SHOWA DENKO K.K.

Consolidated Financial Statements

For the year ended December 31, 2004

Ⅰ. Consolidated Financial Results

(1) Results of operations: (¥ in millions, US$ in thousands, except for net income per share)

	Results for the year ended December 31, 2004 and 2003			
	2004	2003	Increase (Decrease)	2004
	¥	¥	%	$
Net sales	740,706	689,366	7.4	7,107,825
Operating income	52,071	38,546	35.1	499,674
Ordinary income	38,912	23,840	63.2	373,399
Net income	7,596	10,317	(26.4)	72,887
Net income per share: Basic	6.66	9.07	−	0.064
Net income per share: Diluted	6.35	−	−	0.061
	%	%		
Net income on equity	4.4	6.5		
Ordinary income on total assets	4.1	2.5		
Ordinary income to net sales	5.3	3.5		

Notes
Changes in accounting policies : applicable

(2) Financial position: (¥ in millions, US$ in thousands, except for net income per share)

	Dec. 31, 2004	Dec. 31, 2003	Dec. 31, 2004
	¥	¥	$
Total assets	943,908	939,879	9,057,744
Stockholders' equity	177,701	166,087	1,705,217
Stockholders' equity per share	155.53	145.96	1.49
	%	%	%
Stockholders' equity ratio	18.8	17.7	18.8

(3) Cash flows: (¥ in millions, US$ in thousands)

	2004	2003	2004
	¥	¥	$
Cash flows from operating activities	59,528	63,561	571,233
Cash flows from investing activities	(12,412)	(25,099)	(119,108)
Cash flows from financing activities	(45,123)	(35,900)	(432,996)
Cash and cash equivalents at end of the year	29,153	26,485	279,752

(4) Subsidiaries and affiliates

Consolidated subsidiaries 47 companies
Non-consolidated subsidiaries 44 companies (The equity method was applied to 4 companies.)
Affiliates 64 companies (The equity method was applied to 22 companies.)

1) 6 new companies have been consolidated while 1 company has been removed from consolidation.
2) The equity method has been applied to 1 additional company while 8 companies have been excluded from the application.

Ⅱ. Forecast of performance for the year ending December 31, 2005

(¥ in millions, US$ in thousands, except for net income per share)

	2005	
	¥	$
Net sales	780,000	7,484,886
Operating income	52,500	503,790
Ordinary income	40,500	388,638
Net income	18,500	177,526
Net income per share	16.19	0.16

※The above forecast is based on the information available at this point of time. Actual results may differ materially due to a variety of reasons, including such economic factors as fluctuations in foreign currency exchange rates as well as market supply and demand conditions.

Notes
The U.S. dollar is valued at ¥104.21 throughout this statement for convenience only.

Ⅱ. Management Policy

1. Showa Denko's basic management policy

(Our vision)

We at Showa Denko K.K. and its Group companies will provide products and services that are useful and safe and exceed our customers' expectations, thereby enhancing the value of the Group, giving satisfaction to our shareholders, and contributing to the sound growth of society on a global scale.

(Basic policy)

(1) We will develop and provide useful and safe technologies, products, and services to contribute to the sound growth of society.

(2) We will do our best to ensure safety and to protect the global environment, saving resources and energy while reducing industrial waste and emission of chemical substances.

(3) We will observe the laws of Japan and of the foreign countries in which we operate, abide by the Company rules, and strive to maintain the social order. At the same time, we will conduct business in Japan and abroad based on the principle of fair and free competition.

2. Management indexes

The Showa Denko Group regards operating income, which shows the results of operations, and ROA (operating income/total assets ratio) as important management indexes.

3. Basic policy regarding appropriation of the Company's profits

The Company considers the payment of dividends as an important obligation to its shareholders. The Company's basic policy is to decide on dividends after consideration of the profit level for the term and the need for internal reserve for use in future business expansions.

4. Medium to long-term business strategy

Under the three-year consolidated business plan named the "Sprout Project," the Company attaches the utmost importance to the process of transforming itself into a "focused and individualized chemical company." Specifically, the Company is promoting its growth strategy by viewing things from a customer standpoint and establishing technical advantages.

The transformation will be achieved through accelerated development of individualized, competitive, high-value product lines. At the same time, the Company will further clarify its business portfolio and allocate resources in a more efficient and concentrated manner, thereby ensuring speedy realization of satisfactory results.

We will further curtail costs to enhance competitiveness and improve earning power. The Company will establish itself as a “focused and individualized chemical company” by carrying out the Sprout Project. By doing so, we will enhance our corporate value, give satisfaction to shareholders, meet customers’ expectations and contribute to the sound growth of society on a global scale.

In 2005, the final year under the Sprout Project, we will make sure to complete the project and announce, by the end of this year, a new medium-term consolidated business plan for 2006 and thereafter.

5. Basic concept regarding corporate governance and implementation of measures

(1) Basic concept regarding corporate governance

We fully recognize the importance of corporate governance and compliance, and have been taking various measures in this regard to ensure the continued growth and long-term value of the Company.

(2) The Company’s decision-making, execution, supervision, and other corporate-governance-related systems

The board of directors makes decisions based on the discussions at the Company’s Management Committee and R&D Committee meetings. The decisions are executed in accordance with the Company’s internal rules. The Company’s auditors and the Audit Office supervise the execution. While the Company has no outside directors, three out of the four auditors of the Company are from outside organizations.

(3) Interests

There are no special interests between the Company and the said three outside auditors.

(4) Steps taken for improvement of corporate governance

① Reforms of the board of directors

The Company introduced a corporate officers system in 2001. The execution of duties by directors and corporate officers is supervised by the board of directors and audited by the board of auditors. To energize the discussions and increase the speed of decision making at the board of directors’ meetings, the Company reduced the number of directors by three in 2002 and one in 2003, resulting in 11 as at December 31, 2004.

