

Management's Discussion and Analysis of Operations

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
Years ended March 31

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 60 subsidiaries in Japan and overseas. The equity method of accounting is applied to 7 of the 36 unconsolidated subsidiaries and the 16 affiliated companies.

Operating Environment

In this fiscal year (April 1, 2000 to March 31, 2001) there were some signs of economic recovery in Japan, such as an upward trend of capital investment in mainly IT-related fields. However, personal consumption continued to be weak, so the overall economy was not able to enter a sustained recovery mode.

On the other hand, the U.S. economy remained firm, as capital investment continued strong in the first half of the year. However, it began to slow during the second half, and this trend began to have a negative impact on the Japanese economy.

Under these circumstances, the Shin-Etsu Group companies aggressively proceeded with investments in growing business fields where the company had advantages in domestic and overseas markets and endeavored to secure and further develop its leading world market positions. At the same time, the Shin-Etsu Group companies were striving to increase net sales and net income, as they continued to pursue R&D activities aiming at developing strong new products, streamlining their management structure and improving productivity.

Sales, Expenses and Earnings

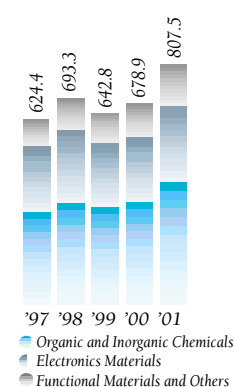
Consolidated net sales rose ¥128,626 million, or 18.9%, to ¥807,485 million (\$6,512 million). Operating income was up ¥25,212 million, or 28.8%, to ¥112,677 million (\$909 million).

Sales of Organic and Inorganic Chemicals increased ¥66,959 million, or 19.5%, to ¥410,371 million (\$3,309 million). This reflected solid first-half sales of PVC in the United States and the inclusion of European operations in reporting from fiscal 2001. On the negative side, operating income for this segment rose ¥1,853 million, or 4.1%, to ¥47,015 million (\$379 million). This stemmed from higher prices for raw materials used in PVC and sluggish domestic demand.

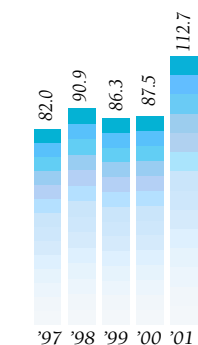
In Electronics Materials, sales increased ¥38,614 million, or 17.5%, to ¥258,746 million (\$2,087 million). Segment operating income was up ¥13,017 million, or 55.8%, to ¥36,361 million (\$293 million). These solid gains reflected strong shipments of semiconductor silicon and photoresists for the domestic and overseas device markets, which continued to boom.

Sales of Functional Materials and Others were up ¥23,053 million, or 20.0%, to ¥138,368 million (\$1,116 million), with operating income rose ¥10,676 million, or 57.2%, to ¥29,328 million (\$237 million). The main factors here were strong global telecommunications demand, supported by significantly higher sales of synthetic quartz, oxide single crystals, rare earth magnets and others.

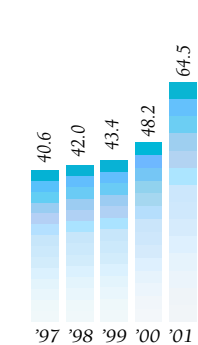
NET SALES
(Billions of yen)



OPERATING INCOME
(Billions of yen)



NET INCOME
(Billions of yen)



Net other expenses were down ¥684 million, or 15.0%, to ¥3,876 million (\$31 million). The breakdown was principally ¥27,498 million of a special provision for retirement benefit costs, which was amortized at once, an increase of ¥15,078 million as net gains on sales of property, plant and equipment, which was to offset that special loss, and an increase of ¥15,623 million as net foreign exchange gain.

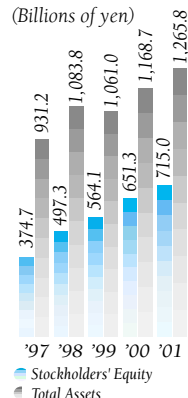
Income before income taxes increased ¥25,896 million, or 31.2%, to ¥108,801 million. Net income was up ¥16,276 million, or 33.7%, to ¥64,505 million. Net income per share rose ¥37.02, or 31.8%, to ¥153.58 (\$1.24).

Including an interim cash dividend of ¥6.00 (\$0.05), cash dividends for the period were ¥12.00 (\$0.10), up ¥2.00 from a year earlier.

Financial Position

STOCKHOLDERS' EQUITY/ TOTAL ASSETS

(Billions of yen)



At year-end, total assets were ¥1,265,799 million (\$10,208 million), up ¥97,070 million, or 8.3%, from a year earlier.

Total current assets increased ¥94,393 million, or 15.5%, to ¥704,686 million (\$5,683 million). This was primarily because of growth in notes and accounts receivable and in inventories as a result of sales expansion.

Total investments and advances were down ¥6,213 million, or 4.4%, to ¥135,027 million (\$1,089 million), mainly because of a reduction in investments in and advances to unconsolidated subsidiaries and affiliates.

Total property, plant and equipment increased ¥43,971 million, or 11.6%, to ¥422,243 million (\$3,405 million). Capital expenditures were ¥96,770 million (\$780 million), while depreciation was ¥70,767 million (\$571 million).

At year-end, total liabilities were up ¥32,355 million, or 6.5%, from a year earlier, at ¥526,523 million (\$4,246 million).

This amount included short- and long-term interest-bearing debt, which was down ¥62,833 million, or 24.8%, to ¥191,000 million (\$1,540 million). This decline was due to particularly a \$500 million redemption of the Company's debenture with warrant.

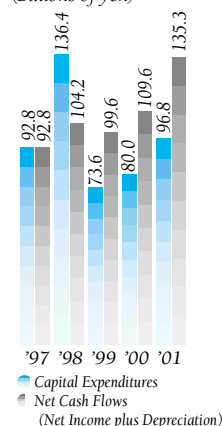
Also contributing to higher total liabilities were an increase of ¥30,031 million in notes and accounts payable owing to operational expansion, and a ¥22,508 million rise in accrued income taxes as a result of higher earnings. The company also had a special provision for retirement benefit costs of ¥27,498 million to cover amortization of differences arising from adopting the new standard.

Total stockholders' equity was up ¥63,735 million, or 9.8%, to ¥714,996 million (\$5,766 million). The equity ratio was up 0.8 percentage point, to 56.5%, primarily because of a ¥59,710 million rise in the consolidated legal reserve and retained earnings.

Cash Flow Statement

CAPITAL EXPENDITURES/ NET CASH FLOWS

(Billions of yen)



Net cash provided by operating activities was ¥142,202 million (\$1,147 million), an increase of ¥46,326 million. This rise was due principally to an increase in income before income taxes, as well as higher depreciation and amortization and increase in accrued retirement benefit costs—both noncash expenses.

Net cash used for investing activities amounted to ¥87,170 million (\$703 million). The main factor here was purchases of property, plant and equipment. The Company allocated much of its capital expenditure during the year to the construction of a PVC plant in Louisiana and investment in the semiconductor silicon business, particularly for 300-millimeter wafer production facilities.

Net cash used for financing activities was ¥70,364 million (\$567 million), compared with ¥12,142 provided by such activities in fiscal 2000. This amount included a \$500 million outlay to redeem debentures with warrants. Borrowings, debentures and convertible debentures were down ¥62,833 million from a year earlier.

As a result of these factors, cash and cash equivalents at end of year was ¥272,769 million (\$2,200 million), up ¥1,134 million from the previous period.

Ten-Year Summary

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
Years ended March 31

(Millions of Yen, except per Share)

	2001	2000	1999
For the Year:			
Net sales	¥ 807,485	¥ 678,859	¥ 642,796
Operating income	112,677	87,465	86,323
Net income	64,505	48,229	43,363
Per Share (Yen):			
Net income—primary	153.58	116.56	109.36
Net income—fully diluted	150.24	113.46	103.17
Cash dividends	12.00	10.00	9.00
Capital expenditures	96,770	80,003	73,641
Depreciation	70,767	61,384	56,196
At Year-End:			
Total assets	¥1,265,799	¥1,168,729	¥1,060,973
Working capital	350,273	273,193	261,691
Common stock	110,247	107,664	98,243
Stockholders' equity	714,996	651,261	564,067
Stockholders' equity per share (Yen)	1,699.74	1,557.48	1,380.43
General:			
Number of employees	19,398	18,754	18,384
Number of shares issued (Thousands)	422,542	419,848	410,015

(Thousands of U.S. Dollars, except per Share)

	2001	2000	1999
For the Year:			
Net sales	\$ 6,511,976	\$ 5,474,669	\$ 5,183,839
Operating income	908,685	705,363	696,153
Net income	520,202	388,944	349,702
Per Share (Dollars):			
Net income—primary	1.239	0.940	0.882
Net income—fully diluted	1.212	0.915	0.832
Cash dividends	0.097	0.081	0.073
Capital expenditures	780,403	645,185	593,879
Depreciation	570,702	495,032	453,194
At Year-End:			
Total assets	\$10,208,056	\$ 9,425,234	\$ 8,556,234
Working capital	2,824,782	2,203,169	2,110,411
Common stock	889,089	868,258	792,282
Stockholders' equity	5,766,097	5,252,105	4,548,927
Stockholders' equity per share (Dollars)	13.708	12.560	11.133
General:			
Number of employees	19,398	18,754	18,384
Number of shares issued (Thousands)	422,542	419,848	410,015

Note: The U.S. dollar amounts represent conversions of yen, for convenience only, at the rate of ¥124=US\$1.

