

Annual Report 2004

Year ended May 31, 2004

Coming into Focus

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* Company information after May 31, 2004 is disclosed as part of company information herein.

* Descriptions about future results imply uncertainty and risks, and do not guarantee realization of these results as such. There are possibilities that discrepancies will occur between goals and results due to such factors as changes in management environment.

Since our founding in 1916, from a base in the fine chemicals business, Nippon Kayaku has continued to expand into a broad range of new fields, including explosives, dyes, pharmaceuticals, agrochemicals, functional products, catalysts and inflators to construct our current business foundation. We have succeeded in expanding by continually improving ourselves to meet the needs of the rapidly changing times.

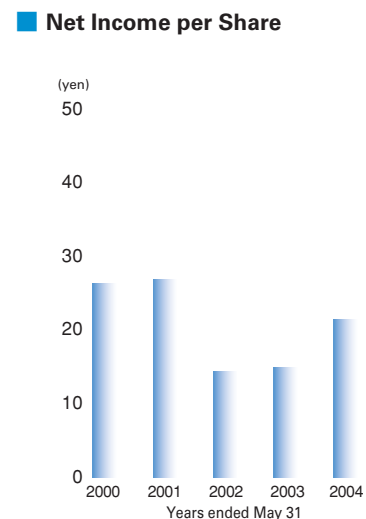
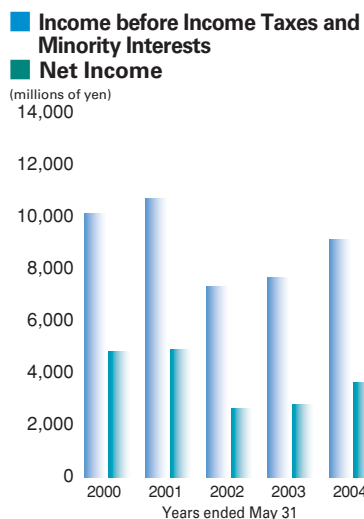
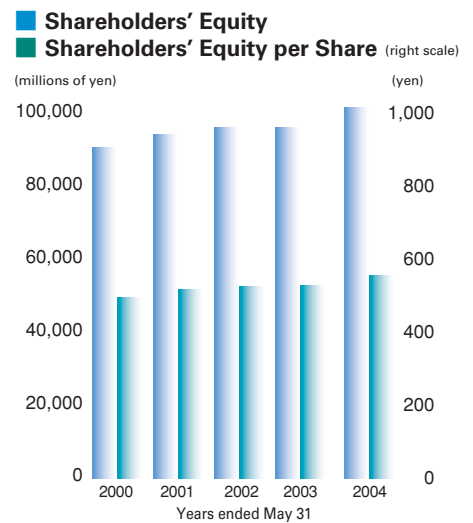
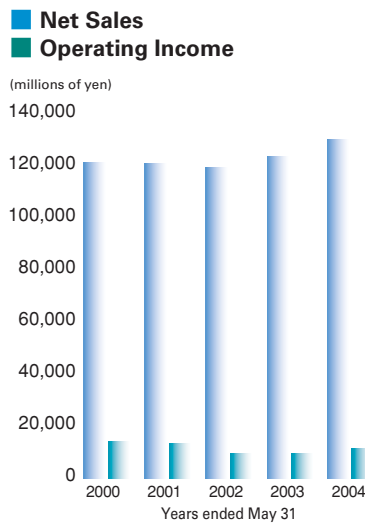
Nippon Kayaku has undergone many changes during our long history, and we are now focusing on the fields of information/communications, health care, and safety systems, three fields we have identified as growth fields at the start of the new century. We are constructing business portfolios, and are concentrating business resources in order to target global niche markets in these fields. While creating a fusion of the broad range of technologies that we have developed in the Group, we are also actively pursuing alliances with other companies. In doing so, we are aiming for rapid start-up of new businesses that no other company can match, and for high market shares or "only one" shares of small-scale markets where the size of Nippon Kayaku is an effective advantage. At the same time, we are working to increase profit-earning capacity and expand the value of our business in global markets, where price competition is becoming increasingly fierce.

Consolidated Financial Highlights

Years ended May 31

Millions of yen, except per share amounts

	2004	2003	2002	2001	2000
Net Sales	128,016	123,431	119,435	121,002	121,302
Operating Income	10,097	9,697	9,384	13,277	14,071
Income before Income Taxes and Minority Interests	8,941	7,643	7,309	10,675	10,132
Net Income	3,926	2,780	2,630	4,903	4,807
Shareholders' Equity	100,207	96,204	96,248	94,331	90,666
Shareholders' Equity per Share (Yen)	550.12	527.93	527.61	516.97	496.90
Net Income per Share (Yen)	21.22	14.92	14.42	26.87	26.34



Message from the President



Koichiro Shimada
President
Representative Director

We are striving to maximize the value of our business by targeting niche markets in the information/communications, health care, and safety systems fields, and through strategic fusion of technologies within and beyond our company.

Performance review for the fiscal year ended May 2004 (FY 2003)

The Japanese economy finally began a gradual recovery in 2003, driven by expanding demand for digital home electronics and IT-related products, and by increasing private capital investment spurred by improved business performance and from increased exports accompanying the recovery of overseas economies, primarily in the U.S. and China. Under these conditions, sales in the fine chemicals business were strong and made it possible to cover the drop in our pharmaceuticals business following revisions in drug prices and heightened competition. Consequently, Nippon Kayaku's consolidated business results in the fiscal year ended May 31, 2004 (June 2003 - May 2004) showed a rise over the previous fiscal year, with sales of 128.016 billion yen and an operating income of 10.097 billion yen.

Targeted growth markets

Nippon Kayaku Group has established maximizing the value of our business as a key management objective, and we are expanding our operations with focus on the fields of information/communications, health care, and safety systems, all of which are clear growth markets at the start of the 21st century. In the information/communications field, based on our primary technologies of resins and color chemicals, we have developed and marketed products including epoxy resins for semiconductor encapsulation and DVD optical disks, liquid-crystal sealants, projection materials and polarizing plates, colors and inks for color inkjet printers, and other electronics-related materials. In the health care field, we have introduced unique new products centered on our anti-cancer drugs, and in the safety systems field we have marketed automotive safety products based on our long-held explosives technology.

Carrying out structural reforms

In order to clarify Nippon Kayaku's business strategy and to concentrate business resources in key areas, we carried out structural reforms that were completed on August 27, 2004. Under the new organization, the Functional Chemicals Group, Pharmaceuticals Group, and Safety Systems Division have been positioned as growth businesses, while the Fine Chemicals Group has been positioned as a business generating stable income.

Targeting niche markets

The Nippon Kayaku Group focuses on markets and customers in order to target global niche markets that are suitable for the scale of our business. In other words, rather than targeting large markets, we are aiming to obtain large shares in smaller-scale markets, or to be the "only one" in these markets.

Examples are seen in the information/communications field, where Nippon Kayaku is targeting niche products for our various electronics materials. While our consolidated subsidiary Polatechno Co., Ltd. manufactures polarizing films, it also specializes particularly in materials used for projectors. Meanwhile, we have focused our main efforts on anti-cancer drugs in the health care field, and on squibs (igniters for airbag inflators) and micro gas generators (for seatbelt pretensioners) in the automotive safety products field.

Accelerating the fusion of technologies within and beyond the company

By creating a strategic fusion of the broad range of technologies possessed by the Nippon Kayaku Group while boosting the synergistic effects of these technologies, we are aiming to make maximum use of our intellectual assets and create a clear difference between ourselves and other companies.

Nippon Kayaku has achieved success in a broad range of fields since our founding in 1916. From our beginnings with explosives, we have continued to develop as we challenge ourselves in new product areas including dyes, pharmaceuticals, agrochemicals, functional products, catalysts, and inflators. Through the years, we have accumulated a vast store of intellectual assets, and it is well known that one of our company's strengths is our wealth of technologies and other intellectual assets that cover a wide variety of fields.

Our group has successfully created new products and pioneered new business areas through a comprehensive fusion of our company's technologies in polymers, organic synthesis, biotechnology, and other areas that are expected to yield next-generation key technologies.



This fusion also covers our broad range of processing technologies. We have also established the development of nanotechnologies as a corporate theme, and are planning to apply this cutting-edge technology in several strategic areas.

In October 2004, we began redevelopment at the site of our Tokyo plant, and began construction of a new integrated research building. Here we will concentrate in one location all of our research facilities for pharmaceuticals, functional chemicals, and fine chemicals,

accelerating the fusion of the advanced technologies held by each of these research facilities.

As we develop new key technologies, we are also actively developing strategic external alliances to create a fusion with technologies and capabilities beyond our company. With this cooperation, we are working to accelerate the development of new products and the creation of promising new business areas.

One example of an alliance we have created in the functional chemicals business is the establishment of Kayaku MicroChem Corporation as a joint venture with the U.S. company MicroChem Corp. This joint venture is engaged in the development and marketing of resins for micro electro mechanical systems (MEMS). In addition, it is conducting joint R&D into new photoresists with companies that develop, sell, and prototype the systems that manufacture MEMS devices. In the pharmaceuticals business, we have concluded a licensing agreement with NanoCarrier Co., Ltd., a company with unique proprietary nanotechnology, for creation of drug delivery system (DDS) pharmaceuticals. In January 2004, we also established a research center (Nanotherapy Co., Ltd.) as a joint venture with other companies and universities to develop heat immunotherapy as a new method for the treatment of cancer.

Accelerating the development of overseas business

With the advance of globalization, there are no longer national boundaries that serve to limit competition between companies. Enterprises that lack international competitiveness are inevitably driven out of business. In this sense, internationalization is demanded of all businesses, regardless of size. Nippon Kayaku began operations in China for our color chemicals business nine years ago in 1995, and we are now actively engaged in manufacturing and sales in the China domestic market. In addition, within the grounds of our consolidated subsidiary Wuxi Advanced Kayaku Chemical Co., Ltd., we have established Kayaku Chemical (Wuxi) Co., Ltd., which manufactures and sells resist ink for functional materials, as well as Wuxi Polatechno Optics Co., Ltd., which manufactures and sells polarizing film for our consolidated subsidiary Polatechno Co., Ltd. Operations at both of these new companies are proceeding smoothly. In January 2004, Polatechno also acquired the U.S. company Moxtek Inc., a manufacturer of special polarizing film.

Full-scale operations are under way at U.S. company LifeSparc Inc. and Czech

company Indet Safety Systems a.s., both of which manufacture and sell inflator squibs and micro gas generators for seatbelt pretensioners.

Raising group-wide cost awareness

While developing new technologies and expanding overseas business are important strategies for survival in a harsh competitive environment, another key strategy is increasing the cost competitiveness of existing businesses. What is fundamentally most important is to raise cost awareness among all employees and the company as a whole. Cost awareness includes the understanding that any time spent that is not related to the generation of added value is wasted time. Not only management, but all employees must spend the greatest amount of time possible in the creation of added value. The knowledge required for the creation of added value comes less from the individuals themselves than from the results of group collaboration. For this reason, we are devoting more efforts to actively promoting “group creativity” programs for small group activities.

Strengthening group management

As part of the most recent reorganization, the Business Support Center was changed to the Administration Group. This change is intended to qualitatively strengthen the business support system that covers the group, and to streamline management and staff operations throughout the entire group.


We are also working to further strengthen our group management through effective utilization of the Group Management System (GMS), which is centered on the enterprise resource planning application SAP R/3 that was introduced in 2003.

Maximizing the value of our business

Nippon Kayaku is striving to improve the return on assets (ROA) and return on shareholders’ equity (ROE) by strengthening the profit base and reinforcing our financial standing. In addition, we have introduced performance evaluation indexes that take capital cost into account and are utilizing them to evaluate each of our business divisions.

In the future, we will continue to accelerate business reforms, with renewed focus on capital efficiency, and further strengthen our business base in order to maximize the value of our business.

October 1, 2004


Koichiro Shimada
President

We are striving to make a fusion of technologies within and beyond our company, and are aiming to be the “number one” or “only one” presence in global niche markets, primarily in the information/communications field.



Masao Komaki
Managing Director
Director of Functional Chemicals Group

Expanding business through new products and new business

The functional chemicals business delivered strong performance in the year ended May 2004, buoyed by a rapid recovery in the information/communications field, including increasing demand for items like digital home electronics and cellular telephones. While a short-term corrective phase is anticipated, we have determined that the growth trend will continue in the long term, and Nippon Kayaku will continue to position the information/communications field as a growth area for concentration of business resources. We will retain a solid aggressive approach, continually supplying new products to the customers, and we are aiming to expand our business by identifying and developing new business areas that are consistent with technical and market trends.

