Report to shareholders

Business Report 2007

April 1, 2007 – March 31, 2008

A Message from our President

The chemical industry currently faces a number of obstacles: oil prices continue to rise, the weak dollar is affecting exports, and there is concern over the possibility of higher interest rates in the future.

We have worked through FY 2006-2007 to complete Phase I of our 5-year management plan, 'Innovation 90'. In response to the harsh business climate, we stepped up the pace of our plans and implemented a number of measures.

Phase I has, on the whole, been a success. Our business reorganization and infrastructure development plans were implemented ahead of schedule. Though we were not able to meet our sales and profitability targets, we did meet our fiscal targets and achieve our principal objective of establishing a firm foundation for growth.

As a result of our business reorganization, we have dramatically improved our ability to weather fluctuations in interest rates, currency exchange rates and oil prices. We look forward to continued progress as we enter Phase II of our plan.

With that objective in mind, we recently made an additional assignment of Nippon Polyurethane Industry Co., Ltd. stock to Tosoh Corporation. Our ownership of Nippon Polyurethane Industry Co., Ltd. is now 19.7%, and as of this fiscal year, it will no longer be classified as an equity method affiliate.

This stock assignment will help our group make a clean transition from process industry to specialty industry, allowing us to focus on high performance and high value-added businesses. Our attention to improving both our business portfolio and capital efficiency in Phase II have made it possible for us to increase shareholder dividends to 8 yen per share.

Today's world is confronted with a variety of problems: resources and food supplies are limited, and environmental concerns are growing. As people look to chemical technologies for solutions, these difficult times will present a number of unique business opportunities for our group.

Our group is sensitive to the changing times, and we approach Phase II with a strong sense of purpose and responsibility.

We thank you for your continued support.

June, 2008

Takashi Okamoto, Chairman
Toshikazu Kitano, President

‘Innovation 90’ Management Plan: Overview

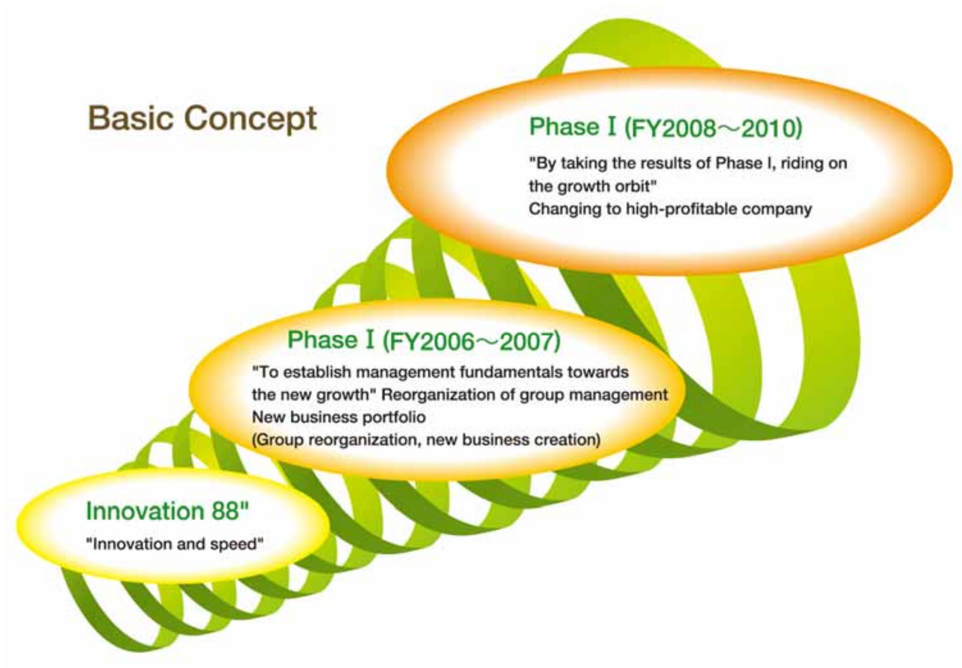
◎ ‘Innovation 90’ is a five year plan covering FY 2006-2010.
◎ Basic concept: establishing a firm foundation for high-profit growth.

The basic concept of ‘Innovation 90’ is to establish a firm foundation for high-profit growth.

