

# Annual Report 2005

Year ended May 31, 2005



## ACCELERATING GROWTH

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

Now, at the start of the 21st century, the Nippon Kayaku Group has established information/communications, health care, and safety systems as growth fields, and we are concentrating our business resources in these areas. In addition to 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 and institutions, in order to accelerate the development of new products and the launch of new businesses. In this way, we are aiming for efficient expansion of our business in global niche markets where the size of the Nippon Kayaku Group is an advantage, and also for a faster pace of growth.

# ACCELERATING GROWTH

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\* Company information after May 31, 2005 is disclosed as part of company information herein.

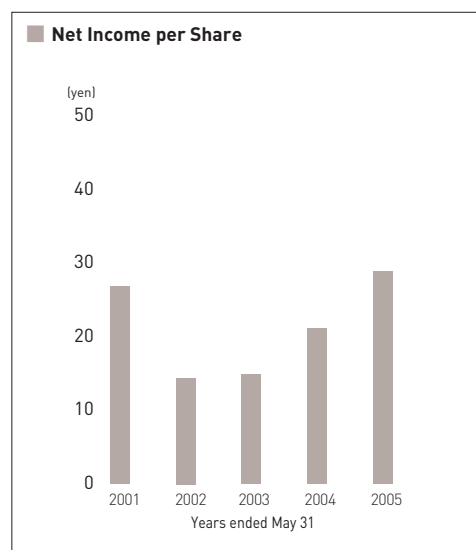
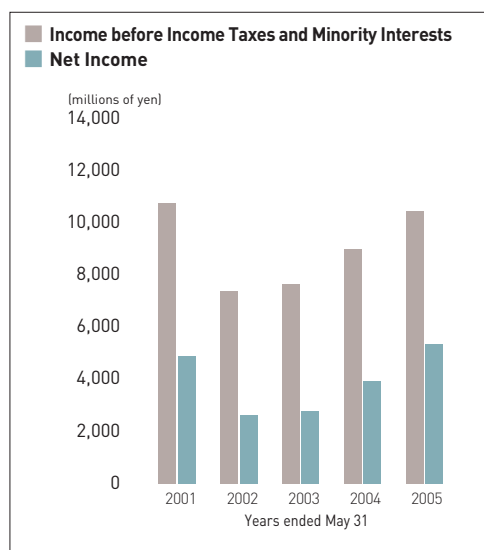
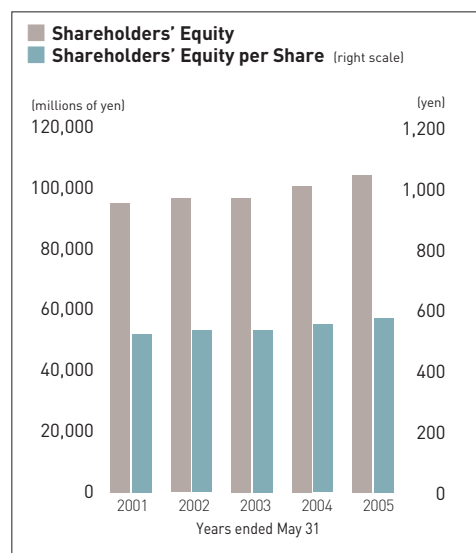
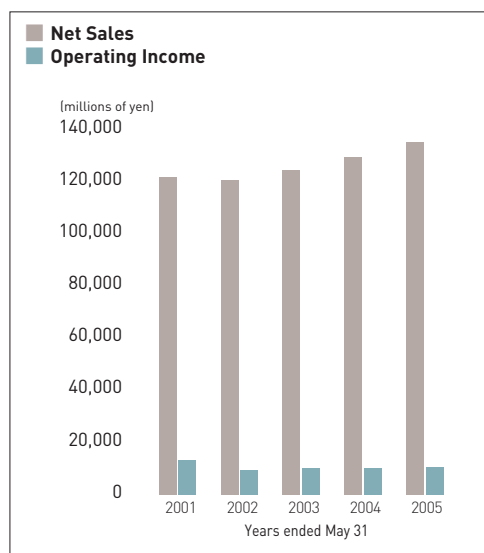
\* Descriptions about future results imply uncertainty and risks, and do not guarantee realization of these results as such. There are possibilities that discrepancies will occur between goals and results due to such factors as changes in management environment.

## Consolidated Financial Highlights

Years ended May 31

Millions of yen, except per share amounts

	2005	2004	2003	2002	2001
<b>Net Sales</b>	<b>134,205</b>	128,016	123,431	119,435	121,002
<b>Operating Income</b>	<b>10,166</b>	10,097	9,697	9,384	13,277
<b>Income before Income Taxes and Minority Interests</b>	<b>10,404</b>	8,941	7,643	7,309	10,675
<b>Net Income</b>	<b>5,315</b>	3,926	2,780	2,630	4,903
<b>Shareholders' Equity</b>	<b>103,810</b>	100,207	96,204	96,248	94,331
<b>Shareholders' Equity per Share (Yen)</b>	<b>570.31</b>	550.12	527.93	527.61	516.97
<b>Net Income per Share (Yen)</b>	<b>28.87</b>	21.22	14.92	14.42	26.87



# Message from the President

## **We are aiming for growth by rapidly moving forward with our business strategy and expanding our operations in global niche markets.**

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### **Performance review for the fiscal year ended May 2005**

Consolidated sales for the Nippon Kayaku Group in the fiscal year ended May 31, 2005 were 134.205 billion yen, an increase of 6.188 billion yen from the previous fiscal year. Operating income increased by 68 million yen to 10.166 billion yen, and net income increased by 1.389 billion yen to 5.315 billion yen.

Looking at the individual business areas, we see that growth slowed in the functional chemicals business due to a sudden drop in IT-related demand in the electronic materials business during the second half of the year. However the safety systems business grew, due to the acquisition of new customers and other positive factors, and overall growth was strong.

The pharmaceuticals business faced a difficult struggle during the first half of the year, however with the introduction of an arterial infusion drug IA CALL (an anti-cancer drug) and other new products in the second half of the year, it is in the process of regaining its original strength.

In the fine chemicals business, sales of color chemicals and explosives were strong, however there are issues which remain to be resolved in the agrochemicals business.

### **Rapid execution of the business strategy**

The basic strategy of the Nippon Kayaku Group is to maintain a strong focus on markets and customers, and to rapidly execute our business strategy for targeting niche markets by utilizing a fusion of technologies within and beyond our company. Based on this basic strategy, we have identified three growth fields: information/communications, health care, and safety systems. We intend to differentiate ourselves from other companies through efficient business development in global niche markets which suit the size of our operations, and we are working to expand and grow our business.

### **Business development in growth fields**

Following are some of the specific actions we are taking to develop our business in growth fields. First, in the information/communications field, we are working to expand sales of new environmentally friendly epoxy resins which meet the changing needs of the IT markets, as well as sales of electronic materials and IT market products such as functional materials, optical films, and LCD projector materials. We are also aiming to develop new products which deliver greater value to the customer.

In the health care field, we are focusing our efforts on maintaining sales of existing products, and on expanding sales and achieving early launches of new products, centering on the arterial infusion drug IA CALL (an anti-cancer drug), which was introduced in July 2004. We are also accelerating development of nanotechnology-based drug delivery systems (DDS), aiming for early introduction into the market.

In the safety systems field, we are striving to expand sales of new airbag inflator products. We are also expanding our global operations through manufacturing and sales conducted by our Japan-U.S.-Europe tripartite system for the micro gas generators for seatbelt pretensioners.



### **Company-wide reorganization**

In order to carry out our business strategy rapidly and effectively, Nippon Kayaku conducted a company-wide reorganization in August 2004. This reorganization resulted in the creation of the Functional Chemicals Group, the transfer of the active pharmaceutical ingredients business to the Pharmaceuticals Group, the creation of an independent Safety Systems Division, and the transfer of the Agrochemicals Division to the Fine Chemicals Group. Under this new system, we are reinforcing our business strategy, strengthening company-wide research and development, and strengthening our Administration Group and the support organization. These efforts are described in detail below.

#### **1) Reinforcing our business strategy**

Based on our business portfolios, Nippon Kayaku Group has positioned the Functional Chemicals Group, Pharmaceuticals Group, and Safety Systems Division as growth businesses, while the Fine Chemicals Group has been positioned as a stable income business. The growth businesses are centered on the three growth fields described above, and we are concentrating business resources in key areas, aiming to achieve growth through rapid research and development. For the stable income business, we expect to secure stable income in a demanding business environment by carrying out cost-cutting measures and by improving our business structure.

#### **2) Strengthening company-wide research and development**

The Nippon Kayaku Group has achieved success in a broad range of fields since its 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 chemicals, 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.

We are currently constructing the Integrated Research Building (provisional name) in Kita-ku, Tokyo. (Scheduled for completion in January 2006.) This facility is intended to accelerate the formation of unique businesses and new products by creating a fusion of our extensive range of technologies and other intellectual assets. We have also established a new Research and Development Group, which oversees all Nippon Kayaku research and development, and are further expanding our corporate themes which are centered on advanced technologies and nanotechnologies, and are proceeding with company-wide research and development aimed at constructing next-generation key technologies.

#### **3) Strengthening the Administration Group and the support organization**

With the Administration Group and Technical Operations Group at the center, we are qualitatively strengthening the support system that covers our group companies, and resolving business issues in order to provide stronger support to, and improve the participation of, our business divisions. We are also utilizing an Enterprise Resource Planning (ERP) system to further improve the efficiency of administration and personnel operations throughout the entire group.

### **Corporate governance**

At the Nippon Kayaku Group, we understand that disclosing information to our shareholders and investors in a timely and fair manner is an important matter, as is strengthening internal check functions in order to ensure

management transparency. One suggested possible mechanism for new corporate governance is adopting the approach of a "Company with Committees;" however, Nippon Kayaku believes that a system based on decision-making by the board of directors, and corporate governance through the auditor system is the most effective in terms of effective management functions. In order to further improve corporate governance and ensure transparency within this framework, in August 2005 we enacted steps including reducing the number of directors, reforming management functions and organization by introducing an executive director system, linking bonuses to consolidated performance results, and carrying out a revision of the director compensation system which eliminated director retirement bonuses.

#### **Environmental safety management**

Environment, safety, and quality are at the core of Nippon Kayaku Group management. We have carried out a fusion of our intellectual assets in these fields as well, and have worked to strengthen our environmental safety management throughout Nippon Kayaku Group. Now, at the start of the 21st century, a company must be focused on the environment, and must also take steps to fulfill its social responsibilities and contribute to the development of a sustainable society.

#### **Revisions to the dividend policy**

At Nippon Kayaku, we have long concentrated on returning profits to all our shareholders. In order to further clarify this policy, beginning from the fiscal year ended May 31, 2005 the payment of dividends is now linked to the consolidated performance results for each year. With consideration for stable and continuing profit returns and for the level of internal profit retention, we have established a mid-range target of 40% of the consolidated net income as the dividend payout ratio. However this figure will be adjusted as necessary if any special variable factors occur. Profits retained by the company will be allocated to capital investment, research and development, and other needs for growth fields such as electronic materials and automotive safety products, in order to raise the value of our company.

#### **Focus on growth**

An analysis of the recent business environment shows a return to balance after the confusion which followed the bursting of the economic bubble, as well as the beginning of a new era of global competition. Under these conditions, where only the strong survive, a policy which focuses solely on stability is likely to result in stagnation. In each of the past three years, from the fiscal year ended May 31, 2003 to the fiscal year ended May 31, 2005, we have successfully achieved both rising income and rising profits. We are now aiming for development and growth in the Nippon Kayaku Group by further accelerating the expansion of our growth businesses.

It is clear that due to the declining birth rate and other factors, the Japan domestic markets are shrinking, and growth will be impossible without an expansion of overseas business. Our group is already involved in overseas operations in the safety systems business and color chemicals business. In addition, we are working to develop global business for electronic materials, in order to achieve an even higher rate of growth.

December 1, 2005



Koichiro Shimada  
President



# Functional Chemicals Business

**We are striving to create a fusion of technologies within and beyond our company, and are working for the rapid introduction of new products. In this way, we are aiming to be the “number one” or “only one” presence in global niche markets, primarily in the information/communications field.**

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## Further expanding our business through new products and new operations

During the first half of the fiscal year ended May 31, 2005, the functional chemicals business delivered strong performance, buoyed by growing demand for such items as LCD and plasma televisions, and other digital home electronics, as well as for cellular telephones. However we faced harsh conditions in the second half of the year, as demand for these products dropped suddenly and dramatically. Severe business measures have been required to secure profits as well, as material costs have risen due largely to the soaring price of oil. Consequently, we have focused efforts on correcting product prices, primarily in the functional materials business, and have engaged in company-wide cost-cutting efforts. This market swing has already reached bottom, and is gradually moving towards recovery. We expect a full-scale recovery to take place in or soon after the second half of 2005.

While a short-term corrective phase is anticipated, we have determined that the growth trend will continue in the mid- to long-term, and Nippon Kayaku will continue to position the information/communications field as a growth area for concentrating business resources. We will retain a solid, aggressive approach, maintaining a constant supply of new products to our customers. We are aiming to expand our business by identifying and developing new business areas that are consistent with technological and market trends.

