

Despite the persistent sluggishness of the Japanese economy and the adverse effects of the worldwide slowdown in the information technology industry, Shin-Etsu once again posted record-high net income during the fiscal year ended March 31, 2002. This solid performance is primarily attributable to the Company's continued proactive and timely response to the needs of its customers and its markets. Consolidated net income rose 6.2% to ¥68.5 billion, marking the ninth consecutive year of growth in profits. Operating income and net income both reached record highs for the seventh consecutive year. Consolidated net income per share rose ¥9.35 to ¥162.93. Reflecting the support and high acclaim of its shareholders, the Company attained a market value at the end of March of ¥2,294.5 billion (\$17,252million), ranking it fifth among the world's chemical manufacturers.



Stable growth

Management Policy

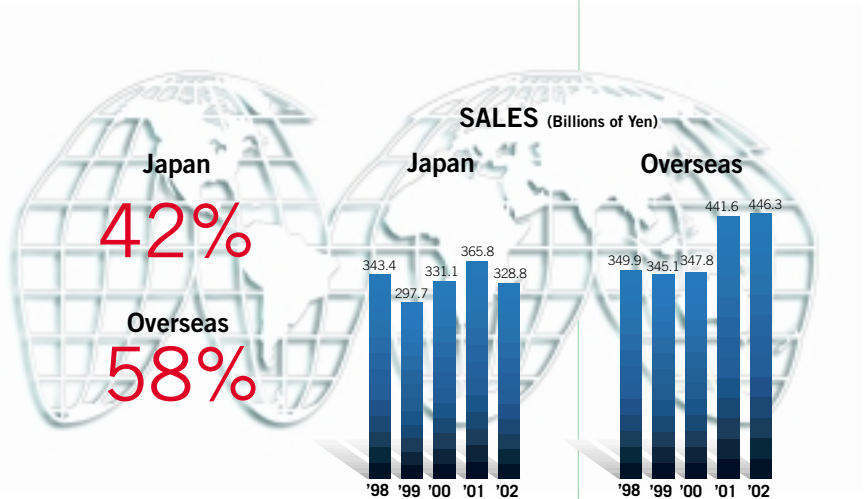
I will continue my management policy of "attaining stable growth and performing to the expectations of our shareholders while meeting customer needs." However, the specific strategies or means I employ for achieving this policy may change in response to changing business environments.

Anticipating Market Trends to Reliably Deliver Products to Our Customers

To ensure the delivery of reliable supplies to our customers, we focus on anticipating market trends and making "the best investments with the best timing." In the U.S. PVC market, for example, despite deteriorating market conditions, Shintech Inc., a wholly owned U.S. subsidiary of Shin-Etsu, completed and started up the second expansion of its PVC production facilities in the State of Louisiana during 2001. With this addition, Shintech's production capacity increased to 2,040,000 tons per year. As a result, we are now firmly positioned to respond to the demand in the North American PVC market and the rest of the world's markets. These markets began to show a strong recovery in the early part of 2002.

Further highlighting our commitment to meeting customer needs, Shin-Etsu attained distinction by becoming the first company in the world to produce 300mm-diameter silicon wafers when it began commercial production of these products at its Shirakawa plant in Japan in February 2001. We subsequently increased our manufacturing capabilities during the fiscal year to 75,000 wafers per month. Since setting up 300mm wafer manufacturing facilities requires a large investment, we carefully evaluated the projected demand for these wafers before making the investment decision. We then swiftly carried out construction of the manufacturing plant. This approach allowed us to become the first company to mass produce 300mm wafers and to successfully expand sales.

As soon as we saw a long-term growth potential in the optical-fiber preform business, we constructed a manufacturing facility for preforms at the Kashima Chemical Complex in Japan. Shin-Etsu's optical-fiber preform business contributed significantly to the Company's profits during this fiscal year.