In Phase I (2006-2007), we focused on preparing our management fundamentals for future growth. To this end, we reorganized our group and reevaluated our business portfolio, restructuring some businesses and laying the foundations for new opportunities in next-generation.

In Phase II (2008-2010), we will continue the transition to high profitability by incorporating the successes of Phase I and getting on track for growth.

Through ‘Innovation 90’, we intend to establish ourselves as “high performance and high value creation company”. Our targets for 2010 are annual sales of 50,000 million yen, operating profit margin of 13%, and ROE of 10%.



Phase II: Main Initiatives and Targets

Objective	To become “high performance and high value creation company”
Basic Concept	Incorporating successes to get on track for growth
Targets	Sales: 50,000 million yen, Operating Profit Margin: 13%, ROE: 10%

Strengthening R&D Capabilities

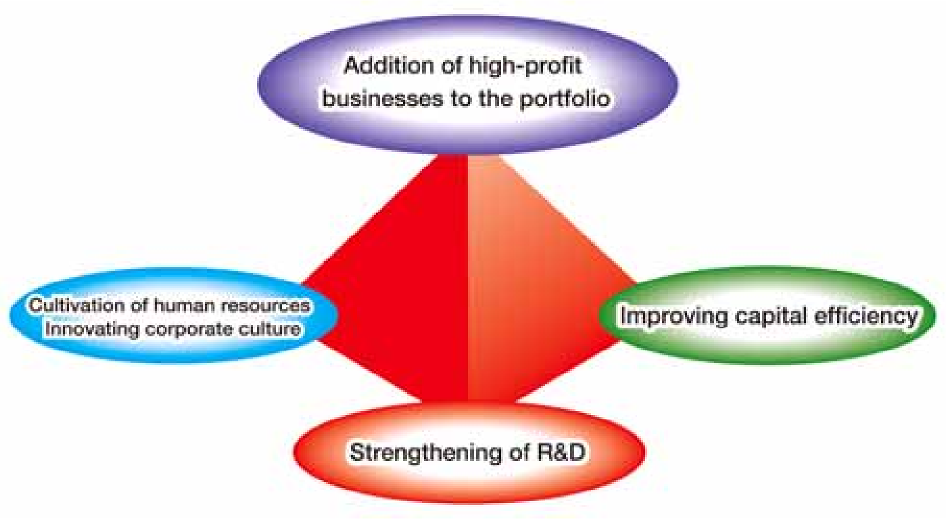
Resources will be focused on core businesses such as electronics materials and OLED materials, and on the businesses of the future, such as CNT and hair color agents.

By reevaluating our R&D system and strengthening our assessment capabilities, we aim to make new product sales more than 20% of the total (on a non-consolidated basis) by 2010.

Cultivating Human Resources and Innovating the Corporate Culture

In Phase I, we established a ‘Human Resources Development Office’ to help us in our efforts to secure and cultivate the workforce that we need to support our growth.

In Phase II, we plan to strengthen our R&D and business capabilities through focused personnel placement and effective communication of technologies between generations of workers. By shoring up policies and ensuring that adequate training opportunities are available, we hope to create a lively corporate culture, and cultivate a workforce populated by self-motivated individuals who are ready to face challenges.



Main Initiatives

Adding to our High-profit Business Portfolio

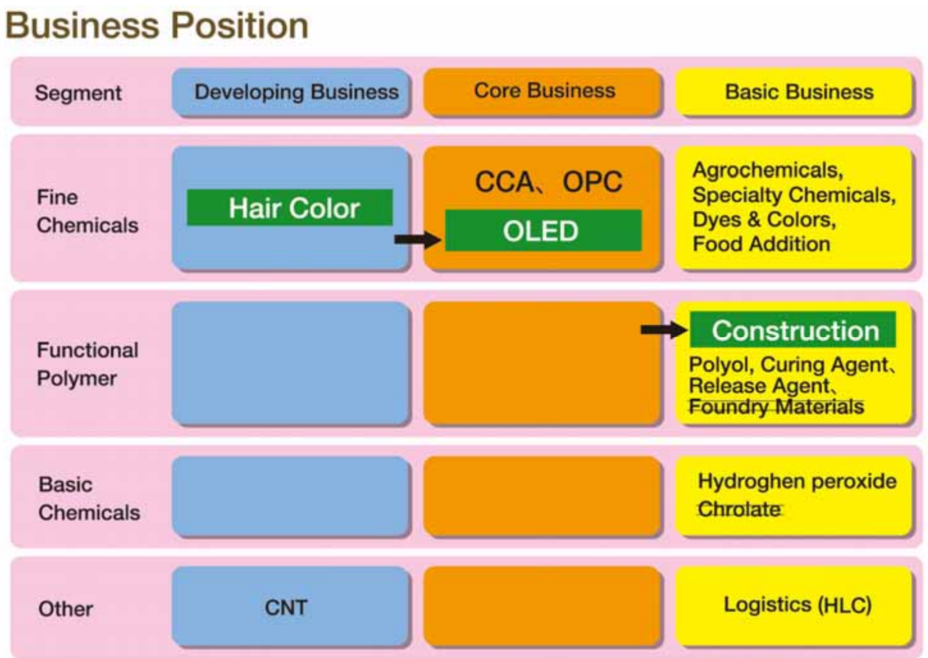
We are accelerating growth in the core business areas of electronics materials, including charge control agents (CCA) and organic photoconductors (OPC) materials, and OLED materials.

