Ishihara Sangyo Kaisha

Annual Report 2005

Year Ended March 31, 2005

ISK

Ishihara Sangyo Kaisha, Ltd. and Consolidated Subsidiaries

Consolidated Financial Highlights

For the years ended March 31, 2003, 2004 and 2005

	Millions of yen			Thousands of U.S. dollars (Note)
	2003	2004	2005	2005
For the years ended March 31,				
Net sales:				
Domestic	¥ 43,020	¥ 38,013	¥ 41,683	$ 388,149
Overseas	52,854	55,663	54,833	510,595
Total	95,874	93,676	96,516	898,744
Sales classified by business segment:				
Inorganic chemicals	48,449	46,201	45,641	425,000
Organic chemicals	42,645	42,718	44,769	416,883
Other business	4,780	4,757	6,106	56,861
Total	95,874	93,676	96,516	898,744
Operating income	8,480	9,009	10,360	96,474
Net income	1,351	3,639	5,755	53,586
Depreciation of property, plant and equipment	4,789	4,574	4,374	40,728
Research and development costs	5,667	5,936	6,177	57,515
At the year end				
Current assets	83,470	78,035	80,010	745,040
Total assets	146,912	141,537	146,590	1,365,020
Current liabilities	74,942	67,369	62,805	584,828
Shareholders' equity	45,671	50,254	56,890	529,756

	Yen			U.S. dollars (Note)
Per share data				
Net income	¥ 3.70	¥ 9.86	¥ 15.71	$ 0.15
Shareholders' equity	125.32	137.80	152.60	1.42

Number of employees (as of March 31)	1,814	1,776	1,905	—

Note: The U.S. dollar amounts in this report have been translated from the yen amounts, for convenience only, at ¥107.39 = U.S.$1.00, the rate of exchange prevailing on March 31, 2005.

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To Our Shareholders and Friends

Fujio Tamura
President

It is our pleasure to present this annual report covering the performance of Ishihara Sangyo Kaisha Group (ISK) for fiscal 2004, ended March 31, 2005.

The global economy was affected by robust economic expansion in the United States and strong economic growth in China, which ensured continued growth in Asia. On the other hand, a strong euro slowed the pace of recovery in the European economy and caused instability for exports.

The economy in Japan saw robust capital investment from the private sector, but due to adjustments in inventory in the information technology sector and a slow down of exports to Asia the economy continued to go through an adjustment period. From the fiscal year under review raw material prices including oil rose dramatically setting the scene for a severe business environment for many companies.

By segment, sales of functional materials in the inorganic chemicals division were up but sales of titanium dioxide were slightly lower as a result of a high yen to the U.S. dollar for exported products. Direct manufacturing costs increased sharply with higher oil prices and marine freight costs for titanium ore exerting downward pressure on profits. The organic chemical segment saw strong growth in independently developed agrochemicals to the domestic market in Japan as well as overseas.

As a result, consolidated sales for the year under review increased ¥2,840 million to stand at ¥96,516 million (US$899 million), operating income rose ¥1,351 million to post ¥10,360 million (US$96 million) indicating overall solid performance. Net income increased ¥2,116 million to stand at ¥5,755 million (US$54 million) due to improvement of foreign exchange gain and loss, reduction of interest-bearing debt and equity in earnings of affiliates.

ISK is carrying out its new medium-term management plan, covering the three-year period from April 2003 to March 2006, formulated in 2003 to achieve medium term management goals.

The new plan has two key objectives:

(1) Build a robust earnings base for our titanium dioxide business, which is largely resilient to external economic conditions;

and

(2) Demonstrate our full potential to become a growth-oriented group of companies.

The business climate for ISK, both domestically and overseas, is characterized by increasing uncertainty and dramatic change. Facing these conditions, we must accelerate our decision-making processes and become more efficiency-oriented in order to win against intensifying global competition. To this end, we will target sustained growth and improved earnings by cutting costs and reinforcing our R&D activities, which will include establishing new businesses. To solidify our financial position, we will adopt a cash-flow-intensive management policy, shrink our asset base, and further reduce interest-bearing liabilities.

We have formed specific policies for each of our major business categories. In our titanium dioxide business, we will pursue reforms of our cost and business structure in order to restore profitability and strengthen our international competitiveness. In functional materials, we will seek to become a highly profitable, development-oriented company by continually introducing high-value-added products and targeting ongoing business growth. In agrochemicals, we will reinforce our business in an effort to become one of the TIER II group of manufacturers in the world market and one of the top three companies in Japan as a challenge of achieving a second period of growth.

To achieve sustained growth and progress over the long term, ISK will endeavor to enhance operating efficiency and reinforce international competitiveness. We are also aware of the importance of building a corporate governance system that focuses on maximizing shareholder value. To achieve such a system, we recognize that increasing the transparency, credibility, and soundness of management will be crucial. For this reason, on April 2004, we established and published “the (ISK) business moral precepts and norms” for all members of our ISK group, in order to reinforce internal controls and build a strong awareness of the importance of legal and ethical compliance.

ISK is promoting a better environment and society by carrying out measures to lighten the burden on the environment, conserve energy, save resources and reduce industrial waste.

Crisis management will also play a key role, and to this end we will undertake more extensive risk management activities.

In this manner we will provide high quality products suited to customer needs in the organic and inorganic fields by promoting advances in science in order to contribute to society, the lifestyles of people and the environment.

Based on this corporate philosophy we will improve corporate value by ensuring sustainable growth and achieving stable profits. It is our aim to develop and grow into a resilient company that is seen as vibrant and successful by shareholders, investors, customers and employees alike.

We look forward to the ongoing support and understanding of our shareholders and customers as we tackle the challenges ahead.

