

# Business Report 2004

Fiscal 2004, yea end March 31, 2005

## **A Message to Shareholders**

During the first half of the past consolidated fiscal year, our nation's economy was affected by the rapid rise of oil prices, but generally speaking, economic conditions continued on the path to recovery: corporate profits were greatly bolstered by increased exports to the United States and China, there was steady capital investment in the private sector, and improvements were seen in personal spending, employment and income. However, the second half of the fiscal year saw economic growth coming to a standstill, as the costs of raw material costs and the strength of the yen increased, slowdowns in IT-related demand led to inventory adjustments, personal spending stagnated, and exports decreased.

The chemical industry was affected by the rising costs of raw materials due to the increase in oil prices, but the overall atmosphere was favorable, as exports to China and other parts of Asia grew, and increased demand enabled product price corrections.

It was against this backdrop that our Group began the first year of a three-year medium-term management plan called "Innovation 88". Under this plan, our polyurethane materials and imaging materials segments were designated as core businesses, and management resources were accordingly allotted to the strengthening of these critical areas of our organization in general. At the same time, we have continued our concerted effort to reduce costs and improve profitability. In order to improve financial strength, we have, in addition to pursuing increased profitability, taken active measures towards financial restructuring; 3 billion yen worth of unsecured convertible bonds with stock acquisition rights were issued followed by full conversion to stocks, and liquidation of accounts receivable in order to reduce debt and strengthen our capital base.

As a result, we saw solid performance in our core polyurethane materials and imaging materials businesses. Consolidated sales rose to 106,315 million yen, an increase of 12,825 million yen (13.7%) over the previous year.

In terms of profit and loss, profit-reducing factors such as increased raw materials cost and the strong yen were offset by product price corrections and reduced costs, resulting in operating profits of 10,368 million yen, an increase of 6,086 million yen (142.2%) over the previous year. Pre-tax income rose by 6,592 million yen (245.9%) to 9,273 million yen. Net profits increased by 4,305 million yen (790.3%) to 4,850 million yen, despite extraordinary losses stemming from the sale of subsidiary company housing.

With the U.S. and Chinese economies on an even keel, it is hoped that the Japanese economy will gradually improve as exports recover and capital investment increases. However, worries such as the rising costs of raw materials and uncertainty in the foreign exchange markets continue to raise concerns, so the future remains unpredictable.

This is the atmosphere in which we approach the second year of our Innovation 88 plan. The critical policies of this plan include the strengthening of core businesses, a review of our business portfolio, further efforts to reduce costs and improve profitability, and attention to research and development, so that we can develop the new businesses that will sustain our future. At the same time, we will be working to improve financial strength through the reduction of debt, and fortifying our business structure as a whole.

I thank you again for your continued support.

CEO,

Takashi Okamoto

June, 2005

## Overview By Business Segment

### **SPECIALTY POLYMERS**

Domestic demand for polyurethane materials in the automotive and construction sectors has held steady, and the demand is increasing in export markets such as China and other parts of Asia. At the same time, the costs of raw materials rose as a result of increased crude oil and naphtha prices, making it necessary for us to adjust pricing both domestically and overseas. This resulted in a large increase in sales. A principal resin business, polyether glycol (PTG), saw increased demand in specialty electronics applications, but decreased overall due to the delayed recovery of optical fiber demand. The construction materials business grew, thanks to steady demand for waterproofing materials in parking facilities and increases in exports. The foundry business grew as well, as automotive exports increased and domestic and overseas demand for machine tools and construction equipment rose. Total sales in this segment were 81,064 million yen, an increase of 13,703 million yen (20.3%) over the previous year.

### **FINE CHEMICALS**

Increases in sales of charge control agents for toner were seen as demand remained steady both in the domestic market and in the U.S. and other overseas markets. Organic photoconductor materials for OPC drums grew with steady demand in the domestic and overseas markets. In the field of organic light emitting diode (OLED) materials, we augmented our hole transporting material lineup with the successful development of a new high-performance electron transporting materials, and began shipping samples of the new material in the second half of the year. In our dyes and colors business, sales of Spilon dyes increased due to steady performance in the area of aluminum coloring, but sales of Cathilon dyes were down as a result of the continued downsizing of the domestic fiber dyeing industry. In the custom manufacturing business, polymer-related sales were weak, but phosgene derivatives for pharmaceutical applications grew. The agrochemicals business grew, thanks to steady domestic demand for herbicides for home gardening. Total sales in this segment were 13,375 million yen, an increase of 329 million yen (2.5%) over the previous year.