	1998	1997	1996	1995	1994	1993	1992
¥	693,275	¥624,405	¥575,176	¥522,917	¥464,449	¥460,929	¥478,351
	90,860	82,024	73,427	51,914	32,450	34,815	49,795
	42,027	40,614	37,825	26,862	17,547	15,989	24,581
	110.73	118.24	116.51	82.80	54.17	49.37	75.96
	101.69	103.95	106.66	—	—	—	—
	8.50	7.50	7.50	7.50	7.50	7.50	7.50
	136,384	92,844	66,791	67,689	34,421	41,292	69,875
	62,144	52,191	45,647	42,986	40,351	37,675	36,912
¥1,083,780	¥931,159	¥708,637	¥643,937	¥600,754	¥602,483	¥614,490	
	221,869	195,729	118,936	110,901	94,362	78,907	54,869
	83,957	44,256	36,440	36,384	35,829	35,800	35,781
	497,312	374,726	320,987	285,361	265,030	257,058	243,730
	1,265.39	1,071.97	988.59	879.06	818.12	793.64	752.56
	19,238	18,896	17,106	16,075	11,697	11,557	11,744
	393,722	349,569	324,691	324,621	323,949	323,899	323,867

	1998	1997	1996	1995	1994	1993	1992
\$	5,590,927	\$5,035,524	\$4,638,516	\$4,217,073	\$3,745,556	\$3,717,169	\$3,857,669
	732,742	661,484	592,153	418,661	261,694	280,766	401,573
	338,927	327,532	305,040	216,629	141,508	128,944	198,234
	0.893	0.954	0.940	0.668	0.437	0.398	0.613
	0.820	0.838	0.860	—	—	—	—
	0.069	0.060	0.060	0.060	0.060	0.060	0.060
	1,099,871	748,742	538,637	545,879	277,589	333,000	563,508
	501,161	420,895	368,121	346,661	325,411	303,831	297,677
\$	8,740,161	\$7,509,347	\$5,714,815	\$5,193,040	\$4,844,790	\$4,858,734	\$4,955,565
	1,789,266	1,578,460	959,161	894,363	760,984	636,347	442,492
	677,073	356,903	293,871	293,419	288,944	288,710	288,556
	4,010,581	3,021,984	2,588,605	2,301,298	2,137,339	2,073,048	1,965,565
	10.205	8.645	7.973	7.089	6.598	6.400	6.069
	19,238	18,896	17,106	16,075	11,697	11,557	11,744
	393,722	349,569	324,691	324,621	323,949	323,899	323,867

Consolidated Balance Sheets

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
As of March 31, 2001 and 2000

Assets

	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	2001	2000	2001
Current Assets:			
Cash and time deposits	¥ 221,222	¥ 209,058	\$ 1,784,048
Securities (Note 6)	99,782	85,066	804,694
Notes and accounts receivable (Note 4):			
Trade	211,922	174,798	1,709,048
Unconsolidated subsidiaries and affiliates	16,845	11,565	135,847
Others	6,276	4,367	50,613
Less: Allowance for doubtful accounts (Note 2 (5))	(4,211)	(2,265)	(33,960)
	230,832	188,465	1,861,548
Inventories (Note 5)	118,279	97,456	953,863
Deferred taxes, current	24,005	17,121	193,589
Others	10,566	13,127	85,210
Total current assets	704,686	610,293	5,682,952
Investments and Advances:			
Investments in and advances to unconsolidated subsidiaries and affiliates (Note 8)	25,642	37,200	206,790
Investments in securities (Note 6)	84,507	87,917	681,508
Long-term loans	1,164	906	9,387
Deferred taxes, non-current	15,962	9,028	128,726
Others	7,804	6,265	62,935
Less: Allowance for doubtful accounts (Note 2 (5))	(52)	(76)	(419)
Total investments and advances	135,027	141,240	1,088,927
Property, Plant and Equipment:			
Buildings and structures	267,434	241,510	2,156,726
Machinery and equipment	738,435	652,237	5,955,121
Less: Accumulated depreciation	(642,206)	(578,228)	(5,179,081)
	363,663	315,519	2,932,766
Land	33,441	29,530	269,685
Construction in progress	25,139	33,223	202,734
Total property, plant and equipment	422,243	378,272	3,405,185
Deferred Charges and Other Assets	3,843	7,134	30,992
Foreign Currency Translation Adjustment (Note 2 (4))	—	31,790	—
	¥1,265,799	¥1,168,729	\$10,208,056

The accompanying notes are an integral part of the statements.

**Liabilities and
Stockholders' Equity**

	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	2001	2000	2001
Current Liabilities:			
Short-term borrowings (Note 9)	¥ 68,113	¥ 71,636	\$ 549,298
Current portion of long-term debt (Note 9)	17,546	67,753	141,500
Notes and accounts payable (Note 4):			
Trade	92,692	77,827	747,516
Unconsolidated subsidiaries and affiliates	19,904	13,012	160,516
Others	42,088	33,814	339,420
	154,684	124,653	1,247,452
Accrued income taxes	40,593	18,085	327,363
Accrued expenses	56,096	44,424	452,387
Advances received	4,504	1,532	36,322
Others	12,877	9,017	103,847
Total current liabilities	354,413	337,100	2,858,169
Long-Term Liabilities:			
Long-term debt (Note 9)	105,341	114,444	849,524
Accrued retirement benefits (Note 10)	27,967	7,222	225,540
Deferred taxes, non-current	19,243	15,718	155,185
Lease obligations	18,366	18,662	148,113
Others	1,193	1,022	9,622
Contingent Liabilities (Note 11)			
Total long-term liabilities	172,110	157,068	1,387,984
Minority Interests in Consolidated Subsidiaries	24,280	23,300	195,806
Stockholders' Equity (Note 12):			
Common stock: ¥50 per share	110,247	107,664	889,089
Authorized: 2000— 800,000,000 shares			
2001—1,670,000,000 shares			
Issued: 2000— 419,848,360 shares			
2001— 422,542,358 shares			
Additional paid-in capital	119,016	115,857	959,806
Legal reserve and retained earnings (Note 12)	493,170	433,460	3,977,178
Unrealized gain on available-for-sale securities	9,742	—	78,564
Foreign currency translation adjustment (Note 2 (4))	(9,530)	—	(76,855)
	722,645	656,981	5,827,782
Less: Treasury stock, at cost	(7,649)	(5,720)	(61,685)
Total stockholders' equity	714,996	651,261	5,766,097
	¥1,265,799	¥1,168,729	\$10,208,056

Consolidated Statements of Income

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
For the years ended March 31, 2001, 2000 and 1999

	Millions of Yen			Thousands of U.S. Dollars (Note 3)
	2001	2000	1999	2001
Net Sales (Note 15)	¥807,485	¥678,859	¥642,796	\$6,511,976
Cost of Sales (Notes 10, 13 and 15)	603,561	507,194	471,667	4,867,428
Gross profit	203,924	171,665	171,129	1,644,548
Selling, General and Administrative Expenses (Notes 10 and 13)	91,247	84,200	84,806	735,863
Operating income	112,677	87,465	86,323	908,685
Other Income (Expenses):				
Interest and dividend income	9,230	9,578	13,273	74,435
Foreign exchange gain (loss)	9,080	(6,543)	(11,246)	73,226
Gains on sales of investments in securities	8,411	—	—	67,831
Gains on sales of property, plant and equipment	8,081	1,414	—	65,169
Gain on transfer of securities to retirement benefits trust	5,234	—	—	42,210
Equity in earnings of affiliates	1,925	1,324	564	15,524
Interest expenses	(7,841)	(8,983)	(10,855)	(63,234)
Special provision for retirement benefits costs	(27,498)	—	—	(221,758)
Loss on write-down of investment securities	(5,265)	(2,932)	(3,533)	(42,460)
Other, net	(5,233)	1,582	2,681	(42,201)
Income before income taxes	108,801	82,905	77,207	877,427
Income Taxes (Note 16):				
Current	61,031	33,243	26,655	492,185
Deferred	(19,342)	(366)	5,660	(155,984)
	41,689	32,877	32,315	336,201
Income after income taxes	67,112	50,028	44,892	541,226
Minority Interests in Earnings of Consolidated Subsidiaries	(2,607)	(1,799)	(1,529)	(21,024)
Net Income	¥ 64,505	¥ 48,229	¥ 43,363	\$ 520,202

	Yen			U.S. Dollars (Note 3)
Per Share (Note 2 (15)):				
Net income—primary	¥ 153.58	¥ 116.56	¥ 109.36	\$ 1.239
Net income—fully diluted	150.24	113.46	103.17	1.212
Cash dividends	12.00	10.00	9.00	0.097
Weighted Average Number of Shares (Thousands)	421,895	415,536	397,752	421,895

The accompanying notes are an integral part of the statements.

