



kuraray

Toward Exciting Innovation and Outstanding Earnings

Annual Report 2006

For the year ended March 31, 2006



In June 2006, Kuraray Co., Ltd. celebrated its 80th year in business, and the Company took the opportunity to renew its corporate trademark by introducing a new logo to represent the Kuraray Group. The new logo is designed to contribute to a generation of renewed brand value through a coherent visual image for the Group's operations around the world.

Light blue, lower-case lettering represents the Group's growth potential and mobility. The last three letters of the logo, "ray," are italicized for emphasis and correspond to Kuraray's founding business of chemical fiber rayon as well as new business growth in the field of optical materials (which makes use of rays of light), depicting the Group's history and its future business expansion.

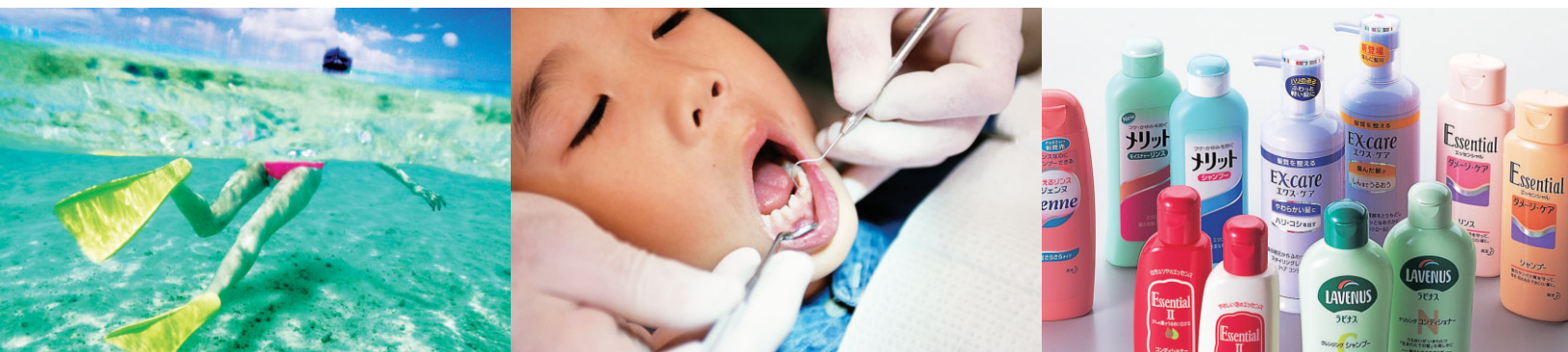
CONTENTS

01	Profile
02	Consolidated Financial Highlights
04	To Our Shareholders
05	Toward Exciting Innovation and Outstanding Earnings
06	10-Year Corporate Vision
08	New Medium-Term Business Plan GS-21
10	Interview with the President
15	Kuraray's Optical Materials – Paving the Way for Tomorrow's LCDs
18	Kuraray Group's Segments and Products
20	Review of Operations
21	Chemicals and Resins Business
24	Fibers and Textiles Business
26	High-Performance Materials, Medical Products and Others Business
28	Research and Development
30	Corporate Governance
33	Board of Directors, Corporate Auditors, and Executive Officers
34	Corporate Social Responsibility
38	Topics
40	Financial Section
65	Consolidated Companies
66	History
67	Investor Information

Forward-Looking Statements

This annual report contains various forward-looking statements, which are based on the current expectations and assumptions of future events. All figures and statements with respect to the future performance, projections, and business plans of Kuraray and its Group companies constitute forward-looking statements. Although Kuraray believes its expectations and assumptions are reasonable, actual results and trends of Kuraray's performance could differ materially from those expressed or implied by such figures or statements due to risks and uncertainties in future business circumstances. The factors that may cause such differences include, without limitation: (1) general market and economic conditions in Asia, including Japan, the United States, Europe, and other regions; (2) fluctuations of currency exchange rates, especially between the Japanese yen and the U.S. dollar and other foreign currencies; (3) changes in raw material and fuel costs; (4) industrial competition and price fluctuations in Japan and international markets; (5) advances or delays in the construction of new plants and production lines; (6) successful development of new products and technologies; (7) changes in laws and regulations (including tax and environmental) and legal proceedings; and (8) unforeseeable risks, including natural disasters.

In this annual report, italicized product names are registered trademarks of Kuraray Co., Ltd.





kuraray

In 1926, Kuraray was established to commercialize the production of rayon filament yarn, an undertaking that required the very latest technology. We were pioneers of the chemical synthetic fiber industry in Japan with our successful commercial production of the poval-based polyvinyl alcohol (PVA) fiber *KURALON* in 1950.

In the intervening years, we have brought our technological expertise to bear on the development of numerous unique products, which have heightened our standing in markets worldwide.

In particular, we claim the largest world-market shares for such products as the man-made leather *CLARINO*; poval resin, which has outstanding adhesive properties and water solubility; optical-use poval film, which is indispensable for liquid crystal displays (LCDs); and *EVAL* resin, which is gas impermeable and used for food packaging and fuel tanks.



Consolidated Financial Highlights

CONSOLIDATED FINANCIAL HIGHLIGHTS

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

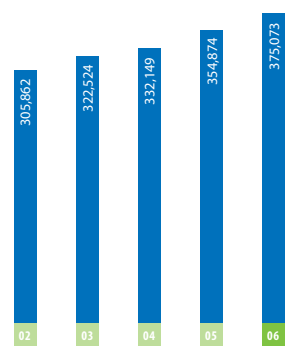
	Millions of yen					Thousands of U.S. dollars (Note 1)
Years ended March 31	2006	2005	2004	2003	2002	2006
Net sales	¥375,073	¥354,874	¥332,149	¥322,524	¥305,862	\$3,205,752
Operating income	38,277	33,187	28,046	25,186	18,958	327,154
Net income	21,186	18,465	15,181	8,051	2,866	181,077
Capital expenditure	33,872	45,715	32,164	19,091	50,716	289,504
Depreciation and amortization	25,186	21,324	20,785	19,108	16,056	215,265
Gross cash flow	46,372	39,789	35,966	27,159	18,922	396,342
Total research and development expenses	14,069	13,874	13,684	12,523	12,131	120,248
Total assets	481,357	454,941	413,227	426,877	487,432	4,114,162
Total shareholders' equity	339,127	312,930	300,306	287,263	290,643	2,898,521
Amounts per share:						
	Yen					U.S. dollars
Net income:						
Primary	¥ 57.51	¥ 50.13	¥ 40.81	¥ 21.01	¥ 7.49	\$0.49
Fully diluted	57.41	50.12	—	20.71	7.45	0.49
Cash dividends applicable to period	15.00	12.00	10.00	9.00	9.00	0.13
Total shareholders' equity	922.65	852.26	817.57	771.38	759.25	7.89
Financial ratios:						
Equity ratio (%)	70.5%	68.8%	72.7%	67.3%	59.6%	
Return on equity (ROE) (%)	6.5	6.0	5.2	2.8	1.0	
Return on assets (ROA) (%)	8.2	7.6	6.7	5.5	3.8	
Payout ratio (%)	26.0	23.9	24.4	42.2	120.2	
Number of employees	6,842	6,919	6,760	6,983	7,115	

Notes: 1. The U.S. dollar amounts represent the translation from Japanese yen at the rate of ¥117=\$1.

2. Since the year ended March 31, 2003, the "Amounts per share" figures have been calculated in accordance with the Japanese Financial Accounting Standard "Accounting for Earnings per Share."

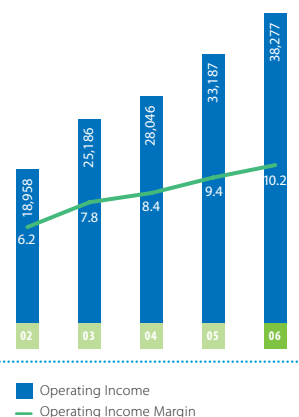
Net Sales

¥ Millions



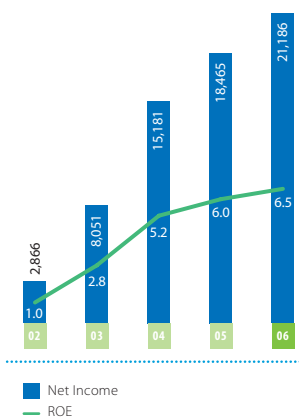
Operating Income & Operating Income Margin

¥ Millions %



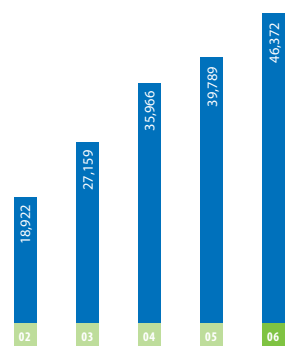
Net Income & ROE

¥ Millions %



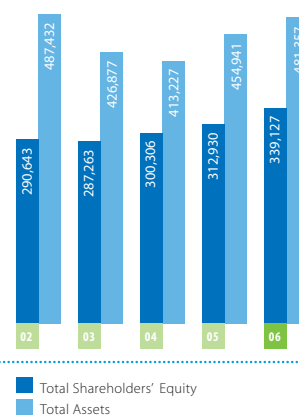
Gross Cash Flow

¥ Millions



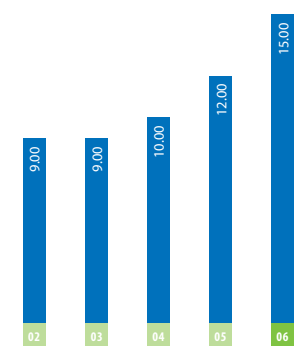
Total Shareholders' Equity & Total Assets

¥ Millions



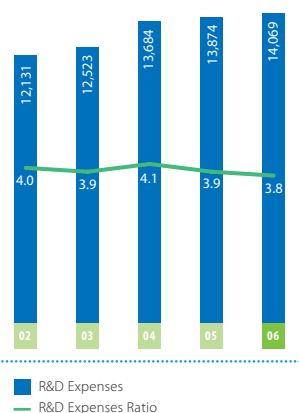
Cash Dividends per Share

¥



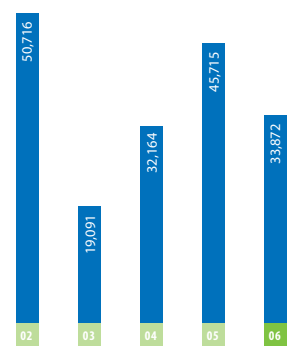
R&D Expenses & R&D Expenses Ratio

¥ Millions %



Capital Expenditure

¥ Millions



Crude Oil Prices

U.S. dollars



Source: Average March price of Dubai crude oil



Yasuaki Wakui
Representative Director and President

In the fiscal year under review, ended March 31, 2006, Japan enjoyed a generally favorable business climate, thanks to improvements in corporate performances and an upturn in consumer spending. However, negative factors included continuing hikes in raw material and fuel prices and rising interest rates. Furthermore, amid large-scale disasters and geopolitical instability, uncertainty deepened over the outlook for economies worldwide, such as those of the United States and China.

In this operating environment, the Kuraray Group expanded core businesses and fast-growing optical materials businesses. As a result, we grew revenues and earnings for the fourth consecutive fiscal year – posting new records for net sales and in all income categories – with net sales of ¥375.1 billion, operating income of ¥38.3 billion, and net income of ¥21.2 billion.

Under the G-21 Medium-Term Business Plan initiated from the fiscal year ended March 2002, we advanced a growth strategy focused on three core businesses and four strategic areas. At the same time, we accelerated the development of new businesses while strengthening competitiveness through stepped-up efforts to improve profit structures and reorganize low-profit businesses. These efforts enabled us to reach our ROA commitment target of 8.0% or higher. However, our results were slightly less than our targets of ¥400.0 billion for net sales and ¥40.0 billion for operating income. This was mainly attributable to a lack of speed, which remains an issue, in such areas as the realization of investment benefits, response to market conditions, new product development, the reflection of raw material and fuel prices in sales prices, and the enhancement of operational efficiency at head offices. Furthermore, regarding the accident at one of our plants in the fiscal year as a serious warning, we will give high priority to bolstering safety management.

The new Medium-Term Business Plan, GS-21, calls for measures in four key areas: accelerating the development of new businesses and new growth fields and the realization of investment benefits; enhancing the efficiency of global management and speeding up management processes; reforming the personnel compensation system, including the recruitment and training of required personnel; and furthering the environmental sustainability of the Group and society. In addition, for the fiscal year ending

March 2009 the new plan sets out as commitment targets net sales of ¥450.0 billion, operating income of ¥50.0 billion, ROA of 9.0%, and ROE of 7.0%. Also, the Kuraray Group prepared a 10-Year Corporate Vision clarifying its long-term goals.

The current fiscal year, ending March 2007, marks the 80th anniversary of the Company's founding. Moreover, to coincide with our transition to a new phase as we head toward the realization of a new 10-Year Corporate Vision from the current fiscal year, we have created a new Kuraray Group logo that suggests global growth. Adhering to a long-standing corporate culture of "contributing to the world and individual well-being through actions that others are unable to produce," the Kuraray Group aims to be a high-quality corporate group that contributes to the global environment and the realization of a sustainable society.

In the fiscal year under review, the Company raised year-end cash dividends ¥2.00 from the previous fiscal year-end, to ¥8.50 per share, giving a ¥3.00 increase in full-year cash dividends, to ¥15.00 per share. Targeting a payout ratio of between 25.0% and 30.0%, the Company aims to raise cash dividends through the continuous enhancement of business results.

In closing, we would like to ask our shareholders for their continued support and understanding.

August 2006

A handwritten signature in black ink that reads "Yasuaki Wakui". The signature is written in a cursive, flowing style.

Yasuaki Wakui
Representative Director and President



Toward Exciting Innovation and Outstanding Earnings

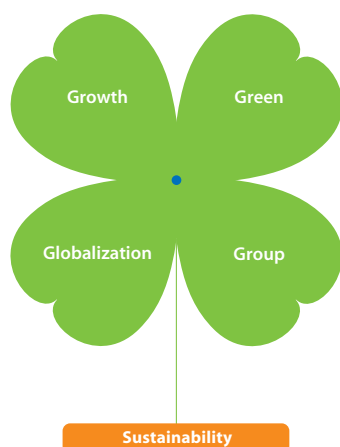
Kuraray prepared a 10-Year Corporate Vision outlining the Kuraray Group's long-term goals and a new GS-21 Medium-Term Business Plan, covering the period from April 2006 through to March 2009.

GS-21: The "G" represents a 4G concept (Growth, Green, Globalization, and Group) set out in our previous G-21 Medium-Term Business Plan. The "S" stands for "sustainability." Kuraray chose this title to emphasize its principal objective of becoming a corporate group driven by sustainable growth and ongoing protection of the global environment.

10-Year Corporate Vision

The high-paced changes that characterize the current era make three years the limit for practical plans. With this in mind, we prepared the 10-Year Corporate Vision to clarify the type of company we want to become in the long term in the context of the large changes in business conditions that we expect.

GS-21



OUR VIEW OF BUSINESS CONDITIONS

Over the past decade, the world economy enjoyed steady growth of between 3% and 4%, supported by a stable U.S. economy and robust BRICs economies. Japan's economy, however, remained weak in the aftermath of the economic bubble. Over the next decade, the economic environment is expected to see long-term structural transformation, which will likely include the following trends:

- Rising concern over the global environment and resources and increasingly unsustainable mass-producing, high-energy-consuming economies
- Emerging geographic imbalances in the global economy, lower growth rates, and increasingly intense global competition
- Heightening in the sophistication of market needs and rapid change caused by diversifying values
- Growing risk associated with Japan's fundamental structure, including fiscal deficit, an aging society, and a declining birthrate.

Against this backdrop, chemicals manufacturers will increasingly have to shift their management focus from quantity to quality.

In its 10-Year Corporate Vision, Kuraray gave an outline of its future profile and development over the long term that reflected its tradition, history, and corporate culture.

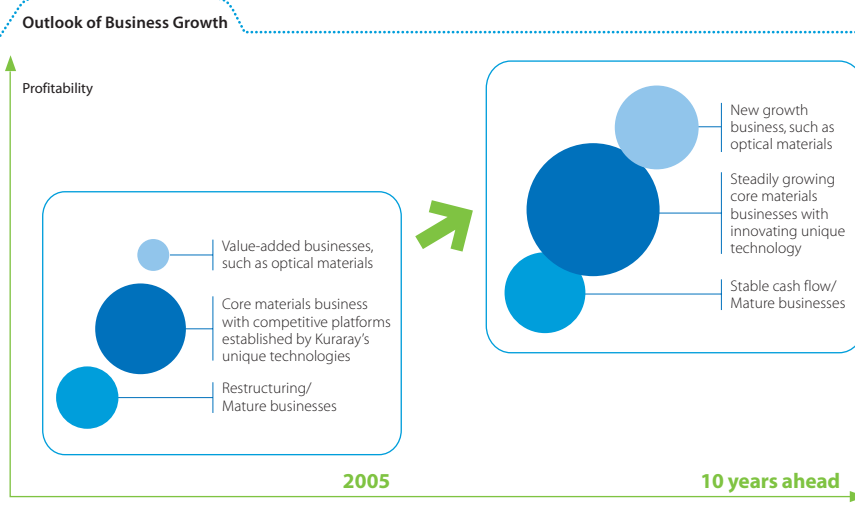
Toward Exciting Innovation and Outstanding Earnings
Recognized throughout the World, To Make the Kuraray Group a Sustainably
Growing Diversified Specialty Chemicals Company

Contributing to the world and individual well-being through actions that others are unable to produce



Targeting net sales of ¥1 trillion in 2015

- Having established competitive platforms by capitalizing on original core technologies, core materials businesses will pursue continued steady growth through further technological innovation and global business development.
- G-21 established the foundations for such high-value-added operations as optical materials. We will focus management resources on the expansion of these operations as new highly profitable growth businesses.
- Restructuring businesses and mature businesses will gain competitive superiority and realize steady earnings.

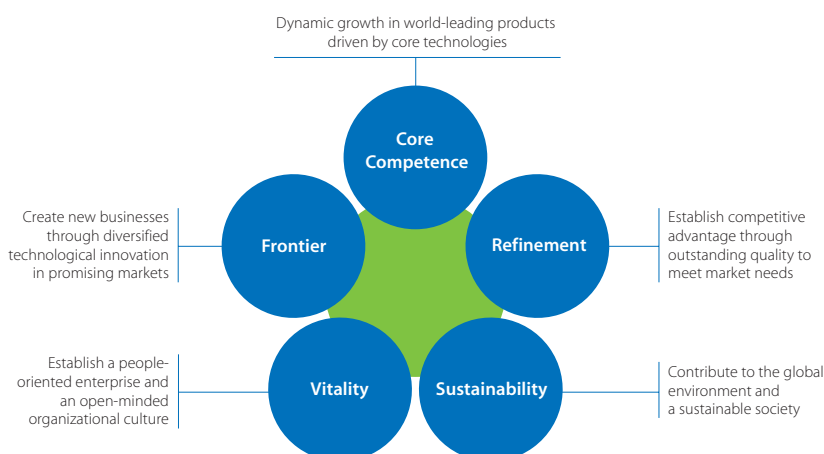


BASIC POLICIES TO REALIZE VISION

Kuraray is renowned for its innovation capabilities, which enable the Company to create numerous specialty chemical products and develop high-value-added applications that meet the needs of markets worldwide.

Leveraging a corporate platform steadily built up over many years, in the coming decade Kuraray will continue to reinforce core technologies that have produced the world's finest products and global competitiveness (Core Competence), create a continuous stream of highly profitable businesses by developing diverse technologies (Frontier), and strengthen global competitiveness by delivering the highest quality (Refinement). These reforms will better position Kuraray to achieve its ¥1 trillion net sales target. In the postindustrial capitalist 21st century, in which corporate value is expected to focus more on people than it did in traditional capitalism, Kuraray will redouble efforts to promote a dynamic corporate culture (Vitality) and become a high-quality corporate Group that contributes to the global environment and a sustainable society (Sustainability).

Basic Policies to Realize Visions

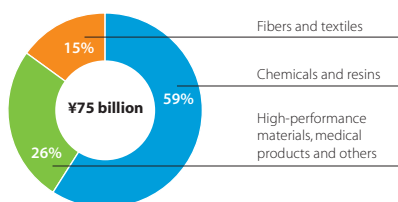


New Medium-Term Business Plan GS-21

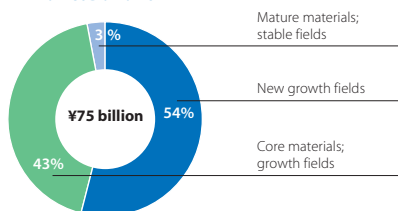
The new GS-21 Medium-Term Business Plan sets out strategies over three years. In the GS-21, we place considerable importance on concrete action plans that will enable us to reach commitment targets. Moreover, the plan sets out more ambitious targets, which assume the successful pursuit of new businesses, M&A, and individual strategic projects.

Breakdown of Sales Targets

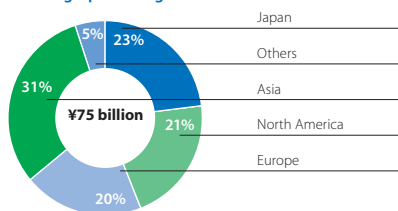
Business Segments



Market Domains



Geographical Segments



PERFORMANCE OUTLOOK

Billions of Yen

FY 2005 Actual

Net Sales	¥375.1
Operating Income	38.3
ROA	8.2%
ROE	6.5%

FY 2008 Commitment Target

Net Sales	¥450.0
Operating Income	50.0
ROA	9.0%
ROE	7.0%

FY 2008 Stretch Target

Net Sales	¥550.0
Operating Income	60.0
ROA	10.0%
ROE	8.0%

Create new businesses, expand operations through M&A (¥100 billion in net sales and ¥10 billion in operating income)

NET SALES AND OPERATING INCOME PLAN BY BUSINESS SEGMENT (COMMITMENT)

Billions of Yen

		FY 2005	FY 2008	Increase / Decrease
Chemicals and Resins	Net Sales	¥190.8	¥235.0	+44.2
	Operating Income	31.9	42.0	+10.1
Fibers and Textiles	Net Sales	109.1	120.0	+10.9
	Operating Income	9.5	12.0	+2.5
High-Performance Materials, Medical Products and Others	Net Sales	75.2	95.0	+19.8
	Operating Income	8.5	9.0	+0.5
Eliminated on Consolidation and Corporate	Operating Income	-11.5	-13.0	-1.5
Total	Net Sales	375.1	450.0	+74.9
	Operating Income	38.3	50.0	+11.7

STRATEGIES BY SEGMENT

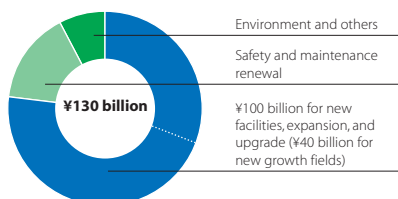
Chemicals and Resins

■ Raise profit growth through priority investments outlined in G-21

Underpinned by Kuraray's proprietary technology, poval, EVAL, and isoprene boast international competitiveness. While maintaining competitive advantages based on its global strategies, Kuraray will accelerate growth through technological innovation and new product development. At the same time, the Company will actively expand new growth fields, such as optical materials.

Resource Allocation

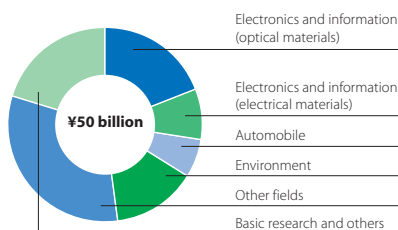
① Capital Expenditure

Major Capital Expenditure
(Acceptance basis)

Start of Operation

EWAL (4th line in USA+24,000 t)	Second half of FY 2006
SEPTON (USA+6,000 t)	Second half of FY 2006
Inorganic EL manufacturing and testing machines	Second half of FY 2006
PVA film for LCDs (+30 million m ²)	First half of FY 2007
TIRRENINA new man-made leather (+5 million m ²)	First half of FY 2008
GENESTAR (+6,000 t)	Second half of FY 2008

② Business Development Strategies



③ Financial Strategies

¥ Billions

Income

Expenditure

G-21 FY 2001–FY 2005

Net income	65	Dividends and buy back	31
Depreciation and amortization	103	Capital expenditure	185
Others	50		
Decrease in cash	35	Working capital and others	37

GS-21 FY 2006–FY 2008

Net income	78	Dividends	20
Depreciation and amortization	96	Capital expenditure	130
		Working capital and others	11
		Increase in cash	13

GS-21 Next 3–5 years

Funding		New business projects and M&A	200
---------	--	-------------------------------	-----

In the methacrylic resin business, Kuraray will establish a stable earnings structure by launching such new products as high-value-added optical materials as well as reinforcing manufacturing bases in China.

Fibers and Textiles

- Establish firm profitability in core materials while strengthening and improving product portfolio

Kuraray's *KURALON*, *KURALON K-II*, and *CLARINO* are world-leading products. Responding to market needs, Kuraray will step up efforts to upgrade technologies, increase production capacity, and invest in innovative processes to consolidate its platform for growth.

