

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

SHIN-ETSU CHEMICAL CO., LTD. and Subsidiaries

For the years ended 31st March

Review of Operations

The operations of Shin-Etsu Chemical Co., Ltd. (the Company) and its subsidiaries are divided into three business segments according to product type, sales area, and other factors. The Organic and Inorganic Chemicals segment focuses on the manufacture and sale of polyvinyl chloride (PVC), silicones and other products. The Electronics Materials segment concentrates on the manufacture and sale of semiconductor silicon and other materials, and the Functional Materials and Others segment focuses on the manufacture and sale of synthetic quartz and other products as well as providing a variety of other services, including construction and maintenance. Consolidated data include the results of the Company and its 61 subsidiaries in Japan and overseas. The equity method of accounting is applied to 7 of the 38 unconsolidated subsidiaries and the 16 affiliated companies.

Operating Environment

There were signs of an economic recovery in Japan in the fiscal year ended March 31, 2000, as public expenditures and housing construction increased during the first half of the period as a result of government economic policies. The second half of the fiscal year saw an upturn in capital expenditures, centering on IT-related fields. However, a deteriorating environment for employment and income led to continued stagnation in consumer spending and the recovery lacked strength. On the other hand, although there are uncertainties

about the future, the US economy continued to grow steadily led by increases in consumer spending and capital expenditures.

In this operating environment, the companies of the Shin-Etsu Group strove to further improve their competitive strength in their core international business fields. In addition, Group companies made every effort to improve profitability, develop new products and bring them to market.

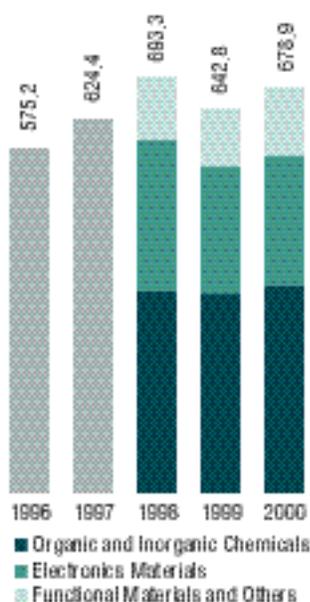
Net Sales

Overseas sales made up 51.2% of consolidated net sales for the year ended March 31, 2000 so the appreciation of the yen and the accompanying foreign exchange loss had an effect on the Company's results. However, growth in demand in each business segment, both abroad and in Japan, more than compensated for this negative factor and consolidated net sales increased 5.6%, or ¥36,063 million, to ¥678,859 million (US\$6,404 million).

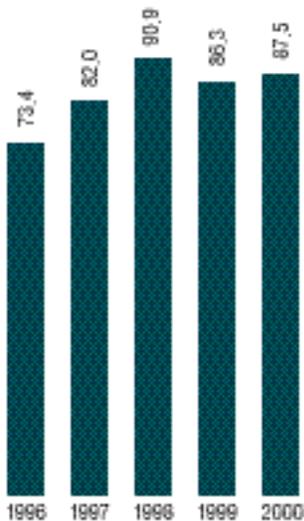
Net sales for the Organic and Inorganic Chemicals segment rose 4.4%, or ¥14,487 million, to ¥343,412 million (US\$3,240 million). Sales in this segment accounted for 50.6% of total net sales, down from the previous fiscal year's figure of 51.2%. Increased net sales for the segment made up 40.2% of the total increase.

Although sales of PVC did not perform well in the Japanese market, demand overseas, led by the United States, turned around and grew steadily. Sales of silicones surpassed those of the

Net Sales
Billions of yen



Operating Income
Billions of yen



Net Income
Billions of yen



previous period as demand in Japan recovered, led by sales for use in communications devices. Sales of silicones overseas also expanded, led by sales in other parts of Asia.

Net sales for the Electronics Materials segment during the period under review rose 2.6% compared to the previous period, up ¥5,527 million to ¥220,132 million (US\$2,077 million). Sales in this segment accounted for 32.4% of total net sales, down from 33.4% for the previous period. Increased net sales for the segment made up 15.3% of the total increase.