## Functional materials business

Nippon Kayaku holds the global top market share in the field of the epoxy resins which are used for the encapsulation of semiconductors. Our environmentally friendly epoxy resin NC-3000, developed as a replacement for our earlier core product EOCN, has been recognized in fields extending beyond use simply as an encapsulation material, and sales are quickly growing in the laminate and other fields. We are proceeding with improvements to our supply system in preparation for a sudden future increase in demand.

For the resist ink resins which form the base of RC resins, we are shifting our research and development away from conventional rigid PCB resins and towards flexible printed circuit (FPC) resins, where a future large increase in demand is

expected. We have already introduced several unique resist ink resin products into the market, and these have been highly evaluated by customers. We expect sales of these products to grow in the future.

We are also planning to expand our efforts aimed at the development of new uses, primarily those related to FPC, for polyimide, polyamide, and other new resins.

In addition to its business of resist ink resins for PCBs, Kayaku Chemical (Wuxi) Co., Ltd. (KCW) in Wuxi, China has successfully begun production and sales of a range of coating resins for the rapidly expanding domestic market in China. In the future, this company will further strengthen its involvement with Japanese manufacturers operating in China, as well as with local Chinese users, and will work for greater business growth in the expanding Chinese market.

## Electronic materials business

We achieved a large-scale increase in sales of our colors for color inkjet printers, thanks to an extremely well-conducted new-product development and marketing process. We will continue to develop next-generation products which meet customer needs in the future. Aiming for further business expansion, we are also developing a range of commercial and industrial inkjet inks which are based on the technologies that we have refined through our earlier development efforts, and which we are continuously developing in cooperation with printer and print head manufacturers.

Our range of flat panel display (FPD) films has also shown a significant boost in sales. Our primary product, the front films for plasma televisions, is based on a fusion of Nippon Kayaku dye technology and resin technology, and was developed and marketed in close connection with customers. We will continue working to identify market trends and customer needs at an early stage, and to develop original new products which will allow us to expand our film business.

Despite difficult conditions in the market, sales of other new products, including liquid crystal display (LCD) products, optics, and data storage products, have also been strong. DVD-related materials have been subject to fierce price competition as the market expands. However, extensive cost cutting and measures aimed at differentiating our products from the competition have

allowed us to retain our top share of the market. We expect further expansion of this market in the near term.

We are proceeding with development of different systems (HD DVD, BR DVD) for next-generation DVDs. As we develop each of these systems, we are working to extend our cooperation with the customers who will use these new products.

LCD sealants have also shown a strong increase in sales. In particular, as a result of the ever increasing performance demands for the heat-curing sealants which are used in small- and mid-size panels, Nippon Kayaku has gained recognition for the superiority of our technology, allowing us to boost our market share. While the release of our UV-curing resins was delayed, their adoption by the customers has been confirmed, and we expect full-scale growth in sales to begin in the near future.

While our subsidiary company Polatechno Co, Ltd., which produces primarily small- and mid-size polarizing films and materials for projector optics, will be affected by market fluctuations in the near-term, fundamentally it is continuing to deliver strong performance. In particular, growth in rear projection televisions is expected to translate into rapid growth in sales of the inorganic polarizing film ProFlux, produced by the U.S. company Moxtek Inc., which was acquired by Polatechno last year.

Kayaku MicroChem Corporation, which is engaged in development and sales of resists for micro electro mechanical systems (MEMS), is marketing an alkali-developable resist and other new products, and has achieved strong sales. This company has also begun sales of "resist-coated wafers," a product which has been very well received. These products are silicon wafers with MEMS resist resin already applied, for greater customer convenience when using this resist.

## Catalyst business

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

The market for super absorbent polymers (SAP), which are used in disposable diapers and feminine hygiene products, is growing rapidly worldwide. As the demand for the acrylic acids which are a fundamental component of these products grows, demand continues to outpace supply. As a result, a large number of new and expanded plants for the production of acrylic acids are planned in China and many other countries around the world. We are actively negotiating with these plants so that they will make use of catalysts from Nippon Kayaku.

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 the reasons above, we believe that the catalyst business will continue to grow.

## 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 create 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. We are actively engaged

in joint development together with our customers because we believe that an exchange of information with the customers is essential for 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 are not limited to our own company's technology, and we are actively involved in alliances and business ventures with other companies.



Masao Komaki

Member of the Board  
Managing Director  
Director of Functional Chemicals Group

**System for large-scale increase in production of polarizing films for LCD projectors in Wuxi, China (Polatechno)**

Polatechno Co., Ltd. is a joint venture established by Nippon Kayaku and Arisawa Manufacturing Co., Ltd. As a manufacturer of optical films, it holds a greater-than-80% share of the world market for polarizing films used in LCD projectors. In August 2003, this company established Wuxi Polatechno Optics Co., Ltd. as a wholly-owned subsidiary in Wuxi, China. The new subsidiary started production with a system for monthly production of 200,000 wafers. A year later, a system for monthly production of 600,000 wafers was completed, in order to meet expected future growth in demand and sudden large-scale temporary increases in orders. Combined with the production that is contracted to another company in Guangdong Province, the total monthly production capacity in China has increased to 1.1 million wafers.

Polatechno maintains two plants in Japan: the Niigata Plant and the Nakadahara Plant (Joetsu City, Niigata Prefecture). The Niigata Plant produces polarizing films for LCD projectors, and in 2002 expanded its production system to a monthly production capacity of 1 million wafers.

Polatechno mainly produces raw films for the polarizing films and phase-contrast films used in polarizing plates in Japan. Currently, the production facilities are operating at full capacity, and Polatechno intends to further increase production efficiency and make other improvements in the future.

**Strengthening business activities in special optical film fields (Polatechno)**

Polatechno currently holds the top share worldwide for polarizing films used in LCD projectors. This company is now working to increase sales by expanding into special fields where it can make the best use of its strengths. One major target of these efforts is the field of LCD monitors for use in automobiles. By approximately 2014, the market for automobile LCD monitors is expected to rival the current size of the cellular telephone LCD market. The dye-type polarizing films that are among Polatechno's strongest products feature superior durability and heat resistance, and have already been highly rated for use in automobile LCD monitors. Together with the temperature-matched elliptical polarizing films produced by a subsidiary, Dejima Optical Films, in the Netherlands, Polatechno is strengthening its aggressive market approach.

In fields other than LCD products, Polatechno is focusing on products such as the polarizing base films for polarizing sunglasses, and elliptical polarizing films for organic electro luminescence (EL).

**Center for production and sales of LCD polarizing films in Taiwan (Polatechno)**

Polatechno has established a center for production and sales of polarizing films for liquid crystal displays (LCDs) in Taiwan. This company was established in December 2004 as a joint venture with four Taiwanese venture capital firms. The plant is now under construction, and is expected to begin mass production in the spring of 2006. The flat panel display (FPD) industry in Taiwan, centered on LCD displays, has shown significant growth in recent years, and is expanding to become a key industry in Taiwan on the same level as the semiconductor industry. The FPD industry is expected to continue growing in the future, as is demand for the polarizing films which are a key element of LCD panels. While the initial annual production capacity is expected to be 4 million square meters, Polatechno will monitor changes in demand and expand the facilities at this center as necessary.

Polatechno business to this point has been focused primarily on small- and mid-size polarizing films, however the new center in Taiwan will provide integrated production from raw film to final product for the large-size polarizing films which are used for notebook PCs, monitors, and LCD televisions. These films will be sold to local LCD panel manufacturers, and will also be used to supplement production from the Niigata Plant in Japan.

This full-scale entry into the field of large-size polarizing films is intended to expand Polatechno's business, and also to produce technical synergy with existing businesses.



Conceptual drawing of the joint venture company building in Taiwan

## 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.





# Pharmaceuticals Business

**By fusing intellectual assets from within and beyond the company, and accelerating the pace of research and development, we are aiming for growth in the health care field, and particularly growth in cancer-related treatment areas.**

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## **Strengthening 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, to accelerate the development 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 18 anti-cancer drugs in Japan. In the process of creating these drugs, we have accumulated a broad range of information related to the full spectrum of anti-cancer drug research, development, production, and sales. In order to apply this information in the best way to efficient business practices, we are not only researching and developing new drugs, but we are also 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 order to provide the best possible response to these needs, Nippon Kayaku has, together with NEC Corporation, jointly developed a highly advanced “in silico screening system” which can rapidly identify candidate compounds from a vast compound library.

In addition to our conventional research into cytotoxic 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. In addition, we have established the development of heat immunotherapy, in which heat is used to treat cancer, as a corporate theme. Under this theme, we have established a venture company and are conducting a broad range of research.

## **Lineup of cancer-related products**

At present, Nippon Kayaku has marketed 18 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, we are engaged in providing and collecting information concerning not only our own products, but also concerning the administration, efficacy, and side effects of anti-cancer drugs in general. This allows us to collect a greater amount of information concerning anti-cancer drugs for research, production, and sales. Nippon Kayaku is continuing to provide information which is useful for actual cancer treatment, and also working to efficiently expand our business. For these purposes, a strong product lineup is essential and we are engaged in efforts to further improve it.

In 2004, we introduced ONCOVIN and EXAL from Eli Lilly Japan K.K., and in 2005 we introduced CALSED from Sumitomo Pharmaceuticals Co., Ltd. (currently Dainippon Sumitomo Pharma Co., Ltd.), GELPART from Yamanouchi Pharmaceuticals (currently Astellas Pharma Inc.), and EPIRUBICIN MERCK from Merck Hoesl Ltd.

We have also introduced the new anti-cancer drug NK408 from NeoPharm Inc. to combat brain tumors, and have started on local development.

We will continue to actively pursue the introduction of new cancer-related products, and conduct extensive joint development 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 has strengthened drug information (DI) in the group, and is organizing lectures, seminars, and briefing sessions to answer these needs. We have also trained and dispatched cancer 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, 96 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 via the Internet directly to health care professionals who wish to receive it.

### Reinforcement of facilities for production of high-potency active ingredients—Expanding integrated contract manufacturing from API to pharmaceuticals

For many years, the Takasaki Plant has carried out integrated production of anti-cancer drugs which meet US FDA (Food and Drug Administration) standards, and we have constructed a complete GMP (Good Manufacturing Practices: standards related to manufacturing control and quality control of pharmaceuticals) system that covers 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 that covers 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, and 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, we installed additional multipurpose production equipment for chemically hazardous drugs at the

Takasaki Plant (Gunma Prefecture). We are also expanding our lyophilizing facilities and aseptic facilities, aiming to complete a system for contract manufacturing of anti-cancer drugs and other high-potency active ingredients by the fiscal year ending May 31, 2006.

### Active development of anti-cancer drugs using nano-technology

Research into drug delivery systems (DDS) is nearing a breakthrough point, as DDS technologies continue to incorporate

nano-technology and information technology (IT). At Nippon Kayaku, we are aiming to expand our business by creating a fusion of intellectual assets, and are focusing our efforts on the development of anti-cancer drugs delivered by DDS which utilize nanotechnology.

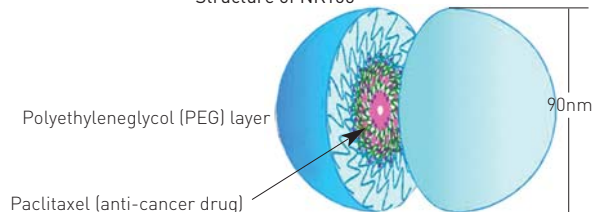
The new blood vessels generated by cancer tissues to supply nutrients have small openings in the vessel walls. It is through these small openings that drug-carrying polymer micelles 50 to 200 nanometers in diameter can reach the tumor cells and deliver drugs directly. Achieving this highly specific delivery of anti-cancer drugs will allow the side effects of anti-cancer drugs to be reduced, and will deliver better results.

Clinical trials for our Paclitaxel polymer micelle DDS pharmaceutical (NK105) are under way at the National Cancer Center. NK105 (licensing agreement concluded with NanoCarrier Co., Ltd.) began phase I clinical trials in April 2004, and development is proceeding smoothly. We are also planning to launch a new polymer micelle anti-cancer drug project to follow on NK105. In addition, we are studying the

possibility of applying this polymer micelle manufacturing technology to fields other than the anti-cancer drug field.



Structure of NK105



### Starting sales of CALSED

In December 2004, Nippon Kayaku received a transfer of sales for the drug CALSED from Sumitomo Pharmaceuticals Co., Ltd., (currently Dainippon Sumitomo Pharma Co., Ltd.) and we began sales in May 2005. CALSED is an anthracycline antibiotic for malignant tumors to be produced by total synthesis, and is manufactured by Sumitomo Pharmaceuticals Co., Ltd.. It has been approved as effective in combating both non-small-cell lung cancer and small-cell lung cancer. Currently, clinical trials are under way to evaluate the additional effectiveness of CALSED in combating malignant lymphoma.

Specialist physicians have high expectations for CALSED, which is a product that is certain to see expanding use. Through the actual use of CALSED, we expect this product to be confirmed as evidence-based medicine (EBM).



### Agreement with a US company for development and sales of new anti-cancer drugs

In December 2004, Nippon Kayaku concluded a license agreement with the US pharmaceutical venture company NeoPharm Inc. for the exclusive development and distribution in Japan of the new anti-cancer drug NK408 (IL13-PE38QQR), used to treat malignant brain tumors.

NK408 is a molecular targeted drug which utilizes genetic engineering technology to combine the physiologically active substance interleukin (IL) 13 with *Pseudomonas aeruginosa* exotoxin A.