田村藤夫

Fujio Tamura
President

Inorganic Chemicals

Our mainstay titanium dioxide business benefited from healthy overseas demand in the first half, especially in our main market, China and other parts of Asia. Although prices of titanium dioxide improved owing to aggressive efforts by our salespeople, the yen's appreciation against the U.S. dollar led to lower sales results. On the manufacturing front, efforts to improve efficiency and reduce production costs were offset by procurement costs such as high raw material and oil costs and price hikes for titanium ore marine transportation. These factors had added downward pressure to profits.

Despite efforts to increase sales of functional materials for IT-related applications, production adjustments in the IT sector in the second half of the year under review caused a decline in orders with sales rising only slightly.

Consequently, sales in this segment—also covering sales for other inorganic chemicals—decreased ¥560 million to amount to ¥45,641 million (US$425 million) and operating income fell ¥1,232 million to stand at ¥3,878 million (US$36 million).

In March 2005, ISK carried out a share swap with its former equity-method affiliate Fuji Titanium Industry Co., Ltd. to acquire it as a wholly-owned subsidiary. ISK aims to fully utilize production, sales and R&D synergy created by integrating Fuji Titanium's inorganic chemical business in order to raise corporate value.

Organic Chemicals

The global agrochemical industry saw continued reshuffling of key players, further intensifying competition. In response to those severe business circumstances, we focused on in-house development to achieve a second period of growth. We aim to increase sales using internationally competitive existing and newly developed agrochemicals on a global basis.

Agrochemical sales were built on solid growth in Europe with corn herbicides and orchard & vegetable fungicides. Herbicide sales for soybeans played a central role for steady sales in the Americas. In Asia including Japan, sales were robust with increased sales for fungicides to China and Korea. As part of reorganizing our production framework for agrochemical technical materials and in efforts to lower production costs, manufacturing of key technical materials and a portion of intermediates heretofore outsourced to overseas manufacturers was reverted to the Yokkaichi Plant for in-house production.

As a result, sales, including intermediates, increased ¥2,051 million to ¥44,769 million (US$417 million) and operating income rose ¥2,816 million to ¥8,765 million (US$82 million).

Other Businesses

Our other businesses are carried out mainly by Japanese construction and trading company subsidiaries. Fiscal 2004 sales increased ¥1,349 million to ¥6,106 million (US$57 million) and operating income rose ¥67 million to ¥655 million (US$6 million).

Consolidated Balance Sheets

As of March 31, 2005 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
Assets			
Current assets:			
Cash and time deposits (Note 13)	¥ 14,940	¥ 17,641	$ 139,124
Short-term investments (Note 3)	91	91	847
Trade receivables:			
Notes	3,461	3,356	32,229
Accounts	28,899	26,525	269,105
	32,360	29,881	301,334
Less allowance for doubtful receivables	(276)	(941)	(2,572)
Trade receivables, net	32,084	28,940	298,762
Inventories (Note 4)	26,178	26,564	243,755
Deferred income taxes (Note 8)	2,985	1,077	27,793
Other current assets	3,732	3,722	34,759
Total current assets	80,010	78,035	745,040
Property, plant and equipment (Note 5):			
Land	6,388	5,825	59,487
Buildings and structures	46,722	44,392	435,066
Machinery and equipment	110,574	100,271	1,029,648
Construction in progress	6,586	3,847	61,329
	170,270	154,335	1,585,530
Less accumulated depreciation	(116,788)	(106,303)	(1,087,511)
Property, plant and equipment, net	53,482	48,032	498,019
Investments and other assets:			
Investments in securities (Note 3):			
Unconsolidated subsidiaries and affiliates	1,595	2,987	14,851
Other	7,025	6,397	65,417
Total investments in securities	8,620	9,384	80,268
Long-term loans	136	110	1,269
Excess of cost over equity in net assets of subsidiaries	861	—	8,020
Deferred income taxes (Note 8)	2,418	4,508	22,520
Other	1,063	1,468	9,884
Total investments and other assets	13,098	15,470	121,961
Total assets	¥146,590	¥141,537	$1,365,020

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

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
Liabilities, Minority Interests and Shareholders' Equity			
Current liabilities:			
Short-term bank loans (Note 5)	¥ 30,625	¥ 41,055	$ 285,174
Current portion of long-term debt (Note 5)	4,789	4,671	44,590
Trade payables:			
Notes	5,522	3,566	51,421
Accounts	12,183	9,980	113,446
	17,705	13,546	164,867
Accrued income taxes (Note 8)	331	192	3,082
Accrued expenses	3,338	3,369	31,087
Other current liabilities	6,017	4,536	56,028
Total current liabilities	62,805	67,369	584,828
Long-term liabilities:			
Long-term debt (Note 5)	17,527	15,366	163,207
Accrued retirement benefits for employees (Note 7)	5,794	5,008	53,952
Accrued retirement benefits for directors and corporate auditors	322	347	3,001
Deferred income taxes (Note 8)	264	230	2,457
Other long-term liabilities (Note 5)	2,689	2,691	25,033
Total long-term liabilities	26,596	23,642	247,650
Contingent liabilities (Note 12)			
Minority interests	299	272	2,786
Shareholders' equity:			
Common stock:			
Authorized: 1,000,000,000 shares			
Issued: 384,360,431 shares in 2005			
369,757,510 shares in 2004	42,029	42,029	391,364
Capital surplus (Note 9)	8,594	5,235	80,027
Retained earnings (Notes 9,14 and 16)	9,756	6,091	90,842
Surplus arising from land revaluation	—	100	—
Net unrealized holding gain on securities (Note 3)	1,414	1,092	13,163
Translation adjustments	(2,108)	(1,998)	(19,610)
Less treasury stock, at cost:			
11,927,308 shares in 2005	(2,795)	—	(26,030)
5,407,994 shares in 2004	—	(2,295)	—
Total shareholders' equity	56,890	50,254	529,756
Total liabilities, minority interests and shareholders' equity	¥146,590	¥141,537	$1,365,020

