years.

In addition to the Corporate Auditors, TDK is required to appoint an accounting auditor which is required to be a certified public accountant or an auditing firm. The primary duty of an accounting auditor is to audit the financial statements proposed to be submitted by the Representative Director to the ordinary general meetings of shareholders for approval thereof, and to report their opinion to the Board of Corporate Auditors if they have found any wrongdoings or material facts which are in violation of laws and regulations or the Articles of Incorporation with respect to director's performance of its duties.

There are no family relationships between any Director or Corporate Officer or Corporate Auditor and any other Director or Corporate Officer or Corporate Auditor of TDK.

Significant differences in corporate governance practices between TDK and U.S. listed companies on the New York Stock Exchange

1. Directors' Independence

Under the Company Law of Japan (the "Company Law"), which became effective on May 1, 2006, TDK is a "Company with Board of Corporate Auditors," meaning a company which has the board of corporate auditors (*kansayaku-kai*). The Company Law allows a company to choose to be a "Company with Committees," meaning a company that has a nominating committee, audit committee, compensation committee and one or more executive officers, without having corporate auditors. However, TDK has not chosen to be a Company with Committees.

Under the New York Stock Exchange Corporate Governance Rules (the "Rules"), listed companies must have a majority of independent directors. By contrast, while the Company Law requires "Companies with a Board of Directors," meaning a company which has established or is required to establish a board of the directors, to have a minimum of three directors, it does not require that a Company with a Board of Corporate Auditors have outside directors. An "outside director" is defined as "a director who was not a managing director, executive officer, manager or employee of the company or any of its subsidiaries at any time in the past, and who is not currently a managing director, executive officer, manager or employee of the company or any of its subsidiary."

TDK is in compliance with the Company Law and has seven directors. In addition, although TDK is not required to have outside directors by law, it has voluntarily elected one outside director (Yasuhiro Hagihara).

2. Definition of "Independent Director"

The meaning of "outside director" under the Company Law is not exactly the same as the meaning of "independent director" provided under the Rules.

Under the Rules, no director qualifies as "independent" unless the board of directors affirmatively determines that the director has no material relationship with the listed company, either directly or as a partner, shareholder or officer of an organization that has a relationship with the company. Companies must identify which directors are independent and disclose the basis for that determination. In addition, a director is not independent if:

- The director is, or has been within the last three years, an employee of the listed company, or an immediate family member is, or has been within the last three years, an executive officer, of the listed company.
- The director has received, or has an immediate family member who has received, during any twelve-month period within the last three years, more than \$100,000 in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service).
- The director or an immediate family member is a current partner of a firm that is the company's internal or external auditor; the director is a current employee of such a firm; the director has an immediate family member who is a current employee of such a firm and who participates in the firm's audit, assurance or tax compliance (but not tax planning) practice; or the director or an immediate family member was within the last three years (but is no longer) a partner or employee of such a firm and personally worked on the listed company's audit within that time.

- The director or an immediate family member is, or has been within the last three years, employed as an executive officer of another company where any of the listed company's present executive officers at the same time serves or served on that company's compensation committee.
- The director is a current employee, or an immediate family member is a current executive officer, of a company that has made payments to, or received payments from, the listed company for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of \$1 million, or 2 percent of such other company's consolidated gross revenues.

By contrast, the Company Law provides that an “outside director” is “a director who was not a managing director, executive officer, manager or employee of the company or any of its subsidiaries at any time in the past, and who is not currently a managing director or executive officer, manager or employee of the company or any of its subsidiary.”

Mr. Yasuhiro Hagihara is an outside director within the meaning of the Company Law.

3. Corporate Auditors

TDK, a Company with Board of Corporate Auditors within the meaning of the Company Law, is required to have at least three corporate auditors. At least half of such corporate auditors must be outside auditors.

The Company Law provides that an “outside corporate auditor” is “a corporate auditor of the company who has not been a director, accounting officer (*kaikai sanyo*), executive officer, manager or other employee of such company or any of its subsidiaries at any time before their assumption of office as corporate auditor”. On the other hand, the Rules provide that all audit committee members satisfy the requirements for director independence.

Of the five TDK corporate auditors, three – Mr. Kazutaka Kubota, Mr. Kaoru Matsumoto and Mr. Ryoichi Ohno – are outside corporate auditors within the meaning of the Company Law.

4. Regularly Scheduled Sessions without Management

Japanese law does not require that TDK hold regular meetings without management as mentioned in the Rules. Since TDK is a Company with Board of Corporate Auditors, each of its corporate auditors and the board of directors audit/monitor the management, and such auditing/monitoring by the corporate auditors and the board of directors functions as TDK’s management-check system.

5. Nominating / Corporate Governance Committee

Whereas under the Rules, listed companies must have a nominating / corporate governance committee composed entirely of independent directors, under Japanese law, TDK, as a Company with Board of Corporate Auditors, is not required to establish a nominating committee. Thus, TDK currently does not have a nominating committee.

The Directors and Corporate Auditors of TDK must be appointed at a shareholders' meeting in accordance with the Company Law. The Company Law requires directors of a Company with Board of Corporate Auditors to obtain the consent of the board of corporate auditors if the directors desire to submit to a shareholders' meeting a proposal concerning the appointment of a corporate auditor. Also, the board of corporate auditors may demand that the directors include the appointment of a corporate auditor in the agenda of a shareholders' meeting or that the directors submit a proposal concerning the appointment of a corporate auditor who is recommended by the board of corporate auditors. In order to dismiss a corporate auditor, any such dismissal must be by special resolution of a general shareholders meeting.

6. Compensation Committee

Under the Rules, listed companies must have a compensation committee composed entirely of independent directors. On the other hand, Japanese law does not require TDK, a Company with Board of Corporate Auditors, to set up a compensation committee. TDK has, however, voluntarily established a compensation advisory committee (the "CAC"). The CAC is responsible for (i) investigating compensation levels for directors and executive officers, (ii) reviewing compensation systems, performance evaluation standards and the method of calculating compensation, and (iii) making proposals for compensation level for certain individuals. The CAC is authorized to make and submit proposals to the Board of Directors.

The CAC has three members: one outside director (Yasuhiro Hagihara), one non-outside director (Jiro Iwasaki) and an outside expert on compensation.

In the case of TDK, a Company with Board of Corporate Auditors, the Company Law and the Articles of Incorporation requires the following matters with respect to the amount of compensation for the Directors to be determined by the resolution of a shareholders' meeting:

- (1) With respect to any item of compensation in a definitive amount, such amount;
- (2) With respect to any item of compensation not in a definitive amount, a concrete method for the calculation thereof; and
- (3) With respect to non-monetary items as compensation, the specific contents thereof.

7. Audit Committee

Japanese law does not require TDK, a Company with Board of Corporate Auditors, to set up an audit committee, and TDK therefore has not established an audit committee. TDK, however, has established the board of corporate auditors pursuant to the Company Law (consisting of five corporate auditors including three outside corporate auditors) and this exempts TDK from Rule 10A-3 of the Securities Exchange Act of 1934, as amended, requiring companies to have an audit committee. This exemption is specifically provided by Rule 10A-3(c)(3) of the Securities Exchange Act of 1934, as amended, and applies to TDK because TDK meets all of the following elements that are enumerated:

- (i) TDK has a Board of Corporate Auditors (*kansayaku-kai*) established and selected pursuant to the Company Law;

- (ii) The Company Law requires the board of corporate auditors to be separate from the board of directors;
- (iii) Under the Company Law, the corporate auditors are not elected by management, but by the shareholders at a shareholders' meeting. In addition, no executive officer of TDK is a member of the board of corporate auditors;
- (iv) The Company Law prohibits a corporate auditor from serving as a director, manager or other employee of the company or any of its subsidiaries, or as an accounting officer (*kaikei sanyo*) or executive officer of any subsidiary of the company. The Company Law requires a Company with Board of Corporate Directors to have at least half of the auditors thereof must be an outside auditor as such term is defined in the Company Law. As such, the Company Law provide for the standards for independence of the board of corporate auditors from the management of TDK;
- (v) The Company Law provides that an accounting auditor (*kaikei kansanin*) must be appointed at a shareholders' meeting. However, it also provides that in order to submit a proposal concerning an appointment of an accounting auditor to a shareholders' meeting, the directors must obtain the consent of the Board of Corporate Auditors and that the Board of Corporate Auditors may demand that the directors include the appointment of an accounting auditor in the agenda of a shareholders' meeting or demand that the directors submit a proposal concerning the appointment of a certain accounting auditor who is recommended by the Board of Corporate Auditors. In addition, the Company Law provides that the Board of Corporate Auditors may dismiss an accounting auditor for causes such as breach of his or her duties that are enumerated in the Company Law. Further, pursuant to the Company Law and Company Accounting Regulations thereunder, the board of corporate auditors audit the financial statements separately from an audit by the accounting auditor, and if the board believes that the manner or result of an audit by the accounting auditors is not reasonable, it must indicate its objections and the reasons therefor in the audit report. To this end, a corporate auditor may, if necessary for the performance of his/her duties, request the accounting auditor to provide a report thereon. As such, in accordance with the Company Law, the Board of Corporate Auditors of TDK is responsible, to the extent permitted by law, for the appointment, retention and supervision of the work of a registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for TDK; and
- (vi) Under Japanese law, the establishment of the procedures for the receipt, retention, and treatment of complaints and the confidential, anonymous submission by employees is a responsibility of the board of directors, not the corporate auditors or the board of corporate auditors, and thus, the Board of Directors of TDK has established such procedures. Each Corporate Auditor of TDK may, however, investigate the status of such procedures at any time and state his/her opinion at a meeting of the Board of Directors if he/she considers it necessary. In addition, each Corporate Auditor of TDK has the authority to engage independent counsel and other advisers if such engagement is necessary to carry out his/her duties. Furthermore, each Corporate Auditor may require TDK to pay any and all expenses necessary for carrying out his/her duties, including compensation of any advisers employed by him/her and ordinary administrative expenses.

As discussed above, TDK has established a Board of Corporate Auditors pursuant to the Company Law (consisting of five corporate auditors including three outside corporate auditors), and therefore does not have an audit committee.

8. Corporate Governance Guidelines

Under the Rules, listed companies must adopt and disclose corporate governance guidelines. On the other hand, Japanese law does not require TDK to either adopt or disclose corporate governance guidelines, and thus TDK has not established such guidelines. However, TDK has disclosed “The Status Concerning Corporate Governance” in its Japanese Annual Securities Report in accordance with the Securities Exchange Law of Japan and regulations thereunder. Furthermore, in conjunction with the amendment (effective as of March 1, 2006) of the Regulations Concerning Listing of Securities issued by the Tokyo Stock Exchange, TDK has delivered to the Tokyo Stock Exchange a report titled “Report Concerning Corporate Governance”. Additionally, because the Company Law requires that Large Companies (a company with paid in capital of Five Hundred Million Japanese Yen (JPY 500,000,000) or more or debt of Twenty Billion Japanese Yen (JPY 20,000,000,000) or more) determine whether or not to establish internal control systems to ensure that the performance by directors of their duties comply with applicable laws and regulations and the articles of incorporation of such Large Company, and the internal control systems provided under the Regulations Concerning Enforcement of the Company Law to ensure the integrity of the business activities of a company (collectively referred to as the “Internal Control System”), the Board of Directors of TDK has, through resolution, determined upon the detailed content of a corporate governance system.

9. Code of Business Conduct and Ethics

Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers under the Rules. By contrast, although Japanese law does not require TDK to adopt or disclose a code of business conduct and ethics, TDK has voluntarily adopted and disclosed one. See Item 16B. “Code of Ethics”. Furthermore, TDK has incorporated such code of business conduct and ethics into the Internal Control System indicated in the preceding paragraph.

D. Employees

The following table lists the number of TDK full-time employees as of March 31, 2006, 2005 and 2004.

| As of March 31, 2006 | <u>Japan</u> | <u>Overseas</u> | <u>Total</u> |
|-------------------------------------|--------------|-----------------|--------------|
| Electronic materials and components | 7,697 | 42,419 | 50,116 |
| Recording media | 993 | 1,258 | 2,251 |
| Corporate | 1,516 | 40 | 1,556 |
| Total | 10,206 | 43,717 | 53,923 |

| As of March 31, 2005 | <u>Japan</u> | <u>Overseas</u> | <u>Total</u> |
|-------------------------------------|--------------|-----------------|--------------|
| Electronic materials and components | 6,938 | 26,112 | 33,050 |
| Recording media | 1,128 | 1,465 | 2,593 |
| Corporate | 1,436 | 36 | 1,472 |
| Total | 9,502 | 27,613 | 37,115 |

| As of March 31, 2004 | <u>Japan</u> | <u>Overseas</u> | <u>Total</u> |
|-------------------------------------|--------------|-----------------|--------------|
| Electronic materials and components | 7,147 | 25,204 | 32,351 |
| Recording media | 1,173 | 1,734 | 2,907 |
| Corporate | 1,524 | 22 | 1,546 |
| Total | 9,844 | 26,960 | 36,804 |

The increase in the number of employees compared with the previous fiscal year is principally attributable to the net increase in the number of employees of the electronic materials and components segment, as Lambda Power Business became subsidiaries of TDK that are included in the scope of new consolidation, and TDK increased the number of employees in order to respond to the increased orders.

TDK considers its employee relations to be excellent; there have been no significant strikes or labor disputes.

All full-time employees in Japan, except management and certain other personnel, must become union members. Approximately 76 percent of full-time employees of TDK are members of the TDK Labor Union, which is affiliated with ZENKIN RENGO. About 45 percent of the full-time employees of TDK and its domestic subsidiaries are members of unions affiliated with ZENKIN RENGO.

As is customary in Japan, TDK negotiates with the TDK Labor Union for annual wage increases, and twice a year for bonuses. TDK also renews the terms and conditions of labor contracts, other than those relating to wage and bonuses, every year.

E. Share ownership

The following table lists the number of shares (which exclude shares underlying stock acquisition rights) and shares underlying stock acquisition rights owned by the Directors, Corporate Officers and Corporate Auditors of TDK as of June 29, 2006. The total number of shares held is 27,500, and the total number of share underlying acquisition rights held is 282,100, as shown below, and these numbers constituted 0.2 percent of all outstanding shares as of such date.

| <u>Name</u> | <u>Position</u> | <u>Number of shares</u> | <u>Number of shares underlying stock acquisition rights</u> |
|--------------------|--|-------------------------|---|
| Hajime Sawabe | Representative Director, Chairman and CEO | 9,000 | 51,300 |
| Takehiro Kamigama | Representative Director, President and COO | 3,300 | 27,000 |
| Jiro Iwasaki | Director, Executive Vice President | 2,000 | 17,000 |
| Shinji Yoko | Director, Senior Vice President | 1,000 | 30,800 |
| Takeshi Nomura | Director, Senior Vice President | 1,000 | 31,000 |
| Yasuhiro Hagihara | Director (outside) | 1,000 | 2,500 |
| Seiji Enami | Director and CFO | 1,100 | 5,500 |
| Kiyoshi Ito | Corporate Officer, Senior Executive Vice President | 1,000 | 29,600 |
| Takaya Ishigaki | Corporate Officer, Senior Vice President | 800 | 9,900 |
| Minoru Takahashi | Corporate Officer, Senior Vice President | 200 | 9,900 |
| Michinori Katayama | Corporate Officer, Senior Vice President | 500 | 12,500 |
| Yukio Hirokawa | Corporate Officer | 1,400 | 16,700 |
| Masatoshi Shikanai | Corporate Officer | 300 | 12,500 |
| Kenryo Namba | Corporate Officer | 2,000 | 16,500 |
| Raymond Leung | Corporate Officer | 0 | 2,000 |
| Shunji Itakura | Corporate Officer | 600 | 3,300 |
| Shiro Nomi | Corporate Officer | 300 | 2,400 |
| Shinichi Araya | Corporate Officer | 0 | 1,700 |
| Masaaki Miyoshi | Full-time Corporate Auditor | 1,000 | - |
| Takuma Otsuka | Full-time Corporate Auditor | 1,000 | - |
| Kazutaka Kubota | Corporate Auditor (outside) | 0 | - |
| Kaoru Matsumoto | Corporate Auditor (outside) | 0 | - |
| Ryoichi Ohno | Corporate Auditor (outside) | 0 | - |
| Total | | 27,500 | 282,100 |

Stock option plans

TDK obtained approval of the Ordinary General Meeting of Shareholders held on June 29, 2006 regarding the issuance of stock acquisition rights as stock options for a stock-linked compensation plan (the Stock Acquisition Rights) to Directors. Upon approval, the Board of Directors adopted resolutions to issue an aggregate of 176 Stock Acquisition Rights, each representing a stock option to purchase 100 shares of common stock of TDK, to the 7 Directors. The Stock Acquisition Rights are exercisable during the period from August 6, 2006 to August 5, 2026. The amount to be paid by qualified persons upon the exercise of each Stock Acquisition Rights is set at ¥1 per share of common stock, which is subject to an adjustment in certain events, including but not limited to a stock split, stock dividend and issue of new shares at a price less than the current market price of the shares of TDK.

TDK obtained approval of the Ordinary General Meeting of Shareholders held on June 29, 2006 regarding the issuance of stock acquisition rights as stock options for a stock-linked compensation plan (the Stock Acquisition Rights) to Corporate Officers, pursuant to Articles 236, 238 and 239 of the Company Law (*Kaisha-ho*). Upon approval, the Board of Directors adopted resolutions to issue an aggregate of 153 Stock Acquisition Rights, each representing a stock option to purchase 100 shares of common stock of TDK, to the 10 Corporate Officers. The Stock Acquisition Rights are exercisable during the period from August 6, 2006 to August 5, 2026. The amount to be paid by qualified persons upon the exercise of each Stock Acquisition Rights is set at ¥1 per share of common stock, which is subject to an adjustment in certain events, including but not limited to a stock split, stock dividend and issue of new shares at a price less than the current market price of the shares of TDK.

TDK also obtained approval of the Ordinary General Meeting of Shareholders held on June 29, 2006 regarding the issuance of stock acquisition rights as stock options (the Stock Acquisition Rights) to select senior executives, pursuant to Articles 236, 238 and 239 of the Company Law. Upon approval, the Board of Directors adopted resolutions to issue an aggregate of 1,200 Stock Acquisition Rights, each representing a stock option to purchase 100 shares of common stock of TDK, to select senior executives of TDK, and the Directors and select senior executives of subsidiaries. The Stock Acquisition Rights are exercisable during the period from August 1, 2008 to July 31, 2012.

TDK obtained approval of the Ordinary General Meeting of Shareholders held on June 29, 2005 regarding the issuance of stock acquisition rights as share-based compensation stock options (the Stock Acquisition Rights) to Board members and Corporate Officers, pursuant to Articles 280-20 and 280-21 of the Japanese Commercial Code. Upon approval, the Board of Directors adopted resolutions to issue an aggregate of 246 Stock Acquisition Rights, each representing an option to purchase 100 shares of common stock of TDK, to the then 17 Directors and Corporate Officers of TDK. The Stock Acquisition Rights issued on June 30, 2005 are fully vested on date of issuance and are exercisable during the period from July 1, 2005 to June 30, 2025. The amount to be paid by qualified persons upon the exercise of each Stock Acquisition Rights is set at ¥1 (\$0.01) per share of common stock. Stock option related compensation cost of ¥186 million (\$1,590 thousand) has been recognized in fiscal 2006, representing the amount attributed to service rendered during the current period of the amount by which the market price of the underlying common stock exceeded the exercise price of stock options approved for issuance at the Ordinary General Meeting of Shareholders held in June 2005.

TDK obtained approval of the Ordinary General Meeting of Shareholders held on June 29, 2005 regarding the issuance of stock acquisition rights as stock options to select senior executives, pursuant to Articles 280-20 and 280-21 of the Japanese Commercial Code. Upon approval, the Board of Directors adopted resolutions to issue an aggregate of 906 Stock Acquisition Rights, each representing an option to purchase 100 shares of common stock of TDK, to the then 172 select senior executives of TDK, and the Directors and select senior executives of subsidiaries. The Stock Acquisition Rights issued on August 11, 2005 are exercisable during the period from August 1, 2007 to July 31, 2011. The amount to be paid by qualified persons upon the exercise of each Stock Acquisition Rights is set at ¥8,134 (\$69.52) per share of common stock, which was calculated by a formula approved by shareholders at the said annual shareholders meeting and is subject to an adjustment in certain events, including but not limited to a stock split, stock dividend and issue of new shares at a price less than the current market price of the shares of TDK. The exercise price of each Stock Acquisition Rights was equal to or greater than the fair market value of TDK's common stock on the date of grant.

To cover these options and share-based compensation stock options issued on June 30, 2005, TDK purchased on the Tokyo Stock Exchange ("TSE") a total of 115,200 common shares with an aggregate purchase price of ¥930 million (\$7,949 thousand) from August 17, 2005 through August 22, 2005.

TDK obtained approval of the Ordinary General Meeting of Shareholders held on June 29, 2004 regarding the issuance of stock acquisition rights as stock options, pursuant to Articles 280-20 and 280-21 of the Japanese Commercial Code. Upon approval, the Board of Directors adopted resolutions to issue an aggregate of 2,343 Stock Acquisition Rights, each representing a stock option to purchase 100 shares of common stock of TDK, to the then 187 Directors, Corporate Officers and select senior executives of TDK, and the Directors and select senior executives of its subsidiaries. The Stock Acquisition Rights are exercisable during the period from August 1, 2006 to July 31, 2010. The amount to be paid by qualified persons upon the exercise of each Stock Acquisition Rights was set at ¥8,147 per share of common stock. The exercise price of each Stock Acquisition Rights was equal to or greater than the fair market value of TDK's common stock on the date of grant. To cover these options TDK purchased on the TSE a total of 234,300 common shares with an aggregate purchase price of ¥1,656 million from August 9, 2004 through August 16, 2004.

TDK obtained approval of the Ordinary General Meeting of Shareholders held on June 27, 2003 regarding the issuance of stock acquisition rights as stock options, pursuant to Articles 280-20 and 280-21 of the Japanese Commercial Code. Upon approval, the Board of Directors adopted resolutions to issue an aggregate of 2,547 Stock Acquisition Rights, each representing a stock option to purchase 100 shares of common stock of TDK, to the then 179 Directors, Corporate Officers and select senior executives of TDK, and the Directors and select senior executives of its subsidiaries. The Stock Acquisition Rights issued on August 7, 2003 are exercisable during the period from August 1, 2005 to July 31, 2009. The amount to be paid by qualified persons upon the exercise of each Stock Acquisition Rights was set at ¥6,954 per share of common stock. The exercise price of each Stock Acquisition Rights was equal to or greater than the fair market value of TDK's common stock on the date of grant. To cover these options TDK purchased on the TSE a total of 260,000 common shares with an aggregate purchase price of ¥1,847 million from August 8, 2003 through August 18, 2003.

TDK obtained approval of the Ordinary General Meeting of Shareholders held on June 27, 2002 regarding the issuance of stock acquisition rights as stock options, pursuant to Articles 280-20 and 280-21 of the Japanese Commercial Code, as amended. Upon approval, the Board of Directors adopted resolutions to issue an aggregate of 2,236 Stock Acquisition Rights, each representing a stock option to purchase 100 shares of common stock of TDK, to the then 197 Directors, Corporate Officers and select senior executives of TDK, and the Directors and select senior executives of its subsidiaries. The Stock Acquisition Rights issued on August 9, 2002 are exercisable during the period from August 1, 2004 to July 31, 2008. The amount to be paid by qualified persons upon the exercise of each Stock Acquisition Rights was set at ¥5,909 per share of common stock. The exercise price of each Stock Acquisition Rights was equal to or greater than the fair market value of TDK's common stock on the date of grant. To cover these options TDK purchased on the TSE a total of 223,600 common shares with an aggregate purchase price of ¥1,209 million from August 12, 2002 through August 19, 2002.

