Shin-Etsu Chemical Co.,Ltd.

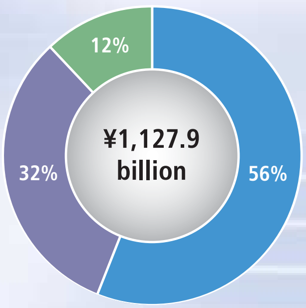
Annual Report 2006

Investing to Create Value

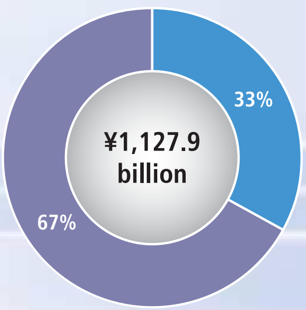
Profile

The Shin-Etsu Group offers a broad array of market-leading products in its Organic and Inorganic Chemicals, Electronics Materials and Functional Materials and Others businesses. The Group has also pursued a global strategy from its early days of selecting the optimal production sites near its main markets and raw materials procurement sources around the world. We focus on cultivating businesses with future growth potential that contribute to the advancement of society while achieving consistently favorable results in daily business. At the same time, the Group places priority on safety, the environment and corporate ethics in its operations around the world in order to be a trusted corporate citizen.

Net Sales by Business Segment



Net Sales in Japan and Overseas



Contents

Forward-looking Statements

This annual report contains forward-looking statements regarding the Company's plans, outlook, strategies and results for the future. All forward-looking statements are based on judgments derived from the information available to the Company at the time of publication.

Certain risks and uncertainties could cause the Company's actual results to differ materially from any projections presented in this report. These risks and uncertainties include, but are not limited to, the economic circumstances surrounding the Company's businesses, competitive pressures, changes in related laws and regulations, status of product development programs, and changes in exchange rates.

Financial Highlights

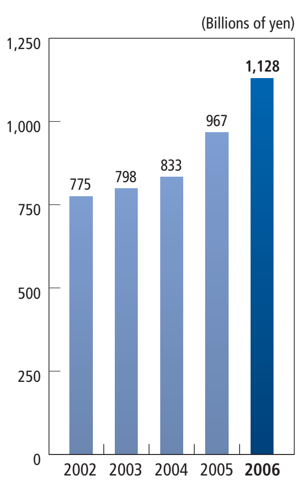
SHIN-ETSU CHEMICAL CO., LTD. AND SUBSIDIARIES

For the years ended March 31, 2006, 2005 and 2004	Millions of yen 2006	2005	2004	% Change 2006/2005	Thousands of U.S. dollars 2006
For the year:					
Net sales	**¥1,127,916**	¥ 967,486	¥ 832,805	**16.6%**	**$ 9,640,308**
Operating income	**185,320**	151,734	125,626	**22.1**	**1,583,932**
Net income	**115,045**	93,161	74,806	**23.5**	**983,291**
Capital expenditures	**145,330**	110,278	113,591	**31.8**	**1,242,137**
At year-end:					
Total assets	**¥1,671,281**	¥1,476,249	¥1,386,216	**13.2%**	**$14,284,453**
Working capital	**572,206**	444,935	401,879	**28.6**	**4,890,650**
Stockholders' equity	**1,173,680**	996,307	900,724	**17.8**	**10,031,453**

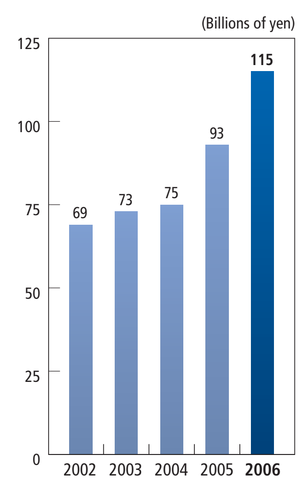
Per share data (yen and U.S. dollars):	Yen 2006	2005	2004	% Change	U.S. dollars
Net income	**¥ 266.63**	¥ 219.10	¥ 177.25	**21.7%**	**$ 2.28**
Stockholders' equity	**2,730.94**	2,329.47	2,140.23	**17.2**	**23.34**
Cash dividends	**35.00**	20.00	16.00	**75.0**	**0.30**
Return on equity (ROE)	**10.6%**	9.8%	8.6%		
Return on assets (ROA)	**11.8%**	10.6%	9.3%		
Number of employees	**18,888**	18,151	17,384		

Note: U.S. dollar amounts have been translated from yen, solely for the convenience of the reader, at the rate prevailing on March 31, 2006 of ¥117 to US$1.

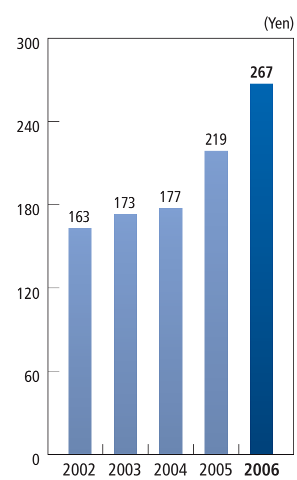
Net Sales



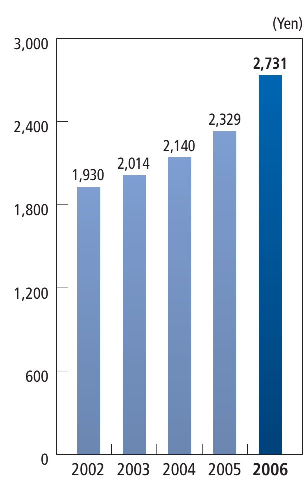
Net Income



Net Income per Share



Stockholders' Equity per Share



Note: Graphs are based on fiscal years ended March 31.

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.

Chihiro Kanagawa
President and CEO

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 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.

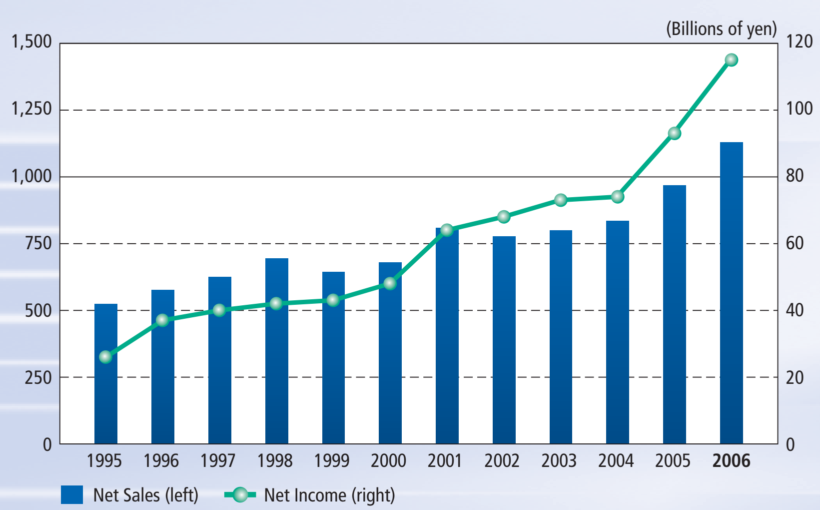
Despite these unsettled conditions, the Shin-Etsu Group still managed to achieve its goal of ¥1 trillion in consolidated net sales and ¥100 billion in consolidated net income. The Group will continue to make even greater efforts to achieve steady year-to-year growth. Our management team operates with 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.

When making major investment decisions, we systematically and constantly collect relevant market information. In cases where we project future demand growth, we execute and complete the capital projects with unmatched speed and diligence.

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 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.

When making major investment decisions, we systematically and constantly collect relevant market information. In cases where we project future demand growth, we execute and complete the capital projects with unmatched speed and diligence.

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

	Net Sales Before Acquisition	Most Recent Annual Net Sales
1999 SHIN-ETSU PVC B.V. (Acquisition of PVC business in the Netherlands)	¥35 Billion	¥50.0 Billion
2003 SE TYLOSE GMBH & CO. KG (Acquisition of Clariant's cellulose business in Germany)	¥24 Billion	¥28.0 Billion
2005 Underwrite full third-party allocation of shares in Mimasu Semiconductor Industry Co., Ltd.	¥33 Billion	

Mimasu Semiconductor Industry Co., Ltd.

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.

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.

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

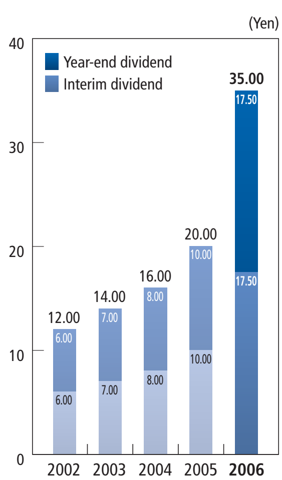
The Shin-Etsu Group has been included for the third time in the FTSE4Good Index Series, a guide for investors that measures corporate performance against globally recognized corporate responsibility standards.

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.

Chihiro Kanagawa
President and CEO

Investing to Create Value

The key to success for a materials manufacturer lies in building relationships of trust with customers by listening humbly to their requests and opinions, and developing and offering products that meet their needs in a timely fashion. This requires technological capabilities and speed. For this reason, a tripartite business structure incorporating sales, research and production is essential. This business structure, which Shin-Etsu established early on, now permeates throughout the Group as a kind of basic policy, and serves as an engine of Shin-Etsu's success as a continuous market leader.

Yoshiaki Ono
General Manager, Silicone-Electronics Materials Research Center,
R&D and Patent Department and New Products Department

Thorough Customer Communication and Original Technologies Produce Distinctive Products

The Shin-Etsu Group's fundamental R&D policy is to develop products that customers find valuable and to supply them ahead of competitors. We do so by using close communication to thoroughly draw needs, including latent ones, from customers.

In product development, we believe that technologies that can differentiate our products from those of other companies are essential to staying ahead of the competition. The Shin-Etsu Group consistently maintains its world-class technological competitiveness by using its core original technologies, gained through the process of adapting to increasingly diverse and high-quality products, to produce new technologies.

In these existing businesses, the Shin-Etsu Group promotes development of new applications and new products that meet customers' needs. The Group does so by rapidly sharing information with customers under its tripartite business structure. Sales and research staff work together as one team to build strong relationships with customers by following up on their needs. This enables the Shin-Etsu Group to continuously find research themes with high growth potential. The Group's semiconductor silicon and its related materials constitute an excellent example of a business that has grown significantly from beginnings as a research theme found in this manner. After developing new materials, the sales and research staff work closely with production divisions to bring them rapidly to commercial production with efforts to maintain and enhance their quality. This kind of stable commercial production capability is also a strength of the Shin-Etsu Group.

New research themes can be proposed at any time from any of Shin-Etsu's divisions, but mainly by staff at the research centers. These new themes are selected by the New Z Committee, chaired by the Company president, based on the standards of technology, market size, growth potential and expected profitability. A new research project will start after the most appropriate researchers are gathered together from throughout the Company. The New Z Committee will regularly follow up and check the progress of the project with the aim of commercializing a new product over the medium term. Currently, over 10 research themes are progressing with high expectations for commercialization.

Highly successful products that have emerged from businesses created through this system include photoresists and fluororubber. Shin-Etsu Group researchers are not bound by existing research topics and can think freely to propose research themes in areas outside of their fields. This system helps to increase motivation and technological capabilities, thereby contributing to the development of the entire Shin-Etsu Group.

Number of Patents by Region

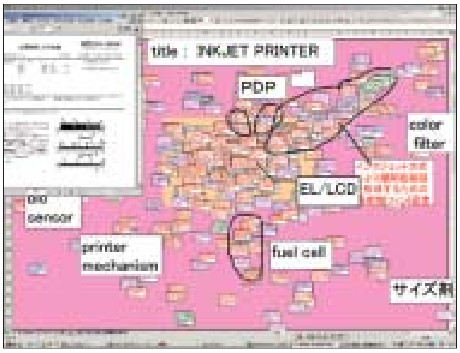
	Number of patents acquired during 2005	Cumulative number of patents acquired as of the end of fiscal 2005
Japan	406	4,187
North America	167	2,089
Asia/Oceania	192	1,068
Europe	183	1,614
Other Areas	0	10
Total	948	8,968

Intellectual Property Strategy

The Shin-Etsu Group recognizes that intellectual property, including patents and technological expertise, is an important management resource, with protection of its rights through patent acquisition positioned as the final step in the research process. The Group is enhancing the studies it makes of patent acquisition issues to determine if the Group's technologies under development are ahead of other companies and how such technologies can best be managed with patents, and aggressively using the results of these studies in business activities. The Group's intellectual property strategy has been recognized in the business community, earning top place in the ranking of corporate intellectual property strategy management conducted by Intellectual Property Bank Corp.

At the end of March 2006, the Shin-Etsu Group as a whole holds 4,187 domestic and 4,781 overseas patents. In addition, Shin-Etsu obtained 121 patents in the U.S. in 2005, ranking number one among Japanese chemical companies.

In addition, a Group company, Shin-Etsu Polymer Co., Ltd., has developed a patent data analysis system for viewing thousands of public Japanese patents. The Group uses the system to compare its research areas of focus and R&D activities with those of other companies in a variety of ways. This system has been introduced by The Japan Intellectual Property Association and other organizations.



Shin-Etsu Polymer Co., Ltd.'s patent data analysis system enables viewing of the distribution of patents by theme.

Intellectual Property Strategy Management Ranked Number One

Intellectual Property Bank Corp. (IPB), which is involved in patent evaluation, published a "Company Ranking of Intellectual Property Strategy Management" in the July 12, 2005 issue of the *Nikkei Shimbun* newspaper. Shin-Etsu was ranked first among 485 companies in the five fields of chemicals, pharmaceuticals, electricity, automobiles and precision machinery. The result was based on IPB's analysis, which determined that Shin-Etsu's collection of technological data and close cooperation among divisions were effective in strengthening the competitiveness of its products.

The Shin-Etsu Group concentrates its R&D on the three fields of flat-panel displays, mobile phones and semiconductors. The following introduces products developed in these three fields.

Flat-Panel Displays

Synthetic Quartz and Large-Size Photomask Substrates Used in the Manufacturing of LCDs

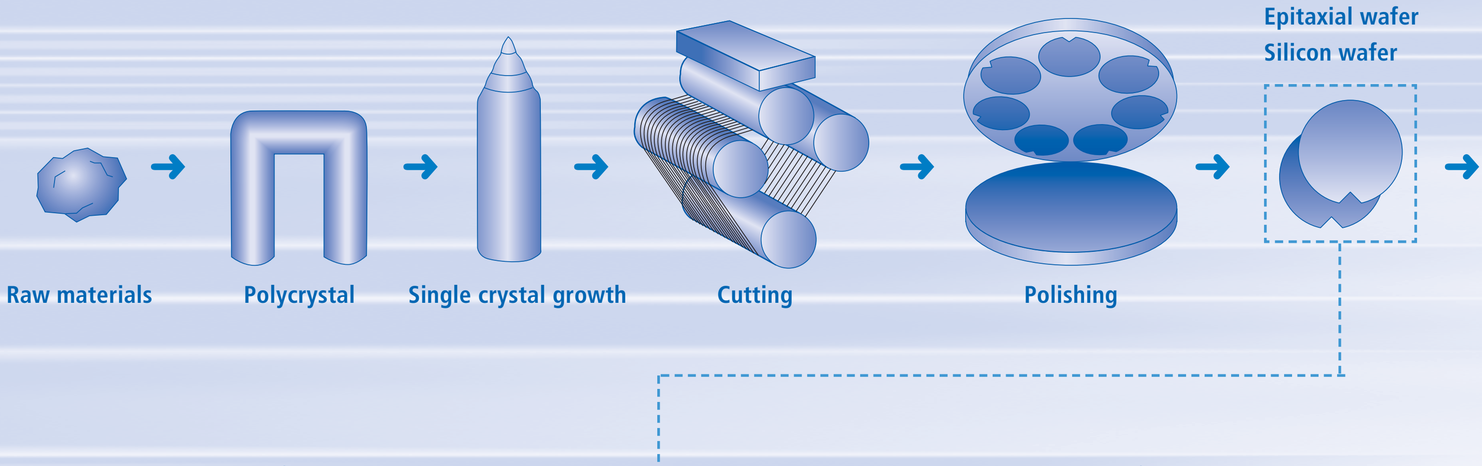
Driven by the Group's silicon technology, Shin-Etsu was the first company in the world to commercially produce super-high-purity synthetic quartz, which is significantly higher in purity than natural quartz. Shin-Etsu brought this large-size product to market ahead of other companies as a mask for integrated circuits. After this success, the Shin-Etsu Group took up the challenge of developing applications for large-size photomask substrates, which are essential to the manufacture of flat-panel displays. Fully utilizing Shin-Etsu's polishing technologies, the Group succeeded in overcoming challenging barriers to obtain a high degree of flatness in the photomask substrates. The Group has the top global market share in large-size photomask substrates for use in the manufacture of liquid crystal displays (LCD).

Mobile Phones

Silicone Rubber Keypad (Rubber Contact)

Silicone rubber for use in keypads was developed and produced by Shin-Etsu Chemical in the 1970s, and since then it has been processed by Shin-Etsu Polymer Co., Ltd. Shin-Etsu also developed selective adhesion, an epoch-making technology by which liquid silicone rubber adheres directly to plastics without adhesion to molding-metal. This significantly reduces costs, giving Shin-Etsu unrivaled cost competitiveness. In 2003, selective adhesion technology received the Silicon Chemistry Technology Award

Among these fields, various products developed by Shin-Etsu are indispensable to semiconductor materials and their production processes.



300mm Silicon Wafers

Shin-Etsu was the first company in Japan to design and produce silicon wafers. Since then, the Shin-Etsu Group has been providing products that quickly and accurately meet customers' needs, and began the world's first commercial production of 300mm silicon wafers in 2001. Shin-Etsu Handotai Co., Ltd. has established defect-free technology for single crystals, gaining strong customer trust for its commercial production capabilities and quality technologies, and has maintained its position as the world's largest manufacturer of silicon wafers.