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

Consolidated Statements of Income

For the years ended March 31, 2005 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
Net sales (Note 15)	¥96,516	¥93,676	$898,744
Cost of sales (Note 6)	66,497	64,743	619,210
Gross profit	30,019	28,933	279,534
Selling, general and administrative expenses (Note 6)	19,659	19,924	183,060
Operating income (Note 15)	10,360	9,009	96,474
Other income:			
Interest and dividend income	210	137	1,961
Equity in earnings of affiliates	116	—	1,081
Foreign exchange gain	234	—	2,182
Gain on sales of investments in securities	—	655	—
Other	305	287	2,824
	865	1,079	8,048
Other expenses:			
Interest expense	1,326	1,469	12,351
Loss on disposal of fixed assets	826	174	7,691
Loss on devaluation of investments in securities	123	35	1,149
Foreign exchange loss	—	588	—
Other	2,700	3,688	25,132
	4,975	5,954	46,323
Income before income taxes and minority interests	6,250	4,134	58,199
Income taxes (Note 8):			
Current	505	477	4,701
Deferred	(39)	4	(360)
Minority interests	29	14	272
Net income	¥ 5,755	¥ 3,639	$ 53,586

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

Consolidated Statements of Shareholders' Equity

For the years ended March 31, 2005 and 2004

		Millions of yen						
	Number of shares of common stock	Common stock	Capital surplus	Retained earnings	Surplus arising from land revaluation	Net unrealized holding gain (loss) on securities	Translation adjustments	Treasury stock, at cost
Balance at March 31, 2003	369,757,510	¥42,029	¥5,235	¥2,452	¥100	¥ (260)	¥(1,609)	¥(2,276)
Net income for the year ended March 31, 2004	—	—	—	3,639	—	—	—	—
Gain on sales of treasury stock	—	—	0	—	—	—	—	—
Unrealized holding gain on securities	—	—	—	—	—	1,352	—	—
Translation adjustments	—	—	—	—	—	—	(389)	—
Increase in treasury stock	—	—	—	—	—	—	—	(19)
Balance at March 31, 2004	369,757,510	¥42,029	¥5,235	¥6,091	¥100	¥1,092	¥(1,998)	¥(2,295)
Net income for the year ended March 31, 2005	—	—	—	5,755	—	—	—	—
Shares issued to acquire all outstanding shares of an affiliate by way of an exchange of shares	14,602,921	—	3,359	—	—	—	—	—
Increase in earnings resulting from exclusion of a consolidated subsidiary	—	—	—	52	—	—	—	—
Dividends	—	—	—	(1,093)	—	—	—	—
Bonuses to directors and corporate auditors	—	—	—	(44)	—	—	—	—
Loss on sales of treasury stock	—	—	(0)	(1,005)	—	—	—	—
Decrease in surplus arising from land revaluation resulting from inclusion of a consolidated subsidiary	—	—	—	—	(100)	—	—	—
Unrealized holding gain on securities	—	—	—	—	—	322	—	—
Translation adjustments	—	—	—	—	—	—	(110)	—
Increase in treasury stock	—	—	—	—	—	—	—	(500)
Balance at March 31, 2005	384,360,431	¥42,029	¥8,594	¥9,756	¥ —	¥1,414	¥(2,108)	¥(2,795)

		Thousands of U.S. dollars (Note 1)						
	Number of shares of common stock	Common stock	Capital surplus	Retained earnings	Surplus arising from land revaluation	Net unrealized holding gain (loss) on securities	Translation adjustments	Treasury stock, at cost
Balance at March 31, 2004	369,757,510	$391,364	$48,756	$56,715	$931	$10,171	$(18,609)	$(21,369)
Net income for the year ended March 31, 2005	—	—	—	53,586	—	—	—	—
Shares issued to acquire all outstanding shares of an affiliate by way of an exchange of shares	14,602,921	—	31,275	—	—	—	—	—
Increase in earnings resulting from exclusion of a consolidated subsidiary	—	—	—	485	—	—	—	—
Dividends	—	—	—	(10,178)	—	—	—	—
Bonuses to directors and company auditors	—	—	—	(406)	—	—	—	—
Loss on sales of treasury stock	—	—	(4)	(9,360)	—	—	—	—
Decrease in surplus arising from land revaluation resulting from inclusion of a consolidated subsidiary	—	—	—	—	(931)	—	—	—
Unrealized holding gain on securities	—	—	—	—	—	2,992	—	—
Translation adjustments	—	—	—	—	—	—	(1,001)	—
Increase in treasury stock	—	—	—	—	—	—	—	(4,661)
Balance at March 31, 2005	384,360,431	$391,364	$80,027	$90,842	$ —	$13,163	$(19,610)	$(26,030)