② Establishment of a Corporate Ethics Committee

We give the highest priority to social justice and corporate ethics. We have Code of

Conduct and its Guidelines as the ethical standard for the Showa Denko Group employees. To ensure full compliance and increase the level of corporate ethics, we established a Corporate Ethics Committee in 2003. At the same time, we opened new channels of communications whereby anyone can send information directly to a Company official by intranet, e-mail, or telephone. Furthermore, we started observing a Corporate Ethics Month. Through these measures, we will strive to prevent the occurrence of transgressions.

③ Promotion of Responsible Care activities

As part of corporate governance, we are promoting Responsible Care activities, which mean that we ensure the safety and health and protect the environment from harm caused by chemical substances throughout their entire life cycles, namely, the development, production, distribution, use, final consumption, and disposal. Responsible Care activities are conducted at the head office, within our five business segments, branches, an R&D Center, and major subsidiaries and affiliates, based on voluntary, specific action plans prepared in line with the company-wide basic plan.

We have been working hard to acquire certification under the ISO 14001 international standard for environmental management systems. All of Showa Denko K.K.'s operation sites acquired the certification by the end of 2002 and 18 of our subsidiaries and affiliates acquired it by the end of 2004.

6. Changes in management organizations

(1) Establishment of SPS Innovation Office

We established an SPS (Showa Denko Production System) Innovation Office in April 2004 to coordinate and further encourage innovations made independently so far at respective production sites of the Company and its subsidiaries and affiliates.

(2) Modification of the aluminum business structure

In the Company's Aluminum sector, the Extrusion Division and the Aluminum Specialty Products Division were merged in July 2004 to create the Extrusions/Specialty Products Division. This was intended as a measure to improve the quality of aluminum cylinders for laser beam printers and strengthen the capability to develop new products. The segment's R&D and production technology control functions were also integrated, resulting in the formation of Aluminum Technology Center.

(3) Establishment of the Capacitor Division

In the Company's Electronics sector, the Capacitor Division was established in January 2005 following the expansion of production facilities for solid conductive polymer aluminum surface-mount capacitors. We will grow the capacitor business as an independent profit center.

(4) Establishment of regional offices in Omachi and Shiojiri

In the Company's Inorganic Materials sector, regional offices were established in January 2005 at the sector's two operation sites in Nagano Prefecture, namely, Omachi and Shiojiri. Before that, the two sites had been managed by a single Shinshu Regional Office. The new setup is intended as a measure to enhance management efficiency and to ensure appropriate response to regional and business requirements.

Ⅲ. Business Results

1. Business results

In 2004, despite the rising oil prices and inventory adjustments by the electronic parts industry in the latter part of the year, the Japanese economy underwent a gradual recovery. This was due to improved consumer spending and increased corporate earnings and capital expenditures, which reflected economic recovery in the United States and Asia.

In the chemical and nonferrous metals industries, costs of naphtha, aluminum ingot, and other raw materials shot up. However, demand for chemical products increased, helped by steady exports to China and other Asian countries. In the electronic parts/materials industry, demand continued to expand until the middle of the year mainly from the digital appliances sector. However, the demand started to stagnate in the latter half of the year due to inventory adjustments.

Under the circumstances, the Showa Denko Group proceeded with the development of the "strategic growth businesses" as defined in the Sprout Project, while continuing to restructure operations and reduce costs.

As a result, consolidated net sales in 2004 increased 7.4% from the preceding year, to ¥740,706 million, and operating income jumped 35.1%, to ¥52,071 million. Ordinary income also rose 63.2%, to ¥38,912 million, due partly to improvement in the balance between interest expense and interest/dividend income. Net income was down 26.4%, to ¥7,596 million. This was because early implementation of the "accounting for the impairment of fixed assets" resulted in an extraordinary loss of ¥11,807 million.

2. Appropriation of profits

The company is planning to pay dividends at the rate of ¥3 per share, up ¥1 per share from the previous term.

3. Summary of results by business segment

(Petrochemicals)

Production of ethylene and propylene in 2004 increased over the preceding year due to higher demand for petrochemical products from China and other markets. Sales of olefins were up due to higher selling prices, which reflected soaring raw material costs, and brisk overseas markets. Sales of organic chemicals were also up, reflecting higher selling prices of vinyl acetate and increased shipment volumes of ethyl acetate.

Sales of plastics declined substantially due to the transfer in 2003 of the polyethylene business to Japan Polyethylene Corporation, to which the equity method was applied. Sales of plastics by Showa Highpolymer Co., Ltd. increased due to an increase in shipment volumes that reflected increasing domestic demand for construction materials. Sales of plastic products by Heisei Polymer Co., Ltd. also increased due to increases in shipment volumes.

As a result, the Petrochemicals segment's sales rose 8.2%, to ¥254,351 million, and operating income shot up 68.2%, to ¥20,132 million.

(Chemicals)

Due to a scheduled shutdown that took a considerable time, production of liquefied ammonia fell below the level in the preceding year. In the gases & chemicals operations, sales of industrial gases fell as a result of the transfer of the oxygen/nitrogen/hydrogen businesses to TG Showa K.K. Meanwhile, we withdrew from the epichlorohydrin business in 2003. Overall sales of gases & chemicals increased due partly to the start of full-scale operation of our facility for processing waste plastics.

In the specialty chemicals operations, the shipment volumes of *Shoprene* polychloroprene synthetic rubber increased and those of *Shodex* analytical columns remained steady. However, shipment volumes of vitamin C for feed additives and agrochemical intermediates fell. Thus, overall sales of specialty chemicals declined. Sales of agrochemicals at SDS Biotech K.K. were maintained at the previous year's level.

As a result, the Chemicals segment's sales rose 2.5%, to ¥80,188 million, but operating income fell 19.1%, to ¥4,845 million, due mainly to the stagnation in the agrochemical intermediate and feed-additive vitamin C businesses.

(Electronics)

Production and shipment volumes of hard disks (HDs) increased substantially over the preceding year following the consolidation of Showa Denko HD Trace Corporation in Taiwan in July 2004 and the expansion of the Group's HD capacities in Japan and overseas plants in the latter half of the year. The shipment volumes of gallium phosphide (GaP) for LEDs and other compound semiconductors were maintained at the level in the preceding year due to inventory adjustments. Thus combined sales of HDs and compound semiconductors were up.

