

# Business Report 2003

Fiscal 2003, year end March 31, 2004

## A Message to Our Shareholders

During the past fiscal year, our nation's economy has enjoyed a moderate upward trend. Both the corporate world and the stock market saw improved performance and gains, as exports to strong economic regions such as the United States picked up and capital investment increased. Personal spending is gradually rising as well, spurred by improvements in employment and income.

The chemical industry, although facing uncertainty from rising prices of raw materials, is also experiencing a partial recovery, buoyed by the continued spread of the digital economy and other such developments.

Within this fiscal environment, our group has been striving to fortify our position by focusing the distribution of management resources on the businesses that we have identified as core areas, polyurethane materials and imaging materials. In this way, we have worked to shift our profit structure and improved our financial strength.

During this fiscal year, exports of polyurethane materials have grown steadily against the backdrop of rising demand in China and other parts of Asia. The imaging materials business has also seen steady growth both domestically and abroad.

As a result, consolidated net sales rose by ¥6,672 million to ¥93,489 million, a gain of 7.7% over the previous year. This includes ¥2,674 million in additional sales resulting from the extended fiscal year (15 months) of subsidiaries that switched to an accounting period ending on March 31, rather than a calendar year accounting period. In terms of profit and loss, increased revenue in both the polyurethane materials and imaging materials combined with the reduction of fixed costs to increase operating income by ¥1,750 million. The total of ¥4,281 million represents a 69.2% gain over the previous year. Ordinary income rose by ¥1,228 million to ¥2,681 million (a gain of 84.5% over the previous year), despite inventory write-down. Although we posted gains from the reversal of Hodogaya Chemical's retirement bonus system for directors, profit increases were squeezed by the disposal of some fixed assets in anticipation of the implementation of asset-impairment accounting. Net income for this fiscal year increased by ¥180 million (a gain of 49.4% compared with the previous year) to ¥544 million,.

To briefly note non-consolidated results, Hodogaya Chemical's sales were down by ¥1,788 million (a decrease of 8.1% compared with the previous year) to ¥20,240 million, operating income was up ¥312 million (35.6%) to ¥1,190 million, Ordinary income was down by ¥296 million (51.6%) to ¥278 million, and net income (or loss) was down by ¥691 million for a net loss of ¥648 million.

We deeply regret that we have not paid dividends to our shareholders for over the past ten years. In order to resume dividend payments as soon as possible, we have taken various measures to improve our fiscal strength and reorganize our profit structure, but unfortunately, profits have not recovered to an extent that would allow us to provide dividends for this year.

As the United States and other world economies continue to recover, the Japanese economy is expected to benefit from increased exports and capital investments. Our group's medium-term plan, "Innovation 88", is intended to help us strengthen our position in this economic climate not only by focusing resources on our core businesses, reducing costs and investing in research and development for future businesses, but by reducing debt to increase the soundness of the Group's financial foundation and shoring up our fiscal strength overall.

In the coming fiscal year, we expect that a net profit of ¥2,200 million will enable us to eliminate our deficit of retained earnings.

I thank you for your continued support.

Takashi Okamoto, President

June, 2004

## Overview by Business Segment

### (Specialty Polymers)

The polyurethane business continued to grow significantly this past year, due to continued strong demand in the Asian market, particularly in China. There had been concern over the possible effects of an antidumping investigation carried out by the Chinese government, but fortunately this had only a minimal impact on exports, with TDI being subjected to a 5% dumping tariff, and the MDI investigation being withdrawn altogether.

In order to prepare for the continued growth that is expected in China and the other Asian markets, we established Nippon Polyurethane R&D (Shanghai) Co., Ltd. in 2002, and Nippon Polyurethane (Shanghai) Co., Ltd. a manufacturing and sales company, in 2003. By establishing this framework, we are able to reduce product development lead time and address the needs of our customers more efficiently.

A core resin business, Polytetramethylene Ether Glycol (PTG), has declined because we are now supplying the growing Asian market with product manufactured by our licensing partner, Dairen Chemical Corp. and because some of our domestic customers have withdrawn from the business. The specialty PTG business has also been hampered by delays in IT-sector recovery in the U.S. and Europe, and by inventory adjustments made by some of our customers. On the other hand, the tire adhesive business is performing well, thanks to the recovery of demand in the domestic and overseas markets.

The construction materials business has been adversely affected by stagnant demand in both the public and private sectors, and by increasingly severe competition in the construction market. We have made efforts to counteract the effects of this negative climate by expanding sales of waterproofing materials for parking facilities and developing new business in the civil engineering sector, but with our withdrawal from unprofitable product lines, this business segment has posted an overall decline.

In an effort to reduce cumulative losses and shore up the financial position of Hodogaya Construction Products Co., Ltd. the subsidiary responsible for the development of construction materials businesses, Hodogaya Chemical wrote off the previous capitalization of ¥320 million, and then invested another ¥250 million in the company. The company is currently ahead of schedule on the execution of a reorganization plan, and is expected to eliminate its deficit by March, 2005.