Consolidated Statements of Stockholders' Equity

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
For the years ended March 31, 2001, 2000 and 1999

	Millions of Yen			Thousands of U.S. Dollars (Note 3)
	2001	2000	1999	2001
Common stock				
Balance at beginning of year	¥107,664	¥ 98,243	¥ 83,957	\$ 868,258
Conversion of convertible debentures	312	1,094	13,954	2,516
Exercise of warrant attached to debentures	2,271	8,327	332	18,315
Balance at end of year	110,247	107,664	98,243	889,089
Additional Paid-in Capital				
Balance at beginning of year	115,857	104,324	89,976	934,330
Conversion of convertible debentures	312	1,093	13,931	2,516
Exercise of warrant attached to debentures	2,847	10,440	417	22,960
Balance at end of year	119,016	115,857	104,324	959,806
Legal Reserve and Retained Earnings				
Balance at beginning of year	433,460	365,253	325,499	3,495,645
Net income	64,505	48,229	43,363	520,202
Effect of increase in consolidated subsidiaries	—	429	50	—
Cash dividends	(4,613)	(3,911)	(3,444)	(37,202)
Directors' and statutory auditors' bonuses	(182)	(177)	(215)	(1,468)
Prior year's adjustment by application of deferred tax accounting	—	23,637	—	—
Balance at end of year	493,170	433,460	365,253	3,977,177
Unrealized Gain on Available-for-sale securities				
Balance at beginning of year	—	—	—	—
Balance at end of year	9,742	—	—	78,565
Foreign Currency Translation Adjustment				
Balance at beginning of year	—	—	—	—
Balance at end of year	(9,530)	—	—	(76,855)
Treasury Stock at Cost				
Balance at beginning of year	(5,720)	(3,753)	(2,120)	(46,129)
Acquisition	(2,970)	(3,231)	(1,800)	(23,951)
Exercise of stock options	1,041	1,264	167	8,395
Balance at end of year	(7,649)	(5,720)	(3,753)	(61,685)
Number of Shares of Common Stock Issued				
	Thousands of shares			
	2001	2000	1999	
Balance at beginning of year	419,848	410,015	393,722	
Conversion of convertible debentures	326	1,151	15,946	
Exercise of warrant attached to debentures	2,368	8,682	347	
Balance at end of year	422,542	419,848	410,015	

Consolidated Statements of Cash Flows

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
For the years ended March 31, 2001, 2000 and 1999

	Millions of Yen			Thousands of U.S. Dollars (Note 3)
	2001	2000	1999	2001
Cash Flows from Operating Activities:				
Income before income taxes	¥108,801	¥ 82,905	¥ 77,207	\$ 877,427
Adjustments to reconcile income before income taxes to net cash provided by operating activities:				
Depreciation and amortization	71,348	63,128	57,940	575,387
Increase in accrued retirement benefits	26,915	2,033	(570)	217,056
Loss on write-down of investment securities	5,265	2,932	3,533	42,460
Interest and dividend income	(9,230)	(9,578)	(13,273)	(74,435)
Interest expenses	7,841	8,983	10,855	63,234
Exchange loss (gain)	(6,331)	5,478	207	(51,056)
Equity in earnings of affiliates	(1,925)	(1,324)	(564)	(15,524)
Transfer of securities to retirement benefits trust	7,255	—	—	58,508
Gains on transfer of securities to retirement benefits trust	(5,235)	—	—	(42,218)
Changes in assets and liabilities:				
(Increase) decrease in notes and accounts receivable	(30,665)	(36,847)	19,974	(247,298)
Increase in inventories	(15,538)	(5,009)	(9,673)	(125,307)
Increase (decrease) in notes and accounts payable	25,652	12,519	(32,985)	206,871
Other, net	(3,594)	(6,622)	(5,033)	(28,984)
Subtotal	180,559	118,598	107,618	1,456,121
Proceeds from interest and dividend	9,328	9,578	13,272	75,226
Payment of interest	(9,004)	(8,838)	(10,852)	(72,613)
Payment of income taxes	(38,681)	(23,462)	(41,587)	(311,944)
Net cash provided by operating activities	142,202	95,876	68,451	1,146,790
Cash Flows from Investing Activities:				
Net (increase) decrease in marketable securities	(561)	(8,698)	13,095	(4,524)
Purchases of property, plant and equipment	(87,641)	(54,666)	(79,583)	(706,782)
Proceeds from sales of property, plant and equipment	8,741	1,463	546	70,492
Purchases of intangible fixed asset	(641)	(4,245)	—	(5,169)
Purchases of investment securities	(26,997)	(4,922)	(16,946)	(217,718)
Proceeds from sales and redeeming of investment securities	23,339	3,995	—	188,218
Payments of loans	(2,354)	(11,252)	4,453	(18,984)
Other, net	(1,056)	1,976	4,637	(8,517)
Net cash used for investing activities	(87,170)	(76,349)	(73,798)	(702,984)
Cash Flows from Financing Activities:				
Net increase (decrease) in short-term debt	(4,428)	78	16,570	(35,710)
Proceeds from long-term debt	10,945	17,871	10,003	88,266
Repayment of long-term debt	(21,957)	(12,640)	(12,071)	(177,073)
Payment of debentures on redemption	(52,351)	(3,558)	(2,631)	(422,185)
Proceeds from issue of shares	4,539	16,645	664	36,605
Cash dividends paid	(4,614)	(3,911)	(3,444)	(37,209)
Other, net	(2,498)	(2,343)	(1,962)	(20,145)
Net cash provided by (used for) financing activities	(70,364)	12,142	7,129	(567,451)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	14,465	(10,434)	(3,324)	116,653
Net Increase (Decrease) in Cash and Cash Equivalents	(867)	21,235	(1,542)	(6,992)
Cash and Cash Equivalents at Beginning of Year	271,635	249,181	250,723	2,190,605
Net Increase in Cash and Cash Equivalents by Change of Consolidation Scope	2,001	1,219	—	16,137
Cash and Cash Equivalents at End of Year	¥272,769	¥271,635	¥249,181	\$2,199,750

The accompanying notes are an integral part of the statements.

Notes to Consolidated Financial Statements

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
As of March 31, 2001, 2000 and 1999

Note 1

Basis of presenting financial statements

The accompanying consolidated financial statements have been prepared from accounts and records maintained by Shin-Etsu Chemical Co., Ltd. (the "Company") and its subsidiaries. The Company and its domestic consolidated subsidiaries have maintained their accounts and records in accordance with the provisions set forth in the Japanese Commercial Code and the Securities and Exchange Law and in conformity with generally accepted accounting principles and practices prevailing in Japan, which are different in certain respects as to the application and disclosure requirements of International Accounting Standards. The accounts of overseas consolidated subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles and practices prevailing in the respective countries. In general, no adjustments to the accounts of overseas consolidated subsidiaries have been reflected in the accompanying consolidated financial statements to present them in compliance with Japanese accounting principles and practices followed by the Company.

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.

The presentation of the accompanying consolidated financial statements is made in conformity with the Consolidated Financial Statements Regulation (ordinance promulgated by the Ministry of Finance) and meets the requirements for disclosure of financial information of the Company on a consolidated basis. However, certain account balances, as disclosed in the basic consolidated financial statements in Japan, have been reclassified to the extent deemed necessary to enable presentation in a form which is more familiar to readers outside Japan.

Note 2

Summary of significant accounting policies

(1) Principles of consolidation

The Company had 96 majority-owned subsidiaries as of March 31, 2001 (99 as of March 31, 2000 and 99 as of March 31, 1999). The consolidated financial statements include the accounts of the Company and its 60 (61 for 2000 and 58 for 1999) majority-owned subsidiaries (the Companies), of which principal firms are listed on page 47 with their respective fiscal year-ends.

The remaining 36 (38 for 2000 and 41 for 1999) unconsolidated subsidiaries whose combined assets, net sales, net income and retained earnings in the aggregate are not significant compared with those of the consolidated financial statements of the Companies, therefore, have not been consolidated with the Company. For consolidation of the accounts of subsidiaries whose fiscal year-ends are not in agreement with the Company, necessary adjustments are made on significant intercompany transactions which took place during the periods between the fiscal year-end of respective consolidated subsidiaries and that of the Company.

Unrealized intercompany profits and losses among the Companies are entirely eliminated, and the portion thereof attributable to the minority interests is charged to the minority interests.

Elimination of cost of investments in consolidated subsidiaries with the underlying equity in net assets of such subsidiaries has been made by the Company to include equity in the net income (loss) of subsidiaries earned subsequent to the acquisition of each block of shares. Any difference between the cost of an investment in a subsidiary and the amount of underlying equity in net assets of the subsidiary is treated as an asset or a liability, as the case may be, and amortized over a period of five years on a straight-line basis.

Legal reserve of consolidated subsidiaries provided subsequent to the acquisition of such subsidiaries by the Company is included in retained earnings and is not shown separately in the consolidated financial statements.