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

Consolidated Statements of Cash Flows

For the years ended March 31, 2005 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
Cash flows from operating activities			
Income before income taxes and minority interests	¥ 6,250	¥ 4,134	$ 58,199
Adjustments to reconcile income before income taxes and minority interests to net cash provided by operating activities:			
Depreciation and amortization	4,936	4,814	45,966
Loss on disposal of fixed assets	769	60	7,158
Loss on devaluation and sales of investments in securities and other	188	38	1,751
Foreign exchange (gain) loss	(368)	673	(3,425)
Gain on sales of investments in securities	—	(655)	—
(Reversal) provision of accrued retirement benefits for employees, directors and corporate auditors	323	(15)	3,008
Interest and dividend income	(211)	(137)	(1,961)
Interest expense	1,326	1,469	12,351
Equity in (earnings) losses of affiliates	(116)	839	(1,081)
Other	487	252	4,538
Changes in operating assets and liabilities:			
Trade receivables	(2,015)	4,005	(18,761)
Inventories	2,412	(155)	22,459
Other current assets	7	537	62
Trade payables	2,888	(3,357)	26,886
Accrued expenses and other current liabilities	362	(634)	3,377
Subtotal	17,238	11,868	160,527
Interest and dividends received	194	135	1,804
Interest paid	(1,278)	(1,457)	(11,903)
Income taxes paid	(392)	(456)	(3,652)
Net cash provided by operating activities	15,762	10,090	146,776
Cash flows from investing activities			
Purchases of property, plant and equipment	(5,228)	(4,581)	(48,684)
Purchases of short-term investments and investments in securities	(73)	(129)	(681)
Proceeds from sales of property, plant and equipment	35	98	328
Proceeds from maturity and sales of short-term investments and investments in securities	—	1,296	—
Loans made	(108)	(123)	(1,006)
Collection of loans	107	124	992
Increase in cash and cash equivalents arising from inclusion of a consolidated subsidiary by way of an exchange of shares	227	—	2,112
Other, net	77	(349)	721
Net cash used in investing activities	(4,963)	(3,664)	(46,218)
Cash flows from financing activities			
Decrease in short-term bank loans, net	(9,675)	(2,652)	(90,088)
Proceeds from long-term bank loans	3,100	2,880	28,867
Repayment of long-term bank loans	(4,498)	(6,606)	(41,887)
Payment of dividends	(1,076)	—	(10,024)
Purchases of treasury stocks	(2,611)	—	(24,317)
Proceeds from sales of treasury stocks	1,205	—	11,229
Other, net	(56)	(18)	(522)
Net cash used in financing activities	(13,611)	(6,396)	(126,742)
Effect of exchange rate changes on cash and cash equivalents	140	(290)	1,303
Decrease in cash and cash equivalents	(2,672)	(260)	(24,881)
Cash and cash equivalents at beginning of year	17,641	17,901	164,271
Decrease in cash and cash equivalents resulting from change in consolidation scope	(49)	—	(455)
Cash and cash equivalents at end of year (Note 13)	¥14,920	¥17,641	$138,935

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

Notes to Consolidated Financial Statements

For the years ended March 31, 2005 and 2004

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 countries of domicile. The accompanying consolidated financial statements of the Company and consolidated subsidiaries are 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.

The translation of yen amounts into U.S. dollar amounts is included solely for convenience, as a matter of arithmetic computation only, at the rate of ¥107.39 = U.S.$1.00, the approximate rate of exchange in effect on March 31, 2005. 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 years' financial statements have been reclassified to conform to the current year's presentation. This reclassification had no effect on consolidated net income or shareholders' equity.

2. Summary of Significant Accounting Policies

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

The accompanying consolidated financial statements for the years ended March 31, 2005 and 2004 consist of the accounts of the Company, ISK Bioscience K.K., ISK Singapore Pte. Ltd., the ISK Americas Incorporated Group (6 subsidiaries), ISK Biosciences Europe S.A. Group (3 subsidiaries), ISK Taiwan Co., Ltd., Ishihara Techno Corporation, Ishihara Enterprise & Co. Inc., ISK Engineering Corporation and ISK Distribution Service Co. Ltd. ISK Biosciences S. L., which was established during the year ended March 31, 2005, has been initially consolidated effective the year ended March 31, 2005. The accounts of Ishihara Argentina S.A. have been excluded from the scope of consolidation effective the year ended March 31, 2005, since they were immaterial.

On March 1, 2005, the Company exchanged shares of its own common stock for all outstanding shares of common stock of Fuji Titanium Industry Co., Ltd. which then became a wholly owned subsidiary of the Company. Prior to April 1, 2004, Fuji Titanium Industry Co., Ltd. was an affiliate and had been accounted for by the equity method. Since this exchange of shares was made close to the balance sheet date, the balance sheet accounts at March 31, 2005 were consolidated and the operating results of Fuji Titanium Industry Co., Ltd. for the year ended March 31, 2005 were accounted for by the equity method.

All significant intercompany accounts and transactions have been eliminated in consolidation.

All assets and liabilities of the consolidated subsidiaries are revalued at fair value as of their 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 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 affiliates 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 shareholders' equity 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 income but are reported as minority interests and translation adjustments, a component of shareholders' equity.

(c) Cash and cash equivalent

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 at ISK Singapore Pte. Ltd. being determined by the moving average method and the cost of those at 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 shareholders' equity. 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 the hedging, 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 non-performance by the counterparties to the currency and interest-rate 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 as an asset or a liability. 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

Depreciation of the respective assets 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 accounts

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 accounts of the overseas consolidated subsidiaries has been provided at an estimated aggregate amount of their probable bad debts.

(j) 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 either as accepted in the countries in which they are incorporated.

(k) 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 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 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 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.

(l) 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.

