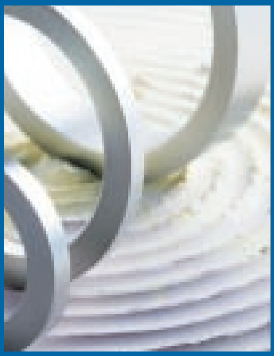
Shin-Etsu Chemical Co., Ltd.
Annual Report 1997

A Global Base For Success

Shin-Etsu

Chemical Co., Ltd. is a diversified chemical company manufacturing products capable of generating high returns. Most sales come from chemicals such as polyvinyl chloride (PVC) and silicones, and electronics materials such as semiconductor silicon, synthetic quartz and rare earth magnets.

The company pursues a clearly defined strategy of channeling resources to markets where demand is growing on a global scale. Based on this policy, Shin-Etsu is the world leader in PVC resins and semiconductor silicon.



Shin-Etsu is the world's only fully integrated manufacturer of rare earth magnets. In this photo, three magnets are shown on a bed of rare earth powder.

CONTENTS

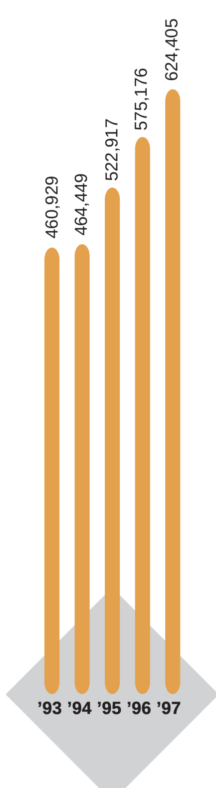
Financial Highlights

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
Fiscal year ended 31st March, 1997 (1st April, 1996 to 31st March, 1997)

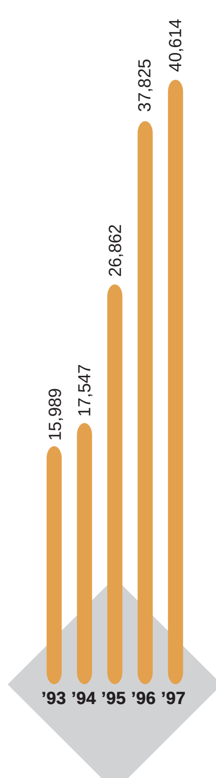
	31st March,			31st March,
	1995	1996	**1997**	**1997**
	(millions of yen)			(thousands of U.S. dollars)
For the Year:				
Net Sales	¥522,917	¥575,176	**¥624,405**	**$5,035,524**
Operating Income	51,914	73,427	**82,024**	**661,484**
Net Income	26,862	37,825	**40,614**	**327,532**
Capital Expenditures	67,689	66,791	**92,844**	**748,742**
Net Income Per Share (in yen, dollars)	¥ 82.80	¥ 116.51	**¥ 118.24**	**$ 0.954**
Cash Dividends Per Share (in yen, dollars)	7.50	7.50	**7.50**	**0.060**
Return on Equity (percent)	9.8	12.5	**11.7**	
At Year-End:				
Total Assets	¥643,937	¥708,637	**¥931,159**	**$7,509,347**
Working Capital	110,901	118,936	**195,729**	**1,578,460**
Stockholders' Equity	285,361	320,987	**374,726**	**3,021,984**

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

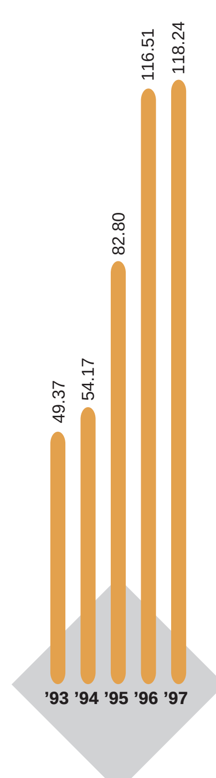
Net Sales
(Millions of Yen)



Net Income
(Millions of Yen)



Net Income Per Share
(Yen)



President & CEO
Chihiro Kanagawa

In 1991,
Shin-Etsu Chemical Co., Ltd. was among the first companies in Japan to embark on a comprehensive program to raise productivity and profitability throughout its worldwide operations. This program was accompanied by a heightened concentration of strategic investments in core businesses and an emphasis on utilization of the most suitable locations in which to manufacture the company's key products. Together, these strategies have given the company a powerful earnings base. Net income has reached a record high in each of the past two years. This interview focuses on how Shin-Etsu plans to build on these strengths for even greater achievements.

Would you briefly list the highlights of consolidated results for the fiscal year that ended on March 31, 1997?

Net sales rose 8.6 percent to ¥624,405 million. Much of this excellent sales performance was due to increases in sales of semiconductor silicon and other products in the electronics materials business. The share of the company's total sales contributed by the electronics materials business segment rose from 37.3 to 41.0 percent. Net income was up 7.4 percent to ¥40,614 million, another record high. Naturally, sales growth was a major reason for this excellent business performance. Equally important was the progress we have made in recent years in strengthening our multi-regional business structure. We have continuously sought ways to cut costs, flatten and simplify our organization, and to utilize our management resources in the most productive manner.

Other than the record-setting sales and earnings, what do you regard as the most important achievements of the past fiscal year?

I am constantly trying to envision what our operating environment will be like five or ten years from now. Based on the projections we make in our mid- and long-term planning, we attempt to anticipate problems that must be solved, and then take the actions necessary to effectively cope with these challenges. At present, our business strategy consists of four key policies. One is to further integrate production activities to extend from raw materials through finished products. The second is to avoid an over-reliance on demand from any single market to generate future growth in sales and net income. We must diversify thirdly to sustain stability. The fourth strategic policy is to make our business structure more global so that we manufacture products at the most profitable locations. During the past year, Shin-Etsu made considerable progress in implementing all four of these strategic policies, while, at the same time, managing to raise earnings to an all-time high. I regard this as our most important achievement.

Can you be more specific about accomplishments involving these core policies?

Backward integration of production is an excellent example. We are the world's largest supplier of semiconductor silicon and synthetic quartz. We are also one of the world's largest producers of silicon based chemicals. Silicon metal is the basic raw material for all of these product lines. In the past, we have relied entirely on other companies for this important raw material, which made us very susceptible to supply shortages. In February 1996, we acquired Simcoa Operations Pty. Ltd., an Australian company that manufactures silicon metal from quartz. This acquisition, in addition, gives us a quartz mine of outstanding quality. With a secure, inhouse supply of silicon metal, we have helped to stabilize the future availability and cost of this vital material for all of our silicon related products. It is one of the steps towards our goal of controlling our own destiny.

We are working hard to diversify our sales bases and to expand our product lines so as to reduce the impact of business cycles on our sales and profitability.

Sales in our electronics materials business have been growing rapidly as a proportion of our total business. This is due to the strong expansion of the electronics industry and especially the semiconductor industry. Demand in the semiconductor industry, historically, has been very cyclical in nature. This means Shin-Etsu must structure itself so that performance of the whole company does not decline when conditions decline in such an important individual market.

In our chemicals business, we produce polyvinyl chloride, silicone and cellulose derivatives. Among these, polyvinyl chloride is currently a very important product. Demand for it from housing, construction and other civil engineering industries has been excellent. Silicone chemicals are another major source of revenue. These products are sold to an extremely diverse range of customers including, among others, the pulp and paper, cosmetics, automobile, construction and electrical industries. Similarly our cellulose derivative business serves a vast variety of industries, and so it and the silicone chemical parts of our business are well insulated from the cycles in individual markets.

Our goal is to structure all of our businesses for this kind of stability. This is why we are using our technologies in silicon chemistry, and other fields where we have a technical edge, to develop products outside the field of semiconductors. Two examples of newer fields for which I have high hopes for future growth are synthetic quartz and rare earth magnets.

Synthetic quartz is sold primarily as preforms to fiber optic cable manufacturers. Demand for this material is growing very rapidly. Shin-Etsu is the only producer of optical fiber preform outside the electric wire industry. We are expanding our production capability and expect to maintain our superiority in terms of both quality and cost.

Rare earth magnets are widely used in voice-coil motors for hard-disk drives. We rank among the world's leading suppliers of magnets for these motors. The products are leading candidates for such promising applications as electric car motors, linear motors, medical equipment and compressors for air-conditioners and refrigerators. Shin-Etsu is in an excellent position to achieve leadership in this business field. We are the world's only company that handles everything from the refinement of rare earth ores through the final products. This integration provides valuable advantages in terms of raw-material procurement and quality control.

What is Shin-Etsu's basic strategy for its PVC business?

I have no doubt that we will see steady future growth in the PVC market. We are aiming to become even more global, and align our production network to make us as cost competitive as possible. In 1996, PVC sales in Canada and the United States were about 6 million tons. That's more than 10 percent higher than in 1995. Our most important objective in the PVC business is to raise capacity in the United States, where we can manufacture PVC at the lowest cost. Plans are moving ahead for a second plant at Shintech on the U.S. Gulf Coast. The new production facility will become a key global strategic base supplying not only the U.S. market, but also targeting markets in Canada, Latin America, the Middle East, Africa and Asia—where a particularly large potential demand exists.

Japan is another key PVC market for us. Here, intense competition is creating an extremely difficult business environment for all suppliers. However, there still exists a large and high-quality market for PVC in Japan. We are working hard to improve our performance here.

What is the outlook for Shin-Etsu's semiconductor operations?

The Shin-Etsu Handotai group of companies account for about 25 percent of global output of semiconductor silicon, the primary material used in our electronics materials business. We have production bases in Japan, Malaysia, the United States and the United Kingdom. This diversification means that no single semiconductor producer accounts for an inordinately large share of our sales. In fact, we supply almost all of the world's producers of semiconductor devices. Recently, Shin-Etsu Handotai again demonstrated its technological leadership by being first in the world to succeed in making a prototype 12-inch wafer suitable for mass production.

We are determined to maintain our position as the world leader in technology, production capacity, and sales volume of semiconductor silicon. We are increasing our semiconductor silicon capacity even though some semiconductor device producers are restricting their capital investment programs. We believe that this is necessary in order to keep up with the rapid pace of change in electronics. The needs of our customers change very rapidly. Currently, for example, the major demand is for 8-inch diameter wafers, because the larger wafer makes possible lower fabrication costs for our customers. Because of this development, our mid-term business projections foresee excellent growth in demand for semiconductor silicon. To provide for this growth, we began operations in July 1997 at new plants for 8-inch wafers in the United Kingdom and Taiwan.

Can you summarize current plans for capital spending at Shin-Etsu in Japan and overseas?

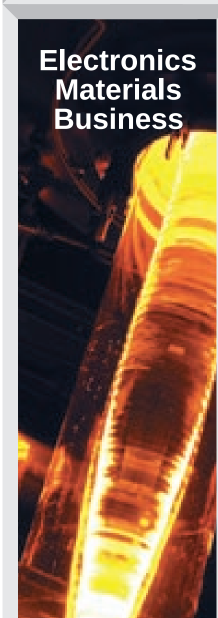
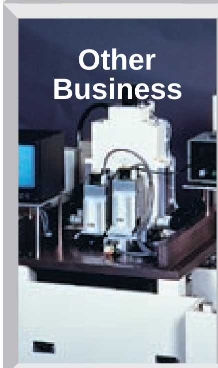
We give priority to investments that will contribute the most growth in sales over the mid- and long-terms. To fund these investments, in 1996 we conducted our first equity-related financing initiative in about six and a half years. This consisted of the August sales of ¥50 billion of convertible debentures in Japan and US$500 million of notes with warrants in Europe. Altogether, we raised more than ¥100 billion. We plan to use these funds to strengthen and increase production capacity for major products, such as PVC, silicone and semiconductor silicon.

We estimate that over the next five years our capital spending will be between ¥450 billion and ¥600 billion. This estimate includes approximately ¥150 billion to ¥200 billion for the parent company, and ¥300 billion to ¥400 billion at our subsidiaries. We expect these expenditures to be funded from the above-mentioned debt plus retained cash flow.

What is the outlook for Shin-Etsu's business performance over the next few years?

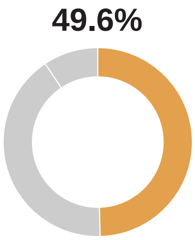
Our capital program is expected to assure increased sales and earnings over the next several years. In terms of both sales and margins on sales, Japanese chemical companies fall behind the large U.S. and European chemical producers. Our aim is to rank among the world's leaders in terms of profitability. We will do this by enhancing our global technical superiority in markets where those strengths are the most valuable. As we seek to achieve higher goals in the years to come, we ask for the continued support of our stockholders, employees and business associates.