In the electronic materials business, shipment volumes of specialty gases increased for use in processing of semiconductors and liquid crystal displays (LCDs). Shipments of magnetic alloys were up due to the recovery of demand for rare earth magnets. Shipment volumes of *VGCF* carbon nanofiber and ceramics for electronics also increased. Thus, overall sales of electronic materials were up.

As a result, the Electronics segment's sales increased 18.7%, to ¥112,455 million, and operating income soared 39.4%, to ¥14,919 million.

(Inorganic Materials)

Production of graphite electrodes increased slightly. Sales of ceramics were up as shipment volumes of alumina improved. The graphite electrode business of both Showa Denko K.K. and its U.S. subsidiary Showa Denko Carbon, Inc. recorded increased sales due to steady shipment volumes and selling prices.

As a result, the Inorganic Materials segment's sales increased 8.5%, to ¥55,295 million, and operating income jumped 129.8%, to ¥6,099 million.

(Aluminum)

Production of automotive heat exchangers in 2004 increased in Europe, but decreased in Japan and North America. Meanwhile, production of extrusions, rolled products and *Shotic* forged products increased. Sales of aluminum ingot rose due to higher selling prices that reflected rising prices on the international markets. The shipment volumes increased for rolled products, centering on high purity foils for capacitors, and forged products, centering on car air-conditioner parts, resulting in higher sales for these two areas. Sales of extrusions and specialty products were up due to increases in shipment volumes. Sales of heat exchangers decreased as shipment volumes fell in Japan and North America. Aluminum can sales also fell due to the decline in selling prices.

As a result, the Aluminum segment's sales increased 3.5%, to ¥238,419 million, and operating income increased 5.8%, to ¥12,321 million.

4. Major steps taken in 2004

(General)

・The Company issued on March 25, 2004 euro-yen-based convertible bonds due 2009 in the amount of ¥23 billion. There will be no interest payment, and the bond will be redeemed on March 25, 2009.

・As part of the corporate social responsibility (CSR) activities, the Company established Green Purchase Guidelines. Based on the guidelines, the Company will preferentially purchase environment-friendly products to contribute to the protection of the global environment.

(Petrochemicals)

・In 2000, the Company strategically reduced its ethylene production capacity at its Oita Petrochemical Complex from 750,000 tons a year (two trains) to 600,000 tons a year (one train). Since then, the ethylene plant has maintained high capacity utilization. The Company has also worked to diversify raw materials and introduce an optimized operation system. The Company obtained the governmental approval to lengthen the intervals between scheduled shutdowns of the ethylene plant from two to four years. The Company is already allowed to inspect safety of its ethylene plant by itself under the High Pressure Gas Safety Law. The approval of extended plant operation has further improved the competitiveness of the Oita ethylene plant.

・The Company established Japan Ethyl Acetate Co., Ltd., a joint venture with Kyowa Hakko Kogyo Co., Ltd., to meet the growing demand for ethyl acetate in Asia. The new company started operating its 100,000-ton-a-year ethyl acetate plant in the Oita Petrochemical Complex in April 2004.

・Heisei Polymer Co., Ltd., a consolidated subsidiary, became a fully owned subsidiary of Showa Denko in August 2004 through a share exchange agreement. This was intended as a measure to strengthen the Group’s plastic products business.

(Chemicals)

・ The Company began in the first half of 2004 commercial production of ammonia at Kawasaki using waste plastic. This recycling project started in 2003. The Company utilizes waste plastic—used containers and wrapping for consumer products as well as industrial waste—as feedstock for the production of ammonia and other chemical products. The new process enables the Company to almost halve the consumption of conventional petroleum-based feedstock, including naphtha, and to reduce load on the environment.

・The Company established TG Showa K.K., a joint venture with Tokyo Gas Chemicals Co., Ltd., which is a consolidated subsidiary of Tokyo Gas Co., Ltd. The new company, which began operation in July 2004, sells the parent companies’ industrial gases, centering on oxygen, nitrogen and hydrogen. The integration of the sales will raise efficiency of marketing and logistics in the main market of the Kanto District, and strengthen the competitiveness of the parent companies' industrial gas businesses.

・The Company developed a new isocyanate product" Karenz AOI" containing both acrylic- and isocyanate-groups. The product enables high-speed photo-curing of resins. Sample shipments began for use in the electronics and printing industries.

・The Company delivered its innovative waste anesthetic gas disposal system to Karolinska University Hospital in Huddinge, Stockholm County, the Kingdom of Sweden. The system helps reduce emission of nitrous oxide (N_2O), which is a greenhouse gas.

・The Company developed the world's first grade of stabilized vitamin C that permeates deep into the skin. Sales of the product, effective for wrinkle care when used as additive to cosmetics, started in early 2005 under the trade name of *Apprecier*.

(Electronics)

・The Company acquired two thirds of the capital of Trace Storage Technology Corp., an HD media manufacturer in Taiwan, in July 2004 through purchase of new shares. Trace has become a consolidated subsidiary, Showa Denko HD Trace Corporation, and has been provided with the Company's new technology. The Company increased its HD production capacity by more than two million disks a month through debottlenecking at Trace and facilities in Chiba, Japan, and Singapore. After the expansions, the Company has established its status as the largest independent HD supplier in the world with the production capacity of more than 10 million disks a month.

・The Company developed a blue light-emitting diode (LED) based on gallium nitride (GaN) having brightness at the highest level on the market. The development resulted from the combination of proprietary technologies for the production of compound semiconductors and hard disk media. Demand for blue LEDs is growing for such applications as mobile phones, outdoor displays, illumination and automotive devices.