The Kuraray Group will reinforce its earnings structure in the mature domestic markets for *KURAFLEX*, *MAGIC TAPE*, and polyester by developing unique products through sophisticated processing technologies.

High-Performance Materials, Medical Products and Others

- Actively expand new growth fields through speedy technology innovation for diversified products

In opto-screens, *GENESTAR*, and liquid crystalline polymer film businesses, Kuraray will accelerate technological innovation that reflects customer needs to establish competitive advantages in new growth fields. Furthermore, Kuraray will expand by leveraging its strengths as a leading manufacturer of dental materials and activated carbon in the domestic market and developing unique products and global businesses. At the same time, Kuraray will implement strict measures to ensure management efficiency in engineering and other related businesses.

FINANCIAL STRATEGIES

Kuraray will continue to invest actively, implementing capital expenditure of ¥130 billion over three years. Of the ¥100 billion for investment in facilities enhancement, we have earmarked 40% for such growth fields as optics, automobiles, and energy. Further, we will concentrate investment on the strengthening of our facilities control systems and the securing of safe operations. The top left table shows our main capital expenditure. However, we are considering separate strategic investment of ¥200 billion for new businesses and M&A in the next three to five years.

Over the three-year period, we will invest ¥50 billion in R&D. Previously, we tended to overly disperse resources by investing in wide-ranging peripheral operations and diverse areas. Under GS-21, our strategy is to concentrate resources on the development of highly processed components in such strong-growth fields as optics, automobiles, and energy.

In G-21, including the acquisition of businesses, we undertook capital investments that were higher than net cash and cash equivalents provided by operating activities. Under GS-21, we plan to cover capital needs with net cash and cash equivalents provided by operating activities. However, we must raise funds externally for new business projects under the GS-21 and strategic investment capital for M&A. Targeting a payout ratio of between 25% and 30%, we aim to enhance the dividends-on-equity ratio through continued dividend increases based on higher ROE.

Interview with the President

Business Refinement to Become a ¥ 1 Trillion Company in 10 Years



“...we strengthened competitiveness by adhering to our growth strategy while stepping up the pace of business development, profit structure improvements, and the reorganization of businesses with low profitability.”

■ **Q: Looking back at the G-21 Medium-Term Business Plan, what were the concrete achievements and what issues remain?**

A: We prepared G-21 based on a reassessment of business conditions in light of the increasingly adverse effects of deflation. Under the previous Medium-Term Business Plan, we strengthened competitiveness by adhering to our growth strategy while stepping up the pace of business development, profit structure improvements, and the reorganization of businesses with low profitability.

Under G-21, we improved our business, asset, and regional portfolios. In our business portfolio, we expanded core material businesses and rebuilt mature businesses to enhance profitability. In assets, we reduced inventory assets, financial assets, and such non-operational assets as land while increasing operational assets through capital investment and M&A. In our regional portfolio, we grew overseas operations through the expansion of core material businesses in Europe and North America and the establishment of a processing base in China. In Japan, revenues decreased.

Meanwhile, as part of structural reform efforts aimed at speeding up management we introduced an in-house company system and an executive officer system. These changes have fostered a more rounded approach to business management because the head of each in-house company considers issues from the three perspectives of marketing, development, and production. Nevertheless, it became evident that a lack of perspective or sectionalism was negatively affecting some operational areas, evidenced, for example, by a reluctance to release personnel. These issues resulted from splitting operations into sections that were too small. To rectify this, in April 2006 we reorganized the Group into three companies responsible for specialty resins and films, fibers and textiles, and chemicals. This new structure will enable us to manage business from a medium- to long-term perspective, accelerate our responses to demand, and enhance the effective use of management resources. As for future issues, we need to step up the speed of our responses in relation to such areas as reducing inventory months, reflecting increases in raw material and fuel costs in product prices, realizing the benefits of capital investments, and bringing new products to market.

■ **Q: Could you explain the backdrop to your structural reform efforts to date in more detail?**

A: The 1990s are referred to as Japan's lost decade. But I do not necessarily see it that way. Most Japanese business managers had never experienced the business conditions that followed the collapse of the bubble economy and the onset of deflation. As in the period after the first oil shock, companies took belt-tightening measures, including cost reductions and personnel rationalizations. However, faced with stagnant sales due to deflation, business managers realized that simply expanding market share through increases in price competitiveness or offerings of general-purpose products were no longer effective. Japan's business leaders saw that to survive in world markets they had to build up corporate strength, not downsize. Furthermore, today's companies cannot keep business strategies close to their chests and move forward in whichever direction they please. They have third parties assess management strategies objectively and change their strategies if needed. To realize such checks, the establishment of relevant company structures is the first priority. Accordingly, we have bolstered our audit system and created a management advisory council. We consult with outside experts on important management issues two or three times a year. Although we came through tough times in the 1990s, the experience shook up our business management and has set us on the right track for the future.

■ **Q: Why did you prepare both a three-year Medium-Term Business Plan and a 10-Year Corporate Vision?**

A: Under our past two five-year plans, operations diverged from the proposed plans, forcing us to review plan targets. Considering the fast-paced changes of the current era, discrepancies between operational developments and plans are almost unavoidable. Therefore, we decided that a three-year period was more practical. At the same time, we wanted to clarify the Company's orientation over the longer term, based on the assumption of changing business conditions. Taking an overview of business conditions in the coming decade, the main changes we anticipate are the further manifestation of global environmental issues and the rapid curbing of economies' volume-based expansion. Because natural resources are finite, the global environment and sustainable economic growth will likely become major issues. Other large trends will include intensified global competition among companies and markets' accelerated regional expansion and change. As a result, the life spans of businesses and products will shorten, and the development of new products and applications will determine companies' survival. Only high-quality businesses and products that are internationally competitive or that have particular advantages in their markets will win out. In light of these trends, we believe companies must shift the focus of management strategies from quantity growth to quality enhancement. With our sights set on becoming a world-class company with net sales of ¥1.0 trillion, in 10 years we want to make the Kuraray Group a sustainable and growing diversified specialty chemicals company aimed toward exciting innovation and outstanding earnings and recognized throughout the world. In an era that values quality over quantity, the Kuraray Group will draw on a long-standing corporate culture that values

“With our sights set on becoming a world-class company with net sales of ¥1.0 trillion, in 10 years we want to make the Kuraray Group a sustainable and growing diversified specialty chemicals company aimed toward exciting innovation and outstanding earnings and recognized throughout the world.”

“...we will give priority to enhancing the quality of business development rather than increasing overall business size. In other words, our goal is to realize volume growth by garnering high quality.”



“contributing to the world and individual well-being through actions that others are unable to produce” to make a concerted advance toward the achievement of its 10-Year Corporate Vision.

■ **Q: In an age calling for quality rather than quantity, what do you think the key focuses of corporate management should be?**

A: Among the five basic strategies for the realization of our 10-Year Corporate Vision, I place particular weight on “refinement.” We do not intend to pursue general-use products as mainstay business areas. Rather than becoming caught up in the price competition that such business areas entail, we will succeed by adding value in quality, functionality, benefits, and beauty. Our pursuit of quality will involve the “streamlining” and “refinement” of a wide range of operations. By “streamlining,” we mean conserving management resources by reducing volumes and enhancing efficiency. Meanwhile, we use “refinement” to refer to intelligence as well as high quality that is more sophisticated and precise. As a company, we will pursue growth and expansion. However, we will give priority to enhancing the quality of business development rather than increasing overall business size. In other words, our goal is to realize volume growth by garnering high quality.

■ **Q: Why have you included two levels of targets in GS-21?**

A: While taking on ambitious targets is beneficial, I think failing to attain targets renders them meaningless. On the other hand, I feel we should avoid overly conservative targets that we reach ahead of schedule or even surpass. It is important to have a firm grasp of market information and the degree of maturity of each business and resolutely strive to achieve targets. Therefore, in GS-21 we established two levels of targets: commitment targets that we must reach no matter what happens and ambitious targets that we will reach if new businesses and M&A prove successful. Revenues from new ventures are always difficult to predict. There may be times when we cannot make the necessary technological breakthroughs. However, if we achieve these stretch targets, our 10-Year Corporate Vision’s ¥1.0 trillion net sales target will be within reach.

■ **Q: What types of businesses are you targeting for M&A?**

A: Until now, our M&A initiatives have sought to strengthen the profitability of existing businesses by increasing market share and expand our operational area by developing downstream businesses. At this juncture, we need to pursue M&A that will supplement management resources for the creation of new businesses as well as midstream and downstream M&A that will accelerate our development activities. One of our targets is the IT-related industry, which is very fast moving. If we cannot keep up with that pace, we will not deliver results, no matter how much effort or talent we apply. I think it will become ever more important for us to broaden points of contact with the outside to find out where we are lagging behind and where we are making good progress.

“...we must constantly identify and further strengthen businesses’ earnings structures while reorganizing and culling businesses that have become unviable. Selection and concentration will continue to be important management issues.”

■ **Q: Would it be correct to say that new business creation is the key to achieving net sales of ¥1.0 trillion?**

A: The keys to achieving this target are the creation of new businesses for such products as inorganic electroluminescence (EL) materials and the expansion of businesses in new growth fields, including optics, automobiles, and energy related materials. I had the figure of ¥550.0 billion set out in GS-21 as a stretch net sales target in mind for some time. However, we have not been able to reach that level due to the downsizing of polyester fibers and textiles businesses and other factors. Now, circumstances are different because we have almost completed the reconstruction of our business portfolio. Among Japanese specialty chemicals manufacturers, ¥500.0 billion or more is high for net sales. But by 2015, it will no longer seem such a considerable amount. As a first step toward becoming a ¥1.0 trillion company, we aim to take net sales past the ¥500.0 billion milestone in three or four years. Although three years is a tight schedule, I think this target is attainable.

■ **Q: Regarding the expansion of businesses in growth fields, will you change your current business portfolio?**

A: Historically, our earnings mainstays have been upstream materials businesses. However, in the coming decade we will increase the proportion of revenues generated by operations that involve high levels of processing, such as intermediary materials and components businesses. If we capitalize on our expertise in high precision molding and processing technologies and other areas to add value and quality, volume will follow naturally. Volume increases that are detrimental to earnings, in response to price competition for example, are undesirable. I think the economy as whole has reached a turning point and is beginning to move from quantity to quality. Although we now have a strong business portfolio in place, businesses always mature and decline. Therefore, we must constantly identify and further strengthen businesses’ earnings structures while reorganizing and culling businesses that have become unviable. Selection and concentration will continue to be important management issues.

■ **Q: Rather than a central R&D division, why does Kuraray spread its R&D activities across various operational divisions?**

A: The objective of our R&D activities is the creation of new businesses. Accordingly, in April 2006 we established the New Business Development Division, which integrates new business development functions, including M&A transactions and alliances, into the existing R&D section. The Group has approximately 800 researchers and engineers. However, until now we had too many development themes for our personnel to handle. Consequently, even when we commercialized R&D achievements, in many cases they did not generate substantial earnings. As part of measures to rectify this situation, we drastically narrowed down our development themes. Under this initiative, we established strategic R&D themes to enable us to concentrate the deployment of management resources on themes that promise significant earnings. The president of a major



“Aiming to respect this corporate culture in the next decade and beyond, we will create numerous high-quality businesses and products that contribute to the realization of a sustainable society.”

sensor manufacturer commented that his company was able to win in competition with large companies that had 1,000 researchers because the large company allocated 10 researchers to sensor R&D whereas his company dedicated between 50 and 60 researchers. In other words, clarifying overall direction and consolidating research themes increase development speed and produce results. Furthermore, failing to keep abreast of the latest developments can result in situations in which technology that you thought was outstanding is in fact out of date. If we cannot see the world outside because we are absorbed in research, our efforts will be fruitless. This does not only apply to R&D; we have to make greater efforts to foster outside relationships, particularly with customers. The success or failure of our GS-21 Medium-Term Business Plan depends on our ability to gather outside information accurately and heighten profitability by discovering business chances based on combinations of our resources with those of other companies. It is important for those involved in R&D to be familiar with the market. Even if we focus efforts on the development of optical applications as a chemicals manufacturer, chemists alone cannot develop new products. We have to forge alliances with universities and companies to help guide our R&D activities while dispatching our personnel to absorb technology. For example, we are speeding up the development of inorganic EL through the operational dovetailing that has resulted from an alliance.

■ **Q: Lastly, what does Kuraray's corporate culture of “contributing to the world and individual well-being through actions that others are unable to produce” mean, and how will you exploit it in the 10-Year Corporate Vision?**

A: The Company began 80 years ago by commercializing rayon. Our 1950 commercialization of vinylon – the first synthetic fiber manufactured in Japan – was the first step toward becoming a specialty chemicals manufacturer. Feeling a strong social obligation to help repair the devastation that war had wreaked on the lives of the Japanese, we spared no efforts in commercializing vinylon. Furthermore, we overcame significant hurdles in developing *CLARINO* and isoprene, which we subsequently commercialized as substitutes for limited natural resources. Since our development of *EVAL*, we have single-handedly led the world in the development of new markets for food packaging. These commercialization initiatives have formed two values. First, we believe in addition to being profitable, our businesses must benefit consumers. In other words, companies have not only financial responsibilities but also social responsibilities. Second, to benefit society we have to create businesses based on revolutionary technologies. “Contributing to the world and individual well-being” refers to social responsibility, while “through actions that others are unable to produce” indicates the development of unique technology and the innovation of adopted technology. These two unchanging values in relation to management and technology will be the most important factors supporting the sustainability of Kuraray's operations. Aiming to respect this corporate culture in the next decade and beyond, we will create numerous high-quality businesses and products that contribute to the realization of a sustainable society.

Kuraray's Optical Materials – Paving the Way for Tomorrow's LCDs

WHY OPTICAL MATERIALS?

Until now, Kuraray's business expansion has focused on development products based on vinyl acetate, isoprene, man-made leather, and other materials. We have established a number of world-leading businesses by opening up new markets through the application of our unique technology to realize materials' distinctive properties. However, no matter how distinctive, there are limits to the advancements in growth and earnings that can be achieved through the production and sale of such materials. Therefore, we have to contribute directly to increasing the sophistication of finished products by processing materials to add value. In other words, we must shift the focus of our business strategy from quantity to quality to become a specialty chemicals manufacturer. Kuraray has technologies for the production and development of materials with outstanding optical properties, such as poval and methacrylic resin. However, optical materials account for only 10% of consolidated net sales. Because high-value-added optics-related products are one of our most promising growth fields, the marketing of such products to drive growth will be Kuraray's key business strategies.

Display	Application	Material	Technology	World market share
LCD	Polarized film	Poval film	Film molding	80%
	Light guide plates	Methacrylic pellet	Precision molding	65%

KURARAY'S OPTICAL MATERIALS

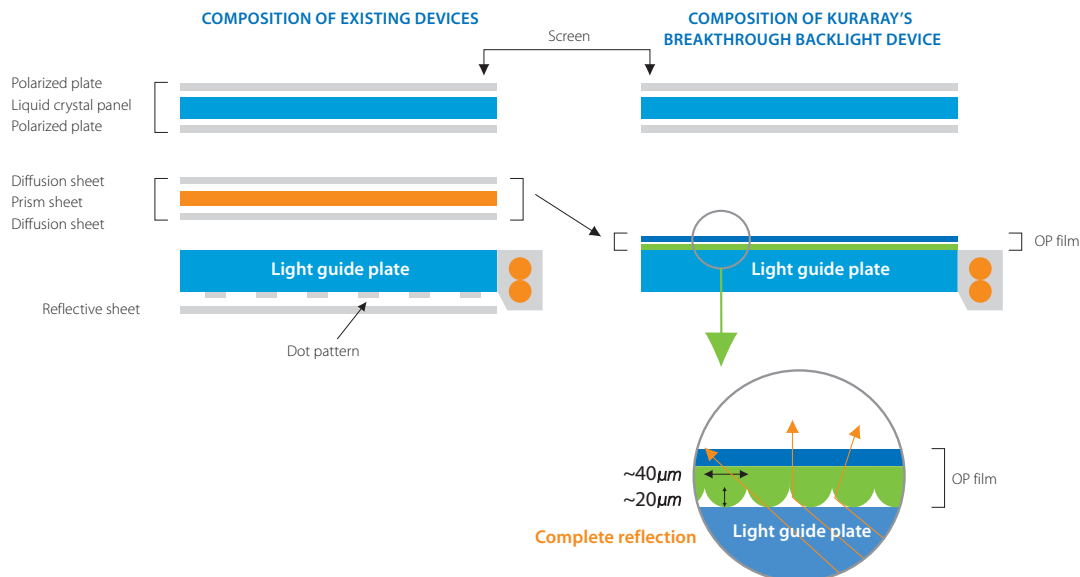
Poval film was used mainly for apparel packaging. In 1965, however, the excellent optical properties of the film gained attention when it was used as a polarized film for sunglasses. Using our molding technology for films, we can produce a range of characteristics, including precise molecular orientation, transparency, stretchability, antistatic properties, and dyeability. Today, poval film is indispensable in the production of liquid crystal displays (LCDs). Furthermore, we accumulated precision molding technology for methacrylic resin through our participation in laser disk operations as a downstream business in the 1980s. We have further honed this technology for the production of light guide plates and opto-screens. Our molding technology for films and our precision molding technology for methacrylic resin form the foundations of our development of optical materials.

THE DEVELOPMENT OF BACKLIGHTS THROUGH INNOVATIVE TECHNOLOGY

Backlights and color filters are among the highest-cost LCD components. Despite demand for slimmer, lighter, lower-cost backlights, the development of these components lags behind other LCD components. Leveraging technology cultivated in the manufacturing of light guide plates, Kuraray has successfully developed a breakthrough backlight device, which satisfies that demand. This device combines multiple functions in a single thin layer through the bonding of a special OP film with diffusion and prism functions to a light guide plate. Reducing the number of layers enables slimmer backlight devices, more reliable quality, reduced costs for components and assembly, and enhanced yield. Furthermore, according to our research, OP film has a microlens architecture that enhances light utilization by about 20% compared with existing products. Within the Technology Research Association for Advanced Display Materials, TRADIM, which is led by Japan's Ministry of Economy, Trade and Industry, Kuraray is in charge of backlight development. The application of our breakthrough backlight technology (combined multiple function light guide plate) has allowed us to reduce the thickness of backlight devices to 0.36mm, compared with thicknesses of between 1.0mm and 1.5mm for existing devices. This new technology will enable the creation of much slimmer LCDs as well as smaller and lighter portable devices.

Slimmer backlight devices

We are enabling slimmer backlight devices through the use of a single layer that performs the functions previously carried out by a four-layer structure.



Properties of Ultra-Bright Inorganic EL

	Brightness (cd/m ²)	Lifetime (hours)
Ultra-bright inorganic EL	350,000	25,000 or more
Inorganic EL	100	30,000
Organic EL (low-molecular type)	1,000	10,000

- Emits light at low voltage (5~6V)
→ Can operate using batteries
- Ultra-bright with no heat generation
→ Long lifetime
- Coating method enables production of large-surface-area light sources
→ Low-cost production
- Very stable and safe with respect to air humidity
→ Easy to handle and manufacture

JOINT DEVELOPMENT OF ULTRA-BRIGHT INORGANIC EL MATERIAL

In addition to realizing thinner backlight devices, devising a thinner light source is crucial to developing slimmer LCDs. Among current light sources, light-emitting diodes are at a disadvantage as they are point illuminants and thus not suited to large-screen displays. In addition, there are limits to the slimness that can be achieved using cold cathode-ray tubes (CRT). By comparison, EL materials are attracting attention as a next-generation light source because they can be made ultrathin and are surface rather than point illuminants. Organic and inorganic EL materials are under development. Inorganic EL materials have long life spans but inadequate brightness. Organic EL materials have high brightness but short life spans. It is expected that resolving the trade off problem between durability and brightness would produce a revolutionary light source. Our business partner T. Chatani & Co., Ltd. overcame this problem and developed an ultra-bright long-lasting inorganic EL material. Kuraray and T. Chatani & Co. then established the K-C Luminas Co., Ltd. to conduct research targeting the commercialization of material, focusing on the creation of a white light source product for LCD backlight devices. Moreover, we intend to develop a backlight device that combines ultra-bright inorganic EL material with our breakthrough backlight technology. Also, we are setting our view on the development of luminescence materials for full-color displays as well as various light sources.

OUR CONTRIBUTIONS TO THE FUTURE OF DISPLAYS

We will allocate management resources to development activities that combine the technology of T. Chatani & Co. for the development of inorganic materials with our polymer, synthetic, and precision molding technologies to create the ultimate ultra-thin, long-life, low-electric-power-consumption display components that can be used with any size of screen. Kuraray will deepen its R&D collaborations with major companies and institutions to accumulate new technologies and contribute to the future of displays.

CURRENT CAPABILITIES OF VARIOUS TYPES OF DISPLAYS

		Cathode-ray tube (CRT)	Liquid crystal display (LCD)	Plasma display	Electroluminescence (EL)		
		CRT	LCD	PDP	Inorganic EL	Organic EL	Ultra-bright inorganic EL (under development)
Image quality	Brightness	○	△	△	×	△	◎
	Viewing angle	◎	△	○	◎	◎	◎
	Moving image performance	◎	△	○	◎	◎	◎
Thin-type compatibility		×	○	△	◎	◎	◎
Electric power consumption		×	△	△	○	○	◎
Product lifetime		◎	○	△	◎	△	◎

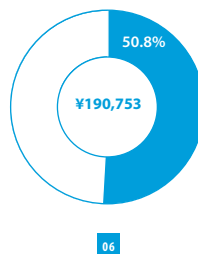
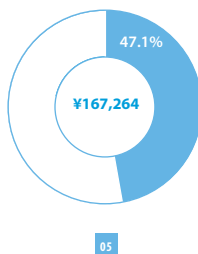
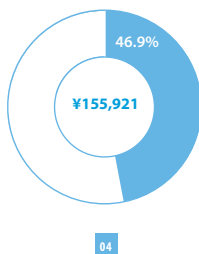
Kuraray Group's Segments and Products

BUSINESS SEGMENT

NET SALES BY BUSINESS SEGMENT (¥ Millions)

MAJOR PRODUCTS

Chemicals and Resins



■ KURARAY POVAL, MOWIOL

■ PVA film

■ MOWITAL (PVB resin)

■ PVB film

■ EVAL resin

■ EVAL film

■ SEPTON, HYBRAR (thermoplastic elastomer)

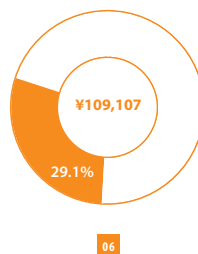
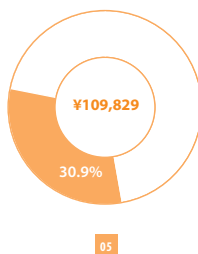
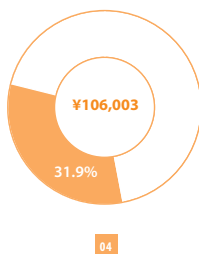
■ Fine chemicals

■ Methacrylic monomer

■ Methacrylic resin

■ Methacrylic sheets

Fibers and Textiles



■ KURALON (PVA fiber)

■ KURALON K-II (new type of PVA fiber)

■ VECTRAN (Polyarylate fiber)

■ Polyester staple

■ Polyester filament

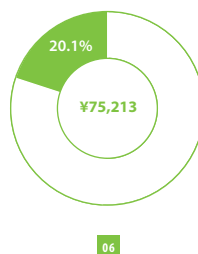
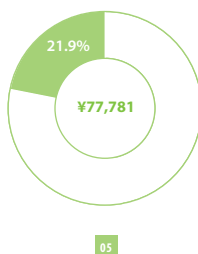
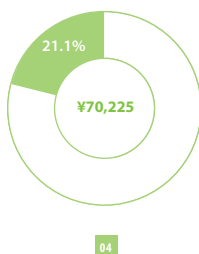
■ CLARINO, AMARETTA (man-made leather)

■ KURAFLEX (nonwoven fabric)

■ Melt-blown nonwoven fabric

■ MAGIC TAPE (hook and loop fastener)

High-Performance Materials, Medical Products and Others



■ GENESTAR (heat-resistant polyamide resin)

■ VECSTAR (liquid crystalline polymer film)

