Ishihara Sangyo Kaisha

Annual Report 2007

Year Ended March 31, 2007

ISK

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Consolidated Financial Highlights

For the years ended March 31, 2005, 2006 and 2007

	Millions of yen			Thousands of U.S. dollars (Note)
	2007	2006	2005	2007
For the years ended March 31,				
Net sales:				
Domestic	¥ 46,376	¥ 46,671	¥ 41,683	$ 392,719
Overseas	59,785	57,696	54,833	506,266
Total	106,161	104,367	96,516	898,985
Sales classified by business segment:				
Inorganic chemicals	57,641	55,825	45,641	488,112
Organic chemicals	43,196	42,180	44,769	365,791
Other businesses	5,324	6,362	6,106	45,082
Total	106,161	104,367	96,516	898,985
Operating income	12,711	13,392	10,360	107,640
Net (loss) income	(3,935)	(10,774)	5,755	(33,322)
Depreciation of property, plant and equipment	5,179	5,307	4,374	43,860
Research and development costs	6,398	5,900	6,177	54,180
At the year end				
Current assets	115,861	100,041	79,998	981,129
Total assets	193,176	170,489	146,578	1,635,837
Current liabilities	88,728	85,902	62,805	751,357
Net assets	45,692	47,678	57,177	386,930

	Yen			U.S. dollars (Note)
Per share data				
Net (loss) income	¥ (10.54)	¥ (28.93)	¥ 15.71	$ (0.09)
Net assets	118.28	127.20	152.60	1.00

Number of employees (as of March 31)	1,851	1,882	1,905	—

Note: The U.S. dollar amounts in this report have been translated from the yen amounts, for convenience only, at ¥118.09 = U.S.$1.00, the rate of exchange prevailing on March 31, 2007.

Kenzo Oda
President

Looking back on the global economy during fiscal 2006, higher employment levels pushed up consumer spending in the United States, and the economy benefited from favorable corporate operating performance, which prompted capital investment. However, a major falloff in housing investment hampered the pace of economic growth. In Asia, IT businesses in certain regions experienced a slowdown in exports, but the robust Chinese economy drove export and investment levels, posting 10% economic growth and sustaining the economic expansion of the overall region. In Europe, ongoing export expansion—centering on Germany—continued, investment demand increased and employment improved. These factors led to favorable consumption levels and firm economic growth.

The Japanese economy experienced favorable performance from its two typical drivers of internal growth, private-sector capital investment and personal consumption, and exports were solid. Although such autonomous recovery continued, rapid growth by developing nations continued to push up raw materials prices, and a buoyant employment situation resulted in higher human resource costs. As a result, the corporate operating environment remained challenging.

Against this backdrop, the Group continued to persevere along the fundamental path established by its third medium-term management plan, which is designed to guide the Company during the three-year period from April 2006 through March 2009. We pursued business developments in accordance with action plans deriving from the medium-term plan.

Sales of inorganic chemicals increased, as the titanium dioxide business enjoyed an increase in Asia-bound exports and the functional and electronic materials business benefited from higher sales for use in electronic components. However, soaring raw materials prices drove up costs in this business segment, causing income to decline.

In organic chemicals, domestic sales of such proprietary agrochemicals as fungicides were firm, as were overseas sales. Overseas sales also benefited from strong currencies in Europe—our principal export market. As a result, this division posted increases in both sales and income.

In terms of other income and expenses, interest expense increased but commission expenses declined, owing to the syndicated loan structure implemented during the preceding term. As a result, net other income improved. However, the Company posted an extraordinary loss of ¥18,907 million (US$160 million), owing to such factors as Ferosilt removal expense.

As a result of these factors, net sales expanded ¥1,794 million, to ¥106,161 million (US$898 million), and operating income fell ¥681 million, to ¥12,711 million (US$107 million). The Company posted a net loss for the second consecutive year, with a net loss of ¥3,935 million (US$33 million) in fiscal 2006 following on the heels of a ¥10,774 million net loss during the preceding term.

In fiscal 2006, the Group launched its third medium-term management plan, based on the theme of "rising to the challenge of recovery and future development." This plan aims to improve ISK's existing corporate culture and implement strategies to expand individual business endeavors.

Concerning the aforementioned Ferosilt issue, ISK will do its utmost to complete the removal of Ferosilt at the earliest possible date. At the same time, we are strengthening a thorough internal control program to prevent the recurrence of such issues. We also are reinforcing our internal compliance system to regain the trust of society and rebuild our corporate value—two of the most essential challenges of the Company at present. We are striving to enhance our system for managing the environment, health and safety. At the same time, we are working to invigorate internal communications, raise transparency and cultivate a corporate culture characterized by a sense of openness.

As a manufacturer, in each business division we will refocus on research and development and manufacturing—the roots of our manufacturing business—and plant our feet firmly on the ground as we work to achieve sustained growth in corporate value through accelerated technology-centric innovation.

In the titanium dioxide business, we aim to retain our firm position as the top supplier in Japan and throughout Asia, while striving to achieve a world market share of 5%. We will continue to transform our production structure to chloride process manufacturing to strengthen our international competitiveness. We intend to improve operating profitability as one of our core businesses, expand our scope of operations and the value of our business, and add value from the perspectives of technology, quality, cost and services, as we aim to earn the trust of our customers. Regarding sulfate process titanium dioxide, ISK will continue to honor the Company's commitment to existing users while seeking to provide distinctive high-added value products.

In functional and electronic materials, our third core business, as well as one that is development-oriented and highly profitable, ISK aims to double sales to ¥15,000 million (US$127 million) to contribute to the growth of the inorganic chemicals division and further enhance corporate value. To achieve this goal, we will employ leading-edge technologies to bring into the marketplace specialty products that anticipate customer needs in growth fields, such as information technology, electronics and environment- and lifestyle-related sectors. This business strategy is designed to position ISK as a world-leading manufacturer of titanium and non-titanium specialty materials and maximize the value of the products it provides to customers.

In agrochemicals, we aim to be a second-tier manufacturer in the global market and one of the top three companies in Japan. In our second phase of growth, we aim to achieve annual net sales of ¥70,000 million (US$592 million) as quickly as possible. To reach this target, we will pursue unique lines of research and development, expand and grow our agrochemicals business in a sustainable manner and reinforce our presence and strengthen cost-reduction efforts as we work to raise profits and heighten our competitiveness. Furthermore, we will seek to acquire competing products and introduce them ourselves to expand our product lines. While maintaining or enhancing existing relationship with business partners, we will expand our operations organically, forge strategic alliances and remain on the lookout for M&A opportunities. Through such efforts, we intend to expand our businesses while enhancing safety and security initiatives.

ISK believes that its core mission is to contribute to “society”, “life” and “environment”, while pursuing scientific advances. In the organic and inorganic fields, we believe we must respond to diverse customer needs by offering high-quality, environmentally friendly products that deliver value.

In line with this philosophy, we will raise corporate value by ensuring sustainable and profitable growth. We aim to develop and grow into a company that our shareholders, other investors, customers, business partners and employees all view as attractive.

We appreciate your past support and ask for your continued understanding as we work toward these goals.

Kenzo Oda
President

■ Inorganic Chemicals

In the titanium dioxide business, tight supplies prompted a recovery in market prices. In this environment, we worked assiduously to revise our selling prices. As a result of this situation, sales expanded to the Group's core export market of Asia, centered on China, and higher selling prices bolstered segment sales. However, rising costs outpaced these sales improvements. On the manufacturing front, prices of raw materials, crude oil and coal rose substantially, and the cost of processing industrial waste grew.

In the functional and electronic materials business, we strove to extend the range of product applications in the IT and cosmetics fields, and in Japan and other parts of Asia sales of these products for use in electronic components expanded. As a result, sales of products in this segment increased.

Consequently, segment sales, including sales of other inorganic chemicals, rose ¥1,816 million, to ¥57,641 million (US$488 million). Conversely, operating income declined ¥1,298 million, to ¥4,098 million (US$34 million).

