

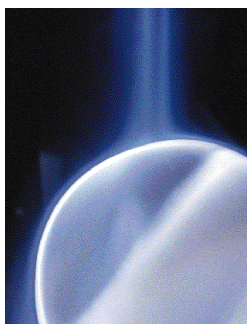
The logo for Shin-Etsu, featuring the word "Shin-Etsu" in a stylized, blue, italicized font with a white outline. The background of the entire page is a dark blue gradient with a large, bright, circular light source on the right side, creating a lens flare effect.

Shin-Etsu Chemical Co., Ltd.
Annual Report 1998

Expanding Core Strengths

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Part of the manufacturing process of synthetic quartz, a new growth product for Shin-Etsu.

The Shin-Etsu Chemical Identity

Scale

Consolidated net sales rose 11.0 percent to ¥693.3 billion for the year ended March 31, 1998. Sales have grown at an average annual rate of 8.5 percent during the past five years. Net income advanced 3.5 percent to ¥42.0 billion. Shin-Etsu was ranked number 401 in the Business Week 1997 Global 1,000.

Operations

Headquartered in Tokyo, Japan, Shin-Etsu has production facilities in Japan, the United States, the United Kingdom, the Netherlands, Malaysia, and many other countries. There are approximately 19,000 employees worldwide.

Core Products

Shin-Etsu is distinguished by its policy of building leading positions in key global markets where demand is expanding steadily. The world's largest producer of polyvinyl chloride (PVC) and semiconductor silicon, Shin-Etsu also has a major presence in markets for silicones, synthetic quartz and rare earth magnets.

New Markets

Always vigilant for opportunities to leverage core skills, Shin-Etsu has a number of new products with long-term potential. Prowess in silicon chemistry points to more growth in semiconductor silicon, silicones and synthetic quartz. Experience serving semiconductor device makers enables Shin-Etsu to establish positions in markets for such products as photoresists and pellicles.

A Message From the President



Record Sales and Earnings

Sales and earnings rose to all-time highs for the third consecutive year in the most recent fiscal term. Net sales increased 11.0 percent to ¥693,275 million, while net income was up 3.5 percent to ¥42,027 million. Higher demand for key Shin-Etsu products stimulated growth, much of which was sparked by strength in the electronics industry during the first half of the fiscal year. All of our core product sectors benefited from higher demand. Shin-Etsu retained the top world market shares in both PVC and semiconductor silicon. We rank first in Japan in silicones as well as in synthetic quartz, which is now positioned as our fourth core product. Other major products also performed well, including rare earth magnets, epoxy molding compounds and cellulose derivatives.

The Need to Sustain Steady Growth and Maximize Earnings

I believe that the most important goal for the company is to aim for stable growth while generating the highest possible level of earnings over the long term for our stockholders. Shin-

Financial Highlights

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
Fiscal year ended 31st March, 1998 (1st April, 1997 to 31st March, 1998)

	31st March,			31st March,
	1996	1997	1998	1998
	(millions of yen)			(thousands of U.S. dollars)
For the Year:				
Net Sales	¥575,176	¥624,405	¥693,275	\$5,252,083
Operating Income	73,427	82,024	90,860	688,333
Net Income	37,825	40,614	42,027	318,386
Capital Expenditures	66,791	92,844	136,384	1,033,212
Net Income per Share (in yen, dollars)	¥ 116.51	¥ 118.24	¥ 110.73	\$ 0.839
Cash Dividends per Share (in yen, dollars)	7.50	7.50	8.50	0.064
Return on Equity (percent)	12.5	11.7	9.6	
At Year-End:				
Total Assets	¥708,637	¥931,159	¥1,083,780	\$8,210,455
Working Capital	118,936	195,729	221,869	1,680,826
Stockholders' Equity	320,987	374,726	497,312	3,767,515

Note: The U.S. dollar amounts represent conversions of Japanese yen, for convenience only, at the rate of ¥132=\$1.

Etsu has an integrated production system that includes everything from raw materials to finished products. Our diverse product line is not overly dependent on demand from a single client industry, while our global production network serves a broad range of customers. And our top-quality products enjoy high market shares, backed by some of the world's most cost-competitive manufacturing bases. This infrastructure ensures many more years of stable growth and solid earnings. Achieving this objective demands the efficient use of our resources, everything from people to capital, as well as the confidence to make bold decisions regarding the investments that will support Shin-Etsu's growth for many years to come.

Investing From a Long-Term Perspective

Investments fuel growth. I am constantly envisioning the kind of company Shin-Etsu should be five or ten years from now. And what we must do to get there. To reach that point, we must invest aggressively to expand our business in targeted product sectors. This is why Shin-Etsu has budgeted about ¥500 billion for capital expenditures over the next five years to increase output and boost efficiency in respect of core products like polyvinyl chloride (PVC), semiconductor silicon and silicones. Another very important goal is fostering new core products, such as synthetic quartz and rare earth magnets. An appropriate share of resources will be channeled into these new core products. Typical of this drive was our establishment of Silica Products Inc. in April 1997. This company started producing synthetic quartz in March 1998 at its plant, which stands next to an existing Shin-Etsu PVC facility in Freeport, Texas. The primary applications for this material are stepper lenses and photomask substrates for integrated circuits (ICs) and liquid crystal displays (LCDs). With synthetic quartz plants in

Japan and the United States, we are firmly positioned to be a reliable supplier for our customers and to maintain our No. 1 market share.

We do not overlook or underestimate the value of niche markets in our quest for global expansion. Research and development programs include new products aimed squarely at highly focused opportunities. Our basic policy is to avoid concentrating investments in a single field, but rather to seek a balance in order to cover as many markets as reasonably possible. I am well aware of the immense value of high-potential R&D and marketing capabilities, assets that do not appear on the balance sheet. Unless we pay constant attention to these kinds of assets, our prospects for growth become severely limited.

Outlook

Financial instability in Asia was a major cause of the steady deterioration in market conditions during the second half of the past fiscal year. The Japanese economy and the Shin-Etsu Group will undoubtedly feel the effects of these events. At this challenging time, we will be concentrating on strengthening existing businesses while fostering new sources of earnings. The top priority is to sustain our steady growth and maximize earnings, as we expand our presence in Japan and markets outside of Asia. The key to achieving this goal is to tighten our focus on specialty products. This is where we can best differentiate ourselves by carving out high market shares and establishing ourselves as a truly global enterprise.



Chihiro Kanagawa
President & CEO
June 1998

*Dedicated to Growth, Shin-Etsu
Invests to Build More Core Strengths*

**Synthetic Quartz—The Newest Cornerstone
of Earnings**

This substrate derived from synthetic quartz is used as a photomask for semiconductors.

Shin-Etsu has targeted synthetic quartz as its next core business, behind PVC, semiconductor silicon and silicones. Strategic investments are transforming this goal into a reality. Silica Products Inc., a wholly owned subsidiary, was formed in April 1997 to build a synthetic quartz plant in the United States. Located in Freeport, Texas, adjacent to Shintech, Inc.'s PVC plant, the new facility is already shipping synthetic quartz to stepper lens manufacturers. The plant can also make synthetic quartz for photomask substrates.

In Japan, Shin-Etsu produces synthetic quartz at two locations: the Gunma complex makes preform for optical fibers; at the Naoetsu plant, synthetic quartz for stepper lenses and photomask substrates for LCDs and ICs are produced. A second plant, completed in March 1998, was added to the Naoetsu facility to supply synthetic quartz for photomask substrates. These plants serve two purposes. First is meeting rising demand. Second is to allocate production among different locations, thereby reducing risks and ensuring a reliable supply for customers.

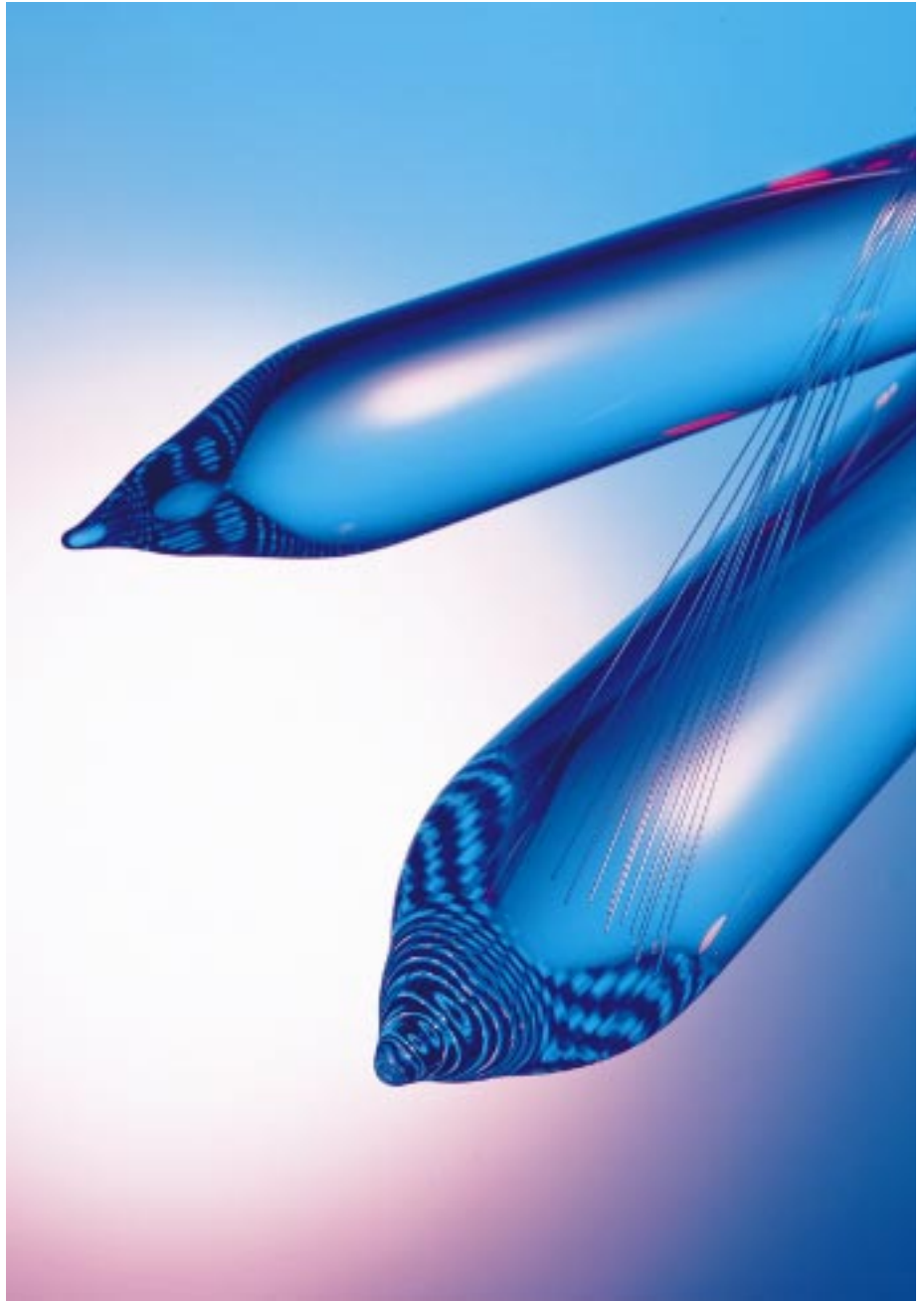
Shin-Etsu handles the main stages of synthetic quartz production, from raw materials onward. One more competitive advantage is the company's expertise in silicon chemistry. Integration and silicon expertise together form the groundwork for skill in producing large lots of synthetic quartz while closely controlling its structure. This makes synthetic quartz a field where Shin-Etsu's pride as a chemical company shines brightly.



