

# To Our Shareholders



The Shin-Etsu Group attained record-high profits for the 10th consecutive year in a rapidly changing operational environment during fiscal 2005, which ended on March 31, 2005. This stellar business performance was the result of the Group's efforts in vigorously pursuing growth and development based on its sales capability, strengths nurtured in global markets and a line of products offering unique features. In addition, Shin-Etsu aggressively invested in a several large projects. The Group also energetically pursued capacity optimization together with a strategy of locating its new production facilities in the most suitable sites around the world. Looking toward the future, the Shin-Etsu Group will continue to maximize its shareholder value by strengthening its position as a constantly growing company.

## Chihiro Kanagawa

President and CEO

### Operating Environment in Fiscal 2005

Although there were some signs of a slight economic slowdown toward the end of fiscal 2005, the Japanese economy attained a modest recovery supported by firm personal consumption and an increase in capital investments. The U.S., Southeast Asian and Chinese economies performed well overall, mainly as a result of growth in personal consumption and capital investments, as business expansion continued.

Under these circumstances, the Shin-Etsu Group continued strong sales efforts with its customers around the world by emphasizing the unique features of Shin-Etsu products and by utilizing the Group companies' sales capabilities in world markets. At the same time, the Group aggressively pursued the growth and development of its business operations by making strategic investments as well as by implementing further optimization and increasing the efficiency of its management systems.

As a result, the net sales of the Shin-Etsu Group increased by 16.2% over the previous fiscal year to reach ¥967.5 billion. Compared to the performance of the previous fiscal year, operating income rose by 20.8% to ¥151.7 billion and ordinary income increased 20.6% to ¥151.5 billion. Net income increased 24.5% to ¥93.2 billion, thus allowing the Group to attain its 10th consecutive year of record-high profits. Shin-Etsu declared a dividend of ¥10 per share for the second half of fiscal 2005, making the total dividend for fiscal 2005 ¥20 per share, an increase of ¥4 compared to the previous fiscal year.

### Continued Steady Growth

The Shin-Etsu Group's achievement of record profits for 10 consecutive years represents a milestone in our corporate history. The Shin-Etsu Group intends to make even greater efforts to assure its continued, long-term growth. First, we will aim to achieve one of our key business goals of attaining consolidated net sales of ¥1 trillion and consolidated net income of ¥100 billion in fiscal 2006. We will then endeavor to attain an even more challenging goal of becoming an ever-growing company. To achieve this goal, we are working to further strengthen our business structure by combining the efforts of the sales, technology and production divisions and by taking the specific measures explained below.

## Strengthening Our Core Businesses for Future Growth

To assure sustainable future growth, we believe it is important to strengthen our core businesses and nurture promising new business lines by focusing on the years ahead. To attain this goal, we must continue to accurately understand our customers' needs as well as overall market trends. The Shin-Etsu Group strives to grow hand-in-hand with our customers on a long-term basis. We must develop and execute in a timely fashion effective strategic planning and aggressively implement major investment projects. In our core businesses, we will intensively enhance the world's highest levels of technology, quality and cost-competitiveness. While we continue to build long-term business relationships with a growing number of customers around the world, we will make certain that our business structure and organization can effectively cope with changes in the operating environment.

### PVC Business

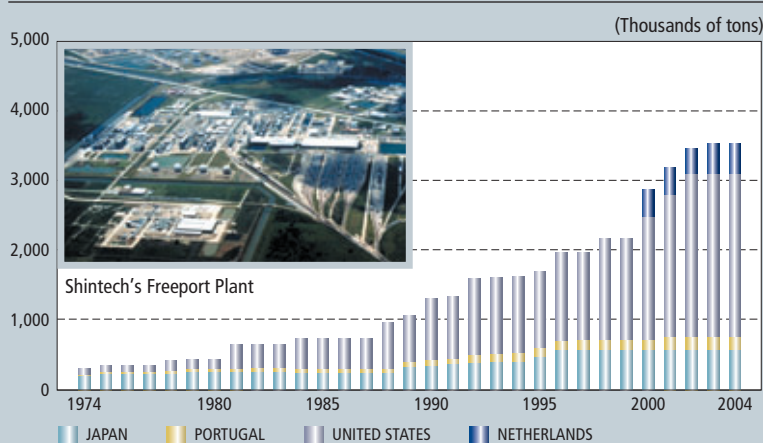
PVC is a general-purpose resin with excellent properties that makes the world less dependent on crude oil and natural gas. PVC is easy to process as well as economical. Demand for PVC is steadily growing, not only in China and Southeast Asia but also in North America and Europe. To cope with increasing demand in the U.S. and around the world, Shintech Inc. is now proceeding with plans to construct a large-scale, integrated PVC manufacturing facility that will include CHLORO-ALKALI, VCM, and PVC plants. With the construction of these new facilities, the Shin-Etsu Group will further strengthen its position as the world's largest PVC supplier.

