MANUFACTURE GROWTH

Annual Report 2006

Year ended March 31, 2006

DAICEL CHEMICAL INDUSTRIES, LTD.

We successfully achieved

our Medium-Term Business Plan targets one year in advance.

	FY2006 Results		FY2007 Targets
Net Sales	¥336 billion	>	¥300 billion
Operating Income	¥33.6 billion	>	¥30 billion
ROA*	7.2 %	>	6.0 %

*the ratio of total assets to recurring profit

Contents

CAUTION WITH RESPECT TO FORWARD-LOOKING STATEMENTS

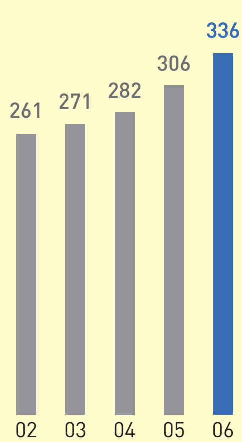
This annual report contains forward-looking statements about the future plans, strategies, beliefs and performance of the Daicel Group as a whole and its individual consolidated companies. These forward-looking statements are not historical facts. They are expectations, estimates, forecasts and projections based on information currently available to the Daicel Group and are subject to a number of risks, uncertainties and assumptions, which, without limitation, include economic trends, fluctuations in foreign currency exchange rates, fluctuations in the price of raw materials, competition in markets where the Company is active, personal consumption, market demand, the tax system and other legislation. As such, actual results may differ materially from those projected and the Daicel Group cannot guarantee that these forward-looking statements are accurate or will be achieved.

Financial Highlights

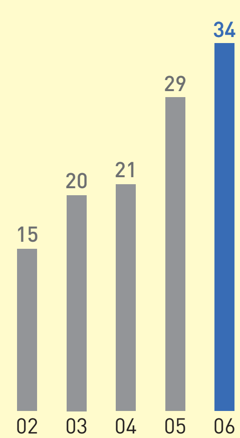
Daicel Chemical Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2006	2005	2004	2006
Net sales	¥ 335,520	¥ 306,335	¥ 281,740	$ 2,867,692
Operating income	33,570	28,553	21,207	286,923
Income before income taxes and minority interests	29,386	22,380	8,055	251,162
Net income	14,221	10,844	5,166	121,547
Total assets	483,469	413,493	381,485	4,132,214
Total shareholders' equity	197,780	171,225	160,479	1,690,427
Amounts per common share:	Yen			U.S. dollars (Note 1)
Net income	¥ 39.16	¥ 29.82	¥ 14.21	$ 0.33
Cash dividends applicable to the year	8.00	8.00	6.00	0.07

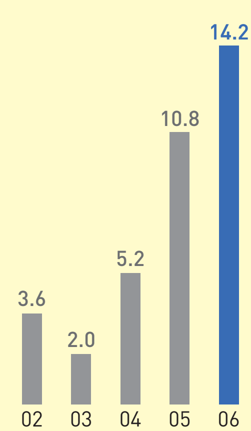
Notes: 1. The U.S. dollar amounts in this report are translated from Japanese yen, for convenience only, at the rate of ¥117=$1, the approximate exchange rate at March 31, 2006.
2. The computations of net income per share of common stock are based on the weighted average number of shares outstanding.



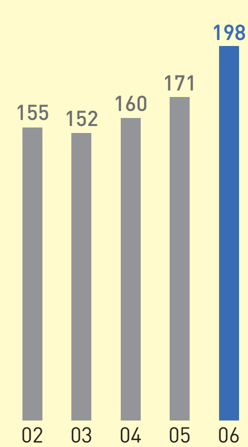
Net Sales
(Billions of yen)



Operating Income
(Billions of yen)



Net Income
(Billions of yen)



Total Shareholders' Equity
(Billions of yen)

Message from the President

In the fiscal year ended March 31, 2006, Daicel Chemical Industries Ltd.'s consolidated net sales of ¥335.5 billion, operating income of ¥33.6 billion and net income of ¥14.2 billion all marked record highs, and the ratio of total assets to recurring profit was 7.2%, thus achieving a year ahead of schedule the targets set for fiscal 2007, the final year of the Medium-Term Business Plan. The increase in net sales was brought about by significant growth, carried over from the previous fiscal year, in triacetyl cellulose (TAC), which is used in the manufacture of liquid crystal display (LCD) film, as well as automobile air bag inflators. Although prices for raw materials and fuel remained at high levels, sales price revisions were carried out, mainly on acetic acid and engineering plastics. From the segment perspective, all segments achieved increases in both sales and profit.

Having been created by the merger of eight celluloid producers in 1919, the Company's original celluloid-related technology has expanded into areas including cellulose chemistry, organic synthesis chemistry, polymer chemistry and pyrotechnic chemistry. Based on these technologies, in recent years we have been focusing our efforts on creating new businesses in fields where growth is expected, including electronics and IT, life sciences, and environment and safety.

Daisuke Ogawa
President and CEO

Based on the techniques accumulated with distinction over more than 80 years, the Company has been managed with sustainable "growth with profit" as its aim. While striving for profitable growth, Daicel places great emphasis on environment-friendly operations and corporate social responsibility.

Strategies for Continuing "Growth with Profit"

Strategies by Business Segment

In the cellulosic derivatives segment, continuing significant growth is expected in the LCD market, in which TAC is used as a base material. Demand is also expanding for cigarette filter tow in Asia, Daicel's principal market. To respond to burgeoning demand, new production facilities are being built and existing capabilities expanded and upgraded in both Japan (for both TAC and tow) and China (for tow only).

In the organic chemicals segment, in June 2006, Daicel merged the Organic Chemical Products Company and the Organic Designed Products Company to establish the new Organic Chemical Products Company. This reorganization was put into effect to make production facilities and marketing efforts more efficient. The CPI company focus will be on chiral columns, which have the dominant share in the market.

Development in the Chinese and ASEAN markets is continuing in the plastics and films segment. Group companies offer high-value-added, top-quality products in response to thriving demand from the IT, telecommunications, automotive and electronics fields for highly functional engineering plastics. With a view to exploring new markets, the company acquired Ticona's cyclic olefin copolymer (COC, trademark: TOPAS®) business. Through the evolution of business development activities with a focus on optical material applications, COC sales of ¥10 billion are anticipated in the fiscal year ending March 31, 2011.

In the pyrotechnic devices segment, the air bag inflator business will grow more rapidly as overall automobile production increases, and as the installation rate of primarily side impact air bags is expected to increase, Daicel forecasts a corresponding demand for air bag inflators. To respond to this increased demand, new production facilities are being built and existing capabilities expanded and upgraded on a global basis.

Global Strategies

In principle, two factors advance the globalization of the Daicel Group:

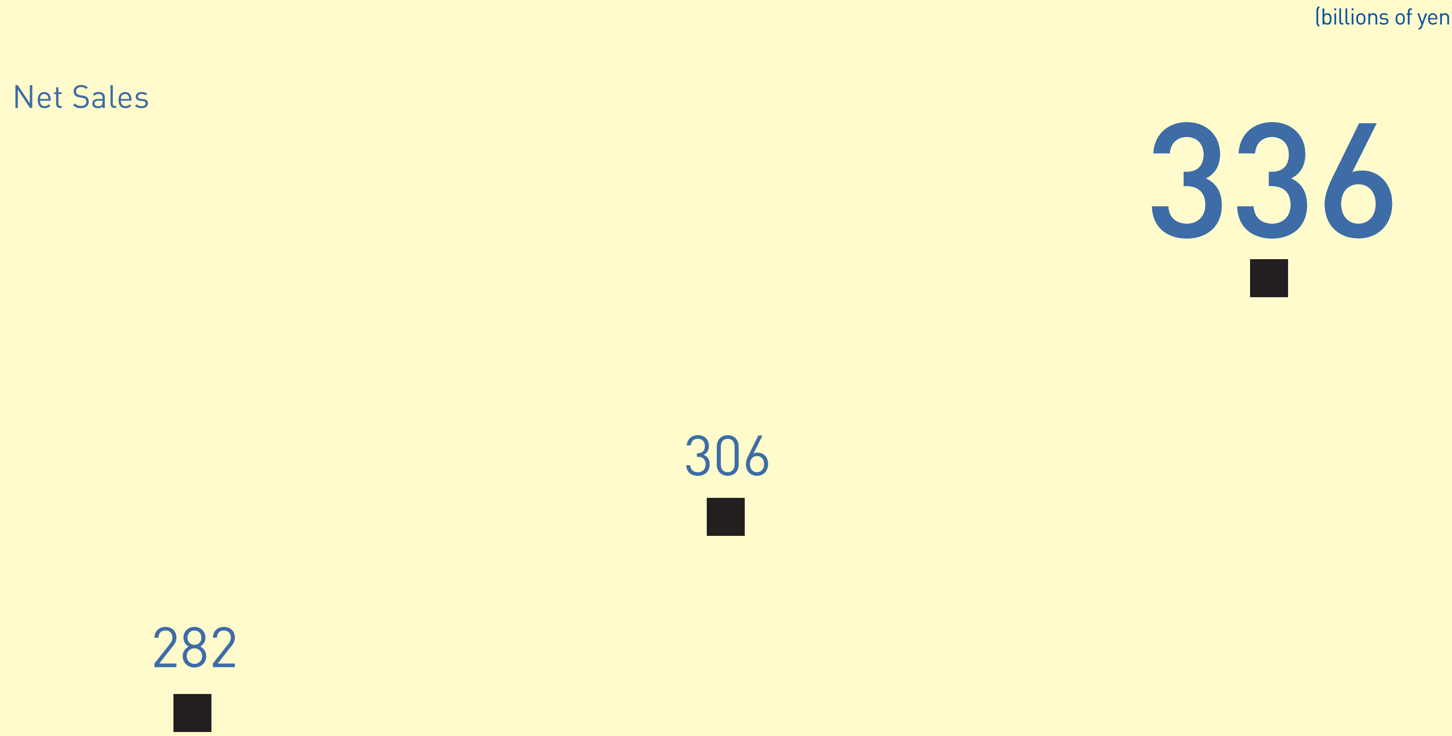
- Evaluating globalization leads to sustained improvements in global competitive superiority
- Responding to market and customer requests

With "C&I" (China and Inflator) as its slogan, Daicel's future global evolution calls for the selective injection of management resources into the development of businesses that possess competitive superiority in China, where the market is massive, and into the global five-basis production and sales structure of the automobile air bag inflator business.

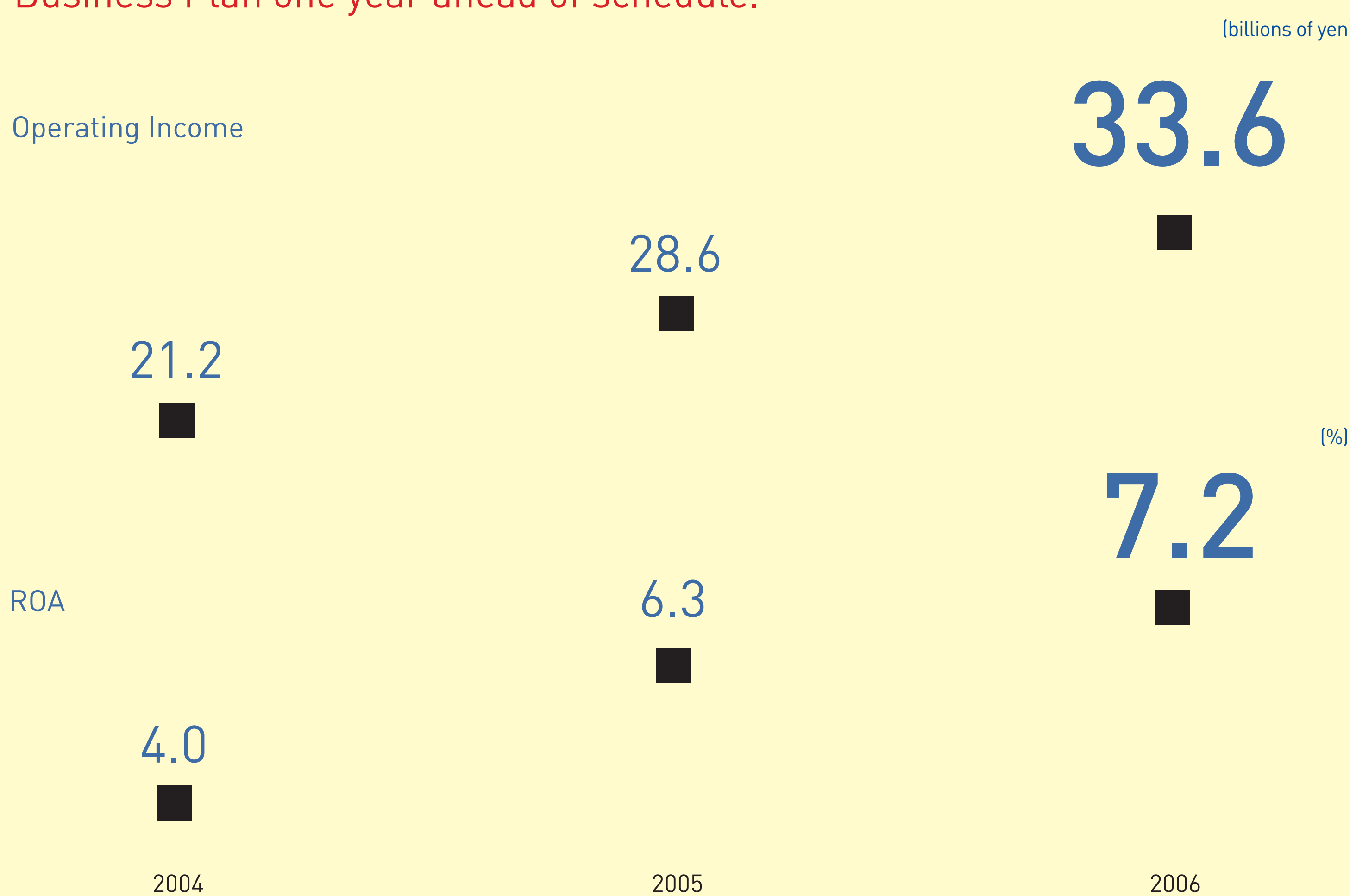
Daicel will promote local management resources, integrate its operations, make headway with global development that is both strategic and efficient, and supply customers with indispensable products.

Outlook

While the Japanese economy is expected to progress from a transitional period to one showing signs of sustained growth, such factors as a long-term escalation in raw material and fuel costs, uncertain economic prospects in the United States and



Daicel Chemical Industries Ltd.'s consolidated net sales of ¥335.5 billion, operating income of ¥33.6 billion and net income of ¥14.2 billion all marked record highs, and the ratio of total assets to recurring profit was 7.2%, thus achieving the targets set for fiscal 2007, the final year of the Medium-Term Business Plan one year ahead of schedule.



China, as well as a sense of deepening turmoil in international affairs give no grounds for optimism in terms of business conditions.

The business environment in the chemical industry remains wrought with difficulties, brought about by sales price revisions in response to the escalating costs of raw materials and fuel, the need to maintain cost competitiveness and strengthen R&D, as well as environmental safety concerns and other problems that need to be addressed.

Under these circumstances, the Daicel Group's performance outlook depends on a number of factors: continued growth in demand for TAC; an increase in sales volume of engineering plastics; a significant rise in sales volume for automobile air bag inflators; upward sales price revisions to keep pace with the rising costs of raw materials and fuel; and efforts to reduce costs. For fiscal 2007, Daicel is forecasting record highs in terms of net sales (¥367 billion), operating income (¥35 billion)—marking the ninth consecutive period of increased operating income—and net income (¥15.5 billion). This outlook assumes an exchange rate of $1=¥110.

Basic Policy Regarding Distribution of Profits

Daicel gives careful consideration to its dividend policy, taking a comprehensive and long-term perspective while assessing profit conditions and future business development prospects each fiscal year. The Company has adopted a balanced basic policy of consistently rewarding shareholders with appropriate dividends and reinforcing internal reserves in order to establish an increasingly firm revenue base.

In the previous fiscal year, the annual dividend of ¥8 included a commemorative dividend of ¥2 per share to celebrate the 85th anniversary of the Company's establishment. The annual dividend for the year ended March 31, 2006 was also ¥8, which represented a mid-term dividend of ¥4 and a period-end dividend of ¥4.

Next Medium-Term Business Plan

The next Medium-Term Business Plan runs from fiscal 2008 to fiscal 2010. Fiscal 2010 is also the final year of the Second Long-Term Plan, one of the goals of which is to achieve a ratio of total assets to recurring profit of 10%. The seeds of what will become the Daicel Group's mainstay businesses beyond fiscal 2011 will be recognized as a critical issue and steadily nurtured. I firmly believe that I will be able to report medium-term growth to all shareholders in the next annual report.