Preform for optical fiber is one of the main applications of synthetic quartz. Shin-Etsu is by far the largest supplier of preform to the global optical fiber industry. Concentrating on this product rather than the entire fiber process gives Shin-Etsu a critical competitive edge. Large capacity permits Shin-Etsu to capitalize on merits of scale.

More valuable still is knowledge about chemical synthesis that makes Shin-Etsu the supplier of choice for the top grades of preform. By tapping this prowess, Shin-Etsu has forged relationships with most of the world's leading optical fiber makers, some of whom do not produce preform at all. The outlook is excellent. As the information age progresses, optical fiber networks are now reaching the home.

In the market for IC photomask substrates, Shin-Etsu is the undisputed world leader. Demands for better technology continue to rise. Finer semiconductor lithography mandates the use of excimer lasers. Only the most transparent and durable substrates can withstand the laser's powerful beams. Conventional glass is no longer up to the task. Silane is now essential as a raw material. While other companies purchase silane, Shin-Etsu has its own supply of this material. Experienced in many semiconductor-related products, Shin-Etsu also boasts powerful sales channels to many prominent manufacturers.



Synthetic quartz has been identified as Shin-Etsu's next major growth field. The material is used as preform for optical fiber.

Emerging Applications for Synthetic Quartz

Rare Earth Magnets: On a Growth Curve

Shin-Etsu is one of the world's largest makers of rare earth magnets, used primarily in computer hard disk drives.

Among the world's rare earth magnet suppliers, Shin-Etsu stands alone with its fully integrated production system. Operations begin with the separation and refining of rare earth elements from ore. This is followed by the formation of magnets, surface processing and final assembly. All steps take place at a Shin-Etsu facility. Furthermore, Shin-Etsu is the world's sole producer of all three major categories of rare earth magnets: neodymium, samarium and cerium.

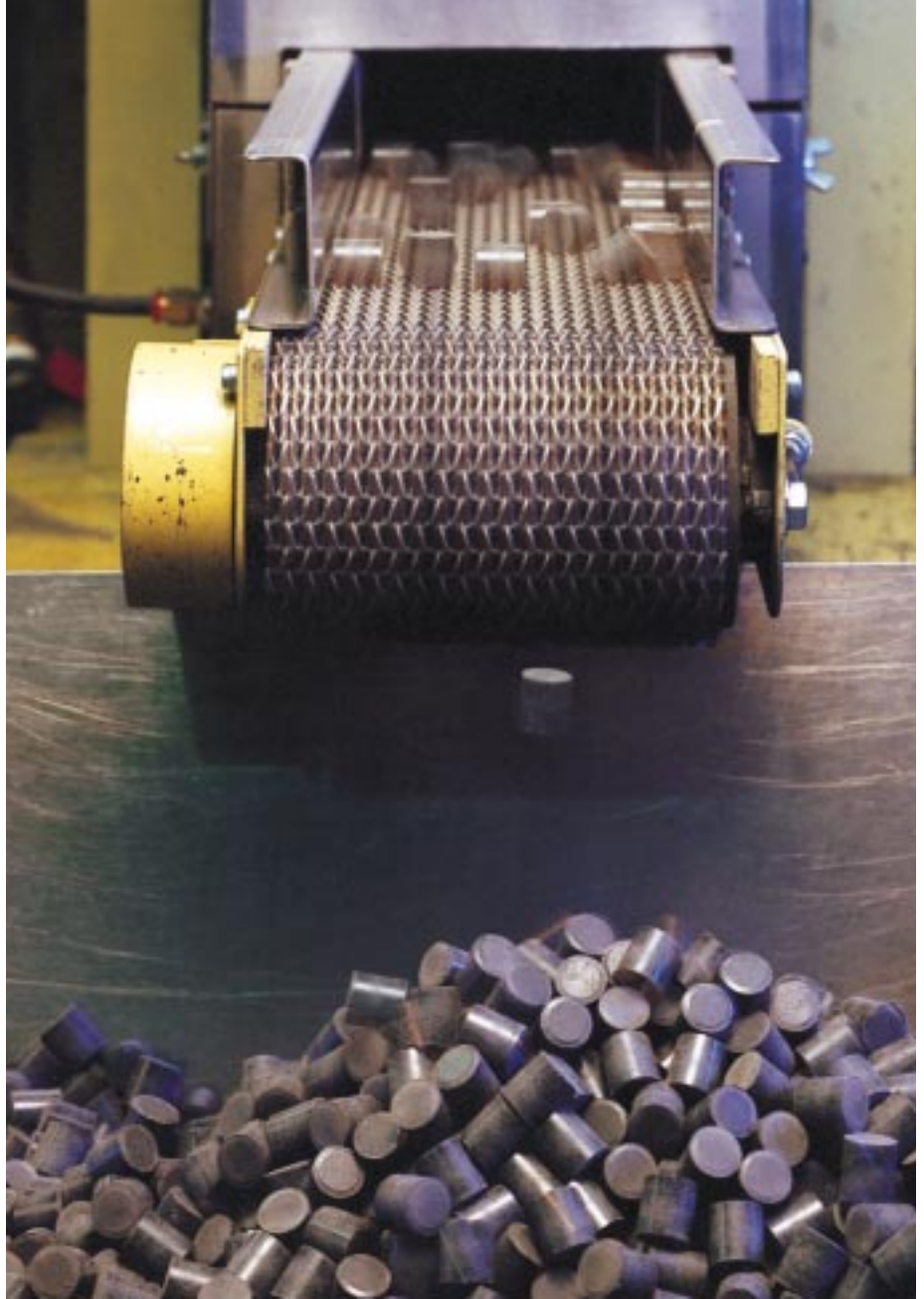
These unique strengths add up to a formidable position in the rare earth magnet marketplace. In particular, Shin-Etsu ranks first in supplying these magnets for hard disk drives, the largest single market. Rare earth magnets are also found in small motors for office equipment, automated production systems, automotive sensors and many other applications. Recently, makers of air conditioners and other home appliances have been turning to rare earth magnets to cut power consumption. The conclusion is inescapable: demand for rare earth magnets will keep climbing.



Leveraging its knowledge of silicon chemistry, Shin-Etsu ranks among the world leaders in the field of epoxy molding compounds (EMC), which encapsulate and protect LSIs and other semiconductor devices. Excluding epoxy resin, which the company purchases, Shin-Etsu develops and produces all key ingredients: silica, silicones and the silane coupling agent. Today's LSI packages are becoming thinner and smaller.

Withstanding heat requires certain physical characteristics of the encapsulation material and the chip inside. In particular, the chip must be protected from heat-induced stress during soldering. Naturally, the encapsulation material too must withstand this heat. To fulfill this role, the material needs to conduct and dissipate heat from the chip efficiently. By meeting these exacting demands, Shin-Etsu's EMCs are helping raise the speed and density of semiconductor devices.

With the advent of the 64M DRAM, semiconductor makers are demanding EMC grades that can handle more stress. Shin-Etsu's solution is a proprietary technique for adding silica to the EMC, thereby accurately controlling the heat expansion rate and realizing low-stress properties. One more advance is an EMC in which spherical silica accounts for more than 80 percent of the ingredients. Viscosity is reduced, further enhancing performance and raising production efficiency of this material as well.



Epoxy molding compound cylinders roll off the production line. They are used to encapsulate and protect LSIs and other semiconductor devices.

More Advances in Semiconductor Encapsulation Technology

Commercial Production of Photoresists for Excimer Lasers

Finer circuit lines are driving advances in semiconductor devices. Etching these lines demands higher resolution in photoresists. To meet this need, Shin-Etsu developed a KrF photoresist that is suitable for the powerful beams of excimer lasers. Full-scale production began in December 1997 at the Naoetsu plant. Operations extend from the base polymer onward. Currently, this revolutionary photoresist is used by major manufacturers worldwide in the production of 64M DRAMs, which have circuit lines of under 0.25 microns.

The same technology holds the promise of creating photoresists for 0.20- and 0.18-micron rules as well. Furthermore, sensitivity is high enough for compatibility with next-generation, scan-type exposure machines. The long-term outlook is excellent. Shin-Etsu's advanced photoresists have the properties that will be in demand as 256M DRAM and 1G DRAM processes require even smaller circuit width.

Photoresist skills extend to giant magneto-resistive (GMR) heads, too. Shin-Etsu has devised the world's first high-resolution, thick-film photoresist for these heads, which are used to increase the capacity in computer hard disk drives. Sales have already begun.

Orders are likely to rise steeply along with demand for GMR heads. The Shin-Etsu resist is designed for i-line processes. This yields sub-micron-order resolution for thick films, which measure about 10 microns, or 10 times more than a semiconductor photoresist. Shin-Etsu is supplying this product to GMR head makers in Japan and overseas. All indications point to robust sales growth.

Pellicles Crafted From Proprietary Technology in Semiconductor Materials

Pellicles are one more way in which Shin-Etsu serves the semiconductor industry. With outstanding transparency and durability, these pellicles can be used with excimer lasers. Mass production has already started.

Pellicles basically consist of a thin film encased in an aluminum frame measuring about 5mm in height. Their primary function is protecting photomasks from dust and other impurities. Fabricating pellicles calls for extensive knowledge of electronic materials and processes.

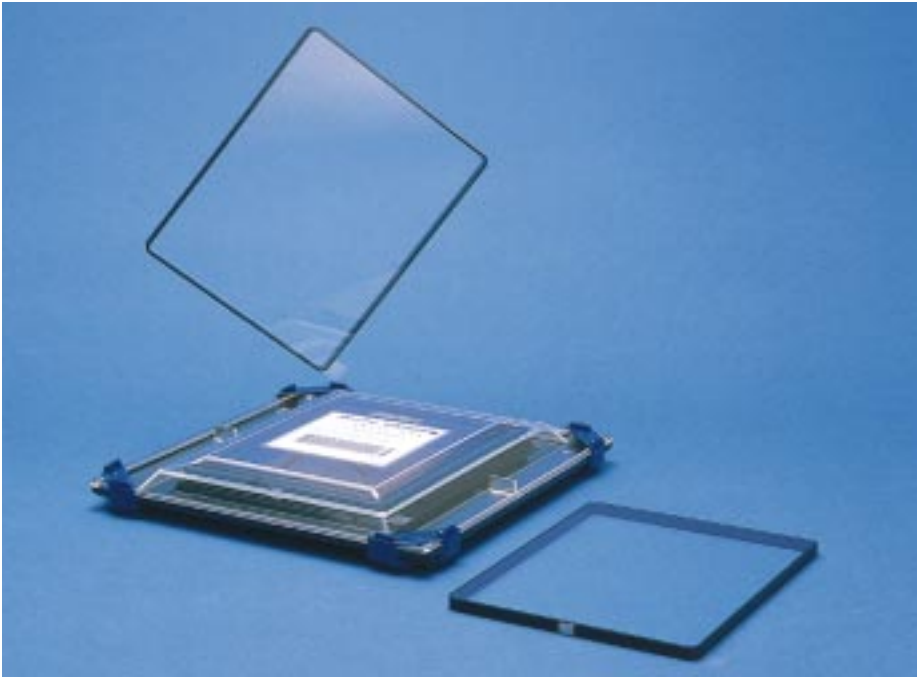
Shin-Etsu's new pellicle incorporates a film with a fluorine polymer and an exclusive fluorine adhesive. This greatly improves the link between the film and frame.

Guarding against microscopic particles is critical as the complexity of semiconductor devices climbs. Here, the Shin-Etsu pellicle is clearly superior to those of competitors.

To affix the pellicle to a photomask, Shin-Etsu developed a new silicone-based adhesive that is highly resistant to light. Pellicles draw on experience in cleanliness and inspections gained from fabricating semiconductor materials. Shin-Etsu's silicone adhesive, pressure adhesion and formation technology were also instrumental in the development of this revolutionary adhesive. Even the storage container incorporates exclusive Shin-Etsu features.



Photoresist in the photolithography process. Photolithography for semiconductors requires high resolution of photoresist chemicals.



