Chemistry with a heart

TOKUYAMA

TOKUYAMA CORPORATION
ANNUAL REPORT 2006

YEAR ENDED MARCH 31, 2006

Tokuyama traces its roots back to 1918, when it began producing soda ash (sodium carbonate), one of the basic materials used in various industries.

While adding various chemicals to our product lineup, we have grown to incorporate diverse businesses covering a wide range of products including organic and inorganic chemicals, plastics, cement/building materials, electronic materials, and materials used in the medical field. In this way, Tokuyama has continued to serve industry and a variety of markets for more than 85 years.

Tokuyama aims to be a thoroughly unique company, characterized by technology, rather than pursuing scale. At the same time, we strive to become a meaningful presence in society, full of originality, and to generate increased corporate value from a medium- to long-term perspective while also practicing a style of management that is both future-oriented and in harmony with society.

PROFILE & CONTENTS

CAUTIONARY NOTES: FORWARD-LOOKING STATEMENTS

This annual report contains information about forward-looking statements related to such matters as the Company's plans, strategies and business results. These forward-looking statements represent judgments made by the Company based on information available at present and are inherently subject to a variety of risks and uncertainties. The Company's actual activities and business results could differ significantly from the forward-looking statements due to changes including, but not limited to, those in the economic environment, business environment, demand and exchange rates.

CONSOLIDATED FINANCIAL HIGHLIGHTS

Tokuyama Corporation and Consolidated Subsidiaries Years ended March 31, 2006 and 2005

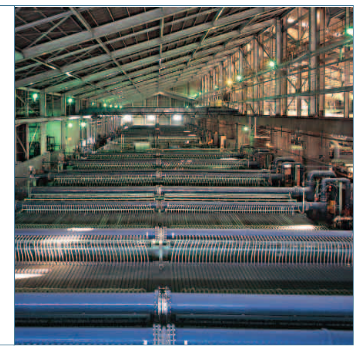
	Millions of yen		Change (%)	Thousands of U.S. dollars
	2006	2005	2006/2005	**2006**
Net sales	**¥263,374**	¥237,553	10.9%	**$2,251,056**
Operating income	**24,312**	18,173	33.8	**207,793**
Income before income taxes	**21,912**	13,729	59.6	**187,278**
Net income	**13,964**	11,012	26.8	**119,351**
Per share amounts (in yen, dollars)				
Net income (basic)	**52.61**	43.01	—	**0.450**
Net income (diluted)	**—**	—	—	**—**
Cash dividends	**6.00**	6.00	—	**0.051**
Total assets	**361,103**	308,925	16.9	**3,086,352**
Total shareholders' equity	**179,025**	134,396	33.2	**1,530,125**
Capital expenditures	**21,652**	15,073	43.6	**185,057**
Depreciation	**18,087**	18,336	(1.4)	**154,592**
R&D expenses	**9,397**	8,866	6.0	**80,314**
Number of employees	**4,630**	4,584	1.0	**—**
Consolidated subsidiaries	**43**	42	2.4	**—**

Note: U.S. dollar amounts above and elsewhere in this annual report are converted from Japanese yen, for convenience only, at the rate of ¥117=US$1.

AT A GLANCE

Group Segment
Business Division
CHEMICALS
(Billions of yen)
104
3.4
97
5.8
89
5.5
96
8.5
103
7.6
'02
'03
'04
'05
'06
Sales
Operating Income
Chemicals
SPECIALTY PRODUCTS
(Billions of yen)
54
5.2
59
5.1
60
6.3
67
9.2
77
16.1
'02
'03
'04
'05
'06
Sales
Operating Income
Si
Advanced Materials
CEMENT, BUILDING MATERIALS AND OTHERS
(Billions of yen)
69
3.2
70
3.0
71
4.0
75
3.2
84
3.4
'02
'03
'04
'05
'06
Sales
Operating Income
Cement

Business Unit	Major Direct Products	Major Products of Affiliate Companies
SODA ASH AND CALCIUM CHLORIDE	SODA ASH, CALCIUM CHLORIDE	POLYVINYL CHLORIDE (Shin Dai-ichi Vinyl Corp.) POLYPROPYLENE FILM (Sun•Tox Co., Ltd.) POLYPROPYLENE FILM (Tianjin Sunshine Plastics Co., Ltd.) MICROPOROUS FILM (Shanghai Tokuyama Plastics Co., Ltd.)
CHLOR-ALKALI	CAUSTIC SODA, PROPYLENE OXIDE	
VINYL CHLORIDE	VINYL CHLORIDE MONOMER	
NEW ORGANIC CHEMICALS	ISOPROPYL ALCOHOL (IPA)	
NF	MICROPOROUS FILM	



Business Unit	Major Direct Products	Major Products of Affiliate Companies
ELECTRONIC MATERIALS	POLYCRYSTALLINE SILICON	PRECIPITATED SILICA (Tokuyama Siam Silica Co., Ltd.)
FUMED SILICA	FUMED SILICA	
PRECIPITATED SILICA	PRECIPITATED SILICA (WHITE CARBON)	

Business Unit	Major Direct Products	Major Products of Affiliate Companies
FINE CHEMICALS	PHARMACEUTICAL & AGRICULTURAL INTERMEDIATES OPTICAL LENS MATERIALS	MEDICAL DIAGNOSIS SYSTEMS (A&T Corp.) DEVELOPER (Hantok Chemicals Co., Ltd.) DENTAL MATERIALS (Tokuyama Dental Corp.) ION-EXCHANGE MEMBRANES (ASTOM Co., Ltd.)
SHAPAL	ALUMINUM NITRIDE (SHAPAL®)	
IC CHEMICALS	HIGH PURITY CHEMICALS FOR ELECTRONICS MANUFACTURING	
CLEANING SYSTEM	CLEANING SOLVENTS AND SYSTEM	

Business Unit	Major Direct Products	Major Products of Affiliate Companies
CEMENT	ORDINARY PORTLAND CEMENT OTHER CEMENT	CEMENT & READY-MIXED CONCRETES (Oguri shonan Corp. Tokuyama Trading Co., Ltd.) PLASTIC SASHES (Shanon Co., Ltd.) OTHERS (Shunan System Sangyo Co., Ltd.)
RECYCLING AND ENVIRONMENT	RECYCLING WASTE AND BY-PRODUCTS	

MESSAGE FROM THE PRESIDENT

Outline of Three-Year Management Plan: Four Growth Initiatives

April 2005 marked the start of our Three-Year Management Plan to realize "a scenario of boosting the corporate value of the Tokuyama Group over the medium to long term." Our belief is that we can realize higher corporate value by generating more stable and larger returns on our investments of management resources. The Three-Year Management Plan is positioned as a medium- to long-term scenario with the aim of realizing our stated goal.

Under the plan, we are targeting four kinds of growth: "quality growth," "volume growth," "functional growth," and "infrastructure growth."

"Quality growth" refers to initiatives to enhance the differentiation of our businesses from those of competitors. "Volume growth" refers to efforts that differentiate our businesses in terms of scale in areas where we have business strength based on "quality growth," and demand is projected to expand over the medium to long term. We refer to "quality growth" and "volume growth" together as "business growth," which encapsulates efforts to change the structure and development of our businesses. To realize this overall objective, we are also advancing "functional growth" and "infrastructure growth" simultaneously.

Core Policy Measures: Creating "Business Growth"

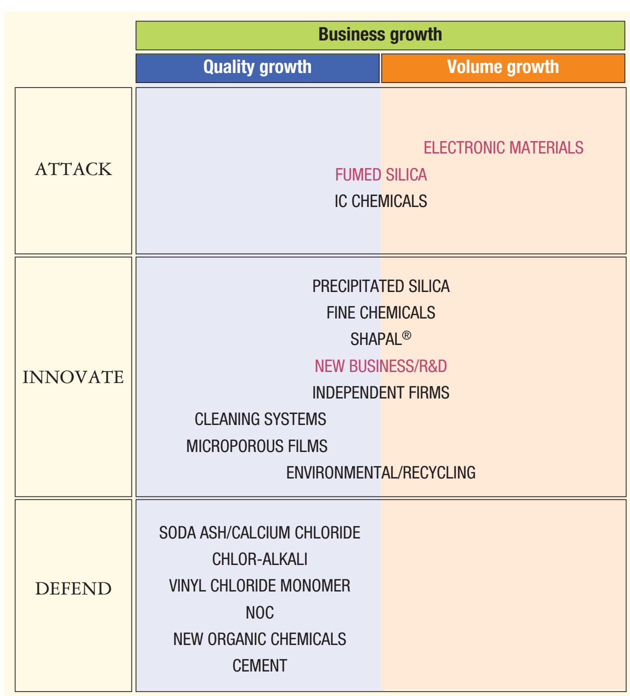
Under the plan, the core policy adopted for each business within the Tokuyama Group's operations is defined by the three principles of "Attack," "Defend," or "Innovate." Through this policy we aim to generate stable and sustained growth in corporate value.

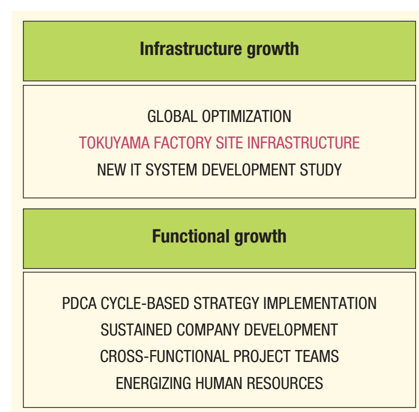
Businesses designated as "Attack" businesses are those areas where (a) we have a high global market share, (b) global demand is projected to grow, and (c) the products are expected to have a long life cycle. These are areas where we expect efforts to successfully generate "quality growth" and "volume growth." Based on further honing our technical competitive edge and reinforcing our strength in such areas, we aim to respond to increasing demand by optimizing global production to raise supply capacity in strategic growth regions. We expect greater operational scale in these business areas to generate higher earnings.

Shigeaki Nakahara
President

Businesses categorized as “Defend” businesses are those involving products with long life cycles that we manufacture and sell primarily in the Japanese market. In these areas we are targeting “quality growth” based on establishing increased differentiation through low-cost operations and efforts to revise product prices. We maintain and develop the various infrastructural and technical advantages enjoyed by Tokuyama Group companies. As a result, we aim to maintain or boost earnings in this area.

The areas that we have designated as “Innovate” businesses are those where product life cycles are short and business environments change rapidly. Here the major challenge is to target “quality growth” by ensuring that we maintain the functional superiority of our products over those of competitors. The key in these areas is to work closely with customers to accurately grasp their changing requirements and then to develop products that meet their needs ahead of our rivals. Ensuring close cooperation between our marketing and R&D teams, we aim to boost profits by securing positive customer evaluations of the functionality and quality of our products.





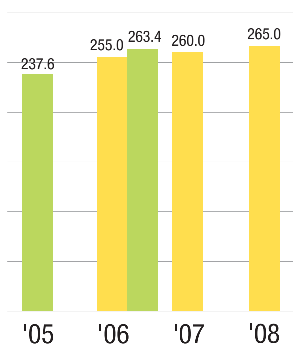
Progress Status: First-Year Overview of Three-Year Management Plan

Let me start this review with the status of initiatives for "Attack" businesses. At the end of 2005, we completed construction of a verification plant with an annual production capacity of 200 tons as part of a program to establish a new manufacturing method of polycrystalline silicon for solar cells. Verification tests are currently underway. After fully evaluating manufacturing technology and product quality, we aim to build a commercial plant. In addition, we continue to study a program to expand production capacity for polycrystalline silicon for semiconductors, for which supply remains tight in the market. As for the fumed silica business, we are in the process of building a plant in China.