The Ordinary General Meeting of Shareholders held on June 28, 2001 approved the implementation of TDK's stock option plan for Directors and certain employees of TDK, and the purchase of TDK's own shares for transfer to them under the plan, pursuant to Article 210-2 of Japanese Commercial Code. Stock options were provided to the then 12 Directors on the Board and 184 associate directors and officials in amounts ranging from 500 to 10,000 common shares each, at an exercise price of ¥6,114 per share. The exercise price of each Stock Acquisition Right was equal to or greater than the fair market value of TDK's common stock on the date of grant. To cover these options TDK purchased on the TSE a total of 158,000 common shares with an aggregate purchase price of ¥917 million from July 2, 2001 through July 23, 2001.

The Ordinary General Meeting of Shareholders held on June 29, 2000 approved the implementation of TDK's stock option plan for Directors and certain employees of TDK, and the purchase of TDK's own shares for transfer to them under the plan, pursuant to Article 210-2 of the Japanese Commercial Code. Stock options were provided to the then 13 Directors on the Board and 191 associate directors and officials in amounts ranging from 500 to 10,000 common shares each, at an exercise price of ¥15,640 per share. The exercise price of each Stock Acquisition Right was equal to or greater than the fair market value of TDK's common stock on the date of grant. To cover these options TDK purchased on the TSE a total of 170,400 common shares with an aggregate purchase price of ¥2,665 million from July 3, 2000 through August 2, 2000.

Employees (excluding Directors and Corporate Officers) Shareholding Association

As of March 31, 2006, the number of members of the TDK Employees Shareholding Association totaled 1,570. The Employees Shareholding Association accepts new memberships in March and September of every year. Members are entitled to purchase shares of TDK, the maximum amount being ¥50,000 a month. In addition, members have received a monthly subsidy equivalent to 5 percent of the purchase price of shares. The subsidy amounted to ¥18 million (\$156 thousand) for fiscal 2006. The total amount of TDK shares having voting rights owned by the TDK Employees Shareholding Association was as follows:

| <u>Title of class</u> | <u>Identity of person or group</u> | <u>Amount owned</u> | <u>Percent of class</u> |
|-----------------------|--|---------------------|-------------------------|
| Common stock | TDK Employees Shareholding Association | 486,210 shares | 0.37 % |

Item 7. Major Shareholders and Related Party Transaction

A. Major shareholders

The table below lists the number of TDK shares held by holders of 5 percent or more of TDK shares and their percentage ownership as of March 31, 2006:

| Name of major shareholder | Shares owned (in thousands) | Percentage |
|--|--------------------------------|------------|
| The Master Trust Bank of Japan, Ltd. (Trust account) | 14,660 | 11.00% |
| Japan Trustee Services Bank, Ltd. (Trust account) | 11,176 | 8.39% |

Major shareholders do not have voting rights different from other shareholders, subject to the limitation on exercise as set forth in “Item 10. B. Memorandum and Articles of Association – Common Stock – Voting rights.”

At March 31, 2006, there were 1,411,860 registered ADRs outstanding and 359 registered holders, of which 1,411,341 ADRs were held by 212 registered U.S. holders.

The Depository of ADRs of TDK is Citibank N.A. of New York.

TDK is not, directly or indirectly, owned or controlled by another corporation or by any foreign government.

B. Related party transaction

Since the beginning of TDK’s last full fiscal year, TDK has not transacted with, nor does TDK currently plan to transact with, a related party, except for transactions among TDK and its affiliates.

C. Interests of experts and counsel

Not applicable.

Item 8. Financial Information

A. Consolidated statements and other financial information

Consolidated financial statements

TDK's audited financial statements are included under Item 17 "Financial Statements". Except for TDK's financial statements included under Item 17, no other information in this Annual Report has been audited by TDK's independent auditors.

Refer to Consolidated Financial Statements and Notes to Consolidated Financial Statements (See Item 17).

Export sales

Finished goods and materials sent out of Japan are mainly bound for consolidated subsidiaries of TDK, and are not, therefore, recorded as exports on a consolidated basis. For this reason, the proportion of exports to total net sales is not significant.

Legal proceedings

There are no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which TDK or any of its subsidiaries is a party or of which any of their property is the subject.

Dividend policy

Returning earnings to shareholders is one of TDK's highest management priorities. Therefore, TDK's fundamental policy is to give consideration to a consistent increase in dividends based on factors such as the return on equity (ROE), dividends as a percentage of equity (DOE) and TDK's results of operations on a consolidated basis.

B. Significant changes

No significant change has occurred since the date of the annual consolidated financial statements.

Item 9. The Offer and Listing

A. Offer and listing details

The primary market for TDK's shares of common stock (Common Stock) is the Tokyo Stock Exchange (the "TSE"). The shares are traded on the First Section of that exchange and are also listed on the Osaka Securities Exchange in Japan. In addition, TDK's shares are listed on the New York Stock Exchange in the form of American Depositary Receipts ("ADRs"), on the Euronext Brussels Stock Exchange in the form of Bearer Depositary Receipts, and on the London Stock Exchange in the form of shares of TDK.

The following table sets forth for the periods indicated the reported high and low sales prices of TDK's shares of common stock on the TSE (both in yen and translated into U.S. dollars per American Depositary Share) and the reported high and low bid prices for American Depositary Shares of which each represents one share of common stock, as reported by the New York Stock Exchange.

| | Yen per share of Common stock (1) | | U.S. market price per American Depositary Share (2) | |
|----------------------------|--------------------------------------|------------|---|------------|
| | <u>High</u> | <u>Low</u> | <u>High</u> | <u>Low</u> |
| Annual highs and lows | | | | |
| Year ended March 31, 2002 | 8,670 | 4,800 | 69.00 | 40.00 |
| Year ended March 31, 2003 | 7,380 | 4,060 | 57.00 | 32.95 |
| Year ended March 31, 2004 | 8,350 | 3,810 | 77.86 | 32.40 |
| Year ended March 31, 2005 | 8,630 | 6,790 | 80.10 | 61.40 |
| Year ended March 31, 2006 | 10,230 | 7,250 | 85.40 | 62.50 |
| Quarterly highs and lows | | | | |
| Year ended March 31, 2005 | | | | |
| 1st quarter | 8,630 | 7,130 | 80.10 | 64.50 |
| 2nd quarter | 8,390 | 6,790 | 77.05 | 61.40 |
| 3rd quarter | 7,910 | 7,160 | 74.85 | 67.80 |
| 4th quarter | 7,880 | 7,050 | 75.93 | 68.40 |
| Year ended March 31, 2006 | | | | |
| 1st quarter | 8,020 | 7,250 | 74.35 | 68.02 |
| 2nd quarter | 8,740 | 7,480 | 79.25 | 67.05 |
| 3rd quarter | 10,230 | 7,530 | 85.40 | 62.50 |
| 4th quarter | 9,070 | 7,730 | 76.29 | 66.50 |
| Year ending March 31, 2007 | | | | |
| 1st quarter | 10,000 | 7,990 | 89.00 | 69.89 |
| Monthly highs and lows | | | | |
| January 2006 | 8,760 | 7,730 | 73.79 | 68.00 |
| February 2006 | 8,600 | 7,750 | 72.81 | 66.50 |
| March 2006 | 9,070 | 8,030 | 76.29 | 69.43 |
| April 2006 | 9,760 | 8,960 | 84.13 | 76.22 |
| May 2006 | 10,000 | 9,010 | 89.00 | 81.10 |
| June 2006 | 9,400 | 7,990 | 84.16 | 69.89 |

Notes:

- (1) As reported by the Tokyo Stock Exchange.
- (2) As reported by the New York Stock Exchange.

B. Plan of distribution

Not applicable.

C. Markets

See Item 9.A. "Offer and listing details".

D. Selling shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the issue

Not applicable.

Item 10. Additional Information

A. Share capital

Not applicable.

B. Memorandum and articles of association

The discussion below reflects the enactment of the Company Law, which became effective on May 1, 2006 and the latest amendments to TDK's Articles of Incorporation, which reflects the enactment of the Company Law and was approved by the ordinary general shareholders meeting held on June 29, 2006. The Company Law integrated into a single code formerly effective legislation regarding companies, including Chapters 2, 3 and 4 of the Commercial Code, the Limited Liability Company (*yugen kaisha*) Law and the Law for Special Provisions for the Commercial Code concerning Audits, etc. of Joint Stock Corporations (*kabushiki kaisha*), all of which were now abolished. In addition, the Company Law significantly changed traditional concepts and systems under the formerly effective Commercial Code and other laws in many respects.

Organization

TDK is a joint stock corporation (*kabushiki kaisha*) incorporated in Japan under the Commercial Code (*shoho*) of Japan. It is registered in the Commercial Register (*shogyo tokibo*) maintained by the Tokyo Legal Affairs Bureau (Registration Number: 0199-01-034849).

Objects and purposes

Article 2 of the Articles of Incorporation of TDK provides that its purpose is to engage in the following lines of business:

- Manufacture and sale of electric machinery and appliances;
- Manufacture and sale of magnetic materials such as ferrite and magnet;
- Manufacture and sale of electronic machinery and appliances such as automatic inserting machine for electronic components, automatic mounter for electronic components, and electronic measuring equipment and of components thereof;
- Manufacture and sale of recording media such as magnetic tape, floppy disk and optical disk and of data writing, reading and storage equipment therefor;
- Manufacture and sale of ceramic materials such as electricity inductive ceramics, piezoelectric ceramics, semiconductor ceramics and electricity insulating ceramics;
- Manufacture and sale of circuit components such as coil and transformers;
- Manufacture and sale of semiconductor;
- Manufacture and sale of stabilizing power supplies (units to stabilize electric current or voltage);
- Manufacture and sale of machinery and appliances for medical use and medical instruments and of components thereof;
- Manufacture and sale of single crystal materials and each product applying the same;
- Manufacture and sale of precious metals, precious stones, artificial precious stones and each product applying or utilizing the same;

- Manufacture and sale of outer wall materials of buildings and structures;
- Designing and contracting of construction work;
- Development, production, sale and grant of license of software;
- Manufacture, sale and contracting of applied product, machinery and tools and equipment of each of the foregoing; and
- Any and all businesses incidental or relating to each of the foregoing.

With respect to directors, TDK's Articles of Incorporation, bylaws and associated internal rules issued pursuant to the Articles provide in summary as follows:

- (a) a director is not entitled to vote on a proposal or arrangement or contract in which the director is materially interested;
- (b) the remuneration and retirement allowances for directors are determined at a general meeting of shareholders;
- (c) the Board of Directors have authority to approve long-term borrowing of ¥10 billion or more by resolution passed at a duly convened meeting of the Board of Directors. The Representative Director is authorized by the Board of Directors to make final decisions with respect to long-term borrowings in an amount less than ¥10 billion and short-term borrowings (including issuance of commercial paper);
- (d) there are no provisions requiring the mandatory retirement of directors at a specified age; and
- (e) share ownership is not required in order to be eligible to serve as a director.

Common Stock

General

Set forth below is information relating to TDK's Common Stock, including brief summaries of the relevant provisions of TDK's Articles of Incorporation and Share Handling Regulations, as currently in effect, and of the Company Law and related legislation.

In order to assert shareholders' rights against TDK, a shareholder must have its name and address registered on TDK's register of shareholders, in accordance with TDK's Share Handling Regulations. The registered beneficial holder of deposited shares underlying the ADSs is the Depository for the ADSs. Accordingly, holders of ADSs will not be able directly to assert shareholders' rights against TDK.

Authorized capital

Article 6 of the Articles of Incorporation of TDK provides that the total number of shares authorized to be issued by TDK is four hundred and eighty million (480,000,000) shares.

As of March 31, 2006, 133,189,659 shares of Common Stock without having any par value were issued, including 922,831 shares of treasury stock.

There is no concept of "par value" of shares of capital stock under the Company Law. Thus, all shares of capital stock of TDK have no par value.

Dividends

The Articles of Incorporation of TDK provides that the accounts shall be closed on March 31 of each year and that year-end dividends, if any, shall be paid to shareholders, beneficial shareholders and pledgees of record as of the end of such day. Under the Company Law and the Articles of Incorporation of TDK, TDK may fix a record date and, subject to certain limitation on the distributable surplus, pay dividends on retained earnings, if any, to shareholders, beneficial shareholders and pledgees of record as of that date from time to time by a resolution of a general meeting of shareholders. In addition, the Board of Directors may by its resolution declare an interim dividend pursuant to Article 454 paragraph 5 of the Company Law and the Articles of Incorporation of TDK to shareholders, beneficial shareholders and pledgees of record as of the end of each September 30, without shareholders' approval, but subject to the limitations described below. Dividends may be distributed in cash or in kind subject to certain conditions being met.

Under the Company Law, TDK is permitted to make a distribution of surplus to the extent that the aggregate book value of the assets to be distributed to shareholders does not exceed the distributable amount provided for by the Company Law and the ordinance of the Ministry of Justice as at the effective date of such distributable surplus.

The amount of surplus at any given time shall be the amount of TDK's assets and the book value of TDK's treasury stock after subtracting and adding the amounts of the items provided for by the Company Law and the ordinance of the Ministry of Justice.

In Japan, the ex-dividend date and record date for dividends precede the date of determination of the amount of the dividend. The price of shares generally goes ex-dividend on the third business day prior to the record date.

Stock splits

Under the Company Law, the Board of Directors of TDK may at any time make stock splits by its resolution. Generally, upon stock splits, shareholders will not be required to exchange share certificates held by them for new share certificates. In respect of shares deposited with the Japan Securities Depository Center, Inc. ("JASDEC"), new shares resulting from the stock split will automatically be deposited with JASDEC, and shareholders who directly possess share certificates will receive additional certificates representing the additional shares resulting from the stock split. Before a stock split, TDK must give public notice of the stock split, specifying the record date for the stock split, not less than two weeks prior to the record date.

Under the Company Law, the Board of Directors of TDK may increase the authorized share capital up to the number reflecting the rate of stock splits and amend the Articles of Incorporation of TDK without the approval of a shareholders' meeting.

Consolidation of shares

TDK may at any time consolidate shares issued into a smaller number of shares by a special resolution of a general meeting of shareholders. When a consolidation of shares is to be made, TDK must give public notice or notice to each shareholder that, within a period of not less than one month specified in the notice, share certificates must be submitted to TDK for exchange. The Director of TDK must disclose the reason for the consolidation of shares at the general meeting of shareholders.

General meeting of shareholders

The ordinary general meeting of shareholders of TDK for each fiscal year is normally held in June in each year in Chuo-ku, Tokyo, Japan (address of principal executive office) or any adjacent place thereto or in Ichikawa-shi, Chiba, Japan. In addition, TDK may hold an extraordinary general meeting of shareholders whenever necessary by giving notice of convocation thereof at least two weeks prior to the date set for the meeting.

Notice of convocation of a shareholders' meeting setting forth the place, time and purpose thereof, must be mailed to each shareholder having voting rights (or, in the case of a non-resident shareholder, to his or her standing proxy or mailing address in Japan) at least two weeks prior to the date set for the meeting. Under the Company Law, such notice may be given to shareholders by electronic means, subject to the consent by the relevant shareholders. The record date for an ordinary general meeting of shareholders is March 31 of each year.

Any shareholder or group of shareholders holding at least 3 percent of the total number of voting rights for a period of six months or more may require the convocation of a general meeting of shareholders for a particular purpose. Unless such shareholders' meeting is convened promptly or a convocation notice of a meeting which is to be held not later than eight weeks from the day of such demand is dispatched, the requiring shareholder may, upon obtaining a court approval, convene such shareholders' meeting.

Any shareholder or group of shareholders holding at least 300 voting rights or 1 percent of the total number of voting rights for a period of six months or more may propose a matter to be considered at a general meeting of shareholders by submitting a request to a Representative Director at least eight weeks prior to the date set for such meeting.

Voting rights

So long as TDK maintains the unit share system (see "*Unit*" share system, below) a holder of shares constituting one or more whole units is entitled to one voting right per unit of shares subject to the limitations on voting rights set forth in the following paragraph. Except as otherwise provided by law or by the Articles of Incorporation, a resolution can be adopted at a general meeting of shareholders by a majority of the number of voting rights of all the shareholders represented at the meeting. The Company Law and TDK's Articles of Incorporation provide, however, that the quorum for the election of Directors and Corporate Auditors shall not be less than one-third of the total number of voting rights of the shareholders who can exercise voting rights. TDK's shareholders are not entitled to cumulative voting in the election of Directors and Corporate Auditors. A company, partnership or other similar business enterprise that holds shares of TDK stock may not exercise its voting rights with respect to such TDK shares if TDK and its subsidiaries, either alone or together, hold shares or membership interests representing more than 25 percent of the voting power of such shareholder or has any relationship with such shareholder provided in the ordinance of the Ministry of Justice under which TDK may substantially control the management of such shareholder. Shareholders may exercise their voting rights through proxies, provided that the proxies are also shareholders holding voting rights. TDK's shareholders also may cast their votes in writing. Shareholders may also exercise their voting rights by electronic means when TDK decides to permit such method of exercising voting rights.

The Company Law provides that in order to amend the Articles of Incorporation and in certain other instances, including a reduction of stated capital, the removal of a Corporate Auditor, dissolution, merger or consolidation with a certain exception under which shareholders' resolution is not required, the transfer of the whole or an important part of the business, the taking over of the whole of the business of any other corporation with a certain exception under which shareholders resolution is not required, share exchange or share transfer for the purpose of establishing 100 percent parent-subsidiary relationships with a certain exception under which shareholders resolution is not required, splitting of the corporation into two or more corporations with a certain exception under which shareholders resolution is not required, or any offering of new shares at a "specially favorable" price (or any offering of stock acquisition rights to subscribe for or acquire shares of capital stock ("stock acquisition rights") or bonds with stock acquisition rights at a "specially favorable" exercise conditions or price) to any persons other than shareholders, the quorum shall be one-third of the total voting rights of all the shareholders and the approval by at least two-thirds of the voting rights of all the shareholders represented at the meeting is required (the "special shareholders resolutions").

Issue of additional shares and pre-emptive rights

Holders of TDK's shares of Common Stock have no pre-emptive rights under its Articles of Incorporation. Authorized but unissued shares may be issued at such times and upon such terms as the Board of Directors determines, subject to the limitations as to the offering of new shares at a "specially favorable" price mentioned under "*Voting rights*" above. The Board of Directors may, however, determine that shareholders shall be given subscription rights regarding a particular issue or transfer of shares, in which case such rights must be given on uniform terms to all shareholders as at a record date of which not less than two weeks' prior public notice must be given. Such subscription rights are nontransferable. However, a shareholder may be allotted stock acquisition rights without consideration thereto, and transfer such rights.

Subject to certain requirements, TDK may issue stock acquisition rights by a resolution of the Board of Directors. Holders of stock acquisition rights may exercise their rights to acquire a certain number of shares within the exercise period as prescribed in the terms of their stock acquisition rights. Upon exercise of stock acquisition rights, TDK will be obliged to issue the relevant number of new shares or alternatively to transfer the necessary number of existing shares held by it (treasury stock).

Liquidation rights

In the event of a liquidation of TDK, the assets remaining after payment of all debts and liquidation expenses and taxes will be distributed among shareholders in proportion to the respective numbers of shares of common stock held.

Record date

March 31 is the record date for TDK's year-end dividends. So long as TDK maintains in its Articles of Incorporation a provision for the unit of shares, the shareholders and beneficial shareholders who are registered as the holders of one unit of shares or more in TDK's registers of shareholders and/or beneficial shareholders at the end of each March 31 are also entitled to exercise shareholders' rights at the ordinary general meeting of shareholders with respect to the fiscal year ending on such March 31. September 30 is the record date for interim dividends. In addition, TDK may set a record date for determining the shareholders and/or beneficial shareholders entitled to other rights and for other purposes by giving at least two weeks' prior public notice.

The price of shares generally goes ex-dividends or ex-rights on Japanese stock exchanges on the third business day prior to a record date (or if the record date is not a business day, the fourth business day prior thereto), for the purpose of dividends or rights offerings.

Acquisition of TDK's own shares

TDK may acquire its own shares (i) by way of purchase on any Japanese stock exchange on which its shares are listed or by way of tender offer (pursuant to a resolution of the Board of Directors in accordance with the Articles of Incorporation of TDK), (ii) from a specific shareholder other than its subsidiary (pursuant to a special resolution of a general meeting of shareholders), or (iii) from its subsidiary (pursuant to a resolution of a meeting of the Board of Directors). In the case of (ii) above, any other shareholder may make a request directly to a representative director, five days prior to the relevant shareholder's meeting, to include such other shareholder as the seller of shares in the proposed purchase. However, the acquisition of its own shares at a price not exceeding the then market price provided under the ordinance of the Ministry of Justice will not trigger the right of any shareholder to include him/her as the seller of his shares in such proposed acquisition.

Any such acquisition of TDK's shares must satisfy certain requirements, including that the total amount of the purchase price may not exceed the amount of the distributable dividends. (See *Dividends* above)

Shares acquired by TDK may be held by it for any period or may be cancelled by resolution of the Board of Directors. TDK may also transfer to any person the shares held by it, subject to a resolution of the Board of Directors, and subject also to other requirements those applicable to the issuance of new shares including the limitation as to the offering of new shares at a "specially favorable" price mentioned in "*Voting Rights*" above. TDK may also utilize its treasury shares for the purpose of transfer to any person upon exercise of stock acquisition rights or for the purpose of acquiring another company by merger, share exchange or corporate split through exchange of treasury shares for shares or assets of the acquired company.

The Company Law generally prohibits any subsidiary of TDK from acquiring shares of TDK.

"Unit" share system

Pursuant to the Articles of Incorporation of TDK, 100 shares of TDK constitute one unit. Although the number of shares constituting a new unit is included in the Articles of Incorporation, any amendment to the Articles of Incorporation reducing (but not increasing) the number of shares constituting a unit or eliminating the provisions for the unit of shares may be made by the resolution of the Board of Directors rather than by the special shareholders resolution, which is otherwise required for amending the Articles of Incorporation. The number of shares constituting one new unit, however, cannot exceed 1,000.

—Voting rights under the unit share system

Under the unit share system, shareholders shall have one voting right for each unit of shares that they hold. Any number of shares less than a full unit will carry no voting rights.

—Share certificates for less than a unit

Unless TDK's Board of Directors adopts a resolution to eliminate the provision for the unit shares from the Articles of Incorporation or the shareholders amend the Articles of Incorporation by a special shareholders resolution to eliminate the provision not to issue share certificates for less than a unit of shares, a share certificate for any number of shares less than a unit will in general not be issued. As the transfer of shares normally requires the delivery of the share certificates therefor, any fraction of a unit for which no share certificates are issued is not transferable.

—Repurchase or sale by TDK of shares constituting less than a unit

A holder of shares constituting less than one unit may require TDK to purchase such shares, or sell such number of shares which, if combined with the shares already held by such holder, would constitute one unit of shares, at their market value in accordance with the provisions of the Share Handling Regulations of TDK.

—Effect of the unit share system on holders of ADRs

A holder who owns ADRs evidencing less than 100 ADSs will indirectly own less than a whole unit of shares of Common Stock. Although, as discussed above, under the unit share system holders of less than a unit have the right to require TDK to purchase their shares, holders of ADRs evidencing ADSs that represent other than integral multiples of whole units are unable to withdraw the underlying shares of Common Stock representing less than a unit and, therefore, are unable, as a practical matter, to exercise the rights to require TDK to purchase such underlying shares unless TDK's Articles of Incorporation are amended to eliminate the provision not to issue share certificates for the numbers of shares less than a unit. As a result, access to the Japanese markets by holders of ADRs through the withdrawal mechanism will not be available for dispositions of shares of Common Stock in lots less than a unit. The unit share system does not affect the transferability of ADSs, which may be transferred in lots of any size.

Reporting of substantial shareholdings

The Securities and Exchange Law of Japan and regulations thereunder require any person who has become, beneficially and solely or jointly, a holder of more than 5 percent of the total issued shares of capital stock of a company listed on any Japanese stock exchange to file with the Director-General of a competent Local Finance Bureau of the Ministry of Finance within five business days a report concerning such shareholdings.