Daisuke Ogawa
President and CEO

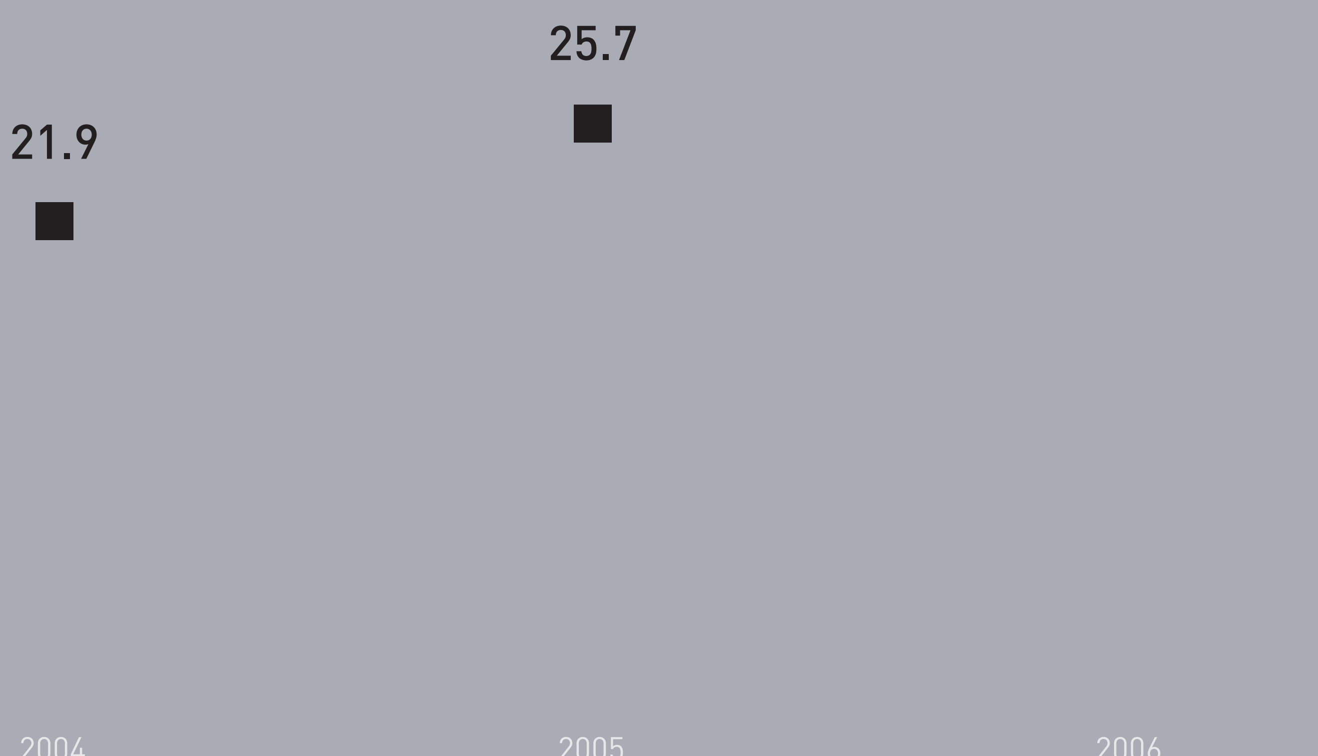
and what´s next?

(billions of yen)

2.4 Times More Capital Investment Compared with Fiscal 2005

Invested 62.0

The ¥62.0 billion of capital invested in the period under review was primarily allocated to Daicel's growth drivers, the Cellulosic Derivatives segment and the Pyrotechnic Devices segment. The amount includes such factors as the relocation of the acetate tow for cigarette filters business within the Sakai Plant caused by the expressway construction plans. As a result, capital investment was 2.4 times greater than in the previous fiscal year in terms of the monetary amounts involved, and will serve as a firm step on the path toward long-term growth. Proactive capital investment that focuses on areas of anticipated growth will be undertaken.



¥30.2billion

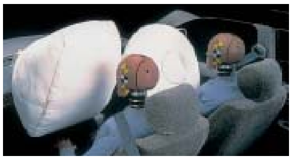
Capital Investment in the Cellulosic Derivatives Segment

In the Cellulosic Derivatives segment, investment was selectively targeted on facilities producing TAC, which is the raw material for LCD film, and on acetate tow used in cigarette filters.

Because of expanded production volumes brought about by the larger sizes of flat-screen LCD TVs on the market, significant growth in the LCD film business is expected to continue. To respond to the increasing demand for LCD film, plants specializing in TAC have recently been established in Japan to expand production capabilities.

With regard to the acetate tow used in cigarette filters, the major U.S. and European tobacco makers are relocating manufacturing sites from Europe to Asia, Africa and the Middle East. To take full advantage of the opportunity presented by this greater demand in a market in which the Company possesses a geographical edge, state-of-the-art production facilities will be established as a result of the plant relocation brought about by the expressway construction. In addition, improvements in productivity and increased production capacity will be effected. The new facilities are envisaged to be fully operational in the second half of 2007. There are also plans to triple production capacity and increase sales volumes at China-based equity-method affiliate company, Xi'an Huida Chemical Industries Co., Ltd.

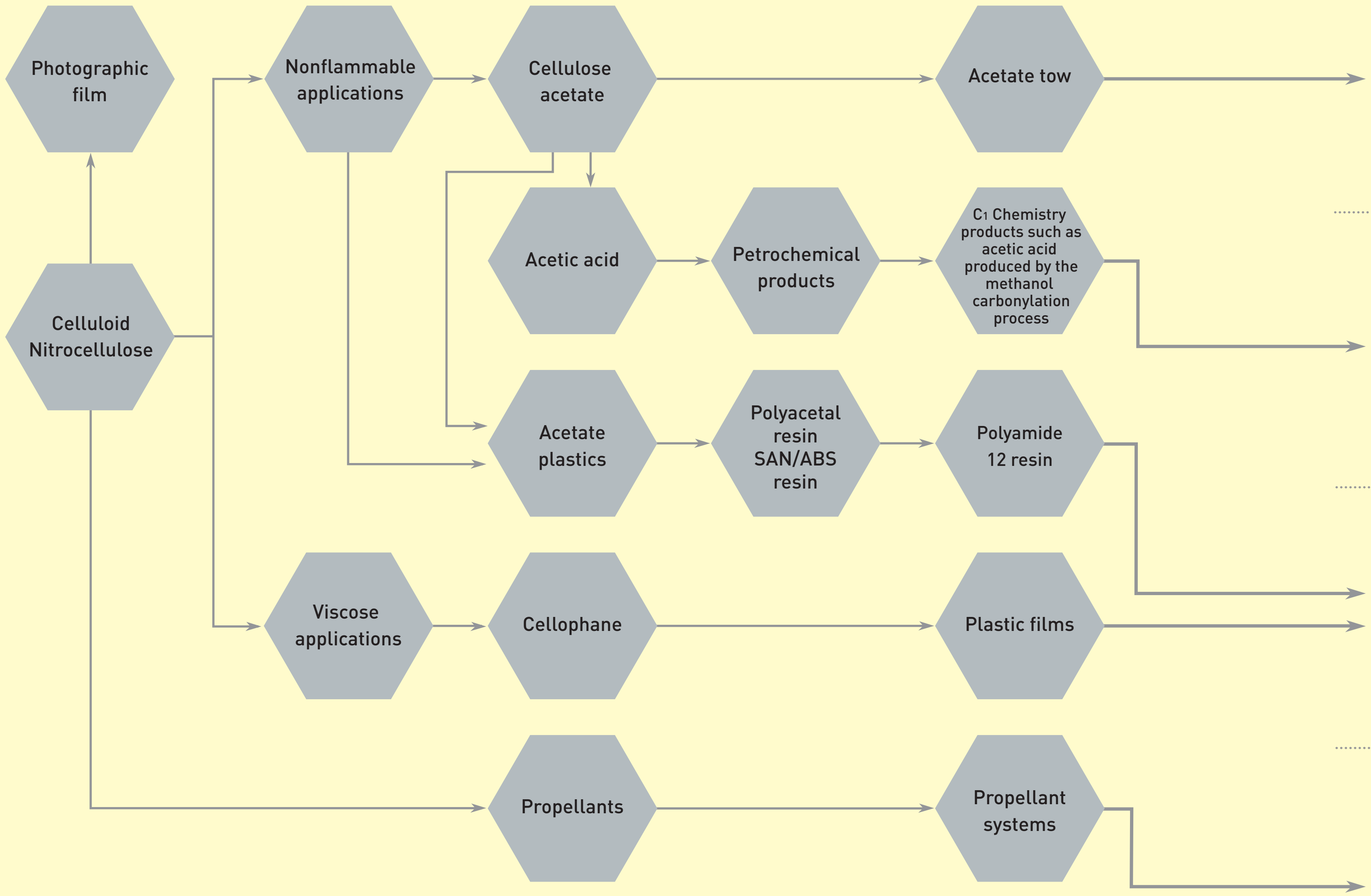
¥12.7 billion

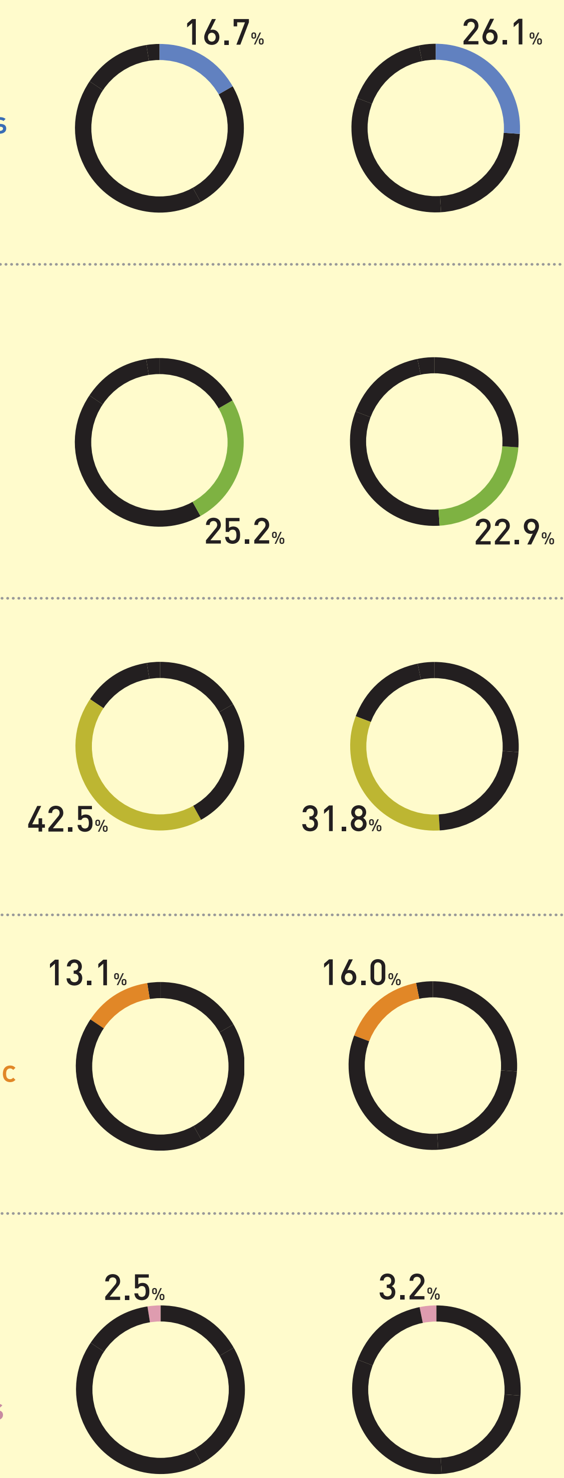


Capital Investment in the Pyrotechnic Devices Segment

The inflators used in the automobile air bag systems produced by the Pyrotechnic Devices Business have been highly acclaimed by customer (automakers) for their compact and lightweight design, resulting from the wealth of technologies Daicel has amassed over the years in dealing with gunpowder. The number of automobiles being produced globally with air bag systems offered as standard equipment is increasing, and improving the proportion of those equipped with air bags in new positions, such as side and curtain air bag systems, is expected to result in significant growth in volume. To meet increasing demand, production capacity at existing inflator production bases in Japan, the United States and Thailand will be expanded, while a new base came on stream in Poland in the spring. During the autumn of 2006, the latest base in China is scheduled to start production. Through these efforts, a global five-basis production and sales structure encompassing Japan, the United States, Thailand, Europe and China will be established. Daicel continues to move toward steady growth.

Business Development Flowchart





Business Segment	Sales	Operating Income	Major Products	Uses
Cellulosic Derivatives	16.7%	26.1%	Cellulose acetate	LCD films, acetate fibers, photographic films, plastics
			Acetate tow	Cigarette filters
			Carboxymethyl cellulose (CMC) and other water-soluble polymers (WSP)	Foods, pharmaceuticals, cosmetics, adhesives, textiles, mud stabilizers, thickeners
			Acetate plastic Celluloid	Frames for glasses, other products
Organic Chemicals	25.2%	22.9%	Acetic acid	Cellulose acetate, vinyl acetate Auxiliary dyeing agents, pharmaceuticals Agricultural chemicals, pure terephthalic acid (PTA)
			Solvents	
			Chiral HPLC columns	Separation of optical isomers
			Other organic and inorganic industrial-use chemicals	
Plastics and Films	42.5%	31.8%	Polyacetal resin Polybutylene terephthalate (PBT) resin SAN/ABS resins and alloys Polystyrene sheets and plastic products	Electric and electronic appliance parts, automobile parts Communications appliance parts, household goods, sundry goods
			Moisture-proof packaging films	Packaging for foods, drugs, textiles
Pyrotechnic Devices	13.1%	16.0%	Inflators	Automobile air bag systems
			Aircrew emergency-escape systems	Fighters, trainers, helicopters
			Rocket motors	Missiles
			Propellants	
Functional Products and Others	2.5%	3.2%	Separation membrane modules	Water treatment

Cellulosic Derivatives

(billions of yen)

Sales to Outside Customers

Operations

	Millions of yen		
	2006	2005	2004
Sales to outside customers	**¥ 55,899**	¥ 50,132	¥ 48,180
Intersegment sales	**2,222**	1,942	1,785
Total sales	**58,121**	52,074	49,965
Total cost and expenses	**47,290**	42,409	39,139
Operating income	**¥ 10,831**	¥ 9,665	¥ 10,826
Total assets	**¥ 86,828**	¥ 57,894	¥ 55,103
Depreciation	**4,131**	4,127	4,254
Capital investments	**30,154**	4,398	4,440

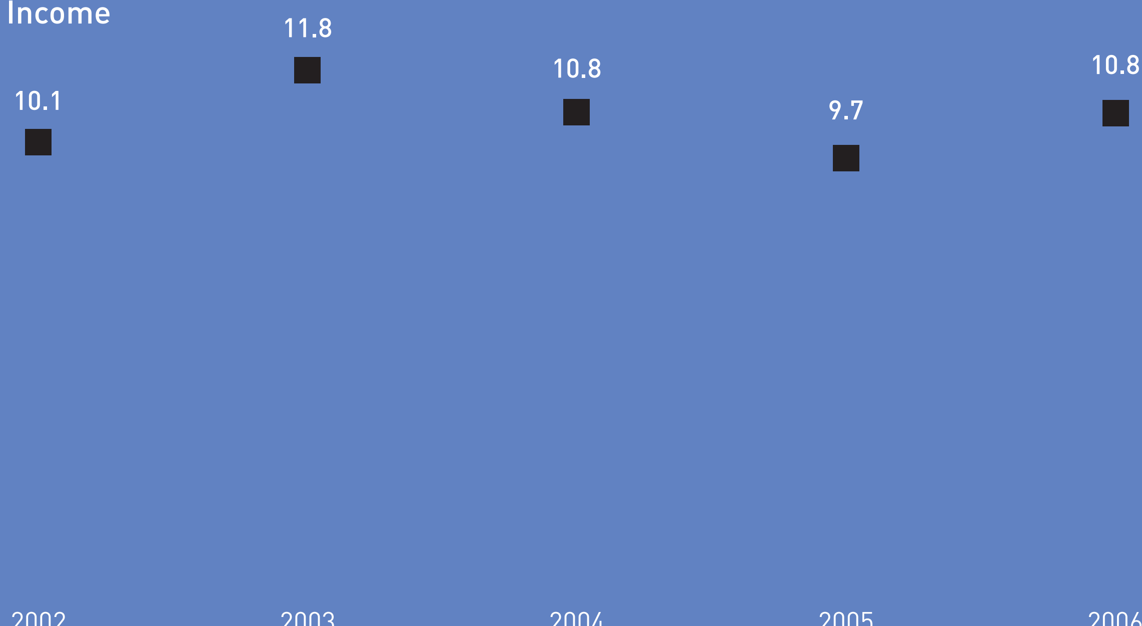
Cellulose acetate sales volume increased, primarily due to stronger demand from LCD film applications, and sales increased owing to price revisions in accordance with the escalating raw material and fuel prices.

The sales volume of acetate tow for cigarette filters remained on par with the previous fiscal year, but sales increased, owing to sales price corrections in overseas markets and weakening yen exchange rates.

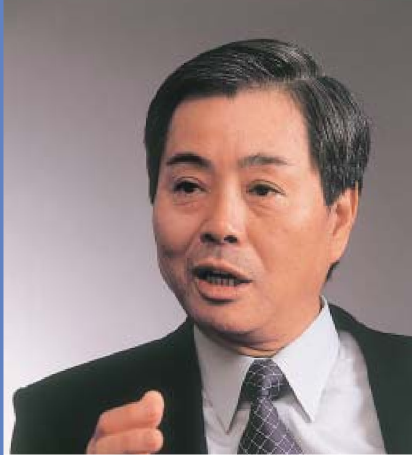
Expanding sales for newly developed hydroxyethyl cellulose (HEC) pharmaceutical and cosmetic products and increased overseas demand from oil drilling and cosmetic applications contributed to increased volume and sales of water-soluble polymer (WSP).

Net sales in the cellulosic derivatives segment were ¥55.9 billion, up 11.5 % compared with the previous fiscal year, and operating income increased 12.1% to ¥10.8 billion.

Operating Income



Cellulose Company



Ichiro Katagiri
President of
Cellulose Company

The Cellulose Company supplies cellulose acetate to film and textile manufacturers as the base material in the production of LCD and photographic films, acetate fibers, and acetate tow and manufactures and sells acetate tow for cigarette filters to domestic and overseas cigarette manufacturers. As a Daicel core business, the Cellulose Company holds the position of Asia's top manufacturer of both cellulose acetate and acetate tow.

Because the market for triacetyl cellulose (TAC), which is used in the manufacture of LCD film, is primarily based in Japan, the company maintains close relations with film manufacturers. These relations, coupled with the ability to provide TAC tailored for LCD film manufacturing, are further sources of the Cellulose Company's competitive strength.

There is expected to be continued pressure on the supply and demand of LCD film as a result of the expanding market for flat-screen televisions. For that reason, film makers are planning to augment their production capabilities. In response to these conditions, Daicel is undertaking proactive capital investment on an ongoing basis and proceeding to ramp up production rates.

The competitive edge that Daicel has in cigarette filter tow comes from its integrated manufacturing structure, which starts from the raw material stage of acetic acid to assuring a stable supply. The company is closely linked with its specialized customers in Asia, the Middle East and Africa, providing them with superior service.