With regard to "Defend" business initiatives, we are continuing to renovate our electrolytic facilities in order to raise the competitiveness of our chlor-alkali business. In our cement business, we are working to expand capacity for disposal of waste, and increase the types of waste accepted as raw materials and fuels for cement to expand our recycling and environment business.

In terms of "Innovate" business initiatives, our R&D Division is targeting product development areas under the key themes of "optics" and "crystals." We have now reached the experimental commercial stage for development and manufacturing systems to produce ultra-large single crystals of calcium fluoride utilizing the Czochralski method. These crystals will play a critical role in the development of next-generation photolithography processes for semiconductor production. In other work, we have succeeded in manufacturing essentially defect-free monocrystal aluminum nitride to use as a substrate in blue or deep-UV light-emitting diodes. The next goal in this program is to develop mass-production technology. In another promising area related to fuel cells, we are applying our core technical expertise in hydrocarbon ion-exchange membranes to the development of electrolyte membranes, including MEA (membrane-electrode assembly). Meanwhile, we have also been working to expand our existing operations for aluminum nitride (Tokuyama's trade name: Shapal®) by developing new heat dissipation packages. We aim to commercialize this business soon.

Our programs targeting "functional growth" involve various organizational and personnel reforms designed to realize "business growth." In concrete terms, we are working to strengthen the functions responsible for implementing business strategy, based on the PDCA (Plan-Do-Check-Act) cycle. We have introduced the balanced scorecard method as a framework for implementation of strategy so that we can apply the PDCA cycle in a more functional manner. Efforts are underway to train employees in this method. In terms of reforming our organization, we are making much greater use of cross-functional teams across divisions to create situations in which information and knowledge can be shared more efficiently between divisions. On the human resources front, in view of the 2007 problem, or the mass retirement of skilled workers and labor shortages that we expect to face in Japan as the population enters a possible long-term decline, we are boosting management efforts to secure capable people and to maximize the suitability of job assignments.

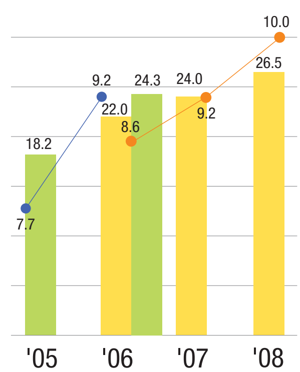


Net Sales

(Billions of yen)

Net Sales (Management Plan Targets)

Net Sales (Results)



Operating Income,
Operating Margin

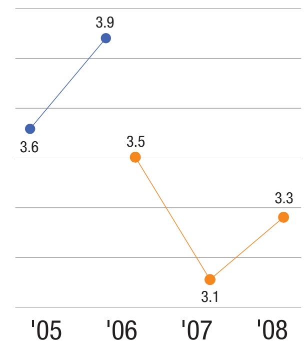
(Billions of yen, %)

Operating Income (Management Plan Targets)

Operating Income (Results)

Operating Margin (Management Plan Targets)

Operating Margin (Results)



ROA

(%)

ROA (Management Plan Targets)

ROA (Results)

Regarding "infrastructure growth," we are working to reinforce and expand our infrastructure, focusing principally on expansion and improvement of the Tokuyama Factory site, and fuel changeover of the No.7 boiler at the Central power plant, etc. We are also positioning this key site as the mother factory for production-related and technical expertise as we strive to optimize global production. As for information infrastructure, recognizing that our mainframe IT system is starting to approach the end of its useful life, we have initiated a study on the development of a new system, including the related issue of reform in administration and business processes.

Toward a New Age

During the final year of the Three-Year Management Plan Tokuyama will celebrate the 90th anniversary of its establishment. Looking beyond this milestone to our centennial, we aim to generate increased corporate value from a medium- to long-term perspective while also striving to practice a style of management that is both future-oriented and in harmony with society.

I would like to ask all stakeholders for their continued support and understanding.

S. Nakahara

Shigeaki Nakahara
President
June 2006

PROMOTING ENVIRONMENTAL MANAGEMENT

The Tokuyama Group is actively involved in addressing and solving environmental issues through planned programs of action. Tokuyama recognizes this as part of its social mission to promote sustained development for the good of the company and society alike. Tokuyama promotes the concept of environmental management, which means adopting an environmental perspective in the management of all operating activities, from development and manufacturing to sales and distribution. Tokuyama Group companies make every effort to convince customers and the general public that they play a valuable role in promoting a shift toward a recycling-oriented society.

Ongoing environmental programs at Tokuyama cover a broad range of activities. These include material recycling programs in the company's recycling and environment business and energy conservation programs targeting reductions in greenhouse gas emissions.

Fiscal 2006 Activities: Results and Evaluation

Tokuyama sets targets for environmental programs as part of Responsible Care (RC) activities that involve the entire company. The areas targeted include environmental preservation, process safety, occupational health and safety, the safety of chemicals and other products, and the development of trust-based relationships with local communities.

Tokuyama achieved one of the most challenging targets for the year, which was to reduce unit energy consumption by 15% below levels recorded in the base year (fiscal 1991). In fact, Tokuyama achieved a cut of 17.5% relative to base year energy consumption, which was the target for the end of by fiscal 2011.

Fiscal 2006 Responsible Care (RC) Activities: Priority Issues and Measures

AREA	PRIORITY ISSUES	MEASURES
MANAGEMENT	Senior management review	RC Administration Committee Safety/environment inspections
ENVIRONMENTAL PRESERVATION ENVIRONMENTAL IMPACT REDUCTION ENERGY CONSERVATION RECYCLING	Reduction of environmental impact (air/water, etc.) Lower emissions of PRTR substances and atmospheric pollutants Lower unit energy consumption Promotion of zero-emission activities Promotion of "green purchase"	Lower NOx, soot and dust emissions Lower emissions of EDC, etc. Promotion of energy conservation Increased use of wastes as fuels and raw materials in cement production "Green purchase" applied to office supplies and lighting equipment Implementation of Environmental Management System
PROCESS SAFETY	Zero accidents Promotion of risk management Promotion of safety self-management	Acquisition of a certification of high pressure gas safety inspection Safety training/inspections for distribution operations
OCCUPATIONAL HEALTH AND SAFETY	No disaster	Achievement of Category III zero-accident record
CHEMICAL PRODUCT SAFETY	Ensured product safety	Product assessments MSDS system development; surveys to identify potentially poisonous and deleterious substances Participation in HPV program
TRUSTING RELATIONSHIPS WITH LOCAL COMMUNITIES	Participation in community activities Co-existence with local communities	Participation in local community volunteer activities Promotion of community dialogues on RC issues Factory tours
RC PROGRAM PROMOTION WITHIN TOKUYAMA GROUP	Dissemination of RC activities	Safety/environment inspections Acquisition of ISO certification Sharing of RC-related information

Results of Fiscal 2006 Environmental Impact Reduction Activities

AREA	ITEM		BASE YEAR (FY)	FY2006 TARGETS	FY2006 RESULTS	EVALUATION
POLLUTION CONTROL	Air	Soot dust	FY2005	10% reduction	5% reduction	Try harder
	Water quality	COD	FY2005	±0%	8% increase	Fail
		Nitrogen	FY2005	±0%	1% increase	Try harder
		Phosphorus	FY2005	±0%	48% reduction	Pass
	PRTR substances	PRTR substances	FY2005	25% reduction	13% reduction	Try harder
		Harmful atmospheric pollutants (VCM/EDC)	FY2005	40% reduction	19% reduction	Try harder
GLOBAL ENVIRONMENT PROTECTION	Energy conservation	Unit energy consumption (relativ to base year)	FY1991	15% improvement	18.1% improvement	Pass
WASTE REDUCTION	Recycling	Effective waste utilization rate	—	94.4% or more	94.0%	Try harder
	Zero-emission activities	Zero-emission ratio	—	99.8% or more	99.8%	Pass

Hydrocarbon-based electrolyte membrane for fuel cells (anionic type)

Verification plant for polycrystalline silicon for solar cells

Development of Eco-Friendly Products and Environmental Technologies

The development of eco-friendly products and recycling technologies is a critical part of realizing a recycling-oriented society. The Tokuyama Group continued to focus on this goal in a variety of ways in fiscal 2006.

-Hydrocarbon-based electrolyte membranes for fuel cells

Direct methanol fuel cells (DMFCs) are widely expected to replace lithium-ion batteries as the power source for the next generation of mobile phones, laptop PCs and other portable electronic equipment. In the year ended March 2005, Tokuyama developed low-cost, high-performance electrolyte membranes as a pivotal material for use in such fuel cells. Development efforts continued in fiscal 2006 to create systems to supply a wide range of material specifications tailored to specific user needs.

- Polycrystalline silicon for solar cells

As one of the world's few manufacturers of polycrystalline silicon, Tokuyama is investing in the development of manufacturing technology to facilitate the production of polycrystalline silicon for solar cells at lower cost. In fiscal 2006, Tokuyama completed the construction of a high-efficiency verification plant (with an annual production capacity of 200 tons) for sample shipments.

-Closed recycling system for liquid developers begins operation

In collaboration with Sharp Corporation, Tokuyama has developed material recycling technology for reusing liquid developer within liquid crystal display (LCD) plants. Since April 2005, Tokuyama has operated a dedicated plant that recovers, reuses and recycles liquid developers originating at Sharp's LCD plant in Mie Prefecture, Japan. This closed recycling system operates on a commercial basis.

BOARD OF DIRECTORS

As of June 26, 2006

President
Shigeaki Nakahara

Executive Managing Director
Hisami Tanimoto
Assistant to the President
General Manager of Tokuyama Factory

Senior Managing Director
Hiroaki Masaki
Supervision of the Corporate Administration Div., the Auditing Dept., the Secretarial Dept., all branches, and all subsidiaries and affiliates

Managing Directors
Yoshikazu Mizuno
General Manager of the Chemicals Business Div.

Kazuo Ikeda
General Manager of the Manufacturing Technology Div.

Masao Kusunoki
General Manager of the Cement Business Div.

Etsuro Matsui
General Manager of the Corporate Planning Div., Supervision of the Responsible Care & Eco-Management Dept.

Shouji Iida
General Manager of the General & Personnel Affairs Div.

Directors
Nobuyuki Kuramoto
General Manager of the Research & Development Div.

Seiichi Shiraga
Deputy General Manager of Tokuyama Factory

Hiroo Momose
General Manager of the Si Business Div.

Tatsuo Segawa
General Manager of the Corporate Administration Div.

Koji Yasumoto
General Manager of the Personnel Dept.