In accordance with a law on the amendment of local tax laws, and so forth, which went into effect on April 1, 2004, a corporation with capital in excess of ¥100 million is subject to business scale taxation on the basis of the total amount of value added, the size of its capital and its taxable income. Based on the new accounting standard for business scale taxation, the Company and certain of its consolidated subsidiaries have accounted for business scale taxation with respect to the amount of value added and capital as a component of selling, general and administrative expenses. Consequently, selling, general and administrative expenses for the year ended March 31, 2005 increased by ¥186 million ($1,732 thousand) and operating income and income before income taxes and minority interests for the year ended March 31, 2005 decreased by ¥186 million ($1,732 thousand)

(m) Appropriation of retained earnings

Under the Commercial Code of Japan, the appropriation of retained earnings with respect to a given financial period is made by approval of the shareholders at a general meeting held subsequent to the close of the financial period. The accounts for that period, therefore, do not reflect such appropriations. (see Note 16 (a))

(n) New accounting pronouncement

A new Japanese accounting standard called “Impairment of Fixed Assets” was issued in August 2002 which went into effect for fiscal years beginning on or after April 1, 2005. Early adoption is allowed from fiscal years beginning on or after April 1, 2004 and application from fiscal years ending from March 31, 2004 through March 30, 2005 is also permitted. The new standard requires that tangible and intangible fixed assets be carried at cost less depreciation, and be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. A company will be required to recognize an impairment loss in its statement of income if certain indicators of asset impairment exist and the book value of an asset exceeds the undiscounted sum of the future cash flows of the asset. The Company is currently assessing the impact of this new accounting standard on the consolidated financial position and results of operations of the Company and its consolidated subsidiaries.

3. Short-Term Investments and Investments in Securities

Marketable securities classified as held-to-maturity debt securities and other securities at March 31, 2005 and 2004 were as follows:

(a) Held-to-maturity debt securities

	Millions of yen						Thousands of U.S. dollars		
	2005			2004			2005		
	Carrying value	Estimated fair value	Unrealized loss	Carrying value	Estimated fair value	Unrealized loss	Carrying value	Estimated fair value	Unrealized loss
Securities whose fair value exceeds their carrying value	¥—	¥—	¥—	¥—	¥—	¥—	$—	$—	$—
Securities whose carrying value exceeds their fair value	10	10	(0)	10	10	(0)	93	91	(2)
Total	¥10	¥10	¥ (0)	¥10	¥10	¥ (0)	$93	$91	$ (2)

(b) Other securities

	Millions of yen						Thousands of U.S. dollars		
	2005			2004			2005		
	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	¥3,632	¥6,024	¥2,392	¥3,525	¥5,339	¥1,814	$33,822	$56,093	$22,271
Subtotal	3,632	6,024	2,392	3,525	5,339	1,814	33,822	56,093	22,271
Securities whose acquisition cost exceeds their carrying value:									
Equity securities	31	29	(2)	110	96	(14)	291	273	(18)
Other	3	3	(0)	3	3	(0)	27	25	(2)
Subtotal	34	32	(2)	113	99	(14)	318	298	(20)
Total	¥3,666	¥6,056	¥2,390	¥3,638	¥5,438	¥1,800	$34,140	$56,391	$22,251

The carrying value of the principal investments in non-marketable securities at March 31, 2005 and 2004 is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Held-to-maturity debt securities:			
Discounted bank bonds	¥ 91	¥ 91	$ 847
Other securities:			
Unlisted equity securities	959	950	8,932

The proceeds from sales of, and gross realized gain and loss on, other securities for the years ended March 31, 2005 and 2004 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Proceeds from sales	¥—	¥1,162	$—
Gross realized gain	—	655	—

The redemption schedule at March 31, 2005 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 through five years	Due after five years through ten years	Due in one year or less	Due after trough five year	Due after five years through ten years
Government bonds	¥ —	¥—	¥ 10	$ —	$ —	$ 93
Discounted bank bonds	91	—	—	847	—	—
Other	—	3	—	—	27	—

4. Inventories

Inventories at March 31, 2005 and 2004 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Finished goods	¥13,860	¥14,078	$129,059
Work in process	4,137	3,620	38,520
Raw materials and supplies	8,181	8,866	76,176
	¥26,178	¥26,564	$243,755

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

The average annual interest rates on short-term bank loans for the years ended March 31, 2005 and 2004 were 1.4% and 1.5%, respectively.

Long-term debt including the current portion at March 31, 2005 and 2004 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Secured bank loans	¥16,448	¥16,593	$153,164
Unsecured bank loans	5,868	3,444	54,633
	22,316	20,037	207,797
Less amounts due within one year	(4,789)	(4,671)	(44,590)
	¥17,527	¥15,366	$163,207

Interest rates applicable to long-term bank loans presented in the above table fell in the range from 1.1% to 5.8% at March 31, 2005 and 2004. These bank loans become due through 2017.

The aggregate annual maturities of long-term debt subsequent to March 31, 2005 are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2006	¥ 4,789	$ 44,590
2007	5,168	48,126
2008	3,465	32,266
2009	2,150	20,017
2010	3,758	34,990
2011 and thereafter	2,986	27,808
	¥22,316	$207,797

At March 31, 2005, the following assets were pledged as collateral for short-term bank loans, long-term debt and other long-term liabilities:

	Millions of yen	Thousands of U.S. dollars
Property, plant and equipment, net of accumulated depreciation	¥37,828	$352,249
All assets of ISK Singapore Pte. Ltd. (except for certain property, plant and equipment)	8,617	80,237
	¥46,445	$432,486

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, 2005 were as follows:

	Millions of yen	Thousands of U.S. dollars
Short-term bank loans	¥14,924	$138,968
Current portion of long-term debt	4,253	39,598
Long-term debt	12,195	113,566
Other long-term liablities	107	995
	¥31,479	$293,127

6. Research and Development Costs

Research and development costs included in manufacturing costs and selling, general and administrative expenses for the years ended March 31, 2005 and 2004 totaled ¥6,177 million ($57,515 thousand) and ¥5,936 million, respectively.