With regard to performance by product category, falling prices and the sudden recovery in demand for electronic devices, driven by increased demand worldwide for personal computers and mobile phones, pushed sales of semiconductor silicon to surpass those of the previous period despite falling prices. Sales of rare earth magnets for use in electronics applications were affected by significant adjustments in the production of hard disk drives (HDDs) and suffered a downturn.

The Functional Materials and Others segment recorded a 16.2% increase in net sales compared to the previous period, climbing ¥16,049 million to ¥115,315 million (US\$1,088 million). Sales for the segment as a proportion of total net sales rose 1.6%, from 15.4% to 17.0%. Exports of synthetic quartz products for optical fiber increased and other sales to the electronics and telecommunications industries also rose. Sales of rare earth magnets for use in optical pickups, factory automation devices, and

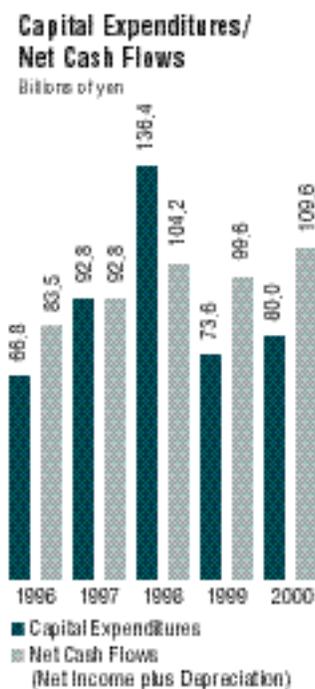
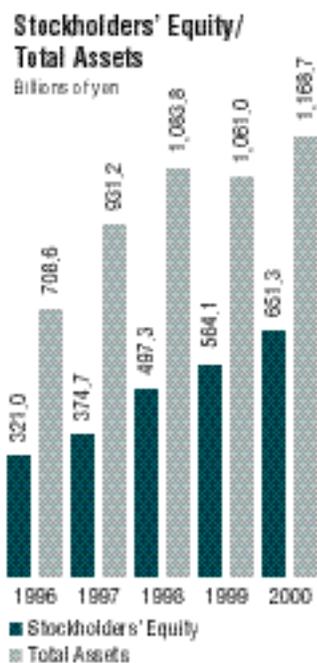
mobile phones were also strong. Overall, increased net sales for the segment made up 44.5% of the total increase in sales.

Overseas sales accounted for ¥347,792 million compared with total net sales of ¥678,859. The proportion of overseas sales to total sales dropped 2.5%, from 53.7% in the previous fiscal period to 51.2%. This reflects stronger growth in domestic sales than in overseas sales as well as the effect of the appreciation of the yen and the accompanying foreign exchange loss.

Expenses and Earnings

Operating income for the period under review rose 1.3%, or ¥1,142 million, to ¥87,465 million (US\$825 million). Operating income for the Organic and Inorganic Chemicals segment increased 1.8%, or ¥796 million, to ¥45,162 million. The Electronics Materials segment was affected by falling prices for some products and inventory adjustments, and operating profit fell 20.6%, or ¥6,054 million, to ¥23,344 million. The Functional Materials and Others segment recorded a significant increase in operating income, surging 45.7%, or ¥5,854 million, to ¥18,652 million.

Other expenses (net) totaled ¥4,560 million (US\$43 million), roughly half of the figure for the previous fiscal year, ¥9,116 million, largely because the loss associated with foreign exchange fluctuations was reduced to ¥4,703 million. Net interest expense rose ¥1,823 million as a result of lower interest earned following the reduced use of US dollar-based funds.



Income before income taxes increased 7.4%, or ¥5,698 million, to ¥82,905 million, while consolidated net income soared 11.2%, rising ¥4,866 million, to ¥48,229 million. This difference is attributed to the transition to tax-effect accounting made during this fiscal period by the Company, its domestic subsidiaries and affiliates, which resulted in an increase in net profits of ¥943 million and a reduction in Japanese income tax rates.

Primary net income per share was ¥116.56 (US\$1.10), an increase of ¥7.20.