Kazuhisa Kogo
General Manager of the Advanced Materials Business Div., Supervision of Kashima Factory

Standing Auditor
Kiyoshi Saigou

Auditor
Masahiro Katagiri

External Auditors
Kiyoshi Nukariya
Ryuji Hori

Financial Section

CONSOLIDATED FIVE-YEAR SUMMARY

Tokuyama Corporation and Consolidated Subsidiaries   Years ended March 31

	Millions of yen					Thousands of U.S. dollars
	2006	2005	2004	2003	2002	**2006**
Results of operations:						
Net sales	¥263,374	¥237,553	¥219,394	¥225,528	¥226,950	$2,251,056
Cost of sales	179,961	167,433	154,745	159,627	161,728	1,538,124
Operating income	24,312	18,173	13,195	12,853	10,297	207,793
Net income	13,964	11,012	6,038	317	792	119,351
Per share amounts (in yen, dollars):						
Net income (basic)	¥52.61	¥43.01	¥23.52	¥1.22	¥3.11	$0.450
Net income (diluted)	—	—	—	—	—	—
Cash dividends	6.00	6.00	6.00	6.00	6.00	0.051
Financial position:						
Property, plant and equipment	¥142,807	¥140,318	¥144,933	¥149,509	¥159,015	$1,220,572
Total assets	361,103	308,925	308,816	316,751	346,600	3,086,352
Interest-bearing debt	83,523	89,304	104,615	131,355	149,919	713,870
Total liabilities	177,578	170,684	182,246	203,940	229,503	1,517,768
Total shareholders' equity	179,025	134,396	124,452	111,273	114,365	1,530,125
Ratios:						
Return on sales (ROS)	5.3%	4.6%	2.7%	0.1%	0.3%	—
Return on equity (ROE)	8.9%	8.5%	5.1%	0.3%	0.7%	—
Return on assets (ROA)	3.9%	3.6%	1.9%	0.1%	0.2%	—
Common stock price range (in yen):						
High	2,260	¥801	¥466	¥454	¥580	—
Low	732	392	365	268	300	—

Notes: 1. U.S. dollar amounts are translated from Japanese yen, for convenience only, at the rate of ¥117=US$1.

2. Common stock prices refer to the market price on the Tokyo Stock Exchange.

FINANCIAL REVIEW

Income Analysis

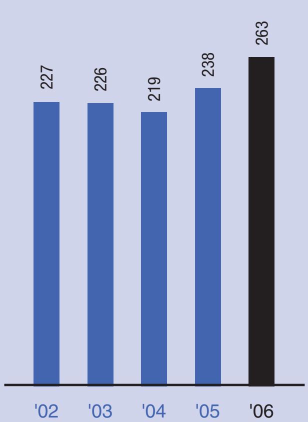
In fiscal 2006 (the year ended March 31, 2006), global economic growth remained brisk overall as China maintained a high rate of growth and the U.S. economy continued to grow strongly despite concerns over steep rises in crude oil prices and the impact of devastating hurricanes. The Japanese economy maintained a gradual recovery trend, buoyed by various factors such as higher capital investment associated with improved corporate earnings and a consumer spending revival. However, sharp rises in the prices of raw materials, particularly crude oil, together with higher distribution costs sparked uncertainty over future economic prospects.

The Tokuyama Group responded to conditions by reinforcing cost-reduction measures on a number of fronts while also setting in motion plans for prioritized investments aimed at realizing a strategy to raise corporate value through steady growth. On the sales front, Tokuyama redoubled efforts to maintain or secure increases in sales prices to bolster profitability and also devoted considerable resources to acquiring new customers.

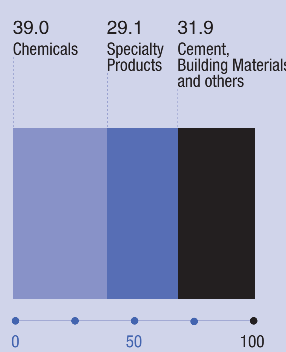
Reflecting higher sales volumes and successful efforts to secure upward price adjustments, consolidated net sales in fiscal 2006 amounted to ¥263,374 million (US$2,251 million), an increase of 10.9% compared with the previous year.

By business segment, Chemicals segment sales rose 7.2% year-on-year to ¥102,647 million (US$877 million), sales in the Specialty Products segment rose 14.2% year-on-year to ¥76,716 million (US$656 million), and sales recorded by the Cement, Building Materials and Others segment increased 12.6% year-on-year to ¥84,011 million (US$718 million).

Sharp increases in raw material prices outweighed the effect of sustained cost-reduction efforts, resulting in a 7.5% year-on-year increase in cost of sales to ¥179,961 million (US$1,538 million). Effective fiscal 2006, cost of sales totaling ¥5,888 million (US$50 million) attributable to Tokuyama Logistics



NET SALES
(Billions of yen)



SALES COMPOSITION
(%)

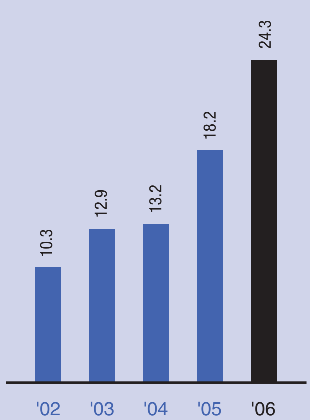
Corporation, a distribution firm in the Tokuyama Group, was reclassified as selling expenses; at the same time, cost of sales totaling ¥1,011 million (US$9 million) attributable to Tokuyama Information Service Corporation, an IT systems firm in the Tokuyama Group, was reclassified as general and administrative expenses. The net effect of these changes was to decrease cost of sales and increase selling, general and administrative (SG&A) expenses by ¥6,899 million (US$59 million) in fiscal 2006 compared with previous accounting standards.

Reflecting higher R&D expenses, together with an increase in SG&A expenses totaling ¥6,899 million (US$59 million) due to a change in the accounting classification of costs recorded by the aforementioned two Tokuyama Group companies, SG&A expenses amounted to ¥59,101 million (US$505 million), an increase of 13.8% compared with the previous year.

The net aggregate effect of higher sales volumes, price adjustments and various efforts to cut costs more than offset the impact of steep increases in raw material prices. Operating income surged 33.8% year-on-year to ¥24,312 million (US$208 million). The operating margin was 9.2%, an increase of 1.5 percentage points compared with the figure of 7.7% recorded in the previous year.

In non-operating income and expenses, equity in earnings of unconsolidated subsidiaries and affiliates fell to ¥484 million (US$4 million) from the previous year's figure of ¥1,384 million. Having incurred a loss on impairment of fixed assets of¥1,402 million in the previous year, Tokuyama did not report any impairment gains or losses in fiscal 2006. Reflecting these and other factors, net non-operating expenses amounted to ¥2,400 million (US$20 million), a decline of 46.0% compared with the previous year.

Income before income taxes totaled ¥21,912 million (US$187 million), a gain of ¥8,183 million (US$70 million) compared with the previous year's figure of ¥13,729 million. Income taxes were ¥7,086 million (US$61 million) and minority interests totaled ¥862 million (US$7 million). As a result, net income rose from ¥11,012 million to ¥13,964 million (US$119 million). The return on sales (ROS) was 5.3%, compared



OPERATING INCOME
(Billions of yen)

with 4.6% in the previous year. Net income per share was ¥52.61 (US$0.450), up from ¥43.01 in the previous year. Total dividends per share were unchanged at ¥6.00 (US$0.051).

Return on equity (ROE) and return on assets (ROA) were 8.9% and 3.9%, respectively, compared with 8.5% and 3.6% in the previous year.

Segment Information

The Tokuyama Group comprises the parent company Tokuyama Corporation, 46 subsidiaries and 48 affiliated companies. The Group's operations are divided into the three business segments of Chemicals, Specialty Products, and Cement, Building Materials and Others. For accounting purposes, 43 of the Company's major subsidiaries are consolidated, while 16 affiliates are accounted for using the equity method.

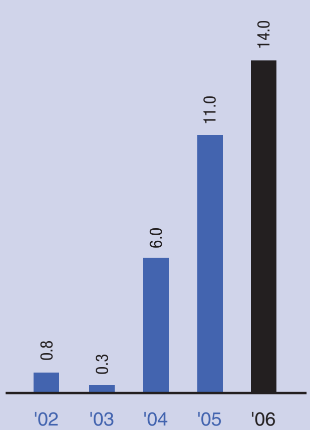
Chemicals

The Chemicals segment includes the operations of 7 consolidated subsidiaries and 5 equity-method affiliates.

Segment net sales increased 7.2% year-on-year to ¥102,647 million (US$877 million), while operating income declined 10.2% year-on-year to ¥7,693 million (US$66 million). The segment accounted for 39.0% of total net sales (a fall of 1.3 percentage points compared with the previous year).

As in the previous fiscal year, sharp increases in raw material prices exerted a negative impact on many products in the chemicals business, including caustic soda, propylene oxide (PO), isopropyl alcohol (IPA), and vinyl chloride polymer. The Tokuyama Group continued to focus on lowering costs while also seeking corrective adjustments in sales prices.

Sales and profits recovered with caustic soda and IPA due to buoyant demand combined with



NET INCOME
(Billions of yen)

corrective price adjustments. Sales of soda ash benefited from a sales price revision at the beginning of the fiscal year, while shipment volumes for calcium chloride recovered due to greater demand for antifreeze as a result of higher-than-usual snowfall across Japan. However, sales of propylene oxide suffered as price adjustments failed to keep pace with rising raw material costs. Sales of sodium silicate and cullet (anhydrous sodium silicate) also remained depressed due to lack of growth in demand for the primary applications of soil improvement and use in cleaning solvents.

Efforts by Shin Dai-ichi Vinyl Corporation to secure price increases and reduce costs were insufficient to compensate for higher raw materials prices, resulting in lower sales and profits.

In the film business, Sun•Tox Co., Ltd. recorded better results than in the previous year due to successful efforts to boost efficiency and secure sales price increases in the face of further raw material price hikes. Tianjin Sunshine Plastics Co., Ltd. posted poorer results, however, due to fiercer competition in the film market in China, which compounded the effect of higher material prices.

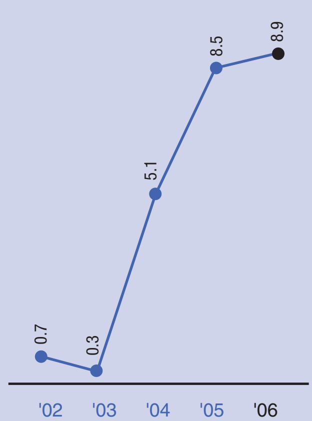
Specialty Products

The Specialty Products segment consists of the operations of 14 consolidated subsidiaries and 5 equity-method affiliates.

Segment net sales increased 14.2% year-on-year to ¥76,716 million (US$656 million) and operating income soared 74.5% year-on-year to ¥16,105 million (US$138 million). The segment accounted for 29.1% of total net sales (a gain of 0.8 percentage points compared with the previous year).

In the silicon business, demand for polycrystalline silicon continued to grow strongly. Having secured higher export prices in the second half of the previous year, Tokuyama pushed through a sales price increase for the domestic market at the beginning of the year under review and then secured a further upward adjustment in the export sales price during the second half of fiscal 2006.

In functional powder operations, shipments of fumed silica recorded solid growth amid continued



RETURN ON EQUITY
(%)

brisk demand, particularly from China. Results were poorer for amorphous precipitated silica, however, as Tokuyama was unable to pass on all of the increase in raw material costs in product prices, despite higher demand for applications such as tires.

