

# Consolidated Balance Sheets

Nippon Kayaku Co., Ltd. and Consolidated Subsidiaries  
Years Ended May 31, 2002 and 2001

|   | Millions of yen  |                  | Thousands of<br>U.S. dollars<br>(Note 2) |
|---|------------------|------------------|--|
|   | 2002             | 2001             | 2002                                     |
| <b>Assets</b>   |                  |                  |  |
| <b>Current assets:</b>                                      |                  |                  |  |
| Cash and cash equivalents (Note 4).....                     | ¥ 25,942         | ¥ 27,826         | \$ 210,141                               |
| Time deposits (Note 6).....                                 | 301              | 3,207            | 2,438                                    |
| Marketable securities (Note 4).....                         | 3,501            | 1,498            | 28,359                                   |
| Receivables:  |                  |                  |  |
| Trade .....   | 42,332           | 41,645           | 342,908                                  |
| Less allowance for doubtful receivables.....                | (138)            | (197)            | (1,117)                                  |
| Inventories (Note 3) .....                                  | 20,886           | 22,262           | 169,185                                  |
| Deferred income taxes (Note 7).....                         | 1,273            | 1,390            | 10,311                                   |
| Other current assets .....                                  | 1,999            | 2,211            | 16,192                                   |
| <b>Total current assets</b> .....                           | <b>96,099</b>    | <b>99,845</b>    | <b>778,444</b>                           |
| <b>Property, plant and equipment (Notes 5 and 6):</b> ..... | <b>169,470</b>   | <b>162,666</b>   | <b>1,372,782</b>                         |
| Less accumulated depreciation .....                         | <b>(110,786)</b> | <b>(105,482)</b> | <b>(897,415)</b>                         |
| <b>Property, plant and equipment, net</b> .....             | <b>58,683</b>    | <b>57,183</b>    | <b>475,358</b>                           |
| <b>Investments and other assets:</b>                        |                  |                  |  |
| Investment securities (Notes 4 and 6) .....                 | 14,606           | 15,030           | 118,315                                  |
| Deferred income taxes (Note 7).....                         | 1,366            | 2,235            | 11,065                                   |
| Other assets .....  | 6,081            | 5,587            | 49,258                                   |
| <b>Total investments and other assets</b> .....             | <b>22,054</b>    | <b>22,853</b>    | <b>178,647</b>                           |
| <b>Total assets</b> .....                                   | <b>¥ 176,836</b> | <b>¥ 179,882</b> | <b>\$1,432,450</b>                       |

|   | Millions of yen  |                  | Thousands of<br>U.S. dollars<br>(Note 2) |
|---|------------------|------------------|--|
|   | 2002             | 2001             | 2002                                     |
| Liabilities and shareholders' equity                    |                  |                  |  |
| <b>Current liabilities:</b>                             |                  |                  |  |
| Short-term bank loans (Note 6).....                     | ¥ 3,279          | ¥ 2,981          | \$ 26,561                                |
| Current portion of long-term debt (Note 6).....         | 4,497            | 3,596            | 36,427                                   |
| Payables:   |                  |                  |  |
| Trade (Note 6).....                                     | 15,409           | 17,145           | 124,819                                  |
| Unconsolidated subsidiaries and affiliates.....         | 815              | 1,264            | 6,601                                    |
| Construction.....                                       | 1,929            | 2,420            | 15,625                                   |
| Other.....  | 5,851            | 4,404            | 47,395                                   |
| Accrued expenses.....                                   | 4,237            | 3,379            | 34,321                                   |
| Accrued income taxes.....                               | 754              | 3,997            | 6,107                                    |
| Other current liabilities.....                          | 571              | 682              | 4,625                                    |
| <b>Total current liabilities</b> .....                  | <b>37,346</b>    | <b>39,872</b>    | <b>302,519</b>                           |
| <b>Non-current liabilities:</b>                         |                  |                  |  |
| Long-term debt, less current portion (Note 6).....      | 10,170           | 12,169           | 82,381                                   |
| Retirement benefits (Note 8).....                       | 7,479            | 8,570            | 60,583                                   |
| Other non-current liabilities (Note 6).....             | 19,600           | 19,534           | 158,768                                  |
| Deferred income taxes (Note 7).....                     | 833              | 897              | 6,747                                    |
| <b>Total non-current liabilities</b> .....              | <b>38,084</b>    | <b>41,172</b>    | <b>308,497</b>                           |
| <b>Minority interests</b> .....                         | <b>5,157</b>     | <b>4,507</b>     | <b>41,773</b>                            |
| <b>Shareholders' equity (Notes 11 and 15):</b>          |                  |                  |  |
| Common stock:   |                  |                  |  |
| Authorized – 700,000,000 shares                         |                  |                  |  |
| Issued – 182,503,570 shares in 2002 and 2001.....       | 14,932           | 14,932           | 120,955                                  |
| Additional paid-in capital.....                         | 17,257           | 17,257           | 139,789                                  |
| Retained earnings.....                                  | 62,402           | 61,841           | 505,484                                  |
| Translation adjustments.....                            | 590              | 322              | 4,779                                    |
| Less treasury stock, at cost.....                       | (42)             | (23)             | (340)                                    |
| Unrealized holding gains on other securities.....       | 1,107            | –                | 8,967                                    |
| <b>Total shareholders' equity</b> .....                 | <b>96,248</b>    | <b>94,331</b>    | <b>779,651</b>                           |
| <b>Contingent liabilities (Note 10)</b>                 |                  |                  |  |
| <b>Total liabilities and shareholders' equity</b> ..... | <b>¥ 176,836</b> | <b>¥ 179,882</b> | <b>\$1,432,450</b>                       |