Pellicles—a thin film encased in an aluminum frame—protect photomasks from dust and other impurities.

Segment Profile

Products

Polyvinyl chloride, silicones, vinyl acetate monomer, polyvinyl alcohol, methanol, caustic soda, chloromethanes, cellulose derivatives, synthetic pheromones, lime nitrogen, fused phosphates, alloys, silicon metal, plastic products and others

Major Contributors

Manufacturing and sales:

Shin-Etsu Chemical Co., Ltd.

Shintech, Inc.

Simcoa Operations Pty. Ltd.

Shin-Etsu Polymer Co., Ltd.

Nissin Chemical Industry Co., Ltd.

Manufacturing:

Shin-Etsu Vinyl Acetate Co., Ltd.

Kashima Vinyl Chloride Monomer Co., Ltd.

and 49 other companies

Note: The above list includes non-consolidated subsidiaries and affiliated companies.



Pipes are one of the largest applications of PVC.

Steady Growth in Core PVC and Silicones Sectors

The Chemicals Business Segment encompasses a broad range of products. Polyvinyl chloride (PVC) and silicones account for a large share of segment sales. In fiscal 1998, segment sales advanced 9.7 percent to ¥340,051

million. While PVC sales were higher, growth was limited by softening demand in Japan in the second half of the year. PVC demand rose steadily in the United States during the year, posting an increase of 5.6 percent. Expansion of demand in this region, the world's largest PVC market, is expected to continue. Silicones sales also increased. Performance was strong in Japan and overseas during the year's first half. In the following months, domestic demand slumped and the Asian currency crisis, among other factors, exerted downward pressure on prices.

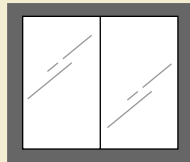
Organic and Inorganic Chemicals

Polyvinyl Chloride(PVC)

0.4 kg

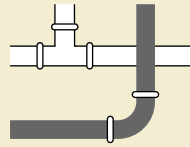
Just what is PVC?

Salt provides the ingredients for about 60 percent of PVC, a widely used type of plastic. The remainder comes from petroleum. That means only 0.4 kilograms of petroleum is needed for each kilogram of PVC consumed. Compared with the many other synthetic resins made entirely from petroleum, PVC conserves petroleum and energy. As such, it is firmly positioned as an indispensable element of our everyday lives.



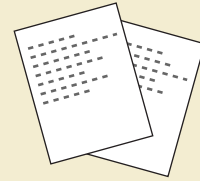
PVC is kind to trees.

The world needs less wood and oil thanks to PVC. Building materials are the single largest application of PVC: interior and siding products, windows and floors. Without PVC, many of these items would need to use wood instead. An excellent insulator, PVC profile and other materials cut energy consumption for heating and cooling.



A material for the ages.

Compared with most other plastics, PVC has an extremely long life. PVC excels with regard to durability, the ability to withstand the elements, and resistance to fire. This makes PVC an economical choice for water and sewer pipes, greenhouses, electric wire sheathing and many other punishing applications.



The Vinyl Environmental Council is born.

In January 1998, Shin-Etsu and 16 other Japanese manufacturers of PVC and vinylchloride monomer formed the Vinyl Environmental Council. Shin-Etsu President Chihiro Kanagawa was named chairman. The following May, this council merged with the Japan PVC Association to form the Vinyl Environmental Council, also led by Mr. Kanagawa. The new council is carrying on the original mission of promoting an accurate understanding of PVC among the public, as well as supporting research in PVC recycling and other subjects related to the PVC business.



Silicone sales have risen steadily as new uses are found for this versatile material.

silicone industry. Worldwide, Shin-Etsu has captured a large share of the Asian market and ranks third among silicone producers. Essential to adding desirable characteristics and functions to products, silicones have many applications. Many types of shampoo and rinse incorporate silicones. In fact, silicones play a central role in all kinds of toiletries and cosmetics.

A highly versatile substance, silicones can take the form of a fluid, resin or rubber. In any form, silicones offer excellent resistance to weather, heat and cold, as well as desirable electrical and interfacial properties. Cosmetics, automobiles, construction, data and communications are just a few of the countless industries where these qualities are needed. This breadth means that silicone demand is not susceptible to cycles in any one client industry. Shin-Etsu takes full advantage of this diversity by catering to specific customer requirements. This is evidenced by the more than 4,000 products currently incorporating Shin-Etsu silicones.

Expanding the World's No. 1 PVC Market Share

Shin-Etsu manufactures PVC in the United States, Japan and Portugal. The U.S. facility, Shintech, Inc., located in Texas, is the world's largest single PVC plant with an annual output of 1.27 million tons. With demand on the increase, construction of a second PVC plant in the United States is now in the planning stage. In May 1997, approval was granted by the State of Louisiana, where the new facility is to be located. However, the U.S. Environmental Protection Agency subsequently asked the state government to reexamine the proposal. The U.S. PVC market is roughly three times larger than Japan's. Higher output in the United States will bolster the company's ranking as the world's largest PVC supplier.

PVC is a general-purpose material used to fabricate a wide variety of products. Unlike other general-purpose materials, PVC quality differs considerably depending on the production processes and polymerization technology of individual manufacturers. Shin-Etsu's number-one position in this market testifies to the company's ability to maintain this level of consistently high quality, as well as providing a reliable supply capability. The rapid response of sales and research professionals working together ensures that customer expectations are fully met.

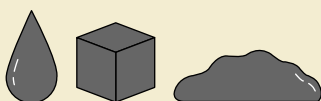
More Applications Spur Demand for Silicones

Shin-Etsu began selling silicones in 1953. Sales have climbed ever since, keeping Shin-Etsu at the top of Japan's



The world's largest single PVC facility is the Freeport, Texas plant of Shintech, Inc.

Silicones



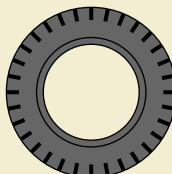
What's inside silicones?

Silicones are made by creating a repetitive molecular structure made up of siloxane (Si-O-Si) with organic radicals. This compound can be produced in many forms: fluid, resin and rubber.

4000

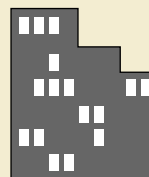
Thousands of applications

Shin-Etsu's silicones are used to produce more than 4,000 different products. Powerful siloxane bonds make silicones resistant to heat and the elements. Silicones also possess good electrical properties. Its molecular structure enables this material to be formulated to be water repellent, resist low temperatures, and have antifoaming properties. This makes silicones suitable for use under a variety of conditions.



Where silicone never tires

In tires, a special grade of silicone boosts performance. Durability rises. And better tire resilience greatly improves braking performance while cutting fuel consumption.



Going to the top

Look around. The buildings and other structures you see may incorporate Shin-Etsu's new *Sealant Master 300*, which has exactly the right adhesive properties needed for sealing materials. Market response has been strong. *Polymer Ace*, made by Shin-Etsu Polymer Co., Ltd., is a revolutionary tape-like sealing material. No follow-up smoothing or finishing is needed, and stains can be removed with ease.



Use of synthetic pheromones is expanding, since they are not harmful to the environment, unlike conventional insecticides.

concessions, as well as customers throughout North America.

Other Chemicals

Collectively, other chemical products continue to post stable sales and earnings. Shin-Etsu has more than 30 years of experience making methylcellulose derivatives, versatile compounds used in high-performance building materials, improvement materials for unsteady ground, automotive exhaust cleansers, pharmaceutical tablets and granules, and soaps, among others. Synthetic pheromones are a key building block of insecticides that prevent harmful insects from reproducing. This substance is attracting much attention as an environmentally compatible replacement for conventional insecticides. Backed by other promising applications as well, Shin-Etsu has captured a sizeable share of the world market. Synthetic pheromones are likely to keep recording double-digit sales gains.

Future advances in products of all types spell even more potential for Shin-Etsu's silicones business. In fact, global sales continue to rise at a near double-digit pace. To meet this demand, Shin-Etsu in 1998 embarked on a plan that will raise output capacity in Japan.

Rubber Contacts Link Shin-Etsu to Growing Markets

The Shin-Etsu Polymer Group manufactures silicone rubber contacts. As electronics find their way into more products, rubber contacts are needed in everything from automobiles and home appliances to cellular phones and computers. With market conditions vibrant, Shin-Etsu Polymer (Malaysia)

Sdn. Bhd. completed expansion work on its plant in November 1997 that raised output capacity. The increased capacity is in response to demand from home appliance and communications equipment makers that have relocated to Asia to produce high-end products. The same month, Shin-Etsu Polymer Mexico, S.A. de C.V. commenced rubber contact operations at a new plant in Reynosa, Mexico. The plant took over the manufacturing facilities of Shin-Etsu Polymer America Inc., which now concentrates on rubber contact sales. Shin-Etsu can now better serve the growing number of rubber contact clients in Mexico following the NAFTA agreement, which affords special tax



Silicone rubber contacts are used in a vast array of products. Shin-Etsu Polymer's overseas plants are increasing production of these materials.

Segment Profile

Products

Semiconductor silicon; organic materials for the electronics industry; rare earth magnets for the electronics industry

Major Contributors

Manufacturing and sales:

Shin-Etsu Chemical Co., Ltd.
Shin-Etsu Handotai Co., Ltd.
Shin-Etsu Handotai America, Inc.

Processing and sales:

S.E.H. Malaysia Sdn. Bhd.
Shin-Etsu Handotai Europe, Ltd.

Processing:

Naoetsu Electronics Co., Ltd.

and 24 other companies

Note: The above list includes non-consolidated subsidiaries and affiliated companies.

Through the Shin-Etsu Handotai Group, Shin-Etsu is the world's largest manufacturer of semiconductor silicon. Recently, shipments of prototype 300mm wafers were initiated.



Continuing to Grow as a Comprehensive Maker of Semiconductor Materials

The Electronics Materials Business Segment is involved in the production and sale of semiconductor silicon, organic materials and rare earth magnets for the electronics industry.

In fiscal 1998, the segment posted sales

of ¥247,708 million, a jump of 10.3 percent over the previous year. Through the Shin-Etsu Handotai (SEH) Group, Shin-Etsu is the world's largest manufacturer of semiconductor silicon. Epoxy molding compounds, which protect and encapsulate semiconductor devices, are another area of strength. With an array of related products as well, the company is unrivaled in the world as a comprehensive supplier of materials used to fabricate semiconductor devices. Expansion is continuing in the global semiconductor market. Output of 16M DRAM memory chips roughly doubled in 1997. Furthermore, the rise in output of 64M DRAM devices is expected to accelerate. Rare earth magnets, currently used mainly in hard disk drives, are in increasing demand for a wide range of applications including motors in home appliances.

Electronics Materials



A Shin-Etsu technician manufactures epitaxial wafers by growing a microscopic layer of silicon on the surface of a silicon wafer.

prototypes of next-generation 300mm wafers to makers of semiconductor production equipment.