In the advanced materials business, sales of high-purity chemicals for use in production of semiconductors and liquid crystal displays were robust, reflecting increased sales of high-purity developer (including shipments by overseas-based subsidiaries) and of IPA-SE (high-purity electrical-grade isopropyl alcohol). The performance of fine chemicals operations showed signs of recovery, led by growth in sales of plastic lens-related materials. In aluminum nitride, Tokuyama continued to focus on reducing costs and on developing new applications.

A&T Corporation recorded higher sales of diagnostic reagents, but higher SG&A expenses together with a drop in sales of laboratory information systems resulted in a squeeze on profits. Tokuyama Dental Corporation, which manufactures and sells dental materials, posted improved results. However, in the semiconductor gas sensors business, Figaro Engineering Inc. saw profits slide due to fiercer competition plus an inventory adjustment in overseas markets. In the ion-exchange membrane business, although ASTOM Corporation performed well, Eurodia Industrie S.A. posted poorer results due to a drop in orders.

Cement, Building Materials and Others

The Cement, Building Materials and Others segment comprises the operations of 22 consolidated subsidiaries and 6 equity-method affiliates.

Segment net sales increased 12.6% year-on-year to ¥84,011 million (US$718 million) and operating income rose 7.3% year-on-year to ¥3,496 million (US$30 million). The segment accounted for 31.9% of total net sales (an increase of 0.5 percentage points compared with the previous year).

In cement operations, business conditions generally remained adverse. While a recovery in private-sector construction demand linked to disaster reconstruction projects and a building boom in major urban areas helped to stem the decline in aggregate cement demand in Japan, sharply higher raw material prices pushed up costs significantly. Tokuyama responded to these conditions by trying to pass on higher costs in sales prices and to maintain sales volumes, and by promoting sales of soil stabilizers. However, these efforts were inadequate to absorb higher raw materials costs, and overall performance deteriorated as a result.

In contrast, reflecting increased volumes of coal ash and soil received from construction sites and other sources, the recycling and environment business posted a strong performance. Rationalization efforts by Tokuyama Group firms also contributed to a general recovery in performance in this sector.

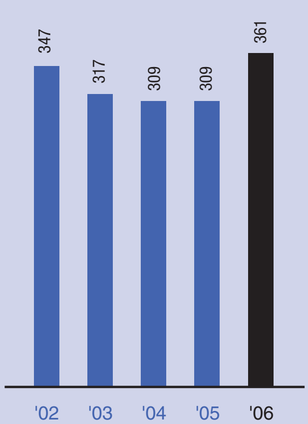
In building materials operations, the Shanon Group continued to develop its plastic window sash business by expanding its network of sales offices in west Japan and by pursuing rationalization measures to reduce costs, but increased raw material prices and other factors caused performance to deteriorate.

In other operations in this segment, which include transport and property maintenance, the Tokuyama Group continued to make efforts to lower general costs and to improve operational efficiency.

Financial Position and Liquidity

As of March 31, 2006, total assets amounted to ¥361,103 million (US$3,086 million), an increase of¥52,178 million from the figure of ¥308,925 million at the previous fiscal year-end.

Current assets increased 27.1% compared with the previous fiscal year-end to ¥143,279 million (US$1,225 million). This was due primarily to increased cash and deposits as a result of new share issuance and to an increase in receivables linked to higher sales. Current liabilities rose 16.2% to ¥95,070 million (US$813 million). This mainly reflected an increase in short-term bank loans and higher accrued income taxes. As a result, the current ratio improved to 1.51 times, from 1.38 times at the previous fiscal year-end. Investments and long-term receivables increased 35.6% to ¥72,282 million



TOTAL ASSETS
(Billions of yen)

(US$618 million). This was primarily due to an increase in the market value of investment securities compared with the previous fiscal year-end, reflecting Japanese stock market gains.

Property, plant and equipment totaled ¥142,807 million (US$1,221 million) as of the fiscal year-end. Partial renovation of production facilities for fumed silica and investments in other production facilities were offset by a further increase in accumulated depreciation and the disposal of some facilities as part of a program of partial reconstruction and renovation targeting electrolysis production facilities. The net increase compared with the previous fiscal year-end was 1.8%.

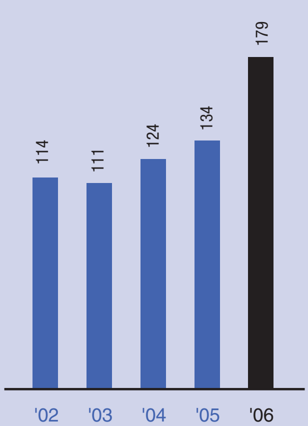
Other assets increased 7.7% to ¥2,735 million (US$23 million).

As of March 31, 2006, total liabilities amounted to ¥177,578 million (US$1,518 million), an increase of 4.0% compared with the previous fiscal year-end figure of ¥170,684 million. One of the main contributory factors was a rise in deferred tax liabilities. Interest-bearing liabilities declined 6.5% from¥89,304 million to ¥83,523 million (US$713 million).

Minority interest in consolidated subsidiaries increased 17.0% from ¥3,845 million to ¥4,500 million (US$38 million). Total shareholders' equity grew 33.2% compared with the previous fiscal year-end, from ¥134,396 million to ¥179,025 million (US$1,530 million). This was due primarily to the increase in capital associated with the issuance of new shares. The ratio of shareholders'equity to total assets was 49.6%, up from 43.5% at the previous fiscal year-end. Shareholders' equity per share was ¥651.64 (US$5.56), compared with ¥528.35 at the previous fiscal year-end.

Capital Expenditures

Capital expenditures totaled ¥21,652 million (US$185 million), an increase of 43.6% compared with the previous years figure of ¥15,073 million. Major items of capital spending included a partial reconstruction and renovation program that covered electrolysis production facilities and Tokuyama'fs own onsite power generation facilities.



TOTAL SHAREHOLDERS' EQUITY
(Billions of yen)

Cash Flows

Net cash provided by operating activities totaled ¥25,748 million (US$220 million), an increase of ¥129 million compared with the previous year's figure of ¥25,619 million. Principal items included income before income taxes, which increased by ¥8,183 million, from ¥13,729 million to ¥21,912 million (US$187 million). Depreciation totaled ¥18,087 million (US$155 million). The cash outflow due to the increase in trade receivables totaled ¥11,496 million (US$98 million). Income taxes paid equaled ¥3,648 million (US$31 million).

Net cash used in investing activities totaled ¥22,758 million (US$195 million), an increase of ¥6,985 million compared with the previous year's figure of ¥15,773 million. A major contributory factor was the cash outflow due to payments for purchases of property, plant and equipment, which increased by ¥6,422 million, from ¥16,511 million to ¥22,933 million (US$196 million).

Net cash provided by financing activities equaled ¥13,155 million (US$112 million). Compared with the cash outflow of ¥17,393 million in the previous year, this represented a net increase in cash of ¥30,548 million (US$260 million). This was primarily attributable to the issuance of new shares, which generated net cash proceeds of ¥21,394 million (US$183 million).

Cash and cash equivalents increased by ¥16,198 million (US$138 million) compared with the previous fiscal year-end, to ¥30,999 million (US$265 million).

CONSOLIDATED BALANCE SHEETS

Tokuyama Corporation and Consolidated Subsidiaries Years ended March 31, 2006 and 2005

ASSETS	Millions of yen 2006	Millions of yen 2005	Thousands of U.S. dollars (Note 2) 2006
Current assets:			
Cash and cash equivalents	**¥ 30,999**	¥ 14,801	**$ 264,949**
Time deposits	**478**	227	**4,083**
Short-term investments	**1,797**	1,767	**15,361**
Marketable securities (Note 5)	**50**	57	**427**
Receivables:			
Trade notes and accounts	**76,634**	64,918	**654,992**
Others	**2,647**	3,628	**22,620**
Less allowance for doubtful accounts	**(524)**	(198)	**(4,479)**
	78,757	68,348	**673,133**
Inventories (Note 6)	**26,215**	22,944	**224,059**
Deferred tax assets (Note 8)	**4,263**	3,751	**36,435**
Other current assets	**720**	861	**6,161**
Total current assets	**143,279**	112,756	**1,224,608**
Investments and long-term receivables:			
Investment securities (Note 5)	**52,871**	34,901	**451,891**
Investments in unconsolidated subsidiaries and affiliates	**10,038**	8,118	**85,796**
Long-term receivables	**5,030**	5,495	**42,994**
Others	**4,577**	5,625	**39,111**
Less allowance for doubtful accounts	**(234)**	(827)	**(1,999)**
	72,282	53,312	**617,793**
Property, plant and equipment (Note 4, Note 7)**:**			
Land	**29,218**	28,059	**249,723**
Buildings and structures	**93,778**	92,406	**801,518**
Machinery and equipment	**396,020**	387,104	**3,384,786**
Construction in progress	**7,182**	5,286	**61,388**
	526,198	512,855	**4,497,415**
Less accumulated depreciation	**(383,391)**	(372,537)	**(3,276,843)**
	142,807	140,318	**1,220,572**
Other assets:			
Intangible assets	**1,976**	1,707	**16,896**
Deferred tax assets (Note 8)	**759**	639	**6,483**
Excess of investment cost over equity in net assets acquired	**—**	193	**—**
	2,735	2,539	**23,379**
Total assets	**¥361,103**	¥308,925	**$3,086,352**

See notes to consolidated financial statements

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen 2006	Millions of yen 2005	Thousands of U.S. dollars (Note 2) 2006
Current liabilities:			
Short-term bank loans (Note 7)	**¥ 10,798**	¥ 11,190	**$ 92,287**
Current portion of long-term debt (Note 7)	**14,169**	6,643	**121,101**
Notes and accounts payable:			
Trade notes and accounts	**37,647**	34,977	**321,768**
Others	**8,718**	9,707	**74,510**
	46,365	44,684	**396,278**
Accrued income taxes (Note 8)	**7,705**	2,443	**65,857**
Accrued expenses	**8,638**	7,105	**73,828**
Guarantee deposits received from dealers	**5,428**	5,386	**46,397**
Other current liabilities	**1,967**	4,372	**16,819**
Total current liabilities	**95,070**	81,823	**812,567**
Long-term liabilities:			
Long-term debt, less current portion (Note 7)	**58,556**	71,471	**500,481**
Accrued retirement and severance benefits (Note 9)	**8,789**	8,529	**75,115**
Deferred tax liabilities (Note 8)	**14,038**	7,877	**119,985**
Other long-term liabilities	**1,125**	984	**9,620**
Total long-term liabilities	**82,508**	88,861	**705,201**
Minority interest in consolidated subsidiaries	**4,500**	3,845	**38,459**
Contingent liabilities (Note 17)			
Shareholders' equity (Note 14)**:**			
Common stock, ¥50 par value:			
Authorized: 700,000,000 shares			
Issued: 275,671,876 shares	**29,976**	19,274	**256,203**
Additional paid-in capital	**34,192**	23,497	**292,236**
Retained earnings	**91,889**	79,522	**785,373**
Unrealized holding gains on available-for-sale securities	**24,250**	13,652	**207,266**
Foreign currency translation adjustments	**(606)**	(1,243)	**(5,176)**
	179,701	134,702	**1,535,902**
Less treasury stock, at cost	**(676)**	(306)	**(5,777)**
Total shareholders' equity	**179,025**	134,396	**1,530,125**
Total liabilities and shareholders' equity	**¥361,103**	¥308,925	**$3,086,352**

