

# Financial Section

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## CONSOLIDATED SIX-YEAR SUMMARY

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

Years ended March 31	Millions of yen						Thousands of U.S. dollars (Note 1)
	2006	2005	2004	2003	2002	2001	2006
Net sales	<b>¥375,073</b>	¥354,874	¥332,149	¥322,524	¥305,862	¥313,651	<b>\$3,205,752</b>
Cost of sales	<b>266,284</b>	254,115	236,246	230,618	228,184	234,946	<b>2,275,931</b>
Selling, general and administrative expenses	<b>70,512</b>	67,572	67,857	66,720	58,720	58,774	<b>602,667</b>
Operating income	<b>38,277</b>	33,187	28,046	25,186	18,958	19,931	<b>327,154</b>
Net income	<b>21,186</b>	18,465	15,181	8,051	2,866	4,045	<b>181,077</b>
Capital expenditure	<b>33,872</b>	45,715	32,164	19,091	50,716	15,814	<b>289,504</b>
Depreciation and amortization	<b>25,186</b>	21,324	20,785	19,108	16,056	16,593	<b>215,265</b>
Gross cash flow	<b>46,372</b>	39,789	35,966	27,159	18,922	20,638	<b>396,342</b>
Total research and development expenses	<b>14,069</b>	13,874	13,684	12,523	12,131	12,251	<b>120,248</b>
Total assets	<b>481,357</b>	454,941	413,227	426,877	487,432	512,479	<b>4,114,162</b>
Total current assets	<b>200,668</b>	182,317	171,428	185,748	198,474	239,654	<b>1,715,111</b>
Property, plant and equipment, net	<b>159,396</b>	158,294	137,867	135,985	134,907	127,468	<b>1,362,359</b>
Total current liabilities	<b>79,229</b>	84,857	75,165	97,394	122,274	110,234	<b>677,171</b>
Total long-term liabilities	<b>60,647</b>	54,901	37,689	42,156	74,460	112,723	<b>518,350</b>
Total shareholders' equity	<b>339,127</b>	312,930	300,306	287,263	290,643	289,469	<b>2,898,521</b>

## Amounts per share:

	Yen						U.S. dollars
Net income:							
Primary	<b>¥ 57.51</b>	¥ 50.13	¥ 40.81	¥ 21.01	¥ 7.49	¥ 10.56	<b>\$0.49</b>
Fully diluted	<b>57.41</b>	50.12	–	20.71	7.45	10.46	<b>0.49</b>
Cash dividends applicable to period	<b>15.00</b>	12.00	10.00	9.00	9.00	9.00	<b>0.13</b>
Total shareholders' equity	<b>922.65</b>	852.26	817.57	771.38	759.25	756.07	<b>7.89</b>

## Financial ratios:

Cost of sales ratio (%)	<b>71.0%</b>	71.6%	71.1%	71.5%	74.6%	74.9%
Equity ratio (%)	<b>70.5</b>	68.8	72.7	67.3	59.6	56.5
Return on equity (%)	<b>6.5</b>	6.0	5.2	2.8	1.0	1.4
Return on assets (%)	<b>8.2</b>	7.6	6.7	5.5	3.8	3.9
Number of employees	<b>6,842</b>	6,919	6,760	6,983	7,115	7,121

Notes: 1. The U.S. dollar amounts represent the translation from Japanese yen at the rate of ¥117=\$1.

2. Certain reclassifications of previously reported amounts have been made to conform with current classifications.

3. Since the year ended March 31, 2003, the "Amounts per share" figures have been calculated in accordance with the Japanese Financial Accounting Standard "Accounting for Earnings per Share."

## FINANCIAL REVIEW

The following section refers to the consolidated financial statements of the Kuraray Group for fiscal 2005 (from April 1, 2005, to March 31, 2006).

### SALES

Total consolidated net sales increased 5.7%, or ¥20,199 million, to ¥375,073 million (US\$3,205,752 thousand) for fiscal 2005.

Sales of chemicals and resins rose 14.0%, or ¥23,489 million, to ¥190,753 million (US\$1,630,368 thousand). Increased sales of poval were attributable to strong sales of optical-use poval film, which is used as a base for polarizing film, to meet extremely strong demand for LCD applications and a 30 million square meter per year increase in production capacity. Sales of poval resin were flat because of stagnant sales in Europe due to higher imports from other regions, which were triggered by a strong euro, and intensified competition in Asia. Further, sales of PVB film for use in construction materials, the manufacturer of which we acquired in 2004, were brisk. Sales of EVAL resin for use in food product packaging were favorable. In isoprene-related products, heavy demand for the thermoplastic elastomer SEPTON as a substitute for vulcanized rubber and soft PVC increased sales in Europe, the United States, and Asia. Sales of methacrylic resin were flat because lackluster demand for the resin for general applications counteracted strong demand for such optical applications as LCD light guide plates.

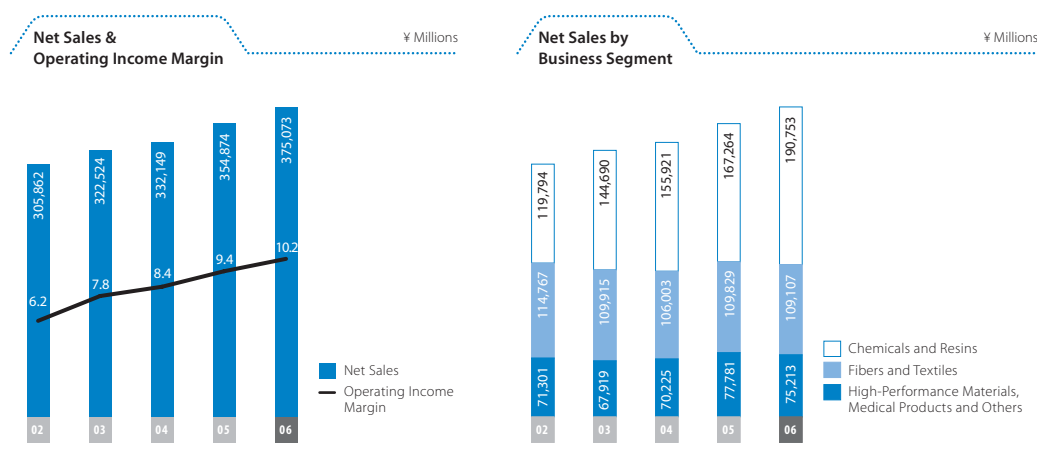
Sales of fibers and textiles decreased 0.7%, or ¥722 million, to ¥109,107 million (US\$932,538 thousand). Revenues from KURALON

declined, as the effect of an accident at the Okayama Plant offset solid sales of products in specialty categories, such as asbestos substitutes for reinforced cement, materials for rubber, and applications in paper and nonwoven fabrics. Sales of the man-made leather CLARINO were up, as brisk sales of the product for use in bags and other accessories and for polishing materials shrugged off weak demand for interior applications. Sales of nonwoven fabrics and fasteners grew on the back of a pick-up in domestic demand. Sales of polyester declined due to a shift toward differentiated products.

Sales of high-performance materials, medical products and others decreased 3.3%, or ¥2,568 million, to ¥75,213 million (US\$642,846 thousand). Despite facing fiercer competition, the medical products business achieved higher revenues thanks to favorable sales of dental materials in Japan and the United States. The opto-electronics business saw lower revenues due to a sharp decrease in demand for CRT-type opto-screens that offset expansion of the market for MD-type opto-screens for rear-projection televisions. In the high-performance materials business, demand for the heat-resistant polyamide resin GENESTAR for electronic materials applications increased steadily in Japan and Asia.

Net sales in each of Kuraray's geographic segments displayed year-on-year increases during fiscal 2005.

Domestic sales increased 1.6%, or ¥4,223 million, to ¥273,757 million (US\$2,339,803 thousand). Revenues were up as a result of higher sales and exports of such lineups as optical-use poval film, optical-use methacrylic resin, SEPTON, CLARINO, KURALON,



Note: New business segments were adopted in the year ended March 31, 2003.  
Data for the previous year has been restated.

and *GENESTAR* and the reflection of raw material and fuel prices in product prices.

In North America, net sales rose 11.0%, or ¥3,024 million, to ¥30,610 million (US\$261,624 thousand). This increase was attributable to stepped-up sales of *SEPTON* as a substitute for vulcanized rubber and soft PVC and higher sales of *EVAL* for food product packaging.

In Europe, net sales rose 27.9%, or ¥11,787 million, to ¥53,974 million (US\$461,316 thousand). Increased sales related to the acquisition of a PVB film business and favorable demand for *EVAL* and *SEPTON* compensated for the negative effect of a strong euro and hikes in raw material and fuel prices.

Sales throughout Asia were strong, rising 7.5%, or ¥1,165 million, to ¥16,732 million (US\$143,009 thousand). This increase in revenues stemmed from the development of poval operations with an emphasis on reflecting higher raw material and fuel prices through higher product prices.