• Functional materials business

For our epoxy resins used for the encapsulation of semiconductors, which hold the top global market share, we have been planning a shift from our previous core product EOCN to a new epoxy resin. Moreover, demand is growing rapidly for NC-3000, a non-halogen type encapsulation material, and large increases in sales can be expected for this resin and other new epoxy resins. Full-scale use of new resins such as polyimide and polyamide resins for flexible printed circuit boards (PCBs) and multilayer PCBs has begun. We are working to further expand sales by developing new applications for materials for the high-performance resins that are used in electronics materials, utilizing resins that were transferred from the Fine Chemicals Group.

In addition, operations have begun smoothly at Kayaku Chemical (Wuxi) Co., Ltd. (KCW) in Wuxi, China. It has started production and sales of oligomers used in resist ink for PCBs, and its operations will be expanded to include UV-curing resin products, for which future demand growth is expected, particularly in China.

• Electronic materials business

We have developed and marketed new colors for color inkjet printers, with the superior weather resistance to fit customers' demand. Large-scale increases in sales can be expected for these products. Under our new organization, we

are also proceeding with the development of peripheral technologies, and are working to further expand our business areas.

Sales of other new products, including liquid crystal display (LCD) products, optics, and data storage products, have also been strong. In particular, sales of materials for DVD showed a large increase, due to the rapid proliferation of DVD recording devices. Fierce price competition is expected as the market expands; however, we will maintain our top share of the market by thorough cost-cutting and by creating unique products that differentiate us from the competition. Sales of heat-curing LCD sealant are growing steadily, and future growth is also expected in sales of UV-curing sealants. In FY 2004 we will introduce new products and review our sales strategy in order to recover our market share.

Strong performance has been delivered by our consolidated subsidiary Polatechno Co., Ltd, which specializes in mid- and small-size polarizing films and in materials for projector optics. Polatechno controls a high market share for projector optics materials in particular, based on its powerful technological strengths and advance identification of customer needs. In the autumn of 2003, Wuxi Polatechno Optics Co., Ltd. was established in Wuxi, China, and has enjoyed a smooth start of operations. In July 2004 it completed a large-scale expansion of its production equipment in order to meet the rapid growth in demand. In January 2004, Polatechno acquired the U.S. company Moxtek, Inc., which manufactures special polarizing films that are a key device in the development of next-generation high-performance projectors. These polarizing films have been highly rated by customers, and sales are expected to increase in the future.

Kayaku MicroChem Corporation, a technology-oriented venture company which develops and sells resins for micro electro mechanical system (MEMS), has reached its second year and is performing strongly. In addition to its efforts in the Japan market, this company has also begun approaching the Taiwan and Korea markets. We have also acquired a capital stake in a manufacturer of MEMS devices, and are proceeding with joint development. With this foothold, we are studying the possibility of entry into the downstream MEMS business.

• Catalyst business

We are engaged in the manufacture and sales of catalysts for acrylic acid production, which are used in the propylene direct-oxidation technology that was developed independently by our company, and also the manufacture and sales of catalysts for methacrylic acid production, which are used in isobutylene direct-oxidation technology. Our catalysts have been highly rated for their performance by customers throughout the world, and are in use in a large number of plants producing acrylic acid and methacrylic acid.

The acrylic acid produced with our catalysts is used in a broad range of fields for products including super absorbent

polymers in disposable diapers and feminine hygiene products, dental materials, adhesives, and water-based paints, and the market for these products is growing quickly. Methacrylic acid is used as a raw material for plastic (acrylic plastic), and because of its superior transparency it has a great many uses, including in a range of displays, automobile tail lamps, large tanks at aquariums, and more recently as optical material in LCD televisions and projection televisions. For these reasons we expect that our catalyst business will continue to grow in the future.

Fusing technologies from within and beyond our company to develop new technologies and business areas

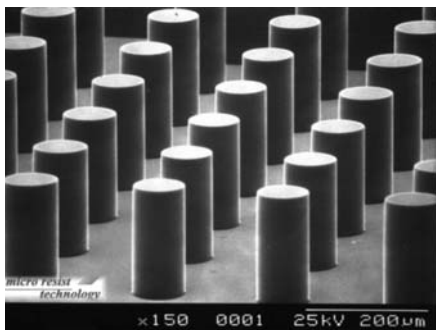
Research themes at Nippon Kayaku are divided into two categories: short- and mid-term themes, and long-term themes. Within each category, the research is categorized as research directly related to business or else as research for establishment of a technology base. After the system of responsibility has been made clear, we proceed with creating a fusion of the technologies in our possession. We are also actively proceeding with joint research together with universities and other public research institutions, primarily for our long-term themes.

The R&D conducted by our company is always focused on the market. In particular, we are actively engaged in joint development together with our customers because we believe that an exchange of information with the customers is essential to our research that is directly related to business. Nippon Kayaku does not simply follow in the footsteps of existing technologies and business areas. Instead, we continuously challenge ourselves to develop new technologies and business areas. These efforts do not stop at the borders of our company, and we are actively involved in alliances and business ventures with other companies. This concept underlies all of the efforts described above, including the acquisition of Moxtek, Inc. and the establishment of Kayaku MicroChem Corporation.

Development and sales of new photoresist products for micro-machines (Kayaku MicroChem Corporation)

The micro-machine market is a growing market expected to reach 1.4 trillion yen in 2005, and even greater market expansion is expected in and after 2010. Micro electro mechanical systems (MEMS) are expected to be a core technology in this field. Nippon Kayaku concluded a technical tie-up with the U.S. company Microchem Corp., a powerful manufacturer of MEMS photoresists, in order to establish the joint venture Kayaku MicroChem Corporation in Japan. Consequently, we began imports and sales of the SU-8 series of chemically amplified thick UV negative resist, which is ideally suited for fine three-dimensional processing.

The SU-8 series is used in products such as printer ink nozzles, micro-machine motor parts, magnetic head dies, and biochips. Sales are strong, and Kayaku Microchem is working to develop new products that meet the increasingly advanced and diversified needs of Japanese electronics manufacturers. In January 2004, it marketed two new types of thick film resists. The new SU-3000 series is a solvent-developing type permanent resist that is an improved version of SU-8, and the KMPR-1000 series is an alkali- and solvent-developing peeling type resist. Both series feature 50–100 micrometer film thickness, aspect ratios of 5 or greater, edge verticality, and superior adhesion to a broad range of substrates. These products are manufactured in Japan and are enjoying growing sales in the Asia and Oceania regions. We are developing a special-order formulation capability as well as new applications to meet customer needs. In cooperation with a manufacturer of MEMS devices, we are also proceeding with efforts to solidify a base for device manufacture and sales.



Photoresist for micro-machines, SU-8 series

Operations started at a new plant for PCB photoresist ink materials

Construction of a plant for production of PCB photoresist ink materials was completed at our 100% subsidiary Kayaku Chemical (Wuxi) Co., Ltd., located in Wuxi, China, and this plant began operating in January 2004. With a production capacity of 1,500 tons, it is expected to generate sales of 700 million yen in FY 2005.

Demand in China for the PCBs used in digital home electronics and mobile communications devices is growing rapidly. In pace with this growth, local production by manufacturers of resist ink and other process materials is increasing. Many Japanese resist ink manufacturers are demanding local supply from the manufacturers who produce the raw materials. With the completion of our China plant, Nippon Kayaku is able to meet these demands.

At the Asa Plant, where we have already boosted production capacity by 300%, we are producing high-precision products and other special products. At the same time, at our China plant we are producing primarily general-purpose products for supply to the local market and neighboring markets. This two-base system enables us to meet increasing demand and expand our business.

Acquisition of a U.S. nanotech venture company for production of special polarizing films (Polatechno Co., Ltd.)

Polatechno Co., Ltd. is a joint venture established by Nippon Kayaku and Arisawa Manufacturing Co., Ltd. As a manufacturer of optical films, it holds the leading share worldwide in the market for the polarizing films that are used in LCD projectors. In January 2004, Polatechno acquired the U.S. company Moxtek, Inc., a company with which it had cooperated previously and which possesses ProFlux, an inorganic polarizing film with ultra-high heat resistance. The current Moxtek resulted from a merger between the U.S. company Moxtek and our U.S. subsidiary Polatechno.

The market for LCD projectors is promising, with a global annual expansion rate of 30%. In recent years, demand has been growing for rear-type projectors, primarily those used in rear projection televisions. Attention has also been focused on reflecting liquid crystal on silicon (LCOS) type projectors. These products require polarizing film with extremely high durability, a requirement that can be met only by Moxtek's ProFlux film. These products are inorganic polarizing films created using nanotechnology to form a lattice from aluminum that is vapor-deposited on a glass substrate. In order to meet the increasing demand from customers that is expected in the future, we have begun equipment modifications and expansions at the Moxtek

plants to gradually increase the production capacity from 150,000 wafers (films converted to 5-inch wafers), which was the production level at the time the company was acquired, to 500,000–600,000 wafers in 2005.

Front-type projectors are primarily used for business and educational purposes, while rear-type projectors are used in home flat-panel televisions. Based on the future demand for these two products, the market is expected to expand rapidly. Polatechno deals in both organic and inorganic polarizing films, and we are working to construct a solid position for ourselves in the projector industry as a top supplier of optical materials, and to further expand the scope of our business.

In addition to optical materials, Moxtek also produces materials for X-ray analysis. There are expectations that these materials can also be applied to analysis of biomolecular structures, and to environmental and business applications, as well as to existing analytic devices.



Polatechno Co., Ltd.

Development of inexpensive new dyes for next-generation solar cells

The Nippon Kayaku Research Group has developed inexpensive new dyes for dye-sensitized solar cells. This type of solar cell holds much promise as next-generation solar cells that are lightweight and bendable. The use of inexpensive polyene dyes—instead of the high-priced ruthenium dyes that are ordinarily used—cuts material costs, and delivers power-generating efficiency on the same level as conventional dyes. In addition to being lightweight and bendable, dye-sensitized solar cells can be dyed any color, and are gaining much interest as solar cells incorporated in interior design, and as portable power generators. We expect that practical application of this technology will begin at an early date.

Business Areas

Functional Products

We manufacture and sell special epoxy resins, UV-curing resins, acrylic polymers, and polymer flocculants.

Major products

- Epoxy resins (EOCN-1020, EPPN-500, NC-3000, BREN)
- Hardeners for epoxy resins (KAYAHARD)
- Photo-curing resins (KAYARAD, KAYAMER, KAYACURE)
- Polyamide/polyimide resins
- Polymer flocculants (KAYAFLOC)

Electronics Materials

We develop, manufacture, and sell a broad range of electronics materials, LCD sealants, CCD photoresists, DVD adhesives, and colors for color inkjet printers.

Our consolidated subsidiary Polatechno Co., Ltd. manufactures and sells polarizing films, specially treated films, and other optical films. Kayaku MicroChem Corporation imports and exports photo resists for micro-machines, etc.



Catalysts

We are engaged in the manufacture, sales, and plant licensing business for acrylic acids, methacrylic acids and other catalysts used in manufacturing.



Through a fusion of intellectual assets from within and beyond the company, and through accelerated product development, we are aiming for growth in the health care field, and particularly growth in cancer-related treatment areas.



Haruo Inose
Senior Managing Director
Representative Director
Director of Pharmaceuticals Group

A product lineup aimed at strengthening and streamlining our focused research and development for cancer-related products

In the pharmaceuticals business, we are actively investing our business resources for the development of cancer-related products, and are continually working to strengthen our business base in this area. For research and development in particular, we are working to create a fusion of technologies from within and beyond the company, and also to accelerate the development and marketing of a broad range of anti-cancer drug products. For this purpose, we are actively engaged in alliances with other companies.

Nippon Kayaku currently sells 17 anti-cancer drugs in Japan, and during our many years of experience we have accumulated a wealth of diverse information covering the entire anti-cancer drug field. In order to apply this information in the best way to efficient business practices, we are actively introducing new products and proceeding with joint development to constantly strengthen our product lineup.

Broad-based research activities in the anti-cancer products field

The demand for effective cancer treatment will continue to increase in the future. In addition to demands for improving the utility of anti-cancer drugs that are currently on the market, there is also a strong demand for new anti-cancer drugs. In response, Nippon Kayaku is proceeding with joint development together with NEC Corporation to create a highly advanced "insilico screening system" which can rapidly identify candidate compounds from a vast compound library.

In addition to our conventional research into anti-cancer drugs, we are engaged in research over a broad range of areas. Examples include the development of a drug delivery system (DDS) in which an anti-cancer drug is contained inside nano-size polymer micelles, and the development of anti-cancer drugs that are effective against hormone-dependent cancer. As part of our corporate focus on company-wide research and development, we have also established a development venture (Nanotherapy Co., Ltd.), centered on Nippon Kayaku and incorporating links with universities and industry. Research at this venture company is being conducted for heat immunotherapy, in which heat is applied to treat cancer.