7. 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, 2005 and 2004 for the Company's and the consolidated subsidiaries' defined benefit plans:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Retirement benefit obligation	¥10,476	¥10,589	$97,555
Plan assets at fair value	(455)	(314)	(4,239)
Unfunded retirement benefit obligation	10,021	10,275	93,316
Unrecognized net retirement benefit obligation at transition	(4,338)	(4,771)	(40,390)
Unrecognized actuarial gain (loss)	219	(496)	2,042
Unrecognized prior service cost	(108)	—	(1,016)
Accrued retirement benefits	¥ 5,794	¥ 5,008	$53,952

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, 2005 and 2004 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Service cost	¥ 562	¥ 540	$ 5,231
Interest cost	251	245	2,342
Expected return on plan assets	(8)	(7)	(73)
Amortization of retirement benefit obligation at transition	434	434	4,039
Amortization of unrecognized actuarial loss	33	33	308
Amortization of unrecognized prior service cost	7	—	64
Retirement benefit expenses	¥1,279	¥1,245	$11,911

The retirement benefit expenses of domestic consolidated subsidiaries which calculated these by simplified methods have 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, 2005 and 2004 were as follows:

	2005	2004
Discounted rate	2.5%	2.5%
Expected rate of return on plan assets	2.5%	2.5%

8. 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, 2005 and 2004 were, in the aggregate, approximately 39.5% and 40.8%, respectively.

The difference between the statutory tax rates and the effective tax rates for the years ended March 31, 2005 and 2004 is reconciled as follows:

	2005	2004
Statutory tax rates	39.5%	40.8 %
Permanently non-deductible expenses	2.9	1.4
Permanently non-taxable income	(0.7)	(0.5)
Per capita portion of inhabitants' taxes	0.7	1.3
Foreign income taxes	0.4	1.9
Changes in valuation allowance	(21.1)	(37.9)
Effect of differences in tax rates applicable to consolidated subsidiaries	(0.8)	(2.1)
Unrealized profit on intercompany transactions	(13.4)	6.1
Other	—	0.6
Effective tax rates	7.5%	11.6 %

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, 2005 and 2004 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Deferred tax assets:			
Tax loss carryforwards	¥10,219	¥12,585	$ 95,155
Retirement benefits	2,145	1,738	19,976
Unrealized profit on intercompany transactions	1,023	1,157	9,528
Write-downs of marketable and investment securities	386	386	3,592
Accrued expenses	458	108	4,261
Write-downs of inventories	345	260	3,213
Accrued bonuses	232	198	2,156
Write-downs of property, plant and equipment	122	126	1,137
Other	1,859	1,049	17,313
Gross deferred tax assets	16,789	17,607	156,331
Less valuation allowance	(9,578)	(10,414)	(89,187)
Total deferred tax assets	7,211	7,193	67,144
Deferred tax liabilities:			
Property, plant and equipment	1,125	1,124	10,471
Other	947	714	8,818
Total deferred tax liabilities	2,072	1,838	19,289
Net deferred tax assets	¥ 5,139	¥ 5,355	$ 47,855

9. Shareholders' Equity

The Commercial Code of Japan (the "Code") provides that an amount equal to at least 10% of the amounts to be disbursed as distributions of retained earnings be appropriated to the legal reserve until the sum of the legal reserve and additional paid-in capital equals 25% of the common stock account. The Code also stipulates that, to the extent that the sum of the additional paid-in capital account and the legal reserve exceeds 25% of the common stock account, any such excess is available for appropriation by resolution of the shareholders. Retained earnings include the legal reserve provided in accordance with the Code. The Code provides that neither additional paid-in capital nor the legal reserve is available for dividends, but both may be used to reduce or eliminate a deficit by resolution of the shareholders or may be transferred to common stock by resolution of the Board of Directors. The legal reserve of the Company included in retained earnings at March 31, 2005 amounted to ¥115 million ($1,072 thousand); however no legal reserve was included in retained earnings at March 31, 2004. As dividends and bonuses to directors and corporate auditors are disbursements of retained earnings, 10% of these (¥115 million) were appropriated to the legal reserve during this fiscal year.

10. Leases

The following pro forma amounts represent the acquisition costs, accumulated depreciation and net book value of the leased assets as of March 31, 2005 and 2004, 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		
	2005			2004			2005		
	Acquisition costs	Accumulated depreciation	Net book value	Acquisition costs	Accumulated depreciation	Net book value	Acquisition costs	Accumulated depreciation	Net book value
Machinery and equipment	¥4,492	¥2,423	¥2,069	¥4,523	¥2,386	¥2,137	$41,832	$22,564	$19,268

Lease payments relating to finance leases accounted for as operating leases for the years ended March 31, 2005 and 2004 amounted to ¥769 million ($7,163 thousand) and ¥776 million, respectively. Depreciation of the leased assets computed by the straight-line method over the respective lease terms for the years ended March 31, 2005 and 2004 amounted to ¥769 million ($7,163 thousand) and ¥776 million, respectively.

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2005 for finance leases accounted for as operating leases are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2006	¥ 733	$ 6,828
2007 and thereafter	1,336	12,440
	¥2,069	$19,268

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2005 for operating leases are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2006	¥ 337	$ 3,137
2007 and thereafter	1,014	9,439
	¥1,351	$12,576

11. Derivatives

The open interest rate swaps at March 31, 2005 were as follows:

	Millions of yen			Thousands of U.S. dollars		
	Notional amount	Fair value	Unrealized loss	Notional amount	Fair value	Unrealized loss
(Interest-rate-related derivatives)						
Interest-rate swaps:						
Receiving/floating and pay/fixed	¥1,850	¥(15)	¥15	$17,227	$(140)	$140

Disclosure of the corresponding information on other derivatives which qualified for hedge accounting has been omitted.