Moreover, Shin-Etsu PVC B.V. in the Netherlands has steadily increased its sales and is continuing to expand the company's production facilities to serve the growing market demand. By fully utilizing the

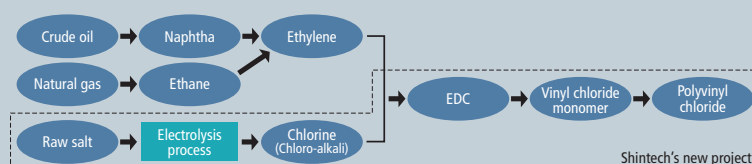
## ► Large-Scale Investment in U.S. PVC Operations

Shintech has continuously expanded its PVC production facilities since it began operations in 1974. Its current annual production of 2 million tons is 20 times greater than it was when the company launched its operations. Construction of Shintech's new large-scale expansion in Louisiana will take place in two stages. This expansion will increase Shintech's annual production capacity by 750,000 tons of VCM, 450,000 tons of chlorine, 500,000 tons of caustic soda and 600,000 tons of PVC. We plan to complete the construction of new facilities with an annual PVC production capacity of 300,000 tons around the end of 2006. We further plan to add 300,000 tons of capacity around the end of 2007. The decision to construct an integrated PVC manufacturing facility in the U.S. was made mainly due to the relatively low country risk offered by the U.S., the expected strong growth in demand for PVC in North America and the outlook for stable, long-term procurement of competitive raw materials. Shintech is using its own internal capital resources to fund the total investment of ¥100 billion.

### Total PVC Production Capacity of the Shin-Etsu Group



### PVC Production Process



strong sales capabilities it has developed in world markets, Shin-Etsu will continue to strengthen its global PVC business.

### **Semiconductor Silicon Business**

The Shin-Etsu Group's semiconductor silicon business is proceeding with an expansion in the production capacity of 300mm wafers to meet the increasing demand for these wafers in global markets. Thus, Shin-Etsu Handotai Co., Ltd., a Shin-Etsu Group company and the world's largest supplier of 300mm silicon wafers to international customers, has decided to implement major expansions of production capacity at its Shirakawa Plant in Japan as well as at Shin-Etsu Handotai America, Inc. in the United States. Shin-Etsu Handotai plans to increase 300mm wafer production capacity to 500,000 wafers per month by the fall of 2006. As part of this expansion program, Shin-Etsu Handotai will initiate the production of crystals in the U.S. aimed at diversifying supply capabilities as well as improving the stability of supply for 300mm wafer products. For wafer products under 200mm, Shin-Etsu Handotai will continue to strive for steady growth by providing products uniquely different from those of its competitors. The company will also aim at expanding its sales of specialized wafers.

### **Cellulose Business**

With the acquisition at the end of 2003 of the cellulose business of Clariant AG (now SE Tylose GmbH & Co. KG) in Wiesbaden, Germany, the Shin-Etsu Group became the world's largest manufacturer of methylcellulose. The total production capacity of the Shin-Etsu Group is 47,000 tons annually. By capitalizing on its capability of manufacturing a wide variety of quality and unique cellulose-derivative products, the Group will expand its cellulose business both in Japan and Germany. Currently, we are proceeding with major expansions of our methylcellulose production capacity in Japan and Germany. These expansions will bring our global annual capacity to 63,000 tons. In Japan, the production capacity of Shin-Etsu Chemical's Naoetsu Plant will be increased by 3,000 tons annually, while in Europe the production capacity of SE Tylose will be raised by 13,000 tons annually.

In the making of such large-scale investment decisions, we endeavor to systematically and constantly collect market information, and in the future as demand for methylcellulose, a product with a whole host of very useful applications in a wide variety of business fields, grows further, we will strive to grasp demand trends and move in a timely fashion to make further investments.

## **Basic Themes and Strategies for Fiscal 2006**

### **Research and Development**

The Shin-Etsu Group considers R&D to be a critical driving force for future business growth. Our R&D Centers are tirelessly working on the development of new products for our existing businesses and related peripheral businesses. In developing new businesses, we place primary importance on making the right selection of R&D projects. We carefully examine on-going and new R&D projects to increase the efficiency of the R&D process. We will focus on the research themes that have a strong possibility of resulting in new businesses that will grow in the future and make a major contribution to the Group's profit performance.

Moreover, by devoting our efforts to the development of originality in products and reinventing product development methods from the development stage through commercialization, we strive to maintain a high level of challenge and enthusiasm among our researchers, thus preventing any of them

from falling into a creative rut. Furthermore, because such intellectual property as patents and engineering know-how are important business assets, we accelerate the acquisition of patent rights and reinforce the Group's patent administration.

### Capital Structure and Financial Strategy

While maintaining and improving the Shin-Etsu Group's sound, stable financial underpinnings, we are using our own financial resources to make major investments in areas where earnings can be increased. As for acquisitions or businesses alliances, we will make timely decisions based on the required level of profitability, the synergistic effects that could be created with our existing businesses and the required allocation of management resources. Over the past several years, we completed a number of business acquisitions after carrying out careful evaluations. As a result, they have all contributed to achieving enhanced synergistic effects with our existing businesses and are all contributing to the Group's growing profits.