### OPERATING INCOME AND NET INCOME

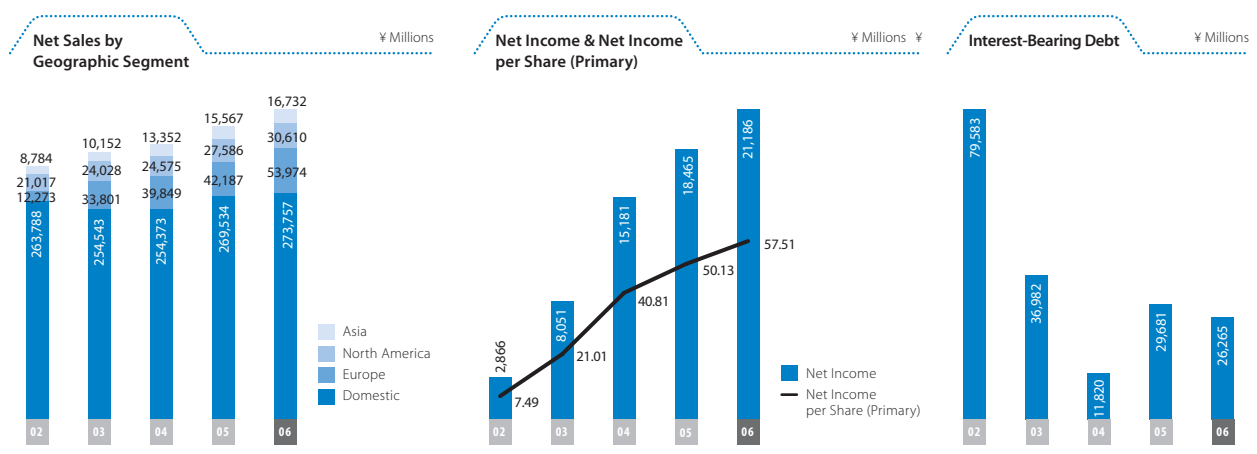
Cost of sales increased 4.8%, to ¥266,284 million (US\$2,275,931 thousand), and as a percentage of net sales decreased, from the previous fiscal year's 71.6%, to 71.0%. This improvement was largely due to an improvement in the Company's business portfolio – resulting from a shift toward high-value-added products in line with the G-21 Medium-Term Business Plan – as well as rationalization based on tireless cost reduction efforts and efforts to raise

prices in step with hikes in raw material and fuel costs. Selling, general and administrative (SG&A) expenses increased 4.4%, to ¥70,512 million (US\$602,667 thousand). As a percentage of net sales, SG&A expenses declined, from 19.0% to 18.8%. Operating income grew 15.3%, to ¥38,277 million (US\$327,154 thousand). The operating margin has risen for five successive fiscal years, increasing from 6.2% in fiscal 2000, to 10.2% in fiscal 2005.

Interest and dividend income continued an upward trend, increasing 8.6%, to ¥1,294 million (US\$11,060 thousand). Meanwhile, interest expenses rose 39.4%, to ¥414 million (US\$3,539 thousand). Income before income taxes and minority interests continued to increase, climbing 15.1%, to ¥34,363 million (US\$293,701 thousand). Income taxes were ¥13,068 million (US\$111,692 thousand), and the effective tax rate remained at the previous year's level, at 38.0%. As a result, net income surged 14.7%, to ¥21,186 million (US\$181,077 thousand), passing the ¥20,000 million milestone for the first time.

### FINANCIAL POSITION

Cash and cash equivalents, end of year, increased ¥11,342 million, to ¥28,085 million (US\$240,043 thousand). Due to the increase in sales, notes and accounts receivable increased ¥8,408 million, to ¥94,561 million (US\$808,213 thousand). Marketable securities were reduced ¥5,990 million, leaving no outstanding marketable securities. Also, inventories increased ¥5,258 million, to ¥69,431 million (US\$593,426 thousand), because the initiation of capital expenditure



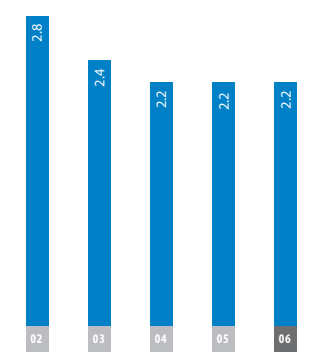
Note: Due to their growing weight in total net sales, the North America and Asia segments were separated out from the year ended March 31, 2003. Data for the previous year has been restated.

for mainstay products was offset by a temporary pause in sales expansion, hikes in raw material and fuel prices, and a weak yen. The number of months' sales in inventory remained unchanged from the previous year, at 2.2 months. As a result of these and other factors, total current assets increased 10.1%, to ¥200,668 million (US\$1,715,111 thousand). Property, plant and equipment increased 0.7%, to ¥159,396 million (US\$1,362,359 thousand). This was because land decreased 3.0%, to ¥19,676 million (US\$168,171 thousand), buildings decreased 4.8%, to ¥88,265 million (US\$754,401 thousand), machinery and equipment increased 5.4%, to ¥443,689 million (US\$3,792,214 thousand), and construction-in-progress rose 14.2%, to ¥24,590 million (US\$210,171 thousand). Strategic acquisition and expansion fueled much of the improvement in these areas.

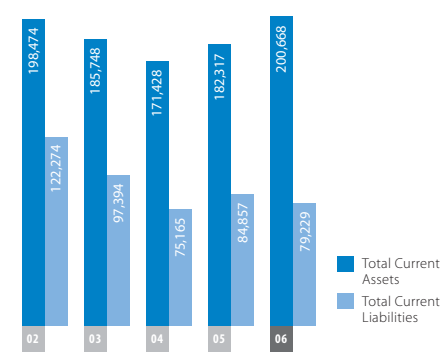
Investments and other assets rose 6.1%, to ¥121,293 million (US\$1,036,692 thousand), as a result of a 57.5% increase in investment securities, to ¥37,970 million (US\$324,530 thousand) – largely related to unrealized gains – that compensated for a 9.6% decrease in goodwill, to ¥28,625 million (US\$244,658 thousand), and a 4.1% decrease in other intangible assets, to ¥6,014 million (US\$51,402 thousand). Working capital (the difference between the balance of notes and accounts receivable plus inventories and notes and accounts payable) rose from ¥99,949 million in the previous year, to ¥115,708 million, and the current ratio rose from 214.9% in the previous fiscal year, to 253.3%. Return on total assets improved, from 7.6% to 8.2%.

Total current liabilities decreased 6.6%, to ¥79,229 million (US\$677,171 thousand), as short-term bank loans decreased 33.9%, to ¥6,619 million (US\$56,573 thousand), the current portion of long-term debt decreased 88.6%, to ¥390 million (US\$3,333 thousand), notes and accounts payable edged down 4.2%, to ¥48,284 million (US\$412,683 thousand), accrued income taxes climbed 22.5%, to ¥7,165 million (US\$61,239 thousand), and accrued expenses and other advanced 10.5%, to ¥16,771 million (US\$143,343 thousand). Related to the increase in assets, total long-term liabilities increased 10.5%, to ¥60,647 million (US\$518,350 thousand). Long-term debt rose 18.6%, to ¥19,256 million (US\$164,581 thousand), and deferred income taxes increased 86.7%, reaching ¥13,714 million (US\$117,214 thousand). Accrued retirement benefits declined 0.5%, to ¥13,404 million (US\$114,564 thousand), and other decreased 20.1%, to ¥14,273 million (US\$121,991 thousand). Minority interests increased 4.5% from ¥2,253 million, to ¥2,354 million (US\$20,120 thousand). Total shareholders' equity increased 8.4%, to ¥339,127 million (US\$2,898,521 thousand). Principal factors included an 11.8% increase in retained earnings, to ¥155,377 million (US\$1,328,009 thousand), an 82.3% rise in unrealized gain on revaluation of securities, to ¥16,426 million (US\$140,393 thousand), and a 2.0% decrease in treasury stock at cost, to ¥11,584 million (US\$99,009 thousand). As a result, total liabilities and shareholders' equity rose 5.8%, to ¥481,357 million (US\$4,114,162 thousand), and the equity ratio rose 1.7 percentage points, to 70.5%.

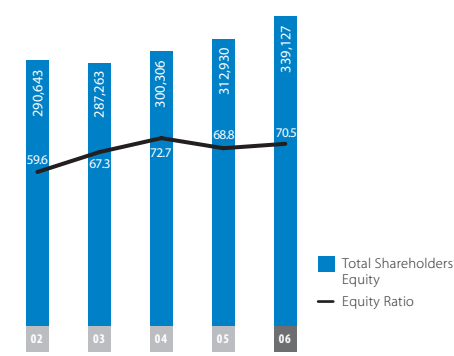
Number of Months' Sales in Inventory



Total Current Assets & Total Current Liabilities



Total Shareholders' Equity & Equity Ratio



### CASH FLOWS

Net cash and cash equivalents provided by operating activities decreased 17.5%, to ¥32,691 million (US\$279,410 thousand). This decline was primarily due to an increase in notes and accounts receivable of ¥5,838 million, an increase in inventories of ¥4,219 million, and a decrease in notes and accounts payable of ¥2,505 million. Furthermore, interest paid increased from ¥299 million, to ¥388 million, and income taxes paid increased from ¥8,189 million, to ¥10,226 million.

Net cash and cash equivalents used in investing activities decreased from ¥44,696 million in fiscal 2004, to ¥13,693 million (US\$117,034 thousand) in fiscal 2005. The most significant outlays were payments for acquisition of property, plant, equipment and intangible assets of ¥36,069 million and payments for purchase of investment securities of ¥1,379 million. This was partially offset by proceeds from sales of property, plant, equipment and intangible assets of ¥10,550 million, up from ¥470 million in the previous term, and proceeds from sales and redemption of investment securities of ¥3,604 million, down from ¥8,400 million in fiscal 2004.