Quartz Glass for Semiconductor Production Processes

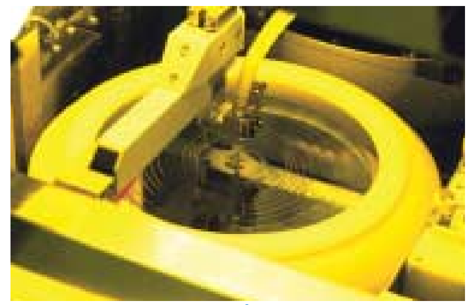
Improvements in the degree of integration of semiconductors necessitates greater levels of purity and accuracy of quartz glass for semiconductor production processes, which can be achieved through means including further miniaturizing production processes. The Shin-Etsu Group provides highly functional materials and products based on its expertise in silicon chemistry technologies. In particular, synthetic quartz glass, which has dramatically improved heat resistance, has an excellent reputation due to its ability to meet the needs of high-humidity processes in ultra-clean rooms.

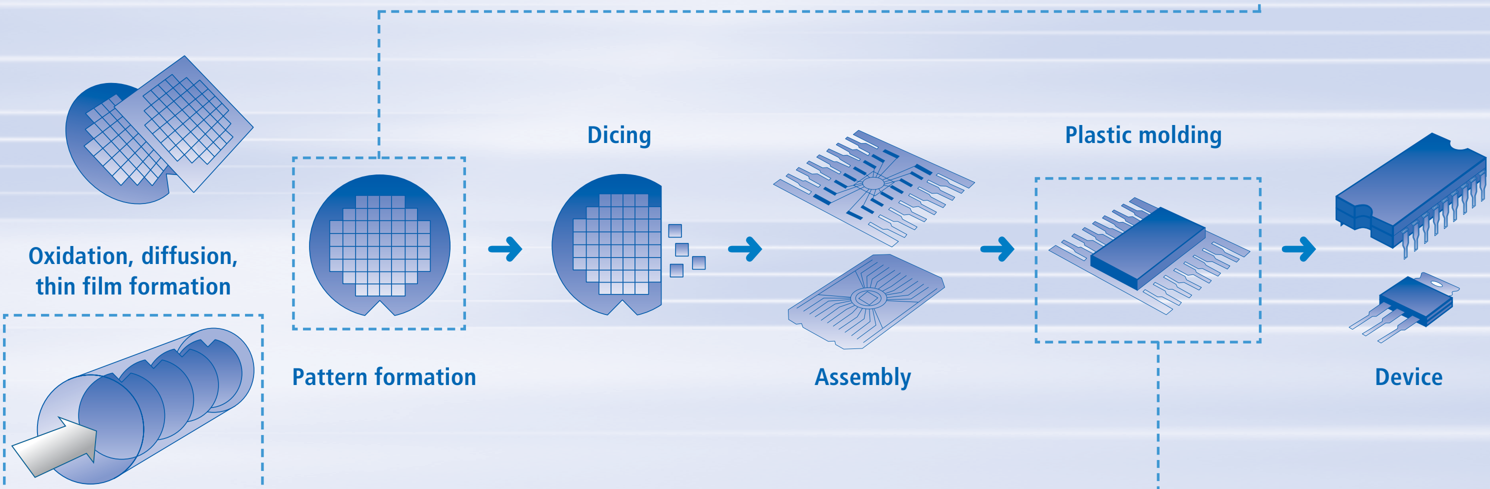
presented by The Society of Silicon Chemistry, Japan, the world's first academic society for silicon research.

Semiconductors

Photoresists

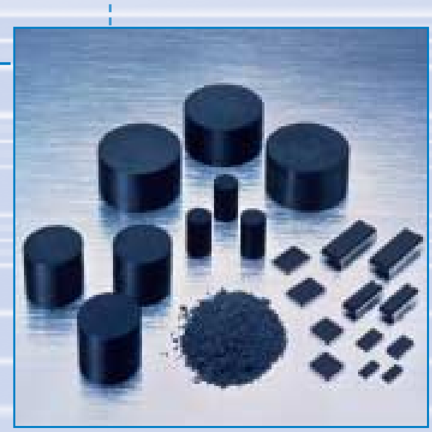
Photoresists are used to imprint integrated circuits (IC) on silicon wafers during semiconductor manufacturing. They play an important role in IC miniaturization, which influences the data volume of the semiconductor. Highly integrated semiconductor devices require both miniaturization of the circuit pattern and advanced exposure technology. In 1996, Shin-Etsu utilized its polymerization technology to develop the first photoresist for use with KrF (krypton fluoride) excimer lasers, which use short wavelengths. Shin-Etsu's strengths as the leading manufacturer in this field include: 1) status as the world's only photoresist manufacturer with an integrated production system for a range of products beginning with base polymers; and 2) its consultation process with customer engineers who make decisions relating to all aspects of production, from making specifications to product delivery.





Epoxy Molding Compounds

Epoxy molding compounds (EMCs) are widely used as an encapsulation material for all kinds of semiconductor packaging. Shin-Etsu developed EMCs using the plastic modifier technology that it had cultivated in the field of silicone development. These highly functional products meet strict requirements for plastic molding and have excellent humidity resistance, high heat-conductance and formability. In addition, Shin-Etsu has introduced a new proprietary heat-resistance system, a "green" halogen and antimony trioxide-free EMC that contributes to environmental conservation.



The Shin-Etsu Group at a Glance

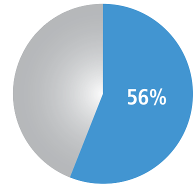
Organic and Inorganic Chemicals

No. 1 market share worldwide for **polyvinyl chloride (PVC)**

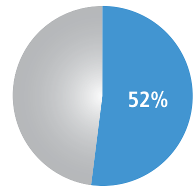
Main Products

- Polyvinyl chloride (PVC)
- Silicones
- Methanol
- Caustic soda
- Cellulose derivatives
- Synthetic pheromones
- Silicon metal

% of Net Sales



% of Operating Income



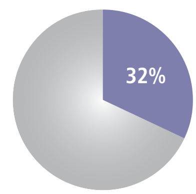
Electronics Materials

No. 1 market share worldwide for **semiconductor silicon**

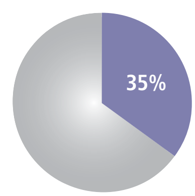
Main Products

- Semiconductor silicon
- Rare earth magnets for the electronics industry
- Epoxy molding compounds
- Photoresists

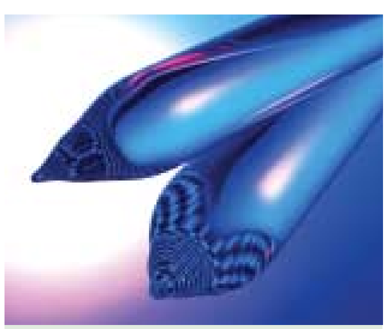
% of Net Sales



% of Operating Income



Functional Materials and Others

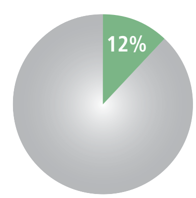


No. 1 market share worldwide for **photomask substrates**

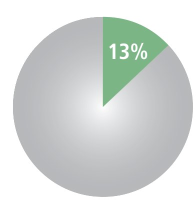
Main Products

- Synthetic quartz products
- Rare earth magnets for general applications
- Rare earths
- Liquid fluoroelastomers
- Flexible copper-clad laminates
- Pellicles

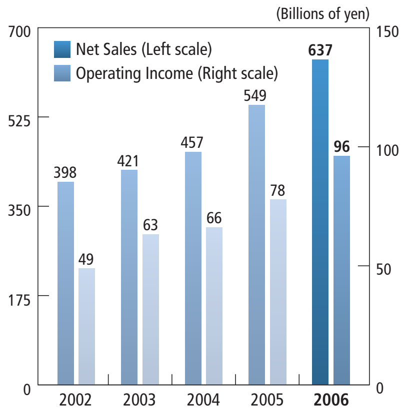
% of Net Sales



% of Operating Income



Net Sales and Operating Income



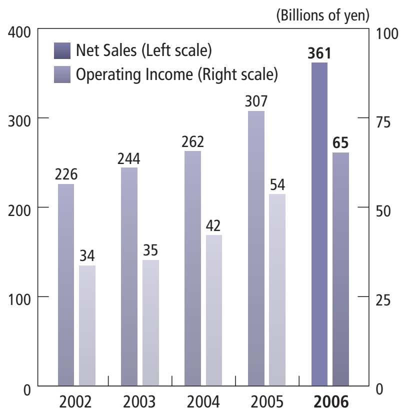
Results for Fiscal 2006

The PVC business expanded substantially, due to excellent performance by Shintech Inc. (the Company's U.S. PVC base) and solid sales in Europe. In the silicones business, domestic sales increased and export sales and income greatly improved. The domestic cellulose derivatives business was firm, and sales at SE Tylose GmbH & Co. KG in Germany of cellulose for building materials applications were strong.

Fiscal 2007 Objectives

In the PVC business, Shin-Etsu is constructing large-scale integrated manufacturing facilities at Shintech Inc. and will increase production capacity in Europe. Efforts to expand the silicones business will include development of new products and measures to ensure stable operations at plants worldwide. To expand the cellulose business, SE Tylose GmbH & Co. KG is upgrading its production facilities.

Net Sales and Operating Income



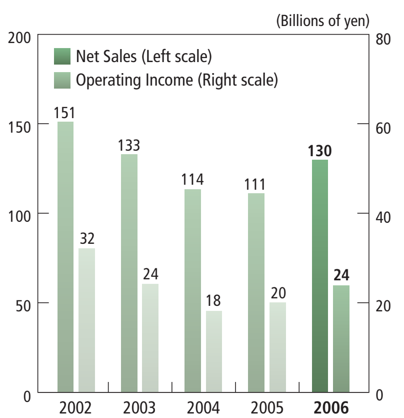
Results for Fiscal 2006

In the semiconductor silicon business, sales of 300mm silicon wafers grew substantially as a result of higher demand from semiconductor device manufacturers and increased production capacity, while 200mm wafers also performed well. Sales of rare earth magnets for the electronics industry were strong, with net sales and income both increasing. Sales and income of photoresist products and organic materials for the electronics industry also increased.

Fiscal 2007 Objectives

The semiconductor silicon business will increase production capacity in Japan and the U.S., building a stable supply system with several production bases to meet increased demand for 300mm wafers. Efforts to enhance competitiveness will focus on further improving the quality of 200mm and smaller wafers.

Net Sales and Operating Income



Results for Fiscal 2006

In the synthetic quartz products business, sales of large-size photomask substrates used in the manufacturing of LCDs grew substantially. Sales of rare earth magnets for general applications continued to be firm, and sales of liquid fluoroelastomers also grew. Other businesses, including design and construction of various kinds of plants, were solid.

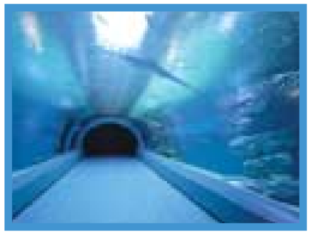
Fiscal 2007 Objectives

The synthetic quartz products business will continue to respond precisely to future growth in demand for large-size photomask substrates for LCDs, which have been selling strongly. Successive expansion of production capacity for rare earth magnets will support expansion of the business for applications in home appliances and automobiles.

Review of Operations

ORGANIC AND INORGANIC CHEMICALS

PVC sheeting is now widely used in greenhouses as an alternative to glass.



The superior adhesiveness, durability and deep hardening qualities of silicone-based, elastic joint sealing material make it effective for aquariums and other large-size water tanks.

Net Sales of Main Products

(Billions of yen)

	2006	2005	2004
Polyvinyl chloride (PVC)	345.3	296.5	254.9
Silicones	176.5	155.9	135.8
Cellulose derivatives and others	114.7	96.6	66.3
Total	636.5	549.0	457.0

Polyvinyl Chloride (PVC)

PVC is a general-purpose resin that has many advantageous properties. It is easy to process and economical as well. Moreover, from the standpoint of its contribution to the quality of the environment, while other plastics depend 100% on petroleum, the manufacturing of PVC involves far less dependency on petroleum resources, with 60% of its material being salt and only 40% petroleum. With the progress of recycling, PVC makes a major contribution to the environment from the standpoint of life cycle assessment as well.

The superior qualities of PVC have received a high evaluation, backed by continuing growth in global demand of 3% to 4% annually. Demand for PVC is growing for applications in pipes and sidings in the U.S. and for pipes and window profiles in Europe and Asia. In particular, demand is growing strongly in China, mainly for construction materials and consumer goods. In addition, use of PVC window profiles has started to spread in Japan over the past few years because PVC's insulating effect prevents condensation in winter and contributes to the reduction of global warming while cutting air conditioning and heating costs.

PVC is an indispensable material that supports our daily lives in contemporary society. Strong future growth in demand is expected in various regions around the world. In anticipation of this trend, the Shin-Etsu Group, the world's largest manufacturer of PVC, is implementing major expansion plans at Shintech Inc. in the U.S. and Shin-Etsu PVC B.V. in the Netherlands, two core companies of its PVC business. When the expansion is completed, the combined production capacity of Shin-Etsu Group companies in Japan, the U.S. and Europe is expected to be about 4 million tons annually. In the future, the Group will utilize its world-leading production capacity and sales capabilities that were nurtured in global markets in order to continue to assure its world number-one position.

Silicones

Shin-Etsu has been selling silicones for over half a century since it became the first company in Japan to commercially produce silicones in 1953. During these years, the Shin-Etsu Group has aggressively incorporated customer needs so that today it provides more than 4,000 different silicone products for applications in such fields as the electric, electronics, automotive, construction, cosmetics, toiletries and chemical industries.

Silicones combine organic and inorganic properties and can take forms including fluid, resin or rubber. Their numerous unique properties include electrical insulation and heat, cold and weather resistance. In each field, we are contributing in such ways as helping to improve product functions and to make production processes more efficient.

Among the wide range of application fields for silicones, one that has been steadily growing in recent years is in the automotive field, where high functionality is increasingly required. Silicones are becoming an essential material in various applications such as electronics equipment, interior finishes, airbags and inside engine casings. Furthermore, in the case of electrical and electronics devices, silicones serve application needs for an efficient heat transfer medium, and in cosmetics applications, silicones have attracted a great deal of attention for their ability to help make these products feel good on the skin and make them easier to apply. Silicones are a material with unlimited potential. In the future, we will continue to develop new products and new applications and endeavor to further create and expand global demand.

The Shin-Etsu Group is aggressively going forward on a global basis with the expansion of production and sales of silicones in the regions where demand is growing. In addition to its production bases in Japan, the U.S., the Netherlands, Korea, Taiwan and China, the Shin-Etsu Group has been working to expand the business by concentrating on stable operations at its integrated silicone monomer and polymer manufacturing facilities in Thailand since they began full-scale production.

Cellulose Derivatives

Cellulose derivatives are an environment-friendly material made from a natural polymer. Shin-Etsu has developed a wide array of cellulose derivative products that are used in diverse fields.

Their broad range of applications includes construction, civil engineering, agriculture, additives for fine ceramics, paper processing and toiletries. Demand is particularly strong for applications of cellulose derivatives as pharmaceutical coatings and binders for tablets and granules and for industrial use as molding binders for ceramics that purify automobile exhaust emissions.

When Shin-Etsu acquired the cellulose business of Clariant AG at the end of December 2003, establishing SE Tylose GmbH & Co. KG in Germany, the Shin-Etsu Group became the world's largest manufacturer of methylcellulose. Demand is projected to increase steadily in the future. Therefore, the Shin-Etsu Group expanded production capacity at the Naoetsu Plant in Japan and will complete expansion at SE Tylose's facilities in fall 2006. In the future, the Shin-Etsu Group will use the advantages of this bipolar production system to strengthen its methylcellulose business.

Organic and Inorganic Chemicals and Other Related Products

Insects secrete pheromones as part of their reproductive cycle. Synthetic pheromones were developed for the purpose of suppressing the birth of the next generation of harmful insects using a technique known as "mating disruption." In Europe and North America, they are now used in apple and peach orchards and other crops. In Japan, they are mainly used in fruit orchards as well as for vegetables such as cabbage, and in tea orchards. Mating disruption is now being focused on as an innovative method that will replace the use of insecticides. The Shin-Etsu Group has the world's number-one market share of synthetic pheromones. In addition, the Group supplies a large number of acetylene derivative products such as synthetic aroma chemicals, which are widely used in perfumes and food flavorings.

The Shin-Etsu Group also manufactures silicon metal, an essential raw material in such products as silicones, semiconductor silicon, and synthetic quartz, which are among the Group's core businesses. Simcoa Operations Pty. Ltd., a wholly owned subsidiary in Western Australia, has long-term mining rights to high-quality silica, and produces 30,000 tons of silicon metal annually from this raw material. Simcoa contributes to securing a stable, long-term supply of quality silicon metal raw material.

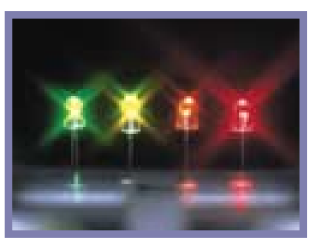
Topics **Conductive Silicone Rubber for Electronic Keypads (Rubber Contact)**

As the pioneering developer of conductive silicone rubber and keypads, Shin-Etsu Polymer Co., Ltd. uses its strengths in advanced design capability and processing technologies to develop products with enhanced operability and functionality.

Shin-Etsu Polymer's keypads hold the top share in the global market, and are used in a variety of input devices in products including mobile phones, digital cameras, automobiles, personal computers and medical equipment. In response to continued growth in sales of keypads for use in mobile phones and automobile electronic components, Shin-Etsu Polymer established a production base in Hungary in 2004, and currently produces keypads in six countries.

Electronics Materials

Silicon wafers boast a degree of evenness to within 100 nanometers.



Epoxy molding compounds, which are silicone variations, are necessary materials for high-intensity LEDs.