Although demand for cigarettes has hit a peak, there is a growing trend toward low-tar brands that has arisen globally on health grounds. The tobacco industry is pressing ahead with such measures as the manufacture of longer filters and switching from other raw materials. These changes in the industry are giving impetus to steady growth in demand for acetate tow for cigarette filters. The company believes that demand for cigarette filter tow will remain solid in its primary operating market of Asia. In anticipation of growing demand, the company is expanding and strengthening the capabilities of its plants at Ohtake in Japan and at Xi'an Huida Chemical Industries Co., Ltd. in China.

By the manufacture and sale of TAC in positive response to the burgeoning demand for LCD film, the company will play a key role in driving further growth at Daicel.

Atsushi Taguchi
President of
WSP Company

WSP Company

The business of the WSP Company is the manufacture and sale of water-soluble polymers, primarily carboxymethyl cellulose (CMC) and hydroxyethyl cellulose (HEC), and the manufacture and sale of Celish and Tiara microfibrillated products.

CMC is an anionic cellulose derivative. Dissolved in water, it becomes a clear and colorless liquid that, as a viscosifier, emulsion dispersant, adhesive and colloid stabilizer, has widespread applications in the food product, civil engineering and oil drilling, fish feed, pharmaceutical and cosmetics fields. Our strength in the CMC business comes from our rich product lineup that we tailor to customer needs through our ability to manufacture carboxymethyl group with a wide degree of substitution, ranging from low to high. Amid the intense competition in the Japanese market, WSP plans to improve profitability by focusing on the exploration of new product markets and the cultivation of new customers. As growth is expected in the export field, where the oil drilling market is buoyant and the Southeast Asian food industry market is expanding at a remarkable pace, a stable supply system will be established.

Highly transparent HEC is a non-ionic cellulose derivative that is receiving high acclaim for its cosmetic (shampoos, conditioners) and other applications (paint products). One of WSP's unique selling points is that it possesses multi-purpose manufacturing facilities that are capable of producing not only HEC but also its derivatives, giving WSP a high degree of latitude in its manufacturing operations. Progress was made with the market entry of new applications in the cosmetic and household fields in fiscal 2006, ended March 31, 2006, and there is still scope for potential growth.

Celish is a microfibrillated cellulose that brings fiber diameters down to the nanometer level. Its netlike structure exhibits various features such as shape retention, filtration and enhanced strength with a little dosage.

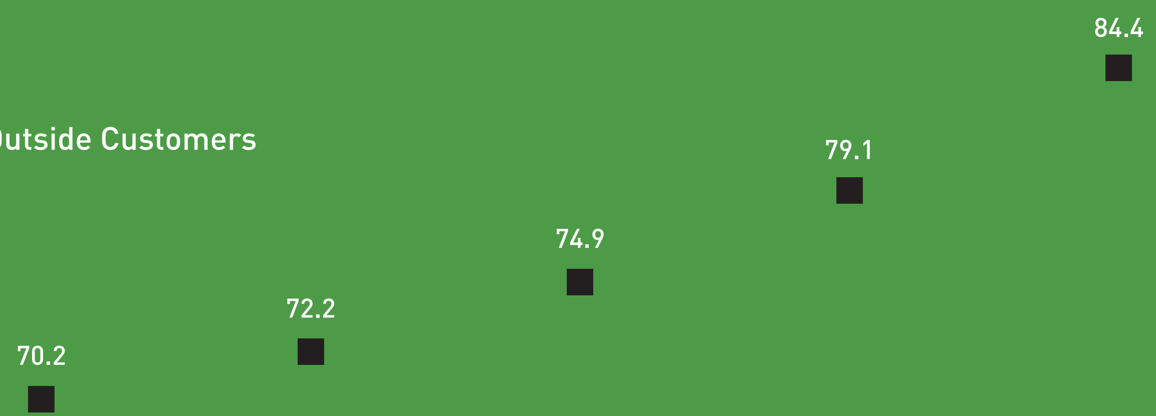
Tiara is a microfibrillated aramid fiber that also brings fiber diameters down to the nanometer level. Its netlike structure has functions that improve heat resistance and anti-abrasive qualities.

Daicel is the sole manufacturer of both Celish and Tiara. As new developments in automotive applications are bearing fruit, it is anticipated that sales as catalytic applications for exhaust particulate filters and for clutch plates will gain momentum.

Organic Chemicals

(billions of yen)

Sales to Outside Customers



Operations

	Millions of yen		
	2006	2005	2004
Sales to outside customers	**¥ 84,435**	¥ 79,087	¥ 74,916
Intersegment sales	**10,989**	11,083	9,816
Total sales	**95,424**	90,170	84,732
Total cost and expenses	**85,947**	83,310	79,930
Operating income	**¥ 9,477**	¥ 6,860	¥ 4,802
Total assets	**¥ 82,909**	¥ 82,321	¥ 84,530
Depreciation	**6,426**	7,062	7,861
Impairment loss on fixed assets	**895**	-	-
Capital investments	**5,461**	5,209	4,586

Increases in the sales of acetic acid were brought about by sales price revisions carried out in an environment marked by supply and demand pressures.

The sales volume of general-use products such as acetic acid derivatives and solvents declined, brought about by reducing the sales of unprofitable products, as business selection and focus measures were carried out, and by adjusting production of acetic acid derivatives to take into account supply and demand pressures on acetic acid. Sales increased, however, supported by generally brisk demand as price revisions were put into effect to counteract the higher costs of raw materials.

Fine chemical product sales also rose, by focusing on sales of sophisticated products for electronic materials, bringing to market new health care products, and reducing the sales of unprofitable lines.

Sales volume and sales of intermediate pharmaceuticals both decreased as a result of a decline in demand for certain products, while sales in the chiral chromatography business increased, thanks to healthy, predominantly overseas sales of chiral chromatographic columns and bulk chiral stationary phase.

Net sales in the organic chemicals segment increased 6.8% to ¥84.4 billion, and operating income jumped 38.2% to ¥9.5 billion.

Operating Income

Organic Chemical Products Company

Shuzaburo Kumano
President of
Organic Chemical
Products Company

The new Organic Chemical Products Company was established in June 2006 by merging the Organic Chemical Products Company and the Organic Designed Products Company. As well as strengthening marketing functions in the organic chemical field, the merger has brought the management of R&D and production functions under one umbrella, accelerated decision-making and expedited responsiveness to market requirements.

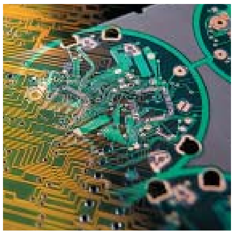
The company manufactures general-purpose and fine chemical products built-around acetic acid and its derivatives. The product lineup chemicals are used as raw materials in a wide array of fields, including synthetic fibers, coatings, pharmaceuticals, and agricultural chemicals. In addition, the company manufactures and markets an array of organic-designed products, such as epsilon-caprolactone and its oligomers and polymers, as well as alicyclic epoxide compounds and special-purpose monomers. These products are used to advantage in a variety of fields, including coatings, health care products, and electronic materials.

While endeavoring to sustain and improve competitiveness by comprehensive cost reductions related to its existing products, the company will undertake selection and focus measures aimed at a strong, winning product range.

At the same time, with regard to its core products, the aim is to heighten the company's presence in the Asian market, including China, where growth in demand is expected, to upgrade and expand manufacturing sites in Japan, and to endeavor to secure manufacturing bases in the Asian region. Synchronized with these measures will be a focus on correcting sales prices to keep pace with soaring raw material costs, with the aim of establishing a firm and sustainable business base.

The R&D focus on the development of substances for use in the highly competitive but high-growth markets in the electronics and life-science fields. Collaboration between development and sales divisions will be conducted at unprecedented levels in order to rapidly respond to market needs and to seize new business opportunities.

The company will fulfill its social responsibilities as a manufacturer of chemical products by accumulating product safety data, upgrading and expanding the eco-friendly aspects of its operations and products—solvent recovery, for example—as well as by doing all in its power to reduce or eliminate any impact that production activities might have on the environment.



Hisao Nishimura
President of
CPI Company

CPI Company

The CPI Company markets and produces stationary phases and columns for the chromatographic separation of optical isomers and also manufactures pharmaceutical ingredients and intermediates, taking full advantage of its chromatographic separation technologies, biotechnologies and organic synthesis technologies.

Optical isomers are chemically related, but distinct compounds. Due to a special characteristic in their molecular structures, the two isomers of a chiral compound can have very different affects on biological systems. While one isomer can be a beneficial pharmaceutical, the other isomer may have negative affects on the body, or no effect at all. An increased understanding of these effects by the drug manufacturers and the regulatory authorities has resulted in an increased demand for single-isomer drugs in recent years.

Daicel's line-up of columns for the separation of optical isomers is world-leading, and all operations in Japan, the United States (Chiral Technologies Inc., CTI) and Europe (Chiral Technologies Europe S.A.S., CTE) provide customer support at every stage of pharmaceutical product development from R&D to commercial manufacturing. The CPI Company and its subsidiaries offer chiral separation services through Supercritical Fluid Chromatography (SFC), High Performance Liquid Chromatography (HPLC) and Simulated Moving Bed (SMB) processes.

The benefits of SFC when compared with HPLC are shorter elution times and smaller amounts of solvents used. Demand for SFC separations is growing at a rapid pace, particularly in the United States, and is expected to spread to Europe and then to Asia.

A sales office in China was opened in the fiscal year ended March 31, 2006 to provide an adequate sales structure and technical support to the growing Asian region. Entry into the Indian market is also anticipated.

Looking into the future, beyond R&D activities, manufacturing operations will be the focus of the CPI Company. As these prove commercially viable, they will result in a further globalization of the company.

Microbe bioconversion is another chiral technique utilized by the CPI Company for the industrial commercialization of pharmaceutical intermediates. This technique is currently used to improve processes by which pharmaceuticals are manufactured.

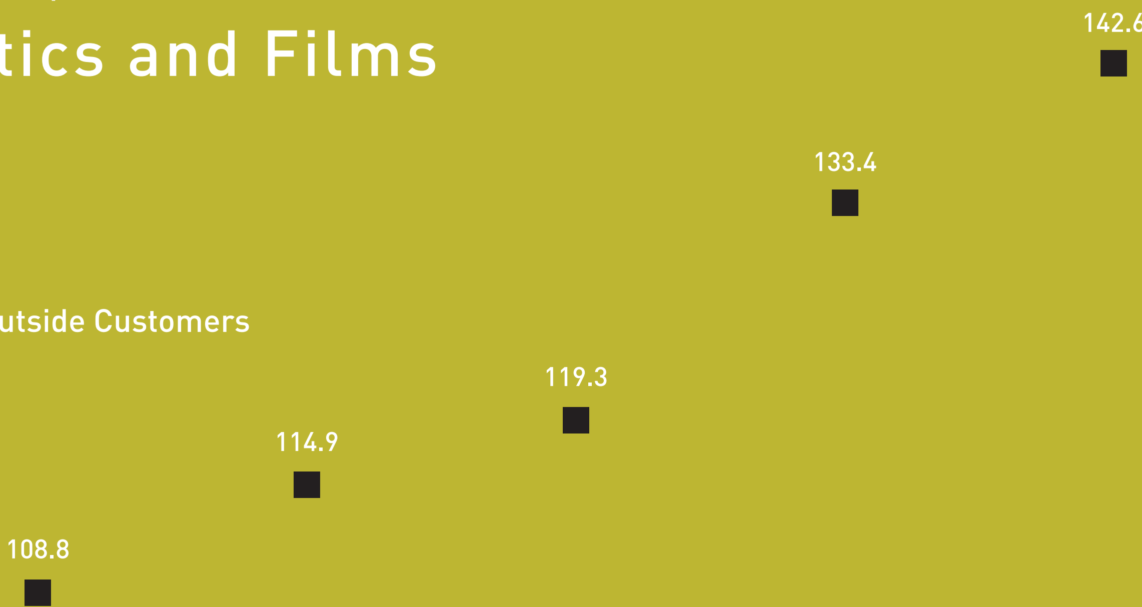
"Best Solutions for Chiral Processes" summarizes best our offering to the pharmaceutical industry, and its continually growing need for chiral compounds.

By utilizing the CPI Company's two chiral technologies (chromatographic separation and bioconversion), we will focus on the final phases of drug development and chiral switches (switching from racemic to single isomer pharmaceuticals), as well as increasing profitability by reducing costs through streamlining production facilities.

Plastics and Films

(billions of yen)

Sales to Outside Customers



Operations

	Millions of yen		
	2006	2005	2004
Sales to outside customers	**¥142,556**	¥133,390	¥119,299
Intersegment sales	**37**	49	46
Total sales	**142,593**	133,439	119,345
Total cost and expenses	**129,421**	120,430	111,796
Operating income	**¥ 13,172**	¥ 13,009	¥ 7,549
Total assets	**¥149,738**	¥135,949	¥128,172
Depreciation	**6,887**	6,770	7,491
Impairment loss on fixed assets	**15**	-	-
Capital investments	**6,960**	10,583	5,615

Although engineering plastic alloys such as polyacetal (POM) and polybutylene terephthalate (PBT) performed favorably in the Japanese automobile and electronic device components markets, their sales volumes declined due to such factors as the delayed recovery in demand in the Chinese market. On the other hand, sales price revisions prompted by the high cost of raw materials contributed to increased sales.

In the plastics compounds business, which centers on the AS and ABS resins and engineering plastic alloys, there were declining sales volumes of general-purpose resins, but sales increased due to price amendments in line with higher raw material costs and favorable movement in both domestic and overseas markets for highly functional engineering plastic alloys.

The sheets business, which partially withdrew from unprofitable product operations, witnessed increased sales due to the price revisions prompted by the high cost of raw materials and higher sales volume brought about by increased demand from major customers.

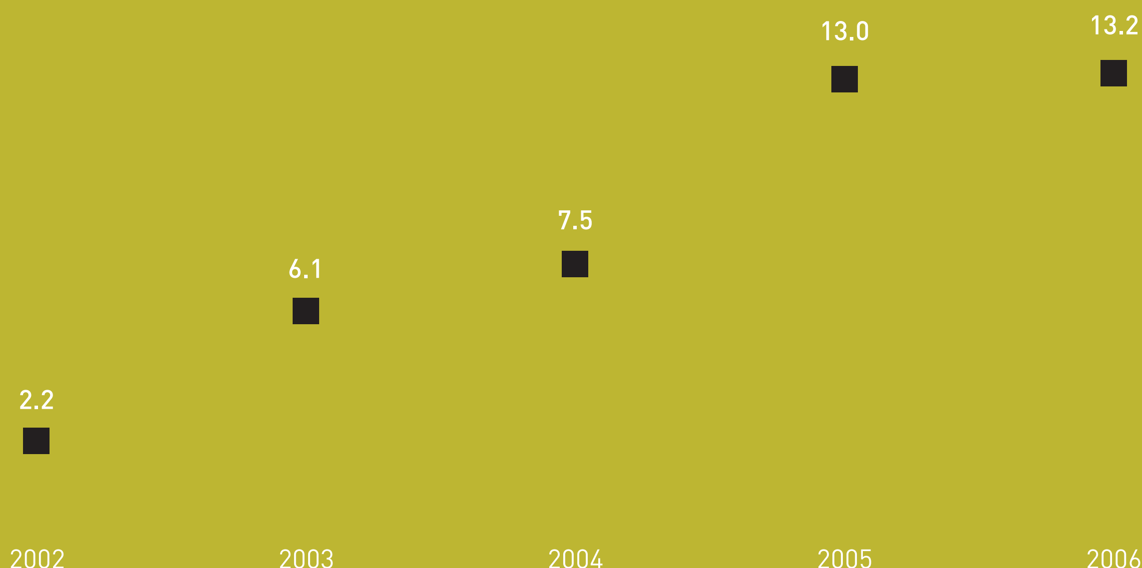
Sales volumes declined in the molded vessels and shock-absorbing materials businesses, but reflecting the higher cost of raw materials in product prices and sales of high-value-added products had the effect of increasing sales.

The film business recorded an increase in sales by adding to its new coatings business with outside orders and increasing sales of barrier film, its core product.

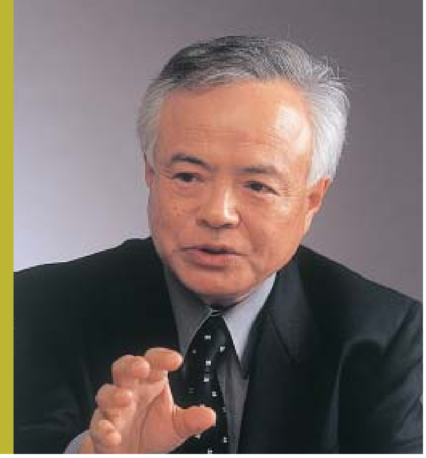
In the other plastic products business, sales increased of such products as pressure-resistant polyethylene pipes for the civil engineering field, but overall sales declined as a result of reduced demand for certain construction material products.

Net sales in the plastics and films segment rose 6.9% to ¥ 142.6 billion, while operating income edged up 1.2% to ¥13.2 billion.

Operating Income



Polyplastics Co., Ltd.



Yasumasa Komura
President of
Polyplastics Co., Ltd.

Polyplastics Co., Ltd. (Polyplastics) was established in 1964 as a joint venture between Daicel and Celanese Corporation (currently named Ticona Limited Liability Company [Ticona]), with Daicel holding a 55% controlling share and Ticona holding a 45% share.

As a leading manufacturer and marketer of engineering plastics—centered on polyacetal (POM), polybutylene terephthalate (PBT), polyphenylene sulfide (PPS) and liquid crystal polymer (LCP)—Polyplastics is primarily active in the Asia-Pacific market.

The company holds a 40% share of the Asian market for POM, which is used in the electrical, electronic and automotive fields for its qualities that combine strength and rigidity with workability, stability to heat, and chemical resistance.

PBT features excellent dimensional stability and electrical insulation properties and has applications in electrical, electronic and automotive components. The company enjoys an Asian market share in these fields of approximately 30%.

The melting point of crystalline plastic PPS is 280 degrees C, so it displays excellent heat resistance properties, with chemical and flame resistance, as well as mechanical strength being among its many other special features. It also has applications in the electrical, electronic, automotive, and OA machine fields. The company has an Asian market share of more than 20%.