NeoPharm Inc. is currently conducting clinical development in Europe and the United States, where it has begun phase III clinical trials. Nippon Kayaku will begin clinical development of this drug beginning from the second half of 2005, aiming to market it in 2010.

Currently patients suffering from malignant brain tumors in Japan each year number 2,000, and this is expected to increase to 3,000 in ten years' time. At the peak, this translates into pharmaceutical sales of approximately 2.5 – 3.0 billion yen each year.

### Introduction of the hepatic artery-embolizing material GELPART

In February 2005, we acquired the exclusive right in Japan to sales, distribution, and development of additional

applications for the hepatic artery-embolizing material GELPART, which is produced by Yamanouchi Pharmaceuticals Co., Ltd. (currently Astellas Pharma Inc.) and which received official approval in January 2005. We are planning to begin sales during the fiscal year ending May 31, 2006.

GELPART is a porous gelatin, and is a new embolizing material used in the new treatment transcatheter arterial embolization, one type of treatment for patients with hepatocellular carcinoma. This treatment blocks the hepatic artery which supplies nutrition to the tumor, and interrupts the blood flow in order to treat the tumor selectively and by minimally invasive means.

Nippon Kayaku is aiming to achieve growth by focusing on cancer-related fields, and the field of liver cancer is one of our priorities. In July 2004 we marketed IA CALL, a drug for the treatment of hepatocellular cancer. With the acquisition of the rights for GELPART, we have further expanded our product lineup in the liver cancer field, and are working to improve our record of cancer treatment.

### First use of VelP treatment for germ cell tumors in Japan

In December 2004, the anti-cancer drug Injectable EXAL (vinblastine sulfate) received additional approval for use in treating recurring and difficult-to-treat germ cell tumors (testicular tumors, ovarian tumors, and extragonadal tumors). Overseas, the standard method for treatment of recurring and difficult-to-treat germ cell tumors is a combined treatment using vinblastine sulfate, ifosfamide, and cisplatin (VelP treatment). With this additional approval, VelP treatment becomes possible in Japan as well. The Nippon Kayaku cisplatin drug RANDA Injection has been approved as effective for the treatment of germ cell tumors, and ifosfamide has also been similarly approved. As a result, it is now possible to carry out VelP treatment using Nippon Kayaku anti-cancer drugs.

### Acquiring approval for new effectiveness using combined treatment with 3 anti-cancer drugs

In February 2005, approval was given for the new effectiveness of three Nippon Kayaku anti-cancer drugs used in combination with anti-cancer drugs from other companies.

This new effectiveness describes the effects of RANDA Injection against malignant bone tumors, of LASTET Injection against pediatric solid malignant tumors, and of Injectable ONCOVIN 1mg against multiple myeloma and against glioma which contain malignant astrocytoma or oligodendroglioma components.

## Status of New Product Development by Stage

(as of October 1, 2005)

Stage	Development code Product name (Generic name)	Dosage form or route of administration	Therapeutic category (Indications)	Domestic developer	Characteristics/Others
				Origin	
NDA	SL-1100 (Filed in Dec. '03) (Estradiol)	Gel preparation	Estrogen drug (Climacteric disorder)	Joint dev. with Shiseido Besins International (France)	First estradiol gel preparation in Japan. Approved in 61 countries.
	NS75A (Filed in Dec. '00) (Cetrorelix acetate)	Injection	Anti-hormone drug (Prevention of premature ovulation)	Joint dev. with Shionogi, Kayaku Zentaris Zentaris (Germany)	LHRH (hormone that stimulates secretion of pituitary gonadotropin) antagonist
P III	IMMUCYST PMCJ-9 (Connaught strain BCG)	Bladder instillation	Anti-cancer drug (for preventing recurrence of bladder cancer)	Own development Sanofi Pasteur (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.
	NK211/HYCAMTIN® (Nogitecan hydrochloride)	Injection	Anti-cancer drug (Ovarian cancer)	Own development GSK	Extended indication
	NK911 (Micelle doxorubicin hydrochloride)	Injection	Anti-cancer drug (Pancreatic cancers)	Own development Tokyo Women's Medical University	Macromolecular micelle anti-cancer drug. Basic patent license obtained from Japan Science and Technology Corp. Development in other fields being considered.
	NS75A (Cetrorelix acetate)	Injection	Anti-hormone drug (Hysteromyoma)	Joint dev. with Shionogi, Kayaku Zentaris Zentaris (Germany)	LHRH (hormone that stimulates secretion of pituitary gonadotropin) antagonist
P I	NK408 (IL13-PE38QQR)	Injection	Anti-cancer drug (cerebral cancer)	Own development NeoPharm (US)	New molecular targeted anti-cancer drug. Phase III in EU and US.
	NK105 (Micelle paclitaxel)	Injection	Anti-cancer drug (Solid cancers)	Own development Joint dev. with NanoCarrier	Macromolecular micelle anti-cancer drug
	NS75B (Cetrorelix pamoate)	Injection (sustained release preparation)	Anti-hormone drug (Prostatic hypertrophy)	Joint dev. with Shionogi, Kayaku Zentaris Zentaris (Germany)	LHRH (hormone that stimulates secretion of pituitary gonadotropin) antagonist
	NK314	Injection	Anti-cancer drug (Solid cancers)	Own development Own development	New cytotoxic anti-cancer drug
	NK012 (Micelle camptothecin analogue)	Injection	Anti-cancer drug (Solid cancers)	Own development Own development	Macromolecular micelle anti-cancer drug

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

### Anti-Cancer and Cancer-Related Drugs

- CALSED (2005)
- EPIRUBICIN (2005)
- IA CALL (2004) ①
- ONCOVIN (2004) ②
- EXAL (2004) ②
- CARBOMERCK (2003)
- IMMUCYST (2003) ③
- HYCAMTIN®(2003)
- MS-TWICELON (2001)
- COFORIN (1996)
- FARESTON (1995)
- ODYNE (1994)
- STARASID (1992)
- PINORUBIN (1988)
- LASTET (1987)
- BESTATIN (1987)
- RANDA (1984) ④
- PEPELO (1981)
- BLEO (1969)



①



②



③



④

### Immunosuppressants

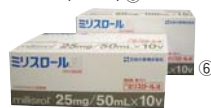
- SPANIDIN (1994) ⑤



⑤

### Cardiovascular Drugs

- MILLISROL for Coronary Infusion (2001)
- ADEHL (1999)
- MILLISTAPE (1998)
- NITROPEN TABLETS (1988)
- MILLISROL (1984) ⑥
- NITROGLYCERINE TABLETS (1953)



⑥

### Neurological Drugs

- SALIGREN (2001)
- MUSCALM (1975)

### Other Drugs

- ASTRIC DRY SYRUP (2002) ⑦



⑦

### Diagnostic Agents

- LANA MAMMO CARD CEA (2002) ⑧



⑧

- LANA TP AUTO (2001)
- LANA 1,5AG AUTO LIQUID (2000)
- LANAZYME BFP PLATE (2000)
- LANAZYME ST-439 PLATE (1999)

### Pharmaceutical API and Intermediates



# Safety Systems Business

Through the development of highly competitive products and global operations, we aim to further expand our business.

### Automotive safety products: Promising rapid growth globally

In developed societies where motorized traffic is extensive, demand is growing for collision protection for passengers, for improved performance of protective devices, and even for protection of pedestrians in the case of accidents. 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. Growth in automobile production is expected to continue, centered on BRICs. Global production of passenger cars was approximately 60 million vehicles in 2004, and is forecast to reach approximately 75 million in 2014. 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 globally.

Our Safety Systems Division is riding this wave of expansion, and we are also working to 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 three directions:

- Strengthening our R&D capabilities in order to continually develop and market new products with strong market appeal;
- Further boosting the competitiveness of existing products to increase our market share and expand our business; and,
- Carrying out global operations which allow us to maintain a stable

and economical supply of products to Japanese and other automobile manufacturers who operate globally.

### 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 completely 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 aiming to quickly complete and market our compact inflator, currently under development, for use in side-impact airbags.

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 keeping with the needs of the times, we are also proceeding with efforts to expand our range of lead-free and green products, to create a lineup of environmentally friendly products.



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 raised concerns over market share by automotive parts manufacturers. Consequently, the competition has become extremely fierce. The following are essential if we are to survive in this environment.

- All staff must maintain a strong cost awareness.
- The company must continuously carry out product improvements, process improvements, distribution improvements, and streamlining of the organization.
- We must strengthen the competitiveness of our existing products.
- We must carry out stable production under an absolute awareness of safety.

Total cost awareness must penetrate all production divisions, engineering divisions, and management divisions, and the combined strength of the safety divisions and quality control divisions 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 expand sales and increase the profit-earning capacity of our consolidated business.

### Topics

#### 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, and we are planning to establish an additional plant in China, where automobile production is growing rapidly, and work to expand our global operations. Because production by Japanese OEMs in China is growing rapidly, Nippon Kayaku has studied the possibility of entering this market, including the possibility of local inflator production. We have begun work on the selection of the actual sites and the products which will be produced, aiming to begin production in China at the start of 2007.

#### Acquiring a 100% share of our three safety system 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.

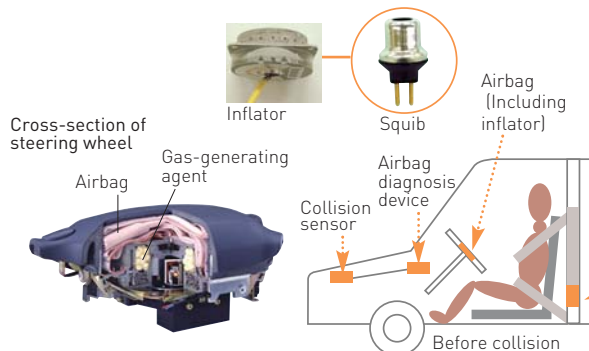
### Mechanisms of Airbag and Seatbelt Pretensioner Operation

#### ◆ 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.

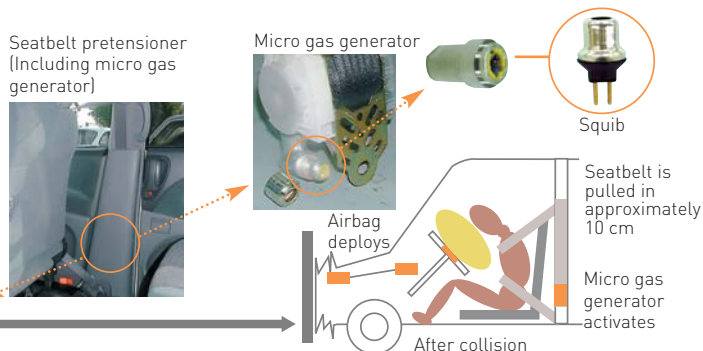


#### ◆ Micro Gas Generator Mechanism

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.





# Fine Chemicals Business

**We are carrying out further reforms in order to stabilize earnings.**

## **A faster pace of reform**

One year has passed since the launch of the Fine Chemicals Group, which was created by reorganization of our business in 2004. This group has dedicated its full efforts to reforms aimed at achieving a transformation to a stable-earnings business, which has been our mission for this past year. However, the market in which the Fine Chemicals Group operates continues to shrink, and we have continued to face a difficult struggle.

Under these conditions, it was due to the sales from the agrochemicals business that our performance exceeded that of last year, however our profit situation worsened. Demand for dyes in Japan continues to decline, and sales from the color chemicals business fell. However efforts to improve profits by cutting costs and reducing fixed expenditures were successful, and the profit situation for this business improved. Like the color chemicals business, the explosives business also saw a drop in sales, however there was a dramatic improvement in profits due to the effects of the cost-cutting activities which have been continuing for the past two years. The result was a slight decline in sales, and a slight increase in profits, for the group as a whole.

With the expected continuing contraction of the market, the market forecast is not optimistic. However, in both the color chemicals business and explosives business, some progress was made towards the goal of establishing these businesses as generators of stable earnings. However, drastic reforms are needed in the agrochemicals business, and these reforms have just recently gotten under way. In the future, we will strive to increase the pace of these reforms, aimed at generating stable earnings.



**Yoshiaki Fukushima**

Member of the Board  
Managing Director  
Director of Fine Chemicals Group

## **Regeneration of the agrochemicals business**

Struggling against trends such as the shrinking area under cultivation and reductions in the use of agricultural chemicals, the agrochemicals business suffered an extreme slump in the fiscal year ended May 31, 2005. Major causes of this slump were the lack of any influential new products and a decline in domestic sales. While the color chemicals business and explosives business have begun to show improved profits, the immediate reorganization of the agrochemicals business has become an urgent issue for this group. For this reason, we have constructed a business regeneration scenario for the agrochemicals business and have begun to carry it out. The following is an overview of this scenario.

- (1) Strengthen the ailing Japan sales system.
- (2) Review the research and development themes and organization, and construct a system for systematic and rapid marketing of new products.
- (3) Eliminate waste from the organization, and construct a slim and efficient management system.

Due to a change in the method of calculating sales from consigned products in the fiscal year ending May 31 2006, sales will show a large decline even if the actual sales essentially remain the same. However, we will be certain to achieve improved profits. The reforms required for this regeneration will be painful, however we will carry out these reforms to their full extent, aiming for a return to rising business performance.