Lineup of cancer-related products

At present, Nippon Kayaku has marketed 17 anti-cancer drugs, two analgesics for cancer-related pain, and two cancer diagnostic agents. Development of new pharmaceuticals is especially focused on anti-cancer drugs, and we will continue to strengthen our product lineup in this important area. Because combined therapy is most often used by medical institutions for cancer chemotherapy, in addition to providing and collecting information concerning our own products, it is also possible for us to collect information concerning the administration, efficacy, and side effects of anti-cancer drugs in general, including the products of other companies. This allows us to collect a greater amount of information concerning anti-cancer drugs for research, production, and sales. We are further strengthening our lineup of anti-cancer products, because this allows us to provide information that is useful for actual treatment and to expand our business. In 2003 we introduced HYCAMTIN® from GlaxoSmithKline and CARBOMERCK from Merck Hoesl, and in 2004 we introduced ONCOVIN and EXAL from Eli Lilly Japan. We will continue to actively pursue the introduction of new products, joint-development products, and similar efforts in the future.

Strengthening our ability to provide information and reinforcing our specialist medical representatives (MRs)

Cancer treatment today is generally conducted by a team, centered on a specialist physician and including a pharmacist and nurse with advanced learning and extensive practical experience. It is therefore necessary to provide a broad range of information to them, and to react quickly to any and all new developments in the cancer field. For this reason, Nippon Kayaku organizes lectures, seminars, and briefing sessions to answer these needs, and we have trained and dispatched specialist MRs equipped with the ability to provide and collect information related to anti-cancer drugs in general.

Nippon Kayaku currently has 500-plus certified MRs. Of these, 90 specialist MRs are assigned to the two fields of anti-cancer drugs and pharmacologically active drugs to meet the growing demand in these fields. To help them in their information-sensitive jobs, each MR is provided with a personal computer containing custom software developed by Nippon Kayaku. This software helps to strengthen the system that allows us to collect and provide information quickly. We have also constructed the MINK web system, which allows us to send information directly to health care professionals who wish to receive it.

Reinforcement of facilities for production of high-potency active ingredients—Expanding contract manufacturing of API

For many years Nippon Kayaku has been engaged in integrated production of anti-cancer drugs that satisfy FDA standards, and we have constructed a complete good manufacturing practices (GMP) system covering every step from active pharmaceutical ingredients (API) to the final pharmaceuticals.

Making use of the vast amount of technology that we have

acquired for the production of high-potency active ingredients, in autumn 2003 we began expanding our contract manufacturing of API. Combining original synthesis and bioscience technologies, we are working to meet the strong demand for integrated production covering API, intermediates, and final pharmaceuticals. In particular, we are striving to differentiate ourselves from the competition in the production of anti-cancer agents and other drugs that contain high-potency active ingredients. The production of anti-cancer agents naturally requires thorough GMP, which are standards related to manufacturing control and quality control of pharmaceuticals. In addition, because the drugs are more potent than other pharmaceuticals and require special hazard-protection measures, control of the production process requires an advanced level of technology and experience. We possess production equipment for our primary anti-cancer drugs, which can be used to safely produce chemically hazardous medical compounds. In 2003, additional multi-purpose production equipment for chemically hazardous drugs was installed at the Takasaki Plant (Gunma Prefecture), completing a system for contract manufacturing of anti-cancer drugs and other high-potency active ingredients.

Active development of anti-cancer drugs utilizing nano-technology

The research into drug delivery systems (DDS) is rapidly advancing with the integration of nano-technology and information technology (IT). Patients and doctors have long awaited life-saving drugs with an innovative mechanism that properly regulates the release of drugs at the lesion site or which is especially effective for a specific population that can be selected through screening and diagnosis. Nippon Kayaku has been successful in new businesses based on the fusion of fine chemical-based knowledge arising from biotechnology, polymers, organic synthesis, and related technologies. Now we are focusing on the development of nano-technology-based DDS. Already we have synthesized a DDS utilizing polymer micelle technology that allows entrapment of an anti-cancer drug and delivery to the tumor site. Development of this promising approach has already progressed to the clinical trial stage and is attracting widespread attention. Unlike those formed by normal cells, the blood vessels generated by cancer tissues to supply nutrients have small openings in the vessel wall. It is through these small openings that drug-carrying polymer micelles 50 to 200 nanometers in diameter can reach the tumor cells and deliver drugs directly. If this highly specific delivery of anti-cancer drugs is realized, the side effects and dosage can be reduced.

We have also concluded a licensing agreement with NanoCarrier Co., Ltd. for paclitaxel polymer micelle DDS pharmaceuticals utilizing nano-technology, and the phase I clinical trials began at the National Cancer Center in April 2004.

Marketing of the arterial infusion IA CALL 100 mg

In July 2004 we began to market IA CALL 100 mg, a cisplatin drug specifically designed for arterial infusion in patients with hepatocellular carcinoma. IA CALL is the world's first platinum drug to be specifically approved for hepatocellular carcinoma, and there are high expectations by cancer specialists for its use. We believe that future research based on the actual clinical use of this drug will firmly establish its high effectiveness.



Expanded use of HYCAMTIN® against ovarian cancer and phase III clinical trials of IMMUCYST intravesical

In November 2002 we introduced injectable HYCAMTIN® from GlaxoSmithKline K.K., and we began clinical trials aimed at expanding the use of this drug to treat ovarian cancer. HYCAMTIN® has been approved for the treatment of ovarian cancer in more than 70 countries worldwide, and its approval in Japan is eagerly anticipated.

In October 2003, we began importing and sale of IMMUCYST introduced from AventisPasteur K.K. In April 2004 we began phase III clinical trials aimed at establishing this drug as a maintenance treatment in order to prevent recurrence after transurethral resection of bladder cancer (TUR-Bt).

Establishment of a research center for development of heat immunotherapy, a new type of cancer treatment

In January 2004, Nanotherapy Co., Ltd. was established in Nagoya by Nippon Kayaku, Dai-Ichi High Frequency Co., Ltd. (Meguro Ward, Tokyo), Toda Kogyo Corp. (Otake City, Hiroshima Prefecture), and the technology-support venture company TTC (Meguro Ward, Tokyo). The purpose of this company is to develop practical applications and commercialize the new heat immunotherapy of cancer originally developed by Professor Takeshi Kobayashi and others at the Nagoya University Graduate School of Engineering. (Professor Kobayashi is now professor emeritus at Nagoya University and a professor at Chubu University.) The ratios of capital investment in the new company are 55% from Nippon Kayaku, 30% from Dai-Ichi High Frequency, 5% from Toda Kogyo, and 15% from TTC and others. The Nippon Kayaku's DDS pharmaceutical technology for targeted delivery of drugs to cancer cells and the Nippon Kayaku experience in commercializing a large number of anti-cancer drugs are combined with Dai-Ichi High Frequency's original high-frequency heating

technology and equipment manufacturing ability, and Toda Kogyo's superior nano-technology utilizing magnetic particles. Together we have entrusted rapid practical development of the drugs and medical devices for this new treatment to Nanotherapy Co., Ltd., and are aiming to commercialize this promising treatment method.

With this approach, heat-generating magnetic particles are covered with lipids and converted into a nano-size pharmaceutical agent. After injection into cancer tissues, an alternating magnetic field quickly heats only the tumor, which destroys it. Compared with conventional heat treatment methods, this revolutionary treatment is thought to cause least physical burden on the patient or adverse side effects. It has also been found that this treatment strongly induces immunological activity to the cancer cells.

By approximately 2010, our companies are aiming for clinical use of this method to treat solid cancers for which no effective treatment is available.

Acquisition of the distribution rights to two types of anti-cancer agents from Eli Lilly Japan

In January 2004, Nippon Kayaku obtained transfer of importation approvals of two anti-cancer agents from Eli Lilly Japan, and acquired their distribution rights. Sales of these two agents began on April 1, 2004. Injectable ONCOVIN 1 mg has been approved for leukemia, etc., while injectable EXAL 10 mg is approved for malignant lymphoma.



ISO9001 certification for all divisions in the Pharmaceuticals Group

In September of 2003, the quality management systems in all divisions of the Pharmaceuticals Group were certified according to the international standard ISO9001. This includes the Research & Development division, all pharmaceutical district offices in our East Japan Branch and West Japan Branch. In the Pharmaceuticals Group, the Takasaki Plant and Tokyo Plant had previously been certified, and now with the current certifications we have established an integrated quality management system that covers research and development, production, sales, and post-marketing activities. We intend to maintain and improve this system in order to raise the level of customer satisfaction and contribute to our business performance.

Status of New Product Development by Stage

Stage	Development code Product name (Generic name)	Dosage form or route of administration	Therapeutic category (Indications)	Domestic developer	Characteristics/Others
				Origin	
NDA	NS75A (NDA Dec. '00) (Cetorelix)	Injection	Anti-hormone drug (Infertility)	Joint dev. with Shionogi, Kayaku Zentaris Zentaris (Germany)	LHRH (Luteinizing hormone-releasing hormone) antagonist
	SL-1100 (NDA Dec. '03) (Estradiol)	Gel preparation	Estrogen (Climacteric disorder)	Joint dev. with Shiseido Besins International (France)	First estradiol gel preparation in Japan. Approved in 61 countries.
P III	IMMUCYST PMCJ-9 (BCG)	Bladder instillation	Anti-cancer drug (for preventing recurrence of bladder cancer)	Own development AventisPasteur (Canada)	Extended indication
P II	NKT-01/ SPANIDIN (Gusperimus hydrochloride)	Injection	Immunosuppressant (Wegener's granulomatosis)	Own development Institute of Microbial Chemistry	Developed overseas. Designated as an orphan drug (Mar. 2001) by the EMEA. Late phase II trial is currently in progress.
	NK911 (Micelle doxorubicin hydrochloride)	Injection	Anti-cancer drug (Pancreatic cancers)	Own development Tokyo Women's Medical University	Macromolecular micelle anti-cancer drug. Early phase II trial for pancreatic cancer was started in October 2003. Development consigned by Japan Science and Technology Corp.
	NK211 (Nogitecan)	Injection	Anti-cancer drug (Ovarian cancer)	Own development GSK	Extended indication
	NS75A (Cetorelix)	Injection	Anti-hormone drug (Hysteromyoma)	Joint dev. with Shionogi, Kayaku Zentaris Zentaris (Germany)	LHRH (Luteinizing hormone-releasing hormone) antagonist
P I	NK105 (Micelle paclitaxel)	Injection	Anti-cancer drug (Solid cancers)	Own development Joint dev. with NanoCarrier	Macromolecular micelle anti-cancer drug.

Major Products

The year in parentheses is when the product was first marketed.

■ Anti-Cancer and Cancer-Related Drugs

- IA CALL (2004)
- ONCOVIN (2004)
- EXAL (2004)
- CARBOMERCK (2003)
- IMMUCYST (2003) ①
- Hycamtin® (2003)
- MS-TWICELON (2001)
- COFORIN (1996)
- FARESTON (1995)
- ODYNE (1994)
- STARASID (1992)
- PINORUBIN (1988)
- LASTET (1987)
- BESTATIN (1987)
- Randa (1984) ②
- PEPLEO (1981)
- BLEO (1969)



①



②

■ Immunosuppressants

- SPANIDIN (1994) ③



③

■ Cardiovascular Drugs

- MILLISROL for Coronary Infusion (2001)
- ADEHL (1999)
- MILLISTAPE (1998)
- NITROPEN TABLETS (1988)
- MILLISROL (1984) ④
- NITROGLYCERINE TABLETS (1953)



④

■ Neurological Drugs

- SALIGREN (2001)
- MUSCALM (1975)

■ Other Drugs

- ASTRIC DRY SYRUP (2002) ⑤



⑤

■ Diagnostic Agents

- LANA MAMMO CARD CEA (2002) ⑥
- LANA TP AUTO (2001)
- LANA 1,5AG AUTO LIQUID (2000)
- LANAZYME BFP PLATE (2000)
- LANAZYME ST-439 PLATE (1999)



⑥

■ Pharmaceutical API and Intermediates

By developing and marketing highly competitive products, we aim to further expand our business in the automotive safety products field.



Yoshiyuki Ikeda
Director
General Manager of Safety Systems Division

Automotive safety products: Promising rapid growth globally

In developed societies where motorization is widespread, demand is growing for collision passenger protection, for improved performance of protective devices, and even for protection of pedestrians when accidents occur. We anticipate that in the future there will be increasingly varied paths of development for automotive safety products that will meet these demands, and these products will be installed in an expanding number of vehicles. While growth in vehicle sales is expected in Eastern Europe, vehicle sales have reached their zenith in North America and Japan. Nevertheless, rapid growth in automobile safety products can still be expected. From a global standpoint, Japanese automobile manufacturers are waging a successful struggle to expand in all corners of the world, and as a result much attention has been

focused on Japanese automotive parts manufacturers for their efforts to enter and expand in local markets throughout the world.