LCP is a self-reinforcing, liquid-crystal polymer that displays both heat resistance and dimensional stability, as well as high mechanical strength. Its main applications are in AV machines and OA machine components, with the company holding more than a 40% share of the Asian market.

Having established Topas Advanced Polymers GmbH in Germany under joint management with Daicel Chemical Industries, Ltd., the company acquired Ticona's cyclic olefin copolymer (COC) operations. TOPAS® possesses optical properties comparable with PMMA and superior heat resistance to PC. Moreover, it possesses excellent dimensional stability due to the fact that it absorbs almost no moisture. These attributes have earned the resin a high evaluation in the optical market sector.

In addition to applications in optical elements such as all types of lenses and films, COCs can also be of use in medical instruments and as packaging material. The users of high-value-added optical elements are particularly concentrated in the Japanese market. By having the Daicel Group, which is developing its business with a focus on Asia, assume responsibility for manufacture, sales and research, it is firmly believed that it will be possible to develop products that accurately reflect customer needs. Being promoted as the company's fifth core product, there are plans for COC sales to reach ¥10 billion in the fiscal year ending March 31, 2011.

The aims are sustained growth and an enhanced company presence in the Chinese and ASEAN markets. In order to achieve these aims, the focus will be on such factors as reducing production costs, improving product quality and the market development of high-value-added products, while at the same time strengthening the business partnership with Ticona.

Daicel Polymer Ltd.

Masayuki Mune
President of
Daicel Polymer Ltd.

Daicel Polymer Ltd. primarily manufactures and markets plastic compounds and biaxially oriented polystyrene sheets and long fiber reinforced thermoplastics. The company makes proactive proposals to its customers by undertaking the development of proprietary functional materials, with a focus on compound technologies and on products in advance of global market changes.

Primary applications for its plastic compounds include electronics, IT devices, and automobiles. In the electronics and IT devices markets, there is an ever-increasing need for high-functionality resins, in response to which Daicel Polymer provides thorough technical services and develops high-value-added products, predominantly those featuring polymer alloys.

The company will specialize in highly profitable products based on superior general-purpose AS and ABS resins, such as compound alloy grades derived from them and engineering plastics. At the same time, Daicel Polymer is exploring new markets with newly developed products.

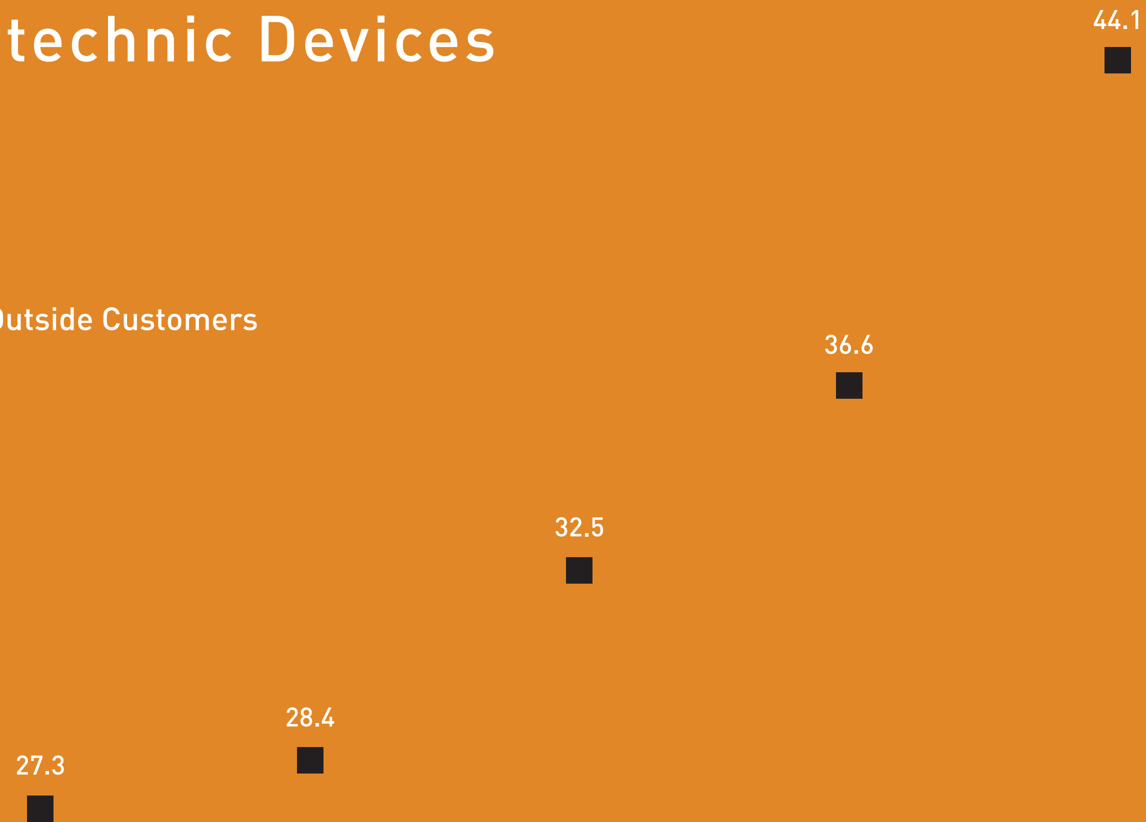
These newly developed products stemmed from ongoing research into resins for plating that make high-environmental-impact chromium etching unnecessary, PP resins reinforced with natural cellulose fibers, and compounds suitable for laser welding that make the use of adhesives superfluous. In the case of the latter, the company will consolidate the manufacturing process whereby cellulose fiber is finely dispersed into a PP resin that has been particularly acclaimed for its suitability as a building material that provides a fine surface texture.

As an independent company with a manufacturing, sales and research structure in the Asian region, Daicel Polymer conducts its business centered on two bases in China (Shanghai and Hong Kong) and a third in Singapore, aiming to establish a flexible network. In addition to improving research capabilities and expanding production with the full operation of a second plant at Shanghai Daicel Polymers, Ltd., the structure is able to respond even faster to customer requirements through Daicel Polymer Trading (Shanghai). These two companies are focusing on securing orders from Japanese-owned OA equipment and automotive components manufacturers that are continuing to make inroads in their target Chinese market. In Hong Kong and Singapore, the company is concentrating on expanding sales of polymer alloys, at which it excels, into growth areas.

Pyrotechnic Devices

(billions of yen)

Sales to Outside Customers



Operations

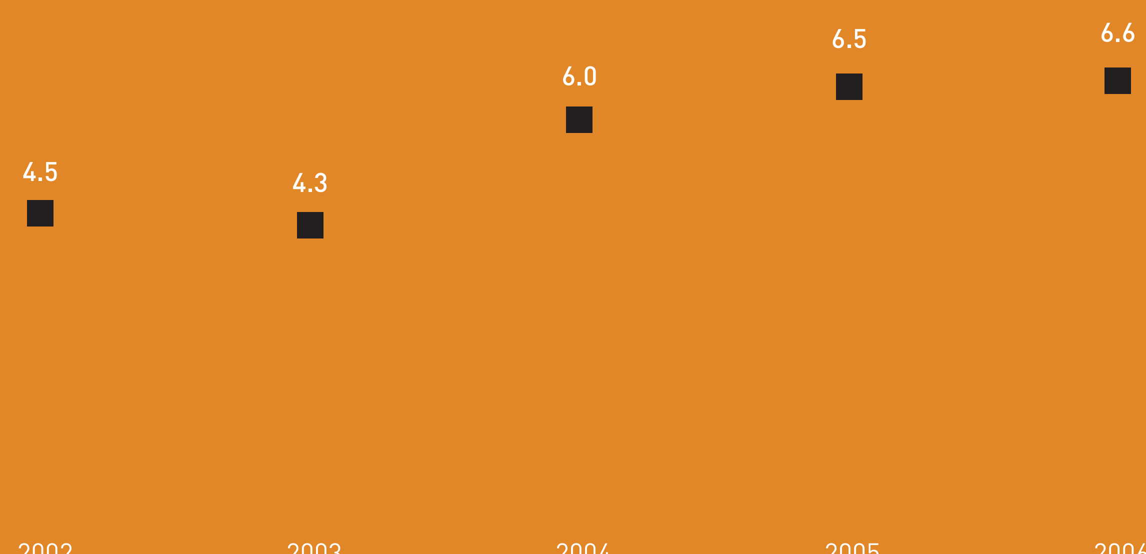
	Millions of yen		
	2006	2005	2004
Sales to outside customers	**¥ 44,090**	¥ 36,605	¥ 32,541
Total sales	**44,090**	36,605	32,541
Total cost and expenses	**37,473**	30,063	26,573
Operating income	**¥ 6,617**	¥ 6,542	¥ 5,968
Total assets	**¥ 52,786**	¥ 39,730	¥ 32,418
Depreciation	**3,434**	3,069	3,000
Capital investments	**12,678**	4,449	5,559

There were significant increases recorded in both sales volumes and sales of inflators (gas generation devices) for automobile air bag systems, particularly of the side-impact type, in addition to new models for drivers' seats and front-seat passengers, amid an upward trend in Japanese automotive production and a buoyant overseas market for inflators.

In the aerospace and defense business, reduced Japan Defense Agency procurement levels adversely impacted missile assembly components, and although gun propellant sales increased and there was a slight increase in pilot emergency-escape system sales, overall sales flattened out.

Net sales in the pyrotechnic devices segment rose 20.4% compared with the previous fiscal year to ¥44.1 billion, and operating income edged up 1.1% to ¥6.6 billion.

Operating Income

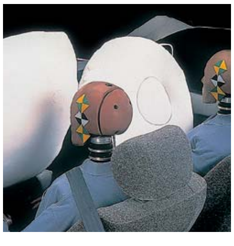


Aerospace & Defense Systems / Safety Systems Company

Tetsuzo Miyazaki
President of
Aerospace & Defense
Systems/Safety
Systems Company

Our company's impressive product line-up includes air bag inflators (gas-generation devices) for enhanced automobile passenger safety and such defense-related products as gun propellants, rocket motors, and emergency-escape systems for pilots. Our commitment to safety has grown in tandem with our manufacturing capabilities. Beginning with the manufacture of single-base gunpowder, our expertise has developed steadily, giving rise to sophisticated technologies that ensure the safe handling of propellants and other pyrotechnic devices. Moreover, applications of these technologies have contributed broadly to society by promoting, for example, automobile safety through the development of air bag inflators.

Highly acclaimed for their sophisticated performance in restraining car occupants, the company's air bag inflators also boast a design which is compact, lightweight and environmentally friendly. Major breakthroughs were achieved in fiscal 2006 with the market launch of the lightest and most compact inflators ever developed for both driver and front passenger seats. Simultaneously, these inflators integrate cutting-edge technologies to minimize environmental impact and realize the world's most advanced performance.



Momentum continues to build throughout the global automobile market, with especially strong demand in China, India and Southeast Asia. Given this trend, the company anticipates further global growth in production to accompany the expansion of the Asian market. Demand for inflators is expected to rise more rapidly than overall automobile production, due to the increasing standardization of air bags for drivers and front seat passengers, as well as the increased number of applications for additional air bag restraints, such as side-impact, knee and curtain shield air bags, throughout the passenger compartment.

To meet increasing demand, the company has been rapidly instituting a global five-basis production and sales structure encompassing Japan, the United States, Thailand, Europe, and China. During autumn of 2006, the latest base in China is scheduled to start production.

The company is targeting a 20% share of the global market in 2010. Sales growth will proceed in rhythm with the global production expansion of our customers. In addition, by forging stronger ties with major Japanese automakers, we plan to further create a framework to ensure consistent production through "safe manufacturing with consistently high quality," while promoting profit-driven sales activities. Simultaneously, the company will strive to implement new product development while realizing effective measures to reduce costs.

The Aerospace & Defense Systems division continues to encounter a challenging domestic operating environment, because of procurement cutbacks by the Japanese government. Nevertheless, the company will rely on its heritage as it promotes safety to establish new markets for its defense-related products.

Functional Products and Others

(billions of yen)

Sales to Outside Customers

Operations

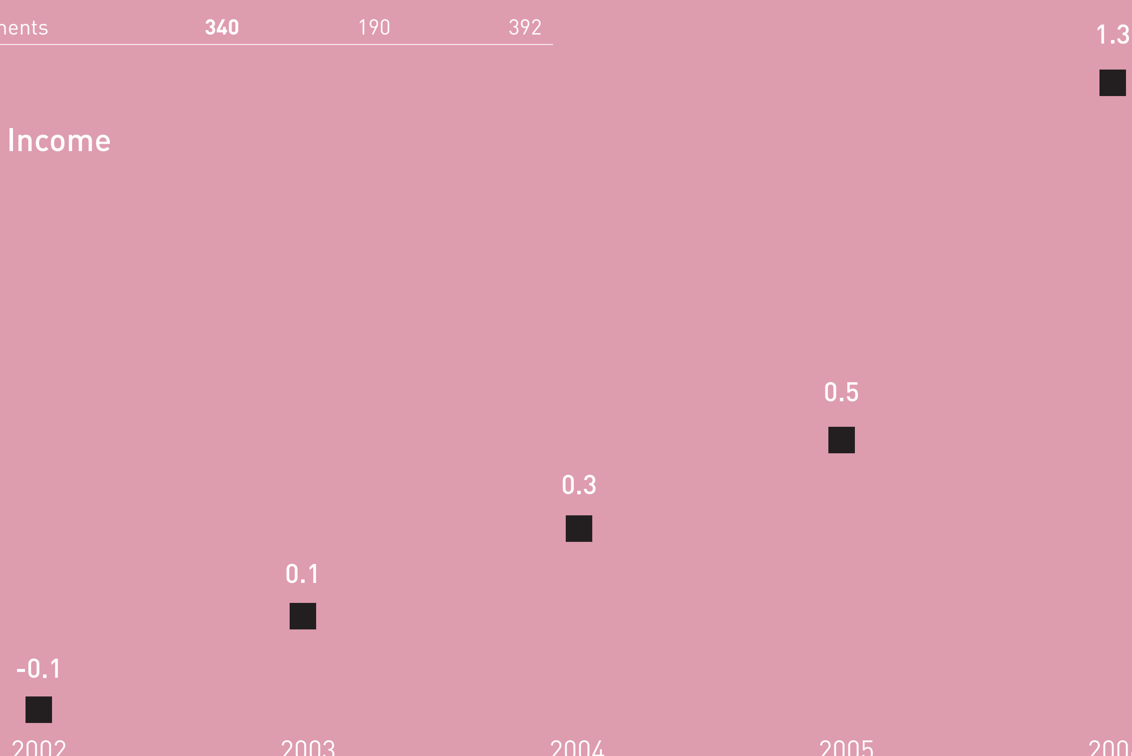
	2006	2005	2004
	Millions of yen		
Sales to outside customers	**¥ 8,540**	¥ 7,121	¥ 6,804
Intersegment sales	**10,267**	10,082	9,293
Total sales	**18,807**	17,203	16,097
Total cost and expenses	**17,490**	16,723	15,832
Operating income	**¥ 1,317**	¥ 480	¥ 265
Total assets	**¥ 10,908**	¥ 10,323	¥ 8,372
Depreciation	**290**	348	406
Capital investments	**340**	190	392

In the membrane systems business, sales of separation membrane modules and other products for water treatment remained flat due to declining sales of mainstay products for water treatment works, but newly developed products for environmental recycling and medical applications performed well.

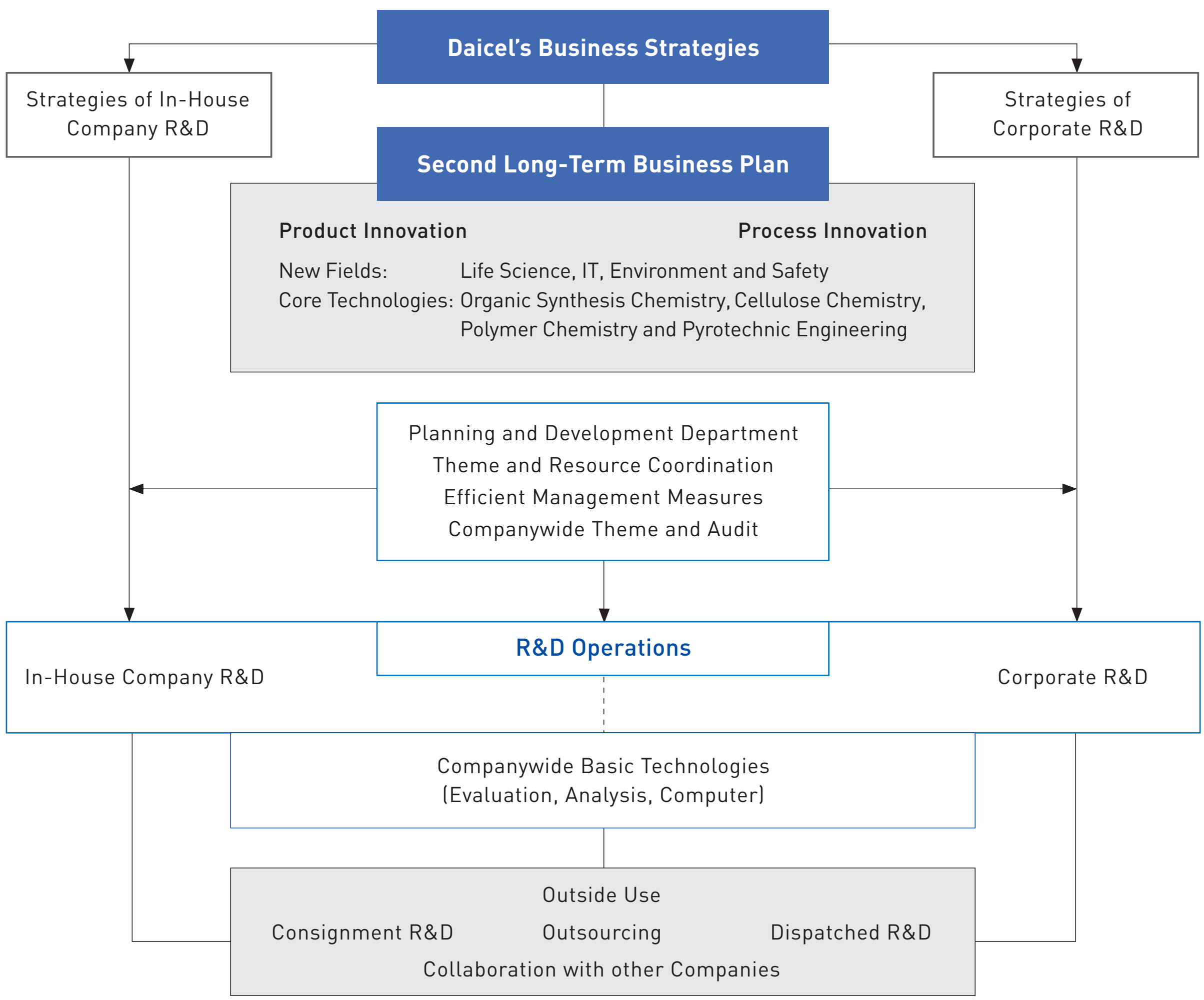
With regard to other functional products, sales increased due to factors such as resist polymers for ArF excimer lasers, sales of which commenced in the fiscal year under review.

