

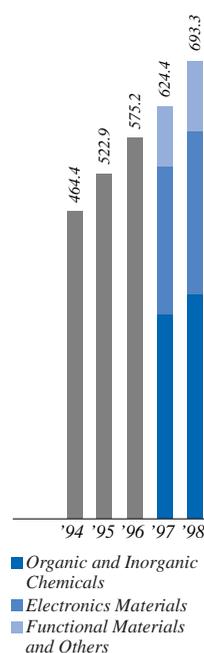
Management's Discussion and Analysis of Operations

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
For the years ended 31st March

	31st March,						31st March,
	1993	1994	1995	1996	1997	1998	1998
							(thousands of U.S. dollars)
(millions of yen)							
For the Year:							
Net sales	¥460,929	¥464,449	¥522,917	¥575,176	¥624,405	¥ 693,275	\$5,252,083
Operating income	34,815	32,450	51,914	73,427	82,024	90,860	688,333
Net income	15,989	17,547	26,862	37,825	40,614	42,027	318,386
Capital expenditures	41,292	34,421	67,689	66,791	92,844	136,384	1,033,212
Depreciation	37,675	40,351	42,986	45,647	52,191	62,144	470,787
Net income per share							
(in yen, dollars)	49.37	54.17	82.80	116.51	118.24	110.73	0.839
Cash dividends per share							
(in yen, dollars)	7.50	7.50	7.50	7.50	7.50	8.50	0.064
At year-end:							
Total assets	¥602,483	¥600,754	¥643,937	¥708,637	¥931,159	¥1,083,780	\$8,210,455
Working capital	78,907	94,362	110,901	118,936	195,729	221,869	1,680,826
Stockholders' equity	257,058	265,030	285,361	320,987	374,726	497,312	3,767,515
Short-term and long-term debt	186,800	173,304	172,280	171,865	271,860	269,395	2,040,872

Note: The U.S. dollar amounts represent conversions of Japanese yen, for convenience only, at the rate of ¥132=\$1.

Net Sales
(Billions of Yen)



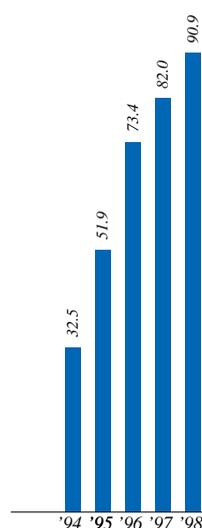
New Business Segments

Beginning with fiscal 1998, the year ended 31st March, 1998, the names and principal products of the business segments of Shin-Etsu Chemical Co., Ltd. (the "Company") and its subsidiaries (the "Companies") have been revised as follows: **Organic and Inorganic Chemicals**, where main products are polyvinyl chloride (PVC), silicones, vinyl acetate monomer, methanol and cellulose derivatives; **Electronics Materials**, where main products are semiconductor silicon, organic materials for the electronics industry, and rare earth magnets for the electronics industry; and **Functional Materials and Others**, where main products are synthetic quartz, oxide single-crystal, rare earths, rare earth magnets for applications outside the electronics industry, as well as the export of technology and plants, export and import of merchandise, construction and plant engineering, and information processing services. Fiscal 1997 results have been restated to incorporate these revisions.

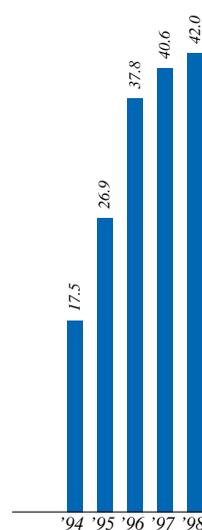
There were two principal changes. First was the transfer of synthetic quartz, oxide single-crystal and rare earths from the Electronics Materials segment to the Functional Materials and Others segment. Second was the division of the rare earth magnet line into products for electronic and non-electronic applications. The former were assigned to the Electronics Materials segment and the latter to the Functional Materials and Others segment. The purpose of the realignment is to create segments that more accurately reflect the characteristics of individual products and their applications.