Chihiro Kanagawa
President & CEO

	Products	Market Strengths	Major Contributors
Chemicals Business 	Polyvinyl chloride, silicones, vinyl acetate monomer, polyvinyl alcohol, methanol, caustic soda, chloromethanes, cellulose derivatives, synthetic pheromones, lime nitrogen, fused phosphates, ferroalloys, silicon metal, plastic products and others	The Shin-Etsu Group is the world's preeminent supplier of PVC. A Shin-Etsu subsidiary, Shintech, Inc. in the United States, has the world's largest PVC production capacity. In silicones, Shin-Etsu ranks first in Japan and among the leaders worldwide. With silicone used in more than 4,000 products, the company serves an extremely diverse range of customers. This creates an operating base that is resistant to a downturn in any particular industry, thus contributing to stable growth. Shin-Etsu also sells cellulose derivatives to a well balanced customer base, yielding consistent gains in sales and earnings.	Manufacturing and sales: Shin-Etsu Chemical Co., Ltd. Shintech, Inc. Shin-Etsu Polymer Co., Ltd. Nissin Chemical Industry Co., Ltd. Manufacturing: Shin-Etsu Vinyl Acetate Co., Ltd. Kashima Vinyl Chloride Monomer Co., Ltd. Sales: Shin-Etsu Astech Co., Ltd. and 50 other companies
Electronics Materials Business 	Semiconductor silicon; oxide single crystal, synthetic quartz products (photomask substrates and fiber-optic preform), organic materials for the electronics industry; rare earths and rare earth magnets	With a global market share of 25 percent, Shin-Etsu is the world's largest manufacturer of semiconductor silicon. This material is made by subsidiary Shin-Etsu Handotai Co., Ltd. (SEH) and SEH Group companies. An aggressive expansion program is raising output to meet surging demand in all areas of the world and make the SEH Group even more competitive. Shin-Etsu has captured large shares of the markets for synthetic quartz substrates, epoxy encapsulant products and other materials. Outside the semiconductor field, the company is a leading supplier of synthetic quartz fiber-optic preforms. Shin-Etsu is a prominent maker of powerful rare earth magnets, which are invaluable in electrical machinery, computers, automobiles and many other applications.	Manufacturing and sales: Shin-Etsu Chemical Co., Ltd. Shin-Etsu Handotai Co., Ltd. Shin-Etsu Handotai America, Inc. Shin-Etsu Quartz Products Co., Ltd. Processing and sales: S.E.H. Malaysia Sdn. Bhd. Shin-Etsu Handotai Europe, Ltd. Processing: Naoetsu Electronics Co., Ltd. and 28 other companies
Other Business 	Exports of technology and machinery; export and import of merchandise; construction and plant engineering; information processing services; other services	Shin-Etsu offers a number of value-added services by focusing on fields that draw on strengths in core businesses. Knowledge gained through the design and construction of its own production facilities, particularly in electronics and chemicals, is one example. Shin-Etsu is also skilled in the design of production machinery. This comprehensive plant engineering and construction capability is much in demand from companies in a number of industries.	Shin-Etsu Chemical Co., Ltd. Shin-Etsu Astech Co., Ltd. Shin-Etsu Engineering Co., Ltd. and 32 other companies

Note: The above figures include non-consolidated subsidiaries and affiliated companies.

Sustained Growth by Concentrating Investments in Core Businesses



Share of Total Sales

Shin-Etsu
maintains dominant positions
in several key products.
In PVC the company is number-one worldwide,
while in silicones it is first in Japan and
among the leaders globally.
Ongoing investments are aimed at further
reinforcing the company's stature
in these huge markets.

Dominant Market Positions Attest to Technical Leadership

Sales from chemicals are derived from synthetic resins, such as polyvinyl chloride (PVC) and silicones, including their processing and formation; and inorganic and organic chemicals, such as caustic soda, chloromethanes and cellulose derivatives. Activities include the results of the parent company, Shintech, Inc., Shin-Etsu Polymer Co., Ltd. and 31 other consolidated subsidiaries.

In fiscal 1997, chemicals business sales increased 2.2 percent to ¥310,030 million. PVC accounts for the largest share of these sales. In the U.S., the world's largest PVC market, conditions were strong in the first half of the fiscal year, then turned downward in the second half. However, prices rebounded sharply in January 1997, bringing the global market for this product back into balance by the end of the fiscal year. In Japan, activity in public-works projects and residential construction supported growth in shipments of PVC, although prices were raised to reflect an increase in the cost of naphtha and other raw materials due to the yen's depreciation. In silicones, another important source of

Demand for PVC is rising steadily for applications ranging from household products to building and civil engineering materials.

sales, performance was supported by strong demand from makers of building materials and automobiles within Japan. Rising demand elsewhere in Asia also led to higher exports. Cellulose derivatives, an organic chemical product, similarly generated higher sales, with orders up substantially for use in building materials and as an additive in pharmaceuticals.

Building on Strengths in PVC

With PVC production facilities in the U.S., Portugal and Japan, Shin-Etsu has the ability to supply customers efficiently in all major markets. In the U.S. in particular, Shin-Etsu has a dominant position. With annual sales of about 6 million tons, the U.S. market is approximately three times larger than the Japanese market. Furthermore, demand in the U.S. is forecast to grow annually at 10 percent, chiefly for residential building materials. Shin-Etsu is therefore targeting the U.S. as a primary source of future growth. Shintech, a Shin-Etsu subsidiary, operates the world's largest single PVC resin plant in Freeport, Texas. To meet anticipated future demand, the construction of a second plant is currently being planned.

Silicones–A Stable Source of Earnings

Shin-Etsu accounts for about half of all silicone output in Japan. In terms of sales, Shin-Etsu is well ahead of its competitors. The material offers many desirable properties. Among them are resistance to heat and climatic changes, as well as good electrical characteristics. Furthermore, silicone can be produced in oil, rubber and several other forms. Thus there is demand for it in many industries, including electrical machinery, electronics, automobiles, building materials and cosmetics. In all, silicone is found in more than 4,000 products. This diversity makes it very resistant to a downturn in any one industry, and a stable source of sales and earnings.

Subsidiaries Shin-Etsu Silicones of America, Inc. and Shincor Silicones, Inc., both located in Akron, Ohio, serve the U.S. market, while Shin-Etsu Silicones Europe B.V. in the Netherlands serves the European

Shintech, Inc., a Shin-Etsu subsidiary based in Freeport, Texas, operates the largest single PVC production facility in the world.

There are more than 4,000 types of silicone products.

market. Manufacturers of electronic components and automobile parts represent a large share of sales. In Asia, where demand is rising rapidly, Shin-Etsu has two production and sales bases for rubber and emulsion products in Korea and Taiwan. There is also a sales subsidiary in Singapore and a sales office in Hong Kong. This geographical diversity gives Shin-Etsu a solid base for expanding its silicone operations worldwide.

Growing Sales in Cellulose Derivatives

Shin-Etsu has a large share of the domestic market for cellulose derivatives, with strong demand from makers of building materials supporting growth. Seizing this opportunity, Shin-Etsu developed a new grade for use in forming outer walls of homes and buildings. The material offers better performance and allows work to proceed more quickly at construction sites. Sales of cellulose derivatives for pharmaceutical excipients rose substantially in Japan and overseas.

Investments Raise Output of Rubber Contacts

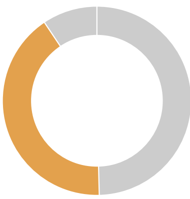
Rubber contacts are the largest product sector at Shin-Etsu Polymer and its subsidiaries. With orders rising worldwide, the companies are raising output capacity. Made of conductive silicone rubber, rubber contacts serve as switching elements in computer keyboards, mobile phones and many other products. Home appliances and automobile parts are two other important applications. The world's largest supplier of these contacts, the Shin-Etsu Polymer Group has production and sales bases in Japan, Malaysia, the U.S., the Netherlands and China. In Malaysia, construction of a fourth plant was completed in December 1996. In July 1996, Shin-Etsu Polymer México, S.A. de C.V. was established and soon broke ground for a factory. When completed, this facility will further expand supply capabilities to customers in North America.

Cellulose derivatives are in increasing demand from makers of building materials. Pharmaceuticals represent another important market; these derivatives make excellent coatings and granules for tablets.

The world's largest supplier of rubber contacts, the Shin-Etsu Polymer Group is expanding output worldwide.

A Relentless Quest for Higher Quality and Productivity

41.0%



Share of Total Sales

Semiconductor

silicon is the core product of this segment.
Almost one in every four silicon wafers made worldwide comes from a Shin-Etsu plant.
Shin-Etsu has tapped its expertise in electronics materials to establish solid position in markets for synthetic quartz, rare earth magnets and organic materials for the electronics industry.
All are developing into major sources of earnings.

Rapid Growth in Products for Semiconductors as well as for Communications and Electrical and Automotive Components

In fiscal 1997, segment sales rose 19.2 percent to ¥255,840 million. Results cover 18 companies including the parent company, Shin-Etsu Handotai Co., Ltd., Shin-Etsu Handotai America, Inc., and S.E.H. Malaysia Sdn. Bhd. Semiconductor silicon represents a large share of sales and earnings in this business segment, and was responsible for much of the growth in overall sales. Demand for wafers is rising quickly as chip makers produce increasingly sophisticated products. All signs point to more growth in demand. This is good news for Shin-Etsu, the world's largest supplier of semiconductor silicon wafers.

Several other electronics materials have excellent growth prospects: representative products are synthetic quartz photomask substrate and organic materials such as epoxy molding compounds, both of which are essential to the manufacture of semiconductor chips. Synthetic quartz fiber-optic preform and oxide single crystal as used in the communications industry, as well as rare earths and rare earth magnets as used in electrical equipment and

Shin-Etsu is dramatically expanding production facilities for 8-inch silicon wafers in Japan and overseas. Trial shipments of 12-inch next-generation wafers have already begun.

automobiles are other highly promising product sectors. Increasing sales for these materials are testimony to Shin-Etsu's ability to utilize newly developed products to build outward from its core strength in semiconductor silicon.

The World's Number One Maker of Silicon Wafers

Shin-Etsu Handotai (SEH) and its group companies rank first among the world's makers of silicon for the semiconductor industry. Members of the SEH Group produce silicon wafers in Japan, the U.S., the U.K., and Malaysia. This ensures a reliable supply for customers around the world. Large-scale investments now under way are expanding output capacity for 8-inch wafers, the current industry standard. This will further reinforce SEH's leading position. At the same time, SEH is working on wafers of even larger diameter. The company's researchers have made a prototype 12-inch (300mm) wafer suitable for mass production, and started shipping samples.

Increasing Silicon Wafer Output Worldwide

Firmly committed to meeting demand from local production bases, SEH and the overseas SEH companies are conducting large-scale expansion programs. In 1996, Shin-Etsu Handotai America, Inc. embarked on a US$710 million expansion program. As of the spring of 1997, a CZ single crystal production facility had been completed and ingot production started. In the U.K., Shin-Etsu Handotai Europe, Ltd. completed a new 8-inch wafer plant in July 1997 to meet rising demand from customers in EU nations. In Malaysia, S.E.H. Malaysia Sdn. Bhd. and S.E.H. (Shah Alam) Sdn. Bhd. are already operating at full capacity to fulfill demand for 8-inch wafers. Meanwhile, Shin-Etsu Handotai Taiwan Co., Ltd., established in 1995, has completed its new plant in the Hsin-Chu Science-Based Industrial Park. The plant commenced operations from July of this year and will produce only 8-inch wafers initially, with other products to be added in

Shin-Etsu Handotai America, Inc. is investing US$710 million to expand and upgrade its facilities. CZ single crystal production for 8-inch wafers has already begun.

In July 1997, Shin-Etsu Handotai Europe, Ltd. started producing 8-inch wafers at a newly completed plant in Scotland, further solidifying its standing in the growing European wafer market.

The latest addition to the global SEH family, Shin-Etsu Handotai Taiwan, Co., Ltd. initiated production of 8-inch silicon wafers in July 1997 at a prestigious high-tech industrial park.

The commercialization of blue LEDs enables the production of bright, full-color LED displays.

stages. In close cooperation with the Malaysian production bases, Shin-Etsu Handotai Taiwan will expand sales still further in the rapidly growing Taiwanese and Southeast Asian markets. In Japan, SEH increased its output capacity for such value-added products as 8-inch epitaxial wafers and SOI (silicon-on-insulator) wafers.

Alliances Speed Development of Next-Generation Products

At SEH research is progressing on technology that will replace present-day 8-inch wafers. Investments in this area are critical to preserving Shin-Etsu's position at the forefront of the silicon wafer market for years to come. Originally only four inches, wafer diameter grew to five, six and then eight inches, the current standard. Today, the industry stands on the verge of the 12-inch (300mm) era. SEH assumed this challenge early on. The company has already succeeded in making a prototype suitable for mass production and started shipments of samples.

SOI wafers are a highly promising technology. SEH is raising capacity to meet demand for these high-performance products. SOI wafers are made by oxidizing the surface of a silicon wafer, and then adding an extremely thin film of pure silicon. This structure yields outstanding electrical insulation properties. Such wafers are ideal for semiconductor devices in circuits where power consumption must be minimized, as in portable phones. High-speed microprocessors are another SOI application with immense potential. In April 1997, Shin-Etsu formed an alliance with SOITEC Co. of France, which has developed proprietary knowledge in this field. This alliance places Shin-Etsu in an even more powerful position within this attractive market.