(2) Accounting for investments in unconsolidated subsidiaries and affiliates

The Company had 36 (38 for 2000 and 41 for 1999) unconsolidated subsidiaries (majority-owned) and 16 (16 for 2000 and 21 for 1999) affiliates (meaning 20% to 50% ownership of a company's equity interest). The equity method is applied to the investments in seven major affiliates since investments in the remaining unconsolidated subsidiaries and affiliates are not material for the consolidated financial statements.

The major unconsolidated subsidiaries and affiliates accounted for by the equity method are listed below:

Shin-Etsu Quartz Products Co., Ltd.

Kashima Vinyl Chloride Monomer Co., Ltd.

Nagano Electronics Industrial Co., Ltd.

(3) Translation of foreign currency transactions

Effective April 1, 2000, "Accounting for transaction in foreign currencies" has been adopted. Revenue and expense items arising from transactions denominated in foreign currencies are generally translated into yen at the rates effective at the respective transaction dates.

Foreign currency deposits, receivables and payables denominated in foreign currencies are translated into yen at the exchange rate prevailing at the respective balance sheet dates and the resulting translation gain or loss is included in the determination of net income for the year.

However, all of the overseas consolidated subsidiaries apply the current rate method to translate transactions and account balances in foreign currencies into their respective home currencies.

(4) Translation of foreign currency financial statements (accounts of overseas subsidiaries)

The translation of foreign currency financial statements of overseas subsidiaries into yen for consolidation purposes is made by the method of translation prescribed by the statements issued by the Business Accounting Council (BAC) of Japan.

Under the BAC method, all assets and liabilities are translated into yen at current exchange rates while capital accounts and retained earnings are translated at historical rates, and revenue and expense items are translated at the average exchange rates during the year. The resulting translation adjustments are, as before, shown as "Foreign Currency Statement Translation Adjustment" in the accompanying balance sheets as of March 31, 2001 and 2000.

(5) Allowance for doubtful accounts

The Company and consolidated subsidiaries provide the allowance for doubtful accounts by the method which uses the percentage of its own actual experience of bad debt loss written off against the balance of total receivables plus the amount deemed necessary to cover individual accounts estimated to be uncollectible.

(6) Inventories

Inventories of the Company and its domestic subsidiaries are valued at cost determined by the average cost method.

Inventories of the foreign subsidiaries are valued principally at cost determined by the first-in, first-out method.

(7) Financial instruments

Effective April 1, 2000, "Accounting for financial instruments" has been adopted.

Securities:

Bonds held to maturity: Amortized cost method

Available-for-sale securities for which market quotations are available are stated at fair value. Net unrealized gains or losses on these securities are reported as a separate item in the shareholders' equity at a net-of-tax amounts. Other securities for which market quotation are unavailable are stated at cost, which is determined by the moving-average cost method.

Derivatives:

Under the new standard, all derivatives are stated at fair value, with changes in fair value included in net profit or loss for the period in which they arise, except for derivatives that are designated as "hedging instruments".

Hedge accounting:

Gains or losses arising from changes in fair value of the derivatives designated as “hedging instruments” are deferred as an asset or liability and included in net profit or loss in the same period during which the gains and losses on the hedged items or transactions are recognized.

The derivatives designated as hedging instruments by the Company are interest swaps. The related hedged items are long-term bank loans, and debt securities issued by consolidated subsidiaries.

The Company has a policy to utilize the above hedging instruments in order to reduce the Company’s exposure to the risk of interest rate fluctuation. Thus, the Company’s purchases of the hedging instruments are limited to, at maximum, the amounts of the hedged items and not for speculation or dealing purposes.

The Company evaluates effectiveness of its hedging activities by reference to the accumulated gains or losses on the hedging instruments and the related hedged items from the commencement of the hedges.

(8) Property, plant and equipment

Depreciation of the Company and its domestic subsidiaries is principally computed on the declining-balance method, based on the estimated useful lives of assets prescribed by the Japanese tax laws. Depreciation of foreign subsidiaries is principally computed by the straight-line method over the estimated useful lives of the assets. The cost of property, plant and equipment retired or otherwise disposed of and accumulated depreciation are eliminated from the related accounts, and the resulting profit or loss is reflected in income.

(9) Amortization

New share issue expenses are charged to income as incurred. Discounts on bond issues are deferred and amortized on a straight-line basis over a period up to the maturity of the relevant bonds.

(10) Repairs and maintenance

Normal repairs and maintenance, including minor renewals and improvements, are charged to income as incurred.

(11) Accounting for leases

Finance leases other than those which are deemed to transfer the ownership of the leased assets to lessees are accounted for by the method similar to that applicable to ordinary operating leases.

(12) Accrued retirement benefits

Pension and severance costs for employees are accrued based on the estimates of the pension obligations and the plan assets at the end of the current fiscal year. The difference of ¥27,498 million resulting from the adoption of new accounting standards for retirement benefits is charged to income and reported in the income statement. The actuarial difference is amortized over a five-year period, which is within the average employee’s service year, using the straight-line method from the time when the difference was generated (see Note 10).

(13) Income taxes

Income taxes are provided based on amounts required by the tax return for the period. Tax effect is recorded for temporary differences in recognition of certain expenses between tax and financial reporting on the consolidated financial statements.

(14) Research and development costs

Research and development costs are charged to income as incurred.

(15) Net income and dividends per share

Net income per share is based upon the weighted average number of shares of common stock outstanding during each fiscal year. Net income per share adjusted for dilution represents net income per share assuming full conversion of all convertible debentures of the Company outstanding with related reduction in interest expenses.

Cash dividends per share represents actual dividends per share declared as applicable to the respective years.

(16) Dividends

Dividends are proposed by the Board of Directors and approved by the stockholders at meetings held subsequent to the fiscal year to which the dividends are applicable, and registered stockholders as of the end of such fiscal year are entitled to the subsequently declared dividends. Interim cash dividends are also paid (see Note 12).

Dividends charged to retained earnings in the accompanying consolidated statements of stockholders' equity represent dividends approved and paid during the year.

(17) Appropriation of retained earnings

Under the Japanese Commercial Code and the Articles of Incorporation of the Company, the plan for appropriation of retained earnings (primarily for cash dividend payments) proposed by the Board of Directors should be approved by the stockholders' meeting which must be held within three months after the end of each fiscal year. The appropriation of retained earnings reflected in the accompanying consolidated financial statements represents the results of such appropriations which relate to the immediately preceding fiscal year but were approved by the stockholders' meeting and disposed of during that year. As is customary practice in Japan, the payment of bonuses to directors and statutory auditors is made out of retained earnings instead of being charged to income for the year and constitutes a part of appropriations cited above.

(18) Consumption tax

The consumption tax withheld by the Company on sales of products is not included in the amount of net sales in the accompanying consolidated statements of income. The consumption tax borne by the Company on purchases of goods and services, and expenses, is not included in the related amounts in the accompanying consolidated statements of income, either.

Note 3

United States dollar amounts

The Company prepares its consolidated financial statements in yen. The dollar amounts included in the consolidated financial statements and notes thereto represent the arithmetical results of translating yen to dollars on a basis of ¥124 to US\$1, the approximate effective rate of exchange on March 31, 2001. The inclusion of such dollar amounts is solely for convenience and is not intended to imply that yen amounts have been or could be readily converted, realised or settled in dollars at ¥124 to US\$1 or at any other rate.

Note 4

Notes and accounts receivable and payable

The companies recognize the settlements of notes receivable and notes payable at such time as the bank clearance of the notes are actually made. The balance sheet date of March 31, 2001 was incidentally a holiday for financial institutions and, therefore, the following accounts include the balances of notes receivable and notes payable due on that date as unsettled in the relevant amount in the accompanying consolidated balance sheet as of March 31, 2001.

	Millions of Yen	Thousands of U.S. Dollars
Notes and accounts receivable	¥6,927	\$55,863
Notes and accounts payable	5,601	45,169

Note 5

Inventories

Inventories as of March 31, 2001 and 2000 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2001	2000	2001
Merchandise	¥ 9,322	¥ 5,982	\$ 75,177
Finished products	41,959	36,677	338,379
Semifinished products	16,040	15,149	129,355
Raw materials	33,290	25,143	268,468
Supplies	11,740	11,580	94,677
Others	5,928	2,925	47,807
	¥118,279	¥97,456	\$953,863

Note 6

Securities

Securities as of March 31, 2001 consisted of the following:

(1) *Market value of bonds held to maturity*

Description	Millions of Yen		
	Book value	Market value	Difference
Securities with fair value that exceed book value	¥2,020	¥2,038	¥18
Securities with fair value that do not exceed book value	20	20	0
Total	¥2,040	¥2,058	¥18

Description	Thousands of U.S. Dollars		
	Book value	Market value	Difference
Securities with fair value that exceed book value	\$16,291	\$16,436	\$145
Securities with fair value that do not exceed book value	161	161	0
Total	\$16,452	\$16,597	\$145

(2) *Available-for-sale securities with defined fair values*

Description	Millions of Yen		
	Acquisition cost	Book value	Unrealized gain (loss)
Securities with fair value that exceed book value			
Stocks	¥17,786	¥35,667	¥17,881
Others	2,243	2,288	45
Subtotal	¥20,029	¥37,955	¥17,926
Securities with fair value that do not exceed book value			
Stocks	¥18,174	¥17,077	¥(1,097)
Others	480	468	(12)
Subtotal	¥18,654	¥17,545	¥(1,109)
Total	¥38,683	¥55,500	¥16,817