## Color chemicals business

The dye market in Japan is forecast to continue shrinking. Fortunately, however, sales from our China subsidiary have finally begun taking off. In addition, while prices of the color chemicals used for paper pulp are declining, the amounts used are increasing. For these reasons, sales of color chemicals, which had previously been in continuous decline, are expected to flatten out in the fiscal year ending May 31, 2006. We will continue to raise our profit rate by marketing unique products and by cutting costs, aiming to boost profits. We also intend to generate good business results from the functional chemicals which have been in development for a long period of time.

## Explosives business

Efforts at cutting costs which have been under way since 2003 are showing results, and profits in this business have made a rapid recovery. However, the decline in public works continues to result in lower sales of industrial explosives. Our current level of competitiveness is not enough to ensure the survival of this business under these conditions. We will make definite and devoted efforts to becoming the strongest manufacturer of industrial explosives in Japan.

## Future development

The environment surrounding the Fine Chemicals Group has been harsh for all business areas. However the business of this group is an essential part of our lives, and it is unthinkable that it will disappear. Nippon Kayaku maintains a vast supply of technologies and expertise that we have built up over our many years of experience. We will make even better use of these strengths in order to make our existing products easier to use, more convenient, safer, and more competitive, and we will work to develop new products which differentiate us from other companies. By improving our business, we aim to become a unique, if small, business group.

## Topics

### Expanded production of textile dyes in China

Our consolidated subsidiary in China, Wuxi Advanced Kayaku Chemical Co., Ltd., manufactures and sells water-soluble dyes, disperse dyes, and other textile dyes. Currently, approximately three-fourths of the products produced in China are exported to Japan. However as the dye market in Japan shrinks, expanding Japan sales has become difficult. Instead, Nippon Kayaku is planning to expand its business by increasing sales in China. Our goal is to sell three-fourths of these products in China in the fiscal year ending May 31, 2007.

In order to reinforce the sales system for expanding sales, we are planning to gradually increase the number of sales staff at the Wuxi Advanced Kayaku Chemical branch in Shanghai. While there is still ample production capacity at the current plant overall, we will add facilities as necessary for the appropriate dye types, and will construct a new plant in the next few years to meet the needs of future sales plans.

### Successful granulation of slurried explosives

In February 2005, Nippon Kayaku developed and marketed a new product, Landex. This product is the world's first granulated slurried explosive, a type of explosive that is used in projects such as tunnel blasting. Patents are currently pending in Japan and overseas.

Slurried explosives contain moisture, and are also called "emulsion explosives." They have several advantages, including little production of toxic gas, which have led to their use in tunnel blasting work. However, because they are in liquid form, previously these explosives had to be sealed in a cylindrical shape using waterproof paper or film. This meant that the explosives had to be loaded by hand at the time of the blasting work. This increased the level of danger and required more time. However Landex comes in pellets 4 millimeters in diameter. This makes it possible to use a loading machine, improving both safety and efficiency.

## 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



### 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



# Corporate Governance

## 1. Basic Concept of Corporate Governance

Nippon Kayaku understands that disclosing information to our shareholders and investors in a timely and fair manner is an important issue, as is strengthening check functions in order to ensure management transparency. Based on this understanding, we have adopted an auditor system as our mechanism for corporate governance. Under the revised Japanese Commercial Law which was enacted in April 2003, one possibility was adopting the "Company with Committees" approach, however Nippon Kayaku determined that a system based on decision-making by the board of directors, and corporate governance through an auditor system is the most effective in terms of effective management functions, and we will continue to use an auditor system.

In order to further improve corporate governance and transparency under this framework, we carried out the reformation of management functions and organization in August 2005. This reorganization clearly separates the decision-making and supervision functions from the operational functions, strengthening each of them to ensure correct decision-making and rapid operations.

## 2. Board of Directors

Important decision-making concerning operations is based on the rules and policies of the board of directors, in accordance with laws and articles of incorporation, and is conducted by voting of the board of directors. In order to ensure rapid management decision-making, during our reformation of management functions and organization we cut the number of directors from 25 to 10. All director positions with official posts were abolished, except for the chairman and president.

## 3. Board of Auditors

Monitoring and supervision of operations involves thorough checks by the board of directors and board of auditors. In addition, three auditors from outside the company (forming the majority of the auditors) have been added in order to ensure monitoring from an independent perspective and monitoring which can offer advice, as well as to strengthen the monitoring and supervision functions.

## 4. Executive Director System

We have introduced a director system in order to ensure our ability to react quickly to changes in the business environment and carry out flexible operations.

Executive directors are appointed by a vote of the board of directors, and carry out the duties which the board of directors entrusts to them. An executive director may also concurrently serve as a director. The maximum number of executive directors is 25, and each serves for a term of one year.

## 5. Internal Check System

In order to prevent improper acts or errors by directors and employees in the course of operations, and to strengthen internal checks that contribute to improving operations, the Audit Division has been established, independent of the board of auditors, as an internal organization. Based on a yearly plan, this division conducts audits of operations, including those of group companies.

## Outline for Corporate Governance



## 6. Reform of the director compensation system

In order to clarify the responsibilities of the directors and improve fairness and transparency, the director retirement bonus system, which was largely based on seniority, was eliminated. A new system of bonuses linked to consolidated performance has been adopted; the new system for director compensation is now composed of a monthly salary and a performance-linked bonus.

## 7. Compliance System

A code of conduct has been established to specify the ranges of allowable director and employee activities. An Ethics Committee, chaired by a corporate officer with an official post, has been established in order to ensure complete observance of these activity standards, and works to strengthen compliance.

## 8. Risk Management System

Risk management is strengthened by the Crisis Management Committee, chaired by a corporate officer with an official post, which is convened whenever necessary in order to identify risks at an early stage, and reliably prevent risks from surfacing.

## 9. Prompt and appropriate disclosure of information

The Public Relations and Investor Relations Division has been established to strengthen and carry out investor relations activities. This division strives to provide information to shareholders and investors which is necessary to make investment decisions, and to issue this information in an appropriate manner and at the appropriate time. In addition, a Disclosure Committee has been established, chaired by the company president, in order to further strengthen this system.

# Programs for the Environment, Safety, and Sustainability

## Environmental safety management

Environment, safety, and quality are at the core of Nippon Kayaku Group management. We have carried out a fusion of our intellectual assets in these fields as well, and have worked to strengthen our environmental safety management throughout the Company. Now, at the start of the 21st century, a company must be focused on the environment, and must also take steps to fulfill its social responsibilities and contribute to the development of a sustainable society.

## Quality and Environment Management System

In order to raise the level of customer satisfaction, Nippon Kayaku Group began efforts in 1995 at our plants to acquire certification under the international quality management standard ISO9001. Since then, all divisions ranging from research to sales at our district offices including Nippon Kayaku Group companies, have been working on gaining certification. Currently, ISO9001 certification has been obtained by all divisions in the Functional Chemicals Group, all divisions in the Pharmaceuticals Group, the Agrochemicals Division, the Explosives Division, and the Fine Chemicals R&D Laboratories. Among group companies, this certification has been obtained by Polatechno Co., Ltd., Zhaoyuan Advanced Kayaku Chemical Co., Ltd., and Kayaku Chemical (Wuxi) Co., Ltd. In our safety systems business, we have obtained the quality control system standard QS9000, which is based on ISO9001 and has been incorporated by the three major US automobile manufacturers into their own requirements.

For environmental management, and in order to promote our Responsible Care activities more effectively, Nippon Kayaku has worked towards ISO14001, the international standard for environmental management. By the fiscal year ended May 31, 2002, all six Nippon Kayaku plants had obtained this certification, which has also been obtained by the group companies Indet Safety Systems a.s. and Polatechno Co, Ltd.

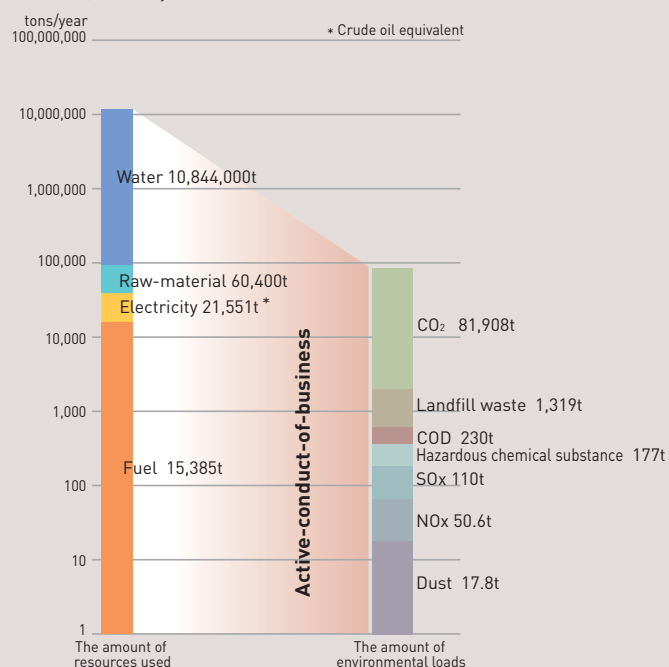
## Environmental numerical targets

At Nippon Kayaku, we have established numerical targets for the following three items, and are proceeding with activities according to a company-wide master plan.

- (1) In the fiscal year ending May 31, 2006, we will reduce the amount of dichloromethane emissions by 85% from the level of the fiscal year ended May 31, 2000, to 10 tons or less.
- (2) In the fiscal year ending May 31, 2011, we will reduce the generation of waste products to the level of the fiscal year ended May 31, 1997.
- (3) In the fiscal year ending May 31, 2011, we will reduce the amount of total landfill waste by 60% from the level of the fiscal year ended May 31, 1997.
- (4) In the fiscal year ending May 31, 2011, we will reduce the amount of energy consumed (crude oil equivalent) by 8.6% from the level of the fiscal year ended May 31, 1991.
- (5) By the fiscal year ending May 2011, we will reduce atmospheric discharges of VOC (volatile organic compounds) by 50% (70 tons) from the level in the fiscal year ended May 2001.

## Amounts of resources used and environmental loads (non-consolidated)

[June 1, 2004 – May 31, 2005]



## Environmental accounting (non-consolidated)

Nippon Kayaku is aware of the costs for environmental protection and has publicly released such figures since the fiscal year ended May 31, 2001. Starting from the fiscal year ending May 31, 2004, we have carried out assessments to determine the effects of our environmental protection activities. Capital investment costs for the fiscal year ending May 31, 2005 were 266.36 million yen. Management costs were 1.48558 billion yen, and the environmental protection effects were 60.96 million yen.

## Development of environmentally friendly products

Nippon Kayaku Group is dedicated to the development of environmentally friendly products. We have developed biological pesticides using natural predator insects which do not harm people or livestock, UV and EB curable resins which are used as low-pollution environmentally friendly resins for preventing problems such as sick house syndrome, environment-adaptive epoxy resins, safe and environmentally friendly dyes, and other products which have little effect on health or the environment. In this way, we are working to contribute to the development of a sustainable society.

## Relations with the local communities

The Nippon Kayaku Group conducts business activities with a focus on working closely with the local communities. In its business activities, each plant places great importance on the agreements concluded with the local community where it belongs concerning issues such as the prevention of pollution, prevention of water contamination, green agreements, and mutual support in case of disaster.

## Board of Directors/Auditors

As of December 1, 2005

### Board of Directors



**Koichiro Shimada**  
Member of the Board  
President  
Representative Director



**Hidetoshi Kitazawa**  
Member of the Board  
Representative Director  
Senior Managing Director  
Director of Strategic Corporate  
Planning Group  
Director of Research & Development  
Group



**Masao Komaki**  
Member of the Board  
Managing Director  
Director of Functional  
Chemicals Group



**Koichi Chiba**  
Member of the Board  
Managing Director  
Director of Administration  
Group



**Yoshiaki Fukushima**  
Member of the Board  
Managing Director  
Director of Fine Chemicals Group



**Akira Mandai**  
Member of the Board  
Managing Director  
Director of Pharmaceuticals Group



**Yoshiyuki Ikeda**  
Member of the Board  
Managing Director  
General Manager of Safety Systems  
Division



**Koichi Takase**  
Member of the Board  
President, Representative Director  
of Polatechno Co., Ltd.

### Auditors

**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

	2005	2004	2003	2002	2001
<b>Results for the year</b> (millions of yen)					
Net sales .....	¥134,205	¥128,016	¥123,431	¥119,435	¥121,002
Cost of sales .....	86,062	81,621	79,002	74,745	72,775
Selling, general and administrative expenses .....	37,976	36,297	34,730	35,305	34,950
Operating income .....	10,166	10,097	9,697	9,384	13,277
Income before income taxes and minority interests ....	10,404	8,941	7,643	7,309	10,675
Net income .....	5,315	3,926	2,780	2,630	4,903
<b>Amounts per share</b> (yen)					
Net income .....	¥ 28.87	¥ 21.22	¥ 14.92	¥ 14.42	¥ 26.87
Cash dividend applicable to the year .....	11.70	11.00	11.00	11.00	11.00
Shareholders' equity .....	570.31	550.12	527.93	527.61	516.97
<b>Year-end financial position</b> (millions of yen)					
Current assets .....	¥ 92,716	¥ 93,651	¥ 99,223	¥ 96,099	¥ 99,845
Current liabilities .....	35,509	39,389	42,065	37,346	39,872
Working capital .....	57,207	54,262	57,158	58,753	59,973
Property, plant and equipment .....	57,533	57,069	58,009	58,683	57,183
Total assets .....	181,364	179,823	179,117	176,836	179,882
Total shareholders' equity .....	103,810	100,207	96,204	96,248	94,331
<b>Year-end statistics</b>					
Number of shares outstanding (thousands) .....	182,503	182,503	182,503	182,503	182,503
Number of round-lot shareholders .....	18,770	19,756	20,367	21,010	20,059
Number of employees .....	4,049	3,934	3,679	3,552	3,639
<b>Financial ratios</b>					
Current ratio (times) .....	2.6	2.4	2.4	2.6	2.5
Equity ratio (%).....	57.2	55.7	53.7	54.4	52.4
ROE (%).....	5.2	4.0	2.9	2.8	5.3
ROA (%).....	2.9	2.2	1.6	1.5	2.7
<b>Sales by business segment</b> (millions of yen)					
Functional chemicals business .....	¥ 64,574	¥ 56,405			
Functional materials .....	15,448	15,942			
Electronic materials .....	36,181	30,410			
Catalysts.....	2,574	2,096			
Safety systems .....	10,370	7,955			
Pharmaceuticals business .....	39,660	41,122			
Fine chemicals business .....	26,843	27,053			
Agrochemicals .....	11,333	11,150			
Color chemicals .....	9,269	9,617			
Explosives .....	6,241	6,286			
Other businesses .....	3,126	3,434			

\* Business segments have changed from June 1, 2004. Sales by business segment for 2004 are reclassified to the current business segments.