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Income and Retained Earnings

Nippon Kayaku Co., Ltd. and Consolidated Subsidiaries  
Years Ended May 31, 2002 and 2001

|  | Millions of yen  |           | Thousands of<br>U.S. dollars<br>(Note 2) |
|--|------------------|-----------|--|
|  | 2002             | 2001      | 2002                                     |
| <b>Net sales</b> .....   | <b>¥ 119,435</b> | ¥ 121,002 | <b>\$ 967,476</b>                        |
| <b>Cost of sales</b> .....   | <b>74,745</b>    | 72,775    | <b>605,467</b>                           |
| <b>Gross profit</b> .....  | <b>44,690</b>    | 48,227    | <b>362,008</b>                           |
| <b>Selling, general and administrative expenses</b> .....              | <b>35,305</b>    | 34,950    | <b>285,986</b>                           |
| <b>Operating income</b> .....  | <b>9,384</b>     | 13,277    | <b>76,014</b>                            |
| <b>Other income (expenses):</b>  |                  |           |  |
| Interest and dividend income .....                                     | <b>279</b>       | 596       | <b>2,260</b>                             |
| Interest expense .....   | <b>(492)</b>     | (598)     | <b>(3,985)</b>                           |
| Other, net.....  | <b>(1,861)</b>   | (2,600)   | <b>(15,074)</b>                          |
|  | <b>(2,074)</b>   | (2,601)   | <b>(16,800)</b>                          |
| <b>Income before income taxes and minority interests</b> .....         | <b>7,309</b>     | 10,675    | <b>59,206</b>                            |
| <b>Income taxes (Note 7):</b>  |                  |           |  |
| Current .....  | <b>4,087</b>     | 6,562     | <b>33,106</b>                            |
| Deferred.....  | <b>147</b>       | (1,714)   | <b>1,190</b>                             |
| <b>Minority interests</b> .....  | <b>444</b>       | 923       | <b>3,596</b>                             |
| <b>Net income</b> .....  | <b>2,630</b>     | 4,903     | <b>21,304</b>                            |
| <b>Retained earnings at beginning of year</b> .....                    | <b>61,841</b>    | 58,500    | <b>500,939</b>                           |
| Increase resulting from consolidation of additional subsidiaries ..... | —                | 505       | —  |
| Bonuses to directors .....   | <b>(63)</b>      | (60)      | <b>(510)</b>                             |
| Cash dividends paid .....  | <b>(2,007)</b>   | (2,007)   | <b>(16,257)</b>                          |
| <b>Retained earnings at end of year</b> .....                          | <b>¥ 62,402</b>  | ¥ 61,841  | <b>\$ 505,484</b>                        |

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

Nippon Kayaku Co., Ltd. and Consolidated Subsidiaries  
Years Ended May 31, 2002 and 2001

|  | Millions of yen |         | Thousands of<br>U.S. dollars<br>(Note 2) |
|--|-----------------|---------|--|
|  | 2002            | 2001    | 2002                                     |
| Cash flows from operating activities   |                 |         |  |
| <b>Income before income taxes and minority interests</b> .....                           | <b>¥ 7,309</b>  | ¥10,675 | <b>\$ 59,206</b>                         |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                 |         |  |
| Depreciation and amortization .....  | 7,250           | 7,157   | 58,728                                   |
| Increase (decrease) in reserves .....  | (1,355)         | 343     | (10,976)                                 |
| Interest and dividend income.....  | (279)           | (596)   | (2,260)                                  |
| Interest expense .....   | 492             | 598     | 3,985                                    |
| Equity in earnings of affiliates .....   | (306)           | (37)    | (2,478)                                  |
| Gain on contribution of securities to employees' retirement benefit trust .....          | —               | (3,571) | —  |
| Amortization of net retirement benefit obligation at transition.....                     | —               | 6,203   | —  |
| Gain on sales of property, plant and equipment, net.....                                 | (94)            | (588)   | (761)                                    |
| Gain on sales of investment securities, net .....  | 760             | (916)   | 6,156                                    |
| Loss on revaluation of investment securities .....                                       | 1,107           | 155     | 8,967                                    |
| Changes in operating assets and liabilities:   |                 |         |  |
| Notes and accounts receivable - trade .....  | (654)           | 1,740   | (5,297)                                  |
| Inventories .....  | 1,391           | (926)   | 11,267                                   |
| Notes and accounts payable - trade .....   | (2,209)         | 1,678   | (17,893)                                 |
| Payables - other.....  | 1,322           | (4,725) | 10,708                                   |
| Other .....  | 1,591           | (633)   | 12,887                                   |
| Subtotal.....  | 16,326          | 16,556  | 132,247                                  |
| Interest and dividends received .....  | 454             | 596     | 3,677                                    |
| Interest paid .....  | (495)           | (603)   | (4,009)                                  |
| Income taxes paid.....   | (7,330)         | (4,677) | (59,376)                                 |
| <b>Net cash provided by operating activities</b> .....                                   | <b>8,954</b>    | 11,872  | <b>72,531</b>                            |
| Cash flows from investing activities   |                 |         |  |
| Proceeds from maturity of time deposits, net .....                                       | 2,893           | (870)   | 23,434                                   |
| Purchase of marketable securities, net .....   | (2,172)         | 1       | (17,594)                                 |
| Purchase of property, plant and equipment.....   | (8,585)         | (6,475) | (69,542)                                 |
| Proceeds from sales of property, plant and equipment .....                               | 601             | 916     | 4,868                                    |
| Acquisition of goodwill and other intangible assets .....                                | (1,206)         | (997)   | (9,769)                                  |
| Proceeds from sales of investment securities, net .....                                  | 492             | 956     | 3,985                                    |
| Other.....   | 32              | (447)   | 259                                      |
| <b>Net cash used in investing activities</b> .....                                       | <b>(7,944)</b>  | (6,915) | <b>(64,349)</b>                          |
| Cash flows from financing activities   |                 |         |  |
| Net increase (decrease) short-term debt.....   | 230             | 726     | 1,863                                    |
| Proceeds from long-term debt .....   | 2,707           | 327     | 21,927                                   |
| Repayment of long-term debt .....  | (3,965)         | (1,793) | (32,118)                                 |
| Proceeds from payment by minority shareholders .....                                     | 165             | 607     | 1,336                                    |
| Cash dividends paid .....  | (2,001)         | (2,005) | (16,208)                                 |
| Other.....   | (80)            | (59)    | (648)                                    |
| <b>Net cash used in financing activities</b> .....                                       | <b>(2,945)</b>  | (2,197) | <b>(23,855)</b>                          |
| <b>Effect of exchange rate changes on cash and cash equivalents</b> .....                | <b>50</b>       | 343     | <b>405</b>                               |
| <b>Increase in cash and cash equivalents</b> .....                                       | <b>(1,883)</b>  | 3,102   | <b>(15,253)</b>                          |
| <b>Cash and cash equivalents at beginning of year</b> .....                              | <b>27,826</b>   | 23,968  | <b>225,402</b>                           |
| <b>Increase due to inclusion in consolidation</b> .....                                  | <b>—</b>        | 755     | <b>—</b>                                 |
| <b>Cash and cash equivalents at end of year</b> .....                                    | <b>¥25,942</b>  | ¥27,826 | <b>\$210,141</b>                         |