Net cash and cash equivalents used in financing activities was ¥7,791 million (US\$66,590 thousand), compared with net cash and cash equivalents provided by financing activities of ¥13,221 million in the previous fiscal year. Principal elements included a decrease in short-term bank loans of ¥3,322 million, proceeds from long-term debt of ¥3,400 million, and repayments of long-term debt of ¥3,407 million. Dividends paid amounted to ¥4,772

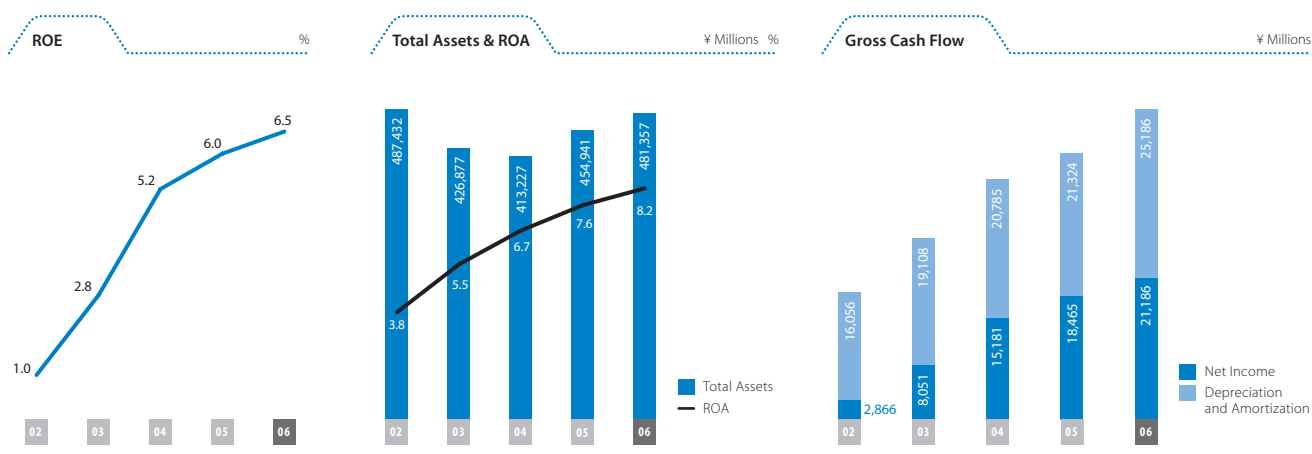
million, compared with ¥4,039 million in the previous fiscal year. Cash and cash equivalents at the end of the fiscal year were ¥28,085 million (US\$240,043 thousand), up from ¥16,743 million in the previous fiscal year.

### RESEARCH AND DEVELOPMENT

Total R&D expenses for the year were ¥14,069 million (US\$120,248 thousand), or 3.8% of net sales, compared with 3.9% in the previous year. Companywide R&D expenses once again accounted for the largest portion of total R&D expenses: ¥4,852 million, or 34.5%. R&D focused on developing new products related to such fields as optics and electronics. R&D in the chemicals and resins segment, at ¥4,135 million, accounted for 29.4%. Fibers and textiles accounted for ¥2,298 million, or 16.3% of the total, while high-performance materials, medical products and others accounted for ¥2,782 million, or 19.8% of total R&D expenses. In all, the Group employs 810 research personnel.

### CAPITAL EXPENDITURE

Capital expenditure for the year under review decreased 25.9%, to ¥33,872 million (US\$289,504 thousand). Capital expenditure related to chemicals and resins operations amounted to ¥23,810 million, accounting for 70.3% of total capital expenditure. Capital expenditure mainly comprised a 30 million square meter per year increase in production facilities for optical-use poval film. Together with existing facilities, this gives a total production



capacity of 61 million square meters per year. In the United States, the Company increased *EVAL* production facilities by 24,000 tons. Capital expenditure for fibers and textiles rose 16.0%, to ¥4,787 million, or 14.1% of the total, and capital expenditure for high performance materials, medical products and others decreased 54.5%, to ¥3,283 million, or 9.7% of the total. The Company will continue aggressive capital expenditure focused on mainstay businesses.

### OUTLOOK

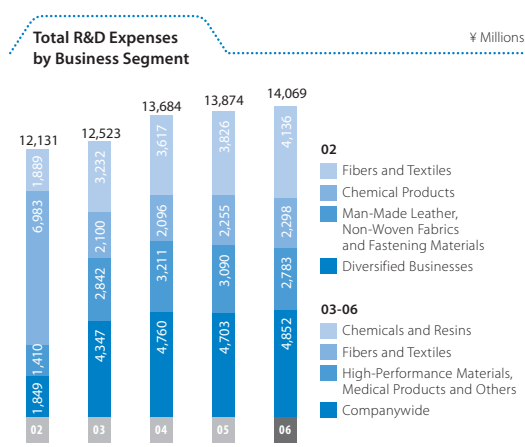
In fiscal 2006, ending March 31, 2007, the Japanese economy will continue to break away from prolonged deflationary conditions. In the global economy, high raw material and fuel prices are forecast to continue with fears of an economic slowdown in the United States and China. These factors make it impossible to be complacent about the future. Under these circumstances, Kuraray will pursue the following business initiatives. In the chemicals and resins business, we will endeavor to pass higher raw material and fuel prices along in the form of higher poval resin prices and increase sales of high-value-added products. In poval film, we will adopt measures that accurately address growing demand for optical-use film and accelerate price increases and sales expansion through the introduction of new high-performance products. In *EVAL*, Kuraray is committed to raising product prices and expanding sales of new products, such as *EVAL SP*, *KURARISTER*,

and others. We will also work to expand global markets for isoprene-related products, including thermoplastic elastomers, while curtailing activities in low-profit methacrylic resins and expanding optical applications.

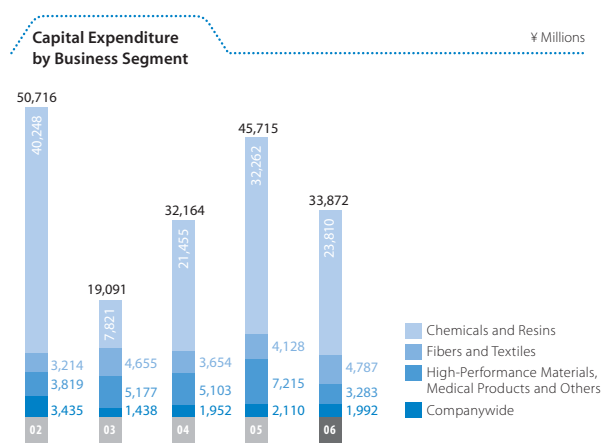
Kuraray will seek to secure increased profits in the fibers and textiles business by expanding sales of *KURALON* as a substitute for asbestos and raising product prices. Utilizing new processes, we will introduce *CLARINO* products and expand applications, including car seats, polishing materials, and other industrial uses. In the polyester business, Kuraray will accelerate the development of proprietary polymers and the shift toward differentiated products.

The Group will expand sales of dental materials in the medical business in Europe, the United States, and overseas markets as well as a new dialyzer with the aim of bolstering the high-performance materials, medical products and others business. In the optical products business, we will introduce new MD-type screens that offer superior optical properties. For *GENESTAR*, we will expand electric and electronic material applications and step up the development of applications for automobile use.

Forecasts for fiscal 2006, ending March 31, 2007, are net sales of ¥400.0 billion, operating income of ¥41.0 billion, and net income of ¥22.0 billion. Projections for fiscal 2006 assume an average exchange rate of ¥115 to the U.S. dollar, ¥140 to the euro, and a Dubai crude oil price of US\$58 per barrel.



Note: Data for the year ended March 31, 2003, reflects the conversion to an in-house company system so as to combine Companywide R&D expenses. Data for prior years has not been restated.



Note: Data for the year ended March 31, 2003, reflects the conversion to an in-house company system so as to combine Companywide capital expenditure. Data for prior years has not been restated.

## BUSINESS RISKS

Significant risks that could have an impact on the Kuraray Group's results of operations and financial condition are discussed below. Estimates of future performance are the Kuraray Group's best judgment as of March 31, 2006.

### (1) Changes in the Market Environment

In the rapidly growing information and communications fields, the Kuraray Group supplies a broad variety of materials and components, notably film and molded resin products for flat panel displays. The Group is strategically expanding net sales and profits in this field, where the market environment can undergo drastic changes within a short period as a result of reverses in industry standards and changes in the supply-and-demand balance. If these events occur, sales volumes could contract or sales prices could fall, with an adverse effect on the Kuraray Group's performance.

### (2) Changes in Raw Material and Fuel Prices

The Kuraray Group is primarily engaged in the manufacturing and sale of synthetic fibers and textiles, chemical products, and synthetic resins as well as finished goods made from these materials. In this business structure, the effects of raw material and fuel prices on cost of sales are relatively large. If high market prices for raw materials, such as ethylene and other chemical materials, crude oil, and natural gas, cannot be offset by such internal measures as increases in productivity and passing costs along in sales prices, it is possible that the Kuraray Group's performance would be adversely affected.

### (3) Product Defects

The Kuraray Group has instituted thorough product quality control measures, and the Group carries liability insurance against product liability claims. However, the possibility exists that major product defects arising from unforeseeable causes could necessitate a large-scale product recall. Under such circumstances, recall expenses, loss of public trust, compensation of customers, legal costs, and indemnification expenses could adversely affect the financial position of the Kuraray Group.

### (4) Changes in Exchange Rates

The Kuraray Group is expanding its manufacturing and sales operations in Japan and in various overseas regions, including Europe, North America, and Asia. Exports of the Kuraray Group's domestically manufactured products are affected by changes in export sales prices. Sales of products manufactured at our overseas bases are affected by sales prices in different currency blocks and the value of foreign-currency-denominated assets and liabilities. All the Group's businesses are composed of operations in different currency blocks and are therefore subject to the effects of changes in raw material prices. The Kuraray Group is in general affected negatively by a rise in the value of the yen with respect to other currencies.