12. Contingent Liabilities

At March 31, 2005, 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	¥331	$3,081
As guarantor for borrowings of unconsolidated subsidiaries	225	2,091
	¥556	$5,172

13. 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 March 31, 2005 and 2004 is presented as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	**2005**
Cash and time deposits	**¥14,940**	¥17,641	**$139,124**
Time deposits with a maturity in excess of three months	**20**	—	**189**
Cash and cash equivalents	**¥14,920**	¥17,641	**$138,935**

On March 1, 2005, the Company exchanged shares of its own common stock for all outstanding shares of common stock of Fuji Titanium Industry Co., Ltd. As a result, Fuji Titanium Industry Co., Ltd. became a wholly owned subsidiary of the Company.

The following summarizes the assets and liabilities included in consolidation:

	Millions of yen	Thousands of U.S. dollars
Current assets	¥3,559	$33,141
Fixed assets	5,754	53,580
Total assets	9,313	86,721
Current liabilities	3,960	36,875
Fixed liabilities	1,698	15,811
Total liabilities	¥5,658	$52,686

As a result of consolidation of the accounts of the balance sheet of Fuji Titanium Industry Co., Ltd. at March 31, 2005, cash and cash equivalents increased by ¥227 million ($2,112 thousand) and, as a result of the exchange of shares, capital surplus increased by ¥3,359 million ($31,275 thousand).

14. Amounts per Share

	Yen		U.S. dollars
	2005	2004	2005
Net income	¥ 15.71	¥ 9.86	$0.15
Net assets	152.60	137.80	1.42

Net income per share is based on the net income available for distribution to shareholders of common stock and the weighted-average number of shares of common stock outstanding during each year, and the amounts per share of net assets are 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 income per share for the years ended March 31, 2005 and 2004 is presented since no potentially dilutive securities have been issued.

The basic financial data for the computation of net income per share based on the above standard for the years ended March 31, 2005 and 2004 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Net income	¥5,755	¥3,639	$53,586
Amounts not attributable to shareholders of common stock:			
Bonuses to directors and corporate auditors appropriated from retained earnings	(56)	(44)	(525)
Adjusted net income attributable to shareholders of common stock	¥5,699	¥3,595	$53,061
	Thousands of shares		
Weighted-average number of shares of common stock outstanding during the year	362,725	364,397	

15. Segment Information

Business segments

The Company and its consolidated subsidiaries' operations are classified into 3 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, electric 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, 2005 and 2004 is as follows:

	Millions of yen					
	2005					
	Inorganic chemicals	Organic chemicals	Other businesses	Total	Eliminations and corporate	Consolidated
Sales and operating income:						
Net sales:						
Outside customers	¥45,641	¥44,769	¥ 6,106	¥ 96,516	¥ —	¥ 96,516
Intersegment	—	—	8,156	8,156	(8,156)	—
Total sales	45,641	44,769	14,262	104,672	(8,156)	96,516
Operating expenses	41,763	36,004	13,607	91,374	(5,218)	86,156
Operating income	¥ 3,878	¥ 8,765	¥ 655	¥ 13,298	¥ (2,938)	¥ 10,360
Total assets	¥64,251	¥41,861	¥12,922	¥119,034	¥27,556	¥146,590
Depreciation and amortization	3,324	993	78	4,395	268	4,663
Capital expenditures	3,829	1,380	44	5,253	(98)	5,155

	Millions of yen					
	2004					
	Inorganic chemicals	Organic chemicals	Other businesses	Total	Eliminations and corporate	Consolidated
Sales and operating income:						
Net sales:						
Outside customers	¥46,201	¥42,718	¥ 4,757	¥ 93,676	¥ —	¥ 93,676
Intersegment	—	—	8,740	8,740	(8,740)	—
Total sales	46,201	42,718	13,497	102,416	(8,740)	93,676
Operating expenses	41,091	36,769	12,909	90,769	(6,102)	84,667
Operating income	¥ 5,110	¥ 5,949	¥ 588	¥ 11,647	¥ (2,638)	¥ 9,009
Total assets	¥56,753	¥41,398	¥13,164	¥111,315	¥30,222	¥141,537
Depreciation and amortization	3,521	856	81	4,458	297	4,755
Capital expenditures	3,474	1,437	74	4,985	(110)	4,875

	Thousands of U.S. dollars					
	2005					
	Inorganic chemicals	Organic chemicals	Other businesses	Total	Eliminations and corporate	Consolidated
Sales and operating income:						
Net sales:						
Outside customers	$425,000	$416,883	$ 56,861	$ 898,744	$ —	$ 898,744
Intersegment	—	—	75,947	75,947	(75,947)	—
Total sales	425,000	416,883	132,808	974,691	(75,947)	898,744
Operating expenses	388,890	335,265	126,710	850,865	(48,595)	802,270
Operating income	$ 36,110	$ 81,618	$ 6,098	$ 123,826	$ (27,352)	$ 96,474
Total assets	$598,299	$389,806	$120,325	$1,108,430	$256,590	$1,365,020
Depreciation and amortization	30,949	9,244	726	40,919	2,503	43,422
Capital expenditures	35,657	12,852	412	48,921	(916)	48,005

Unallocable operating expenses, consisting primarily of the Company's expenses relating to general affairs, totaled ¥2,727 million ($25,397 thousand) and ¥2,422 million for the years ended March 31, 2005 and 2004, respectively. These have been included in "Eliminations and corporate." Corporate assets principally consisted 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, Taiwan
America: United States
Europe: Belgium, France and Spain