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

## Results of Operations

### Business Overview

During the first half of the fiscal year ended May 31, 2005, Japan's economy was in a state of recovery as a result of such factors as increased capital investment and expanding exports. During the second half, however, the future became unclear, because of skyrocketing crude oil and other raw material prices.

During the first half of the year, the chemicals industry showed robust performance, thanks to rising demand for digital home electronics and other IT-related products. In the second half, however, the business environment turned harsh as the IT field entered an adjustment period.

In the pharmaceuticals industry, drug prices were revised in April 2004 and the trend toward controlling the cost of drugs became even stronger. As well, global competition in the research, development, and sale of new medicines has become even more intense and has developed into a competition of survival between companies.

In the midst of such circumstances, the Nippon Kayaku Group has promoted (1) development and introduction of new products in growth fields, (2) qualitative strengthening and improved efficiency of business capabilities, (3) restructuring of the fine chemicals business and strengthening of the operating base, and (4) qualitative strengthening and improved efficiency of the Administration Group and the support organization.

As a result, the functional chemicals business began to show robust performance, covering the decline in the pharmaceuticals business caused by the effects of drug price revisions. Thus, the fiscal year ended May 31, 2005 produced more revenue and greater profit than the previous fiscal year.

### Net sales

In the fiscal year ended May 31, 2005, net sales reached 134.205 billion yen, an increase of 6.188 billion yen (4.8%) from the previous fiscal year. Net sales for the entire Group were 137% of the net sales for the parent company alone.

### Cost of Sales; Selling, General and Administrative Expenses

In the fiscal year ended May 31, 2005, the cost of sales was 86.062 billion yen, an increase of 4.441 billion yen (5.4%) from the previous fiscal year. It was also up 0.3% from the previous fiscal year to 64.1% as a percentage with respect to net sales. Selling, general and administrative expenses in the fiscal year ended May 31, 2005 were 37.963 billion yen, an increase of 1.676 billion yen (4.6%) from the previous fiscal year.

### Operating Income

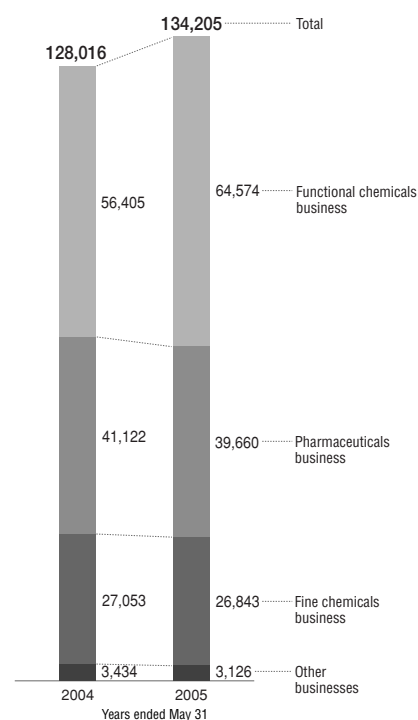
In the fiscal year ended May 31, 2005, operating income was 10.166 billion yen, an increase of 68 million yen from the previous fiscal year (0.7%). It was down 0.3% from the previous fiscal year to 7.6% as a percentage with respect to net sales.

### Operating Performance by Business Segment

As of the fiscal year ended May 31, 2005, the type-based business segments have changed. Therefore, when comparison is made with a previous fiscal year, the results from the previous year's segment are accordingly reclassified to correspond to the segment that applies after the change.

## Sales by Business Segment

(Unit: million yen)



### [Functional Chemicals Business]

In the fiscal year ended May 31, 2005, sales for the functional chemicals business reached 64.574 billion yen, an increase of 8.169 billion yen (14.5%) from the previous fiscal year.

In the functional materials business, sales of special epoxy resins for semiconductor encapsulation, UV-curing-type resins, and high-performance chemicals were up from the previous fiscal year, but sales of general-purpose chemical products were down from the previous fiscal year due to a stoppage in the production and sale of some products.

In the electronic materials business, sales of products such as colors for color inkjet printers, lens resins, LCD sealants, and resins for optical disks went smoothly and were up from the previous fiscal year. Also, optical films, Polatechno's polarizing plate business, and plasma display films did well, surpassing sales from the previous fiscal year.

In the catalysts business, sales of catalysts for acrylic acid manufacturing increased, surpassing sales from the previous fiscal year.

In the safety systems business, domestic and export sales of airbag inflators went well and were up from the previous fiscal year. Also, sales of micro gas generators for seatbelt pretensioners went smoothly at overseas subsidiaries (Europe and the United States), and saw a rise from the previous fiscal year.

In the fiscal year ended May 31, 2005, overall operating income for the functional chemicals business was 7.147 billion yen, an increase of 239 million yen (3.5%) from the previous fiscal year.

### [Pharmaceuticals Business]

Sales amounted to 39.66 billion yen, a decrease of 1.462 billion yen (3.6%) from the previous fiscal year.

Pharmaceutical products for the Japanese domestic market include new products "IA CALL" (anti-cancer drug) and "IMMUCYST" (anti-cancer drug), which contributed to sales; as well as "SALIGREN Cap." (drug for treatment of dry mouth syndrome) and "CARBOMERCK" (anti-cancer drug), the sales of which were strong, surpassing the previous fiscal year. On the other hand, sales of "AREDIA" (osteoclastic inhibitor) were down from the previous fiscal year due to changes in sales affiliations, while sales of "MILLISROL Inj." (vasodilator), "FARESTON Tab." (anti-cancer drug), "ODYNE tab." (anti-cancer drug), and "RANDA Inj." (anti-cancer drug) were down due to the effects of drug price revisions and other factors.

In the area of exports, ETOPOSIDE (anti-cancer drug) sales were up from the previous fiscal year, while BLEO (anti-cancer drug) sales remained at the same level.

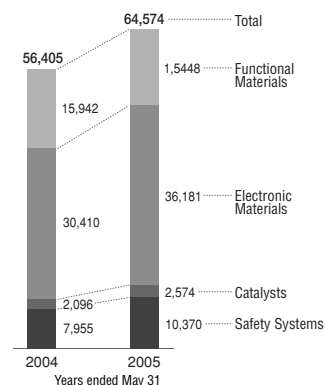
As for active pharmaceutical ingredients (API), sales of pharmaceutical bulk were up from the previous fiscal year, and sales of health food bulk by Nippon Kayaku Food Techno Co., Ltd., went well, surpassing sales from the previous fiscal year.

In the area of diagnostic agents, sales of "LANAZYME ST-439 plates" (breast cancer diagnostic agent) went smoothly, but remained at the same level as the previous fiscal year.

In the fiscal year ended May 31, 2005, overall operating income for the pharmaceuticals business was 4.86 billion yen, a decrease of 442 million yen (8.3%) from the previous fiscal year.

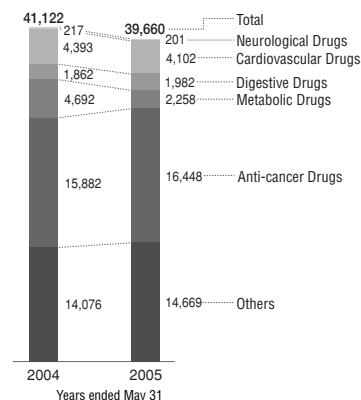
### Sales of the Functional Chemicals Business

(Unit: million yen)



### Sales of the Pharmaceuticals Business

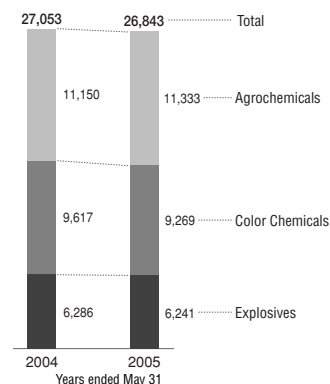
(Unit: million yen)



\* Sales by drug category are the results for domestic sales.

### Sales of the Fine Chemicals Business

(Unit: million yen)



#### [Fine Chemicals Business]

In the fiscal year ended May 31, 2005, sales for the fine chemicals business amounted to 26.843 billion yen, a decrease of 209 million yen (0.8%) from the previous fiscal year.

Domestic sales for the agrochemicals business declined, but thanks to an increase in exports, total sales were up from the previous fiscal year.

In the color chemicals business, domestic demand for textile dyes declined and was down from the previous fiscal year.

In the explosives business, sales were down from the previous fiscal year, due to a decline in domestic demand.

In the fiscal year ended May 31, 2005, overall operating income for the fine chemicals business was 1.887 billion yen, an increase of 115 million yen (6.5%) from the previous fiscal year. This was largely the result of cost reductions.

#### [Other Businesses]

In the fiscal year ended May 31, 2005, sales from other businesses were 3.126 billion yen, a decrease of 308 million yen (9.0%) from the previous fiscal year.

Overall operating income from other businesses was 1.482 billion yen, an increase of 74 million yen (5.3%) from the previous fiscal year.

#### Other Income and Expenses

In the fiscal year ended May 31, 2005, interest and dividends received amounted to 349 million yen, while interest paid was 416 million yen. Other expenses (net) amounted to 305 million yen, an increase of 1.371 billion yen (128.6%) from the previous fiscal year.

#### Income before Income Taxes and Minority Interests

From the aforementioned results, income before income taxes and minority interests in the fiscal year ended May 31, 2005 was 10.404 billion yen, an increase of 1.462 billion yen (16.4%) from the previous fiscal year.

#### Corporate Tax

In the fiscal year ended May 31, 2005, corporate tax was 4.067 billion yen, an increase of 103 million yen (2.6%) from the previous fiscal year.

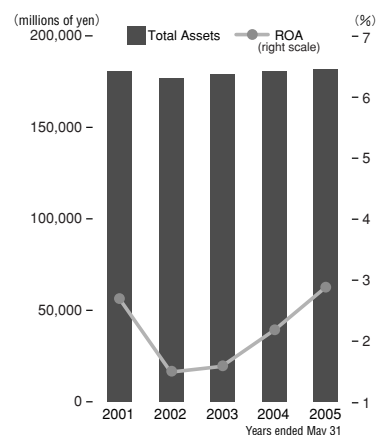
#### Minority Interests

In the fiscal year ended May 31, 2005, minority interests amounted to 1.02 billion yen, a decrease of 29 million yen (2.9%) from the previous fiscal year.

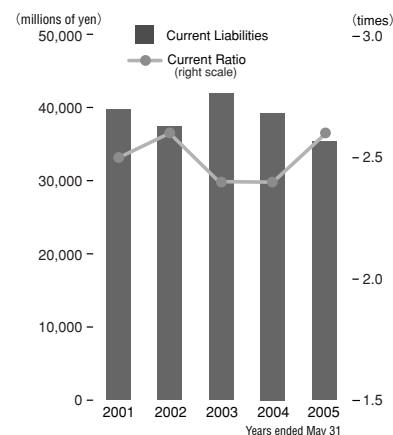
#### Net Income

In the fiscal year ended May 31, 2005, net income was 5.315 billion yen, an increase of 1.389 billion yen (35.4%) from the previous fiscal year. It improved 0.9% from the previous fiscal year to 4.0% as a percentage with respect to sales. In the fiscal year ended May 31, 2005, net income for the entire Group was 112% of the net income for the parent company alone. Net income per share was 28.87 yen.

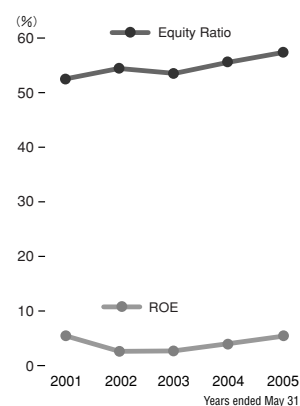
#### Total Assets/ROA



#### Current Liabilities/Current Ratio



#### Equity Ratio/ROE



## Financial Condition

### Total Assets

As of the end of May 2005, total assets were 181.364 billion yen, an increase of 1.541 billion yen (0.9%) from the end of the previous fiscal year.