In April 1990, SEH made an equity investment in Cree Research, Inc. of the U.S. in the field of compound semiconductors. This led to the commencement of sales in Japan of SiC wafers and blue LED chips made from those wafers. With the recent commercialization of super-bright blue LEDs, it is now possible to produce white light by combining red, green and blue LEDs. This breakthrough may well open the way to an entirely new type of full-color display. Based on a September 1996 technology transfer contract with Cree Research, SEH will soon commence production and sales of its own blue LED chips in Japan.

New Sources of Earnings From Silicon Chemistry Technologies

Within the company's Electronics Materials Business Segment, semiconductor silicon is augmented by other highly versatile products which are essential to a broad range of industrial applications. These products are also generating impressive sales levels, contributing to overall earnings for the company. Shin-Etsu utilized its particular technologies in silicon chemistry to build up its silicones and semiconductor silicon businesses. These same technologies led to the development of a new, highly competitive product, namely synthetic quartz.

For more than 15 years, Shin-Etsu has been a high-ranking maker of synthetic quartz photomask substrates for ICs. Now this strength has been augmented by the successful addition of photomask substrates for LSIs and for LCD glass substrates. With high permeability to ultraviolet light and dimensional stability when heated, synthetic quartz is ideally suited for use as IC and LSI photomask substrates. With regard to substrates for LCDs, there has been rising demand for large-size photomasks due to growth in the size of LCD screens. Shin-Etsu has already succeeded in making substrates up to 800 x 900 mm in size to meet this demand. As fiber-optic preform, synthetic quartz is indispensable to the ongoing expansion of high-density, high-speed data transmission networks. Shin-Etsu is capable of producing this preform with consistently high quality, and is the world's only manufacturer selling this material to other companies. Future investments will further bolster capacity to meet rapidly rising demand and enhance Shin-Etsu's stature in the field of optical networks.

Innovative Products Using Pioneering Technology

Rare earths are another successful material utilizing Shin-Etsu's proprietary technology. With many unique properties, rare earths can be used for applications ranging from optical materials to fine ceramics, electric motors and even as a catalyst. However, their most important application from Shin-Etsu's point of view is in rare earth magnets, which are used in voice coil motors to move heads in computer hard-disk drives. Shin-Etsu has a significant share of this market. However, these powerful magnets also have many other uses, including for energy-efficient home appliances, especially air conditioners and refrigerators. In automobiles, these magnets are found in sensors, and are expected to be used in the drive motors of electric cars.

Shin-Etsu is constantly building outward from expertise in electronics materials. One example is synthetic quartz, primarily for use as photomask substrates and preforms for fiber optics.

One of the world's largest makers of rare earth magnets, Shin-Etsu is taking the lead in exploring ways to create variations that open up entirely new applications.

Shin-Etsu has a fully integrated system for making these magnets, a unique capability among the world's rare earth magnet makers. This is because most competitors outsource production of magnetic alloys. Shin-Etsu, however, performs all steps in this difficult process: separation of rare earth elements from ore; refining of elements to create a metallic substance; and mixing to create the desired alloy, which is then crushed into a fine powder. Shin-Etsu is also distinguished by its diverse line-up, including cerium, samarium and neodymium, and a global supply system. These resources make it possible to capitalize on a broad range of opportunities.

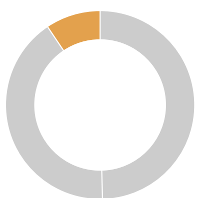
New Rare Earth Magnet Plant in Indonesia

At its Takefu Plant in Fukui prefecture Shin-Etsu has established a comprehensive production facility covering the entire process from the refining of rare earth to completion of rare earth magnets. Outside Japan, Shin-Etsu has been making these magnets since 1989 at Shin-Etsu (Malaysia) Sdn. Bhd. in the Malaysian state of Selangor. Output capacity at this plant was raised several times to meet rising demand. The Malaysian plant coats and processes magnets, and is also capable of assembling voice-coil motors. In May 1996, capacity for voice-coil motor assembly rose again with the completion of a new Indonesian plant owned by P.T. Shin-Etsu Magnetics Indonesia. The market for these motors that are used in computer hard-disk drives continues to sustain an annual growth rate of 20 to 30 percent. Determined to remain the world's top manufacturer in this field, Shin-Etsu established a further assembly facility in the Philippines in July 1997.

The May 1996 completion of a plant owned by P.T. Shin-Etsu Magnetics Indonesia boosted output of voice-coil motors.

Creating Value by Building Outward From Core Strengths

9.4%



Share of Total Sales

Activities in the Other Business Segment center around exports of technology and machinery, as well as construction and engineering. All these businesses are firmly rooted in Shin-Etsu's long-standing prowess in the fields of chemicals and electronics materials.

Building on Areas of Established Strengths

Revenues in the Other Business Segment are derived from construction, engineering and a number of other services. These activities are conducted by Shin-Etsu and 13 consolidated subsidiaries, including Shin-Etsu Astech Co., Ltd. and Shin-Etsu Engineering Co., Ltd. In fiscal 1997, segment revenues rose 2.2 percent to ¥58,535 million. Shin-Etsu Astech is primarily involved in plant and building construction and in market development support for the chemical products of Shin-Etsu and other manufacturers. Shin-Etsu Engineering is the former engineering division of Shin-Etsu and employs know-how in plant design inherited from its parent company. This company is experienced in fields ranging from machinery for large-scale processes to intricate production machinery for precision electronic materials. With this technical base, Shin-Etsu Engineering is capable of designing and selling production systems and entire plants.

Specialized skills in chemicals and electronics enable Shin-Etsu Engineering to attract business from many customers outside the Shin-Etsu Group.

Comprehensive Plant Engineering Services

Shin-Etsu Engineering has extensive experience in chemical plants as well as in the design of production equipment for the exacting processes used to make electronic components. The company is highly competitive, and is able to offer comprehensive engineering services that bring together a wide range of specialized knowledge. PVC plants exemplify this strength. Shin-Etsu Engineering was involved in building Japan's enormous Kashima PVC complex, as well as plants for Shintech and other companies. No other engineering company in the world has taken part in building more PVC capacity.

In the field of electronics materials, Shin-Etsu Engineering has considerable experience in semiconductor silicon plants and other types of production facilities. Achievements extend overseas too. Shin-Etsu Engineering has assisted not only Shin-Etsu companies, but also helped supply equipment and technology to companies in the U.S., France, China and elsewhere. Altogether, the company has completed more than 50 projects for customers outside the Shin-Etsu Group covering the manufacture of PVC , silicones, semiconductor silicon, rare earth magnets and many other materials.

Developing System Components to Integrate Technologies

The Other Business Segment includes the development and design of mechatronics products that embrace optics, precision devices and computers. The outlook for more growth is excellent in the fields of semiconductors, electronic components and electronic materials, where manufacturers are seeking ways to raise quality while holding down production cost. Shin-Etsu Engineering addresses these needs by integrating various technologies to produce automated inspection and production equipment that meets sub-micron tolerances. Many orders come from outside the Shin-Etsu Group. In fiscal 1997, Shin-Etsu Engineering delivered systems to makers of LCDs, plasma displays and several other products.

Shin-Etsu Engineering Co., Ltd. has a wealth of proprietary knowledge regarding the design of plants and plant facilities.

Capable of designing processing systems that achieve sub-micron accuracy, Shin-Etsu sells a large volume of production equipment to makers of LCDs and plasma displays.

An Aggressive Stance Regarding Environmental Issues

As a global chemical manufacturer, Shin-Etsu is firmly committed to dealing responsibly with environmental challenges. The company's success in achieving official recognition for its efforts, both within Japan and internationally, bear testimony to Shin-Etsu's resolve and the efficacy of initiatives adopted.

Support for Tokyo University's Global Environmental Engineering Chair

As part of events to mark its 70th anniversary, Shin-Etsu became a sponsor of a chair at the Global Environmental Engineering Laboratory at the University of Tokyo. For three years beginning in April 1997, Shin-Etsu will support the development of technologies to protect the world's environment. On April 14, a symposium on the theme "Toward Solving Global Environmental Problems" was held at the university to commemorate the opening of the first seminar. The seminar sparked interest in a variety of topics relating to global environmental engineering. Among them are development of a comprehensive system to utilize solar energy; studies on methods to absorb carbon dioxide over oceans and land; and the development of solar and fuel cells as well as systems to effectively use natural resources. This project's achievements will contribute directly to improvements in the environment.

Celebrating its 70th anniversary in 1997, Shin-Etsu is sponsoring a chair of the Global Environmental Engineering Laboratory at the University of Tokyo.

Two Shin-Etsu Production Bases Earn ISO 14001 Certification

Two of Shin-Etsu's largest production facilities have received ISO 14001 certification, a widely respected international standard for environmental management. The first to be certified was the Gunma Complex, a research and manufacturing base for silicones and electronics materials. The July 1996 certification, from the Japan Chemical Quality Assurance Co., was the first ISO 14001 certification earned by a Japanese chemical major. In January 1997, the Shirakawa Plant of Shin-Etsu Handotai earned this certification from the United Kingdom's certification body, SGS Yarsley, representing a first among Japanese makers of silicon wafers. Obtaining this certification requires passing examinations to confirm stringent compliance with environmental laws and regulations. Certification also mandates that a company constantly and actively seek ways to make improvements. At both of these Shin-Etsu facilities, the company is setting even higher numerical targets to reduce energy consumption, the use of natural resources and the generation of waste. Ultimately, Shin-Etsu intends to obtain ISO 14001 certification for its other plants in Japan and around the world.

Rigorous Safety and Quality Assurance Programs

Since its inception, Shin-Etsu has placed priority on safety and quality assurance at all of its plants. Total quality management activities are at the heart of the activities of group companies as well. This steadfast commitment has earned numerous accolades from outside the company. Recognition has come in the form of awards for excellence in safety, hygiene and environmental efforts. In October 1996, the Gunma Complex was named an Outstanding Production Facility at the Pressurized Gas Safety Association's National Conference, and received the MITI Minister's Award. In June 1996, the Shirakawa Plant of Shin-Etsu Handotai received the Prime Minister's Award. Overall, plants in Japan have been selected as winners of five awards from cabinet ministers over the past five years.

The Gunma Complex, pictured above, and the Shin-Etsu Handotai Shirakawa Plant have received ISO 14001 certification for their environmental programs.

In June 1996, SEH's Shirakawa Plant received the Prime Minister's Prize for the promotion of greenery.

President and CEO
Chihiro Kanagawa

Executive Vice President
Shunichi Koyanagi

Senior Managing Directors
Tadashi Wada
Osamu Hiura

Managing Directors
Akira Kaneko
Katsuhiko Ayama
Toshiji Miyaji
Yasuhiko Watanabe
Kunio Itoh
Kazuo Ishida
Hiroaki Tsubokura
Shunzo Mori
Hironobu Ichimura
Isao Iwashita

Director-Advisor
Zentaro Kosaka

Directors
Kenichi Itoh
Kiyoshi Imada
Ryoei Miki
Kiichi Habata
Jiro Yamada
Masanori Takagi
Kiyoshi Imai

Full-Time Statutory Auditors
Hachiro Kondo
Masahiko Watase

Statutory Auditors
Haruo Kobayashi
Masao Okazaki

(as of 27th June, 1997)


President and CEO
Chihiro Kanagawa


Executive Vice President
Shunichi Koyanagi


Senior Managing Director
Tadashi Wada


Senior Managing Director
Osamu Hiura

Management's Discussion and Analysis of Operations

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

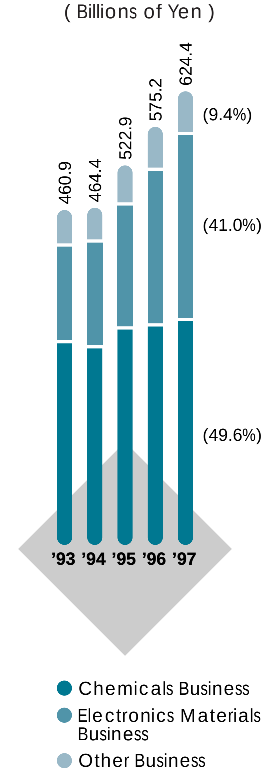
	31st March,						31st March,
	1992	1993	1994	1995	1996	**1997**	**1997**
	(millions of yen)						(thousands of U.S. dollars)
For the Year:							
Net sales	¥478,351	¥460,929	¥464,449	¥522,917	¥575,176	**¥624,405**	**$5,035,524**
Operating income	49,795	34,815	32,450	51,914	73,427	**82,024**	**661,484**
Net income	24,581	15,989	17,547	26,862	37,825	**40,614**	**327,532**
Capital expenditures	69,875	41,292	34,421	67,689	66,791	**92,844**	**748,742**
Depreciation and amortisation	36,912	37,675	40,351	42,986	45,647	**52,191**	**420,895**
Net income per share (in yen, dollars)	75.96	49.37	54.17	82.80	116.51	**118.24**	**0.954**
Cash dividends per share (in yen, dollars)	7.50	7.50	7.50	7.50	7.50	**7.50**	**0.060**
At year-end:							
Total assets	¥614,490	¥602,483	¥600,754	¥643,937	¥708,637	**¥931,159**	**$7,509,347**
Working capital	54,869	78,907	94,362	110,901	118,936	**195,729**	**1,578,460**
Stockholders' equity	243,730	257,058	265,030	285,361	320,987	**374,726**	**3,021,984**
Short-term and long-term debt	198,926	186,800	173,304	172,280	171,865	**271,860**	**2,192,419**

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

The operations of Shin-Etsu Chemical Co., Ltd. (the "Company") and its subsidiaries (the "Companies") are composed of three business segments: Chemicals, where main products are polyvinyl chloride (PVC), silicones, vinyl acetate monomer, methanol and cellulose derivatives; Electronics Materials, where main products are semiconductor silicon, synthetic quartz, organic materials for the electronics industry, rare earths and rare earth magnets; and Other, where the main businesses are export of technology and plants, export and import of merchandise, construction and plant engineering, and information processing services.