A similar report must also be filed in respect of any subsequent change of 1 percent or more in any such holding or any change in material matters set out in reports previously filed, with certain exceptions. For this purpose, shares issuable to such person upon conversion of convertible securities or exercise of share subscription warrants or stock acquisition rights are taken into account in determining both the number of shares held by such holder and the issuer's total issued share capital. Copies of such report must also be furnished to the issuer of such shares and all Japanese stock exchanges on which the shares are listed.

Except for the general limitation under Japanese anti-trust and anti-monopoly regulations against holding of shares of capital stock of a Japanese corporation which leads or may lead to a restraint of trade or monopoly, and except for general limitations under the Company Law or TDK's Articles of Incorporation on the rights of shareholders applicable regardless of residence or nationality, there is no limitation under Japanese laws and regulations applicable to TDK or under its Articles of Incorporation on the rights of non-resident or foreign shareholders to hold the shares of Common Stock of TDK or exercise voting rights thereon.

There is no provision in TDK's Articles of Incorporation that would have an effect of delaying, deferring or preventing a change in control of TDK and that would operate only with respect to merger, consolidation, acquisition or corporate restructuring involving TDK.

C. Material contracts

All contracts entered into by TDK during the two years prior to the date of this annual report were entered into in the ordinary course of business.

D. Exchange controls

Japanese Foreign Exchange Regulations

The Foreign Exchange and Foreign Trade Law of Japan, frequently referred to as the Foreign Exchange Law, and the cabinet orders and ministerial ordinances thereunder govern the issuance of shares by companies and the acquisition and holding of shares by “exchange non-residents” and “foreign investors” under the Foreign Exchange Law.

Exchange non-residents are:

- individuals who do not reside in Japan; and
- corporations whose principal offices are not located in Japan.

Generally, branches and other offices located within Japan of non-resident corporations are regarded as exchange residents of Japan and branches and other offices of Japanese corporations located outside Japan are regarded as exchange non-residents of Japan.

Foreign investors are:

- individuals who do not reside in Japan;
- corporations which are organized under the laws of foreign countries or whose principal offices are located outside Japan; and
- corporations in which more than 50 percent of the shares are held by individuals who do not reside in Japan and/or corporations which are organized under the laws of foreign countries or whose principal offices are located outside Japan or a majority of the officers (or officers having the power of representation) are persons who do not reside in Japan.

Any individuals or corporations that do not correspond to any of the above may be regarded as a foreign investor when they acquire or hold shares on behalf of foreign investor.

Due to the amendments to the Foreign Exchange Law effective on April 1, 1998, all aspects of foreign exchange and foreign trade transactions that were previously subject to licensing or other prior notifications or approvals, with minor exceptions, were changed to require only post-transaction reporting. However, the Minister of Finance of Japan will have the power to impose licensing requirements for transactions in limited circumstances.

Potential Consequences Resulting from an Acquisition of Listed Shares

In the event that a foreign investor acquires shares of a Japanese company listed on a Japanese stock exchange ("listed shares") and if the foreign investor's direct and indirect total holdings are 10 percent or more of the issued shares of the company after the acquisition, the foreign investor must file a report of the acquisition with the Minister of Finance and any other competent Minister within 15 days from and including the date of such acquisition. However, in certain limited circumstances (including the case where the acquisition of the shares reaches 10 percent), a prior notification of such an acquisition must be filed with the Minister of Finance and any other competent Minister, who may then modify or prohibit the proposed acquisition. The acquisition of shares by exchange non-residents as a result of stock splits is not subject to any of the foregoing requirements.

Potential Consequences Resulting from Dividends and Proceeds of Sales

Under the current Foreign Exchange Law, dividends paid on, and the proceeds of sales in Japan of, shares held by exchange non-residents may, in general, be converted into foreign currency and repatriated abroad.

Potential Consequences Resulting from the Sale of Securities to Exchange Non-Resident

A Japanese resident is required to file a report with the Minister of Finance concerning the transfer of securities for value exceeding ¥100 million to an exchange non-resident within 20 days of the date of the transfer. If an exchange resident issues or offers its securities for value of ¥1 billion or more outside Japan, the exchange resident must file a report of the issuance or offering of securities with the Minister of Finance within 20 days of the date of the closing.

American Depositary Shares

The deposit of shares of Common Stock by a non-resident of Japan, the issuance of ADRs in exchange therefor and the withdrawal of the underlying shares of Common Stock upon surrender of ADRs are not subject to any formalities or restrictions referred to under "Potential Consequences Resulting from an Acquisition of Listed Shares" above, except where, as a result of such deposit or withdrawal, the aggregate number of shares held by the depositary (or its nominee) or the holder surrendering ADRs, as the case may be, would be 10 percent or more of the total outstanding shares of Common Stock, in which event the reporting to the Minister of Finance of Japan may be required as outlined in the second sentence under the same heading.

E. Taxation

Dividends, Stock Splits and Repurchase

Generally, a non-resident of Japan or a non-Japanese corporation is subject to Japanese withholding tax on dividends paid by Japanese corporations. Stock splits are not subject to Japanese income tax.

The rate of Japanese withholding tax applicable to dividends on TDK's shares paid by TDK to non-resident shareholders is 7 percent for dividends paid on or before March 31, 2008 and 15 percent thereafter, except for any individual shareholder who holds 5 percent or more of the issued shares, for whom the applicable rate is 20 percent.

Japan has income tax treaties, conventions or agreements which generally provide that the withholding tax rate may not exceed 15 percent for portfolio investors with, among others, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, New Zealand, Norway, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the United States. In case of the Japan-U.S. tax treaty, however, as a result of a recent amendment, the maximum withholding tax rate has been reduced, generally to 10 percent for portfolio investors effective from July 1, 2004. Under Japanese tax law, the maximum rate applicable under the tax treaties, conventions or agreements shall be applicable except when such maximum rate is more than the Japanese statutory rate.

TDK, as a Japanese corporation, may be obligated to withhold a certain amount from any payments by TDK to its shareholder that is a non-resident of Japan or a non-Japanese corporation. Specifically, according to Articles 212-1 and 212-2 of the Income Tax Law of Japan, TDK has the obligation to withhold the amount determined by the applicable tax rate from its dividends to such of its shareholders.

Acquisition or Disposal of Shares or ADRs

Gains derived by a non-resident of Japan or a non-Japanese corporation from the sale outside Japan of Shares or ADRs, or from the sale of Shares or ADRs within Japan by a non-resident of Japan or a non-Japanese corporation not having a permanent establishment in Japan are in general not subject to Japanese income tax.

Japanese inheritance and gift taxes at progressive rates may be payable by an individual who has acquired Shares or ADRs as a legatee, heir or donee.

F. Dividends and paying agents

Not applicable.

G. Statements by experts

Not applicable.

H. Documents on display

According to the Securities Exchange Act of 1934, as amended, TDK is subject to the requirements of informational disclosure. TDK files various reports and other information, including Form 20-F and Annual Reports, with the Securities Exchange Commission and the New York Stock Exchange. These reports may be inspected at the following sites.

Securities Exchange Commission:
100 F Street, NE, Washington D.C. 20549

New York Stock Exchange:
20 Broad Street, New York, New York 10005

Form 20-F is also available at the Electronic Data Gathering, Analysis, Retrieval system (EDGAR) website maintained by the Securities Exchange Commission.

Securities Exchange Commission Home Page:
<http://www.sec.gov>

I. Subsidiary information

Not applicable.

Item 11. Quantitative and Qualitative Disclosures about Market Risk

Market risk exposure

TDK is subject to market risk associated with changes in stock prices, interest rates and foreign currency exchange rates. Foreign exchange risk is considered as the primary market risk exposure. TDK has a policy for the procedures and controls to manage market risk sensitive instruments. In order to hedge interest rate risk and foreign currency exchange rate risk, TDK uses derivative financial instruments. TDK does not hold or issue derivative financial instruments for trading purposes.

Foreign exchange and interest rate risk

Forward exchange contracts and currency swap contracts have been entered into to hedge adverse effects of foreign currency exchange rate fluctuations mainly on foreign-currency-denominated trade receivables and foreign-currency-denominated forecasted transactions.

At March 31, 2006 and 2005, TDK and certain of its subsidiaries had forward exchange contracts to sell and buy foreign currencies (principally U.S. dollars and Japanese Yen) and currency option contracts for a contract amount of ¥17,726 million (\$151,504 thousand) and ¥28,990 million, respectively.

TDK and one of its subsidiaries had currency swaps and interest rate and currency swaps with certain financial institutions to limit their exposure to fluctuations in foreign exchange rates and interest rates involved mainly with loans made by TDK to its subsidiaries in a total amount of ¥11,067 million at March 31, 2005. These swaps require TDK and the subsidiary to pay principally euros and U.S. dollars and to receive Japanese yen at a specified rate on specific dates.

The following table provides information about TDK's derivative instruments related to foreign exchange risk as of March 31, 2006 and 2005.

| | 2006 | | | 2005 | | |
|---|-------------------|------------|--------------------------|-------------------|------------|--------------------------|
| | (millions of yen) | | Average contractual rate | (millions of yen) | | Average contractual rate |
| | Contract amounts | Fair value | | Contract amounts | Fair value | |
| Forward exchange contracts | | | | | | |
| To sell Euro / receive Yen | ¥ 5,669 | ¥ (4) | 141.73 | ¥ - | ¥ - | - |
| To sell USD / receive Yen | 1,183 | 12 | 118.30 | 4,295 | (88) | 105.00 |
| To sell CHF / receive Euro | - | - | - | 54 | - | 1.54 |
| Total | ¥ 6,852 | ¥ 8 | | ¥ 4,349 | ¥ (88) | |
| Currency option contracts | | | | | | |
| To sell USD / receive USD | ¥ 4,675 | ¥ (27) | 116.88 | ¥ 23,803 | ¥ (354) | 105.10 |
| To sell USD / receive Yen | 5,359 | 23 | 118.00 | | | |
| To sell Euro / receive Euro | 840 | (4) | 141.30 | 838 | (12) | 39.07 |
| Total | ¥ 10,874 | ¥ (8) | | ¥ 24,641 | ¥ (366) | |
| Currency and interest rate swaps contracts | | | | | | |
| To receive Euro / pay GBP | ¥ - | ¥ - | - | ¥ 2,041 | ¥ (10) | 0.69 |
| To receive Yen / pay Euro | - | - | - | 9,026 | (302) | 134.75 |
| Total | ¥ - | ¥ - | | ¥ 11,067 | ¥ (312) | |

TDK's exposure to market risk related to changes in interest rates relates primarily to its debt securities. TDK has debt securities with fixed rates. TDK, to the extent possible, plans to limit debt securities to short-term debt securities. TDK believes that the fair values of interest rate sensitive instruments as of March 31, 2006 and 2005, and potential, near-term losses affecting future earnings, fair values, and/or cash flows from reasonable near-term changes in interest rates are immaterial.

Stock price risk

TDK's exposure to market risk involving changes in stock prices relates only to its equity securities categorized as available-for-sale securities. TDK purchases equity securities for the purpose of acquiring technological information and as part of its sales strategy, and not as a means of investing surplus funds. The aggregate cost and fair value of these equity securities were ¥9.2 billion (\$79 million) and ¥12.1 billion (\$103 million) as of March 31, 2006, and ¥6.0 billion and ¥7.0 billion as of March 31, 2005, respectively. As of March 31, 2006, these securities mainly represented investments in companies in the transportation, communications and electronic equipment industries, and the cost and fair value of these equity securities were ¥8.8 billion (\$75 million) and ¥11.1 billion (\$95 million), respectively. As of March 31, 2005, these securities mainly represented investments in companies in the transportation, communications and electronic equipment industries, and the cost and fair value of the equity securities were ¥5.6 billion and ¥6.5 billion, respectively.

TDK's portfolio of equity securities, including available-for-sale securities, at March 31, 2006 and 2005, is as follows:

| 2006 | | | | 2005 | | | |
|----------------|--------------------------------|---------------------------------|------------|----------------|--------------------------------|---------------------------------|------------|
| Yen (Millions) | | | | Yen (Millions) | | | |
| Cost | Gross unrealized holding gains | Gross unrealized holding losses | Fair value | Cost | Gross unrealized holding gains | Gross unrealized holding losses | Fair value |
| ¥ 9,246 | 2,859 | 2 | 12,103 | 5,951 | 1,054 | - | 7,005 |

Item 12. Description of Securities Other than Equity Securities

A. Debt securities

Not applicable.

B. Warrants and rights

Not applicable.

C. Other securities

Not applicable.

D. American depositary shares

Not applicable.

PART 2

Item 13. Defaults, Dividend Arrearages and Delinquencies

None.

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

None.

Item 15. Controls and Procedures

(a) Disclosure controls and procedures

TDK's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of its "disclosure controls and procedures" (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of March 31, 2006 (the "Evaluation Date"), the end of the period covered by this Annual Report, have concluded that, as of the Evaluation Date, TDK's disclosure controls and procedures were adequate and effective and designed to ensure that material information relating to TDK and its consolidated subsidiaries is made known to the Chief Executive Officer and the Chief Financial Officer by others within TDK and its consolidated subsidiaries.

(b) Management's annual report on internal control over financial reporting

This requirement was "intentionally omitted pursuant to SEC Release No. 33-8345 dated March 2, 2005" and SEC Release No. 33-8618 dated September 22, 2005.

(c) Attestation report of the registered public accounting firm

This requirement was "intentionally omitted pursuant to SEC Release No. 33-8345 dated March 2, 2005" and SEC Release No. 33-8618 dated September 22, 2005.

(d) Changes in internal control over financial reporting

There were no changes in TDK's internal control over financial reporting that occurred during the period covered by this Annual Report that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

Item 16A. Audit Committee Financial Expert

The registrant, a foreign private issuer, has at least one "audit committee financial expert" serving on its audit committee. TDK's board of auditors has determined that Ryoichi Ohno qualifies as an "audit committee financial expert" as defined by the rules of SEC. Mr. Ohno is an outside corporate auditor within the meaning of the Special Audit Law. See *Significant differences in corporate governance practices between TDK and U.S. listed companies on the New York Stock Exchange* in Item 6.C. "Board practices". Mr. Ohno was registered as a U.S. Certified Public Accountant in 1988 and elected as one of TDK's corporate auditors at an Ordinary General Meeting of Shareholders held in June 2004. See Item 6.A. for additional information regarding Mr. Ohno.

Item 16B. Code of Ethics

TDK has established a code of business ethics ("TDK Code of Ethics") that applies to TDK's corporate officers and all TDK employees and is actively promoting ethical business practices on a worldwide basis. TDK amended the TDK Code of Ethics as of May 25, 2005 to revise the section pertaining to the civil rights of its employees and to add a new section regarding employment conditions. Both sections apply to TDK's corporate officers and all TDK employees. Please see Sections 2.2.3 and 2.2.4 of the TDK Code of Ethics. The TDK Business Ethics & CSR Committee (formerly named "TDK Business Ethics Committee") has been charged with the oversight of the ethics program at TDK. It has built a global ethics framework which encompasses domestic and overseas consolidated subsidiaries. Built into the framework is a direct communication means called the "helpline" for employees to report matters relating to business ethics issues and offer suggestions. The TDK Code of Ethics is attached as Exhibit 11.1 to this annual report. TDK has not granted a waiver or implicit waiver from any provision of the TDK Code of Ethics in the most recent fiscal year.

Item 16C. Principal Accountant Fees and Services

The following table discloses the aggregate fees accrued or paid to KPMG AZSA & Co. and KPMG International member firms for each of the last two fiscal years and briefly describes the services performed:

| | (Yen in millions) | |
|--------------------|-----------------------------|------------|
| | <u>Years ended March 31</u> | |
| | 2006 | 2005 |
| Audit fees | 609 | 323 |
| Audit-related fees | 131 | 36 |
| Tax fees | 279 | 211 |
| All other fees | 0 | 5 |
| Total | 1,019 | 575 |

Audit fees consist of fees for "Audit Services". "Audit Services" are professional services rendered by the Principal Auditor for the audit of TDK's annual financial statements and services that are normally provided by the Principal Auditor in connection with statutory and regulatory filings or engagements: (i) Services associated with statutory audits; and (ii) Services associated with U.S. SEC registration statements or other periodic filings.

Audit-related fees consist of fees for "Audit-Related Services". "Audit-Related Services" are professional services relating to the Audit Services: (i) Audits of employee benefit plans; (ii) Sarbanes-Oxley Act related assistance; and (iii) Financial due diligence.

Tax fees consist of fees for "Tax Services": (i) Federal and local tax compliance; (ii) Review of federal, local and international income, franchise, and other tax returns; (iii) Transfer pricing documentation assistance; and (iv) Domestic and foreign indirect taxes.

Audit and Non-Audit Services Pre-Approval Policy

Subject to the confirmation as stipulated below, no pre-approval of the Board of Directors, in the context of the United States Sarbanes-Oxley Act of 2002 ("Sarbox Act") or the U.S. SEC rules, is required for any non-audit services rendered by any Non-Outside Auditor. Any contracts involving such services shall be processed in the usual manner in accordance with the applicable laws, in-house rules or any other regulations.

Any person who wishes to retain a Non-Outside Auditor for non-audit services (“Retainer”) is not allowed to do so unless both of the following conditions are met:

- (i) The Retainer has received a letter of confirmation from such public accounting firm that the public accounting firm is neither the Outside Auditor nor a person associated with the Outside Auditor; and
- (ii) The Retainer has confirmed that such public accounting firm does not appear on the list of persons associated with the Outside Auditor, which is contained in the database system (“Pre-Approval Database”) within the TDK intranet system.

The foregoing letter of confirmation shall be regularly renewed at least once every 12 months and the manager of the Pre-Approval Database described in that Database shall update the list of associated persons to reflect changes or modifications as reported by the Outside Auditor.

The types of services generally described in above explanation for audit fees, audit-related fees and tax fees shall be pre-approved by the Board of Directors. Those services described are provided for the sake of establishing general criteria as to the types of services requiring pre-approval. The Board of Directors shall evaluate and determine whether or not to pre-approve each application for such services.

TDK is prohibited from causing the Outside Auditor to provide, and the Outside Auditor is prohibited from rendering such services generally described as follows: (i) Bookkeeping or other services related to the accounting records or financial statements of the audit client; (ii) Financial information systems design and implementation; (iii) Appraisal or valuation services, fairness opinions or contribution-in-kind reports; (iv) Actuarial services; (v) Internal audit outsourcing services; (vi) Management functions or human resources; (vii) Broker or dealer, investment adviser or investment banking services; (viii) Legal services and expert services unrelated to the audit; and (ix) Any other service that the Board of Directors determines, by regulation, is impermissible. When such an application is received, the Board of Directors must not pre-approve the application.

In accordance with the Sarbox Act and related SEC Rules, audit or non-audit services which do not fit in with any of the types generally described in above explanation for audit fees, audit-related fees and tax fees may have to be pre-approved by the Board of Directors. The Board of Directors shall evaluate and determine whether or not to pre-approve each application for such services.

TDK may engage the Outside Auditor to render an audit or non-audit service pursuant to this policy without obtaining individual pre-approval by the Board of Directors, provided that all of the following conditions are met:

- (i) the service to be rendered shall fall under any of the types listed in above explanation for audit fees, audit-related fees and tax fees;
- (ii) the engagement to render the service shall commence within one year from the time when the Board of Directors adopts this Policy;
- (iii) the fee for the service to be rendered shall be less than 20,000,000 yen (“Individual Fee Limit”); and
- (iv) the total amount of fees payable to the Outside Auditor by TDK on account of non-audit services with respect to any fiscal year shall not exceed the total amount of audit fees payable to the Outside Auditor by TDK with respect to such year (“Overall Fee Limit”).

The Appointed Director must confirm whether an audit or non-audit service to be rendered by the Outside Auditor meets the foregoing conditions. The Appointed Director also shall report to the Board of Directors all audit and non-audit services in which the Outside Auditor is engaged in accordance with this Section. The Board of Directors must appoint a director as the Appointed Director and after the appointment the Appointed Director must be listed in the Pre-Approval Database.

Any divisions or departments of TDK, which contemplate or attempt to receive audit or non-audit services from an Outside Auditor or Non-Outside Auditor, shall report its intention and submit designated information, using the Pre-Approval Database.

The Appointed Director must evaluate such audit or non-audit services to be rendered either by the Outside Auditor or Non-Outside Auditor reported electronically through the Pre-Approval Database and must confirm whether any given reported services requires pre-approval by the Board of Directors. The Appointed Director shall request pre-approval to the Board of Directors if pre-approval by the Board of Directors is required.

In making determination, the Board of Directors is required to consider the following:

- (i) Whether the Outside Auditor cannot function in the role of management;
- (ii) Whether the Outside Auditor cannot audit its own work; and
- (iii) Whether the Outside Auditor cannot serve in an advocacy role for its client.

The Board of Directors must not pre-approve, in the absence of strong countervailing considerations, non-audit services proposed to be performed by the Outside Auditor if the total amount of fees payable to the Outside Auditor by TDK on account of non-audit services with respect to any fiscal year exceeds the total amount of audit fees payable to the Outside Auditor by TDK with respect to such year.

Item 16D. Exemptions from Listing Standards for Audit Committees

TDK is relying on the general exemption contained in Rule 10A-3(c)(3) under the Exchange Act. Because of such reliance, TDK does not have an audit committee which can act independently and satisfy the other requirements of Rule 10A-3 under the Exchange Act.

According to Rule 10A-3 under the Exchange Act and NYSE listing standards, TDK's Board of Corporate Auditors acts in place of an audit committee. The Board of Corporate Auditors meets the following requirements of the general exemption contained in Rule 10A-3(c)(3):

- the Board of Corporate Auditors is established pursuant to the Company Law;
- as required by the Company Law, the Board of Corporate Auditors is separate from the Board of Directors;
- the Board of Corporate Auditors is not elected by the management of TDK and no executive officer of TDK is a member of the Board of Corporate Auditors;
- the Company Law provides for the standards for independence of the Board of Corporate Auditors from the management of TDK;
- in accordance with the Company Law, the Board of Corporate Auditors of TDK is responsible, to the extent permitted by law, for the appointment, retention and supervision of the work of a registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for TDK; and

- Under the Company Law, the establishment of the procedures for the receipt, retention, and treatment of complaints and the confidential, anonymous submission by employees is a responsibility of the board of directors, not the corporate auditors or the board of corporate auditors, and thus, the Board of Directors of TDK has established such procedures. In addition, each Corporate Auditor of TDK has the authority to engage independent counsel and other advisers if such engagement is necessary to carry out his/her duties. Furthermore, each Corporate Auditor may require TDK to pay any and all expenses necessary for carrying out his/her duties, including compensation of any advisers employed by him/her and ordinary administrative expenses.

TDK's reliance on Rule 10A-3(c)(3) does not, in its opinion, materially adversely affect the ability of its Board of Corporate Auditors to act independently and to satisfy the other requirements of Rule 10A-3.

Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table sets forth certain information with respect to TDK's purchases of our own shares during the year ended March 31, 2006.

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share (Yen) | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number of Shares that May Be Purchased Under the Plans or Programs |
|-----------------------------------|--------------------------------------|--|--|--|
| April 1 to April 30, 2005 | 194 | 7,497.89 | - | - |
| May 1 to May 31, 2005 | 146 | 7,551.51 | - | - |
| June 1 to June 30, 2005 | 216 | 7,824.31 | - | - |
| July 1 to July 31, 2005 | 242 | 7,727.31 | - | - |
| August 1 to August 31, 2005 | 555 | 8,049.78 | 115,200 | - |
| September 1 to September 30, 2005 | 296 | 8,382.84 | - | - |
| October 1 to October 31, 2005 | 273 | 8,055.71 | - | - |
| November 1 to November 30, 2005 | 165 | 8,401.52 | - | - |
| December 1 to December 31, 2005 | 625 | 9,542.42 | - | - |
| January 1 to January 31, 2006 | - | - | - | - |
| February 1 to February 28, 2006 | 246 | 8,234.43 | - | - |
| March 1 to March 31, 2006 | 108 | 8,711.30 | - | - |
| Total | 3,066 | 8,343.80 | - | - |

Note: Under the Company Law, a holder of shares constituting less than one full unit may request TDK to purchase such shares at their market value (See Item 10. Additional Information "Common Stock" "Unit" share system). All purchases described in the above table were made pursuant to such requests by shareholders excluding the reserve for stock option plans of the amount of 115,200 shares in August 2005.