A Bright Future for Blue LEDs

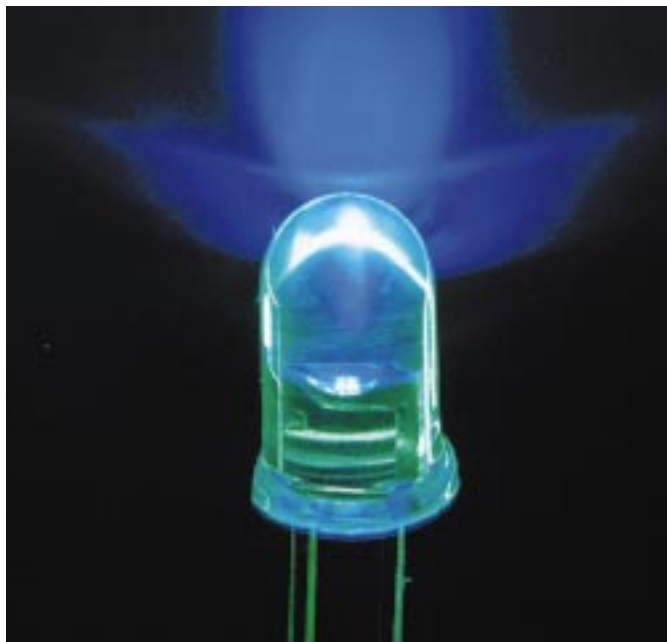
The SEH Group has an agreement with U.S.-based Cree Research, Inc., one of the world's leading SiC wafer companies, to gain access to that company's chip production and epitaxial wafer technology for blue LEDs. Construction has commenced in Japan on state-of-the-art production facilities. The SEH Group is already a major manufacturer of red and green LEDs. With the addition of blue light to the picture, the company is now capable of supplying LEDs for all three primary colors.

High-Quality 200mm Wafers Leading the Way

The focal point of the wafer market is shifting from 150mm to 200mm technology. Currently, almost all SEH plants are producing these larger wafers. Along with larger diameters, chip makers are asking for wafers that are completely free of imperfections down to the atomic level. This uncompromising quality is becoming essential as circuit density rises just as the size of semiconductor devices fall. Epitaxial wafers are one answer. These wafers are made by growing a microscopic layer of silicon on the surface of a silicon wafer. The productivity of wafer manufacture is greatly enhanced. At present, roughly 20 percent of the SEH Group's 200mm wafers are epitaxial. Plans call for members of the SEH

Group in Japan, the U.S. and Europe to raise production capacity of epitaxial wafers fivefold in the near future.

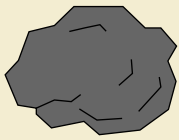
Furthermore, SEH has started shipping



A blue LED. Already a major maker of green and red LEDs, the Shin-Etsu Handotai Group will soon commence production of their blue counterpart, permitting supply of all three primary colors.

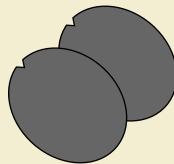
Semiconductor Silicon

400%



Silica— You may have some on your finger right now

Oxygen is the most abundant component of the earth's crust, accounting for 47 percent of all elements. Silicon is second at 27 percent. Most of this silicon exists in the form of silica, a mineral consisting of silicon and oxygen. Quartz and opals are two examples. Semiconductor silicon and other types of silicon are produced from high-purity silica.



Epitaxial wafers? Why bother?

Epitaxial wafers are made by growing an epitaxial layer of single crystals of silicon on the surface of a silicon wafer. Through this process, any microscopic imperfections present on the surface are covered over. While these wafers have started to be used in microprocessors, most are shipped to producers of 64M DRAMs.

On the horizon:

The 300mm wafer

Why make wafers larger? Simple. Doubling the diameter, for example, means that four times as many chips can be squeezed onto the surface. Production efficiency rises dramatically. Naturally, semiconductor makers are investing more in facilities to cash in on these benefits.



Silicon-on-insulator (SOI) wafers

SOI wafers are made by oxidizing the surface of a silicon wafer. An extremely thin film of pure silicon is then added. Outstanding electrical insulation is the main benefit. As such, they are ideal for products such as portable phones where power consumption must be minimized. High-speed microprocessors are another SOI application with immense potential.



Three rare earth magnets on a bed of rare earth powder. Such products have a wide array of applications in the electronics field.

in CRTs, especially computer monitors. When applied to the inside of a CRT's screen, rare earths enhance color-emitting properties. Other important applications for rare earths are as an additive for sintering fine ceramics and an additive to enhance the performance of multilayer ceramic chip capacitors. By utilizing sophisticated separation and refining techniques, Shin-Etsu is producing a variety of value-added rare earth products that offer consistently high quality. This focus on high-end grades sets Shin-Etsu apart from other rare earth suppliers, such as those in China, that sell primarily general-use grades.

A Major Breakthrough—Spherical Rare Earth Oxide Particles

Shin-Etsu has succeeded in mass producing spherical rare earth oxide particles. In March 1998, keying off this success, the company started full-scale marketing of these materials. Shin-Etsu discovered a way to produce spherical particles in the laboratory some time

Segment Profile

Products

Functional Materials:

Synthetic quartz products (photomask substrates, etc. and optical fiber preform); oxide single crystals; rare earth and rare earth magnets for non-electronics industries

Others:

Export of technology and plants, export and import of goods; construction and plant engineering, and information processing

Major Contributors

Manufacturing and Sales:

Shin-Etsu Chemical Co., Ltd.

Shin-Etsu Quartz Products Co., Ltd.

Engineering:

Shin-Etsu Engineering Co., Ltd.

Sales:

Shin-Etsu Astech Co., Ltd.

and 38 other companies

Note: The above list includes non-consolidated subsidiaries and affiliated companies.

In fiscal 1998, sales for the Functional Materials and Other Businesses segments combined rose 17.5 percent to ¥105,516 million.

Functional Materials

Demand and Applications Expand for Synthetic Quartz

Synthetic quartz continues to perform well. Fiber-optic preforms, photomask substrates, and lens materials for steppers all enjoyed robust demand. Rare earths also played their part in boosting sales, chiefly because of higher orders for use in cathode-ray tubes (CRT) and fluorescent lamps.

A Broad Range of Rare Earth Oxides

Shin-Etsu's high-quality rare earth oxides rank with the best in the world. Applications for these compounds include red, blue and green phosphors in fluorescent lamps and red phosphors

Functional Materials and Others

ago. However, the feat could not be replicated on the production floor. The need to find ways to facilitate the further downsizing of electronic components while boosting performance changed all that. Electronics makers sought ways to create uniform applications for rare earth oxides with microscopic precision. This was impossible with conventional powders; mechanical pulverization yields particle diameters of several microns. Shin-Etsu's spherical particles were the answer. The technology was first applied to yttrium oxide and other single rare earth oxides. At present, Shin-Etsu is also able to supply yttrium-europium compound oxide and other compound rare earth oxides in spherical form.



Shin-Etsu Engineering designs chemical plants and production equipment for the processes used to make electronic components.

Other Businesses

Activities in the Other Businesses Segment center on exports of plants and technologies, and construction-related business as well as engineering. All these businesses are capitalizing on proprietary technology in the company's core fields of chemicals and electronics. In the construction-related business, Shin-Etsu has many achievements in chemical plants. The company is designing and constructing cutting-edge process lines for electronics-related production facilities. Shin-Etsu's accomplishments in offering proprietary knowledge in both hardware and software are not limited to within the Shin-Etsu Group. In countries throughout Europe, in the U.S. and across Asia, the company has made a name for



Shin-Etsu Engineering takes pride in its high market share in LCD alignment systems in Japan and overseas.

itself. Polyvinyl chloride plants, silicon production plants, semiconductor and magnetic materials-related facilities are but a few of the diverse areas where the company is front and center. In the engineering business, optical technology, precision equipment and computers have been fused to enable the development and production of mechatronics products.

The outlook for 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 costs. Shin-Etsu Engineering addresses these needs by integrating various technologies to produce automated inspection and production equipment that meet sub-micron tolerances. This company takes pride in its high market share in LCD alignment systems in Japan and overseas. In this way, Shin-Etsu is contributing to progress in a number of other industries.

Recognition for Innovative Pheromone-Based Pest Prevention Technology

In November 1997, Shin-Etsu received the Japan Chemical Industry Association's Technology Award for an innovative technology that keeps agricultural pests at bay. Called "Pest Prevention Using Pheromones and Realizing Integrated Pest Management (IPM)," the technology is revolutionizing the protection of crops and agricultural products. Agricultural chemicals such as insecticides have until now played the lead role in the prevention of crop destruction by insects. Over the years, though, insects have developed resistance to the chemicals, which are also blamed for toxicity in the environment. This has been accompanied by a decline in the insects' natural enemies. The result has been the emergence of secondary pests. In an unprecedented breakthrough, Shin-Etsu formulated a



Conventional insecticides can harm the environment and upset ecological balances. Not so Shin-Etsu's "Pest Prevention Using Pheromones and Realizing Integrated Pest Management" technology.

synthetic pheromone that is both environmentally benign and economical. With the environmental impact reduced, farmers can grow produce secure in the knowledge that it will be free of even trace elements of agricultural chemicals.

All Japanese SEH Production Sites Now ISO 14001 Certified

As of the end of 1997, all four domestic production facilities of Shin-Etsu Handotai (SEH) received ISO 14001 certification, a new international standard for environmental management. With this achievement, SEH became first among the domestic silicon wafer makers to complete the certification process. The first facility certified was the Shirakawa Plant in January 1997 followed by the Takefu Plant in July and Isobe Plant in November the same year. Later, in December 1997, the Saigata Plant accomplished the same feat.

International interest in environmental management is on the increase.

The Environment

Furthermore, semiconductor makers are making a concerted effort to respond to demands for sophisticated environmental management techniques. SEH has worked hard at following through to fruition a policy initiated in December 1995 aimed at obtaining certification. The company set forth an ambitious target: to establish an Environmental Management System (EMS) at each global production site in line with ISO 14001 guidelines within three years. Only two years were needed to achieve this goal at domestic bases. Outside Japan, S.E.H. Malaysia Sdn. Bhd. completed in February 1998 the final evaluation leading to certification. Within calendar 1998, both Shin-Etsu Handotai America, Inc. and Shin-Etsu Handotai Europe, Ltd. will push forward with their plans for certification. Prospects are thus excellent for the

achievement of the group's three-year goal.

Assistance for Global Environmental Engineering Research

Shin-Etsu has become a sponsor of a chair at the Global Environmental Engineering Laboratory at the University of Tokyo. With its three-year sponsorship, which began in April 1997, the company is supporting the development of technologies to protect the world's environment. The laboratory is aiming to develop an array of technologies in response to global environmental problems. Expectations for technological advances that will play a major role in the 21st century are high. Some of the themes include attempting to develop a comprehensive system to tap the power of solar energy; studying methods to absorb carbon



CO₂ reduction targets were set at the 1997 COP3 meeting in Kyoto. Research in this direction has begun at the Global Environmental Engineering Laboratory of the University of Tokyo, where Shin-Etsu is a sponsor of a chair.

Photo: Kyodo News

dioxide over oceans and land; developing an effective recycling system for natural resources; and development of solar and fuel cells. Last year, all eyes were on the Third Conference of Parties of the United Nations Framework Convention on Climate Change (COP3), held in Kyoto, Japan, as it set targets for the reduction of gases blamed for global warming. In the same vein, the Laboratory is carrying out research for the purpose of reducing, by half, emissions of carbon dioxide gas. The results of its hard work will have a direct effect on the future of all life forms, including humans, and the planet itself. As such, the results will undoubtedly attract considerable attention.



Shin-Etsu Handotai's Shirakawa Plant, Shin-Etsu's first facility to have earned ISO 14001 certification, a new international standard for environmental management.