CCA is used as an additive in copy machine and laser printer toner products. In addition to an environmentally friendly new product for color applications, we have been developing products to meet customers' needs, and expanding our line of offerings. The synergistic effect of the business we acquired in OPC materials is a great asset in our efforts to meet our customers' expectations.

The OLED materials market has expanded rapidly, thanks to the cellular phone display application. We are working to develop new applications, such as flat-panel televisions and lights, and as the top manufacturer of hole transport materials, we plan to further expand the market by stepping up our business capabilities in Korea, Taiwan and other markets.

Management resources will also be used to ensure continued growth in developing business areas such as carbon nanotubes and hair coloring agents.

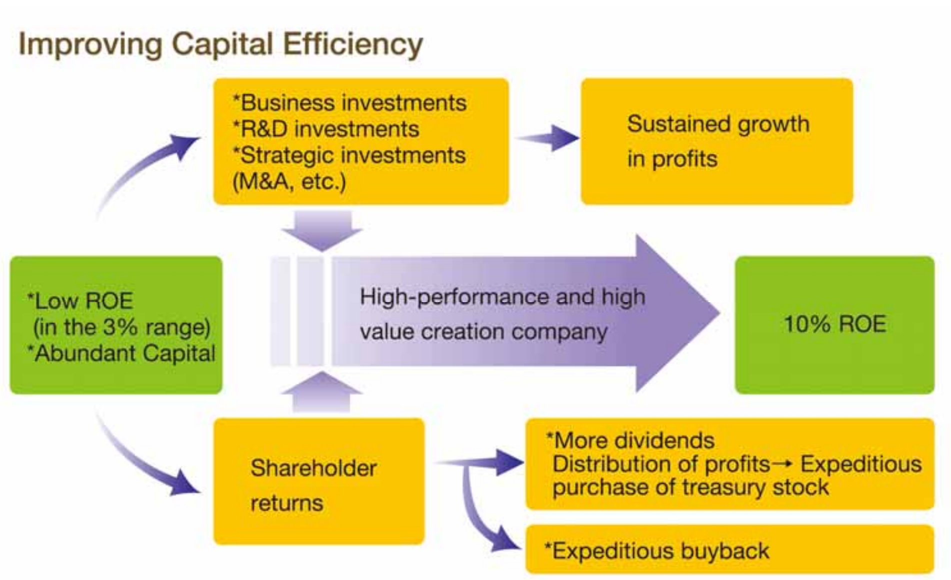
At the same time, we will shore up our basic businesses, such as agro-science, logistics and warehousing, and Hydrogen peroxide, to support stable growth.



Improving Capital Efficiency

While our group possesses ample resources to cope with future risks, our ROE is in the 3% range.

With the measures taken in Phase I and the second group reorganization, we took a big step in our efforts to transform ourselves from a process industry into a high-performance, specialty industry. As a result, we have greatly reduced our exposure to large-scale capital investment burdens and unforeseen business risks. In pursuing our goal of achieving an ROE of 10% by 2010, we will aggressively invest in business and development, and work to increase capital efficiency and shareholder returns.