Consolidated data include the results of the Company and 54 subsidiaries in Japan and overseas. Of the remaining 42 subsidiaries and 21 affiliated companies, the equity method of accounting is applied to 2 subsidiaries and 4 affiliated companies.

Net Sales
(Billions of Yen)



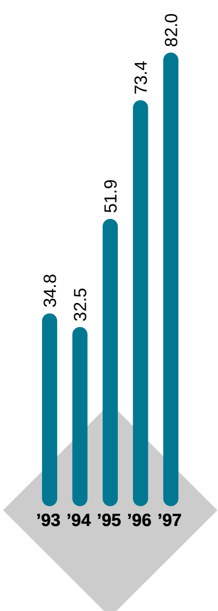
Operating Environment

In the fiscal year that ended in March 1997, strength in housing construction and capital expenditures raised hopes of a recovery in the Japanese economy. While economic expansion did take place, the pace of the upturn was tempered by weakness in consumer spending. In the face of intense competition, restructuring in the Japanese chemical industry continued as companies formed alliances and consolidated or scrapped production facilities. In this challenging environment, the Companies took steps to strengthen their competitive position by utilizing resources more productively and implementing a more streamlined organization.

Net Sales and Segment Information

Fiscal 1997 consolidated net sales rose 8.6 percent to ¥624,405 million (US$5,036 million) and operating income climbed 11.7 percent to ¥82,024 million (US$661 million). Operating income

Operating Income
(Billions of Yen)



increased from 12.8 percent to 13.1 percent of net sales. The higher operating margin was mainly attributable to the increase in sales and the benefits of efforts to hold down the cost of raw materials and other manufacturing expenses. Results by segment are as follows.

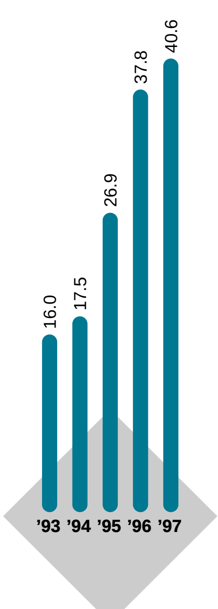
Chemicals—The Chemicals segment includes results of the Company and 34 subsidiaries, including Shintech, Inc., and Shin-Etsu Polymer Co., Ltd. In fiscal 1997, segment sales increased 2.2 percent to ¥310,030 million (US$2,500 million), which is 49.6 percent of total sales. Silicone sales in Japan were substantially higher due to a rise in demand from makers of construction materials and automobiles. Additionally, the strength of Japan's homebuilding sector supported growth in sales of cellulose derivatives used to make housing materials. Operating income decreased 15.8 percent to ¥28,445 million (US$229 million). This was mainly the result of weakness in domestic and overseas PVC markets during the second half of the fiscal year.

Electronics Materials—This segment includes results of the Company and 17 subsidiaries, including Shin-Etsu Handotai Co., Ltd., Shin-Etsu Handotai America, Inc., and S.E.H. Malaysia Sdn. Bhd. Segment sales were up 19.2 percent to ¥255,840 million (US$2,063 million), representing 41.0 percent of total sales. Despite weakening conditions in the semiconductor market, semiconductor silicon sales increased due to growth in shipments of wafers for advanced devices. Additionally, the Companies posted substantial growth in sales of synthetic quartz, organic materials for the electronics industry and rare earth magnets, all strategic product sectors positioned to become significant sources of segment sales in the future. Higher demand from the communications, electric machinery and automobile industries was behind this growth. Operating income climbed 31.8 percent to ¥51,493 million (US$415 million).

Other—This segment includes the results of the Company and 13 subsidiaries, including Shin-Etsu Astech Co., Ltd., and Shin-Etsu Engineering Co., Ltd. Fiscal 1997 segment sales increased 2.2 percent to ¥58,535 million (US$472 million), accounting for 9.4 percent of total sales. The export and import of merchandise and construction and plant engineering were the primary sources of growth. Operating income was up by 141.7 percent to ¥2,062 million (US$17 million).

Segment information on assets, depreciation, and capital expenditures and other figures is provided in Note 16 on page 37.

Net Income
(Billions of Yen)



Other Income (Expense) and Net Income

Interest and dividend income increased 56.7 percent to ¥7,296 million (US$59 million). This was mostly due to a temporary increase in interest income generated by proceeds from the 1996 issues of convertible debentures and notes with warrants. These funds were raised for the purpose of conducting future capital expenditures at the Companies. **Interest expense** increased 42.8 percent to ¥7,669 million (US$62 million), mainly a reflection of interest payments on the newly issued convertible bonds and notes with warrants. After inclusion of a foreign exchange gain of ¥3,463 million (US$28 million) and other items, **other income/(expenses)** resulted in a net expense of ¥326 million (US$3 million).

The increase in operating income and the decline in net other expenses resulted in a 13.6 percent rise in **income before income taxes** to ¥81,698 million (US$659 million). Income taxes rose 20.8 percent to ¥41,761 million (US$337 million). **Equity in earnings of affiliates** increased 16.3 percent to ¥1,502 million (US$12 million), and **minority interests in earnings of consolidated subsidiaries** increased to ¥1,032 million (US$8 million). **Amortisation of difference between cost of investment and equity in net assets of consolidated subsidiaries** was ¥207 million (US$2 million). Consolidated **net income** was up 7.4 percent to ¥40,614 million (US$328 million), resulting in primary net income per share of ¥118.24 (US$0.95).

Overseas Operations

Overseas sales, which are derived from foreign subsidiaries, rose 23.7 percent to ¥220,296 million (US$1,777 million), which is 35.3 percent of total sales compared with 31.0 percent in fiscal 1996. Higher demand for PVC in the United States and electronics materials in Asia were the most important contributors.

Financial Position

As of 31st March, 1997, current assets were ¥518,690 million (US$4,183 million), 37.3 percent more than at the previous fiscal year-end. This increase was mainly due to growth in cash and time deposits, which rose 70.1 percent to ¥234,152 million (US$1,888 million). This temporary rise in cash is mostly attributable to proceeds from the 1996 issues of convertible debentures and notes with warrants. These proceeds were also responsible for the more than fourfold rise in marketable securities to ¥36,839 million (US$297 million). Reflecting the growth in sales during the fiscal year, inventories increased 17.7 percent to ¥73,934 million (US$596 million). Property, plant and equipment rose 28.6 percent to ¥319,955 million (US$2,580 million) as the Companies continued to make substantial capital expenditures. Total assets increased 31.4 percent to ¥931,159 million (US$7,509 million).

Current liabilities rose 24.8 percent to ¥322,961 million (US$2,605 million). Notes and accounts payable, short-term loans and accrued expenses all increased. Additionally, there was a large increase in the current portion of long-term debt due to the inclusion of convertible debentures due on 31st March, 1998. Long-term debt was up by 73.9 percent to ¥168,192 million (US$1,356 million). During fiscal 1997, the Company issued ¥50 billion of convertible debentures in Japan and US$500 million of notes with warrants overseas. Stockholders' equity increased 16.7 percent to ¥374,726 million (US$3,022 million) due to the conversion of convertible debentures and higher retained earnings. As of 31st March, 1997, the stockholders' equity ratio was 40.2 percent.

At the stockholders meeting held in June 1997, approval was given for the acquisition of treasury stock for the purpose of granting stock options. The amendment to the Articles of Incorporation provides for the acquisition of no more than 722 thousand shares of the Company's par-value common stock at a cost that shall not exceed ¥2,500 million (US$20 million).

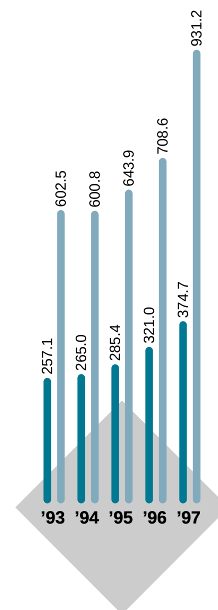
Capital Expenditures

Fiscal 1997 capital expenditures amounted to ¥92,844 million (US$749 million). A significant share of these expenditures were for the expansion and upgrading of production facilities for semiconductor silicon and other electronics materials. During the five-year period ending in March 2002, the Company, subsidiaries and affiliated companies plan to make capital expenditures of approximately ¥450 billion (US$3,629 million), primarily to expand and streamline production activities and to install environmental systems.

Cash Flows

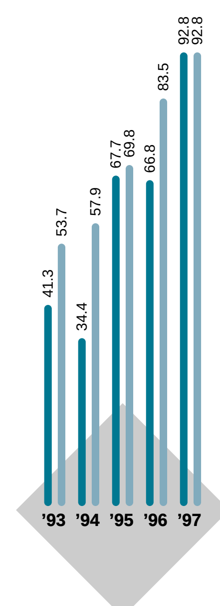
Cash and cash equivalents at the end of fiscal 1997 amounted to ¥270,991 million (US$2,185 million), 86.2 percent more than at the end of fiscal 1996. Net cash provided by operating activities was ¥124,676 million (US$1,005 million) as both net income and depreciation and amortisation rose. Net cash used for investing activities was ¥117,993 million (US$952 million), mainly due to a high level of capital expenditures. Net cash provided by financing activities was ¥125,634 million (US$1,013 million) due to the proceeds from the issue of convertible debentures and notes with warrants.

Stockholders' Equity/ Total Assets
(Billions of Yen)



Stockholders' Equity
Total Assets

Capital Expenditures/ Net Cash Flows
(Billions of Yen)



Capital Expenditures
Net Cash Flows
(Net Income plus Depreciation and Amortisation)

Consolidated Balance Sheets

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
As of 31st March, 1996 and 1997

	31st March,		31st March,
	1996	**1997**	**1997**
ASSETS	(millions of yen)		(thousands of U.S. dollars) (Note 3)
Current Assets:			
Cash and time deposits	¥137,649	**¥ 234,152**	**$ 1,888,322**
Marketable securities (Note 6)	7,881	**36,839**	**297,089**
Notes and accounts receivable (Note 4):			
Trade	148,435	**156,080**	**1,258,710**
Unconsolidated subsidiaries and affiliates	15,748	**10,721**	**86,460**
Other	4,230	**5,426**	**43,758**
Less: allowance for doubtful accounts	(2,323)	**(3,148)**	**(25,387)**
	166,090	**169,079**	**1,363,541**
Inventories (Note 5)	62,825	**73,934**	**596,242**
Other current assets	3,240	**4,686**	**37,790**
Total current assets	377,685	**518,690**	**4,182,984**
Investments and Advances:			
Investments in and advances to unconsolidated subsidiaries and affiliates (Note 7)	21,486	**25,186**	**203,113**
Investments in securities (Note 6)	41,771	**48,767**	**393,282**
Long-term loans	894	**1,510**	**12,177**
Other	9,452	**9,707**	**78,283**
Less: allowance for doubtful accounts	(15)	**(31)**	**(250)**
Total investments and advances	73,588	**85,139**	**686,605**
Property, Plant and Equipment (Note 8)**:**			
Buildings and structures	154,469	**196,072**	**1,581,226**
Machinery and equipment	452,836	**525,335**	**4,236,573**
Less: accumulated depreciation	(399,065)	**(454,626)**	**(3,666,339)**
	208,240	**266,781**	**2,151,460**
Land	26,460	**27,206**	**219,403**
Construction in progress	14,131	**25,968**	**209,419**
Total property, plant and equipment	248,831	**319,955**	**2,580,282**
Deferred Charges and Other Assets	1,767	**7,375**	**59,476**
Excess of Investment Cost Over Equity in Net Assets of Consolidated Subsidiaries	182	**—**	**—**
Adjustments on Foreign Currency Statement Translation (Note 2(4))	6,584	**—**	**—**
	¥708,637	**¥ 931,159**	**$ 7,509,347**

The accompanying notes are an integral part of the statements.