Net Sales of Main Products (Billions of yen)

	2006	2005	2004
Semiconductor silicon	305.7	256.6	214.1
Others	55.7	50.3	48.1
Total	361.4	306.9	262.2

Semiconductor Silicon

The Shin-Etsu Group, as a world leader in the silicon wafer business, constantly works to achieve the world's highest quality products and highest level of customer satisfaction. The Group has been developing the world's most advanced technologies to produce larger-diameter, super-smooth silicon wafers with the lowest defect rate. Demand for semiconductor devices has been expanding for a wide range of applications, including personal computers, mobile telephones, digital home appliances and automobiles. Amid significant growth in the silicon wafer market in recent years, the Shin-Etsu Group has been providing a stable supply to users from its silicon wafer production bases in Japan, Malaysia, the U.S., the U.K. and Taiwan.

The Shin-Etsu Group is the world's leading silicon wafer supplier with a world market share of approximately 32 percent, and is the undisputed leader in the steadily expanding 300mm wafer segment. In the future, the Group will increase production capacity in Japan and the United States to respond to growing demand for 300mm wafers, and is structuring a stable supply system based on multiple production bases.

Shin-Etsu had been commissioning Mimasu Semiconductor Industry Co., Ltd. in Japan to process its semiconductor silicon wafers. In fiscal 2006, Shin-Etsu obtained a large percentage of shares in this company by underwriting a full third-party allocation of newly issued shares and additionally acquiring shares through a tender offer bid. By strengthening its capital relationship with Mimasu, which has high-level processing technology, the Shin-Etsu Group is working to strengthen this wafer production base, which will become even more important in the future.

The Group is also focusing on expansion of sales of such newer products as SOI wafers and annealed wafers, used for applications in highly functional devices. For existing wafer products of up to 200mm, the Group will pursue greater competitiveness through rationalization of production, product quality improvement efforts and product differentiation, as it works to strengthen its systems for meeting any and all requests of customers.

Rare Earth Magnets for the Electronics Industry

Rare earth magnets are high-performance, permanent magnets that have about 10 times the magnetic force of ferrite magnets. They have been contributing to the development of more compact and lightweight electric and magnetic components for products that have more highly specialized functions and are more energy efficient. The Shin-Etsu Group has the largest global market share for rare earth magnets for voice coil motors (VCM) for hard disk drives (HDD) used in computers and consumer electronics, for which demand is strong. To meet this demand, the Group is working to successively expand production capacity. The Shin-Etsu Group is the only manufacturer in the world to carry out integrated production of high-quality rare earth magnets starting from high-purity rare earth. Starting by developing materials with the characteristics that customers demand, the Shin-Etsu Group then uses its ability to move quickly from prototype to commercial production and provide a stable supply of products, with product development to meet application requirements and thorough product quality control to respond to customer needs.

Epoxy Molding Compounds

Demand in the semiconductor device market for thinner and smaller devices is driving the development of chip-size packages and the system-in-package trend in which multiple large-scale integrated (LSI) chips are stacked and installed in a single package. Amid these trends, the Shin-Etsu Group is working aggressively to meet diversified needs for semiconductor packaging.

Employing cutting-edge technology accumulated through the development of various silicone products, the Shin-Etsu Group supplies a line-up of unique products that are differentiated from those of other companies. These include Green EMC products, which incorporate a flame-retardant system that responds to recent environmental concerns, and moldable silicone products for high-power LEDs, for which applications have rapidly grown in recent years.

Photoresists and Pellicles

Shin-Etsu Group is developing a system to supply the principal materials needed in the lithography process for manufacturing semiconductor devices. We have commercially produced and marketed photoresists compatible with KrF (krypton fluoride) excimer lasers as a photo-sensitive material used in imprinting semiconductor circuits, next-generation ArF (argon fluoride) resists, and I-line resists for thin-film magnetic heads and for wafer-level chip-size packaging (WLCSP). The Group has also succeeded in developing pellicles, which are the protective dust covers used for photomasks in excimer laser lithography.

As it capitalizes on its leading market share in the global silicon wafer market, and makes use of its close ties with the semiconductor industry, the Group's efforts to prepare for the next generation of semiconductor devices include collaboration with users to develop ArF excimer lasers for photoresists.

Topics

Shin-Etsu Underwrites Third-Party Allocation of Shares in Mimasu Semiconductor Industry Co., Ltd. and Obtains Shares in Public Offering

Shin-Etsu has long outsourced wafer processing of silicon wafers to Mimasu Semiconductor Industry Co., Ltd. In order to further strengthen this alliance, in August 2005 Shin-Etsu underwrote the third-party allotment of shares of Mimasu Semiconductor, thereby making it an affiliate. In addition, Shin-Etsu acquired shares of Mimasu Semiconductor by way of a tender offer from December 2005 to February 2006 and now has a 41.3 percent stake in Mimasu Semiconductor (as of March 31, 2006).

As an important company in the Shin-Etsu Group's semiconductor silicon business, Mimasu Semiconductor will continue to work intensively with Shin-Etsu on projects including joint development of cutting-edge wafer processing technologies.

Functional Materials and Others

Shin-Etsu's rare earth magnets are used in motors for hybrid cars, reducing energy consumption and environmental impact.

Synthetic quartz photomask substrates act as a negative for production of LCD panels. Shin-Etsu is responding rapidly to larger-sized LCD panels.

Net Sales of Main Products (Billions of yen)

	2006	2005	2004
Synthetic quartz products	34.5	26.5	25.7
Rare earths and rare earth magnets, etc.	30.6	28.2	26.5
Others	64.9	56.9	61.4
Total	130.0	111.6	113.6

Synthetic Quartz Products

The Shin-Etsu Group, with its know-how in silicon chemistry, is the first in the world to mass produce super-high-purity synthetic quartz, which is higher in purity than natural quartz. With silicon metal refined to a high degree of purification as a raw material, the Group established a manufacturing technology for super-high-purity synthetic quartz that holds impurities to the level of 1 ppb (one part per billion).

Synthetic quartz products such as preforms for optical fiber, photomask substrates for LSI and large-size photomask substrates for LCDs have become essential materials for the development of the high-level information society. Optical fiber is key to the further advance of broadband, and demand is projected to continue growing constantly. The Shin-Etsu Group is striving to further improve product quality and expand supply capabilities for preforms for optical fiber to prepare for future business growth. In addition, the Group has the top global market share for large-size photomask substrates, and orders from LCD panel manufacturers remain robust. We will endeavor to accurately anticipate and be ready to cope with the expansion in future demand.

Rare Earths and Rare Earth Magnets for General Industrial Use

The Shin-Etsu Group possesses its own original proprietary high-level separation and refining technologies and physical property control technologies. We use them for the separation and refining of various kinds of rare earths with a high purity of 99.9999%. The Group's rare earths are widely applied in such products as plasma display panels, LCD TVs and fluorescent lights, luminescence for medical equipment, oxygen sensors in automobile engines, catalytic converters and capacitors. In addition, applications in various other fields are expected to expand.

By maximizing strong magnetic force, the Group's rare earth magnets for general industrial use help to enable the introduction of products that are lighter in weight, smaller in size, and higher in output for such equipment as motors. Shin-Etsu offers a group of rare earth magnet products that have the world's highest magnetic force level. Our extensive product line-up consists of both samarium-cobalt magnets and neodymium magnets, both of which are gaining a high level of trust from users. The range of applications is vast. Rare earth magnets are used in such product areas as household appliances including energy-efficient air conditioners and washing machines, and various motors for automobiles. In addition, rare earth magnets have begun to be used in such energy-saving and environmentally friendly applications as motors for fuel-cell cars, motors for hybrid cars, which are rapidly spreading throughout the market, and motors for wind-power generators.

Liquid Fluoroelastomer SHIN-ETSU SIFEL®

SHIN-ETSU SIFEL® is a revolutionary liquid fluoroelastomer that Shin-Etsu was the first in the world to develop. Its form before hardening is either a liquid or a paste, and after heat curing, it becomes a flexible synthetic rubber material. SHIN-ETSU SIFEL® is superior in resistance to cold, keeping its elasticity even at minus 50°C. In addition, it has such desirable characteristics as resistance to oils, solvents, chemicals, heat and excellent electrical insulation properties. Accordingly, it is used as rubber molding, adhesive sealant material and filler in a wide range of application fields including the automotive, aircraft, electric, electronics, office equipment and petrochemical industries. It is contributing to the improvement of product reliability in many application areas.

Flexible Copper-Clad Laminates

Shin-Etsu's flexible copper-clad laminates are used as materials for thin, lightweight flexible printed circuit (FPC) boards because of their superior flexibility. FPC boards are used in such electronic products as mobile phones, digital cameras, video cameras and DVD recorders and players, and are contributing to making these products lighter and more compact.

In addition to its existing three-layer flexible copper-clad laminates, Shin-Etsu started marketing two-layer flexible copper-clad laminates (FCLs) it developed using its proprietary technology. Moreover, Shin-Etsu has responded to rising concerns about the environment by developing and launching a halogen-free cover layer with excellent properties.

Other Products

Shin-Etsu Engineering Co., Ltd., a Shin-Etsu Group company, celebrated its 30th anniversary in 2006. It consists of the Plant Division, which mainly handles the integrated design and construction of various types of plants, and the Electro-Mechanics Division, which handles the development designing and manufacturing of mechatronics equipment for electronics-related industries that manufacture such products as semiconductors and LCDs. Both divisions also receive a large number of orders from companies outside of the Shin-Etsu Group. In particular, with the rapid spread in popularity of flat-panel TVs, the demand for LCDs and plasma display panels (PDPs) has grown, and sales of Shin-Etsu Engineering's panel alignment machine are increasing. The key to demand expansion for flat-panel TVs is increasing panel size, and Shin-Etsu's timely supply of panel alignment machines meets this need.

Topics — New High-Performance Technology for Neodymium Rare Earth Magnets

In 2005, Shin-Etsu developed a binary alloy method enhanced by grain boundary diffusion, a new high-performance technology for neodymium rare earth magnets, and began sample shipments. With this production method, Shin-Etsu has realized the world's highest heat-resistance characteristics for neodymium rare earth magnets. The new technology helps to achieve both high heat-resistance and high performance, which were difficult to obtain simultaneously with conventional production methods. The technology is expected to find applications in areas where growth is expected, such as automobile motors, which require high heat resistance, and motors for air conditioners and other home appliances.

Corporate Social Responsibility (CSR)

The Shin-Etsu Group believes that the primary social responsibility a corporation must fulfill is to obey laws and regulations in conducting its corporate activities, make a profit and pay taxes. In conducting corporate activities, all employees of the Shin-Etsu Group diligently carry out their respective duties, and focus on product development and quality control while taking into consideration their effects on the environment and society. Moreover, they aim to contribute to society through various activities including support for education and culture on the local community level.

Kiichi Habata
Managing Director
In charge of Silicone and Environmental Control & Safety

Basic CSR Policy

As a good corporate citizen, the Shin-Etsu Group has always endeavored to contribute to society through positive activities in local communities. In April 2005, we established a CSR Promotion Committee, and are totally devoting our efforts to fulfilling our corporate social responsibilities.

The entire Shin-Etsu Group is working to implement the following basic CSR policies.

- The Shin-Etsu Group's mission is to contribute to people's daily lives as well as to the advance of industry and society by providing key materials and technologies. To achieve this raison d'être of all companies, the Group places utmost priority on such core business principles as assuring product quality and safety, engaging in fair competition, maintaining good relationships with citizens and governments, strictly managing and protecting customer data and carrying out fair and sound business practices. By faithfully following these principles, the Group strives to enhance the worth of the Group and become an ever-growing company.
- The Shin-Etsu Group makes it a fundamental management principle to pursue the goals of safety and environmental conservation. The Group promotes corporate activities that place primary importance on safety and environmental conservation and strives to maintain the trust of its stakeholders.
- Respecting the principles of human dignity and life fulfillment, the Shin-Etsu Group forbids any discrimination, any use of compulsory labor and any use of child labor. Furthermore, the Group endeavors to create a work environment in which all employees can perform their jobs easily and effectively and fully realize their potential.
- The Shin-Etsu Group is committed to contributing to society and to disclosing accurate and timely information to the public about the business activities and position of the Group so as to continue to maintain the trust of society.

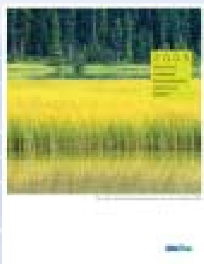
Activities for Environmental Control and Safety Management

The Shin-Etsu Group has made safety and the environment top management priorities. We work to assure safe operations of our facilities and obtain the trust of local communities with regard to the Group's business activities.

Since its establishment in 1970, Shin-Etsu Chemical's Environmental Control and Safety Department has been strenuously working to ensure environmental control and plant safety.

We decide upon aims and goals for environmental issues, management of chemical substances, management of facilities and prevention of work-related accidents, and we strive to achieve them. The results are checked by means of various self-diagnosis and audit systems so as to allow Shin-Etsu to further develop its systems to attain the next level of objectives.

Furthermore, the Group is aggressively promoting measures for environmental control such as saving resources and energy and development of ecology-oriented products that are effective in reducing the environmental burden.



Environmental and Social Responsibility Report 2005
http://www.shinetsu.co.jp./e/profile/kankyo.shtml

Louisiana state legislators sent a letter of thanks for the Shin-Etsu Group's contributions to disaster relief.

From left: Shintech Vice President Ervin E. Schroeder, Lake Jackson Historical Museum Director Maria Laughlin and Mr. Schroeder's assistant Stephanie Whitehurst

In 1998, Shin-Etsu adopted its Environmental Charter, which sets forth the basic spirit of its environmental control measures. The Group is carrying out its business activities in strict conformity with the principles embodied in this Charter. Each plant and Group company conducts Responsible Care activities, a voluntary program for improvement of the environment, and a safety improvement program. In addition, all plants and major subsidiaries have obtained ISO14001 certification, the international standard for environmental management systems, and other Shin-Etsu Group companies are working to obtain certification.

To assure safety, the Shin-Etsu Group utilizes a risk assessment method, repeatedly checking and reviewing safety measures in each aspect of its facility operations, including employee operations, the handling of chemical substances, and control procedures. At the time of planning of new facilities or the start-up of manufacturing of new products, we examine environmental impact and safety measures in addition to conducting safety evaluations. Furthermore, at Shin-Etsu's existing facilities, we make improvements upon regularly reviewing work processes and safety measures.

Activities to Support Local Communities

The Shin-Etsu Group is actively making a global contribution to society not only in Japan but also in each region of the world where the Group has business operations, according to regional characteristics. These include friendship exchanges with local governments and residents near Shin-Etsu plants such as support for clean-up projects and co-sponsorship of events in those areas. In addition, Group companies in the United States and Malaysia have established scholarship systems.

The following introduces the Shin-Etsu Group's programs in fiscal 2006 contributing to local communities in various regions around the world.

Helping Louisiana Recover from Hurricane Katrina

The powerful hurricane Katrina struck Louisiana, U.S.A. in August 2005, leaving over a million residents homeless. Immediately after the disaster, Shin-Etsu Group company Shintech Incorporated, which conducts business in Louisiana, donated $2 million to the Louisiana Disaster Recovery Foundation set up by the state government.

Shin-Etsu Group employees also contributed to the Foundation, and Shintech employees participated in relief activities such as cooking teams for a good supply of food and transport of goods. Two Louisiana state congresspersons sent President Kanagawa a letter thanking the Shin-Etsu Group and its employees for their contribution to the disaster relief.

Support for Lake Jackson Historical Association

Lake Jackson, Texas is intertwined with the petrochemical industry. Located near the Gulf of Mexico, the area is a center of petrochemical manufacturing using both oil and natural gas. The Lake Jackson Historical Association maintains a museum that provides education covering the history and culture of Lake Jackson from prehistoric to modern times. As a company in Texas' representative petrochemical industry, Shintech made a donation to the museum and set up a display corner showing the PVC production process. Shintech's exhibit in the 13,000-square-foot museum shows the processes by which salt and other raw materials are used to manufacture PVC, which is then made into PVC pipe, vinyl siding and other products, making it easy for visitors to understand PVC. Through cultural and educational efforts like these, Shintech contributes to local communities.

Board of Directors and Auditors

(As of June 29, 2006)

PRESIDENT AND CEO

Chihiro Kanagawa

EXECUTIVE SENIOR MANAGING DIRECTORS

Shunzo Mori

In charge of General Affairs and Personnel & Labor Relations
General Manager, Electronics Materials Division

Fumio Akiya

In charge of Advanced Materials, Technologies, and Auditing

Yasuhiko Saitoh

In charge of Office of the President, Public Relations, Finance & Accounting and Legal Affairs

Corporate Governance and Compliance

Basic Policies concerning Corporate Governance

The Shin-Etsu Group's management appreciates the fundamental importance of its shareholders, placing top priority on continuously raising corporate value. To realize this policy, it is developing an efficient organizational structure and various systems that can respond swiftly to changes in the business environment. Moreover, from the standpoint of increasing transparency and strengthening supervisory functions, Shin-Etsu's basic policy concerning corporate governance is to make efforts to actively disclose timely and accurate information to shareholders and investors, which is positioned as one of its most important management issues.

Corporate Governance System

Three out of the eighteen members of Shin-Etsu's Board of Directors are outside directors. Limiting the number of directors to the minimum necessary, the Shin-Etsu Group is establishing a system to promote speedier decision-making and agile management.

Out of Shin-Etsu's five statutory auditors, including full-time auditors, three are outside auditors. Statutory auditors attend meetings of the Board of Directors as well as other important internal meetings, and carry out audits concerning Shin-Etsu's business operations. They also exchange information and opinions directly with Shin-Etsu's accounting auditors, Chuo Aoyama PricewaterhouseCoopers.

With regard to decisions about reviewing and recognizing officers' remuneration, Shin-Etsu has an Officers' Remuneration Committee chaired by an outside director. Total officers' remuneration was ¥733 million in fiscal 2006.

In May 2005, Shin-Etsu established an Auditing Department dedicated to matters concerning internal audits of business operation and control systems within the company, and works to further strengthen its corporate governance.

Regarding the risk management system, the Risk Management Committee promotes companywide activities and develops various related regulations in order to prevent and forestall risks that may occur in connection with business operations.