### (5) Litigation

Engaged in a broad range of business activities, the Kuraray Group is subject to potential litigation across numerous fields. In the fiscal year under review, Kuraray did not face litigation of a material nature. In the event the Group is subject to future litigation, however, its performance and financial standing may be adversely affected.

### (6) Accidents and Disasters

The Kuraray Group has manufacturing facilities in Japan, Europe, North America, and Asia. Many of these are large chemical plants that handle a variety of chemicals. If an industrial accident or release of pollutants to the environment should occur, the loss of the lives and property of third parties could result in claims against the assets of the Kuraray Group and halt manufacturing operations for long periods, adversely affecting the performance and financial position of the Kuraray Group. The occurrence of an earthquake, flood, or other natural disaster, an epidemic of a communicable disease or other medical incident, war, riot, terrorist attack, trouble with information systems, or information leaks could interfere with the business operations of the Kuraray Group, with an adverse impact on performance and financial position. Accidents or disasters such as those mentioned above could also interfere with the business operations of the Kuraray Group's customers and suppliers, with a similar adverse effect on the Kuraray Group's performance and financial position.

## CONSOLIDATED BALANCE SHEETS

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

Thousands of  
U.S. dollars  
(Note 1)

	Millions of yen		
March 31, 2006 and 2005	<b>2006</b>	2005	<b>2006</b>
<b>ASSETS</b>			
<b>Current assets:</b>			
Cash and cash equivalents	¥ 28,085	¥ 16,743	\$ 240,043
Marketable securities (Note 3)	-	5,990	-
Notes and accounts receivable:			
Trade	88,677	82,079	757,922
Unconsolidated subsidiaries and affiliates	1,757	1,752	15,017
Other	4,127	2,322	35,274
Loans receivable from unconsolidated subsidiaries, affiliates and others	624	429	5,334
Allowance for doubtful accounts	(1,015)	(904)	(8,675)
	<b>94,170</b>	85,678	<b>804,872</b>
Inventories (Note 4)	69,431	64,173	593,426
Deferred income taxes (Note 9)	6,478	7,313	55,368
Other current assets	2,504	2,420	21,402
<b>Total current assets</b>	<b>200,668</b>	182,317	<b>1,715,111</b>
<b>Property, plant and equipment (Note 5):</b>			
Land	19,676	20,289	168,171
Buildings	88,265	92,759	754,401
Machinery and equipment	443,689	421,146	3,792,214
Construction-in-progress	24,590	21,527	210,171
	<b>576,220</b>	555,721	<b>4,924,957</b>
Less accumulated depreciation	(416,824)	(397,427)	(3,562,598)
	<b>159,396</b>	158,294	<b>1,362,359</b>
<b>Investments and other assets:</b>			
Goodwill	28,625	31,661	244,658
Other intangible assets	6,014	6,272	51,402
Investment securities (Note 3)	37,970	24,115	324,530
Investments in unconsolidated subsidiaries and affiliates	4,512	4,465	38,564
Loans receivable from:			
Unconsolidated subsidiaries and affiliates	2,802	2,947	23,949
Other	475	619	4,060
Accumulated premiums on insurance	29,707	35,188	253,906
Deferred income taxes (Note 9)	2,650	2,077	22,650
Prepaid pension costs (Note 10)	5,142	3,512	43,948
Other	3,511	4,811	30,008
Allowance for doubtful accounts	(115)	(1,337)	(983)
	<b>121,293</b>	114,330	<b>1,036,692</b>
	<b>¥481,357</b>	¥454,941	<b>\$4,114,162</b>

See notes to consolidated financial statements.

	Millions of yen	2005	Thousands of U.S. dollars (Note 1)
	2006		2006
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current liabilities:</b>			
Short-term bank loans (Note 6)	¥ 6,619	¥ 10,013	\$ 56,573
Current portion of long-term debt (Note 6)	390	3,434	3,333
Notes and accounts payable:			
Trade	39,150	39,905	334,615
Unconsolidated subsidiaries and affiliates	1,004	1,733	8,581
Other	8,130	8,739	69,487
Accrued income taxes (Note 9)	7,165	5,850	61,239
Accrued expenses and other	16,771	15,183	143,343
<b>Total current liabilities</b>	<b>79,229</b>	<b>84,857</b>	<b>677,171</b>
<b>Long-term liabilities:</b>			
Long-term debt (Note 6)	19,256	16,234	164,581
Deferred income taxes (Note 9)	13,714	7,345	117,214
Accrued retirement benefits (Note 10)	13,404	13,469	114,564
Other	14,273	17,853	121,991
<b>Total long-term liabilities</b>	<b>60,647</b>	<b>54,901</b>	<b>518,350</b>
<b>Minority interests</b>	<b>2,354</b>	<b>2,253</b>	<b>20,120</b>
<b>Commitments and contingencies (Note 13)</b>			
<b>Shareholders' equity (Note 7):</b>			
Common stock:			
Authorized – 700,000,000 shares			
Issued – 382,863,603 shares	88,955	88,955	760,299
Capital surplus	87,227	87,156	745,530
Retained earnings	155,377	138,951	1,328,009
Unrealized gain on revaluation of securities (Note 3)	16,426	9,012	140,393
Cumulative translation adjustments	2,726	679	23,299
	350,711	324,753	2,997,530
Treasury stock at cost – 15,379,675 shares in 2006			
15,755,698 shares in 2005	(11,584)	(11,823)	(99,009)
<b>Total shareholders' equity</b>	<b>339,127</b>	<b>312,930</b>	<b>2,898,521</b>
	¥481,357	¥454,941	\$4,114,162

## CONSOLIDATED STATEMENTS OF INCOME

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

	Millions of yen		Thousands of U.S. dollars (Note 1)
Years ended March 31, 2006 and 2005			
	<b>2006</b>	2005	<b>2006</b>
<b>Net sales</b>	<b>¥375,073</b>	¥354,874	<b>\$3,205,752</b>
<b>Cost of sales (Note 12)</b>	<b>266,284</b>	254,115	<b>2,275,931</b>
<b>Gross profit</b>	<b>108,789</b>	100,759	<b>929,821</b>
<b>Selling, general and administrative expenses (Notes 11 and 12)</b>	<b>70,512</b>	67,572	<b>602,667</b>
<b>Operating income</b>	<b>38,277</b>	33,187	<b>327,154</b>
<b>Other income (expenses):</b>			
Interest and dividend income	<b>1,294</b>	1,192	<b>11,060</b>
Equity in earnings of affiliates	<b>56</b>	30	<b>479</b>
Interest expenses	<b>(414)</b>	(297)	<b>(3,539)</b>
Restructuring charges	<b>(1,693)</b>	(1,249)	<b>(14,470)</b>
Gain on sales of investment securities	<b>1,029</b>	–	<b>8,795</b>
Write-down of investment securities	<b>(253)</b>	–	<b>(2,163)</b>
Gain on sales of property, plant and equipment	<b>8,446</b>	259	<b>72,188</b>
Loss on disposal of property, plant and equipment	<b>(492)</b>	–	<b>(4,205)</b>
Impairment loss on property, plant and equipment (Note 5)	<b>(5,455)</b>	–	<b>(46,624)</b>
Other, net	<b>(6,432)</b>	(3,277)	<b>(54,974)</b>
	<b>(3,914)</b>	(3,342)	<b>(33,453)</b>
<b>Income before income taxes and minority interests</b>	<b>34,363</b>	29,845	<b>293,701</b>
<b>Income taxes (Note 9):</b>			
Current	<b>11,674</b>	8,723	<b>99,777</b>
Deferred	<b>1,394</b>	2,564	<b>11,915</b>
	<b>13,068</b>	11,287	<b>111,692</b>
<b>Minority interests in net income of consolidated subsidiaries</b>	<b>(109)</b>	(93)	<b>(932)</b>
<b>Net income</b>	<b>¥ 21,186</b>	¥ 18,465	<b>\$ 181,077</b>

	Yen		U.S. dollars (Note 1)
<b>Net income per share:</b>			
Primary	<b>¥57.51</b>	¥50.13	<b>\$0.49</b>
Fully diluted	<b>57.41</b>	50.12	<b>0.49</b>

See notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

Millions of yen

Years ended March 31, 2006 and 2005	Common stock	Capital surplus	Retained earnings	Unrealized gain on revaluation of securities (Note 3)	Cumulative translation adjustments	Treasury stock
<b>Balance at March 31, 2004</b>	¥ 88,955	¥ 87,150	¥ 127,148	¥ 7,902	¥ 842	¥ (11,691)
Net income			18,465			
Cash dividends, ¥12.00 per share			(4,039)			
Bonuses to directors			(57)			
Effect of changes in reporting entities			(2,569)			
Minimum pension liability adjustment			3			
Changes in unrealized gain on revaluation of securities (Note 3)				1,110		
Translation adjustments					(163)	
Treasury stock acquired, net		6				(132)
<b>Balance at March 31, 2005</b>	¥ 88,955	¥ 87,156	¥ 138,951	¥ 9,012	¥ 679	¥ (11,823)
Net income			21,186			
Cash dividends, ¥13.00 per share			(4,772)			
Bonuses to directors			(59)			
Effect of changes in reporting entities			56			
Minimum pension liability adjustment			15			
Changes in unrealized gain on revaluation of securities (Note 3)				7,414		
Translation adjustments					2,047	
Treasury stock sold, net		71				239
<b>Balance at March 31, 2006</b>	<b>¥88,955</b>	<b>¥87,227</b>	<b>¥155,377</b>	<b>¥16,426</b>	<b>¥2,726</b>	<b>¥(11,584)</b>