LIABILITIES AND STOCKHOLDERS' EQUITY	31st March, 1996 (millions of yen)	31st March, 1997 (millions of yen)	31st March, 1997 (thousands of U.S. dollars) (Note 3)
Current Liabilities:			
Short-term loans (Note 8)	¥ 62,732	**¥ 73,353**	**$ 591,556**
Current portion of long-term debt (Note 8)	12,425	**30,315**	**244,476**
Notes and accounts payable (Note 4):			
Trade	74,191	**84,138**	**678,532**
Unconsolidated subsidiaries and affiliates	14,144	**11,485**	**92,621**
Other	37,484	**46,020**	**371,129**
	125,819	**141,643**	**1,142,282**
Accrued income taxes	17,674	**22,205**	**179,073**
Accrued expenses	30,988	**38,832**	**313,161**
Advance received	956	**2,103**	**16,960**
Other current liabilities	8,155	**14,510**	**117,016**
Total current liabilities	258,749	**322,961**	**2,604,524**
Long-Term Liabilities:			
Long-term debt (Note 8)	96,708	**168,192**	**1,356,387**
Accrued employees' severance indemnities (Note 9)	5,891	**6,287**	**50,702**
Deferred taxes—non-current	7,623	**11,095**	**89,476**
Other	1,439	**15,974**	**128,822**
Total long-term liabilities	111,661	**201,548**	**1,625,387**
Excess of Investment Cost Over Equity in Net Assets of Consolidated Subsidiaries	—	**955**	**7,702**
Adjustments on Foreign Currency Statement Translation (Note 2 (4))	—	**12,741**	**102,750**
Minority Interests in Consolidated Subsidiaries	17,240	**18,228**	**147,000**
Contingent Liabilities (Note 10)	—	**—**	**—**
Stockholders' Equity (Note 11)**:**			
Common stock:			
Authorized: 800,000,000 shares			
Issued, par value ¥50 per share:			
324,691,433 shares and 349,569,337 shares as of 31st March, 1996 and 1997, respectively	36,440	**44,256**	**356,903**
Additional paid-in capital	38,330	**46,180**	**372,419**
Legal reserve	4,705	**4,967**	**40,057**
Retained earnings (Note 17)	241,513	**279,326**	**2,252,629**
	320,988	**374,729**	**3,022,008**
Less: treasury stock	(1)	**(3)**	**(24)**
Total stockholders' equity	320,987	**374,726**	**3,021,984**
	¥708,637	**¥931,159**	**$7,509,347**

The accompanying notes are an integral part of the statements.

Consolidated Statements of Income

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
For the years ended 31st March, 1995, 1996 and 1997

	For the years ended 31st March,			For the year ended 31st March,
	1995	1996	**1997**	**1997**
		(millions of yen)		(thousands of U.S. dollars) (Note 3)
Net Sales (Note 14)	¥522,917	¥575,176	**¥624,405**	**$5,035,524**
Cost of Sales (Notes 9, 12 and 14)	396,723	420,818	**452,974**	**3,653,016**
Gross profit	126,194	154,358	**171,431**	**1,382,508**
Selling, General and Administrative Expenses (Notes 9 and 12)	74,280	80,931	**89,407**	**721,024**
Operating income	51,914	73,427	**82,024**	**661,484**
Other Income/(Expenses):				
Interest and dividend income	5,108	4,656	**7,296**	**58,839**
Interest expenses	(6,197)	(5,369)	**(7,669)**	**(61,847)**
Amortisation of bond discounts	—	—	**(1,163)**	**(9,379)**
Loss on sale/disposal of property, plant and equipment	(1,035)	(2,701)	**(1,136)**	**(9,161)**
Foreign exchange gain/(loss)	(319)	1,120	**3,463**	**27,927**
Other, net	333	771	**(1,117)**	**(9,008)**
Income before income taxes	49,804	71,904	**81,698**	**658,855**
Income Taxes (Note 15):				
Current	26,009	33,547	**39,398**	**317,726**
Deferred	526	1,014	**2,363**	**19,056**
	26,535	34,561	**41,761**	**336,782**
Income after income taxes	23,269	37,343	**39,937**	**322,073**
Minority Interests in Earnings of Consolidated Subsidiaries	(420)	(813)	**(1,032)**	**(8,323)**
Equity in Earnings of Affiliates	686	1,291	**1,502**	**12,113**
Adjustments on Foreign Currency Statement Translation (Note 2 (4))	3,330	—	**—**	**—**
Amortisation of Difference Between Cost of Investment and Equity in Net Assets of Consolidated Subsidiaries	(3)	4	**207**	**1,669**
Net income	¥ 26,862	¥ 37,825	**¥ 40,614**	**$ 327,532**

		(Yen)		(U.S. dollars) (Note 3)
Per Share (Note 2 (14)):				
Net income—primary	¥ 82.80	¥ 116.51	**¥ 118.24**	**$ 0.954**
Net income—fully diluted	—	¥ 106.66	**¥ 103.95**	**$ 0.838**
Cash dividends	¥ 7.50	¥ 7.50	**¥ 7.50**	**$ 0.060**
Weighted Average Number of Shares (Thousands)	324,415	324,649	**343,490**	**343,490**

The accompanying notes are an integral part of the statements.

Consolidated Statements of Stockholders' Equity

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
For the years ended 31st March, 1995, 1996 and 1997

	Number of shares of common stock issued	Common stock	Additional paid-in capital	Legal reserve	Retained earnings
	(thousands)	(millions of yen)			
Balance as of 31st March, 1994	323,949	¥35,829	¥37,672	¥4,194	¥187,335
Net income for the year	—	—	—	—	26,862
Increase in retained earnings due to additional consolidation of subsidiaries	—	—	—	—	2,463
Increase in retained earnings due to increase in ownership percentage in consolidated subsidiaries	—	—	—	—	3
Cash dividends	—	—	—	—	(2,431)
Transfer to legal reserve	—	—	—	254	(254)
Directors' and statutory auditors' bonuses	—	—	—	—	(163)
Conversion of convertible debentures	672	555	555	—	—
Increase in equity interests in a consolidated subsidiary due to conversion of convertible debentures issued by the consolidated subsidiary	—	—	1	—	—
Increase in additional paid-in capital due to additional consolidation of subsidiaries	—	—	45	—	—
Adjustment on foreign currency statement translation (Note 2 (4))	—	—	—	—	(7,557)
Balance as of 31st March, 1995	324,621	36,384	38,273	4,448	206,258
Net income for the year	—	—	—	—	37,825
Increase in retained earnings due to additional consolidation of subsidiaries	—	—	—	—	320
Increase in retained earnings due to increase in ownership percentage in consolidated subsidiaries	—	—	—	—	4
Cash dividends	—	—	—	—	(2,434)
Transfer to legal reserve	—	—	—	257	(257)
Directors' and statutory auditors' bonuses	—	—	—	—	(203)
Conversion of convertible debentures	70	56	56	—	—
Increase in equity interests in a consolidated subsidiary due to conversion of convertible debentures issued by the consolidated subsidiary	—	—	1	—	—
Balance as of 31st March, 1996	324,691	36,440	38,330	4,705	241,513
Net income for the year	**—**	**—**	**—**	**—**	**40,614**
Increase in retained earnings due to additional consolidation of subsidiaries	**—**	**—**	**—**	**—**	**151**
Increase in retained earnings due to increase in ownership percentage in consolidated subsidiaries	**—**	**—**	**—**	**—**	**1**
Cash dividends	**—**	**—**	**—**	**—**	**(2,501)**
Transfer to legal reserve	**—**	**—**	**—**	**262**	**(262)**
Directors' and statutory auditors' bonuses	**—**	**—**	**—**	**—**	**(190)**
Conversion of convertible debentures	**8,463**	**7,643**	**7,633**	**—**	**—**
Exercise of warrant attached to debentures	**180**	**173**	**216**	**—**	**—**
Stock split on 20th May, 1996 (1 into 1.05)	**16,235**	**—**	**—**	**—**	**—**
Increase in equity interests in a consolidated subsidiary due to conversion of convertible debentures issued by the consolidated subsidiary	**—**	**—**	**1**	**—**	**—**
Balance as of 31st March, 1997	**349,569**	**¥44,256**	**¥46,180**	**¥4,967**	**¥279,326**

The accompanying notes are an integral part of the statements.

	Number of shares of common stock issued	Common stock	Additional paid-in capital	Legal reserve	Retained earnings
	(thousands)	(thousands of U.S. dollars) (Note 3)			
Balance as of 31st March, 1996	324,691	$293,871	$309,113	$37,944	$1,947,685
Net income for the year	—	—	—	—	**327,532**
Increase in retained earnings due to additional consolidation of subsidiaries	—	—	—	—	**1,218**
Increase in retained earnings due to increase in ownership percentage in consolidated subsidiaries	—	—	—	—	**8**
Cash dividends	—	—	—	—	**(20,169)**
Transfer to legal reserve	—	—	—	**2,113**	**(2,113)**
Directors' and statutory auditors' bonuses	—	—	—	—	**(1,532)**
Conversion of convertible debentures	**8,463**	**61,637**	**61,556**	—	—
Exercise of warrant attached to debentures	**180**	**1,395**	**1,742**	—	—
Stock split on 20th May, 1996 (1 into 1.05)	**16,235**	—	—	—	—
Increase in equity interests in a consolidated subsidiary due to conversion of convertible debentures issued by the consolidated subsidiary	—	—	**8**	—	—
Balance as of 31st March, 1997	**349,569**	**$356,903**	**$372,419**	**$40,057**	**$2,252,629**

The accompanying notes are an integral part of the statements.

Consolidated Statements of Cash Flows

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
For the years ended 31st March, 1995, 1996 and 1997

	For the years ended 31st March,			For the year ended 31st March,
	1995	1996	**1997**	**1997**
		(millions of yen)		(thousands of U.S. dollars) (Note 3)
Cash Flows From Operating Activities:				
Net income	¥ 26,862	¥ 37,825	**¥ 40,614**	**$ 327,532**
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortisation	42,986	46,034	**54,554**	**439,952**
Equity in earnings of affiliates	(686)	(1,291)	**(1,502)**	**(12,113)**
Loss on sale/disposal of property, plant and equipment	1,035	2,701	**1,136**	**9,161**
Other, net	(13,652)	(7,171)	**13,779**	**111,121**
Changes in assets and liabilities:				
Increase in notes and accounts receivable	(8,056)	(20,331)	**(3,814)**	**(30,758)**
Increase in inventories	(4,734)	(8,681)	**(11,109)**	**(89,589)**
Increase in notes and accounts payable	15,858	22,881	**15,824**	**127,613**
Increase in accrued income taxes	5,566	1,933	**4,531**	**36,540**
Other, net	1,057	6,813	**10,663**	**85,992**
Net cash provided by operating activities	66,236	80,713	**124,676**	**1,005,451**
Cash Flows From Investing Activities:				
Purchase of properties	(67,689)	(71,863)	**(110,570)**	**(891,694)**
Proceeds from sales of properties	839	15,000	**1,383**	**11,153**
Increase in investments in securities	(71)	(1,335)	**(6,996)**	**(56,419)**
Decrease (increase) in investments in unconsolidated subsidiaries and affiliates	16,495	(2,952)	**(2,220)**	**(17,903)**
Other, net	3,580	1,155	**410**	**3,307**
Net cash used for investing activities	(46,846)	(59,995)	**(117,993)**	**(951,556)**
Cash Flows From Financing Activities:				
Proceeds from issue of debentures	—	—	**105,065**	**847,298**
Borrowing of long-term debt	13,394	10,822	**15,025**	**121,169**
Payment of long-term debt	(6,814)	(11,597)	**(16,243)**	**(130,992)**
Increase (decrease) in short-term loans	(6,391)	375	**10,621**	**85,653**
Cash dividends paid	(2,431)	(2,434)	**(2,501)**	**(20,169)**
Other, net	381	(1,154)	**13,667**	**110,218**
Net cash provided by (used for) financing activities	(1,861)	(3,988)	**125,634**	**1,013,177**
Effect of Exchange Rate Changes on Cash	4,487	(1,320)	**(6,856)**	**(55,290)**
Net Increase in Cash and Cash Equivalents	22,016	15,410	**125,461**	**1,011,782**
Cash and Cash Equivalents at Beginning of Year	108,104	130,120	**145,530**	**1,173,629**
Cash and Cash Equivalents at End of Year	¥130,120	¥145,530	**¥ 270,991**	**$ 2,185,411**

The accompanying notes are an integral part of the statements.