The foundry business grew, thanks to increased demand resulting from the implementation of diesel vehicle emissions regulations.

Overall, this segment's sales reached ¥67,360 million, an increase of ¥6,509 million (10.7%) over the previous year.

### (Fine Chemicals)

The imaging materials business expanded, due to steadily increasing demand for charge control agents for toner both domestically and in the United States. The organic photo conductor business grew only marginally: while domestic demand was steady, exports were slightly down. The organic light emitting diode (OLED) materials business has not yet reached the full commercial stage, but business development work proceeded smoothly over the past year.

In the area of dyes and colors, slack domestic demand for wood paints had a negative impact on the Spilon dyes, but demand for aluminum coloring and dyes for stationery supplies grew steadily, so that overall results maintained the levels of the previous year. On the other hand, the Cathilon dye business for Acrylic fiber declined, as the shift of fiber processing operations to China and the resulting contraction of the domestic industry accelerated.

Despite efforts at global business development, the custom manufacturing business was negatively affected by a lag in demand for pharmaceutical phosgene derivatives and delays in the drug development process.

In the agrochemicals area, demand for herbicides for home gardens has grown steadily, but the business as a whole declined as the result of inventory adjustments at the distribution level.

Overall, sales in this segment were ¥13,046 million, a ¥101 million (0.8%) decrease from the previous year.

### (Basic Chemicals)

In the area of inorganic industrial chemicals, the sodium chlorate business was adversely affected by cutbacks in the paper manufacturing industry. The hydrogen peroxide business was buoyed by increased demand in industrial applications.

Organic industrial chemicals lost ground to low-cost overseas competitors.

Overall, sales in this segment were ¥10,737 million, an increase of ¥52 million (0.5%) over the previous year.

# Medium-term Consolidated Management Plan

## < Innovation 88 >

In April 2004, as we commemorated our 88th year of business, the Hodogaya Group implemented a three-year medium-term management plan called "Innovation 88".

The following elements of the plan are common to the Group as a whole:

### 1. Management Philosophy

Through ceaseless commitment to scientific innovation, we will provide the world with high-quality products that fulfill customer expectations and contribute to the establishment of an environmentally-conscious society.

### 2. Vision

With business management principles that make the most of our strengths in the ability to take advantage of organic synthesis and the ability to develop polymer materials, we intend to respond to the trust placed in us by our stakeholders by increasing group value and profitability, and by maximizing our presence in the world of chemical business.

### 3. Fiscal Year 2006 Management Goals

Consolidated Net Sales:	¥108,000 million
Consolidated Ordinary Income:	¥5,500 million
Return on Equity (ROE):	13%

### 4. Fundamental Strategy

#### 1) Strengthening of Core Businesses

We have designated polyurethane materials and imaging materials (charge control agents for toners, charge transport materials for organic photo conductors, etc.) as core business areas, and will devote management resources to the fortification and expansion of these areas of strategic importance.

Further, the organic light emitting diode (OLED) materials business and our reorganized agrochemicals business are expected to contribute to the growth of the Group, and will be cultivated accordingly.

#### 2) Improvement of Cost-Competitiveness

##### (1) Reduction of Costs

The Group will implement all measures necessary to reduce costs.

##### (2) Establishing a Streamlined Production System

Polyurethane materials are produced in our Nanyo Plant, which is adjacent to Tosoh Corporation's Nanyo Complex. Close cooperation between these two operations will ensure the stable supply of key raw materials, and boost our competitive position.

### 3) Research and Development

R&D resources will be devoted to development in strategic areas: the core businesses of polyurethane materials, charge control agents for toners, charge transport materials for organic photo conductors, etc., and areas of future growth, such as organic light emitting diode (OLED) materials.

### 4) Development of Overseas Markets

#### (1) Increased focus on Asian markets, particularly China

##### - Polyurethane Materials

In order to respond more efficiently to the rapidly growing Chinese market, we established Nippon Polyurethane R&D (Shanghai) Co., Ltd. and Nippon Polyurethane (Shanghai) Co., Ltd. a manufacturing and sales company.

#### (2) Expansion of Business in the U.S. and Europe

- Successes in electronics materials and resins will be used as a base for further expansion.

### 5) Improvement of Financial Standing

In an effort to reduce interest-bearing debt, we will increase profitability and make more efficient use of our working capital by liquidating receivables and reducing cash and savings.

### 6) Group Management Initiative

A Group management system will maximize synergy between the Group companies, and enhance the speed and efficiency of our operations.

(1) Specific initiatives will be put in place to implement and enforce the Group management system.

(2) The Group will be reorganized and integrated for greater management efficiency.

### The following elements of the Plan are specific to Hodogaya Chemical:

As the Group implements this medium-term management plan, Hodogaya Chemical will be making a special effort to incorporate the concepts of “innovation” and “speed” into its operations.