In late July of 2006, we sold a magnetic iron oxide business of our U.S. consolidated subsidiary ISK MAGNETICS, INC. to Cathay Pigments (U.S.A.) Inc. ISK generated a ¥100 million (US$0.8 million) loss on the disposal of this business, which was posted as an extraordinary loss.

■ Organic Chemicals

The global agrochemicals market experienced a reshuffling among European and U.S. conglomerates, a shift toward oligopoly and an increasingly evident difference in business scale. Such restructuring took place in Japan as well, creating a problematic operating environment. Under these circumstances, the Group are working to achieve its second phase of growth by developing new markets for the existing and new products centered on our proprietary compounds, which are internationally competitive, on the global basis. We also aim to reinforce our own promotional structure, which includes potential business alliances with other companies.

During the year, ISK posted increased overseas sales of agrochemicals, including our proprietary insecticides and fungicides. The Company also benefited from the effects of strong European currencies. Although agricultural crises hampered sales in some regions, overall sales were firm. In Japan, despite a difficult sales environment, sales of our proprietary fungicides expanded, resulting in strong sales of agrochemicals, both in Japan and overseas.

In the pharmaceuticals business, sales of active pharmaceutical ingredient, which ISK manufactures under the contract, increased.

As a result, segment sales, including intermediates, expanded ¥1,016 million, to ¥43,196 million (US$365 million). Operating income grew ¥534 million, to ¥10,666 million (US$90 million).

■ Other Businesses

Our other businesses are conducted primarily by Japanese construction and trading company subsidiaries. Fiscal 2006 sales in this segment declined ¥1,038 million, to ¥5,324 million (US$45 million), whereas operating income increased ¥543 million, to ¥1,367 million (US$11 million).

Consolidated Balance Sheets

As of March 31, 2007 and 2006

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Assets			
Current assets:			
Cash and time deposits (Notes 7 and 16)	¥ 42,349	¥ 23,424	$ 358,619
Short-term investments (Note 5)	0	91	0
Trade receivables:			
Notes (Note 4)	3,758	3,676	31,824
Accounts	28,617	29,705	242,335
	32,375	33,381	274,159
Less allowance for doubtful receivables	(425)	(431)	(3,597)
Trade receivables, net	31,950	32,950	270,562
Inventories (Note 6)	30,527	26,808	258,505
Deferred income taxes (Note 11)	8,233	13,385	69,720
Other current assets	2,802	3,383	23,723
Total current assets	115,861	100,041	981,129
Property, plant and equipment (Note 7):			
Land	6,430	6,437	54,453
Buildings and structures	48,764	47,885	412,936
Machinery and equipment	125,153	121,562	1,059,807
Construction in progress	2,980	1,248	25,240
	183,327	177,132	1,552,436
Less accumulated depreciation	(129,029)	(123,145)	(1,092,632)
Property, plant and equipment, net	54,298	53,987	459,804
Investments and other assets:			
Investments in securities (Note 5):			
Unconsolidated subsidiaries and affiliates	1,813	1,623	15,351
Other	6,129	9,975	51,906
Total investments in securities	7,942	11,598	67,257
Long-term loans	400	156	3,387
Goodwill	634	689	5,366
Deferred income taxes (Note 11)	13,210	3,092	111,868
Other	831	926	7,026
Total investments and other assets	23,017	16,461	194,904
Total assets	¥193,176	¥170,489	$1,635,837

The accompanying notes are an integral part of the consolidated financial statements.

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Liabilities and net assets			
Current liabilities:			
Short-term bank loans (Note 7)	¥ 28,529	¥ 28,417	$ 241,587
Current portion of long-term debt (Note 7)	10,716	4,097	90,741
Trade payables:			
Notes (Note 4)	6,119	3,166	51,814
Accounts	13,243	11,051	112,144
	19,362	14,217	163,958
Accrued income taxes (Note 11)	707	405	5,990
Accrued expenses	6,242	4,171	52,856
Accrual for periodic repairs	61	109	520
Reserve for Ferosilt removal	16,591	29,632	140,498
Other current liabilities	6,520	4,854	55,207
Total current liabilities	88,728	85,902	751,357
Long-term liabilities:			
Long-term debt (Note 7)	33,044	27,020	279,820
Accrued retirement benefits for employees (Note 9)	6,696	6,398	56,705
Accrued retirement benefits for directors and corporate auditors	372	364	3,148
Deferred income taxes (Note 11)	116	361	982
Reserve for Ferosilt removal	15,266	—	129,274
Other long-term liabilities (Note 7)	3,262	2,766	27,621
Total long-term liabilities	58,756	36,909	497,550
Contingent liabilities (Note 15)			
Net assets:			
Shareholders' equity (Note 12):			
Common stock:			
Authorized: 1,000,000,000 shares			
Issued: 384,360,431 shares in 2007 and 2006	42,029	42,029	355,903
Capital surplus	8,594	8,594	72,776
Retained earnings-deficit	(7,315)	(2,564)	(61,944)
Less treasury stock, at cost:			
139,211 shares in 2007	(33)	—	(275)
12,078,489 shares in 2006	—	(2,829)	—
Total shareholders' equity	43,275	45,230	366,460
Valuation, translation adjustments and other:			
Net unrealized holding gain on securities (Note 5)	1,974	3,188	16,712
Unrealized deferred gain on hedges	3	(2)	26
Translation adjustments	192	(1,063)	1,627
Total valuation, translation adjustments and others	2,169	2,123	18,365
Minority interests in consolidated subsidiaries	248	325	2,105
Total net assets	45,692	47,678	386,930
Total liabilities and net assets	¥193,176	¥170,489	$1,635,837

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statements of Operations

For the years ended March 31, 2007 and 2006

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Net sales (Note 18)	¥106,161	¥104,367	$898,985
Cost of sales (Note 8)	72,650	70,133	615,205
Gross profit	33,511	34,234	283,780
Selling, general and administrative expenses (Note 8)	20,800	20,842	176,140
Operating income (Note 18)	12,711	13,392	107,640
Other income:			
Interest and dividend income	291	202	2,467
Equity in earnings of affiliates	252	524	2,134
Foreign exchange gain	274	177	2,324
Other	209	153	1,770
	1,026	1,056	8,695
Other expenses:			
Interest expense	1,280	1,048	10,843
Loss on disposition of inventories	275	344	2,328
Retirement benefit expense	434	434	3,673
Commission paid	—	443	—
Other	686	749	5,814
	2,675	3,018	22,658
Income before extraordinary gains and losses	11,062	11,430	93,677
Extraordinary gains:			
Gain on prior-year adjustment	—	13	—
Gain on sales of investments in securities	2,198	5	18,610
Reversal of reserve for Ferosilt removal	254	—	2,154
Other	28	—	234
	2,480	18	20,998
Extraordinary losses:			
Loss on prior-year adjustment	—	56	—
Loss on disposal of fixed assets	269	298	2,276
Loss on impairment of fixed assets (Note 10)	1,006	—	8,520
Loss on devaluation of investments in securities	48	5	402
Ferosilt removal expense	—	3,020	—
Reserve for Ferosilt removal	18,907	29,632	160,107
Other	124	601	1,057
	20,354	33,612	172,362
Loss before income taxes and minority interests	(6,812)	(22,163)	(57,687)
Income taxes (Note 11):			
Current	972	607	8,230
Deferred	(3,899)	(12,017)	(33,019)
Minority interests	50	21	424
Net loss	¥ (3,935)	¥ (10,774)	$ (33,322)

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statements of Changes in Net Assets