Thousands of U.S. dollars (Note 1)

<b>Balance at March 31, 2005</b>	\$760,299	\$744,923	\$1,187,615	\$ 77,026	\$ 5,803	\$(101,051)
Net income			181,077			
Cash dividends, \$0.11 per share			(40,786)			
Bonuses to directors			(504)			
Effect of changes in reporting entities			479			
Minimum pension liability adjustment			128			
Changes in unrealized gain on revaluation of securities (Note 3)				63,367		
Translation adjustments					17,496	
Treasury stock sold, net		607				2,042
<b>Balance at March 31, 2006</b>	<b>\$760,299</b>	<b>\$745,530</b>	<b>\$1,328,009</b>	<b>\$140,393</b>	<b>\$23,299</b>	<b>\$(99,009)</b>

See notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

Thousands of  
U.S. dollars  
(Note 1)

	Millions of yen		
Years ended March 31, 2006 and 2005	2006	2005	2006
<b>Cash flows from operating activities:</b>			
Income before income taxes and minority interests	¥34,363	¥29,845	\$293,701
Adjustments to reconcile income before income taxes and minority interests to net cash and cash equivalents provided by operating activities:			
Depreciation and amortization	25,186	21,324	215,265
Increase in allowance for doubtful accounts	37	27	316
Decrease in accrued retirement benefits, net	(141)	(357)	(1,205)
Impairment loss on property, plant and equipment (Note 5)	5,455	-	46,624
Gain on sales of property, plant and equipment	(8,446)	(259)	(72,188)
Loss on disposal of property, plant and equipment	492	-	4,205
Gain on sales of investment securities	(1,029)	-	(8,795)
Write-down of investment securities	253	-	2,163
Interest and dividend income	(1,294)	(1,192)	(11,060)
Interest expenses	414	297	3,539
(Increase) decrease in notes and accounts receivable	(5,838)	273	(49,897)
Increase in inventories	(4,219)	(2,155)	(36,060)
(Decrease) increase in notes and accounts payable	(2,505)	2,633	(21,410)
Increase in prepaid pension costs (Note 10)	(1,630)	(2,221)	(13,932)
Other, net	1,264	(933)	10,802
<b>Sub-total</b>	<b>42,362</b>	<b>47,282</b>	<b>362,068</b>
Interest and dividend received	943	821	8,060
Interest paid	(388)	(299)	(3,316)
Income taxes paid	(10,226)	(8,189)	(87,402)
<b>Net cash and cash equivalents provided by operating activities</b>	<b>32,691</b>	<b>39,615</b>	<b>279,410</b>
<b>Cash flows from investing activities:</b>			
Decrease (increase) in marketable securities	3,000	(3,000)	25,641
Payments for acquisition of property, plant, equipment and intangible assets	(36,069)	(47,512)	(308,282)
Proceeds from sales of property, plant, equipment and intangible assets	10,550	470	90,171
Payments for purchase of investment securities	(1,379)	(1,607)	(11,786)
Proceeds from sales and redemption of investment securities	3,604	8,400	30,803
Payments of premiums on insurance	(702)	(928)	(6,000)
Withdrawals from accumulated premiums on insurance	6,573	55	56,179
Other, net	730	(574)	6,240
<b>Net cash and cash equivalents used in investing activities</b>	<b>(13,693)</b>	<b>(44,696)</b>	<b>(117,034)</b>
<b>Cash flows from financing activities:</b>			
(Decrease) increase in short-term bank loans	(3,322)	7,125	(28,393)
Decrease in commercial paper	-	(3,000)	-
Proceeds from long-term debt	3,400	6,075	29,060
Repayments of long-term debt	(3,407)	(2,821)	(29,120)
Proceeds from issuance of standard bonds	-	10,000	-
Dividends paid	(4,772)	(4,039)	(40,786)
Proceeds from sales of treasury stock	461	58	3,940
Payments for purchase of treasury stock	(151)	(177)	(1,291)
<b>Net cash and cash equivalents (used in) provided by financing activities</b>	<b>(7,791)</b>	<b>13,221</b>	<b>(66,590)</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>134</b>	<b>454</b>	<b>1,145</b>
<b>Net increase in cash and cash equivalents</b>	<b>11,341</b>	<b>8,594</b>	<b>96,931</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>16,743</b>	<b>7,015</b>	<b>143,103</b>
<b>Effect of changes in reporting entities</b>	<b>1</b>	<b>1,134</b>	<b>9</b>
<b>Cash and cash equivalents, end of year</b>	<b>¥28,085</b>	<b>¥16,743</b>	<b>\$240,043</b>

See notes to consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

Years ended March 31, 2006 and 2005

### 1. BASIS OF PRESENTING CONSOLIDATED FINANCIAL STATEMENTS:

The accompanying consolidated financial statements of Kuraray Co., Ltd. (the "Company") and its subsidiaries are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements from 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.

In preparing these consolidated financial statements, certain reclassifications have been made to the consolidated financial statements issued domestically to present them in a form more familiar to readers outside Japan. In addition, certain notes included herein are not required under accounting principles and practices generally accepted in Japan but have been presented as additional information.

Certain reclassifications of the accompanying consolidated financial statements as of and for the year ended March 31, 2005 have been made to conform to the 2006 presentation.

The United States dollar amounts included herein are provided solely for the convenience of readers outside Japan and are stated, as a matter of arithmetical computation only, at the rate of ¥117=\$1, the approximate exchange rate prevailing on March 31, 2006. The translations should not be construed as representations that the Japanese yen amounts have been, could have been or could in the future be, converted into United States dollars at this or any other rate.

### 2. SIGNIFICANT ACCOUNTING POLICIES:

#### (a) Principles of consolidation

These consolidated financial statements include the financial statements of the Company and its significant 35 subsidiaries (37 subsidiaries at March 31, 2005). A subsidiary is a company, more than 50% of whose shares are held by the Company, or a company, 40%-50% of whose shares are held by the Company and which is controlled by the Company through certain channels. Hereinafter, the Company and its consolidated subsidiaries are collectively referred to as the "Companies".

In the case of a change in reporting entity, the consolidated financial statements are not restated, but the effect of the change to retained earnings at the beginning of the year is directly charged or credited to retained earnings during the year.

Investments in unconsolidated subsidiaries and 20%-50% owned companies other than subsidiaries ("affiliates"), with minor exceptions, are accounted for using the equity method.

Some foreign subsidiaries of the Company are consolidated using a fiscal year ending December 31, which differs from that of the Company. Those subsidiaries do not prepare their financial statements at any date after December 31, or on or before March 31 in the succeeding year.

Any material events occurring during the January 1 to March 31 period are adjusted for in those consolidated financial statements.

The difference between the cost and the underlying net equity of investments in consolidated subsidiaries and affiliates accounted for on an equity basis are amortized using the straight-line method over the estimated period of the benefit, with minor exceptions, in case of which the difference is charged or credited to income when incurred. The differences recognized in overseas subsidiaries and affiliates are accounted for in accordance with accounting principles generally accepted in those countries.

#### (b) Cash and cash equivalents

Cash and cash equivalents include all highly liquid investments with an original maturity of three months or less, of which at least the face amount can be withdrawn at any time without penalty.

#### (c) Marketable securities and investment securities

Marketable securities and investment securities are classified into three categories: held-to-maturity, trading and available-for-sale securities. Trading securities are carried at fair value with unrealized gains or losses included in income, and held-to-maturity securities are carried at amortized cost. As of March 31, 2006 and 2005, marketable securities and investment securities represented available-for-sale securities. Available-for-sale securities are carried at fair value with unrealized gains or losses recorded as a component of shareholders' equity, net of applicable taxes. Available-for-sale securities whose fair value is not readily determinable are stated at cost except for debt securities, which are stated at amortized cost. Moreover, available-for-sale securities with a maturity of one year or less are classified as current assets.

#### (d) Inventories

Inventories other than supplies are stated at cost principally determined using the average cost method. Supplies are stated at cost principally determined using the moving average method.

#### (e) Property, plant and equipment

Property, plant and equipment are stated at cost.

Depreciation, except for buildings, is principally computed using the declining-balance method over the estimated useful lives of the assets. The depreciation method for buildings is principally computed using the straight-line method.

The estimated useful lives of assets are principally as follows:

Buildings	31 to 50 years
Machinery and equipment	4 to 10 years

The Companies use machinery and equipment under financing leases that do not transfer ownership to the lessee, and such leased assets used by the Company and its domestic subsidiaries are not capitalized on the balance sheet in conformity with accounting principles generally accepted in Japan.

**(f) Goodwill**

Goodwill is stated at cost less amortization.

Amortization is principally computed over 15 years using the straight-line method.

During the year ended March 31, 2005, a subsidiary of the Company purchased property, plant, equipment and goodwill relating to the PVB film business from HT Troplast AG. A consideration of ¥4,826 million (\$41,248 thousand) was included in “Acquisition of property, plant, equipment and intangible assets” in the consolidated statements of cash flows.

**(g) Accounting for impairment losses on fixed assets**

The Company and its domestic consolidated subsidiaries and affiliates have adopted “Accounting Standard for Impairment of Fixed Assets” and “Implementation Guidance for Accounting for Impairment of Fixed Assets” from the fiscal year beginning April 1, 2005. The standard, which was issued by the Business Accounting Council in Japan on August 9, 2002, requires that fixed assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The effective date of the standard is the fiscal year beginning on or after April 1, 2005.