・The Company established in October 2004 a subsidiary in Taiwan, Taiwan Showa Chemicals Manufacturing Co., Ltd., for the production of high-purity ammonia to meet fast-growing demand in that country. High-purity ammonia is used as a nitrogen source in the production of GaN LEDs and electronic devices. It is also used as a nitride-film-forming gas in the production of semiconductors and LCDs. The Company will meet the rapidly increasing demand for high-purity ammonia from its existing production facility in Japan and the new facility to be built in Taiwan. Showa Specialty Gas (Taiwan) Co., Ltd., a specialty gas marketing subsidiary, has been consolidated since the second half of 2004.

(Ceramics)

Lianyungang Zhaoling Abrasives Co., Ltd., our joint venture with Mitsubishi Corporation and Shoko Co., Ltd. for the production of ceramic abrasive grains, began trial runs in late 2004 at its plant in Jiangsu Province, China.

(Aluminum)

・The Company developed high-performance aluminum reflector for LCDs and began sample shipments in the first half of 2004. The product is an extension of the Company's *ST60* aluminum alloy used as heat sinks for plasma display panels. Due to the proprietary white coating, the new product offers high heat dissipation efficiency and light resistance.

・ The Company started supplying B.A.R Honda, a Formula 1 team, with aluminum radiators. The Company has developed radiators for commercial vehicles in cooperation with Honda Motor Co., Ltd. and supplied the products to Honda over the years. Based on the results of such technical cooperation, the two companies have developed lightweight aluminum radiators for machines used under extreme conditions in F1 race, the greatest of all motor sports.

・To participate in the Chinese automotive market, the Company acquired in November 2004 a 35% stake in a local car air-conditioner heat exchanger manufacturer, which subsequently changed its name to Grand Ocean-Showa Auto Air Conditioning (Dalian) Co., Ltd. It will start supplying the Volkswagen Group in China in early 2005 with the latest models based on SDK technology that meet the Group's worldwide specifications.

5. Projections for 2005

(1) Overall projections

As to the Japanese economy in 2005, production and exports are expected to remain steady owing to continued growth of overseas economies, centering on the United States and China. However, due to the influence of inventory adjustments by the electronic parts industry, stronger yen, and expected continuation of high prices of oil and other raw materials, the business environment is forecast to remain severe.

Under the circumstances, the Company will promote the growth strategy as defined in the Sprout Project and pursue thorough cost reductions, thereby striving to improve competitiveness and earning power. The Showa Denko Group's performance forecast for 2005 is as follows:

(Unit: millions of yen)

	Forecast for the term ending Dec. 31, '05	Results for the term ended Dec. 31, '04	Differ-ence	Rate of change
Net sales	780,000	740,706	39,294	5.3%
Operating income	52,500	52,071	429	0.8%
Ordinary income	40,500	38,912	1,588	4.1%
Net income	18,500	7,596	10,904	143.5%

Net sales, operating income and ordinary income will increase over the previous year to ¥780,000 million, ¥52,500 million, and ¥40,500 million, respectively. Net income will increase about ¥10,900 million, to ¥18,500 million, as we expect a decline in extraordinary loss. The above forecast is based on the assumption that the exchange rate of the yen will be ¥105 to the U.S. dollar and the naphtha price will be ¥36,000/KL.

(2) Net sales by business segment

(Unit: millions of yen)

	Forecast for the term ending Dec. 31, '05	Results for the term ended Dec. 31, '04	Differ-ence	Rate of change
Petrochemicals	280,000	254,351	25,649	10.1%
Chemicals	80,000	80,188	- 188	- 0.2%
Electronics	128,000	112,455	15,545	13.8%
Inorganic Materials	56,000	55,295	705	1.3%
Aluminum	236,000	238,419	- 2,419	- 1.0%
Total	780,000	740,706	39,294	5.3%

6. Operation risks and other risks

Showa Denko K.K. and its Group companies are taking steps to minimize risks to the Group's operations. While the SDK Group is implementing the three-year (2003-2005) consolidated business plan, the Sprout Project, we consider we face the risks as explained below that could adversely affect our future performances and financial conditions. The following cover important risk factors considered being present as of this February 9, 2004. The list is not inclusive.

(1) Substantial fluctuations in the performances of individual businesses

The SDK Group is manufacturing and selling a wide variety of products, such as petrochemicals, chemicals, electronics, inorganic materials and aluminum. The following risks are expected in major business fields, but those risks are not limited to the businesses mentioned below.

・Petrochemicals

The SDK Group purchases and imports a large amount of feedstock naphtha. When naphtha price rises due to an increase in crude oil prices, tight supply, or weaker yen, and when we cannot absorb the manufacturing cost increase in the form of higher product prices, the Group's performances and financial conditions can be affected. Furthermore, earnings from petrochemicals largely depend on the supply-demand balance. Construction of large plants by competitors and resultant oversupply as well as a sharp decrease in demand due to unfavorable changes in the Japanese or world economies can affect the Group's performances and financial conditions.

・Aluminum

The Group imports aluminum ingot from overseas sources. When aluminum ingot price rises due to fluctuations in LME prices or weaker yen, and when we cannot absorb the manufacturing cost increase in the form of higher product prices, the Group's performances and financial conditions can be affected. Furthermore, in some of the product lines, sales to specific customers account for a large portion. Those customers' performances, which are beyond our control, can substantially affect such businesses.

・HDs

In the Group's HD business, the sales volume is largely influenced by demand for electric appliances and PCs. And the business requires innovations at a rapid pace and involves a fierce international competition. The Group is prepared to develop and provide products meeting the market needs. However, when customer needs change more quickly than we expected, and when supply-demand balance changes substantially, the Group's performances and financial conditions can be affected.

・Overseas operations

The Group is producing and selling in Asia, North America and Europe. Operations overseas involve such special risks as unexpected changes in laws and regulations, deterioration in political/economic situations, and social disorder due to war and terrorism. Such risks can become real and affect our overseas operations, resulting in adverse impacts on the Group's performances and financial conditions.