For the years ended March 31, 2007 and 2006

		Millions of yen										
		Shareholders' equity					Valuation, translation adjustments and other					
	Number of shares of issued common stock	Common stock	Capital surplus	Retained earnings (deficit)	Treasury stock, at cost	Total shareholders' equity	Net unrealized holding gain on securities	Unrealized deferred gain on hedges	Translation adjust-ments	Total valuation, translation adjustments and other	Minority interests in consolidated subsidiaries	Total net assets
Balance at March 31, 2005	384,360,431	¥42,029	¥8,594	¥ 9,756	¥(2,795)	¥ 57,584	¥ 1,414	¥(12)	¥(2,108)	¥ (706)	¥299	¥57,177
Net loss for the year ended March 31, 2006	—	—	—	(10,774)	—	(10,774)	—	—	—	—	—	(10,774)
Dividends	—	—	—	(1,490)	—	(1,490)	—	—	—	—	—	(1,490)
Bonuses to directors and corporate auditors	—	—	—	(56)	—	(56)	—	—	—	—	—	(56)
Acquisition of treasury stock	—	—	—	—	(62)	(62)	—	—	—	—	—	(62)
Disposition of treasury stock	—	—	—	—	28	28	—	—	—	—	—	28
Other changes	—	—	—	—	—	—	1,774	10	1,045	2,829	26	2,855
Balance at March 31, 2006	384,360,431	¥42,029	¥8,594	¥ (2,564)	¥(2,829)	¥ 45,230	¥ 3,188	¥ (2)	¥(1,063)	¥2,123	¥325	¥47,678
Net loss for the year ended March 31, 2007	—	—	—	(3,935)	—	(3,935)	—	—	—	—	—	(3,935)
Acquisition of treasury stock	—	—	—	—	(27)	(27)	—	—	—	—	—	(27)
Disposition of treasury stock	—	—	(0)	(816)	2,823	2,007	—	—	—	—	—	2,007
Other changes	—	—	—	—	—	—	(1,214)	5	1,255	46	(77)	(31)
Balance at March 31, 2007	384,360,431	¥42,029	¥8,594	¥ (7,315)	¥ (33)	¥ 43,275	¥ 1,974	¥ 3	¥ 192	¥2,169	¥248	¥45,692

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statements of Changes in Net Assets

For the years ended March 31, 2007 and 2006

		Thousands of U.S. dollars (Note 1)										
		Shareholders' equity					Valuation, translation adjustments and other					
	Number of shares of issued common stock	Common stock	Capital surplus	Retained earnings (deficit)	Treasury stock, at cost	Total shareholders' equity	Net unrealized holding gain on securities	Unrealized deferred gain on hedges	Translation adjust-ments	Total valuation, translation adjustments and other	Minority interests in consolidated subsidiaries	Total net assets
Balance at March 31, 2006	384,360,431	$355,903	$72,776	$(21,714)	$(23,960)	$383,005	$ 26,998	$(21)	$(8,991)	$17,986	$2,747	$403,738
Net loss for the year ended March 31, 2007	—	—	—	(33,322)	—	(33,322)	—	—	—	—	—	(33,322)
Acquisition of treasury stock	—	—	—	—	(229)	(229)	—	—	—	—	—	(229)
Disposition of treasury stock	—	—	(0)	(6,908)	23,914	17,006	—	—	—	—	—	17,006
Other changes	—	—	—	—	—	—	(10,286)	47	10,618	379	(642)	(263)
Balance at March 31, 2007	384,360,431	$355,903	$72,776	$(61,944)	$ (275)	$366,460	$ 16,712	$ 26	$ 1,627	$18,365	$2,105	$386,930

Consolidated Statements of Cash Flows

For the years ended March 31, 2007 and 2006

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Cash flows from operating activities			
Loss before income taxes and minority interests	¥ (6,812)	¥(22,163)	$ (57,687)
Adjustments to reconcile loss before income taxes and minority interests to net cash provided by operating activities:			
Depreciation and amortization	5,470	5,676	46,318
Loss on disposal of fixed assets	161	122	1,367
Loss on devaluation of investments in securities	48	5	402
Loss on impairment of fixed assets	1,006	—	8,520
Foreign exchange gain	(85)	(108)	(717)
Gain on sales of investments in securities	(2,198)	(6)	(18,610)
Provision for accrued retirement benefits for employees, directors and corporate auditors	306	646	2,590
Reserve for Ferosilt removal	2,226	29,632	18,848
Interest and dividend income	(291)	(202)	(2,467)
Interest expense	1,280	1,048	10,843
Equity in earnings of affiliates	(160)	(387)	(1,360)
Other	(5)	50	(40)
Changes in operating assets and liabilities:			
Trade receivables	1,844	(729)	15,612
Inventories	(2,965)	(19)	(25,105)
Other current assets	763	(1,747)	6,465
Trade payables	3,735	(3,186)	31,627
Accrued expenses and other current liabilities	3,587	800	30,379
Subtotal	7,910	9,432	66,985
Interest and dividends received	282	425	2,388
Interest paid	(1,266)	(1,057)	(10,718)
Income taxes paid	(673)	(535)	(5,702)
Net cash provided by operating activities	¥ 6,253	¥ 8,265	$ 52,953
Cash flows from investing activities			
Increase in time deposits	(100)	—	(849)
Decrease in time deposits	20	—	171
Purchases of property, plant and equipment	(5,645)	(6,020)	(47,799)
Purchases of short-term investments and investments in securities	(21)	(159)	(178)
Proceeds from sales of property, plant and equipment	113	72	954
Proceeds from maturity and sales of short-term investments and investments in securities	3,796	387	32,150
Loans made	(450)	(159)	(3,811)
Collection of loans made	193	138	1,631
Purchases of treasury stock from minority shareholders	(250)	—	(2,117)
Other, net	—	734	—
Net cash used in investing activities	(2,344)	(5,007)	(19,848)
Cash flows from financing activities			
Increase (decrease) in short-term bank loans, net	111	(213)	942
Proceeds from long-term bank loans	16,660	12,515	141,079
Repayment of long-term bank loans	(4,125)	(5,921)	(34,937)
Payment of dividends	—	(1,475)	—
Purchases of treasury stock	(27)	(62)	(228)
Proceeds from sales of treasury stock	2,008	28	17,006
Net cash provided by financing activities	14,627	4,872	123,862
Effect of exchange rate changes on cash and cash equivalents	309	354	2,613
Increase in cash and cash equivalents	18,845	8,484	159,580
Cash and cash equivalents at beginning of year	23,404	14,920	198,190
Cash and cash equivalents at end of year (Note 16)	¥ 42,249	¥23,404	$357,770

The accompanying notes are an integral part of the consolidated financial statements.

Notes to Consolidated Financial Statements

Years ended March 31, 2007 and 2006

1. Basis of Preparation of Consolidated Financial Statements

Ishihara Sangyo Kaisha, Ltd. (the "Company") and its domestic consolidated subsidiaries maintain their accounts and records in accordance with accounting principles generally accepted in Japan. Its overseas consolidated subsidiaries maintain their accounts in conformity with the requirements of their respective countries of domicile. The accompanying consolidated financial statements have been 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.

Effective the year ended March 31, 2007, the Company has adopted a new accounting standard for the presentation of net assets in the balance sheet and the related implementation guidance. In addition, effective the year ended March 31, 2007, the Company is required to prepare consolidated statements of changes in net assets instead of consolidated statements of shareholders' equity. In this connection, the previously reported consolidated balance sheet as of March 31, 2006 and consolidated statement of shareholders' equity for the year then ended have been restated to conform to the presentation and disclosure of the consolidated financial statements for the year ended March 31, 2007.

Under this accounting standard, certain items which were previously presented as liabilities are now presented as components of net assets. Such items include minority interests in consolidated subsidiaries and unrealized deferred gain on hedges.

The translation of yen amounts into U.S. dollar amounts is included solely for convenience, as a matter of arithmetic computation only, at ¥118.09 = U.S.$1.00, the approximate rate of exchange in effect on March 31, 2007. This translation should not be construed as a representation that yen have been, could have been, or could in the future be, converted into U.S. dollars at the above or any other rate.

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year's presentation.