Board of Directors

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Executive Vice President

Shunichi Koyanagi

Senior Managing Directors

Tadashi Wada

Osamu Hiura

Toshiji Miyaji

Shunzo Mori



Chihiro Kanagawa

Managing Directors

Akira Kaneko

Katsuhiko Ayama

Kunio Itoh

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Isao Iwashita

Kiyoshi Imada



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Fumio Akiya



Tadashi Wada



Osamu Hiura



Toshiji Miyaji



Shunzo Mori

Full-Time Statutory Auditors

Masahiko Watase

Ryoji Endo

Statutory Auditors

Haruo Kobayashi

Masao Okazaki

(as of 26th June, 1998)

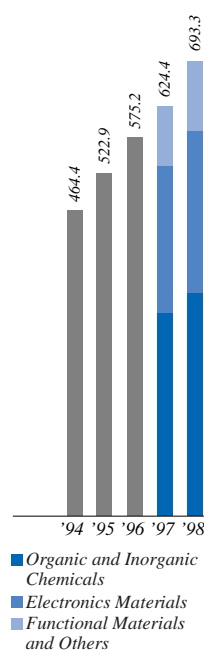
Management's Discussion and Analysis of Operations

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

	31st March,						31st March,
	1993	1994	1995	1996	1997	1998	1998
							(thousands of U.S. dollars)
(millions of yen)							
For the Year:							
Net sales	¥460,929	¥464,449	¥522,917	¥575,176	¥624,405	¥ 693,275	\$5,252,083
Operating income	34,815	32,450	51,914	73,427	82,024	90,860	688,333
Net income	15,989	17,547	26,862	37,825	40,614	42,027	318,386
Capital expenditures	41,292	34,421	67,689	66,791	92,844	136,384	1,033,212
Depreciation	37,675	40,351	42,986	45,647	52,191	62,144	470,787
Net income per share							
(in yen, dollars)	49.37	54.17	82.80	116.51	118.24	110.73	0.839
Cash dividends per share							
(in yen, dollars)	7.50	7.50	7.50	7.50	7.50	8.50	0.064
At year-end:							
Total assets	¥602,483	¥600,754	¥643,937	¥708,637	¥931,159	¥1,083,780	\$8,210,455
Working capital	78,907	94,362	110,901	118,936	195,729	221,869	1,680,826
Stockholders' equity	257,058	265,030	285,361	320,987	374,726	497,312	3,767,515
Short-term and long-term debt	186,800	173,304	172,280	171,865	271,860	269,395	2,040,872

Note: The U.S. dollar amounts represent conversions of Japanese yen, for convenience only, at the rate of ¥132=\$1.

Net Sales
(Billions of Yen)



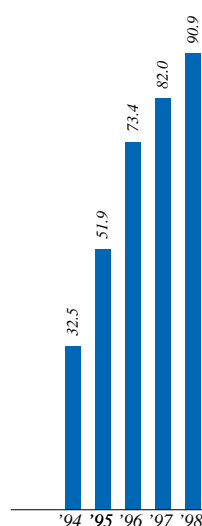
New Business Segments

Beginning with fiscal 1998, the year ended 31st March, 1998, the names and principal products of the business segments of Shin-Etsu Chemical Co., Ltd. (the "Company") and its subsidiaries (the "Companies") have been revised as follows: **Organic and Inorganic Chemicals**, where main products are polyvinyl chloride (PVC), silicones, vinyl acetate monomer, methanol and cellulose derivatives; **Electronics Materials**, where main products are semiconductor silicon, organic materials for the electronics industry, and rare earth magnets for the electronics industry; and **Functional Materials and Others**, where main products are synthetic quartz, oxide single-crystal, rare earths, rare earth magnets for applications outside the electronics industry, as well as the export of technology and plants, export and import of merchandise, construction and plant engineering, and information processing services. Fiscal 1997 results have been restated to incorporate these revisions.

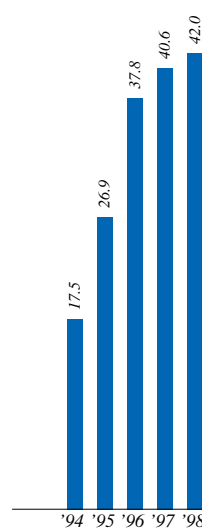
There were two principal changes. First was the transfer of synthetic quartz, oxide single-crystal and rare earths from the Electronics Materials segment to the Functional Materials and Others segment. Second was the division of the rare earth magnet line into products for electronic and non-electronic applications. The former were assigned to the Electronics Materials segment and the latter to the Functional Materials and Others segment. The purpose of the realignment is to create segments that more accurately reflect the characteristics of individual products and their applications.

Consolidated data include the results of the Company and 57 subsidiaries in Japan and overseas. Of the remaining 39 subsidiaries and 21 affiliated companies, the equity method of accounting is applied to 2 subsidiaries and 7 affiliated companies.

Operating Income
(Billions of Yen)



Net Income
(Billions of Yen)



Operating Environment

In the fiscal year that ended in March 1998, an increase in the consumption tax rate and other factors held down housing construction and personal consumption in Japan. In the second half of the year, financial system instability and the deepening turmoil in Asian economies had an adverse impact on Japan's economy, accelerating its recessionary tendencies. In the U.S. economy, personal consumption, housing construction and capital investment were all robust. In this environment, the Companies sought to bolster domestic and overseas marketing activities and improve earnings.

Net Sales and Segment Information

Fiscal 1998 consolidated net sales rose 11.0 percent to ¥693,275 million (US\$5,252 million) and operating income climbed 10.8 percent to ¥90,860 million (US\$688 million). The ratio of operating income to net sales was unchanged at 13.1 percent. Results by segment are as follows.

Organic and Inorganic Chemicals—This segment includes results of the Company and 33 subsidiaries, including Shintech, Inc. and Shin-Etsu Polymer Co., Ltd. In fiscal 1998, segment sales increased 9.7 percent to ¥340,051 million (US\$2,576 million), which is 49.1 percent of total sales. In addition to rising demand for vinyl chloride in the U.S., silicone sales were strong due to growth in the number of applications. Other organic and inorganic chemical products posted stable growth. Operating income rose 25.7 percent to ¥35,753 million (US\$271 million).

Electronics Materials—This segment includes results of the Company and 15 subsidiaries, including Shin-Etsu Handotai Co., Ltd., Shin-Etsu Handotai America, Inc., and S.E.H. Malaysia Sdn. Bhd. Segment sales were up 10.3 percent to ¥247,708 million (US\$1,877 million), representing 35.7 percent of total sales. Despite weakening conditions in the semiconductor market in the year's second half, semiconductor silicon sales were generally stable throughout the year due to higher worldwide demand. Operating income declined 7.4 percent to ¥42,507 million (US\$322 million), mostly because of higher depreciation.

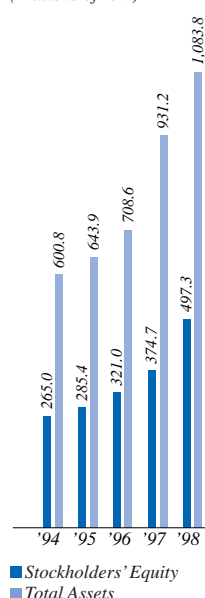
Functional Materials and Others—Sales in this segment include the results of the Company and 15 subsidiaries, including Shin-Etsu Astech Co., Ltd. and Shin-Etsu Engineering Co., Ltd. Fiscal 1998 segment sales increased 17.5 percent to ¥105,516 million (US\$799 million), accounting for 15.2 percent of total sales. Synthetic quartz, including preform for optical fiber, and rare earths for fluorescent plate makers performed well. The export and import of merchandise and construction and repairs were both stable. Operating income was up by 71.7 percent to ¥13,120 million (US\$99 million).

Other Income (Expense) and Net Income

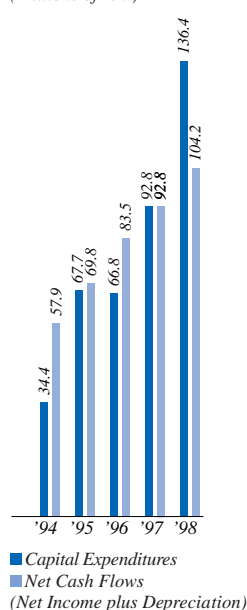
Interest and dividend income increased 38.1 percent to ¥10,075 million (US\$76 million). This was mostly due to income generated by the temporary investment of proceeds from the 1996 issues of convertible bonds and bonds with warrants. These funds were raised for the purpose of funding capital expenditures at the Companies. **Interest expense** climbed 20.2 percent to ¥9,220 million (US\$70 million), mainly a reflection of interest payments on the 1996 convertible and warrant bond issues. After inclusion of a foreign exchange loss of ¥950 million (US\$7 million) and other items, **other income/(expenses)** resulted in a net expense of ¥2,222 million (US\$17 million).

The increase in operating income and in net other expenses resulted in a 8.5 percent rise in **income before income taxes** to ¥88,638 million (US\$672 million). Income taxes were up 12.4 percent to ¥46,925 million (US\$355 million). **Equity in earnings of affiliates** declined 10.0 percent to ¥1,352 million (US\$10 million), and **minority interests in earnings of consolidated subsidiaries** increased to ¥1,310 million (US\$10 million). **Amortisation of difference between cost of investment and equity in net assets of consolidated subsidiaries** was ¥272 million (US\$2 million). Consolidated **net income** was up 3.5 percent to ¥42,027 million (US\$318 million), resulting in primary net income per share of ¥110.73 (US\$0.84).

Stockholders' Equity/
Total Assets
(Billions of Yen)



Capital Expenditures/
Net Cash Flows
(Billions of Yen)



Overseas Operations

Overseas sales, which are derived from foreign subsidiaries, rose 12.1 percent to ¥246,904 million (US\$1,870 million). This is 35.6 percent of total sales, compared with 35.3 percent in fiscal 1997. Higher demand for PVC in the United States and for semiconductor silicon were the most important contributors.

Financial Position

As of 31st March, 1998, current assets were ¥545,865 million (US\$4,135 million), 5.2 percent more than at the previous fiscal year-end. Cash and time deposits declined by 15.5 percent to ¥197,967 million (US\$1,500 million) due to purchases of short-term marketable securities. For the same reason marketable securities rose by 93.3 percent to ¥71,227 million (US\$540 million). Reflecting the growth in sales during the fiscal year, inventories increased 17.9 percent to ¥87,148 million (US\$660 million). Investments in securities, because of mainly purchase of Euroyen bonds, were up 87.8 percent to ¥91,569 million (US\$694 million). Capital expenditures were the principal reason for a 22.0 percent rise, to ¥390,259 million (US\$2,957 million), in tangible fixed assets. Total assets increased 16.4 percent to ¥1,083,780 million (US\$8,210 million).

Current liabilities rose 0.3 percent to ¥323,996 million (US\$2,455 million). Notes and accounts payable increased, but short-term loans were lower. In long-term liabilities, corporate bonds and long-term borrowings both rose. The conversion of convertible bonds limited the increase in total long-term debt to 4.8 percent, resulting in a year-end balance of ¥176,274 million (US\$1,335 million). Stockholders' equity was up 32.7 percent to ¥497,312 million (US\$3,768 million) due to the conversion of convertible bonds and higher retained earnings and the equity ratio advanced to 45.9 percent.

At the stockholders meeting held in June 1998, 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 745 thousand shares of the Company's par-value common stock at a cost not to exceed ¥2,500 million (US\$19 million).

Capital Expenditures

Fiscal 1998 capital expenditures amounted to ¥136,384 million (US\$1,033 million). The principal share of these expenditures was for the expansion and upgrading of production facilities for semiconductor silicon and other electronic materials. During the five-year period ending in March 2003, the Company, subsidiaries and affiliated companies plan to make capital expenditures of about ¥500 billion (US\$3,788 million). These investments will be used primarily to expand and streamline production activities and to install environmental systems.

Cash Flows

Cash and cash equivalents at the end of fiscal 1998 were ¥269,194 million (US\$2,039 million), 0.7 percent less than at the end of fiscal 1997. Net cash provided by operating activities was ¥112,055 million (US\$849 million) as both net income and depreciation and amortisation rose. Net cash used for investing activities was ¥164,719 million (US\$1,248 million), mainly due to a large volume of capital expenditures. Net cash provided by financing activities was ¥56,862 million (US\$431 million). This is mainly attributable to proceeds from the issue of debentures.