Our Safety Systems Division is riding this wave of expansion, and we are also working to greatly grow our business by applying the expertise and trust that we have developed over many years through business conducted with Japanese OEMs and Tier 1 manufacturers. For this purpose, our efforts are concentrated in the following two directions:

- Strengthening our R&D capabilities in order to continually develop and market new products with strong market appeal; and,
- Further boosting the competitiveness of existing products to increase our market share and expand our business.

Strengthening our R&D

Applying our industrial explosive technologies (particularly for explosive products such as igniters and detonators) and backed by our many years of experience, Nippon Kayaku has independently developed airbag inflators and micro gas generators used for seatbelt pretensioners. These two products are also described as precision explosive devices. By reinforcing this special R&D strength, and by further streamlining operation of our research organization, we are developing and marketing new products with the performance, price, and quality that strongly appeal to customers. In 2004, we began to market a new thick-type disk inflator with a unique structure that is different from conventional passenger inflators, and we are working to create new applications for this product. Currently, we are in the process of developing a compact inflator for use in side-impact airbags, and plan to complete and market it at an early date.

For our highly rated micro gas generators, we are developing high-reliability squibs with features that make them more competitive. These will help to greatly increase the attractiveness of the micro gas generators that utilize these squibs.

In addition, we are developing a range of new products that utilize our explosives technologies and expertise, and we are further increasing our focus on the development of semiconductor bridge (SCB) squibs, aiming for their utilization in vehicles beginning in 2008.

Strengthening the competitiveness of existing products

The expanding automotive safety products market has stimulated concerns over market share on the part of automotive parts

manufacturers. Consequently, the competitive forces are extremely fierce. In order to survive in this environment, it is mandatory that we strengthen the competitiveness of our existing products. Thus, all staff are urged to maintain strong cost awareness, and the company must continuously carry out product improvements, process improvements, distribution improvements, and streamlining of the organization. Total cost awareness must penetrate all production divisions, engineering divisions, and management divisions, and the combined strength of the company must be focused on achieving the highest level of competitiveness in the industry. This competitiveness will then lead to expansion of business.

Global business

In the safety systems business, we established Indet Safety Systems a.s. (ISS) in the Czech Republic in 1999, and LifeSparc Inc. (LS) in the U.S. in 2000. Together with our Himeji Plant (Himeji, Hyogo Prefecture), we have created a global manufacturing system for squibs and micro gas generators.

In the future, we will consider additional local production possibilities in overseas regions, coordinated with the business of Japanese OEMs overseas. We are also planning to establish a global system for inflators, and are focusing in particular on the rapidly expanding China market.

We are working for closer links between all of our production centers, including those located overseas, and are improving the efficiency of our organization worldwide. By constructing and utilizing the Internet, company intranets, and global databases, we are improving global communication, the distribution of responsibilities, and our many support services, and are striving to increase the profit-earning capacity of our consolidated business. At

the same time, we are gearing ourselves toward a sales target of doubling our current consolidated sales in FY 2006.

Topic

Plans for inflator production in China

In the Nippon Kayaku safety systems business, we have constructed a Japan-U.S.-Europe tripartite development and supply system for squibs and micro gas generators. Production at these facilities is on track. Because production by Japanese OEMs in China is growing rapidly, Nippon Kayaku is studying the possibility of entering this market, including the possibility of local inflator production. Decisions such as the location for plant construction, the business configuration (whether, for instance, to construct integrated operations that include the production of explosives used in protective devices), and the capital configuration will be made in FY 2004.

Acquiring a 100% share of our three safety systems subsidiary companies

To promote our safety systems business overseas, we established Indet Safety Systems a.s. (Czech Republic), LifeSparc Inc. (U.S.), and the patent management company NKNM (British Virgin Islands) as joint ventures with Nichimen Corporation. On March 31, 2004, we acquired the shares that were in the possession of Nichimen, transforming these three companies into 100% wholly-owned subsidiaries of Nippon Kayaku. This has enabled us to further strengthen the Japan-U.S.-Europe tripartite organization for our safety systems business.

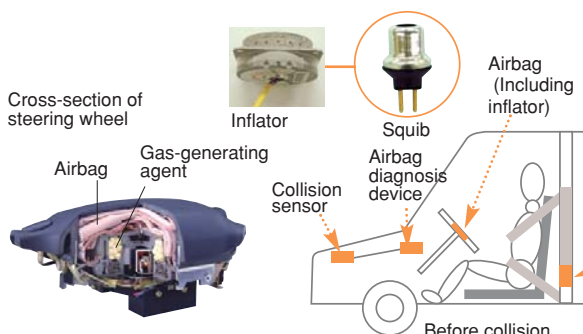
Mechanisms of Airbag and Seatbelt Pretensioner Operation

◆ Inflator Mechanism

An inflator is a device, incorporated in safety airbags, that generates gas to instantly inflate the bag when a vehicle collision occurs.

[Operating mechanism]

- (1) A sensor detects the collision, and sends a signal to the inflator.
- (2) The squib inside the inflator operates, igniting a gas-generating agent. The generated gas enters the airbag, instantly inflating it.

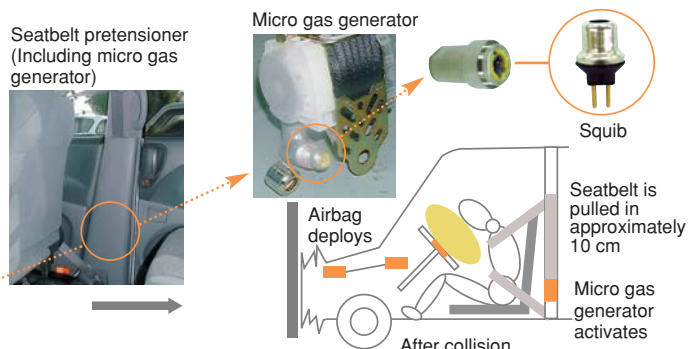


◆ Micro Gas Generator Mechanism

The micro gas generator generates gas for the seatbelt pretensioner device, which winds up the seatbelt and instantly restrains the occupant's body when a vehicle collision occurs.

[Operating mechanism]

- (1) A sensor detects the collision, and sends electric current to the micro gas generator.
- (2) The squib inside the micro gas generator ignites the gas generating agent. The generated gas pressure becomes the dynamic force that winds up the seatbelt.



Through sweeping cost-cutting and aggressive development of peripheral products and unique products that differentiate us from our competitors, we are working to establish ourselves as an independent business generating stable earnings.



Yoshiaki Fukushima
Managing Director
Director of Fine Chemicals Group

Accelerating business reforms aimed at increasing our profit-earning capacity

The newly established Fine Chemicals Group comprises the Explosives Division, Color Chemicals Division, and Agrochemicals Division. In each of these areas, no substantial growth can be expected for business related to the food, shelter, and clothing that are the basic necessities of our lives. However, these business areas can be expected to yield a relatively stable level of demand. Nippon Kayaku got its start in the explosives business, where we were the first to produce dynamite in Japan. Today, our color chemicals business produces superior quality, for which we were awarded the prestigious Deming Prize, as well as excellent technology and services. In the agrochemicals

business, we offer large-scale products with strong, established reputations, such as DIAZINON, an agricultural-use pesticide. In all our business areas we are rated highly by the industry, offering products that have gained the solid trust of our customers. Our operations in these areas have allowed us to amass a great wealth of technologies and expertise.

However, even with these powerful product groups and established customers, business results slumped in recent years due to competition and low-priced products from developing countries where labor costs are low, and also due to declining prices and a contraction of the market. In this harsh environment, we have made a large number of business reforms that have begun to show some results. For the future, we will further accelerate these reforms, aiming to increase our profit-earning capacity as a stable source of profits. Specifically, our business reforms are focused on the following three points: complete cost-cutting, creation of a peripheral products business, and development of unique products that differentiate us from other companies.

Complete cost-cutting

The three divisions in this group all have long histories, and there are many work practices that were necessary during the growth phase but which are not applicable now. We are working for complete cost-cutting by replacing these inefficient practices with more rational ones, and by thoroughly reviewing business practices from the multiple standpoints of purchasing, production, sales, and distribution. In addition, we are making ourselves into a lean and powerful division by expanding production and sales in China, and by effectively utilizing Group Management System (GMS), which is centered on the enterprise resource planning application SAP R/3 that we introduced last year.

Creation of peripheral product business that makes full use of our intellectual assets

We believe that the most important point when carrying out business reforms is to determine how best to ensure a continual supply of new products to the market. We are making effective use of the intellectual assets we have assembled over many years, and are proceeding with a fusion of intellectual assets

from outside the company, in order to promote peripheral products businesses such as pharmaceuticals and functional materials, all products that are downstream our current product groups. For this purpose, we will focus our targets and establish clear deadlines to enable our researchers, production staff, and sales staff to work productively together. These efforts have already begun to show positive results, and there are large expectations for future growth.

Promoting creative reforms

The typical earnings model for a mature business involves expanding market share and creating overwhelming cost competitiveness. However, because the products of the Fine Chemicals Group include a large number of niche products, this model cannot be applied here. Therefore in place of this approach we are aiming for creative reforms, working to utilize our intellectual assets and human resources and, in cooperation with our customers, creating unique products that feature convenience, simplicity, ease of use, and high quality. Rather than seeking to increase profits by expanding in size, we are aiming to boost earnings by being the “only one” company in small-scale markets.

Topic

ISO9001 certification

In September 2003, Nippon Kayaku received certification through the international standard ISO9001 for the quality management system at our Agrochemicals Division and Fine Chemicals R&D Laboratories. We had previously received certification at our Kashima Plant, and with this new certification we have established an integrated quality management system that covers all stages from research and development to production, sales, and after-sales service. In the Agrochemicals Division, we are working to make continual improvements to this system, ensuring that we can always provide high-quality products with superior effectiveness and safety, and further increasing customer satisfaction.



Business Areas

■ Agrochemicals

We manufacture and sell agrochemicals and similar products.

Major products

- DIAZINON
- MATRIC
- SAFROTIN
- EVISECT
- CYCLOSAL
- MCPB
- CHLOROPICRIN
- CUCUMERIS
- RATDEN
- SIMETRYN
- CHLORPIC-FLOW ①



■ Color Chemicals

We manufacture and sell fabric and textile dyes and dyes for paper pulp.

Major products

- KAYALON POLYESTER
- KAYACRYL-ED
- KAYACELON REACT
- KAYARUS
- KAYACION
- KAYAFECT
- KAYAPHOR LIQUID
- KAYASET



■ Explosives

We manufacture and sell explosives, black powder, and pyrotechnic products.

Major products

- Dynamite
- Slurried Explosives
- Ammonium Nitrate Fuel Oil Explosive (ANFO Explosive)
- Black Powder
- Electric Detonators



Board of Directors/ Auditors

As of October 1, 2004



Koichiro Shimada
President
(Representative Director)



Haruo Inose
Senior Managing Director
(Representative Director,
Director of
Pharmaceuticals Group)



Hidetoshi Kitazawa
Managing Director
(Director of Strategic
Corporate Planning Group)



Hajime Yoshitake
Managing Director
(Director of Technical
Operations Group)



Masao Komaki
Managing Director
(Director of Functional
Chemicals Group)



Koichi Chiba
Managing Director
(Director of Administration
Group)



Yoshiaki Fukushima
Managing Director
(Director of Fine Chemicals
Group)

Kunio Nishii, Dr.
Director
(General Manager of Takasaki Plant)

Koichi Takase
Director
(President, Representative Director of
Polatechno Co., Ltd.)