2. Summary of Significant Accounting Policies

(a) Principles of consolidation and accounting for investments in unconsolidated subsidiaries and affiliates

The accompanying consolidated financial statements as for and for the years ended March 31, 2007 and 2006 consist of the accounts of the Company, ISK Bioscience K.K., ISK Singapore Pte. Ltd., the ISK Americas Incorporated Group (5 subsidiaries), ISK Biosciences Europe S.A. Group (3 subsidiaries), ISK Taiwan Co., Ltd., Fuji Titanium Industry Co., Ltd., Ishihara Techno Corporation, Ishihara Enterprise & Co. Inc., ISK Engineering Corporation and ISK Distribution Service Co., Ltd.

All assets and liabilities of the consolidated subsidiaries are revalued at fair value as of their respective dates of acquisition by the full value method, if applicable. The difference between the cost of investments in subsidiaries and the equity in their net assets at the respective dates of acquisition is amortized over a period of five years to twenty years on a straight-line basis in accordance with the accounting practices of their respective countries of domicile if the excess is material, or charged to income when incurred if immaterial.

The overseas consolidated subsidiaries are consolidated on the basis of fiscal periods ending December 31, which differs from the balance sheet date of the Company. As a result, adjustments have been made for any significant intercompany transactions which took place during the period between the year ends of these overseas consolidated subsidiaries and the year end of the Company.

The Company's remaining subsidiaries have not been consolidated because they are not significant in terms of total assets, retained earnings, net sales and net income. The investments in significant affiliates have been stated at their underlying net equity after the elimination of intercompany profit. Investments in unconsolidated subsidiaries and the remaining affiliated companies are stated at cost.

(b) Foreign currency translation

Foreign currency transactions

All monetary assets and liabilities denominated in foreign currencies are translated into yen amounts at the rates of exchange in effect at the balance sheet date, except that receivables and payables hedged by qualified forward foreign exchange contracts are translated at their corresponding contract rates. All other assets and liabilities denominated in foreign currencies are translated at their historical rates.

Revenue and expense items arising from transactions denominated in foreign currencies are generally translated into yen at the exchange rates in effect at the respective transaction dates. Foreign exchange gain or loss is credited or charged to income in the year in which such gain or loss is recognized for financial reporting purposes.

Financial statements of overseas consolidated subsidiaries

The balance sheet accounts of the overseas consolidated subsidiaries are translated into yen at the rates of exchange in effect at the balance sheet date except that the components of net assets excluding minority interests in consolidated subsidiaries are translated at their historical rates. Revenue and expense accounts are translated at the average rates of exchange in effect during the year. Differences resulting from translating financial statements denominated in foreign currencies have not been included in the determination of net loss but are reported as minority interests in consolidated subsidiaries and translation adjustments which are components of net assets.

(c) Cash and cash equivalents

For the purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand and in banks and other highly liquid investments with maturities of three months or less when purchased.

(d) Inventories

Inventories of the Company and its domestic consolidated subsidiaries are valued at cost determined by the weighted-average method. Inventories of the overseas consolidated subsidiaries are stated at the lower of cost or market, the cost of inventories of ISK Singapore Pte. Ltd. being determined by the moving average method and the cost of those of other subsidiaries, by the weighted-average method.

(e) Securities

Securities are classified into three categories: trading securities, held-to-maturity debt securities and other securities. Trading securities, consisting of debt and marketable equity securities, are carried at fair value. Gain and loss, both realized and unrealized, are charged to income. Held-to-maturity debt securities are carried at amortized cost. Marketable securities classified as other securities are carried at fair value, with any changes in unrealized holding gain or loss, net of the applicable income taxes, reported as a separate component of net assets. Non-marketable securities classified as other securities are carried at cost. Cost of securities sold is determined by the moving average method.

(f) Derivatives and hedging activities

Derivative financial instruments are utilized by the Company and its domestic consolidated subsidiaries principally in order to manage risk arising from adverse fluctuation in foreign exchange rates and interest rates. The Company and its domestic consolidated subsidiaries have established a control environment which includes policies and procedures for risk assessment, including an assessment of the effectiveness of their hedging activities, and for the approval, reporting and monitoring of transactions involving derivatives. The Company and its domestic consolidated subsidiaries do not hold or issue derivatives for speculative trading purposes.

The Company and its domestic consolidated subsidiaries are exposed to market risk arising from their forward foreign exchange contracts, interest-rate options positions and interest-rate swap contracts. The Company and its domestic consolidated subsidiaries are also exposed to the risk of credit loss in the event of nonperformance by the counterparties to these contracts; however, they do not anticipate nonperformance by any of these counterparties, all of whom are financial institutions with high credit ratings.

Derivatives are carried at fair value with any changes in unrealized gain or loss credited or charged to income, except for those which meet the criteria for deferral hedge accounting under which unrealized gain or loss is deferred and reported as a component of net assets. Receivables and payables hedged by forward foreign exchange contracts which meet certain conditions are translated at their contracted rates. Interest-rate swaps which meet certain conditions are accounted for as if the interest rates which apply to the swaps had originally applied to the underlying debt.

(g) Property, plant and equipment and depreciation

Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment is recognized primarily by the straight-line method over the useful lives of the respective assets. The useful lives of property, plant and equipment are principally as follows:

Buildings and structures ....3 to 55 years
Machinery and equipment ....2 to 20 years

Costs for maintenance, repairs and minor renewals are charged to income as incurred; major renewals and betterments are capitalized.

(h) Research and development costs and computer software

Research and development costs are charged to income as incurred. Expenditures relating to computer software developed for internal use are charged to income as incurred, except if these are deemed to contribute to the generation of future income or cost savings. Such expenditures are capitalized as assets and amortized by the straight-line method over their useful lives, generally a period of 5 years.

(i) Allowance for doubtful receivables

The Company and its domestic consolidated subsidiaries have provided an allowance for doubtful receivables based on their historical experience of bad debts on ordinary receivables plus an additional estimate of probable specific doubtful accounts from customers experiencing financial difficulties.

The allowance for doubtful receivables of the overseas consolidated subsidiaries has been provided at an estimated aggregate amount of their probable bad debts.

(j) Accrual for Periodic Repairs

The main items of equipment of the Company installed during the year ended March 31, 2005 are subject to periodic overhaul every two or more years. The Company have provided an accrual for periodic repairs based on the estimated costs for overhauling this equipment.

(k) Reserve for Ferosilt removal

The Company has provided a reserve for Ferosilt removal and disposal based on local costs for the removal, transportation and disposal of Ferosilt at each location estimated according to construction region and disposal location.

(l) Leases

The Company and its domestic consolidated subsidiaries lease certain equipment under non-cancelable lease agreements referred to as finance leases. Finance leases other than those which transfer the ownership of the leased property to the Company and its domestic consolidated subsidiaries are accounted for as operating leases.

The overseas consolidated subsidiaries lease certain equipment under non-cancelable lease agreements. These leased assets are generally classified and accounted for by methods generally accepted in the respective countries in which they are incorporated.

(m) Retirement benefits

The Company and its domestic consolidated subsidiaries have defined benefit pension plans and retirement benefit plans. The retirement benefit plans provide for lump-sum payments to eligible employees upon retirement and are determined by reference to their basic salary, years of service and certain other factors.

Accrued retirement benefits are provided based on the amount of the projected benefit obligation reduced by the pension plan assets at fair value at the balance sheet date. The net retirement benefit obligation at transition of ¥6,506 million is being amortized by the straight-line method over 15 years.

Prior service cost is amortized by the straight-line method over the estimated average remaining years of service of the employees participating in the plans.

Actuarial gain or loss is amortized in the year following the year in which such gain or loss is recognized, principally by the straight-line method over the estimated average remaining years of service of the employees participating in the plans.

Directors and corporate auditors are not covered by these plans. Accrued retirement benefits for directors and corporate auditors have been recorded at an amount equal to an estimate of the amounts which would be payable to them if they had retired at the balance sheet date.