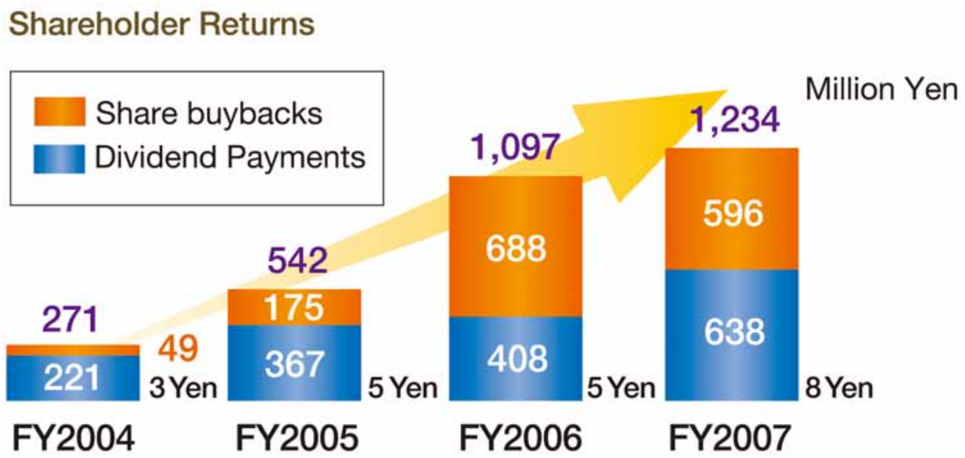


Shareholder Returns

Our group's fundamental mission is to build a healthy and stable foundation and consistently increase corporate value so that we can return profits to our shareholders.

Shareholder dividends and internal reserves are determined upon an overall consideration of performance trends, future business development needs, unforeseen risks and other factors.

Because of the successes we had in Phase I and with the second group reorganization, we are able to increase dividends from 5 yen per share to 8 yen per share.



2008 Business Forecast

Working Toward Continued Growth by Building on the Successes of Phase I

With uncertainty in the world economies, rising fuel costs and an unstable currency exchange market, the Japanese economy is likely to face continued difficulties going forward.

Within this tough environment, we embarked on Phase II (2008-2010) of our group's 'Innovation 90'plan. Building on the results of Phase I, we will devote more resources to functional colorants, such as our core electronics materials and OLED materials businesses, and to new applications of functional materials. We will also accelerate our transition to a specialty-based business portfolio, as we strive to establish ourselves as high performance and high value creation company.

Our consolidated and non-consolidated forecasts for FY 2008 are shown below (estimated using the exchange rate of 105 yen= $1 US).

Because of the additional divesture of Nippon Polyurethane Co. Ltd. holdings, we expect to post an extraordinary profit of 4,900 million yen (non-consolidated) and 1,200 million yen (consolidated) in FY 2008. The non-consolidated extraordinary profit will be subject to corporate tax (approximately 2,000 million yen), and so the stock sale will contribute to a reduction of approximately 800 million yen in consolidated net profits for the period.

CONSOLIDATED FINANCIAL STATEMENT

CONSOLIDATED BALANCE SHEETS

Hodogaya Chemical Co., Ltd and its Consolidated Subsidiaries for the years ending March 31, 2008 and 2007

	MILLIONS OF YEN	
	2008	**2007**
ASSETS		
Current Assets	22,707	25,364
Cash and cash equivalents	3,989	5,847
Notes and accounts receivable	12,380	12,883
Inventories	4,895	5,544
Others	1,442	1,090
Fixed Assets	42,557	43,194
Tangible Fixed Assets	21,182	22,102
Intangible Fixed Assets	1,449	948
Investment	19,925	20,142
Total Assets	65,265	68,558
LIABILITIES		
Notes and accounts payable	5,739	6,762
Currents portion of bond	16,698	16,330
Others	7,043	8,752
Total Liabilities	29,481	31,845
SHAREHOLDERS' EQUITY		
Common stock	11,196	11,196
Capital surplus	9,594	9,594
Retained earnings	13,524	12,797
Less: Treasury share at cost, 2,366,213 shares in 2007		(936)
Less: Treasury share at cost, 4,385,756 shares in 2008	(1,531)	
	2,903	3,856
Minority interests	97	204
Total Shareholders' equity	35,783	36,712
Total Liabilities and Shareholders' equity	65,265	68,558

CONSOLIDATED STATEMENTS OF INCOME

Hodogaya Chemical Co., Ltd. and its Consolidated Subsidiaries for the years ending March 31, 2008 and 2007