Product Portfolio Supports Stability and Growth

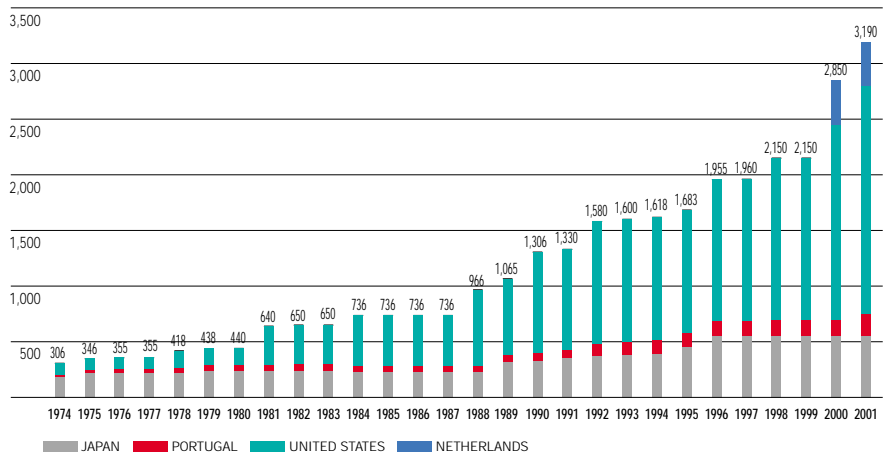
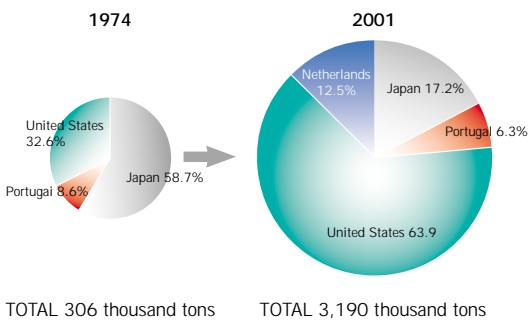
Shin-Etsu manufactures numerous products that command large shares of their respective global markets, including PVC, silicones, semiconductor silicon, synthetic quartz, and cellulose derivatives. It is the Company's policy to avoid overdependence on any one line of product and to strengthen its diversified, individual lines of business. This portfolio approach is shown in our segment-by-segment breakdown of operating profits for the fiscal year on page 43.



Management efforts

The organic and inorganic segment the company accounted for 43% of its Shin-Etsu's operating income during the fiscal year. This segment includes PVC, silicones, cellulose derivatives and other products. One line of business in this segment warranting special mention is our PVC business in North America. The PVC business is susceptible to the cyclical conditions of the economy and the market. Despite the cyclicity of the market, Shintech has been able to minimize this influence with its extraordinary managerial efforts, resulting in stable income from these operations. Shintech has made major contributions to Shin-Etsu's consolidated profits every year.

TOTAL PVC PRODUCTION VOLUME BY THE SHIN-ETSU GROUP



Our high-growth business segments include semiconductor silicon, synthetic quartz, rare earth magnets and photoresists. While there are good, long-term prospects for high growth in the semiconductor silicon business, the demand for these products has been very cyclical. Semiconductor silicon has been thrust into a particularly severe environment since the second quarter of 2001, when the global semiconductor industry experienced a sharp decline in demand. Nevertheless, Shin-Etsu achieved an increase in operating income, thanks to the large contributions made by its 300mm wafers and specialized wafers such as silicon on insulator (SOI) wafer and annealed wafers.

Despite a decline in demand for preforms for optical fibers in the United States and Europe in the second half of the fiscal year, Shin-Etsu posted an increase in operating income in its optical-fiber preform business for this fiscal year. This unique achievement was possible by virtue of strong global demand for optical fibers during the first half of the fiscal year, exceptional sales efforts in Japan, Asia, Europe and other world markets, and by utilizing the new production capabilities of our new plant in the Kashima Chemical Complex in Japan.



Enhancing the Quality of Our Current Lineup of Products

We concentrate on developing products demanded by our customers and which are distinct from those of our competitors. To this end, we are developing products that significantly enhance performance and function. This elevates our products to the first choice of customers. A prime example is our cellulose derivatives, which are a type of water-soluble polymer. We offer a unique selection of cellulose derivatives, including those with industrial applications such as components for use in purifying vehicle emissions and medical applications that include coatings for tablets. We remain committed to the development of new applications in a variety of fields for cellulose derivatives.