The overseas consolidated subsidiaries do not have pension plans such as those of the Company and its domestic consolidated subsidiaries.

(n) Income taxes

Income taxes are calculated based on taxable income and charged to income on an accrual basis. Certain temporary differences exist between taxable income and income reported for financial statement purposes which enter into the determination of taxable income in a different period. The Company and its domestic consolidated subsidiaries recognize the tax effect of such temporary differences in their consolidated financial statements.

3. Changes in Accounting Policies

(a) Presentation of Net Assets in the Balance Sheet

Effective the year ended March 31, 2007, the Company has adopted "Accounting Standard for Presentation of Net Assets in the Balance Sheet" (Accounting Standards Board of Japan (ASBJ) Statement No. 5 issued on December 9, 2005) and "Guidance on Accounting Standard for Presentation of Net Assets in the Balance Sheet" (ASBJ Guidance No. 8 issued on December 9, 2005). Total shareholders' equity under the previous method of presentation amounted to ¥45,441 million ($384,799 thousand) at March 31, 2007.

(b) Accounting Standard for Business Combinations

Effective the year ended March 31, 2007, the Company has adopted "Accounting Standard for Business Combinations" (issued on October 31, 2003 by the Business Accounting Council of Japan,) and "Guidance on Accounting Standard for Business Combinations and Accounting Standard for Business Divestitures" (ASBJ Guidance No. 10 revised on December 22, 2006).

4. Notes Receivable and Notes Payable

Although the balance sheet date for the year ended March 31, 2007 fell on a bank holiday, notes receivable, trade of ¥388 million ($3,284 thousand) and notes payable, trade of ¥371 million ($3,138 thousand) with due dates of March 31, 2007 were included in the respective balances and were settled on the next business day.

5. Short-Term Investments and Investments in Securities

Marketable securities classified as held-to-maturity debt securities and other securities at March 31, 2007 and 2006 were as follows:

(a) Held-to-maturity debt securities

	Millions of yen						Thousands of U.S. dollars		
	2007			2006			2007		
	Carrying value	Estimated fair value	Unrealized loss	Carrying value	Estimated fair value	Unrealized loss	Carrying value	Estimated fair value	Unrealized loss
Securities whose carrying value exceeds their estimated fair value	¥10	¥10	¥ (0)	¥10	¥9	¥ (1)	$85	$82	$ (3)
Total	¥10	¥10	¥ (0)	¥10	¥9	¥ (1)	$85	$82	$ (3)

(b) Other securities

	Millions of yen						Thousands of U.S. dollars		
	2007			2006			2007		
	Acquisition cost	Carrying value	Unrealized gain (loss)	Acquisition cost	Carrying value	Unrealized gain (loss)	Acquisition cost	Carrying value	Unrealized gain (loss)
Securities whose carrying value exceeds their acquisition cost:									
Equity securities	¥2,133	¥5,134	¥3,001	¥3,645	¥8,982	¥5,337	$18,065	$43,480	$25,415
Subtotal	2,133	5,134	3,001	3,645	8,982	5,337	18,065	43,480	25,415
Securities whose acquisition cost exceeds their carrying value:									
Equity securities	32	31	(1)	18	17	(1)	275	260	(15)
Subtotal	32	31	(1)	18	17	(1)	275	260	(15)
Total	¥2,165	¥5,165	¥3,000	¥3,663	¥8,999	¥5,336	$18,340	$43,740	$25,400

The carrying value of the principal investments in non-marketable securities at March 31, 2007 and 2006 is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Held-to-maturity debt securities:			
Discounted bank bonds	¥ —	¥ 91	$ —
Other securities:			
Unlisted equity securities	954	966	8,081

Proceeds from sales of, and gross realized gain on, other securities for the years ended March 31, 2007 and 2006 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Proceeds from sales	¥3,706	¥10	$31,383
Gross realized gain	2,198	5	18,610

The redemption schedule at March 31, 2007 for held-to-maturity debt securities and debt securities classified as other securities was as follows:

	Millions of yen			Thousands of U.S. dollars		
	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due in one year or less	Due after one year through five years	Due after five years through ten years
Government bonds	¥ —	¥ —	¥ 10	$ —	$ —	$ 85

6. Inventories

Inventories at March 31, 2007 and 2006 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Finished goods	¥15,302	¥13,539	$129,577
Work in process	5,772	5,130	48,879
Raw materials and supplies	9,453	8,139	80,049
	¥30,527	¥26,808	$258,505

7. Short-Term Bank Loans, Long-Term Debt and Other Long-Term Liabilities

The average annual interest rates on short-term bank loans at March 31, 2007 and 2006 were 1.8% and 1.4%, respectively.

Long-term debt including the current portion of long-term debt at March 31, 2007 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Secured bank loans	¥12,725	¥14,886	$107,754
Unsecured bank loans	31,035	16,231	262,807
	43,760	31,117	370,561
Less amounts due within one year	(10,716)	(4,097)	(90,741)
	¥33,044	¥27,020	$279,820

Interest rates applicable to long-term bank loans presented in the above table fell in the range from 1.0% to 5.9% at March 31, 2007 and 2006.

These bank loans become due through 2017.

The aggregate annual maturities of long-term debt subsequent to March 31, 2007 are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2008	¥10,716	$ 90,741
2009	9,549	80,860
2010	11,229	95,087
2011	9,127	77,288
2012	1,011	8,564
2013 and thereafter	2,128	18,021
	¥43,760	$370,561

At March 31, 2007, the following assets were pledged as collateral for short-term bank loans, the current portion of long-term debt, long-term debt and other long-term liabilities:

	Millions of yen	Thousands of U.S. dollars
Cash and time deposits	¥ 80	$ 677
Property, plant and equipment, net of accumulated depreciation	41,169	348,624
All assets of ISK Singapore Pte. Ltd. (except for certain property, plant and equipment)	9,119	77,225
	¥50,368	$426,526

Short-term banks loans, the current portion of long-term debt, long-term debt and other long-term liabilities secured by such collateral at March 31, 2007 were as follows:

	Millions of yen	Thousands of U.S. dollars
Short-term bank loans	¥14,159	$119,898
Current portion of long-term debt	4,406	37,308
Long-term debt	8,319	70,446
Other long-term liabilities	35	301
	¥26,919	$227,953

8. Research and Development Costs

Research and development costs included in manufacturing costs and selling, general and administrative expenses for the years ended March 31, 2007 and 2006 totaled ¥6,398 million ($54,180 thousand) and ¥5,900 million, respectively.

9. Retirement Benefits

The following table sets forth the funded and accrued status of the employees' retirement benefit plans and the amounts recognized in the consolidated balance sheets at March 31, 2007 and 2006 for the Company's and the consolidated subsidiaries' defined benefit plans:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Retirement benefit obligation	¥(10,780)	¥(11,036)	$ (91,284)
Plan assets at fair value	602	588	5,100
Unfunded retirement benefit obligation	(10,178)	(10,448)	(86,184)
Unrecognized net retirement benefit obligation at transition	3,470	3,904	29,384
Unrecognized actuarial (gain) loss	(52)	72	(444)
Unrecognized prior service cost	96	102	809
Net retirement benefit obligation	(6,664)	(6,370)	(56,435)
Prepaid pension cost	(32)	(28)	(270)
Accrued retirement benefits	¥ (6,696)	¥ (6,398)	$ (56,705)

The domestic consolidated subsidiaries have adopted simplified methods for calculating their accrued retirement benefits as permitted under the accounting standard for employees' retirement benefits.

The components of retirement benefit expenses for the years ended March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Service cost	¥ 606	¥ 590	$ 5,133
Interest cost	242	230	2,047
Expected return on plan assets	(10)	(7)	(80)
Amortization of retirement benefit obligation at transition	434	434	3,673
Amortization of unrecognized actuarial loss (gain)	10	(7)	81
Amortization of unrecognized prior service cost	7	6	58
Retirement benefit expense	¥ 1,289	¥ 1,246	$ 10,912

The retirement benefit expense of certain domestic consolidated subsidiaries, which calculated these by simplified methods, has been included in service cost in the above table.