See accompanying notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

Nippon Kayaku Co., Ltd. and Consolidated Subsidiaries  
May 31, 2002 and 2001

## 1. Basis of Consolidated Financial Statements

### a. Basis of Preparation

The books and records of Nippon Kayaku Co., Ltd. (the "Company") and its consolidated domestic subsidiaries are maintained in the manner and form required or permitted under the Commercial Code of Japan and Japanese accounting practices. The books and records of overseas consolidated subsidiaries are maintained in conformity with the accounting principles and relevant legal requirements of their countries of domicile.

The accompanying consolidated financial statements have been compiled from the consolidated financial statements prepared by the Company as required under the Securities and Exchange Law of Japan, and in conformity with accounting principles and practices generally accepted in Japan, which may differ in some material respects from accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

In addition, the notes to the consolidated financial statements include information which is not required under accounting principles generally accepted in Japan but is presented herein as additional information.

As permitted by the Securities and Exchange Law of Japan, amounts of less than one million yen have been omitted. As a result, the totals shown in the accompanying financial statements (both in yen and in dollars) do not necessarily agree with the sums of the individual amounts.

Certain amounts previously reported have been reclassified to conform to the current year classifications.

### b. Basis of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its significant subsidiaries controlled directly or indirectly by the Company (the "Companies"). Investment in companies over which the Company exercises significant influence in terms of their operating and financial policies have been included in the consolidated financial statements on an equity basis.

All significant intercompany balances and transactions have been eliminated in consolidation.

Investments in unconsolidated subsidiaries and affiliates not accounted for by the equity method are generally stated at cost.

The differences at the dates of acquisition between the cost and underlying net equity of the consolidated subsidiaries and companies accounted for by the equity method are being amortized by the straight-line method over a period of five years.

In consolidated statements of shareholders' equity, legal reserve of the Company and the consolidated domestic subsidiaries have been included in retained earnings.

### c. Foreign Currency Translation

The accounts of foreign consolidated subsidiaries, except for the components of shareholders' equity, are translated into yen at the rates of exchange in effect at the balance sheet date. The components of shareholders' equity are translated at their historical exchange rates.

Translation differences arising from the translation of the financial statements of the foreign consolidated subsidiaries are presented as translation adjustments.

In accordance with a new accounting standard for foreign currency translation which became effective June 1, 2000, the Company has presented translation adjustments as a component of shareholders' equity and minority interests (instead of as a component of assets or liabilities) in its consolidated financial statements for the year ended May 31, 2001, and has restated the previously reported consolidated financial statements for the year ended May 31, 2000. However, the adoption of this new standard had no material impact on the consolidated statement of income for the year ended May 31, 2001.

Monetary assets and liabilities denominated in foreign currencies of the Company and its domestic consolidated subsidiaries are translated into yen at the current rates except for those hedged by forward foreign exchange contracts, which are translated at the contracted rates.

Gains and losses arising from exchange differences are credited or charged to income in the year in which they are incurred.

The revised accounting standard for foreign currency translation has been applied effective the year ended May 31, 2001. The effect of the adoption of this revised standard on the consolidated financial statements was immaterial.

### d. Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

### e. Securities

Until the year ended May 31, 2000, marketable securities were stated principally at the lower of cost or market, cost being determined by the moving average method and investment securities other than marketable securities were stated at cost determined by the moving average method.

