

To Our Shareholders

The Shin-Etsu Group attained record-high profits for the 11th consecutive year in fiscal 2006, which ended on March 31, 2006. Net sales surpassed ¥1 trillion and net income totaled more than ¥100 billion for the first time since Shin-Etsu was established in 1926. Moreover, for the second consecutive year, consolidated operating income, ordinary income, and net income each increased at a rate of more than 20 percent.

This stellar business performance was the result of the Shin-Etsu Group's many diverse efforts including the global expansion of Shin-Etsu's unique marketing capabilities, aggressive and appropriately timed capital investments, locating production facilities in advantageous sites around the world, research and development that creates new products with quality and performance characteristics unmatched by other companies, and improvements in our production technology.

Shin-Etsu will mark its 80th anniversary in September of 2006. It was our utmost pleasure to attain double-digit growth two years in a row during such a memorable calendar year. For Shin-Etsu, however, the 80th anniversary is just one of the milestones in our continuing development. Looking forward to the future, we will work to continuously raise corporate value in our aim to be a constantly growing company.

Operating Environment and Performance in Fiscal 2006

Global economic conditions during fiscal 2006 were generally favorable despite uncertainties created by the worldwide increase in raw material prices. The United States, Southeast Asian and Chinese economies performed well overall, mainly as a result of growth in personal consumption and capital investments. Japan also attained a modest recovery overall, with firm capital investment and an upward trend in personal consumption.

Given the global economic circumstances, the Shin-Etsu Group continued its strong sales efforts with its customers around the world by promoting the unique features of its products and by strengthening the Group's sales capabilities in world markets. The Group pursued continuing growth and expansion of its business operations by decisively implementing well-established management policies and plans.

As a result, the net sales of the Shin-Etsu Group increased 16.6% over the previous fiscal year to reach ¥1,127.9 billion. Operating income and ordinary income each rose by 22.1% from the previous fiscal year to ¥185.3 billion and ¥185.0 billion, respectively. Net income increased by 23.5% to ¥115.0 billion, enabling the Group to attain its 11th consecutive year of record-high profits.

While the Shin-Etsu Group's products are subject to changing market conditions, the Group's management has led the Company to new record profits, which have resulted



Chihiro Kanagawa
President and CEO

in increased dividends to shareholders. Shin-Etsu increased its dividend by ¥15 per share over fiscal 2005 to ¥35 per share for fiscal 2006. Compared with fiscal 1996, dividends have more than quadrupled.

Continued Steady Growth

Several global economic developments caused concern during fiscal 2006. Among them were a rapid increase in crude oil consumption by China and, at the same time, there was a rapid expansion in the volume of polyvinyl chloride (PVC) manufactured in China using the carbide acetylene process. The huge increase in production has caused an imbalance between supply and demand, thereby increasing the possibility of disruptions in the global PVC markets. In addition, China became more active in acquiring the rights to crude oil, natural gas and other mineral resources in various regions of the world including South America, Central Asia, and Africa. As a result, it has become more urgent for the Shin-Etsu Group to revise energy resource allocations and acquisitions strategies.

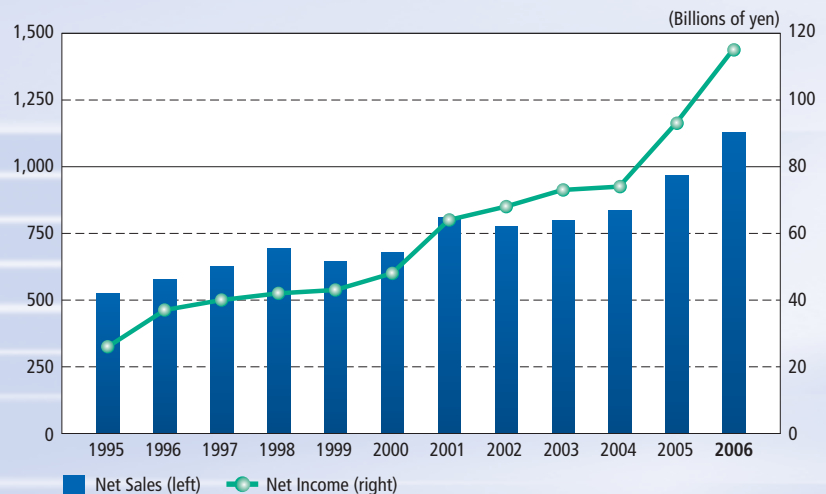
Despite these unsettled conditions, the Shin-Etsu Group still managed to achieve its goal of ¥1 trillion in consolidated net sales and ¥100 billion in consolidated net income. The Group will continue to make even greater efforts to achieve steady year-to-year growth. Our management team operates with the goal of being an ever-growing company. To achieve this goal, we are reinforcing the coordination among our sales, research and development, and production divisions, and implementing specific measures mentioned below.