### Strengthening Corporate Governance

By following corporate policies based on strict compliance with the law, the Shin-Etsu Group proactively carries out the disclosure of appropriate corporate information and public relations activities in order to better inform investors and other stakeholders. These policies and activities all embody the basic principles that Shin-Etsu is following in regard to corporate governance. Indeed, the Company considers these activities to be one of the most important tasks of management.

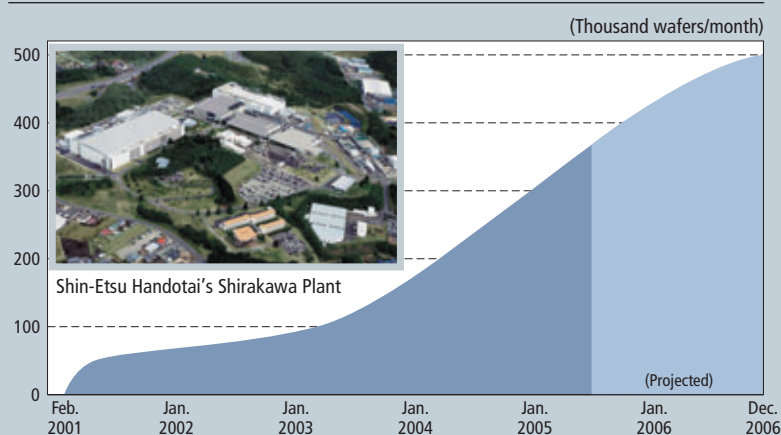
As part of our efforts to strengthen corporate governance, we have appointed two external directors to Shin-Etsu's sixteen-member Board of Directors. External directors provide Shin-Etsu not only with independent monitoring and supervision, but also with extensive, valuable advice on overall corporate management. Moreover, three of Shin-Etsu's four statutory auditors are from outside the Company.

One of the external directors chairs the Officers' Remuneration Committee, which reviews, recognizes and decides on remuneration for board members. Shin-Etsu has also established a Risk Management Committee to effectively ascertain risks and take preventive measures on the various kinds of risks that

## ➤ Growth in the 300mm Silicon Wafer Business

Shin-Etsu Handotai Co., Ltd. began commercial production of 300mm wafers in 2001, ahead of other wafer manufacturing companies. Since then, it has continued to make timely investments in manufacturing facilities. Its production capacity was expanded to 300,000 wafers per month at the end of December 2004. The Shin-Etsu Group plans to invest a total of ¥100 billion to increase the production capacity of 300mm wafers to 500,000 wafers per month by the fall of 2006. The worldwide demand for 300mm wafers reached approximately 700,000 wafers per month at the end of 2004. It is currently estimated that monthly demand will increase to 1.4 million wafers by the end of 2007.

### 300mm Wafer Production Capacity



could occur during its business operations. In addition, the Auditing Department functions as a specific, fulltime department dedicated to matters of internal company business auditing and internal control systems. By implementing these policies, Shin-Etsu has further strengthened its corporate governance.

### **Fulfilling Corporate Social Responsibility (CSR)**

We believe that one of the most important social responsibilities a company must fulfill is to make a profit and pay taxes while observing the host nation's laws and regulations. In addition, an important task in fostering the sustainable growth of the company is to create a work environment in which employees can perform their jobs effectively and professionally. Shin-Etsu is committed to a merit system of employment under which staff members can fully realize their potential. Furthermore, Shin-Etsu's management holds regular meetings with employees and representatives of the employees aimed at deepening an understanding of Company policies and understanding of the views of the employees.

For a chemical manufacturer, it is a number-one priority to assure employee safety and environmental conservation. Accordingly, the Shin-Etsu Group makes it a fundamental management principle to pursue the goals of safety and strict environmental management in all of its business activities. As a basic set of guidelines for the Shin-Etsu Group in carrying out its environmental conservation policies, the Group adopted an Environmental Charter. The Shin-Etsu Group is carrying out its business activities in strict conformity with the principles embodied in this charter. All of Shin-Etsu's domestic manufacturing facilities and the manufacturing facilities in the main Shin-Etsu Group companies have obtained ISO 14001 certification, the international standard for environmental management systems. Shin-Etsu Group companies are working in cooperation with local communities to make useful contributions to society and to promote environmental conservation.

Furthermore, Shin-Etsu has established a CSR Promotion Committee. Shin-Etsu makes every effort to maintain and promote corporate values that reflect our deep commitment to Corporate Social Responsibility (CSR). We strive to remain a good corporate citizen that is trusted by society.

### **Increasing Shareholder Value**

By continuing to steadily grow, the Shin-Etsu Group strives to meet the expectations of all of its shareholders, thereby enhancing the worth of every Shin-Etsu Group company. Toward this goal, we will continue to make vigorous efforts in fiscal 2006 to strengthen our existing businesses and expand production facilities for the mid- to long-term projects that we have initiated. The Shin-Etsu Group will accelerate the early take-off of new businesses. We will communicate through our public relations activities with those who are interested in our business activities, so that they will understand the Shin-Etsu Group better. We provide as many opportunities as possible for our investors to be appropriately informed. In conclusion, we would like to express our sincere appreciation for the continued support of our shareholders, our customers and our suppliers.



**Chihiro Kanagawa**  
President and CEO