PART 3

Item 17. Financial Statements

Index of Consolidated Financial Statements of TDK Corporation and subsidiaries:

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Schedules other than those listed above have been omitted as they are not applicable or the information is presented in the consolidated financial statements and related notes.

Financial statements of 50 percent or less owned persons accounted for by the equity method have been omitted as, in the aggregate, they do not meet the tests of a significant subsidiary at a 20 percent level as of or for the years ended March 31, 2006, 2005 and 2004.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
TDK Corporation:

We have audited the consolidated financial statements of TDK Corporation and subsidiaries as listed in the accompanying index. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule as listed in the accompanying index. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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.

The Company declined to present segment information for each of the years in the three-year period ended March 31, 2006. In our opinion, disclosures of segment and related information about the different types of business activities in which the company engages and the different economic environments in which it operates is required by U.S. generally accepted accounting principles. The omission of segment information results in an incomplete presentation of the Company's consolidated financial statements.

In our opinion, except for the omission of the segment information as discussed in the preceding paragraph, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of TDK Corporation and subsidiaries as of March 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended March 31, 2006, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

The accompanying consolidated financial statements as of and for the year ended March 31, 2006, have been translated into United States dollars solely for the convenience of the reader. We have audited the translation and, in our opinion, the consolidated financial statements expressed in yen have been translated into United States dollars on the basis set forth in Note 2 to the consolidated financial statements.

/s/ KPMG AZSA & Co.

Tokyo, Japan
May 23, 2006

Consolidated statements of income

For the years ended March 31, 2006, 2005 and 2004

| | Yen (Millions) | | | U.S. Dollars (Thousands) (Note 2) |
|--|-------------------|--|---------|---|
| | 2006 | 2005 | 2004 | 2006 |
| Net sales (Notes 20 and 24) | ¥795,180 | 657,853 | 655,792 | \$6,796,410 |
| Cost of sales (Note 24) | 585,780 | 484,323 | 476,407 | 5,006,666 |
| Gross profit | 209,400 | 173,530 | 179,385 | 1,789,744 |
| Selling, general and administrative expenses (Note 24) | 142,052 | 119,886 | 122,875 | 1,214,120 |
| Transfer to the government of the substitutional portion of Employees' Pension Fund (Note 8): | | | | |
| Subsidy from the government | - | (33,533) | - | - |
| Loss on settlement | - | 27,347 | - | - |
| Restructuring cost (Note 16) | 6,825 | - | - | 58,333 |
| Operating income | 60,523 | 59,830 | 56,510 | 517,291 |
| Other income (deductions): | | | | |
| Interest and dividend income | 3,605 | 1,692 | 1,189 | 30,812 |
| Interest expense | (149) | (967) | (323) | (1,274) |
| Equity in earnings of affiliates | 1,368 | 1,765 | 1,639 | 11,692 |
| Gain (loss) on securities, net (Note 4) | (286) | (142) | (1,093) | (2,444) |
| Foreign exchange gain (loss) | 948 | (856) | (3,064) | 8,103 |
| Other - net | 94 | (594) | 989 | 803 |
| | 5,580 | 898 | (663) | 47,692 |
| Income from continuing operations before income taxes | 66,103 | 60,728 | 55,847 | 564,983 |
| Income taxes (Note 7) | 21,057 | 23,284 | 12,133 | 179,974 |
| Income from continuing operations before minority interests | 45,046 | 37,444 | 43,714 | 385,009 |
| Minority interests, net of tax | 635 | 479 | 359 | 5,428 |
| Income from continuing operations | 44,411 | 36,965 | 43,355 | 379,581 |
| Discontinued operations (Note 21): | | | | |
| Loss from operations of discontinued business (including loss on disposal of ¥224 million in 2006) | 310 | 3,509 | 244 | 2,649 |
| Income tax expense | - | 156 | 1,010 | - |
| Loss from discontinued operations | 310 | 3,665 | 1,254 | 2,649 |
| Net income | ¥44,101 | 33,300 | 42,101 | \$376,932 |
| Amounts per share: | | | | |
| | | Yen (except number of common shares outstanding) | | U.S. Dollars (Note 2) |
| Income from continuing operations per share (Note 19): | | | | |
| Basic | ¥335.84 | 279.41 | 327.27 | \$2.87 |
| Diluted | 335.54 | 279.25 | 327.15 | 2.87 |
| Loss from discontinued operations per share (Note 19): | | | | |
| Basic | ¥(2.34) | (27.70) | (9.47) | \$(0.02) |
| Diluted | (2.34) | (27.69) | (9.46) | (0.02) |
| Net income per share (Note 19): | | | | |
| Basic | ¥333.50 | 251.71 | 317.80 | \$2.85 |
| Diluted | 333.20 | 251.56 | 317.69 | 2.85 |
| Weighted average basic common shares outstanding (in thousands) (Note 19) | 132,239 | 132,293 | 132,475 | |
| Weighted average diluted common shares outstanding (in thousands) (Note 19) | 132,355 | 132,376 | 132,523 | |
| Cash dividends paid during the year (Note 9) | ¥80.00 | 60.00 | 50.00 | \$0.68 |

See accompanying notes to consolidated financial statements.

Consolidated balance sheets

As of March 31, 2006 and 2005

| | Yen (Millions) | | U.S. Dollars (Thousands) (Note 2) |
|---|-------------------|-------------|---|
| ASSETS | 2006 | 2005 | 2006 |
| Current assets: | | | |
| Cash and cash equivalents | ¥239,017 | 251,508 | \$2,042,880 |
| Marketable securities (Note 4) | 56 | 1,609 | 479 |
| Trade receivables (Note 20): | | | |
| Notes | 7,899 | 6,133 | 67,513 |
| Accounts (Note 24) | 185,224 | 144,426 | 1,583,111 |
| Allowance for doubtful receivables | (4,064) | (2,560) | (34,735) |
| Net trade receivables | 189,059 | 147,999 | 1,615,889 |
| Inventories (Note 5) | 88,968 | 74,924 | 760,410 |
| Income tax receivables (Note 7) | 265 | 204 | 2,265 |
| Assets held for sale (Note 17) | 4,110 | 993 | 35,128 |
| Prepaid expenses and other current assets (Notes 7 and 24) | 45,278 | 33,366 | 386,992 |
| Total current assets | 566,753 | 510,603 | 4,844,043 |
| | | | |
| Investments in securities (Note 4) | 28,757 | 22,698 | 245,786 |
| | | | |
| Property, plant and equipment, at cost: | | | |
| Land | 21,790 | 20,097 | 186,239 |
| Buildings | 187,810 | 181,581 | 1,605,214 |
| Machinery and equipment | 482,398 | 445,636 | 4,123,060 |
| Construction in progress | 12,687 | 15,206 | 108,436 |
| | 704,685 | 662,520 | 6,022,949 |
| Less accumulated depreciation | (461,020) | (445,551) | (3,940,342) |
| Net property, plant and equipment | 243,665 | 216,969 | 2,082,607 |
| | | | |
| Goodwill (Note 18) | 19,453 | 9,210 | 166,265 |
| Intangible assets (Note 18) | 29,478 | 13,247 | 251,949 |
| Deferred income taxes (Note 7) | 7,287 | 8,633 | 62,282 |
| Other assets (Notes 8 and 12) | 28,110 | 26,641 | 240,256 |
| | ¥923,503 | 808,001 | \$7,893,188 |

See accompanying notes to consolidated financial statements.

| | Yen (Millions) | | U.S. Dollars (Thousands) (Note 2) |
|---|-------------------|---------------------|---|
| LIABILITIES AND STOCKHOLDERS' EQUITY | 2006 | 2005 | 2006 |
| Current liabilities: | | | |
| Short-term debt (Note 6) | ¥4,469 | - | \$38,197 |
| Current installments of long-term debt (Note 6) | 1,958 | 103 | 16,735 |
| Trade payables: | | | |
| Notes | 4,353 | 638 | 37,205 |
| Accounts (Note 24) | 80,336 | 61,454 | 686,632 |
| Accrued salaries and wages | 19,010 | 12,915 | 162,479 |
| Accrued expenses (Notes 16 and 24) | 43,524 | 31,065 | 372,000 |
| Income taxes payables (Note 7) | 9,155 | 19,283 | 78,248 |
| Liabilities held for sale (Note 17) | - | 92 | - |
| Other current liabilities (Note 7) | 6,817 | 5,307 | 58,265 |
| Total current liabilities | <u>169,622</u> | <u>130,857</u> | <u>1,449,761</u> |
| Long-term debt, excluding current installments (Note 6) | 405 | 81 | 3,462 |
| Retirement and severance benefits (Note 8) | 26,790 | 28,839 | 228,974 |
| Deferred income taxes (Note 7) | 5,314 | 751 | 45,419 |
| Other noncurrent liabilities | 4,979 | 3,244 | 42,555 |
| Total liabilities | <u>207,110</u> | <u>163,772</u> | <u>1,770,171</u> |
| Minority interests | 13,974 | 5,162 | 119,436 |
| Commitments and contingent liabilities (Notes 12 and 13) | | | |
| Stockholders' equity: | | | |
| Common stock | | | |
| Authorized 480,000,000 shares; | | | |
| issued 133,189,659 shares in 2006 and 2005; | | | |
| outstanding 132,266,828 shares in 2006 | | | |
| and 132,244,587 shares in 2005 | | | |
| | 32,641 | 32,641 | 278,983 |
| Additional paid-in capital | 63,237 | 63,051 | 540,487 |
| Legal reserve (Note 9) | 17,517 | 16,918 | 149,718 |
| Retained earnings (Note 9) | 618,259 | 585,557 | 5,284,265 |
| Accumulated other comprehensive income (loss) | (21,946) | (51,657) | (187,573) |
| | | | |
| | | (Notes 7, 8 and 11) | |
| Treasury stock at cost; 922,831 shares in 2006 | | | |
| and 945,072 shares in 2005 (Note 10) | (7,289) | (7,443) | (62,299) |
| Total stockholders' equity | <u>702,419</u> | <u>639,067</u> | <u>6,003,581</u> |
| | <u>¥923,503</u> | <u>808,001</u> | <u>\$7,893,188</u> |

Consolidated statements of stockholders' equity

For the years ended March 31, 2006, 2005 and 2004

U.S. Dollars

(Thousands)

Yen
(Millions)

(Note 2)

| | 2006 | 2005 | 2004 | 2006 |
|---|-----------------|----------------------|----------------|--------------------|
| Common stock: | | | | |
| Balance at beginning of period | ¥32,641 | 32,641 | 32,641 | \$278,983 |
| Balance at end of period | 32,641 | 32,641 | 32,641 | 278,983 |
| Additional paid-in capital: | | | | |
| Balance at beginning of period | 63,051 | 63,051 | 63,051 | 538,897 |
| Non-cash compensation charges under a stock option plan | 186 | - | - | 1,590 |
| Balance at end of period | 63,237 | 63,051 | 63,051 | 540,487 |
| Legal reserve (Note 9): | | | | |
| Balance at beginning of period | 16,918 | 16,497 | 15,953 | 144,598 |
| Transferred from retained earnings | 599 | 421 | 544 | 5,120 |
| Balance at end of period | 17,517 | 16,918 | 16,497 | 149,718 |
| Retained earnings (Note 9): | | | | |
| Balance at beginning of period | 585,557 | 560,756 | 525,919 | 5,004,761 |
| Net income | 44,101 | 33,300 | 42,101 | 376,932 |
| Cash dividends | (10,578) | (7,938) | (6,625) | (90,410) |
| Losses on sales of treasury stock | (222) | (140) | (95) | (1,898) |
| Transferred to legal reserve | (599) | (421) | (544) | (5,120) |
| Balance at end of period | 618,259 | 585,557 | 560,756 | 5,284,265 |
| Accumulated other comprehensive income (loss) | | | | |
| | | (Notes 7, 8 and 11): | | |
| Balance at beginning of period | (51,657) | (90,387) | (78,824) | (441,513) |
| Other comprehensive income (loss) for the period, net of tax | 29,711 | 38,730 | (11,563) | 253,940 |
| Balance at end of period | (21,946) | (51,657) | (90,387) | (187,573) |
| Treasury stock (Note 10): | | | | |
| Balance at beginning of period | (7,443) | (6,339) | (4,855) | (63,615) |
| Acquisition of treasury stock | (955) | (1,672) | (1,865) | (8,162) |
| Exercise of stock options | 1,109 | 568 | 381 | 9,478 |
| Balance at end of period | (7,289) | (7,443) | (6,339) | (62,299) |
| Total stockholders' equity | ¥702,419 | 639,067 | 576,219 | \$6,003,581 |
| Disclosure of comprehensive income: | | | | |
| Net income for the period | ¥44,101 | 33,300 | 42,101 | \$376,932 |
| Other comprehensive income (loss) for the period, net of tax (Note 11) | 29,711 | 38,730 | (11,563) | 253,940 |
| Total comprehensive income for the period | ¥73,812 | 72,030 | 30,538 | \$630,872 |

See accompanying notes to consolidated financial statements.

Consolidated statements of cash flows

For the years ended March 31, 2006, 2005 and 2004

| | Yen (Millions) | | | U.S. Dollars (Thousands) (Note 2) |
|---|-------------------|----------|----------|---|
| | 2006 | 2005 | 2004 | 2006 |
| Cash flows from operating activities: | | | | |
| Net income | ¥44,101 | 33,300 | 42,101 | \$376,932 |
| Loss from discontinued operations, net of tax | 310 | 3,665 | 1,254 | 2,649 |
| Income from continuing operations | 44,411 | 36,965 | 43,355 | 379,581 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | |
| Depreciation and amortization | 58,540 | 52,806 | 50,726 | 500,342 |
| Loss on disposal of property and equipment | 3,220 | 1,190 | 1,363 | 27,521 |
| Deferred income taxes | (696) | (5,532) | 1,858 | (5,949) |
| Loss (gain) on securities, net | 286 | 142 | 1,093 | 2,445 |
| Gain on sale of a subsidiary | - | (1,799) | (567) | - |
| Changes in assets and liabilities, net of effects of acquisition of businesses: | | | | |
| Increase in trade receivables | (16,886) | (7,343) | (7,680) | (144,325) |
| Decrease (increase) in inventories | (287) | 3,461 | (7,868) | (2,453) |
| Decrease (increase) in other current assets | (8,748) | 1,149 | (4,387) | (74,769) |
| Increase in trade payables | 7,101 | 245 | 8,200 | 60,692 |
| Increase (decrease) in accrued expenses | 12,347 | (2,496) | 8,878 | 105,530 |
| Increase (decrease) in income taxes payables, net | (10,689) | 14,464 | 5,704 | (91,359) |
| Increase (decrease) in retirement and severance benefits, net | 981 | 2,519 | 9,285 | 8,385 |
| Other - net | (462) | (522) | 4,059 | (3,949) |
| Net cash provided by operating activities | 89,118 | 95,249 | 114,019 | 761,692 |
| Cash flows from investing activities: | | | | |
| Capital expenditures | (73,911) | (61,005) | (44,471) | (631,718) |
| Proceeds from sale and maturity of investments in securities | 4,263 | 1,788 | 1,814 | 36,436 |
| Payment for purchase of investments in securities | (4,227) | (2,424) | (1) | (36,128) |
| Acquisition of businesses, net of cash acquired | (32,868) | (1,496) | - | (280,923) |
| Proceeds from sale of property, plant and equipment | 3,373 | 999 | 4,299 | 28,829 |
| Acquisition of minority interests | (2,587) | - | (366) | (22,111) |
| Proceeds from sale of a subsidiary | - | - | 1,523 | - |
| Proceeds from sale of discontinued operations | 1,538 | - | - | 13,145 |
| Other - net | (363) | (221) | (445) | (3,103) |
| Net cash used in investing activities | (104,782) | (62,359) | (37,647) | (895,573) |
| Cash flows from financing activities: | | | | |
| Proceeds from long-term debt | 269 | 218 | 69 | 2,299 |
| Repayment of long-term debt | (218) | (164) | (479) | (1,863) |
| Increase (decrease) in short-term debt, net | 3,688 | (330) | (1,047) | 31,521 |
| Proceeds from exercise of stock options | 887 | 428 | 286 | 7,581 |
| Cash paid to acquire treasury stock | (955) | (1,672) | (1,865) | (8,162) |
| Dividends paid | (10,578) | (7,938) | (6,625) | (90,410) |
| Other - net | (218) | (171) | (199) | (1,863) |
| Net cash used in financing activities | (7,125) | (9,629) | (9,860) | (60,897) |
| Cash flows of discontinued operations (Revised - Note 1(v)) | | | | |
| Operating cash flows: | (407) | (1,458) | 885 | (3,478) |
| Investing cash flows: | (4) | (166) | (123) | (34) |
| Financing cash flows: | - | - | - | - |
| Effect of exchange rate changes on cash and cash equivalents from discontinued operations | (3) | (1) | (1) | (26) |
| Net cash provided by (used in) discontinued operations | (414) | (1,625) | 761 | (3,538) |
| Effect of exchange rate changes on cash and cash equivalents | 10,712 | 2,717 | (10,669) | 91,555 |
| Net increase (decrease) in cash and cash equivalents | (12,491) | 24,353 | 56,604 | (106,761) |
| Cash and cash equivalents at beginning of period | 251,508 | 227,155 | 170,551 | 2,149,641 |
| Cash and cash equivalents at end of period | ¥239,017 | 251,508 | 227,155 | \$2,042,880 |

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Operations and Summary of Significant Accounting Policies

(a) Nature of Operations

TDK, a Tokyo-based company founded in 1935, is a multinational manufacturer of ferrite products and a producer of inductor, ceramic capacitors, magnetic head and other components and recording media. TDK's two business segments are electronic materials and components, and recording media, which accounted for 86.5 percent and 13.5 percent of net sales, respectively, for the year ended March 31, 2006. The main products which are manufactured and sold by the two business segments are as follows:

(i) Electronic materials and components products:

Ferrite cores, Multilayer chip capacitors, High-frequency components, Inductors, GMR heads, and Organic electroluminescent (EL) display

(ii) Recording media products:

Audio tapes, Video tapes, CD-Rs, MDs, DVDs, and Tape-based data storage media for computers

TDK sells electronic materials and components products to electric and communication equipment manufacturers and audio equipment manufacturers, mainly in Asia and Japan, and recording media products to distribution agents and audio equipment manufacturers, mainly in Japan, Europe, and North America.

(b) Basis of Presentation

TDK and its domestic subsidiaries maintain their books of account in conformity with financial accounting standards of Japan, and its foreign subsidiaries in conformity with those of the countries of their domicile.

The consolidated financial statements presented herein reflect certain adjustments, not recorded on the primary books of TDK and subsidiaries, to present the financial position, results of operations, and cash flows in conformity with U.S. generally accepted accounting principles (the "U.S. GAAP"). Such adjustments relate principally to accounting for retirement and severance benefits.

(c) Consolidation Policy

The consolidated financial statements include the accounts of TDK, its subsidiaries and those variable interest entities where TDK is the primary beneficiary under Financial Accounting Standards Board ("FASB") Interpretation No. 46 (revised December 2003) ("FIN 46R"), "Consolidation of Variable Interest Entities". All significant intercompany accounts and transactions have been eliminated in consolidation.

The investments in affiliates in which TDK's ownership is 20 percent to 50 percent and where TDK exercises significant influence over their operating and financial policies are accounted for by the equity method. All significant intercompany profits from these affiliates have been eliminated.

(d) Cash Equivalents

Cash equivalents include all highly liquid debt instruments purchased with an original maturity of three months or less.

(e) Allowance for Doubtful Receivables

The allowance for doubtful receivables is TDK's best estimate of the amount of probable credit losses in TDK's existing trade receivables. An additional reserve for individual receivables is recorded when TDK becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings or deterioration in a customer's operating results or financial position. If customer circumstances change, estimates of the recoverability of receivables would be further adjusted.

(f) Investments in Securities

TDK classifies its debt and equity securities into one of three categories: trading, available-for-sale, or held-to-maturity. Trading securities are bought and held principally for the purpose of selling them in the near term. Held-to-maturity securities are those securities in which TDK has the ability and intent to hold the security until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized holding gains and losses on trading securities are included in earnings. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of accumulated other comprehensive income (loss) until realized. As of March 31, 2006 and 2005, TDK did not hold any trading or held-to-maturity securities. Available-for sale securities, which mature or are expected to be sold in less than one year, are classified as current assets.

A decline in the fair value of any available-for-sale security below cost that is deemed to be other-than-temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether an impairment is other-than-temporary, TDK periodically reviews the fair value of available-for-sale securities for possible impairment by taking into consideration the financial and operating conditions of the issuer, the general market conditions in the issuer's industry, degree and period of the decline in fair value and other relevant factors.

Nonmarketable securities are recorded at cost, as fair value is not readily determinable. TDK periodically evaluates whether an event or change in circumstances may have a significant adverse effect on the fair value of the investment. Factors considered in accessing whether an indication of impairment exists include the financial and operating conditions of the issuer, the general market conditions in the issuer's industry and other relevant factors. If an indication of impairment is present, TDK estimates the fair value of nonmarketable securities. If the fair value is less than cost and the impairment is determined to be other-than-temporary, a nonmarketable security is written down to its impaired value through a charge to earnings.

(g) Inventories

Inventories are stated at the lower of cost or market. Cost is determined principally by the average cost method.

(h) Property, Plant and Equipment

Depreciation of property, plant and equipment is principally computed by the declining-balance method for assets located in Japan and of certain foreign subsidiaries and by the straight-line method for assets of other foreign subsidiaries based on the following estimated useful lives:

| | |
|-----------------------------------|---------------|
| Buildings | 3 to 60 years |
| Machinery and equipment | 2 to 22 years |

(i) Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards.

Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. TDK uses a specific identification method to release the residual tax effects associated with components of accumulated other comprehensive income resulting from a change in tax law or rate.

(j) Stock Option Plan

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148 (“SFAS 148”), “Accounting for Stock-Based Compensation - Transition and Disclosure”, which amends FASB Statement No. 123 (“SFAS 123”), “Accounting for Stock-Based Compensation”. SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. However, it gives an entity a choice of recognizing related compensation expense by adopting the fair value method or to continue to measure compensation using the intrinsic value-based method prescribed under Accounting Principles Board Opinion No. 25 (“APB 25”), “Accounting for Stock Issued to Employees”, the former standard. TDK has chosen to use the measurement principle prescribed by APB 25. As such, stock-based compensation cost is recognized by TDK only if the market price of the underlying common stock exceeds the exercise price on the date of grant. Accordingly, stock option related compensation cost of ¥186 million (\$1,590 thousand) has been recognized in fiscal 2006, representing the amount attributed to service rendered during the current period of the amount by which the market price of the underlying common stock exceeded the exercise price of stock options approved for issuance at the Ordinary General Meeting of Shareholders held in June 2005 (note 10). No compensation cost has been recognized in fiscal 2005 and fiscal 2004 for TDK’s stock based compensation plan.