For the Shin-Etsu Group to assure sustainable future growth, it is essential to strengthen our existing businesses and nurture promising new lines of business. With respect to our existing businesses, we are determined to continuously improve the world's highest levels of technology, quality and cost-competitiveness.

A Return to Dynamic Growth

Fiscal 2006 represented a milestone in the Shin-Etsu Group's performance. For the first time since Shin-Etsu was established, net sales surpassed ¥1 trillion and net income exceeded ¥100 billion. Consolidated net sales increased 16.6% over the previous fiscal year to ¥1,127.9 billion, and operating income rose 22.1% to ¥185.3 billion. Not only was it the Group's eleventh consecutive year of record-high profits, but operating income, ordinary income and net income each increased more than 20% for the second consecutive year.

Record Levels of Net Sales and Net Income for Eleven Consecutive Years



While continuing 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 international changes in economic conditions. For example, since the prices of crude oil and other basic raw materials are rising, we are moving ahead with orderly and timely price adjustments for our products.

We are also taking measures to secure and diversify raw materials sources. In addition, we are strengthening our operational base while diversifying our product portfolio to minimize the effects of rapid increases in crude oil prices and any economic slow-down that may result from the energy price increases.

At the same time, we will concentrate our management resources on promising new product lines based on appropriate strategies that have been developed with a clear understanding of the current global economic conditions. Accordingly, we will make major investments to support business expansion over the medium and long-term.

Investment Strategy

The Shin-Etsu Group has been carrying out a series of previously announced capital investments. We are moving forward with large-scale initiatives in two of our core businesses: the PVC business in the United States and the semiconductor silicon business as described below.

PVC is a general-purpose resin that is economical to produce and has excellent properties that allow it to be easily processed into a wide variety of products by our customers: industrial products for municipalities, products for home construction, medical applications and other uses.

Global demand for PVC is steadily growing, not only in China and Southeast Asia, but also in North America and Europe. The Shin-Etsu Group is the world's largest producer of PVC. To supply the growing markets in the U.S. and elsewhere, our U.S. subsidiary, Shintech Inc., is building a world-scale integrated PVC manufacturing facility in Louisiana, U.S.A. The new facility will encompass the entire PVC manufacturing process from the electrolysis of salt to PVC resin production. When completed, the Louisiana facility will increase Shintech's annual production capacity by 450,000 tons of chlorine, 500,000 tons of caustic soda, 750,000 tons of vinyl chloride monomer, and 600,000 tons of PVC.

Shin-Etsu PVC B.V. in the Netherlands has steadily increased sales of PVC and is continuing to expand the company's production facilities in order to serve the growing market demand in Europe.

By utilizing the sales capabilities it has developed in world markets, Shin-Etsu intends to continue strengthening its global PVC business.

In the semiconductor silicon business, the Shin-Etsu Group is further improving its position as the world's largest manufacturer of semiconductor silicon wafers. Shin-Etsu Handotai Co., Ltd. is moving forward with capacity expansions at its Shirakawa Plant in Japan to meet the increasing demand for 300mm wafers. In addition, the Shin-Etsu Group is adding to multiple production

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bases by investing in integrated production facilities in the United States to assure supply for its customers. In May 2005, Shin-Etsu Handotai started production of crystals for use in 300mm wafers in the United States.

Closely assessing the demand from 300mm wafer customers, Shin-Etsu will continue to make timely capital investments for the production of these wafers. The semiconductor industry has historically been characterized by cyclical market conditions known as the “silicon cycle.” Although the volatility of the cycle remains difficult to predict, we will utilize a variety of tested measures to manage our business in all phases of the cycle.

The Shin-Etsu Group is also the world’s largest producer of methylcellulose, with an annual production capacity of 50,000 tons. We will expand sales in our cellulose business by capitalizing on our production bases in Japan and Germany and by taking advantage of the capability of each of those plants to produce a broad spectrum of products.

The products of our rare earth magnets business are used in a wide variety of hard-disk drives — primarily those used in computers — and in automobiles. We are expanding production capacity in stages to respond to brisk demand from growing applications such as energy-saving home appliances.

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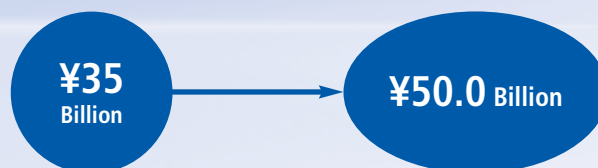
In our constantly changing operational environment, the acquisition of businesses will complement plant capital investments as a method for expanding our business. We will continue to carefully evaluate factors such as the earning potential of acquisition candidates as well as their fit, linkage with, and contributions to synergistic effects with our existing businesses. Our strategy emphasizes amicable relationships between the acquired companies and the Shin-Etsu Group.