Net sales in the functional products and others segment increased 19.9% to ¥8.5 billion and operating income jumped 174.2% to ¥1.3 billion.

Operating Income



The Position of R&D



Given Japan's lack of natural resources, to achieve continued profitable growth, chemical manufacturers must demonstrate the ability to seamlessly place on the market creative, markedly differentiated products that embody proprietary technologies. Research and development (R&D) is acknowledged as being a key factor for this ability. For that reason, the Daicel Group considers R&D to be one of its most important management strategies. Based on the core technologies it has amassed over the years in organic synthesis chemistry, cellulose chemistry, polymer chemistry and pyrotechnic engineering, Daicel aims to create value for customers by establishing world-first, pioneering technologies, developing high-value-added, high-performance products and focusing on R&D connected to new business creation. By such measures as advancing R&D into technologies that bring about significant cost reductions, R&D will contribute to profit expansion.

Research and Development Structure

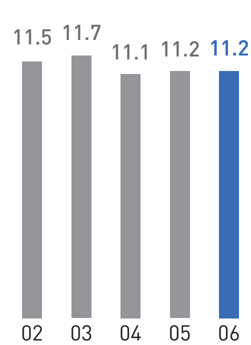
In accordance with the introduction of an in-house company system in 2002, both in-house companies and the corporation have R&D functions and established systems for conducting further market-oriented R&D. In-house companies are charged with developing their existing business domains and related R&D activities, while corporate R&D efforts are focused on developing functional products for the creation of new businesses. The areas of responsibility for both in-house and corporate R&D are thus clearly defined. Furthermore, because we are living in an age in which raw materials display functionality, evaluating function is of paramount importance. For that reason, the Company has established an Analysis Service Center and endeavors to reinforce the center's function as a shared R&D asset.

Manufacture and Sale of Resist Polymer Produced by NHPI Catalytic Method Starts in Earnest

Daicel has been advancing studies into commercial applications of N-hydroxyphthalimide (NHPI) catalyst air-oxidation technology in partnership with its discoverer, Professor Yasutaka Ishii of the Department of Chemistry, Faculty of Engineering, Kansai University. The production of resist polymers for ArF excimer lasers, which utilize NHPI technology, was commenced at the Arai Plant in October 2004. From the fiscal year under review, the market has taken off with sales in excess of ¥1 billion. The Company aims to take full advantage of its technological superiority to expand sales in the years to come.

The groundbreaking NHPI technology, which is no longer considered to be any more difficult than previous improvements in oxygen oxidation reactions, is capable of highly efficient oxidation reactions at significantly lower temperatures and pressures than existing manufacturing methods. Furthermore, NHPI technology reduces both by-products and energy costs during the manufacturing process, as well as cutting down greenhouse gas emissions, thereby significantly reducing environmental impact.

With regard to NHPI's applications in bulk manufacturing, collaborations between companies both in and outside Japan are being strengthened, with added impetus given to advancing NHPI's commercial development. As a project under the Ministry of Economy, Trade and Industry, the Research Association for Ishii Oxidation Technology was formed in 2005 to conduct industry-academia joint research activities. The Research into aromatic carboxylic acids, including adipic and terephthalic acids, as well as methyl ethyl ketone products, will continue with a view to commercialization. As conventional manufacturing methods for these products generates dinitrogen



Research and Development Expenses
(Billions of yen)

monoxide (which produces a greenhouse gas effect of 310 times more than carbon dioxide) through nitric acid oxidation and the use of halogen catalyzer which discharges environmentally harmful materials, the development of highly efficient auto-oxidation techniques that use neither nitric acid nor halogen is eagerly anticipated. If a manufacturing technique based on the NHPI process can be established, equipment costs will be significantly reduced and energy savings can be expected.

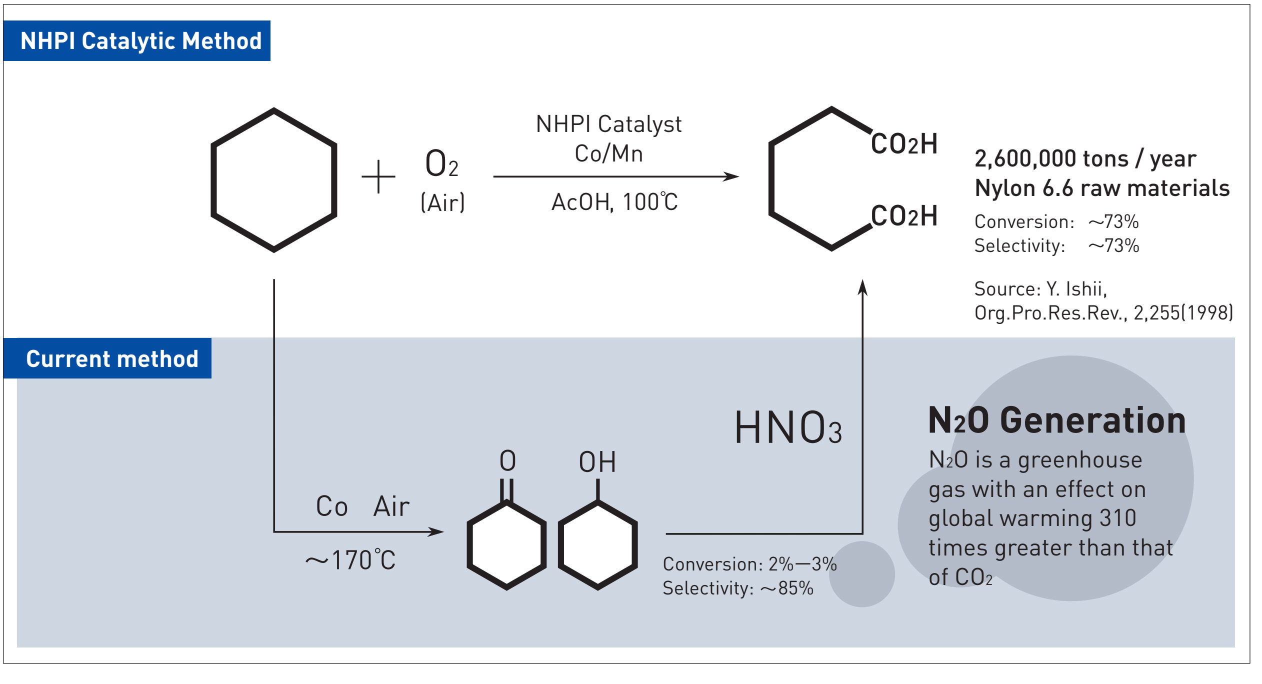
Corporate R&D Activities

Daicel will be giving added impetus to strengthening R&D for the creation of new products and new businesses in the long-term growth focus fields of electronic and IT materials, life sciences and environmental safety. More specifically, R&D efforts are focusing on materials for second- and third-generation ArF semiconductors, optic materials, interlayer isolation film, fuel cell materials, porous multi-metal plate substrates and separation membrane material. With existing chemical products, developments are under way that have as their central theme the commercialization of innovative, non-polluting processes and proprietary technologies that enable dramatically reduced costs and inhibit greenhouse gases.

The creation of new reactive techniques that make energy reduction and greenhouse gas emission controls a reality will also be addressed on an ongoing basis in relation to the NHPI process. The highest importance will be attached to direct oxidation techniques using heteropoly acid auto-oxidation, which permits yields 10 times greater than existing processes, and conducting R&D into technology for the manufacture of vinyl ether from acetic acid vinyl and alcohol using an iridium catalyst.

Adipic Acid One-Stage Manufacturing Technique

NHPI catalyst air-oxidation technology is a highly efficient one-stage manufacturing technique for adipic acid that generates zero N_2O



Basic Approach to Corporate Governance

Daicel recognizes corporate governance as an important aspect of business that can contribute to improved corporate value. As a publicly listed enterprise, Daicel is committed to carrying out its social mission and responsibilities. We believe in the need to strengthen our relationships with various stakeholders.

We ensure our maneuverability by clarifying the role-sharing of various organs, and we have implemented an agile management system capable of timely decision-making and execution. We can respond quickly to opinions from outside the company and can apply them to our corporate operations. We intend to maintain a sound company administration by improving the transparency and fairness of management.

Framework

The Company has adopted an auditing system and appointed external directors and auditors to oversee and guide its operations. In order to clearly separate the decision-making and supervisory functions from the business execution functions, Daicel has also introduced an executive officer system. For the present, we will promote the further enhancement of corporate governance activities within the current framework.

Brief overviews of each organ are as follows.

Board of Directors

The Company's Board of Directors comprises eight directors, three of whom are external directors. In principle, the Board of Directors meets once a month, and based on the Company's internal rules and regulations, acts to make decisions regarding important management items, while also overseeing the operating and executive functions.

In order to increase opportunities for shareholders to appoint directors, and to promote more effective corporate governance by clarifying the responsibilities of directors, the decision to reduce the term of directors from two years to one year was ratified at the Company's annual general meeting of shareholders held on June 27, 2003.

In addition, following the annual general meeting of shareholders held on June 29, 2004, directors decided not to appoint themselves to the positions of senior managing director and managing director. This initiative was implemented to reinforce the decision-making and oversight functions of the Board of Directors and to more clearly distinguish them from business execution functions.

Auditors

The Company appoints four auditors, two of whom are external auditors. Auditors attend Board of Directors' meetings, while standing corporate auditors also attend management meetings and other important meetings to oversee the business and affairs of the Company.

Furthermore, the Company maintains the Board of Auditors comprising four auditors, which reports, deliberates, and decides on auditing matters relevant to the Company.

Auditors regularly receive reports from the internal audit division and from financial auditors, and exchange information and opinions as necessary to execute a coordinated auditing effort.

Nomination and Compensation Committee
The Nomination and Compensation Committee has been established and comprises the president and external directors. The function of this committee is to deliberate on matters raised by the Chairperson of the Board of Directors and to serve as the decision-making body for personnel matters relating to the nomination and compensation of directors and executive officers.

Management Advisory Committee
Reporting to the president, this committee thoroughly deliberates such important matters as the formulation of Group strategies and corresponding business restructuring. The Management Advisory Committee comprises the president, in-house directors, and executive officers designated by the president. Meetings are held on an as-needed basis.

Executive Officers
An executive officer system has been introduced to clearly separate the functions of decision-making and supervision from the functions of business execution. The executive officer system also serves to promote a more vital corporate management through strengthening the business execution framework. Currently, there are 20 executive officers, five of whom concurrently hold the position of director. Executive officers are appointed as presidents of in-house companies, plant general managers, divisional general managers, and presidents of Group companies. Their role is to attend to the daily operations of the Daicel Group.

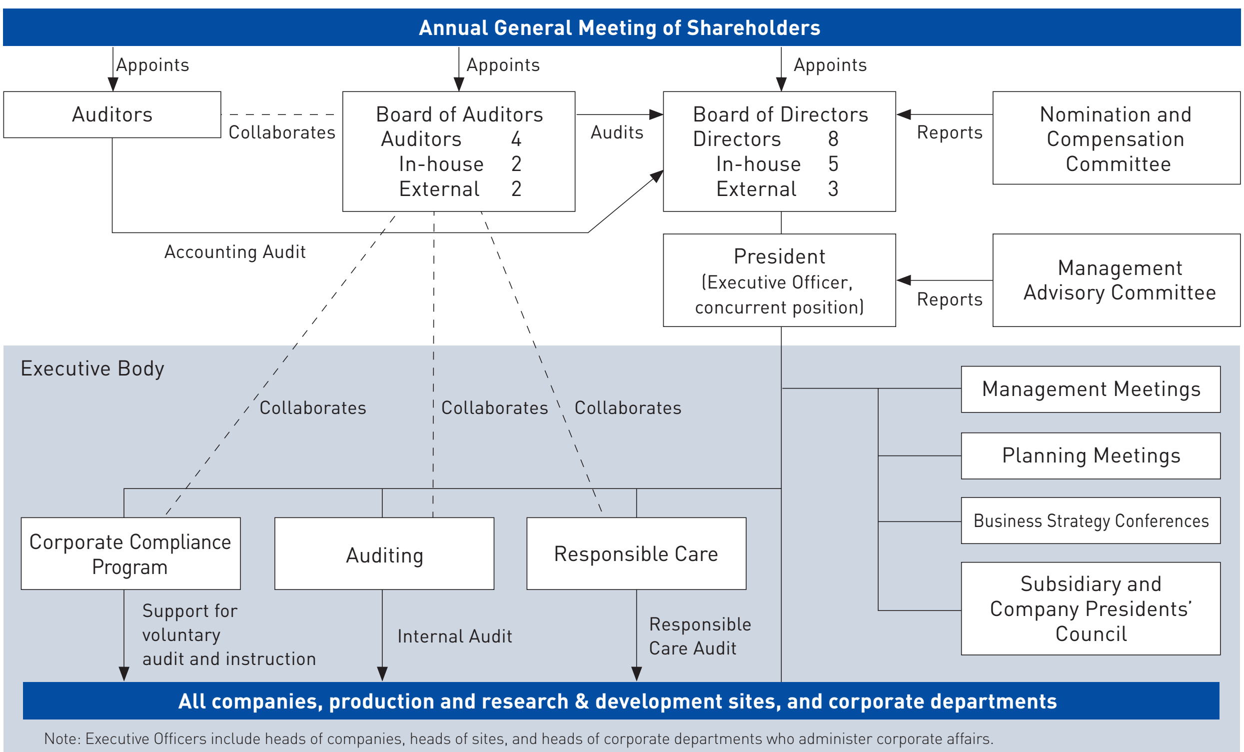
Management Meetings
Management meetings serve as the forum to deliberate and ratify the execution of the Company's fundamental management policies as determined by the Board of Directors. Management meetings are attended by the president, members of the Management Advisory Committee, standing corporate auditors, and other executive officers designated by the president. In principle, meetings are held twice a month.

Planning Meetings
Planning meetings are comprised of members of management meetings, and are held in principle twice a month. Planning meetings serve as the forum to discuss proposals put forward by each operating division.

Business Strategy Conferences
On a Group-wide management level, Daicel conducts business strategy conferences in which issues and problems are discussed for each individual Group company and business division. Conferences are held in principle once a month.

Subsidiary and Company Presidents' Council
Daicel has established the Subsidiary and Company Presidents' Council, through which upper management receives progress reports from in-house company presidents and presidents of Daicel subsidiaries. The council accurately ascertains the current state of each business and swiftly takes action to provide support or resolve problems when deemed necessary. In principle, the council meets five times a year.

Corporate Governance Framework



New Corporate Governance Initiatives

March 2006: The Information Disclosure Code was established to set out the information disclosure policy and disclosure criteria to ensure timely and appropriate information disclosure.

The Information Disclosure Committee was established with the president as chairman to deliberate and determine specific details, timing and method of information disclosure. As well, this committee deliberates on issues that could be covered by information disclosure requirements in the future.

April 2006: The Risk Management Code was established to ensure a proper response to the risks that exist among the activities of the Daicel Group companies.

The Risk Management Committee was established with the president as committee chairman to deliberate and determine policies for the company-wide promotion of risk management. The committee is also charged with evaluating the risk management circumstances of Daicel and each group company.

A company's continued existence naturally involves complying with the law and acting with the highest standards of ethics and judgment, as well as having to earn and maintain the trust of society as a whole. Daicel goes to great lengths to position legal and ethical compliance at the core of every facet of its business activities.

Establishment of Corporate Compliance Program Division

In October 2000, Daicel established the Corporate Compliance Program Division and created the post of Corporate Ethics Officer to more thoroughly promote ongoing corporate ethics awareness activities. Corporate Ethics Management Rules were adopted to encourage Daicel's departments and sections to voluntarily promote and implement a commitment to corporate ethics. As a result, each department and section has not only complied with laws and regulations, but has also adopted an even higher standard of corporate ethical behavior through repetition of our plan-do-check-act (PDCA) cycle.

Formulation of the Daicel Group Conduct Policy and Daicel Chemical Industries Code of Conduct

The Daicel Group Conduct Policy establishes a corporate ethics framework and action principles so that Daicel Group and all its employees can offer assistance to and earn the trust of the community at large.

Based on this policy, the Daicel Chemical Industries Code of Conduct clearly states how each employee should act in specific situations. The Daicel Group Conduct Policy and Daicel Chemical Industries Code of Conduct have been distributed in booklet form to all Daicel directors, officers and employees.

Furthermore, because of the importance of group management, we are asking all group companies worldwide to develop their own code of conduct on the basis of the Daicel Group Conduct Policy.

Corporate Ethics Help Line

In the event that an action of an individual or organization appears to violate the Daicel Chemical Industries Code of Conduct or violate laws, regulations or corporate ethics, and an immediate solution through a superior is not available, the Corporate Ethics Help Line has been set up as an internal reporting system. In addition, a parallel external Corporate Ethics Help Line has been put into effect to promote use of the initiative.