Consolidated Balance Sheets

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
As of 31st March, 1997 and 1998

	31st March,		31st March,
	1997	1998	1998
	(millions of yen)		(thousands of U.S. dollars) (Note 3)
ASSETS			
Current Assets:			
Cash and time deposits	¥ 234,152	¥ 197,967	\$1,499,750
Marketable securities (Note 5)	36,839	71,227	539,598
Notes and accounts receivable:			
Trade	156,080	165,233	1,251,765
Unconsolidated subsidiaries and affiliates	10,721	13,535	102,538
Other	5,426	7,570	57,349
Less: allowance for doubtful accounts	(3,148)	(3,764)	(28,515)
	169,079	182,574	1,383,137
Inventories (Note 4)	73,934	87,148	660,212
Other current assets	4,686	6,949	52,644
Total current assets	518,690	545,865	4,135,341
Investments and Advances:			
Investments in and advances to unconsolidated subsidiaries and affiliates (Note 6)	25,186	34,353	260,250
Investments in securities (Note 5)	48,767	91,569	693,705
Long-term loans	1,510	2,144	16,242
Other	9,707	13,943	105,629
Less: allowance for doubtful accounts	(31)	(64)	(485)
Total investments and advances	85,139	141,945	1,075,341
Property, Plant and Equipment (Note 7):			
Buildings and structures	196,072	237,723	1,800,932
Machinery and equipment	525,335	604,132	4,576,758
Less: accumulated depreciation	(454,626)	(504,860)	(3,824,697)
	266,781	336,995	2,552,993
Land	27,206	29,579	224,083
Construction in progress	25,968	23,685	179,432
Total property, plant and equipment	319,955	390,259	2,956,508
Deferred Charges and Other Assets	7,375	5,711	43,265
	¥ 931,159	¥1,083,780	\$8,210,455

The accompanying notes are an integral part of the statements.

	31st March,		31st March,
	1997	1998	1998
LIABILITIES AND STOCKHOLDERS' EQUITY	(millions of yen)		(thousands of U.S. dollars) (Note 3)
Current Liabilities:			
Short-term loans (Note 7)	¥ 73,353	¥ 52,752	\$ 399,636
Current portion of long-term debt (Note 7)	30,315	40,369	305,826
Notes and accounts payable:			
Trade	84,138	93,005	704,583
Unconsolidated subsidiaries and affiliates	11,485	11,624	88,061
Other	46,020	45,951	348,114
	141,643	150,580	1,140,758
Accrued income taxes	22,205	20,958	158,773
Accrued expenses	38,832	44,893	340,098
Advance received	2,103	2,706	20,500
Other current liabilities	14,510	11,738	88,924
Total current liabilities	322,961	323,996	2,454,515
Long-Term Liabilities:			
Long-term debt (Note 7)	168,192	176,274	1,335,410
Accrued employees' severance indemnities (Note 8)	6,287	6,161	46,674
Deferred taxes—non-current	11,095	13,384	101,394
Other	15,974	25,452	192,818
Total long-term liabilities	201,548	221,271	1,676,296
Excess of Investment Cost Over Equity in Net Assets of Consolidated Subsidiaries	955	717	5,432
Adjustments on Foreign Currency Statement Translation (Note 2 (4))	12,741	21,460	162,576
Minority Interests in Consolidated Subsidiaries	18,228	19,024	144,121
Contingent Liabilities (Note 9)	—	—	—
Stockholders' Equity (Note 10):			
Common stock:			
Authorized: 800,000,000 shares			
Issued, par value ¥50 per share:			
349,569,337 shares and 393,721,883 shares as of			
31st March, 1997 and 1998, respectively	44,256	83,957	636,038
Additional paid-in capital	46,180	89,976	681,636
Legal reserve	4,967	5,273	39,947
Retained earnings (Note 16)	279,326	320,226	2,425,955
	374,729	499,432	3,783,576
Less: treasury stock	(3)	(2,120)	(16,061)
Total stockholders' equity	374,726	497,312	3,767,515
	¥931,159	¥1,083,780	\$8,210,455

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, 1996, 1997 and 1998

	For the years ended 31st March,			For the year ended
	1996	1997	1998	31st March,
	(millions of yen)			(thousands of U.S. dollars) (Note 3)
Net Sales (Note 13)	¥575,176	¥624,405	¥693,275	\$5,252,083
Cost of Sales (Notes 8, 11 and 13)	420,818	452,974	515,728	3,907,030
Gross profit	154,358	171,431	177,547	1,345,053
Selling, General and Administrative Expenses (Notes 8 and 11)	80,931	89,407	86,687	656,720
Operating income	73,427	82,024	90,860	688,333
Other Income/(Expenses):				
Interest and dividend income	4,656	7,296	10,075	76,325
Interest expenses	(5,369)	(7,669)	(9,220)	(69,848)
Amortisation of bond discounts	—	(1,163)	(1,744)	(13,212)
Loss on sale/disposal of property, plant and equipment	(2,701)	(1,136)	(1,433)	(10,856)
Foreign exchange gain/(loss)	1,120	3,463	(950)	(7,197)
Other, net	771	(1,117)	1,050	7,955
Income before income taxes	71,904	81,698	88,638	671,500
Income Taxes (Note 14):				
Current	33,547	39,398	46,105	349,280
Deferred	1,014	2,363	820	6,212
Income after income taxes	34,561	41,761	46,925	355,492
Income after income taxes	37,343	39,937	41,713	316,008
Minority Interests in Earnings of Consolidated Subsidiaries	(813)	(1,032)	(1,310)	(9,924)
Equity in Earnings of Affiliates	1,291	1,502	1,352	10,242
Amortisation of Difference Between Cost of Investment and Equity in Net Assets of Consolidated Subsidiaries	4	207	272	2,060
Net income	¥ 37,825	¥ 40,614	¥ 42,027	\$ 318,386

(Yen)

(U.S. dollars) (Note 3)

Per Share (Note 2 (14)):

Net income—primary	¥ 116.51	¥ 118.24	¥ 110.73	\$ 0.839
Net income—fully diluted	¥ 106.66	¥ 103.95	¥ 101.69	\$ 0.770
Cash dividends	¥ 7.50	¥ 7.50	¥ 8.50	\$ 0.064
Weighted Average Number of Shares (Thousands)	324,649	343,490	380,084	380,084

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, 1996, 1997 and 1998

	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, 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
Net income for the year	—	—	—	—	42,027
Increase in retained earnings due to additional consolidation of subsidiaries	—	—	—	—	2,318
Cash dividends	—	—	—	—	(2,927)
Transfer to legal reserve	—	—	—	306	(306)
Directors' and statutory auditors' bonuses	—	—	—	—	(212)
Conversion of convertible debentures	27,183	23,427	23,392	—	—
Exercise of warrant attached to debentures	16,970	16,274	20,404	—	—
Balance as of 31st March, 1998	393,722	¥83,957	¥89,976	¥5,273	¥320,226

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, 1997	349,569	\$335,273	\$349,848	\$37,629	\$2,116,106
Net income for the year	—	—	—	—	318,386
Increase in retained earnings due to additional consolidation of subsidiaries	—	—	—	—	17,561
Cash dividends	—	—	—	—	(22,174)
Transfer to legal reserve	—	—	—	2,318	(2,318)
Directors' and statutory auditors' bonuses	—	—	—	—	(1,606)
Conversion of convertible debentures	27,183	177,477	177,212	—	—
Exercise of warrant attached to debentures	16,970	123,288	154,576	—	—
Balance as of 31st March, 1998	393,722	\$636,038	\$681,636	\$39,947	\$2,425,955

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, 1996, 1997 and 1998

	For the years ended 31st March,			For the year ended
	1996	1997	1998	31st March,
	(millions of yen)			(thousands of U.S. dollars) (Note 3)
Cash Flows From Operating Activities:				
Net income	¥ 37,825	¥ 40,614	¥ 42,027	\$ 318,386
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortisation	46,034	54,554	63,147	478,386
Equity in earnings of affiliates	(1,291)	(1,502)	(1,352)	(10,242)
Loss on sale/disposal of property, plant and equipment	2,701	1,136	1,433	10,856
Other, net	(7,171)	13,779	12,122	91,833
Changes in assets and liabilities:				
Increase in notes and accounts receivable	(20,331)	(3,814)	(14,111)	(106,902)
Increase in inventories	(8,681)	(11,109)	(13,214)	(100,106)
Increase in notes and accounts payable	22,881	15,824	8,937	67,705
Decrease (increase) in accrued income taxes	1,933	4,531	(1,247)	(9,447)
Other, net	6,813	10,663	14,313	108,432
Net cash provided by operating activities	80,713	124,676	112,055	848,901
Cash Flows From Investing Activities:				
Purchase of properties	(71,863)	(110,570)	(135,452)	(1,026,151)
Proceeds from sales of properties	15,000	1,383	811	6,144
Increase in investments in securities	(1,335)	(6,996)	(22,258)	(168,621)
Decrease in investments in unconsolidated subsidiaries and affiliates	(2,952)	(2,220)	(5,677)	(43,008)
Other, net	1,155	410	(2,143)	(16,235)
Net cash used for investing activities	(59,995)	(117,993)	(164,719)	(1,247,871)
Cash Flows From Financing Activities:				
Proceeds from issue of debentures	—	105,065	49,189	372,644
Borrowing of long-term debt	10,822	15,025	24,906	188,682
Payment of long-term debt	(11,597)	(16,243)	(35,591)	(269,629)
Decrease (increase) in short-term loans	375	10,621	(20,601)	(156,068)
Cash dividends paid	(2,434)	(2,501)	(2,927)	(22,174)
Other, net	(1,154)	13,667	41,886	317,318
Net cash provided by (used for) financing activities	(3,988)	125,634	56,862	430,773
Effect of Exchange Rate Changes on Cash	(1,320)	(6,856)	(5,995)	(45,417)
Net Decrease (Increase) in Cash and Cash Equivalents	15,410	125,461	(1,797)	(13,614)
Cash and Cash Equivalents at Beginning of Year	130,120	145,530	270,991	2,052,962
Cash and Cash Equivalents at End of Year	¥145,530	¥ 270,991	¥269,194	\$2,039,348

The accompanying notes are an integral part of the statements.

Notes to Consolidated Financial Statements

Shin-Etsu Chemical Co., Ltd. and Subsidiaries
As of 31st March, 1996, 1997 and 1998

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, 1996, 1997 and 1998 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, 1998 (96 as of 31st March, 1997 and 97 as of 31st March, 1996). The consolidated financial statements include the accounts of the Company and its 57 (54 for 1997 and 51 for 1996) majority-owned subsidiaries listed on page 45 with closing dates for their respective fiscal years (the “Companies”).

The remaining 39 (42 for 1997 and 46 for 1996) 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 39 (42 for 1997 and 46 for 1996) unconsolidated subsidiaries (majority-owned) and 21 (21 for 1997 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 seven 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.

(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.

Under the BAC method, 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, 1997 and 1998.

(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 17 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. Net income per share adjusted for dilution represents net income per share assuming full conversion of all convertible debentures of the Company outstanding with related reduction in interest expenses.

Cash dividends per share represents 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 10)

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 ¥132 to U.S.\$1, the approximate effective rate of exchange on 31st March, 1998.

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 ¥132 to U.S.\$1 or at any other rate.