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF INCOME

Tokuyama Corporation and Consolidated Subsidiaries Years ended March 31, 2006, 2005 and 2004

	Millions of yen			Thousands of U.S. dollars (Note 2)
	2006	2005	2004	**2006**
Net sales	**¥263,374**	¥237,553	¥219,394	**$2,251,056**
Cost of sales (Note 4)	**179,961**	167,433	154,745	**1,538,124**
Gross profit	**83,413**	70,120	64,649	**712,932**
Selling, general and administrative expenses (Note 4, Note 11)	**59,101**	51,947	51,454	**505,139**
Operating income	**24,312**	18,173	13,195	**207,793**
Other income (expenses):				
Interest and dividend income	**477**	373	322	**4,073**
Interest expenses	**(1,638)**	(1,889)	(2,442)	**(13,997)**
Loss from disposal of property, plant and equipment	**(461)**	(444)	(695)	**(3,943)**
Impairment loss on fixed assets (Note 4)	**—**	(1,402)	—	**—**
Gain on sale of marketable and investment securities	**830**	170	32	**7,096**
Loss on write-down of marketable and investment securities	**(6)**	(8)	(37)	**(49)**
Foreign exchange gain (loss)	**380**	74	(434)	**3,252**
Seconded employee labor cost	**(1,883)**	(1,820)	(1,255)	**(16,098)**
Amortization of net transition obligation	**—**	(107)	(113)	**—**
Amortization of prior service benefit	**—**	—	2,104	**—**
Costs of idle operations	**(580)**	(627)	(622)	**(4,960)**
Equity in earnings of unconsolidated subsidiaries and affiliates	**484**	1,384	85	**4,140**
Compensation expense	**—**	—	(333)	**—**
Other—net	**(3)**	(148)	497	**(29)**
	(2,400)	(4,444)	(2,891)	**(20,515)**
Income before income taxes	**21,912**	13,729	10,304	**187,278**
Income taxes (Note 8):				
Current	**8,748**	3,205	2,675	**74,772**
Deferred	**(1,662)**	(1,798)	1,440	**(14,211)**
	7,086	1,407	4,115	**60,561**
Minority interests	**(862)**	(1,310)	(151)	**(7,366)**
Net income	**¥ 13,964**	¥ 11,012	¥ 6,038	**$ 119,351**

	Yen			U.S. dollars (Note 2)
	2006	2005	2004	**2006**
Per share amounts:				
Net income (basic)	**¥ 52.61**	¥ 43.01	¥ 23.52	**$ 0.450**
Net income (diluted)	**—**	—	—	**—**
Cash dividends	**6.00**	6.00	6.00	**0.051**

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Tokuyama Corporation and Consolidated Subsidiaries   Years ended March 31, 2006, 2005 and 2004

	Millions of yen			Thousands of U.S. dollars (Note 2)
	2006	2005	2004	**2006**
Common stock				
Balance at beginning of year	**¥19,274**	¥19,274	¥19,274	**$164,734**
Issuance of common stock	**10,702**	—	—	**91,469**
Balance at end of year	**¥29,976**	¥19,274	¥19,274	**$256,203**
Additional paid-in capital				
Balance at beginning of year	**¥23,497**	¥23,496	¥23,495	**$200,829**
Issuance of common stock	**10,692**	—	—	**91,384**
Gain on disposal of treasury stock	**3**	1	1	**23**
Balance at end of year	**¥34,192**	¥23,497	¥23,496	**$292,236**
Retained earnings				
Balance at beginning of year	**¥79,522**	¥71,184	¥66,377	**$679,674**
Net income	**13,964**	11,012	6,038	**119,351**
Cash dividends paid	**(1,525)**	(1,526)	(1,527)	**(13,033)**
Bonuses to directors and statutory auditors	**(72)**	(54)	(8)	**(619)**
Decrease due to change in equity of consolidated subsidiaries	**—**	(187)	(10)	**—**
Decrease due to increase of consolidated subsidiaries	**—**	—	(3)	**—**
Increase due to increase of affairs accounted for by the equity method	**—**	—	521	**—**
Decrease due to exclusion of consolidated subsidiaries and affiliates	**—**	(907)	(204)	**—**
Balance at end of year	**¥91,889**	¥79,522	¥71,184	**$785,373**
Unrealized holding gains on available-for-sale securities				
Balance at beginning of year	**¥13,652**	¥12,066	¥3,363	**$116,682**
Increase	**10,598**	1,586	8,703	**90,584**
Balance at end of year	**¥24,250**	¥13,652	¥12,066	**$207,266**
Foreign currency translation adjustments				
Balance at beginning of year	**¥(1,243)**	¥(1,387)	¥(1,088)	**$(10,624)**
Increase (decrease)	**637**	144	(299)	**5,448**
Balance at end of year	**¥(606)**	¥(1,243)	¥(1,387)	**$(5,176)**
Less treasury stock, at cost				
Balance at beginning of year	**¥(306)**	¥(181)	¥(148)	**$(2,616)**
Decrease	**(370)**	(125)	(33)	**(3,161)**
Balance at end of year	**¥(676)**	¥(306)	¥(181)	**$(5,777)**
Shares of common stock (thousands)				
Balance at beginning of year	**254,972**	254,972	254,972	**—**
Balance at end of year	**275,672**	254,972	254,972	**—**

See notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

Tokuyama Corporation and Consolidated Subsidiaries Years ended March 31, 2006, 2005 and 2004

	Millions of yen			Thousands of U.S. dollars (Note 2)
	2006	2005	2004	**2006**
Cash flows from operating activities:				
Income before income taxes	**¥21,912**	¥13,729	¥10,304	**$187,278**
Adjustments to reconcile net cash provided by operating activities:				
Depreciation	**18,087**	18,336	18,875	**154,592**
Increase (decrease) in provision	**1,124**	624	(3,855)	**9,604**
Interest and dividend income	**(477)**	(373)	(322)	**(4,073)**
Gain on sale of marketable and investment securities	**(826)**	(154)	(26)	**(7,059)**
Foreign exchange (gain) loss	**(88)**	(70)	364	**(751)**
Loss on sale and disposal of property, plant and equipment	**461**	444	695	**3,943**
Impairment loss on fixed assets	**—**	1,402	—	**—**
Equity in earnings of affiliates	**(484)**	(1,384)	(85)	**(4,140)**
Interest expenses	**1,638**	1,889	2,442	**13,997**
Loss on write-down of marketable and investment securities	**6**	8	37	**49**
Amortization of net transition obligation	**—**	107	113	**—**
(Increase) decrease in trade receivables	**(11,496)**	(6,489)	2,319	**(98,256)**
(Increase) decrease in inventories	**(3,166)**	(369)	1,395	**(27,064)**
Increase (decrease) in trade payable	**2,497**	3,643	(1,124)	**21,339**
Payment for bonuses to directors and statutory auditors	**(79)**	(61)	(12)	**(676)**
Other	**1,147**	(1,904)	2,155	**9,811**
Sub total	**30,256**	29,378	33,275	**258,594**
Interest and dividend received	**767**	644	544	**6,559**
Interest paid	**(1,627)**	(1,865)	(2,501)	**(13,907)**
Income taxes paid	**(3,648)**	(2,538)	(3,608)	**(31,175)**
Net cash provided by operating activities	**25,748**	25,619	27,710	**220,071**
Cash flows from investing activities:				
Increase in time deposits	**(399)**	(116)	(44)	**(3,410)**
Decrease in time deposits	**149**	162	112	**1,270**
Payments for purchases of marketable securities	**(50)**	(50)	(57)	**(427)**
Proceeds from sales of marketable securities	**57**	50	57	**487**
Payments for purchases of property, plant and equipment	**(22,933)**	(16,511)	(14,802)	**(196,005)**
Proceeds from sales of property, plant and equipment	**771**	568	1,114	**6,586**
Payments for purchases of investment securities	**(626)**	(961)	(1,290)	**(5,353)**
Proceeds from sales of investment securities	**1,345**	2,441	793	**11,500**
Increase in loans receivable	**(93)**	(2,904)	(2,402)	**(797)**
Decrease in loans receivable	**572**	325	967	**4,886**
Other	**(1,551)**	1,223	(729)	**(13,254)**
Net cash used in investing activities	**(22,758)**	(15,773)	(16,281)	**(194,517)**
Cash flows from financing activities:				
Decrease in short-term loans	**(1,193)**	(9,507)	(5,013)	**(10,195)**
Increase (decrease) in commercial papers	**(3,000)**	3,000	—	**(25,641)**
Proceeds from long-term debt	**1,326**	3,527	3,952	**11,333**
Repayments of long-term debt	**(3,388)**	(7,907)	(10,879)	**(28,954)**
Proceeds from issue of bonds	**—**	5,000	5,000	**—**
Redemption of bonds	**—**	(9,800)	(19,680)	**—**
Issuance of common stock	**21,394**	—	—	**182,854**
Cash dividends paid	**(1,525)**	(1,526)	(1,527)	**(13,034)**
Cash dividends paid to minority interest	**(92)**	(57)	(20)	**(786)**
Increase in treasury stock	**(367)**	(123)	(33)	**(3,139)**
Capital contribution from minority	**—**	—	348	**—**
Net cash used in financing activities	**13,155**	(17,393)	(27,852)	**112,438**
Effect of exchange rate changes on cash and cash equivalents	**53**	25	(17)	**455**
Net increase (decrease) in cash and cash equivalents	**16,198**	(7,522)	(16,440)	**138,447**
Cash and cash equivalents at beginning of the year	**14,801**	22,215	38,440	**126,502**
Increase in cash and cash equivalents due to changes of scope of consolidation	**—**	108	215	**—**
Cash and cash equivalents at end of year	**¥30,999**	¥14,801	¥22,215	**$264,949**

See notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Tokuyama Corporation and Consolidated Subsidiaries

1. BASIS OF FINANCIAL STATEMENTS

The accompanying consolidated financial statements have been prepared from accounts and records maintained by Tokuyama Corporation (the "Company") and its subsidiaries. The Company and its consolidated domestic subsidiaries have maintained their accounts and records in accordance with the provisions set forth in the Japanese Commercial Code (the "Code") and the Securities and Exchange Law and in conformity with accounting principles and practices generally accepted in Japan, which are different from the accounting and disclosure requirements of International Accounting Standards.

The accounts of consolidated overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles and practices prevailing in the respective countries of domicile.

Certain items presented in the consolidated financial statements filed with the appropriate Local Finance Bureau of the Ministry of Finance ("MOF") in Japan have been reclassified for the convenience of readers outside Japan. Such reclassifications have no effect on net income or retained earnings.

The consolidated financial statements are not intended to present the consolidated financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

2. U.S. DOLLAR AMOUNTS

The U.S. dollar amounts included in the consolidated financial statements and notes represent the arithmetic results of translating Japanese yen to U.S. dollars at the rate of ¥117=US$1, the approximate exchange rate on March 31, 2006. The U.S. dollar amounts are included solely for the convenience of readers outside Japan, and are not intended to imply that the assets and liabilities that originated in yen have been or could be readily converted, realized, or settled in U.S. dollars at this or at any other rate.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation:

The consolidated financial statements include the accounts of the Company and its 43 significant subsidiaries (42 in 2005 and 41 in 2004). Significant intercompany transactions and accounts have been eliminated in consolidation.