As a result of this change, income before income taxes and minority interests for the year ended March 31, 2006 decreased ¥5,455 million (\$46,624 thousand). The effects of this change are further discussed in Note 5.

**(h) Income taxes**

Accrued income taxes are provided at the amount currently payable. The Companies adopted the interperiod income tax allocation accounting, using the assets and liabilities method, in which deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. A valuation allowance is deducted from deferred tax assets when there is uncertainty regarding their realizability.

**(i) Retirement benefits**

Most of the Companies have unfunded lump-sum benefit plans and funded contributory pension plans, generally covering all of their employees.

Under the terms of the Companies’ retirement plans, substantially all of their employees are entitled to a lump-sum payment at the time of retirement. The amount of the retirement benefit is, in general, based on the length of service, basic salary at the time of retirement and reason for retirement.

The contributory pension plans of the Company and its domestic subsidiaries, which principally cover those employees who retire at age 60 or who have served with those companies for more than 20 years and are age 50 or more, generally provide for pension payments for a period of 10

years subsequent to age 60. The annual charge for the current service cost of these plans is determined actuarially and currently funded through outside trustees.

Directors and corporate auditors are entitled, subject to shareholders’ approval, to lump-sum payments under the unfunded retirement plan. The accrued liabilities for their retirement benefits are, in general, based upon the amounts required by the Companies’ internal regulations at the respective balance sheet date.

**(j) Foreign currency items**

Income and expenses in foreign currency are translated into Japanese yen at the exchange rates prevailing at the transaction dates. Foreign currency denominated assets and liabilities are translated into Japanese yen at the exchange rates prevailing at the balance sheet date.

In preparing the consolidated financial statements, the assets and liabilities of foreign subsidiaries have been translated into Japanese yen at the rates in effect at the balance sheet date, and income and expenses have been translated at the average rate for the year then ended. Translation adjustments resulting from this process are charged or credited directly to shareholders’ equity as cumulative translation adjustments in the consolidated balance sheets.

**(k) Research and development expenses**

Expenses relating to research and development activities are charged to income when incurred.

**(l) Net income per share**

The computation of primary net income per share is based on the weighted average number of shares outstanding during each financial period. The computation of fully diluted net income per share is based on the weighted average number of outstanding shares after consideration of the effect of dilution of common stock equivalents.

**(m) Allowance for doubtful accounts**

The Companies provide for doubtful accounts principally at an amount computed based on the historical bad debt ratio during a certain reference period plus an estimated uncollectible amount based on the analysis of certain individual accounts.

**(n) Derivative financial instruments and hedging**

Derivative financial instruments, which include forward foreign exchange contracts, currency swap contracts and interest rate swap contracts, are used to offset the Companies’ risk of exposure to changes in interest and currency exchange rates in respect of their financial assets and liabilities, in accordance with the Companies’ internal policies and procedures.

**a. Derivatives**

All derivatives are stated at fair value, except for derivatives that are designated as hedging instruments (see below).

## b. Hedge accounting

The Companies adopt the method for hedging instruments whereby any gain or loss is deferred over the period of the hedging contract and is offset against the deferred loss or gain on the related hedged items.

However, when an interest rate swap contract meets certain conditions, the net amount to be paid or received under the contract is added to or deducted from the interest on the hedged items.

## c. Hedging policy

The Companies use financial instruments to hedge market fluctuation risks in accordance with their internal policies and procedures.

## d. Assessment method for hedge effectiveness

The Companies evaluate the effectiveness of their hedging activities by reference to the accumulated gains or losses on the hedging instruments and the related hedged items. Interest rate swap contracts which meet certain conditions are evaluated for effectiveness at the commencement of the hedges.

## 3. SECURITIES:

The following is a summary of available-for-sale securities at March 31, 2006 and 2005:

	Millions of yen			
	Cost	Gross unrealized gains	Gross unrealized losses	Book value (estimated fair value)
March 31, 2006				
Equity securities	¥6,756	¥27,636	¥4	¥34,388
Bonds and debentures	—	—	—	—
Other	—	—	—	—
	¥6,756	¥27,636	¥4	¥34,388

	Millions of yen			
	Cost	Gross unrealized gains	Gross unrealized losses	Book value (estimated fair value)
March 31, 2005				
Equity securities	¥ 5,795	¥14,588	¥ 4	¥20,379
Bonds and debentures	5,352	638	—	5,990
Other	—	—	—	—
	¥11,147	¥15,226	¥ 4	¥26,369

	Thousands of U.S. dollars			
	Cost	Gross unrealized gains	Gross unrealized losses	Book value (estimated fair value)
March 31, 2006				
Equity securities	\$57,744	\$236,205	\$34	\$293,915
Bonds and debentures	—	—	—	—
Other	—	—	—	—
	\$57,744	\$236,205	\$34	\$293,915

Available-for-sale securities with no available fair values as of March 31, 2006 and 2005, amounting to ¥3,212 million (\$27,453 thousand) and ¥3,121 million, respectively, are excluded from the above table.

Securities with an original maturity of three months or less have been transferred to cash and cash equivalents.

#### 4. INVENTORIES:

Inventories at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of
	2006	2005	U.S. dollars
Finished products	<b>¥47,840</b>	¥46,203	<b>\$408,888</b>
Semi-finished products and work-in-progress	<b>10,499</b>	7,052	<b>89,735</b>
Raw materials and supplies	<b>11,092</b>	10,918	<b>94,803</b>
	<b>¥69,431</b>	¥64,173	<b>\$593,426</b>

#### 5. IMPAIRMENT LOSSES ON FIXED ASSETS:

The significant component of impairment losses on fixed assets for the fiscal year ended March 31, 2006 is as follows:

	Millions of yen		Thousands of
	2006	2005	U.S. dollars
Plant and equipment for polyester filaments	<b>¥1,242</b>		<b>\$10,615</b>
Plant and equipment for opto-screens	<b>2,627</b>		<b>22,453</b>
Plant and equipment for high-flux filter membranes for artificial kidneys	<b>1,468</b>		<b>12,547</b>

As a minimum unit for generating cash flow, business assets are grouped into sections used for management accounting, and lent assets and idle assets are assessed individually.

Impairment losses are recognized in the consolidated statements of income by reducing the carrying amount of the impaired assets to the recoverable amounts to be measured as value in use, which is equivalent

to their discounted future cash flows, or the net saleable value of the assets, whichever is higher.

For the year ended March 31, 2006, the discount rate used for the estimation of the recoverable amounts, using future cash flows, of the assets showing signs of impairment was 4%.

#### 6. SHORT-TERM BANK LOANS, LONG-TERM DEBT AND BONDS:

Short-term bank loans were generally represented by 365-day notes with interest rates principally of 1.6% at March 31, 2006.

Long-term debt and bonds consisted of the following:

	Millions of yen		Thousands of
	2006	2005	U.S. dollars
Unsecured loans principally from banks and insurance companies with interest rates ranging from 0.37% to 3.30% maturing serially until 2022	<b>¥ 9,646</b>	¥ 9,668	<b>\$ 82,444</b>
0.99% yen unsecured bonds due December 20, 2011	<b>10,000</b>	10,000	<b>85,470</b>
	<b>19,646</b>	19,668	<b>167,914</b>
Current portion	<b>(390)</b>	(3,434)	<b>(3,333)</b>
	<b>¥19,256</b>	¥16,234	<b>\$164,581</b>

The annual maturities of long-term debt and bonds outstanding at March 31, 2006 for the respective years ending March 31 were as follows:

	Millions of yen	Thousands of U.S. dollars
2006	¥ 390	\$ 3,333
2007	7,400	63,248
2008	1,000	8,547
2009	850	7,265
2010	1	8
Thereafter	10,005	85,513
	¥19,646	\$167,914

#### 7. SHAREHOLDERS' EQUITY:

The Company and its domestic subsidiaries were subject to the Japanese Commercial Code (the "Code") as of March 31, 2006.

The Code required at least 50% of the issue price of new shares to be designated as stated capital following the passing of a resolution by the Board of Directors. Proceeds in excess of the amounts designated as stated capital were credited to additional paid-in capital. Additional paid-in capital was included in capital surplus in the accompanying balance sheets as of March 31, 2006 and 2005.

The Code provided that an amount equal to at least 10% of cash dividends and directors' bonuses, etc., to be paid from retained earnings, should be appropriated as a legal reserve. No further appropriation is required when the sum of the additional paid-in capital and legal reserve equals 25% or more of common stock. If the sum of the additional paid-in capital and legal reserve exceeded the required amount, the excess amount is allowed to be appropriated following the passing of a resolution at the ordinary general meeting of shareholders. All or part of the additional paid-in capital and/or a legal reserve may be used to reduce a deficit or may be transferred to common stock through the appropriate legal procedures. A legal reserve amounting to ¥6,570 million (\$56,154 thousand) was included in retained earnings as of March 31, 2006 and 2005.

#### 9. INCOME TAXES:

The Companies were subject to several taxes based on income, which, in the aggregate, resulted in a normal effective tax rate of approximately 40.4% in Japan for the years ended March 31, 2006 and 2005.

Reconciliation of the differences between the normal effective tax rate and the income tax rate in the accompanying consolidated statements of income is as follows:

	2006	2005
Normal effective tax rate	40.4%	40.4%
Non-taxable income	(0.3)	(0.3)
Tax credit primarily for research and development expenses	(2.9)	(2.9)
Other, largely loss incurred by consolidated subsidiaries	0.8	0.6
Income tax rate per statements of income	38.0%	37.8%

#### 8. STOCK-BASED COMPENSATION PLANS:

The Company has a stock option plan. On June 27, 2002, the shareholders of the Company approved the issuance of new stock acquisition rights in the form of a stock option plan for directors, corporate auditors and managers of the Company and its subsidiaries. Based on this approval, the Company issued new stock acquisition rights of 1,076,500 shares of common stock of the Company. These rights are exercisable from June 28, 2004 to June 27, 2012. The exercise price is ¥825 (\$7.05) per share. The number of shares to be issued under this option, if all rights were exercised, as of March 31, 2006 was 754,500.