■ High-performance membranes

■ PVA gel

■ Dental materials

■ Medical devices

■ Activated carbon

PRIMARY APPLICATIONS	PRODUCTION FACILITIES	ANNUAL PRODUCTION CAPACITY
Textiles, paper additives, adhesives, butyral precursor	Okayama Plant (Okayama)	96,000 t
	Niigata Plant (Niigata)	28,000 t
	Kuraray Specialities Europe GmbH (Frankfurt, Germany)	70,000 t
	Poval Asia Pte Ltd. (Singapore)	20,000 t
Computers, LCD televisions, monitors	Kuraray Saijo Co., Ltd. (Ehime)	31,000,000 m ²
	Kuraray Tamashima Co., Ltd. (Okayama)	30,000,000 m ²
		(1st half FY 2007: +30,000,000 m ²) (2nd half FY 2007: +30,000,000 m ²)
Interlayers for windows and windshields, paints, adhesives	Kuraray Specialities Europe GmbH (Frankfurt, Germany)	20,000 t
Laminated safety glass	Kuraray Specialities Europe GmbH (Troisdorf, Germany)	22,000 t
		(June 2007: +8,000 t)
Food packaging materials, plastic fuel tanks	OOO Trosifol (Nizhniy Novgorod, Russia)	4,000 t
	Okayama Plant (Okayama)	10,000 t
	Eval Company of America (Texas, U.S.A.)	23,000 t
		(2nd half FY 2006: +24,000 t)
	EVAL Europe N.V. (Antwerp, Belgium)	24,000 t
Food packaging materials	Okayama Plant (Okayama)	3,000 t
PVC and vulcanized rubber substitute, food packaging materials	Kashima Plant (Ibaraki)	23,000 t
	SEPTON Company of America (Texas, U.S.A.)	12,000 t
		(March 2007: +6,000 t)
Pharmaceutical and agrochemical intermediates, vitamin precursor	Niigata Plant (Niigata)	–
Solvents, adhesives, methacrylic resin	Niigata Plant (Niigata)	67,000 t
Resins for molding, light guides plates, synthetic marble	Niigata Plant (Niigata)	40,000 t
Signboards, displays, TV front panels, light guides plates	Niigata Plant (Niigata)	43,600 t
	Kuraray Methacrylate (Zhangjiagang) Co., Ltd.	3,000 t
Agriculture and fishery materials, civil engineering materials	Okayama Plant (Okayama)	35,000 t
Cement reinforcing agents, woven and knitted textiles	Okayama Plant (Okayama)	7,000 t
Rope, fishing nets, and other industrial products	Kuraray Saijo Co., Ltd. (Ehime)	500 t
		(October 2006: +100 t)
Materials for nonwoven fabrics and industrial materials	Kuraray Tamashima Co., Ltd. (Okayama)	12,000 t
Woven and knitted textiles, tents, sheets	Kuraray Saijo Co., Ltd. (Ehime)	10,000 t
Shoes, bags, sporting goods, luxury clothing, interior furnishings	Okayama Plant (Okayama)	15,500,000 m ²
	Hexin Kuraray Micro Fiber Leather (Jiaxing)	4,000,000 m ²
Wiping materials, wet wipes, surgical masks	Kuraflex Co., Ltd. (Okayama)	10,500 t
	Kuraflex Ibaraki Co., Ltd. (Ibaraki)	3,500 t
Coffee bags, filters	Kuraray Saijo Co., Ltd. (Ehime)	1,800 t
Clothing, shoes, car seats	Magictape Co., Ltd. (Fukui)	48,000,000 m
	Kuraray Magictape (Shanghai) Co., Ltd.	10,000,000 m
Electronics parts, auto parts	Kuraray Saijo Co., Ltd. (Ehime)	4,000 t (neat polymer base) (July 2007: +1,500 t)
Circuit-board substrates	Kurashiki Plant (Okayama)	150,000 m ²
Water purification and wastewater treatment	Kurashiki Plant (Okayama)	100,000 m ²
Water purification and wastewater treatment	Kuraray Saijo Co., Ltd. (Ehime)	3,000 m ³
Dental adhesives, dental filling materials	Kuraray Medical Inc. (Okayama)	600,000 sets
Artificial kidneys, dialysis machines	Kuraray Medical Inc. (Okayama)	2,800,000 units
		(artificial kidneys)
Water purification facilities, gas separators, capacitor materials	Kuraray Chemical Co., Ltd. (Osaka)	22,500 t
	Cenapro Chemical Corporation (Philippines)	13,000 t
	Kuraray Chemical (Ningxia) Environmental Industry Co., Ltd.	2,000 t

Review of Operations



Chemicals and Resins

- **Poval**
Poval resin/Poval film/PVB resin/PVB film
- **EVAL**
- **Isoprene Chemicals**
SEPTON/HYBRAR/Aroma chemicals/
Pharmaceutical intermediates
- **Methacrylic**
Methacrylic resin/Methacrylic sheets/
Synthetic marble



Fibers and Textiles

- **Man-Made Leather**
CLARINO/AMARETTA/PARCASSIO/
TIRRENINA
- **KURALON/KURALON K-II**
- **New-Type Polyester**
SOPHISTA
- **Nonwoven Fabrics**
KURAFLEX
- **Fastening Materials**
MAGIC TAPE



High-Performance Materials, Medical Products and Others

- **High-Performance Materials**
Opto-screens/GENESTAR/
VECSTAR
- **Medical Products**
Dental materials/Artificial kidneys
- **Environmental Businesses**
Industrial membranes/Activated carbon

Chemicals and Resins Business

The segment posted increases of ¥23,489 million, or 14.0%, in net sales, to ¥190,753 million, and ¥3,448 million, or 12.1%, in operating income, to ¥31,868 million.

Group Companies

Company Name

- 1 Kuraray America, Inc.
- 2 Eval Company of America
- 3 SEPTON Company of America
- 4 Kuraray Europe GmbH
- 5 EVAL Europe N.V.
- 6 Kuraray Specialities Europe GmbH
- 7 Kuraray Hong Kong Co., Ltd.
- 8 Kuraray Specialities Asia Pte., Ltd.
- 9 Poval Asia Pte Ltd.
- 10 Kuraray (Shanghai) Co., Ltd.
- 11 Kuraray Trading Co., Ltd. (Seoul Branch)
- 12 Kuraray Methacrylate (Zhangjiagang) Co., Ltd.
- 13 Kuraray Trading Co., Ltd.
- 14 Kuraray Co., Ltd.

Capital (Millions)

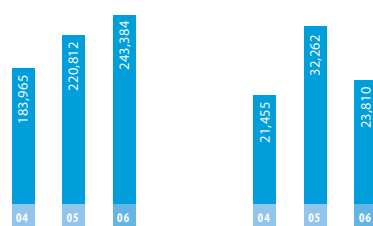
US\$10.1
US\$4.15
US\$35
€ 31.2
€ 29.7
€ 20.0
HK\$4.65
SP\$45.6
SP\$40
US\$5.0
US\$5.0
¥2,200
¥ 88,955

Activities

Importing and sales of Kuraray products in the United States
Manufacture and sales of *EVAL* in the United States
Manufacture and sales of thermoplastic elastomers
Importing and sales of Kuraray products in Europe
Manufacture and sales of *EVAL* in Europe
Manufacture and sales of poval and butyral resins and film
Processing and sales of Kuraray products in China and Southeast Asia
Sales of poval resins
Manufacture of poval resins
Importing and sales of Kuraray products in China
Importing, exporting, and wholesale of fiber and textile products and chemicals
Manufacture of methacrylic resin sheets in China
Importing, exporting, and wholesale of fiber and textile products and chemicals
Manufacture and sales of Kuraray products

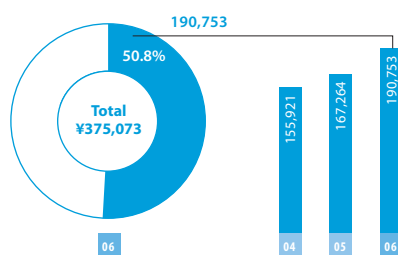
Identifiable Assets and Capital Expenditure

¥ Millions



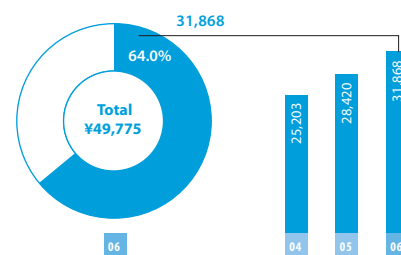
Net Sales

¥ Millions



Operating Income*

¥ Millions



* Including ¥11,498 million eliminated on consolidation and corporate.

POVAL

Sales of optical-use poval film for use in LCDs were strong. The expansion of optical film manufacturing facilities (30 million m² per year) during the fiscal year under review also contributed to sales growth. Sales of poval resin in Europe were stagnant impacted by increased imports from other regions reflecting the strong euro, and fared little better in Asia due to intense competition. Spurred by a robust performance in polyvinyl butyral (PVB) film for use in construction materials, overall poval resin sales enjoyed an increase in both revenues and earnings. In an effort to address continued strong demand for optical-use poval film for

use in LCDs, Kuraray is advancing further expansion of manufacturing facilities (30 million m² per year) for scheduled completion in the first half of fiscal 2007.

EVAL

Demand for *EVAL*, an ethylene vinyl alcohol polymer resin, for food packaging application was steady in Japan, Europe and the United States. In addition to a slump in demand for automobile fuel tank application in the United States, results were also impacted by the sharp rise in raw material and fuel prices. Accounting for these factors, *EVAL* results saw an increase in revenues and a drop in earnings.

Major Products



POVAL RESIN

Kuraray was first in the world to develop PVA fiber and has developed numerous applications for this material, including use as a fiber-sizing

agent, an adhesive, a paper-processing agent, a raw material for butyral, and as a polarized film for LCDs. Kuraray has a high level of technological expertise in fields where quality and performance of stabilizers and paper processing agents are needed and is expanding sales of water-soluble and easily molded *EXCEVAL* and other differentiated and high-specification materials.

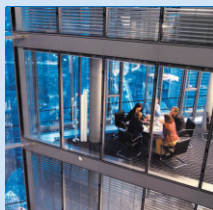


POVAL FILM

Utilizing poval's transparency, dyeability, antistatic properties, stretchability, and molecular orientation, poval film is used as a base

for the polarized film needed in LCD manufacturing. Kuraray commands an 80% share of this market. Demand is forecast to grow further as a result of the growth in demand for LCD televisions and other LCD devices as well as increasing screen size. Water-soluble film, employing poval's most significant characteristic – its water solubility – is used in curved-surface printing applications. Further, we have used a new polymer to develop the optical-use film VF-PE, which improves upon the polarization and other optical functions of

previous optical-use poval films. This new material will contribute to the realization of slimmer LCDs with enhanced contrast, higher yield, and lower electric power consumption. Commercialization of the film commenced at the beginning of 2006.



BUTYRAL RESIN/FILM

Kuraray markets a wide range of PVB, which is characterized by excellent adhesion to a variety of surfaces, such as glass

and metals, and ease of workability into films with outstanding optical transparency. The array of applications for butyral resins and films include interlayers for shatterproof laminated safety glass; windows for building materials and automobile windshields, binders for ceramic, paint and ink, and base adhesives for retroreflective films used for such applications as highway signs.



EVAL (FOOD PACKAGING)

EVAL has the highest gas impermeability of any plastic. When used as a food packaging material, therefore, this resin is

extremely effective in preventing the passage of oxygen and preventing the oxidation and deterioration of the contents. Kuraray was the first in the world to develop

this material, which has a broad range of applications as a food packaging material. It is also an eco-friendly material, because no harmful substances are emitted when it is incinerated. Combining high elasticity and gas impermeability characteristics, SP-Grade *EVAL* caters to a broad range of market needs, including shrink film applications and use for beverage containers with complex shapes.



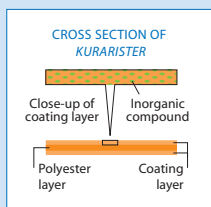
EVAL (OTHER APPLICATIONS)

EVAL is used to make plastic fuel tanks, where its high gas impermeability protects the environment

by preventing volatilized gasoline from leaking into the atmosphere. As automakers increasingly turn to plastic fuel tanks in new cars, and as regulations on atmospheric emissions become stronger, this application should show high growth – particularly in Japan, the United States, and Western Europe. Furthermore, the adoption of plastic fuel tanks is spreading in China, Southeast Asia, South America, and Eastern Europe. In addition, *EVAL* is used in wallpaper and similar applications because of its resistance to soiling.

ISOPRENE

Strong demand for the thermoplastic elastomer *SEPTON* as a substitute for vulcanized rubber and soft PVC resulted in higher sales in Europe, the United States, and Asia. On the earnings front, however, profits were impacted by rising raw material and fuel prices. Kuraray is currently moving forward with an expansion of manufacturing facilities (6,000 tons per year) in the United States in response to further growth in *SEPTON* demand. Completion of facility expansion is scheduled for the second half of fiscal 2006. In the fine chemicals field, sales were also steady for items such as medical intermediates. As a result, revenues and earnings for isoprene-related products were up year on year.



KURARISTER

This new barrier film realizes excellent gas impermeability and outstanding durability under retort treatment, with the ability to with-

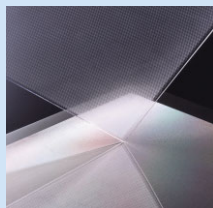
stand sterilization at 135°C for 60 minutes. A specially coated polyester film, *KURARISTER* achieves robust gas impermeability after retort processing, with oxygen permeability of less than 1 cc per square meter per day. Unlike conventional aluminum packs, *KURARISTER* can be heated in microwave ovens. The new material enables the use of metal detectors to check for foreign objects after packaging at food processing plants.



METHACRYLIC RESIN AND SHEETS (GENERAL PURPOSE)

Methacrylic resin's transparency and weather resistance are among the highest of any plastic.

It is therefore used in lighting fixtures, signboards, construction materials, aquaria, and automotive applications. Special processing converts it into synthetic marble for kitchens and bathrooms. Because demand for such applications is forecast to rise in China, the Company started up production at facilities (3,000 tons per year) in China in fall 2005.



METHACRYLIC

Despite stagnant demand for methacrylic resin for general applications, demand was robust for optical-use products such as LCD light-guide plates. As a result, sales remained flat while profits increased. Effective September 30, 2005, the Company terminated its relationship with regard to Kyodo Monomer Co., Ltd., a joint venture between Kuraray and Mitsui Chemicals, Inc. to manufacture methyl methacrylate (MMA) monomer. Kuraray has transferred its entire stockholding to Mitsui Chemicals. In addition, construction of cast sheet manufacturing facilities (3,000 tons per year) in China was completed. Operations commenced from the second half of fiscal 2005.

OPTICAL-USE

METHACRYLIC RESIN

Kuraray is using its high-level precision molding and processing technology to develop optical applications for its methacrylic

resin. These include high-performance, high-quality optical materials used in light guides and diffusion plates for LCD backlighting devices and front plates with antireflective properties and hard coatings for various display devices.



SEPTON

With the elasticity of rubber and as moldable as plastic, the thermoplastic elastomer *SEPTON* is used as a substitute for vulcanized rubber and flexible PVC

in electronics materials, construction materials, tools, stationery, toys, and various other applications. We are working to expand the use of V-grade *SEPTON* in fields where heat resistance is needed, such as auto parts. In the future, a number of new applications are expected.



ISOPRENE SPECIALTY CHEMICALS

With its proprietary specialty chemicals and compounding technologies, Kuraray has become the sole source for diol and

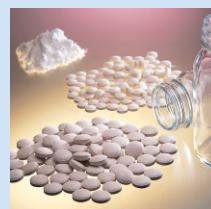
polyol products used as raw materials for polyurethane and resin modifiers. In addition, the highly stable and easy-to-handle industrial solvent is attracting attention in a number of industrial sectors in this era of rising environmental concern.



AROMA CHEMICALS

The Company has built a unique fine chemicals business around isoprene, a component molecule of natural rubber. Today, Kuraray markets more

than 30 aroma chemicals, including linalool (lily of the valley scented) and citral (lemon scented) as well as isoprene glycol and other materials used in cosmetics manufacturing. Aroma chemicals produced through isoprene chemistry are used in various hair care products.



PHARMACEUTICAL INTERMEDIATES

Employing its expertise in fine chemicals technology, Kuraray has developed pharmaceutical intermediates for antivirals, hyper-tension drugs, antibiotics, and other medications. The Company also markets intermediates for highly safe agricultural chemicals and home-use pyrethroid insecticides.

Fibers and Textiles Business

Net sales edged down ¥722 million, or 0.7%, to ¥109,107 million. However, operating income was up ¥1,530 million, or 19.3%, to ¥9,451 million.

Group Companies

Company Name	Capital (Millions)	Activities
1 Kuraray America, Inc.	US\$10.1	Importing and sales of Kuraray products in the United States
2 Kuraray Europe GmbH	€ 31.2	Importing and sales of Kuraray products in Europe
3 amaretta GmbH	€ 1.0	Sales of man-made leather in Europe
4 Lorica Sud S.r.l.	€ 0.9	Processing and sales of man-made leather in Europe
5 Kuraray Hong Kong Co., Ltd.	HK\$4.65	Processing and sales of Kuraray products in China and Southeast Asia
6 Kuraray Trading (Shanghai) Co., Ltd.	US\$0.3	Importing, exporting, and wholesale of fiber and textile products and chemicals
7 Kuraray Trading Co., Ltd. (Seoul Branch)		Sales of Kuraray products
8 Kuraray Trading Co., Ltd. (Taipei Branch)		Sales of Kuraray products
9 Kuraray Trading Co., Ltd. (Hong Kong Branch)		Sales of Kuraray products
10 Kuraray Trading Co., Ltd. (Hanoi Branch)		Sales of Kuraray products
11 Nantong Kuratray Garment Co., Ltd.	¥220	Manufacturing and sales of a wide range of textile products
12 Kuraray Magictape (Shanghai) Co., Ltd.	US\$0.85	Processing and sales of fastening materials in China
13 Kuraray (Shanghai) Co., Ltd.	US\$5.0	Importing and sales of Kuraray products in China
14 Kuraray Trading Co., Ltd.	¥2,200	Importing, exporting, and wholesale of fiber and textile products and chemicals
15 Kuraray Co., Ltd.	¥88,955	Manufacture and sales of Kuraray products

Major Products



CLARINO
The world's top brand of man-made leather, CLARINO is used in applications ranging from sports shoes, street shoes for men

and women, clothing, interior furnishings, bags, and sporting goods to industrial materials. Kuraray has also developed the new materials PARCASSIO, which boasts improved air and moisture permeability and is highly regarded in the marketplace, and the environment-friendly material TIRRENINA, which is manufactured using a revolutionary organic-solvent-free process.



AMARETTA
AMARETTA is a premium man-made, suede-style leather made from microfiber. Used to manufacture up-market coats and jackets, AMARETTA is also used to upholster sofas and in other interior furnishing applications. The Company is also striving to open the car-seat field.



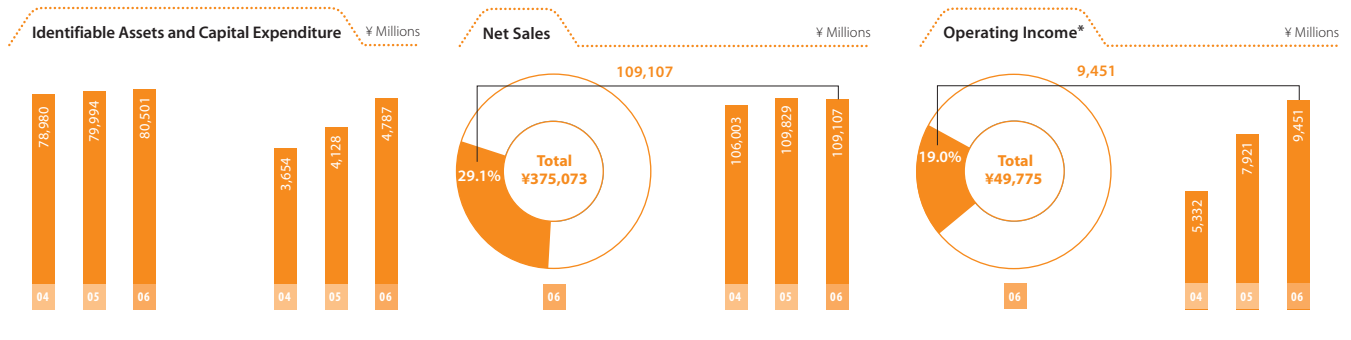
KURALON and KURALON K-II
In 1950, Kuraray achieved the world's first commercialization of the synthetic fiber KURALON, which has characteristics that

include high strength, low elasticity, hydrophilic properties, alkali compatibility, and weather resistance. This makes it suitable for use in industrial materials. It is essential in the manufacture of high-pressure hoses and as a cement-reinforcing agent.

KURALON K-II is water soluble at any temperature and has high strength. It is in the limelight as a fiber that allows new design concepts and has applications in a number of industries.



VECTRAN
This high-performance polyarylate fiber has a wide variety of properties, including outstanding grip and non-water-absorbency as well high strength



* Including ¥11,498 million eliminated on consolidation and corporate.

KURALON

KURALON saw firm demand in specialty fields, including use in fiber-reinforced cement as an asbestos substitute, in the manufacture of rubber, and in paper and nonwoven fabric. However, an accident at the Okayama Plant impacted sales. Despite a sharp increase in raw material and fuel prices, earnings were at approximately the same level as in the previous fiscal year.

CLARINO

Revenues and earnings were up, as brisk sales of products for use in bags and other accessories and in such industrial applications as polishing materials enabled these lineups to shrug off stagnant sales for interior applications. Further, having completed construction

of production facilities (4 million m² per year) in China for a joint venture company established with a local company, Kuraray started up operations in the second half of the fiscal year under review.

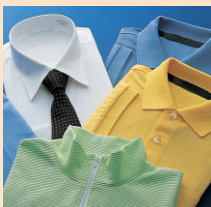
NONWOVEN FABRICS AND FASTENERS

Thanks to a pick-up in domestic demand and cost reductions, nonwoven fabrics and hook and loop fasteners generated higher revenues and earnings.

POLYESTER

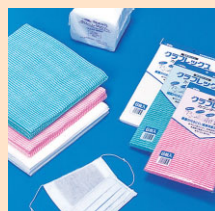
Sales of polyester declined, as demand shifted toward differentiated products, reflecting higher raw material and fuel prices in product prices and reducing costs improved earnings.

and moisture-abrasion resistance in extremely cold conditions. It is used in rope, submarine cables, tension member in fiber optic, and fishing net, and other industrial material applications, as well as sporting goods and a range of other applications. It was also used in the air bags on the Mars exploration rovers.



New Polyesters

Kuraray is developing new, high-value-added fibers and textiles for use in clothing by blending polyester with the Company's proprietary polymers. The EVAL blend SOPHISTA, a material with a cool feel, and the series of lightweight fabrics made by eluting the water-soluble resin EXCEVAL at the dyeing stage, are growing in popularity.



KURAFLEX

Kuraray's KURAFLEX dry-laid nonwoven fabric is used in disposable sanitary products, and the Company is developing high-order blended products using its proprietary polymers. We are strongly promoting the use of this material in industrial and construction materials, where strength and durability are required.

The melt-blown nonwoven fabrics offer a number of properties, including filtering functionality, moisture permeability, and water repellency. We are using this material to develop coffee bags, food packaging materials, filter masks, and other products.

In 2006, Kuraray developed a new nonwoven fabric with characteristics, such as bulkiness, water

solubility, and elasticity, etc., that we achieved by leveraging the unique properties of raw material cut fibers.



MAGIC TAPE

Kuraray's hook and loop MAGIC TAPE are used in clothing, shoes, bags, medical products, and various industrial fields. The Company is

presently engaged in the development of a back coating that uses no organic solvents for an environment-friendly MAGIC TAPE. Further, MAGILOCK is a plastic surface fastener for industrial use that offers outstanding fastening strength. Used to secure such items as automotive seats and join construction materials, this new product contributes to labor saving in assembly operations and the promotion of recycling.

High-Performance Materials, Medical Products and Others Business

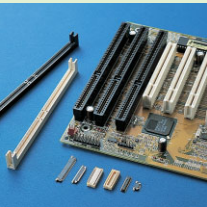


Net sales declined ¥2,568 million, or 3.3%, to ¥75,213 million. Nevertheless, operating income rose ¥1,123 million, or 15.3%, to ¥8,456 million.

Group Companies

Company Name	Capital (Millions)	Activities
1 Kuraray America, Inc.	US\$10.1	Importing and sales of Kuraray products in the United States
2 Kuraray Europe GmbH	€ 31.2	Importing and sales of Kuraray products in Europe
3 Kuraray (Shanghai) Co., Ltd.	US\$5.0	Importing and sales of Kuraray products in China
4 Kuraray Chemical Co., Ltd.	¥600	Manufacture and sales of activated carbon and related products
5 Kuraray Chemical (Ningxia) Environmental Industry Co., Ltd.	¥400	Manufacture and sales of activated carbon and related products
6 Kuraray Trading Co., Ltd.	¥2,200	Importing, exporting, and wholesale of fiber and textile products and chemicals
7 Kuraray Co., Ltd.	¥88,955	Manufacture and sales of Kuraray products

Major Products



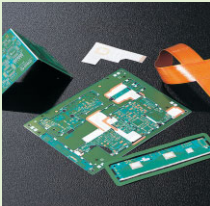
GENESTAR
GENESTAR is a heat- and abrasion-resistant polyamide resin developed by Kuraray, which is widely used in thin-walled, narrow

pitch surface mount technology (SMT) connectors for computer devices. This is a durable resin that can withstand conditions in automobile engine compartments and other severe conditions. Expectations that GENESTAR will become an important material in the automotive industry are rising.



