

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.

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