(2) Unexpected fluctuations in financial conditions and cash flows

・Substantial fluctuations in exchange rates

The Group imports part of its feedstock requirements from overseas and exports part of its domestic production to foreign countries. The Group makes its best efforts to minimize relevant exchange rate fluctuation risks mainly through exchange contracts. However, substantial fluctuations in exchange rates can affect the Group's foreign-currency-based transactions and assets/liabilities, and affect the Group's performances and financial conditions.

Exchange rate fluctuations can affect the Group's overseas subsidiaries in the like manner. Furthermore, the exchange rate fluctuations can affect the Group's performances and financial conditions through conversion of overseas subsidiaries' financial statements into the Japanese yen.

・Trends in financial markets

The Group has been making continuous efforts to reduce its interest-bearing debt, resulting in a substantial decline in the ratio of interest-bearing debt to shareholders' equity. However, the trends in the financial markets can change the fund-raising and interest-rate situations, and affect the Group's performances and financial conditions.

・Employees' severance indemnities

The Group's employees' severance indemnities and expenses are calculated based on various basic rates and yield of pension assets used in pension calculations. Fluctuations in the current price of pension assets, trends in interest rates, and changes in the retirement benefit/pension systems can affect the Group's performances and financial conditions.

・Securities

As the Group owns securities with current prices, fluctuations in stock prices can result in valuation profits or losses, and affect the Group's performances and financial conditions.

・Accounting for impairment of fixed assets

The Group adopted the accounting standards regarding impairment of fixed assets in 2004, earlier than legally required. The Group may incur additional losses from impairment of fixed assets as a result of future changes in the current prices of land and other fixed assets or a substantial change in the business environment.

・Deferred tax assets

The Group's financial statements include deferred tax assets in relation to temporary differences (differences between the assets/liabilities on the consolidated financial statements and the assets/liabilities in calculation of taxable income). The calculation of deferred tax assets is based on various projections for future taxable income. Thus, when actual results differ from the projections and when it becomes necessary to revise deferred tax assets, it can affect the Group's performances and financial conditions.

(3) Specific regulations

The Group's businesses are subject to various restrictions as stipulated by laws and regulations. The restrictions relate to industrial safety (such as Law for Prevention of Disasters at Petroleum Complex, etc.; Fire Service Law; High Pressure Gas Safety Law) and the environment and chemical substances (such as Basic Environment Law; Air Pollution Control Law; Law concerning the Examination and Regulation of Manufacture, etc. of Chemical Substances). The Group observes these laws and regulations as it conducts respective businesses. In the event the Group fails to observe any of the laws and regulations, the Group's activities can be restricted. In case more strict regulations are introduced and result in higher costs, that can affect the Group's performances and financial conditions.

(4) Important lawsuits

While the Group makes best efforts to observe pertinent laws and regulations, the Group may be sued as it conducts its wide-ranging businesses.

(5) Others

・R&D

In line with its policy of securing market orientation and establishing technical advantages, the Group is engaged in continuous R&D to improve its core technologies in inorganic/aluminum and organic chemical technologies and achieve synergies in an effort to create individualized products and high-value businesses. However, in case the actual results materially differ from original plans, the Group's performances and financial conditions can be affected.

・Intellectual property

The Group is making best efforts to protect its accumulated patent rights and know-how in recognition of their ability to make the Group's businesses more competitive. However, in the event of failure to duly protect any of the patent rights or know-how, infringement by a third party, or the Group is considered to have infringed a third party's patent right, that can cause trouble with the Group's operations, and affect the Group's performances and financial conditions.

・Product quality and product liability

The Group has established its internal rules on quality assurance and quality control, as well as organizations for managing and promoting quality assurance. Furthermore, the

Group has obtained certification under ISO 9001 standards to ensure strict quality control. However, in the event of a serious quality defect or being sued for product liability, the Group's reputation can be damaged and the Group may be forced to pay compensation to customers. This can affect the Group's performances and financial conditions.

・Accidents and disasters

The Group is committed to securing steady and safe operations. The Group conducts regular inspections of all manufacturing facilities in an effort to minimize any risk factors pertaining to suspension of operations or accidents due to troubles with manufacturing facilities. In the event of injury or damage to property due to an accident or a natural disaster, the Group's reputation can be damaged and the Group may incur a lot of costs and lose business opportunities due to suspension of production. This can affect the Group's performances and financial conditions.

・Impact on environment

The Group is committed to the principles of Responsible Care, which means that we are working to ensure the safety and health of everyone and to protect the environment from harm caused by chemical substances throughout their life cycles, namely, development, production, distribution, use, and disposal. In the event of causing impacts on the environment, the Group's reputation can be damaged. The Group may incur a lot of costs, including compensation, lose business opportunities due to suspension of production and pay compensation to customers. This can affect the Group's performances and financial conditions.

Ⅳ. Financial Conditions

1. Assets, liabilities and equity at end-2004

Although we continued our efforts to reduce total assets, the figure increased ¥4,029 million, to ¥943,908 million, due partly to the consolidation of Showa Denko HD Trace Corporation.

Interest-bearing debt further decreased ¥24,956 million, to ¥502,433 million. As a result, total liabilities fell ¥11,436 million, to ¥721,060 million.

Stockholders' equity increased ¥ 11,613 million, to ¥177,701 million. This was due to increases in retained earnings and security valuation surplus, as well as an increase in capital surplus resulting from the fact that Heisei Polymer Co., Ltd. became a wholly owned subsidiary through a share exchange agreement.

2. Cash flows in 2004

Net cash provided by operating activities decreased ¥4,033 million from the preceding year, to ¥59,528 million, despite a substantial increase in operating income, as working capital increased due partly to the rise in raw material costs. Net cash used in investing activities decreased ¥12,687 million, to ¥12,412 million, due to lower capital expenditures than in the preceding year.

Thus, free cash flow increased ¥8,654 million, to ¥47,116 million. Net cash used in financing activities increased ¥9,223 million, to ¥45,123 million, as a result of reductions in interest-bearing debt. As a result, cash and cash equivalents at December 31, 2004 increased ¥2,668 million, to ¥29,153 million, after changes in the list of consolidated subsidiaries.