In our semiconductor silicon business, we are making good progress in expanding markets and also in increasing our production capabilities to meet the growing demand for our SOI wafers. We are also upgrading the quality of these wafers to support development of the next generation of devices.



New Challenges

As demonstrated by these examples, we are not only strengthening our position in commodity products, but also making continuous efforts to develop distinctive products that are a step ahead of those of our competitors.

R&D

When I assumed the presidency of Shin-Etsu Chemical, I formed the “Z Committee”, to propel our targeted research and development (R&D) activities. Today, I still chair the Committee. I believe that the key element of R&D is making the right selection of themes. In determining these themes, we must consider a number of crucial points such as whether the product in question will attain a large market in the future and whether we can attain synergies with the Company’s current businesses as well as how and when we can develop unique technologies. As the life span of each generation of technology shortens, it is critical to accelerate Shin-Etsu’s R&D and achieve rapid results in the development of new products and applications. In addition, it is essential to move from the product development stage to commercialization within the shortest possible time. Two examples of products that have been brought to life from the Committee are our photoresists for excimer lasers and fluoroelastomers.

Emphasis on Cash Flows

The Company is rapidly generating excess cash flows by fully utilizing its existing capital base, careful management of its new capital investment, from aggressive inventory reduction and prompt collection of account receivables. These measures contribute to a stable financial foundation as we providing a pillar for sustaining long-term growth. We use our cash flows primarily for capital re-investment and R&D. During this fiscal year, capital investment amounted to ¥81.5 billion, of which 32% was allocated to the Organic and Inorganic Chemicals segment, 45% to the Electronics Materials segment and 23% to the Functional Materials and Others segment.

We will continue to use our cash flows to further strengthen our international competitiveness and vigorously carry out our new businesses, as we strive to raise our total corporate value.

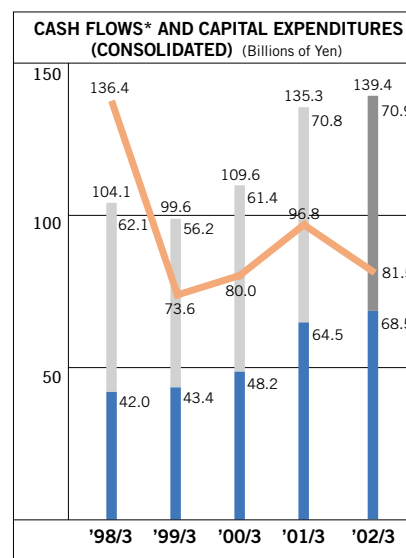
In order to help broaden our shareholder base and invigorate investor interest in our stock, we reduced the trade unit of our stock in August 2001 from 1,000 shares to 100 shares. As a result, we increased the number of our shareholders from 16,485 at the end of fiscal 2000 to 20,138 at the end of this fiscal year.

Protecting the Environment

Shin-Etsu's fundamental philosophy in carrying out its business activities is to consider environmental protection from every perspective. Highlighting the scope of these efforts, the Company has been awarded ISO14001 certification—the international standard for environmental management—at all of the principal facilities of the Shin-Etsu Group, including those of its subsidiaries Shin-Etsu Polymer Co., Ltd. and Shin-Etsu Handotai Co., Ltd. Keeping in mind its "safety first" principle, Shin-Etsu is doing its utmost to ensure safety, focusing not only on its manufacturing processes but also on product safety. At the same time, we are striving to cooperate with and contribute to the betterment of the local communities in which we operate.

New Challenges

Our key word for the current year is "Challenge." With this word, I intend to convey the message that we shall not be content merely with the achievement of what anybody can do, but rather we shall constantly urge ourselves to succeed in undertaking that are generally believed to be impossible. By continuing to implement the strategies that I have outlined here and by making appropriate management decisions day in and day out, we will do our utmost to sustain our growth and meet the expectations of our shareholders as well as our customers.



*(Cash Flows=Net Income + Depreciation)

■ Depreciation
■ Net Income
— Capital Expenditures

Chihiro Kanagawa
PRESIDENT AND CEO