Description	Thousands of U.S. Dollars		
	Acquisition cost	Book value	Unrealized gain (loss)
Securities with fair value that exceed book value			
Stocks	\$143,436	\$287,638	\$144,202
Others	18,088	18,451	363
Subtotal	\$161,524	\$306,089	\$144,565
Securities with fair value that do not exceed book value			
Stocks	\$146,565	\$137,718	\$ (8,847)
Others	3,871	3,774	(97)
Subtotal	\$150,436	\$141,492	\$ (8,944)
Total	\$311,960	\$447,581	\$135,621

(3) *“Available-for-sale securities” sold during the fiscal year ended March 31, 2001*

	Millions of Yen	Thousands of U.S. Dollars
Amount sold	¥10,033	\$80,911
Net gain	8,411	67,831

(4) *Major components and book values of securities without market value*

	Book value	
	Millions of Yen	Thousands of U.S. Dollars
Bonds held to maturity	¥65,362	\$527,113
Investments in non-consolidated subsidiaries and affiliates	24,385	196,653
Available-for-sale securities	61,387	495,056

(5) Repayment schedule of available-for-sale securities with maturity and bonds held to maturity

	Millions of Yen	Thousands of U.S. Dollars
Within one year	¥96,183	\$775,669
Over one year within five years	23,057	185,944
Over five years within ten years	4	32

Note 7

Derivative transactions

Derivative financial instruments were as follows:

As of March 31, 2001

Currency relatives

Description	Millions of Yen		
	Notional amounts	Market value	Unrealized gain (loss)
Foreign exchange contracts			
Sales Contracts:			
US\$	¥21,231	¥21,801	¥(570)
Other	419	427	(8)
Buys Contracts:			
US\$	3,956	4,167	211
Total	¥ —	¥ —	¥(367)

Description	Thousands of U.S. Dollars		
	Notional amounts	Market value	Unrealized gain (loss)
Foreign exchange contracts			
Sales Contracts:			
US\$	\$171,218	\$175,815	\$(4,597)
Other	3,379	3,444	(65)
Buys Contracts:			
US\$	31,903	33,605	1,702
Total	\$ —	\$ —	\$(2,960)

Notes: 1. Market rate represents the forward foreign exchange rate prevailing as of March 31, 2001.

2. Any derivative transactions to which hedge accounting is applied are excluded from the above table.

Interest relatives

Description	Millions of Yen		
	Notional amounts	Market value	Unrealized gain (loss)
Interest swap contracts:			
Receive fixed, pay floating	¥10,000	¥ 467	¥ 467
Receive floating, pay fixed	10,000	(534)	(534)
Total	¥20,000	¥ (67)	¥ (67)

Description	Thousands of U.S. Dollars		
	Notional amounts	Market value	Unrealized gain (loss)
Interest swap contracts:			
Receive fixed, pay floating	\$ 80,645	\$ 3,766	\$ 3,766
Receive floating, pay fixed	80,645	(4,306)	(4,306)
Total	\$161,290	\$ (540)	\$ (540)

Notes: 1. The market value is provided by financial institutes with which we made the contracts of interest swap.

2. Any derivative transactions to which hedge accounting is applied are excluded from the above table.

As of March 31, 2000
Currency relatives

Description	Millions of Yen		
	Notional amounts	Market value	Unrealized gain (loss)
Foreign exchange contracts			
Sales Contracts:			
US\$	¥ 351	¥ 356	¥ (5)
DGL	7	7	0
Buys Contracts:			
US\$	2,196	2,104	(92)
Total	¥ —	¥ —	¥(97)

Notes: 1. Market rate represents the forward foreign exchange rate prevailing as of March 31, 2000.
2. Any assets or liabilities denominated in foreign currencies, which are covered with the forward foreign exchange contracts to fix Japanese yen amount, and recorded in Japanese yen in the balance sheet, are excluded from the above.

Interest relatives

Description	Millions of Yen		
	Notional amounts	Market value	Unrealized gain (loss)
Interest swap contracts:			
Receive fixed, pay floating	¥15,000	¥ 504	¥ 504
Receive floating, pay fixed	29,500	(1,029)	(1,029)
Total	¥44,500	¥ (525)	¥ (525)

Note: The market value is provided by financial institutes with which we made the contracts of interest swap.

Note 8

Investments in and advances to unconsolidated subsidiaries and affiliates

Investments in and advances to unconsolidated subsidiaries and affiliates as of March 31, 2001 and 2000 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2001	2000	2001
Held Directly by the Company:			
Affiliates:			
Four affiliates accounted for by the equity method (See Note 2 (2))*			
Kashima Denkai Co., Ltd.	¥13,170	¥11,161	\$106,210
Unitika Chemical Co., Ltd.	805	805	6,492
Others	600	600	4,839
	228	228	1,838
	14,803	12,794	119,379
Unconsolidated subsidiaries:			
Shin-Etsu Electronics Malaysia Sdn. Bhd.	1,400	1,400	11,290
Shin-Etsu Film Co., Ltd.	199	199	1,605
Shin-Etsu Magnetics Philippines, Inc.	184	—	1,484
Others	155	320	1,250
	1,938	1,919	15,629
Held Indirectly through Subsidiaries:			
Unconsolidated subsidiaries and affiliates:			
Three affiliates accounted for by the equity method (See Note 2 (2))*			
Others	¥ 5,617	¥ 7,889	\$ 45,298
	2,078	1,799	16,758
	¥ 7,695	¥ 9,688	\$ 62,056
Advances:	1,206	12,799	9,726
	¥25,642	¥37,200	\$206,790

* Accounted for by the equity method. Others are carried at cost or less.

Note 9

Short-term borrowings and long-term debt

Short-term borrowings outstanding as of March 31, 2001 and 2000 are represented generally by one-year notes issued by the Companies to banks. Substantially all of the notes are issued to banks which have written basic agreements with the Companies to the effect that, with respect to all present or future loans with such banks, the Companies shall provide collateral (including sums on deposit with such banks), or guarantors for such loans, immediately upon the banks' request, and that any collateral furnished pursuant to such agreements or otherwise will be applicable to all indebtedness to such banks.

Long-term debt as of March 31, 2001 and 2000 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2001	2000	2001
Loans with Banks and Other Financial Institutions:			
Secured	¥ 11,170	¥ 28,420	\$ 90,081
Unsecured	47,231	38,266	380,895
Unsecured Debentures:			
3 ³ / ₈ % notes in U.S. dollars, due August 2000 with warrants	—	51,661	—
6.7% debentures issued by a consolidated subsidiary, due April 2001	3,236	2,888	26,097
6 ⁷ / ₈ % debentures issued by a consolidated subsidiary, due July 2002	13,910	12,413	112,177
2.7% debentures issued by a consolidated subsidiary, due August 2004	8,000	8,000	64,516
2.5% debentures issued by a consolidated subsidiary, due August 2003	5,000	5,000	40,322
2.2% debentures issued by a consolidated subsidiary, due August 2002	5,000	5,000	40,322
2.6% debentures issued by a consolidated subsidiary, due December 2007	3,000	3,000	24,194
2.5% debentures issued by a consolidated subsidiary, due February 2003	3,000	3,000	24,194
2.1% debentures issued by a consolidated subsidiary, due March 2003	2,000	2,000	16,129
2.1% debentures issued by a consolidated subsidiary, due March 2003	3,000	3,000	24,194
5.0% debentures issued by a consolidated subsidiary, due May 2008	—	584	—
Unsecured Convertible Debentures:			
0.4% convertible debentures, due September 2005	18,340	18,965	147,903
	122,887	182,197	991,024
Less Portion Due within One Year	(17,546)	(67,753)	(141,500)
	¥105,341	¥114,444	\$ 849,524

Additional information with respect to the Companies convertible debentures is summarized as follows:

	Issue Date and Principal Amount at Issue	Terms of Conversion as of March 31, 2001			Additional Shares Issuable upon Full Conversion (Thousands)
		Balance as of March 31, 2001 in Denominated Currencies	Current Conversion Price per Share*	Fixed Exchange Rates for Conversion	
Unsecured:					
0.4% convertible debentures in yen, due 2005	August 8, 1996 (¥50,000 million)	¥18,340 million	¥1,917.0	—	9,567

As of March 31, 2001, assets pledged as collateral for short-term loans, mortgage debentures and long-term loans were as follows:

	Millions of Yen	Thousands of U.S. Dollars
Net book value of property, plant and equipment	¥44,141	\$355,976

The aggregate annual maturities of long-term debt are as follows:

	Millions of Yen	Thousands of U.S. Dollars
Year ending March 31,		
2002	¥ 17,546	\$141,500
2003	50,835	409,960
2004	14,267	115,056
2005	15,068	121,516
2006	19,913	160,589
2007 and thereafter	5,258	42,403
	¥122,887	\$991,024

Note 10

Retirement and pension plans

The Company and its domestic consolidated subsidiaries have tax-qualified pension plans and lump-sum severance payment plans as part of their defined benefits scheme.