The assumptions used in accounting for the defined benefit plans for the years ended March 31, 2007 and 2006 were as follows:

	2007	2006
Discount rate	2.5%	2.5%
Expected rate of return on plan assets	2.5%	2.5%

10. Loss on Impairment of Fixed Assets

For the year ended March 31, 2007, the Company recorded a loss on impairment of fixed assets. The loss on impairment of fixed assets is summarized as follows:

Location	Major use	Classification	Millions of yen	Thousands of U.S. dollars
Yokkaichi Factory (Yokkaichi City, Mie Prefecture)	Idle assets	Structures, Machinery and equipment	¥1,006	$ 8,520

The aggregate loss on impairment of fixed assets of ¥1,006 million ($8,520 thousand) consisted of ¥65 million ($554 thousand) on buildings, ¥425 million ($3,598 thousand) on machinery, ¥1 million ($7 thousand) on other assets and ¥515 million ($4,361 thousand) on removal expenses.

The Company and its domestic consolidated subsidiaries group their assets in association with the business and production process. Idle assets which are not anticipated to be utilized in the future and leased property are classified as individual cash-generating units. Assets, which are not definitely linked to a specific business, such as the head-office building, the facilities for research and development and the facilities for welfare, are classified as corporate assets.

The Company acknowledges that their oil boiler facilities are unemployed assets and recorded a loss on impairment of the oil boiler facilities as an extraordinary loss since the Company achieved a reduction in energy costs through the operation of their coal boiler facilities which were completed in June 2005, and achieved a stable technical outcome by completing regular repairs to the coal boiler facilities in October 2006. As a result, the Company determined to dismantle the oil boiler facilities which had been idle and were a backup for the coal boiler facilities. The recoverable amount of the oil boiler facilities was based on their net sales price.

11. Income Taxes

Income taxes applicable to the Company and its domestic consolidated subsidiaries consist of corporation, inhabitants' and enterprise taxes. The statutory tax rates in Japan for the years ended March 31, 2007 and 2006 were, in the aggregate, approximately 40.1% and 39.5%, respectively.

A reconciliation of the differences between the statutory tax rates and the effective tax rates for the years ended March 31, 2007 and 2006 has not been presented because loss before income taxes and minority interests was recorded.

Deferred income taxes reflect the net tax effect of the temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the corresponding amounts for income tax purposes. The significant components of the Company's and consolidated subsidiaries' deferred tax assets and liabilities at March 31, 2007 and 2006 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Deferred tax assets:			
Tax loss carryforwards	¥12,621	¥10,163	$ 106,882
Retirement benefits	2,666	2,511	22,574
Unrealized profit on intercompany transactions	1,093	839	9,255
Write-downs of marketable and investment securities	2	386	20
Accrued expenses	827	789	7,006
Write-downs of inventories	139	279	1,175
Accrued bonuses	235	262	1,988
Write-downs of property, plant and equipment	131	138	1,113
Reserve for ferosilt removal	12,775	11,716	108,178
Other	2,130	1,595	18,035
Gross deferred tax assets	32,619	28,678	276,226
Less valuation allowance	(9,625)	(8,593)	(81,507)
Total deferred tax assets	22,994	20,085	194,719
Deferred tax liabilities:			
Property, plant and equipment	(206)	(1,450)	(1,744)
Unrealized holding gain on securities	(994)	(2,115)	(8,420)
Other	(474)	(404)	(4,016)
Total deferred tax liabilities	(1,674)	(3,969)	(14,180)
Net deferred tax assets	¥21,320	¥16,116	$ 180,539

12. Shareholders' Equity

The new Corporation Law of Japan (the "Law"), which superseded most of the provisions of the Commercial Code of Japan (the "Code"), went into effect on May 1, 2006. The Law provides that an amount equal to 10% of the amount to be disbursed as distributions of capital surplus (other than the capital reserve) and retained earnings (other than the legal reserve) be transferred to the capital reserve and the legal reserve, respectively, until the sum of the capital reserve and the legal reserve equals 25% of the capital stock account. Such distributions can be made at any time by resolution of the shareholders, or by the Board of Directors if certain conditions are met.

The Company's legal reserve included in retained earnings at March 31, 2007 and 2006 amounted to ¥270 million ($2,285 thousand) and ¥270 million, respectively.

Under the Law, upon the issuance and sale of new shares of common stock, the entire amount of the proceeds is required to be accounted for as common stock, although a company may, by resolution of the Board of Directors, account for an amount not exceeding one-half of the proceeds of the sale of new shares as additional paid-in capital.

Treasury stock

Movements in treasury stock during the year ended March 31, 2007 are summarized as follows:

	Number of shares			
	2007			
	March 31, 2006	Increase	Decrease	March 31, 2007
Treasury stock	12,078,489	157,007	12,096,285	139,211

13. Leases

The following proforma amounts represent the acquisition costs, accumulated depreciation and net book value of the leased assets at March 31, 2007 and 2006, which would have been reflected in the consolidated balance sheets, if finance lease accounting had been applied to the finance leases currently accounted for as operating leases:

	Millions of yen						Thousands of U.S. dollars		
	2007			2006			2007		
	Acquisition costs	Accumulated depreciation	Net book value	Acquisition costs	Accumulated depreciation	Net book value	Acquisition costs	Accumulated depreciation	Net book value
Machinery and equipment	¥2,434	¥1,290	¥1,144	¥2,671	¥1,568	¥1,103	$20,607	$10,924	$ 9,683
Other	1,145	623	522	1,365	779	586	9,698	5,273	4,425
	¥3,579	¥1,913	¥1,666	¥4,036	¥2,347	¥1,689	$30,305	$16,197	$14,108

Lease payments relating to finance leases accounted for as operating leases for the years ended March 31, 2007 and 2006 amounted to ¥675 million ($5,712 thousand) and ¥767 million, respectively. Depreciation of the leased assets computed by the straight-line method over the respective lease terms for the years ended March 31, 2007 and 2006 amounted to ¥675 million ($5,712 thousand) and ¥767 million, respectively.

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2007 for finance leases accounted for as operating leases are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2008	¥ 546	$ 4,627
2009 and thereafter	1,120	9,481
	¥ 1,666	$ 14,108

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2007 for operating leases are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2008	¥ 324	$ 2,746
2009 and thereafter	749	6,341
	¥1,073	$ 9,087

14. Derivatives

Open interest-rate swaps at March 31, 2006 were as follows:

	Millions of yen		
	Notional amount	Fair value	Unrealized loss
(Interest-rate-related derivatives)			
Interest-rate swaps:			
Receiving/floating and pay/fixed	¥750	¥(6)	¥(0)

At March 31, 2007 all derivatives utilized by the Company met the criteria for deferral hedge accounting and the disclosure of fair value information has thus been omitted.

15. Contingent Liabilities

At March 31, 2007, the Company and its consolidated subsidiaries were contingently liable for the following:

	Millions of yen	Thousands of U.S. dollars
Trade notes receivable discounted with banks	¥ 932	$ 7,888
Endorsed notes	144	1,219
As guarantor for borrowings of unconsolidated subsidiaries	198	1,679
	¥1,274	$10,786

16. Supplemental Information to Consolidated Statements of Cash Flows

A reconciliation between cash and cash equivalents in the consolidated statements of cash flows and cash and time deposits in the consolidated balance sheets as of and for the years ended March 31, 2007 and 2006 is presented as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Cash and time deposits	¥42,349	¥23,424	$358,619
Time deposits with a maturity in excess of three months	100	20	849
Cash and cash equivalents	¥42,249	¥23,404	$357,770

17. Amounts per Share

	Yen		U.S. dollars
	2007	2006	2007
Net loss per share	¥ (10.54)	¥ (28.93)	$ (0.09)
Net assets per share	118.28	127.20	1.00

Net loss per share is based on the net loss attributable to shareholders of common stock and the weighted-average number of shares of common stock outstanding during each year, and net assets per share is based on the net assets available for distribution to the shareholders of common stock and the number of shares of common stock outstanding at the year end.