To ensure the fair operation of the system, the Corporate Ethics Help Line adopts rules that include the assurance of confidentiality and the prevention of reprisals against those reporting a problem or seeking consultation, along with restorative measures for anyone who receives prejudicial treatment as a result of filing a report.

Corporate Ethics Training

Daicel provides scheduled position-specific corporate ethics training for all its employees, from newly hired staff to directors; everyone has an opportunity to attend a program at least once per year. Moreover, Daicel has continually offered training sessions to impart the knowledge of laws and regulations required for business operations.

Corporate Ethics training session

Natural gas engine cogeneration facility at Polyplastics Co., Ltd.'s Fuji Plant

Daicel has carried out business activities with consideration for the environment and safety since its inception. In 1995, the Company declared its intention to implement "Responsible Care" and has since then made efforts to promote Responsible Care in all of its business activities. Responsible Care is the voluntary commitment by which corporations that manufacture and handle chemical substances take measures concerning the environment, health, and safety in all stages of business, from research and development to final disposal. This is an international initiative.

As one aspect of these efforts to implement Responsible Care at overseas bases, Daicel took part in a preoperational safety review meeting for the manufacturing facilities at Daicel Safety Technologies (Thailand) Co., Ltd., which produces the initiators used in automobile air bag inflator components, and conducted a follow-up total environmental, health and safety (EHS) assessment of the manufacturing facilities at the initial planning phase. At the same time, an exchange of views was held to improve environmental and safety activities.

The total EHS assessment forms a comprehensive early evaluation and risk management method from the environment and safety point of view, put into effect by Daicel.

A preoperational safety review meeting gets under way at Daicel Safety Technologies (Thailand) Co., Ltd.

Solvent Recycling Facility in Operation at the Ohtake Plant

The recent expansion in the electronic materials market has resulted in a commensurate increase in solvent consumption. From the environmental impact reduction standpoint, there is a heightened demand for the collection and recycling of used solvents.

Daicel established a facility that collects and recycles solvents used for electronics materials in 2005 and began to offer high-quality recycled products to customers. Since then, in response to increasing numbers of potential customers, the decision has been taken to upgrade and expand the recycling facility.

Reducing Greenhouse Gas Emissions by Converting to Natural Gas

The Company's Arai Plant, the Aboshi Plant in the Himeji Production Sector, as well as Polyplastics Co., Ltd.'s Fuji Plant, have all pressed ahead with conversions from heavy oil to natural gas.

Compared with heavy oil, use of natural gas can reduce greenhouse gas emissions (carbon dioxide, etc.) and minimize sulfur oxide emissions, one of the causes of atmospheric pollution, and thus represents an eco-friendly energy source. Energy savings are also attained, because natural gas requires less air for combustion.

The Arai Plant has been undergoing conversion from an industrial cracking furnace, from December 2005, and will complete the switch to use of natural gas in the fall of 2006. The Himeji Production Sector's Aboshi Plant has also decided to make the move away from the use of an industrial cracking furnace and boiler.

The natural gas engine cogeneration facility introduced at the Polyplastics' Fuji Plant has been in operation since November 2005.

Board of Directors and Corporate Auditors/Executive Officers

(As of July 31, 2006)

President
Daisuke Ogawa (Left)
Director
Yasuo Umeno (Right)

Board of Directors and Corporate Auditors

PRESIDENT

Daisuke Ogawa

DIRECTORS

Yasuo Umeno

Tetsuji Yanami

Keiichiro Tsuji

Kazuo Yamaguchi

Shigetaka Komori
President of Fuji Photo Film Co., Ltd.

Akishige Okada
Advisor of Sumitomo Mitsui Banking Corporation

Yuichi Miura
Advisor of Tokuyama Corporation

CORPORATE AUDITORS

Mikio Kitagawa

Hideo Asanuma

AUDITORS

Hirokuni Imai
Deputy President of Century Leasing System, Inc.

Yoshikatsu Moriguchi
Lawyer

Executive Officers

CHIEF EXECUTIVE OFFICER

Daisuke Ogawa

SENIOR MANAGING EXECUTIVE OFFICER

Yasuo Umeno
General Manager of Corporate Support Center, Corporate Compliance Program, Business Process Innovation, President of Daicel Finance Ltd.

MANAGING EXECUTIVE OFFICERS

Tetsuji Yanami
General Manager of R&D Management, Intellectual Property Center, Analysis Service Center

Keiichiro Tsuji
General Manager of Himeji Production Sector, General Manager of Aboshi Plant,President of Kyodo Sakusan Co., Ltd.

Kazuo Yamaguchi
General Manager of Production Technology Management, Responsible Care

Tetsuzo Miyazaki
President of Aerospace & Defense Systems/Safety Systems Company

Kohji Shima
General Manager of Engineering Center, Deputy General Manager of Production Technology Management

Ichiro Katagiri
President of Cellulose Company

Shuzaburo Kumano
President of Organic Chemical Products Company

Masumi Fukuda
General Manager of Corporate Planning

Masayuki Mune
President of Daicel Polymer Ltd.

EXECUTIVE OFFICERS

Yoshiro Taniguchi
General Manager of Nagoya Sales Office, Executive Vice President of Aerospace & Defense Systems/Safety Systems Company, General Manager of Safety Systems Division and Safety Systems Overseas Business Division, Aerospace & Defense Systems/Safety Systems Company

Shinzo Uda
Vice Chairman of Xi'an Huida Chemical Industries Co., Ltd.

Tetsuo Yoshioka
General Manager of Aerospace & Defense Systems Division, Aerospace & Defense Systems/Safety Systems Company

Mitsuharu Shimada
General Manager of Ohtake Plant

Hitoshi Oya
General Manager of Raw Material Purchasing Center

Yasunori Iwai
President of Daicel Safety Systems America, LLC

Yuji Iguchi
Deputy General Manager of Corporate Planning

Misao Fudaba
Deputy General Manager of Corporate Support Center

Yoshimi Ogawa
Executive Vice President of Aerospace & Defense Systems / Safety Systems Company, General Manager of Harima Plant, Aerospace & Defense Systems / Safety Systems Company

Contents

Eleven Year Summary

Years ended March 31

Millions of yen, except per share amounts and other information

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
For the year:											
Net sales	**¥335,520**	¥306,335	¥281,740	¥271,342	¥261,358	¥261,520	¥238,240	¥249,111	¥257,177	¥260,884	¥248,514
Total cost and expenses	**301,950**	277,782	260,533	250,932	245,875	246,893	223,871	235,817	249,286	244,744	229,908
Operating income	**33,570**	28,553	21,207	20,410	15,483	14,627	14,369	13,294	7,891	16,140	18,606
Income before income taxes and minority interests	**29,386**	22,380	8,055	6,864	6,841	10,066	8,396	6,469	5,968	12,891	13,643
Net income (loss)	**14,221**	10,844	5,166	2,029	3,635	3,381	3,125	1,401	(845)	3,141	4,983
Amounts per common share (yen):											
Net income (loss)	**¥ 39.16**	¥ 29.82	¥ 14.21	¥ 5.50	¥ 9.86	¥ 9.03	¥ 8.48	¥ 3.77	¥ (2.26)	¥ 8.40	¥ 13.33
Cash dividends applicable to the year	**8.00**	8.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	
Capital expenditures	**¥ 59,018**	¥ 25,377	¥ 20,991	¥ 16,747	¥ 20,082	¥ 22,189	¥ 38,820	¥ 27,490	¥ 29,122	¥ 26,597	¥ 24,605
Depreciation and amortization	**22,484**	22,490	24,514	25,413	26,709	28,484	26,931	27,666	30,805	30,419	29,750
Research and development expenses	**11,221**	11,219	11,085	11,747	11,485	11,841	10,393	10,735	11,395	11,195	
At year-end:											
Total current assets	**¥172,344**	¥160,541	¥141,233	¥143,280	¥150,862	¥168,079	¥191,248	¥169,695	¥180,026	¥225,678	¥183,552
Total assets	**483,469**	413,493	381,485	381,518	412,008	442,055	439,108	401,062	414,088	462,308	432,585
Total current liabilities	**133,420**	102,779	105,093	107,385	135,303	141,072	156,916	131,812	147,891	190,885	141,332
Total long-term liabilities	**121,159**	110,875	88,684	94,934	95,150	114,526	107,933	100,218	95,937	98,887	121,048
Total shareholders' equity	**197,780**	171,225	160,479	151,987	154,515	155,314	142,777	138,257	139,735	143,510	142,870
Ratios:											
Current ratio (%)	**129.2**	156.2	134.4	133.4	111.5	119.1	121.9	128.7	121.7	118.2	129.9
Shareholders' equity ratio (%)	**40.9**	41.4	42.1	39.8	37.5	35.1	32.5	34.5	33.7	31.0	33.0
Return on assets (%)	**3.2**	2.7	1.4	0.5	0.9	0.8	0.7	0.3	(0.2)	0.7	1.1
Return on equity (%)	**7.7**	6.5	3.3	1.3	2.3	2.3	2.2	1.0	(0.6)	2.2	3.5
Ratio of net income to net sales (%)	**4.2**	3.5	1.8	0.7	1.4	1.3	1.3	0.6	(0.3)	1.2	2.0
Assets turnover (times)	**0.7**	0.8	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Tangible fixed assets turnover (times)	**1.8**	1.9	1.7	1.5	1.4	1.4	1.3	1.3	1.4	1.4	1.3
Other information:											
Price range of common stock (yen):											
High	**¥ 1,017**	¥ 597	¥ 501	¥ 423	¥ 467	¥ 378	¥ 497	¥ 395	¥ 491	¥ 698	¥ 650
Low	**516**	441	374	293	290	273	260	212	150	441	410
Exchange rate at year-end (yen per US$1)	**¥ 117.00**	¥ 107.00	¥ 106.00	¥ 120.00	¥ 133.00	¥ 124.00	¥ 106.00	¥ 121.00	¥ 132.10	¥ 124.10	¥ 106.35
Number of employees (at year-end)	**6,248**	5,819	5,604	5,416	5,363	5,412	5,132				

Operating Results

Net Sales

In fiscal 2006, ended March 31, 2006, net sales were ¥335.5 billion, an increase of ¥29.2 billion, or 9.5%, over the previous fiscal year, due mainly to an increase in sales volume and price revisions in accordance with escalating raw material and fuel prices. Accounting for movements in the yen against the U.S. dollar, consolidated net sales for the fiscal year under review increased ¥3.7 billion.

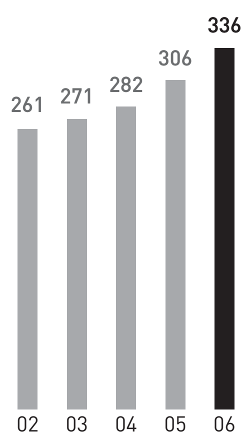
Factors underlying the increase in sales included the following. In the pyrotechnic devices segment, there were significant increases recorded in both sales volumes and sales of inflators for automobile air bag systems, due to the increased demand for additional air bag installations to the passenger compartment in domestic and overseas. This led to a rise of ¥7.5 billion in segment sales.

In the organic chemicals segment, sales of acetic acid gained ¥1.9 billion over the previous fiscal year, brought about by increased sales prices reflecting methanol sales price increases, the main raw material, in an environment marked by supply and demand pressures. Acetic acid derivatives, solvents and fine chemicals increased ¥4.0 billion, primarily as a result of price revisions put into effect to counteract the higher costs of raw materials.

In the plastics and films segment, sales of engineering plastics such as polyacetal (POM) and polybutylene terephthalate (PBT) rose ¥5.9 billion year on year, buoyed by a favorable performance in the Japanese automobile and electronic device components markets and price revisions. Similarly, in the plastic compounds, sheets, molded vessels and shock-absorbing materials and films businesses, sales increased ¥3.6 billion due to such factors as price revisions.

In the cellulosic derivatives segment, sales of cellulose acetate increased ¥4.3 billion year on year, due to greater sales volume for LCD film applications and price revisions. An increased sales volume, price revisions and weakening yen exchange rates also led to a ¥1.6 billion year-on-year increase in sales of acetate tow for cigarette filters.

In the functional products and others segment, sales increased ¥1.4 billion, due to such factors as



Net sales
(Billions of yen)

resist polymers for ArF excimer lasers, sales of which commenced in the fiscal year under review.

Factors underlying decreases in sales included the following. In the organic chemicals segment, in which the CPI Company develops pharmaceutical-related business, whereas chiral chromatographic columns performed favorably, sales of intermediate pharmaceuticals decreased, resulting in a loss of ¥0.5 billion compared with the previous fiscal year.

In the plastics and films segment, reduced demand for certain construction material products in the molded plastic products business, which is classified within the other plastic products business, resulted in a year-on-year loss of ¥0.3 billion.

Gross Profit

Gross profit, which is the cost of sales deducted from net sales, rose ¥5.7 billion, or 7.1%, from a year earlier to ¥86.7 billion. The gross profit to sales ratio fell 0.6 percentage point to 25.8%.

The negative impact of escalating raw material and fuel prices was offset by stronger sales volume and revisions in sales prices.

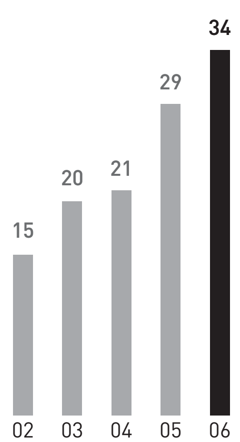
Selling, General and Administrative (SG&A) Expenses

SG&A expenses totaled ¥53.2 billion, an increase of ¥0.7 billion, or 1.3%, from the previous fiscal year. The increase largely came as a result of the costs incurred in the start-up of four overseas subsidiaries that have been newly added to the scope of consolidation to produce inflators for the automobile air bag systems business as part of the pyrotechnic devices segment. The ratio of SG&A expenses to consolidated net sales improved 1.3 percentage points to 15.8%.

Operating Income

As a result of the foregoing, operating income for the fiscal year under review climbed ¥5.0 billion, or 17.6%, from the previous fiscal year, to ¥33.6 billion. The ratio of operating income to net sales was 10.0%, an improvement of 0.7 percentage point over the previous fiscal year's figure. Accounting for movements in the yen against the U.S. dollar, operating income increased ¥1.4 billion.

The increase was primarily attributable to the following factors. The organic chemicals segment increased its operating income by ¥2.6 million through



Operating income
(Billions of yen)

such methods as revising its prices and withdrawing from underperforming businesses. The cellulosic derivatives segment improved the sales volume of cellulose acetate, which, along with the sales price revisions, contributed to an increase of ¥1.2 billion compared with the previous fiscal year. In the functional products and others segment, sales of resist polymers for ArF excimer lasers contributed to the sales from the fiscal year under review, and an intellectual and integrated production system consulting business in collaboration with Yokogawa Electric Corporation contributed to sales, resulting in a ¥0.8 billion increase in income.

Other Income (Expenses)

By recording a loss of ¥4.2 billion, other income (expenses) decreased ¥2.0 billion, or 32.2%. The primary factor in the improvement was a ¥0.9 billion foreign exchange gain.

Income Before Income Taxes and Minority Interests

Income before income taxes and minority interests climbed ¥7.0 billion, or 31.3%, to ¥29.4 billion.

Income Taxes

The effective income tax rate after application of tax-effect accounting edged up 3 percentage points, to 39%. Income tax totaled ¥11.5 billion, an increase of ¥3.6 billion (44.6%).

Minority Interests

Minority interests totaled ¥3.6 billion, remaining at approximately the same level as the previous fiscal year.

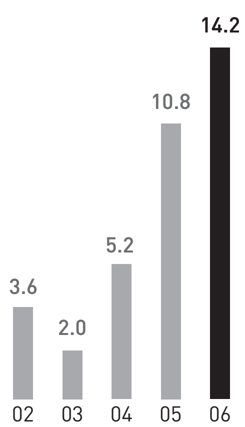
Net Income

As a result of all of the above factors, net income for the period was ¥14.2 billion, a gain of ¥3.4 billion, or 31.1%, from a year earlier.

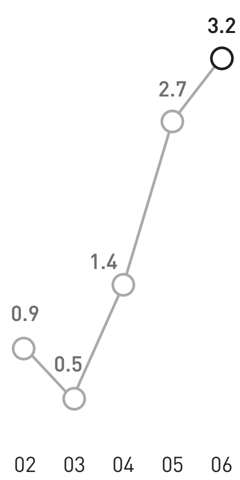
Per Share Information

Net income per share reached ¥39.16, up from ¥29.82 per share a year earlier.

In the previous fiscal year, the annual dividend of ¥8 included a commemorative dividend of ¥2 per share to celebrate the 85th anniversary of Daicel's establishment. The annual dividend for the fiscal year under



Net income
(Billions of yen)



Return on assets
(%)

review was also ¥8, comprising a mid-term dividend of ¥4 and a period-end dividend of ¥4.

Financial Position

Assets

Total assets as of March 31, 2006 were ¥483.5 billion, up ¥70.0 billion, or 16.9%, from a year earlier.

Current assets totaled ¥172.3 billion, an increase of ¥11.8 billion, or 7.4%, from the end of the previous fiscal year. Major components of the increase included a rise of ¥5.6 billion in notes and accounts receivable and an increase of ¥7.8 billion in inventories due to hikes in the prices of raw materials and fuels.

Property, plant and equipment totaled ¥201.4 billion, an increase of ¥36.3 billion, or 22.0%, from the end of the previous fiscal year. This was primarily attributable to an increase in investment in plant and equipment.

Investments and other assets increased ¥21.8 billion compared with the end of the previous fiscal year, to ¥109.8 billion. The primary component was an increase in investment securities due to climbing share prices.

Liabilities

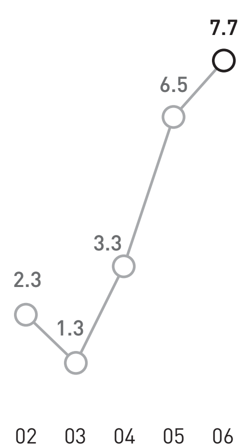
Current liabilities as of March 31, 2006 totaled ¥133.4 billion, a rise of ¥30.6 billion, or 29.8%, from a year earlier. The major components were a ¥5.6 billion rise in short-term bank loans and a ¥19.3 billion increase in the current portion of long-term debt.

