

# Financial Review

KANEKA CORPORATION AND CONSOLIDATED SUBSIDIARIES

## Sales

The Kaneka Group's net sales for FY 2009 (April 1, 2008 to March 31, 2009) decreased 10.6% from the previous fiscal year to ¥449,585 million. International sales fell 21.3% to ¥147,204 million, owing to a downturn in the performance of its subsidiaries in the United States, Europe and Asia, as well as lower exports from Japan. The ratio of international sales to total sales fell from 37.2% to 32.7%.

By geographical area, sales in Japan decreased 8.5% to ¥372,171 million. Overseas sales fell in almost all regions, creating a 19.6% drop in overseas sales to ¥77,414 million.

Sales grew in two out of our seven business segments, but contracted in the remaining five. In the Foodstuffs Products segment, efforts to introduce distinctive products and improve costs resulted in a 4.6% sales increase, and expanded sales of medical devices and other products boosted sales in the Life Science Products segment 10.2%. However, sluggish markets, the impact of an appreciation of the yen and other factors caused sales declines in the Chemicals, Functional Plastics, Expandable Plastics and Products, Electronic Products, and Synthetic Fibers and Others segments.

## Cost of Sales and SG&A Expenses

During FY 2009, factors such as lower selling volumes reduced cost of sales 6.1% to ¥353,179 million. However, as net sales fell by a larger percentage, 10.6%, the cost of sales ratio rose from 74.8% to 78.6%.

SG&A expenses edged down 2.6% to ¥88,802 million, but the ratio of SG&A expenses to sales increased 1.6 percentage points to 19.8%.

## Operating Income

Operating income during FY 2009 decreased 78.7% to ¥7,604 million. By region, operating income decreased 62.2% in Japan, to ¥13,190 million and 89.9% in other areas to ¥574 million. Operating income increased in three out of seven segments, but decreased in the remaining four.

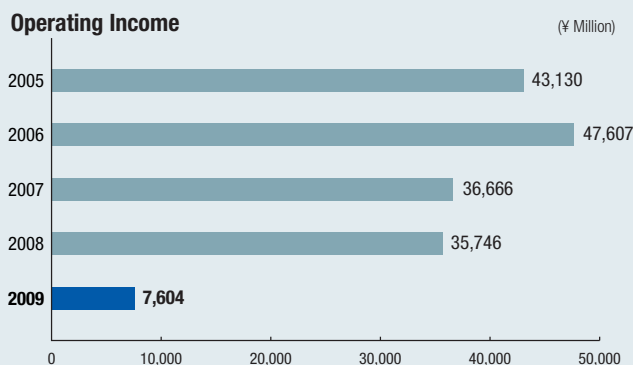
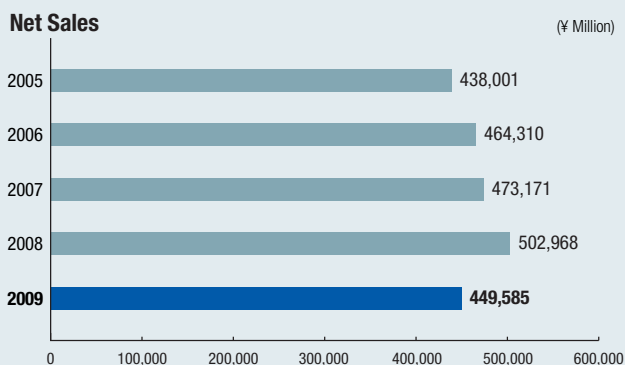
The Chemicals segment posted an operating loss, down ¥5,639 million from the operating profit recorded in the preceding term, owing to lackluster Japanese and overseas markets for PVC and specialty PVC resins and made worse by the inability to revise prices in time with rapid fluctuations in raw material prices.

In the Functional Plastics segment, operating income dropped 74.7%, as sales of modifiers decreased due to a slump in sales in the U.S. housing market, compounded by lower sales volumes in Asia and Europe. In addition, demand for modified silicone fibers fell in Japan, the United States and Europe.