Basic Policy concerning Compliance

The Shin-Etsu Group's corporate philosophy is to conduct fair business activities in a thoroughly law-abiding spirit. The Group has established various regulations regarding its compliance system, which all employees follow in carrying out their duties. Internal audits of the operating status of this system are conducted by the Auditing Department and the other respective departments related to the contents of the audit.

MANAGING DIRECTORS

Ryoei Miki
General Manager, Business Development Department

Kiichi Habata
In charge of Silicone and Environmental Control & Safety

Yoshiaki Ono
General Manager, Silicone-Electronics Materials Research Center, R&D and Patent Department and New Products Department

Masashi Kaneko*
Director & Chairman, Nikko Cordial Corporation

Toshinobu Ishihara
General Manager, New Functional Materials Research Center and New Functional Materials Department

Masaki Miyajima
General Manager, PVC Division

Atsushi Nakamura
General Manager, Organic Chemicals Division

Fumio Arai
Director & President, Shin-Etsu PVC B.V.
Director & President, SE Tylose GmbH & Co. KG

Koji Takasugi
In charge of Purchasing
General Manager, International Division

Toshiyuki Kasahara
General Manager, Finance & Accounting Department

Hidenori Onezawa
In charge of Semiconductor Materials

Masahiko Todoroki
General Manager, Planning & Administrative Department, Semiconductor Materials Division

DIRECTORS

Frank P. Popoff*
Former Chairman of US The Dow Chemical Company

Shunji Kono*
Adviser, Tokio Marine & Nichido Fire Insurance Co., Ltd.

FULL-TIME STATUTORY AUDITOR

Osamu Okada

STATUTORY AUDITORS

Masahiko Watase

Masao Okazaki**

Taku Fukui**

Yoshihito Kosaka**

* External director
** External auditor

Towards Thorough Compliance Management

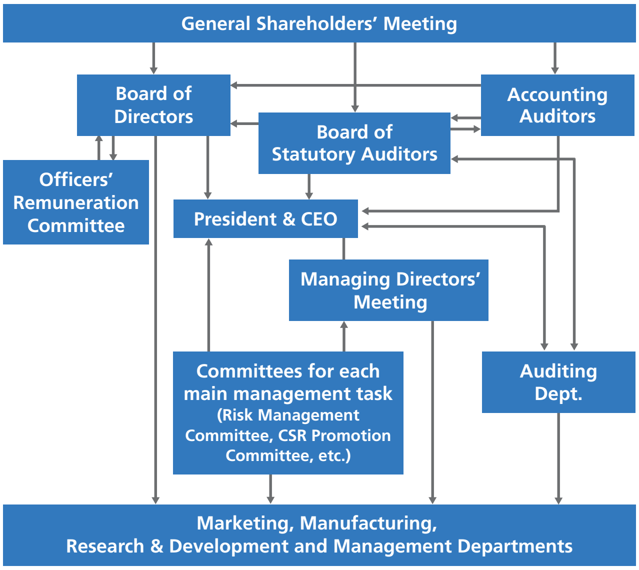
As a part of its thorough compliance management system for reaffirming company-wide awareness concerning compliance issues, all officers and employees of the Shin-Etsu Group have signed a written Compliance Pledge.

Moreover, we have set up a Compliance Consultation Office, which supports every staff member of the Shin-Etsu Group in conducting their business activities in strict compliance with laws, government regulations and in-company rules.

In consideration of the Act on the Protection of Personal Information, the Shin-Etsu Group has established and disclosed on the Shin-Etsu website a personal information protection policy and is working to ensure appropriate handling and thorough protection of personal information.

The Shin-Etsu Group is taking these practical approaches to promote compliance management.

Shin-Etsu's Corporate Governance Structure



Eleven-year Summary

SHIN-ETSU CHEMICAL CO., LTD. AND SUBSIDIARIES

For the years ended March 31, 1996 through 2006

(Millions of Yen, except per share)	2006	2005	2004	2003
For the Year:				
Net sales	**¥1,127,916**	¥ 967,486	¥ 832,805	¥ 797,523
Operating income	**185,320**	151,734	125,626	122,150
Net income	**115,045**	93,161	74,806	73,016
Per Share (Yen):				
Net income—primary	**266.63**	219.10	177.25	173.13
Net income—fully diluted	**266.07**	216.11	173.52	169.36
Cash dividends	**35.00**	20.00	16.00	14.00
Capital expenditures	**145,330**	110,278	113,591	75,211
Depreciation and amortization	**111,637**	90,875	73,582	66,566
At Year-End:				
Total assets	**¥1,671,281**	¥1,476,249	¥1,386,216	¥1,310,875
Working capital	**572,206**	444,935	401,879	409,262
Common stock	**119,420**	117,513	110,493	110,272
Stockholders' equity	**1,173,680**	996,307	900,724	846,962
Stockholders' equity per share (Yen)	**2,730.94**	2,329.47	2,140.23	2,014.11
General:				
Number of employees	**18,888**	18,151	17,384	16,573
Number of shares issued (Thousands)	**432,107**	430,119	422,798	422,568

(Thousands of U.S. Dollars, except per share)	2006	2005	2004	2003
For the Year:				
Net sales	**$ 9,640,308**	$ 8,269,111	$ 7,117,991	$ 6,816,436
Operating income	**1,583,932**	1,296,872	1,073,726	1,044,017
Net income	**983,291**	796,248	639,368	624,068
Per Share (Dollars):				
Net income—primary	**2.279**	1.873	1.515	1.480
Net income—fully diluted	**2.274**	1.847	1.483	1.448
Cash dividends	**0.299**	0.171	0.137	0.120
Capital expenditures	**1,242,137**	942,547	970,863	642,829
Depreciation and amortization	**954,162**	776,709	628,906	568,940
At Year-End:				
Total assets	**$14,284,453**	$12,617,513	$11,848,000	$11,204,060
Working capital	**4,890,649**	3,802,863	3,434,863	3,497,966
Common stock	**1,020,684**	1,004,385	944,385	942,496
Stockholders' equity	**10,031,453**	8,515,445	7,698,496	7,238,991
Stockholders' equity per share (Dollars)	**23.341**	19.910	18.293	17.215
General:				
Number of employees	**18,888**	18,151	17,384	16,573
Number of shares issued (Thousands)	**432,107**	430,119	422,798	422,568

Note: The U.S. dollar amounts represent conversion of yen, for convenience only, at the rate of ¥117=US$1, the approximate rate of exchange on March 31, 2006.

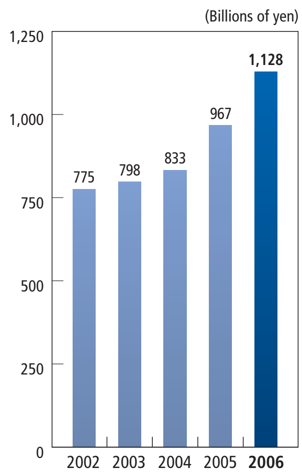
	2002	2001	2000	1999	1998	1997	1996
	¥ 775,097	¥ 807,485	¥ 678,859	¥ 642,796	¥ 693,275	¥ 624,405	¥575,176
	114,724	112,677	87,465	86,323	90,860	82,024	73,427
	68,519	64,505	48,229	43,363	42,027	40,614	37,825
	162.93	153.58	116.56	109.36	110.73	118.24	116.51
	159.38	150.24	113.46	103.17	101.69	103.95	106.66
	12.00	12.00	10.00	9.00	8.50	7.50	7.50
	81,543	96,770	80,003	73,641	136,384	92,844	66,791
	70,878	70,767	61,384	56,196	62,144	52,191	45,647
	¥1,288,432	¥1,265,799	¥1,168,729	¥1,060,973	¥1,083,780	¥ 931,159	¥708,637
	363,677	350,273	273,193	261,691	221,869	195,729	118,936
	110,260	110,247	107,664	98,243	83,957	44,256	36,440
	812,068	714,996	651,261	564,067	497,312	374,726	320,987
	1,930.30	1,699.74	1,557.48	1,380.43	1,265.39	1,071.97	988.59
	16,456	19,398	18,754	18,384	19,238	18,896	17,106
	422,555	422,542	419,848	410,015	393,722	349,569	324,691

	2002	2001	2000	1999	1998	1997	1996
	$ 6,624,761	$ 6,901,581	$5,802,214	$5,493,983	$5,925,427	$5,336,795	$4,916,034
	980,547	963,051	747,564	737,803	776,581	701,060	627,581
	585,632	551,325	412,214	370,624	359,205	347,128	323,291
	1.393	1.313	0.996	0.935	0.946	1.011	0.996
	1.362	1.284	0.970	0.882	0.869	0.888	0.912
	0.103	0.103	0.085	0.077	0.073	0.064	0.064
	696,949	827,094	683,786	629,410	1,165,675	793,538	570,863
	605,795	604,846	524,650	480,308	531,145	446,077	390,145
	$11,012,239	$10,818,795	$9,989,137	$9,068,145	$9,263,077	$7,958,624	$6,056,726
	3,108,350	2,993,786	2,334,983	2,236,675	1,896,316	1,672,897	1,016,547
	942,393	942,282	920,205	839,684	717,581	378,256	311,453
	6,940,752	6,111,077	5,566,333	4,821,085	4,250,530	3,202,786	2,743,479
	16.498	14.528	13.312	11.799	10.815	9.162	8.449
	16,456	19,398	18,754	18,384	19,238	18,896	17,106
	422,555	422,542	419,848	410,015	393,722	349,569	324,691

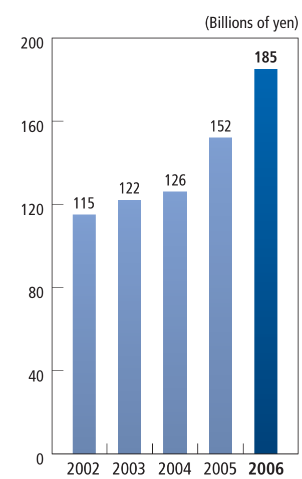
Management’s Discussion and Analysis

SHIN-ETSU CHEMICAL CO., LTD. AND SUBSIDIARIES

Net Sales



Operating Income



Overview of the Shin-Etsu Group

The Shin-Etsu Group (the “Group”) is composed of Shin-Etsu Chemical Co., Ltd. (the “Company”), 92 subsidiaries and 16 affiliates, as of March 31, 2006. The Group’s operations are divided into three business segments according to product type, sales markets 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, rare earth magnets and other products as well as providing a variety of other services, including construction and repair. The Company develops business activities in mutual cooperation with Group companies in the areas of manufacturing and sales.

Consolidated Operating Performance

During fiscal 2006, the Japanese economy followed a steady basic path of recovery. Along with improvement in corporate profits came such positive trends as increases in facility investment and consumer spending. On the other hand, while there were concerns regarding the impact of the steep rise in crude oil prices and the after-effects of the big autumn hurricanes, the U.S. economy continued along a steady growth path. In addition, the economies of Southeast Asia and China continued their growth trends.

Under these circumstances, the Group, by making the most of Group companies’ collective strength, expanded its positive sales efforts to a wide range of customers worldwide, and at the same time, strenuously worked on strengthening its production capacities as well as developing and commercializing new products.

As a result, the consolidated business results for fiscal 2006 show that net sales increased by 16.6% (¥160.4 billion) compared to the previous fiscal year, to ¥1,127.9 billion. Compared to the performance of the previous fiscal year, operating income increased 22.1% (¥33.6 billion) to ¥185.3 billion and net income increased 23.5% (¥21.9 billion) to ¥115.0 billion.

Factors increasing net sales and operating income included strong performance by the PVC business in the United States and steady sales in the semiconductor silicon business, centered on 300mm wafers. In the silicones business, an export price adjustment substantially improved sales and earnings. In addition, ongoing rationalization of production costs at each Shin-Etsu Group company contributed to increased sales and earnings.

Net non-operating expenses totaled ¥0.3 billion, as an improvement in interest expenses and an increase in equity in earnings of affiliates covered foreign exchange loss.

Operating performance by business segment is presented as follows.

Summary of Net Sales, Operating Costs and Income

(Millions of yen)

Years ended March 31,	**2006**	2005	2004	% Change **2006**/2005
Net Sales	**1,127,916**	967,486	832,805	16.6%
Cost of Sales	**831,334**	715,143	619,085	16.2%
SG&A Expenses	**111,262**	100,609	88,094	10.6%
Operating Income	**185,320**	151,734	125,626	22.1%

Organic and Inorganic Chemicals

The PVC business expanded substantially, due to the continued high level of shipments by Shintech Inc. (the Company's U.S. PVC base) in response to vigorous demand for housing construction as well as to the implementation of an upward price adjustment following the steep rise in raw materials costs. Furthermore, Shin-Etsu PVC B.V. in the Netherlands, supported by the demand throughout Europe, continued its strong sales performance. On the other hand, in the Company's domestic PVC business, although sales increased as efforts were made to maintain the price of PVC, operating income decreased due to a downturn in export prices from the latter half of fiscal 2006.

With regard to the silicone business, in addition to increased domestic sales, mainly in such application fields as automobiles and cosmetics, export earnings greatly improved with the implementation of a price revision. Moreover, sales of silicone-related products, such as keypads for mobile phones made by Shin-Etsu Polymer Co., Ltd., were also firm.

Sales of cellulose derivatives continued to be strong in the domestic market, mainly in such application areas as pharmaceuticals as well as automobile-related applications. In addition, SE Tylose GmbH & Co. KG in Germany did well in sales in product applications for building materials. JAPAN VAM & POVAL Co., Ltd., whose business results were incorporated into the Group's consolidated business statement as a subsidiary company from the end of fiscal 2005 (April 1, 2004 to March 31, 2005), also contributed to the good business results.

As a result, the net sales of this business segment increased 15.9% (¥87.5 billion) compared to the previous fiscal year to ¥636.5 billion. Operating income also increased 23.5% (¥18.3 billion) to ¥96.2 billion.

Electronics Materials

In the semiconductor silicon business, sales of 300mm silicon wafers greatly increased as a result of the expansion in demand for wafers from semiconductor device makers in such application fields as PCs, mobile phones and digital home appliances as well as the build-up of the Company's production capacity. In addition, 200mm wafers and specialty wafers such as SOI wafers also continued to do well. Accordingly, both net sales and operating income increased greatly.

To further strengthen its silicon wafer business, the Company has strengthened its capital relationship with Mimasu Semiconductor Industry Co., Ltd., which the Company has been commissioning to process its semiconductor silicon wafers, by obtaining a large percentage of shares in the company by underwriting a full third-party allocation of newly issued shares and additionally acquiring shares through a tender offer bid.

Sales of rare earth magnets for the electronics industry did well in their various hard disk drive applications, particularly in applications for PCs. Net sales and operating income both increased. Sales of photoresist products continued to be strong. In addition to applications of KrF resists, full-scale adoption of ArF resists for semiconductor devices started. Sales of organic materials for the electronics industry were also good.

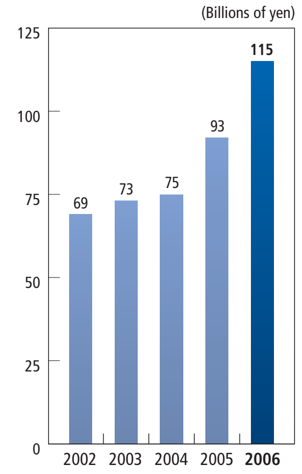
As a result, the net sales of this business segment increased 17.8% (¥54.5 billion) compared to the previous fiscal year, reaching ¥361.5 billion. Operating income increased 21.6% (¥11.6 billion) compared to the previous fiscal year to reach ¥65.3 billion.

Functional Materials and Others

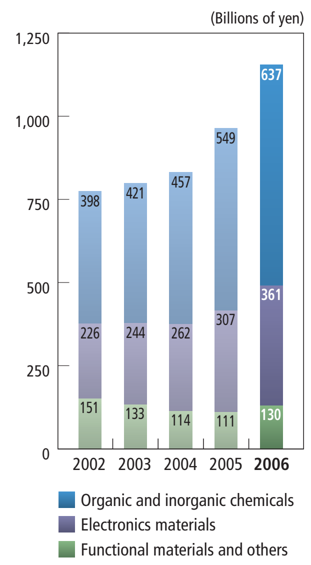
The synthetic quartz products business greatly increased for large-size photomask substrates used for LCDs, as LCD panel manufacturers are expanding their facilities.

Sales of rare earth magnets continued to be strong, mainly for applications in home appliances such as air conditioners and automobile-related products. In addition, sales of liquid fluoroelastomers also did well.

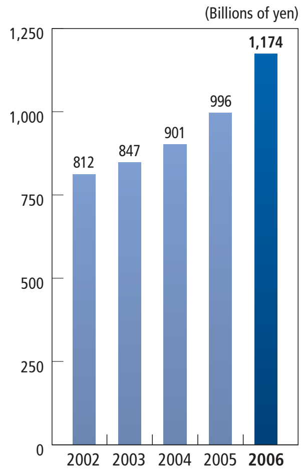
Net Income



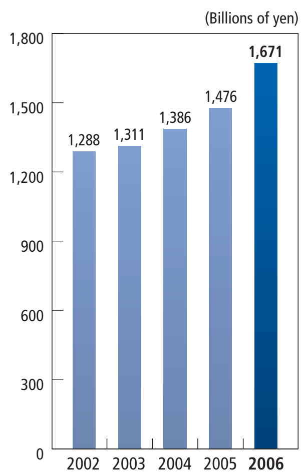
Net Sales by Business Segment



Stockholders' Equity



Total Assets



Other businesses, such as the design and construction of various kinds of plants, were bullish.

As a result, the net sales of this business segment increased 16.4% (¥18.4 billion) compared to the previous fiscal year to become ¥130.0 billion. Operating income increased 19.4% (¥3.9 billion) compared to the previous fiscal year to reach ¥24.0 billion.