The following table illustrates the effects on both income from continuing operations and net income if the fair-value-based method had been applied to all outstanding and unvested stock based awards with such costs recognized ratably over the vesting period of the underlying instruments.

| | Yen (Millions) | | | U.S. Dollars (Thousands) |
|--|-------------------|--------|--------|-----------------------------|
| | 2006 | 2005 | 2004 | 2006 |
| Income from continuing operations, as reported | ¥ 44,411 | 36,965 | 43,355 | \$ 379,581 |
| Add compensation expense recognized under intrinsic value method | 186 | - | - | 1,590 |
| Deduct total stock-based employee compensation expense determined under fair-value-based method for all awards | (607) | (438) | (330) | (5,188) |
| Pro forma income from continuing operations | ¥ 43,990 | 36,527 | 43,025 | \$ 375,983 |
| | | Yen | | U.S. Dollars |
| Basic income from continuing operations per share: | | | | |
| As reported | ¥ 335.84 | 279.41 | 327.27 | \$ 2.87 |
| Pro forma | 332.66 | 276.11 | 324.78 | 2.84 |
| Diluted income from continuing operations per share: | | | | |
| As reported | ¥ 335.54 | 279.25 | 327.15 | \$ 2.87 |
| Pro forma | 332.39 | 275.98 | 324.74 | 2.84 |

(p) Accounting for the Impairment or Disposal of Long-Lived Assets

Property, plant and equipment and certain identifiable intangibles with finite useful lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows (undiscounted and without interest charges) expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceed the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(q) Goodwill and Other Intangible Assets

Goodwill is not amortized, but instead is tested for impairment at least annually or more frequently if certain indicators arise. Intangible assets with finite useful lives are amortized over their respective estimated useful lives. Intangible assets determined to have an indefinite useful life are not amortized, but instead are tested for impairment until the life is determined to no longer be indefinite.

TDK conducts its annual impairment test in the fourth quarter of each fiscal year.

(r) Derivative Financial Instruments

TDK has elected not to apply hedge accounting. Accordingly, changes in the fair value of derivatives are recognized in earnings in the period of the changes.

(s) Net Income per Share

Basic net income per share has been computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during each year. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock of TDK. For the years ended March 31, 2006, 2005 and 2004, stock options to purchase 116,100 shares, 364,300 shares and 156,500 shares, respectively, were excluded from the calculation of diluted earnings per share as the effect would have been antidilutive.

(t) Revenue Recognition

TDK generates revenue principally through the sale of electronic materials & components and recording media under separate contractual arrangements for each. TDK recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred and title and risk of loss have been transferred to the customer, the sales price is fixed or determinable, and collectibility is probable.

Revenue from sales of electronic materials & components including electronic materials, electronic devices and recording devices is recognized when the products are received by customers based on the free-on board destination sales term. With regards to sales of electronic materials & components, TDK's policy is not to accept product returns unless the products are defective. The conditions of acceptance are governed by the terms of the contract or customer arrangement and those not meeting the predetermined specification are not recorded as revenue.

Revenue from sales of recording media products such as videotape and DVDs is also recognized when the products are received by customers based on the free-on board destination sales term.

TDK offers sales incentives through various programs to certain resellers and retailers. These sales incentives include product discounts, volume-based discounts, marketing development funds (“MDFs”), rebates and coupons, and are accounted for in accordance with the Emerging Issues Task Force Issue No. 01-9 “Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of Vendor’s Product)” (“EITF 01-9”). Generally, under EITF 01-9, consideration given by a vendor to a customer is presumed to be a reduction of the selling price of goods and services, and, therefore, should be recognized as a reduction of revenue in the vendor’s income statement. The presumption may be overcome based on certain factors. These sales incentives totaled to ¥13,479 million (\$115,205 thousand), ¥14,292 million and ¥15,089 million for the years ended March 31, 2006, 2005 and 2004, respectively.

A number of product discounts are based on a certain percentage off the invoice price predetermined by spot contracts or based on contractually agreed upon amounts with resellers and retailers. Product discounts are recognized as a reduction of revenue at the time the related revenue is recognized and amounted to ¥7,415 million (\$63,376 thousand), ¥7,194 million and ¥5,993 million for the years ended March 31, 2006, 2005 and 2004, respectively.

Volume-based discounts are provided only if the resellers and retailers achieve a specified cumulative level of revenue transactions in a year or less period. Liabilities are recognized as a reduction of revenue for the expected sales incentive at the time the related revenue is recognized and are initially based on the estimation of sales volume by using historical experience on an individual customer basis. Estimates of expected sales incentives are evaluated and adjusted periodically based on actual revenue transactions and forecasts for the balance of the year or incentive period. Volume-based discounts recognized as a reduction of revenue amounted to ¥2,646 million (\$22,615 thousand), ¥3,005 million and ¥2,982 million for the years ended March 31, 2006, 2005 and 2004, respectively.

MDFs are provided to certain resellers and retailers as a contribution to or a sponsored fund for customers’ marketing programs, such as customers’ coupons, catalog, sales contests and advertisements, mostly in the form of a subsidy. Under this program, we do not receive an identifiable benefit sufficiently separable from our customers. Accordingly, MDFs are accounted for as a reduction of revenue based on the annual contract or at the time TDK has incurred the obligation, if earlier, and amounted to ¥1,970 million (\$16,838 thousand), ¥2,631 million and ¥2,923 million for the years ended March 31, 2006, 2005 and 2004, respectively.

Consumer promotions mainly consist of coupons and mail-in rebates offered to end users, who are reimbursed by TDK to retailers or end users for the coupons or mail-in rebates redeemed. Liabilities are recognized at the time related revenue is recognized (or at the time of the offer if the sale to retailers occurs before the offer) for the expected number of coupons or mail-in rebates to be redeemed. TDK uses historical rates of redemption on similar offers for similar products to estimate redemption rates for current incentive offerings. Consumer promotions recognized as a reduction of revenue amounted to ¥995 million (\$8,504 thousand), ¥1,061 million and ¥2,446 million for the years ended March 31, 2006, 2005 and 2004, respectively.

TDK also provides slotting fees paid to certain retailers for putting TDK products at attractive areas or shelves in the store. Slotting fees are recognized as a reduction of revenue at the time TDK has incurred the obligation. Slotting fees recognized as a reduction of revenue amounted to ¥274 million (\$2,342 thousand), ¥205 million and ¥451 million for the years ended March 31, 2006, 2005 and 2004, respectively.

Additionally, TDK has advertising programs with certain resellers and retailers where TDK agrees to reimburse them for advertising cost incurred by them to put TDK products on their flyers, catalogs and billboards. TDK receives an identifiable benefit (advertising) in return for the consideration and that benefit is sufficiently separable because TDK could have purchased that advertising from other parties. Also, TDK can reasonably estimate the fair value of the benefit through obtaining sufficient evidence from the resellers and retailers in the form of the invoice issued by the third party providing the service to the resellers and retailers. Therefore, such advertising programs are expensed as selling, general and administrative expenses at the time TDK has incurred the obligation and amounted to ¥179 million (\$1,530 thousand), ¥196 million and ¥293 million for the years ended March 31, 2006, 2005 and 2004, respectively.

TDK allows limited right of returns in certain cases and reduces revenue for estimated future returns based upon historical experience at the time the related revenue is recorded.

Warranties offered on TDK's products are insignificant.

(u) New Accounting Standards Not Yet Adopted

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151 ("SFAS 151"), "Inventory Costs – an amendment of Accounting Research Bulletin No. 43 ("ARB 43"), Chapter 4". SFAS 151 amends the guidance in ARB 43, Chapter 4, "Inventory Pricing", to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS 151 requires that items such as idle facility expense, excessive spoilage, double freight and rehandling costs be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal" as stated in ARB 43. In addition, SFAS 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred in fiscal periods beginning after June 15, 2005. TDK does not expect the adoption of SFAS 151 to have a material effect on TDK's consolidated financial position and results of operations.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), "Share Based Payment" ("SFAS 123R"). SFAS 123R is a revision of SFAS 123, "Accounting for Stock Based Compensation", and supersedes APB 25. SFAS 123R requires TDK to measure the cost of employee services received in exchange for equity awards based on the grant date fair value of the awards. The cost will be recognized as compensation expense over the vesting period of the awards. In April 2005, the Securities and Exchange Commission deferred the effective date of SFAS 123R to the beginning of the first annual period after June 15, 2005. TDK adopted SFAS 123R in the first quarter of fiscal 2007 and will continue to evaluate the impact of SFAS 123R on TDK's consolidated financial position and results of operations. The pro forma information presented in Note 1(j) and Note 10 presents the estimated compensation charges under SFAS 123. TDK's assessment of the estimated compensation charges is affected by TDK's stock price as well as assumptions regarding a number of complex and subjective variables and the related tax impact. These variables include, but are not limited to, TDK's stock price volatility and employee stock option exercise behaviors. TDK will recognize the compensation cost for stock-based awards issued after April 1, 2006 on a straight-line basis over the requisite service period for the entire award. In addition, TDK will recognize the unvested portion of the grant date fair value of awards issued prior to adoption based on the fair values previously calculated for disclosure purposes. At March 31, 2006, the aggregate value of unvested options, as determined using a Black-Scholes option pricing model, was ¥227 million. Upon adoption of SFAS 123R, this amount will be recognized over the remaining vesting period of these options.

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154 ("SFAS 154"), "Accounting Changes and Error Corrections – a replacement of Opinion of the Accounting Principle Board No. 20 ("APB 20") and Statement of Financial Accounting Standards No. 3 ("SFAS 3")". SFAS 154 replaces APB 20, "Accounting Changes" and SFAS 3, "Reporting Accounting Changes in Interim Financial Statements", and provides guidance on the accounting for and reporting of accounting changes and error corrections. SFAS 154 establishes retrospective application, or the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. TDK does not expect the adoption of SFAS 154 to have a material effect on TDK's consolidated financial position and results of operations.

(v) Reclassifications

Certain reclassifications have been made to the prior year's consolidated financial statements to conform to the presentation used for the year ended March 31, 2006.

In 2006 TDK has separately disclosed the operating, investing and financing portions of the cash flows attributable to its discontinued operations, which in prior periods were reported on a combined basis as a single amount.

2. Financial Statement Translation

The consolidated financial statements are expressed in Japanese yen, the functional currency of TDK. Supplementally, the Japanese yen amounts as of and for the year ended March 31, 2006, have also been translated into U.S. dollar amounts, solely for the convenience of the reader, at the rate of ¥117=U.S.\$1, the approximate exchange rate on the Tokyo Foreign Exchange Market on March 31, 2006. This translation should not be construed as a representation that the amounts shown could be converted into U.S. dollars at such rate.

3. Foreign Operations

Amounts included in the consolidated financial statements relating to subsidiaries operating in foreign countries are summarized as follows:

| | Yen (Millions) | | | U.S. Dollars (Thousands) |
|------------|------------------|---------|---------|-----------------------------|
| | 2006 | 2005 | 2004 | 2006 |
| Net assets | ¥ 435,381 | 360,925 | 318,915 | \$ 3,721,205 |
| Net sales | 626,626 | 498,366 | 494,184 | 5,355,778 |
| Net income | 28,582 | 17,362 | 38,731 | 244,291 |

4. Marketable Securities and Investments in Securities

Marketable securities and investments in securities at March 31, 2006 and 2005, are as follows:

| | Yen (Millions) | | U.S. Dollars (Thousands) |
|----------------------------------|-----------------|--------|-----------------------------|
| | 2006 | 2005 | 2006 |
| Short-term marketable securities | ¥ 56 | 1,609 | \$ 479 |
| Long-term marketable securities | 13,042 | 7,094 | 111,470 |
| Nonmarketable securities | 596 | 1,555 | 5,094 |
| Investments in affiliates | 15,119 | 14,049 | 129,222 |
| | ¥ 28,813 | 24,307 | \$ 246,265 |

Marketable securities and investments in securities include available-for-sale securities. Information with respect to such securities at March 31, 2006 and 2005, is as follows:

As of March 31, 2006

| | Cost | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses | Fair Value |
|-------------------|-----------------|---|--|---------------|
| Yen (Millions): | | | | |
| Equity securities | ¥ 9,246 | 2,859 | 2 | 12,103 |
| Debt securities | 1,002 | - | 7 | 995 |
| | ¥ 10,248 | 2,859 | 9 | 13,098 |

As of March 31, 2005

| | Cost | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses | Fair Value |
|-------------------|----------------|---|--|--------------|
| Yen (Millions): | | | | |
| Equity securities | ¥ 5,951 | 1,054 | - | 7,005 |
| Debt securities | 1,698 | - | - | 1,698 |
| | ¥ 7,649 | 1,054 | - | 8,703 |

As of March 31, 2006

| | Cost | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses | Fair Value |
|---------------------------|------------------|---|--|----------------|
| U.S. Dollars (Thousands): | | | | |
| Equity securities | \$ 79,026 | 24,436 | 17 | 103,445 |
| Debt securities | 8,564 | - | 60 | 8,504 |
| | \$ 87,590 | 24,436 | 77 | 111,949 |

Debt securities classified as available-for-sale at March 31, 2006 mature in fiscal 2008 (weighted average remaining term of 1.7 years).

The proceeds from sale and settlement of available-for-sale securities are ¥4,263 million (\$36,436 thousand), ¥1,788 million and ¥1,814 million for the years ended March 31, 2006, 2005 and 2004, respectively. The gross realized gains on the sale and settlement of available-for-sale securities are ¥714 million (\$6,103 thousand), ¥377 million and ¥135 million for the years ended March 31, 2006, 2005 and 2004, respectively. TDK recorded a write-down of ¥1,000 million (\$8,547 thousand), ¥519 million and ¥1,228 million on certain available-for-sale securities and nonmarketable securities representing other-than-temporary declines in the fair value for the years ended March 31, 2006, 2005 and 2004, respectively.

At March 31, 2006, all of the available-for-sale securities with unrealized losses had been in a continuous unrealized loss position for less than 12 months.

The aggregate cost of nonmarketable securities accounted for under the cost method at March 31, 2006 and 2005 totaled ¥596 million (\$5,094 thousand) and ¥1,555 million, respectively, and, as of March 31, 2006 and 2005, those securities were not evaluated for impairment because (a) TDK did not estimate the fair value of those investments as it was not practicable to estimate the fair value of the investment and (b) TDK did not identify any events or changes in circumstances that might have had significant adverse effect on the fair value of those investments.

Investments in affiliates accounted for by the equity method consist of 26.1 percent of the common stock of Semiconductor Energy Laboratory Co., Ltd., a research and development company, 50.0 percent of the common stock of TMP Co., Ltd., a magnetic products manufacturing company, and five other affiliated companies, collectively, which are not significant. The difference between TDK's carrying value of investments in affiliates and its share of the underlying net equity in such affiliates substantially consists of unamortized amounts of equity-method goodwill of ¥1,231 million (\$10,521 thousand) as of both March 31, 2006 and 2005.

As of March 31, 2006 and 2005, certain debt securities in the amount of ¥989 million and ¥1,695 million, respectively were pledged as collateral for extended custom duty payments to Tokyo Customs.

5. Inventories

Inventories at March 31, 2006 and 2005, are summarized as follows:

| | Yen (Millions) | | U.S. Dollars (Thousands) |
|-----------------|-------------------|--------|-----------------------------|
| | 2006 | 2005 | 2006 |
| Finished goods | ¥ 36,826 | 30,819 | \$ 314,752 |
| Work in process | 23,490 | 21,633 | 200,769 |
| Raw materials | 28,652 | 22,472 | 244,889 |
| | ¥ 88,968 | 74,924 | \$ 760,410 |

The cost elements for finished goods and work in process include direct costs for materials such as primary materials and purchased semi-finished products, direct labor costs such as basic salaries, bonuses, and legal welfare expenses, direct costs such as expenses paid to subcontractors, and indirect manufacturing costs comprising material costs, labor costs and other overhead costs.

6. Short-Term and Long-Term Debt

Short-term debt and weighted average interest rates at March 31, 2006 and 2005, are as follows:

| | Yen (Millions) | | U.S. Dollars (Thousands) | Weighted average interest rate | |
|-----------------------------------|-------------------|------|-----------------------------|-----------------------------------|------|
| | 2006 | 2005 | 2006 | 2006 | 2005 |
| Short-term bank loans - unsecured | ¥ 4,469 | - | \$ 38,197 | 1.63% | - |

Long-term debt at March 31, 2006 and 2005, is set forth below:

| | Yen (Millions) | | U.S. Dollars (Thousands) |
|---|-------------------|------|-----------------------------|
| | 2006 | 2005 | 2006 |
| Loans from banks, unsecured, due fiscal 2007 (weighted average: 2006 - 0.96%) | ¥ 1,700 | - | \$ 14,530 |
| Loans from banks, secured, due fiscal 2009-2012 (weighted average: 2006 - 0.95%) | 345 | - | 2,949 |
| Lease obligation (weighted average: 2006 - 5.78%, 2005 - 4.05%) | 318 | 184 | 2,718 |
| | 2,363 | 184 | 20,197 |
| Less current installments | 1,958 | 103 | 16,735 |
| | ¥ 405 | 81 | \$ 3,462 |

The aggregate annual maturities of long-term debt outstanding at March 31, 2006, are as follows:

| | Yen (Millions) | U.S. Dollars (Thousands) |
|-----------------------|----------------|-----------------------------|
| Year ending March 31, | | |
| 2007 | ¥ 1,958 | \$ 16,735 |
| 2008 | 196 | 1,675 |
| 2009 | 127 | 1,086 |
| 2010 | 36 | 308 |
| 2011 | 31 | 265 |
| Later years | 15 | 128 |
| | <u>¥ 2,363</u> | <u>\$ 20,197</u> |

Short-term and long-term bank loans were made under general agreements that provide that under certain circumstances security and guarantees for present and future indebtedness will be given upon request of the bank, and that the bank shall have the right, as the obligations become due, or in the event of their default, to offset cash deposits against such obligations due to the bank.

Property, plant and equipment having a net book value of ¥2,264 million (\$19,350 thousand) is pledged as a collateral for long-term debt from banks.

There were no debt covenants, or cross-default provisions under TDK's financing arrangements. Furthermore, there were no subsidiary level dividend restrictions under the financing arrangements.

7. Income Taxes

TDK and its domestic subsidiaries are subject to a national corporate tax of 30 percent, an inhabitants tax of between 5.2 percent and 6.2 percent and a deductible enterprise tax of between 7.7 percent and 8.0 percent, which in the aggregate resulted in a statutory rate of approximately 40 percent for the years ended March 31, 2006 and 2005. For the year ended March 31, 2004, the deductible enterprise tax rate was between 9.6 percent and 10.1 percent, which in the aggregate resulted in statutory rate of approximately 41 percent.

Amendments to Japanese tax regulations were enacted into law on March 24, 2003. As a result of this amendment, the statutory income tax rate was reduced from approximately 41 percent to 40 percent effective from April 1, 2004. Current income taxes were calculated at the rate of 40 percent, in effect for the years ended March 31, 2006 and 2005, respectively, and 41 percent in the year 2004.

For the year ended March 31, 2005, residual tax effects of ¥4,571 million previously recorded in accumulated other comprehensive income (minimum pension liability adjustments) were released and recorded as a reduction to income tax expense in the consolidated statements of income as a result of the elimination of the minimum pension liability adjustment.

The effective tax rates of TDK for the years ended March 31, 2006, 2005 and 2004, are reconciled with the Japanese statutory tax rate in the following table:

| | 2006 | 2005 | 2004 |
|--|---------------|--------|--------|
| Japanese statutory tax rate | 40.4% | 40.4% | 41.0% |
| Expenses not deductible for tax purposes | 1.6 | 1.1 | 1.2 |
| Non taxable income | (0.1) | (0.2) | 0.0 |
| Difference in statutory tax rates of foreign subsidiaries | (13.9) | (10.5) | (23.0) |
| Change in the valuation allowance | 4.7 | 3.8 | 4.5 |
| Investment tax credit | (0.1) | (1.2) | (1.6) |
| Research and development tax credit | (1.4) | (3.6) | (1.3) |
| Residual tax effect in minimum pension liability adjustments | - | (7.5) | - |
| Additional tax related to prior years income | 1.7 | 17.0 | - |
| Other | (1.0) | (1.0) | 0.9 |
| Effective tax rate | 31.9% | 38.3% | 21.7% |

On June 29, 2005, TDK received a notification and assessment of additional tax from the Tokyo Regional Tax Bureau (Nihonbashi Tax Office) asserting that prices charged and paid by TDK in connection with sales and purchases of products involving its overseas subsidiaries have not been commensurate with the prices of similar transactions involving unrelated third parties. The period of additional assessments covers the tax years ending from March 1999 through March 2003. The additional tax assessed by the Tokyo Regional Tax Bureau amounts to ¥11,960 million including interest and penalty, which has been reflected as additional tax expense and other expense, net of deferred income tax benefits in the accompanying consolidated statements of income for the year ended March 31, 2005.

Total income taxes for the years ended March 31, 2006, 2005 and 2004 are allocated as follows:

| | Yen (Millions) | | | U.S.Dollars (Thousands) |
|--|-------------------|--------|--------|----------------------------|
| | 2006 | 2005 | 2004 | 2006 |
| Income from continuing operations | ¥ 21,057 | 23,284 | 12,133 | \$ 179,974 |
| Loss from discontinued operations | - | 156 | 1,010 | - |
| Stockholders' equity, accumulated other comprehensive income (loss): | | | | |
| Foreign currency translation adjustments | 8 | 8 | 245 | 68 |
| Net unrealized gains (losses) on securities | 849 | (148) | 348 | 7,256 |
| Minimum pension liability adjustments | 2,074 | 29,538 | 9,422 | 17,727 |
| Total income taxes | ¥ 23,988 | 52,838 | 23,158 | \$ 205,025 |

Income from continuing operations before income taxes and income taxes for the years ended March 31, 2006, 2005 and 2004, are summarized as follows:

| | Income From Continuing Operations Before Income Taxes | Income Taxes | | Total |
|---------------------------|---|----------------|-----------------|----------------|
| | | Current | Deferred | |
| Yen (Millions): | | | | |
| 2006 | | | | |
| Japanese | ¥ 28,004 | 11,160 | 657 | 11,817 |
| Foreign | 38,099 | 10,593 | (1,353) | 9,240 |
| | ¥ 66,103 | 21,753 | (696) | 21,057 |
| 2005 | | | | |
| Japanese | 36,836 | 22,261 | (5,026) | 17,235 |
| Foreign | 23,892 | 6,555 | (506) | 6,049 |
| | 60,728 | 28,816 | (5,532) | 23,284 |
| 2004 | | | | |
| Japanese | 8,611 | 4,411 | (7) | 4,404 |
| Foreign | 47,236 | 5,864 | 1,865 | 7,729 |
| | 55,847 | 10,275 | 1,858 | 12,133 |
| U.S. Dollars (Thousands): | | | | |
| 2006 | | | | |
| Japanese | \$ 239,350 | 95,385 | 5,615 | 101,000 |
| Foreign | 325,633 | 90,538 | (11,564) | 78,974 |
| | \$ 564,983 | 185,923 | (5,949) | 179,974 |

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

| | Yen (Millions) | | U.S. Dollars (Thousands) |
|--|-------------------|----------|-----------------------------|
| | 2006 | 2005 | 2006 |
| Deferred tax assets: | | | |
| Trade accounts receivable, principally due to allowance for doubtful receivables | ¥ 433 | 332 | \$ 3,701 |
| Inventories | 1,005 | 894 | 8,590 |
| Accrued business tax | 370 | 1,330 | 3,162 |
| Accrued expenses | 5,145 | 3,863 | 43,974 |
| Retirement and severance benefits | 11,884 | 10,648 | 101,573 |
| Net operating loss carryforwards | 20,116 | 14,631 | 171,932 |
| Tax credit carryforwards | 684 | 208 | 5,846 |
| Minimum pension liability adjustments | 2,269 | 4,174 | 19,393 |
| Property, plant and equipment, principally due to differences in depreciation | 3,153 | 2,523 | 26,949 |
| Other | 1,835 | 1,867 | 15,684 |
| Total gross deferred tax assets | 46,894 | 40,470 | 400,804 |
| Less valuation allowance | (20,298) | (15,409) | (173,487) |
| Net deferred tax assets | ¥ 26,596 | 25,061 | \$ 227,317 |
| Deferred tax liabilities: | | | |
| Investments, principally due to differences in valuation | (6,030) | (6,034) | (51,538) |
| Undistributed earnings of foreign subsidiaries | (3,948) | (2,656) | (33,744) |
| Net unrealized gains on securities | (1,223) | (272) | (10,453) |
| Acquired intangible assets | (4,990) | (374) | (42,650) |
| Other | (1,086) | (1,220) | (9,282) |
| Total gross deferred tax liabilities | (17,277) | (10,556) | (147,667) |
| Net deferred tax assets | ¥ 9,319 | 14,505 | \$ 79,650 |

The net changes in the total valuation allowance for the years ended March 31, 2006, 2005 and 2004, are an increase of ¥4,889 million (\$41,786 thousand), ¥4,381 million and ¥1,338 million, respectively. The valuation allowance primarily relates to deferred tax assets associated with net operating loss carryforwards incurred by certain foreign subsidiaries. The decrease in the valuation allowance attributable to preacquisition tax benefits recognized during the years ended March 31, 2006 and 2005 amounted to ¥154 million and ¥119 million, respectively. The reversal of the valuation allowance upon realization of tax benefits resulted in a reduction of goodwill. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible and tax carryforwards are utilized. Management considered the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods which the deferred tax assets are deductible, management believes it is more likely than not TDK will realize the benefits of these deductible differences and tax carryforwards, net of the existing valuation allowance at March 31, 2006.