Long-term liabilities rose ¥10.3 billion to ¥121.2 billion compared with the end of the previous fiscal year. This was primarily due to deferred tax liabilities of ¥9.8 billion.

Interest-bearing debt, composed of short-term bank loans, current portion of long-term debt and long-term debt, totaled ¥124.1 billion, an increase of ¥28.0 billion compared with the end of the previous fiscal year. The interest-bearing debt to total assets ratio climbed 2.5 percentage points to 25.7%.

Shareholders' Equity

Shareholders' equity increased ¥26.6 billion, or 15.5%, from a year earlier to ¥197.8 billion. This was due to increases of ¥10.8 billion in retained earnings and of ¥12.5 billion in unrealized gain on available-for-sale securities.



Return on equity
(%)

The shareholders' equity ratio edged down to 40.9%, a decrease of 0.5 percentage point compared with the end of the previous fiscal year. Shareholders' equity per share was ¥546.29, up from the ¥473.49 per share recorded a year earlier.

Cash Flows

Cash and cash equivalents, hereinafter "cash," at the end of the fiscal year under review were ¥14.4 billion, a fall of ¥2.3 billion, or 13.8%, from a year earlier. Factors are as follows:

Cash from operating activities

Net cash provided by operating activities totaled ¥32.8 billion, down ¥8.9 billion, or 21.4%, from the previous fiscal year. This was mainly due to such factors as an increase in income taxes-paid.

Cash from investing activities

Net cash used in investing activities was ¥60.0 billion, an increase of ¥49.1 billion, or 449.3%, over the previous fiscal year.

The primary factor was the increase in capital expenditures in conjunction with the acquisition of new facilities in accordance with Daicel's plans to transfer production of the acetate tow for cigarette filters from its Sakai Plant to its Ohtake Plant.

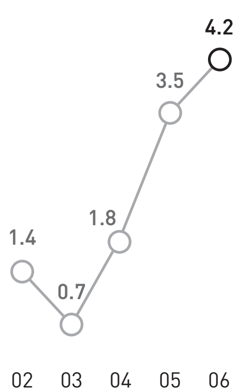
Cash from financing activities

Net cash provided by financing activities amounted to ¥19.6 billion, an increase of ¥46.0 billion compared with an outflow of ¥26.4 billion in the previous fiscal year.

The main factors in the difference with the previous fiscal year were increases in proceeds from the issuance of long-term debt and net change in short-term debt, as well as a decrease in repayments of long-term debt.

Business Risks

Business risks that may potentially have significant influence on investor decisions include not only risks common to the industrial sector, such as changes in macroeconomic and political conditions, but also the following sorts of factors. Items listed in this annual report do not comprise all of the risks related to the business of the Daicel Group.



Ratio of net income to net sales
(%)

Trends in currency exchange rates

The Company's ratio of net overseas sales to consolidated net sales is increasing year by year (32.2% in fiscal 2006), and the Company's results can be more easily influenced by trends in currency exchange rates than previously. We generally believe that depreciation of the yen has a positive effect on performance, while appreciation of the yen has a negative effect on our performance. Though the Company executes forward-exchange contracts and other risk-hedging activities, this does not guarantee that such exchange risks can be completely avoided.

Risks in expanding overseas business development

The Company is broadening its overseas business development, centered on Asia and China, in North America, Europe and elsewhere. However, unforeseeable risks are inherent in the case of overseas operations, such as legal and regulatory changes, vulnerability of industrial infrastructure, difficulties in hiring and retaining qualified employees, or social or political instability caused by acts of terrorism and war. In the event that any of these risks arise and cause disruption to overseas business operations, there is the possibility that Daicel Group's consolidated performance and business plans would be affected.

Swings in raw material (methanol) prices

The Daicel Group purchases a large volume of methanol, the raw material for its core products such as acetic acid and polyacetal. We apply mechanisms to consistently purchase methanol at a relatively low price, such as entering long-term contracts and investing in methanol-producing companies. Upswings in the methanol market may affect Group performance.

Swings in other raw material prices

Daicel goes to great lengths to absorb long-term raw material and fuel price increases by switching to raw material and fuel that is less expensive and more stable in price, by making cost savings from improved manufacturing as well as by revising product sales prices. However, there is a limit as to how much can be absorbed. In the event of escalating costs that exceed limits, there is the possibility that this would have a significant negative impact on Group performance.

Quality guarantee and product liability

Daicel has established a quality guarantee structure and strives to assure product safety. As a precaution, we also carry product liability insurance. However, in cases where products manufactured by the Company are found to be the cause of damage, the Company's performance may be impacted.

Industrial accidents

The Company consistently conducts safety and disaster prevention activities and strives daily to assure the safety of its manufacturing plants and other facilities. However, in cases where fires, explosions or other industrial accidents or disasters occur, performance may be affected.

Earthquakes and natural disasters

One of the Group's primary manufacturing bases, the Fuji Plant of Polyplastics Co., Ltd., is standing in a region that requires reinforced countermeasures for disaster prevention related to the expected Tokai earthquake. We conduct earthquake-training drills and take countermeasures to protect equipment there. We also practice disaster preparedness and emergency training drills at other facilities. However, in the event that significant damage is incurred by a natural disaster, Group results may be affected.

Risks from product and technological obsolescence

Depending on the industry, products are rapidly superseded, sales volume decreases beyond initial sales expectations and R&D expenses cannot be recouped, so that there is the possibility that Daicel's income from its businesses could deteriorate. In cases of products on which there is intense pressure to reduce prices, cost reductions cannot keep pace with sales prices, so that there is again the possibility that Daicel's income from its businesses would worsen.

Risk from violent market fluctuations

In the event of an excess of supply caused by such factors as large-scale plants being constructed by other companies, or a drastic decline in demand caused by abnormal economic conditions, there is the possibility that Daicel's income from its businesses could deteriorate.

Outlook for Fiscal 2007

While the Japanese economy is expected to progress from a transitional period to one showing signs of sustained growth, such factors as a long-term escalation in raw material and fuel costs, uncertain economic prospects in the United States and China, as well as a sense of deepening turmoil in international affairs give no grounds for optimism in terms of business conditions.

The business environment in the chemical industry remains wrought with difficulties, brought about by sales price revisions in response to the escalating costs of raw materials and fuel, the need to maintain cost competitiveness and strengthen R&D, as well as environmental safety concerns and other problems that need to be addressed.

Under these circumstances, the Daicel Group's performance outlook depends on a number of factors: continued growth in demand for TAC; an increase in sales volume of engineering plastics; a significant rise in sales volume for automobile air bag inflators; upward sales price revisions to keep pace with the rising costs of raw materials and fuel; and efforts to reduce costs. For fiscal 2007, Daicel is forecasting net sales of ¥367 billion, operating income of ¥35 billion and net income of ¥15.5 billion. This outlook assumes an exchange rate of $1=¥110.

Should the above-mentioned targets be successfully achieved, it would mean record highs in terms of net sales, operating income (marking the ninth consecutive period of increased operating income) and net income.

Consolidated Balance Sheets

Daicel Chemical Industries, Ltd. and Consolidated Subsidiaries
March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Assets			
Current assets:			
Cash and cash equivalents	**¥ 14,350**	¥ 16,640	**$ 122,650**
Marketable securities (Note 3)	**63**		**538**
Notes and accounts receivable:			
Trade notes	**6,943**	7,503	**59,342**
Trade accounts	**76,356**	69,167	**652,615**
Unconsolidated subsidiaries and associated companies	**4,034**	5,096	**34,479**
Allowance for doubtful notes and accounts	**(204)**	(195)	**(1,744)**
Inventories (Note 4)	**59,512**	51,714	**508,650**
Deferred tax assets (Note 8)	**3,072**	3,008	**26,256**
Account receivable for expropriation (Note 16)	**2,363**	3,150	**20,197**
Other current assets	**5,855**	4,458	**50,043**
Total current assets	**172,344**	160,541	**1,473,026**
Property, plant and equipment (Notes 5 and 15)**:**			
Land	**27,849**	27,143	**238,026**
Buildings and structures	**134,639**	127,621	**1,150,761**
Machinery and equipment	**454,191**	430,317	**3,881,974**
Construction in progress	**31,825**	15,632	**272,008**
Total	**648,504**	600,713	**5,542,769**
Accumulated depreciation	**(447,143)**	(435,695)	**(3,821,735)**
Net property, plant and equipment	**201,361**	165,018	**1,721,034**
Investments and other assets:			
Investment securities (Note 3)	**77,954**	56,951	**666,274**
Investments in and advances to unconsolidated subsidiaries and associated companies (Note 3)	**7,396**	9,223	**63,214**
Deferred tax assets (Note 8)	**697**	822	**5,957**
Account receivable for expropriation (Note 16)	**6,282**	8,556	**53,692**
Other assets	**17,435**	12,382	**149,017**
Total investments and other assets	**109,764**	87,934	**938,154**
Total	**¥ 483,469**	¥ 413,493	**$ 4,132,214**

See notes to consolidated financial statements.

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Liabilities and Shareholders' Equity			
Current liabilities:			
Short-term bank loans (Note 5)	¥ 23,066	¥ 17,441	$ 197,146
Current portion of long-term debt (Note 5)	29,323	10,008	250,624
Notes and accounts payable:			
Trade notes	1,474	1,491	12,598
Trade accounts	47,866	46,601	409,111
Capital expenditure	8,691	5,664	74,282
Unconsolidated subsidiaries and associated companies	2,022	2,360	17,282
Income taxes payable (Note 8)	7,466	5,481	63,812
Other current liabilities	13,512	13,733	115,487
Total current liabilities	133,420	102,779	1,140,342
Long-term liabilities:			
Long-term debt (Note 5)	71,665	68,607	612,521
Liability for retirement benefits (Note 6)	7,894	6,579	67,470
Deferred tax liabilities (Note 8)	16,750	6,919	143,162
Deferred gain from expropriation (Note 16)	22,580	26,388	192,992
Other long-term liabilities	2,270	2,382	19,402
Total long-term liabilities	121,159	110,875	1,035,547
Minority interests	31,110	28,614	265,898
Commitments and contingent liabilities (Notes 11 and 17)			
Shareholders' equity (Notes 7 and 18)**:**			
Common stock—authorized 1,450,000,000 shares in 2006 and 550,963,000 shares in 2005; issued 364,942,682 shares	36,275	36,275	310,043
Capital surplus	31,573	31,379	269,855
Retained earnings	98,483	87,669	841,735
Unrealized gain on available-for-sale securities	32,704	20,156	279,521
Foreign currency translation adjustments	(156)	(3,196)	(1,334)
Treasury stock—at cost 3,001,241 shares in 2006 and 3,443,076 shares in 2005	(1,099)	(1,058)	(9,393)
Total shareholders' equity	197,780	171,225	1,690,427
Total	¥ 483,469	¥ 413,493	$ 4,132,214

Consolidated Statements of Income

Daicel Chemical Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006, 2005 and 2004

			Millions of yen	Thousands of U.S. dollars (Note 1)
	2006	2005	2004	**2006**
Net sales	**¥ 335,520**	¥ 306,335	¥ 281,740	**$ 2,867,692**
Cost and expenses (Note 9):				
Cost of sales	**248,791**	225,324	207,808	**2,126,419**
Selling, general and administrative	**53,159**	52,458	52,725	**454,350**
Total cost and expenses	**301,950**	277,782	260,533	**2,580,769**
Operating income	**33,570**	28,553	21,207	**286,923**
Other income (expenses):				
Interest and dividend income	**873**	638	572	**7,462**
Gain on sales of securities	**594**		566	**5,077**
Equity in earnings of unconsolidated subsidiaries and associated companies	**450**	619	280	**3,846**
Interest expense	**(2,029)**	(2,096)	(2,551)	**(17,342)**
Foreign exchange gain (loss)	**793**	(127)	(1,878)	**6,778**
Gain on sales of plant for expropriation (Note 16)		26,388		
Provision for deferred gain from expropriation (Note 16)		(26,388)		
Reversal of deferred gain from expropriation (Note 16)	**3,807**			**32,538**
Subsidies from municipal governments (Note 15)	**2,218**	40		**18,957**
Reduction of cost of property, plant and equipment (Notes 15 and 16)	**(6,025)**	(40)		**(51,496)**
Loss on dispositions of property, plant and equipment	**(1,367)**	(2,007)	(2,505)	**(11,684)**
Loss on revaluation of property, plant and equipment		(1,060)		
Past period service cost of employees' retirement benefit (Note 6)	**(1,190)**			**(10,171)**
Impairment loss on fixed assets	**(1,150)**			**(9,829)**
Compensation received for the transfer of facilities (Note 16)	**197**			**1,684**
Write-down of investment securities			(33)	
Settlement payment (Note 14)			(2,548)	
Loss on investment in partnership			(919)	
Loss on restructuring of subsidiaries and affiliates			(3,128)	
Special early retirement payments for employees			(439)	
Other—net	**(1,355)**	(2,140)	(569)	**(11,581)**
Other expenses—net	**(4,184)**	(6,173)	(13,152)	**(35,761)**
Income before income taxes and minority interests	**29,386**	22,380	8,055	**251,162**
Income taxes (Note 8):				
Current	**10,417**	6,881	2,704	**89,034**
Deferred	**1,115**	1,094	(1,629)	**9,530**
Total income taxes	**11,532**	7,975	1,075	**98,564**
Minority interests	**3,633**	3,561	1,814	**31,051**
Net income	**¥ 14,221**	¥ 10,844	¥ 5,166	**$ 121,547**

			Yen	U.S. dollars
Per share information (Notes 2 and 10):				
Net income	**¥ 39.16**	¥ 29.82	¥ 14.21	**$ 0.33**
Cash dividends applicable to the year	**8.00**	8.00	6.00	**0.07**

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Daicel Chemical Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006, 2005 and 2004

							Millions of yen
	Outstanding number of shares of common stock	Common stock	Capital surplus	Retained earnings	Unrealized gain on available-for-sale securities	Foreign currency translation adjustments	Treasury stock
Balance, April 1, 2003	361,983,092	¥36,275	¥31,376	¥76,446	¥10,868	¥ (2,049)	¥ (929)
Effect of initial inclusion of certain subsidiaries in consolidation				(72)			
Net income				5,166			
Decrease due to exclusion of previously consolidated subsidiaries				(142)			
Cash dividends, ¥6.00 per share				(2,170)			
Bonuses to directors and corporate auditors				(25)			
Repurchase of treasury stock	(69,944)						(31)
Disposal of treasury stock	10,708		1				4
Net increase in unrealized gain on available-for-sale securities					6,551		
Net change in foreign currency translation adjustments						(790)	
Balance, March 31, 2004	361,923,856	36,275	31,377	79,203	17,419	(2,839)	(956)
Effect of initial inclusion of certain subsidiaries in consolidation				(195)			
Net income				10,844			
Cash dividends, ¥6.00 per share				(2,170)			
Bonuses to directors and corporate auditors				(13)			
Repurchase of treasury stock	(432,099)						(105)
Disposal of treasury stock	7,849		2				3
Net increase in unrealized gain on available-for-sale securities					2,737		
Net change in foreign currency translation adjustments						(357)	
Balance, March 31, 2005	361,499,606	36,275	31,379	87,669	20,156	(3,196)	(1,058)
Effect of initial inclusion of certain subsidiaries in consolidation				**(97)**			
Net income				**14,221**			
Cash dividends, ¥9.00 per share				**(3,255)**			
Bonuses to directors and corporate auditors				**(55)**			
Repurchase of treasury stock	**(118,531)**						**(86)**
Disposal of treasury stock	**560,366**		**194**				**45**
Net increase in unrealized gain on available-for-sale securities					**12,548**		
Net change in foreign currency translation adjustments						**3,040**	
Balance, March 31, 2006	**361,941,441**	**¥36,275**	**¥31,573**	**¥98,483**	**¥32,704**	**¥ (156)**	**¥(1,099)**

						Thousands of U.S. dollars (Note 1)
	Common stock	Capital surplus	Retained earnings	Unrealized gain on available-for-sale securities	Foreign currency translation adjustments	Treasury stock
Balance, March 31, 2005	$ 310,043	$ 268,197	$ 749,308	$ 172,274	$ (27,316)	$ (9,043)
Effect of initial inclusion of certain subsidiaries in consolidation			**(829)**			
Net income			**121,547**			
Cash dividends, $0.08 per share			**(27,821)**			
Bonuses to directors and corporate auditors			**(470)**			
Repurchase of treasury stock						**(735)**
Disposal of treasury stock		**1,658**				**385**
Net increase in unrealized gain on available-for-sale securities				**107,247**		
Net change in foreign currency translation adjustments					**25,982**	
Balance, March 31, 2006	**$310,043**	**$269,855**	**$841,735**	**$279,521**	**$ (1,334)**	**$(9,393)**

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Daicel Chemical Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006, 2005 and 2004