A new accounting standard for financial instruments, which became effective April 1, 2000, requires that

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securities be classified into three categories: trading, held-to-maturity or other securities. Under the new standard, trading securities are carried at fair value and held-to-maturity securities are carried at amortized cost. Marketable securities classified as other securities are carried at fair value with changes in unrealized holding gain or loss, net of the applicable income taxes, included directly in shareholders' equity. Non-marketable securities classified as other securities are carried at cost. Cost of securities sold is determined by the moving average method.

However, the Company and its consolidated subsidiaries stated all marketable securities classified as other securities at the lower of cost or market, taking advantage of an exception rule which allows the Company and its consolidated subsidiaries to measure marketable securities classified as other securities at cost until the year ended May 31, 2001. As of June 1, 2000, the Company and its consolidated subsidiaries assessed their intent to hold their securities and classified their securities as "trading", "held-to-maturity" or "other securities" and accounted for the securities at May 31, 2001 in accordance with the new standard referred to above.

The effect of the adoption of this new standard for financial instruments was to increase income before income taxes by ¥508 million for the year ended May 31, 2001 and to decrease marketable securities by ¥3,817 million and to increase investment securities by the same amount at May 31, 2001.

Effective June 1, 2001, the Company and its consolidated subsidiaries have adopted this new accounting standard for financial instruments with respect to securities classified as other securities with quoted market prices. These securities are stated at market value although they were stated at cost in the previous year as described above. The effect of this change was to account for unrealized holding gain on other securities of ¥1,107 million (\$8,967 thousand) in the shareholders' equity, deferred tax liabilities of ¥775 million (\$6,277 thousand) and minority interests of ¥(11) million (\$89 thousand) at May 31, 2002 compared with those at May 31, 2001.

**f. Inventories**

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

**g. Property, Plant and Equipment**

Property, plant and equipment is stated at cost except that the cost of certain assets has been reduced by certain capital gains in accordance with the Corporation Tax Law of Japan.

Depreciation is mainly computed on the declining-balance method, except that the straight-line method is applied to buildings which were acquired after April 1, 1998 based on the estimated useful lives of the respective assets.

**h. Leases**

Finance lease transactions are primarily accounted for as operating leases except that lease agreements which stipulate transfer of ownership of the leased assets to the lessee are accounted for as finance leases.

**i. Retirement Benefits**

The Company and its domestic consolidated subsidiaries have defined benefit plans, i.e., welfare pension fund plans, tax-qualified pension plans and lump-sum payment plans, covering substantially all employees who are entitled to lump-sum or annuity payments, the amounts of which are determined by reference to their basic rates of pay, length of service, and the conditions under which termination occurs. Certain foreign subsidiaries have defined contribution plans.

Until the year ended May 31, 2000, accrued severance indemnities represent 40% of the amount which would be required to be paid if all employees covered by the plan voluntarily terminated their employment at the balance sheet date exclusive of the payments to be made under the pension plans.

In accordance with a new accounting standard for retirement benefits which became effective April 1, 2000, accrued retirement benefits for employees at May 31, 2002 have been provided mainly at an amount calculated based on the retirement benefit obligation and the fair value of the pension plan assets as of May 31, 2002, as adjusted for unrecognized net retirement benefit obligation at transition, unrecognized actuarial gain or loss, and unrecognized past service cost. The retirement benefit obligation is attributed to each period by the straight-line method over the estimated years of service of the eligible employees. The net retirement benefit obligation at transition was fully charged to income for the year ended May 31, 2001. Actuarial gain and loss are amortized in the year following the year in which the gain or loss is recognized primarily by the straight-line method over periods of 10 years which are shorter than the average remaining years of service of the eligible employees.

The effect of the adoption of the new standard for retirement benefit was to decrease income before income taxes and minority interests by ¥2,565 million for the year ended May 31, 2001.

Directors and statutory auditors of the Company and its domestic consolidated subsidiaries are customarily entitled to lump-sum retirement payments under their respective unfunded retirement plan subject to the stockholders' approval. Provision for the retirement benefits for those officers has been made at estimated amount.

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**j. Derivative Financial Instruments**

The Company has entered into various derivative transactions in order to manage certain risks arising from adverse fluctuations in foreign currency exchange rates. In accordance with a new accounting standard for financial instruments which became effective April 1, 2000, derivatives are carried at fair value with changes in unrealized gain or loss charged or credited to operations. Receivables and payables hedged by qualified derivatives are translated at the corresponding foreign exchange contract rates.

**2. U.S. Dollar Amounts**

The translation of yen amounts into U.S. dollar amounts is included solely for the convenience of readers outside Japan. The rate of ¥123.45 = U.S.\$1, the approximate rate of exchange on May 31, 2002, has been used. The inclusion of such amounts is not intended to imply that the yen amounts have been or could be readily converted, realized or settled in U.S. dollars at that or any other rate.