VECRY
VECRY is a polyarylate hybrid conjugated monofilament, whose special properties include high strength, high modulus, and low creep.

It is used for the high-precision, high-density printing screens required in the production of plasma display panels, semiconductors, and printed wiring boards.



VECSTAR
The application of Kuraray's original molecular orientation technology to a polyarylate-type liquid crystal polymer film has realized a high-performance film with advanced functionality that curbs various types of liquid crystal polymer film anisotropy. VECSTAR film is a circuit-board material that will contribute to

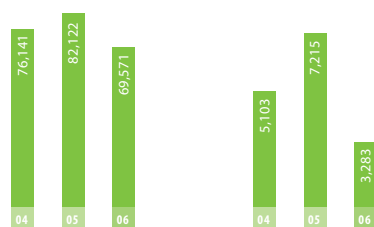
the realization of a sophisticated information society. It has properties, such as low moisture absorbcency, outstanding electrical characteristics, and shape stability, that manufacturers will increasingly seek in circuit-board materials as they step up efforts to create smaller electronic devices with more advanced functionality.



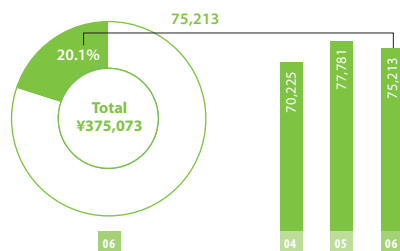
Dental Materials
Employing polymerization and synthesis technology, Kuraray has developed dental adhesives and filling resins. These are highly

regarded for their adhesive properties, wealth of varieties, and ease of use. Kuraray boasts the top share of Japan's domestic market for these products. Demand for these products is growing in the world dental materials market as a result of their reputation for quality and functionality, particularly in the United States and Europe.

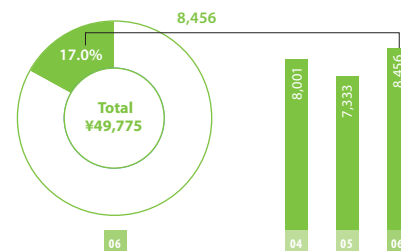
Identifiable Assets and Capital Expenditure ¥ Millions



Net Sales ¥ Millions



Operating Income* ¥ Millions



* Including ¥11,498 million eliminated on consolidation and corporate.

OPTO-ELECTRONICS BUSINESS

Revenues and earnings declined, because growth of the market for MD-type opto-screens for rear-projection televisions did not fully offset a sharp decrease in demand for CRT-type opto-screens.

MEDICAL BUSINESS

In medical devices, challenging market conditions continued. However, dental materials shipments were favorable in Japan and the United States. As a result, revenues and earnings increased. Further, Kuraray Medical Inc. transferred its contact lens business to Facile Co., Ltd. on September 30, 2005.

HIGH-PERFORMANCE MATERIALS

The use of the heat-resistant polyamide resin *GENESTAR* as an electronics material increased steadily in Japan and Asia. Moreover, the development of automotive markets for *GENESTAR* progressed. Hikes in raw material and fuel prices affected activated carbon business. However, engineering and other related businesses performed solidly.



Artificial Organs

Artificial kidneys remove waste products from the blood when kidneys are not functioning properly. Using EVAL resin that has excellent blood

compatibility, the artificial kidneys of Kuraray Medical Inc. have won high acclaim as patient-friendly products. Further, in October 2005 Kuraray Medical launched *EVABRANE EK* as an advanced artificial kidney in Japan. This new product realizes outstanding functionality for the removal of harmful protein thought to cause dialysis amyloidosis, a complication that can occur in long-term dialysis patients.



Activated Carbon

Kuraray's proprietary technology for controlling the diameter and volume of pores in the surface of activated carbon allows a heightened

response to growing environmental concerns in areas ranging from household water purifiers to municipal and industrial water treatment, air purification, and electrode materials for capacitors in fuel cell powered automobiles.

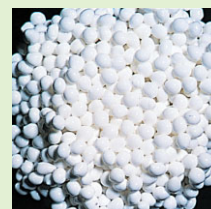


Industrial Membranes

These filter membranes, which can remove micro particles of sizes ranging from 0.003 to 3 microns from liquids, have

numerous industrial applications. They are used in food processing, including the manufacture of Japanese sake,

water purification, and wastewater treatment, and are marketed as filters for producing the ultra pure water that is indispensable in semiconductor manufacturing and other cutting-edge manufacturing processes.



PVA Gel

PVA gel is small white spherical mold-fixed carriers made from PVA resin. With an extremely fine net-like structure, each sphere can sustain

one billion microorganisms. PVA gel is designed to clean industrial and domestic wastewater through bacterial activity. Because it enables the use of smaller facilities and more efficient processing than conventional activated sludge method, this technology is being adopted for household septic tanks, factory wastewater facilities, and sewage processing plants.

Research and Development

Guided by the GS-21 Medium-Term Business Plan as an overriding development policy, the Kuraray Group aims to convert from quantity to quality as it becomes a specialty chemicals company that can achieve sustainable growth. To that end, we will concentrate efforts on business “refinement” by developing businesses based on not only materials but also on highly processed components with high added value. At the same time, the Kuraray Group will draw on its long-standing competences by developing materials for such promising growth fields as optics, electronics/electronics, automobiles, environmental products, energy, and health care.



FRONT-LOADING BUSINESS COMMERCIALIZATION

Employing more than 820 researchers and engineers, the Kuraray Group's R&D activities comprise corporate research, undertaken by the New Business Development Division; divisional R&D, undertaken by in-house companies and affiliates; and manufacturing technology development, undertaken by the Technology Division. Of those personnel, 35% are involved in corporate research, 60% work for Group companies or affiliates, and 5% belong to the Technology Division.

In corporate research, we stepped up the pace of new business creation by integrating the Corporate Strategy and Planning Division and the Research and Development Division to establish the New Business Development Division in April 2005. We tasked this new division with accelerating commercialization of business creation projects and identifying next-generation businesses.

Moreover, the Project Promotion Department, which we established to front-load business commercialization in priority fields, is moving forward with business creation centered on operations for environmental products, display components, electronics materials, and medical-use microdevices.

Further, in September 2005 Kuraray began joint development with T. Chatani & Co., Ltd. of a breakthrough ultra-bright long-lasting inorganic EL material invented by T. Chatani & Co. In April 2006, Kuraray and T. Chatani & Co. jointly established a development company, K•C Luminas Co., Ltd. in which Kuraray is responsible for manufacturing technology development and industrialization.

FORTIFYING AND EXPANDING EXISTING BUSINESSES THROUGH MATRIX MANAGEMENT

We employ a matrix management system in which corporate research performs an inter-divisional coordinating role for the R&D activities of each division. Consequently, the New Business Development Division pursues corporate research through close collaboration with manufacturing technology departments and the R&D departments of in-house companies and affiliates. Since vinyl acetate chain related operations are our mainstay operation – generating approximately one-third of revenues – we allocate about 10% of corporate research investment for vinyl acetate related R&D. Among these efforts, we are researching new applications for PVB, in addition to those produced by our existing operations, and we hope to use the outcomes of these efforts in the development of new products and markets.

New Business Creation

WHAT TYPE OF PROMISING NEW BUSINESSES AND R&D PROJECTS IS KURARAY CURRENTLY PURSUING?

Our vision is to develop and provide innovative, indispensable materials for customers. To that end – using core competence in such technologies as organic synthesis, catalysts design, synthesis and composition of polymers as a base – Kuraray is leveraging nanotechnology as well as processing technologies accumulated for sheet and film, precision molding, and optical design while applying component design and assembly technologies.

In R&D, we are creating new businesses in a range of fields. In optics, we are focusing on inorganic EL materials, backlight devices, LCD components, and others. In electronics/energy, we are concentrating on fuel cell components (electrolyte membranes), and capacitor components. Further, in health care

we are developing medical-use microdevices, orthopedic materials, and others. In addition, having sharpened the focus of development themes, we are concentrating efforts on new barrier materials, new elastomers, next-generation man-made leather, and advanced PVA materials with a view to enhancing the quality of our operations.

By strategically concentrating the deployment of management resources, Kuraray is decisively advancing these promising projects. In addition to the materials field, the Company will pursue midstream and downstream M&A to buttress management resources for new business creation and step up the pace of development.

CREATION OF NEW BUSINESSES

Optoelectronics (Optics) Field

- Inorganic EL materials
- Backlight devices
- LCD components
- Others

Electronics/Energy Field

- Fuel cell components
(electrolyte membranes)
- Capacitor components
- Others

Health Care Field

- Medical-use microdevices
- Orthopedic materials
- Others

To supplement new-business-creation management resources and accelerate development

+

M&A

+

ENHANCEMENT OF OPERATIONAL QUALITY
(CREATION OF ADVANCED PERFORMANCE MATERIALS)

High-Performance Resins/Films

- New barrier materials
- New optical-use films
- Advanced PVA materials

Chemicals

- New elastomers
- Electrochemicals

Fibers and Textiles

- Next-generation man-made leather
- Advanced function fibers and textiles

Corporate Governance

Kuraray believes that the maintenance of appropriate relationships with shareholders and other stakeholders and the fulfillment of environmental and social responsibilities are consistent with its objective of achieving a long-term improvement in business results and sustainable growth as a company that does business globally. Kuraray seeks to fulfill its responsibilities as an enterprise open to society by enhancing the corporate governance function and establishing highly transparent and fair management.

CORPORATE GOVERNANCE SYSTEM

Kuraray is establishing a corporate governance system to increase the effectiveness of supervision and monitoring functions as well as to ensure management efficiency.

Board of Directors and Organizations Responsible for Business Execution

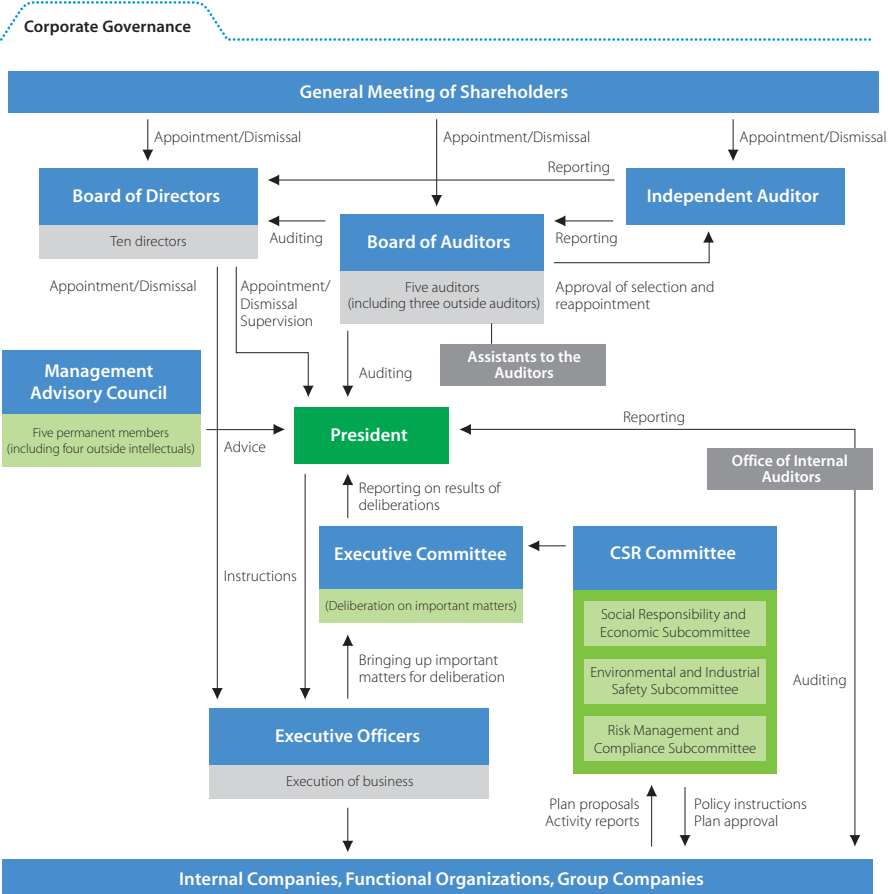
- The Board of Directors establishes the Board of Directors' Regulations, deliberates on and decides important management matters, including legal matters, and supervises the execution of business. The maximum number of directors is 10, and the term of office is one year.
- As the chief executive responsible for business execution, the president exercises control over the execution of business in the Kuraray Group.
- Executive officers (one-year term of office) selected by the Board of Directors are responsible for business execution in the various organizations of the Kuraray Group. As the heads of in-house companies, divisions, and major functional organizations, the executive officers bear operational responsibility and profit responsibility.
- The president establishes the Executive Committee and other various councils and committees to deliberate and report on important matters concerning the Group's management policies and business execution.

Management Advisory Council

- Kuraray has established the Management Advisory Council to serve as a consultative body to the president from the perspectives of compliance, the protection of shareholder rights, and management transparency. The Council, which consists of five permanent members, four of whom are intellectuals from outside the Group who have a wealth of experience in corporate management or corporate legal affairs, advises the president on such issues as important management policies and issues, succession of the president, successor candidates, and compensation.

Board of Auditors

- The Board of Auditors consists of five corporate auditors, including three outside auditors from outside the Kuraray Group. The corporate auditors attend meetings of the Board of Directors and other important meetings and monitor the directors' performance of duties through inquiries conducted by such means as the examination of important documents and requests for explanations of the state of business affairs. Kuraray appoints dedicated assistants to the auditors to assist the auditors in the performance of their duties.



INTERNAL CONTROL AND RISK MANAGEMENT

The Kuraray Group recognizes that the establishment and implementation of internal controls is an important management task and is engaged in putting in place an internal control system based on the Basic Policy for Establishing Internal Controls decided by the Board of Directors.

- The CSR Committee administers the establishment and operation of the Group's integrated compliance and risk management systems. The Office of CSR and Communications serves as the CSR Committee's secretariat, administering the Committee's business and working to inculcate compliance within the Group.

- The Office of CSR and Communications plays a central role in risk management with the functional organizations engaging in continuous management. In times of serious emergency, Kuraray puts into operation an Emergency Response Headquarters directed by the president and launches a rapid response that musters the resources of the entire organization.
- The Office of Internal Auditors, an internal audit organization that reports directly to the president, cooperates with corporate auditors and the independent auditor to audit the legality, appropriateness, and effectiveness of business operations in each organization.
- To enhance these systems, Kuraray has established the Internal Controls Reform Team, which inspects and promotes establishment of group-wide internal controls.

COMPLIANCE

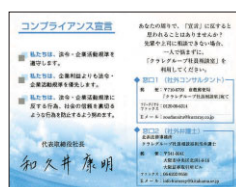
To ensure transparency and fairness in business activities, and in addition to putting in place an effective corporate governance system, it is necessary to build an organizational culture to encourage individual employees to act appropriately on the basis of a highly developed sense of ethics. For this reason, Kuraray engages in systematic activities to strengthen compliance.

In fiscal 2005, Kuraray distributed the Kuraray Group Compliance Handbook, an instructional guide intended for all Kuraray employees, held meetings to explain compliance and incorporated compliance in employee training curricula.



Kuraray Group Compliance Handbook

The Kuraray Group Compliance Handbook is an instructional handbook in which conduct guidelines based on the Principles for Business Conduct are presented in an easy-to-understand way in the context of day-to-day work activities.



Compliance Card

The Compliance Card is a wallet-sized card on which are printed the Principles for Business Conduct, the Compliance Declaration, and the contact number of the Kuraray Employee Counseling Room.

HISTORY OF COMPLIANCE ACTIVITIES AT KURARAY

- | | |
|-------------|--|
| 1998 | Establishment of the In-House Ethics Committee chaired by the president, formulation of the Principles for Business Conduct |
| 2001 | Establishment of the Kuraray Employee Counseling Room as a point of contact for disclosure of misconduct |
| 2003 | Publication by the president of the Compliance Declaration, distribution of the Compliance Card to all Kuraray employees

Reorganization of the In-House Ethics Committee as the Ethics and Compliance Team under the Social Responsibility Subcommittee of the CSR Committee |
| 2005 | Strengthening of the Kuraray Employee Counseling Room system (engagement of an external attorney)

Distribution of the Kuraray Group Compliance Handbook and Compliance Card (Revised) to all domestic Kuraray Group employees and implementation of explanatory meetings and training on compliance |

COMPLIANCE DECLARATION

On behalf of the Kuraray Group, the president of Kuraray publicly announced the Compliance Declaration, making compliance and the practice of corporate ethics the most important corporate activity at Kuraray.

- We will comply with the law and the Principles for Business Conduct.
- We will give precedence to laws and regulations, and to the Principles for Business Conduct, over corporate profits.
- We will strive to prevent any act that goes against laws and regulations or the Principles for Business Conduct, or that betrays the trust that society has placed in us.

Board of Directors, Corporate Auditors, and Executive Officers



From left: Seiji Wajiki, Osamu Asaba, Noriaki Yoshimura, Yasuaki Wakui, Shiro Kataoka, Junsuke Tanaka, Nobuo Iwawaki, Yoichi Ninagawa, Hiroaki Yoshino, Fumio Ito.

BOARD OF DIRECTORS

- *Representative Director and President*
Yasuaki Wakui
- *Representative Senior Managing Director*
Junsuke Tanaka
President, Specialty Resin and Film Company
- *Managing Director*
Seiji Wajiki
Responsible for Environmental, Industrial Safety and Technology Division, Plants, Kuraray Medical Inc.
- *Managing Director*
Osamu Asaba
President, Fibers and Textiles Company
Responsible for Kuraray Fastening Co., Ltd., Kuraray Kuraflex Co., Ltd.
- *Managing Director*
Nobuo Iwawaki
Responsible for Internal Control Reform Team, Office of Global Business Development, Accounting and Finance Division, General Affairs and H.R. Division, Kuraray Business Service Co., Ltd.
- *Managing Director*
Yoichi Ninagawa
President, Chemicals Company
- *Managing Director*
Fumio Ito
Responsible for Corporate Management Division, Office of CSR and Communications, Purchasing and Logistics Division
- *Director*
Noriaki Yoshimura
Responsible for New Business Development Division
President, K-C Luminas Co., Ltd.
- *Director*
Shiro Kataoka
General Manager, Poval Resin Division
Managing Director, Kuraray Specialties Asia Pte., Ltd.
- *Director*
Hiroaki Yoshino
General Manager, Office of CSR and Communications

CORPORATE AUDITORS

- *Standing Corporate Auditor*
Tsutomu Yabuta
- *Standing Corporate Auditor*
Akira Matsuzawa
- *Corporate Auditor*
Toshimitsu Kitagawa
- *Corporate Auditor*
Hiroo Onodera
- *Corporate Auditor*
Hiroataka Ikuno

SENIOR EXECUTIVE OFFICERS

- **Junsuke Tanaka**
President, Specialty Resin and Film Company
- **Osamu Asaba**
President, Fibers and Textiles Company
Responsible for Kuraray Fastening Co., Ltd., Kuraray Kuraflex Co., Ltd.
- **Yoichi Ninagawa**
President, Chemicals Company
- **Shiro Kataoka**
General Manager, Poval Resin Division
Managing Director, Kuraray Specialties Asia Pte., Ltd.
- **Hiroaki Yoshino**
General Manager, Office of CSR and Communications
- **Kenzo Sawada**
General Manager, Office of Global Business Development
- **Hideo Tomita**
General Manager, General Affairs and H.R. Division

EXECUTIVE OFFICERS

- **Toshihide Sakai**
General Manager, Okayama Plant
- **Susumu Gotanda**
General Manager, Niigata Plant
- **Katsuya Hashimoto**
General Manager, Clarino Division
- **Mitsuo Matsumoto**
General Manager, New Business Development Division
- **Kohei Maeda**
General Manager, Office of Internal Auditors
- **Tokio Aikura**
General Manager, Methacrylate Division
- **Mitsuaki Manabe**
General Manager, Accounting and Finance Division
- **Yuichi Kawarasaki**
General Manager, Corporate Management Division
- **Keiji Murakami**
General Manager, EVAL Division
- **Gerd Lepper**
President, Kuraray Specialties Europe GmbH
- **Jean-Marie Baetens**
President, EVAL Europe N. V.
- **Nobuya Tomita**
President, Eval Company of America

Notes:

1. Junsuke Tanaka serves concurrently as Representative Senior Managing Director and Senior Executive Officer.
2. Osamu Asaba and Yoichi Ninagawa serve as Managing Directors and Senior Executive Officers.
3. Shiro Kataoka and Hiroaki Yoshino serve as Directors and Senior Executive Officers.

Corporate Social Responsibility

Trailblazing efforts to form a richer society and the history of Kuraray's development as a company are inseparable. Demonstrating a commitment to a social mission rather than the simple pursuit of profits is at the heart of the Kuraray Group's tradition. Typically, we apply our technological capabilities to produce materials useful in people's everyday lives and provide the materials to those that need them. The unflagging efforts of the Company's founding fathers have created a valuable inheritance that lives on as part of Kuraray's corporate DNA.

OVERVIEW

Since its establishment in 1926 to commercialize rayon, the Company has sought to benefit people's lives and society in the pursuit of business ventures.

Our founding business, rayon, or the so-called "man-made silk," underpins rich comfortable lifestyles in a wide variety of ways as a substitute material for limited natural resources. As well as being a business entrepreneur, Magosaburo Ohara, the Company's first president, was a social engineer and a pioneer of philanthropy in Japan. He provided financial assistance for orphanages, established hospitals, constructed an art museum, and instituted scholarship programs.

Soon after the Second World War, in 1950, our second president, Soichiro Ohara, achieved the world's first successful commercialization of the synthetic PVA fiber *KURALON*. This material contributed significantly to people's lives as a substitute for cotton. Furthermore, aiming to enable people outside Japan to enjoy the benefits of this new material, we exported a manufacturing plant to China even before Japan had resumed diplomatic ties with China. In addition, after a single-minded development effort, Soichiro Ohara succeeded in commercializing the man-made leather *CLARINO* in 1965. This is one example of our development of materials by studying natural materials and adding new properties to them.

Initiated from the fiscal year under review, the GS-21 Medium-Term Business Plan's name combines the "G" from G-21, the previous Medium-Term Business Plan, which stands for Growth,

Green, Globalization, and Group, and a new keyword, Sustainability, represented by "S." Because companies exist in the global environment as members of international society, protecting the environment and contributing to the sustainability of society have a significant bearing on the continuation of companies themselves. With this in mind, we are pursuing business refinement that shifts the source of our competitiveness from quantity to quality. By producing smaller quantities of products with higher-value-added, we will reduce the burden we place on the environment.

We are a chemicals manufacturer with operations that require large volumes of natural resources, water, and air. Therefore, eco-friendliness is, of course, one of our responsibilities. As early as 1970, we established a section devoted to environmental protection. Furthermore, we have participated in the Japan Responsible Care Council since it was established in 1995. Also, we have implemented a wide range of environmental measures, including the development of products and processes that place less burden on the environment and substitutes for environmentally harmful substances.

In addition, Kuraray maintains long-standing commitments in the field of philanthropy. To this day, Kuraray's employees take part in volunteer activities at hospitals that are strongly associated with the Company's founder. Also, we dispatch our employees to participate in a range of activities. For example, our researchers offer Chemistry Classes for Boys and Girls. We intend to extend the scope of such philanthropic initiatives.

CSR PROMOTION STRUCTURE

The CSR Committee, established in 2003, plays a central role in implementing the Kuraray Group's CSR activities. The far-reaching social responsibility required of companies necessitates response across an organization. The CSR Committee is a management level special committee that decides group-wide policies, objectives, and action plans, and puts into practice wide ranging CSR programs with the cooperation of other Group organizations.

The CSR Committee maintains the Social Responsibility and Economic Subcommittee, the Environmental and Industrial Safety Subcommittee, and the Risk Management and Compliance Subcommittee. The subcommittees maintain theme-specific working teams that focus on implementing concrete activities and ascertaining and evaluating results. The Office of CSR and Communications serves as the CSR Committee's secretariat, administering the Committee's activities and bearing responsibility for the vitalization of activities by means of two-way communication through information dissemination within the Group and beyond, information gathering, and feedback.

Corporate Social Responsibility



SOCIALLY BENEFICIAL ACTIVITIES – POLICIES

As set forth in the Corporate Mission, the Kuraray Group's primary mission is to create new businesses by means of pioneering technology and to benefit society through superb products and services.

At the same time, as a good corporate citizen, we devote efforts to wide-ranging interaction with society and socially beneficial activities, especially in the host communities with which we are closely involved through our business activities.

We engage in steady, community-based initiatives in the areas of education, health care, and social services, placing importance on activities that take advantage of the imagination and ingenuity of our employees, activities in which everyone can participate on their own initiative, and activities that can be continued over time.