The Expandable Plastics and Products segment moved into the black on an operating basis. Although demand for expandable polystyrene and extruded polystyrene foam boards fell, we succeeded in raising operating income ¥1,367 million compared with the preceding term through selling price adjustments and cost improvements.

Operating income in the Foodstuffs Products segment grew 32.7%, as we expanded sales by introducing distinctive products while curtailing costs. In addition, we revised selling prices to reflect sharply higher raw material costs.

In the Life Science Products segment, a higher sales volume of functional foodstuffs in the United States expanded sales of highly functional products. However, lower selling prices caused operating profits to remain at a level similar to the preceding year. In the market for medical devices, sales



expanded favorably, and bulk and intermediate pharmaceuticals sales volumes were firm. Consequently, the segment posted an 11.6% increase in operating income.

Affected severely by the appreciation of the yen, profits on solar cells decreased, and a major decline in demand for mobile phones and electronic parts resulted in lower sales of ultra heat-resistant polyimide films and LCD-related products. Because of these factors, operating level performance in the Electronic Products segment dropped ¥10,000 million, resulting in an operating loss.

The Synthetic Fibers and Others segment faced substantially lower overseas demand. In the synthetic fibers business, the Group concentrated on sales of high value added products. Sales volumes fell nevertheless, and the appreciation of the yen had a major impact on this business, causing an 82.0% drop in operating income.

## Net Income

During the year, the Group posted an extraordinary loss stemming from a ¥4,207 million loss on the valuation of investments in securities, impairment losses of ¥1,467 million and a ¥925 million loss on liquidation of business. In addition, the Kaneka Group liquidated ¥1,536 million in deferred tax assets. As a result, the Group recorded a net loss of ¥1,851 million, compared with net income of ¥18,817 million in the preceding fiscal year.

## Financial Condition

Total assets for the year shrank 7.5%, to ¥418,490 million. Current assets fell 12.0% to ¥192,221 million, due in part to a decrease in notes and accounts receivable.

Tangible fixed assets were ¥162,336 million, up 1.1%. Primary capital expenditures for the period included the acquisition of land for the Takasago Plant and construction of facilities to expand synthetic fiber production. Investments and other assets contracted 12.7% to ¥61,747 million as the result of a decrease in the market valuation of investment securities because of lower share prices.

Current liabilities amounted to ¥118,933 million, a 11.4% decrease, due to a decline in notes payable and accounts receivable. Fixed liabilities shrank 1.6% to ¥50,028 million.

A decrease in retained earnings and falling share prices reduced unrealized gains on available-for-sale securities, reducing net assets 6.8% to ¥249,529 million.

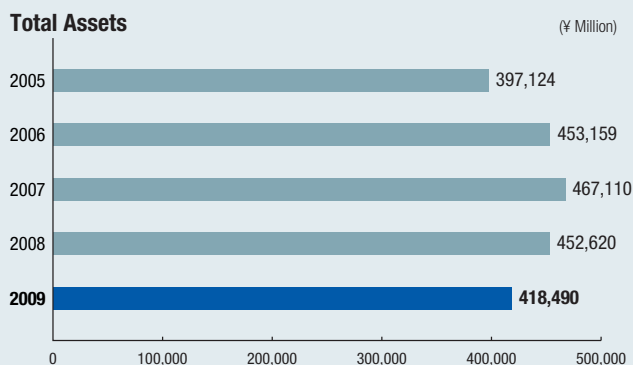
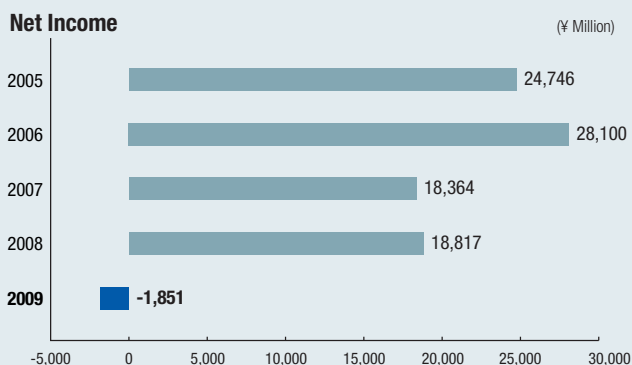
As a result, return on assets (ROA) was -0.4%, compared to 4.2% for the previous year; the shareholders' equity ratio increased from 57.7% to 58.1%; and the debt-to-equity ratio rose from 0.21 to 0.30.