	MILLIONS OF YEN	
	2008	**2007**
Net Sales	36,070	37,033
Cost of sales	26,134	27,141
Selling, general and administrative expenses	7,219	7,029
Operating income	2,715	2,863
Other income	1,173	1,137
Other expenses	1,426	1,380
Ordinary income	2,462	2,620
Extraordinary income	63	5,695
Extraordinary expenses	1,055	1,624
Income before income taxes	1,470	6,690
Current	293	2,020
Deferred	179	556
Minority interests	(138)	(84)
Net income	1,135	4,198

STOCK

AUTHORIZED NUMBER OF SHARES (AS OF MARCH 31, 2008)

200,000,000

NUMBER OF COMMON SHARES ISSUED (AS OF MARCH 31, 2008)

84,137,261

NUMBER OF SHAREHOLDERS

10,563

MAIN SHAREHOLDERS (TOP 10 COMPANIES)

Shareholder	Number of Shares Held (in thousands)	Percentage of Shares Held (%)
Tosoh Corporation	28,049	33.34
Hodogaya Chemical Co., Ltd.	4,385	-
Mizuho Corporate Bank, Ltd.	2,987	3.55
The Norinchukin Bank	2,274	2.70
Meiji Yasuda Life Insurance Company	1,645	1.96
Mitsui Sumitomo Insurance Co., Ltd	1,414	1.68
The Bank of Tokyo-Mitsubishi UFJ, Ltd.	1,201	1.43
The Toho Bank, Ltd.	1,183	1.41
The Yamaguchi Bank, Ltd	1,000	1.19
Asahi Mutual Life Insurance Company	1,000	1.19

TOP INTERVIEW

Q1 Please tell us about your FY 2007 results.

A1 Income and earnings were down, but when adjusted for special factors such as tax code revisions, profitability actually increased.

We saw gains in the specialty chemical, Hydrogen peroxide, and OLED businesses, but other factors, such as our withdrawal from Chlorate business as part of our restructuring, corrections in construction-related business demand following extraordinary demand in the previous year, and poor conditions in the construction materials sector, contributed to an overall reduction in consolidated sales, which were down 2.6% from the previous year at 36,070 million yen.

In terms of operating profits, our efforts to reduce costs and adjust product pricing were not able to completely offset the effects of higher oil prices and the increased depreciation costs that followed tax code revisions. Operating profits were 2,715 million yen, a reduction of 5.2% from the previous year. However, when adjusted for the effects of extraordinary factors such as the tax code revisions, our actual profits increased.

As for ordinary income, in spite of increased equity method investment gains, other factors such as currency exchange losses offset the gains, resulting in earnings of 2,462 million yen, a reduction of 6.0% from the previous year.

Net income for FY 2007 were down by 73.0% compared with the previous year, at 1,135 million yen. This is a reflection of the extraordinary profits that were posted in FY 2006 in connection with the sale of affiliate company's stock.

Total assets dropped by 4.8%, due to reductions in cash, savings and inventory assets.

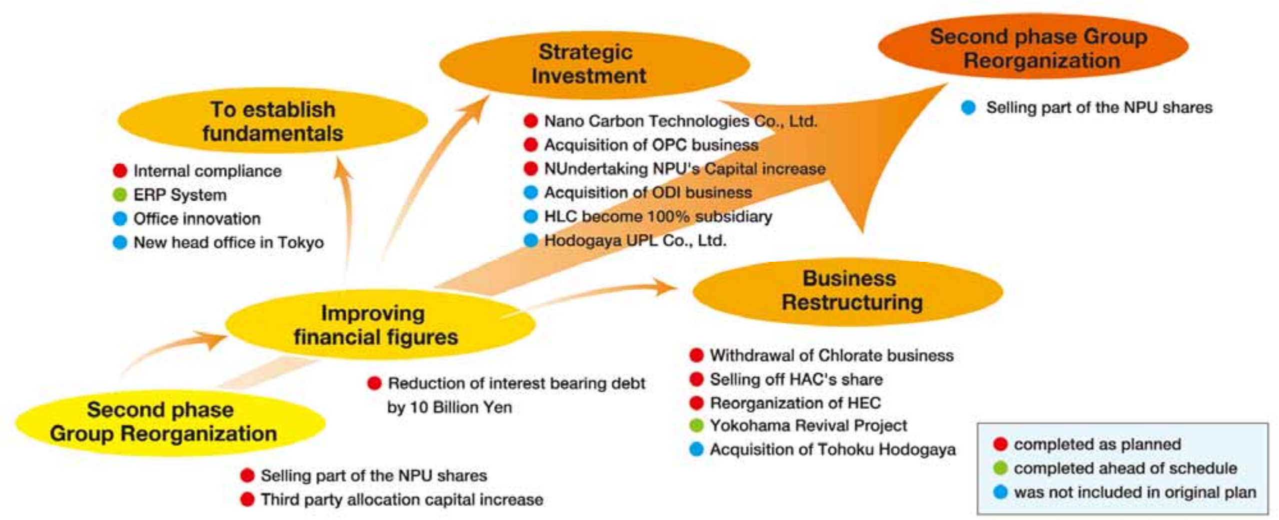
Net assets were reduced by 2.5%, as increases in retained earnings were offset by increases in treasury stock and stock valuation differences.