### **BASIC CHEMICALS**

Sales of sodium chlorate increased, as the shift to environmentally-friendly bleaching processes for paper pulp continued. Hydrogen peroxide sales also increased due to the larger demand for paper pulp, as well as for industrial applications. On the other hand, sales of other industrial chemicals decreased due to intense competition. Total sales in this segment were 10,036 million yen, a decrease of 701 million yen (6.5%) compared with the previous year.

## Innovation 88

### **MEDIUM-TERM CONSOLIDATED MANAGEMENT PLAN**

"Innovation and Speed" were the watchwords of our Group as we embarked on the management plan "Innovation 88" in April, 2004, the 88th anniversary of our company's establishment. By the end of the first year we had, with the exception of sales, achieved all of the quantitative targets of the third and final year of the plan. In this, the second year of the plan, our group will continue to strive for increased profitability and financial strength, as described below.

### **STRENGTHENING OF CORE BUSINESSES**

We will continue to allocate management resources to the core areas of polyurethane materials and imaging materials in order to further strengthen and expand these businesses. In the area of polyurethane materials, we will increase production capacity of MDI to 200,000 tons by the end of 2005 in order to be able to meet rapidly growing demand in China and other parts of Asia. In the area of imaging materials, we will continue working on environmental safety issues regarding charge control agents for toners, and will expand our product lineup with the development of new products for color toners. Regarding organic photoconductor materials for OPC drums, we intend to expand business by concentrating on high-performance materials. Organic light emitting diode (OLED) and agrochemical also support our growth, and these businesses will be developed and strengthened as well.

### **IMPROVEMENT OF COST-COMPETITIVENESS**

#### **REDUCTION OF COSTS**

The entire Group is focused on the implementation of cost-cutting measures to improve profitability.

### **ESTABLISHMENT OF A STREAMLINED PRODUCTION SYSTEM**

We plan to increase production efficiency by further strengthening cooperation between our Nanyo Plant, which manufactures polyurethane materials, and Tosoh Corporation adjacent Nanyo complex. Last year we implemented the supply of carbon monoxide, and this year we will continue this effort with the establishment of a stable supply system for another key raw material, aniline.

### **STRENGTHENING OF RESEARCH AND DEVELOPMENT EFFORTS**

R&D resources will be devoted to aggressive development work in the core business areas of polyurethane materials and imaging materials, as well as in vital new business areas such as OLED materials.

### **DEVELOPMENT OF OVERSEAS MARKETS**

### **SPEEDING DEVELOPMENT IN CHINA AND OTHER ASIAN MARKETS**

In the area of polyurethane materials, we will deepen customer contact through the overseas offices of our subsidiary company, Nippon Polyurethane Industry Co., Ltd., and work towards strengthening our position as one of the top MDI suppliers in the Asian markets.

#### **EXPANSION OF BUSINESS IN THE U.S. AND EUROPE**

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

#### **IMPROVEMENT OF FINANCIAL STANDING**

Our efforts to boost competency in core businesses such as polyurethane materials has led to increased investment in equipment, but earning power will be improved by the resulting changes in our business portfolio. Further, by taking such measures as the reduction of cash reserves and inventory assets to improve operating capital efficiency, we will continue to strengthen our financial health.

#### **IMPLEMENTATION AND FORTIFICATION OF GROUP MANAGEMENT**

Our Group management system is designed to increase speed and efficiency, and to maximize synergy between the Group companies. The Group will continue to be restructured and integrated as necessary to improve management efficiency.

By implementing the measures described above, we intend to increase the corporate value of our Group as a whole, provide a stable base for continued profitability in the future, and increase returns to our shareholders.