## Cash flows

Net cash provided by operating activities totaled ¥26,465 million, consisting principally of depreciation and amortization of ¥27,353 million. Compared with the preceding fiscal year, cash required for working capital and tax payments decreased. However, owing to the loss before income taxes, net cash provided by operating activities was ¥12,954 million lower than in the previous year.

The principal component of net cash used in investing activities of ¥36,349 million was ¥35,328 million for the purchase of property, plant and equipment.

Net cash provided by financing activities was ¥12,308 million. Increases in debt provided ¥23,953 million, while uses of cash included ¥5,442 million in dividends paid and a



## Financial Review

### Financial Index Trends

	Year ended March 31, 2005	Year ended March 31, 2006	Year ended March 31, 2007	Year ended March 31, 2008	Year ended March 31, 2009
Shareholders' equity ratio	56.4%	57.5%	56.8%	57.7%	58.1%
Shareholders' equity ratio based on market value	103.5%	107.2%	82.4%	46.8%	39.2%
Interest-bearing debt coverage ratio	1.1	1.0	1.6	1.4	2.7
Interest coverage ratio	35.1	44.6	19.9	24.9	19.7

Shareholders' equity ratio: Equity capital/total assets  
 Shareholders' equity ratio based on market value: Total market value of stock/total assets  
 Interest-bearing debt coverage ratio: interest-bearing debt/cash flows  
 Interest coverage ratio: Operating cash flows/interest paid

#### Notes

- All calculated according to financial figures on a consolidated basis.
- The calculation of the total market value of stock is based on the total number of shares outstanding, excluding treasury stock.
- "Cash flows" refers to cash flows from operations.
- The scope of interest-bearing debt is all liabilities in the consolidated balance sheets for which interest is payable.
- Paid interest is based on the amount of interest paid shown in the consolidated statements of cash flows.

¥5,000 million payment for the redemption of bonds. As a result, cash and cash equivalents at the end of the current fiscal year was ¥24,241 million, up ¥2,253 million from the end of the previous fiscal year.

### Business Risks and Uncertainties

Factors that may significantly affect the performance and the financial position of the Kaneka Group include those described below.

Please note that the matters described are only those that we considered risks as of March 31, 2009; this is not an exhaustive list of risks borne by the Group.

#### (1) Risks related to the Group's ability to maintain operational advantages and trends in the Japanese and overseas economic environments

The Kaneka Group maintains its operational advantages by developing and commercializing high value added products in a host of fields and consistently cultivating new markets with its ability to integrate its expertise in core polymer and fermentation technologies. At the same time, we are working to ensure a corporate structure that is not affected by the entry of competitors into these markets, a situation that could result in increasingly severe price competition, reduced profitability and the growth of generic products, which could cause the demand for the Group's products to decrease and push the Group toward withdrawing from or restructuring

certain operations, and are working to mitigate the potential effects of changes in the economic environment. However, such measures may not be sufficient to withstand a sudden downturn in the economic environment, obsolescence of the Company's technologies, or an unexpectedly rapid drop-off in demand for the Company's products. Such circumstances could seriously affect the Group's financial position and performance.

#### (2) Risks associated with the globalization of our business (fluctuations in foreign exchange rates and overseas business development)

For the Kaneka Group, globalization is a key element of its management strategy. Accordingly, international sales accounted for 32.7% of total sales in the current fiscal year. However, overseas business operations face various risks, including unexpected changes in laws, regulations and tax systems, transfer price taxation, and social and political disturbances resulting from terrorism and warfare. If these risks materialize, they may adversely affect the Group's performance and financial position. Meanwhile, fluctuations in foreign exchange rates have the potential to significantly affect the Group's performance because of its revenue structure. Therefore, we employ foreign exchange forward contracts and other hedges in connection with foreign trade transactions, as appropriate, to minimize the risk of foreign exchange rate fluctuations. However, sharp fluctuations in exchange rates beyond the coverage of hedge instruments may seriously affect the performance and financial position of the Group.