Akira Mandai
Director
(General Manager of West Japan
Branch)

Katsuhiko Matsunaga
Director
(General Manager of Personnel Division,
Administration Group)

Keizo Shimomiya
Director
(General Manager of Electronic Materials Division,
Functional Chemicals Group)

Yoshiyuki Ikeda
Director
(General Manager of Safety Systems Division)

Tetsushi Saino
Director
(General Manager of Research and Development
Division, Pharmaceuticals Group)

Tasuku Oshima
Standing Auditor

Yukichi Ozawa
Auditor

Shoichi Saito
Auditor

Yo Ota
Auditor

Consolidated Five-Year Summary

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

	2004	2003	2002	2001	2000
Results for the year (millions of yen)					
Net sales	¥128,016	¥123,431	¥119,435	¥121,002	¥121,302
Cost of sales	81,621	79,002	74,745	72,775	73,525
Selling, general and administrative expenses	36,297	34,730	35,305	34,950	33,705
Operating income	10,097	9,697	9,384	13,277	14,071
Income before income taxes and minority interests ..	8,941	7,643	7,309	10,675	10,132
Net income	3,926	2,780	2,630	4,903	4,807
Amounts per share (yen)					
Net income	¥ 21.22	¥ 14.92	¥ 14.42	¥ 26.87	¥ 26.34
Cash dividend applicable to the year	11.00	11.00	11.00	11.00	11.00
Shareholders' equity	550.12	527.93	527.61	516.97	496.90
Year-end financial position (millions of yen)					
Current assets	¥ 93,651	¥ 99,223	¥ 96,099	¥ 99,845	¥ 97,554
Current liabilities	39,389	42,065	37,346	39,872	37,042
Working capital	54,262	57,158	58,753	59,973	60,512
Property, plant and equipment	57,069	58,009	58,683	57,183	57,490
Total assets	179,823	179,117	176,836	179,882	174,613
Total shareholders' equity	100,207	96,204	96,248	94,331	90,666
Year-end statistics					
Number of shares outstanding (thousands)	182,503	182,503	182,503	182,503	182,503
Number of round lot shareholders	19,756	20,367	21,010	20,059	22,583
Number of employees	3,934	3,679	3,552	3,639	3,164
Financial ratios					
Current ratio (times).....	2.4	2.4	2.6	2.5	2.6
Equity ratio (%).....	55.7	53.7	54.4	52.4	51.9
ROE (%)	4.0	2.9	2.8	5.3	5.3
ROA (%)	2.2	1.6	1.5	2.7	2.8
Net sales by business segment (millions of yen)					
Pharmaceutical business	¥ 34,266	¥ 35,111	¥ 37,421	¥ 36,845	¥ 49,335
Fine chemical business.....	69,088	63,637	57,005	60,747	68,404
Inflaters	7,955	6,334	6,000	5,063	4,802
Catalysts	2,096	2,103	1,388	1,503	811
Functional products.....	41,007	35,396	27,693	32,365	27,163
Color chemicals.....	11,742	12,865	13,778	14,526	14,187
Agro & fine chemicals	—	—	—	—	14,896
Explosives	6,286	6,937	8,144	7,290	6,543
Agro & specialty chemical business	21,226	21,248	21,618	19,958	—
Agrochemicals.....	11,149	11,560	11,042	9,044	—
Specialty chemicals.....	10,077	9,688	10,576	10,914	—
Other businesses	3,434	3,434	3,388	3,450	3,562

* In June 2001 the Pharmaceuticals Group, Specialty Chemicals Division and the Fine Chemicals Group, Agro & Fine Chemicals Division were reorganized to become the Agro & Specialty Chemicals Group, Agrochemicals Division and Specialty Chemicals Division.

* Sales data by business segment for FY 2001 was calculated after reorganization of the business into three groups.

Management's Discussion and Analysis of Results of Operations and Financial Condition

Results of Operations

Business Overview

While employment conditions were poor and personal spending was sluggish during the first half of the year, Japan's economy started on a slow path to recovery during the fiscal year ended May 31, 2004. Factors contributing to this recovery included an increase in exports accompanying the recovery of overseas economies, primarily in the U.S. and China, and the increased private capital investment that resulted from improved business performance. On the other hand, the Iraq situation generated global instability, while higher oil prices and other issues fueled concern, and the situation continued to defy an optimistic outlook.

In the pharmaceutical industry, reform of the health care system continued to force down drug prices, and a drug price revision was implemented in April 2004. In addition, because of the need for large-scale R&D, such as for genetic drug discoveries, there have been large mergers and widespread changes among companies that are now battling for survival.

In the chemicals industry, although demand for digital home electronics and other IT-related demand continued to increase and remained strong overall, increasing competition with neighboring countries resulted in falling prices and a harsh environment for the industry in some areas.

Under these conditions, at Nippon Kayaku we have been engaged in structural reforms which include the following:

- (1) Development and marketing of new products in growth markets
- (2) Qualitative strengthening and streamlining of the company's sales power
- (3) Restructuring of matured fields and strengthening of our business base
- (4) Strengthening of business support for management divisions, and the introduction of an ERP (Enterprise Resource Planning) system to streamline our indirect business.

As a result, sales and income increased in the fiscal year ended May 31, 2004. Solid demand in the fine chemicals business, including strong manufacturing and sales of polarizing film by Polatechno Co., Ltd., helped to make up for a decline in the pharmaceutical business caused by the April 2004 revision of drug prices and by overall increased competition.

Net Sales

Net sales in the fiscal year ended May 31, 2004 were ¥128.016 billion, up ¥4.585 billion (3.7%) over the previous fiscal year. Net sales for the entire Group were 133% of the sales for the parent company alone.

Cost of Sales; Selling, General and Administrative Expenses

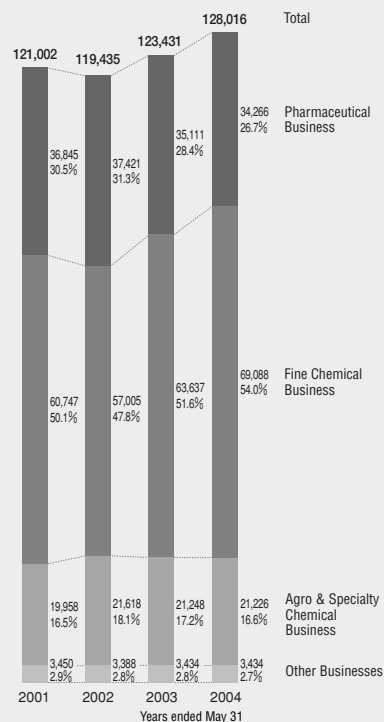
The cost of sales in the fiscal year ended May 31, 2004 was ¥81.621 billion, up ¥2.618 billion (3.3%) from the previous fiscal year, but declining 0.2 percentage points to 63.8% as a percentage with respect to net sales. Selling, general and administrative expenses in the fiscal year ended May 31, 2004 were ¥36.297 billion, an increase of ¥1.566 billion (4.5%) from the previous fiscal year.

Operating Income

Operating income in the fiscal year ended May 31, 2004 was ¥10.097 billion, up ¥399 million (4.1%) from the previous fiscal year and remaining constant at 7.9% as a percentage with respect to net sales.

Sales by Business Segment

(Unit: million yen)



* In June 2001 the Pharmaceuticals Group, Specialty Chemicals Division and the Fine Chemicals Group, Agro & Fine Chemicals Division were reorganized to become the Agro & Specialty Chemicals Group, Agrochemicals Division and Specialty Chemicals Division.

* Sales data for the fiscal year ended May 31, 2001 was calculated after reorganization of the business into three groups.

Operating Performance by Business Segment

[Pharmaceutical Business]

Sales in the pharmaceutical business for the fiscal year ended May 31, 2004 were ¥34.266 billion. While we worked primarily to expand sales of our existing products, we faced increasing competition for our main products, the effects of the drug price revision, and other factors. As a result, net sales declined by ¥844 million (2.4%) from the previous fiscal year.

Among pharmaceutical products for the Japanese domestic market, sales increased for SALIGREN capsules (drug for treatment of dry mouth syndrome), ASTRIC DRY SYRUP (anti-virus chemotherapy drug), and MS-TWICELON capsules (sustained release drug for cancer pain). However, sales of other products, including FARESTON tablets (anti-cancer drug) and RANDA injections (anti-cancer drug) declined, resulting in an overall decrease in net sales from the previous fiscal year.

Exports of the anti-cancer drug BLEO increased; however, those of another anti-cancer drug, ETOPOSIDE, fell below the previous fiscal year level.

For our diagnostic agents, sales increased for LANAZYME ST-439 PLATE, used in the diagnosis of breast cancer, while sales fell for LANA 1,5 AG AUTO LIQUID, a diabetes diagnostic agent.

Overall operating income in the pharmaceutical business for the fiscal year ended May 31, 2004 was ¥5.048 billion, down ¥1.004 billion (16.6%) from the previous fiscal year.

[Fine Chemical Business]

Due to growing demand for the materials that are used in IT-related products and digital home electronics, Sales in the fine chemical business for the fiscal year ended May 31, 2004 increased by ¥5.451 billion (8.6%) from the previous fiscal year to reach a total of ¥69.088 billion.

In the inflator business, sales of airbag inflators were up, due to strong sales of vehicles equipped with these products. Sales also grew for the micro gas generators that are used in seatbelt pretensioners, and business performance overall rose above the level of the previous fiscal year. Sales at both Indet Safety Systems a.s. (Czech Republic) and LifeSparc Inc. (U.S.) exceeded their previous fiscal year levels.

In the catalyst business, sales of catalysts used for acrylic acid production—our primary product—continued at the same level as the previous fiscal year.

Performance in the functional materials business increased both for domestic sales and exports. There was particular growth in sales of lens resins for projector televisions and resins for DVD optical discs. Sales of functional colors and thermal inks were also strong, and a recovery in demand for epoxy resins boosted sales of these products to above the level of the previous fiscal year. At Polatechno Co., Ltd., sales of projection materials and polarizing films were strong, and increased from their previous fiscal year levels.

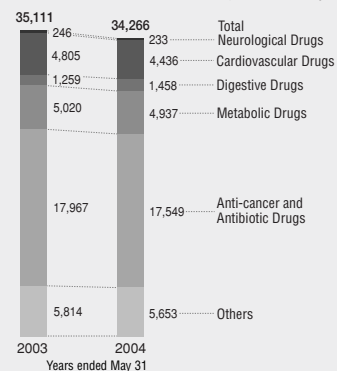
In the color chemicals business, sales of colors for color inkjet printers were strong and increased from the previous fiscal year. However, the sluggish state of the dyeing industry reduced demand for textile dyes, while falling prices and lower demand reduced sales of special non-textile dyes used for paper pulp. As a result, the overall performance of this business was lower than the previous fiscal year.

Sales in the explosives business also declined, due to lower demand from civil engineering projects.

Overall operating income from the fine chemicals business in the fiscal year

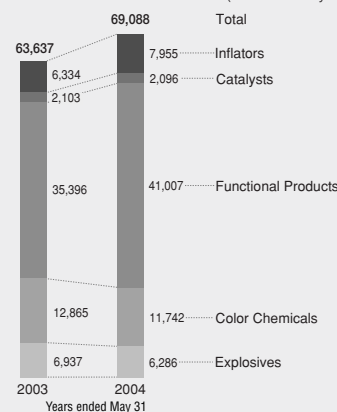
Sales of the Pharmaceutical Business

(Unit: million yen)



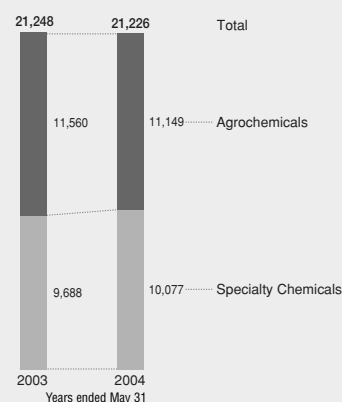
Sales of the Fine Chemical Business

(Unit: million yen)



Sales of the Agro & Specialty Chemical Business

(Unit: million yen)



ended May 31, 2004 was ¥8.170 billion, an increase of ¥2.269 billion (38.5%) over the previous fiscal year.

[Agro & Specialty Chemical Business]

Sales of the agro & specialty chemical business in the fiscal year ended May 31, 2004 were ¥21.226 billion, down ¥21 million (0.1%) from the previous fiscal year.

Performance in the agrochemicals business declined as a result of lower domestic sales.

Sales in the specialty chemicals business rose due to an increase in the level of already-consigned products and also to rising sales of preservatives and other products produced by Nippon Kayaku Food Techno Co., Ltd.

Overall operating income from the agro & specialty chemicals business in the fiscal year ended May 31, 2004 was ¥585 million, down ¥420 million (41.8%) from the previous fiscal year.

[Other Businesses]

Sales from other businesses in the fiscal year ended May 31, 2004 were ¥3.434 billion, on the same level as the previous fiscal year. Operating income was ¥1.408 billion, an increase of ¥170 million (13.8%) from the previous fiscal year.

Other Income and Expenses

Interest and dividend income in the fiscal year ended May 31, 2004 was ¥312 million, while interest expense was ¥402 million. Other net expenses decreased by ¥743 million to ¥1.066 billion (41.1%). This decrease was primarily due to the elimination of the write down on investment securities that was calculated in the previous fiscal year.

Income before Income Taxes and Minority Interests

As a result of the above, our income before income taxes and minority interests in the fiscal year ended May 31, 2004 was ¥8.941 billion, an increase of ¥1.297 billion (17.0%) from the previous fiscal year.

Income Taxes

Income taxes for the fiscal year ended May 31, 2004 were ¥3.964 billion, down ¥183 million (4.4%) from the previous fiscal year.

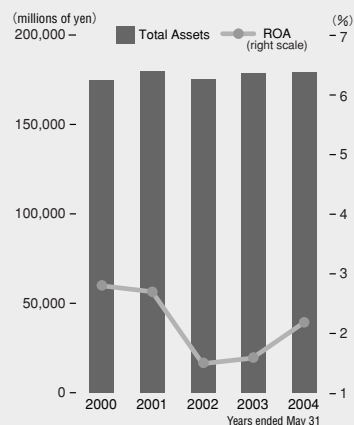
Minority Interests

Minority interests in the fiscal year ended May 31, 2004 were ¥1.050 billion, up ¥335 million (46.9%) from the previous fiscal year.