Subsequently, on June 26, 2003, the shareholders of the Company approved the issuance of new stock acquisition rights in the form of a stock option plan for directors, corporate auditors, executive officers and employees of the Company and its subsidiaries. Based on this approval, the Company issued new stock acquisition rights of 2,811,000 shares of common stock of the Company. These rights are exercisable from June 27, 2005 to June 26, 2013. The exercise price is ¥918 (\$7.85) per share. The number of shares to be issued under this option, if all rights were exercised, as of March 31, 2006 was 2,273,500.

The significant components of deferred tax assets and liabilities at March 31, 2006 and 2005 are as follows:

(1) Current:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets			
Accrued enterprise taxes and other taxes	¥ 829	¥ 776	\$ 7,085
Accrued bonuses	2,446	2,379	20,906
Other	3,228	4,441	27,590
Total deferred tax assets	6,503	7,596	55,581
Total deferred tax liabilities	25	283	213
Net deferred tax assets	¥6,478	¥7,313	\$55,368

(2) Non-current:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets			
Accrued retirement benefits	¥ 824	¥ 757	\$ 7,043
Impairment loss on property, plant and equipment	620	—	5,299
Other	1,413	1,545	12,077
Total deferred tax assets	2,857	2,302	24,419
Deferred tax liabilities			
Deferred gain on sales of fixed assets to the public	105	105	898
Special depreciation	10	10	85
Unrealized gain on revaluation of securities	30	26	256
Other	62	84	530
Total deferred tax liabilities	207	225	1,769
Net deferred tax assets	¥ 2,650	¥2,077	\$ 22,650
Deferred tax liabilities			
Depreciation	¥ 5,056	¥4,802	\$ 43,214
Deferred gain on sales of fixed assets to the public	2,681	1,438	22,915
Special depreciation	303	282	2,590
Special account for reserve for deferred gains on sales of fixed assets	698	—	5,966
Unrealized gain on revaluation of securities	11,103	5,824	94,897
Prepaid pension costs	2,077	1,419	17,752
Other	885	885	7,563
Total deferred tax liabilities	22,803	14,650	194,897
Deferred tax assets			
Accrued retirement benefits	3,981	3,701	34,025
Impairment loss on property, plant and equipment	1,536	—	13,128
Other	3,572	3,604	30,530
Total deferred tax assets	9,089	7,305	77,683
Net deferred tax liabilities	¥13,714	¥7,345	\$117,214

At March 31, 2006 and 2005, valuation allowances of ¥5,864 million (\$50,120 thousand) and ¥5,172 million were deducted from non-current deferred tax assets, respectively.

The deferred tax assets and liabilities of the consolidated subsidiaries in different tax jurisdictions are presented without offset in accordance with Japanese accounting practices.

**10. RETIREMENT BENEFITS:**

The following tables set forth the changes in the benefit obligation, plan assets and funded status of the Companies at March 31, 2006 and 2005.

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Projected benefit obligation at end of year	¥(50,058)	¥(50,161)	\$(427,846)
Fair value of plan assets at end of year	36,999	28,953	316,231
Funded status:			
Projected benefit obligation in excess of plan assets	(13,059)	(21,208)	(111,615)
Unrecognized prior service costs	(1,179)	(1,300)	(10,077)
Unrecognized actuarial losses	6,781	13,302	57,956
Accrued pension liability recognized in the consolidated balance sheets	(7,457)	(9,206)	(63,736)
Prepaid pension costs	5,142	3,513	43,948
Net accrued retirement benefits	¥(12,599)	¥(12,719)	\$(107,684)

Accrued retirement benefits for directors and corporate auditors at March 31, 2006 and 2005, amounting to ¥805 million (\$6,880 thousand) and ¥750 million, respectively, are excluded from the above tables.

Retirement and pension costs of the Companies for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Service costs	¥ 1,846	¥2,230	\$15,778
Interest costs	958	957	8,188
Expected return on plan assets	(1,132)	(1,061)	(9,675)
Amortization:			
Prior service costs	(104)	(84)	(889)
Actuarial losses	1,017	841	8,692
Net periodic benefit costs	¥ 2,585	¥2,883	\$22,094

Assumptions used in accounting for the defined benefit plans for the years ended March 31, 2006 and 2005 are as follows:

Discount rate	mainly 2.0%
Long-term rate of return on fund assets	mainly 4.0%
Amortization period for transition charges at date of adoption	1 year
Amortization period for prior service cost	mainly 15 years (straight-line method)
Amortization period for actuarial losses	mainly 15 years (straight-line method)

**11. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES:**

The major components of selling, general and administrative expenses for the years ended March 31, 2006 and 2005 were as follows:

Account	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Freight and storage	¥13,758	¥12,755	\$117,590
Research and development	12,642	12,319	108,051
Salaries and bonuses	17,038	16,741	145,624

**12. RESEARCH AND DEVELOPMENT EXPENSES:**

Total research and development expenses for the years ended March 31, 2006 and 2005 amounted to ¥14,069 million (\$120,248 thousand) and ¥13,874 million, respectively.

### 13. COMMITMENTS AND CONTINGENCIES:

The Companies were contingently liable for guarantees, mainly for bank loans of unconsolidated subsidiaries, affiliates and others, of ¥1,681 million (\$14,368 thousand) and ¥1,152 million at March 31, 2006 and 2005 respectively.

These guarantees include letters of commitment for guarantees, letters of awareness and other items of a similar nature.

### 14. LEASES:

#### (a) Financing leases

Lease transactions as a lessee:

Payment of fees for financing leases, in which ownership of the leased assets is not transferred to the lessee and which are not required to be capitalized, for the years ended March 31, 2006 and 2005, were ¥277 million (\$2,368 thousand) and ¥282 million, respectively. Future lease payments, including amounts representing interest were as follows:

Account	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Due within one year	¥237	¥268	\$2,026
Due after one year	256	320	2,188
	¥493	¥588	\$4,214

The leased assets were as follows:

Year ended March 31, 2006	Millions of yen			Thousands of U.S. dollars
	Cost	Accumulated depreciation	Net	Net
Machinery and equipment	¥1,205	¥712	¥493	\$4,214

Year ended March 31, 2005	Millions of yen		
	Cost	Accumulated depreciation	Net
Machinery and equipment	¥1,358	¥770	¥588

Lease transactions as a lessor are immaterial.

#### (b) Operating leases

Lease transactions as a lessee:

Future lease payments under non-cancellable operating leases were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Due within one year	¥ 378	¥ 384	\$ 3,231
Due after one year	2,472	2,619	21,128
	¥2,850	¥3,003	\$24,359

Lease transactions as a lessor are immaterial.

### 15. DERIVATIVE FINANCIAL INSTRUMENTS:

Derivative financial instruments are utilized by the Companies principally to reduce interest rate and foreign exchange risks. The Companies have established a control environment, which includes policies and procedures for risk assessment and for the approval, reporting and monitoring of transactions involving derivative financial instruments. The Companies do not hold or issue derivative financial instruments for trading purposes.

## Hedging instruments and hedged items

<b>March 31, 2006</b>		March 31, 2005	
Hedging instruments:	Hedged items:	Hedging instruments:	Hedged items:
Forward foreign exchange contracts	Future transactions in foreign currency	Forward foreign exchange contracts	Future transactions in foreign currency
Currency swap contracts	Future transactions in foreign currency	Interest rate swap contracts	Interest payable
Interest rate swap contracts	Interest payable		

The forward foreign exchange contracts and currency swap contracts outstanding at March 31, 2006 and 2005 were as follows:

	Millions of yen						Thousands of U.S. dollars		
	2006			2005			2006		
	Notional amount	Market value	Unrealized loss	Notional amount	Market value	Unrealized loss	Notional amount	Market value	Unrealized loss
Forward foreign exchange contracts:									
Foreign currency sales	<b>¥32,440</b>	<b>¥(2,498)</b>	<b>¥(2,498)</b>	¥26,998	¥(1,324)	¥(1,324)	<b>\$277,265</b>	<b>\$(21,350)</b>	<b>\$(21,350)</b>
Currency swap contracts:									
Yen into foreign currency obligation	<b>13,829</b>	<b>(660)</b>	<b>(660)</b>	14,233	(336)	(336)	<b>118,197</b>	<b>(5,641)</b>	<b>(5,641)</b>
	<b>¥46,269</b>	<b>¥(3,158)</b>	<b>¥(3,158)</b>	¥41,231	¥(1,660)	¥(1,660)	<b>\$395,462</b>	<b>\$(26,991)</b>	<b>\$(26,991)</b>

The amounts include contracts entered into in order to hedge inter-company transactions in foreign currency or forward foreign exchange contracts for accounts receivable and payable in foreign currency, which are not accounted for by hedge accounting but by the primary method of accounting for the instruments in accordance with the Accounting Standard for Financial Instruments. The amounts exclude derivative transactions to which hedge accounting is applied.