Analysis of Financial Position

Assets, Liabilities and Stockholders' Equity

As of March 31, 2006, total assets increased ¥195.0 billion from a year earlier to ¥1,671.3 billion. Trade notes and accounts receivable increased ¥43.9 billion as a result of the increase in net sales. Securities increased ¥72.7 billion from a year earlier. Cash and time deposits increased ¥15.4 billion from a year earlier to ¥262.1 billion.

As of March 31, 2006, total liabilities increased ¥12.5 billion from a year earlier to ¥463.4 billion, due to factors such as an increase of ¥8.5 billion in trade notes and accounts payable in connection with the expanded scope of transactions.

In addition, retained earnings increased ¥102.2 billion from a year earlier. As a result, total stockholders' equity increased ¥177.4 billion to ¥1,173.7 billion. The stockholders' equity ratio increased 2.7 percentage points from a year earlier to 70.2%. Stockholders' equity per share increased ¥401.47 from a year earlier to ¥2,730.94.

Cash Flows

The balance of cash and cash equivalents at the end of fiscal 2006 increased ¥56.1 billion compared with the end of the previous fiscal year, to ¥373.9 billion.

Net cash provided by operating activities amounted to ¥220.6 billion due to increases in income before income taxes and depreciation and amortization compared with the end of the previous fiscal year. Net cash used for investing activities increased to ¥138.8 billion. This was mainly due to purchases of property, plant and equipment, including expansion of production facilities for 300mm silicon wafers for semiconductors, and payment for an additional acquisition of shares of Mimasu Semiconductor Industry Co., Ltd. Net cash used for financing activities amounted to ¥42.5 billion, due mainly to repayment of short term debt and payment of debentures on redemption.

Business Risks

The risks discussed hereinafter could potentially influence such key business matters as the Group's business operations results, financial status and cash flow.

The Group endeavors to reduce these risks by preventing, dispersing or hedging them. However, if any unforeseeable event occurs, there is a possibility it could have serious consequences for the Group's business operations results. As of the end of the current fiscal year, the types of risks listed below are those that the Group considers most significant. This list does not represent an attempt to discuss all possible risks that could impact on the Group.

1) Influence of Economic Trends and Product Markets

Trends in the economic situation of a country or in local areas where the Group's key products are marketed can have an impact on the results of the Group's business operations.

In addition, among the Group's key products, some products could be affected by large price fluctuations due to the global supply and demand environment. Although the Group is hedging its risks by such strategies as diversifying and globalizing its business, demand for certain of its products could decrease and price competition could escalate. Such a pattern of events can have huge consequences for the results of the Group's business operations.

2) Influence of Fluctuations in Foreign Exchange Rates

Overseas sales accounted for 66.7% of the total consolidated sales of the Group in fiscal 2006. It is expected that this ratio will remain at a high level. The yen conversion amount of such items included in the Group's consolidated financial statements related to the results of the Group's consolidated subsidiary companies are influenced by the exchange rate. In case of a large fluctuation in exchange rates, there is a possibility of a major impact on the business operations results of the whole Group. In addition, for transactions in foreign currencies, to reduce risks the Company is taking such measures as making forward-exchange contracts; however, a similar major impact might occur.

3) Influence of Natural Disasters, Unexpected Disasters or Unforeseen Accidents

To minimize the damage that could be caused by an interruption of production activities, the Group's production facilities implement such measures as conducting regular disaster prevention checks, carrying out a constant program of facility maintenance activities and making facility investment for safety enhancement. However, unexpected disasters, natural calamities or the effects of unforeseen accidents may cause damage to production facilities and other areas. Such circumstances could have a major impact on the Group's business operations results.

4) Influence of Public Regulatory Requirements and Law

In the countries or local areas where the Group is carrying out business activities, in addition to approvals and licensing requirements regarding investment and import/export regulations, various laws, particularly those concerning commercial transactions, labor, patents, taxes and exchange rates, apply to the Group's business activities. Any changes in these regulations or laws could have a major impact on the Group's business operations results.

5) Influence of Supply Factors on Procurement of Materials

The Group uses various raw materials in its production activities, and strives to assure steady procurement of these materials by diversifying raw material supply sources. However, in cases where tightening or delays of supplies in these materials occur, resulting in price increases, there is a possibility of a major impact on the Group's business operations results.

6) Influence on Development of New Products and Technologies

Development of new products and technologies in the electronics industry is very rapid, and this industry is an important market for some of the products of Group companies. Accordingly, the Company is continuously striving to develop the most advanced materials so it can meet customers' needs for speedy technological innovation. However, if the Group should be unable to accurately anticipate and take prompt appropriate measures to respond to changes in industries and markets, such a situation could have a major impact on the Group's business operations results.

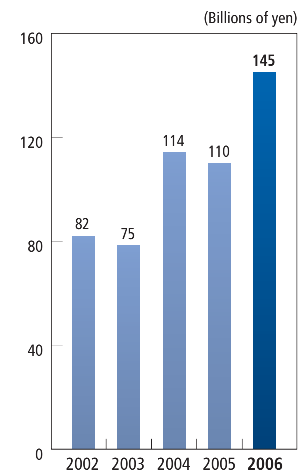
7) Influence of Environmental Problems

The Group handles various kinds of chemical substances, and strictly adheres to various laws and regulations concerning the environment. At the same time, the Group is dedicating its all-out efforts to achieve energy-savings to help contribute to the prevention of global warming, and it also is endeavoring to severely curb the emission of any substance that could have an impact on the environment. However, if regulations concerning the environment become more severe than presently anticipated and it becomes necessary to implement large facility investments, such investments could have a major impact on the Group's business operations results.

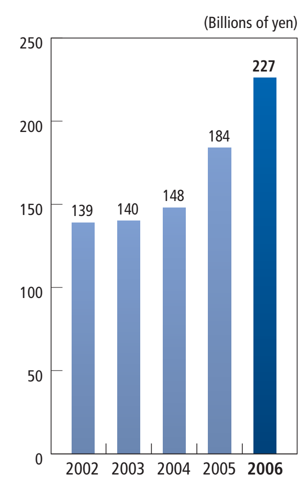
8) Influence of Product Liability

The Group is making enormous efforts to secure optimum product quality appropriate to the products' characteristics. However, in case a product-quality problem occurs due to unforeseen circumstances, there is a possibility of product-liability issues having a major impact on the Group's business operations results.

Capital Expenditures



Net Cash Flow*



* Net cash flow = Net income + Depreciation and amortization

Consolidated Balance Sheets

SHIN-ETSU CHEMICAL CO., LTD. AND SUBSIDIARIES

As of March 31, 2006 and 2005	Millions of yen		Thousands of U.S. dollars (Note 3)
Assets	**2006**	2005	**2006**
Current Assets:			
Cash and time deposits (Note 16)	**¥ 262,145**	¥ 246,741	**$ 2,240,556**
Securities (Notes 5 and 16)	**178,555**	105,839	**1,526,111**
Notes and accounts receivable:			
Trade	**272,173**	228,229	**2,326,264**
Unconsolidated subsidiaries and affiliates	**16,540**	15,298	**141,368**
Others	**5,778**	5,877	**49,385**
Less: Allowance for doubtful accounts (Note 2 (5))	**(5,233)**	(4,784)	**(44,726)**
	289,258	244,620	**2,472,291**
Inventories (Note 4)	**147,368**	135,225	**1,259,554**
Deferred taxes, current (Note 15)	**34,103**	27,761	**291,479**
Others	**13,667**	15,929	**116,812**
Total current assets	**925,096**	776,115	**7,906,803**
Property, Plant and Equipment (Note 2 (8)):			
Buildings and structures	**330,379**	313,065	**2,823,751**
Machinery and equipment	**1,056,500**	974,916	**9,029,915**
Less: Accumulated depreciation	**(1,009,857)**	(909,532)	**(8,631,256)**
	377,022	378,449	**3,222,410**
Land	**57,237**	48,663	**489,205**
Construction in progress	**34,524**	21,072	**295,077**
Total property, plant and equipment	**468,783**	448,184	**4,006,692**
Intangible Fixed Assets	**25,347**	28,637	**216,642**
Investments and Other Assets:			
Investments in and advances to unconsolidated subsidiaries and affiliates (Note 7)	**61,237**	33,635	**523,393**
Investments in securities (Note 5)	**157,283**	152,735	**1,344,299**
Long-term loans	**1,030**	931	**8,803**
Deferred taxes, non-current (Note 15)	**13,268**	14,842	**113,402**
Others	**19,262**	21,189	**164,633**
Less: Allowance for doubtful accounts (Note 2 (5))	**(25)**	(19)	**(214)**
Total investments and other assets	**252,055**	223,313	**2,154,316**
Total assets	**¥1,671,281**	¥ 1,476,249	**$14,284,453**

The accompanying notes are an integral part of the statements.

Liabilities and Stockholders' Equity	Millions of yen 2006	Millions of yen 2005	Thousands of U.S. dollars (Note 3) 2006
Current Liabilities:			
Short-term borrowings (Note 8)	**¥ 12,906**	¥ 30,439	**$ 110,308**
Current portion of long-term debt (Note 8)	**13,262**	13,078	**113,350**
Notes and accounts payable:			
Trade	**110,736**	102,257	**946,462**
Unconsolidated subsidiaries and affiliates	**24,397**	12,775	**208,521**
Others	**54,869**	53,182	**468,966**
	190,002	168,214	**1,623,949**
Accrued income taxes	**47,260**	35,974	**403,932**
Accrued expenses	**80,683**	80,855	**689,598**
Advances received	**1,039**	694	**8,880**
Others (Note 15)	**7,738**	1,926	**66,137**
Total current liabilities	**352,890**	331,180	**3,016,154**
Long-Term Liabilities:			
Long-term debt (Note 8)	**57,670**	76,905	**492,906**
Accrued retirement benefits (Note 9)	**10,398**	7,677	**88,872**
Deferred taxes, non-current (Note 15)	**40,735**	33,417	**348,162**
Lease obligations	**119**	147	**1,017**
Others	**1,570**	1,551	**13,419**
Commitment and Contingent Liabilities (Note 10)			
Total long-term liabilities	**110,492**	119,697	**944,376**
Minority Interests in Consolidated Subsidiaries	**34,219**	29,065	**292,470**
Stockholders' Equity:			
Common stock:	**119,420**	117,513	**1,020,684**
Authorized: 1,720,000,000 shares			
Issued: 432,106,693 shares and 430,118,735 shares as of			
March 31, 2006 and 2005, respectively			
Additional paid-in capital	**128,179**	126,274	**1,095,547**
Retained earnings (Note 11)	**882,413**	780,199	**7,541,991**
Unrealized gain on available-for-sale securities (Note 2 (7))	**38,599**	13,688	**329,906**
Foreign currency translation adjustment (Note 2 (4))	**11,369**	(30,275)	**97,171**
	1,179,980	1,007,399	**10,085,299**
Less: Treasury stock, at cost (Note 11)	**(6,300)**	(11,092)	**(53,846)**
Total stockholders' equity	**1,173,680**	996,307	**10,031,453**
Total liabilities and stockholders' equity	**¥1,671,281**	¥ 1,476,249	**$14,284,453**

Consolidated Statements of Income

SHIN-ETSU CHEMICAL CO., LTD. AND SUBSIDIARIES

For the years ended March 31, 2006, 2005, and 2004	Millions of yen 2006	2005	2004	Thousands of U.S. dollars (Note 3) 2006
Net Sales (Notes 14 and 17)	**¥1,127,916**	¥967,486	¥832,805	**$9,640,308**
Cost of Sales (Notes 9, 12 and 14)	**831,334**	715,143	619,085	**7,105,419**
Gross profit	**296,582**	252,343	213,720	**2,534,889**
Selling, General and Administrative Expenses (Notes 9 and 12)	**111,262**	100,609	88,094	**950,957**
Operating income (Note 17)	**185,320**	151,734	125,626	**1,583,932**
Other Income (Expenses):				
Interest and dividend income	**6,771**	4,627	3,797	**57,871**
Gain on early settlement of finance leases	**—**	—	2,055	**—**
Gains on sales of property, plant and equipment	**21**	12	535	**179**
Equity in earnings of affiliates	**3,996**	1,616	301	**34,154**
Interest expenses	**(2,706)**	(3,014)	(4,168)	**(23,128)**
Loss on disposal of property, plant and equipment	**(1,226)**	(3,297)	(2,837)	**(10,479)**
Foreign exchange gain (loss)	**(6,055)**	934	(742)	**(51,752)**
Other, net	**(1,081)**	(1,109)	1,050	**(9,239)**
Income before income taxes	**185,040**	151,503	125,617	**1,581,538**
Income Taxes (Note 15):				
Current	**82,639**	63,754	47,332	**706,316**
Deferred	**(16,714)**	(8,535)	1,069	**(142,855)**
	65,925	55,219	48,401	**563,461**
Income after income taxes	**119,115**	96,284	77,216	**1,018,077**
Minority Interests in Earnings of Consolidated Subsidiaries	**(4,070)**	(3,123)	(2,410)	**(34,786)**
Net Income	**¥ 115,045**	¥ 93,161	¥ 74,806	**$ 983,291**
	Yen			U.S. dollars (Note 3)
Per Share (Note 2 (14)):				
Net income—primary	**¥266.63**	¥219.10	¥177.25	**$2.279**
Net income—fully diluted	**266.07**	216.11	173.52	**2.274**
Cash dividends	**35.00**	20.00	16.00	**0.299**
Weighted-Average Number of Shares Outstanding (Thousands)	**429,587**	423,519	420,484	**429,587**

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, 2006, 2005 and 2004	Millions of yen 2006	2005	2004	Thousands of U.S. dollars (Note 3) 2006
Common Stock				
Balance at beginning of year	**¥117,513**	¥110,493	¥110,272	**$1,004,385**
Conversion of convertible debentures	**1,907**	7,020	221	**16,299**
Balance at end of year	**119,420**	117,513	110,493	**1,020,684**
Additional Paid-in Capital				
Balance at beginning of year	**126,274**	119,262	119,041	**1,079,265**
Conversion of convertible debentures	**1,905**	7,012	221	**16,282**
Balance at end of year	**128,179**	126,274	119,262	**1,095,547**
Retained Earnings				
Balance at beginning of year	**780,199**	694,997	626,142	**6,668,368**
Net income	**115,045**	93,161	74,806	**983,291**
Effect of increase in consolidated subsidiaries	**9**	—	574	**77**
Cash dividends (Note 11)	**(11,793)**	(7,600)	(6,307)	**(100,795)**
Directors' and statutory auditors' bonuses	**(352)**	(316)	(189)	**(3,009)**
Loss on disposal of treasury stocks	**(109)**	(43)	(29)	**(932)**
Effect of change of accounting standard at an overseas consolidated subsidiary	**(586)**	—	—	**(5,009)**
Balance at end of year	**882,413**	780,199	694,997	**7,541,991**
Unrealized Gain (Loss) on Available-for-Sale Securities				
Balance at beginning of year	**13,688**	11,928	(1,482)	**116,991**
Balance at end of year	**38,599**	13,688	11,928	**329,906**
Foreign Currency Translation Adjustment				
Balance at beginning of year	**(30,275)**	(26,737)	2,626	**(258,761)**
Balance at end of year	**11,369**	(30,275)	(26,737)	**97,171**
Treasury Stock, at Cost				
Balance at beginning of year	**(11,092)**	(9,219)	(9,637)	**(94,803)**
Net change during the year	**4,792**	(1,873)	418	**40,957**
Balance at end of year	**(6,300)**	(11,092)	(9,219)	**(53,846)**

Number of Shares of Common Stock Issued

	Thousands of shares 2006	2005	2004
Balance at beginning of year	**430,119**	422,798	422,568
Conversion of convertible debentures	**1,988**	7,321	230
Balance at end of year	**432,107**	430,119	422,798

The accompanying notes are an integral part of the statements.

Consolidated Statements of Cash Flows

SHIN-ETSU CHEMICAL CO., LTD. AND SUBSIDIARIES

For the years ended March 31, 2006, 2005 and 2004	Millions of yen 2006	2005	2004	Thousands of U.S. dollars (Note 3) 2006
Cash Flows from Operating Activities:				
Income before income taxes	**¥ 185,040**	¥ 151,503	¥ 125,617	**$ 1,581,538**
Adjustments to reconcile income before income taxes to net cash provided by operating activities:				
Depreciation and amortization	**111,637**	90,875	73,582	**954,162**
Increase (decrease) in accrued retirement benefits	**1,948**	1,385	(1,360)	**16,650**
Loss on write-down of investment securities	**119**	41	668	**1,017**
Interest and dividend income	**(6,771)**	(4,627)	(3,797)	**(57,871)**
Interest expenses	**2,706**	3,014	4,168	**23,128**
Exchange gain	**(27)**	(14)	(188)	**(231)**
Equity in earnings of affiliates	**(3,996)**	(1,616)	(301)	**(34,154)**
Changes in assets and liabilities:				
Increase in notes and accounts receivable	**(30,505)**	(11,647)	(23,631)	**(260,726)**
(Increase) decrease in inventories	**(7,798)**	(16,706)	4,237	**(66,649)**
Increase in notes and accounts payable	**21,672**	7,688	4,804	**185,231**
Other, net	**14,364**	13,384	3,301	**122,768**
Subtotal	**288,389**	233,280	187,100	**2,464,863**
Proceeds from interest and dividends	**6,613**	4,773	4,225	**56,521**
Payment of interest	**(2,809)**	(3,099)	(4,075)	**(24,008)**
Payment of income taxes	**(71,600)**	(57,577)	(31,246)	**(611,966)**
Net cash provided by operating activities	**220,593**	177,377	156,004	**1,885,410**
Cash Flows from Investing Activities:				
Net (increase) decrease in marketable securities	**(5,151)**	4,262	4,975	**(44,026)**
Purchases of property, plant and equipment	**(126,661)**	(95,501)	(68,578)	**(1,082,572)**
Proceeds from sales of property, plant and equipment	**1,351**	726	1,226	**11,547**
Purchases of intangible fixed assets	**(1,046)**	(1,270)	(2,594)	**(8,940)**
Purchases of investment securities	**(52,708)**	(45,291)	(66,721)	**(450,496)**
Proceeds from sales and redemption of investment securities	**47,070**	44,350	33,005	**402,308**
Payment for purchases of newly consolidated subsidiaries' shares and acquisition of business	**—**	(5,705)	(30,213)	**—**
Proceeds from sales of consolidated subsidiaries' shares	**—**	385	—	**—**
Payments of loans	**(32)**	(384)	(6,833)	**(274)**
Proceeds from collection of loans	**3,187**	2,100	480	**27,239**
Increase in long-term time deposits	**—**	(10,000)	—	**—**
Other, net	**(4,823)**	(2,428)	6,216	**(41,222)**
Net cash used for investing activities	**(138,813)**	(108,756)	(129,037)	**(1,186,436)**
Cash Flows from Financing Activities:				
Net decrease in short-term debt	**(17,718)**	(18,873)	(18,028)	**(151,436)**
Proceeds from long-term debt	**5,738**	2,426	20,645	**49,043**
Repayment of long-term debt	**(9,393)**	(13,133)	(12,105)	**(80,282)**
Proceeds from issuance of debentures	**—**	8,000	10,000	**—**
Payment of debentures on redemption	**(13,209)**	(10,165)	(5,000)	**(112,897)**
Payments for early settlement of finance leases	**—**	—	(15,589)	**—**
Cash dividends paid	**(11,793)**	(7,600)	(6,307)	**(100,795)**
Other, net	**3,878**	(2,566)	(311)	**33,145**
Net cash used for financing activities	**(42,497)**	(41,911)	(26,695)	**(363,222)**
Effect of Exchange Rate Changes on Cash and Cash Equivalents	**16,608**	(1,955)	(10,008)	**141,949**
Net Increase (Decrease) in Cash and Cash Equivalents	**55,891**	24,755	(9,736)	**477,701**
Cash and Cash Equivalents at Beginning of Year	**317,733**	292,978	302,370	**2,715,667**
Net Increase in Cash and Cash Equivalents by Change of Consolidation Scope	**240**	—	344	**2,051**
Cash and Cash Equivalents at End of Year (Note 16)	**¥ 373,864**	¥ 317,733	¥ 292,978	**$ 3,195,419**

The accompanying notes are an integral part of the statements.