	Millions of yen						
	2005						
	Japan	Asia	America	Europe	Total	Eliminations and corporate	Consolidated
Sales and operating income:							
Net sales:							
Outside customers	¥ 62,792	¥ 9,279	¥6,336	¥18,109	¥ 96,516	¥ —	¥ 96,516
Intersegment	24,461	2,154	46	40	26,701	(26,701)	—
Total sales	87,253	11,433	6,382	18,149	123,217	(26,701)	96,516
Operating expenses	74,185	10,897	6,401	17,928	109,411	(23,255)	86,156
Operating income (loss)	¥ 13,068	¥ 536	¥ (19)	¥ 221	¥ 13,806	¥ (3,446)	¥ 10,360
Total assets	¥119,794	¥16,556	¥3,869	¥10,572	¥150,791	¥ (4,201)	¥146,590

	Millions of yen						
	2004						
	Japan	Asia	America	Europe	Total	Eliminations and corporate	Consolidated
Sales and operating income (loss):							
Net sales:							
Outside customers	¥ 59,275	¥ 9,070	¥7,857	¥17,474	¥ 93,676	¥ —	¥ 93,676
Intersegment	23,730	2,632	53	19	26,434	(26,434)	—
Total sales	83,005	11,702	7,910	17,493	120,110	(26,434)	93,676
Operating expenses	71,760	10,834	7,878	17,254	107,726	(23,059)	84,667
Operating income	¥ 11,245	¥ 868	¥ 32	¥ 239	¥ 12,384	¥ (3,375)	¥ 9,009
Total assets	¥109,505	¥16,796	¥4,448	¥ 7,368	¥138,117	¥ 3,420	¥141,537

	Thousands of U.S. dollars						
	2005						
	Japan	Asia	America	Europe	Total	Eliminations and corporate	Consolidated
Sales and operating income:							
Net sales:							
Outside customers	$ 584,710	$ 86,409	$58,996	$168,629	$ 898,744	$ —	$ 898,744
Intersegment	227,776	20,059	430	372	248,637	(248,637)	—
Total sales	812,486	106,468	59,426	169,001	1,147,381	(248,637)	898,744
Operating expenses	690,796	101,472	59,604	166,945	1,018,817	(216,547)	802,270
Operating income (loss)	$ 121,690	$ 4,996	$ (178)	$ 2,056	$ 128,564	$ (32,090)	$ 96,474
Total assets	$1,115,500	$154,169	$36,030	$ 98,441	$1,404,140	$ (39,120)	$1,365,020

Unallocable operating expenses, consisting primarily of the Company's expenses relating to general affairs, totaled ¥2,727 million ($25,397 thousand) and ¥2,422 million for the years ended March 31, 2005 and 2004, respectively. These have been included in "Eliminations and corporate." Corporate assets principally consisted of the Company's cash and time deposits, and investments in securities.

Overseas net sales

The regions are determined in conformity with geographic proximity and the Company's business activities, as follows:

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

	Millions of yen				
	2005				
	Asia	America	Europe	Other	Total
Overseas net sales	¥19,112	¥14,227	¥20,829	¥665	¥54,833
Consolidated net sales					96,516
Overseas net sales as a percentage of consolidated net sales	19.8%	14.7%	21.6%	0.7%	56.8%

	Millions of yen				
	2004				
	Asia	America	Europe	Other	Total
Overseas net sales	¥19,534	¥13,785	¥21,826	¥518	¥55,663
Consolidated net sales					93,676
Overseas net sales as a percentage of consolidated net sales	20.9%	14.7%	23.3%	0.5%	59.4%

	Thousands of U.S. dollars				
	2005				
	Asia	America	Europe	Other	Total
Overseas net sales	$177,966	$132,480	$193,960	$6,189	$510,595
Consolidated net sales					898,744
Overseas net sales as a percentage of consolidated net sales	19.8%	14.7%	21.6%	0.7%	56.8%

16. Subsequent Event

(a) The following appropriations of retained earnings of the Company, which have not been reflected in the accompanying consolidated financial statements for the year ended March 31, 2005, were approved at a shareholders' meeting held on June 29, 2005:

	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥4.0 = U.S.$0.037 per share)	¥1,490	$13,879
Bonuses to directors and corporate auditors	56	525

(b) The Company sold Ferosilt, a titanium dioxide by-product, as backfill material and provides its users with thorough instructions in civil works project management for the use of Ferosilt; however, it has come to the attention of the Company that, in some cases, inappropriate work methods were used, causing local communities to become concerned.

Based on a resolution approved by the Board of Directors at a meeting held on June 9, 2005, the Company, in its capacity as a manufacturer, decided to take necessary measures including a voluntary recall after confirming the safety of the sites at issue. This decision was taken with the guidance of the regulatory authorities and after conferring with the landowners in order to alleviate the concerns of the residents near the project sites.

Since the specific nature of the measures to be carried out have yet to be determined, it is uncertain as to what the impact of this decision will be on the Company's financial results for the next fiscal year.

17. Other

The Company is one of several defendants in two class action lawsuits filed in the United States on behalf of certain customers claiming that these customers suffered unquantified losses because of the Company's participation in alleged infringements of U.S. antitrust laws with respect to certain transactions involving magnetic iron oxide products. The Company is currently negotiating a potential settlement with the plaintiffs.

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, 2005 and 2004, and the related consolidated statements of income, shareholders' equity, 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, 2005 and 2004, 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.

Supplementary Information

The matter regarding product Ferosilt is described in Note 16 (b).

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2005 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 Shin Nihon

June 29, 2005

A MEMBER OF ERNST & YOUNG GLOBAL

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