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
As of 31st March, 1995, 1996 and 1997

1. Basis of presenting financial statements

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

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

Although the consolidated statements of cash flows are not disclosed in Japan for domestic reporting purposes, such statements for the years ended 31st March, 1995, 1996 and 1997 have been prepared in compliance with the methods recommended by the Japanese Institute of Certified Public Accountants.

2. Summary of significant accounting policies

(1) Principles of consolidation

The Company had 96 majority-owned subsidiaries as of 31st March, 1997 (97 as of 31st March, 1996 and 90 as of 31st March, 1995). The consolidated financial statements include the accounts of the Company and its 54 (51 for 1996 and 1995) majority-owned subsidiaries listed on page 41 with closing dates for their respective fiscal years (the "Companies").

The remaining 42 (46 for 1996 and 39 for 1995) unconsolidated subsidiaries whose combined assets, net sales, net income and retained earnings in the aggregate are not significant compared to those of the consolidated financial statements of the Companies, therefore, have not been consolidated with the Company. For consolidation of the accounts of subsidiaries whose closing dates are not in agreement with the Company, necessary adjustments are made on significant intercompany transactions which took place during the periods between the closing dates for the fiscal years of respective consolidated subsidiaries and that of the Company.

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

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

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

(2) Accounting for investments in unconsolidated subsidiaries and affiliates

The Company had 42 (39 for 1995 and 46 for 1996) unconsolidated subsidiaries (majority-owned) and 21 (19 for 1995 and 22 for 1996) affiliates (meaning 20 percent to 50 percent ownership of company's equity interest). The equity method is applied to the investments in two unconsolidated subsidiaries and four major affiliates since investments in the remaining unconsolidated subsidiaries and affiliates are not material for the consolidated financial statements.

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

Shin-Etsu Handotai Taiwan Co., Ltd.

Shin-Etsu Quartz Products Co., Ltd.

Kashima Vinyl Chloride Monomer Co., Ltd.

Nagano Electronics Industrial Co., Ltd.

(3) Translation of foreign currency transactions

Revenue and expense items arising from transactions denominated in foreign currencies are generally translated into Japanese yen at the rates effective at the respective transaction dates.

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

Long-term receivables and payables denominated in foreign currencies including investments in overseas unconsolidated subsidiaries and affiliates are translated at the historical rates prevailing at the transaction dates.

Exceptionally, receivables and payables denominated in foreign currencies which are hedged by forward exchange contracts are translated at the contracted rate of exchange.

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

The accounting standards for translation of transactions and account balances denominated in foreign currencies have been amended and became effective from the year ended 31st March, 1996. The new standards were adopted by the Company and its domestic subsidiaries during the year ended 31st March, 1996 and 1997. If the new standards had been applied in the year ended 31st March, 1995, there would have been no effect at all.

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

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

Until the year ended 31st March, 1995, short-term monetary items were translated at current rates. In contrast, short-term non-monetary items and long-term assets and liabilities were translated at historical rates, except for some overseas subsidiaries whose foreign currency financial statements were translated at current exchange rates prevailing at the balance sheet dates because short-term non-monetary items and long-term assets and liabilities of these subsidiaries were not significant.

Net income for the year and the balance of retained earnings at year-end were required to be translated at current exchange rates while revenue and expense items were translated at the average exchange rate or at the historical rate, as appropriate.

In this connection, certain adjusting accounts were set up in the balance sheet, statements of income, and stockholders’ equity to enable balancing of debit and credit totals as well as the reconciliation of the beginning balance with the ending balance of retained earnings. Such adjusting account balances are shown as “Adjustments on Foreign Currency Statement Translation” in the accompanying consolidated financial statements as of 31st March, 1995 and for the fiscal years then ended.

In compliance with the new accounting standards for foreign currency transactions, which became effective from the year ended 31st March, 1996, the Company changed its translation method. Under the new standards, all assets and liabilities are translated into Japanese yen at current exchange rates while capital accounts and retained earnings are translated at historical rates, and revenue and expense items are translated at the average exchange rates during the year. The resulting translation adjustments are, as before, shown as “Adjustments on Foreign Currency Statement Translation” in the accompanying balance sheets as of 31st March, 1996 and 1997.

The “income before income taxes” for the year ended 31st March, 1995 would have increased by ¥3,640 million as compared with the amount which would have been reported if the current method had been applied for the translation of the financial statements of subsidiaries for the year 1995 stated in foreign currencies.

(5) Inventory valuation

Inventories are valued principally at cost determined by the annual average method.

(6) Valuation of securities

Investments in securities, both quoted and non-quoted, are valued principally at cost determined by the moving average method.

(7) Property, plant and equipment

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

(8) Amortisation

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

(9) Repairs and maintenance

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

(10) Accounting for leases

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

(11) Recognition of certain accrued expenses

In general, the Companies follow the accrual basis of accounting for all income and expense items. However, the Japanese income tax laws provide for limits deductible for tax purposes with respect to certain accrued expenses which are essentially the estimates of amounts to be determined in future years. The accrued expenses of the Companies to which such limits apply under the laws are: accrued bonuses to employees, accrued employees' severance indemnities and allowance for doubtful accounts. The Companies generally record such accrued expense items on the Companies' own estimate, which is deemed to be adequate for financial reporting purposes.

(12) Income taxes

Income taxes are provided based on amounts required by the tax returns for the period. No tax effect is recorded for timing differences in recognition of certain expenses between tax and financial reporting, except for those of 14 subsidiaries including Shintech, Inc., Shin-Etsu Handotai America, Inc., which follow the interperiod income tax allocation.

(13) Research and development costs

Research and development costs are charged to income as incurred.

(14) Net income and dividend per share

Net income per share is based upon the weighted average number of shares of common stock outstanding during each fiscal year. In accordance with the amendments to the Japanese securities and exchange regulations, net income per share adjusted for dilution (assuming full conversion of all convertible debentures of the Company outstanding with related reduction in interest expenses) has been disclosed from the fiscal year ended 31st March, 1996.

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

(15) Dividends

Dividends are proposed by the Board of Directors and approved by the stockholders at meetings held subsequent to the fiscal year to which the dividends are applicable, and registered stockholders as of the end of such fiscal year are entitled to the subsequently declared dividends. Also the interim cash dividends are paid. (See Note 11)

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

(16) Appropriation of retained earnings

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

(17) Consumption tax

The consumption tax withheld by the Company on sales of products is not included in the amount of "Net Sales" in the accompanying Consolidated Statements of Income. And the consumption tax borne by the Company on purchases of goods and services, and expenses is not included in the related amounts in the accompanying Consolidated Statements of Income, either.

3. United States dollar amounts

The Company prepares its consolidated financial statements in yen. The dollar amounts included in the consolidated financial statements and notes thereto represent the arithmetical results of translating yen to dollars on a basis of ¥124 to U.S.$1, the approximate effective rate of exchange on 31st March, 1997. The inclusion of such dollar amounts is solely for convenience and is not intended to imply that yen amounts have been or could be readily converted, realised or settled in dollars at ¥124 to U.S.$1 or at any other rate.

4. Notes and accounts receivable and payable

The companies recognise the settlements of notes receivable and notes payable at such time as the bank clearance of the notes are actually made. The balance sheet date of 31st March, 1996 was incidentally a holiday for financial institutions and, therefore, the following accounts include the balances of notes receivable and notes payable due on that date as unsettled in the relevant amount in the accompanying consolidated balance sheet as of 31st March, 1996:

	(millions of yen)
Notes and accounts receivable	¥8,263
Notes and accounts payable	7,049
Contingent liabilities—Notes discounted by banks	104
Contingent liabilities—Notes endorsed to outsiders	41

5. Inventories

Inventories as of 31st March, 1996 and 1997 consisted of the following:

	31st March,		
	1996	**1997**	**1997**
	(millions of yen)		(thousands of U.S. dollars)
Merchandise	¥ 3,991	**¥ 4,197**	**$ 33,847**
Finished products	24,571	**30,544**	**246,322**
Semifinished products	10,981	**11,419**	**92,089**
Raw materials	14,736	**16,960**	**136,774**
Supplies	5,090	**7,808**	**62,968**
Others	3,456	**3,006**	**24,242**
	¥62,825	**¥73,934**	**$596,242**

6. Marketable securities and investments in securities

Marketable securities (current portfolio) and investments in securities (non-current portfolio) held by the Companies as of 31st March, 1996 and 1997 consisted of the following:

	31st March,		
	1996	**1997**	**1997**
	(millions of yen)		(thousands of U.S. dollars)
Marketable securities (current portfolio):			
Listed corporate shares	¥ 1,606	**¥ 1,395**	**$ 11,250**
Bonds, debentures and others	6,275	**35,444**	**285,839**
	¥ 7,881	**¥36,839**	**$297,089**
Investments in securities (non-current portfolio):			
Listed corporate shares	¥35,950	**¥37,003**	**$298,411**
Other shares (unquoted)	1,609	**2,113**	**17,040**
Bonds, debentures and others	4,212	**9,651**	**77,831**
	¥41,771	**¥48,767**	**$393,282**

The aggregate market value of listed corporate shares (marketable equity securities) and net unrealised gains as of 31st March, 1996 and 1997 amounted to as follows:

	31st March,		
	1996	**1997**	**1997**
	(millions of yen)		(thousands of U.S. dollars)
Current:			
Market value	¥ 3,642	**¥ 2,726**	**$ 21,984**
Net unrealised gains	2,036	**1,331**	**10,734**
Non-current:			
Market value	¥101,616	**¥80,303**	**$647,605**
Net unrealised gains	65,666	**43,300**	**349,194**

7. Investments in and advances to unconsolidated subsidiaries and affiliates

Investments in and advances to unconsolidated subsidiaries and affiliates as of 31st March, 1996 and 1997 consisted of the following:

	31st March,		
	1996	**1997**	**1997**
	(millions of yen)		(thousands of U.S. dollars)
Held directly by the Company:			
Affiliates:			
Three affiliates accounted for by the equity method (See Note 2(2))	*¥ 5,977	***¥ 7,525**	***$ 60,685**
Kashima Denkai Co., Ltd.	805	**805**	**6,492**
Unitika Chemical Co., Ltd.	600	**600**	**4,839**
Others	233	**203**	**1,637**
	7,615	**9,133**	**73,653**
Unconsolidated subsidiaries:			
Silicon Metal Company of Australia Ltd. (1)	2,567	**—**	**—**
Shin-Etsu Silicones Europe B.V.	734	**734**	**5,919**
MicroSi, Inc.	499	**499**	**4,024**
Shin-Etsu Electronics Malaysia Sdn. Bhd.	494	**1,400**	**11,290**
Shin-Etsu Electronics Materials Singapore Pte. Ltd. (1)	203	**—**	**—**
Shin-Etsu Film Co., Ltd.	199	**199**	**1,605**
Others	354	**332**	**2,678**
	5,050	**3,164**	**25,516**
Held indirectly through subsidiaries			
Unconsolidated subsidiaries:			
Two unconsolidated subsidiaries and an affiliate accounted for by the equity method (See Note 2(2))	—	**5,318**	**42,887**
Others	8,138	**5,710**	**46,049**
	8,138	**11,028**	**88,936**
Advances	683	**1,861**	**15,008**
	¥21,486	**¥25,186**	**$203,113**

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

(1) Newly consolidated with effect from the year ended 31st March, 1997.

8. Short-term loans and long-term debt

Short-term loans outstanding as of 31st March, 1996 and 1997 are represented generally by one-year notes issued by the Companies to banks. Substantially all of the notes are issued to banks which have written basic agreements with the Companies to the effect that, with respect to all present or future loans with such banks, the Companies shall provide collateral (including sums on deposit with such banks), or guarantors for such loans, immediately upon the banks' request, and that any collateral furnished pursuant to such agreement or otherwise will be applicable to all indebtedness to such banks.