3. Projections for 2005

In 2005, despite an increase in cash flows from operating activities, net cash used in investing activities will increase due to increased capital investments and a decline in proceeds from sale of assets. Thus, free cash flow for the year is expected to decrease around ¥26,600 million, to ¥20,500 million. Interest-bearing debt at the end of the year will be ¥487,000 million, down ¥15,400 million from the end of the preceding year.

4. Trends in cash flow indexes

	2001	2002	2003	2004
Equity ratio	13.5%	15.2%	17.7%	18.8%
Equity ratio on a market value basis	15.4%	17.4%	29.2%	32.0%
Debt maturity (years)	17.4	15.5	8.3	8.4
Interest coverage ratio	2.8	3.3	6.0	5.9

[Notes]

Equity ratio: Shareholders' equity / Total assets

Equity ratio on a market value basis: Total market value of listed shares / Total assets

Debt maturity (years): Interest-bearing debt / Cash flows from operating activities

Interest coverage ratio: Cash flows from operating activities / Interest payment

・Each index is calculated by relevant formulas with financial figures quoted from the consolidated balance sheet.

・Market capitalization is calculated by multiplying the closing share price at the year-end by the number of shares issued, after deduction of own shares at year-end.

・As to the cash flows, the amount of "cash flows from operating activities" in the consolidated cash flow statement is used. "Interest-bearing debt" refers to all debts with interest out of all liabilities listed in the consolidated balance sheet.

・As to the interest payment, the amount of "interest expense" in the consolidated cash flow statement is used.

Consolidated Balance Sheets

(¥ in millions, US$ in thousands)

	Dec. 31, 2004 (A)	Dec. 31, 2003 (B)	(A)-(B)	Dec. 31, 2004
Assets	¥	¥		$
Current assets				
Cash and deposit	29,627	26,791	2,836	284,300
Notes and accounts receivable	150,275	136,405	13,871	1,442,043
Inventories	68,736	60,921	7,815	659,596
Deferred tax assets	7,665	6,718	946	73,549
Other current assets	34,100	32,721	1,380	327,228
Allowance for doubtful receivables	(2,497)	(1,254)	(1,243)	(23,965)
Total current assets	287,906	262,301	25,605	2,762,751
Fixed assets				
Tangible fixed assets	518,371	538,154	(19,784)	4,974,289
Buildings and structures	99,008	100,093	(1,085)	950,080
Machinery and transports	123,281	130,532	(7,251)	1,183,010
Equipments	9,159	9,526	(367)	87,890
Land	276,438	291,469	(15,031)	2,652,697
Construction in process	10,485	6,535	3,950	100,613
Intangible fixed assets	25,956	23,163	2,793	249,072
Goodwill	14,677	11,336	3,341	140,837
Other intangible fixed assets	11,279	11,827	(548)	108,235
Investments and other assets	111,675	116,244	(4,569)	1,071,632
Investment securities	90,094	83,375	6,719	864,547
Deferred tax assets	7,631	16,668	(9,037)	73,230
Other investments	16,751	19,140	(2,389)	160,744
Allowance for doubtful accounts	(2,802)	(2,939)	137	(26,889)
Total fixed assets	656,001	677,561	(21,559)	6,294,993
Deferred assets	—	17	(17)	—
Total assets	943,908	939,879	4,029	9,057,744
Liabilities				
Current liabilities				
Notes and accounts payable	120,456	113,351	7,105	1,155,895
Short-term loans payable	100,146	117,729	(17,583)	961,003
Commercial paper	325	—	325	3,116
Current portion of long-term loans payable	89,314	73,830	15,483	857,053
Current portion of corporate bonds	15,500	—	15,500	148,738
Current portion of convertible bonds	28,884	—	28,884	277,171
Reserve for periodic repairs	106	—	106	1,016
Reserve for bonus payment	2,034	1,787	247	19,518
Reserve for restructuring expenses	5,569	4,214	1,355	53,440
Other current liabilities	39,776	32,104	7,673	381,692
Total current liabilities	402,109	343,016	59,094	3,858,644
Long-term liabilities				
Bonds	26,500	42,000	(15,500)	254,294
Convertible bonds	930	29,814	(28,884)	8,924
Bonds with subscription warrant	23,000	—	23,000	220,708
Long-term loans payable	217,834	264,015	(46,181)	2,090,339
Deferred tax liabilities	6,224	6,353	(129)	59,728
Deferred tax liabilities due to land revaluation	22,864	23,929	(1,065)	219,401
Accrued pension and severance costs	8,879	8,640	240	85,206
Reserve for directors' retirement allowance	1,332	869	463	12,781
Reserve for periodic repairs	924	—	924	8,867
Other long-term liabilities	10,463	13,861	(3,397)	100,406
Total long-term liabilities	318,951	389,481	(70,530)	3,060,654
Total liabilities	721,060	732,496	(11,436)	6,919,298
Minority interests	45,147	41,295	3,851	433,229
Stockholders' equity				
Common stock	110,451	110,451	—	1,059,893
Capital surplus	11,089	8,175	2,914	106,413
Retained earnings	18,316	13,271	5,045	175,756
Revaluation reserve (Land revaluation)	33,280	34,832	(1,552)	319,352
Securities valuation surplus	7,842	2,501	5,340	75,248
Foreign currency translation adjustments	(3,213)	(3,096)	(117)	(30,833)
Treasury stock	(64)	(47)	(17)	(611)
Total stockholders' equity	177,701	166,087	11,613	1,705,217
Total liabilities, minority interests and stockholders' equity	943,908	939,879	4,029	9,057,744

Consolidated Statements of Income

(¥ in millions, US$ in thousands)