4. Inventories

Inventories as of 31st March, 1997 and 1998 consisted of the following:

	31st March,		1998 (thousands of U.S. dollars)
	1997	1998	
	(millions of yen)		
Merchandise	¥ 4,197	¥ 5,916	\$ 44,818
Finished products	30,544	35,072	265,697
Semifinished products	11,419	13,418	101,652
Raw materials	16,960	22,357	169,371
Supplies	7,808	8,149	61,735
Others	3,006	2,236	16,939
	¥73,934	¥87,148	\$660,212

5. 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, 1997 and 1998 consisted of the following:

	31st March,		1998 (thousands of U.S. dollars)
	1997	1998	
	(millions of yen)		
Marketable securities (current portfolio):			
Listed corporate shares	¥ 1,395	¥ 1,164	\$ 8,818
Bonds, debentures and others	35,444	70,063	530,780
	¥36,839	¥71,227	\$539,598
Investments in securities (non-current portfolio):			
Listed corporate shares	¥37,003	¥37,811	\$286,447
Other shares (unquoted)	2,113	4,035	30,568
Bonds, debentures and others	9,651	49,723	376,690
	¥48,767	¥91,569	\$693,705

The aggregate market value of listed corporate shares (marketable equity securities) and net unrealised gains as of 31st March, 1997 and 1998 amounted to as follows:

	31st March,		
	1997	1998	1998
	(millions of yen)		(thousands of U.S. dollars)
Current:			
Market value	¥ 2,726	¥ 1,446	\$ 10,954
Net unrealised gains	1,331	282	2,136
Non-current:			
Market value	¥80,303	¥69,907	\$529,599
Net unrealised gains	43,300	32,096	243,152

6. Investments in and advances to unconsolidated subsidiaries and affiliates

Investments in and advances to unconsolidated subsidiaries and affiliates as of 31st March, 1997 and 1998 consisted of the following:

	31st March,		
	1997	1998	1998
	(millions of yen)		(thousands of U.S. dollars)
Held directly by the Company:			
Affiliates:			
Four (three for 1997) affiliates accounted for by the equity method (See Note 2 (2))	*¥ 7,525	*¥ 8,586	*\$ 65,045
Kashima Denkai Co., Ltd.	805	805	6,098
Unitika Chemical Co., Ltd.	600	600	4,545
Others	203	228	1,729
	9,133	10,219	77,417
Unconsolidated subsidiaries:			
Shin-Etsu Electronics Malaysia Sdn. Bhd.	1,400	1,400	10,606
Shin-Etsu Silicones Europe B.V.	734	734	5,561
MicroSi, Inc. ⁽¹⁾	499	—	—
Shin-Etsu Film Co., Ltd.	199	199	1,508
Others	332	225	1,704
	3,164	2,558	19,379
Held indirectly through subsidiaries			
Unconsolidated subsidiaries and affiliates:			
Two unconsolidated subsidiaries and three (one for 1997) affiliates accounted for by the equity method (See Note 2 (2))	* 5,318	* 12,407	* 93,992
Others	5,710	4,369	33,098
	11,028	16,776	127,090
Advances	1,861	4,800	36,364
	¥25,186	¥34,353	\$260,250

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

⁽¹⁾ Newly consolidated with effect from the year ended 31st March, 1998.

7. Short-term loans and long-term debt

Short-term loans outstanding as of 31st March, 1997 and 1998 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, 1997 and 1998 consisted of the following:

	31st March,		
	1997	1998	1998
	(millions of yen)		(thousands of U.S. dollars)
Loans with banks and other financial institutions:			
Secured	¥ 16,474	¥ 17,896	\$ 135,576
Unsecured	28,105	44,481	336,977
Secured debentures:			
6.5% mortgage debentures issued by a consolidated subsidiary, due November 1997	2,000	—	—
Unsecured debentures:			
3 ³ / ₈ % notes in U.S. dollars, due August 2000 with warrants	52,562	52,562	398,197
2.7% debentures issued by a consolidated subsidiary, due April 2001	3,274	3,669	27,796
6 ⁷ / ₈ % debentures issued by a consolidated subsidiary, due July 2002	—	19,833	150,250
2.7% debentures issued by a consolidated subsidiary, due August 2004	—	8,000	60,606
2.5% debentures issued by a consolidated subsidiary, due August 2003	—	5,000	37,879
2.2% debentures issued by a consolidated subsidiary, due August 2002	—	5,000	37,879
2.6% debentures issued by a consolidated subsidiary, due December 2007	—	3,000	22,727
2.5% debentures issued by a consolidated subsidiary, due February 2003	—	3,000	22,727
2.1% debentures issued by a consolidated subsidiary, due March 2003	—	2,000	15,152
2.1% debentures issued by a consolidated subsidiary, due March 2003	—	3,000	22,727
Unsecured convertible debentures:			
3.0% convertible debentures in U.S. dollars, due May 2000	29	27	205
2.1% convertible debentures, due May 1997	357	—	—
2.0% convertible debentures, due March 1998	17,966	—	—
1.3% convertible debentures, due March 1999	37,538	27,917	211,492
0.4% convertible debentures, due September 2005	40,098	21,154	160,258
Secured convertible debentures:			
2.4% convertible mortgage debentures issued by a consolidated subsidiary, due March 1999	104	104	788
	198,507	216,643	1,641,236
Less portion due within one year	(30,315)	(40,369)	(305,826)
	¥168,192	¥176,274	\$1,335,410

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, 1998 in denominated currencies	Terms of conversion of 31st March, 1998		
			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.\$0.105 million	¥1,112.2	U.S.\$1=¥262.60	25
1.3% convertible debentures in yen, due 1999	13th February, 1990 (¥40,000 million)	¥27,917 million	¥1,748.6	—	15,965
0.4% convertible debentures in yen, due 2005	8th August, 1996 (¥50,000 million)	¥21,154 million	¥1,917.0	—	11,035
Secured:					
2.4% convertible mortgage debentures in yen, due 1999*	31st March, 1987 (¥5,000 million)	¥104 million	¥ 540.7	—	N/A
					27,025

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

	Issue date and principal amount at issue	Balance as of 31st March, 1998 in denominated currencies	Terms of exercise of 31st March, 1998		
			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.\$200 million	¥1,917.0	U.S.\$1=¥109.45	11,397
					11,397

*Issued by a subsidiary Shin-Etsu Polymer Co., Ltd.

**Subject to adjustment for subsequent stock dividends, stock splits and others.

3³/₈% 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, 1998, ¥409 million (\$3,098 thousand) was amortised to income as a credit to "Foreign exchange

loss" in "Other Income/(Expenses)" in the accompanying Consolidated Statements of Income for the year ended 31st March, 1998. The unamortised balance was included in "Other current liabilities" in an amount of ¥409 million (\$3,098 thousand) and in "Other" in the Long-term Liabilities section in an amount of ¥546 million (\$4,136 thousand), respectively in the accompanying Consolidated Balance Sheet at 31st March, 1998. 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, 1998, 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	¥59,596	\$451,485

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

	(millions of yen)	(thousands of U.S. dollars)
Year ending 31st March, 1999	¥ 40,369	\$ 305,826
2000	14,614	110,712
2001	66,969	507,341
2002 and thereafter	94,691	717,357
	¥216,643	\$1,641,236

8. 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, 1996, 1997 and 1998 were ¥2,803 million, ¥3,498 million and ¥3,360 million (\$25,455 thousand), respectively.

9. Contingent liabilities

As of 31st March, 1998, 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 ¥1,192 million (\$9,030 thousand).

In addition, as of 31st March, 1998, the Companies had contingent liabilities arising from notes discounted by banks and notes endorsed and delivered for payment to vendors in the amounts of ¥417 million (\$3,159 thousand) and ¥13 million (\$98 thousand), respectively.

10. 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, 1996, 1997 and 1998 in the amounts of ¥1,217 million, ¥1,283 million and ¥1,616 million (\$12,242 thousand) (¥4.25 per share) respectively, which were actually paid to stockholders on 8th December, 1995, 10th December,

1996 and 10th December, 1997, respectively. In the accompanying consolidated statements of stockholders' equity, these dividend payments are reflected in the years ended 31st March, 1996, 1997 and 1998, respectively.

11. Research and development costs

Research and development costs incurred and charged to income for the years ended 31st March, 1996, 1997 and 1998

were ¥17,634 million, ¥18,256 million and ¥19,174 million (\$145,258 thousand), respectively.

12. Lease transactions

Lease rental expenses on finance lease contracts without ownership-transfer for the years ended 31st March, 1997 and 1998 amounted to ¥377 million and ¥304 million (\$2,303 thousand), respectively.

The amount of outstanding future lease payments due in respect of finance lease contracts at 31st March, 1998, which included the portion of interest thereon, was summarised as follows:

	31st March,	
	1998	
	(millions of yen)	(thousands of U.S. dollars)
Future lease payments		
Within one year	¥ 290	\$ 2,197
Over one year	456	3,455
	¥ 746	\$ 5,652

The amount of outstanding future lease payments due in respect of operating lease contracts at 31st March, 1998 was summarised as follows:

	31st March,	
	1998	
	(millions of yen)	(thousands of U.S. dollars)
Future lease payments		
Within one year	¥ 765	\$ 5,795
Over one year	1,192	9,030
	¥1,957	\$14,825

13. Related party transactions

The Company's sales to and purchases from its unconsolidated subsidiaries and affiliates for the years ended 31st March, 1996, 1997 and 1998 are summarised as follows:

	Year ended 31st March,			1998 (thousands of U.S. dollars)
	1996	1997	1998	
	(millions of yen)			
Sales	¥26,016	¥14,891	¥17,401	\$131,826
Purchases	25,290	28,316	31,069	235,371

14. Income taxes

Income taxes in Japan applicable to the Company and its domestic subsidiaries for the years ended 31st March, 1996, 1997 and 1998 consisted of corporate income tax (national),

enterprise tax (local) and resident income taxes (local) at the approximate rates indicated below:

	Rates on taxable income		
	1996	1997	1998
Corporate income tax	37.5%	37.5%	37.5%
Enterprise tax	12.1	12.1	12.1
Resident income taxes	7.7	7.5	7.1
	57.3%	57.1%	56.7%
Statutory tax rate in effect to reflect the deductibility of enterprise tax when paid (unlike other income taxes, enterprise tax is deductible for tax purposes when it is paid)	51.1%	50.9%	50.6%

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.

15. Segment information

(1) Business segment information

The Companies had operated principally in the following three lines of business, "Chemicals", "Electronics Materials" and "Other," until the year ended 31st March, 1997. These lines of business had dealt 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, 1996 and 1997 and for the years then ended, classified by business segments had been presented below.

	For the year ended 31st March, 1996				
	Chemicals	Electronics materials	Other	Elimination or common assets	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				Consolidated total
	Chemicals	Electronics materials	Other	Elimination or common assets (Note)	
	(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

The above-mentioned three business segments, “Chemicals”, “Electronics Materials” and “Other” were changed to the following three lines of business in the light of the type of products and their markets with effect from the year ended 31st March, 1998: “Organic and inorganic chemicals business segment”, “Electronics materials business segment” and “Functional materials and other business segment”.

These lines of business deal with the following main products and merchandise:

- Organic and inorganic chemicals business segment Polyvinyl chloride, Silicones, Vinyl acetate monomer, Polyvinyl alcohol, Methanol, Chloromethanes, Cellulose derivatives, Caustic soda, Fertilizers, Alloys, Silicon metal
- Electronics materials business segment Semiconductor silicon, Organic materials for the electronics industry, Rare earth magnets for the electronics industry
- Functional materials and other business segment Synthetic quartz products, Oxide single-crystals, Rare earths and rare earth magnets, Export of technology and plants, Export and import of goods, Construction and plant engineering, Information processing

Though synthetic quartz products, oxide single-crystals, rare earths and rare earth magnets for the non-electronics industry had been included in the “Electronics materials business segment” until the year ended 31st March, 1997, it has been included in “Functional materials and other business segment” with effect from the year ended 31st March, 1998 in order to clearly reflect the quality and the use of the products. And also, the name of the industrial segment of “Organic and inorganic chemicals business” have been changed from “Chemicals business” in the previous presentation.

The segment information classified by business segment for the year ended 31st March, 1997 as below are restated to conform to the presentation of the business segment for the year ended 31st March, 1998.