Long-term debt as of 31st March, 1996 and 1997 consisted of the following:

	31st March,		
	1996	**1997**	**1997**
	(millions of yen)		(thousands of U.S. dollars)
Loans with banks and other financial institutions:			
Secured	¥ 18,970	**¥ 16,474**	**$ 132,855**
Unsecured	26,792	**28,105**	**226,653**
Secured debentures:			
6.5% mortgage debentures issued by a consolidated subsidiary, due November 1997	2,000	**2,000**	**16,129**
Unsecured debentures:			
$3^3/_8$% notes in U.S. dollars, due August 2000 with warrants	—	**52,562**	**423,887**
2.7% debentures issued by a consolidated subsidiary, due April 2001	—	**3,274**	**26,403**
Unsecured convertible debentures:			
3.0% convertible debentures in U.S. dollars, due May 2000	40	**29**	**234**
2.1% convertible debentures, due May 1997	439	**357**	**2,879**
2.0% convertible debentures, due March 1998	20,992	**17,966**	**144,887**
1.3% convertible debentures, due March 1999	39,794	**37,538**	**302,726**
0.4% convertible debentures, due September 2005	—	**40,098**	**323,371**
Secured convertible debentures:			
2.4% convertible mortgage debentures issued by a consolidated subsidiary, due March 1999	106	**104**	**839**
	109,133	**198,507**	**1,600,863**
Less portion due within one year	(12,425)	**(30,315)**	**(244,476)**
	¥ 96,708	**¥168,192**	**$1,356,387**

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

	Issue date and principal amount at issue	Balance as of 31st March, 1997 in denominated currencies	Terms of conversion of 31st March, 1997		
			Current conversion price per share**	Fixed exchange rates for conversion	Additional shares issuable upon full conversion (in thousands)
Unsecured:					
3.0% convertible debentures in U.S. dollars, due 2000	4th March, 1985 (U.S.$30 million)	U.S.$0.115 million	¥1,112.2	U.S.$1=¥262.60	27
2.1% convertible debentures in yen, due 1997	16th December, 1986 (¥15,000 million)	¥357 million	¥1,084.1	—	329
2.0% convertible debentures in yen, due 1998	5th December, 1988 (¥25,000 million)	¥17,966 million	¥1,560.5	—	11,513
1.3% convertible debentures in yen, due 1999	13th February, 1990 (¥40,000 million)	¥37,538 million	¥1,748.6	—	21,467
0.4% convertible debentures in yen, due 2005	8th August, 1996 (¥50,000 million)	¥40,098 million	¥1,917.0	—	20,917
Secured:					
2.4% convertible mortgage debentures in yen, due 1999*	31st March, 1987 (¥5,000 million)	¥104 million	¥ 540.7	—	N/A
					54,253

Additional information with respect to the Companies' warrants is summarised as follows:

	Issue date and principal amount at issue	Balance as of 31st March, 1997 in denominated currencies	Terms of exercise of 31st March, 1997		
			Current exercise price per share**	Fixed exchange rates for exercise	Additional shares issuable upon full exercise (in thousands)
Warrants attached to:					
$3^3/_8$% notes in U.S. dollars, due 2000	8th August, 1996 (U.S.$500 million)	U.S.$497 million	¥1,917.0	U.S.$1=¥109.45	28,367
					28,367

*Issued by a subsidiary Shin-Etsu Polymer Co., Ltd.
**Subject to adjustment for subsequent stock dividends, stock splits and others.

$3^3/_8$% notes with warrants denominated in foreign currency are covered by a long-term forward exchange contract and accordingly are translated into yen at the contracted exchange rate. The difference between the amount translated at the contract rates and the amount translated at the historical exchange rates is deferred and amortised over a period from the date of concluding the forward exchange contract to the date of settlement based on the number of months. As a result, during the year ended 31st March, 1997, ¥273 million ($2,202 thousand) was amortised to income as a credit to "Interest expenses" and "Other, net", respectively, in "Other Income/(Expenses)" in the accompanying Consolidated Statements of Income for the year ended 31st March, 1997. The unamortised balance was included in "Other current liabilities" in an amount of ¥410 million ($3,306 thousand) and in "Other" in the Long-term Liabilities section in an amount of ¥956 million ($7,710 thousand), respectively in the accompanying Consolidated Balance Sheet at 31st March, 1997. Under the Japanese tax laws, such translation gains are not taxable until such time as the forward exchange contract is performed.

As of 31st March, 1997, assets pledged as collateral for short-term loans, mortgage debentures and long-term loans were as follows:

	(millions of yen)	(thousands of U.S. dollars)
Net book value of property, plant and equipment	¥57,946	$467,306

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

	(millions of yen)	(thousands of U.S. dollars)
Year ending 31st March,		
1998	¥ 30,315	$ 244,476
1999	50,735	409,153
2000	65,756	530,290
2001 and thereafter	51,701	416,944
	¥198,507	$1,600,863

9. Retirement and pension plans

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

Unamortised past service liability, arising from the adoption of the plan during 1970, is being funded and amortised over a 29-year period.

In addition to the programmes described above, the Company and certain subsidiaries have also established employee early retirement plans. In such plans, the employees are entitled to receive lump sum payments which are determined according to their age at the time of voluntary termination of their employment. Reserves for liabilities for payments under such plans are provided for 100 percent of the amounts payable if all eligible employees voluntarily terminated employment at the respective balance sheet date.

In certain subsidiaries which have not adopted the above-mentioned plans, employees are entitled to receive lump sum payments based on the current rate of pay, length of service and conditions under which terminations occur. These subsidiaries provide reserves for liabilities for payments under the plans for 40 percent of the amount payable, which is the maximum amount permitted by the Japanese tax laws, if all employees voluntarily terminated their employment at the respective balance sheet date.

Charges to income for such retirement and pension plan costs for the years ended 31st March, 1995, 1996 and 1997 were ¥2,999 million, ¥2,803 million and ¥3,498 million ($28,210 thousand), respectively.

10. Contingent liabilities

As of 31st March, 1997, the Companies were contingently liable as a guarantor of housing loans for employees and loans to unconsolidated subsidiaries, affiliates and others in the aggregate amount of ¥1,438 million ($11,597 thousand).

In addition, as of 31st March, 1997, the Companies had contingent liabilities arising from notes discounted by banks in the amounts of ¥541 million ($4,363 thousand).

11. Legal reserve and retained earnings

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

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

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

The Japanese Commercial Code provides that interim cash dividends (payable to stockholders of record as of 30th September of each year in the case of the Company on a semi-annual basis) may be distributed upon approval by the Board of Directors. The Company paid interim dividends during the years ended 31st March, 1995, 1996 and 1997 in the amounts of ¥1,217 million, ¥1,217 million and ¥1,283 million ($10,347 thousand) (¥3.75 per share) respectively, which were actually paid to stockholders on 9th December, 1994, 8th December, 1995 and 8th December, 1996, respectively. In the accompanying consolidated statements of stockholders' equity, these dividend payments are reflected in the years ended 31st March, 1995, 1996 and 1997, respectively.

12. Research and development costs

Research and development costs incurred and charged to income for the years ended 31st March, 1995, 1996 and 1997 were ¥16,674 million, ¥17,634 million and ¥18,256 million ($147,226 thousand), respectively.

13. Lease transactions

Lease rental expenses on finance lease contracts without ownership-transfer for the year ended 31st March, 1997 amounted to ¥377 million ($3,040 thousand).

14. Related party transactions

The Company's sales to and purchases from its unconsolidated subsidiaries and affiliates for the years ended 31st March, 1995, 1996 and 1997 are summarised as follows:

	Year ended 31st March,			
	1995	1996	**1997**	**1997**
		(millions of yen)		(thousands of U.S. dollars)
Sales	¥22,715	¥26,016	**¥14,891**	**$120,089**
Purchases	22,666	25,290	**28,316**	**228,355**

15. Income taxes

Income taxes in Japan applicable to the Company and its domestic subsidiaries for the years ended 31st March, l995, 1996 and 1997 consisted of corporate income tax (national), enterprise tax (local) and resident income taxes (local) at the approximate rates indicated below:

	Rates on taxable income		
	1995	1996	**1997**
Corporate income tax	37.5%	37.5%	**37.5%**
Enterprise tax	12.1	12.1	**12.1**
Resident income taxes	7.5	7.7	**7.5**
	57.1%	57.3%	**57.1%**
Statutory tax rate in effect to reflect the deductibility of enterprise tax when paid (unlike other income taxes, enterprise tax is deductible for tax purposes when it is paid)	50.9%	51.1%	**50.9%**

Income tax expenses as shown in the accompanying consolidated statements of income are different from the amounts computed by applying the above-mentioned statutory rates to income before income taxes. The principal reasons such differences arise are that no tax effects have been recognised by the Company and its domestic subsidiaries on certain timing differences between financial accounting and tax reporting purposes consisting primarily of accrued enterprise tax not deductible until paid.

16. Segment information

(1) Business segment information

The Companies operate principally in the following three lines of business, "Chemicals", "Electronics Materials" and "Other." These lines of business deal with the following main products and merchandise:

Chemicals
- Synthetic resins .... Polyvinyl chloride, silicones, vinyl acetate monomer, polyvinyl alcohol
- Organic chemicals .... Methanol, chloromethanes, cellulose derivatives
- Other chemicals .... Caustic soda, lime nitrogen, fused phosphates, ferroalloys, silicon metal

Electronics Materials .... Semiconductor silicon, oxide single-crystals, synthetic quartz, organic materials for electronics industry, rare earths, rare earth magnets

Other .... Export of technology and plants, export and import of merchandise, construction and plant engineering, information processing

Sales, related operating costs and expenses, operating income, assets, depreciation and capital expenditure of the Companies at 31st March, 1995, 1996 and 1997 and for the years then ended, classified by business segments are presented below. The disclosure of assets, depreciation and capital expenditure for each segment classified by business has been made since it became mandatory with effect from the year ended 31st March, 1996, as a result of the amendments to the Consolidated Financial Statement Regulations.

	For the year ended 31st March, 1995				
	Chemicals	Electronics materials	Other	Elimination of inter-segment sales/income	Consolidated total
	(millions of yen)				
Sales					
Sales to outside customers	¥298,467	¥170,706	¥53,744	¥ —	¥522,917
Inter-segment sales	10,841	1,053	33,340	(45,234)	—
Total	309,308	171,759	87,084	(45,234)	522,917
Operating costs and expenses	280,304	149,404	86,526	(45,231)	471,003
Operating income (Note 2)	¥ 29,004	¥ 22,355	¥ 558	¥ (3)	¥ 51,914

	For the year ended 31st March, 1996				
	Chemicals	Electronics materials	Other	Elimination or common assets (Note 1)	Consolidated total
	(millions of yen)				
Sales					
Sales to outside customers	¥303,285	¥214,635	¥57,256	¥ —	¥575,176
Inter-segment sales	12,628	1,208	34,990	(48,826)	—
Total	315,913	215,843	92,246	(48,826)	575,176
Operating costs and expenses	282,134	176,788	91,393	(48,566)	501,749
Operating income	¥ 33,779	¥ 39,055	¥ 853	¥ (260)	¥ 73,427
Assets	¥303,905	¥270,529	¥42,941	¥ 91,262	¥708,637
Depreciation	17,918	27,200	529	—	45,647
Capital expenditure	23,513	42,964	546	(232)	66,791

	For the year ended 31st March, 1997				
	Chemicals	Electronics materials	Other	Elimination or common assets (Note 1)	Consolidated total
	(millions of yen)				
Sales					
Sales to outside customers	**¥310,030**	**¥255,840**	**¥ 58,535**	**¥ —**	**¥624,405**
Inter-segment sales	**12,844**	**1,595**	**47,861**	**(62,300)**	**—**
Total	**322,874**	**257,435**	**106,396**	**(62,300)**	**624,405**
Operating costs and expenses	**294,429**	**205,942**	**104,334**	**(62,324)**	**542,381**
Operating income	**¥ 28,445**	**¥ 51,493**	**¥ 2,062**	**¥ 24**	**¥ 82,024**
Assets	**¥336,365**	**¥366,980**	**¥ 55,852**	**¥171,962**	**¥931,159**
Depreciation	**18,434**	**33,079**	**678**	**—**	**52,191**
Capital expenditure	**15,478**	**76,846**	**835**	**(315)**	**92,844**

	For the year ended 31st March, 1997				
	Chemicals	Electronics materials	Other	Elimination or common assets (Note 1)	Consolidated total
	(thousands of U.S. dollars)				
Sales					
Sales to outside customers	**$2,500,242**	**$2,063,226**	**$472,056**	**$ —**	**$5,035,524**
Inter-segment sales	**103,580**	**12,863**	**385,976**	**(502,419)**	**—**
Total	**2,603,822**	**2,076,089**	**858,032**	**(502,419)**	**5,035,524**
Operating costs and expenses	**2,374,427**	**1,660,823**	**841,403**	**(502,613)**	**4,374,040**
Operating income	**$ 229,395**	**$ 415,266**	**$ 16,629**	**$ 194**	**$ 661,484**
Assets	**$2,712,621**	**$2,959,516**	**$450,420**	**$1,386,790**	**$7,509,347**
Depreciation	**148,661**	**266,766**	**5,468**	**—**	**420,895**
Capital expenditure	**124,822**	**619,726**	**6,734**	**(2,540)**	**748,742**

Notes:

(1) The amounts of the common assets included in the column “Elimination or common assets” for the years ended 31st March, 1996 and 1997 were ¥113,904 million and ¥199,078 million ($1,605,468 thousand), respectively, which mainly consist of surplus working funds (cash, deposits and marketable securities) and long-term investment funds (investments in securities) of the Company.

(2) If the new method of translating foreign currency financial statements, which became effective from the year ended 31st March, 1996, had been applied in the year ended 31st March, 1995, operating income of “Chemicals” and “Electronics Materials” would have increased by ¥1,190 million and ¥2,451 million, respectively, operating income of “Other” would have decreased by ¥1 million and consolidated total operating income would have increased by ¥3,640 million as compared with the amounts which have been reported.