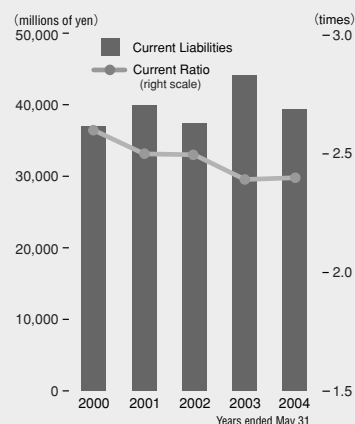
Net Income

Net income in the fiscal year ended May 31, 2004 was ¥3.926 billion, an increase of ¥1.145 billion (41.2%) from the previous fiscal year. The ratio of net income to net sales rose 0.8 percentage points this fiscal year to 3.1%. For the entire Group, net income in the fiscal year ended May 31, 2004 was 103% of that for the parent company alone. Net income per share was ¥21.22.

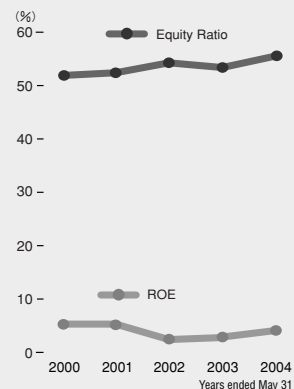
Total Assets/ROA



Current Liabilities/Current Ratio



Equity Ratio/ROE



Financial Conditions

Total Assets

Total assets on May 31, 2004 were ¥179.823 billion, an increase of ¥706 million (0.3%) from the end of the previous fiscal year.

Current Assets

Cash and cash equivalents on May 31, 2004 totaled ¥17.402 billion, a decrease of ¥8.229 billion (32.1%) from the end of the previous fiscal year. Time deposits were ¥10 million, a decrease of ¥1.181 billion (99.2%). Marketable securities were ¥988 million, a decrease of ¥12 million (1.2%). Trade receivables amounted to ¥47.966 billion, an increase of ¥3.3 billion (7.4%). Inventories were ¥23.11 billion, an increase of ¥323 million (1.4%), and deferred income taxes were ¥2.013 billion, an increase of ¥408 million (25.4%). Other current assets decreased by ¥210 million (8.7%) to ¥2.210 billion. As a result, total current assets were ¥93.651 billion, a decrease of ¥5.571 million (5.6%) from the end of the previous fiscal year.

Property, Plants, and Equipment; Investments and Other Assets

The value of property, plants, and equipment on May 31, 2004 totaled ¥57.069 billion, down ¥939 million (1.6%) from the end of the previous fiscal year. Accumulated depreciation was ¥115.496 billion. The total value of investments and other assets was ¥29.102 billion, an increase of ¥7.218 million (33.0%) from the end of the previous fiscal year.

Liabilities

Current liabilities on May 31, 2004 were ¥39.389 billion, a decrease of ¥2.676 billion (6.4%) from the end of the previous fiscal year. Non-current liabilities were ¥34.157 billion, a decrease of ¥1.012 billion (2.9%).

Shareholders' Equity

Shareholders' equity was ¥100.207 billion on May 31, 2004, and the equity ratio rose 2 percentage points to 55.7% compared to the previous fiscal year.

Cash Flows

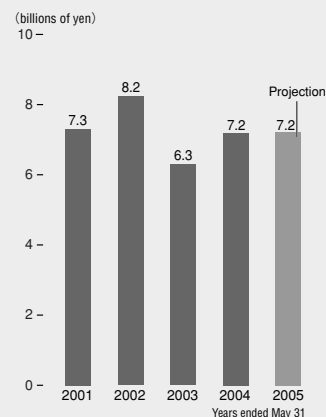
Cash flows from operating activities decreased by ¥7.579 billion from the previous fiscal year to ¥4.644 billion. This decrease was primarily due to the change from a rising trend to a falling trend in notes and accounts payable, and to the increase in the amount of income taxes paid.

The net cash expended in investment activities increased by ¥4.664 billion to ¥11.360 billion. The primary causes of this increase were the purchase of Moxtek, Inc. by Polatechno Co., Ltd. and the acquisition of 100% overseas subsidiaries involved in the inflator business.

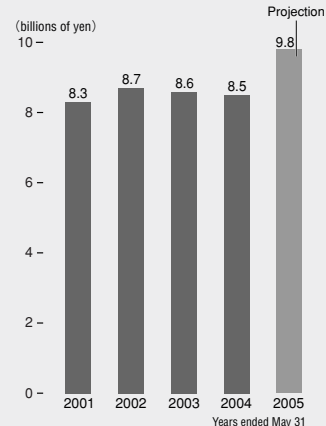
Due primarily to the proceeds from long-term debt, cash flows from financing activities increased by ¥4.361 billion from the previous fiscal year, to a net expenditure of ¥1.445 billion.

As a result of the above, cash and cash equivalents on May 31, 2004 decreased from the end of the previous fiscal year by ¥8.228 billion to ¥17.402 billion.

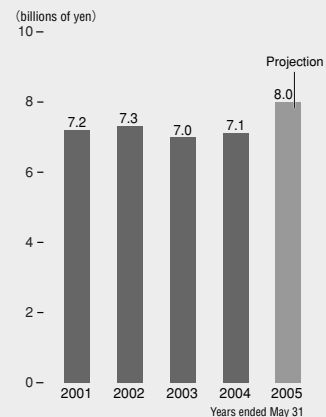
Plant & Equipment Investment



Research & Development Expenditures



Depreciation Expense



Consolidated Balance Sheets

Nippon Kayaku Co., Ltd. and Consolidated Subsidiaries
As of May 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2004	2003	2004
Assets			
Current assets:			
Cash and cash equivalents	¥ 17,402	¥ 25,631	\$ 158,085
Time deposits.....	10	1,191	90
Marketable securities (Note 4).....	988	1,000	8,975
Trade receivables (Note 6).....	47,966	44,666	435,737
Less allowance for doubtful receivables.....	(49)	(78)	(445)
Inventories (Note 3)	23,110	22,787	209,938
Deferred income taxes (Note 7)	2,013	1,605	18,286
Other current assets	2,210	2,420	20,076
Total current assets	93,651	99,223	850,753
Property, plant and equipment (Notes 5 and 6):	172,566	172,241	1,567,641
Less accumulated depreciation	(115,496)	(114,232)	(1,049,200)
Property, plant and equipment, net.....	57,069	58,009	518,432
Investments and other assets:			
Investment securities (Notes 4 and 6).....	16,461	13,446	149,536
Goodwill	3,322	1,521	30,178
Deferred income taxes (Note 7)	650	1,880	5,904
Other assets.....	8,668	5,036	78,742
Total investments and other assets.....	29,102	21,884	264,371
Total assets	¥179,823	¥179,117	\$1,633,566

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2004	2003	2004
Liabilities and shareholders' equity			
Current liabilities:			
Short-term bank loans (Note 6).....	¥ 3,775	¥ 3,595	\$ 34,293
Current portion of long-term debt (Note 6).....	4,041	2,565	36,709
Payables:			
Trade	17,259	19,909	156,785
Unconsolidated subsidiaries and affiliates	89	965	808
Construction	2,525	2,003	22,937
Other.....	4,001	4,864	36,346
Accrued expenses.....	4,690	4,307	42,605
Accrued income taxes (Note 7).....	2,279	3,328	20,703
Other current liabilities	726	524	6,595
Total current liabilities	39,389	42,065	357,821
Non-current liabilities:			
Long-term debt, less current portion (Note 6).....	8,509	7,814	77,298
Retirement benefits (Note 8).....	7,680	6,919	69,767
Other non-current liabilities.....	16,627	19,626	151,044
Deferred income taxes (Note 7).....	1,340	808	12,172
Total non-current liabilities	34,157	35,169	310,292
Minority interests	6,068	5,676	55,123
Contingent liabilities (Note 10)			
Shareholders' equity (Notes 11 and 15):			
Common stock:			
Authorized – 700,000,000 shares			
Issued – 182,503,570 shares in 2004 and 2003.....	14,932	14,932	135,646
Additional paid-in capital	17,257	17,257	156,767
Retained earnings.....	64,973	63,111	590,234
Translation adjustments.....	315	422	2,861
Unrealized holding gains on other securities	2,946	659	26,762
Less treasury stock, at cost	(218)	(178)	(1,980)
Total shareholders' equity	100,207	96,204	910,310
Total liabilities and shareholders' equity	¥179,823	¥179,117	\$1,633,566

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, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2004	2003	2004
Net sales	¥128,016	¥123,431	\$1,162,936
Cost of sales	81,621	79,002	741,469
Gross profit	46,395	44,428	421,466
Selling, general and administrative expenses	36,297	34,730	329,732
Operating income	10,097	9,697	91,724
Other income (expenses):			
Interest and dividend income	312	222	2,834
Interest expense	(402)	(466)	(3,651)
Other, net	(1,066)	(1,809)	(9,683)
	(1,155)	(2,053)	(10,492)
Income before income taxes and minority interests	8,941	7,643	81,222
Income taxes (Note 7):			
Current	4,664	4,666	42,369
Deferred	(699)	(518)	(6,349)
Minority interests	1,050	714	9,538
Net income	3,926	2,780	35,664
Retained earnings at beginning of year	63,111	62,402	573,319
Bonuses to directors	(61)	(64)	(554)
Cash dividends paid	(2,003)	(2,006)	(18,195)
Retained earnings at end of year	¥ 64,973	¥ 63,111	\$ 590,234

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Nippon Kayaku Co., Ltd. and Consolidated Subsidiaries
Years Ended May 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2004	2003	2004
Cash flows from operating activities			
Income before income taxes and minority interests	¥ 8,941	¥ 7,643	\$ 81,222
Adjustments to reconcile income before income taxes and minority interests to net cash provided by operating activities:			
Depreciation and amortization	7,144	7,011	64,898
Increase (decrease) in reserves	890	(275)	8,085
Interest and dividend income	(312)	(222)	(2,834)
Interest expense	402	466	3,651
Equity in earnings of affiliates	(278)	(210)	(2,525)
Loss on disposal of property, plant and equipment, net	866	606	7,867
Loss (gain) on sales of investment securities, net	33	(70)	299
Loss on revaluation of investment securities	-	719	-
Changes in operating assets and liabilities:			
Notes and accounts receivable - trade	(3,079)	(2,374)	(27,970)
Inventories	(261)	(1,932)	(2,371)
Notes and accounts payable - trade	(3,604)	4,647	(32,739)
Payables - other	(678)	(923)	(6,159)
Other	241	(703)	2,189
Subtotal	10,303	14,382	93,595
Interest and dividends received	463	343	4,206
Interest paid	(408)	(409)	(3,706)
Income taxes paid	(5,714)	(2,092)	(51,907)
Net cash provided by operating activities	4,644	12,224	42,187
Cash flows from investing activities			
Proceeds from maturity of time deposits, net	1,161	(893)	10,546
Proceeds from sales of marketable securities, net	(2)	2,501	(18)
Purchase of property, plant and equipment	(5,611)	(6,508)	(50,972)
Proceeds from sales of property, plant and equipment	195	48	1,771
Acquisition of goodwill and other intangible assets	(2,400)	(1,099)	(21,802)
Proceeds from sales (purchase) of investment securities, net	658	(121)	5,977
Purchase of investment securities of consolidated subsidiaries	(1,600)	-	(14,534)
Purchase of investments in subsidiaries resulting in change of consolidation scope	(2,762)	-	(25,090)
Other	(998)	(624)	(9,066)
Net cash used in investing activities	(11,360)	(6,696)	(103,197)
Cash flows from financing activities			
Net change in short-term debt	(170)	530	(1,544)
Proceeds from long-term debt	6,071	745	55,150
Repayment of long-term debt	(2,123)	(1,832)	(19,285)
Repayment of construction cooperation fund	(3,000)	-	(27,252)
Redemption of corporate bond	-	(3,000)	-
Cash dividends paid	(2,005)	(2,006)	(18,214)
Other	(217)	(244)	(1,971)
Net cash used in financing activities	(1,445)	(5,807)	(13,126)
Effect of exchange rate changes on cash and cash equivalents	(66)	(31)	(599)
Decrease in cash and cash equivalents	(8,228)	(311)	(74,745)
Cash and cash equivalents at beginning of year	25,631	25,942	232,839
Cash and cash equivalents at end of year	¥17,402	¥25,631	\$158,085

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Nippon Kayaku Co., Ltd. and Consolidated Subsidiaries
May 31, 2004 and 2003

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 of the Company and consolidated subsidiaries are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company as required by the Securities and Exchange Law of 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 consolidated 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's presentation.

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 of accounting.

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.

c. Foreign Currency Translation

The revenue and expense accounts of the foreign subsidiaries are translated at the average exchange rates prevailing during the year.

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.

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.

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

Securities are classified into three categories: trading, held-to-maturity or other securities. 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.