In total, 12 subsidiaries are consolidated on the basis of their original fiscal years ended at December 31. Material differences in intercompany transactions and accounts arising from the use of the different fiscal year-end are appropriately adjusted in consolidation.

Investments in 16 unconsolidated subsidiaries and affiliates (16 in 2005 and 16 in 2004) are accounted for by the equity method. Investments in unconsolidated subsidiaries and affiliates not accounted for by the equity method are carried at cost.

The excess of investment cost over equity in net assets acquired is amortized on a straight-line basis over five years.

Foreign Currency Transactions:

Revenue and expenses items denominated in foreign currencies are translated into Japanese yen at the rates of respective transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into yen at the exchange rate in effect at the balance sheet date and the resulting exchange gains or losses are credited or charged to income as incurred.

Foreign Currency Financial Statements (Accounts of overseas subsidiaries and affiliates):

All assets and liabilities are translated into yen at the exchange rate in effect at the balance sheet date except for shareholders' equity, which is translated at the historical exchange rates. Revenue and expense accounts of the consolidated overseas subsidiaries are translated at the average rates of exchange prevailing during the year. The resulting translation adjustments are shown as "Foreign currency translation adjustments" in shareholders' equity.

Cash and Cash Equivalents:

Cash and cash equivalents include all highly liquid time deposits with maturities of three months or less, and short-term investments and marketable securities which are readily convertible into cash and have no significant risk of change in value.

Marketable and Investment Securities:

Securities are classified into four groups: trading securities, held-to-maturity debt securities, securities of subsidiaries and affiliates, and other securities. Trading securities are stated at fair market value, held-to-maturity debt securities at amortized cost, and securities of subsidiaries and affiliates are stated at cost. Other securities with a quoted current price are stated at fair value, and those without a quoted current price are stated at cost, cost being determined by the moving-average method. Net unrealized gains or losses of other securities are stated as "Unrealized holding gains on available-for-sale securities" in shareholders' equity after applying tax-effect accounting. The Company and subsidiaries do not hold trading securities.

Inventories:

Inventories are mainly stated at the lower of cost or market value, cost being determined by the moving-average method.

Property, Plant and Equipment:

Property, plant and equipment are stated at cost. Depreciation is mainly computed by the declining-balance method for structures, machinery and equipment, and by the straight-line method for buildings at rates based on the estimated useful lives of assets prescribed by the Japanese Income Tax Law. The range of estimated useful lives is principally from 3 to 50 years for buildings and structures, and from 2 to 17 years for machinery and equipment.

Significant renewals and betterments are capitalized. Maintenance expenses are charged to income as incurred.

Research and Development Expenses:

Research and development expenses are charged to income as incurred.

Derivative Transactions:

All derivative financial instruments, except hedging instruments, are stated at fair value. The Company includes interest rate swaps in hedging instruments subject to hedge accounting.

The Company utilizes financial derivative transactions only for the purpose of hedging foreign exchange risk arising from normal operating activities and for managing interest rate risks. The Company does not hold or issue derivatives for dealing or speculative purposes. All derivative transactions are performed and controlled by the financial section. Directors in charge approve all derivative transactions entered into.

As the counterparties to these derivative transactions are limited to major financial institutions with high credit standings, the Company does not anticipate nonperformance by the counterparties to these agreements, and no material losses are expected.

Leases:

Finance leases, other than those which are deemed to transfer ownership, are accounted for in the same manner as operating leases in accordance with generally accepted accounting principles in Japan.

Allowance for Doubtful Accounts:

The allowance for doubtful accounts of the Company and its consolidated subsidiaries is provided in amounts sufficient to cover possible losses on collection. In determining the allowance for doubtful accounts for normal receivables, regard is taken of the historical default rate. With receivables where there is an acknowledged credit risk, allowances for doubtful accounts are provided for taking account of collectability on a case-by-case basis.

Income Taxes:

The tax effects of temporary differences between the carrying amounts of assets and liabilities for tax and financial reporting is recognized as deferred income taxes. The provision for income taxes is computed based on the pretax income included in the consolidated statement of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Accrued Retirement Benefits:

Accrued retirement and severance benefits for eligible employees are stated in the accompanying balance sheet based on the present discounted value of employee services rendered, at the fiscal year end, in amounts which provided projected benefit obligation for each period, less amounts funded under a pension plan.

Net Income per Share:

Net income per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each year. Diluted net income per share is calculated based on the assumption that all diluted convertible bonds were converted at the beginning of the year. Diluted net income per share for the Years ended March 31, 2006, 2005 and 2004 was not presented because there was no dilutive effect on any assumed conversion of convertible bonds for the year ended March 31, 2006, 2005 and 2004.

4. CHANGE IN ACCOUNTING POLICIES

(1) Adoptipn of new accounting standard for impairment of fixed assets.

Effective April 1, 2004, the Company and its consolidated subsidiaries have adopted the new Japanese accounting standard for impairment of fixed assets, which became applicable to the consolidated financial statements for the year ended March 31, 2004. The new accounting standard of fixed assets requires the Companies to review and evaluate its fixed assets for impairment whenever events or changes in circumstance indicate the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the future undiscounted cash flows expected to result from the continued use and eventual disposition of the asset or asset group. If the asset is determined to be impaired, the impairment loss would be measured, as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition. As a result of the adoption of the standard, income before income taxes and minority interests for the year ended March 31, 2005 decreased by ¥1,402 million (US$12 million).

(2) Change of classification of distribution expenses and information system-related expenses.

Effective April 1, 2005, the distribution expenses and information system-related expenses incurred at some consolidated subsidiaries that had previously been counted in the cost of sales were reclassified as selling, general and administrative expenses.

This change reflected an increase in the material significance of such expenses following the spin-off of the Information Systems Division and an increase in the amount of logistics work contracted out to a consolidated distribution subsidiary. Through this change, Tokuyama aims to ensure a consistent treatment of such costs with the distribution expenses and information system-related expenses incurred in Tokuyama Group operations other than these particular subsidiaries for the purposes of the proper calculation of management indicators and other performance indices.

Compared with the previous accounting standard, the effect of this change was to increase gross profit by ¥6,899 million in the fiscal year ended March 31, 2006. There was no effect on operating income, recurring income or income before income taxes. The change also had no impact on segment information.

5. MARKET VALUE INFORMATION

The market values and net unrealized gains of quoted securities at March 31, 2006 were as follows:

	Millions of yen		
	Carrying amount	Market value	Difference
Held-to-maturity debt securities:			
Government securities and municipal bonds	—	—	—
Bonds and others	—	—	—
Total	—	—	—

	Millions of yen		
	Acquisition cost	Carrying amount	Unrealized gain
Other securities:			
Listed corporate shares	¥8,926	¥49,586	¥40,660
Bonds and others	—	—	—
Total	**¥8,926**	**¥49,586**	**¥40,660**

	Millions of yen
	Carrying amount
Non-quoted main securities:	
Held-to-maturity debt securities	¥ —
Other securities	3,028
Total	**¥3,028**

	Thousands of U.S. dollars		
	Carrying amount	Market value	Difference
Held-to-maturity debt securities:			
Government securities and municipal bonds	—	—	—
Bonds and others	—	—	—
Total	**—**	**—**	**—**

	Thousands of U.S. dollars		
	Acquisition cost	Carrying amount	Unrealized gain
Other securities:			
Listed corporate shares	$76,291	$423,810	$347,519
Bonds and others	—	—	—
Total	**$76,291**	**$423,810**	**$347,519**

	Thousands of U.S. dollars
	Car.rying amount
Non-quoted main securities:	
Held-to-maturity debt securities	$ —
Other securities	25,883
Total	**$25,883**

6. INVENTORIES

Inventories at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Finished products and merchandise	**¥13,007**	¥11,860	**$111,167**
Work in progress	**4,812**	3,833	**41,130**
Raw materials and supplies	**8,396**	7,251	**71,762**
Total	**¥26,215**	¥22,944	**$224,059**

7. SHORT-TERM BANK LOANS AND LONG-TERM DEBT

Short-term bank loans at March 31, 2006 represent loans, which principally bear interest at rates ranging from 0.41% to 5.82% per annum.

A summary of long-term debt at March 31, 2006 and 2005 was as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Loans principally from banks and insurance companies, due through 2020 with interest rates ranging from 0.15 percent to 5.91 percent	**¥ 37,925**	¥ 43,314	**$ 324,146**
2.9 percent unsecured bonds in yen due January 9, 2008	**5,000**	5,000	**42,735**
2.24 percent unsecured bonds in yen due April 27, 2006	**4,800**	4,800	**41,026**
2.65 percent unsecured bonds in yen due September 2, 2009	**5,000**	5,000	**42,735**
2.35 percent unsecured bonds in yen due March 29, 2010	**10,000**	10,000	**85,470**
0.47 percent unsecured bonds in yen due June 19, 2008	**5,000**	5,000	**42,735**
1.36 percent unsecured bonds in yen due May 11, 2011	**5,000**	5,000	**42,735**
	72,725	78,114	**621,582**
Less current portion	**(14,169)**	(6,643)	**(121,101)**
	¥ 58,556	¥ 71,471	**$ 500,481**

The aggregate annual maturities of long-term debt at March 31, 2006 are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Years ending March 31		
2006	**¥14,169**	**$121,101**
2007	13,667	116,814
2008	18,072	154,465
2009	16,297	139,292
2010	1,259	10,758
Thereafter	9,261	79,152
	¥72,725	**$621,582**

Assets pledged as collateral for certain loans and other liabilities at March 31, 2006 and 2005 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Pledged Assets			
Property, plant and equipment	**¥36,540**	¥41,158	**$312,312**
Other	**674**	949	**5,753**
	¥37,214	¥42,107	**$318,065**

8. INCOME TAXES

The Company and its domestic consolidated subsidiaries are subject to a number of income taxes that, in the aggregate, indicate a statutory tax rate in Japan of approximately 40.4% for the year ended March 31, 2006. Overseas subsidiaries are subject to income taxes of countries where they are domiciled.