### Current Assets

As of the end of May 2005, the balance of cash and cash equivalents was 17.191 billion yen, a decrease of 211 million yen (1.2%) from the end of the previous fiscal year. Time deposits were 26 million yen, an increase of 16 million yen (160%) from the end of the previous fiscal year. Trade receivables were 46.523 billion yen, a decrease of 1.443 billion yen (3%) from the end of the previous fiscal year. Inventories were 24.144 billion yen, an increase of 1.034 billion yen (4.5%) from the end of the previous fiscal year; and deferred tax assets were 2.01 billion yen, a decrease of 2 million yen from the end of the previous fiscal year. Other current assets were 2.866 billion yen, a decrease of 332 million yen (10.4%) from the end of the previous fiscal year. As a result, total current assets were 92.716 billion yen, a decrease of 935 million yen (1.0%) from the end of the previous fiscal year.

### Property, Plant and Equipment; Investments and Other Assets

As of the end of May 2005, the value of property, plant and equipment was 57.533 billion yen, a decrease of 463 million yen (0.8%) from the end of the previous fiscal year. Accumulated depreciation was 116.935 billion yen. The total value of investments and other assets was 31.115 billion yen, an increase of 2.013 million yen (6.9%) from the end of the previous fiscal year.

### Liabilities

As of the end of May 2005, current liabilities were 35.509 billion yen, a decrease of 3.879 billion yen (9.8%) from the end of the previous fiscal year. Fixed liabilities were 35.237 billion yen, an increase of 1.08 billion yen (3.2%) from the previous fiscal year.

### Shareholders' Equity

As of the end of May 2005, shareholders' equity was 103.81 billion yen and the equity ratio was 57.2%, an increase of 1.5% from the previous fiscal year.

## Cash Flows

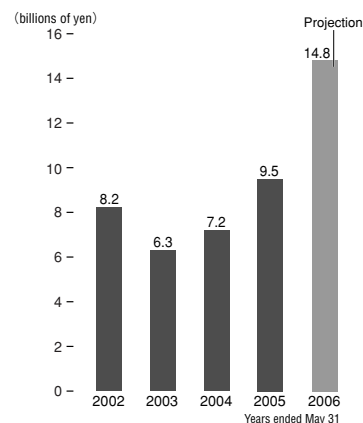
Cash flows from operating activities increased by 7.515 billion yen from the previous fiscal year to 12.16 billion yen. This increase was primarily due to the change from a rising trend to a falling trend in notes and accounts receivable, and to the decrease in the amount of corporate taxes paid.

Cash flows from investment activities showed a decrease in expenditures of 3.595 billion yen from the previous fiscal year to 7.765 billion yen. This decrease was primarily due to a decrease in expenditures from subsidiary stock acquisitions.

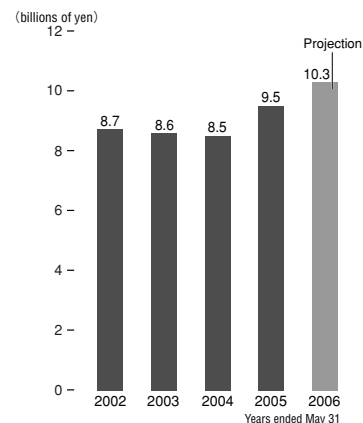
Cash flows from financing activities showed an increase in expenditures of 3.027 billion yen from the previous fiscal year to 4.473 billion yen. This increase was primarily due to expenditures from the redemption of corporate bonds.

As a result of the aforementioned activities, the balance of cash and cash equivalents as of the end of May 2005 decreased by 211 million yen from the end of the previous fiscal year to 17.191 billion yen.

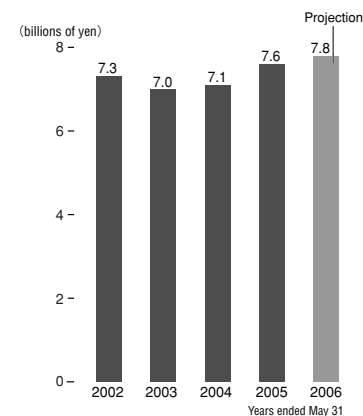
## Plant & Equipment Investment



## Research & Development Expenditures



## Depreciation Expense



# Consolidated Balance Sheets

Nippon Kayaku Co., Ltd. and Consolidated Subsidiaries  
As of May 31, 2005 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2005	2004	2005
<b>Assets</b>			
<b>Current assets:</b>			
Cash and cash equivalents.....	¥ 17,191	¥ 17,402	\$ 159,013
Time deposits.....	26	10	240
Trade receivables (Note 6).....	46,523	47,966	430,330
Less allowance for doubtful receivables.....	(47)	(49)	(434)
Inventories (Note 3).....	24,144	23,110	223,328
Deferred income taxes (Note 7).....	2,010	2,013	18,592
Other current assets.....	2,866	3,198	26,510
<b>Total current assets.....</b>	<b>92,716</b>	<b>93,651</b>	<b>857,607</b>
<b>Property, plant and equipment (Notes 5 and 6):</b> .....	<b>174,468</b>	<b>172,566</b>	<b>1,613,800</b>
Less accumulated depreciation.....	(116,935)	(115,496)	1,081,629
<b>Property, plant and equipment, net</b> .....	<b>57,533</b>	<b>57,069</b>	<b>532,170</b>
<b>Investments and other assets:</b>			
Investment securities (Notes 4 and 6).....	17,938	16,461	165,923
Goodwill.....	2,913	3,322	26,944
Deferred income taxes (Note 7).....	894	650	8,269
Other assets.....	9,369	8,668	86,661
<b>Total investments and other assets</b> .....	<b>31,115</b>	<b>29,102</b>	<b>287,808</b>
<b>Total assets</b> .....	<b>¥181,364</b>	<b>¥179,823</b>	<b>\$1,677,587</b>

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2005	2004	2005
<b>Liabilities and shareholders' equity</b>			
<b>Current liabilities:</b>			
Short-term bank loans (Note 6) .....	¥ 2,203	¥ 3,775	\$ 20,377
Current portion of long-term debt (Note 6).....	2,547	4,041	23,559
Payables:			
Trade .....	16,460	17,259	152,252
Unconsolidated subsidiaries and affiliates.....	288	89	2,663
Construction .....	1,724	2,525	15,946
Other .....	3,467	4,001	32,069
Accrued expenses .....	4,759	4,690	44,019
Accrued income taxes (Note 7) .....	2,189	2,279	20,247
Other current liabilities .....	1,868	726	17,278
<b>Total current liabilities .....</b>	<b>35,509</b>	<b>39,389</b>	<b>328,452</b>
<b>Non-current liabilities:</b>			
Long-term debt, less current portion (Note 6).....	9,785	8,509	90,509
Retirement benefits (Note 8) .....	8,419	7,680	77,874
Other non-current liabilities .....	15,635	16,627	144,621
Deferred income taxes (Note 7).....	1,397	1,340	12,922
<b>Total non-current liabilities .....</b>	<b>35,237</b>	<b>34,157</b>	<b>325,936</b>
<b>Minority interests .....</b>	<b>6,805</b>	<b>6,068</b>	<b>62,945</b>
<b>Contingent liabilities (Note 10)</b>			
<b>Shareholders' equity (Notes 11 and 15):</b>			
Common stock:			
Authorized – 700,000,000 shares			
Issued – 182,503,570 shares in 2005 and 2004.....	14,932	14,932	138,118
Additional paid-in capital .....	17,260	17,257	159,652
Retained earnings .....	68,109	64,973	629,997
Translation adjustments .....	571	315	5,281
Unrealized holding gains on other securities.....	3,231	2,946	29,886
Less treasury stock, at cost.....	(294)	(218)	(2,719)
<b>Total shareholders' equity .....</b>	<b>103,810</b>	<b>100,207</b>	<b>960,225</b>
<b>Total liabilities and shareholders' equity .....</b>	<b>¥181,364</b>	<b>¥179,823</b>	<b>\$1,677,587</b>

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Income and Retained Earnings

Nippon Kayaku Co., Ltd. and Consolidated Subsidiaries  
Years Ended May 31, 2005 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2005	2004	2005
Net sales .....	¥134,205	¥128,016	\$1,241,374
Cost of sales .....	86,062	81,621	796,059
Gross profit.....	48,142	46,395	445,305
Selling, general and administrative expenses.....	37,976	36,297	351,271
Operating income.....	10,166	10,097	94,033
Other income (expenses):			
Interest and dividend income.....	349	312	3,228
Interest expense.....	(416)	(402)	(3,847)
Other, net.....	305	(1,066)	2,821
	238	(1,155)	2,201
Income before income taxes and minority interests.....	10,404	8,941	96,235
Income taxes (Note 7):			
Current.....	4,455	4,664	41,208
Deferred .....	(387)	(699)	(3,579)
Minority interests .....	1,020	1,050	9,434
Net income (Note 11).....	5,315	3,926	49,162
Retained earnings at beginning of year .....	64,973	63,111	600,989
Bonuses to directors .....	(65)	(61)	(601)
Cash dividends paid .....	(2,002)	(2,003)	(18,518)
Decrease resulting from changes in scope of consolidation.....	(112)	—	(1,035)
Retained earnings at end of year .....	¥ 68,109	¥ 64,973	\$ 629,997

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

Nippon Kayaku Co., Ltd. and Consolidated Subsidiaries  
Years Ended May 31, 2005 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2005	2004	2005
<b>Cash flows from operating activities</b>			
Income before income taxes and minority interests .....	¥10,404	¥ 8,941	\$ 96,235
Adjustments to reconcile income before income taxes and minority interests to net cash provided by operating activities:			
Depreciation and amortization .....	7,609	7,144	70,382
Increase in reserves .....	592	890	5,475
Interest and dividend income .....	(349)	(312)	(3,228)
Interest expense .....	416	402	3,847
Equity in earnings of affiliates .....	(331)	(278)	(3,061)
Loss on disposal of property, plant and equipment, net .....	440	866	4,069
Loss (gain) on sales of investment securities, net .....	(636)	33	(5,882)
Changes in operating assets and liabilities:			
Notes and accounts receivable-trade .....	1,538	(3,079)	14,226
Inventories .....	(986)	(261)	(9,120)
Notes and accounts payable-trade .....	(659)	(3,604)	(6,095)
Payables-other .....	(475)	(678)	(4,393)
Other .....	(994)	241	(9,194)
Subtotal .....	16,566	10,303	153,232
Interest and dividends received .....	557	463	5,152
Interest paid .....	(417)	(408)	(3,857)
Income taxes paid .....	(4,545)	(5,714)	(42,040)
<b>Net cash provided by operating activities .....</b>	<b>12,160</b>	<b>4,644</b>	<b>112,478</b>
<b>Cash flows from investing activities</b>			
Proceeds from sales of marketable securities, net .....	1,002	(2)	9,268
Purchase of property, plant and equipment .....	(7,932)	(5,611)	(73,369)
Proceeds from sales of property, plant and equipment .....	1,480	195	13,689
Acquisition of goodwill and other intangible assets .....	(206)	(2,400)	(1,905)
Proceeds from sales (purchase) of investment securities, net .....	(277)	658	(2,562)
Purchase of investment securities of consolidated subsidiaries .....	(76)	(1,600)	(702)
Other .....	(1,755)	(2,599)	(16,233)
<b>Net cash used in investing activities .....</b>	<b>(7,765)</b>	<b>(11,360)</b>	<b>(71,824)</b>
<b>Cash flows from financing activities</b>			
Net change in short-term debt .....	1,049	(170)	9,703
Proceeds from long-term debt .....	1,826	6,071	16,890
Repayment of long-term debt .....	(1,848)	(2,123)	(17,093)
Repayment of construction cooperation fund .....	(234)	(3,000)	(2,164)
Redemption of corporate bond .....	(3,000)	-	(27,749)
Cash dividends paid .....	(2,009)	(2,005)	(18,582)
Other .....	(257)	(217)	(2,377)
<b>Net cash used in financing activities .....</b>	<b>(4,473)</b>	<b>(1,445)</b>	<b>(41,374)</b>
Effect of exchange rate changes on cash and cash equivalents .....	82	(66)	758
Increase (decrease) in cash and cash equivalents .....	3	(8,228)	27
Cash and cash equivalents at beginning of year .....	17,402	25,631	160,965
Decrease resulting from changes in scope of consolidation .....	(215)	-	(1,988)
<b>Cash and cash equivalents at end of year .....</b>	<b>¥17,191</b>	<b>¥ 17,402</b>	<b>\$159,013</b>

See accompanying notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

Nippon Kayaku Co., Ltd. and Consolidated Subsidiaries  
May 31, 2005 and 2004

## Note 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 primary 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.

**Note 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 ¥108.11 = U.S.\$1, the approximate rate of exchange on May 31, 2005, 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.