**3. Inventories**

Inventories at May 31, 2002 and 2001 consisted of the following:

|  | Millions of yen |                 | Thousands of U.S. dollars |
|--|-----------------|-----------------|---------------------------|
|  | 2002            | 2001            | 2002                      |
| Merchandise .....                                | ¥ 3,341         | ¥ 3,057         | \$ 27,063                 |
| Finished products .....                          | 7,861           | 9,030           | 63,677                    |
| Semi-finished products and work in process ..... | 6,163           | 6,663           | 49,923                    |
| Raw materials and supplies .....                 | 3,520           | 3,511           | 28,513                    |
|  | <u>¥ 20,886</u> | <u>¥ 22,262</u> | <u>\$ 169,185</u>         |

**4. Marketable and Investment Securities**

Information regarding marketable securities classified as other securities as of May 31, 2002 is as follows:

Marketable other securities

|  | Millions of yen  |                 |                        | Millions of U.S. dollars |                  |                        |
|--|------------------|-----------------|------------------------|--------------------------|------------------|------------------------|
|  | Acquisition cost | Carrying value  | Unrealized gain (loss) | Acquisition cost         | Carrying value   | Unrealized gain (loss) |
| <b>May 31, 2002</b>  |                  |                 |                        |                          |                  |                        |
| Securities whose carrying value exceeds their acquisition cost : |                  |                 |                        |                          |                  |                        |
| Stock .....  | ¥ 3,555          | ¥ 5,718         | ¥ 2,162                | \$ 28,797                | \$ 46,318        | \$ 17,513              |
| Debt securities .....  | 11               | 16              | 5                      | 89                       | 129              | 40                     |
| Other .....  | 2,786            | 2,803           | 16                     | 22,567                   | 22,705           | 129                    |
| Subtotal .....   | <u>6,354</u>     | <u>8,538</u>    | <u>2,184</u>           | <u>51,470</u>            | <u>69,161</u>    | <u>17,691</u>          |
| Securities whose acquisition cost exceeds their carrying value:  |                  |                 |                        |                          |                  |                        |
| Stock .....  | 725              | 474             | (251)                  | 5,872                    | 3,839            | (2,033)                |
| Debt securities .....  | -                | -               | -                      | -                        | -                | -                      |
| Other .....  | 1,409            | 1,320           | (88)                   | 11,413                   | 10,692           | (712)                  |
| Subtotal .....   | <u>2,134</u>     | <u>1,795</u>    | <u>(339)</u>           | <u>17,286</u>            | <u>14,540</u>    | <u>(2,746)</u>         |
| Total .....  | <u>¥ 8,488</u>   | <u>¥ 10,334</u> | <u>¥ 1,845</u>         | <u>\$ 68,756</u>         | <u>\$ 83,710</u> | <u>\$ 14,945</u>       |

Sales of securities classified as other securities amounted to ¥6,435 million (\$52,126 thousand) with the aggregate gain of ¥105 million (\$850 thousand) and the aggregate loss of ¥176 million (\$1,425 thousand) for the year ended May 31, 2002.

The book value of current and non-current marketable securities and their related aggregate market values at May 31, 2001 were as follows:

|                              | May 31, 2001    |
|------------------------------|-----------------|
|                              | Millions of yen |
| Carrying value .....         | ¥11,023         |
| Aggregate market value ..... | 13,600          |
| Net unrealized gains .....   | 2,577           |

## 5. Depreciation

Depreciation for property, plant and equipment for the years ended May 31, 2002 were ¥6,740 million (\$54,597 thousand).

## 6. Short-Term Bank Loans and Long-Term Debt

Short-term bank loans are unsecured and are generally represented by 60-day notes. The weighted average interest rates for the years ended May 31, 2002 and 2001 were approximately 1.82% and 2.10%, respectively.

The interest rates applicable to the long-term borrowings (except for current portion) at May 31, 2002 and 2001 average approximately 3.60% and 2.85%, respectively.

Long-term debt at May 31, 2002 and 2001 consisted of the following:

|  | Millions of yen |          | Thousands of U.S. dollars |
|--|-----------------|----------|---------------------------|
|  | 2002            | 2001     | 2002                      |
| Bonds without collateral:  |                 |          |                           |
| 1.95% bonds due 2003 .....   | ¥ 3,000         | ¥ 3,000  | \$ 24,301                 |
| 2.47% bonds due 2005 .....   | 3,000           | 3,000    | 24,301                    |
| Collateralized loans from banks, insurance companies, government agencies and other financial institutions, due through 2030 ..... | 3,869           | 4,962    | 31,340                    |
|  | 4,798           | 4,803    | 38,865                    |
| Loans without collateral .....   | 14,667          | 15,765   | 118,809                   |
| Less current portion .....   | (4,497)         | (3,596)  | (36,427)                  |
|  | ¥ 10,170        | ¥ 12,169 | \$ 82,381                 |

The aggregate annual maturities of long-term debt subsequent to May 31, 2002 are as follows:

| Year ending May 31,       | Millions of yen | Thousands of U.S. dollars |
|---------------------------|-----------------|---------------------------|
|                           |                 |                           |
| 2003 .....                | ¥ 4,497         | \$ 36,427                 |
| 2004 .....                | 1,771           | 14,345                    |
| 2005 .....                | 4,155           | 33,657                    |
| 2006 and thereafter ..... | 4,244           | 34,378                    |
|                           | ¥ 14,667        | \$ 118,809                |

Assets pledged as collateral for long-term debt, other non-current liabilities and payables-trade at May 31, 2002 are summarized as follows:

|  | Millions of yen | Thousands of U.S. dollars |
|--|-----------------|---------------------------|
|  |                 |                           |
| Time deposits .....                                    | ¥ 80            | \$ 648                    |
| Investment securities .....                            | 219             | 1,773                     |
| Property, plant and equipment, at net book value ..... | 14,943          | 121,044                   |
|  | ¥ 15,242        | \$ 123,466                |

## 7. Income Taxes

The Company and its domestic consolidated subsidiaries are subject to a number of taxes based on income which, in the aggregate, resulted in statutory tax rates of 41.88% in 2002 and 2001. Income taxes of the foreign consolidated subsidiaries are based generally on the tax rates applicable in their countries of incorporation.