Benefits under these plans are based on the current rate of pay, length of service and conditions under which terminations occur. The plans provide for either a lump-sum payment to terminating employees after 20 years of service or pension payments for a period of 10 years at their option. Employees with more than three years but less than 20 years of service are also entitled to receive a lump-sum payment upon retirement under the plans.

Most overseas consolidated subsidiaries have defined contribution plans while others have defined benefit pension plans.

Effective April 1, 2000, "Accounting for retirement benefits" has been adopted. Pension and severance costs for employees are accrued based on the estimates of the pension obligations and the plan assets at the end of current fiscal year.

The Company set up "Retirement Benefits Trust" in the current fiscal year, contributed certain marketable equity securities to the Trust and recognized a gain of ¥5,234 million as "Gain on transfer of securities to retirement benefits trust" in the consolidated income statement. The adoption of the new accounting standards resulted in the increase in "Pension and Severance Costs" by ¥27,356 million and "Ordinary income" by ¥95 million. On the other hand, "Income before income taxes" was decreased by ¥22,168 million.

The reserve for retirement benefit is analyzed as follows:

Benefit Obligation (As of March 31, 2001)

	Millions of Yen	Thousands of U.S. Dollars
(a) Benefit Obligation	¥(68,999)	\$(556,444)
(b) Pension Assets	37,952	306,065
(c) Unfunded Benefit Obligation [(a)+(b)]	(31,047)	(250,379)
(d) Undisposed of Net Transition Assets	—	—
(e) Unrecognized actuarial differences	3,080	24,839
(f) Unrecognized prior service cost	—	—
(g) Amount shown on Balance Sheet [(c)+(d)+(e)+(f)]	(27,967)	(225,540)
(h) Prepaid pension expenses	—	—
(i) Accrued Retirement Benefits [(g)-(h)]	¥(27,967)	\$(225,540)

Retirement Benefit Costs (From April 1, 2000 to March 31, 2001)

	Millions of Yen	Thousands of U.S. Dollars
(a) Service costs	¥ 3,213	\$ 25,911
(b) Interest costs	1,947	15,702
(c) Expected return on plan assets	(894)	(7,210)
(d) Amortization of differences arising from adopting the new standard	27,498	221,758
(e) Recognized actuarial loss	778	6,274
(f) Amortization of prior service cost	—	—
(g) Retirement Benefit Costs [(a)+(b)+(c)+(d)+(e)+(f)]	¥32,542	\$262,435

Basic Assumption for Calculating Benefit Obligation

(a) Period allocation method for estimated retirement benefits	Benefit / year of service approach
(b) Discount rate	Principally 3%
(c) Expected return on plan assets	Principally 3%
(d) Period of amortizing actuarial differences	Principally 5 years (expensed from current fiscal year based on straight-line method)
(e) Period of Amortization of differences arising from adopting the new standard	Expensed the total in current fiscal year incurred

Note 11

Contingent liabilities

As of March 31, 2001, the Companies were contingently liable as a guarantor of housing loans for employees and loans to unconsolidated subsidiaries, affiliates and others in the aggregate amount of ¥1,575 million (\$12,702 thousand).

In addition, as of March 31, 2001, the Companies had contingent liabilities arising from notes discounted by banks in the amounts of ¥427 million (\$3,444 thousand).

Note 12

Legal reserve and retained earnings

The Japanese Commercial Code provides that an amount equal to at least 10% of cash distribution paid out of retained earnings should be appropriated to legal reserve until such reserve equals 25% of stated common stock. The legal reserve may be used to reduce a deficit or may be transferred to a common stock account through appropriate stockholder and director actions, but is not available for dividend payment.

The legal reserve of consolidated subsidiaries is included in the retained earnings and is not shown separately in the accompanying consolidated financial statements.

The Company's Board of Directors, with subsequent approval by stockholders, has made annual appropriations of retained earnings for various purposes. Any dispositions of such appropriations shall be at the discretion of the Board of Directors and stockholders. Such administrative appropriations have not been segregated from retained earnings in the accompanying consolidated financial statements.

The Japanese Commercial Code provides that interim cash dividends (payable to stockholders of record as of September 30 of each year in the case of the Company on a semiannual basis) may be distributed upon approval by the Board of Directors. The Company paid interim dividends during the years ended March 31, 2001, 2000 and 1999 in the amounts of ¥2,523 million (\$20,347 thousand) (¥6.0 per share), ¥2,072 million and ¥1,774 million, respectively, which were actually paid to stockholders on December 8, 2000, December 10, 1999, and December 10, 1998, respectively. In the accompanying consolidated statements of stockholders' equity, these dividend payments are reflected in the years ended March 31, 2001, 2000 and 1999, respectively.

Note 13

Research and development costs

Research and development costs incurred and charged to income for the years ended March 31, 2001, 2000 and 1999 were ¥25,939 million (\$209,185 thousand), ¥26,967 million and ¥22,351 million, respectively.

Note 14

Lease transactions

Lease rental expenses on finance lease contracts without ownership-transfer for the years ended March 31, 2001 and 2000 amounted to ¥624 million (\$5,032 thousand) and ¥392 million, respectively. Lease expenses corresponding to depreciation expenses for the year ended March 31, 2001, which was computed by the straight-line method over a period up to the maturity of the relevant lease contracts with no residual value, amounted to ¥624 million (\$5,032 thousand).

Pro forma information regarding leased property such as acquisition cost and accumulated depreciation under finance leases were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2001	2000	2001
Acquisition cost	¥2,959	¥1,847	\$23,863
Accumulated depreciation	2,016	1,120	16,258
Net book value	¥ 943	¥ 727	\$ 7,605

The amount of outstanding future lease payments due in respect of finance lease contracts at March 31, 2001 and 2000, which included the portion of interest thereon, was summarized as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2001	2000	2001
Future Lease Payments:			
Within one year	¥545	¥313	\$4,395
Over one year	398	414	3,210
	¥943	¥727	\$7,605

The amount of outstanding future lease payments due in respect of operating lease contracts at March 31, 2001 and 2000 was summarized as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2001	2000	2001
Future Lease Payments:			
Within one year	¥ 866	¥1,229	\$ 6,983
Over one year	2,039	2,191	16,444
	¥2,905	¥3,420	\$23,427

Note 15

Related party transactions

The Company's sales to and purchases from its unconsolidated subsidiaries and affiliates for the years ended March 31, 2001, 2000 and 1999 are summarized as follows:

	Millions of Yen			Thousands of U.S. Dollars
	2001	2000	1999	2001
Sales	¥10,082	¥15,875	¥18,663	\$ 81,306
Purchases	56,794	46,428	50,031	458,016

Note 16

Income taxes

Income taxes in Japan applicable to the Company and its domestic subsidiaries for the years ended March 31, 2001, 2000 and 1999 consisted of corporate income tax (national), enterprise tax (local) and resident income taxes (local) at the approximate rates indicated below:

	2001	2000	1999
Corporate income tax	30.0%	30.0%	34.5%
Enterprise tax	9.6	9.6	11.0
Resident income taxes	6.1	6.1	7.0
	45.7%	45.7%	52.5%
Statutory tax rate in effect to reflect the deductibility of enterprise tax when paid (unlike other income taxes, enterprise tax is deductible for tax purposes when it is paid)	41.7%	41.7%	47.3%

Tax effects of material temporary differences and loss carry forwards which resulted in deferred tax assets or liability at March 31, 2001 were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2001	2000	2001
Deferred Tax Assets			
Special provision for retirement benefits costs	¥12,160	¥ 2,479	\$ 98,065
Depreciation	7,006	3,986	56,500
Unsettled accounts payable	5,782	4,492	46,629
Tax loss carryforwards	3,734	4,329	30,113
Unrealized profit	3,558	3,470	28,694
Accrued enterprise taxes	3,457	1,762	27,879
Accrued bonus allowance	2,456	1,680	19,806
Repair cost	2,064	2,725	16,645
Others	18,495	12,221	149,153
Valuation allowance	(4,772)	(4,975)	(38,484)
Total	¥53,940	¥32,169	\$435,000
Deferred Tax Liabilities			
Depreciation	¥23,509	¥19,863	\$189,589
Unrealized gain on available-for-sale securities	7,013	—	56,556
Reserve for special depreciation	1,122	1,138	9,048
Others	1,572	1,031	12,678
Total	¥33,216	¥22,032	\$267,871
Net Deferred Tax Assets	¥20,724	¥10,137	\$167,129

Reconciliation of the difference between the statutory tax rate and effective rate on taxable income are as follows:

	2001
Statutory tax rate	41.7%
Rate difference from foreign subsidiaries	(3.1)
Dividend income not taxable	(0.8)
Entertainment and other non-deductible expenses	0.3
Other, net	0.2
Effective tax rate	38.3

No significant difference arisen between statutory tax rate and rate on taxable income was noted in the fiscal year of 2000.

Note 17

Cash and cash equivalents on consolidated statements of cash flows

Cash and cash equivalents on consolidated statements of cash flows consist of cash on hand, deposits that can be withdrawn without limitation and liquid investments which are easily convertible into cash, and are matured within approximately three months since acquisition date and have insignificant risk exposure in terms of fluctuation on value of the investments.