The significant differences between the statutory tax rate and effective income tax rate for consolidated financial statement purposes for the years ended March 31, 2006 and 2005 were summarized as follows:

	2006	2005
Statutory tax rate	**40.4%**	40.4%
Increase (decrease) in income taxes resulting from:		
Effect of tax credits	**(5.3)**	(2.8)
Change in valuation allowance allocated to income tax expenses	**(3.4)**	—
Permanent differences	**1.7**	1.7
Equity in earnings of unconsolidated subsidiaries and affiliates	**(0.9)**	—
Utilization of loss carryforward	**—**	(17.3)
Loss on write-down of investments	**—**	(13.9)
Loss carried forward without deferred tax assets	**—**	1.8
Other	**(0.2)**	0.4
Effective income tax rate	**32.3%**	10.3%

Significant components of deferred tax assets and liabilities at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Deferred tax assets:			
Allowance for repairs	**¥ 1,799**	¥ 1,552	**$ 15,376**
Fixed assets	**907**	845	**7,753**
Accrued retirement and severance benefits	**2,923**	2,031	**24,982**
Investment securities	**1,135**	1,103	**9,701**
Deficits	**1,503**	2,919	**12,850**
Others	**3,038**	2,377	**25,967**
Subtotal	**11,305**	10,827	**96,629**
Less valuation allowance	**(919)**	(1,976)	**(7,858)**
Total deferred tax assets	**10,386**	8,851	**88,771**
Deferred tax liabilities:			
Unrealized holding gains on available-for-sale securities	**(16,442)**	(9,239)	**(140,534)**
Special depreciation reserve	**(1,175)**	(1,379)	**(10,041)**
Appropriations for advanced depreciation	**(1,690)**	(1,668)	**(14,448)**
Others	**(99)**	(52)	**(846)**
Total deferred tax liabilities	**(19,406)**	(12,338)	**(165,869)**
Net deferred tax liabilities	**¥ (9,020)**	¥ (3,487)	**$ (77,098)**

9. RETIREMENT AND SEVERANCE PLAN

The Company and consolidated domestic subsidiaries have lump-sum severance benefits plans and tax-qualified pension plans as vested benefits system. Benefits under these plans are based on the current rate of pay, length of service and conditions under which terminations occur. The Company set up an employee retirement benefit trust, contributed certain marketable securities to the trust.

Benefit obligations for the year ended March 31, 2006 were as follows:

	Millions of yen	Thousands of U.S. dollars
Project benefit obligation	¥(32,232)	$(275,489)
Fair value of plan assets	26,104	223,109
Funded status	(6,128)	(52,380)
Unrecognized actuarial loss	(625)	(5,337)
Unrecognized prior service cost	—	—
Net amount shown on balance sheet	(6,753)	(57,717)
Prepaid pension expense	2,036	17,398
Accrued retirement and severance benefits	¥ (8,789)	$ (75,115)

Benefit costs for the year ended March 31, 2006 were as follows:

	Millions of yen	Thousands of U.S. dollars
Service cost	¥ 1,404	$ 12,001
Interest cost	757	6,468
Expected return on plan assets	(349)	(2,982)
Amortization of net transition obligation	—	—
Recognized actuarial loss	368	3,144
Amortization of prior service benefit	—	—
Benefit cost	¥ 2,180	$ 18,631

Assumptions used in the actuarial calculation were as follows:

Discount rate	2.5%
Expected rate of return on plan assets	2.0%

10. LEASES

Lease payments on finance lease contracts that do not transfer ownership for the year ended March 31, 2006 amounted to ¥531 million (US$4,538 thousand). Lease payments corresponding to depreciation expenses for the year ended March 31, 2006, which were computed by the straight-line method over a period up to the maturity of the relevant lease contracts with no residual value, amounted to ¥531 million (US$4,538 thousand).

If the leases were capitalized, the cost of assets and accumulated depreciation at March 31, 2006 and 2005 would be as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Machinery, equipment and vehicles	**¥ 594**	¥ 516	**$ 5,076**
Other	**1,695**	2,158	**14,482**
Less accumulated depreciation	**(1,213)**	(1,651)	**(10,365)**
Total	**¥ 1,076**	¥ 1,023	**$ 9,193**

The future lease payments on finance leases at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Due within one year	**¥ 421**	¥ 402	**$3,596**
Due beyond one year	**655**	621	**5,597**
Total	**¥1,076**	¥1,023	**$9,193**

11. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses for the Years ended March 31, 2006, 2005 and 2004 were as follows:

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Carriage and shipping	**¥27,022**	¥22,228	¥23,084	**$230,954**
Salaries and bonuses	**7,916**	7,487	7,185	**67,658**
Research and development expenses	**7,960**	7,579	7,445	**68,033**
Rent	**1,563**	1,559	1,452	**13,358**
Traveling expenses and postage	**1,837**	1,834	1,775	**15,699**
Welfare expense	**1,443**	1,380	1,373	**12,336**
Other	**11,360**	9,880	9,140	**97,101**
Total	**¥59,101**	¥51,947	¥51,454	**$505,139**

12. DEPRECIATION

Depreciation for the Years ended March 31, 2006, 2005 and 2004 were as follows:

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Depreciation	**¥18,087**	¥18,336	¥18,875	**$154,592**

13. RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses for the Years ended March 31, 2006, 2005 and 2004 were as follows:

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Research and development expenses	**¥9,397**	¥8,866	¥8,751	**$80,314**

14. SHAREHOLDERS' EQUITY

The "Code" provides that an amount equal to at least 10% of cash dividends and other cash appropriations shall be appropriated and set aside as a legal reserve until the total amount of legal reserve and additional paid-in capital equals 25% of stated capital.

The legal reserve was not available for dividends but might be used to reduce a deficit with shareholder approval or capitalized by resolution of the Board of Directors. On condition that the total amount of legal reserve and capital reserve remains being equal to or exceeding 25% of common stock, they are available for distributions and certain other purposes by the resolution of shareholders' meeting.

The legal reserve is included in the retained earnings and is not allowed to show separately in the accompanying consolidated financial statements.

15. SEGMENT INFORMATION

Business segment information

The Company and its consolidated subsidiaries operate primarily in the following three business segments: "Chemicals", "Specialty Products" and "Cement, Building Materials and Others".

Chemicals: caustic soda, soda ash, vinyl chloride monomer, polyvinyl chloride, microporous film and others

Specialty Products: Polycrystalline silicon, aluminum nitride, amorphous precipitated silica, solvent for semiconductor base materials, medical diagnosis systems, dental materials, ion-exchange membranes and others

Cement, Building Materials and Others: cement, ready-mixed concrete, plastic window sashes and others

Until the year ended March 31, 2004, basic research and development expenses have been allocated to each segment as operating expenses and the expense of the Company's general affairs department and corporate administration department were included in "Corporate or elimination" as unallocable costs. Effective April 1, 2004, basic research and development expenses were included in "Corporate or elimination", and the expenses of the Company's general affairs department and corporate administration department were allocated to each segment in order to adjust the operating income by segments for business management to those by segment for official announcement and present more useful segment information.

As a result, compared with the previous method, operating expenses of the chemicals business decreased by ¥132 million (US$ 1 million), those of the specialty products business decreased by ¥1,324 million (US$11 million), and those of the cement, building materials and others business decreased by ¥197 million (US$2 million).

Segment information for the year ended March 31, 2004 have been restated according to the new method.

Business segment information for the Years ended March 31, 2006, 2005 and 2004 was summarized as follows:

	Millions of yen					
2006	Chemicals	Specialty products	Cement, building materials and others	Total	Corporate or elimination	Consolidated
1. Sales						
Sales to customers	**¥102,647**	**¥76,716**	**¥84,011**	**¥263,374**	**¥ —**	**¥263,374**
Inter-segment sales/transfer	**1,681**	**56**	**8,958**	**10,695**	**(10,695)**	**—**
Total sales	**¥104,328**	**¥76,772**	**¥92,969**	**¥274,069**	**¥(10,695)**	**¥263,374**
Operating expense	**96,635**	**60,667**	**89,473**	**246,775**	**(7,713)**	**239,062**
Operating income	**7,693**	**16,105**	**3,496**	**27,294**	**(2,982)**	**24,312**
2. Assets						
Assets	**¥ 94,470**	**¥88,078**	**¥83,645**	**¥266,193**	**¥ 94,910**	**¥361,103**
Depreciation	**6,191**	**6,867**	**4,283**	**17,341**	**746**	**18,087**
Capital expenditures	**6,432**	**7,199**	**5,237**	**18,868**	**2,784**	**21,652**

2005	Millions of yen Chemicals	Specialty products	Cement, building materials and others	Total	Corporate or elimination	Consolidated
1. Sales						
Sales to customers	¥95,771	¥67,156	¥74,626	¥237,553	¥ —	¥237,553
Inter-segment sales/transfer	1,509	114	6,968	8,591	(8,591)	—
Total sales	¥97,280	¥67,270	¥81,594	¥246,144	¥ (8,591)	¥237,553
Operating expense	88,715	58,041	78,337	225,093	(5,713)	219,380
Operating income	8,565	9,229	3,257	21,051	(2,878)	18,173
2. Assets						
Assets	¥91,116	¥78,154	¥79,332	¥248,602	¥ 60,323	¥308,925
Depreciation	6,571	6,674	4,462	17,707	629	18,336
Impairment loss on fixed assets (Note 4)	—	258	31	289	1,113	1,402
Capital expenditures	3,985	7,045	3,591	14,621	452	15,073

2004	Millions of yen Chemicals	Specialty products	Cement, building materials and others	Total	Corporate or elimination	Consolidated
1. Sales						
Sales to customers	¥88,928	¥59,642	¥70,824	¥219,394	¥ —	¥219,394
Inter-segment sales/transfer	1,529	170	6,116	7,815	(7,815)	—
Total sales	¥90,457	¥59,812	¥76,940	¥227,209	¥ (7,815)	¥219,394
Operating expense	84,915	53,448	72,934	211,297	(5,098)	206,199
Operating income	5,542	6,364	4,006	15,912	(2,717)	13,195
2. Assets						
Assets	¥92,901	¥73,606	¥76,780	¥243,287	¥ 65,529	¥308,816
Depreciation	6,613	7,206	4,467	18,286	589	18,875
Capital expenditures	6,627	4,051	5,852	16,530	150	16,680

2006	Thousands of U.S. dollars Chemicals	Specialty products	Cement, building materials and others	Total	Corporate or elimination	Consolidated
1. Sales						
Sales to customers	**$877,326**	**$655,691**	**$718,039**	**$2,251,056**	**$ —**	**$2,251,056**
Inter-segment sales/transfer	**14,369**	**481**	**76,566**	**91,416**	**(91,416)**	**—**
Total sales	**$891,695**	**$656,172**	**$794,605**	**$2,342,472**	**$ (91,416)**	**$2,251,056**
Operating expense	**825,939**	**518,525**	**764,721**	**2,109,185**	**(65,922)**	**2,043,263**
Operating income	**65,756**	**137,647**	**29,884**	**233,287**	**(25,494)**	**207,793**
2. Assets						
Assets	**$807,438**	**$752,806**	**$714,912**	**$2,275,156**	**$ 811,196**	**$3,086,352**
Depreciation	**52,917**	**58,687**	**36,610**	**148,214**	**6,378**	**154,592**
Capital expenditures	**54,973**	**61,534**	**44,756**	**161,263**	**23,794**	**185,057**

Overseas sales information

Overseas sales of the Company and its consolidated subsidiaries for the Years ended March 31, 2006 and 2005 were summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Asia	**¥30,433**	¥26,657	**$260,108**
Others	**11,124**	10,672	**95,079**
Total	**¥41,557**	¥37,329	**$355,187**

16. DERIVATIVE TRANSACTIONS

The Company enters into foreign exchange forward contracts for certain foreign currency-denominated assets and liabilities to hedge against future foreign currency fluctuations. The Company also enters into interest rate swap contracts to hedge against fluctuations in interest rates on bonds and to reduce financing costs on debt instruments.