At March 31, 2006, certain subsidiaries have net operating loss carryforwards for income tax purposes of ¥65,398 million (\$558,957 thousand) which are available to offset future taxable income, if any.

Periods available to offset future taxable income vary in each tax jurisdiction and range from one year to an indefinite period as follows:

| | Yen (Millions) | U.S. Dollars (Thousands) |
|--------------------|-----------------|-----------------------------|
| Within 1 year | ¥ 845 | \$ 7,222 |
| 1 to 5 years | 4,676 | 39,966 |
| 5 to 20 years | 18,626 | 159,196 |
| Indefinite periods | 41,251 | 352,573 |
| | <u>¥ 65,398</u> | <u>\$ 558,957</u> |

At March 31, 2006, certain subsidiaries have tax credit carryforwards for income tax purposes of ¥684 million (\$5,846 thousand) which are available to reduce future income taxes, if any. Approximately ¥44 million (\$376 thousand) of the tax credit carryforwards expire through 2019, while the remainder have an indefinite carryforward period.

Net deferred income tax assets and liabilities at March 31, 2006 and 2005, are reflected in the accompanying consolidated balance sheets under the following captions:

| | Yen (Millions) | | U.S. Dollars (Thousands) |
|--|-------------------|---------------|-----------------------------|
| | 2006 | 2005 | 2006 |
| Prepaid expenses and other current assets | ¥ 7,401 | 6,654 | \$ 63,257 |
| Deferred income taxes (noncurrent assets) | 7,287 | 8,633 | 62,282 |
| Other current liabilities | (55) | (31) | (470) |
| Deferred income taxes (noncurrent liabilities) | (5,314) | (751) | (45,419) |
| | <u>¥ 9,319</u> | <u>14,505</u> | <u>\$ (79,650)</u> |

As of March 31, 2006 and 2005, TDK did not recognize deferred tax liabilities of approximately ¥61,144 million (\$522,598 thousand) and ¥61,663 million, respectively, for certain portions of undistributed earnings of foreign subsidiaries because TDK currently does not expect those unremitted earnings to reverse and become taxable to TDK in the foreseeable future. A deferred tax liability will be recognized when TDK expects that it will recover those undistributed earnings in a taxable manner, such as through receipt of dividends or sale of the investments. As of March 31, 2006 and 2005, the undistributed earnings of these subsidiaries are approximately ¥258,881 million (\$2,212,658 thousand) and ¥244,341 million, respectively.

8. Retirement and Severance Benefits

TDK and certain of its subsidiaries sponsor contributory and noncontributory retirement and severance plans that provide for pension or lump-sum benefit payments, based on length of service, employee salary and certain other factors, to substantially all employees who retire or terminate their employment for reasons other than dismissal for cause. Corporate statutory auditors participate in an unfunded retirement plan sponsored by TDK.

The contributory plan in Japan mainly represents the Employees' Pension Fund plan ("EPF"), comprised of the substitutional portion based on the pay related part of the old age pension benefits prescribed by the Welfare Pension Insurance Law (similar to Social Security benefits in the United States) and the corporate portion based on contributory defined pension arrangements established at the discretion of TDK. The substitutional portions of the EPF represent a welfare pension plan carried out on behalf of the Japanese government. The contributory plan is funded in conformity with the funding requirements of the applicable Japanese governmental regulations.

TDK had been exempted from contributing to the Japanese Pension Insurance ("JPI") program that would otherwise have been required if it had not elected to fund the government substitutional portion of the benefit through an EPF arrangement. The plan assets of the EPF were invested and managed as a single portfolio for the entire EPF and were not separately attributed to the substitutional and corporate portions.

In June 2001, the Contributed Benefit Pension Plan Law was newly enacted. This law permits an employer to elect to transfer the entire substitutional portion benefit obligation from the EPF to the government together with a specified amount of plan assets pursuant to a government formula. After such transfer, the employer would be required to make periodic contribution to JPI, and the Japanese government would be responsible for all benefit payments.

Pursuant to the new law, TDK received an approval of exemption from the Minister of Health, Labor and Welfare, effective September 25, 2003, from the obligation for benefits related to future employee service with respect to the substitutional portion of its EPF. TDK received governmental approval of exemption from the obligation for benefits related to past employee service in October 2004 with respect to the substantial portion of its domestic contributory plan. The transfer to the government was completed on January 31, 2005.

TDK accounted for the transfer in accordance with EITF Issue No. 03-2 "Accounting for the Transfer to the Japanese Government of the Substitutional Portion of Employee Pension Fund Liabilities" ("EITF 03-2"). As specified in EITF 03-2, the entire separation process is to be accounted for at the time of completion of the transfer to the government of the substitutional portion of the benefit obligation and related plan assets as a settlement in accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits". As a result of the transfer, TDK recognized as a subsidy from the Japanese government an amount equal to the difference between the fair value of the obligation deemed "settled" with the Japanese government and the assets required to be transferred to the government. The subsidy that TDK recognized amounted to ¥33,533 million. In addition, TDK recognized a settlement loss equal to the amount calculated as the ratio of the obligation settled to the total EPF obligation immediately prior to settlement, both of which exclude the effect of future salary progression relating to the substitutional portion, times the net unrecognized gain/loss immediately prior to settlement, which amounted to ¥27,347 million. This gain and loss is included in operating income in the accompanying consolidated statements of income for the year ended March 31, 2005.

Effective October 1, 2004, the corporate portion of the EPF was replaced by a new defined benefit plan that provides benefits based on length of service, employee salary and other factors in a manner similar to the predecessor corporate defined benefit plan but, at a reduced rate. The reduction in the pension benefit obligation as of the effective date in the amount of ¥10,925 million has been accounted for as a negative plan amendment and included in prior service cost and is amortized into net periodic benefit cost over the weighted average remaining service period of the plan participants.

TDK and its subsidiaries use a December 31 measurement date for the majority of the plans.

Net periodic benefit cost for TDK's employee retirement and severance defined benefit plans for the years ended March 31, 2006, 2005 and 2004 consisted of the following components:

| | Yen (Millions) | | U.S. Dollars (Thousands) |
|--|-------------------|---------|-----------------------------|
| | 2006 | 2005 | 2004 |
| Service cost-benefits earned during the year | ¥ 6,587 | 6,806 | 10,341 |
| Interest cost on projected benefit obligation | 4,050 | 5,359 | 6,271 |
| Expected return on plan assets | (3,386) | (3,180) | (2,640) |
| Amortization of transition assets | (1,331) | (1,331) | (1,331) |
| Recognized actuarial loss | 3,445 | 5,696 | 7,480 |
| Amortization of unrecognized prior service benefit | (2,041) | (1,522) | (1,353) |
| Settlement gain, net | - | (6,186) | - |
| | ¥ 7,324 | 5,642 | 18,768 |
| | | | \$ 62,598 |

Reconciliations of beginning and ending balances of the benefit obligations and the fair value of the plan assets are as follows:

| | Yen (Millions) | | U.S. Dollars (Thousands) |
|---|-------------------|----------|-----------------------------|
| | 2006 | 2005 | 2006 |
| Change in benefit obligations: | | | |
| Benefit obligations at beginning of period | ¥ 184,997 | 258,991 | \$ 1,581,171 |
| Service cost | 6,587 | 6,806 | 56,299 |
| Interest cost | 4,050 | 5,359 | 34,615 |
| Plan amendments | - | (10,925) | - |
| Actuarial loss (gain) | (336) | (727) | (2,872) |
| Benefits paid | (6,447) | (6,646) | (55,102) |
| Transfer of substitutional portion | - | (67,862) | - |
| Acquisition | 3,600 | - | 30,769 |
| Others | (63) | (437) | (538) |
| Translation adjustment | 904 | 438 | 7,726 |
| Benefit obligations at end of period | 193,292 | 184,997 | 1,652,068 |
| Change in plan assets: | | | |
| Fair value of plan assets at beginning of period | 142,648 | 168,913 | 1,219,214 |
| Actual return on plan assets | 28,124 | 8,053 | 240,376 |
| Employer contributions | 6,050 | 3,596 | 51,710 |
| Benefits paid | (5,815) | (6,046) | (49,701) |
| Transfer of substitutional portion | - | (31,985) | - |
| Acquisition | 1,467 | - | 12,538 |
| Translation adjustment | 386 | 117 | 3,299 |
| Fair value of plan assets at end of period | 172,860 | 142,648 | 1,477,436 |
| Funded status | (20,432) | (42,349) | (174,632) |
| Unrecognized net transition obligation being recognized over 18 years | (1,276) | (2,607) | (10,906) |
| Unrecognized net actuarial loss | 45,280 | 72,650 | 387,008 |
| Unrecognized prior service benefit | (26,254) | (28,295) | (224,393) |
| Net amount recognized | (2,682) | (601) | (22,923) |
| Amounts recognized in consolidated balance sheets consist of: | | | |
| Prepaid pension cost | 18,289 | 17,669 | 156,316 |
| Retirement and severance benefits | (26,790) | (28,839) | (228,974) |
| Intangible assets | 99 | 56 | 846 |
| Accumulated other comprehensive loss | 5,720 | 10,513 | 48,889 |
| Net amount recognized | (2,682) | (601) | (22,923) |
| Actuarial present value of accumulated benefit obligations at end of period | ¥ 175,073 | 167,834 | \$ 1,496,350 |

The projected benefit obligations and the fair value of plan assets for the pension plans with projected benefit obligations in excess of plan assets, and the accumulated benefit obligations and the fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets are as follows.

| | Yen (Millions) | | U.S. Dollars (Thousands) |
|--|-------------------|---------|-----------------------------|
| | 2006 | 2005 | 2006 |
| Plans with projected benefit obligations in excess of plan assets: | | | |
| Projected benefit obligations | ¥ 66,613 | 184,997 | \$ 569,342 |
| Fair value of plan assets | 37,405 | 142,648 | 319,701 |
| Plans with accumulated benefit obligations in excess of plan assets: | | | |
| Accumulated benefit obligations | 60,200 | 54,504 | 514,530 |
| Fair value of plan assets | 36,584 | 28,531 | 312,684 |

Assumptions

Weighted-average assumptions used to determine benefit obligations at March 31:

| | 2006 | 2005 |
|--|------|------|
| Discount rate | 2.2% | 2.2% |
| Assumed rate of increase in future compensation levels | 3.0% | 3.0% |

Weighted-average assumptions used to determine net periodic benefit cost for the years ended March 31:

| | 2006 | 2005 | 2004 |
|--|------|------|------|
| Discount rate | 2.2% | 2.1% | 2.1% |
| Assumed rate of increase in future compensation levels | 3.0% | 3.0% | 3.0% |
| Expected long-term rate of return on plan assets | 2.7% | 2.2% | 2.2% |

TDK determines the expected long-term rate of return based on the expected long-term return of the various asset categories in which it invests. TDK considers the current expectations for future returns and the actual historical returns of each plan asset category.

Plan assets

The weighted-average asset allocations of TDK's benefit plans at March 31, 2006 and 2005 by asset category are as follows:

| | 2006 | 2005 |
|-------------------|--------|--------|
| Equity securities | 65.4% | 26.2% |
| Debt securities | 26.1% | 6.9% |
| Cash | 2.2% | 62.5% |
| Other | 6.3% | 4.4% |
| | 100.0% | 100.0% |

TDK's investment policies are designed to ensure adequate plan assets are available to provide future payments of pension benefits to eligible participants. Taking into account the expected long-term rate of return on plan assets, TDK formulates a "model" portfolio comprised of the optimal combination of equity securities and debt securities. Plan assets are invested in individual equity and debt securities using the guidelines of the "model" portfolio in order to produce a total return that will match the expected return on a mid-term to long-term basis. TDK evaluates the gap between expected return and actual return of invested plan assets on an annual basis to determine if such differences necessitate a revision in the formulation of the "model" portfolio. TDK revises the "model" portfolio when and to the extent considered necessary to achieve the expected long-term rate of return on plan assets.

During the year ended March 31, 2005, the EPF sold certain assets to facilitate the funding of the payment to the Japanese government for the transfer of the substitutional portion of the plan. In addition, the strategic mix for domestic pension plans had increased asset allocation to cash based on the unclear outlook for the bond and equity market in Japan during the middle of 2004. During the year ended March 31, 2006, the strategic mix for domestic pension plans resulted in increase of asset allocation to the equity and debt securities to reflect the completion of the payment to the Japanese government for the transfer of the substitutional portion of the EPF, and the upturn of the equity and debt securities market in Japan. As a result, the relative portion of the equity and debt securities in pension assets at March 31, 2006 increased compared to March 31, 2005.

Contributions

TDK expects to contribute ¥6,315 million (\$53,974 thousand) to its defined benefit plans for the year ending March 31, 2007.

Estimated future benefit payments

The benefits expected to be paid from the pension plans in each year 2007 through 2016 are as follows:

| | Yen (Millions) | U.S. Dollars (Thousands) |
|-----------------------|-------------------|-----------------------------|
| Year ending March 31, | | |
| 2007 | ¥ 5,981 | \$ 51,120 |
| 2008 | 6,887 | 58,863 |
| 2009 | 7,457 | 63,735 |
| 2010 | 8,002 | 68,393 |
| 2011 | 8,049 | 68,795 |
| 2012 - 2016 | ¥ 41,320 | \$ 353,162 |

9. Legal Reserve and Dividends

The Japanese Company Law provides that an amount equal to 10 percent of cash dividends and other distributions from retained earnings paid by TDK and its Japanese subsidiaries be appropriated as a legal reserve. No further appropriations are required when the total amount of the additional paid-in capital and the legal reserve equals 25 percent of their respective stated capital. The Japanese Company Law also provides that to the extent that the sum of the additional paid-in capital and the legal reserve exceeds 25 percent of the stated capital, the amount of the excess (if any) is available for appropriations by resolution of the shareholders. Certain foreign subsidiaries are also required to appropriate their earnings to legal reserves under the laws of the respective countries. Cash dividends and appropriations to the legal reserve charged to retained earnings for the years ended March 31, 2006, 2005 and 2004 represent dividends paid out during those years and the related appropriations to the legal reserve. The accompanying consolidated financial statements do not include any provision for the dividend proposed by the Board of Directors of ¥50 (\$0.43) per share aggregating ¥6,613 million (\$56,521 thousand) in respect of the year ended March 31, 2006.

Cash dividends per common share are computed based on dividends paid for the year.

10. Stock Option Plan

(a) TDK

TDK obtained approval of the Ordinary General Meeting of Shareholders held on June 29, 2005 regarding the issuance of stock acquisition rights as share-based compensation stock options (the Stock Acquisition Rights) to Board members and Corporate Officers, pursuant to Articles 280-20 and 280-21 of the Japanese Commercial Code. Upon approval, the Board of Directors adopted resolutions to issue an aggregate of 246 Stock Acquisition Rights, each representing an option to purchase 100 shares of common stock of TDK, to the then 17 Directors and Corporate Officers of TDK. The Stock Acquisition Rights issued on June 30, 2005 are fully vested on date of issuance and are exercisable during the period from July 1, 2005 to June 30, 2025. The amount to be paid by qualified persons upon the exercise of each Stock Acquisition Rights is set at ¥1 (\$0.01) per share of common stock. Stock option related compensation cost of ¥186 million (\$1,590 thousand) has been recognized in fiscal 2006, representing the amount attributed to service rendered during the current period of the amount by which the market price of the underlying common stock exceeded the exercise price of stock options approved for issuance at the Ordinary General Meeting of Shareholders held in June 2005.

TDK obtained approval of the Ordinary General Meeting of Shareholders held on June 29, 2005 regarding the issuance of stock acquisition rights as stock options to select senior executives, pursuant to Articles 280-20 and 280-21 of the Japanese Commercial Code. Upon approval, the Board of Directors adopted resolutions to issue an aggregate of 906 Stock Acquisition Rights, each representing an option to purchase 100 shares of common stock of TDK, to the then 172 select senior executives of TDK, and the Directors and select senior executives of subsidiaries. The Stock Acquisition Rights issued on August 11, 2005 are exercisable during the period from August 1, 2007 to July 31, 2011. The amount to be paid by qualified persons upon the exercise of each Stock Acquisition Rights is set at ¥8,134 (\$69.52) per share of common stock, which was calculated by a formula approved by shareholders at the said annual shareholders meeting and is subject to an adjustment in certain events, including but not limited to a stock split, stock dividend and issue of new shares at a price less than the current market price of the shares of TDK. The exercise price of each Stock Acquisition Rights was equal to or greater than the fair market value of TDK's common stock on the date of grant.

To cover these options and the share-based compensation stock options issued on June 30, 2005, TDK purchased on the Tokyo Stock Exchange ("TSE") a total of 115,200 common shares with an aggregate purchase price of ¥930 million (\$7,949 thousand) from August 17, 2005 through August 22, 2005.

TDK obtained approval of the Ordinary General Meeting of Shareholders held in June 2004, 2003 and 2002 regarding the issuance of stock acquisition rights as stock options, pursuant to Articles 280-20 and 280-21 of the Japanese Commercial Code. Upon approval, the Board of Directors adopted resolutions to issue an aggregate of 2,343, 2,547 and 2,236 Stock Acquisition Rights, each representing a stock option to purchase 100 shares of common stock of TDK, to the then 187, 179 and 197 Directors, Corporate Officers and selected senior executives of TDK, and the Directors and select senior executives of its subsidiaries, respectively. The amount to be paid by qualified persons upon the exercise of each Stock Acquisition Rights was set at ¥8,147, ¥6,954 and ¥5,909 per share of common stock, respectively. The exercise price of each Stock Acquisition Rights was equal to or greater than the fair market value of TDK's common stock on the date of grant.

The Ordinary General Meeting of Shareholders held in June 2001 and 2000 approved to implement TDK's stock option plan for Directors and certain employees of TDK, and the purchase of TDK's own shares for transfer to them under the plan, pursuant to Article 210-2 of Japanese Commercial Code. Stock options were provided to the then 196 and 204 Directors on the Board and associate directors and officials in amounts ranging from 500 to 10,000 common shares each, at an exercise price of ¥6,114 and ¥15,640 per share. The exercise price of each Stock Acquisition Rights was equal to or greater than the fair market value of TDK's common stock on the date of grant.

TDK currently accounts for these stock option plans as fixed plans pursuant to APB 25.

A summary of the status of TDK's stock option plans as of March 31, 2006, 2005 and 2004, and of the activity during the years ending on those dates, is as follows:

| | 2006 | | 2005 | | 2004 | | 2006 |
|----------------------------------|------------------|--|------------------|--|------------------|--|---|
| | Number of shares | Weighted average exercise price Yen | Number of shares | Weighted average exercise price Yen | Number of shares | Weighted average exercise price Yen | Weighted average exercise price U.S. Dollars |
| Outstanding at beginning of year | 868,600 | ¥ 8,293 | 739,300 | ¥ 8,358 | 548,000 | ¥ 8,967 | \$ 70.88 |
| Granted | 115,200 | 6,397 | 234,300 | 8,147 | 254,700 | 6,954 | 54.68 |
| Exercised | 139,700 | 6,308 | 71,700 | 5,979 | 46,900 | 6,114 | 53.90 |
| Forfeited or Expired | 15,900 | 14,563 | 33,300 | 13,695 | 16,500 | 13,276 | 124.47 |
| Outstanding at end of year | 828,200 | 8,244 | 868,600 | 8,293 | 739,300 | 8,358 | 70.46 |
| Exercisable at end of year | 504,300 | 8,308 | 380,600 | 9,275 | 264,300 | 11,755 | 71.01 |

Information about stock options outstanding at March 31, 2006 is as follows:

| Range of exercise prices Yen | Options Outstanding | | | |
|---------------------------------|--------------------------------------|---|---------------------------------|--------------|
| | Number outstanding at March 31, 2006 | Weighted average remaining contractual life (years) | Weighted average exercise price | |
| | | | Yen | U.S. Dollars |
| 1 | 24,600 | 19.3 | 1 | 0.01 |
| 5,909 | 105,700 | 2.3 | 5,909 | 50.50 |
| 6,114 | 52,400 | 1.1 | 6,114 | 52.26 |
| 6,954 | 205,500 | 3.3 | 6,954 | 59.44 |
| 8,134 | 90,600 | 5.3 | 8,134 | 69.52 |
| 8,147 | 233,300 | 4.3 | 8,147 | 69.63 |
| 15,640 | 116,100 | 0.1 | 15,640 | 133.68 |
| 1 to 15,640 | 828,200 | 3.6 | 8,244 | 70.46 |

The fair value of these stock options was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

The Stock Acquisition Rights – the exercise price is equal to or greater than the market price of the stock on the grant date

| | 2006 | 2005 | 2004 |
|-------------------------|-------------------------------------|-----------|-----------|
| Grant-date fair value | ¥ 2,325 (\$ 19.87) | ¥ 2,223 | ¥ 2,290 |
| Expected life | 4.0 years | 4.0 years | 4.0 years |
| Risk-free interest rate | 0.54% | 0.59% | 0.26% |
| Expected volatility | 38.93% | 46.30% | 51.36% |
| Expected dividend yield | 0.96% | 0.85% | 0.71% |

The Stock Acquisition Rights – the exercise price is less than the market price of the stock on the grant date

| | 2006 |
|-------------------------|-------------------------------------|
| Grant-date fair value | ¥ 7,235 (\$ 61.84) |
| Expected life | 5.5 years |
| Risk-free interest rate | 0.47% |
| Expected volatility | 44.46% |
| Expected dividend yield | 0.80% |

(b) Densei-Lambda

Densei-Lambda K. K. (“Densei-Lambda”), a subsidiary of TDK, obtained approval of the Ordinary General Meeting of Shareholders held in June 2002 regarding the issuance of stock acquisition rights as stock options, pursuant to Articles 280-20 and 280-21 of the Japanese Commercial Code. Upon approval, the Board of Directors adopted resolutions to issue an aggregate of 1,147 Stock Acquisition Rights, each representing a stock option to purchase 100 shares of common stock of Densei-Lambda, to the then 201 Directors, Corporate Auditors, Corporate Officers and certain employees of Densei-Lambda, respectively. The Stock Acquisition Rights issued on January 10, 2003 are exercisable during the period from January 11, 2006 to January 10, 2013. The amount to be paid by qualified persons upon the exercise of each Stock Acquisition Rights was set at ¥789 per share of common stock. The exercise price of each Stock Acquisition Rights was equal to or greater than the fair market value of Densei-Lambda’s common stock on the date of grant.