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 by the declining-balance method, except that the straight-line method is applied to the 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.

Accrued employees' retirement benefits are provided mainly at an amount calculated based on the retirement benefit obligation and the fair value of the pension plan assets at the balance sheet dates, as adjusted for 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. 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. Past service cost is amortized 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.

Directors and corporate 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.

j. Derivative Financial Instruments

The Company has entered into derivative transactions in order to manage certain risks arising from adverse fluctuations in foreign currency exchange rates. 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 ¥110.08 = U.S.\$1, the approximate rate of exchange on May 31, 2004, 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, 2004 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Merchandise	¥ 3,715	¥ 3,659	\$ 33,748
Finished products	8,839	9,218	80,296
Semi-finished products and work in process	5,380	5,218	48,873
Raw materials and supplies	5,173	4,690	46,993
	<u>¥23,110</u>	<u>¥22,787</u>	<u>\$209,938</u>

4

**Marketable and
Investment Securities**

Information regarding marketable securities classified as other securities as of May 31, 2004 and 2003 were as follows:

Marketable other securities

	May 31, 2004					
	Millions of yen			Thousands of U.S. dollars		
	Acquisition cost	Carrying value	Unrealized gain (loss)	Acquisition cost	Carrying value	Unrealized gain (loss)
Securities whose carrying value exceeds their acquisition cost:						
Stock	¥3,264	¥ 8,278	¥5,013	\$29,651	\$ 75,199	\$45,539
Debt securities	-	-	-	-	-	-
Other	2,587	2,593	5	23,501	23,555	45
Subtotal	5,851	10,871	5,019	53,152	98,755	45,594
Securities whose acquisition cost exceeds their carrying value:						
Stock	151	129	(22)	1,371	1,171	(199)
Debt securities	-	-	-	-	-	-
Other	2,004	1,982	(21)	18,204	18,005	(190)
Subtotal	2,156	2,112	(44)	19,585	19,186	(399)
Total	¥8,008	¥12,983	¥4,975	\$72,747	\$117,941	\$45,194
	May 31, 2003					
	Millions of yen					
	Acquisition cost	Carrying value	Unrealized gain (loss)			
Securities whose carrying value exceeds their acquisition cost:						
Stock	¥2,024	¥3,669	¥1,645			
Debt securities	8	13	4			
Other	2,559	2,564	5			
Subtotal	4,592	6,247	1,655			
Securities whose acquisition cost exceeds their carrying value:						
Stock	1,536	1,105	(431)			
Debt securities	-	-	-			
Other	1,637	1,481	(156)			
Subtotal	3,173	2,586	(587)			
Total	¥7,766	¥8,833	¥1,067			

Sales of securities classified as other securities amounted to ¥135 million (\$1,226 thousand) as of May 31, 2004 with the aggregate gain of ¥22 million (\$199 thousand) and the aggregate loss of ¥55 million (\$499 thousand) for the year ended May 31, 2004.

5

Depreciation

Depreciation for property, plant and equipment were ¥6,306 million (\$57,285 thousand) and ¥6,613 million for the years ended May 31, 2004 and 2003, respectively.

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, 2004 and 2003 were approximately 2.14% and 2.13%, respectively.

The interest rates applicable to the long-term borrowings (except for current portion) at May 31, 2004 and 2003 average approximately 2.10% and 3.79%, respectively.

Long-term debt at May 31, 2004 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Bonds without collateral:			
2.47% bonds due 2005	¥ 3,000	¥ 3,000	\$ 27,252
Collateralized loans from banks, insurance companies, government agencies and other financial institutions, due through 2015	2,572	3,139	23,364
Loans without collateral	6,978	4,240	63,390
	12,550	10,380	114,007
Less current portion	(4,041)	(2,565)	(36,709)
	¥ 8,509	¥ 7,814	\$ 77,298

The aggregate annual maturities of long-term debt subsequent to May 31, 2004 are as follows:

	Millions of yen	Thousands of U.S. dollars
Year ending May 31,		
2005	¥ 4,041	\$ 36,709
2006	2,195	19,940
2007	2,128	19,331
2008 and thereafter	4,186	38,026
	¥12,550	\$114,007

Assets pledged as collateral for long-term debt, other non-current liabilities and payables-trade at May 31, 2004 are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Receivables	¥ 134	\$ 1,217
Investment securities	249	2,261
Property, plant and equipment, at net book value	13,286	120,694
	¥13,670	\$124,182

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 2004 and 2003. 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, 2004 and 2003 differed from the statutory tax rate for the following reasons:

	2004	2003
Statutory tax rate.....	41.88%	41.88%
Effect of:		
Expenses not deductible for income tax purposes	2.55	3.00
Dividend income deductible for income tax purposes	(3.19)	-
Inhabitants' tax based on individuals.....	1.08	1.28
Amortization of consolidation adjustments	0.52	0.63
Increase of valuation allowance.....	8.63	-
Tax credit for research and development cost	(4.51)	-
Tax credit for information and technology equipments	(1.65)	-
Loss in consolidated subsidiaries	-	7.41
Effect of change in tax rate	-	0.96
Other, net	(0.97)	(0.89)
Effective tax rate	44.34%	54.27%

7

Income Taxes
(continued)

The significant components of deferred tax assets and liabilities as of May 31, 2004 and 2003 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Deferred tax assets:			
Accrued retirement benefits	¥3,178	¥2,549	\$28,869
Accrued bonuses	1,278	963	11,609
Write down on investment securities	—	48	—
Accrued enterprise tax	247	293	2,243
Allowance for sales rebate	143	136	1,299
Tax loss carried forward	1,284	892	11,664
Other	988	879	8,975
Total deferred tax assets	7,119	5,763	64,671
Valuation allowance	(1,534)	(917)	(13,935)
	5,585	4,846	50,735
Deferred tax liabilities:			
Adjustment of acquisition costs of fixed assets	(823)	(856)	(7,476)
Unrealized holding gains on other securities	(2,075)	(508)	(18,849)
Adjustments for book value relating to land of consolidated subsidiaries....	(706)	(706)	(6,413)
Goodwill and other intangible assets	(456)	—	(4,142)
Other	(200)	(98)	(1,816)
Total deferred tax liabilities	(4,261)	(2,169)	(38,708)
Net deferred tax assets.....	¥1,323	¥2,677	\$12,018

New legislation was enacted in March 2003 which changed the aggregate statutory tax rate from 41.88% to 40.69% effective the fiscal year beginning after May 31, 2004. The effect of this tax rate change was to decrease net deferred tax assets by ¥57 million at May 31, 2003, to increase income taxes-deferred by ¥73 million for the year ended May 31, 2003 and to increase unrealized holding gains of other securities by ¥15 million at May 31, 2003.

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 sheets as of May 31, 2004 and 2003 for the Company's and the consolidated subsidiaries' defined benefit plans:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Retirement benefit obligation	¥(22,728)	¥(21,647)	\$(206,468)
Plan assets at fair value	13,315	10,010	120,957
Unfunded retirement benefit obligation	(9,413)	(11,637)	(85,510)
Unrecognized actuarial gain or loss	5,231	6,030	47,519
Unrecognized past service cost	(2,271)	—	(20,630)
Net retirement benefit obligation.....	(6,453)	(5,606)	(58,621)
Prepaid pension cost	781	691	7,094
Accrued retirement benefits	¥ (7,235)	¥ (6,297)	\$ (65,724)

The components of retirement benefit expenses for the year ended May 31, 2004 and 2003 are outlined as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Service cost	¥1,278	¥1,499	\$11,609
Interest cost	559	668	5,078
Expected return on plan assets	(78)	(224)	(708)
Amortization of actuarial gain or loss	684	362	6,213
Amortization of past service cost	(252)	—	(2,289)
Total	¥2,191	¥2,306	\$19,903

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

	May 31,	
	2004	2003
Discount rates	2.1% – 2.5%	2.5% – 3.1%
Expected rates of return on plan assets	1.0% – 2.5%	2.5% – 3.1%
Period for amortization of prior service liability	10 years	–
Period for recognition of actuarial gain or loss	10 years	10 years

Accrued retirement benefits include ¥444 million (\$4,033 thousand) for directors and corporate auditors of the Company and its domestic consolidated subsidiaries at May 31, 2004.

9
*Research and
Development Expenses*

Research and development expenses amounted to ¥8,554 million (\$77,707 thousand) and ¥8,551 million for the years ended May 31, 2004 and 2003, respectively.

10
Contingent Liabilities

Contingent liabilities at May 31, 2004 were as follows:

	Millions of yen	Thousands of U.S. dollars
	Notes receivable discounted	¥ 476
Guarantees of loan of unconsolidated subsidiary	30	272
Guarantees of loan of employees.....	2,326	21,130

11
Amounts per Share

	Yen		U.S. dollars
	2004	2003	2004
For the year ended May 31:			
Net income:			
Primary	¥ 21.22	¥ 14.92	\$0.19
Cash dividends	11.00	11.00	0.09
At May 31:			
Net assets.....	550.12	527.93	4.99

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 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 ¥434 million (\$3,942 thousand) and ¥447 million for the years ended May 31, 2004 and 2003, respectively.

Future minimum lease payments (including the interest portion) subsequent to May 31, 2004 relating to finance lease transactions accounted for as operating leases are summarized as follows:

Year ending May 31,	Millions of yen	Thousands of U.S. dollars
	2005	¥373
2006 and thereafter	615	5,586
	¥988	\$8,975

Lease income relating to finance leases accounted for as operating leases amounted to ¥51 million (\$463 thousand) and ¥51 million for the years ended May 31, 2004 and 2003, respectively.

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

Industry segment information for the Companies as of or for the years ended May 31, 2004 and 2003 is summarized as follows:

2004							
Millions of yen							
	Pharmaceutical business	Fine chemical business	Agro & specialty chemical business	Other businesses	Total	Eliminations	Consolidated
I. Sales and operating income:							
Sales to third parties.....	¥34,266	¥69,088	¥21,226	¥ 3,434	¥128,016	-	¥128,016
Intersegment.....	19	56	1,518	6	1,602	¥ (1,602)	-
Total	34,285	69,145	22,745	3,441	129,618	(1,602)	128,016
Operating expenses	29,237	60,974	22,160	2,032	114,405	3,513	117,917
Operating income.....	¥ 5,048	¥ 8,170	¥ 585	¥ 1,408	¥ 15,213	¥ (5,115)	¥ 10,097
II. Asset depreciation and capital expenditures:							
Total assets.....	¥29,767	¥76,752	¥26,410	¥17,259	¥150,189	¥29,633	¥179,823
Depreciation and amortization	1,134	3,578	1,243	810	6,767	376	7,144
Capital expenditures	2,933	5,234	1,469	69	9,706	338	10,045

2004							
Thousands of U.S. dollars							
	Pharmaceutical business	Fine chemical business	Agro & specialty chemical business	Other businesses	Total	Eliminations	Consolidated
I. Sales and operating income:							
Sales to third parties.....	\$311,282	\$627,616	\$192,823	\$ 31,195	\$1,162,936	-	\$1,162,936
Intersegment.....	172	508	13,789	54	14,553	\$ (14,553)	-
Total	311,455	628,134	206,622	31,259	1,177,489	(14,553)	1,162,936
Operating expenses	265,597	553,906	201,308	18,459	1,039,289	31,913	1,071,193
Operating income.....	\$ 45,857	\$ 74,218	\$ 5,314	\$ 12,790	\$ 138,199	\$ (46,466)	\$ 91,724
II. Asset depreciation and capital expenditures:							
Total assets.....	\$270,412	\$697,238	\$239,916	\$156,785	\$1,364,362	\$269,195	\$1,633,566
Depreciation and amortization	10,301	32,503	11,291	7,358	61,473	3,415	64,898
Capital expenditures	26,644	47,547	13,344	626	88,172	3,070	91,251

2003							
Millions of yen							
	Pharmaceutical business	Fine chemical business	Agro & specialty chemical business	Other businesses	Total	Eliminations	Consolidated
I. Sales and operating income:							
Sales to third parties.....	¥35,111	¥63,637	¥21,248	¥ 3,434	¥123,431	-	¥123,431
Intersegment.....	-	74	2,114	11	2,199	¥ (2,199)	-
Total	35,111	63,711	23,362	3,445	125,630	(2,199)	123,431
Operating expenses	29,058	57,810	22,356	2,207	111,433	2,300	113,733
Operating income.....	¥ 6,052	¥ 5,901	¥ 1,005	¥ 1,237	¥ 14,197	¥ (4,499)	¥ 9,697
II. Asset depreciation and capital expenditures:							
Total assets.....	¥31,381	¥72,267	¥23,953	¥19,031	¥146,634	¥32,482	¥179,117
Depreciation and amortization	1,060	3,746	1,145	905	6,858	152	7,011
Capital expenditures	830	4,977	855	338	7,001	777	7,779

Overseas sales, which include export sales of the Company and its consolidated subsidiaries, totaled ¥24,560 million (\$223,110 thousand) and ¥20,175 million, or 19.2% and 16.3% of the consolidated net sales for the years ended May 31, 2004 and 2003, respectively.