SOCIALLY BENEFICIAL ACTIVITIES

Sending School Bags across the Sea



Distributing school bags in Afghanistan

Thanks to the understanding and cooperation of everyone involved, in 2005 Kuraray was able to continue the Sending School Bags across the Sea campaign successfully introduced in 2004. Numerous celebrities,

including Athens Olympic women's wrestling bronze medalist Ms. Kyoko Hamaguchi and 73rd All Japan Figure Skating Championships women's singles champion Ms. Miki Ando, attended a January kickoff event for the campaign. In 2005, 12,120 school bags were donated to children in Afghanistan and 1,560 school bags to children in Mongolia.



One of our chemistry classes

Chemistry Classes for Boys and Girls

In 1992, Kuraray began the Chemistry Classes for Boys and Girls program with the goal of enabling children in a higher grades at elementary school to experience the fun of chemistry.

On school holidays, young

Kuraray employees volunteer to serve as instructors or assistants to conduct classes at special classrooms on plant premises and at local elementary schools and public facilities. In 2005, Kuraray

conducted 18 classes in which 640 children in total participated. Many children have emerged from the program with great enthusiasm for science, and no doubt many are today playing active roles as members of society.

Kuraray also participates and conducts chemistry classes at the “Dream Chemistry-21” event (held by the Chemical Society of Japan with cooperation from the Tsukuba Research Laboratories), the Youngsters’ Science Festival Niigata Convention (held with cooperation from the Niigata Plant), the Okayama Research Park’s Interesting Experience event (held with cooperation from the Okayama and Kurashiki Plants), and other events. Kuraray will continue to provide venues to enable as many children as possible to encounter and experience the fun of chemistry.

Disaster Relief Activities

Fiscal 2005 was the second consecutive year of numerous typhoons, earthquakes, and other major natural disasters around the world. Kuraray made monetary contributions through the Red Cross Society for disaster relief for the victims of hurricane Katrina, a major hurricane that struck the southern part of the United States at the end of August, and the victims of the Pakistan-India earthquake, which struck the northern part of Pakistan in early October, to return to their previous way of life as soon as possible. The Kuraray Group will continue to actively engage in relief activities to aid victims in times of natural calamities.



Aizenbashi Hospital

Contributing to Society through Social and Medical Services

Kuraray contributes to society through social and medical services. We provide support for Kurashiki Central Hospital (Okayama Prefecture), Aizenbashi Hospital (Osaka City),

and Saijo Central Hospital (Ehime Prefecture), hospitals with which the Kuraray Group has historically maintained close ties, including involvement in their establishment. To contribute to addressing nursing care problems facing local communities, which will become an increasingly pressing issue as the aging of society progresses, we utilize idle employee welfare facilities at our plants to operate a communal assisted-living facility and a geriatric nursing facility.

On the second Wednesday of each month, employees of the Osaka headquarters volunteer their time to enable residents of the special elderly nursing home adjacent to Aizenbashi Hospital to enjoy the atmosphere of a Japanese-style pub. Each month, the residents, their families, and workers at the facility look forward to this event, which has been conducted since September 2001.

The Kuraray Group intends to continue to be responsive to the desires of our host communities and expand our activities to areas not sufficiently covered by government institutions.

MEDIUM-TERM ENVIRONMENTAL PLAN

Policy

The Kuraray Group has established the Medium-Term Environmental Plan as part of the G-21 Medium-Term Business Plan (covering the years from fiscal 2001 to 2005) and is actively engaged in environmental preservation activities in line with specific numerical targets set forth in the plan. We are reviewing the plan in accordance with legal and regulatory trends and progress to date.

High-Priority Tasks

- Environmental load reduction efforts
 1. Reduction in emissions of harmful chemical substances into the environment
 2. Reduction in emissions of carbon dioxide
 3. Achievement of zero emissions of industrial waste
- Expansion of CSR procurement and green logistics
- Quantification of the environmental load of Kuraray products
 1. Expanded application of lifecycle assessment (LCA)
 2. Introduction of Type III environmental labels
- Development and supply of environment-friendly products
- Strengthening and improvement of communications
 1. Greater information disclosure
 2. Enhanced environmental accounting
 3. Strengthened risk communication with local communities

PROGRESS WITH NUMERICAL TARGETS IN THE MEDIUM-TERM ENVIRONMENTAL PLAN

Target			Unit	Base year		Fiscal 2005	Target fiscal year		Activities in fiscal 2005
Reduction of 90% in emissions of PRTR-designated substances	Kuraray	All substances	Tons	Fiscal 1999	3,545 (100%)	2,064 (58%)	Fiscal 2007	354 (10%)	• Installation of a cover for a wastewater pool (prevention of methanol evaporation)
		PRTR-designated substances			1,361 (100%)	570 (42%)		136 (10%)	
	Domestic affiliates	All substances	Tons		889 (100%)	382 (43%)		89 (10%)	
		PRTR-designated substances			475 (100%)	8 (2%)		48 (10%)	
	Total	All substances	Tons		4,434 (100%)	2,446 (55%)		443 (10%)	
		PRTR-designated substances			1,836 (100%)	578 (31%)		184 (10%)	
Reduction of 90% in external disposal volume of unutilized industrial waste	Kuraray		Thousand tons	Fiscal 1999	9.6	3.6	Fiscal 2005	1.0	• Start of use of a gasification fusion furnace
	Domestic affiliates				5.0	2.2		0.5	• Conversion of film scraps into fuel • Effective utilization of other individual waste materials
	Total				14.6 (100%)	5.8 (39%)		1.5 (10%)	• Reduction in the quantity of coal ash effectively utilized (negative impact)
Increase of 30 percentage points or higher in effective waste utilization	Kuraray		%	Fiscal 1999	63	87	Fiscal 2006	—	• Start of use of a gasification fusion furnace
	Domestic affiliates				16	68		—	• Conversion of film scraps into fuel • Effective utilization of other individual waste materials
	Total				60	85		90	• Reduction in the quantity of coal ash effectively utilized (negative impact)
Reduction of 10% in CO ₂ emissions per unit of output	Kuraray		Tons CO ₂ / ton	Fiscal 1990	2.93 (100%)	3.33 (112%)	Fiscal 2010	2.64 (90%)	• Boiler fuel conversion • Expanded use of biomass fuel
Increase of 6 percentage points or higher in energy efficiency (one point per year)	Kuraray		%	Fiscal 1999	—	−6	Fiscal 2005	6	• Energy efficiency improvement at a power plant

Numerical Targets

1. Reduction of 10% in carbon dioxide emissions per unit of output in fiscal 2010 from the fiscal 1990 level
2. Increase of 6 percentage points or higher in energy efficiency in fiscal 2005 from the fiscal 1999 level
3. Reduction of 90% in emissions of the Japan Chemical Industry Association's PRTR-designated substances in fiscal 2007 from the fiscal 1999 level
4. Reduction of 90% in the external disposal volume of unutilized industrial waste in fiscal 2005 from the fiscal 1999 level
5. Increase of at least 30 percentage points in the effective waste utilization rate in fiscal 2006 from the fiscal 1999 level (from 60% to 90%)

Summary of Target Achievements during the Term of G-21 and Action Points

- With regard to improvement in the effective utilization of industrial waste, owing to the early achievement in fiscal 2002 of the initial target reduction of 20 percentage points, the target was revised

to reduction of 30 percentage points (effective utilization rate of 90%). We aim to achieve the revised target in fiscal 2006 (actual result of 85% in fiscal 2005). We will continue to implement utilization measures, including the conversion of waste into fuel.

- With regard to the target of a reduction of 90% in external disposal volume of unutilized industrial waste, achievement in fiscal 2005 was only about 60%. We will redouble our efforts to curb the volume of waste generated.
- With regard to the target of a reduction of 90% in emissions of PRTR-designated substances, emissions have been sharply reduced since fiscal 1999, and we will engage in capital investment to achieve further reductions.
- With regard to measures to prevent global warming (reduction of CO₂ emissions), we have engaged in various energy conservation measures and moved forward with the use of biomass fuel. We have installed photovoltaic power generation facilities at Tsukuba Research Laboratories as a new energy source. We will expand use of photovoltaic power generation and consider the introduction of new energy sources, such as wind power generation.

2005

Acquisition of VECTRAN Business from Celanese Advanced Materials



An airship that uses VECTRAN

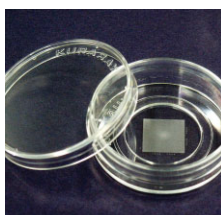


VECTRAN

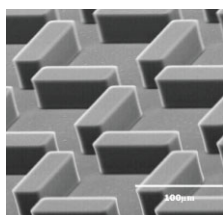
April 2005

Kuraray acquired the VECTRAN polyarylate fiber business of Celanese Advanced Materials Inc., of the United States. With properties that include high strength and flexibility, low creep, non-absorption of moisture, high strength retention at low temperatures, and abrasion resistance in wet conditions, VECTRAN is used for a wide range of applications, such as ropes and materials for the fisheries industry, plastic reinforcement, and protective gloves. We will add impetus to the expansion of these operations by consolidating our R&D, production, and sales organizations in Japan and the United States.

Development of a Microspace Cell-Culture Chip



Disposal dish



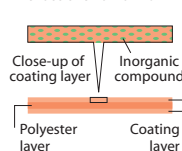
Microspace cell-culture chip

June 2005

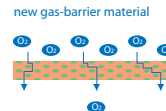
Kuraray successfully developed a microspace cell-culture chip that can be customized to suit different research applications. The chip will contribute to research in such fields as regenerative medicine and bioassay by enabling the stereoscopic regulation of cell growth and differentiation as well as direction and orientation. We intend to develop operations in the field of life sciences by combining our technologies in the areas of polymeric materials, microprocessing, and biotechnology.

Commercialization of High-Value-Added Barrier Film

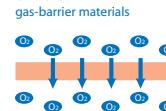
CROSS SECTION OF KURARISTER



KURARISTER new gas-barrier material



Conventional gas-barrier materials



August 2005

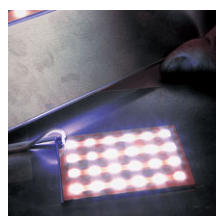
In fall 2006, Kuraray Tamashima Co., Ltd. will begin production of a transparent barrier film for food packaging retorts. KURARISTER features outstanding gas impermeability, with oxygen permeability of less than 1 cc per square meter per day; durability under retort treatment, demonstrating the ability to withstand sterilization at 135°C for 60 minutes; and excellent secondary processability.

Start-Up of Operations at New Activated Carbon Plant in China

September 2005

In response to extremely heavy demand for activated carbon, Kuraray Chemical Co., Ltd., began operations at a wholly owned subsidiary of Kuraray Chemical (Ningxia) Environmental Industry Co., Ltd., established in the Ningxia region of China. Ultimately targeting 10,000 tons per year, we will steadily increase annual production capacity to 1,000 in the first year of operations, 3,000 tons in two to three years, and 5,000 tons in four to five years.

Commencement of Joint Development of Ultra-Bright Inorganic EL Material and Next-Generation Light Sources with T. Chatani & Co.



Light emitting of ultra-bright, inorganic EL

October 2005

We began joint R&D with T. Chatani & Co., Ltd. to speed up the development of an ultra-bright, long-lasting inorganic EL material invented by T. Chatani & Co. Through the application of coating techniques, the newly invented inorganic EL materials can be used as a surface illuminant. Therefore, we hope to develop this material for wall-mounted televisions and other displays and as a replacement for lighting applications that use mercury, which creates environmental problems. Kuraray and T. Chatani & Co. will initially conduct the joint development of a white light source product for LCD backlighting devices, which are indispensable in flat-screen televisions.

* In April 2006, Kuraray and T. Chatani & Co. established the joint venture company K&C Luminas Co., Ltd. for the joint development of inorganic EL materials.

Development of VF-PE Poval Film with Outstanding Polarized Light Efficiency and Stretchability for Next-Generation Polarized Plates



VF-PE optical-use poval film

December 2005

We developed the optical-use poval film VF-PE that realizes significant enhancements in polarized light efficiency and other optical functions in comparison with previous products. At the same time, this film stretches easily and is difficult to break, making it highly suited to manufacturing processes. This latest poval film caters to manufacturers that are striving to create LCDs with higher contrast, thinner construction, higher yield conversion, and lower electric power consumption.

Development of a Carbon Hydride Derived Polymer Electrolyte Membrane for Direct Methanol Fuel Cells*

January 2006

Using proprietary elastomers and membrane production technology, Kuraray developed a new electrolyte membrane with significantly enhanced power generation performance. The new membrane enables the use of smaller fuel tanks and batteries and facilitates easier assembly.

* Direct Methanol Fuel Cells

Direct methanol fuel cells (DMFCs) are a type of polymer electrolyte fuel cell that directly use methanol as a fuel. DMFCs are regarded as a next-generation power source for mobile devices as they operate at low temperatures, have high theoretical energy density compared with gas fuels, do not require fuel improvement, and are compact.

Decision to Increase Production Capacity for Optical-Use Poval Film for Polarized Film

March 2006

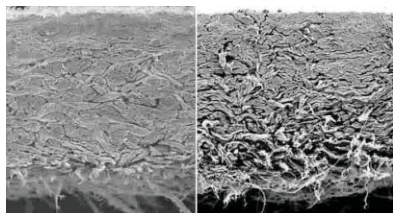
We decided to expand production facilities for optical-use poval film, which forms the base for polarized film, an essential component of LCDs. To attain our goal of building a system that can accurately meet very strong demand, in 2005 Kuraray Tamashima Co., Ltd. increased production capacity by 30 million square meters. Furthermore, we plan to add another 60 million square meters of production capacity by the end of 2007.

Production Capacity (million m²/year)

	Current Capacity	Planned Increase	Completion	Capacity after Completion
Kuraray Saijo	31			31
Kuraray Tamashima	30	+30	1st half 2007	
		+30	2nd half 2007	90
Total	61	+60		121

2006

Development of Environment-Friendly Man-Made Leather

Cross section of natural leather (left) and *TIRRENINA* (right)

January 2006

Kuraray has launched operations for a newly developed man-made leather: *TIRRENINA*. This next-generation environment-friendly product combines the look and feel of natural leather with the outstanding properties unique to man-made leather. Thanks to newly developed ultra-fine fibers and our development of an innovative process that does not use organic solvents during production, *TIRRENINA* overcomes the stiff texture often seen in water-based man-made leathers made with inorganic solvents. Instead, it has a texture, fullness, and appealing appearance close to that of real leather.

Release from Kuraray in the fiscal year under review.

Financial Section



Contents

41	Consolidated Six-Year Summary
42	Financial Review
48	Consolidated Balance Sheets
50	Consolidated Statements of Income
51	Consolidated Statements of Shareholders' Equity
52	Consolidated Statements of Cash Flows
53	Notes to Consolidated Financial Statements
64	Report of Independent Auditors

CONSOLIDATED SIX-YEAR SUMMARY

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

	Millions of yen						Thousands of U.S. dollars (Note 1)
Years ended March 31	2006	2005	2004	2003	2002	2001	2006
Net sales	¥375,073	¥354,874	¥332,149	¥322,524	¥305,862	¥313,651	\$3,205,752
Cost of sales	266,284	254,115	236,246	230,618	228,184	234,946	2,275,931
Selling, general and administrative expenses	70,512	67,572	67,857	66,720	58,720	58,774	602,667
Operating income	38,277	33,187	28,046	25,186	18,958	19,931	327,154
Net income	21,186	18,465	15,181	8,051	2,866	4,045	181,077
Capital expenditure	33,872	45,715	32,164	19,091	50,716	15,814	289,504
Depreciation and amortization	25,186	21,324	20,785	19,108	16,056	16,593	215,265
Gross cash flow	46,372	39,789	35,966	27,159	18,922	20,638	396,342
Total research and development expenses	14,069	13,874	13,684	12,523	12,131	12,251	120,248
Total assets	481,357	454,941	413,227	426,877	487,432	512,479	4,114,162
Total current assets	200,668	182,317	171,428	185,748	198,474	239,654	1,715,111
Property, plant and equipment, net	159,396	158,294	137,867	135,985	134,907	127,468	1,362,359
Total current liabilities	79,229	84,857	75,165	97,394	122,274	110,234	677,171
Total long-term liabilities	60,647	54,901	37,689	42,156	74,460	112,723	518,350
Total shareholders' equity	339,127	312,930	300,306	287,263	290,643	289,469	2,898,521

Amounts per share:

Yen

U.S. dollars

Net income:

Primary	¥ 57.51	¥ 50.13	¥ 40.81	¥ 21.01	¥ 7.49	¥ 10.56	\$0.49
Fully diluted	57.41	50.12	–	20.71	7.45	10.46	0.49
Cash dividends applicable to period	15.00	12.00	10.00	9.00	9.00	9.00	0.13
Total shareholders' equity	922.65	852.26	817.57	771.38	759.25	756.07	7.89

Financial ratios:

Cost of sales ratio (%)	71.0%	71.6%	71.1%	71.5%	74.6%	74.9%
Equity ratio (%)	70.5	68.8	72.7	67.3	59.6	56.5
Return on equity (%)	6.5	6.0	5.2	2.8	1.0	1.4
Return on assets (%)	8.2	7.6	6.7	5.5	3.8	3.9
Number of employees	6,842	6,919	6,760	6,983	7,115	7,121

Notes: 1. The U.S. dollar amounts represent the translation from Japanese yen at the rate of ¥117=\$1.

2. Certain reclassifications of previously reported amounts have been made to conform with current classifications.

3. Since the year ended March 31, 2003, the "Amounts per share" figures have been calculated in accordance with the Japanese Financial Accounting Standard "Accounting for Earnings per Share."

FINANCIAL REVIEW

The following section refers to the consolidated financial statements of the Kuraray Group for fiscal 2005 (from April 1, 2005, to March 31, 2006).

SALES

Total consolidated net sales increased 5.7%, or ¥20,199 million, to ¥375,073 million (US\$3,205,752 thousand) for fiscal 2005.

Sales of chemicals and resins rose 14.0%, or ¥23,489 million, to ¥190,753 million (US\$1,630,368 thousand). Increased sales of poval were attributable to strong sales of optical-use poval film, which is used as a base for polarizing film, to meet extremely strong demand for LCD applications and a 30 million square meter per year increase in production capacity. Sales of poval resin were flat because of stagnant sales in Europe due to higher imports from other regions, which were triggered by a strong euro, and intensified competition in Asia. Further, sales of PVB film for use in construction materials, the manufacturer of which we acquired in 2004, were brisk. Sales of EVAL resin for use in food product packaging were favorable. In isoprene-related products, heavy demand for the thermoplastic elastomer SEPTON as a substitute for vulcanized rubber and soft PVC increased sales in Europe, the United States, and Asia. Sales of methacrylic resin were flat because lackluster demand for the resin for general applications counteracted strong demand for such optical applications as LCD light guide plates.

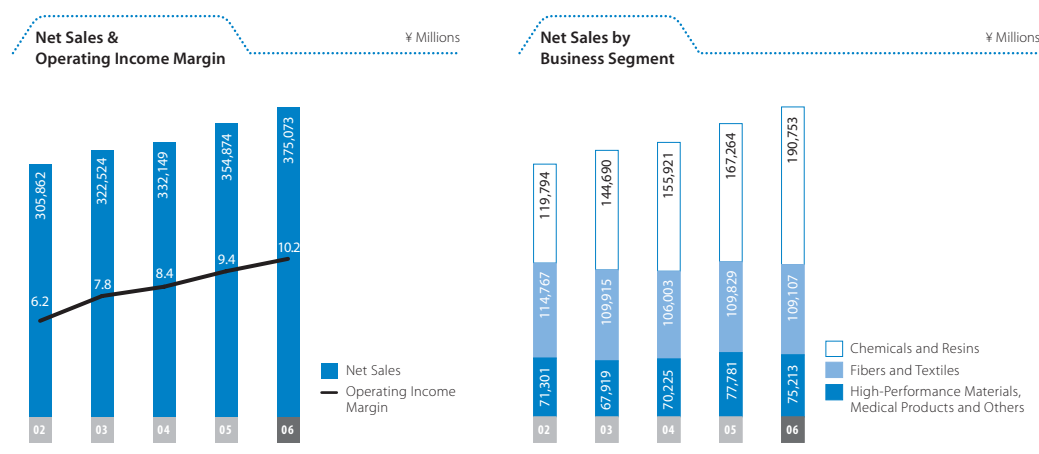
Sales of fibers and textiles decreased 0.7%, or ¥722 million, to ¥109,107 million (US\$932,538 thousand). Revenues from KURALON

declined, as the effect of an accident at the Okayama Plant offset solid sales of products in specialty categories, such as asbestos substitutes for reinforced cement, materials for rubber, and applications in paper and nonwoven fabrics. Sales of the man-made leather CLARINO were up, as brisk sales of the product for use in bags and other accessories and for polishing materials shrugged off weak demand for interior applications. Sales of nonwoven fabrics and fasteners grew on the back of a pick-up in domestic demand. Sales of polyester declined due to a shift toward differentiated products.

Sales of high-performance materials, medical products and others decreased 3.3%, or ¥2,568 million, to ¥75,213 million (US\$642,846 thousand). Despite facing fiercer competition, the medical products business achieved higher revenues thanks to favorable sales of dental materials in Japan and the United States. The opto-electronics business saw lower revenues due to a sharp decrease in demand for CRT-type opto-screens that offset expansion of the market for MD-type opto-screens for rear-projection televisions. In the high-performance materials business, demand for the heat-resistant polyamide resin GENESTAR for electronic materials applications increased steadily in Japan and Asia.

Net sales in each of Kuraray's geographic segments displayed year-on-year increases during fiscal 2005.

Domestic sales increased 1.6%, or ¥4,223 million, to ¥273,757 million (US\$2,339,803 thousand). Revenues were up as a result of higher sales and exports of such lineups as optical-use poval film, optical-use methacrylic resin, SEPTON, CLARINO, KURALON,



Note: New business segments were adopted in the year ended March 31, 2003.
Data for the previous year has been restated.

and *GENESTAR* and the reflection of raw material and fuel prices in product prices.

In North America, net sales rose 11.0%, or ¥3,024 million, to ¥30,610 million (US\$261,624 thousand). This increase was attributable to stepped-up sales of *SEPTON* as a substitute for vulcanized rubber and soft PVC and higher sales of *EVAL* for food product packaging.

In Europe, net sales rose 27.9%, or ¥11,787 million, to ¥53,974 million (US\$461,316 thousand). Increased sales related to the acquisition of a PVB film business and favorable demand for *EVAL* and *SEPTON* compensated for the negative effect of a strong euro and hikes in raw material and fuel prices.

Sales throughout Asia were strong, rising 7.5%, or ¥1,165 million, to ¥16,732 million (US\$143,009 thousand). This increase in revenues stemmed from the development of poval operations with an emphasis on reflecting higher raw material and fuel prices through higher product prices.

OPERATING INCOME AND NET INCOME

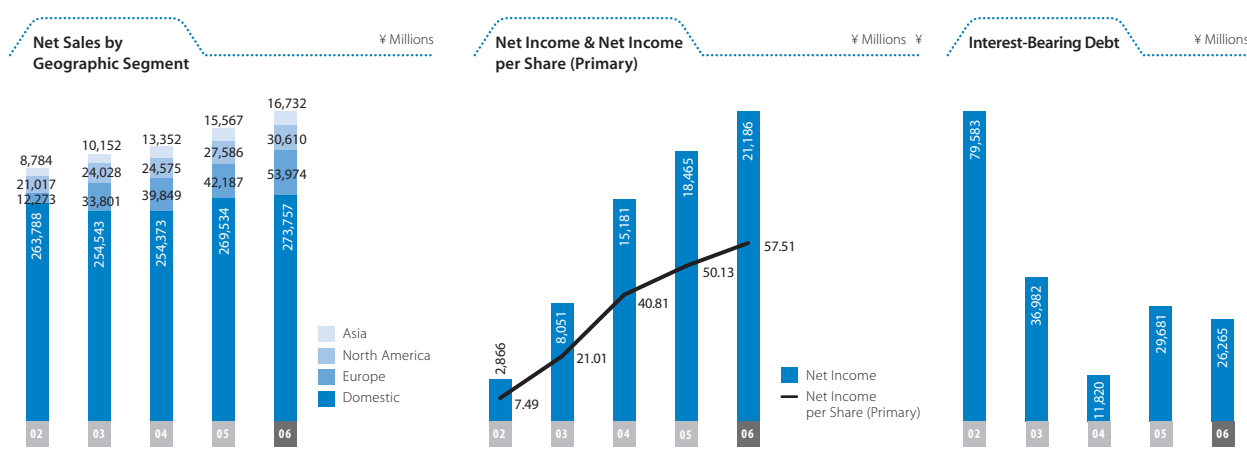
Cost of sales increased 4.8%, to ¥266,284 million (US\$2,275,931 thousand), and as a percentage of net sales decreased, from the previous fiscal year's 71.6%, to 71.0%. This improvement was largely due to an improvement in the Company's business portfolio – resulting from a shift toward high-value-added products in line with the G-21 Medium-Term Business Plan – as well as rationalization based on tireless cost reduction efforts and efforts to raise

prices in step with hikes in raw material and fuel costs. Selling, general and administrative (SG&A) expenses increased 4.4%, to ¥70,512 million (US\$602,667 thousand). As a percentage of net sales, SG&A expenses declined, from 19.0% to 18.8%. Operating income grew 15.3%, to ¥38,277 million (US\$327,154 thousand). The operating margin has risen for five successive fiscal years, increasing from 6.2% in fiscal 2000, to 10.2% in fiscal 2005.