	Results for the year ended Dec.31 2004 and 2003			
	2004(A)	2003(B)	(A)-(B)	2004
	¥	¥		$
Net sales	740,706	689,366	51,340	7,107,825
Cost of sales	604,818	563,828	40,990	5,803,841
Selling, general and administrative expense	83,817	86,991	(3,174)	804,310
Operating income	52,071	38,546	13,525	499,674
Non-operating income	4,584	5,124	(540)	43,985
Interest and dividend income	1,241	1,025	215	11,906
Equity in earnings of non-consolidated subsidiaries and affiliates	1,056	1,614	(557)	10,138
Miscellaneous incomes	2,287	2,484	(198)	21,941
Non-operating expense	17,743	19,830	(2,087)	170,260
Interest paid	9,890	10,507	(617)	94,904
Miscellaneous expenses	7,853	9,323	(1,470)	75,356
Ordinary income	38,912	23,840	15,072	373,399
Extraordinary profit	5,555	8,172	(2,617)	53,304
Gain on fixed assets sold	1,357	92	1,265	13,023
Gain on investment securities sold	2,439	1,874	565	23,408
Subsidy for waste plastic recycle plant	—	3,737	(3,737)	—
Other extraordinary profits	1,758	2,469	(711)	16,873
Extraordinary loss	25,629	13,243	12,386	245,937
Loss on fixed assets sold or retired	4,898	3,210	1,688	47,003
Impairment of fixed assets	11,807	—	11,807	113,297
Loss on investment securities sold	176	39	138	1,692
Loss on valuation of investment securities	434	270	164	4,165
Special severance pay	1,265	2,585	(1,321)	12,135
Reserve for restructuring expenses	2,571	2,968	(397)	24,671
Prior-period expenses for periodic repairs	895	—	895	8,585
Reserve for directors' retirement allowance	374	—	374	3,589
Other extraordinary losses	3,210	4,171	(961)	30,799
Income before income taxes	18,838	18,769	69	180,766
Income taxes (current)	4,090	3,326	764	39,245
Income taxes (deferred)	5,300	5,329	(29)	50,863
Minority interests	1,852	(203)	2,055	17,771
Net income	7,596	10,317	(2,721)	72,887

Consolidated Statements of Surplus

(¥ in millions, US$ in thousands)

	Results for the year ended Dec.31 2004 and 2003		
	2004	2003	2004
Capital surplus	¥	¥	$
Balance at January 1	8,175	8,174	78,446
Net increase	2,914	0	27,966
Increase resulting from stock exchange	2,210	—	21,204
Increase resulting from merger with subsidiary	700	—	6,717
Gain on treasury stock sold	5	0	45
Balance at December 31	11,089	8,175	106,413
Retained earnings			
Balance at January 1	13,271	1,302	127,346
Net increase	9,239	13,531	88,662
Net income for the year	7,596	10,317	72,887
Increase due to inclusion in consolidation	5	—	53
Increase due to exclusion from equity method	86	3,204	827
Reversal of revaluation reserve	1,552	11	14,895
Net decrease	4,195	1,562	40,252
Cash dividends	2,276	—	21,840
Bonuses to directors and statutory auditors	—	8	—
Decrease resulting from merger with subsidiaries	1,014	—	9,733
Decrease due to inclusion in consolidation	195	—	1,871
Decrease in earned surplus accompanying increased percentage ownership of a consolidated subsidiary	614	—	5,892
Decrease due to exclusion from equity method	96	1,555	919
Balance at December 31	18,316	13,271	175,756

Consolidated Statements of Cash Flows

(¥ in millions, US$ in thousands)

	Results for the year ended Dec.31 2004 and 2003		
	2004	2003	2004
	¥	¥	$
Cash flows from operating activities			
Income before income taxes	18,838	18,769	180,766
Adjustments for:			
Depreciation and amortization	34,115	34,543	327,365
Impairment of fixed assets	11,807	—	113,297
Amortization of excess of cost over equity in net assets acquired	1,376	1,124	13,200
Interest and dividend income	(1,241)	(1,025)	(11,906)
Interest expense	9,890	10,507	94,904
Equity in earnings of the non-consolidated subsidiaries and affiliates	(1,056)	(1,614)	(10,138)
Gain on sale and write-down of investment securities, net	(1,916)	(1,684)	(18,383)
Loss on the disposal of property, plant and equipment	3,910	2,218	37,516
Loss on sale of property, plant and equipment	428	1,581	4,112
(Increase) decrease in trade receivables	(8,705)	8,017	(83,531)
(Increase) decrease in inventories	(5,891)	8,785	(56,526)
Increase (decrease) in trade payables	6,942	(8,606)	66,614
Others	3,729	3,265	35,784
Subtotal	72,225	75,880	693,075
Interest and dividend received	1,607	1,441	15,419
Interest paid	(10,006)	(10,635)	(96,021)
Income taxes paid	(4,298)	(3,125)	(41,240)
Net cash provided by operating activities	59,528	63,561	571,233
Cash flows from investing activities			
Proceeds from sales of marketable securities	16	4	152
Payments for purchases of property, plant and equipment	(30,576)	(40,217)	(293,409)
Proceeds from sales of property, plant and equipment	12,136	17,411	116,460
Payments for purchases of investment securities	(1,621)	(9,389)	(15,553)
Proceeds from sales of investment securities	5,458	5,234	52,374
(Increase) decrease in short-term loans, net	(480)	1,231	(4,605)
Payments for long-term loans	(165)	(147)	(1,584)
Proceeds from collection of long-term loans	775	5,658	7,432
Others	2,045	(4,883)	19,624
Net cash used in investing activities	(12,412)	(25,099)	(119,108)
Cash flows from financing activities			
Decrease in short-term debt, net	(29,767)	(18,280)	(285,649)
Proceeds from issuance of long-term debt	43,774	142,450	420,059
Repayments of long-term debt	(76,257)	(161,930)	(731,766)
Proceeds from issuance of bonds	23,000	3,000	220,708
Redemption of bonds	—	(555)	—
Payments of dividends	(2,276)	—	(21,840)
Payments of dividends to minority shareholders	(2,628)	(602)	(25,216)
Others	(968)	17	(9,292)
Net cash used in financing activities	(45,123)	(35,900)	(432,996)
Effect of exchange rate changes on cash and cash equivalents	(11)	(361)	(108)
Increase (decrease) in cash and cash equivalents	1,982	2,202	19,020
Cash and cash equivalents at beginning of the year	26,485	23,260	254,153
Effect of adjustment of newly consolidated subsidiaries on cash and cash equivalents at beginning of the year	686	1,023	6,579
Cash and cash equivalents at end of the year	29,153	26,485	279,751