**Note 3**

**Inventories**

Inventories at May 31, 2005 and 2004 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Merchandise .....	¥ 3,325	¥ 3,715	\$ 30,755
Finished products .....	9,457	8,839	87,475
Semi-finished products and work in process .....	5,789	5,380	53,547
Raw materials and supplies.....	5,570	5,173	51,521
	<u>¥24,144</u>	<u>¥23,110</u>	<u>\$223,328</u>

**Note 4****Marketable and Investment Securities**

Information regarding marketable securities classified as other securities as of May 31, 2005 and 2004 were as follows:

**Marketable other securities**

	<b>May 31, 2005</b>					
	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 .....	¥2,788	¥ 8,276	¥5,488	\$25,788	\$ 76,551	\$50,763
Debt securities .....	-	-	-	-	-	-
Other .....	3,289	3,296	6	30,422	30,487	55
Subtotal .....	6,077	11,572	5,494	56,211	107,039	50,818
Securities whose acquisition cost exceeds their carrying value:						
Stock .....	152	130	(22)	1,405	1,202	(203)
Debt securities .....	-	-	-	-	-	-
Other .....	301	278	(22)	2,784	2,571	(203)
Subtotal .....	453	408	(44)	4,190	3,773	(406)
<b>Total .....</b>	<b>¥6,531</b>	<b>¥11,981</b>	<b>¥5,449</b>	<b>\$60,410</b>	<b>\$110,822</b>	<b>\$50,402</b>

	<b>May 31, 2004</b>		
	Millions of yen		
	Acquisition cost	Carrying value	Unrealized gain (loss)
Securities whose carrying value exceeds their acquisition cost:			
Stock .....	¥3,264	¥ 8,278	¥5,013
Debt securities .....	-	-	-
Other .....	2,587	2,593	5
Subtotal .....	5,851	10,871	5,019
Securities whose acquisition cost exceeds their carrying value:			
Stock .....	151	129	(22)
Debt securities .....	-	-	-
Other .....	2,004	1,982	(21)
Subtotal .....	2,156	2,112	(44)
<b>Total .....</b>	<b>¥8,008</b>	<b>¥12,983</b>	<b>¥4,975</b>

Sales of securities classified as other securities amounted to ¥1,117 million (\$10,332 thousand) as of May 31, 2005 with the aggregate gain of ¥640 million (\$5,919 thousand) and the aggregate loss of ¥3 million (\$27 thousand) for the year ended May 31, 2005.

**Note 5****Depreciation**

Depreciation for property, plant and equipment were ¥6,567 million (\$60,743 thousand) and ¥6,306 million for the years ended May 31, 2005 and 2004, respectively.

**Note 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, 2005 and 2004 were approximately 2.85% and 2.14%, respectively.

The interest rates applicable to the long-term borrowings (except for current portion) at May 31, 2005 and 2004 average approximately 2.54% and 2.10%, respectively.

Long-term debt at May 31, 2005 and 2004 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Bonds without collateral:			
2.47% bonds due 2005.....	–	¥ 3,000	–
Collateralized loans from banks, insurance companies, government agencies and other financial institutions, due through 2015 .....	¥ 3,526	2,572	\$ 32,614
Loans without collateral .....	8,806	6,978	81,454
	12,333	12,550	114,078
Less current portion.....	(2,547)	(4,041)	(23,559)
	<u>¥ 9,785</u>	<u>¥ 8,509</u>	<u>\$ 90,509</u>

The aggregate annual maturities of long-term debt subsequent to May 31, 2005 are as follows:

	Millions of yen	Thousands of U.S. dollars
<u>Year ending May 31,</u>		
2006.....	¥ 2,547	\$ 23,559
2007.....	2,958	27,361
2008.....	2,536	23,457
2009 and thereafter .....	4,291	39,691
	<u>¥12,333</u>	<u>\$114,078</u>

Assets pledged as collateral for long-term debt, other non-current liabilities and payables-trade at May 31, 2005 are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Receivables .....	¥ 100	\$ 924
Investment securities .....	313	2,895
Property, plant and equipment, at net book value.....	13,785	127,509
	<u>¥14,201</u>	<u>\$131,356</u>

**Note 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 2005 and 2004. 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 statements of income for the year ended May 31, 2005 and 2004 differed from the statutory tax rate for the following reasons:

	2004
Statutory tax rate .....	41.88%
Effect of:	
Expenses not deductible for income tax purposes .....	2.55
Dividend income deductible for income tax purposes .....	(3.19)
Inhabitants' tax based on individuals .....	1.08
Amortization of consolidation adjustments .....	0.52
Increase of valuation allowance .....	8.63
Tax credit for research and development cost .....	(4.51)
Tax credit for information and technology equipments .....	(1.65)
Other, net .....	(0.97)
Effective tax rate.....	<u>44.34%</u>

There is no significant difference between the normal effective statutory tax rate and the effective income tax rate reflected in the accompanying consolidated statements of income for the year ended May 31, 2005.

**Note 7****Income Taxes  
(continued)**

The significant components of deferred tax assets and liabilities as of May 31, 2005 and 2004 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Deferred tax assets:			
Accrued retirement benefits .....	¥ 3,763	¥ 3,178	\$ 34,807
Accrued bonuses .....	1,243	1,278	11,497
Accrued enterprise tax .....	205	247	1,896
Allowance for sales rebate .....	102	143	943
Tax loss carried forward .....	1,532	1,284	14,170
Other .....	1,059	988	9,795
Total deferred tax assets .....	7,907	7,119	73,138
Valuation allowance .....	(1,794)	(1,534)	(16,594)
	6,113	5,585	56,544
Deferred tax liabilities:			
Adjustment of acquisition costs of fixed assets .....	(892)	(823)	(8,250)
Unrealized holding gains on other securities .....	(2,264)	(2,075)	(20,941)
Adjustments for book value relating to land of consolidated subsidiaries .....	(706)	(706)	(6,530)
Goodwill and other intangible assets .....	(414)	(456)	(3,829)
Other .....	(327)	(200)	(3,024)
Total deferred tax liabilities .....	(4,605)	(4,261)	(42,595)
Net deferred tax assets .....	¥ 1,508	¥ 1,323	\$ 13,948

**Note 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, 2005 and 2004 for the Company's and the consolidated subsidiaries' defined benefit plans:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Retirement benefit obligation .....	¥(24,062)	¥(22,728)	\$(222,569)
Plan assets at fair value .....	14,431	13,315	133,484
Unfunded retirement benefit obligation .....	(9,631)	(9,413)	(89,085)
Unrecognized actuarial gain or loss .....	4,447	5,231	41,134
Unrecognized past service cost .....	(1,783)	(2,271)	(16,492)
Net retirement benefit obligation .....	(6,968)	(6,453)	(64,452)
Prepaid pension cost .....	969	781	8,963
Accrued retirement benefits .....	¥ (7,937)	¥ (7,235)	\$ (73,415)

The components of retirement benefit expenses for the year ended May 31, 2005 and 2004 are outlined as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Service cost .....	¥1,457	¥1,278	\$13,477
Interest cost .....	462	559	4,273
Expected return on plan assets .....	(170)	(78)	(1,572)
Amortization of actuarial gain or loss .....	707	684	6,539
Amortization of past service cost .....	(252)	(252)	(2,330)
Total .....	¥2,203	¥2,191	\$20,377

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

	May 31,	
	2005	2004
Discount rates .....	2.0% – 2.1%	2.1% – 2.5%
Expected rates of return on plan assets .....	1.0% – 2.1%	1.0% – 2.5%
Period for amortization of prior service liability .....	10 years	10 years
Period for recognition of actuarial gain or loss .....	10 years	10 years

Accrued retirement benefits include ¥482 million (\$4,458 thousand) for directors and corporate auditors of the Company and its domestic consolidated subsidiaries at May 31, 2005.

**Note 9**

**Research and Development Expenses**

Research and development expenses amounted to ¥9,498 million (\$8,854 thousand) and ¥8,554 million for the years ended May 31, 2005 and 2004, respectively.

**Note 10**

**Contingent Liabilities**

Contingent liabilities at May 31, 2005 were as follows:

	Millions of yen	Thousands of U.S. dollars
Notes receivable discounted .....	¥ 361	\$ 3,339
Guarantees of loan of unconsolidated subsidiary .....	27	249
Guarantees of loan of employees .....	2,278	21,071

**Note 11**

**Amounts per Share**

	Yen		U.S. dollars
	2005	2004	2005
For the year ended May 31:			
Net income:			
Primary .....	¥ 28.87	¥ 21.22	\$0.26
Cash dividends .....	11.70	11.00	0.10
At May 31:			
Net assets .....	570.31	550.12	5.27

**Note 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.

**Note 13**

**Leases**

Lease payments relating to finance lease transactions accounted for as operating leases amounted to ¥409 million (\$3,783 thousand) and ¥434 million for the years ended May 31, 2005 and 2004, respectively.

Future minimum lease payments (including the interest portion) subsequent to May 31, 2005 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
2006 .....	¥361	\$3,339
2007 and thereafter .....	507	4,689
	¥868	\$8,028

Lease income relating to finance leases accounted for as operating leases amounted to ¥51 million (\$471 thousand) and ¥51 million for the years ended May 31, 2005 and 2004, respectively.

Note 14

Segment Information

The Companies operate principally in four industry segments: functional chemicals, pharmaceuticals, fine chemicals and other businesses. The functional chemicals business involves the production and sales of inflators, functional materials, catalysts and electric materials. The fine chemicals business involves the production and sales of agro, color chemicals and explosives. Other businesses comprises real estate leasing business.

With its reorganization, effective on June 1, 2004, the Company has changed industry segmentation. The previous industry segment information has been reclassified to the current industry segment of the Company.

Industry segment information for the Companies as of or for the years ended May 31, 2005 and 2004 is summarized as follows:

2005							
Millions of yen							
	Functional chemicals business	Pharmaceuticals business	Fine chemicals business	Other businesses	Total	Eliminations	Consolidated
I. Sales and operating income:							
Sales to third parties.....	¥64,574	¥39,660	¥26,843	¥ 3,126	¥134,205	-	¥134,205
Intersegment .....	253	32	88	6	381	¥ (381)	-
Total .....	64,828	39,692	26,932	3,133	134,586	(381)	134,205
Operating expenses.....	57,680	34,832	25,045	1,650	119,209	4,829	124,039
Operating income.....	¥ 7,147	¥ 4,860	¥ 1,887	¥ 1,482	¥ 15,377	¥ (5,211)	¥ 10,166
II. Asset depreciation and capital expenditures:							
Total assets .....	¥64,247	¥40,248	¥29,293	¥16,991	¥150,780	¥30,583	¥181,364
Depreciation and amortization .....	3,189	1,794	1,395	729	7,108	500	7,609
Capital expenditures .....	3,675	706	986	22	5,391	1,946	7,337

2005							
Thousands of U.S. dollars							
	Functional chemicals business	Pharmaceuticals business	Fine chemicals business	Other businesses	Total	Eliminations	Consolidated
I. Sales and operating income:							
Sales to third parties.....	\$597,299	\$366,848	\$248,293	\$ 28,914	\$1,241,374	-	\$1,241,374
Intersegment .....	2,340	295	813	55	3,524	\$ (3,524)	-
Total .....	599,648	367,144	249,116	28,979	1,244,898	(3,524)	1,241,374
Operating expenses.....	533,530	322,190	231,662	15,262	1,102,663	44,667	1,147,340
Operating income.....	\$ 66,108	\$ 44,954	\$ 17,454	\$ 13,708	\$ 142,234	\$ (48,200)	\$ 94,033
II. Asset depreciation and capital expenditures:							
Total assets .....	\$594,274	\$372,287	\$270,955	\$157,163	\$1,394,690	\$282,887	\$1,677,587
Depreciation and amortization .....	29,497	16,594	12,903	6,743	65,747	4,624	70,382
Capital expenditures .....	33,993	6,530	9,120	203	49,865	18,000	67,866

2004							
Millions of yen							
	Functional chemicals business	Pharmaceuticals business	Fine chemicals business	Other businesses	Total	Eliminations	Consolidated
I. Sales and operating income:							
Sales to third parties.....	¥56,405	¥41,122	¥27,053	¥ 3,434	¥128,016	-	¥128,016
Intersegment .....	181	45	60	6	293	¥ (293)	-
Total .....	56,587	41,167	27,114	3,441	128,310	(293)	128,016
Operating expenses.....	49,679	35,864	25,343	2,032	112,919	4,999	117,919
Operating income.....	¥ 6,908	¥ 5,302	¥ 1,771	¥ 1,408	¥ 15,390	¥ (5,292)	¥ 10,097
II. Asset depreciation and capital expenditures:							
Total assets .....	¥63,397	¥39,270	¥30,261	¥17,259	¥150,189	¥29,633	¥179,823
Depreciation and amortization .....	2,695	1,804	1,456	810	6,767	376	7,144
Capital expenditures .....	4,519	3,891	1,226	69	9,706	338	10,045

Overseas sales, which include export sales of the Company and its consolidated subsidiaries, totaled ¥33,080 million (\$305,984 thousand) and ¥24,560 million, or 24.6% and 19.2% of the consolidated net sales for the years ended May 31, 2005 and 2004, respectively.

Note 15

Subsequent Event

(1) The following appropriations of retained earnings of the Company were approved at a meeting of the shareholders held on August 30, 2005:

	Millions of yen	Thousands of U.S. dollars
2004 year-end cash dividends (¥6.20 = \$0.057 per share) .....	¥1,127	\$10,424
Bonuses to directors .....	55	508

(2) On June 16, 2005, the Company sold its land to Sumitomo Realty & Development Co., Ltd. for ¥8.7 billion (\$80,473 thousand).

As a result, the Company is to record the gain of approximate ¥8.4 billion (\$77,698 thousand) for the fiscal year ending May 31, 2006.



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## 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, 2005 and 2004, 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, 2005 and 2004, 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, 2005 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.