The following appropriations of retained earnings of the Company were approved at a meeting of the shareholders held on August 27, 2004:

	Millions of yen	Thousands of U.S. dollars
2003 year-end cash dividends (¥5.50 = \$0.049 per share).....	¥1,001	\$9,093
Bonuses to directors.....	50	454



■ ERNST & YOUNG SHINNIHON
Hibiya Kokusai Bldg.
2-2-3, Uchisaiwai-cho
Chiyoda-ku, Tokyo, Japan 100-0011
C.P.O. Box 1196, Tokyo, Japan 100-8641

■ Tel : 03 3503 1100
Fax : 03 3503 1197

Report of Independent Auditors

The Board of Directors
Nippon Kayaku Co., Ltd.

We have audited the accompanying consolidated balance sheets of Nippon Kayaku Co., Ltd. and consolidated subsidiaries as of May 31, 2004 and 2003, and the related consolidated statements of income and retained earnings, and cash flows for the years then ended, all expressed in yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Nippon Kayaku Co., Ltd. and consolidated subsidiaries at May 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended May 31, 2004 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 2.

Ernst & Young ShinNihon

August 27, 2004

Organization

As of December 1, 2004

Shareholders Meeting

Board of Directors

President
K. Shimada
Representative Director

Board of Managing Directors

Board of Auditors

Auditors

Environment, Safety, Quality Assurance Management Committee

Ethics Committee

Crisis Management Committee

Business Innovation Committee

Disclosure Committee

Strategic Corporate Planning Group

H. Kitazawa
Managing Director

Corporate Planning Division A. Sakai
Public Relations & Investor Relations Division M. Okamoto
Secretarial Division K. Ichihashi
Research & Development Planning Division T. Nakagawa
Strategic Patents Division T. Fujii

Functional Chemicals Group

M. Komaki
Managing Director

Planning & Coordination Office N. Yamanaka
Functional Materials Division H. Morita
Electronic Materials Division K. Shimomiya
Director
Catalysts Division T. Numa
Functional Chemicals R&D Laboratories M. Yokoshima

Fukuyama Plant K. Takeda
Asa Plant S. Ishii

West Japan Branch A. Mandai
Director

Pharmaceuticals Group

H. Inose
Representative Director,
Senior Managing Director

Planning & Coordination Office K. Kawasaki
Pharmaceuticals Marketing Division H. Sugiyama
International Division H. Fukuno
Specialty Chemicals & Diagnostics Division H. Sugaya
Regulatory Affairs Division T. Tsuji
Pharmaceuticals Technical Operations Division K. Takagi
Research & Development Division T. Saino
Director
Licensing Division Y. Uchida

Takasaki Plant K. Nishii
Director
Tokyo Plant H. Wakaumi

East Japan Branch K. Wada
West Japan Branch A. Mandai
Director

Fine Chemicals Group

Y. Fukushima
Managing Director

Safety Systems Division Himeji Plant T. Saito
Y. Ikeda
Director

Agrochemicals Division N. Tsumagari
Color Chemicals Division T. Higashida
Explosives Division S. Yamamoto
Fine Chemicals R&D Laboratories A. Masui

Kashima Plant S. Kurino
Asa Plant S. Ishii

West Japan Branch A. Mandai
Director

Administration Group

K. Chiba
Managing Director

Personnel Division K. Matsunaga
Director
Purchasing & Logistics Division Y. Kobayashi
Finance & Accounting Division Y. Asakawa
Information Systems Division K. Takada
Legal & General Affairs Division S. Matsunuma

Technical Operations Group

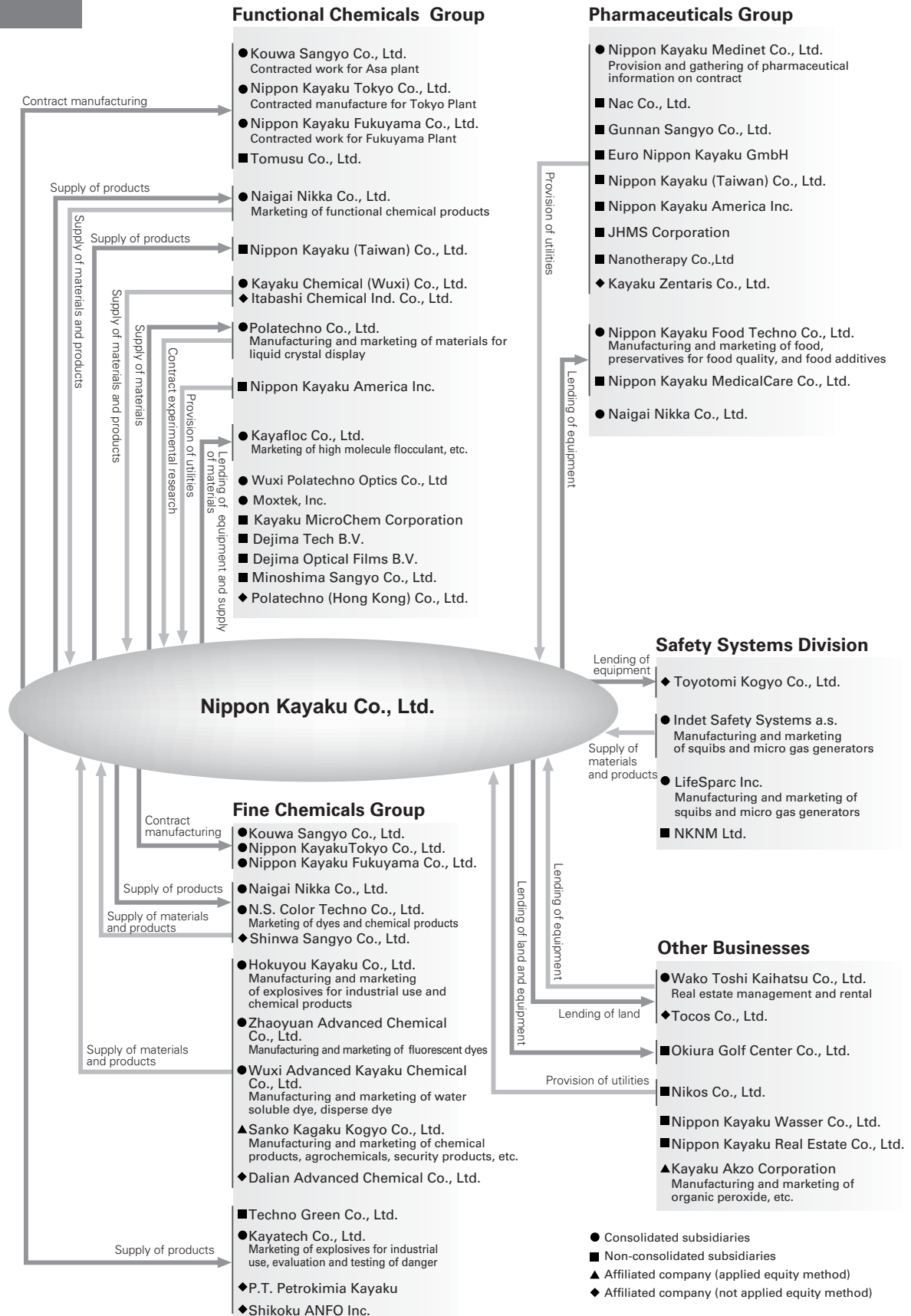
H. Yoshitake
Managing Director

Quality Assurance Division M. Nomura
Technical Administration & Engineering Division R. Sato
Environmental Protection & Safety Division N. Yoshida

Auditors' Division H. Kawachi

Group Companies

The Nippon Kayaku Group comprises Nippon Kayaku Co., Ltd., subsidiary companies, and affiliated companies. The outline of the placement of each company in the relevant business is as shown below (as of October 1, 2004).



As of October 1, 2004

■ Business Name	Nippon Kayaku Co., Ltd.
■ Representative	Koichiro Shimada, President
■ Foundation	June 5, 1916
■ Head Office Address	Tokyo Fujimi Bldg., 11-2, Fujimi 1-chome, Chiyoda-ku, Tokyo 102-8172, Japan Tel +81-3-3237-5046 (Public Relations & Investor Relations Div.) [URL] http://www.nipponkayaku.co.jp/
■ Number of Employees	1,920 (non-consolidated base, as of May 31, 2004)
■ Banks of Accounts	Bank of Tokyo Mitsubishi, Mizuho Bank, Joyo Bank
■ Major Products	
Functional Materials Division	Special epoxy resins, Epoxy resin curers, Combustion retardants for synthetic resins, UV-curing type resins, Acrylic polymers, High molecule flocculant
Electronic Materials Division	LCD sealants, CCD photoresists, DVD adhesives, Colors for color inkjet printers, Optical films
Catalysts Division	Catalysts for the production of acrylic acid and methacrylic acid, Plant licensing business
Pharmaceuticals Division	Anti-cancer agents, Neurological agents, Circulatory system agents, Digestive system agents, Metabolic agents, Antibiotics, Anti-inflammatory analgesic agents, Pharmaceutical intermediates, Food additives, Veterinary pharmaceuticals, Animal feedstuffs and feedstuff additives, Diagnostics
Safety Systems Division	Airbag inflators, Micro gas generators for seatbelt pretensioners
Agrochemicals Division	Insecticides, Herbicides, Fungicides, Acaricide, Biological pesticides, Soil disinfectant, Animal repellents
Color Chemicals Division	Disperse dyes, Cationic dyes, Acidic dyes, Reactive dyes, Direct dyes, Sulphur dyes, Fluorescent dyes, Dye supplements, Special dyes for non-textile applications
Explosives Division	Industrial explosives, Black powder, Electric detonators, Concrete crushers, Hazard evaluation, Pyrotechnics

■ Head Office and Domestic Offices

Head Office Tokyo Fujimi Bldg., 11-2, Fujimi 1-chome, Chiyoda-ku, Tokyo 102-8172, Japan

Domestic Offices
East Japan Branch Tokyo Fujimi Bldg., 11-2, Fujimi 1-chome, Chiyoda-ku, Tokyo 102-8172, Japan

West Japan Branch Kowa Awashin Bldg., 3-7, Awaji 3-chome, Chuo-ku, Osaka-shi, Osaka 541-0047, Japan

■ Administration Group

Sapporo Office Dunlop SK Bldg., 4-16, Ohdorinishi 10-chome, Chuo-ku, Sapporo-shi, Hokkaido 060-0042, Japan

Tokyo Office Tokyo Fujimi Bldg., 11-2, Fujimi 1-chome, Chiyoda-ku, Tokyo 102-8172, Japan

Nagoya Office Taiko Creacion Bldg., 19-11, Kikui 2-chome, Nishi-ku, Nagoya-shi, Aichi 451-0044, Japan

Osaka Office Kowa Awashin Bldg., 3-7, Awaji 3-chome, Chuo-ku, Osaka-shi, Osaka 541-0047, Japan

Fukuoka Office Nishitetsugion Bldg., 1-1, Gokushomachi, Hakata-ku, Fukuoka-shi, Fukuoka 812-0037, Japan

■ Plants

Fukuyama Plant 126, Minookicho, Fukuyama-shi, Hiroshima 721-8567, Japan

Asa Plant 2300, Sanyocho, Asa-gun, Yamaguchi 757-8686, Japan

Takasaki Plant 239, Iwahanamachi, Takasaki-shi, Gunma 370-1208, Japan

Tokyo Plant 31-12, Shimo 3-chome, Kita-ku, Tokyo 115-8588, Japan

Himeji Plant 3903-39, Toyotomi, Toyotomicho, Himeji-shi, Hyogo 679-2123, Japan

Kashima Plant 6, Sunayama, Hasakimachi, Kashima-gun, Ibaraki 314-0255, Japan

■ Laboratories

Functional Chemicals R&D Laboratories 26-8, Shimo 3-chome, Kita-ku, Tokyo 115-0042, Japan

Research & Development Division (Pharmaceuticals Group) 31-12, Shimo 3-chome, Kita-ku, Tokyo 115-8588, Japan

Fine Chemicals R&D Laboratories 225-1, Koshikiya, Ageo-shi, Saitama 362-0064, Japan



Our company logo

This logo symbolizes Nippon Kayaku's company policies.
The space at the center represents the cosmos, world and expanses of the Earth.
The two soaring ellipses represent creativity and courage and the
two circles are the confidence between Nippon Kayaku, which
aspires to extraterrestrial space, and the public.

 **NIPPON KAYAKU CO.,LTD.**

Head Office: Tokyo Fujimi Bldg., 11-2, Fujimi 1-chome, Chiyoda-ku, Tokyo 102-8172, Japan
<http://www.nipponkayaku.co.jp/>