The market values of derivative transactions at March 31, 2006 and 2005 were as follows:

	Millions of yen		
2006	Contract amount	Fair value	Unrealized gain (loss)
Forward exchange contracts:			
To sell foreign currencies:			
U.S. dollars	**¥ —**	**¥ —**	**¥ —**
To buy foreign currencies:			
U.S. dollars	**—**	**—**	**—**
Interest rate swap contracts:			
To receive floating and to pay fixed rates	**5,000**	**(94)**	**(94)**
To receive fixed and to pay floating rates	**¥22,100**	**¥(1,279)**	**¥(1,279)**

	Millions of yen		
2005	Contract amount	Fair value	Unrealized gain (loss)
Forward exchange contracts:			
To sell foreign currencies:			
U.S. dollars	¥ —	¥ —	¥ —
To buy foreign currencies:			
U.S. dollars	—	—	—
Interest rate swap contracts:			
To receive floating and to pay fixed rates	5,000	(214)	(214)
To receive fixed and to pay floating rates	¥15,000	¥(195)	¥(195)

2006	Thousands of U.S.dollars Contract amount	Fair value	Unrealized gain (loss)
Forward exchange contracts:			
To sell foreign currencies:			
U.S. dollars	**$ —**	**$ —**	**$ —**
To buy foreign currencies:			
U.S. dollars	**—**	**—**	**—**
Interest rate swap contracts:			
To receive floating and to pay fixed rates	**42,735**	**(800)**	**(800)**
To receive fixed and to pay floating rates	**$188,889**	**$(10,936)**	**$(10,936)**

The contract and notional amounts of derivatives shown in the above table are estimates and may not represent the Company's actual exposure to credit or market risk.

17. CONTINGENT LIABILITIES

At March 31, 2006 and 2005, the Company and its consolidated subsidiaries were contingently liable as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Notes discounted or endorsed	**¥ 292**	¥ 349	**$ 2,498**
Loans guaranteed	**3,438**	3,966	**29,388**
Commitments to guarantee	**1,168**	1,330	**9,982**
Letters of awareness	**—**	179	**—**

18. SUBSEQUENT EVENTS

At the annual shareholders' meeting of the Company held on June 27, 2006, the appropriation of retained earnings for the year ended March 31, 2006, was approved as follows:

	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥3.00 per share)	¥824	$7,042

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Tokuyama Corporation

We have audited the accompanying consolidated balance sheets of Tokuyama Corporation and subsidiaries as of March 31, 2006, and 2005, and the related consolidated statements of income, shareholders' equity and cashflows for each of the three years in the period ended March 31, 2006, all expressed in Japanese yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Tokuyama Corporation and subsidiaries as of March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2006, in conformity with accounting principles generally accepted in Japan.

Supplemental information

(1) As discussed in Note 4 to the consolidated financial statements, effective April 1, 2004, the Company and its consolidated subsidiaries adopted the new accounting standard for impairment of fixed assets, and effective April 1, 2005, some of consolidated subsidiaries changed classification of distribution expenses and information system-related expenses from cost of sales to selling, general and adminiatrative expenses.

(2) As discussed in Note 15 to the consolidated financial statements, effective April 1, 2004, the Company changed its allocation method of operating expense to each segment.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 are presented solely for conveniences. Our audit also included the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 2 to the consolidated financial statements.

Yamaguchi Audit Corporation

YAMAGUCHI Audit Corporation

Shunan, Japan
June 30, 2006

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Tsukuba, Tokuyama

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MAJOR SUBSIDIARIES AND AFFILIATES

As of March 31, 2006

Company	Capital (millions of yen, local currency in thousands)	Ownership (%)	Scope
Chemicals			
• Shin Dai-ichi Vinyl Corporation	2,000	71	Production and sale of polyvinyl chloride
• Sun Arrow Chemical Co., Ltd.	98	100	Production and sale of polyvinyl chloride compounds
• Sun•Tox Co., Ltd.	1,600	100	Production and sale of plastic films
• Tomitec Co., Ltd.	100	60	Production of plastic molding and moisture absorbing agents, as well as components for gas sensors and office equipment
• Tianjin Sunshine Plastics Co., Ltd.	RMB132,886	100	Production and sale of plastic films
• Tokuyama Siltech Co., Ltd.	200	100	Production and sale of layered silicate
• Shanghai Tokuyama Plastics Co., Ltd.	RMB51,555	100	Production and sale of microporous film
* Nishinihon Resicoat Co., Ltd.	50	50	Manufacture of metal parts and anti-rust surface coating materials
* Dainippon Plastics Co., Ltd.	859	40	Production and sale of plastics
* Tokuyama Polypropylene Co., Ltd.	500	50	Production and sale of polypropylene
(Category also includes another 2 equity method affiliates and 6 affiliates)			
Specialty Products			
• Tokuyama Dental Corporation	100	100	Production and sale of dental and medical materials
• A&T Corporation	577.6	52.42	Production and sale of diagnostic reagents, analyzers and systems
• Figaro Engineering Inc.	48	100	Production and sale of sensor devices
• Tokuyama Siam Silica Co., Ltd.	Baht389,268	52	Production and sale of precipitated silica
• Taiwan Tokuyama Corporation	NT$200,000	100	Production and sale of solvent for semiconductor base materials
• Tokuyama Electronic Chemicals Co., Ltd.	S$11,000	100	Production of solvent for semiconductor base materials
• ASTOM Corporation	450	55	Production and sale of ion-exchange membranes
• Eurodia Industrie S.A.	EUR650	99.99	Sale of ion-exchange membranes and maintenance and leasing of related equipment
• Tokuyama Asia Pacific Pte.Ltd.	S$800	100	Sale of Tokuyama's Products
• Figaro USA, Inc.	US$200	60	Sale of sensor devices
* Hantok Chemicals Co., Ltd.	Won4,500,000	50	Production of developers for photolithography
* Tokuyama Toshiba Ceramics Co., Ltd.	1,600	30	Production and sale of quartz-glass
* Tianjin Figaro Electronic Co., Ltd.	RM23,671	40.7	Production and sale of sensor devices
(Category also includes another 4 consolidated subsidiaries, 3 unconsolidated subsidiaries, 2 equity method affiliate and 4 affiliates)			
Cement, Building Materials and Others			
• Tokuyama Ready Mixed Concrete Co., Ltd.	100	100	Production and sale of ready-mixed concrete
• Seibu Tokuyama Ready Mixed Concrete Co., Ltd.	100	100	Production and sale of ready-mixed concrete
• Kawasaki Tokuyama Ready Mixed Concrete Co., Ltd.	40	100	Production and sale of ready-mixed concrete
• Tokuyama Trading Co., Ltd.	50	100	Sale of cement and building materials
• Oguri Shonan Corporation	80	100	Sale of cement, ready-mixed concrete and building materials
• Tokusho Co., Ltd.	40	100	Sale of cement and steel frame materials
• Shanon Co., Ltd.	495	100	Production, processing and sale of building materials, including plastic window sashes and doors
• Tohoku Shannon Co., Ltd.	300	72	Production of plastic window sashes
• Hachimaru Sangyo Corporation	10	100	Production of plastic window sashes
• Tokuyama Mtech Corporation	50	100	Processing and sale of building materials
• Tokuyama Logistics Corporation	100	100	Transportation and warehousing
• Shunan System Sangyo Co., Ltd.	151	100	Real estate, civil engineering, construction
* Sanyo Tokuyama Ready Mixed Concrete Co., Ltd.	50	50	Production and sale of ready-mixed concrete
* Chugoku Ready Mixed Concrete Co., Ltd.	80	50	Production and sale of ready-mixed concrete
* Southern Cross Cement Corporation	PP342,000	50	Import and sale of cement
(Category also includes another 10 consolidated subsidiaries, 3 equity method affiliates and 22 affiliates)			

• Consolidated subsidiary * Affiliate accounted for by the equity method

OVERSEAS

Company	Capital (thousands)	Ownership (%)	Scope
Tokuyama America Inc.	US$300	100	Sale of Tokuyama's products
Tokuyama Europe GmbH	EUR255	100	Sale of Tokuyama's products
Tokuyama Asia Pacific Pte. Ltd.	S$800	100	Sale of Tokuyama's products
Taiwan Tokuyama Corporation	NT$200,000	100	Production and sale of solvent for semiconductor base materials
Tokuyama Electronic Chemicals Pte. Ltd.	S$11,000	100	Production of solvent for semiconductor base materials
Tokuyama Siam Silica Co., Ltd.	Baht389,268	52	Production and sale of precipitated silica
Eurodia Industrie S.A.	EUR650	99.99	Sale of ion-exchange membranes and maintenance and leasing of related equipment
Figaro USA, Inc.	US$200	60	Sale of sensor devices
Tokuyama Dental Italy S.r.l.	EUR99	51	Production and sale of dental and medical materials
Tianjin Sunshine Plastics Co., Ltd.	RMB132,886	100	Production and sale of plastic films
Hantok Chemicals Co., Ltd.	Won4,500,000	50	Production of developers for photolithography
Southern Cross Cement Corporation	PP342,000	50	Sale of cement
Tianjin Figaro Electronic Co., Ltd.	RMB23,671	29.65	Production and sale of sensor devices
Shanghai Tokuyama Plastics Co., Ltd.	RMB51,555	100	Production and sale of microporous film

MAIN PRODUCTS

Chemicals

Caustic soda
Soda ash
Calcium chloride
Sodium silicate
Vinyl chloride monomer
Polyvinyl chloride
Propylene oxide
Isopropyl alcohol
Methylene chloride
Biaxial-oriented polypropylene film
Multilayer co-extrusion films
Cast polypropylene films
Microporous film

Specialty Products

Polycrystalline silicon
Amorphous precipitated silica
Fumed silica
Aluminum nitride
Dental materials
Pharmaceutical, agricultural chemical bulks and intermediates
Plastic lens materials
Ion-exchange membranes
Methylene chloride for washing metal
Solvent for semiconductor base materials
Medical diagnosis systems
Gas sensitive semiconductor

Cement, Building Materials and Others

Ordinary Portland cement
High early strength Portland cement
Blast furnace slag cement
Ready-mixed concrete
Plastic window sashes
Cement type stabilizer

CORPORATE DATA

As of March 31, 2006

Established:
February 16, 1918

Capital:
¥29,976 million

Employees (consolidated):
4,630

Shares Authorized:
700,000,000

Shares Issued:
275,671,876

Shareholders:
21,581

Major Shareholders:

	Number of Shares Held (Thousands)	Percentage of Total Shares
The Master Trust Bank of Japan, Ltd.	19,163	6.95
State Street Trust and Banking Co., Ltd.	18,819	6.82
Nippon Life Insurance Company	15,534	5.63
The Chase Manhattan Bank	15,332	5.56
Japan Trustee Services Bank, Ltd.	10,299	3.73
The Tokio Marine & Nichido Fire Insurance Co., Ltd.	9,202	3.33
Meiji Yasuda Life Insurance Company	8,103	2.93
The Bank of Tokyo-Mitsubishi UFJ, Ltd.	7,884	2.86
Mizuho Corporate Bank, Ltd.	7,864	2.85
The Yamaguchi Bank, Ltd.	7,798	2.82

Composition of Shareholders:

	Number of Shares Held (Thousands)	Percentage of Total Shares
Financial Institutions	117,955	42.8
Non-Japanese Corporations/Foreigners	83,628	30.3
Individuals/Other	38,642	14.0
Other Domestic Corporations	34,023	12.4
Securities Companies	1,424	0.5

Tokuyama Corp.

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