# CONSOLIDATED FINANCIAL STATEMENT

## CONSOLIDATED BALANCE SHEETS

*Hodogaya Chemical Co., Ltd and its Consolidated Subsidiaries for the years ending March 31, 2005 and 2004*

ASSETS	MILLIONS OF YEN	
	2005	2004
<b>Current Assets</b>		
Cash and cash equivalents	¥16.469	¥14.772
Notes and accounts receivable	28.530	25.463
Marketable securities	1.345	2.430
Inventories	14.301	14.694
Others	3.414	2.271
Allowance for doubtful accounts	(87)	(68)
Total current Assets	63.974	59.564
<b>Fixed Assets</b>		
Tangible Fixed Assets		
Depreciable assets	23.040	24.202
Land	12.904	13.788
Construction in progress	906	448
Others	1.029	988
Total Tangible fixed assets	37.880	39.428
<b>Intangible fixed assets</b>	221	328
<b>Investment</b>		
Investment securities	6.169	6.041
Long-term loans receivable	1.095	1.370
Others	3.803	3.783
Less allowance for doubtful accounts	(680)	(787)
Total Investment	10.387	10.407
Total Fixed Assets	48.490	50.164
Total assets	¥112.464	¥109.729

LIABILITIES/MINORITY INTERESTS AND SHAREHOLDERS' EQUITY	MILLIONS OF YEN	
	2005	2004
<b>Current liabilities</b>		
Notes and accounts payable	¥20.677	¥46.575
Current portion of bond	100	100
Short-term bank loans	27.489	36.762
Others	8.839	6.384
Total current liabilities	57.106	59.822
<b>Long-term liabilities</b>		
Long-term debt less current portion	20.842	23.942
Reserve for employees' retirement benefits	2.528	2.550
Reserve for directors' retirement benefits	262	215
Others	3.835	4.512
Total long-term liabilities	27.469	31.221
Total liabilities	84.576	91.043
<b>Minority interests</b>	5.834	4.488
<b>Shareholders' equity</b>		
Common stock	8.081	6.579
Capital surplus	6.479	4.980
Retained earnings	4.408	(325)
Revaluation reserve	2.416	2.416
Securities valuation surplus	756	(574)
Translation adjustments	(8)	
Less: Treasury share at cost. 173.623 shares in 2004		(27)
Less: Treasury share at cost. 274.225 shares in 2005	(77)	
Total shareholders' equity	22.054	14.197
<b>Total liabilities, minority interests and shareholders' equity</b>	<b>¥112.464</b>	<b>¥109.729</b>

## CONSOLIDATED STATEMENTS OF INCOME

*Hodogaya Chemical Co., Ltd its Consolidated Subsidiaries for the years ending March 31, 2005 and 2004*

	MILLIONS OF YEN	
	2005	2004
<b>Net Sales</b>	¥106.315	¥93.489
<b>Cost of sales</b>	79.141	72.411
<b>Selling, general and administrative expenses</b>	16.805	16.795
<b>Operating income</b>	10.368	4.281
Other income	1.132	1.050
Other expenses	2.226	2.651
<b>Ordinary income</b>	9.273	2.681
Extraordinary income	116	564
Extraordinary losses	990	1.391
<b>Income before income taxes</b>	8.400	1.854
<b>Current</b>	3.202	1.089
<b>Deferred</b>	(1.201)	(228)
<b>Minority interests</b>	1.549	448
<b>Net income</b>	¥4.850	¥544

## Stock

### AUTHORIZED NUMBER OF SHARES (AS OF JUNE 29,2005)

200,000,000

### NUMBER OF COMMON SHARES ISSUED (AS OF MARCH 31,2005)

74,087,261

### NUMBER OF SHAREHOLDERS

9,067

### MAIN SHAREHOLDERS (TOP 10 COMPANIES)

Shareholder	Number of Shares Held (in thousands)	Percentage of Shares Held (%)
Tosoh Corporation	17.799	24.02%
The Master Trust Bank of Japan. Ltd.	9.326	12.58%
Mizuho Corporate Bank. Ltd.	2.987	4.03%
Japan Trustee Services Bank. Ltd.	2.947	3.97%
The Norinchukin Bank	2.274	3.06%
Meiji Yasuda Life Insurance Company	1.645	2.22%
Asahi Life Insurance Company	1.643	2.21%
Mitsui Sumitomo Insurance Co., Ltd.	1.414	1.90%
UFJ Bank. Ltd.	1.201	1.62%
The Toho Bank. Ltd.	983	1.32%