Reconciliation between cash and cash equivalents and the related accounts shown in the consolidated balance sheets as of March 31, 2001, 2000 and 1999 are presented below:

	Millions of Yen			Thousands of U.S. Dollars
	2001	2000	1999	2001
Cash and time deposits	¥221,222	¥209,058	¥184,021	\$1,784,048
Marketable securities	99,782	85,066	76,336	804,694
Time deposits for which maturities are approximately over three months	(1,672)	(922)	(873)	(13,484)
Marketable securities (maturities approximately over three months)	(46,563)	(21,567)	(10,303)	(375,508)
Cash and cash equivalents	¥272,769	¥271,635	¥249,181	\$2,199,750

Note 18

Segment information

(1) Business segment information

The Companies operate principally in the following three lines of business: "Organic and Inorganic Chemicals," "Electronics Materials" and "Functional Materials and Others." These lines of

business deal in the following main products and merchandise:

Organic and inorganic chemicals business segment: Polyvinyl chloride, Silicones, Vinyl acetate monomer, Polyvinyl alcohol, Methanol, Chloromethanes, Cellulose derivatives, Caustic soda, Fertilizers, Silicon metal

Electronics materials business segment: Semiconductor silicon, Organic materials for the electronics industry, Rare earth magnets for the electronics industry, Photoresists

Functional materials and others business segment: Synthetic quartz products, Oxide single crystals, Rare earths and rare earth magnets, Export of technology and plants, Export and import of goods, Construction and plant engineering, Information processing

Sales, related operating costs and expenses, operating income, assets, depreciation and capital expenditure of the Companies at March 31, 2001, 2000 and 1999 and for the years then ended, classified by business segments, have been presented as follows:

	Millions of Yen				
	2001				
	Organic and Inorganic Chemicals	Electronics Materials	Functional Materials and Others	Elimination or Common Assets ⁺	Consolidated Total
Sales:					
Sales to outside customers	¥410,371	¥258,746	¥138,368	¥ —	¥ 807,485
Intersegment sales	11,503	2,299	67,142	(80,944)	—
Total	421,874	261,045	205,510	(80,944)	807,485
Operating costs and expenses	374,859	224,684	176,182	(80,917)	694,808
Operating income	¥ 47,015	¥ 36,361	¥ 29,328	¥ (27)	¥ 112,677
Assets	¥430,164	¥432,768	¥188,000	¥214,867	¥1,265,799
Depreciation	23,503	35,286	12,243	(265)	70,767
Capital expenditures ^{1,2,3}	50,304	37,985	21,838	(303)	109,824

	Millions of Yen				
	2000				
	Organic and Inorganic Chemicals	Electronics Materials	Functional Materials and Others	Elimination or Common Assets ⁺	Consolidated Total
Sales:					
Sales to outside customers	¥343,412	¥220,132	¥115,315	¥ —	¥ 678,859
Intersegment sales	13,373	1,565	56,715	(71,653)	—
Total	356,785	221,697	172,030	(71,653)	678,859
Operating costs and expenses	311,623	198,353	153,378	(71,960)	591,394
Operating income	¥ 45,162	¥ 23,344	¥ 18,652	¥ 307	¥ 87,465
Assets	¥366,882	¥386,321	¥151,531	¥263,995	¥1,168,729
Depreciation	20,994	29,793	10,888	(291)	61,384
Capital expenditures	26,397	25,025	7,842	(154)	59,110

	Millions of Yen				
	1999				
	Organic and Inorganic Chemicals	Electronics Materials	Functional Materials and Others	Elimination or Common Assets ⁺	Consolidated Total
Sales:					
Sales to outside customers	¥328,925	¥214,605	¥ 99,266	¥ —	¥ 642,796
Intersegment sales	14,341	1,656	55,372	(71,369)	—
Total	343,266	216,261	154,638	(71,369)	642,796
Operating costs and expenses	298,900	186,863	141,840	(71,130)	556,473
Operating income	¥ 44,366	¥ 29,398	¥ 12,798	¥ (239)	¥ 86,323
Assets	¥356,663	¥392,399	¥115,796	¥196,115	¥1,060,973
Depreciation	19,106	27,150	9,940	—	56,196
Capital expenditures	23,029	42,737	8,009	(134)	73,641

Thousands of U.S. Dollars					
2001					
	Organic and Inorganic Chemicals	Electronics Materials	Functional Materials and Others	Elimination or Common Assets ⁴	Consolidated Total
Sales:					
Sales to outside customers	\$3,309,444	\$2,086,661	\$1,115,871	\$ —	\$ 6,511,976
Intersegment sales	92,766	18,540	541,468	(652,774)	—
Total	3,402,210	2,105,201	1,657,339	(652,774)	6,511,976
Operating costs and expenses	3,023,057	1,811,967	1,420,823	(652,556)	5,603,291
Operating income	\$ 379,153	\$ 293,234	\$ 236,516	\$ (218)	\$ 908,685
Assets	\$3,469,065	\$3,490,065	\$1,516,129	\$1,732,797	\$10,208,056
Depreciation	189,540	284,565	98,734	(2,137)	570,702
Capital expenditures ^{1,2,3}	405,677	306,331	176,113	(2,444)	885,677

Notes: 1. ¥7,839 million of investments in equipment that Silica Products Inc. made in 1999 is not included in the capital expenditure ("Functional materials and others") for 1999 due to the initial consolidation of the company in 2000. It is substantially accounted as the capital expenditure of 2000.

2. ¥13,053 million paid in January 2000 for acquisition of PVC business in Europe is included in the capital expenditure ("Organic and inorganic chemicals") of 2001. It is substantially accounted as the capital expenditure of 2000.

3. Had the investments of 1 and 2 above been included, total capital expenditure would be amounted to ¥80,003 million for 2000, and ¥96,770 for 2001.

4. The amounts of the common assets included in the column "Elimination or Common Assets" for the years ended March 31, 2001, 2000 and 1999 were ¥271,303 million (\$2,187,927 thousand), ¥294,942 million and ¥225,494 million, respectively, which mainly consist of surplus working funds (cash, deposits and marketable securities) and long-term investment funds (investments in securities) of the Company.

(2) Geographical segment information

The analysis of the sales, operating costs and expenses, operating income and assets of the Companies by geographical segments as of March 31, 2001, 2000 and 1999 and for the years then ended are presented below:

Millions of Yen						
2001						
	Japan	North America	Asia	Other Areas	Elimination or Common Assets ²	Consolidated Total
Sales:						
Sales to outside customers	¥495,560	¥171,452	¥ 71,620	¥68,853	¥ —	¥ 807,485
Intersegment sales	98,588	17,114	32,545	4,418	(152,665)	—
Total	594,148	188,566	104,165	73,271	(152,665)	807,485
Operating costs and expenses	514,551	168,237	95,815	68,560	(152,355)	694,808
Operating income	¥ 79,597	¥ 20,329	¥ 8,350	¥ 4,711	¥ (310)	¥ 112,677
Assets	¥667,046	¥261,713	¥92,636	¥76,132	¥168,272	¥1,265,799

Millions of Yen						
2000						
	Japan	North America	Asia	Other Areas	Elimination or Common Assets ²	Consolidated Total
Sales:						
Sales to outside customers	¥457,603	¥136,602	¥56,997	¥27,657	¥ —	¥ 678,859
Intersegment sales	80,763	16,154	30,126	4,610	(131,653)	—
Total	538,366	152,756	87,123	32,267	(131,653)	678,859
Operating costs and expenses	472,943	137,862	80,368	31,644	(131,423)	591,394
Operating income	¥ 65,423	¥ 14,894	¥ 6,755	¥ 623	¥ (230)	¥ 87,465
Assets	¥606,878	¥230,231	¥77,875	¥65,102	¥188,643	¥1,168,729

Millions of Yen						
1999						
	Japan	North America	Asia	Other Areas	Elimination or Common Assets ²	Consolidated Total
Sales:						
Sales to outside customers	¥420,281	¥140,330	¥52,010	¥30,175	¥ —	¥ 642,796
Intersegment sales	68,561	11,565	28,660	4,665	(113,451)	—
Total	488,842	151,895	80,670	34,840	(113,451)	642,796
Operating costs and expenses	429,541	133,677	74,660	33,184	(114,589)	556,473
Operating income	¥ 59,301	¥ 18,218	¥ 6,010	¥ 1,656	¥ 1,138	¥ 86,323
Assets	¥560,138	¥240,969	¥68,239	¥54,053	¥137,574	¥1,060,973

Thousands of U.S. Dollars						
2001						
	Japan	North America	Asia	Other Areas	Elimination or Common Assets ²	Consolidated Total
Sales:						
Sales to outside customers	\$3,996,452	\$1,382,677	\$577,581	\$555,266	\$ —	\$ 6,511,976
Intersegment sales	795,064	138,017	262,459	35,629	(1,231,169)	—
Total	4,791,516	1,520,694	840,040	590,895	(1,231,169)	6,511,976
Operating costs and expenses	4,149,605	1,356,750	772,701	552,903	(1,228,668)	5,603,291
Operating income	\$ 641,911	\$ 163,944	\$ 67,339	\$ 37,992	\$ (2,501)	\$ 908,685
Assets	\$5,379,403	\$2,110,589	\$747,065	\$613,968	\$1,357,031	\$10,208,056

Notes: 1. Main countries or areas other than Japan:

North America U.S.A.
 Asia Malaysia, Singapore, Korea, Taiwan
 Other areas U.K., Netherlands, Australia

2. The amounts of the common assets included in the column "Elimination or Common Assets" for the years ended March 31, 2001, 2000 and 1999 were ¥271,303 million (\$2,187,927 thousand), ¥294,942 million and ¥225,494 million, respectively, which mainly consist of surplus working funds (cash, deposits and marketable securities) and long-term investment funds (investments in securities) of the Company.