The Ordinary General Meeting of Shareholders held in June 2001 and 2000 approved to implement Densei-Lambda's stock option plan for Directors, Corporate Officers and certain employees of Densei-Lambda, and the purchase of Densei-Lambda's own shares for transfer to them under the plan, pursuant to Article 210-2 of Japanese Commercial Code. Stock options were provided to the then 97 Directors, Corporate Officers and certain employees, and 10 Directors and Corporate Officers at an exercise price of ¥1,817 and ¥2,229 per share, respectively. The exercise price of each Stock Acquisition Rights was equal to or greater than the fair market value of Densei-Lambda’s common stock on the date of grant.

Densei-Lambda currently accounts for these stock option plans, which are immaterial, as fixed plans pursuant to APB 25.

11. Other Comprehensive Income (Loss)

Change in accumulated other comprehensive income (loss) for the years ended March 31, 2006, 2005 and 2004, are as follows:

| | Yen (Millions) | | U.S. Dollars (Thousands) | |
|--|-------------------|----------|-----------------------------|--------------|
| | 2006 | 2005 | 2006 | |
| Foreign currency translation adjustments: | | | | |
| Balance at beginning of period | ¥ (47,171) | (52,807) | (26,520) | \$ (403,171) |
| Adjustments for period | 26,100 | 5,636 | (26,287) | 223,077 |
| Balance at end of period | (21,071) | (47,171) | (52,807) | (180,094) |
| Net unrealized gains (losses) on securities: | | | | |
| Balance at beginning of period | 801 | 648 | 110 | 6,846 |
| Adjustments for period | 892 | 153 | 538 | 7,624 |
| Balance at end of period | 1,693 | 801 | 648 | 14,470 |
| Minimum pension liability adjustments: | | | | |
| Balance at beginning of period | (5,287) | (38,228) | (52,414) | (45,188) |
| Adjustments for period | 2,719 | 32,941 | 14,186 | 23,239 |
| Balance at end of period | (2,568) | (5,287) | (38,228) | (21,949) |
| Total accumulated other comprehensive income (loss): | | | | |
| Balance at beginning of period | (51,657) | (90,387) | (78,824) | (441,513) |
| Adjustments for period | 29,711 | 38,730 | (11,563) | 253,940 |
| Balance at end of period | ¥ (21,946) | (51,657) | (90,387) | \$ (187,573) |

Tax effects allocated to each component of other comprehensive income (loss) and reclassification adjustments for the years ended March 31, 2006, 2005 and 2004, are as follows:

| | Yen (Millions) | | |
|--|----------------------|--------------------------------|----------------------|
| | Before tax amount | Tax (expense) or benefit | Net-of-tax amount |
| 2006 | | | |
| Foreign currency translation adjustments | ¥ 26,108 | (8) | 26,100 |
| Unrealized gains (losses) on securities: | | | |
| Unrealized holding gains arising for period | 2,128 | (856) | 1,272 |
| Reclassification adjustments for (gains) losses realized in net income | (387) | 7 | (380) |
| Net unrealized gains (losses) | 1,741 | (849) | 892 |
| Minimum pension liability adjustments | 4,793 | (2,074) | 2,719 |
| Other comprehensive income (loss) | ¥32,642 | (2,931) | 29,711 |
| 2005 | | | |
| Foreign currency translation adjustments: | | | |
| Amount arising during the year on investments in foreign entities held at end of period | ¥ 5,870 | (8) | 5,862 |
| Reclassification adjustments for the portion of gains and losses realized upon liquidation and sale of investments in foreign entities | (226) | - | (226) |
| Net foreign currency translation adjustments | 5,644 | (8) | 5,636 |
| Unrealized gains (losses) on securities: | | | |
| Unrealized holding gains arising for period | 676 | (119) | 557 |
| Reclassification adjustments for (gains) losses realized in net income | (671) | 267 | (404) |
| Net unrealized gains (losses) | 5 | 148 | 153 |
| Minimum pension liability adjustments | 62,479 | (29,538) | 32,941 |
| Other comprehensive income (loss) | ¥ 68,128 | (29,398) | 38,730 |
| 2004 | | | |
| Foreign currency translation adjustments: | | | |
| Amount arising during the year on investments in foreign entities held at end of period | ¥ (26,464) | (245) | (26,709) |
| Reclassification adjustments for the portion of gains and losses realized upon liquidation of investments in foreign entities | 422 | - | 422 |
| Net foreign currency translation adjustments | (26,042) | (245) | (26,287) |
| Unrealized gains (losses) on securities: | | | |
| Unrealized holding gains arising for period | 886 | (348) | 538 |
| Minimum pension liability adjustments | 23,608 | (9,422) | 14,186 |
| Other comprehensive income (loss) | ¥ (1,548) | (10,015) | (11,563) |

| | U.S. Dollars (Thousands) | | |
|--|-----------------------------|--------------------------------|----------------------|
| | Before tax amount | Tax (expense) or benefit | Net-of-tax amount |
| 2006 | | | |
| Foreign currency translation adjustments | \$ 223,145 | (68) | 223,077 |
| Unrealized gains (losses) on securities: | | | |
| Unrealized holding gains arising for period | 18,188 | (7,316) | 10,872 |
| Reclassification adjustments for (gains) losses realized in net income | (3,308) | 60 | (3,248) |
| Net unrealized gains (losses) | 14,880 | (7,256) | 7,624 |
| Minimum pension liability adjustments | 40,966 | (17,727) | 23,239 |
| Other comprehensive income (loss) | \$ 278,991 | (25,051) | 253,940 |

12. Leases

TDK and its subsidiaries occupy offices and other facilities under various cancellable lease agreements expiring in fiscal 2007 through 2008. Lease deposits made under such agreements, aggregating ¥1,827 million (\$15,615 thousand) and ¥1,900 million, at March 31, 2006 and 2005, respectively, are included in other assets on the accompanying consolidated balance sheets.

The following is a schedule by years of future minimum rental payments required under operating leases that have initial or remaining noncancellable lease terms in excess of one year as of March 31, 2006:

| | Yen (Millions) | U.S. Dollars (Thousands) |
|-----------------------|-------------------|-----------------------------|
| Year ending March 31, | | |
| 2007 | ¥ 2,499 | \$ 21,359 |
| 2008 | 1,894 | 16,188 |
| 2009 | 1,437 | 12,282 |
| 2010 | 1,090 | 9,316 |
| 2011 | 791 | 6,761 |
| Later years | 3,873 | 33,103 |
| | ¥ 11,584 | \$ 99,009 |

13. Commitments and Contingent Liabilities

At March 31, 2006, commitments outstanding for the purchase of property, plant and equipment approximated ¥13,088 million (\$111,863 thousand). TDK has entered into several purchase agreements with certain suppliers whereby TDK committed to purchase a minimum amount of raw materials to be used in the manufacture of its products. Future minimum purchases remaining under the agreements approximated ¥4,539 million (\$38,795 thousand) at March 31, 2006.

TDK and certain of its subsidiaries provide guarantees to third parties on bank loans of its employees. The guarantees on behalf of the employees are made for their housing loans. For each guarantee issued, in the event the employee defaults on payment, TDK would be required to make payments under its guarantee. The maximum amount of undiscounted payments TDK would have to make in the event of default is ¥5,740 million (\$49,060 thousand) and ¥6,296 million at March 31, 2006 and 2005, respectively. As of March 31, 2006, the liability recognized for the estimated fair value of TDK's obligation under the guarantee arrangement is not material.

Several claims against TDK and certain subsidiaries are pending. Provision has been made for the estimated liabilities for the items. In the opinion of management, based upon discussion with counsel, any additional liability not currently provided for will not materially affect the consolidated financial position and results of operations of TDK.

14. Risk Management Activities and Derivative Financial Instruments

TDK and its subsidiaries operate internationally which exposes them to the risk of changes in foreign exchange rates and interest rates; derivative financial instruments are utilized to reduce these risks. TDK and its subsidiaries do not hold or issue financial instruments for trading purposes. TDK and its subsidiaries are exposed to credit related losses in the event of nonperformance by the counterparties to those financial instruments, but does not expect any counterparties to fail to meet their obligations given their high credit ratings. The credit exposure of currency swaps, interest rate and currency swaps, forward foreign exchange contracts and currency option contracts is represented by the fair values of contracts.

TDK and one of its subsidiaries had currency swaps and interest rate and currency swaps with certain financial institutions to limit their exposure to fluctuations in foreign exchange rates and interest rates related primarily to loans made by TDK to its subsidiaries in a total amount of ¥11,067 million at March 31, 2005. During the year ended March 31, 2006, TDK decided to use forward exchange contracts to limit the aforementioned exposure. As a result, no currency swaps or interest and currency swaps were outstanding at March 31, 2006. These swaps required TDK and the subsidiary to pay principally euros and U.S. dollars and to receive Japanese yen at a specified rate on specific dates. Gains or losses on interest and currency swaps and currency swaps were included in interest expense and foreign exchange gain (loss) in the consolidated statements of income, respectively. The swap contracts were measured at fair value and were included in prepaid expenses and other current assets or other current liabilities, as the case may be, in the consolidated balance sheets.

Forward exchange contracts and currency option contracts have been entered into to hedge adverse effects of foreign currency exchange rate fluctuations mainly on foreign-currency-denominated trade receivables and foreign-currency-denominated forecasted transactions.

At March 31, 2006 and 2005, TDK and certain of its subsidiaries had forward exchange contracts to sell and buy foreign currencies (principally U.S. dollars and Japanese yen) and currency option contracts for a contract amount of ¥17,726 million (\$151,504 thousand) and ¥28,990 million, respectively. Gains or losses on forward exchange contracts and currency option contracts were included in foreign exchange gain (loss) in the consolidated statements of income. These contracts were measured at fair value and were included in prepaid expenses and other current assets or other current liabilities, as the case may be, in the consolidated balance sheets.

15. Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of financial instruments in cases for which it is practicable:

(a) Cash and cash equivalents, Trade receivables, Other current assets, Short-term debt, Trade payables, Accrued salaries and wages, Accrued expenses, Income taxes payables and Other current liabilities.

The carrying amount approximates fair value because of the short maturity of these instruments.

(b) Marketable securities and Investments in securities

The fair values of marketable securities and investments in securities are estimated based on quoted market prices for these instruments. For other securities for which there are no quoted market prices, a reasonable estimate of fair values could not be made without incurring excessive costs. Additional information pertinent to the value of unquoted investments is provided below.

(c) Long-term debt

The fair value of TDK's long-term debt is estimated based on the amount of future cash flows associated with the instrument discounted using TDK's current borrowing rate for similar debt of comparable maturity, or based on the quoted market prices for the same or similar issues.

(d) Currency Swaps, Currency and Interest Rate Swaps, Forward Foreign Exchange Contracts and Foreign Currency Option Contracts

The fair values of currency swaps, currency and interest rate swaps, forward foreign exchange contracts and foreign currency option contracts are estimated by obtaining quotes from financial institutions.

The carrying amounts and estimated fair values of TDK's financial instruments at March 31, 2006 and 2005, are summarized as follows:

| <u>As of March 31, 2006</u> | <u>Yen (Millions)</u> | |
|---|------------------------|-----------------------------|
| | <u>Carrying amount</u> | <u>Estimated fair value</u> |
| Nonderivatives: | | |
| Assets: | | |
| Investments in securities and other assets for which it is: | | |
| Practicable to estimate fair value | ¥ 20,497 | 20,497 |
| Not practicable to estimate fair value | 801 | - |
| Liability: | | |
| Long-term debt, including current portion | (2,363) | (2,363) |
| Derivatives: | | |
| Forward foreign exchange contracts in a: | | |
| Gain position | 8 | 8 |
| Loss position | - | - |
| Currency option contracts in a: | | |
| Gain position | - | - |
| Loss position | (8) | (8) |
| <hr/> | | |
| <u>As of March 31, 2005</u> | <u>Yen (Millions)</u> | |
| | <u>Carrying amount</u> | <u>Estimated fair value</u> |
| Nonderivatives: | | |
| Assets: | | |
| Investments in securities and other assets for which it is: | | |
| Practicable to estimate fair value | ¥ 12,684 | 12,684 |
| Not practicable to estimate fair value | 1,741 | - |
| Liability: | | |
| Long-term debt, including current portion | (184) | (184) |
| Derivatives: | | |
| Currency and interest rate swaps in a: | | |
| Gain position | - | - |
| Loss position | (312) | (312) |
| Forward foreign exchange contracts in a: | | |
| Gain position | - | - |
| Loss position | (88) | (88) |
| Currency option contracts in a: | | |
| Gain position | - | - |
| Loss position | (366) | (366) |

| <u>As of March 31, 2006</u> | U.S. Dollars (Thousands) | |
|---|---------------------------------|-----------------------------|
| | Carrying amount | Estimated fair value |
| Nonderivatives: | | |
| Assets: | | |
| Investments in securities and other assets for which it is: | | |
| Practicable to estimate fair value | \$ 175,188 | 175,188 |
| Not practicable to estimate fair value | 6,846 | - |
| Liability: | | |
| Long-term debt, including current portion | (20,197) | (20,197) |
| Derivatives: | | |
| Forward foreign exchange contracts in a: | | |
| Gain position | 68 | 68 |
| Loss position | - | - |
| Currency option contracts in a: | | |
| Gain position | - | - |
| Loss position | (68) | (68) |

The carrying amounts of the nonderivative assets and liabilities are included in the consolidated balance sheets under the indicated captions. The carrying amounts of the currency swaps, the currency and interest rate swaps, forward foreign exchange contracts and foreign currency option contracts in a gain position are included in prepaid expenses and other current assets, while those in a loss position are included in other current liabilities.

It is not practicable to estimate the fair value of investments in untraded companies. Management believes that the carrying amounts approximate fair value.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

16. Restructuring Cost

On March 8, 2006, TDK's board of directors decided to restructure certain of its recording media business, including the withdrawal from the manufacturing of recordable CD and DVDs.

Pursuant to that decision, TDK shut down the production facilities at its European subsidiary, TDK Recording Media Europe S.A. in Luxembourg in April 2006. In March 2006, TDK recorded a restructuring cost of ¥6,825 million (\$58,333 thousand) which included a charge of ¥3,309 million (\$28,282 thousand) relating to employee termination benefits. As a result of the restructuring, a total of 350 regular employees were terminated through May 31, 2006. In addition, TDK recorded a restructuring cost of ¥2,594 million (\$22,171 thousand) relating to an impairment of property, plant and equipment in connection with the decision to shut down production facilities at its European subsidiary.

The change of the restructuring liabilities for the year ended March 31, 2006 is as follows:

| | Yen (Millions) | | | |
|----------------------|------------------------|---|-------|-------|
| | 2006 | | | |
| | Workforce reduction | Impairment on property, plant and equipment | Other | Total |
| Beginning balance | ¥ - | - | - | - |
| Costs and expenses | 3,309 | 2,594 | 922 | 6,825 |
| Payments | 286 | - | 242 | 528 |
| Non-cash adjustments | - | 2,594 | - | 2,594 |
| Ending balance | ¥ 3,023 | - | 680 | 3,703 |

| | U.S. Dollars (Thousands) | | | |
|----------------------|--------------------------|--------|-------|--------|
| Beginning balance | \$ - | - | - | - |
| Costs and expenses | 28,282 | 22,171 | 7,880 | 58,333 |
| Payments | 2,444 | - | 2,068 | 4,512 |
| Non-cash adjustments | - | 22,171 | - | 22,171 |
| Ending balance | \$ 25,838 | - | 5,812 | 31,650 |

Restructuring liabilities were included in Accrued expenses in the consolidated balance sheets as of March 31, 2006.

TDK expects that the entire accrued liabilities of ¥3,703 million (\$31,650 thousand) recognized at March 31, 2006 will be paid by September 30, 2006.

17. Assets Held for Sale

At March 31, 2006, assets held for sale consists of certain property, plant and equipment, which were classified as held for sale in connection with the restructuring activities in Europe (Note 16) and certain property, plant and equipment in Japan in accordance with FASB Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". TDK recorded write-downs to fair value less cost to sell in the amount of ¥2,594 million (\$22,171 thousand) in 2006, which was included in restructuring cost in the consolidated statements of income. TDK expects these assets to be sold during the year ended March 31, 2007.

At March 31, 2005, assets and liabilities held for sale consists of assets and liabilities of TDK's former subsidiary TDK Semiconductor Corporation ("TSC"), which was sold during the year ended March 31, 2006 (Note 21).

The components of the assets and liabilities held for sale at March 31, 2006 and 2005 are as follows:

| | Yen (Millions) | | U.S. Dollars (Thousands) |
|-----------------------------------|-------------------|------------|-----------------------------|
| | 2006 | 2005 | 2006 |
| Assets held for sale | | | |
| Current assets | ¥ - | 548 | \$ - |
| Net property, plant and equipment | 4,110 | 430 | 35,128 |
| Other assets | - | 15 | - |
| | 4,110 | 993 | 35,128 |
| Liabilities held for sale | | | |
| Current liabilities | ¥ - | 92 | \$ - |

18. Goodwill and Other Intangible Assets

The components of acquired intangible assets excluding goodwill at March 31, 2006 and 2005, are as follows:

| | Yen (Millions) | | |
|-------------------------------|--------------------------|--------------------------|----------------|
| | 2006 | | |
| | Gross Carrying Amount | Accumulated Amortization | Net Amount |
| Amortized intangible assets: | | | |
| Patent | ¥ 10,350 | 3,226 | 7,124 |
| Customer relationships | 10,673 | 441 | 10,232 |
| Software | 9,268 | 5,389 | 3,879 |
| Other | 7,024 | 1,658 | 5,366 |
| Total | 37,315 | 10,714 | 26,601 |
| Unamortized intangible assets | ¥ 2,877 | | 2,877 |
| | Yen (Millions) | | |
| | 2005 | | |
| | Gross Carrying Amount | Accumulated Amortization | Net Amount |
| Amortized intangible assets: | | | |
| Patent | ¥ 10,347 | 2,242 | 8,105 |
| Software | 7,271 | 4,399 | 2,872 |
| Other | 2,346 | 715 | 1,631 |
| Total | 19,964 | 7,356 | 12,608 |
| Unamortized intangible assets | ¥ 639 | | 639 |
| | U.S. Dollars (Thousands) | | |
| | 2006 | | |
| | Gross Carrying Amount | Accumulated Amortization | Net Amount |
| Amortized intangible assets: | | | |
| Patent | \$ 88,462 | 27,573 | 60,889 |
| Customer relationships | 91,222 | 3,769 | 87,453 |
| Software | 79,214 | 46,060 | 33,154 |
| Other | 60,034 | 14,171 | 45,863 |
| Total | 318,932 | 91,573 | 227,359 |
| Unamortized intangible assets | \$ 24,590 | | 24,590 |

Intangible assets subject to amortization are amortized using the straight-line method over their estimated useful lives to their estimated residual value of zero. The useful lives are 11 years for the Patents, 5 to 17 years for Customer relationships, 2 to 10 years for Internal-use Software, and 8 to 10 years for Other intangible assets.

Aggregate amortization expense for the years ended March 31, 2006, 2005 and 2004 was ¥3,618 million (\$30,923 thousand), ¥2,467 million and ¥2,626 million, respectively. Estimated amortization expense for the next five years is: ¥3,779 million in 2007, ¥3,217 million in 2008, ¥2,888 million in 2009, ¥2,730 million in 2010, and ¥2,440 million in 2011.

The changes in the carrying amount of goodwill by segment for the year ended March 31, 2006 is as follows:

| | Yen (Millions) | | |
|------------------------|-------------------------------------|-----------------|---------|
| | Electronic materials and components | Recording media | Total |
| March 31, 2004 | ¥ 10,029 | - | 10,029 |
| Additions | 991 | - | 991 |
| Deductions | (1,975) | - | (1,975) |
| Translation adjustment | 165 | - | 165 |
| March 31, 2005 | 9,210 | - | 9,210 |
| Additions | 9,782 | - | 9,782 |
| Deductions | (401) | - | (401) |
| Translation adjustment | 862 | - | 862 |
| March 31, 2006 | ¥ 19,453 | - | 19,453 |

| | U.S. Dollars (Thousands) | | |
|------------------------|-------------------------------------|-----------------|---------|
| | Electronic materials and components | Recording media | Total |
| March 31, 2005 | \$ 78,718 | - | 78,718 |
| Additions | 83,607 | - | 83,607 |
| Deductions | (3,427) | - | (3,427) |
| Translation adjustment | 7,367 | - | 7,367 |
| March 31, 2006 | \$ 166,265 | - | 166,265 |

Goodwill additions during the year ended March 31, 2006 represent the excess of purchase price over the fair value of assets acquired and liabilities assumed in connection with the acquisition of Lambda Power Business in the amount of ¥4,854 million (Note 23) and ¥4,928 million in connection with an immaterial acquisition made during the year. Goodwill deductions during the year ended March 31, 2006 primarily consist of an impairment loss in the amount of ¥159 million and the reclassification to deferred income taxes in the amount of ¥154 million related to post-acquisition adjustment resulting from recognition of preacquisition tax benefits.

Goodwill additions during the year ended March 31, 2005 represent the excess of purchase price over the fair value of assets acquired and liabilities assumed for a certain immaterial acquisition made during the year. Goodwill deductions during the year ended March 31, 2005 primarily consist of an impairment loss from discontinued operations in the amount of ¥1,856 million in connection with the discontinuation of TDK's semiconductor business (Note 21) and a reclassification to deferred income taxes in the amount of ¥119 million related to post-acquisition adjustment resulting from recognition of preacquisition tax benefits.

19. Net Income per Share

A reconciliation of the numerators and denominators of the basic and diluted net income per share computations is as follows:

| | 2006 | Yen (Millions) 2005 | 2004 | U.S. Dollars (Thousands) 2006 |
|--|------------------------------|---------------------------|---------|-------------------------------------|
| Income from continuing operations available to common stockholders | ¥ 44,411 | 36,965 | 43,355 | \$ 379,581 |
| Loss from discontinued operations available to common stockholders | 310 | 3,665 | 1,254 | 2,649 |
| Net income available to common stockholders | ¥ 44,101 | 33,300 | 42,101 | \$ 376,932 |
| | Number of shares (Thousands) | | | |
| | 2006 | 2005 | 2004 | |
| Weighted average common shares outstanding - Basic | 132,239 | 132,293 | 132,475 | |
| Effect of dilutive stock options | 116 | 83 | 48 | |
| Weighted average common shares outstanding - Diluted | 132,355 | 132,376 | 132,523 | |
| | 2006 | Yen 2005 | 2004 | U.S. Dollars 2006 |
| Income from continuing operations per share: | | | | |
| Basic | ¥ 335.84 | 279.41 | 327.27 | \$ 2.87 |
| Diluted | 335.54 | 279.25 | 327.15 | 2.87 |
| Loss from discontinued operations per share: | | | | |
| Basic | ¥ (2.34) | (27.70) | (9.47) | \$ (0.02) |
| Diluted | (2.34) | (27.69) | (9.46) | (0.02) |
| Net income per share: | | | | |
| Basic | ¥ 333.50 | 251.71 | 317.80 | \$ 2.85 |
| Diluted | 333.20 | 251.56 | 317.69 | 2.85 |

20. Business and Credit Concentrations

One significant customer, Maxtor Peripherals (S) Pte. Ltd., related to electronic materials and components business accounted for 11.5 percent, 12.6 percent and 12.1 percent of TDK's net sales for the years ended March 31, 2006, 2005 and 2004, respectively, and 12.7 percent and 13.2 percent of trade receivables at March 31, 2006 and 2005, respectively.

During the year ended March 31, 2006, the said customer agreed to be acquired by a competitor. The acquisition was completed in May 2006. During the year ended March 31, 2007, TDK will be losing the majority of the sales from this customer that it recorded in the year ended March 31, 2006.