Notes to Consolidated Financial Statements

SHIN-ETSU CHEMICAL CO., LTD. AND SUBSIDIARIES
For the years ended March 31, 2006, 2005 and 2004

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 prevailing in Japan. The accounts of overseas consolidated subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles 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 followed by the Company.

The accompanying consolidated financial statements of the Company and its subsidiaries are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company, as required by the Securities and Exchange Law of 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.

2. Summary of significant accounting policies

(1) Principles of consolidation

The Company had 92 majority-owned subsidiaries as of March 31, 2006 (90 as of March 31, 2005 and 2004). The consolidated financial statements include the accounts of the Company and 68 (67 for 2005 and 2004) majority-owned subsidiaries (the Companies), of which the principal firms are listed on page 45 with their respective fiscal year-ends.

The remaining 24 (23 for 2005 and 2004) 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 that of the Company, necessary adjustments are made on significant inter-company 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 minority interests is charged to the minority interests.

Elimination of cost of investments in consolidated subsidiaries with underlying equity in the 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 within 20 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 24 (23 for 2005 and 2004) unconsolidated subsidiaries (majority-owned) and 16 (15 for 2005 and 2004) affiliates (meaning 20% to 50% ownership of a company's equity interest). The equity method is applied to the investments in 7 major affiliates and the cost method is applied to investments in the remaining unconsolidated subsidiaries and affiliates since they are not material for the consolidated financial statements.

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

Mimasu Semiconductor Industry Co., Ltd.
Shin-Etsu Quartz Products Co., Ltd.
Kashima Vinyl Chloride Monomer Co., Ltd.

(3) Translation of foreign currency transactions

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 translation adjustment" in the accompanying balance sheets as of March 31, 2006 and 2005.

(5) Allowance for doubtful accounts

The Company and consolidated subsidiaries provide an 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 are valued principally at cost determined by the average-cost method.

(7) Financial instruments

Securities:

Bonds held to maturity are stated at amortized cost using the straight-line 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 stockholders' equity at net-of-tax amounts. Other securities for which market quotations are unavailable are stated at cost, which is determined by the moving-average cost method.

Derivatives:

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 the 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 by the declining-balance method, based on the estimated useful lives of assets. 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.

On August 9, 2002, the Business Accounting Council of Japan issued new accounting standards entitled "Statement of Opinion on the Establishment of Accounting Standards for impairment of Fixed Assets." Further, on October 31, 2003, the Accounting Standards Boards of Japan issued Financial Accounting Standards Implementation Guidance No. 6 "Application Guidance on Accounting Standards for impairment on Fixed Assets." These new standards have been adopted from the current fiscal year.

As a result of adopting these new accounting standards, "Other, net" in "Other Expenses" for the current fiscal year increased by ¥365 million ($3,120 thousand), and "Income before income taxes" decreased by the same amount.

Accumulated impairment losses are directly credited from the related assets under the new rules of The Presentation of Consolidated Financial Statements.

In the prior fiscal years, the period of depreciation for semiconductor silicon manufacturing facilities at overseas consolidated subsidiaries was ten years, and the period of depreciation was seven years for manufacturing facilities of single crystal silicon among the semiconductor silicon facilities at domestic consolidated subsidiaries. However, in view of the recent rapid changes in the business environment in this field, which have caused the obsolescence of some facilities/equipment in our plants, from the current fiscal year the periods of depreciation have been changed from ten and seven to five years. Consequently, the depreciation expense for the current fiscal year, when compared with the figures calculated for the previous depreciable years, increased by ¥9,957 million ($85,103 thousand), and operating income, ordinary income and net income before income taxes each decreased by ¥9,505 million ($81,239 thousand).

(9) Repairs and maintenance

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

(10) 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.

However, all leases, whether transfer of ownership or not, relating to the overseas consolidated subsidiaries are recognized as sales/purchases of assets on installment payments.

(11) 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 fiscal year. The actuarial difference is amortized over a five-year period, which is within the average remaining service period, using the straight-line method from the fiscal year when the difference was generated. The prior service cost is amortized over a ten-year period, which is within the average remaining service period, using the straight-line method from the time when the difference was generated (see Note 9).

(12) 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.

(13) Research and development costs

Research and development costs are charged to income as incurred.

(14) 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 conversation of all convertible debentures of the Company outstanding with related reduction in interest expenses.

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

From the year ended March 31, 2003, the Company and its subsidiaries adopted the new Japanese accounting standard "Accounting Standard for Earnings per Share" and "Implementation Guidance for application of Accounting Standard for Earnings per Share," which are effective for periods beginning on or after April 1, 2002. However, the effect of adopting the new standard was not material.

(15) 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 11).

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

(16) 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.

(17) 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 on expenses, is not included in the related amounts in the accompanying consolidated statements of income, either.

(18) Reclassifications

Certain reclassifications have been made in the 2005 and 2004 financial statements to conform to the presentation for 2006.

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 ¥117 to US$1, the approximate effective rate of exchange on March 31, 2006. 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, realized or settled in dollars at ¥117 to US$1 or at any other rate.

4. Inventories

Inventories as of March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Merchandise	**¥ 12,134**	¥ 10,682	**$ 103,709**
Finished products	**59,633**	57,323	**509,684**
Semifinished products	**22,131**	18,649	**189,154**
Raw materials	**39,484**	30,903	**337,470**
Supplies	**10,762**	12,567	**91,983**
Others	**3,224**	5,101	**27,554**
Total	**¥147,368**	¥135,225	**$1,259,554**

5. Securities

Securities as of March 31, 2006 consisted of the following:

(1) Market value of bonds held to maturity

	Millions of yen		
Description	Book value	Market value	Difference
Securities with fair value that exceeds book value	**¥23,507**	**¥23,515**	**¥ 8**
Securities with fair value that does not exceed book value	**39,356**	**39,132**	**(224)**
Total	**¥62,863**	**¥62,647**	**¥(216)**

	Thousands of U.S. dollars		
Description	Book value	Market value	Difference
Securities with fair value that exceeds book value	**$200,915**	**$200,983**	**$ 68**
Securities with fair value that does not exceed book value	**336,376**	**334,461**	**(1,915)**
Total	**$537,291**	**$535,444**	**$(1,847)**

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

	Millions of yen		
Description	Acquisition cost	Book value	Unrealized gain (loss)
Securities with book value that exceeds acquisition cost:			
Stocks	**¥29,345**	**¥93,904**	**¥64,559**
Subtotal	**¥29,345**	**¥93,904**	**¥64,559**
Securities with book value that does not exceed acquisition cost:			
Stocks	**¥ 248**	**¥ 236**	**¥ (12)**
Subtotal	**¥ 248**	**¥ 236**	**¥ (12)**
Total	**¥29,593**	**¥94,140**	**¥64,547**

	Thousands of U.S. dollars		
Description	Acquisition cost	Book value	Unrealized gain (loss)
Securities with book value that exceeds acquisition cost:			
Stocks	**$250,812**	**$802,598**	**$551,786**
Subtotal	**$250,812**	**$802,598**	**$551,786**
Securities with book value that does not exceed acquisition cost:			
Stocks	**$ 2,120**	**$ 2,017**	**$ (103)**
Subtotal	**$ 2,120**	**$ 2,017**	**$ (103)**
Total	**$252,932**	**$804,615**	**$551,683**

(3) Available-for-sale securities sold during the fiscal year ended March 31, 2006

Available-for-sale securities sold during the fiscal year ended March 31, 2006 are assumed insignificant.

(4) Bonds held to maturity sold in the fiscal year ended March 31, 2006

	Millions of yen		
	Cost of sales	Sales amount	Realized gain (loss)
Non-listed overseas bonds	**¥12,476**	**¥12,476**	**¥ —**

	Thousands of U.S. dollars		
	Cost of sales	Sales amount	Realized gain (loss)
Non-listed overseas bonds	**$106,632**	**$106,632**	**$ —**

Note: One consolidated subsidiary sold bonds after reviewing its surplus fund investment strategy.

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

	Book value	
	Millions of yen	Thousands of U.S. dollars
Bonds held to maturity	**¥ 31,574**	**$ 269,863**
Investments in unconsolidated subsidiaries and affiliates	**58,944**	**503,795**
Available-for-sale securities	**147,261**	**1,258,641**

(6) 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	**¥178,499**	**$1,525,632**
Over one year within five years	**59,636**	**509,709**
Over five years within ten years	**604**	**5,162**

6. Derivative transactions

Derivative financial instruments were as follows:

As of March 31, 2006

Currency related:

	Millions of yen		
Description	Contract amounts	Market value	Unrealized gain (loss)
Foreign exchange contracts			
Sales Contracts:			
US$	**¥135,097**	**¥139,806**	**¥(4,709)**
EUR	**1,738**	**1,759**	**(21)**
Buys Contracts:			
US$	**2,720**	**2,672**	**(48)**
Foreign currency option contracts			
Buys Contracts:			
US$	**216**	**8**	**8**
Foreign currency swap contracts			
Received Japanese Yen, pay Thai Baht	**3,709**	**(186)**	**(186)**
Received Japanese Yen, pay U.S. Dollars	**780**	**(44)**	**(44)**
Total	**¥ —**	**¥ —**	**¥(5,000)**

	Thousands of U.S. dollars		
Description	Contract amounts	Market value	Unrealized gain (loss)
Foreign exchange contracts			
Sales Contracts:			
US$	**$1,154,675**	**$1,194,923**	**$(40,248)**
EUR	**14,855**	**15,034**	**(179)**
Buys Contracts:			
US$	**23,248**	**22,838**	**(410)**
Foreign currency option contracts			
Buys Contracts:			
US$	**1,846**	**68**	**68**
Foreign currency swap contracts			
Received Japanese Yen, pay Thai Baht	**31,701**	**(1,590)**	**(1,590)**
Received Japanese Yen, pay U.S. Dollars	**6,667**	**(376)**	**(376)**
Total	**$ —**	**$ —**	**$(42,735)**

Notes: 1. Market rate represents the foreign exchange rate prevailing as of March 31, 2006.
2. The market value is provided by financial institutions with which we made the currency swap contracts.
3. Any derivative transactions to which hedge accounting is applied are excluded from the above table.

Interest related:

	Millions of yen		
Description	Contract amounts	Market value	Unrealized gain (loss)
Interest swap contracts:			
Receive floating, pay fixed	**¥11,856**	**¥(26)**	**¥(26)**
Receive fixed, pay floating	**10,224**	**12**	**12**
Total	**¥22,080**	**¥(14)**	**¥(14)**

Description	Thousands of U.S. Dollars		
	Contract amounts	Market value	Unrealized gain (loss)
Interest swap contracts:			
Receive floating, pay fixed	**$101,333**	**$(222)**	**$(222)**
Receive fixed, pay floating	**87,385**	**103**	**103**
Total	**$188,718**	**$(119)**	**$(119)**

Notes: 1. The market value is provided by financial institutions with which we made the interest swap contracts.
2. Any derivative transactions to which hedge accounting is applied are excluded from the above table.

As of March 31, 2005

Currency related:

Description	Millions of yen		
	Contract amounts	Market value	Unrealized gain (loss)
Foreign exchange contracts			
Sales Contracts:			
US$	¥92,714	¥91,516	¥1,198
EUR	1,201	1,209	(8)
Buys Contracts:			
US$	1,034	1,025	(9)
EUR	159	165	6
Foreign currency swaps			
Received Japanese Yen, pay Thai Baht	3,709	88	88
Received Japanese Yen, pay U.S. Dollars	316	26	26
Total	¥ —	¥ —	¥1,301

Notes: 1. Market rate represents the forward foreign exchange rate prevailing as of March 31, 2005.
2. The market value is provided by financial institutions with which we made the currency swap contracts.
3. Any derivative transactions to which hedge accounting is applied are excluded from the above table.

Interest related:

Description	Millions of yen		
	Contract amounts	Market value	Unrealized gain (loss)
Interest swap contracts:			
Receive floating, pay fixed	¥11,856	¥(95)	¥(95)
Receive fixed, pay floating	10,316	45	45
Total	¥22,172	¥(50)	¥(50)

Notes: 1. The market value is provided by financial institutions with which we made the interest swap contracts.
2. Any derivative transactions to which hedge accounting is applied are excluded from the above table.

7. Investments in and advances to unconsolidated subsidiaries and affiliates

Investments in and advances to unconsolidated subsidiaries and affiliates as of March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Held Directly by the Company:			
Affiliates:			
Four affiliates for 2006 and three affiliates for 2005 accounted for by the equity method (See Note 2 (2))*	**¥40,453**	¥13,780	**$345,752**
Kashima Denkai Co., Ltd.	**805**	805	**6,880**
Others	**228**	228	**1,949**
	41,486	14,813	**354,581**
Unconsolidated subsidiaries:			
Shin-Etsu Electronics Malaysia Sdn. Bhd.	**1,400**	1,400	**11,966**
Shin-Etsu Magnetics Philippines, Inc.	**184**	184	**1,573**
Zhejiang Shin-Etsu High-Tech Chemical Co., Ltd.	**332**	332	**2,838**
Others	**175**	175	**1,495**
	2,091	2,091	**17,872**
Held Indirectly through Subsidiaries:			
Unconsolidated subsidiaries and affiliates:			
Three affiliates accounted for by the equity method (See Note 2 (2))*	**¥13,048**	¥ 9,689	**$111,521**
Others	**2,720**	2,040	**23,248**
	¥15,768	¥11,729	**$134,769**
Advances:	**1,892**	5,002	**16,171**
	¥61,237	¥33,635	**$523,393**

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

8. Short-term borrowings and long-term debt

Short-term borrowings outstanding as of March 31, 2006 and 2005 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, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Loans with Banks and Other Financial Institutions:			
Secured	**¥ 9,479**	¥ 4,106	**$ 81,017**
Unsecured	**45,453**	52,977	**388,487**
Unsecured Debentures:			
4.2% debentures issued by a consolidated subsidiary, due July 2005	**—**	2,084	**—**
2.6% debentures issued by a consolidated subsidiary, due December 2007	**3,000**	3,000	**25,641**
0.7% debentures issued by a consolidated subsidiary, due June 2007 (Note)	**—**	6,000	**—**
0.7% debentures issued by a consolidated subsidiary, due August 2009	**5,000**	5,000	**42,735**
0.4% debentures issued by a consolidated subsidiary, due July 2006 (Note)	**—**	5,000	**—**
0.4% debentures issued by a consolidated subsidiary, due February 2007	**8,000**	8,000	**68,376**
Unsecured Convertible Debentures:			
0.4% convertible debentures, due September 2005	**—**	3,816	**—**
	70,932	89,983	**606,256**
Less Portion Due within One Year	**(13,262)**	(13,078)	**(113,350)**
	¥ 57,670	¥ 76,905	**$ 492,906**

Note: These debentures are made off-balance sheet by debt assumption.

As of March 31, 2006, 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	**¥63,611**	**$543,684**

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

	Millions of yen	Thousands of U.S. dollars
Years ending March 31,		
2007	**¥13,262**	**$113,350**
2008	**27,049**	**231,188**
2009	**15,005**	**128,248**
2010	**7,062**	**60,359**
2011	**233**	**1,991**
2012 and thereafter	**8,321**	**71,120**
	¥70,932	**$606,256**

9. Retirement and pension plans

The Company and its domestic consolidated subsidiaries have defined contribution pension plans (DC pension plans), tax-qualified pension plans and lump-sum severance payment plans as their defined benefit pension plans.

Certain overseas consolidated subsidiaries have defined pension plans while others have defined contribution pension plans.

Additionally, the Company has a "Retirement Benefit Trust."

In October 2004, some domestic consolidated subsidiaries terminated the tax-qualified pension plan, and transferred to defined contribution pension plans and lump-sum severance payment plans.