### *Additional information*

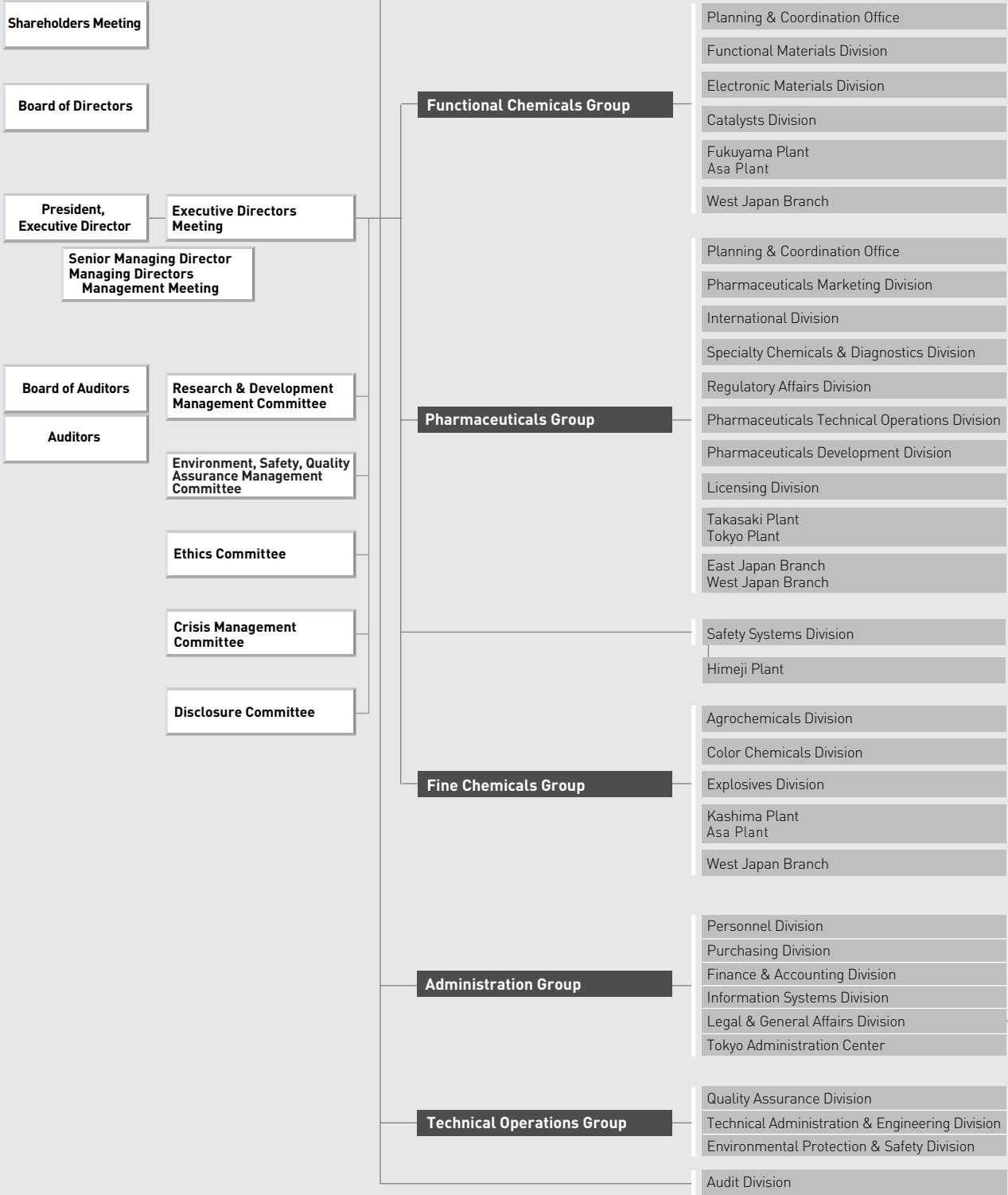
1. As discussed in Note 14, the Company has changed its industry segmentation effective on June 1, 2004.
2. As discussed in Note 15(2), the Company sold its land on June 16, 2005.

*Ernst & Young Shin Nihon*

August 30, 2005

# Organization

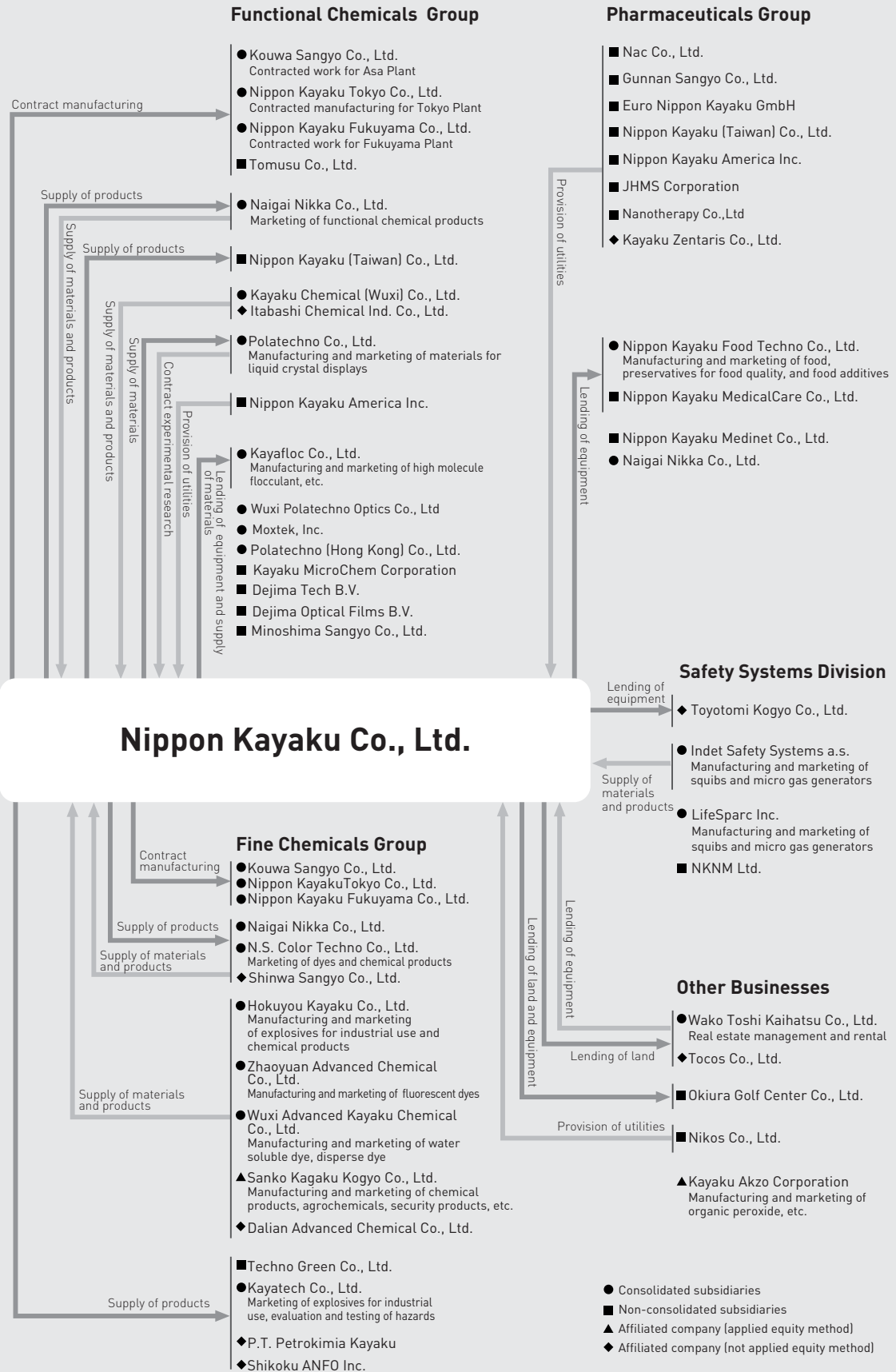
As of December 1, 2005



# Group Companies

As of December 1, 2005

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.



## Corporate Information

As of December 1, 2005

■ <b>Business Name</b>	Nippon Kayaku Co., Ltd.
■ <b>Representative</b>	Koichiro Shimada, President
■ <b>Foundation</b>	June 5, 1916
■ <b>Head Office Address</b>	Tokyo Fujimi Bldg., 11-2, Fujimi 1-chome, Chiyoda-ku, Tokyo 102-8172, Japan
■ <b>Number of Employees</b>	1,933 (non-consolidated), 4,049 (consolidated) (as of May 31, 2005)
■ <b>Banks of Accounts</b>	Bank of Tokyo Mitsubishi, Mizuho Bank, Jyo Bank

### ■ Major Products

Functional Chemicals	
Functional Materials Division	Special epoxy resins, Epoxy resin curers, Combustion retardants for synthetic resins, UV-curing type resins, Polyimide/polyamide resins, High molecule flocculant
Electronic Materials Division	Optical functional films, Disc materials, Optical materials, Functional Colors, Colors for color inkjet printers, LCD projector components
Catalysts Division	Catalysts for the production of acrylic acid and methacrylic acid, Plant licensing business
Safety Systems Division	Airbag inflators, Micro gas generators for seatbelt pretensioners, Squibs
Pharmaceuticals	Anti-cancer agents, Neurological agents, Circulatory system agents, Digestive system agents, Metabolic agents, Antibiotics, Anti-inflammatory analgesic agents, Pharmaceutical API and intermediates, Food and food additives, Veterinary pharmaceuticals, Animal feedstuffs and feedstuff additives, Diagnostics
Fine Chemicals	
Agrochemicals Division	Insecticides, Herbicides, Fungicides, Acaricide, Biological pesticides, Soil disinfectant, Animal repellents, Biological pesticide
Color Chemicals Division	Disperse dyes, Cationic dyes, Acidic dyes, Reactive dyes, Direct dyes, Sulphur dyes, Fluorescent dyes, Functional chemicals, Special dyes for non-textile applications
Explosives Division	Industrial explosives, Black powder, Electric detonators, Non-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, Ohdoronishi 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
Tokyo Administration Center	31-12, Shimo 3-chome, Kita-ku, Tokyo 115-8588, Japan

### ■ Plants

Fukuyama Plant	126, Minookicho, Fukuyama-shi, Hiroshima 721-8567, Japan
Asa Plant	2300, Sanyoonoda-shi, 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, Kamisu-shi, Ibaraki 314-0255, Japan

### ■ Research & Development Group

Functional Chemicals R&D Laboratories	26-8, Shimo 3-chome, Kita-ku, Tokyo 115-0042, Japan
Pharmaceuticals Laboratories	31-12, Shimo 3-chome, Kita-ku, Tokyo 115-8588, Japan
Safety Systems Development Laboratories	3903-39, Toyotomi, Toyotomicho, Himeji-shi, Hyogo 679-2123, Japan
Agrochemicals Laboratories	225-1, Horigome, Koshikiya, Ageo-shi, Saitama 362-0064, Japan

# Investor Information

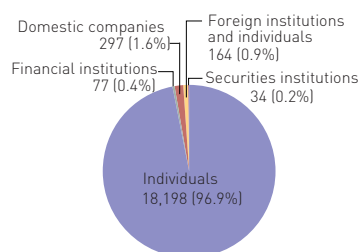
As of May 31, 2005

- Fiscal year-end date                      May 31
- Ordinary general meeting of shareholders                      The Ordinary general meeting of shareholders is normally held in August in Tokyo.
- Record date                                      Ordinary general meeting of shareholders: May 31  
Year-end dividend: May 31  
Interim dividend: November 30
- Stock exchange listing                      Tokyo stock exchanges
- Number of common stock                      Authorized: 700,000,000  
Issued: 182,503,570
- Paid-in capital                                      ¥14,932,922,842
- Number of shareholders                      25,814
- Major shareholders

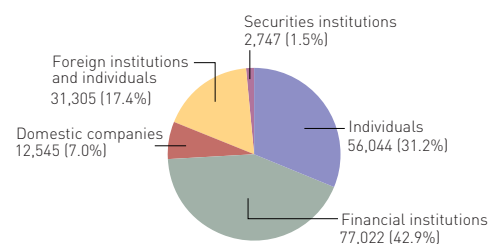
Shareholders	Number of shares held (unit: thousand)	Shareholding ratio
The Master Trust Bank of Japan, Ltd. (Trust account)	13,452	7.37
Japan Trustee Services Bank, Ltd. (Trust account)	12,231	6.70
Mizuho Bank, Ltd.	8,318	4.55
Northern Trust Company (AVFC) Sub-account American Client	5,476	3.00
The Bank of Tokyo-Mitsubishi, Ltd.	5,369	2.94
Meiji Yasuda Life Insurance Company	5,102	2.79
The Jyo Bank, Ltd.	5,089	2.78
Kayavestor Club	4,903	2.68
Nippon Life Insurance Company	3,275	1.79
Employees' stock holding	3,180	1.74

## ■ Breakdown of shareholders

Number of round-lot shareholders



Number of shares held (unit: thousand shares)



- Transfer agent of common stock                      The Chuo Mitsui Trust and Banking Company, Limited  
33-1, Shiba 3-chome, Minato-ku, Tokyo 105-8574, Japan

- Investor information                                      Nippon Kayaku Co., Ltd  
Public Relations & Investor Relations Division  
Tokyo Fujimi Bldg., 19-11, Fujimi 1-chome, Chiyoda-ku,  
Tokyo 102-8172 Japan  
Phone: +81-3-3237-5046  
Email: kouho@nipponkayaku.co.jp  
URL: <http://www.nipponkayaku.co.jp/english/index.html>



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#### **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.



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