Interest and dividend income continued an upward trend, increasing 8.6%, to ¥1,294 million (US\$11,060 thousand). Meanwhile, interest expenses rose 39.4%, to ¥414 million (US\$3,539 thousand). Income before income taxes and minority interests continued to increase, climbing 15.1%, to ¥34,363 million (US\$293,701 thousand). Income taxes were ¥13,068 million (US\$111,692 thousand), and the effective tax rate remained at the previous year's level, at 38.0%. As a result, net income surged 14.7%, to ¥21,186 million (US\$181,077 thousand), passing the ¥20,000 million milestone for the first time.

FINANCIAL POSITION

Cash and cash equivalents, end of year, increased ¥11,342 million, to ¥28,085 million (US\$240,043 thousand). Due to the increase in sales, notes and accounts receivable increased ¥8,408 million, to ¥94,561 million (US\$808,213 thousand). Marketable securities were reduced ¥5,990 million, leaving no outstanding marketable securities. Also, inventories increased ¥5,258 million, to ¥69,431 million (US\$593,426 thousand), because the initiation of capital expenditure



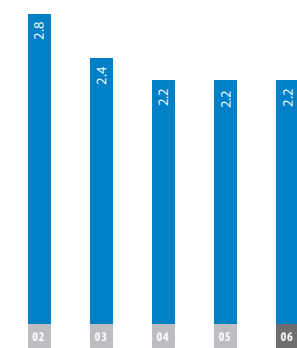
Note: Due to their growing weight in total net sales, the North America and Asia segments were separated out from the year ended March 31, 2003.
Data for the previous year has been restated.

for mainstay products was offset by a temporary pause in sales expansion, hikes in raw material and fuel prices, and a weak yen. The number of months' sales in inventory remained unchanged from the previous year, at 2.2 months. As a result of these and other factors, total current assets increased 10.1%, to ¥200,668 million (US\$1,715,111 thousand). Property, plant and equipment increased 0.7%, to ¥159,396 million (US\$1,362,359 thousand). This was because land decreased 3.0%, to ¥19,676 million (US\$168,171 thousand), buildings decreased 4.8%, to ¥88,265 million (US\$754,401 thousand), machinery and equipment increased 5.4%, to ¥443,689 million (US\$3,792,214 thousand), and construction-in-progress rose 14.2%, to ¥24,590 million (US\$210,171 thousand). Strategic acquisition and expansion fueled much of the improvement in these areas.

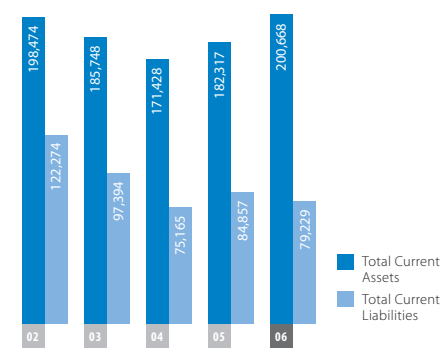
Investments and other assets rose 6.1%, to ¥121,293 million (US\$1,036,692 thousand), as a result of a 57.5% increase in investment securities, to ¥37,970 million (US\$324,530 thousand) – largely related to unrealized gains – that compensated for a 9.6% decrease in goodwill, to ¥28,625 million (US\$244,658 thousand), and a 4.1% decrease in other intangible assets, to ¥6,014 million (US\$51,402 thousand). Working capital (the difference between the balance of notes and accounts receivable plus inventories and notes and accounts payable) rose from ¥99,949 million in the previous year, to ¥115,708 million, and the current ratio rose from 214.9% in the previous fiscal year, to 253.3%. Return on total assets improved, from 7.6% to 8.2%.

Total current liabilities decreased 6.6%, to ¥79,229 million (US\$677,171 thousand), as short-term bank loans decreased 33.9%, to ¥6,619 million (US\$56,573 thousand), the current portion of long-term debt decreased 88.6%, to ¥390 million (US\$3,333 thousand), notes and accounts payable edged down 4.2%, to ¥48,284 million (US\$412,683 thousand), accrued income taxes climbed 22.5%, to ¥7,165 million (US\$61,239 thousand), and accrued expenses and other advanced 10.5%, to ¥16,771 million (US\$143,343 thousand). Related to the increase in assets, total long-term liabilities increased 10.5%, to ¥60,647 million (US\$518,350 thousand). Long-term debt rose 18.6%, to ¥19,256 million (US\$164,581 thousand), and deferred income taxes increased 86.7%, reaching ¥13,714 million (US\$117,214 thousand). Accrued retirement benefits declined 0.5%, to ¥13,404 million (US\$114,564 thousand), and other decreased 20.1%, to ¥14,273 million (US\$121,991 thousand). Minority interests increased 4.5% from ¥2,253 million, to ¥2,354 million (US\$20,120 thousand). Total shareholders' equity increased 8.4%, to ¥339,127 million (US\$2,898,521 thousand). Principal factors included an 11.8% increase in retained earnings, to ¥155,377 million (US\$1,328,009 thousand), an 82.3% rise in unrealized gain on revaluation of securities, to ¥16,426 million (US\$140,393 thousand), and a 2.0% decrease in treasury stock at cost, to ¥11,584 million (US\$99,009 thousand). As a result, total liabilities and shareholders' equity rose 5.8%, to ¥481,357 million (US\$4,114,162 thousand), and the equity ratio rose 1.7 percentage points, to 70.5%.

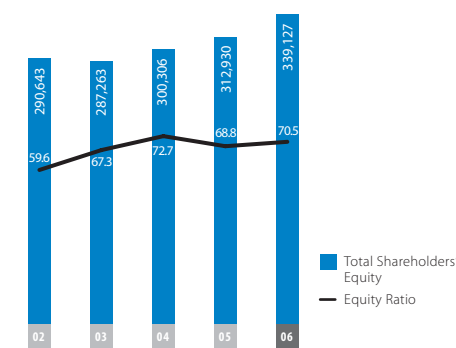
Number of Months' Sales in Inventory ¥ Millions



Total Current Assets & Total Current Liabilities ¥ Millions



Total Shareholders' Equity & Equity Ratio ¥ Millions %



CASH FLOWS

Net cash and cash equivalents provided by operating activities decreased 17.5%, to ¥32,691 million (US\$279,410 thousand). This decline was primarily due to an increase in notes and accounts receivable of ¥5,838 million, an increase in inventories of ¥4,219 million, and a decrease in notes and accounts payable of ¥2,505 million. Furthermore, interest paid increased from ¥299 million, to ¥388 million, and income taxes paid increased from ¥8,189 million, to ¥10,226 million.

Net cash and cash equivalents used in investing activities decreased from ¥44,696 million in fiscal 2004, to ¥13,693 million (US\$117,034 thousand) in fiscal 2005. The most significant outlays were payments for acquisition of property, plant, equipment and intangible assets of ¥36,069 million and payments for purchase of investment securities of ¥1,379 million. This was partially offset by proceeds from sales of property, plant, equipment and intangible assets of ¥10,550 million, up from ¥470 million in the previous term, and proceeds from sales and redemption of investment securities of ¥3,604 million, down from ¥8,400 million in fiscal 2004.

Net cash and cash equivalents used in financing activities was ¥7,791 million (US\$66,590 thousand), compared with net cash and cash equivalents provided by financing activities of ¥13,221 million in the previous fiscal year. Principal elements included a decrease in short-term bank loans of ¥3,322 million, proceeds from long-term debt of ¥3,400 million, and repayments of long-term debt of ¥3,407 million. Dividends paid amounted to ¥4,772

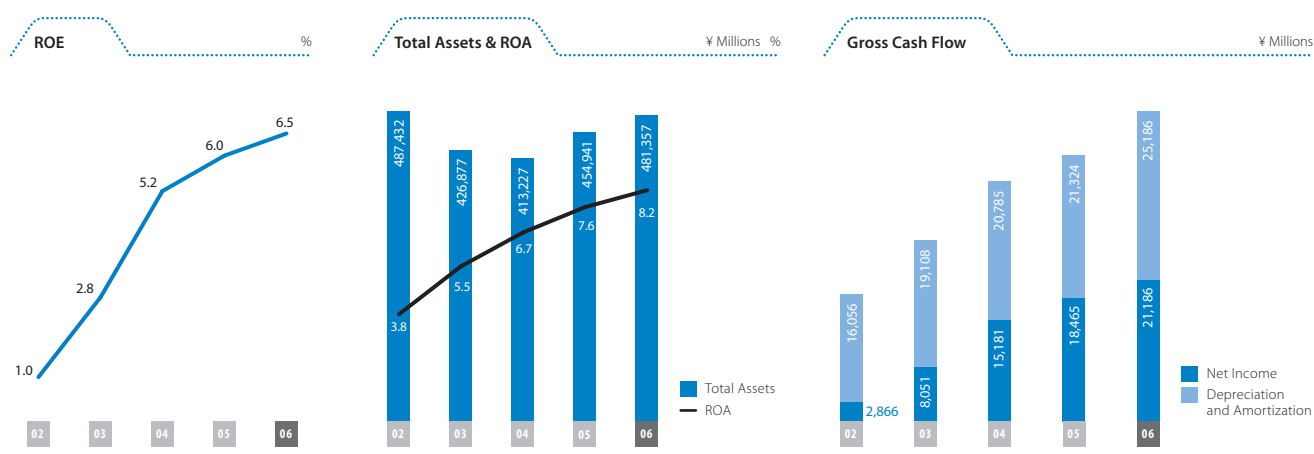
million, compared with ¥4,039 million in the previous fiscal year. Cash and cash equivalents at the end of the fiscal year were ¥28,085 million (US\$240,043 thousand), up from ¥16,743 million in the previous fiscal year.

RESEARCH AND DEVELOPMENT

Total R&D expenses for the year were ¥14,069 million (US\$120,248 thousand), or 3.8% of net sales, compared with 3.9% in the previous year. Companywide R&D expenses once again accounted for the largest portion of total R&D expenses: ¥4,852 million, or 34.5%. R&D focused on developing new products related to such fields as optics and electronics. R&D in the chemicals and resins segment, at ¥4,135 million, accounted for 29.4%. Fibers and textiles accounted for ¥2,298 million, or 16.3% of the total, while high-performance materials, medical products and others accounted for ¥2,782 million, or 19.8% of total R&D expenses. In all, the Group employs 810 research personnel.

CAPITAL EXPENDITURE

Capital expenditure for the year under review decreased 25.9%, to ¥33,872 million (US\$289,504 thousand). Capital expenditure related to chemicals and resins operations amounted to ¥23,810 million, accounting for 70.3% of total capital expenditure. Capital expenditure mainly comprised a 30 million square meter per year increase in production facilities for optical-use poval film. Together with existing facilities, this gives a total production



capacity of 61 million square meters per year. In the United States, the Company increased *EVAL* production facilities by 24,000 tons. Capital expenditure for fibers and textiles rose 16.0%, to ¥4,787 million, or 14.1% of the total, and capital expenditure for high performance materials, medical products and others decreased 54.5%, to ¥3,283 million, or 9.7% of the total. The Company will continue aggressive capital expenditure focused on mainstay businesses.

OUTLOOK

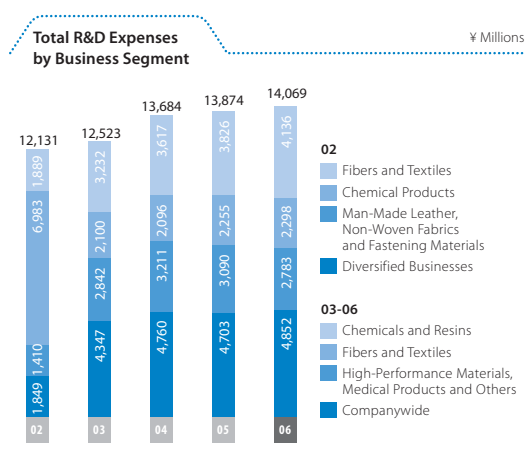
In fiscal 2006, ending March 31, 2007, the Japanese economy will continue to break away from prolonged deflationary conditions. In the global economy, high raw material and fuel prices are forecast to continue with fears of an economic slowdown in the United States and China. These factors make it impossible to be complacent about the future. Under these circumstances, Kuraray will pursue the following business initiatives. In the chemicals and resins business, we will endeavor to pass higher raw material and fuel prices along in the form of higher poval resin prices and increase sales of high-value-added products. In poval film, we will adopt measures that accurately address growing demand for optical-use film and accelerate price increases and sales expansion through the introduction of new high-performance products. In *EVAL*, Kuraray is committed to raising product prices and expanding sales of new products, such as *EVAL SP*, *KURARISTER*,

and others. We will also work to expand global markets for isoprene-related products, including thermoplastic elastomers, while curtailing activities in low-profit methacrylic resins and expanding optical applications.

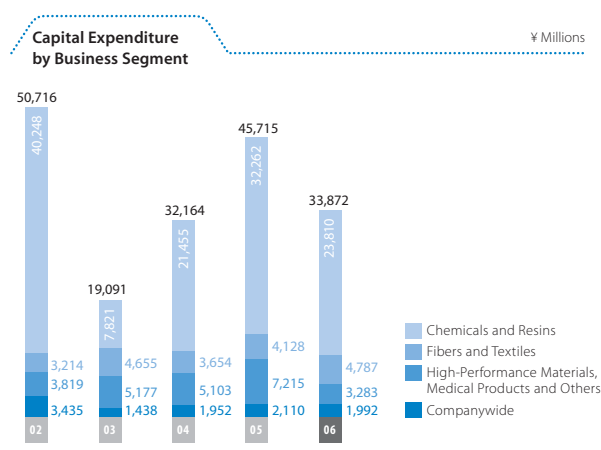
Kuraray will seek to secure increased profits in the fibers and textiles business by expanding sales of *KURALON* as a substitute for asbestos and raising product prices. Utilizing new processes, we will introduce *CLARINO* products and expand applications, including car seats, polishing materials, and other industrial uses. In the polyester business, Kuraray will accelerate the development of proprietary polymers and the shift toward differentiated products.

The Group will expand sales of dental materials in the medical business in Europe, the United States, and overseas markets as well as a new dialyzer with the aim of bolstering the high-performance materials, medical products and others business. In the optical products business, we will introduce new MD-type screens that offer superior optical properties. For *GENESTAR*, we will expand electric and electronic material applications and step up the development of applications for automobile use.

Forecasts for fiscal 2006, ending March 31, 2007, are net sales of ¥400.0 billion, operating income of ¥41.0 billion, and net income of ¥22.0 billion. Projections for fiscal 2006 assume an average exchange rate of ¥115 to the U.S. dollar, ¥140 to the euro, and a Dubai crude oil price of US\$58 per barrel.



Note: Data for the year ended March 31, 2003, reflects the conversion to an in-house company system so as to combine Companywide R&D expenses. Data for prior years has not been restated.



Note: Data for the year ended March 31, 2003, reflects the conversion to an in-house company system so as to combine Companywide capital expenditure. Data for prior years has not been restated.

BUSINESS RISKS

Significant risks that could have an impact on the Kuraray Group's results of operations and financial condition are discussed below. Estimates of future performance are the Kuraray Group's best judgment as of March 31, 2006.

(1) Changes in the Market Environment

In the rapidly growing information and communications fields, the Kuraray Group supplies a broad variety of materials and components, notably film and molded resin products for flat panel displays. The Group is strategically expanding net sales and profits in this field, where the market environment can undergo drastic changes within a short period as a result of reverses in industry standards and changes in the supply-and-demand balance. If these events occur, sales volumes could contract or sales prices could fall, with an adverse effect on the Kuraray Group's performance.

(2) Changes in Raw Material and Fuel Prices

The Kuraray Group is primarily engaged in the manufacturing and sale of synthetic fibers and textiles, chemical products, and synthetic resins as well as finished goods made from these materials. In this business structure, the effects of raw material and fuel prices on cost of sales are relatively large. If high market prices for raw materials, such as ethylene and other chemical materials, crude oil, and natural gas, cannot be offset by such internal measures as increases in productivity and passing costs along in sales prices, it is possible that the Kuraray Group's performance would be adversely affected.

(3) Product Defects

The Kuraray Group has instituted thorough product quality control measures, and the Group carries liability insurance against product liability claims. However, the possibility exists that major product defects arising from unforeseeable causes could necessitate a large-scale product recall. Under such circumstances, recall expenses, loss of public trust, compensation of customers, legal costs, and indemnification expenses could adversely affect the financial position of the Kuraray Group.

(4) Changes in Exchange Rates

The Kuraray Group is expanding its manufacturing and sales operations in Japan and in various overseas regions, including Europe, North America, and Asia. Exports of the Kuraray Group's domestically manufactured products are affected by changes in export sales prices. Sales of products manufactured at our overseas bases are affected by sales prices in different currency blocks and the value of foreign-currency-denominated assets and liabilities. All the Group's businesses are composed of operations in different currency blocks and are therefore subject to the effects of changes in raw material prices. The Kuraray Group is in general affected negatively by a rise in the value of the yen with respect to other currencies.

(5) Litigation

Engaged in a broad range of business activities, the Kuraray Group is subject to potential litigation across numerous fields. In the fiscal year under review, Kuraray did not face litigation of a material nature. In the event the Group is subject to future litigation, however, its performance and financial standing may be adversely affected.

(6) Accidents and Disasters

The Kuraray Group has manufacturing facilities in Japan, Europe, North America, and Asia. Many of these are large chemical plants that handle a variety of chemicals. If an industrial accident or release of pollutants to the environment should occur, the loss of the lives and property of third parties could result in claims against the assets of the Kuraray Group and halt manufacturing operations for long periods, adversely affecting the performance and financial position of the Kuraray Group. The occurrence of an earthquake, flood, or other natural disaster, an epidemic of a communicable disease or other medical incident, war, riot, terrorist attack, trouble with information systems, or information leaks could interfere with the business operations of the Kuraray Group, with an adverse impact on performance and financial position. Accidents or disasters such as those mentioned above could also interfere with the business operations of the Kuraray Group's customers and suppliers, with a similar adverse effect on the Kuraray Group's performance and financial position.

CONSOLIDATED BALANCE SHEETS

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

Thousands of
U.S. dollars
(Note 1)

	Millions of yen		
March 31, 2006 and 2005	2006	2005	2006
ASSETS			
Current assets:			
Cash and cash equivalents	¥ 28,085	¥ 16,743	\$ 240,043
Marketable securities (Note 3)	–	5,990	–
Notes and accounts receivable:			
Trade	88,677	82,079	757,922
Unconsolidated subsidiaries and affiliates	1,757	1,752	15,017
Other	4,127	2,322	35,274
Loans receivable from unconsolidated subsidiaries, affiliates and others	624	429	5,334
Allowance for doubtful accounts	(1,015)	(904)	(8,675)
	94,170	85,678	804,872
Inventories (Note 4)	69,431	64,173	593,426
Deferred income taxes (Note 9)	6,478	7,313	55,368
Other current assets	2,504	2,420	21,402
Total current assets	200,668	182,317	1,715,111
Property, plant and equipment (Note 5):			
Land	19,676	20,289	168,171
Buildings	88,265	92,759	754,401
Machinery and equipment	443,689	421,146	3,792,214
Construction-in-progress	24,590	21,527	210,171
	576,220	555,721	4,924,957
Less accumulated depreciation	(416,824)	(397,427)	(3,562,598)
	159,396	158,294	1,362,359
Investments and other assets:			
Goodwill	28,625	31,661	244,658
Other intangible assets	6,014	6,272	51,402
Investment securities (Note 3)	37,970	24,115	324,530
Investments in unconsolidated subsidiaries and affiliates	4,512	4,465	38,564
Loans receivable from:			
Unconsolidated subsidiaries and affiliates	2,802	2,947	23,949
Other	475	619	4,060
Accumulated premiums on insurance	29,707	35,188	253,906
Deferred income taxes (Note 9)	2,650	2,077	22,650
Prepaid pension costs (Note 10)	5,142	3,512	43,948
Other	3,511	4,811	30,008
Allowance for doubtful accounts	(115)	(1,337)	(983)
	121,293	114,330	1,036,692
	¥481,357	¥454,941	\$4,114,162

See notes to consolidated financial statements.

Millions of yen

Thousands of
U.S. dollars
(Note 1)

	2006	2005	2006
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Short-term bank loans (Note 6)	¥ 6,619	¥ 10,013	\$ 56,573
Current portion of long-term debt (Note 6)	390	3,434	3,333
Notes and accounts payable:			
Trade	39,150	39,905	334,615
Unconsolidated subsidiaries and affiliates	1,004	1,733	8,581
Other	8,130	8,739	69,487
Accrued income taxes (Note 9)	7,165	5,850	61,239
Accrued expenses and other	16,771	15,183	143,343
Total current liabilities	79,229	84,857	677,171
Long-term liabilities:			
Long-term debt (Note 6)	19,256	16,234	164,581
Deferred income taxes (Note 9)	13,714	7,345	117,214
Accrued retirement benefits (Note 10)	13,404	13,469	114,564
Other	14,273	17,853	121,991
Total long-term liabilities	60,647	54,901	518,350
Minority interests	2,354	2,253	20,120
Commitments and contingencies (Note 13)			
Shareholders' equity (Note 7):			
Common stock:			
Authorized – 700,000,000 shares			
Issued – 382,863,603 shares	88,955	88,955	760,299
Capital surplus	87,227	87,156	745,530
Retained earnings	155,377	138,951	1,328,009
Unrealized gain on revaluation of securities (Note 3)	16,426	9,012	140,393
Cumulative translation adjustments	2,726	679	23,299
	350,711	324,753	2,997,530
Treasury stock at cost – 15,379,675 shares in 2006			
15,755,698 shares in 2005	(11,584)	(11,823)	(99,009)
Total shareholders' equity	339,127	312,930	2,898,521
	¥481,357	¥454,941	\$4,114,162

CONSOLIDATED STATEMENTS OF INCOME

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

	Millions of yen		Thousands of U.S. dollars (Note 1)
Years ended March 31, 2006 and 2005	2006	2005	2006
Net sales	¥375,073	¥354,874	\$3,205,752
Cost of sales (Note 12)	266,284	254,115	2,275,931
Gross profit	108,789	100,759	929,821
Selling, general and administrative expenses (Notes 11 and 12)	70,512	67,572	602,667
Operating income	38,277	33,187	327,154
Other income (expenses):			
Interest and dividend income	1,294	1,192	11,060
Equity in earnings of affiliates	56	30	479
Interest expenses	(414)	(297)	(3,539)
Restructuring charges	(1,693)	(1,249)	(14,470)
Gain on sales of investment securities	1,029	–	8,795
Write-down of investment securities	(253)	–	(2,163)
Gain on sales of property, plant and equipment	8,446	259	72,188
Loss on disposal of property, plant and equipment	(492)	–	(4,205)
Impairment loss on property, plant and equipment (Note 5)	(5,455)	–	(46,624)
Other, net	(6,432)	(3,277)	(54,974)
	(3,914)	(3,342)	(33,453)
Income before income taxes and minority interests	34,363	29,845	293,701
Income taxes (Note 9):			
Current	11,674	8,723	99,777
Deferred	1,394	2,564	11,915
	13,068	11,287	111,692
Minority interests in net income of consolidated subsidiaries	(109)	(93)	(932)
Net income	¥ 21,186	¥ 18,465	\$ 181,077

	Yen		U.S. dollars (Note 1)
Net income per share:			
Primary	¥57.51	¥50.13	\$0.49
Fully diluted	57.41	50.12	0.49

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

Millions of yen

Years ended March 31, 2006 and 2005	Common stock	Capital surplus	Retained earnings	Unrealized gain on revaluation of securities (Note 3)	Cumulative translation adjustments	Treasury stock
Balance at March 31, 2004	¥ 88,955	¥ 87,150	¥ 127,148	¥ 7,902	¥ 842	¥ (11,691)
Net income			18,465			
Cash dividends, ¥12.00 per share			(4,039)			
Bonuses to directors			(57)			
Effect of changes in reporting entities			(2,569)			
Minimum pension liability adjustment			3			
Changes in unrealized gain on revaluation of securities (Note 3)				1,110		
Translation adjustments					(163)	
Treasury stock acquired, net		6				(132)
Balance at March 31, 2005	¥ 88,955	¥ 87,156	¥ 138,951	¥ 9,012	¥ 679	¥ (11,823)
Net income			21,186			
Cash dividends, ¥13.00 per share			(4,772)			
Bonuses to directors			(59)			
Effect of changes in reporting entities			56			
Minimum pension liability adjustment			15			
Changes in unrealized gain on revaluation of securities (Note 3)				7,414		
Translation adjustments					2,047	
Treasury stock sold, net		71				239
Balance at March 31, 2006	¥88,955	¥87,227	¥155,377	¥16,426	¥2,726	¥(11,584)