No diluted net loss per share for the years ended March 31, 2007 and 2006 is presented since no potentially dilutive securities have been issued.

The financial data for the computation of basic net loss per share for the years ended March 31, 2007 and 2006 in the table above is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Information on basic net loss per share:			
Net loss	¥ (3,935)	¥(10,774)	$ (33,322)
Adjusted net loss attributable to common stock	¥ (3,935)	¥(10,774)	$ (33,322)
	Thousands of shares		
Weighted-average number of shares of common stock outstanding during the year	373,190	372,383	

The financial data for the computation of net assets per share at March 31, 2007 in the above table is summarized as follows:

	Millions of yen	Thousands of U.S. dollars
	2007	2007
Total net assets	¥ 45,692	$386,930
Deductions from total net assets:	¥ (248)	$ (2,105)
Total net assets used in the calculation of net assets per share	¥ 45,444	$384,825

	Thousands of shares
	2007
Number of shares used in the calculation of net assets per share	384,221

18. Segment Information

Business segments

The Company and its consolidated subsidiaries' operations are classified into 3 business segments as follows:

Inorganic chemicals

This segment's business involves titanium dioxide and functional materials which are value-added products designed to take advantage of the characteristics of titanium dioxide such as electronic materials, magnetic materials and other inorganic chemicals.

Organic chemicals

This segment's business involves agrochemicals, organic intermediates and active pharmaceutical ingredients.

Other businesses

This segment principally involves industries which trade and distribute the Company's goods, construct chemical plants, rent real estate, and so forth.

A summary of financial information by business segment for the years ended March 31, 2007 and 2006 is as follows:

	Millions of yen					
	2007					
	Inorganic chemicals	Organic chemicals	Other businesses	Total	Eliminations and corporate	Consolidated
Net sales and operating income:						
Net sales:						
Outside customers	¥57,641	¥43,196	¥ 5,324	¥106,161	¥ —	¥106,161
Intersegment	—	—	12,058	12,058	(12,058)	—
Net sales	57,641	43,196	17,382	118,219	(12,058)	106,161
Operating expenses	53,543	32,529	16,014	102,086	(8,636)	93,450
Operating income	¥ 4,098	¥10,667	¥ 1,368	¥ 16,133	¥ (3,422)	¥ 12,711
Total assets	¥69,544	¥40,575	¥13,152	¥123,271	¥ 69,905	¥193,176
Depreciation and amortization	4,124	794	87	5,005	218	5,223
Loss on impairment of fixed assets	933	73	—	1,006	—	1,006
Capital expenditures	5,359	762	254	6,375	(416)	5,959

	Millions of yen					
	2006					
	Inorganic chemicals	Organic chemicals	Other businesses	Total	Eliminations and corporate	Consolidated
Net sales and operating income:						
Net sales:						
Outside customers	¥55,825	¥42,180	¥ 6,362	¥104,367	¥ —	¥104,367
Intersegment	10	—	8,470	8,480	(8,480)	—
Net sales	55,835	42,180	14,832	112,847	(8,480)	104,367
Operating expenses	50,438	32,048	14,007	96,493	(5,518)	90,975
Operating income	¥ 5,397	¥10,132	¥ 825	¥ 16,354	¥ (2,962)	¥ 13,392
Total assets	¥70,847	¥37,311	¥12,530	¥120,688	¥ 49,801	¥170,489
Depreciation and amortization	4,181	962	75	5,218	244	5,462
Capital expenditures	4,344	852	143	5,339	(81)	5,258

	Thousands of U.S. dollars					
	2007					
	Inorganic chemicals	Organic chemicals	Other businesses	Total	Eliminations and corporate	Consolidated
Net sales and operating income:						
Net sales:						
Outside customers	$ 488,112	$ 365,791	$ 45,082	$ 898,985	$ —	$ 898,985
Intersegment	—	—	102,114	102,114	(102,114)	—
Net sales	488,112	365,791	147,196	1,001,099	(102,114)	898,985
Operating expenses	453,406	275,464	135,612	864,482	(73,137)	791,345
Operating income	$ 34,706	$ 90,327	$ 11,584	$ 136,617	$ (28,977)	$ 107,640
Total assets	$ 588,905	$ 343,598	$111,370	$1,043,873	$ 591,964	$1,635,837
Depreciation and amortization	34,924	6,719	737	42,380	1,846	44,226
Loss on impairment of fixed assets	7,898	622	—	8,520	—	8,520
Capital expenditures	45,385	6,448	2,152	53,985	(3,527)	50,458

Unallocable operating expenses, consisting primarily of the Company's expenses relating to general affairs, totaled ¥3,163 million ($26,782 thousand) and ¥2,750 million for the years ended March 31, 2007 and 2006, respectively. These have been included in "Eliminations and corporate." Corporate assets consisted principally of the Company's cash and time deposits and investments in securities.

Geographical segments

Geographical segments are determined on the basis of geographic proximity and the Company's business bases, as follows:

Asia: Singapore, and Taiwan
America: The United States
Europe: Belgium, France, and Spain

	Millions of yen						
	2007						
	Japan	Asia	America	Europe	Total	Eliminations and corporate	Consolidated
Net sales and operating income (loss):							
Net sales:							
Outside customers	¥ 70,026	¥10,043	¥5,174	¥20,918	¥106,161	¥ —	¥106,161
Intersegment	27,851	5,127	27	97	33,102	(33,102)	—
Net sales	97,877	15,170	5,201	21,015	139,263	(33,102)	106,161
Operating expenses	82,549	14,921	5,357	20,559	123,386	(29,936)	93,450
Operating income (loss)	¥ 15,328	¥ 249	¥ (156)	¥ 456	¥ 15,877	¥ (3,166)	¥ 12,711
Total assets	¥119,337	¥20,824	¥3,651	¥11,423	¥155,235	¥ 37,941	¥193,176

	Millions of yen						
	2006						
	Japan	Asia	America	Europe	Total	Eliminations and corporate	Consolidated
Net sales and operating income (loss):							
Net sales:							
Outside customers	¥ 69,495	¥ 9,537	¥5,923	¥19,412	¥104,367	¥ —	¥104,367
Intersegment	26,675	4,124	28	66	30,893	(30,893)	—
Net sales	96,170	13,661	5,951	19,478	135,260	(30,893)	104,367
Operating expenses	80,561	12,832	6,087	19,223	118,703	(27,728)	90,975
Operating income (loss)	¥ 15,609	¥ 829	¥ (136)	¥ 255	¥ 16,557	¥ (3,165)	¥ 13,392
Total assets	¥116,325	¥20,409	¥3,993	¥ 9,353	¥150,080	¥ 20,409	¥170,489

	Thousands of U.S. dollars						
	2007						
	Japan	Asia	America	Europe	Total	Eliminations and corporate	Consolidated
Net sales and operating income (loss):							
Net sales:							
Outside customers	$ 592,985	$ 85,048	$43,811	$177,141	$ 898,985	$ —	$ 898,985
Intersegment	235,844	43,414	232	819	280,309	(280,309)	—
Net sales	828,829	128,462	44,043	177,960	1,179,294	(280,309)	898,985
Operating expenses	699,032	126,354	45,363	174,099	1,044,848	(253,503)	791,345
Operating income (loss)	$ 129,797	$ 2,108	$ (1,320)	$ 3,861	$ 134,446	$ (26,806)	$ 107,640
Total assets	$1,010,559	$176,339	$30,922	$ 96,731	$1,314,551	$ 321,286	$1,635,837

Unallocable operating expenses, consisting primarily of the Company's expenses relating to general affairs, totaled ¥3,163 million ($26,782 thousand) and ¥2,750 million for the years ended March 31, 2007 and 2006, respectively. These have been included in "Eliminations and corporate." Corporate assets consisted principally of the Company's cash and time deposits and investments in securities.