21. Discontinued Operations

On March 31, 2005, TDK entered into an agreement to sell all outstanding stock of its wholly owned subsidiary, TSC for \$14,028 thousand to Golden Gates Capital (“Buyer”). The sale of TSC is part of TDK’s continuing shift away from non-core products and technologies. The sale agreement also includes earn-out payments, to be made by the Buyer to TDK, of up to \$32,500 thousand. No earn-out payments were made through March 31, 2006. The payments are contingent upon certain milestones being met related to future revenue targets extending through 2007. The transaction was completed on April 8, 2005. TDK has accounted for the sale of TSC as a discontinued operation pursuant to FASB Statement No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”, as TSC meets the definition of a “component of an entity”. The results of operations for this subsidiary have been reported as discontinued operations for all periods presented. Accordingly, certain financial statement information and related footnote disclosures related to prior periods have been reclassified.

Selected financial information for the years ended March 31, 2006, 2005 and 2004 for the discontinued operations, are summarized as follows:

| | Yen (Millions) | | | U.S. Dollars (Thousands) |
|---|----------------|-------|-------|-----------------------------|
| | 2006 | 2005 | 2004 | 2006 |
| Net sales | ¥ 45 | 2,242 | 3,070 | \$ 385 |
| Loss from operations before income taxes (including loss on disposal of ¥224 million in 2006) | 310 | 3,509 | 244 | 2,649 |
| Income tax expense | - | 156 | 1,010 | - |
| Loss from discontinued operations | ¥ 310 | 3,665 | 1,254 | \$ 2,649 |

Included in loss from discontinued operations for the year ended March 31, 2004, is patent infringement settlement income in the amount of ¥1,933 million which, prior to being reclassified, was previously included in income before income taxes for the year. This patent infringement settlement income has been reflected as a component of loss from discontinued operations as it directly relates to the TSC business being disposed.

On August 6, 2001, TSC filed suit against Silicon Laboratories, Inc. (“SiLabs”) alleging infringement by SiLabs of U.S. Patent No. 5,654,984 entitled “Signal Modulation Across Capacitors” (“the ’984 patent”) owned by TSC. The patent relates to novel methods and circuitry for communicating a signal across an isolation barrier using capacitors. The patented technology is principally useful in modem applications. TDK’s lawsuit alleged that SiLabs integrated the patented technology into its competing modem products. SiLabs counterclaimed alleging (1) unfair competition and (2) intentional and negligent interference with economic relations.

In April 2003, the parties resolved the dispute with the execution of a Settlement Agreement wherein both parties agreed to dismiss all litigation between them without admitting any liability. In exchange for the payment of \$17 million to TSC, SiLabs was granted a fully paid-up, exclusive perpetual license to use the ’984 patent, as well as three ancillary patents owned by TSC. Pursuant to the Settlement Agreement, TDK has no further obligation to provide additional services, product deliverables or enhancements to the licensed technology. TSC did reserve for itself and other TDK companies the right to use the patents with regard to TDK-branded products. In addition, TSC agreed that neither it or any TDK entity would pursue a claim against SiLabs for a period of 20 years for patent infringement related to any SiLabs product in existence at the time of the settlement or any capacitive-based digital access arrangement (“DAA”) product subsequently introduced by SiLabs.

22. Sale of a Subsidiary

On October 1, 2004, TDK Logistics Corporation (“TDK Logistics”), a wholly owned subsidiary which provided warehousing and transportation services to only TDK, was acquired in a share for share exchange by Alps Logistics Co., Ltd. (“ALPS”), a third party listed company on the Tokyo Stock Exchange. The share exchange ratio was 0.82 of an ALPS share for one TDK Logistics share. The fair value of shares issued to effect this transaction was determined based on the market value of ALPS common shares at the consummation date and amounted to ¥3,365 million. As a result of the acquisition, TDK owns approximately 7.9 percent of the outstanding common stock of ALPS. TDK continues to use warehousing and transportation services which are now provided by ALPS. The sale of TDK Logistics does not meet the criteria for reporting as discontinued operations as the operations and cash flows of the former subsidiary will not be eliminated from the cash flows of TDK. TDK recorded a gain on sale of ¥1,799 million which is included in operating income in the consolidated statement of income for the year ended March 31, 2005.

23. Acquisition

On October 1, 2005, TDK acquired 59 percent of the issued and outstanding common shares of Lambda Power Business from U.K.-based Invensys plc. The results of Lambda Power Business’s operations have been included in the accompanying consolidated financial statements of TDK since that date. The acquisition is intended to establish a more resilient operating base for TDK in the power supply field, which is expected to continue to grow in the years ahead, by combining TDK's strengths with those of the various businesses of Lambda Power Business. The total purchase price was ¥24,202 million, net of cash acquired of ¥4,305 million.

The purchase price has been allocated based on the fair value of the assets acquired, including identifiable intangible assets and liabilities assumed, at the date of acquisition. The excess of the cost of the acquisition over the net of amounts assigned to the fair value of the tangible and identifiable intangible assets acquired and the liabilities assumed is recorded as goodwill. Goodwill is not deductible for tax purposes. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of the acquisition.

| | Yen (Millions) | U.S. Dollars (Thousands) |
|-------------------------------|-------------------|-----------------------------|
| Current assets | ¥ 23,176 | \$ 198,086 |
| Property, plant and equipment | 9,673 | 82,675 |
| Intangible assets | 13,686 | 116,974 |
| Goodwill | 4,854 | 41,487 |
| Other assets | 5,090 | 43,504 |
| Total assets acquired | 56,479 | 482,726 |
| Current liabilities | (13,429) | (114,777) |
| Noncurrent liabilities | (9,583) | (81,906) |
| Minority interests | (9,265) | (79,188) |
| Total liabilities assumed | (32,277) | (275,871) |
| Net assets acquired | ¥ 24,202 | \$ 206,855 |

The acquired intangible assets which are being amortized have a weighted average useful life of approximately 15 years. The intangible assets include customer relationships of ¥9,778 million (16-years weighted average useful life), patented technology of ¥1,134 million (8-years weighted average useful life), and other intangible assets of ¥550 million (1-year weighted average useful life). The acquired intangible assets which are not being amortized include trademarks of ¥2,132 million and other intangible assets of ¥92 million.

Pro Forma Results

The following unaudited pro forma financial information presents the combined results of operations of TDK and Lambda Power Business as if the acquisition had occurred as of April 1, 2005 and 2004. The results of Lambda Power Business have been included in the historical financial statements of TDK since the date of acquisition. The unaudited pro forma financial information is not intended to represent or be indicative of TDK's consolidated results of operations or financial condition that would have been reported had the acquisition been completed as of the beginning of the periods presented and should not be taken as indicative of the TDK's future consolidated results of operations or financial condition.

(Unaudited)

| | Yen (Millions) | | U.S. Dollars (Thousands) |
|---|-------------------|-----------|-----------------------------|
| | 2006 | 2005 | 2006 |
| Net sales | ¥ 816,431 | ¥ 702,566 | \$ 6,978,043 |
| Income from continuing operations | 44,188 | 35,354 | 377,675 |
| Loss from discontinued operations | 310 | 3,665 | 2,650 |
| Net income | 43,878 | 31,689 | 375,026 |
| | | | |
| | Yen | | U.S. Dollars |
| | 2006 | 2005 | 2006 |
| Income from continuing operations per share: | | | |
| Basic | ¥ 334.15 | 267.24 | \$ 2.86 |
| Diluted | 333.86 | 267.07 | 2.85 |
| Loss from discontinued operations per share: | | | |
| Basic | ¥ (2.34) | (27.70) | \$ (0.02) |
| Diluted | (2.34) | (27.69) | (0.02) |
| Net income per share: | | | |
| Basic | ¥ 331.81 | 239.54 | \$ 2.84 |
| Diluted | 331.52 | 239.38 | 2.83 |

Unaudited pro forma net income for 2006 and 2005 includes ¥698 million (net of tax effect) for the amortization of acquired intangibles.

On May 17, 2005, TDK acquired 100 percent of the issued and outstanding shares of Amperex Technology Limited ("ATL"), a Hong Kong based company engaged in the production and sale of Polymer Lithium Batteries with about 3,000 employees, for the total purchase price of approximately ¥8,666 million, net of cash acquired. In connection with this transaction, TDK recognized goodwill of ¥3,803 million and intangible assets of ¥3,497 million.

24. Related party transaction

Receivables and payables include the following balances with affiliated companies at March 31, 2006 and 2005:

| | Yen (Millions) | | U.S. Dollars (Thousands) |
|----------|-------------------|-------|-----------------------------|
| | 2006 | 2005 | 2006 |
| Due from | ¥ 5,515 | 4,680 | \$ 47,137 |
| Due to | 5,169 | 5,068 | 44,179 |

Purchases, research and development expenses, and sales include the following transactions with affiliated companies for the years ended March 31, 2006, 2005 and 2004:

| | Yen (Millions) | | | U.S. Dollars (Thousands) |
|--|-------------------|----------|----------|-----------------------------|
| | 2006 | 2005 | 2004 | 2006 |
| Gross purchase | ¥ 55,963 | 52,351 | 46,608 | \$ 478,316 |
| Less raw materials sold with no mark-up | (46,580) | (43,786) | (38,133) | 398,120 |
| Net purchases | 9,383 | 8,565 | 8,475 | 80,196 |
| Research and development expenses | 2,141 | 2,089 | 1,130 | 18,299 |
| Sales | 249 | 198 | 161 | 2,128 |

25. Supplementary Information

| | Yen (Millions) | | | U.S. Dollars (Thousands) |
|------------------------------------|-------------------|--------|--------|-----------------------------|
| | 2006 | 2005 | 2004 | 2006 |
| (a) Statement of Income | | | | |
| Research and development | ¥ 45,528 | 36,348 | 32,948 | \$ 389,128 |
| Rent | 7,739 | 7,349 | 8,037 | 66,145 |
| Maintenance and repairs | 13,732 | 11,090 | 11,875 | 117,368 |
| Advertising costs | 4,828 | 4,926 | 6,261 | 41,265 |
| (b) Statement of Cash Flows | | | | |
| Cash paid during year for: | | | | |
| Interest | ¥ 749 | 331 | 350 | \$ 6,402 |
| Income taxes | ¥ 32,789 | 13,740 | 4,299 | \$ 280,248 |

Noncash activities

In fiscal 2006, noncash investing activities related to the purchase of subsidiaries were as follows:

| | Yen (Millions) | U.S. Dollars (Thousands) |
|---|-------------------|-----------------------------|
| Short-term debt assumed in connection with business acquisition | ¥ 781 | \$ 6,675 |
| Long-term debt assumed in connection with business acquisition | 2,107 | 18,009 |

In fiscal 2005, TDK received a 7.9 percent ownership interest in ALPS having a fair value of ¥3,365 million in exchange for all issued and outstanding shares of TDK Logistics in a share-to-share exchange transaction.

In fiscal 2004, there were no material noncash investing and financing activities.

Schedule

TDK CORPORATION AND SUBSIDIARIES
Valuation and Qualifying Accounts
(In millions of yen)
Years ended March 31, 2006, 2005 and 2004

| | <u>Balance at beginning of period</u> | <u>Charged to earnings</u> | <u>Bad debts written off</u> | <u>Translation adjustment</u> | <u>Balance at end of period</u> |
|---------------------------------------|---|--------------------------------|----------------------------------|-----------------------------------|-------------------------------------|
| Year ended March 31, 2006: | | | | | |
| Allowance for doubtful receivables | ¥ 2,560 | 1,355 | 71 | 220 | 4,064 |
| Year ended March 31, 2005: | | | | | |
| Allowance for doubtful receivables | ¥ 2,000 | 598 | 106 | 68 | 2,560 |
| Year ended March 31, 2004: | | | | | |
| Allowance for doubtful receivables | ¥ 2,850 | (227) | 373 | (250) | 2,000 |

Item 18. Financial Statements

Not applicable.

Item 19. Exhibits

Documents filed as exhibits to this annual report are as follows:

1. 1 ARTICLES OF INCORPORATION (English translation)
1. 2 REGULATIONS OF THE BOARD OF DIRECTORS (English translation)
2. 1 SHARE HANDLING REGULATIONS (English translation)
8. 1 List of Significant Subsidiaries
11. 1 TDK CODE OF ETHICS (English translation)
12. 1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of CEO of the Company
12. 2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of CFO of the Company
13. 1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of CEO of the Company
13. 2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of CFO of the Company

SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the Registrant certifies that it meets all the requirements for filing of Form 20-F and has duly caused this annual report to be signed on its behalf by the undersigned, thereunto duly authorized.

TDK Corporation
(Registrant)

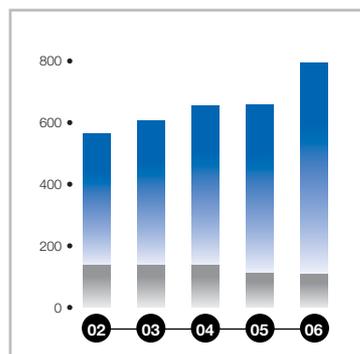
Date: July 27, 2006

By: /s/Hajime Sawabe
Hajime Sawabe
Representative Director,
Chairman and CEO

Financial Data

Net sales

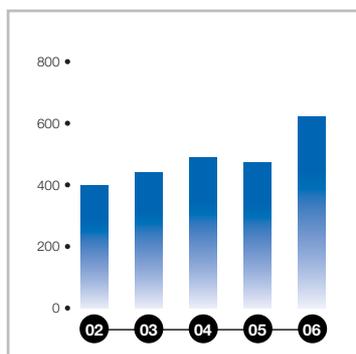
(Yen in billions)



■ Electronic materials and components
■ Recording media

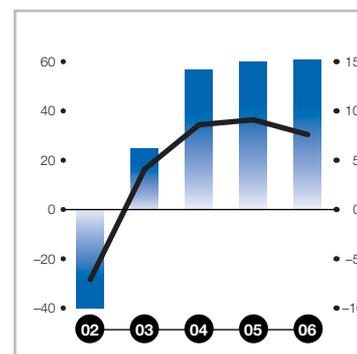
Overseas sales

(Yen in billions)



Operating income (loss) and ratio to net sales

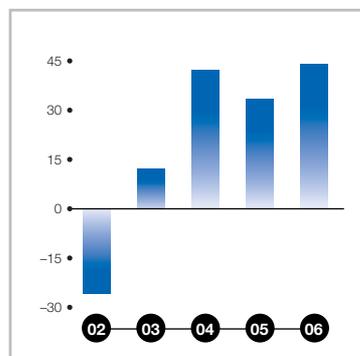
(Yen in billions, %)



■ Operating income (loss)
— Ratio to net sales

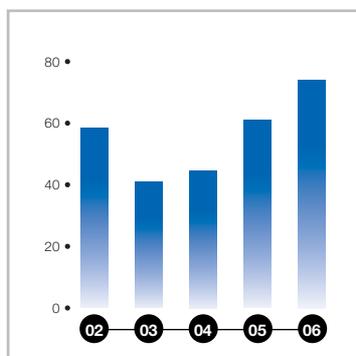
Net income (loss)

(Yen in billions)



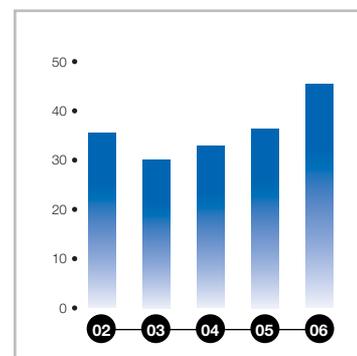
Capital expenditures

(Yen in billions)



Research and development

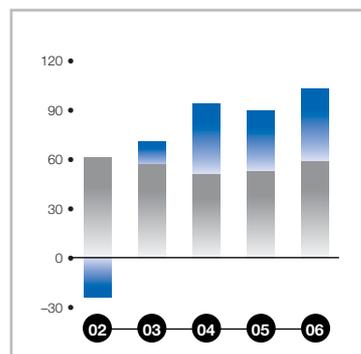
(Yen in billions)



| | (Yen in millions) | | | | |
|--|-------------------|---------|---------|---------|----------|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| Net sales | ¥795,180 | 657,853 | 655,792 | 604,865 | 564,286 |
| Electronic materials and components | ¥687,750 | 545,214 | 519,792 | 468,514 | 426,661 |
| Recording media | ¥107,430 | 112,639 | 136,000 | 136,351 | 137,625 |
| Overseas sales | ¥621,522 | 473,828 | 487,169 | 439,381 | 399,508 |
| Operating income (loss) and ratio to net sales | | | | | |
| Operating income (loss) | ¥ 60,523 | 59,830 | 56,510 | 24,547 | (40,230) |
| Ratio to net sales (%) | 7.6% | 9.1 | 8.6 | 4.1 | (7.1) |
| Net income (loss) | ¥ 44,101 | 33,300 | 42,101 | 12,019 | (25,771) |
| Capital expenditures | ¥ 73,911 | 61,005 | 44,471 | 41,026 | 58,347 |
| Research and development | ¥ 45,528 | 36,348 | 32,948 | 30,099 | 35,530 |

Net cash flows

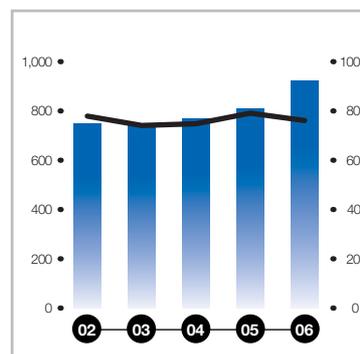
(Yen in billions)



■ Net income (loss)
■ Depreciation and amortization

Total assets and stockholders' equity ratio

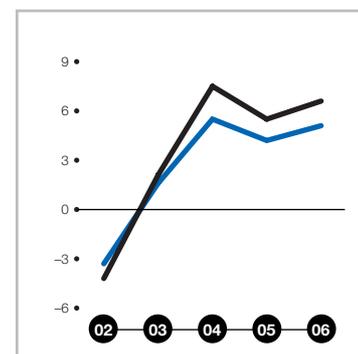
(Yen in billions, %)



■ Total assets
— Stockholders' equity ratio

Return on total assets and return on equity

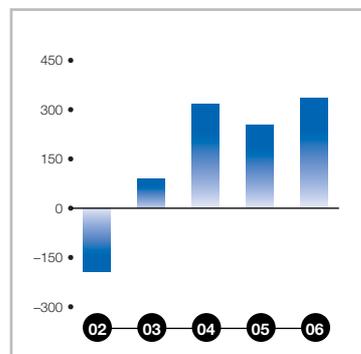
(%)



— Return on total assets
— Return on equity

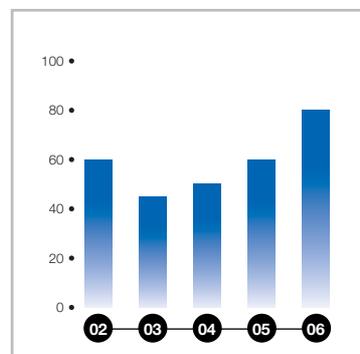
Basic net income (loss) per share

(Yen)

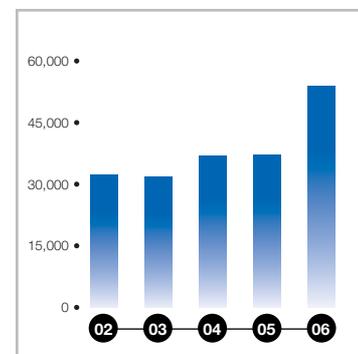


Dividend per share

(Yen)



Number of employees



(Yen in millions)

| | 2006 | 2005 | 2004 | 2003 | 2002 |
|--|----------|---------|---------|---------|----------|
| Net cash flows | | | | | |
| Net income (loss) | ¥ 44,101 | 33,300 | 42,101 | 12,019 | (25,771) |
| Depreciation and amortization | 58,540 | 52,806 | 50,726 | 57,132 | 60,981 |
| Total assets and stockholders' equity ratio | | | | | |
| Total assets | ¥923,503 | 808,001 | 770,319 | 747,337 | 749,910 |
| Stockholders' equity ratio (%) | 76.1% | 79.1 | 74.8 | 74.1 | 77.9 |
| Return on total assets and return on equity | | | | | |
| Return on total assets (%) | 5.1% | 4.2 | 5.5 | 1.6 | (3.3) |
| Return on equity (%) | 6.6% | 5.5 | 7.5 | 2.1 | (4.2) |
| Net income (loss) per share | | | | | |
| Basic (Yen) | ¥ 333.50 | 251.71 | 317.80 | 90.56 | (193.91) |
| Diluted (Yen) | 333.20 | 251.56 | 317.69 | 90.56 | (193.91) |
| Dividend per share (Yen) | ¥ 80.00 | 60.00 | 50.00 | 45.00 | 60.00 |
| Number of employees | 53,923 | 37,115 | 36,804 | 31,705 | 32,249 |

Investor Information (As of March 31, 2006)



CORPORATE HEADQUARTERS

TDK CORPORATION

1-13-1, Nihonbashi, Chuo-ku,
Tokyo 103-8272 Japan

DATE OF ESTABLISHMENT

December 7, 1935

PAID-IN CAPITAL

¥32,641,976,312

AUTHORIZED NUMBER OF SHARES

480,000,000 shares

ISSUED NUMBER OF SHARES

133,189,659 shares

NUMBER OF SHAREHOLDERS

26,068

SECURITIES TRADED

Japan: Tokyo, Osaka
Overseas: New York, London, Brussels

ADMINISTRATOR OF SHAREHOLDER'S REGISTER

The Chuo Mitsui Trust & Banking Co., Ltd.
3-33-1, Shiba, Minato-ku, Tokyo 105-8574 Japan

DEPOSITORY FOR AMERICAN DEPOSITARY RECEIPTS (ADRs)

Citibank, N.A.
111 Wall Street, 20th Floor, Zone 7
New York, NY 10005 U.S.A.

INDEPENDENT AUDITORS

KPMG AZSA & Co.

Quarterly Results and Stock Price Data

Yen in millions, except per share amounts and stock price data

| FY March 2005 | I | II | III | IV |
|---|----------|----------|----------|----------|
| Net sales | ¥157,227 | ¥160,265 | ¥174,218 | ¥166,143 |
| Net income | 10,163 | 9,706 | 12,209 | 1,222 |
| Net income per share (basic) (Yen) | 76.75 | 73.36 | 92.35 | 9.24 |
| (diluted) (Yen) | 76.69 | 73.31 | 92.29 | 9.24 |
| Stock price (Tokyo Stock Exchange) (Yen): | | | | |
| High | 8,630 | 8,390 | 7,910 | 7,880 |
| Low | 7,130 | 6,790 | 7,160 | 7,050 |
| FY March 2006 | I | II | III | IV |
| Net sales | ¥167,422 | ¥182,965 | ¥222,654 | ¥222,139 |
| Net income | 10,874 | 10,792 | 16,568 | 5,867 |
| Net income per share (basic) (Yen) | 82.22 | 81.62 | 125.31 | 44.35 |
| (diluted) (Yen) | 82.18 | 81.55 | 125.16 | 44.31 |
| Stock price (Tokyo Stock Exchange) (Yen): | | | | |
| High | 8,020 | 8,740 | 10,230 | 9,070 |
| Low | 7,250 | 7,480 | 7,530 | 7,730 |

Note: All quarterly data are unaudited and have not been reviewed by the independent auditors.

FURTHER INFORMATION

For further information and additional copies of this booklet and other publications, please contact:

● TDK Corporation

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● TDK Marketing Europe GmbH

MARCO DONADONI
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Tel: +49(2102)4870

● E-mail

tdkhqir@mb1.tdk.co.jp

INTERNET ADDRESS

<http://www.tdk.co.jp/>
TDK provides various investor information, including its latest earnings results, in the IR Information section of its website.

For inquiries concerning ADRs, please contact:

Citibank, N.A. Shareholder Services
P.O. Box 43077
Providence, Rhode Island 02940-3077
U.S.A.
Tel: 1-877-248-4237 CITI-ADR (toll free)
Tel: 1-816-843-4281 (out of U.S.)
Fax: 1-201-324-3284
Internet: www.citigroup.com/adr
E-mail: citibank@shareholders-online.com



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<http://www.tdk.co.jp/>



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