Strategic Mergers & Acquisitions

1999 SHIN-ETSU PVC B.V.
(Acquisition of PVC business in the Netherlands)

Net Sales Before Acquisition

Most Recent Annual Net Sales



2003 SE TYLOSE GMBH & CO. KG
(Acquisition of Clariant’s cellulose business in Germany)



2005 Underwrite full third-party allocation of shares in Mimasu Semiconductor Industry Co., Ltd.



Mimasu Semiconductor Industry Co., Ltd.

As we look ahead to our 80th anniversary in the current fiscal year, we will work to strengthen our existing businesses and expand our production facilities for the mid-to long-term projects that we have launched, thus working to grow our business.

Research and Development

R&D is a critical driving force for the Shin-Etsu Group's future business growth. Our R&D centers are tirelessly working to develop new products for our existing businesses and their related peripheral businesses. Our aim in developing new businesses is to deploy the technology created by the Group's accumulated know-how to develop unique new products that are clearly differentiated from those of our competitors. Examples of research that the Group has commercialized in recent years include a fast-selling photoresist for use with excimer lasers and also fluoroelastomers developed by utilizing technology originally developed by Shin-Etsu.

In our effort to develop unique products, we place a high degree of importance on making the right selection of R&D projects. We carefully examine both ongoing and new R&D projects to increase the efficiency of the entire R&D process. We select and focus on research themes that offer a strong possibility of resulting in new businesses that will grow in the future and make major contributions to the Group's profit performance. Moreover, Shin-Etsu recognizes that intellectual property such as patents and engineering know-how are important business assets. We are working to accelerate the acquisition of patent rights and reinforce the Group's patent administration.

Strengthening Corporate Governance

The Shin-Etsu Group considers corporate governance to be one of the most important tasks of management. Conducting corporate activities fairly and in strict compliance with the law, the Shin-Etsu Group discloses appropriate corporate information to shareholders, investors and other concerned parties, both inside and outside the company.

As part of our efforts to strengthen corporate governance, we have appointed three external directors to Shin-Etsu's eighteen-member Board of Directors. External directors provide Shin-Etsu

not only with independent monitoring and supervision, but also with extensive and valuable advice on overall corporate management. Moreover, three of Shin-Etsu's four statutory auditors are from outside the company.

One of our 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 quickly pinpoint and take preventive measures on the potential risks that could occur during its business operations. In addition, Shin-Etsu further strengthened its internal company business auditing and internal control systems in May 2005 by establishing the Auditing Department as a specific, full-time department dedicated to those matters.

Corporate Social Responsibility (CSR)

We believe that one of the most important responsibilities that a company must fulfill is to make a profit from its operations 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



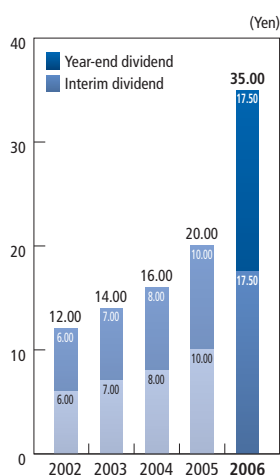
The Shin-Etsu Group has been included for the third time in the FTSE4Good Index Series, a guide for investors that measures corporate performance against globally recognized corporate responsibility standards.

professionally. Shin-Etsu's management holds regular meetings with employees and representatives of the employees aimed at deepening an understanding of Company policies. Moreover, Shin-Etsu is committed to a merit system of employment under which staff members can fully realize their potential.

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 conducting 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. Moreover, the remaining Group companies are working to obtain this certification.

Furthermore, the Shin-Etsu Group has always made every effort to maintain and promote corporate values that reflect our deep commitment to Corporate Social Responsibility (CSR). In 2005, we established a CSR Promotion Committee to further strengthen CSR activities. We are constantly striving to be a good corporate citizen that is trusted by society.

Cash Dividends per Share



Increasing Corporate Value

In order to meet the expectations of our shareholders, the Shin-Etsu Group undertakes its business activities with the aim of increasing corporate value over the long term by continuing our steady growth. As we look ahead to our 80th anniversary in the current fiscal year, we will work to strengthen our existing businesses and expand our production facilities for the mid- to long-term projects that we have launched, thus working to grow our business. In addition, the Shin-Etsu Group will accelerate the early launch of several new businesses.

Shin-Etsu also prepares itself to respond flexibly to changes in the business environment and is eager to build a strong relationship of trust with our customers and suppliers. While each division assumes the responsibility for achieving its own goals, the Shin-Etsu Group will continuously consider the next actions to take in order to achieve rapid growth. We provide as many opportunities as possible for our investors to be appropriately informed. The Shin-Etsu Group will also strictly comply with all laws and regulations in conducting its business activities, and will contribute to society as a whole, including local communities, where we operate, by providing materials and technologies that enhance the lives of people everyone.

In conclusion, we would like to express our sincere appreciation for the continued support of and relationship with our stakeholders, our customers and our suppliers.

A handwritten signature in black ink, appearing to read "C. Kanagawa".

Chihiro Kanagawa
President and CEO