With regard to the Company's cash dividends for the period under review, including the interim cash dividend of ¥5 per share paid previously, the Company plans to declare an annual cash dividend of ¥10 (US\$0.094) per share, an increase of ¥1 compared with the previous fiscal year.

Financial Position

As of March 31, 2000, total assets were ¥1,168,729 million (US\$11,026 million), an increase of ¥107,756 million, or 10.2%.

Current assets grew ¥86,972 million to ¥610,293 million (US\$5,757 million). The main factors contributing to this rise were the growth in notes and accounts receivable of ¥28,232 million, increased retained earnings, and a ¥33,767 million rise in short-term marketable securities and cash equivalent. In addition, deferred tax assets increased significantly in line with the adoption of tax-effect accounting from this fiscal period.

Total investments and advances rose ¥6,622 million to ¥141,240 million (US\$1,332 million), largely as a result of investments in, and advances to, unconsolidated affiliates.

Total property, plant and equipment declined ¥13,193 million to ¥378,272 million (US\$3,569 million).

Investment in plant and facilities and actual depreciation were approximately balanced. In addition to an increase in fixed assets of ¥16,977 million as a result of the consolidation of three firms, the reduction in recorded costs of exchange due to the appreciation of the yen was significant for foreign subsidiaries and tangible fixed assets decreased.

Adjustments on foreign currency statement translation increased ¥26,972 million, to ¥31,790 million (US\$300 million), as yen equivalent increased due to the appreciation of the yen on foreign currency based financial statements.

Total liabilities increased 3.7%, or ¥17,823 million, to ¥493,929 million (US\$4,660 million). Short- and long-term interest-bearing debt rose ¥2,773 million, to ¥253,833 million (US\$2,395 million) due to new procurement and redemption activities. Operating and other liabilities rose ¥15,050 million, to ¥240,096 million (US\$2,265 million), largely due to an increase of ¥8,370 million in notes and

accounts payable used to expand business and an increase in accrued income taxes of ¥9,911 million against higher earnings.

Total stockholders' equity increased 15.5%, or ¥87,194 million, to ¥651,261 million (US\$6,144 million). The equity ratio rose 2.5%, to 55.7%, largely due to an increase of ¥20,954 million in common stock and additional paid-in capital. This was as a result of the conversion of convertible bonds, the exercise of subscription rights, and an increase of ¥68,207 million in legal reserve and earnings, which includes an adjustment of ¥23,637 million for the prior year's caused by the application of deferred tax accounting.

Cash Flow

Cash and cash equivalents as of March 31, 2000, were ¥271,635 million (US\$2,563 million), an increase of ¥22,454 million. This is equivalent to 4.8 times average monthly net sales of ¥56,572 million, and provides liquidity adequate to maintain the Company's business activities.

Net cash provided by operating activities jumped ¥27,425 million, to ¥95,876 million (US\$904 million). The main factors behind the increase were cash inflows, which kept non-cash items, such as depreciation costs within bounds, and lower income taxes.

Net cash used for investing activities slightly surpassed the figure for the previous year, amounting to ¥76,349 million (US\$720 million), up ¥2,551 million. The increase stems from increased investment in marketable securities and loans, although investment in property, plant and equipment decreased slightly.

Net cash from financing activities surged ¥5,013 million, to ¥12,142 million (US\$115 million). While short- and long-term interest-bearing debt was reduced through new procurement and bond conversion and redemption, income from the issue of new shares through the exercise of warrants jumped ¥15,981 million, to ¥16,645 million (US\$157 million).

Exchange loss affecting cash and cash equivalents due to the appreciation of the yen climbed ¥7,110 million, to ¥10,434 million (US\$98 million).

Year 2000 (Y2K)

In consultation with their suppliers, customers, and other relevant parties, the companies of the Shin-Etsu Group launched a coordinated plan of action in anticipation of possible problems associated with Y2K. As of the date of this report, Shin-Etsu has experienced no significant problems related to Y2K conversion, either in Japan or abroad. The Company successfully met its primary Y2K goals of uninterrupted business activities, continued preservation of the environment, and the maintenance of safety standards at its business sites as well as in the communities where it operates.