Overseas net sales

The regions are determined on the basis of geographic proximity and the Company's business activities as follows:

Asia: China, Taiwan, South Korea, Thailand, Indonesia, and Singapore
America: The United States, Canada, Brazil, Argentina, and Mexico
Europe: Germany, Netherland, France, the United Kingdom, Belgium, Italy, Eastern Europe, and the Middle East
Other: Australia, New Zealand, and Africa

	Millions of yen				
	2007				
	Asia	America	Europe	Other	Total
Overseas net sales	¥26,027	¥9,634	¥23,553	¥571	¥ 59,785
Consolidated net sales					106,161
Overseas net sales as a percentage of consolidated net sales	24.5%	9.1%	22.2%	0.5%	56.3%

	Millions of yen				
	2006				
	Asia	America	Europe	Other	Total
Overseas net sales	¥24,532	¥10,606	¥21,890	¥668	¥ 57,696
Consolidated net sales					104,367
Overseas net sales as a percentage of consolidated net sales	23.5%	10.2%	21.0%	0.6%	55.3%

	Thousands of U.S. dollars				
	2007				
	Asia	America	Europe	Other	Total
Overseas net sales	$220,396	$81,585	$199,448	$4,837	$506,266
Consolidated net sales					898,985
Overseas net sales as a percentage of consolidated net sales	24.5%	9.1%	22.2%	0.5%	56.3%

19. Subsequent Events

(a) Merger with Ishihara Enterprise & Co., Inc. ("Ishihara Enterprise")

On May 1, 2007, Ishihara Enterprise, a consolidated subsidiary of the Company, was merged into the Company based on a resolution approved at a meeting of the Board of Directors of the Company held on March 7, 2007, pursuant to Article 796, Paragraph 3 of the Corporation Law and a merger agreement on March 7, 2007. Ishihara Enterprise obtained approval for the merger agreement by resolution of the shareholders at a meeting held on March 23, 2007.

Prior to the merger, Ishihara Enterprise was engaged in the real estate business. The Company determined that the merger would contribute to savings of indirect cost and enhance efficiency in group asset management by integrating the real estate business of Ishihara Enterprise into the Company's owned assets.

In connection with the merger, the Company issued 3,479,000 shares of common stock of the Company based on a conversion ratio of 3.55 shares of the Company's common stock for each share of Ishihara Enterprise.

The Company has accounted for this business combination as a merger under common control which has been eliminated as an internal transaction pursuant to "Accounting Standard for Business Combinations" (issued on October 31, 2003 by the Business Accounting Council of Japan), and "Guidance on Accounting Standard for Business Combinations and Accounting Standard for Business Divestitures" (ASBJ Guidance No. 10 issued on December 22, 2006).

The condensed balance sheet of Ishihara Enterprise at March 31, 2007 was as follows:

	Millions of yen	Thousands of U.S. dollars
Current assets	¥ 151	$ 1,284
Fixed assets	3,753	31,779
Total assets	¥ 3,904	$ 33,063
Current liabilities	¥ 1,987	$ 16,825
Long-term liabilities	538	4,555
Total liabilities	2,525	21,380
Total net assets	1,379	11,683
Total liabilities and net assets	¥ 3,904	$ 33,063

(b) Merger with ISK Distribution Service Co., Ltd. ("ISK Distribution Service")

On June 8, 2007, the Company entered into a consent merger agreement with ISK Distribution Service, a consolidated subsidiary of the Company, pursuant to a resolution approved at a meeting of the Board of Directors of the Company. The Company anticipates that the merger can be completed on October 1, 2007. ISK Distribution Service is engaged in the distribution business. The Company determined that the merger would enhance efficiency in logistic operations by centralizing its logistics from the receipt of raw materials to the packaging and shipping of products at the Yokkaichi plant of the Company. Since ISK Distribution Service is a wholly-owned subsidiary, the Company will not issue any shares in connection with this merger.

The condensed balance sheet of ISK Distribution Service at March 31, 2007 was as follows:

	Millions of yen	Thousands of U.S. dollars
Current assets	¥ 741	$ 6,271
Fixed assets	143	1,216
Total assets	¥ 884	$ 7,487
Current liabilities	¥ 490	$ 4,150
Long-term liabilities	66	559
Total liabilities	556	4,709
Total net assets	328	2,778
Total liabilities and net assets	¥ 884	$ 7,487

ERNST & YOUNG SHINNIHON

Report of Independent Auditors

The Board of Directors
Ishihara Sangyo Kaisha, Ltd.

We have audited the accompanying consolidated balance sheets of Ishihara Sangyo Kaisha, Ltd. and consolidated subsidiaries as of March 31, 2007 and 2006, and the related consolidated statements of operations, changes in net assets, 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 Ishihara Sangyo Kaisha, Ltd. and consolidated subsidiaries at March 31, 2007 and 2006, 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 March 31, 2007 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 1.

Ernst & Young ShinNihon

Osaka, Japan
June 28, 2007

(a) In 1998, the Company sold its U.S. agrochemicals subsidiary in located in Houston, Texas, the United States, to Syngenta, which is headquartered in Switzerland, with an agreement of indemnification of certain environmental liabilities. However, the Company is in discussion with Syngenta about the Company's responsibility for a portion of expenses incurred with regard to environmental issues that arose in Houston in 2001, based on the Stock Purchase Agreement. Said expenses are to be covered by U.S. environmental insurance policy which accommodates the potential environmental indemnity with Syngenta.

(b) The Company has received an Order for Action (the complete removal of landfilled Ferosilt) from Aichi Prefecture, Gifu Prefecture, Kyoto Prefecture, and the city of Gifu under the Wastes Disposal and Public Cleaning Law. In May 2006, the Company filed an action with the Nagoya District Court requesting that the Hatanaka region of the city of Seto in Aichi Prefecture be removed from this order. Thereafter, the Company heard the intentions of Aichi Prefecture and the requests of local related parties, held successive consultations with Aichi Prefecture outside the scope of the action filed; drew up a new plan for removal works outlining the construction period and with a reconsidered construction method taking into account the impact on the local environment; submitted this plan to Aichi Prefecture. Having received approval of the plan, the Company withdrew its action in February 2007.

With regard to the sale of Ferosilt, a former director, et al. of the Company were indicted by the Tsu District Court under this same law (illegal dumping) on November 27, 2006. The Company also received an indictment from this district court under this law for penalties against employer when an employee is indicted (dual liability), and on June 25, 2007, received a decision from this court for a penalty of ¥50 million.

In April 2007, the Company pursued charges against the former director by filing a suit for damages in the Osaka District Court. The suit claims that said director, as deputy plant manager of the Company's Yokkaichi Plant, was in violation of the Wastes Disposal and Public Cleaning Law and in violation of his duty of care as a director, and claims ¥1.0 billion in compensation for damages with respect to the November 27, 2006, action filed for violations that took place during his tenure as a director between June 27, 2003, and June 29, 2005. In 2007, two additional locations of Ferosilt landfill were discovered in Aichi Prefecture. The volume of Ferosilt transported and landfill conditions at these two sites are unclear. Surveys will be conducted to determine these factors, but as of the closing of the Company's books for fiscal 2006 such costs are anticipated to fall within the scope of the provision for losses on Ferosilt removal.

(c) On January 21, 2007, the Company received a claim for ¥564 million in damages from Nippon Aerosil Co., Ltd., pursuant to the cancellation of a contract with the Company. This suit is under deliberation by the Yokkaichi Branch of the Tsu District Court, but the Company has determined that there are no grounds for this request, and we will deal with the case in a timely and appropriate manner by continuing our argument at the court that our assertion is justifiable.

(As of June 28, 2007)

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