(2) Geographical segment information

The analysis of the sales, operating costs and expenses, operating income and assets of the Companies by geographical segments (within Japan and outside Japan) of 31st March, 1995, 1996 and 1997 and for the years then ended are presented below. The disclosure of assets for each segment classified by geographic area has become mandatory with effect from the year ended 31st March, 1996, as a result of the amendments to the Consolidated Financial Statement Regulations:

	Year ended 31st March, 1995			
	Within Japan	Outside Japan	Elimination of inter-segment sales/income	Consolidated total
	(millions of yen)			
Sales				
Sales to outside customers	¥380,773	¥142,144	¥ —	¥522,917
Inter-segment sales	34,293	14,128	(48,421)	—
Total	415,066	156,272	(48,421)	522,917
Operating costs and expenses	381,572	138,834	(49,403)	471,003
Operating income (Note 2)	¥ 33,494	¥ 17,438	¥ 982	¥ 51,914

	Year ended 31st March, 1996			
	Within Japan	Outside Japan	Elimination or common assets (Note 1)	Consolidated total
	(millions of yen)			
Sales				
Sales to outside customers	¥397,026	¥178,150	¥ —	¥575,176
Inter-segment sales	45,323	15,531	(60,854)	—
Total	442,349	193,681	(60,854)	575,176
Operating costs and expenses	398,343	164,981	(61,575)	501,749
Operating income	¥ 44,006	¥ 28,700	¥ 721	¥ 73,427
Assets	¥447,690	¥198,313	¥ 62,634	¥708,637

	Year ended 31st March, 1997			
	Within Japan	Outside Japan	Elimination or common assets (Note 1)	Consolidated total
	(millions of yen)			
Sales				
Sales to outside customers	**¥404,109**	**¥220,296**	**¥ —**	**¥624,405**
Inter-segment sales	**65,073**	**17,261**	**(82,334)**	**—**
Total	**469,182**	**237,557**	**(82,334)**	**624,405**
Operating costs and expenses	**418,712**	**206,511**	**(82,842)**	**542,381**
Operating income	**¥ 50,470**	**¥ 31,046**	**¥ 508**	**¥ 82,024**
Assets	**¥498,088**	**¥304,004**	**¥129,067**	**¥931,159**

	For the year ended 31st March, 1997			
	Within Japan	Outside Japan	Elimination or common assets (Note 1)	Consolidated total
	(thousands of U.S. dollars)			
Sales				
Sales to outside customers	**$3,258,944**	**$1,776,580**	**$ —**	**$5,035,524**
Inter-segment sales	**524,782**	**139,202**	**(663,984)**	**—**
Total	**3,783,726**	**1,915,782**	**(663,984)**	**5,035,524**
Operating costs and expenses	**3,376,710**	**1,665,411**	**(668,081)**	**4,374,040**
Operating income	**$ 407,016**	**$ 250,371**	**$ 4,097**	**$ 661,484**
Assets	**$4,016,839**	**$2,451,645**	**$1,040,863**	**$7,509,347**

Notes:—

(1) The amounts of the common assets included in the column "Elimination or common assets" for the years ended 31st March, 1996 and 1997 were ¥113,904 million and ¥199,078 million ($1,605,468 thousand), respectively, which mainly consist of surplus working funds (cash, deposits and marketable securities) and long-term investment funds (investments in securities) of the Company.

(2) If the new method of translating foreign currency financial statements, which became effective from the year ended 31st March, 1996, had been applied in the year ended 31st March, 1995, operating income of "Outside Japan" and consolidated total operating income would have increased by ¥3,640 million as compared with the amounts which have been reported.

(3) Overseas sales information

Overseas sales of the Companies (export sales of the Company and domestic subsidiaries plus sales of overseas consolidated subsidiaries) for the years ended 31st March, 1995, 1996 and 1997 are summarised as follows:

	Year ended 31st March,			
	1995	1996	**1997**	**1997**
	(millions of yen)			(thousands of U.S. dollars)
Overseas sales	¥205,930	¥246,829	**¥289,451**	**$2,334,282**
Consolidated sales	¥522,917	¥575,176	**¥624,405**	**$5,035,524**
Percentage of overseas sales over consolidated sales	39.4%	42.9%	**46.4%**	**46.4%**

17. Subsequent events

(1) Appropriation of retained earnings

Subsequent to 31st March, 1997, the Company's Board of Directors, with the subsequent approval of stockholders on 27th June, 1997, declared a cash dividend of ¥1,311 million ($10,573 thousand) equal to ¥3.75 ($0.030) per share, applicable to earnings of the year ended 31st March, 1996 and payable to stockholders on the stockholders' register on 31st March, l997.

(2) Stock options

At the stockholders meeting held in June 1997, approval was given for the acquisition of treasury stock for the purpose of granting stock options. The amendment to the Articles of Incorporation provides for the acquisition of no more than 722 thousand shares of the Company's par-value common stock at a cost that shall not exceed ¥2,500 million (US$20 million).

Consolidated Subsidiaries

Name of Consolidated Subsidiary	Equity Ownership Percentage	Closing Date
Shintech, Inc.[1]	100.0	31st December
Shin-Etsu Handotai Co., Ltd.	100.0	31st March
Shin-Etsu Handotai America, Inc.[1]	100.0	31st December
Shin-Etsu Polymer Co., Ltd.	52.5	31st March
Shin-Etsu Astech Co., Ltd.	89.4	31st March
S.E.H. Malaysia Sdn. Bhd.[1][2]	100.0	31st December
Naoetsu Electronics Co., Ltd.	90.0	28th February
Shin-Etsu Handotai Europe, Ltd.[1]	100.0	31st December
Shin-Etsu Engineering Co., Ltd.	100.0	31st March
Shin-Etsu Vinyl Acetate Co., Ltd.	51.0	31st March
Nissin Chemical Industry Co., Ltd.	100.0	28th February
Silicon Metal Company of Australia Ltd.[1]	100.0	31st December
Shin-Etsu Silicones of America, Inc.[1]	100.0	31st December
Shin-Etsu (Malaysia) Sdn. Bhd.[1]	100.0	31st December
Shin-Etsu International Europe B.V.[1]	100.0	31st December
Shin-Etsu Electronics Materials Singapore Pte. Ltd.[1]	100.0	31st December
Shin-Etsu Kasei Co., Ltd.	100.0	31st March
Shin-Etsu Metallurgical Co., Ltd.	100.0	31st March
Naoetsu Sangyo Limited	100.0	31st March
Shin-yo Home Service Company	100.0	31st March
Shin-Etsu Sealant Co., Ltd.	100.0	31st March
Shin-Etsu Singapore Pte. Ltd.[1]	100.0	31st December
Shin-Etsu Delivery Co., Ltd.	100.0	31st March
Shin-Etsu Magnet Co., Ltd.	100.0	31st March
Shin-Etsu Silicone Korea Co., Ltd.[1]	90.0	31st December
Naoetsu Precision Co., Ltd.	100.0	28th February
Shin-Etsu Silicone Taiwan Co., Ltd.[1]	93.3	31st December
Shinkoh Mold Co., Ltd.	100.0	31st March
Skyward Information System Co., Ltd.	100.0	31st March
Human Create Co., Ltd.	100.0	31st March
Shinano Electric Refining Co., Ltd.	68.7	31st March
Shin-Etsu Technology Service Co., Ltd.	76.9	28th February
S.E.H. (Shah Alam) Sdn. Bhd.[1]	100.0	31st December
Shin-Etsu Polymer (Malaysia) Sdn. Bhd.[1]	100.0	31st December
Shincor Silicones, Inc.[1]	100.0	31st December
Shin-Etsu Polymer America, Inc.[1]	100.0	31st January
Shin-Etsu Polymer Europe B.V.[1]	100.0	31st December
Shin-Etsu Unit Co., Ltd.	100.0	31st December
Polymer East Japan Co., Ltd.	100.0	31st March
Shinano Polymer Co., Ltd.	100.0	28th February
Nihon Resin Co., Ltd.	100.0	31st December
Polymer Chemicals Co., Ltd.	100.0	31st March
Sanshin Electronics Co., Ltd.	100.0	31st March
Saitama Shinkoh Mold Co., Ltd.	100.0	31st March
Niigata Polymer Company Limited	100.0	31st December
San-Ace Co., Ltd.	100.0	28th February
Urawa Polymer Co., Ltd.	100.0	31st January
S.E.H. Techno Service Sdn. Bhd.[1]	100.0	31st December
Simcoa Operations Pty. Ltd.[1]	100.0	31st December
S.E.H. Urus Khidmat Sdn. Bhd.[1]	100.0	31st December
K-Bin, Inc.[1]	100.0	31st December
Microsilica Pty. Ltd.[1]	100.0	31st December
Simcoa International Pty. Ltd.[1]	100.0	31st December
Suzhou Shin-Etsu Polymer Co., Ltd.[1]	80.0	31st December

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

To the Board of Directors
Shin-Etsu Chemical Co., Ltd.

We have audited the consolidated balance sheets of Shin-Etsu Chemical Co., Ltd. and its consolidated subsidiaries as of 31st March, 1996 and 1997, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended 31st March, 1997, 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 audit.

We conducted our audit in accordance with the 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Shin-Etsu Chemical Co., Ltd. and its consolidated subsidiaries as of 31st March, 1996 and 1997, and the consolidated results of their operations and their cash flows for each of the three years in the period ended 31st March, 1997, in conformity with generally accepted accounting principles in Japan applied on a consistent basis.

Chuo Audit Corporation

Tokyo, Japan
27th June, 1997

Chuo Audit Corporation

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Shin-Etsu Handotai Europe Ltd.
German Office
Fabrikstr. 8 D-85354, Freising, Germany
Phone: 49-8161-50611
Fax: 49-8161-50682

Shin-Etsu Handotai Europe Ltd.
French Office
30, Ave. de l'Amiral Lemonnier
78160 Marly Le Roi, France
Phone: 33-1-3958-2222
Fax: 33-1-3958-8177

Shin-Etsu Polymer Europe B.V.
Groot Bollerweg 10
5928 NS, Venlo, The Netherlands
Phone: 77-323-6000
Fax: 77-323-6001

C.I.R.E.S. (Companhia Industrial de Resinas Sinteticas, S.A.)
Fua Castilho 165 4˚-E (Mobil Building)
Lisbon, Portugal
Phone: 1-387-9031
Fax: 1-387-9034

OCEANIA

Biocontrol Ltd.
24 Palmerin Street, Warwick
Queensland, Australia
Phone: (076) 61-4488
Fax: (076) 61-7211

Simcoa Operations Pty. Ltd.
Lot 22 Marriott Road
Wellesley, WA 6233, Australia
Phone: 08-97-806666
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MAJOR DOMESTIC SUBSIDIARIES AND AFFILIATES

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3-5, Nihonbashi Honcho 4-chome
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Phone: (03) 3279-1712

Shin-Etsu Handotai Co., Ltd.
4-2, Marunouchi 1-chome
Chiyoda-ku, Tokyo
Phone: (03) 3214-1831

Shin-Etsu Vinyl Acetate Co., Ltd.
11-1, Chikkoshinmachi 3-chome
Sakai-shi, Osaka
Phone: (0722) 45-1131

Shin-Etsu Astech Co., Ltd.
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Chiyoda-ku, Tokyo
Phone: (03) 3293-4611

Shin-Etsu Kasei Co., Ltd.
5-13, Uchikanda 1-chome
Chiyoda-ku, Tokyo
Phone: (03) 3293-3501

Shin-Etsu Engineering Co., Ltd.
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Nissin Chemical Industry Co., Ltd.
17-33, Kitago 2-chome
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Naoetsu Electronics Co., Ltd.
596-2, Jonokoshishinden, Kubiki-mura
Nakakubiki-gun, Niigata
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Shin-Etsu Metallurgical Co., Ltd.
246-1, Haraichi, Annaka-shi, Gunma
Phone: (0273) 82-1081

Shinano Electric Refining Co., Ltd.
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Chiyoda-ku, Tokyo
Phone: (03) 3296-1501

Kashima Vinyl Chloride Monomer Co., Ltd.
2, Towada, Kamisu-machi
Kashima-gun, Ibaraki
Phone: (0299) 96-6372

Nagano Electronics Industrial Co., Ltd.
1393, Yashiro, Koshoku-shi, Nagano
Phone: (026) 261-3100

Shin-Etsu Quartz Products Co., Ltd.
22-2, Nishi-Shinjuku 1-chome
Shinjuku-ku, Tokyo
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Shin-Etsu Film Co., Ltd.
5-13, Uchikanda 1-chome
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Corporate Data

Shin-Etsu Chemical Co., Ltd.

Date of Establishment
16th September, 1926

Capital
¥44,256 million (US$357 million)
(as of 31st March, 1997)

Number of Employees
18,896 (including 54 consolidated subsidiaries)

Number of Shares Issued
349,569,337 shares
(as of 31st March, 1997)

Stock Listings
Tokyo, Osaka, Nagoya, Niigata