Consolidated data include the results of the Company and 57 subsidiaries in Japan and overseas. Of the remaining 39 subsidiaries and 21 affiliated companies, the equity method of accounting is applied to 2 subsidiaries and 7 affiliated companies.

Operating Income
(Billions of Yen)



Net Income
(Billions of Yen)



Operating Environment

In the fiscal year that ended in March 1998, an increase in the consumption tax rate and other factors held down housing construction and personal consumption in Japan. In the second half of the year, financial system instability and the deepening turmoil in Asian economies had an adverse impact on Japan's economy, accelerating its recessionary tendencies. In the U.S. economy, personal consumption, housing construction and capital investment were all robust. In this environment, the Companies sought to bolster domestic and overseas marketing activities and improve earnings.

Net Sales and Segment Information

Fiscal 1998 consolidated net sales rose 11.0 percent to ¥693,275 million (US\$5,252 million) and operating income climbed 10.8 percent to ¥90,860 million (US\$688 million). The ratio of operating income to net sales was unchanged at 13.1 percent. Results by segment are as follows.

Organic and Inorganic Chemicals—This segment includes results of the Company and 33 subsidiaries, including Shintech, Inc. and Shin-Etsu Polymer Co., Ltd. In fiscal 1998, segment sales increased 9.7 percent to ¥340,051 million (US\$2,576 million), which is 49.1 percent of total sales. In addition to rising demand for vinyl chloride in the U.S., silicone sales were strong due to growth in the number of applications. Other organic and inorganic chemical products posted stable growth. Operating income rose 25.7 percent to ¥35,753 million (US\$271 million).

Electronics Materials—This segment includes results of the Company and 15 subsidiaries, including Shin-Etsu Handotai Co., Ltd., Shin-Etsu Handotai America, Inc., and S.E.H. Malaysia Sdn. Bhd. Segment sales were up 10.3 percent to ¥247,708 million (US\$1,877 million), representing 35.7 percent of total sales. Despite weakening conditions in the semiconductor market in the year's second half, semiconductor silicon sales were generally stable throughout the year due to higher worldwide demand. Operating income declined 7.4 percent to ¥42,507 million (US\$322 million), mostly because of higher depreciation.

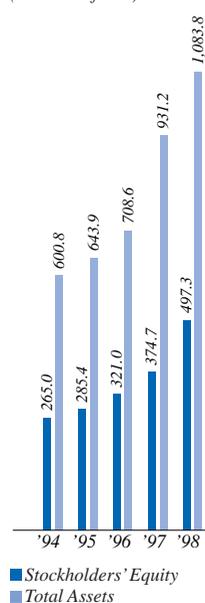
Functional Materials and Others—Sales in this segment include the results of the Company and 15 subsidiaries, including Shin-Etsu Astech Co., Ltd. and Shin-Etsu Engineering Co., Ltd. Fiscal 1998 segment sales increased 17.5 percent to ¥105,516 million (US\$799 million), accounting for 15.2 percent of total sales. Synthetic quartz, including preform for optical fiber, and rare earths for fluorescent plate makers performed well. The export and import of merchandise and construction and repairs were both stable. Operating income was up by 71.7 percent to ¥13,120 million (US\$99 million).

Other Income (Expense) and Net Income

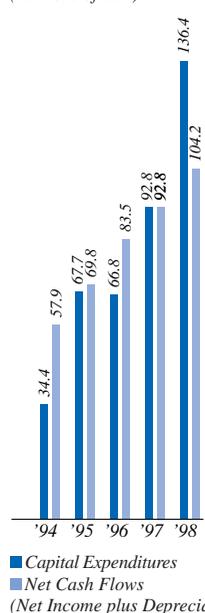
Interest and dividend income increased 38.1 percent to ¥10,075 million (US\$76 million). This was mostly due to income generated by the temporary investment of proceeds from the 1996 issues of convertible bonds and bonds with warrants. These funds were raised for the purpose of funding capital expenditures at the Companies. **Interest expense** climbed 20.2 percent to ¥9,220 million (US\$70 million), mainly a reflection of interest payments on the 1996 convertible and warrant bond issues. After inclusion of a foreign exchange loss of ¥950 million (US\$7 million) and other items, **other income/(expenses)** resulted in a net expense of ¥2,222 million (US\$17 million).