Thousands of U.S. dollars (Note 1)

Balance at March 31, 2005	\$760,299	\$744,923	\$1,187,615	\$ 77,026	\$ 5,803	\$(101,051)
Net income			181,077			
Cash dividends, \$0.11 per share			(40,786)			
Bonuses to directors			(504)			
Effect of changes in reporting entities			479			
Minimum pension liability adjustment			128			
Changes in unrealized gain on revaluation of securities (Note 3)				63,367		
Translation adjustments					17,496	
Treasury stock sold, net		607				2,042
Balance at March 31, 2006	\$760,299	\$745,530	\$1,328,009	\$140,393	\$23,299	\$(99,009)

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

Thousands of
U.S. dollars
(Note 1)

	Millions of yen		
Years ended March 31, 2006 and 2005	2006	2005	2006
Cash flows from operating activities:			
Income before income taxes and minority interests	¥34,363	¥29,845	\$293,701
Adjustments to reconcile income before income taxes and minority interests to net cash and cash equivalents provided by operating activities:			
Depreciation and amortization	25,186	21,324	215,265
Increase in allowance for doubtful accounts	37	27	316
Decrease in accrued retirement benefits, net	(141)	(357)	(1,205)
Impairment loss on property, plant and equipment (Note 5)	5,455	–	46,624
Gain on sales of property, plant and equipment	(8,446)	(259)	(72,188)
Loss on disposal of property, plant and equipment	492	–	4,205
Gain on sales of investment securities	(1,029)	–	(8,795)
Write-down of investment securities	253	–	2,163
Interest and dividend income	(1,294)	(1,192)	(11,060)
Interest expenses	414	297	3,539
(Increase) decrease in notes and accounts receivable	(5,838)	273	(49,897)
Increase in inventories	(4,219)	(2,155)	(36,060)
(Decrease) increase in notes and accounts payable	(2,505)	2,633	(21,410)
Increase in prepaid pension costs (Note 10)	(1,630)	(2,221)	(13,932)
Other, net	1,264	(933)	10,802
Sub-total	42,362	47,282	362,068
Interest and dividend received	943	821	8,060
Interest paid	(388)	(299)	(3,316)
Income taxes paid	(10,226)	(8,189)	(87,402)
Net cash and cash equivalents provided by operating activities	32,691	39,615	279,410
Cash flows from investing activities:			
Decrease (increase) in marketable securities	3,000	(3,000)	25,641
Payments for acquisition of property, plant, equipment and intangible assets	(36,069)	(47,512)	(308,282)
Proceeds from sales of property, plant, equipment and intangible assets	10,550	470	90,171
Payments for purchase of investment securities	(1,379)	(1,607)	(11,786)
Proceeds from sales and redemption of investment securities	3,604	8,400	30,803
Payments of premiums on insurance	(702)	(928)	(6,000)
Withdrawals from accumulated premiums on insurance	6,573	55	56,179
Other, net	730	(574)	6,240
Net cash and cash equivalents used in investing activities	(13,693)	(44,696)	(117,034)
Cash flows from financing activities:			
(Decrease) increase in short-term bank loans	(3,322)	7,125	(28,393)
Decrease in commercial paper	–	(3,000)	–
Proceeds from long-term debt	3,400	6,075	29,060
Repayments of long-term debt	(3,407)	(2,821)	(29,120)
Proceeds from issuance of standard bonds	–	10,000	–
Dividends paid	(4,772)	(4,039)	(40,786)
Proceeds from sales of treasury stock	461	58	3,940
Payments for purchase of treasury stock	(151)	(177)	(1,291)
Net cash and cash equivalents (used in) provided by financing activities	(7,791)	13,221	(66,590)
Effect of exchange rate changes on cash and cash equivalents	134	454	1,145
Net increase in cash and cash equivalents	11,341	8,594	96,931
Cash and cash equivalents, beginning of year	16,743	7,015	143,103
Effect of changes in reporting entities	1	1,134	9
Cash and cash equivalents, end of year	¥28,085	¥16,743	\$240,043

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

Years ended March 31, 2006 and 2005

1. BASIS OF PRESENTING CONSOLIDATED FINANCIAL STATEMENTS:

The accompanying consolidated financial statements of Kuraray Co., Ltd. (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 from 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.

In preparing these consolidated financial statements, certain reclassifications have been made to the consolidated financial statements issued domestically to present them in a form more familiar to readers outside Japan. In addition, certain notes included herein are not required under accounting principles and practices generally accepted in Japan but have been presented as additional information.

Certain reclassifications of the accompanying consolidated financial statements as of and for the year ended March 31, 2005 have been made to conform to the 2006 presentation.

The United States dollar amounts included herein are provided solely for the convenience of readers outside Japan and are stated, as a matter of arithmetical computation only, at the rate of ¥117=\$1, the approximate exchange rate prevailing on March 31, 2006. The translations should not be construed as representations that the Japanese yen amounts have been, could have been or could in the future be, converted into United States dollars at this or any other rate.

2. SIGNIFICANT ACCOUNTING POLICIES:

(a) Principles of consolidation

These consolidated financial statements include the financial statements of the Company and its significant 35 subsidiaries (37 subsidiaries at March 31, 2005). A subsidiary is a company, more than 50% of whose shares are held by the Company, or a company, 40%-50% of whose shares are held by the Company and which is controlled by the Company through certain channels. Hereinafter, the Company and its consolidated subsidiaries are collectively referred to as the "Companies".

In the case of a change in reporting entity, the consolidated financial statements are not restated, but the effect of the change to retained earnings at the beginning of the year is directly charged or credited to retained earnings during the year.

Investments in unconsolidated subsidiaries and 20%-50% owned companies other than subsidiaries ("affiliates"), with minor exceptions, are accounted for using the equity method.

Some foreign subsidiaries of the Company are consolidated using a fiscal year ending December 31, which differs from that of the Company. Those subsidiaries do not prepare their financial statements at any date after December 31, or on or before March 31 in the succeeding year.

Any material events occurring during the January 1 to March 31 period are adjusted for in those consolidated financial statements.

The difference between the cost and the underlying net equity of investments in consolidated subsidiaries and affiliates accounted for on an equity basis are amortized using the straight-line method over the estimated period of the benefit, with minor exceptions, in case of which the difference is charged or credited to income when incurred. The differences recognized in overseas subsidiaries and affiliates are accounted for in accordance with accounting principles generally accepted in those countries.

(b) Cash and cash equivalents

Cash and cash equivalents include all highly liquid investments with an original maturity of three months or less, of which at least the face amount can be withdrawn at any time without penalty.

(c) Marketable securities and investment securities

Marketable securities and investment securities are classified into three categories: held-to-maturity, trading and available-for-sale securities. Trading securities are carried at fair value with unrealized gains or losses included in income, and held-to-maturity securities are carried at amortized cost. As of March 31, 2006 and 2005, marketable securities and investment securities represented available-for-sale securities. Available-for-sale securities are carried at fair value with unrealized gains or losses recorded as a component of shareholders' equity, net of applicable taxes. Available-for-sale securities whose fair value is not readily determinable are stated at cost except for debt securities, which are stated at amortized cost. Moreover, available-for-sale securities with a maturity of one year or less are classified as current assets.

(d) Inventories

Inventories other than supplies are stated at cost principally determined using the average cost method. Supplies are stated at cost principally determined using the moving average method.

(e) Property, plant and equipment

Property, plant and equipment are stated at cost.

Depreciation, except for buildings, is principally computed using the declining-balance method over the estimated useful lives of the assets. The depreciation method for buildings is principally computed using the straight-line method.

The estimated useful lives of assets are principally as follows:

Buildings	31 to 50 years
Machinery and equipment	4 to 10 years

The Companies use machinery and equipment under financing leases that do not transfer ownership to the lessee, and such leased assets used by the Company and its domestic subsidiaries are not capitalized on the balance sheet in conformity with accounting principles generally accepted in Japan.

(f) Goodwill

Goodwill is stated at cost less amortization.

Amortization is principally computed over 15 years using the straight-line method.

During the year ended March 31, 2005, a subsidiary of the Company purchased property, plant, equipment and goodwill relating to the PVB film business from HT Troplast AG. A consideration of ¥4,826 million (\$41,248 thousand) was included in “Acquisition of property, plant, equipment and intangible assets” in the consolidated statements of cash flows.

(g) Accounting for impairment losses on fixed assets

The Company and its domestic consolidated subsidiaries and affiliates have adopted “Accounting Standard for Impairment of Fixed Assets” and “Implementation Guidance for Accounting for Impairment of Fixed Assets” from the fiscal year beginning April 1, 2005. The standard, which was issued by the Business Accounting Council in Japan on August 9, 2002, requires that fixed assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The effective date of the standard is the fiscal year beginning on or after April 1, 2005.

As a result of this change, income before income taxes and minority interests for the year ended March 31, 2006 decreased ¥5,455 million (\$46,624 thousand). The effects of this change are further discussed in Note 5.

(h) Income taxes

Accrued income taxes are provided at the amount currently payable. The Companies adopted the interperiod income tax allocation accounting, using the assets and liabilities method, in which deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. A valuation allowance is deducted from deferred tax assets when there is uncertainty regarding their realizability.

(i) Retirement benefits

Most of the Companies have unfunded lump-sum benefit plans and funded contributory pension plans, generally covering all of their employees.

Under the terms of the Companies’ retirement plans, substantially all of their employees are entitled to a lump-sum payment at the time of retirement. The amount of the retirement benefit is, in general, based on the length of service, basic salary at the time of retirement and reason for retirement.

The contributory pension plans of the Company and its domestic subsidiaries, which principally cover those employees who retire at age 60 or who have served with those companies for more than 20 years and are age 50 or more, generally provide for pension payments for a period of 10

years subsequent to age 60. The annual charge for the current service cost of these plans is determined actuarially and currently funded through outside trustees.

Directors and corporate auditors are entitled, subject to shareholders’ approval, to lump-sum payments under the unfunded retirement plan. The accrued liabilities for their retirement benefits are, in general, based upon the amounts required by the Companies’ internal regulations at the respective balance sheet date.

(j) Foreign currency items

Income and expenses in foreign currency are translated into Japanese yen at the exchange rates prevailing at the transaction dates. Foreign currency denominated assets and liabilities are translated into Japanese yen at the exchange rates prevailing at the balance sheet date.

In preparing the consolidated financial statements, the assets and liabilities of foreign subsidiaries have been translated into Japanese yen at the rates in effect at the balance sheet date, and income and expenses have been translated at the average rate for the year then ended. Translation adjustments resulting from this process are charged or credited directly to shareholders’ equity as cumulative translation adjustments in the consolidated balance sheets.

(k) Research and development expenses

Expenses relating to research and development activities are charged to income when incurred.

(l) Net income per share

The computation of primary net income per share is based on the weighted average number of shares outstanding during each financial period. The computation of fully diluted net income per share is based on the weighted average number of outstanding shares after consideration of the effect of dilution of common stock equivalents.

(m) Allowance for doubtful accounts

The Companies provide for doubtful accounts principally at an amount computed based on the historical bad debt ratio during a certain reference period plus an estimated uncollectible amount based on the analysis of certain individual accounts.

(n) Derivative financial instruments and hedging

Derivative financial instruments, which include forward foreign exchange contracts, currency swap contracts and interest rate swap contracts, are used to offset the Companies’ risk of exposure to changes in interest and currency exchange rates in respect of their financial assets and liabilities, in accordance with the Companies’ internal policies and procedures.

a. Derivatives

All derivatives are stated at fair value, except for derivatives that are designated as hedging instruments (see below).

b. Hedge accounting

The Companies adopt the method for hedging instruments whereby any gain or loss is deferred over the period of the hedging contract and is offset against the deferred loss or gain on the related hedged items.

However, when an interest rate swap contract meets certain conditions, the net amount to be paid or received under the contract is added to or deducted from the interest on the hedged items.

c. Hedging policy

The Companies use financial instruments to hedge market fluctuation risks in accordance with their internal policies and procedures.

d. Assessment method for hedge effectiveness

The Companies evaluate the effectiveness of their hedging activities by reference to the accumulated gains or losses on the hedging instruments and the related hedged items. Interest rate swap contracts which meet certain conditions are evaluated for effectiveness at the commencement of the hedges.

3. SECURITIES:

The following is a summary of available-for-sale securities at March 31, 2006 and 2005:

	Millions of yen			Book value (estimated fair value)
	Cost	Gross unrealized gains	Gross unrealized losses	
March 31, 2006				
Equity securities	¥6,756	¥27,636	¥4	¥34,388
Bonds and debentures	—	—	—	—
Other	—	—	—	—
	¥6,756	¥27,636	¥4	¥34,388

	Millions of yen			Book value (estimated fair value)
	Cost	Gross unrealized gains	Gross unrealized losses	
March 31, 2005				
Equity securities	¥ 5,795	¥14,588	¥ 4	¥20,379
Bonds and debentures	5,352	638	—	5,990
Other	—	—	—	—
	¥11,147	¥15,226	¥ 4	¥26,369

	Thousands of U.S. dollars			Book value (estimated fair value)
	Cost	Gross unrealized gains	Gross unrealized losses	
March 31, 2006				
Equity securities	\$57,744	\$236,205	\$34	\$293,915
Bonds and debentures	—	—	—	—
Other	—	—	—	—
	\$57,744	\$236,205	\$34	\$293,915

Available-for-sale securities with no available fair values as of March 31, 2006 and 2005, amounting to ¥3,212 million (\$27,453 thousand) and ¥3,121 million, respectively, are excluded from the above table.

Securities with an original maturity of three months or less have been transferred to cash and cash equivalents.

4. INVENTORIES:

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

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Finished products	¥47,840	¥46,203	\$408,888
Semi-finished products and work-in-progress	10,499	7,052	89,735
Raw materials and supplies	11,092	10,918	94,803
	¥69,431	¥64,173	\$593,426

5. IMPAIRMENT LOSSES ON FIXED ASSETS:

The significant component of impairment losses on fixed assets for the fiscal year ended March 31, 2006 is as follows:

	Millions of yen	Thousands of U.S. dollars
	2006	2006
Plant and equipment for polyester filaments	¥1,242	\$10,615
Plant and equipment for opto-screens	2,627	22,453
Plant and equipment for high-flux filter membranes for artificial kidneys	1,468	12,547

As a minimum unit for generating cash flow, business assets are grouped into sections used for management accounting, and lent assets and idle assets are assessed individually.

Impairment losses are recognized in the consolidated statements of income by reducing the carrying amount of the impaired assets to the recoverable amounts to be measured as value in use, which is equivalent

to their discounted future cash flows, or the net saleable value of the assets, whichever is higher.

For the year ended March 31, 2006, the discount rate used for the estimation of the recoverable amounts, using future cash flows, of the assets showing signs of impairment was 4%.

6. SHORT-TERM BANK LOANS, LONG-TERM DEBT AND BONDS:

Short-term bank loans were generally represented by 365-day notes with interest rates principally of 1.6% at March 31, 2006.

Long-term debt and bonds consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Unsecured loans principally from banks and insurance companies with interest rates ranging from 0.37% to 3.30% maturing serially until 2022	¥ 9,646	¥ 9,668	\$ 82,444
0.99% yen unsecured bonds due December 20, 2011	10,000	10,000	85,470
	19,646	19,668	167,914
Current portion	(390)	(3,434)	(3,333)
	¥19,256	¥16,234	\$164,581

The annual maturities of long-term debt and bonds outstanding at March 31, 2006 for the respective years ending March 31 were as follows:

	Millions of yen	Thousands of U.S. dollars
2006	¥ 390	\$ 3,333
2007	7,400	63,248
2008	1,000	8,547
2009	850	7,265
2010	1	8
Thereafter	10,005	85,513
	¥19,646	\$167,914

7. SHAREHOLDERS' EQUITY:

The Company and its domestic subsidiaries were subject to the Japanese Commercial Code (the "Code") as of March 31, 2006.

The Code required at least 50% of the issue price of new shares to be designated as stated capital following the passing of a resolution by the Board of Directors. Proceeds in excess of the amounts designated as stated capital were credited to additional paid-in capital. Additional paid-in capital was included in capital surplus in the accompanying balance sheets as of March 31, 2006 and 2005.

The Code provided that an amount equal to at least 10% of cash dividends and directors' bonuses, etc., to be paid from retained earnings, should be appropriated as a legal reserve. No further appropriation is required when the sum of the additional paid-in capital and legal reserve equals 25% or more of common stock. If the sum of the additional paid-in capital and legal reserve exceeded the required amount, the excess amount is allowed to be appropriated following the passing of a resolution at the ordinary general meeting of shareholders. All or part of the additional paid-in capital and/or a legal reserve may be used to reduce a deficit or may be transferred to common stock through the appropriate legal procedures. A legal reserve amounting to ¥6,570 million (\$56,154 thousand) was included in retained earnings as of March 31, 2006 and 2005.

9. INCOME TAXES:

The Companies were subject to several taxes based on income, which, in the aggregate, resulted in a normal effective tax rate of approximately 40.4% in Japan for the years ended March 31, 2006 and 2005.

Reconciliation of the differences between the normal effective tax rate and the income tax rate in the accompanying consolidated statements of income is as follows:

	2006	2005
Normal effective tax rate	40.4%	40.4%
Non-taxable income	(0.3)	(0.3)
Tax credit primarily for research and development expenses	(2.9)	(2.9)
Other, largely loss incurred by consolidated subsidiaries	0.8	0.6
Income tax rate per statements of income	38.0%	37.8%

8. STOCK-BASED COMPENSATION PLANS:

The Company has a stock option plan. On June 27, 2002, the shareholders of the Company approved the issuance of new stock acquisition rights in the form of a stock option plan for directors, corporate auditors and managers of the Company and its subsidiaries. Based on this approval, the Company issued new stock acquisition rights of 1,076,500 shares of common stock of the Company. These rights are exercisable from June 28, 2004 to June 27, 2012. The exercise price is ¥825 (\$7.05) per share. The number of shares to be issued under this option, if all rights were exercised, as of March 31, 2006 was 754,500.

Subsequently, on June 26, 2003, the shareholders of the Company approved the issuance of new stock acquisition rights in the form of a stock option plan for directors, corporate auditors, executive officers and employees of the Company and its subsidiaries. Based on this approval, the Company issued new stock acquisition rights of 2,811,000 shares of common stock of the Company. These rights are exercisable from June 27, 2005 to June 26, 2013. The exercise price is ¥918 (\$7.85) per share. The number of shares to be issued under this option, if all rights were exercised, as of March 31, 2006 was 2,273,500.

The significant components of deferred tax assets and liabilities at March 31, 2006 and 2005 are as follows:

(1) Current:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets			
Accrued enterprise taxes and other taxes	¥ 829	¥ 776	\$ 7,085
Accrued bonuses	2,446	2,379	20,906
Other	3,228	4,441	27,590
Total deferred tax assets	6,503	7,596	55,581
Total deferred tax liabilities	25	283	213
Net deferred tax assets	¥6,478	¥7,313	\$55,368

(2) Non-current:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets			
Accrued retirement benefits	¥ 824	¥ 757	\$ 7,043
Impairment loss on property, plant and equipment	620	—	5,299
Other	1,413	1,545	12,077
Total deferred tax assets	2,857	2,302	24,419
Deferred tax liabilities			
Deferred gain on sales of fixed assets to the public	105	105	898
Special depreciation	10	10	85
Unrealized gain on revaluation of securities	30	26	256
Other	62	84	530
Total deferred tax liabilities	207	225	1,769
Net deferred tax assets	¥ 2,650	¥2,077	\$ 22,650
Deferred tax liabilities			
Depreciation	¥ 5,056	¥4,802	\$ 43,214
Deferred gain on sales of fixed assets to the public	2,681	1,438	22,915
Special depreciation	303	282	2,590
Special account for reserve for deferred gains on sales of fixed assets	698	—	5,966
Unrealized gain on revaluation of securities	11,103	5,824	94,897
Prepaid pension costs	2,077	1,419	17,752
Other	885	885	7,563
Total deferred tax liabilities	22,803	14,650	194,897
Deferred tax assets			
Accrued retirement benefits	3,981	3,701	34,025
Impairment loss on property, plant and equipment	1,536	—	13,128
Other	3,572	3,604	30,530
Total deferred tax assets	9,089	7,305	77,683
Net deferred tax liabilities	¥13,714	¥7,345	\$117,214

At March 31, 2006 and 2005, valuation allowances of ¥5,864 million (\$50,120 thousand) and ¥5,172 million were deducted from non-current deferred tax assets, respectively.

The deferred tax assets and liabilities of the consolidated subsidiaries in different tax jurisdictions are presented without offset in accordance with Japanese accounting practices.

10. RETIREMENT BENEFITS:

The following tables set forth the changes in the benefit obligation, plan assets and funded status of the Companies at March 31, 2006 and 2005.

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Projected benefit obligation at end of year	¥(50,058)	¥(50,161)	\$(427,846)
Fair value of plan assets at end of year	36,999	28,953	316,231
Funded status:			
Projected benefit obligation in excess of plan assets	(13,059)	(21,208)	(111,615)
Unrecognized prior service costs	(1,179)	(1,300)	(10,077)
Unrecognized actuarial losses	6,781	13,302	57,956
Accrued pension liability recognized in the consolidated balance sheets	(7,457)	(9,206)	(63,736)
Prepaid pension costs	5,142	3,513	43,948
Net accrued retirement benefits	¥(12,599)	¥(12,719)	\$(107,684)

Accrued retirement benefits for directors and corporate auditors at March 31, 2006 and 2005, amounting to ¥805 million (\$6,880 thousand) and ¥750 million, respectively, are excluded from the above tables.

Retirement and pension costs of the Companies for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Service costs	¥ 1,846	¥2,230	\$15,778
Interest costs	958	957	8,188
Expected return on plan assets	(1,132)	(1,061)	(9,675)
Amortization:			
Prior service costs	(104)	(84)	(889)
Actuarial losses	1,017	841	8,692
Net periodic benefit costs	¥ 2,585	¥2,883	\$22,094

Assumptions used in accounting for the defined benefit plans for the years ended March 31, 2006 and 2005 are as follows:

Discount rate	mainly 2.0%
Long-term rate of return on fund assets	mainly 4.0%
Amortization period for transition charges at date of adoption	1 year
Amortization period for prior service cost	mainly 15 years (straight-line method)
Amortization period for actuarial losses	mainly 15 years (straight-line method)

11. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES:

The major components of selling, general and administrative expenses for the years ended March 31, 2006 and 2005 were as follows:

Account	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Freight and storage	¥13,758	¥12,755	\$117,590
Research and development	12,642	12,319	108,051
Salaries and bonuses	17,038	16,741	145,624

12. RESEARCH AND DEVELOPMENT EXPENSES:

Total research and development expenses for the years ended March 31, 2006 and 2005 amounted to ¥14,069 million (\$120,248 thousand) and ¥13,874 million, respectively.

13. COMMITMENTS AND CONTINGENCIES:

The Companies were contingently liable for guarantees, mainly for bank loans of unconsolidated subsidiaries, affiliates and others, of ¥1,681 million (\$14,368 thousand) and ¥1,152 million at March 31, 2006 and 2005 respectively.

These guarantees include letters of commitment for guarantees, letters of awareness and other items of a similar nature.

14. LEASES:

(a) Financing leases

Lease transactions as a lessee:

Payment of fees for financing leases, in which ownership of the leased assets is not transferred to the lessee and which are not required to be capitalized, for the years ended March 31, 2006 and 2005, were ¥277 million (\$2,368 thousand) and ¥282 million, respectively. Future lease payments, including amounts representing interest were as follows:

Account	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Due within one year	¥237	¥268	\$2,026
Due after one year	256	320	2,188
	¥493	¥588	\$4,214

The leased assets were as follows:

Year ended March 31, 2006	Millions of yen			Thousands of U.S. dollars
	Cost	Accumulated depreciation	Net	Net
Machinery and equipment	¥1,205	¥712	¥493	\$4,214

Year ended March 31, 2005	Millions of yen		
	Cost	Accumulated depreciation	Net
Machinery and equipment	¥1,358	¥770	¥588

Lease transactions as a lessor are immaterial.

(b) Operating leases

Lease transactions as a lessee:

Future lease payments under non-cancellable operating leases were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Due within one year	¥ 378	¥ 384	\$ 3,231
Due after one year	2,472	2,619	21,128
	¥2,850	¥3,003	\$24,359

Lease transactions as a lessor are immaterial.

15. DERIVATIVE FINANCIAL INSTRUMENTS:

Derivative financial instruments are utilized by the Companies principally to reduce interest rate and foreign exchange risks. The Companies have established a control environment, which includes policies and procedures for risk assessment and for the approval, reporting and monitoring of transactions involving derivative financial instruments. The Companies do not hold or issue derivative financial instruments for trading purposes.