The reserves for retirement benefits as of March 31, 2006 and 2005 are analyzed as follows:

Benefit Obligations

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
(a) Benefit obligations	**¥(30,131)**	¥(18,091)	**$(257,530)**
(b) Pension assets	**22,751**	12,463	**194,453**
(c) Unfunded benefit obligations [(a)+(b)]	**(7,380)**	(5,628)	**(63,077)**
(d) Unrecognized actuarial differences	**(581)**	(233)	**(4,966)**
(e) Unrecognized prior service cost (negative) (Note 1)	**(743)**	(696)	**(6,350)**
(f) Amount shown on balance sheet [(c)+(d)+(e)]	**(8,704)**	(6,557)	**(74,393)**
(g) Prepaid pension expenses	**1,694**	1,120	**14,479**
(h) Accrued retirement benefits [(f)-(g)]	**¥(10,398)**	¥ (7,677)	**$ (88,872)**

Notes: 1. The Company and certain consolidated subsidiaries changed system from tax-qualified pension plans to defined contribution pension plans before prior fiscal year, so that prior service cost is generated.
2. Some subsidiaries adopt a simplified method for the calculation of benefit obligations.

Retirement Benefit Costs

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
(a) Service costs (Note 1)	**¥2,511**	¥2,236	**$21,462**
(b) Interest costs	**1,004**	470	**8,581**
(c) Expected return on plan assets	**(777)**	(294)	**(6,641)**
(d) Recognized actuarial loss	**(778)**	(43)	**(6,650)**
(e) Amortization of prior service cost	**(151)**	(51)	**(1,291)**
(f) Other (Note 2)	**1,580**	1,536	**13,505**
(g) Retirement benefit costs [(a)+(b)+(c)+(d)+(e)+(f)]	**¥3,389**	¥3,854	**$28,966**
(h) (Gain) loss on transfer to DC pension plans	**—**	(82)	**—**
(i) Total [(g)+(h)]	**¥3,389**	¥3,772	**$28,966**

Notes: 1. Retirement benefit costs for subsidiaries adopting a simplified method are reported in "Service costs."
2. "Other" is contributions for defined contribution pension plans.

Basic Assumptions for Calculating Benefit Obligations

(a) Period allocation method for estimating retirement benefit	Benefit/years of service approach
(b) Discount rate	Principally 2.5%
(c) Expected rate of return on plan assets	Principally 2.5%
(d) Amortization of prior service cost	Principally 10 years
(e) Amortization of actuarial differences	Principally 5 years

10. Commitment and contingent liabilities

As of March 31, 2006, 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 ¥280 million ($2,393 thousand) and had contingent liabilities arising from notes discounted by banks in the amounts of ¥152 million ($1,299 thousand).

In addition, one of the Companies was contingently liable, as of March 31, 2006, in accordance with a contract of debt assumption with a bank for debentures issued by itself in the amounts of ¥11,000 million ($94,017 thousand)

11. Retained earnings

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, 2006, 2005 and 2004 in the amounts of ¥7,517 million ($64,248 thousand) (¥17.5 per share), ¥4,234 million and ¥3,364 million, respectively, which were actually paid to stockholders on November 18, 2005, November 18, 2004 and November 18, 2003, respectively. In the accompanying consolidated statements of stockholders' equity, these dividend payments are reflected in the years ended March 31, 2006, 2005 and 2004, respectively.

There were 1,465,968 shares and 2,578,655 shares of treasury stock as at March 31, 2006 and 2005, respectively.

12. Research and development costs

Research and development costs incurred and charged to income for the years ended March 31, 2006, 2005 and 2004 were ¥32,003 million ($273,530 thousand), ¥27,925 million and ¥26,329 million, respectively.

13. Lease transactions

Lease rental expenses on finance lease contracts without ownership-transfer charged to income for the years ended March 31, 2006 and 2005 amounted to ¥373 million ($3,188 thousand) and ¥427 million, respectively. Lease expenses corresponding to depreciation expenses, not charged to income, for the year ended March 31, 2006, 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 ¥373 million ($3,188 thousand).

Pro forma information regarding leased property such as acquisition cost and accumulated depreciation is as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Acquisition cost	**¥1,905**	¥1,851	**$16,282**
Accumulated depreciation	**1,209**	1,218	**10,333**
Net book value	**¥ 696**	¥ 633	**$ 5,949**

The amount of outstanding future lease payments due in respect of finance lease contracts at March 31, 2006 and 2005, which included the portion of interest thereon, is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Future Lease Payments:			
Within one year	**¥309**	¥348	**$2,641**
Over one year	**387**	285	**3,308**
	¥696	¥633	**$5,949**

The amount of outstanding future lease payments due in respect of operating lease contracts at March 31, 2006 and 2005 was summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Future Lease Payments:			
Within one year	**¥4,436**	¥ 6,480	**$37,914**
Over one year	**3,912**	6,507	**33,436**
	¥8,348	¥12,987	**$71,350**

14. Related party transactions

The Company's sales to and purchases from its unconsolidated subsidiaries and affiliates for the years ended March 31, 2006, 2005 and 2004 are summarized as follows:

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Sales	**¥ 9,363**	¥16,224	¥21,060	**$ 80,026**
Purchases	**86,659**	64,110	60,628	**740,675**

15. Income taxes

Income taxes in Japan applicable to the Company and its domestic subsidiaries for the years ended March 31, 2006, 2005 and 2004 consisted of corporate income tax (national), enterprise tax (local) and resident income taxes (local) at the approximate rates indicated below:

	2006	2005	2004
Corporate income tax	**30.0%**	30.0%	30.0%
Enterprise tax	**7.2**	7.2	9.6
Resident income taxes	**6.1**	6.1	6.1
	43.3%	43.3%	45.7%
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)	**40.4%**	40.4%	41.7%

Tax effects of material temporary differences and loss carryforwards which resulted in deferred tax assets or liabilities at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Deferred Tax Assets:			
Depreciation	**¥15,881**	¥11,783	**$135,735**
Unsettled accounts receivable and payable	**6,944**	6,263	**59,350**
Maintenance cost	**5,140**	2,891	**43,932**
Unrealized profit	**4,632**	4,317	**39,590**
Accrued bonus allowance	**3,944**	3,755	**33,709**
Special provision for accrued retirement benefits	**3,614**	3,080	**30,889**
Accrued enterprise taxes	**3,248**	2,181	**27,761**
Tax loss carryforwards	**1,668**	1,235	**14,256**
Others	**21,294**	17,855	**182,000**
Valuation allowance	**(4,339)**	(4,278)	**(37,085)**
Total	**¥62,026**	¥49,082	**$530,137**
Deferred Tax Liabilities:			
Unrealized gain on available-for-sale securities	**¥25,939**	¥ 9,177	**$221,701**
Depreciation	**24,249**	25,770	**207,256**
Reserve for special depreciation	**2,245**	2,465	**19,188**
Others	**2,966**	2,484	**25,351**
Total	**¥55,399**	¥39,896	**$473,496**
Net deferred tax assets	**¥ 6,627**	¥ 9,186	**$ 56,641**

Net Deferred Tax Assets are included in the following accounts:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Current assets: Deferred tax assets	**¥ 34,103**	¥ 27,761	**$ 291,479**
Non-current assets: Deferred tax assets	**13,268**	14,842	**113,402**
Current liabilities: Others	**(9)**	—	**(78)**
Non-current liabilities: Deferred tax liabilities	**(40,735)**	(33,417)	**(348,162)**

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

	2006	2005
Statutory tax rate	**40.4%**	40.4%
Rate difference from foreign subsidiaries	**(3.4)**	(2.3)
Tax deduction for research expenses	**(0.9)**	(1.0)
Dividend income and other not taxable	**(0.5)**	(0.5)
Entertainment and other non-deductible expenses	**0.2**	0.2
Other, net	**(0.2)**	(0.4)
Effective tax rate	**35.6**	36.4

16. Supplemental cash flow information

(1) Cash and cash equivalents on the 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 that mature within approximately three months from the acquisition date and have insignificant risk exposure in terms of fluctuation on value of the investments.

Reconciliation between cash and equivalents and the related accounts shown in the consolidated balance sheets as of March 31, 2006, 2005, and 2004 are presented below:

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Cash and time deposits	**¥262,145**	¥246,741	¥210,323	**$2,240,556**
Marketable securities	**178,555**	105,839	131,216	**1,526,111**
Time deposits for which maturities are approximately over three months	**(8,928)**	(2,205)	(717)	**(76,308)**
Marketable securities (maturities approximately over three months)	**(57,908)**	(32,642)	(47,844)	**(494,940)**
Cash and cash equivalents	**¥373,864**	¥317,733	¥292,978	**$3,195,419**

(2) Purchase of newly consolidated subsidiaries' shares and acquisition of business

During the fiscal year ended March 31, 2005, the Company acquired shares of JAPAN VAM & POVAL Co., Ltd.

Upon consolidation, a net cash flow of ¥5,705 million, representing the excess of the cash consideration of ¥6,999 million paid for acquisition over the "Cash and cash equivalents" of ¥1,294 million held by JAPAN VAM & POVAL Co., Ltd. as at the date of a commencement of consolidation, was disclosed as "Payment for purchase of newly consolidated subsidiaries' shares and acquisition of business" in the consolidated statements of cash flows for the fiscal year ended March 31, 2005.

During the fiscal year ended March 31, 2004, the Company acquired shares of Nagano Electronics Industrial Co., Ltd., SE Tylose Holding GmbH, SE Tylose GmbH & Co. KG and SE Tylose Verwaltungs GmbH.

Upon consolidation, a net cash flow of ¥24,512 million, representing the excess of the cash consideration of ¥28,075 million paid for acquisition over the "Cash and cash equivalents" of ¥3,545 million held by the above four companies as at the date of commencement of consolidation, was disclosed as part of "Payment for purchases of newly consolidated subsidiaries' shares and acquisition of business" in the consolidated statements of cash flows for the fiscal year ended March 31, 2004.

The cash consideration of ¥6,999 million and ¥28,057 million paid for the acquisition during the fiscal years ended March 31, 2006 and 2005, respectively, were allocated as follows:

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Current assets	**¥ —**	¥ 6,134	¥ 15,765	**$ —**
Non-current assets	**—**	5,617	12,502	**—**
Consolidation adjustments	**—**	2,943	15,459	**—**
Current liabilities	**¥ —**	¥(5,622)	¥(12,349)	**$ —**
Non-current liabilities	**—**	(2,073)	(2,649)	**—**
Minority interests	**—**	—	(671)	**—**
Cash consideration	**—**	6,999	28,057	**—**
Cash and cash equivalents acquired	**—**	(1,294)	(3,545)	**—**
Net cash flow	**¥ —**	¥ 5,705	¥ 24,512	**$ —**

(3) Important non-cash transactions were as follows

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Increase of common stock by conversion of convertible debentures	**¥1,907**	¥ 7,020	¥ —	**$16,299**
Increase of additional paid-in capital by conversion of convertible debentures	**1,905**	7,012	—	**16,282**
Decrease of convertible debentures by conversion	**¥3,812**	¥14,032	¥ —	**$32,581**

17. 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 segments: Polyvinyl chloride, Silicones, Methanol, Chloromethanes, Cellulose derivatives, Caustic soda, Silicon metal

Electronics materials business segments: 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, 2006, 2005 and 2004 and for the years then ended, classified by business segment, are presented as follows:

	Millions of yen				
	2006				
	Organic and Inorganic Chemicals	Electronics Materials	Functional Materials and Others	Elimination or Common Assets[4]	Consolidated Total
Sales:					
Sales to outside customers	**¥636,492**	**¥361,453**	**¥129,971**	**¥ —**	**¥1,127,916**
Intersegment sales	**9,503**	**3,567**	**59,692**	**(72,762)**	**—**
Total	**645,995**	**365,020**	**189,663**	**(72,762)**	**1,127,916**
Operating costs and expenses	**549,823**	**299,745**	**165,640**	**(72,612)**	**942,596**
Operating income	**¥ 96,172**	**¥ 65,275**	**¥ 24,023**	**¥ (150)**	**¥ 185,320**
Assets	**¥664,381**	**¥516,974**	**¥165,225**	**¥324,701**	**¥1,671,281**
Depreciation	**27,667**	**75,816**	**8,360**	**(206)**	**111,637**
Capital expenditures[1]	**46,241**	**65,656**	**8,354**	**(443)**	**119,808**

	Millions of yen				
	2005				
	Organic and Inorganic Chemicals	Electronics Materials	Functional Materials and Others	Elimination or Common Assets[3]	Consolidated Total
Sales:					
Sales to outside customers	¥548,950	¥306,925	¥111,611	¥ —	¥ 967,486
Intersegment sales	8,476	2,472	66,552	(77,500)	—
Total	557,426	309,397	178,163	(77,500)	967,486
Operating costs and expenses	479,531	255,713	158,039	(77,531)	815,752
Operating income	¥ 77,895	¥ 53,684	¥ 20,124	¥ 31	¥ 151,734
Assets	¥631,467	¥448,725	¥167,822	¥228,235	¥1,476,249
Depreciation	26,076	55,031	9,998	(230)	90,875
Capital expenditures[2]	30,342	66,764	9,369	(253)	106,222

	Millions of yen				
	2004				
	Organic and Inorganic Chemicals	Electronics Materials	Functional Materials and Others	Elimination or Common Assets[3]	Consolidated Total
Sales:					
Sales to outside customers	¥457,009	¥262,246	¥113,550	¥ —	¥ 832,805
Intersegment sales	8,285	1,539	54,480	(64,304)	—
Total	465,294	263,785	168,030	(64,304)	832,805
Operating costs and expenses	400,182	221,602	149,860	(64,465)	707,179
Operating income	¥ 65,112	¥ 42,183	¥ 18,170	¥ 161	¥ 125,626
Assets	¥548,264	¥422,075	¥166,790	¥249,087	¥1,386,216
Depreciation	21,979	42,419	9,455	(271)	73,582
Capital expenditures[3]	50,520	46,485	5,090	(234)	101,861

	Thousands of U.S. dollars				
	2006				
	Organic and Inorganic Chemicals	Electronics Materials	Functional Materials and Others	Elimination or Common Assets[3]	Consolidated Total
Sales:					
Sales to outside customers	**$5,440,103**	**$3,089,342**	**$1,110,863**	**$ —**	**$ 9,640,308**
Intersegment sales	**81,222**	**30,487**	**510,188**	**(621,897)**	**—**
Total	**5,521,325**	**3,119,829**	**1,621,051**	**(621,897)**	**9,640,308**
Operating costs and expenses	**4,699,342**	**2,561,923**	**1,415,726**	**(620,615)**	**8,056,376**
Operating income	**$ 821,983**	**$ 557,906**	**$ 205,325**	**$ (1,282)**	**$ 1,583,932**
Assets	**$5,678,471**	**$4,418,581**	**$1,412,179**	**$2,775,222**	**$14,284,453**
Depreciation	**236,470**	**648,000**	**71,453**	**(1,761)**	**954,162**
Capital expenditures[1]	**395,222**	**561,162**	**71,402**	**(3,786)**	**1,024,000**

Notes: 1. Mimasu Semiconductor Industry Co., Ltd., which substantially belongs to the Electronics Materials segment, is now included in the affiliates where the equity method accounting is applied during the current fiscal year, as a result of the additional acquisition of shares during the current fiscal year. Payment for this acquisition was ¥25,521 million ($218,128 thousand), which is not included in the "Capital expenditures" in the chart above. If this amount were included, capital expenditures for this fiscal year would be ¥145,330 million ($1,242,137 thousand).

2. As a result of additional acquisition of shares at the end of the fiscal year ended March 31, 2005, JAPAN VAM & POVAL Co., Ltd. which is under the Organic and Inorganic Chemicals segment, became a wholly owned consolidated subsidiary. Previously, in the fiscal year ended March 31, 2004, as an affiliated company, it was included in the scope of the equity method of accounting. Payment for this acquisition was ¥6,999 million. Only ¥2,943 million, which is equivalent to the consolidated adjustment account, is included in the above Capital expenditures. If the remaining ¥4,056 million were included, the total amount of Capital expenditures would come to ¥110,278 million.

3. Under the Organic and Inorganic Chemicals segment, Capital expenditures of our affiliate Asia Silicones Monomer Limited was ¥5,887 million, which corresponds to our share of ownership of the affiliate. Payment for the acquisition of working capital and other assets of the cellulose business in Europe, now known as SE Tylose, was ¥5,843 million, which is included in the total purchase price.

Though these figures are not included in the above Capital expenditures, if these amounts were to be included, the total amount of the Capital expenditures would come to ¥113,591 million.

4. The amounts of the common assets included in the column "Elimination or Common Assets" for the years ended March 31, 2006, 2005, and 2004 were ¥360,148 million ($3,078,188 thousand), ¥328,568 million and ¥330,652 million, respectively, which mainly consisted of surplus working funds (cash, deposits and marketable securities) and long-term investment funds (investments in securities) of the Company.