(3) Overseas sales information

Overseas sales of the Companies for the years ended March 31, 2001, 2000 and 1999 are summarized as follows:

Millions of Yen				
2001				
	North America	Asia	Other Areas	Total
Overseas sales	¥183,060	¥167,721	¥90,865	¥441,646
Consolidated sales	—	—	—	¥807,485
Percentage of overseas sales over consolidated sales	22.7%	20.8%	11.2%	54.7%

Millions of Yen				
2000				
	North America	Asia	Other Areas	Total
Overseas sales	¥153,789	¥146,091	¥47,912	¥347,792
Consolidated sales	—	—	—	¥678,859
Percentage of overseas sales over consolidated sales	22.6%	21.5%	7.1%	51.2%

Millions of Yen				
1999				
	North America	Asia	Other Areas	Total
Overseas sales	¥140,108	¥149,597	¥55,413	¥345,118
Consolidated sales	—	—	—	¥642,796
Percentage of overseas sales over				

consolidated sales	21.8%	23.3%	8.6%	53.7%
Thousands of U.S. Dollars				
2001				
	North America	Asia	Other Areas	Total
Overseas sales	\$1,476,290	\$1,352,589	\$732,782	\$3,561,661
Consolidated sales	—	—	—	\$6,511,976
Percentage of overseas sales over consolidated sales	22.7%	20.8%	11.2%	54.7%

Notes: 1. Main countries or areas:
North America U.S.A., Canada
Asia Korea, Taiwan, China
Other areas Europe, Middle South America, Oceania
2. "Overseas sales" means sales to "outside Japan" by the Company and its consolidated subsidiaries.

Note 19

Subsequent events

(1) Appropriation of retained earnings

Subsequent to March 31, 2001, the Company's Board of Directors, with the subsequent approval of stockholders on June 28, 2001 declared a cash dividend of ¥2,523 million (\$20,347 thousand) equal to ¥6.00 (\$0.048) per share, applicable to earnings of the year ended March 31, 2001 and payable to stockholders on the stockholders' register on March 31, 2001.

(2) Stock options

At the stockholders meeting held in June 2001, 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 646 thousand shares of the Company's par-value common stock at a cost that shall not exceed ¥4,000 million (US\$32 million).

Note 20

Change in accounting presentation

Certain reclassifications have been made in the 2000 and 1999 financial statements to conform to the presentation for 2001.

Consolidated Subsidiaries

As of March 31, 2001

Principal Consolidated Subsidiaries	Equity Ownership Percentage	Fiscal Year-End	Principal Consolidated Subsidiaries	Equity Ownership Percentage	Fiscal Year-End
Shintech Inc. ⁽¹⁾	100.0	December 31	Skyward Information System Co., Ltd.	100.0	March 31
Shin-Etsu Handotai Co., Ltd.	100.0	March 31	Human Create Co., Ltd.	100.0	March 31
Shin-Etsu Handotai America, Inc. ⁽¹⁾	100.0	December 31	Shinano Electric Refining Co., Ltd.	68.7	March 31
Shin-Etsu Polymer Co., Ltd.	52.2	March 31	Shin-Etsu Technology Service Co., Ltd.	76.9	February 28
Shin-Etsu Astech Co., Ltd.	89.4	March 31	S.E.H. (Shah Alam) Sdn. Bhd. ⁽¹⁾	100.0	December 31
S.E.H. Malaysia Sdn. Bhd. ⁽¹⁾⁽²⁾	100.0	December 31	Shin-Etsu Silicones of America, Inc. ⁽¹⁾	100.0	December 31
Naoetsu Electronics Co., Ltd.	90.0	February 28	Shin-Etsu Polymer (Malaysia) Sdn. Bhd. ⁽¹⁾	100.0	December 31
Shin-Etsu Handotai Europe, Ltd. ⁽¹⁾	100.0	December 31	Shincor Silicones, Inc. ⁽¹⁾	100.0	December 31
Shin-Etsu Engineering Co., Ltd.	100.0	March 31	Shin-Etsu Polymer America, Inc. ⁽¹⁾	100.0	December 31
Shin-Etsu Vinyl Acetate Co., Ltd.	51.0	March 31	Shin-Etsu Polymer Europe B.V. ⁽¹⁾	100.0	December 31
Nissin Chemical Industry Co., Ltd.	100.0	February 28	Shin-Etsu MicroSi, Inc. ⁽¹⁾	100.0	December 31
S-E, Inc. ⁽¹⁾	100.0	December 31	Shin-Etsu Unit Co., Ltd.	100.0	March 31
Silicon Metal Company of Australia Ltd. ⁽¹⁾	100.0	December 31	Shin-Etsu Handotai Taiwan Co., Ltd. ⁽¹⁾	70.0	December 31
Shin-Etsu (Malaysia) Sdn. Bhd. ⁽¹⁾	100.0	December 31	Polymer East Japan Co., Ltd.	100.0	March 31
Shin-Etsu International Europe B.V. ⁽¹⁾	100.0	December 31	Silica Products, Inc. ⁽¹⁾	100.0	December 31
Shin-Etsu Silicone Korea Co., Ltd. ⁽¹⁾	100.0	December 31	Shinano Polymer Co., Ltd.	100.0	March 31
Shin-Etsu Electronics Materials Singapore Pte. Ltd. ⁽¹⁾	100.0	December 31	Niigata Polymer Company Limited	100.0	March 31
Shin-Etsu Kasei Co., Ltd.	100.0	March 31	Nihon Resin Co., Ltd.	100.0	December 31
Shin-yo Home Service Company	100.0	March 31	Polymer Chemicals Co., Ltd.	100.0	March 31
Naoetsu Sangyo Limited	100.0	March 31	Urawa Polymer Co., Ltd.	100.0	March 31
Shin-Etsu Silicones Europe B.V. ⁽¹⁾	100.0	December 31	Sanshin Electronics Co., Ltd.	100.0	March 31
Shin-Etsu Sealant Co., Ltd.	100.0	March 31	Saitama Shinkoh Mold Co., Ltd.	100.0	March 31
Shin-Etsu Singapore Pte. Ltd. ⁽¹⁾	100.0	December 31	San-Ace Co., Ltd.	100.0	March 31
Shin-Etsu Magnet Co., Ltd.	100.0	March 31	Simcoa Operations Pty. Ltd. ⁽¹⁾	100.0	December 31
Shin-Etsu Delivery Co., Ltd.	100.0	March 31	Shin-Etsu PVC B.V. ⁽¹⁾	100.0	December 31
Naoetsu Precision Co., Ltd.	100.0	February 28	Shin-Etsu VCM B.V. ⁽¹⁾	100.0	December 31
Shin-Etsu Silicone Taiwan Co., Ltd. ⁽¹⁾	93.3	December 31	K-Bin, Inc. ⁽¹⁾	100.0	December 31
Shinkoh Mold Co., Ltd.	100.0	March 31	Suzhou Shin-Etsu Polymer Co., Ltd. ⁽¹⁾	88.0	December 31

⁽¹⁾ Overseas subsidiary

⁽²⁾ S.E.H. Malaysia Sdn. Bhd. issues non-voting shares

Report of Independent Accountants

The Board of Directors
Shin-Etsu Chemical Co., Ltd.

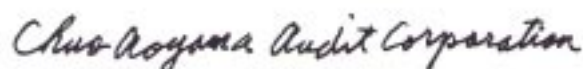
We have audited the accompanying consolidated balance sheets of Shin-Etsu Chemical Co., Ltd. and its consolidated subsidiaries as of March 31, 2001 and 2000, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years ended March 31, 2001, all expressed in Japanese yen. Our audits were made in accordance with auditing standards, procedures and practices generally accepted and applied in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances .

In our opinion, the consolidated financial statements referred to above present fairly the consolidated financial position of the Shin-Etsu Chemical Co., Ltd. and its consolidated subsidiaries as of March 31, 2001 and 2000, and the consolidated results of their operations and their cash flows for each of the three years ended March 31, 2001 in conformity with accounting principles and practices generally accepted in Japan (see Note 1) applied on a consistent basis.

As described in Note 2, effective from the year ended March 31, 2001, the Company and its consolidated subsidiaries have adopted the new Japanese accounting standards for financial instruments, retirement benefits, and foreign currency translation.

The amounts expressed in U.S. dollars, provided solely for the convenience of the reader, have been translated on the basis set forth in Note 3 to the accompanying consolidated financial statements.

Tokyo, Japan
June 28, 2001



ChuoAoyama Audit Corporation