Hedging instruments and hedged items

March 31, 2006

March 31, 2005

Hedging instruments:	Hedged items:	Hedging instruments:	Hedged items:
Forward foreign exchange contracts	Future transactions in foreign currency	Forward foreign exchange contracts	Future transactions in foreign currency
Currency swap contracts	Future transactions in foreign currency	Interest rate swap contracts	Interest payable
Interest rate swap contracts	Interest payable		

The forward foreign exchange contracts and currency swap contracts outstanding at March 31, 2006 and 2005 were as follows:

	Millions of yen						Thousands of U.S. dollars		
	2006			2005			2006		
	Notional amount	Market value	Unrealized loss	Notional amount	Market value	Unrealized loss	Notional amount	Market value	Unrealized loss
Forward foreign exchange contracts:									
Foreign currency sales	¥32,440	¥(2,498)	¥(2,498)	¥26,998	¥(1,324)	¥(1,324)	\$277,265	\$(21,350)	\$(21,350)
Currency swap contracts:									
Yen into foreign currency obligation	13,829	(660)	(660)	14,233	(336)	(336)	118,197	(5,641)	(5,641)
	¥46,269	¥(3,158)	¥(3,158)	¥41,231	¥(1,660)	¥(1,660)	\$395,462	\$(26,991)	\$(26,991)

The amounts include contracts entered into in order to hedge inter-company transactions in foreign currency or forward foreign exchange contracts for accounts receivable and payable in foreign currency, which are not accounted for by hedge accounting but by the primary method of accounting for the instruments in accordance with the Accounting Standard for Financial Instruments. The amounts exclude derivative transactions to which hedge accounting is applied.

16. SEGMENT INFORMATION:

A summary of net sales and operating income and identifiable assets, capital expenditure and depreciation and amortization by industrial segment for the years ended March 31, 2006 and 2005 is as follows:

Net sales and operating income

	Millions of yen				Thousands of U.S. dollars			
	Net sales		Total	Operating income	Net sales		Total	Operating income
	Outside customers	Inter-segment			Outside customers	Inter-segment		
Year ended March 31, 2006								
Chemicals and resins	¥190,753	¥ 723	¥191,476	¥ 31,868	\$1,630,368	\$ 6,179	\$1,636,547	\$272,376
Fibers and textiles	109,107	684	109,791	9,451	932,538	5,846	938,384	80,778
High-performance materials, medical products and others	75,213	27,105	102,318	8,456	642,846	231,667	874,513	72,274
Total	375,073	28,512	403,585	49,775	3,205,752	243,692	3,449,444	425,428
Eliminated on consolidation and corporate	—	(28,512)	(28,512)	(11,498)	—	(243,692)	(243,692)	(98,274)
Consolidated total	¥375,073	¥ —	¥375,073	¥ 38,277	\$3,205,752	\$ —	\$3,205,752	\$327,154

Year ended March 31, 2005

Chemicals and resins	¥167,264	¥ 795	¥168,059	¥28,420
Fibers and textiles	109,829	1,197	111,026	7,921
High-performance materials, medical products and others	77,781	25,166	102,947	7,333
Total	354,874	27,158	382,032	43,674
Eliminated on consolidation and corporate	—	(27,158)	(27,158)	(10,487)
Consolidated total	¥354,874	¥ —	¥354,874	¥33,187

Identifiable assets, capital expenditure and depreciation and amortization

	Millions of yen			Thousands of U.S. dollars		
	Identifiable assets	Capital expenditure	Depreciation and amortization	Identifiable assets	Capital expenditure	Depreciation and amortization
Year ended March 31, 2006						
Chemicals and resins	¥243,384	¥23,810	¥16,029	\$2,080,205	\$203,504	\$137,000
Fibers and textiles	80,501	4,787	3,845	688,043	40,915	32,863
High-performance materials, medical products and others	69,571	3,283	3,720	594,624	28,060	31,795
Total	393,456	31,880	23,594	3,362,872	272,479	201,658
Eliminated on consolidation and corporate	87,901	1,992	1,592	751,290	17,025	13,607
Consolidated total	¥481,357	¥33,872	¥25,186	\$4,114,162	\$289,504	\$215,265
Year ended March 31, 2005						
Chemicals and resins	¥220,812	¥32,262	¥12,119			
Fibers and textiles	79,994	4,128	4,085			
High-performance materials, medical products and others	82,122	7,215	3,679			
Total	382,928	43,605	19,883			
Eliminated on consolidation and corporate	72,013	2,110	1,441			
Consolidated total	¥454,941	¥45,715	¥21,324			

Effective April 1, 2005, the Company and its domestic consolidated subsidiaries and affiliates have adopted “Accounting Standard for Impairment of Fixed Assets” and “Implementation Guidance for Accounting for Impairment of Fixed Assets”. As a result of this change, identifiable assets for “Fibers and textiles” decreased ¥1,242 million (\$10,615 thousand) and identifiable assets for “High-performance materials, medical products and others” decreased ¥4,207 million (\$35,957 thousand) at March 31, 2006. The effects on identifiable assets of other segments are immaterial.

A summary of net sales, operating income and identifiable assets by geographic segment for the years ended March 31, 2006 and 2005 is as follows:

	Millions of yen			Operating income (loss)	Identifiable assets
	Net sales		Total		
	Outside customers	Inter-segment	Total		
Year ended March 31, 2006					
Domestic (inside Japan)	¥273,757	¥28,770	¥302,527	¥43,570	¥259,901
North America	30,610	3,544	34,154	2,987	44,666
Europe	53,974	3,191	57,165	3,211	87,940
Asia	16,732	1,936	18,668	(276)	5,897
Total	375,073	37,441	412,514	49,492	398,404
Eliminated on consolidation and corporate	—	(37,441)	(37,441)	(11,215)	82,953
Consolidated total	¥375,073	¥ —	¥375,073	¥38,277	¥481,357
Year ended March 31, 2005					
Domestic (inside Japan)	¥269,534	¥28,354	¥297,888	¥37,723	¥251,133
North America	27,586	3,907	31,493	3,483	37,322
Europe	42,187	1,509	43,696	2,567	89,896
Asia	15,567	1,456	17,023	(119)	8,430
Total	354,874	35,226	390,100	43,654	386,781
Eliminated on consolidation and corporate	—	(35,226)	(35,226)	(10,467)	68,160
Consolidated total	¥354,874	¥ —	¥354,874	¥33,187	¥454,941

	Thousands of U.S. dollars			Operating income (loss)	Identifiable assets
	Outside customers	Inter-segment	Total		
Year ended March 31, 2006					
Domestic (inside Japan)	\$2,339,803	\$ 245,897	\$2,585,700	\$372,393	\$2,221,376
North America	261,624	30,291	291,915	25,530	381,761
Europe	461,316	27,274	488,590	27,444	751,624
Asia	143,009	16,547	159,556	(2,358)	50,401
Total	3,205,752	320,009	3,525,761	423,009	3,405,162
Eliminated on consolidation and corporate	—	(320,009)	(320,009)	(95,855)	709,000
Consolidated total	\$3,205,752	\$ —	\$3,205,752	\$327,154	\$4,114,162

Effective April 1, 2005, the Company and its domestic consolidated subsidiaries and affiliates have adopted “Accounting Standard for Impairment of Fixed Assets” and “Implementation Guidance for Accounting for Impairment of Fixed Assets”. As a result of this change, identifiable assets for “Domestic (inside Japan)” decreased ¥5,455 million (\$46,624 thousand) at March 31, 2006.

For the years ended March 31, 2006 and 2005, a summary of foreign sales, consisting of the export sales of the Company and its domestic consolidated subsidiaries and the sales of foreign consolidated subsidiaries, is as follows:

	Millions of yen			Thousands of U.S. dollars	
	Foreign sales	Consolidated net sales	Percentage of consolidated net sales	Foreign sales	Consolidated net sales
Year ended March 31, 2006					
North America	¥ 35,413	¥ —	9.5%	\$ 302,675	\$ —
Europe	58,926	—	15.7	503,641	—
Asia	60,062	—	16.0	513,350	—
Other	8,641	—	2.3	73,855	—
Total	¥163,042	¥375,073	43.5%	\$1,393,521	\$3,205,752

	Millions of yen		
	Foreign sales	Consolidated net sales	Percentage of consolidated net sales
Year ended March 31, 2005			
North America	¥ 30,828	¥ —	8.7%
Europe	49,980	—	14.1
Asia	62,078	—	17.5
Other	7,230	—	2.0
Total	¥150,116	¥354,874	42.3%

17. SUBSEQUENT EVENTS:

As of March 31, 2006, the Japanese Commercial Code provided that all appropriations of retained earnings, except interim cash dividends, must be approved at an ordinary general meeting of shareholders.

In accordance with customary practices in Japan, the appropriation of retained earnings is not accrued in the financial statements for the year to which it relates but is recorded in the subsequent accounting year after shareholders' approval has been obtained. The following appropriations of retained earnings of the Company as of March 31, 2006 were approved by the shareholders on June 28, 2006.

	Millions of yen	Thousands of U.S. dollars
Cash dividends, ¥8.50 (\$0.07) per share	¥3,124	\$26,701
Bonuses to directors	68	581

The above year-end cash dividends per share and interim cash dividends of ¥6.50 (\$0.06) per share paid in December 2005 made a total annual cash dividend of ¥15.00 (\$0.13) per share.

REPORT OF INDEPENDENT AUDITORS

Kuraray Co., Ltd. and Its Consolidated Subsidiaries

ChuoAoyama PricewaterhouseCoopers

PRICEWATERHOUSECOOPERS 

Nakanoshima Mitsui Building 16F
3-3-3, Nakanoshima,
Kita-Ku, Osaka 530-8248 Japan

To the Board of Directors and Shareholders of Kuraray Co., Ltd.

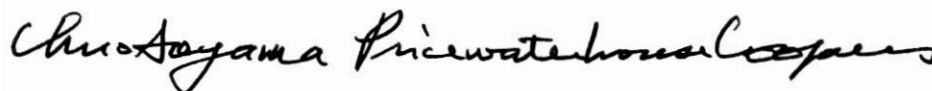
We have audited the accompanying consolidated balance sheets of Kuraray Co., Ltd., and its consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended, all expressed in Japanese Yen. These consolidated 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 Kuraray Co., Ltd., and its consolidated subsidiaries as of March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

As described in Note 2 (g) to the consolidated financial statements, effective on April 1, 2005, the Company and its domestic consolidated subsidiaries and affiliates adopted the accounting standard for impairment losses on fixed assets.

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 1 to the accompanying consolidated financial statements.



June 28, 2006

CONSOLIDATED COMPANIES

(As of July 1, 2006)

JAPAN

Company	Head office	Capital (¥ millions)	Activities
Kuraray Medical Inc.	Tokyo	¥2,500	Manufacture and sales of medical products
Kuraray Trading Co., Ltd.	Osaka	2,200	Import, export, manufacture, and sales of textile products, chemicals, etc.
Kuraray Chemical Co., Ltd.	Osaka	600	Manufacture and sales of activated carbon and related products
KC Processing Co., Ltd.*	Okayama	20	Processing of activated carbon
Mitsukura Chemical Co., Ltd.*	Osaka	10	Manufacture and sales of activated carbon
Kuraray Engineering Co., Ltd.	Osaka	450	Plant design and construction
Kuraray Kiko Co., Ltd.	Ehime	10	Manufacture of machinery parts
Kuraray Fudosan Co., Ltd.	Osaka	10	Real estate leasing and management
Kuraray Interior Co., Ltd.	Osaka	10	Manufacture and sales of luxury furniture
Kuraray Plastics Co., Ltd.	Osaka	180	Manufacture and sales of plastics
Ibuki Kosan Co., Ltd.	Gifu	10	Manufacture of rubber products
Kuraray Living Co., Ltd.	Osaka	101	Manufacture and sales of packaging materials
Kuraray Business Service Co., Ltd.	Osaka	100	Accounting, personnel, and information system service
Techno Soft Co., Ltd.	Osaka	50	Consulting
Kuraray Niigata Kasei Co., Ltd.	Niigata	50	Manufacture and sales of methacrylic sheets
Kuraray Fastening Co., Ltd.	Osaka	100	Manufacture and sales of <i>MAGIC TAPE</i>
Kuraray Travel Service Corporation	Osaka	20	Travel and insurance agency
Kuraray Techno Co., Ltd.	Osaka	100	Production subcontracting
Kuraray Family Products Co., Ltd.	Osaka	30	Sales of health foods, etc.
Kuraray Saijo Co., Ltd.	Ehime	10	Manufacture of chemical products and synthetic fiber
Kuraray Tamashima Co., Ltd.	Okayama	10	Manufacture of synthetic fiber and PVA film
Iruma Country Club Co., Ltd.	Saitama	40	Golf course management
Kyosei Chemical Co., Ltd.	Tokyo	50	Manufacture of pigments and dyes
Nihonkai Acetylene Co., Ltd.*	Tokyo	60	Manufacture and sales of acetylene gas
Kuraray Okayama Spinning Co., Ltd.*	Okayama	50	Manufacture of synthetic fiber
Kuraray Kuraflex Co., Ltd.	Osaka	100	Manufacture and sales of nonwoven fabric products
Kuraflex Ibaraki Co., Ltd.*	Ibaraki	30	Manufacture of nonwoven fabric products
The Kurashiki Kokusai Hotel, Ltd.*	Okayama	450	Hotel management
Hikari Shoes Co., Ltd.*	Chiba	34	Manufacture and sales of shoes
Okayama Rinkoh Co., Ltd.	Okayama	98	Warehousing, distribution, and processing
Okayama Rinkoh Warehouse and Transport Co., Ltd.	Okayama	20	Forwarding (transportation)

OVERSEAS

Kuraray Holdings U.S.A., Inc.	New York, U.S.A.	US\$55.03 million	Holding company, coordination of U.S. subsidiaries
Kuraray America, Inc.	New York, U.S.A.	US\$10.1 million	Importing and sales of Kuraray products
Eval Company of America	Texas, U.S.A.	US\$4.15 million	Manufacture and sales of <i>EVAL</i> in the United States
SEPTON Company of America	Texas, U.S.A.	US\$35 million	Manufacture and sales of thermoplastic elastomers
Kuraray Europe GmbH	Düsseldorf, Germany	€31.2 million	Importing and sales of Kuraray products in Europe
EVAL Europe N.V.	Antwerp, Belgium	€29.7 million	Manufacture and sales of <i>EVAL</i> in Europe
Kuraray Specialities Europe GmbH	Frankfurt, Germany	€20 million	Manufacture and sales of poval and butyral resins and film
OOO Trosifol	Nizhny Novgorod, Russia	RUR78.95 million	Manufacture and sales of PVB film
Kuraray Hong Kong Co., Ltd.	Hong Kong, China	HK\$4.65 million	Processing and sales of Kuraray products in China and Southeast Asia
Kuraray Singapore Pte., Ltd.	Singapore	SP\$93.5 million	Holding company, coordination of local subsidiaries
Kuraray Specialities Asia Pte., Ltd.	Singapore	SP\$45.6 million	Sales of poval resins
Poval Asia Pte Ltd.*	Singapore	SP\$40 million	Manufacture of poval resins

*Equity method subsidiary

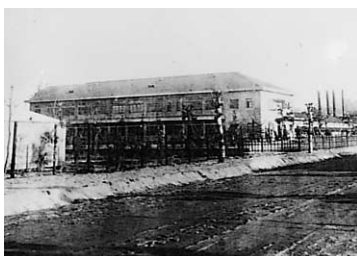
HISTORY

1920s

- 1926 • Kurashiki Kenshoku Co. established
- 1928 • Rayon commercialized: production of rayon filament yarn begun at the Kurashiki Plant

1940s

- 1940 • Chugoku Sangyo Co., Ltd. (now Kuraray Chemical Co., Ltd.) established



New laboratory of Okayama Plant

- 1943 • Capital participation in Kakuichi Rubber Co., Ltd. (now Kuraray Plastics Co., Ltd.)
- 1949 • Company name changed to Kurashiki Rayon Co., Ltd.

1950s

- 1950 • *KURALON* commercialized: production of *KURALON* staple started
- 1958 • Poval commercialized: production of poval for market sale started

1960s

- 1960 • Capital participation in Kyowa Gas Chemical Co., Ltd., which conducts methacrylic resin business
- 1961 • Osaka Goseihin Co., Ltd. (now Kuraray Trading Co., Ltd.) established
- 1962 • Production of PVA film started at Saijo Plant
- 1963 • New York Representative Office established (transferred to Kuraray America, Inc., in April 1996)
- 1964 • Production of polyester staple started at Tamashima Plant
 - Kuraray Fudosan Co., Ltd., established
 - *CLARINO* commercialized: production of *CLARINO* man-made leather started at Kurashiki Plant 1965
 - European Representative Office established in Hamburg, Germany (moved to Düsseldorf in June 1968)
- 1969 • Production of polyester filament started at Saijo Plant

1970s

- 1970 • Company name changed to Kuraray Co., Ltd.
- Hong Kong Representative Office established (transferred to Kuraray Hong Kong Co., Ltd., in June 1998)

- 1972 • Contact lens business started
- *EVAL* commercialized: production facilities for *EVAL* resin completed at Okayama Plant
- Nonwoven fabrics business started
- Isoprene chemicals business launched: operation at Kashima Plant started and production of polyisoprene rubber begun
- 1975 • Artificial organs business started
- 1976 • New isoprene chemicals (NIC) facilities completed at Nakajo Plant



Factory for nonwoven fabrics of Kuraray Chicopee Co., Ltd. (now Kuraflex Co., Ltd.)

- 1977 • Kuraray Engineering Co., Ltd., established
- 1978 • Advanced into the dental materials field: *CLEARFIL* adhesive dental filler produced

1980s

- 1983 • Cement-reinforcing *KURALON* developed
- Eval Company of America established, and marketing of *EVAL* resin in the U.S. begun (production started in 1986)



CLEARFIL adhesive dental filler

- 1984 • Haru-Kuraray GmbH, a man-made leather sales company, established in Germany jointly with Marubeni Corp. and Haru Holding & Management GmbH
 - Merged with Nippon Velcro Co., Ltd., which produces hook and loop fasteners
- 1986 • Clarino America Corporation, a man-made leather sales company, established in the U.S. jointly with Marubeni Corp.
- Production started at Eval Company of America

1990s

- 1990 • *SEPTON* commercialized: Production of *SEPTON* thermoplastic elastomer started at Kashima Plant

- 1991 • Kuraray Europe GmbH established in Düsseldorf, Germany
- 1995 • Kuraray EVAL Europe GmbH established in Düsseldorf
 - Kuraray Hong Kong Co., Ltd., established
- 1996 • Kuraray America, Inc., established in New York as administrative holding company in the U.S.
- Kuraray Singapore Pte., Ltd., established, and capital participation in Poval Asia Pte Ltd.
- 1997 • *EVAL* Europe N.V. established in Belgium
- 1998 • *KURALON K-II* commercialized
- 1999 • Production started at Poval Asia Pte Ltd.
- Mass-production started for the heat-resistant polyamide resin *GENESTAR*
- Production at *EVAL* Europe N.V. started

2000s

- 2000 • Mass-production of a new water-soluble resin *EXCEVAL* was started
- Capital participation in Lorica Sud S.r.l., an Italian man-made leather processing and sales company
- Kuraray Holdings U.S.A., Inc., established as a holding company in the U.S.
- *SEPTON* Company of America established in the U.S.
- 2001 • PVA gel mass-production facilities become operational
- Kuraray terminated its rayon business
- Kuraray Specialities Europe GmbH established in Frankfurt, Germany
- Kuraray Medical Inc. established
- Acquired PVA and PVB operations of Clariant AG
- 2002 • Shanghai Office established
- Production started at *SEPTON* Company of America
- 2004 • Kuraray Research and Technical Center, USA (KRTC), commenced operations
- Acquired and began operating the PVB film business of HT Troplast



Kuraray Research and Technical Center, USA (KRTC)
Location: Pasadena, Texas (on EVALCA's grounds)

- 2005 • Acquired *Vectran* polyarylate fibers business of U.S.-based Celanese Advanced Materials Inc. Operations commenced as a division of Kuraray America, Inc.

INVESTOR INFORMATION

Kuraray Co., Ltd. and Its Consolidated Subsidiaries
As of March 31, 2006

KURARAY CO., LTD.

Established: June 24, 1926

Capital: ¥88,955 million

Shares Authorized: 1,000,000,000 shares (as of June 28, 2006)

Issued: 382,863,603 shares

Number of Shareholders: 29,660

OFFICES, LABORATORIES, AND PLANTS

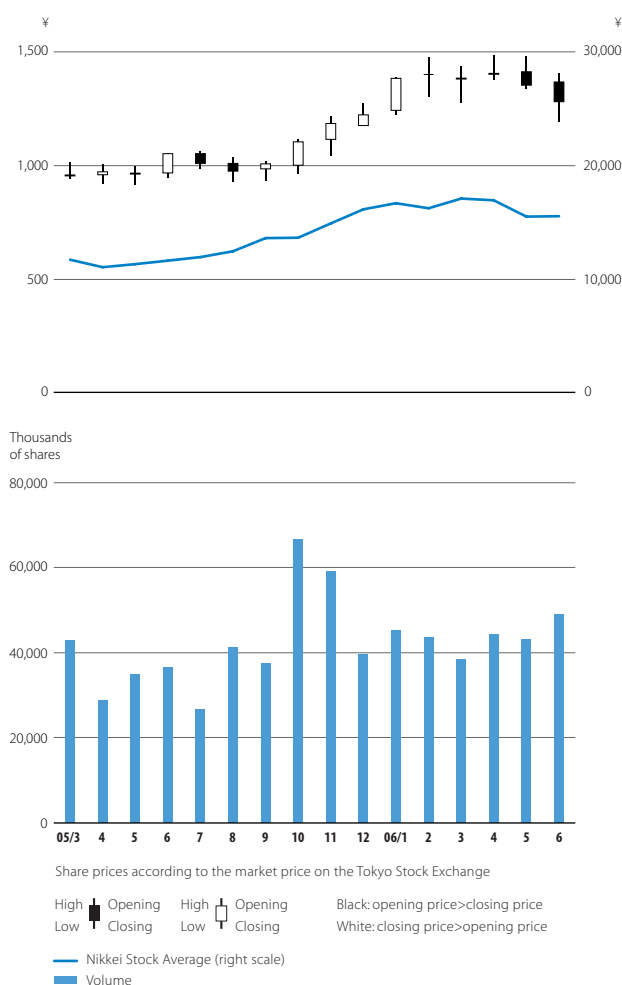
Head Offices: Tokyo, Osaka

Offices: Fukuoka, Shanghai (China)

Research Laboratories: Kurashiki, Tsukuba, Pasadena (Texas)

Plants: Kurashiki, Saijo, Okayama, Niigata, Kashima

SHARE PRICE MOVEMENT



SHAREHOLDER REGISTER AGENT FOR COMMON STOCK

The Sumitomo Trust and Banking Co., Ltd.

Stock Transfer Agency Department

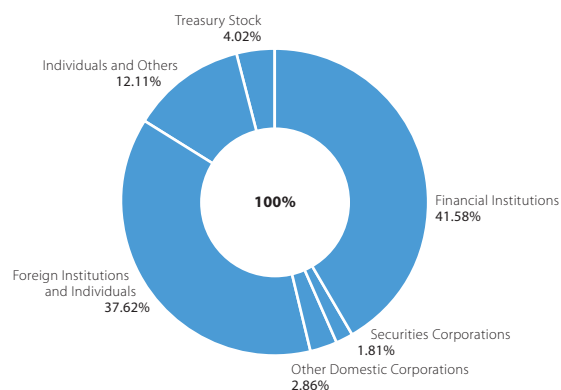
4-5-33, Kitahama, Chuo-ku, Osaka 540-8639, Japan

PRINCIPAL SHAREHOLDERS

Principal Shareholders	Number of Shares Held (thousands)	Percentage of Shares Held
The Chase Manhattan Bank, NA London	29,162	7.62%
Japan Trustee Services Bank, Ltd. (Trust Account)	21,571	5.63%
The Master Trust Bank of Japan, Ltd. (Trust Account)	20,980	5.48%
National Mutual Insurance Federation of Agricultural Cooperatives	13,695	3.58%
Nippon Life Insurance Company	12,061	3.15%
Mellon Bank Treaty Clients Omnibus	9,133	2.39%
Meiji Yasuda Life Insurance Company	8,066	2.11%
Mizuho Corporate Bank, Ltd.	7,395	1.93%
BNP Paribas Securities (Japan) Limited	6,944	1.81%
State Street Bank and Trust Company	6,164	1.61%

Note: Kuraray Co., Ltd. holds 14,455,500 shares of treasury stock.

BREAKDOWN OF ISSUED SHARES BY TYPE





KURARAY CO., LTD.

TOKYO HEAD OFFICE

Ote Center Bldg., 1-1-3, Otemachi,
Chiyoda-ku, Tokyo 100-8115, Japan
tel. +81-3-6701-1000 fax. +81-3-6701-1005

OSAKA HEAD OFFICE

Shin-Hankyu Bldg., 1-12-39, Umeda,
Kita-ku, Osaka 530-8611, Japan
tel. +81-6-6348-2111 fax. +81-6-6348-2165



Printed on recycled paper in Japan