To that end, the following measures have been put into effect:

#### 1. Increased focus on the development of core businesses of the future:

A Business Solutions division will provide a customer-oriented approach to business development, and the framework for R&D activity will be strengthened.

#### 2. Cost reduction:

A Cost Reduction office will implement and oversee comprehensive mechanisms for reducing costs.

#### 3. Reorganization for swifter decision making:

Peripheral departments will be streamlined, the organization will shift to a less centralized structure, and councils and other decision-making bodies will be reevaluated.

By implementing the plans described above, we intend to increase the value of the Group as a whole, establish a stable base for future profits, and provide returns to our shareholders.

# CONSOLIDATED BALANCE SHEETS

Hodogaya Chemical Co.,Ltd and (Its) Consolidated Subsidiaries  
For the years ended March 31, 2004 and 2003

ASSETS	Millions of yen	
	2004	2003
<b>Current assets</b>		
Cash and cash equivalents . . . . .	¥14,772	¥16,378
Notes and accounts receivable . . . . .	25,463	26,827
Marketable securities . . . . .	2,430	958
Inventories . . . . .	14,694	17,292
Others . . . . .	2,271	2,297
Allowance for doubtful accounts . . . . .	(68)	(82)
Total current assets . . . . .	59,564	63,672
<b>Fixed assets</b>		
<b>Tangible fixed assets</b>		
Depreciable assets . . . . .	24,202	24,451
Land . . . . .	13,788	13,885
Construction in progress . . . . .	448	991
Others . . . . .	988	1,048
(Total Tangible fixed assets) . . . . .	39,428	41,376
<b>Intangible fixed assets</b> . . . . .	328	436
<b>Investment</b> . . . . .		
Investment securities . . . . .	6,041	4,743
Long-term loans receivable . . . . .	1,370	1,233
Others . . . . .	3,783	3,816
Less allowance for doubtful accounts . . . . .	(787)	(827)
(Total Investment) . . . . .	10,407	8,965
Total Fixed assets . . . . .	50,164	50,779
Total assets . . . . .	¥109,729	¥114,451

LIABILITIES, MINORITY INTERESTS AND SHAREHOLDERS' EQUITY	Millions of yen	
	2004	2003
<b>Current liabilities</b>		
Notes and accounts payable . . . . .	16,575	18,453
Current portion of bond . . . . .	100	700
Short-term bank loans . . . . .	36,762	35,057
Others . . . . .	6,384	5,334
Total current liabilities . . . . .	59,822	59,545
<b>Long-term liabilities</b>		
Long-term debt less current portion . . . . .	23,942	30,326
Reserve for employees' retirement benefits . . . . .	2,550	2,662
Reserve for directors' retirement benefits . . . . .	215	437
Others . . . . .	4,512	4,691
Total long-term liabilities . . . . .	31,221	38,118
Total liabilities . . . . .	91,043	97,663
<b>Minority interests</b> . . . . .	4,488	4,027
<b>Shareholders' equity</b>		
Common stock . . . . .	6,579	6,579
Capital surplus . . . . .	4,980	4,980
Retained earnings . . . . .	(325)	(868)
Revaluation reserve . . . . .	2,416	2,363
Securities valuation surplus . . . . .	574	(278)
Less: Treasury share at cost, 130,000 shares in 2003 . . . . .		(15)
Less: Treasury share at cost, 173,000 shares in 2004 . . . . .	(27)	
Total shareholders' equity . . . . .	14,197	12,760
Total liabilities, minority interests and shareholders' equity	¥109,729	¥114,451

# CONSOLIDATED STATEMENTS OF INCOME

Hodogaya Chemical Co.,Ltd and Consolidated Subsidiaries  
For the year ended March 31, 2004 and 2003

	Millions of yen	
	2004	2003
<b>Net sales</b> . . . . .	<b>¥93,489</b>	¥86,816
<b>Cost of sales</b> . . . . .	<b>72,411</b>	68,325
<b>Selling,general and administrative expenses</b> . . . . .	<b>16,795</b>	15,959
<b>Operating income</b> . . . . .	<b>4,281</b>	2,531
Other income . . . . .	<b>1,050</b>	1,115
Other expenses . . . . .	<b>2,651</b>	2,193
<b>Ordinary income</b> . . . . .	<b>2,681</b>	1,452
Extraordinary income . . . . .	<b>564</b>	103
Extraordinary losses . . . . .	<b>1,391</b>	1,062
<b>Income before income taxes</b> . . . . .	<b>1,854</b>	494
<b>Current</b> . . . . .	<b>1,089</b>	280
<b>Deferred</b> . . . . .	<b>(228)</b>	(326)
<b>Minority interests</b> . . . . .	<b>448</b>	176
<b>Net income</b> . . . . .	<b>¥544</b>	¥364

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