The effective tax rate reflected in the accompanying consolidated statement of income for the year ended May 31, 2002 and 2001 differed from the statutory tax rate for the following reasons:

|  | 2002   | 2001   |
|--|--------|--------|
| Statutory tax rate .....   | 41.88% | 41.88% |
| Effect of:   |        |        |
| Expenses not deductible for income tax purposes .....                                | 1.94   | 2.21   |
| Dividend income deductible for income tax purposes .....                             | -      | (1.71) |
| Inhabitants' tax based on individuals .....  | 1.23   | 0.98   |
| Amortization of consolidation adjustments .....                                      | 0.68   | 0.48   |
| Effect of sales of investment in affiliates accounted for by the equity method ..... | 11.25  | -      |
| Other, net .....   | 0.96   | 1.58   |
| Effective tax rate .....   | 57.94% | 45.42% |

## 7. Income Taxes (continued)

The significant components of deferred tax assets and liabilities as of May 31, 2002 and 2001 were as follows:

|  | Millions of yen |         | Thousands of<br>U.S. dollars |
|--|-----------------|---------|------------------------------|
|  | 2002            | 2001    | 2002                         |
| Deferred tax assets:   |                 |         |                              |
| Accrued retirement benefits .....  | ¥ 2,456         | ¥ 2,487 | \$ 19,894                    |
| Accrued bonuses .....  | 902             | 568     | 7,306                        |
| Write down on investment securities.....                                       | 138             | 72      | 1,117                        |
| Accrued enterprise tax .....   | 58              | 338     | 469                          |
| Allowance for sales rebate .....   | 75              | 190     | 607                          |
| Other .....  | 887             | 704     | 7,185                        |
| Total deferred tax assets .....  | 4,518           | 4,361   | 36,597                       |
| Valuation allowance.....   | (46)            | (65)    | (372)                        |
|  | 4,471           | 4,295   | 36,217                       |
| Deferred tax liabilities:  |                 |         |                              |
| Adjustment of acquisition costs of fixed assets.....                           | (937)           | (829)   | (7,590)                      |
| Unrealized holding gains on other securities .....                             | (775)           | -       | (6,277)                      |
| Adjustments for book value relating to land of consolidated subsidiaries ..... | (706)           | (706)   | (5,718)                      |
| Other .....  | (247)           | (31)    | (2,000)                      |
| Total deferred tax liabilities .....   | (2,666)         | (1,567) | (21,595)                     |
| Net deferred tax assets.....   | ¥ 1,805         | ¥ 2,728 | \$ 14,621                    |

## 8. Retirement Benefit Plans

The following table sets forth the funded and accrued status of the plans, and the amounts recognized in the consolidated balance sheet as of May 31, 2002 and 2001 for the Company's and the consolidated subsidiaries' defined benefit plans:

|   | Millions of yen |            | Thousands of<br>U.S. dollars |
|---|-----------------|------------|------------------------------|
|   | 2002            | 2001       | 2002                         |
| Retirement benefit obligation .....         | ¥ (22,087)      | ¥ (22,558) | \$(178,914)                  |
| Plan assets at fair value.....              | 12,099          | 12,754     | 98,007                       |
| Unfunded retirement benefit obligation..... | (9,988)         | (9,804)    | (80,907)                     |
| Unrecognized actuarial gain or loss.....    | 3,629           | 2,511      | 29,396                       |
| Net retirement benefit obligation.....      | (6,359)         | (7,292)    | (51,510)                     |
| Prepaid pension cost .....                  | 595             | 372        | 4,819                        |
| Accrued retirement benefits.....            | ¥ (6,954)       | ¥ (7,664)  | \$(56,330)                   |

The components of retirement benefit expenses for the year ended May 31, 2002 and 2001 are outlined as follows:

|  | Millions of yen |         | Thousands of<br>U.S. dollars |
|--|-----------------|---------|------------------------------|
|  | 2002            | 2001    | 2002                         |
| Service cost .....   | ¥ 1,460         | ¥ 1,492 | \$ 11,826                    |
| Interest cost .....  | 682             | 633     | 5,524                        |
| Expected return on plan assets .....                                 | (220)           | (214)   | (1,782)                      |
| Amortization of net retirement benefit obligation at transition..... | -               | 6,203   | -                            |
| Amortization of actuarial gain or loss.....                          | 251             | -       | 2,033                        |
| Total.....   | ¥ 2,173         | ¥ 8,114 | \$ 17,602                    |

The assumptions used in accounting for the above plans were as follows:

|                                     | May 31,     |              |
|-------------------------------------|-------------|--------------|
|                                     | 2002        | 2001         |
| Discount rates .....                | 2.5% - 3.1% | 3.0% - 3.1%  |
| Expected return on plan assets..... | 3.0% - 3.1% | 3.1% - 3.25% |

Accrued retirement benefits include ¥524 million (\$4,244 thousand) for directors and statutory auditors of the Company and its domestic consolidated subsidiaries at May 31, 2002.

## 9. Research and Development Expenditures

Research and development expenditures for the years ended May 31, 2002 amounted to ¥8,722 million (\$70,652 thousand).