SEGMENT INFORMATION

(a) The operations of the Companies for the year ended December 31, 2004 and 2003 were summarized by business segment as follows:

Year ended December 31, 2004	Millions of yen						
	Petrochemicals	Chemicals	Electronics	Inorganic materials	Aluminum	Elimination	Consolidated
Sales							
Outside customers	¥254,351	¥80,188	¥112,455	¥55,295	¥238,419	¥–	¥740,706
Inter-segment	2,021	687	425	249	18,785	(22,167)	–
Total	256,372	80,875	112,880	55,543	257,204	(22,167)	740,706
Operating costs	236,240	76,029	97,961	49,444	244,883	(15,922)	688,635
Operating income	¥20,132	¥4,845	¥14,919	¥6,099	¥12,321	¥(6,245)	¥52,071
Assets	¥229,221	¥145,931	¥108,471	¥111,038	¥347,211	¥2,036	¥943,908
Depreciation and amortization	5,950	5,539	8,198	2,681	11,963	(216)	34,115
Capital expenditures	3,837	3,817	11,668	2,142	8,541	(89)	29,916

Year ended December 31,2003	Millions of yen						
	Petrochemicals	Chemicals	Electronics	Inorganic materials	Aluminum	Elimination	Consolidated
Sales							
Outside customers	¥235,124	¥78,232	¥94,735	¥50,969	¥230,306	¥–	¥689,366
Inter-segment	1,506	780	432	137	17,506	(20,360)	–
Total	236,630	79,011	95,167	51,106	247,812	(20,360)	689,366
Operating costs	224,659	73,022	84,467	48,452	236,165	(15,945)	650,820
Operating income	¥11,971	¥5,989	¥10,700	¥2,654	¥11,647	¥(4,415)	¥38,546
Assets	¥225,387	¥154,415	¥84,624	¥110,436	¥361,702	¥3,315	¥939,879
Depreciation and amortization	7,151	5,175	6,162	2,797	13,692	(434)	34,543
Capital expenditures	5,959	13,208	9,795	2,207	9,823	(144)	40,848

Year ended December 31, 2004	Thousands of U.S. dollars						
	Petrochemicals	Chemicals	Electronics	Inorganic materials	Aluminum	Elimination	Consolidated
Sales							
Outside customers	$2,440,751	$769,482	$1,079,117	$530,606	$2,287,869	$–	$7,107,825
Inter-segment	19,397	6,592	4,078	2,387	180,261	(212,715)	–
Total	2,460,148	776,073	1,083,195	532,994	2,468,130	(212,715)	7,107,825
Operating costs	2,266,963	729,577	940,035	474,470	2,349,898	(152,792)	6,608,151
Operating income	$193,185	$46,497	$143,161	$58,524	$118,231	$(59,923)	$499,674
Assets	$2,199,607	$1,400,353	$1,040,884	$1,065,522	$3,331,840	$19,539	$9,057,744
Depreciation and amortization	57,096	53,152	78,668	25,727	114,797	(2,075)	327,365
Capital expenditures	36,820	36,628	111,966	20,555	81,960	(854)	287,074

(b) The operations of the Companies for the year ended December 31, 2004 and 2003 were summarized by geographic area as follows:

Year ended December 31, 2004	Millions of yen			
	Domestic Companies	Overseas Companies	Elimination	Consolidated
Sales				
Outside customers	¥663,311	¥77,395	¥–	¥740,706
Inter-segment	27,740	6,242	(33,982)	–
Total	691,051	83,637	(33,982)	740,706
Operating costs	630,284	78,107	(19,755)	688,635
Operating income	¥60,767	¥5,531	¥(14,227)	¥52,071
Assets	¥879,446	¥80,440	(¥15,978)	¥943,908

Year ended December 31, 2003	Millions of yen			
	Domestic Companies	Overseas Companies	Elimination	Consolidated
Sales				
Outside customers	¥619,320	¥70,046	¥–	¥689,366
Inter-segment	18,637	3,349	(21,986)	–
Total	637,957	73,394	(21,986)	689,366
Operating costs	597,918	70,160	(17,258)	650,820
Operating income	¥40,040	¥3,234	¥(4,727)	¥38,546
Assets	¥877,921	¥48,013	¥13,945	¥939,879

Year ended December 31, 2004	Thousands of U.S. dollars			
	Domestic Companies	Overseas Companies	Elimination	Consolidated
Sales				
Outside customers.	$6,365,138	$742,687	$–	$7,107,825
Inter-segment.	266,193	59,899	(326,092)	–
Total.	6,631,331	802,586	(326,092)	7,107,825
Operating costs.	6,048,207	749,512	(189,568)	6,608,151
Operating income.	$583,124	$53,074	$(136,524)	$499,674
Assets.	$8,439,167	$771,902	$(153,325)	$9,057,744

(c) Overseas sales, which represent sales to customers outside of Japan, of the Companies for the year ended December 31, 2004 and 2003 were summarized by geographic area as follows:

Year ended December 31, 2004	Millions of yen		
	Asia	Others	Overseas sales
Overseas sales.	¥143,908	¥50,362	¥194,270
Consolidated net sales.	–	–	740,706
Ratio of overseas sales to consolidated net sales.	19.4%	6.8%	26.2%

Year ended December 31, 2003	Millions of yen		
	Asia	Others	Overseas sales
Overseas sales.	¥114,943	¥52,191	¥167,134
Consolidated net sales.	–	–	689,366
Ratio of overseas sales to consolidated net sales.	16.7%	7.6%	24.2%

Year ended December 31, 2004	Thousands of U.S. dollars		
	Asia	Others	Overseas sales
Overseas sales.	$1,380,942	$483,274	$1,864,216