Q2 Phase 1 of 'Innovation 90'ended in FY 2007. How do you think it went?

A2 We believe that we have largely met our Phase I objective of establishing a solid management fundamentals for future growth.

Measures Implemented in Phase I

First Group Reorganization, Improvement of Financial Standing, Infrastructure, Business Restructuring, and Strategic Investment.



1. First Group Reorganization and Improvement of Financial Standing

Our first group reorganization was undertaken with the intention of improving the Hodogaya Chemical Group's long term value, and strengthening our relationship with Tosoh Corporation. Specifically, we made a partial assignment of Nippon Polyurethane Co. Ltd. stock and a third-party allocation of new shares to Tosoh Corporation. Combining part of the funds generated by these transactions with the proceeds from our previous management plan, 'Innovation 88', we were able to improve our financial standing by reducing interest-bearing debt by about 10,000 million yen.

2. Infrastructure

In upgrading our infrastructure, we fortified our internal control system.

Carrying out a Phase II plan ahead of schedule, we installed an ERP system, which became operational in April, 2008. The information garnered by this system will be used in our efforts to innovate in terms of operations, organization and awareness, and will help us to become more responsive to changing business environments.

Although not part of the original plan, we moved our headquarters to Minato-ku in Tokyo in order to better position ourselves to meet the challenges of a rapidly changing business climate.

We also implemented an 'Office Innovation' plan to help us establish ourselves as "high performance and high value creation company".

3. Business Restructuring

Our business restructuring efforts included our withdrawal from the chlorate business, the sale of our holdings in Hodogaya Ashland Co. Ltd., and the restructuring of Hodogaya Engineering Co. Ltd.

We also undertook an effort that we call the 'Yokohama Revival Project'. Initially, we phased out unprofitable products that were manufactured at our Yokohama plant. Then, to meet the rapidly expanding need for hazardous material handling in the metropolitan area, we expanded our hazardous materials warehouse facilities, completing construction three months ahead of schedule. In all, we were able to divest from low profit businesses and complete our business restructuring one year earlier than planned.

In addition to above, though not part of our original plan, we acquired Tohoku Hodogaya Co., Ltd.

4. Strategic Investment

In order to fully commercialize our carbon nanotube (CNT) products, we established Nano Carbon Technologies Co., Ltd. To accelerate growth in a core business area, we acquired an organic photoconductor (OPC) materials business.

Though not part of our original plan, we also made strategic investments to expand and strengthen our basic businesses. We acquired an octadecyl isocyanate (ODI) business, and to bolster the domestic nonfood-use agrichemicals market, we established Hodogaya UPL Co. Ltd. in cooperation with major agrichemical manufacturer; United Phosphorus Limited (UPL) of India. Further, to promote development in the hazardous materials handling business, we made Hodogaya Logistics Co. Ltd. a wholly owned subsidiary.

Phase I Performance

Though we did not meet our earnings targets (sales, operating profits, operating profit margin, ROE), we did achieve our fiscal targets in terms of interest-bearing debt, debt-equity ratio, and equity ratio.

Changes in policies, plans implemented ahead of schedule, and business restructuring were among the reasons that we didn't meet all of our earnings targets, but we view these results as an indication that we need to continue to improve our marketing and R&D capabilities.