## 10. Contingent Liabilities

Contingent liabilities at May 31, 2002 were as follows:

|  | Millions of yen | Thousands of U.S. dollars |
|--|-----------------|---------------------------|
| Notes receivable discounted .....        | ¥ 4,540         | \$ 36,776                 |
| Debtor's acceptance discounted .....     | 18              | 145                       |
| Guarantees of loan of an affiliate ..... | 49              | 396                       |
| Guarantees of loan of employees .....    | 2,561           | 20,745                    |

## 11. Amounts per Share

Amounts per share are summarized as follows:

|                             | yen      |          | U.S. dollars |
|-----------------------------|----------|----------|--------------|
|                             | 2002     | 2001     | 2002         |
| For the years ended May 31: |          |          |              |
| Net income:                 |          |          |              |
| Primary .....               | ¥ 14.42  | ¥ 26.87  | \$ 0.11      |
| Cash dividends.....         | 11.00    | 11.00    | 0.08         |
| At May 31:                  |          |          |              |
| Net assets .....            | ¥ 527.61 | ¥ 516.97 | 4.27         |

Net income per share is computed based on the weighted average number of shares of common stock outstanding during each year. Cash dividends per share represent the dividends paid during respective years.

Net assets per share are computed based on the number of outstanding shares of common stock at the year end.

## 12. Derivatives

- (1) The Companies utilize forward foreign exchange contracts solely in order to hedge against the risk of fluctuations in foreign currency exchange rates and to stabilize their future cash flows relating to debts denominated in foreign currencies relating to their operations.
- (2) The Companies have entered into various derivative transactions solely in order to hedge against certain risks in compliance with their internal policies. The Companies have not and do not utilize derivatives for speculative trading purposes.
- (3) The Companies are exposed to the risk of credit loss in the event of nonperformance by the counterparties to these derivative transactions, but consider the risk of any such loss to be minimal because the Companies enter into derivative transactions only with financial institutions which have high credit ratings.
- (4) The Companies enter into, monitor and manage their derivative positions based on their own internal policies.

## 13. Leases

Lease payments relating to finance lease transactions accounted for as operating leases amounted to ¥475 million (\$3,847 thousand) and ¥354 million for the years ended May 31, 2002 and 2001, respectively.

Future minimum lease payments (including the interest portion) subsequent to May 31, 2002 relating to finance lease transactions accounted for as operating leases are summarized as follows:

|                           | Millions of yen | Thousands of U.S. dollars |
|---------------------------|-----------------|---------------------------|
| Year ending May 31,       |                 |                           |
| 2003 .....                | ¥ 402           | \$ 3,256                  |
| 2004 and thereafter ..... | 661             | 5,354                     |
|                           | ¥ 1,064         | \$ 8,618                  |

Lease income relating to finance leases accounted for as operating leases amounted to ¥51 million (\$413 thousand) and ¥51 million for the years ended May 31, 2002 and 2001, respectively.

## 14. Segment Information

The Company and its consolidated subsidiaries operate principally in four industry segments: pharmaceuticals, fine chemicals, agro & specialty chemicals and other businesses. The fine chemicals business involves the production and sales of inflators, functional products, dyestuffs, explosives and catalysts, and other sophisticated chemical products. Other business comprise a driving school and real estate leasing business.

Effective on June 1, 2001, the Company has established Agro and Specialty Chemicals Group, which was split off from Pharmaceuticals Group and Fine Chemicals Group, respectively. The previous industry segment information has been reclassified to the current industry segment of the Company.

Industry segment information for the Company and its consolidated subsidiaries for the years ended May 31, 2002 and 2001 is summarized as follows:

| 2002  |                         |                                     |                  |           |              |              |             |
|---|-------------------------|-------------------------------------|------------------|-----------|--------------|--------------|-------------|
| Millions of yen                                   |                         |                                     |                  |           |              |              |             |
| Pharmaceuticals business                          | Fine chemicals business | Agro & specialty chemicals business | Other businesses | Total     | Eliminations | Consolidated |             |
| I. Sales and operating income:                    |                         |                                     |                  |           |              |              |             |
| Sales to third parties.....                       | ¥37,421                 | ¥57,005                             | ¥21,618          | ¥ 3,388   | ¥119,435     | –            | ¥119,435    |
| Intersegment.....                                 | –                       | 37                                  | 2,408            | 8         | 2,455        | ¥ (2,455)    | –           |
| Total.....  | 37,421                  | 57,043                              | 24,027           | 3,397     | 121,890      | (2,455)      | 119,435     |
| Operating expenses .....                          | 29,454                  | 52,754                              | 22,783           | 2,359     | 107,351      | 2,699        | 110,051     |
| Operating income .....                            | ¥ 7,967                 | ¥ 4,288                             | ¥ 1,244          | ¥ 1,038   | ¥ 14,538     | ¥ (5,154)    | ¥ 9,384     |
| II. Asset, depreciation and capital expenditures: |                         |                                     |                  |           |              |              |             |
| Total assets .....                                | ¥30,411                 | ¥67,503                             | ¥24,745          | ¥19,606   | ¥142,266     | ¥34,570      | ¥176,836    |
| Depreciation and amortization.....                | 1,087                   | 3,666                               | 1,303            | 1,008     | 7,066        | 183          | 7,250       |
| Capital expenditures.....                         | 1,387                   | 6,087                               | 1,453            | 27        | 8,956        | 399          | 9,356       |
| 2002  |                         |                                     |                  |           |              |              |             |
| Thousands of U.S. dollars                         |                         |                                     |                  |           |              |              |             |
| Pharmaceuticals business                          | Fine chemicals business | Agro & specialty chemicals business | Other businesses | Total     | Eliminations | Consolidated |             |
| I. Sales and operating income:                    |                         |                                     |                  |           |              |              |             |
| Sales to third parties.....                       | \$303,126               | \$461,765                           | \$175,115        | \$ 27,444 | \$ 967,476   | –            | \$ 967,476  |
| Intersegment.....                                 | –                       | 299                                 | 19,505           | 64        | 19,886       | \$(19,886)   | –           |
| Total.....  | 303,126                 | 462,073                             | 194,629          | 27,517    | 987,363      | (19,886)     | 967,476     |
| Operating expenses .....                          | 238,590                 | 427,330                             | 184,552          | 19,108    | 869,590      | 21,863       | 891,462     |
| Operating income .....                            | \$ 64,536               | \$ 34,734                           | \$ 10,076        | \$ 8,408  | \$ 117,764   | \$(41,749)   | \$ 76,014   |
| II. Asset, depreciation and capital expenditures: |                         |                                     |                  |           |              |              |             |
| Total assets .....                                | \$246,342               | \$546,804                           | \$200,445        | \$158,817 | \$1,152,417  | \$280,032    | \$1,432,450 |
| Depreciation and amortization.....                | 8,805                   | 29,696                              | 10,554           | 8,165     | 57,237       | 1,482        | 58,728      |
| Capital expenditures.....                         | 11,235                  | 49,307                              | 11,769           | 218       | 72,547       | 3,232        | 75,787      |
| 2001  |                         |                                     |                  |           |              |              |             |
| Millions of yen                                   |                         |                                     |                  |           |              |              |             |
| Pharmaceuticals business                          | Fine chemicals business | Agro & specialty chemicals business | Other businesses | Total     | Eliminations | Consolidated |             |
| I. Sales and operating income:                    |                         |                                     |                  |           |              |              |             |
| Sales to third parties.....                       | ¥36,845                 | ¥60,747                             | ¥19,958          | ¥ 3,450   | ¥121,002     | –            | ¥121,002    |
| Intersegment.....                                 | –                       | 55                                  | 2,282            | 4         | 2,342        | ¥ (2,342)    | –           |
| Total.....  | 36,845                  | 60,803                              | 22,241           | 3,455     | 123,345      | (2,342)      | 121,002     |
| Operating expenses .....                          | 27,469                  | 53,095                              | 21,170           | 2,640     | 104,376      | 3,348        | 107,725     |
| Operating income .....                            | ¥ 9,375                 | ¥ 7,707                             | ¥ 1,071          | ¥ 814     | ¥ 18,968     | ¥ (5,691)    | ¥ 13,277    |
| II. Asset, depreciation and capital expenditures: |                         |                                     |                  |           |              |              |             |
| Total assets .....                                | ¥30,638                 | ¥66,482                             | ¥24,624          | ¥20,105   | ¥141,851     | ¥38,031      | ¥179,882    |
| Depreciation and amortization.....                | 1,194                   | 3,314                               | 1,334            | 1,170     | 7,013        | 144          | 7,157       |
| Capital expenditures.....                         | 472                     | 6,065                               | 617              | 105       | 7,260        | 12           | 7,273       |

Overseas sales, which include export sales of the Company and its consolidated subsidiaries, totaled ¥17,233 million (\$139,594 thousand) and ¥17,991 million, or 14.4% and 14.9% of the consolidated net sales for the years ended May 31, 2002 and 2001, respectively.

## 15. Subsequent Event

The following appropriations of retained earnings of the Company were approved at a meeting of the shareholders held on August 28, 2002:

|   | Millions of yen | Thousands of U.S. dollars |
|---|-----------------|---------------------------|
| Transfer to legal reserve .....                               | –               | –                         |
| 2001 year-end cash dividends (¥5.50 = \$0.044 per share)..... | ¥ 1,003         | \$ 8,124                  |
| Bonuses to directors.....                                     | 48              | 388                       |

# Independent Auditors' Report

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## Certified Public Accountants

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The Board of Directors  
Nippon Kayaku Co., Ltd.

We have audited the consolidated balance sheets of Nippon Kayaku Co., Ltd. and consolidated subsidiaries as of May 31, 2002 and 2001, and the related consolidated statements of income and retained earnings and statements of cash flows for each of the years then ended, all expressed in Japanese yen. Our audits were made in accordance with auditing standards, procedures and practices generally accepted and applied in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above, expressed in Japanese yen, present fairly the consolidated financial position of Nippon Kayaku Co., Ltd. and consolidated subsidiaries at May 31, 2002 and 2001, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles and practices generally accepted in Japan applied on a consistent basis.

As described in Note 1 to the consolidated financial statements, Nippon Kayaku Co., Ltd. and consolidated subsidiaries have adopted new accounting standards for employees' retirement benefits, financial instruments and foreign currency translations effective the year ended May 31, 2001.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the years ended May 31, 2002 are presented solely for convenience. Our audit also included the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 2 to the consolidated financial statements.

August 28, 2002

A handwritten signature in black ink that reads "Shin Nihon &amp; Co." in a cursive, flowing script.

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*See Note 1 to the consolidated financial statements which explains the basis of preparing the consolidated financial statements of Nippon Kayaku Co., Ltd. and consolidated subsidiaries under Japanese accounting principles and practices.*