The increase in operating income and in net other expenses resulted in a 8.5 percent rise in **income before income taxes** to ¥88,638 million (US\$672 million). Income taxes were up 12.4 percent to ¥46,925 million (US\$355 million). **Equity in earnings of affiliates** declined 10.0 percent to ¥1,352 million (US\$10 million), and **minority interests in earnings of consolidated subsidiaries** increased to ¥1,310 million (US\$10 million). **Amortisation of difference between cost of investment and equity in net assets of consolidated subsidiaries** was ¥272 million (US\$2 million). Consolidated **net income** was up 3.5 percent to ¥42,027 million (US\$318 million), resulting in primary net income per share of ¥110.73 (US\$0.84).

Stockholders' Equity/
Total Assets
(Billions of Yen)



Capital Expenditures/
Net Cash Flows
(Billions of Yen)



Overseas Operations

Overseas sales, which are derived from foreign subsidiaries, rose 12.1 percent to ¥246,904 million (US\$1,870 million). This is 35.6 percent of total sales, compared with 35.3 percent in fiscal 1997. Higher demand for PVC in the United States and for semiconductor silicon were the most important contributors.

Financial Position

As of 31st March, 1998, current assets were ¥545,865 million (US\$4,135 million), 5.2 percent more than at the previous fiscal year-end. Cash and time deposits declined by 15.5 percent to ¥197,967 million (US\$1,500 million) due to purchases of short-term marketable securities. For the same reason marketable securities rose by 93.3 percent to ¥71,227 million (US\$540 million). Reflecting the growth in sales during the fiscal year, inventories increased 17.9 percent to ¥87,148 million (US\$660 million). Investments in securities, because of mainly purchase of Euroyen bonds, were up 87.8 percent to ¥91,569 million (US\$694 million). Capital expenditures were the principal reason for a 22.0 percent rise, to ¥390,259 million (US\$2,957 million), in tangible fixed assets. Total assets increased 16.4 percent to ¥1,083,780 million (US\$8,210 million).

Current liabilities rose 0.3 percent to ¥323,996 million (US\$2,455 million). Notes and accounts payable increased, but short-term loans were lower. In long-term liabilities, corporate bonds and long-term borrowings both rose. The conversion of convertible bonds limited the increase in total long-term debt to 4.8 percent, resulting in a year-end balance of ¥176,274 million (US\$1,335 million). Stockholders' equity was up 32.7 percent to ¥497,312 million (US\$3,768 million) due to the conversion of convertible bonds and higher retained earnings and the equity ratio advanced to 45.9 percent.

At the stockholders meeting held in June 1998, approval was given for the acquisition of treasury stock for the purpose of granting stock options. The amendment to the Articles of Incorporation provides for the acquisition of no more than 745 thousand shares of the Company's par-value common stock at a cost not to exceed ¥2,500 million (US\$19 million).

Capital Expenditures

Fiscal 1998 capital expenditures amounted to ¥136,384 million (US\$1,033 million). The principal share of these expenditures was for the expansion and upgrading of production facilities for semiconductor silicon and other electronic materials. During the five-year period ending in March 2003, the Company, subsidiaries and affiliated companies plan to make capital expenditures of about ¥500 billion (US\$3,788 million). These investments will be used primarily to expand and streamline production activities and to install environmental systems.

Cash Flows

Cash and cash equivalents at the end of fiscal 1998 were ¥269,194 million (US\$2,039 million), 0.7 percent less than at the end of fiscal 1997. Net cash provided by operating activities was ¥112,055 million (US\$849 million) as both net income and depreciation and amortisation rose. Net cash used for investing activities was ¥164,719 million (US\$1,248 million), mainly due to a large volume of capital expenditures. Net cash provided by financing activities was ¥56,862 million (US\$431 million). This is mainly attributable to proceeds from the issue of debentures.