	For the year ended 31st March, 1997				Consolidated total
	Organic and inorganic chemicals	Electronics materials	Functional materials and others	Elimination or common assets (Note)	
	(millions of yen)				
Sales					
Sales to outside customers	¥310,030	¥224,608	¥ 89,767	¥ —	¥624,405
Inter-segment sales	12,844	1,133	47,882	(61,859)	—
Total	322,874	225,741	137,649	(61,859)	624,405
Operating costs and expenses	294,429	179,829	130,006	(61,883)	542,381
Operating income	¥ 28,445	¥ 45,912	¥ 7,643	¥ 24	¥ 82,024
Assets	¥336,365	¥323,175	¥ 99,665	¥171,954	¥931,159
Depreciation	18,434	29,022	4,735	—	52,191
Capital expenditure	15,478	67,876	9,805	(315)	92,844

	For the year ended 31st March, 1998				Consolidated total
	Organic and inorganic chemicals	Electronics materials	Functional materials and others	Elimination or common assets (Note)	
	(millions of yen)				
Sales					
Sales to outside customers	¥340,051	¥247,708	¥105,516	¥ —	¥ 693,275
Inter-segment sales	13,991	2,049	57,755	(73,795)	—
Total	354,042	249,757	163,271	(73,795)	693,275
Operating costs and expenses	318,289	207,250	150,151	(73,275)	602,415
Operating income	¥ 35,753	¥ 42,507	¥ 13,120	¥ (520)	¥ 90,860
Assets	¥368,813	¥401,713	¥122,636	¥190,618	¥1,083,780
Depreciation	18,734	35,064	8,346	—	62,144
Capital expenditure	20,849	91,373	24,581	(419)	136,384

	For the year ended 31st March, 1998				Consolidated total
	Organic and inorganic chemicals	Electronics materials	Functional materials and others	Elimination or common assets (Note)	
	(thousands of U.S. dollars)				
Sales					
Sales to outside customers	\$2,576,144	\$1,876,576	\$ 799,363	\$ —	\$5,252,083
Inter-segment sales	105,992	15,523	437,538	(559,053)	—
Total	2,682,136	1,892,099	1,236,901	(559,053)	5,252,083
Operating costs and expenses	2,411,280	1,570,076	1,137,508	(555,114)	4,563,750
Operating income	\$ 270,856	\$ 322,023	\$ 99,393	\$ (3,939)	\$ 688,333
Assets	\$2,794,039	\$3,043,280	\$ 929,061	\$1,444,075	\$8,210,455
Depreciation	141,924	265,636	63,227	—	470,787
Capital expenditure	157,947	692,220	186,220	(3,175)	1,033,212

Note: The amounts of the common assets included in the column "Elimination or common assets" for the years ended 31st March, 1996, 1997 and 1998 were ¥113,904 million, ¥199,078 million and ¥222,189 million (\$1,683,250 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) Geographical segment information

The analysis of the sales, operating costs and expenses, operating income and assets of the Companies by geographical segments of 31st March, 1996, 1997 and 1998 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, 1996			Consolidated total
	Within Japan	Outside Japan	Elimination or common assets	
	(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 3)	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

	Year ended 31st March, 1998					
	Japan	North America	Asia	Other area	Elimination or common assets (Note 3)	Consolidated total
	(millions of yen)					
Sales						
Sales to outside customers	¥446,371	¥148,162	¥66,661	¥32,081	¥ —	¥ 693,275
Inter-segment sales	73,482	15,770	27,914	2,192	(119,358)	—
Total	519,853	163,932	94,575	34,273	(119,358)	693,275
Operating costs and expenses	456,114	146,517	86,215	33,850	(120,281)	602,415
Operating income	¥ 63,739	¥ 17,415	¥ 8,360	¥ 423	¥ 923	¥ 90,860
Assets	¥553,021	¥258,847	¥80,856	¥61,678	¥ 129,378	¥1,083,780

	Year ended 31st March, 1998					
	Japan	North America	Asia	Other area	Elimination or common assets (Note 3)	Consolidated total
	(thousands of U.S. dollars)					
Sales						
Sales to outside customers	\$3,381,598	\$1,122,439	\$505,008	\$243,038	\$ —	\$5,252,083
Inter-segment sales	556,682	119,470	211,470	16,606	(904,228)	—
Total	3,938,280	1,241,909	716,478	259,644	(904,228)	5,252,083
Operating costs and expenses	3,455,409	1,109,977	653,144	256,439	(911,219)	4,563,750
Operating income	\$ 482,871	\$ 131,932	\$ 63,334	\$ 3,205	\$ 6,991	\$ 688,333
Assets	\$4,189,553	\$1,960,962	\$612,545	\$467,258	\$ 980,137	\$8,210,455

Notes:—

(1) The above segments are classified geographically.

(2) Main countries or areas other than Japan

North America U.S.A.

Asia Malaysia, Singapore, Korea, Taiwan

Other area U.K., Netherlands, Australia

(3) The amounts of the common assets included in the column "Elimination or common assets" for the years ended 31st March, 1996, 1997 and 1998 were ¥113,904 million, ¥199,078 million and ¥222,189 million (\$1,683,250 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.

(3) Overseas sales information

Overseas sales of the Companies for the years ended 31st March, 1996, 1997 and 1998 are summarised as follows:

	Year ended 31st March,	
	1996	1997
	(millions of yen)	
Overseas sales	¥246,829	¥289,451
Consolidated sales	¥575,176	¥624,405
Percentage of overseas sales over consolidated sales	42.9%	46.4%

	Year ended 31st March, 1998			
	North America	Asia	Other area	Total
	(millions of yen)			
Overseas sales	¥144,922	¥155,022	¥49,934	¥349,878
Consolidated sales				¥693,275
Percentage of overseas sales over consolidated sales	20.9%	22.4%	7.2%	50.5%

	Year ended 31st March, 1998			
	North America	Asia	Other area	Total
	(thousands of U.S. dollars)			
Overseas sales	\$1,097,894	\$1,174,409	\$378,288	\$2,650,591
Consolidated sales				\$5,252,083
Percentage of overseas sales over consolidated sales	20.9%	22.4%	7.2%	50.5%

Notes:—

(1) The above segments are classified geographically.

(2) Main countries or areas other than Japan

North America U.S.A., Canada

Asia Korea, Taiwan, China

Other area Europe, Middle South America, Oceania

(3) "Overseas sales" means sales to "outside Japan" by the Company and its consolidated subsidiaries.

16. Subsequent events

(1) Appropriation of retained earnings

Subsequent to 31st March, 1998, the Company's Board of Directors, with the subsequent approval of stockholders on 26th June, 1998, declared a cash dividend of ¥1,670 million (\$12,652 thousand) equal to ¥4.25 (\$0.032) per share, applicable to earnings of the year ended 31st March, 1998 and payable to stockholders on the stockholders' register on 31st March, 1998.

(2) Stock options

At the stockholders meeting held in June 1998, 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 745 thousand shares of the Company's par-value common stock at a cost that shall not exceed ¥2,500 million (US\$19 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
S-E, Inc. ⁽¹⁾	100.0	31st December
Silicon Metal Company of Australia Ltd. ⁽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 Silicone Korea Co., Ltd. ⁽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
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

Name of Consolidated Subsidiary	Equity Ownership Percentage	Closing Date
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 Silicones of America, Inc. ⁽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
MicroSi, Inc. ⁽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
Niigata Polymer Company Limited	100.0	31st December
Nihon Resin Co., Ltd.	100.0	31st December
Polymer Chemicals Co., Ltd.	100.0	31st March
Urawa Polymer Co., Ltd.	100.0	31st January
Sanshin Electronics Co., Ltd.	100.0	31st March
Saitama Shinkoh Mold Co., Ltd.	100.0	31st March
San-Ace Co., Ltd.	100.0	28th February
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
S.E.H. America Foreign Sales Corporation ⁽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⁾	88.0	31st December

⁽¹⁾ Overseas subsidiary

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

Report of Independent Certified Public Accountants

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, 1997 and 1998, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended 31st March, 1998, 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, 1997 and 1998, and the consolidated results of their operations and their cash flows for each of the three years in the period ended 31st March, 1998, in conformity with generally accepted accounting principles in Japan.

As described in Note 15 of the Notes to Consolidated Financial Statements, during the year ended 31st March, 1998, the Companies changed their business segments in which a certain part of products included. The change was made to reflect the quality and use of the products included in electronics materials business segment more clearly because that the electronics materials business segment has grown materially and, we concur the change as appropriate. The effect of the change to the segment information has been described in Note 15 of the Notes to Consolidated Financial Statements.

Tokyo, Japan
26th June, 1998


Chuo Audit Corporation

Shin-Etsu's Worldwide Network

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069542
Phone: 221-8670
Fax: 222-4952

Taiwan

Shin-Etsu Handotai Taiwan Co., Ltd.
(S.E.H. Taiwan)
No. 12, Industry E. Rd. IX,
Science-Based Industrial Park,
Hsin-Chu
Phone: 3-5771188
Fax: 3-5771199

Shin-Etsu Opto Electronic Co., Ltd.
No. 30, Industry East Road 4
Hsin-Chu Science-Based Industrial Park
Hsin-Chu
Phone: 3-5784566
Fax: 3-5789864

Shin-Etsu Silicone Taiwan Co., Ltd.
7F, No. 102, Civil Boulevard,
Sec 4, Taipei
Phone: 2-751-6999
Fax: 2-751-6769

U.K.

Shin-Etsu Handotai Europe, Ltd.
(S.E.H. Europe)
Wilson Road, Toll Roundabout
Elburn, Livingston
West Lothian EH54 7DA
Phone: (1506) 41-5555
Fax: (1506) 41-7171

U.S.A.

Heraeus Shin-Etsu America, Inc.
4600 NW Pacific Rim Blvd.
Camas, WA 98607
Phone: (360) 834-4004
Fax: (360) 834-3115

K-BIN, Inc.
Wesleyan Tower, #24 Greenway Plaza
Suite 811, Houston, TX 77046
Phone: (713) 965-0713
Fax: (713) 965-0629

MicroSi, Inc.
10028 South 51st St.
Phoenix, AZ 85044
Phone: (602) 893-8898
Fax: (602) 893-8637

Silica Products, Inc.
5640 Hwy 332 East,
Freeport, TX 77541
Phone: (713) 965-0713
Fax: (713) 965-0629

Shin-Etsu Bio, Inc.
6650 Lusk Blvd., Suite B-106
San Diego, CA 92121
Phone: (619) 455-8500
Fax: (619) 587-2716

Shin-Etsu Handotai America, Inc.
(S.E.H. America)
4111 N.E. 112th Ave.
Vancouver, WA 98682-6776
Phone: (360) 883-7000
Fax: (360) 254-6973

Shin-Etsu Magnetics, Inc.
2362-A Qume Drive
San Jose, CA 95131-1841
Phone: (408) 383-9240
Fax: (408) 383-9245

Shin-Etsu Polymer America Inc.
34135 7th St.
Union City, CA 94587
Phone: (510) 475-9000
Fax: (510) 475-0613

Shincor Silicones, Inc.
1030 Evans Avenue
Akron, OH 44305
Phone: (330) 630-9460
Fax: (330) 630-1491

Shin-Etsu Silicones of America, Inc.
1150 Damer Drive
Akron, OH 44305
Phone: (330) 630-9860
Fax: (330) 630-9855

Shintech, Inc.
Wesleyan Tower, #24 Greenway Plaza
Suite 811, Houston, TX 77046
Phone: (713) 965-0713
Fax: (713) 965-0629

Corporate Data

Shin-Etsu Chemical Co., Ltd.

Date of Establishment

16th September, 1926

Capital

¥83,957 million (US\$636 million)

(as of 31st March, 1998)

Number of Employees

19,238 (including 57 consolidated subsidiaries)

Number of Shares Issued

393,721,883 shares

(as of 31st March, 1998)

Stock Listings

Tokyo, Osaka, Nagoya, Niigata

Shin-Etsu Chemical Co., Ltd.

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

Phone: +81-3-3246-5011

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http://www.shinetsu.co.jp