**16. SEGMENT INFORMATION:**

A summary of net sales and operating income and identifiable assets, capital expenditure and depreciation and amortization by industrial segment for the years ended March 31, 2006 and 2005 is as follows:

## Net sales and operating income

	Millions of yen				Thousands of U.S. dollars			
	Net sales		Total	Operating income	Net sales		Total	Operating income
	Outside customers	Inter-segment			Outside customers	Inter-segment		
<b>Year ended March 31, 2006</b>								
Chemicals and resins	<b>¥190,753</b>	<b>¥ 723</b>	<b>¥191,476</b>	<b>¥ 31,868</b>	<b>\$1,630,368</b>	<b>\$ 6,179</b>	<b>\$1,636,547</b>	<b>\$272,376</b>
Fibers and textiles	<b>109,107</b>	<b>684</b>	<b>109,791</b>	<b>9,451</b>	<b>932,538</b>	<b>5,846</b>	<b>938,384</b>	<b>80,778</b>
High-performance materials, medical products and others	<b>75,213</b>	<b>27,105</b>	<b>102,318</b>	<b>8,456</b>	<b>642,846</b>	<b>231,667</b>	<b>874,513</b>	<b>72,274</b>
Total	<b>375,073</b>	<b>28,512</b>	<b>403,585</b>	<b>49,775</b>	<b>3,205,752</b>	<b>243,692</b>	<b>3,449,444</b>	<b>425,428</b>
Eliminated on consolidation and corporate	—	<b>(28,512)</b>	<b>(28,512)</b>	<b>(11,498)</b>	—	<b>(243,692)</b>	<b>(243,692)</b>	<b>(98,274)</b>
Consolidated total	<b>¥375,073</b>	<b>¥ —</b>	<b>¥375,073</b>	<b>¥ 38,277</b>	<b>\$3,205,752</b>	<b>\$ —</b>	<b>\$3,205,752</b>	<b>\$327,154</b>

## Year ended March 31, 2005

Chemicals and resins	¥167,264	¥ 795	¥168,059	¥28,420
Fibers and textiles	109,829	1,197	111,026	7,921
High-performance materials, medical products and others	77,781	25,166	102,947	7,333
Total	354,874	27,158	382,032	43,674
Eliminated on consolidation and corporate	—	(27,158)	(27,158)	(10,487)
Consolidated total	¥354,874	¥ —	¥354,874	¥33,187

Identifiable assets, capital expenditure and depreciation and amortization

	Millions of yen			Thousands of U.S. dollars		
	Identifiable assets	Capital expenditure	Depreciation and amortization	Identifiable assets	Capital expenditure	Depreciation and amortization
<b>Year ended March 31, 2006</b>						
Chemicals and resins	¥243,384	¥23,810	¥16,029	\$2,080,205	\$203,504	\$137,000
Fibers and textiles	80,501	4,787	3,845	688,043	40,915	32,863
High-performance materials, medical products and others	69,571	3,283	3,720	594,624	28,060	31,795
Total	393,456	31,880	23,594	3,362,872	272,479	201,658
Eliminated on consolidation and corporate	87,901	1,992	1,592	751,290	17,025	13,607
Consolidated total	¥481,357	¥33,872	¥25,186	\$4,114,162	\$289,504	\$215,265
<b>Year ended March 31, 2005</b>						
Chemicals and resins	¥220,812	¥32,262	¥12,119			
Fibers and textiles	79,994	4,128	4,085			
High-performance materials, medical products and others	82,122	7,215	3,679			
Total	382,928	43,605	19,883			
Eliminated on consolidation and corporate	72,013	2,110	1,441			
Consolidated total	¥454,941	¥45,715	¥21,324			

Effective April 1, 2005, the Company and its domestic consolidated subsidiaries and affiliates have adopted “Accounting Standard for Impairment of Fixed Assets” and “Implementation Guidance for Accounting for Impairment of Fixed Assets”. As a result of this change, identifiable assets for “Fibers and textiles” decreased ¥1,242 million (\$10,615 thousand) and identifiable assets for “High-performance materials, medical products and others” decreased ¥4,207 million (\$35,957 thousand) at March 31, 2006. The effects on identifiable assets of other segments are immaterial.

A summary of net sales, operating income and identifiable assets by geographic segment for the years ended March 31, 2006 and 2005 is as follows:

	Millions of yen			Operating income (loss)	Identifiable assets
	Net sales		Total		
	Outside customers	Inter-segment			
<b>Year ended March 31, 2006</b>					
Domestic (inside Japan)	¥273,757	¥28,770	¥302,527	¥43,570	¥259,901
North America	30,610	3,544	34,154	2,987	44,666
Europe	53,974	3,191	57,165	3,211	87,940
Asia	16,732	1,936	18,668	(276)	5,897
Total	375,073	37,441	412,514	49,492	398,404
Eliminated on consolidation and corporate	—	(37,441)	(37,441)	(11,215)	82,953
Consolidated total	¥375,073	¥ —	¥375,073	¥38,277	¥481,357
<b>Year ended March 31, 2005</b>					
Domestic (inside Japan)	¥269,534	¥28,354	¥297,888	¥37,723	¥251,133
North America	27,586	3,907	31,493	3,483	37,322
Europe	42,187	1,509	43,696	2,567	89,896
Asia	15,567	1,456	17,023	(119)	8,430
Total	354,874	35,226	390,100	43,654	386,781
Eliminated on consolidation and corporate	—	(35,226)	(35,226)	(10,467)	68,160
Consolidated total	¥354,874	¥ —	¥354,874	¥33,187	¥454,941

	Thousands of U.S. dollars				
	Net sales			Operating income (loss)	Identifiable assets
	Outside customers	Inter-segment	Total		
<b>Year ended March 31, 2006</b>					
Domestic (inside Japan)	\$2,339,803	\$ 245,897	\$2,585,700	\$372,393	\$2,221,376
North America	261,624	30,291	291,915	25,530	381,761
Europe	461,316	27,274	488,590	27,444	751,624
Asia	143,009	16,547	159,556	(2,358)	50,401
Total	3,205,752	320,009	3,525,761	423,009	3,405,162
Eliminated on consolidation and corporate	—	(320,009)	(320,009)	(95,855)	709,000
Consolidated total	\$3,205,752	\$ —	\$3,205,752	\$327,154	\$4,114,162

Effective April 1, 2005, the Company and its domestic consolidated subsidiaries and affiliates have adopted “Accounting Standard for Impairment of Fixed Assets” and “Implementation Guidance for Accounting for Impairment of Fixed Assets”. As a result of this change, identifiable assets for “Domestic (inside Japan)” decreased ¥5,455 million (\$46,624 thousand) at March 31, 2006.

For the years ended March 31, 2006 and 2005, a summary of foreign sales, consisting of the export sales of the Company and its domestic consolidated subsidiaries and the sales of foreign consolidated subsidiaries, is as follows:

	Millions of yen			Thousands of U.S. dollars	
	Foreign sales	Consolidated net sales	Percentage of consolidated net sales	Foreign sales	Consolidated net sales
<b>Year ended March 31, 2006</b>					
North America	¥ 35,413	¥ —	9.5%	\$ 302,675	\$ —
Europe	58,926	—	15.7	503,641	—
Asia	60,062	—	16.0	513,350	—
Other	8,641	—	2.3	73,855	—
Total	¥163,042	¥375,073	43.5%	\$1,393,521	\$3,205,752

	Millions of yen		
	Foreign sales	Consolidated net sales	Percentage of consolidated net sales
<b>Year ended March 31, 2005</b>			
North America	¥ 30,828	¥ —	8.7%
Europe	49,980	—	14.1
Asia	62,078	—	17.5
Other	7,230	—	2.0
Total	¥150,116	¥354,874	42.3%

## 17. SUBSEQUENT EVENTS:

As of March 31, 2006, the Japanese Commercial Code provided that all appropriations of retained earnings, except interim cash dividends, must be approved at an ordinary general meeting of shareholders.

In accordance with customary practices in Japan, the appropriation of retained earnings is not accrued in the financial statements for the year to which it relates but is recorded in the subsequent accounting year after shareholders' approval has been obtained. The following appropriations of retained earnings of the Company as of March 31, 2006 were approved by the shareholders on June 28, 2006.

	Millions of yen	Thousands of U.S. dollars
Cash dividends, ¥8.50 (\$0.07) per share	¥3,124	\$26,701
Bonuses to directors	68	581

The above year-end cash dividends per share and interim cash dividends of ¥6.50 (\$0.06) per share paid in December 2005 made a total annual cash dividend of ¥15.00 (\$0.13) per share.

## REPORT OF INDEPENDENT AUDITORS

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

**ChuoAoyama PricewaterhouseCoopers**

**PRICEWATERHOUSECOOPERS** 

Nakanoshima Mitsui Building 16F  
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To the Board of Directors and Shareholders of Kuraray Co., Ltd.

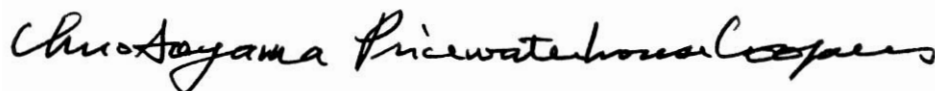
We have audited the accompanying consolidated balance sheets of Kuraray Co., Ltd., and its consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended, all expressed in Japanese Yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Kuraray Co., Ltd., and its consolidated subsidiaries as of March 31, 2006 and 2005, 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.

As described in Note 2 (g) to the consolidated financial statements, effective on April 1, 2005, the Company and its domestic consolidated subsidiaries and affiliates adopted the accounting standard for impairment losses on fixed assets.

The amounts expressed in U.S. dollars, which are provided solely for the convenience of the reader, have been translated on the basis set forth in Note 1 to the accompanying consolidated financial statements.



June 28, 2006