#### (3) Risks of price fluctuations of raw materials and fuels

Through combinations of medium- to long-term forward contracts and spot market purchases, the Kaneka Group has adopted a purchasing framework to achieve the most favorable purchasing cost for raw materials and fuels. However, since most of these commodities are subject to price fluctuations in the international market, there are still some risks involved, as there may be sharp fluctuations in prices beyond expectations which cannot be offset by cost reductions or price revisions. In particular, price fluctuations in petrochemical materials, fuels and edible oils and fats affect the production of PVC/caustic soda, modifier, expandable plastics and products, and foodstuffs, which may in turn significantly

impact the Group's financial position and performance.

**(4) Risks associated with product liability, industrial accidents and large-scale disasters**

The Kaneka Group implements comprehensive strategies to ensure the safe distribution of products that are safe to use. Furthermore, we maintain liability insurance covering the whole Group in order to be prepared should a product related accident occur. However, the possibility remains that unexpected problems with product quality may cause a large-scale product related accident. Moreover, despite our best efforts to ensure safety and prevent accidents by placing the highest priority on safety, risks remain. Major disasters, such as an industrial accident or an earthquake, could destroy manufacturing facilities and losses could be incurred beyond the coverage of property insurance. In such circumstances, it is possible that the Group's financial position and performance could be significantly affected.

**(5) Risks associated with the protection of intellectual property rights**

To maintain its business advantages the Kaneka Group attaches strategic importance to the protection of its patents on newly developed technologies. However, with globalization and the development of IT technologies, it is not possible for us to completely avoid the risk of external leaks of our proprietary technologies and expertise. Nor is it possible to avoid all disputes with other parties in connection with the conveyance of our intellectual property or with our use of other companies' intellectual property. In such circumstances, it is possible that the Group's competitiveness could be undermined and its financial position and performance significantly affected.

**(6) Impact of environment related regulations**

To minimize the impact of its business activities on the global environment and the ecosystem, the Kaneka Group puts forth its best effort to reduce any burden on the environment and to save resources and energy throughout the life cycle of its products. Environmental regulations are tightened every year, and depending on the nature of the regulations, expenses may be incurred in connection with the manufacture, storage and disposal of products that significantly impact the Group's financial position and performance.

**(7) Risks associated with legal action**

The Group attaches importance to compliance

management regarding the observance of laws and social rules. There are risks, however, of the Group becoming the subject of litigation and administrative measures in connection with operations in Japan and abroad. If a significant action is filed against the Group, it is possible that the Group's financial position and performance would be significantly affected.

**(8) Other risks**

To promote long-term business relationships, the Kaneka Group holds shares in its business partners and financial institutions. In the event that the market value of these shares decreased significantly at the end of the fiscal year, the Group could record impairment losses pursuant to the Accounting Standard for Financial Instruments. With regard to fixed assets, a substantial worsening in the operating environment could cause further declines in the market value of idle land held by the Group. Consequently, the Group could record impairment losses with the application of the Accounting Standard for Impairment of Fixed Assets.

For retirement benefit obligations and retirement benefit expenses, actuarial calculations are made each year to determine the discount rate and other core ratios, incorporating the expected rate of investment return on core assets. However, a reduction in the discount rate or a decrease in investment yields on pension assets could affect the Kaneka Group's financial position and performance.

Deferred tax assets are posted against future temporary differences under the assumption that they can be recovered by offsetting future taxable income. However, if actual taxable income differs from what was expected, the liquidation of deferred tax assets could affect the Group's financial position and performance.

The Group's financial position and performance may otherwise be significantly affected by such factors as fluctuations in the markets for its products, changes in laws and regulations, delays in research and development and technical innovations.