- ROE: Net income ÷ equity capital x 100. Indicates the profit generated by shareholder capital.
- Debt-Equity Ratio: Interest-bearing debt ÷ equity capital. Indicates fiscal stability in terms of the balance between interest-bearing debt and capital.
- Equity Ratio: Equity capital ÷ total assets x 100. Indicates corporate management stability as a function of the proportion of total assets financed by stockholders and not creditors.

Phase I: Overview

Objectives were met in the following areas:

1. Transformation of Business Portfolio: As we shifted our emphasis to high-profit businesses through restructuring, we laid the foundations for sustained increases in operating profit margins.
2. Improvement of Financial Health: We dramatically reduced interest-bearing debt and improved our debt-equity ratio.
3. Improved Ability to Absorb Risk By specializing in easily differentiated specialty chemicals businesses, we are less susceptible to shifts in market conditions, and better able to absorb the risks associated with fluctuations in currency exchange rates, interest rates, and raw material prices.

Although we were not able to reach all of our numerical targets in Phase I, we successfully carried out the plans that will be indispensable to our future growth. Thus, we believe that we achieved the objective of Phase I, which was to establish solid management fundamentals for future growth.

Q3 How did you decide to undertake such a large-scale group reorganization?

A3 Our decision to divest additional Nippon Polyurethane Co. Ltd. stock was based on an analysis of changes in the macroeconomic environment and in the MDI business climate, and on an assessment of our future direction.

As part of our group reorganization, we divested part of our Nippon Polyurethane Co. Ltd. (NPU) holdings in two stages.

The first step in the reorganization took place on April 14, 2006, when we assigned part of our NPU holdings to Tosoh Corporation. This reduced our ownership from 65.0% to 48.3%, and changed NPU's status from consolidated subsidiary to equity method affiliate.

Around that time, NPU started construction of a new MDI plant at Tosoh's Nanyo facility that was expected to come on line in January 2008 and increase capacity by 200,000 tons per year. At the same time, Tosoh was looking into adding new raw material distribution facilities to service the new MDI plant. Under these circumstances, we and Tosoh decided that a stronger connection between NPU and Tosoh would enhance NPU's mid-range competitive position, and by extension, increase our corporate value. Thus we decided on the first reorganization.

The second step in the reorganization took place on May 21, 2008, when we assigned an additional part of our NPU holdings to Tosoh. As a result of this assignment, our ownership in NPU has been reduced from 48.3% to 19.7%, and NPU is no longer classified as an equity method affiliate. (The stock was sold for approximately 9,800 million yen, with profits of 4,900 million yen on a non-consolidated basis, and 1,200 million yen on a consolidated basis (FY 2008)).

We decided to take this step upon consideration of the impact that changing conditions are having on the MDI business. With raw material costs rising and the Japanese yen rapidly increasing in value, the MDI business faces stepped up pressure from major U.S., European and Chinese competitors, who are increasing their capacity in the Asian markets that we targeted for growth. Our Phase II plans call for us to build on the successes of Phase I by directing management resources to the functional colorants and new applications of functional materials sectors in order to accelerate our transformation to a high-performance and high value creation company. For these reasons, we proposed the second reorganization to Tosoh, and completed the transaction as described above.

Q4 Please tell us about Phase II (2008-2010)

A4 We will work to establish ourselves as "high performance and high value creation company" by implementing 4 main initiatives.

In Phase II (2008-2010), we will focus on incorporating the successes of Phase I and getting on track for growth, so that we can establish ourselves as "high performance and high value creation company".

The four main initiatives that will help us realize this goal are 1) adding to our high-profit business portfolio, 2) strengthening our R&D capabilities, 3) cultivation of human resources and innovating of corporate culture, and 4) improving capital efficiency.

In order to add businesses with stable profitability to our portfolio, we will not only endeavor to accelerate growth in our core businesses and strengthen developing businesses, we will also improve the profitability of basic business areas.

R&D capabilities are essential to growth. By strengthening our capabilities, we will be able to focus resources on the core businesses that support our growth, and on the developing businesses that we look to for future growth.

By cultivating human resources and innovating our corporate culture, we hope to foster an environment in which ample career opportunities are provided for self-motivated personnel who are always ready to face challenges.

Increasing capital efficiency will allow us both to aggressively invest in businesses and development, and to provide solid returns to our shareholders.