5. As previously mentioned in (8) Property, plant and equipment in Note 2, the period of depreciation for a portion of the semiconductor silicon manufacturing facilities/equipment was shortened in the current fiscal year. With this change, the depreciation expenses under the Electronics Materials business segment for the current fiscal year, when compared with the figures calculated for the previous depreciable years, increased by ¥9,957 million ($85,103 thousand). Operating expenses increased by ¥9,505 million, ($81,239 thousand) and accordingly, operating income decreased by the same amount

(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, 2006, 2005 and 2004 and for the years then ended are presented below:

	Millions of yen					
	2006					
	Japan	North America	Asia/ Oceania	Europe	Elimination or Common Assets[2]	Consolidated Total
Sales:						
Sales to outside customers	**¥574,448**	**¥287,478**	**¥130,027**	**¥135,963**	**¥ —**	**¥1,127,916**
Intersegment sales	**184,833**	**23,198**	**61,737**	**677**	**(270,445)**	**—**
Total	**759,281**	**310,676**	**191,764**	**136,640**	**(270,445)**	**1,127,916**
Operating costs and expenses	**620,502**	**284,079**	**182,164**	**126,768**	**(270,917)**	**942,596**
Operating income	**¥138,779**	**¥ 26,597**	**¥ 9,600**	**¥ 9,872**	**¥ 472**	**¥ 185,320**
Assets	**¥807,041**	**¥362,521**	**¥151,300**	**¥131,265**	**¥ 219,154**	**¥1,671,281**

	Millions of yen					
	2005					
	Japan	North America	Asia/ Oceania	Europe	Elimination or Common Assets[2]	Consolidated Total
Sales:						
Sales to outside customers	¥494,851	¥236,525	¥110,174	¥125,936	¥ —	¥ 967,486
Intersegment sales	147,772	31,253	45,902	913	(225,840)	—
Total	642,623	267,778	156,076	126,849	(225,840)	967,486
Operating costs and expenses	533,230	245,029	145,572	117,243	(225,322)	815,752
Operating income	¥109,393	¥ 22,749	¥ 10,504	¥ 9,606	¥ (518)	¥ 151,734
Assets	¥730,263	¥294,054	¥130,114	¥124,309	¥ 197,509	¥1,476,249

	Millions of yen					
	2004					
	Japan	North America	Asia/ Oceania	Europe	Elimination or Common Assets[2]	Consolidated Total
Sales:						
Sales to outside customers	¥451,026	¥212,786	¥ 90,969	¥ 78,024	¥ —	¥ 832,805
Intersegment sales	123,368	19,512	37,646	979	(181,505)	—
Total	574,394	232,298	128,615	79,003	(181,505)	832,805
Operating costs and expenses	484,956	208,440	120,365	74,763	(181,345)	707,179
Operating income	¥ 89,438	¥ 23,858	¥ 8,250	¥ 4,240	¥ (160)	¥ 125,626
Assets	¥663,055	¥284,358	¥121,464	¥104,897	¥ 212,442	¥1,386,216

	Thousands of U.S. dollars					
	2006					
	Japan	North America	Asia/ Oceania	Europe	Elimination or Common Assets[2]	Consolidated Total
Sales:						
Sales to outside customers	**$4,909,812**	**$2,457,077**	**$1,111,342**	**$1,162,077**	**$ —**	**$ 9,640,308**
Intersegment sales	**1,579,769**	**198,274**	**527,667**	**5,786**	**(2,311,496)**	**—**
Total	**6,489,581**	**2,655,351**	**1,639,009**	**1,167,863**	**(2,311,496)**	**9,640,308**
Operating costs and expenses	**5,303,435**	**2,428,026**	**1,556,958**	**1,083,487**	**(2,315,530)**	**8,056,376**
Operating income	**$1,186,146**	**$ 227,325**	**$ 82,051**	**$ 84,376**	**$ 4,034**	**$ 1,583,932**
Assets	**$6,897,787**	**$3,098,470**	**$1,293,162**	**$1,121,923**	**$ 1,873,111**	**$14,284,453**

Notes: 1. Main countries or other areas other than Japan:
North America................ U.S.
Asia/Oceania.................. Malaysia, Singapore, South Korea, Taiwan, Thailand, Australia
Europe .... U.K., Netherlands, Germany
2. The amounts of the common assets included in the column "Elimination or Common Assets" for the years ended March 31, 2006, 2005, and 2004 were ¥360,148 million ($3,078,188 thousand), ¥328,568 million and ¥330,652 million, respectively, which mainly consisted of surplus working funds (cash, deposits and marketable securities) and long-term investment funds (investments in securities) of the Company.
3. In the fiscal year ended March 31, 2005, the Company revised the classification of geographic areas due to increased business in Europe, which was previously included in "Other Areas."
Current classification of regions: "Japan," "North America," "Asia/Oceania," "Europe"
Previous classification of regions: "Japan," "North America," "Asia," "Other Areas"
The above information for the fiscal year ended March 31, 2004 have been restated to conform to the current classification.
4. As mentioned in (8) Property, plant and equipment in Note 2, the period of depreciation for a portion of the semiconductor silicon manufacturing facilities/equipment was shortened in the current fiscal year. As a result, operating expenses for Japan, North America, Asia/Oceania and Europe for the current fiscal year, increased by ¥1,316 million ($11,248 thousand), ¥5,656 million ($48,342 thousand), ¥1,381 million ($11,803 thousand) and ¥1,151 million ($9,838 thousand), respectively, compared with the figures calculated for the previous depreciable years. Accordingly, operating income decreased by the same amounts.

(3) Overseas sales information

Overseas sales of the Companies for the years ended March 31, 2006, 2005 and 2004 are summarized as follows:

	Millions of yen				
	2006				
	North America	Asia/ Oceania	Europe	Other Areas	Total
Overseas sales	**¥278,342**	**¥310,610**	**¥131,724**	**¥31,950**	**¥ 752,626**
Consolidated sales	**—**	**—**	**—**	**—**	**1,127,916**
Percentage of overseas sales over consolidated sales	**24.7%**	**27.5%**	**11.7%**	**2.8%**	**66.7%**

	Millions of yen				
	2005				
	North America	Asia/ Oceania	Europe	Other Areas	Total
Overseas sales	¥216,704	¥280,851	¥119,152	¥31,895	¥648,602
Consolidated sales	—	—	—	—	967,486
Percentage of overseas sales over consolidated sales	22.4%	29.0%	12.3%	3.3%	67.0%

	Millions of yen				
	2004				
	North America	Asia/ Oceania	Europe	Other Areas	Total
Overseas sales	¥203,210	¥218,413	¥82,041	¥25,632	¥529,296
Consolidated sales	—	—	—	—	832,805
Percentage of overseas sales over consolidated sales	24.4%	26.2%	9.9%	3.1%	63.6%

	Thousands of U.S. dollars				
	2006				
	North America	Asia/ Oceania	Europe	Other Areas	Total
Overseas sales	**$2,378,991**	**$2,654,786**	**$1,125,846**	**$273,078**	**$6,432,701**
Consolidated sales	**—**	**—**	**—**	**—**	**9,640,308**
Percentage of overseas sales over consolidated sales	**24.7%**	**27.5%**	**11.7%**	**2.8%**	**66.7%**

Notes: 1. Main countries or areas
North America................ U.S., Canada
Asia/Oceania .... China, Taiwan, South Korea, Singapore, Thailand, Malaysia
Europe .... Germany, France, Portugal
Other Areas .... Latin America, Middle East
2. "Overseas sales" means sales to outside Japan by the Company and its consolidated subsidiaries.
3. Sales to China included in "Asia/Oceania" for the fiscal years ended March 31, 2006, 2005 and 2004 were ¥77,203 million ($659,855 thousand), ¥77,933 million ($666,094 thousand) and ¥62,820 million ($536,923 thousand), respectively.
4. In the fiscal year ended March 31, 2005, the Company revised the classification of geographic areas due to increased business in Europe, which was previously included in "Other Areas."
Current classification of regions: "North America," "Asia/Oceania," "Europe" "Other Areas."
Previous classification of regions: "North America," "Asia," "Other Areas."
The above information for the fiscal year ended March 31, 2004 has been restated to conform to the current classification.

18. Subsequent event

Appropriation of retained earnings

Subsequent to March 31, 2006, the Company's Board of Directors, with the subsequent approval of stockholders on June 29, 2006 declared a cash dividend of ¥7,536 million ($64,412 thousand) equal to ¥17.50 ($0.150) per share, applicable to earnings of the year ended March 31, 2006 and payable to stockholders on the stockholders' register on March 31, 2006.

Consolidated Subsidiaries

As of March 31, 2006

Principal Consolidated Subsidiaries	Percentage of Voting Rights	Fiscal Year-End
Shintech Inc.(1)	100.0	December 31
Shin-Etsu Handotai Co., Ltd.	100.0	March 31
Shin-Etsu Handotai America, Inc. (1)	100.0	December 31
Shin-Etsu Polymer Co., Ltd.	53.2	March 31
S.E.H. Malaysia Sdn. Bhd. (1)(2)	100.0	December 31
Shin-Etsu PVC B.V.(1)	100.0	December 31
Shin-Etsu Engineering Co., Ltd.	100.0	March 31
SE Tylose GmbH & Co. KG(1)	100.0	December 31
Shin-Etsu-Handotai Europe, Ltd.(1)	100.0	December 31
Nagano Electronics Industrial Co., Ltd.	90.0	February 28
Shin-Etsu Handotai Taiwan Co., Ltd.(1)	70.0	December 31
Naoetsu Electronics Co., Ltd.	100.0	February 28
Shin-Etsu Astech Co., Ltd.	99.6	March 31
S-E, Inc.(1)	100.0	December 31
Shin-Etsu Electronics Materials Singapore Pte. Ltd.(1)	100.0	December 31
Shin-Etsu Fintech Co., Ltd.	100.0	March 31
JAPAN VAM & POVAL Co., Ltd.	100.0	March 31
Shin-Etsu Singapore Pte. Ltd.(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 Silicones Thailand Ltd.(1)	100.0	December 31
Shin-Etsu (Malaysia) Sdn. Bhd.(1)	100.0	December 31
Nissin Chemical Industry Co., Ltd.	100.0	February 28
Shin-Etsu MicroSi, Inc.(1)	100.0	December 31
Shin-Etsu Silicone Taiwan Co., Ltd.(1)	93.3	December 31
Shin-Etsu Silicones of America, Inc.(1)	100.0	December 31
Shin-Etsu Silicones Europe B.V.(1)	100.0	December 31
Shin-Etsu Sealant Co., Ltd.	100.0	March 31
Shin-Etsu Unit Co., Ltd.	100.0	March 31
Shin-Etsu Opto Electronics Co., Ltd.(1)	80.0	December 31
Shin-Etsu Polymer (Malaysia) Sdn. Bhd.(1)	100.0	December 31

Principal Consolidated Subsidiaries	Percentage of Voting Rights	Fiscal Year-End
Shin-Etsu Polymer Europe B.V.(1)	100.0	December 31
Shin-Etsu International Europe B.V.(1)	100.0	December 31
Nihon Resin Co., Ltd.	100.0	December 31
Naoetsu Precision Co., Ltd.	100.0	February 28
Skyward Information Systems Co., Ltd.	100.0	March 31
Shinano Electric Refining Co., Ltd.	75.3	March 31
Fukui Environmental Analysis Center Co., Ltd.	100.0	February 28
Shin-Etsu Film Co., Ltd.	100.0	March 31
Shin-Etsu Technology Service Co., Ltd.	76.9	February 28
Urawa Polymer Co., Ltd.	100.0	March 31
Shin-yo Home Service Company	100.0	March 31
Niigata Polymer Company Limited	100.0	March 31
Shin-Etsu Polymer America, Inc.(1)	100.0	December 31
Naoetsu Sangyo Limited	100.0	March 31
San-Ace Co., Ltd.	100.0	March 31
Shinken Total Plant Co., Ltd.	100.0	February 28
Saitama Shinkoh Mold Co., Ltd.	100.0	March 31
Shinkoh Mold Co., Ltd.	100.0	March 31
Shin-Etsu Magnet Co., Ltd.	100.0	March 31
Shin-Etsu Polymer Mexico S.A. de. C.V.(1)	100.0	December 31
PT. Shin-Etsu Polymer Indonesia(1)	100.0	December 31
Shin-Etsu Polymer Shanghai Co., Ltd.(1)	100.0	December 31
Shin-Etsu Polymer Hungary Kft.(1)	100.0	December 31
Human Create Co., Ltd.	100.0	March 31
Suzhou Shin-Etsu Polymer Co., Ltd.(1)	83.6	December 31
S.E.H. (Shah Alam) Sdn. Bhd.(1)	100.0	December 31
Simcoa Operations Pty. Ltd.(1)	100.0	December 31
Shincor Silicones, Inc.(1)	100.0	December 31
K-Bin, Inc.(1)	100.0	December 31

8 other consolidated subsidiaries

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

Report of Independent Auditors

To 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, 2005 and 2006, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended March 31, 2006, all expressed in Japanese Yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Shin-Etsu Chemical Co., Ltd. and its consolidated subsidiaries as of March 31, 2005 and 2006, and the consolidated results of their operations and cash flows for each of the three years in the period ended March 31, 2006 in conformity with accounting principles generally accepted in Japan.

The amounts expressed in U.S. dollars, which are 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.

ChuoAoyama PricewaterhouseCoopers

ChuoAoyama PricewaterhouseCoopers
Tokyo, Japan
June 29, 2006

Investor Information

As of March 31, 2006

Shin-Etsu Chemical Co., Ltd.

Head Office: 6-1, Ohtemachi 2-chome,
Chiyoda-ku, Tokyo 100-0004, Japan

Date of Establishment:
September 16, 1926

Capital:
¥119,420 million

Number of Employees:
18,888 (including 69 consolidated subsidiaries)

Number of Shares Authorized:
1,720,000,000 (as of June 29, 2006)

Number of Shares Issued:
432,106,693

Number of Shareholders:
52,159

Fiscal Year-End:
March 31

Shareholders' Meeting:
June

Stock Listings:
Tokyo, Osaka, Nagoya (Ticker Code: 4063)

Transfer Agent:
Mitsubishi UFJ Trust and Banking Corporation

Auditor:
Chuo Aoyama PricewaterhouseCoopers

Please visit our website:

http://www.shinetsu.co.jp
(English, Japanese and Chinese)

Major Shareholders:

Name	Number of Shares (Thousands)	Percentage of Total Equity (%)
The Master Trust Bank of Japan, Ltd. (Trust account)	42,101	9.7
Japan Trustee Services Bank, Ltd. (Trust account)	37,241	8.6
Nippon Life Insurance Company	21,970	5.1
Japan Trustee Services Bank Ltd. (Trust account 4)	13,207	3.1
The Hachijuni Bank, Ltd.	11,790	2.7
Meiji Yasuda Life Insurance Company	11,529	2.7
NIPPONKOA Insurance Co., Ltd.	10,077	2.3
State Street Bank and Trust Company 505103	9,693	2.2
The Bank of Tokyo-Mitsubishi UFJ, Ltd.	7,095	1.6
State Street Bank and Trust Company	6,071	1.4

Information:

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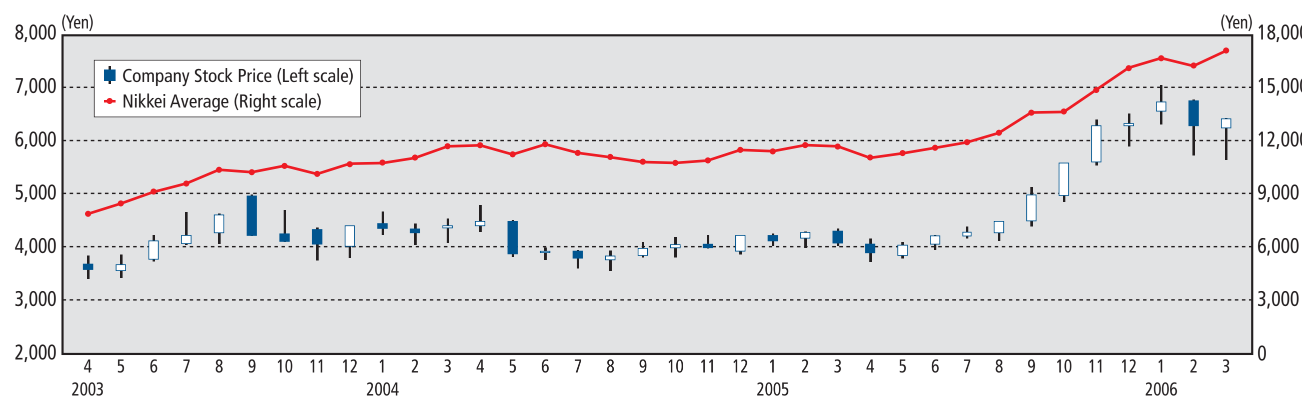
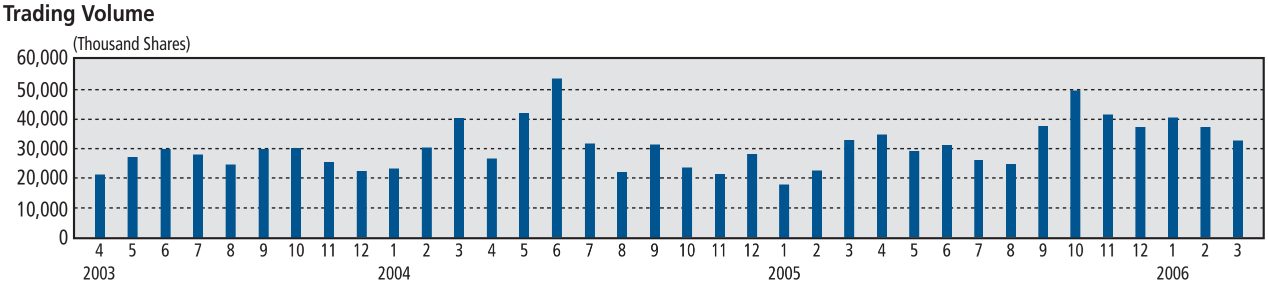
6-1, Ohtemachi 2-chome, Chiyoda-ku, Tokyo 100-0004, Japan
Phone: +81-3-3246-5091
Fax: +81-3-3246-5096
e-mail: sec-pr@shinetsu.jp

Common Stock Price



Trading Volume



Shin-Etsu's Worldwide Network

(Main Shin-Etsu Group Companies)

Australia

SIMCOA OPERATIONS PTY. LTD.
Lot 22 Marriott Road, Wellesley, WA 6233
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3214 Shanghai Central Plaza, 381 Huaihai Zhong Road, Shanghai 200021
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SHIN-ETSU POLYMER HONG KONG CO., LTD.
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Phone: +852-2377-9131
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France

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Germany

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Japan

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SHIN-ETSU FILM CO., LTD.
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SHIN-ETSU HANDOTAI CO., LTD.
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SHIN-ETSU QUARTZ PRODUCTS CO., LTD.
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1393, Yashiro, Chikuma-shi, Nagano
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NISSIN CHEMICAL INDUSTRY CO., LTD.
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Korea

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Malaysia

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SHIN-ETSU ELECTRONICS (MALAYSIA) SDN. BHD.
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Netherlands

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SHIN-ETSU POLYMER EUROPE B.V.
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SHIN-ETSU SILICONES EUROPE B.V.
Bolderweg 32, 1332 AV, Almere
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Fax: +31-36-5326459

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