			Millions of yen	Thousands of U.S. dollars (Note 1)
	2006	2005	2004	**2006**
Operating activities:				
Income before income taxes and minority interests	**¥ 29,386**	¥ 22,380	¥ 8,055	**$ 251,162**
Adjustment for:				
Income taxes-paid	**(8,650)**	(3,233)	(8,305)	**(73,932)**
Income taxes-refunded		1,840		
Depreciation and amortization	**22,484**	22,490	24,514	**192,171**
Impairment loss on fixed assets	**1,150**			**9,829**
Loss on dispositions of property, plant and equipment	**1,367**	2,007	2,505	**11,684**
Loss on revaluation of property, plant and equipment		1,060		
Provision for deferred gain from expropriation		26,388		
Write-down of investment securities			33	
Gain on sales of plant for expropriation		(26,388)		
Reduction of cost of property	**6,025**			**51,496**
Reversal of deferred gain from expropriation	**(3,807)**			**(32,538)**
Subsidies received for purchasing property	**(2,218)**			**(18,957)**
Gain on sales of securities	**(594)**	(33)	(566)	**(5,077)**
Equity in earnings of unconsolidated subsidiaries and associated companies	**(450)**	(619)	(280)	**(3,846)**
Loss on restructuring of subsidiaries and affiliates			1,270	
Changes in assets and liabilities, net of effects from consolidating previously unconsolidated subsidiaries and exclusion of previously consolidated subsidiaries:				
Notes and accounts receivable	**(4,474)**	(6,636)	1,868	**(38,239)**
Inventories	**(6,472)**	(6,687)	(1,246)	**(55,316)**
Notes and accounts payable	**(604)**	8,711	1,400	**(5,162)**
Other-net	**(363)**	404	2,969	**(3,104)**
Net cash provided by operating activities	**32,780**	41,684	32,217	**280,171**
Investing activities:				
Capital expenditures	**(59,018)**	(25,377)	(20,991)	**(504,427)**
Payment for purchases of investment securities	**(2,225)**	(3,290)	(940)	**(19,017)**
Proceeds from sales and redemption of investment securities	**3,057**	600	2,283	**26,128**
Proceeds from sales of property, plant and equipment	**180**	352	664	**1,538**
Decrease (increase) in investments in and advances to unconsolidated subsidiaries and associated companies	**(1,190)**	(3,793)	141	**(10,171)**
Proceeds from sales of plant for expropriation	**3,150**	16,987		**26,923**
Proceeds from suspense receipts for expropriation	**275**	1,862		**2,351**
Payment for suspense payments for expropriation	**(219)**			**(1,872)**
Subsidies received for purchasing property	**1,629**			**13,923**
Payment for long-term prepaid expense	**(4,300)**			**(36,752)**
Other	**(1,369)**	1,729	(98)	**(11,701)**
Net cash used in investing activities	**(60,030)**	(10,930)	(18,941)	**(513,077)**
Financing activities:				
Proceeds from issuance of long-term debt	**33,574**	7,395	12,705	**286,957**
Repayments of long-term debt	**(13,101)**	(24,187)	(20,296)	**(111,974)**
Net change in short-term bank loans	**4,925**	(5,659)	(4,201)	**42,094**
Dividends paid	**(3,255)**	(2,170)	(2,170)	**(27,821)**
Dividends paid to minority interests	**(2,841)**	(2,325)	(717)	**(24,282)**
Payment for purchases of treasury stock	**(86)**	(83)	(31)	**(735)**
Other	**372**	597	752	**3,180**
Net cash used in financing activities	**19,588**	(26,432)	(13,958)	**167,419**
Effect of foreign currency translation adjustments on cash and cash equivalents	**1,797**	(88)	(1,076)	**15,359**
Net increase (decrease) in cash and cash equivalents	**(5,865)**	4,234	(1,758)	**(50,128)**
Cash and cash equivalents of newly consolidated subsidiaries, beginning of year	**3,575**	169	548	**30,556**
Cash and cash equivalents of subsidiaries excluded from consolidation			(78)	
Cash and cash equivalents, beginning of year	**16,640**	12,237	13,525	**142,222**
Cash and cash equivalents, end of year	**¥ 14,350**	¥ 16,640	¥ 12,237	**$ 122,650**
Noncash investing and financing activities:				
Assets increased by consolidation of previously unconsolidated subsidiaries	**¥ 330**	¥ 678	¥ 2,911	**$ 2,821**
Liabilities increased by consolidation of previously unconsolidated subsidiaries		277		

See notes to consolidated financial statements.

1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements of Daicel Chemical Industries, Ltd. (the "Company") have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations and in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

In preparing the consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which the Company is incorporated and operates. The translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥117 to $1, the approximate rate of exchange at March 31, 2006. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

2. Summary of Significant Accounting Policies

a. ***Consolidation***—The consolidated financial statements include the accounts of the Company and its significant 51 (46 in 2005, 44 in 2004) subsidiaries (together the "Companies").

During the year ended March 31, 2004, one existing subsidiary was included in consolidation as a result of an increase of its operations. Five subsidiaries were excluded from consolidation as a result of their liquidation, and one subsidiary was excluded as a result of sales of its share.

During the year ended March 31, 2005, one newly established subsidiary was included in consolidation. One existing subsidiary was included as a result of an increase of its operations.

During the year ended March 31, 2006, two newly established subsidiaries were included in consolidation. Three existing subsidiaries were included as a result of an increase of its operations.

Under the control or influence concept, those companies in which the Company, directly or indirectly, is able to exercise control over operations are fully consolidated, and those companies over which the Companies have the ability to exercise significant influence are accounted for by the equity method.

Investments in 11 (11 in 2005, 11 in 2004) unconsolidated subsidiaries and 6 (6 in 2005, 6 in 2004) associated companies are accounted for by the equity method. Investments in the remaining unconsolidated subsidiaries and associated companies are stated at cost. If the equity method of accounting had been applied to the investments in these companies, the effect on the accompanying consolidated financial statements would not be material.

Cost in excess of the net assets of a subsidiary acquired is amortized on a straight-line basis over three years.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Companies and associated companies accounted for by the equity method has been eliminated.

b. ***Cash Equivalents***—Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value. Cash equivalents include time deposits, certificates of deposits and mutual funds investing in bonds that represent short-term investments, all of which mature or become due within three months of the date of acquisition.

c. ***Marketable and Investment Securities***—Marketable and investment securities are classified and accounted for, depending on management's intent, as follows: i) trading securities, which are held for the purpose of earning capital gains in the near term are reported at fair value, and the related unrealized gains and losses are included in earnings, ii) held-to-maturity debt securities, in which the Companies have the positive intent and ability to hold to maturity are reported at amortized cost and iii) available-for-sale securities, which are not classified as either of the aforementioned securities, are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported as a separate component of shareholders' equity. Non-marketable available-for-sale securities are stated at cost determined by the moving-average method.

All of the Companies' securities are classified as available-for-sale securities.

For other than temporary declines in fair value, investment securities are reduced to net realizable value by a charge to income.

d. ***Inventories***—Inventories are substantially stated at cost determined by the moving average cost method.

e. ***Property, Plant and Equipment***—Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment of the Company and its consolidated domestic subsidiaries is computed substantially by the declining-balance method while the straight-line method is applied to buildings acquired after April 1, 1998. Consolidated foreign subsidiaries primarily apply the straight-line method to property, plant and equipment. The range of useful lives is principally from 3 to 75 years for buildings and structures and from 4 to 15 years for machinery and equipment. Property, plant and equipment are carried at cost, less gains deferred on the sale and replacement of certain assets.

f. ***Long-lived assets***—In August 2002, the Business Accounting Council (BAC) issued a Statement of Opinion, *Accounting for Impairment of Fixed Assets*, and in October 2003 the Accounting Standards Board of Japan (ASBJ) issued ASBJ Guidance No. 6 *Guidance for Accounting Standard for Impairment of Fixed Assets*. These new pronouncements were effective for fiscal years beginning on or after April 1, 2005 with early adoption permitted for fiscal years ending on or after March 31, 2004. The Companies adopted the new accounting standard for important of fixed assets as of April 1,2005. The Companies reviews its long-lived assets for impairment whenever events or changes in circumstance indicate the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition. The Companies adopted the fixed asset impairment accounting standard from 2006. Due to this change, income before income taxes decreased by ¥1,150 million ($9,829 thousand) from the number calculated under the previous policy.

	Millions of yen	Thousands of U.S. dollars
Land	¥ 15	$ 128
Building and structures	235	2,009
Machinery and equipment	693	5,923
Other assets	207	1,769
Total	¥1,150	$9,829

g. ***Retirement and Pension Plans***—Effective April 1, 2000, the Company and its consolidated domestic subsidiaries adopted a new accounting standard for employees' retirement benefits and accounted for the liability for retirement benefits based on the projected benefit obligations and plan assets at the balance sheet date. The full amount of the transitional obligation of the Company of ¥11,512 million, determined as of the beginning of year, was recognized as cost and expenses as a result of the contribution of investment securities in the consolidated statement of income in fiscal 2001. The transitional obligation of certain consolidated subsidiaries of ¥2,586 million, determined as of the beginning of year, has been amortized over five years.

Retirement benefits to directors and corporate auditors are subject to the approval of the shareholders and are charged to income when paid.

h. ***Foreign Currency Transactions***—All short-term and long-term monetary receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rates at the balance sheet date. The foreign exchange gains and losses from translation are recognized in the income statement to the extent that they are not hedged by forward exchange contracts.

i. ***Foreign Currency Financial Statements***—The balance sheet accounts of the consolidated foreign subsidiaries are translated into Japanese yen at the current exchange rate as of the balance sheet date except for shareholders' equity, which is translated at historical rates.

Revenue and expense accounts of consolidated foreign subsidiaries are translated into yen at the average exchange rates.

Differences arising from such translation are shown as "Foreign currency translation adjustments" as a separate component of shareholders' equity.

j. ***Leases***—All leases are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that are deemed to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the lessee's financial statements.

k. ***Research and Development***—Research and development costs are included in "Cost and Expenses" as incurred.

l. ***Income Taxes***—The provision for income taxes is computed based on the pretax income included in the consolidated statements of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

m. ***Cash Dividends***—Cash dividends charged to retained earnings are those actually paid during the year, which represent the year-end dividends for the preceding fiscal year and interim dividends for the current fiscal year.

n. ***Derivatives and Hedging Activities***—The Companies use derivative financial instruments, including foreign exchange forward contracts, interest rate swaps and foreign currency swaps as a means of hedging exposure to foreign exchange and interest rate risks. The Companies do not enter into derivatives for trading or speculative purposes.

All derivatives are recognized as either assets or liabilities and measured at fair value, and gains or losses on derivative transactions are recognized in the income statement. For derivatives used for hedging purposes, if such derivatives qualify for hedge accounting because of high correlation and effectiveness between the hedging instruments and the hedged items, gains or losses on those derivatives are deferred until maturity of the hedged transactions.

Long-term debt and trade accounts denominated in foreign currencies, for which foreign exchange forward contracts or foreign currency swaps are used to hedge the foreign currency fluctuation, are translated at the contracted rate if the forward contracts or the swap contracts qualify for specific hedge accounting. Interest rate swaps are utilized to hedge interest rate exposures of long-term debt. Swaps that qualify for hedge accounting are measured at market value at the balance sheet date and unrealized gains or losses are deferred until maturity and included in other liabilities or assets.

From this fiscal year, a subsidiary adopted the Japanese principle accounting standard for foreign currency translation. Under the standard, all receivables denominated in foreign currencies are translated into Japanese yen at the exchange rates prevailing at the balance sheet date. Forward exchange contracts are stated at market value. Resulting gains and losses are included in net income.

o. ***Per Share Information***—Basic net income per share is computed by dividing net income available to common shareholders, which is more precisely computed than under previous practices, by the weighted-average number of common shares outstanding for the period, retroactively adjusted for stock splits.

Diluted net income per share is not disclosed because the Company has no securities or warrants that may cause an additional issue of common shares.

Cash dividends per share presented in the accompanying consolidated statements of income are dividends applicable to the respective years including dividends to be paid after the end of the year, retroactively adjusted for stock splits.

p. ***New Accounting Pronouncements***—

Business Combination and Business Separation

In October 2003, the BAC issued a Statement of Opinion, *Accounting for Business Combinations*, and on December 27, 2005 the Accounting Standards Board of Japan (ASBJ) issued Accounting Standard for Business Separations and ASBJ Guidance No.10, *Guidance for Accounting Standard for Business Combinations and Business Separations*. These new accounting pronouncements are effective for fiscal years beginning on or after April 1, 2006.

The accounting standard for business combinations allows companies to apply the pooling of interests method of accounting only when certain specific criteria are met such that the business combination is essentially regarded as a uniting-of-interests. These specific criteria are as follows:

(a) the consideration for the business combination consists solely of common shares with voting rights,
(b) the ratio of voting rights of each predecessor shareholder group after the business combination is nearly equal, and
(c) there are no other factors that would indicate any control exerted by any shareholder group other than voting rights.

For business combinations that do not meet the uniting-of-interests criteria, the business combination is considered to be an acquisition and the purchase method of accounting is required. This standard also prescribes the accounting for combinations of entities under common control and for joint ventures. Goodwill, including negative goodwill, is to be systematically amortized over 20 years or less, but is also subject to an impairment test.

Under the accounting standards for business separations, in a business separation where the interests of the investor no longer continue and the investment is settled, the difference between the fair value of the consideration received for the transferred business and the book value of net assets transferred to the separated business is recognized as a gain or loss on business separation in the statement of income. In a business separation where the interests of the investor continue and the investment is not settled, no such gain or loss on business separation is recognized.

Stock Options

On December 27, 2005, the ASBJ issued *Accounting Standards for Stock Options and related guidance*. The new standard and guidance are applicable to stock options newly granted on and after May 1, 2006.

This standard requires companies to recognize compensation expense for employee stock options based on the fair value at the date of grant and over the vesting period as consideration for receiving goods or services. The standard also requires companies to account for stock options granted to non-employees based on the fair value of either the stock option or the goods or services received. In the balance sheet, the stock option is presented as a stock acquisition right as a separate component of shareholders' equity until exercised. The standard covers equity-settled, share-based payment transactions, but does not cover cash-settled, share-based payment transactions. In addition, the standard allows unlisted companies to measure options at their intrinsic value if they cannot reliably estimate fair value.

Bonuses to Directors and Corporate Auditors

Prior to the fiscal year ended March 31, 2005, bonuses to directors and corporate auditors were accounted for as a reduction of retained earnings in the fiscal year following approval at the general shareholders meeting. The ASBJ issued ASBJ Practical Issues Task Force (PITF) No.13, *Accounting Treatment for Bonuses to Directors and Corporate Auditors*, which encouraged companies to record bonuses to directors and corporate auditors on the accrual basis with a related charge to income, but still permitted the direct reduction of such bonuses from retained earnings after approval of the appropriation of retained earnings.

The ASBJ replaced the above accounting pronouncement by issuing a new accounting standard for bonuses to directors and corporate auditors on November 29, 2005. Under the new accounting standard, bonuses to directors and corporate auditors must be expensed and are no longer allowed to be directly charged to retained earnings. This accounting standard is effective for fiscal years ending on or after May 1, 2006. The companies must accrue bonuses to directors and corporate auditors at the year end to which such bonuses are attributable.

3. Marketable and Investment Securities

Marketable and Investment securities as of March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Current:			
Trust fund investments and other	**¥ 63**		**$ 538**
Non-current:			
Equity securities	**¥75,902**	¥54,161	**$ 648,735**
Government and corporate bonds	**395**	1,227	**3,376**
Trust fund investments and other	**1,657**	1,563	**14,163**
Total	**¥78,017**	¥56,951	**$ 666,812**

The carrying amounts and aggregate fair values of investment securities at March 31, 2006 and 2005 were as follows:

	Millions of yen			
	2006			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equity securities	**¥18,061**	**¥55,024**	**¥ 1**	**¥ 73,084**
Trust fund investments and other	**995**	**693**	**0**	**1,688**

	Millions of yen			
	2005			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equity securities	¥16,996	¥34,574	¥229	¥51,341
Debt securities	800	3	20	783
Trust fund investments and other	1,411	190	84	1,517

	Thousands of U.S. dollars			
	2006			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equity securities	**$ 154,368**	**$ 470,291**	**$ 9**	**$ 624,650**
Trust fund investments and other	**8,504**	**5,923**	**0**	**14,427**

Securities whose fair values are not readily determinable as of March 31, 2006 and 2005 were as follows:

	Carrying Amounts		
	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Available-for-sale:			
Equity securities	**¥2,796**	¥2,820	**$23,898**
Debt securities	**420**	444	**3,590**
Trust fund investments and other	**30**	46	**256**
Total	**¥3,246**	¥3,310	**$27,744**

Proceeds from sales of available-for-sale securities for the years ended March 31, 2006, 2005 and 2004 were ¥3,057 million ($26,128 thousand), ¥600 million and ¥2,283 million, respectively. Gross realized gains and losses on these sales, computed on the moving average cost basis, were ¥622 million ($5,316 thousand) and ¥28 million ($239 thousand), respectively for the year ended March 31, 2006 and ¥81 million and ¥1 million, respectively for the year ended March 31, 2005 and ¥604 million and ¥24 million, respectively for the year ended March 31, 2004.

The carrying values of debt and other securities by contractual maturities classified as available-for-sale at March 31, 2006 are as follows:

	Millions of yen	Thousands of U.S. dollars
Due in one year or less	**¥ 25**	**$ 214**
Due after one year through five years	**403**	**3,444**
Due after five years through ten years	**138**	**1,180**
Due after ten years	**154**	**1,316**
Total	**¥720**	**$6,154**

Investments in and advances to unconsolidated subsidiaries and associated companies at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Investments	**¥6,171**	¥8,666	**$52,744**
Advances	**1,225**	557	**10,470**
Total	**¥7,396**	¥9,223	**$63,214**

4. Inventories

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

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Finished products	**¥28,728**	¥27,303	**$245,539**
Semi-finished products and work in process	**12,530**	10,433	**107,094**
Raw materials	**15,561**	11,195	**133,000**
Supplies	**2,693**	2,783	**23,017**
Total	**¥59,512**	¥51,714	**$508,650**

5. Short-term Bank Loans and Long-term Debt

Short-term bank loans were principally represented by bank overdrafts. Weighted average per annual interest rates of short-term bank loans at March 31, 2006 and 2005 were 2.09% and 1.54%, respectively.

Long-term debt at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
3.0% bonds due 2007	**¥ 10,000**	¥ 10,000	**$ 85,470**
0.84% bonds due 2009	**10,000**	10,000	**85,470**
2.2% bonds due 2010	**10,000**	10,000	**85,470**
1.6% bonds due 2013	**10,000**	10,000	**85,470**
Unsecured loans from banks and other financial institutions, due through 2012, with interest rates ranging from 0.50 % to 6.07 % for 2006 (from 0.45% to 5.49% for 2005)	**42,185**	34,477	**360,556**
Collateralized loans from banks and other financial institutions, due through 2014, with interest rates ranging from 0.55% to 5.76% for 2006 (from 1.75% to 3.75% for 2005)	**18,803**	4,138	**160,709**
Total	**100,988**	78,615	**863,145**
Less current portion	**(29,323)**	(10,008)	**(250,624)**
Long-term debt, less current portion	**¥ 71,665**	¥ 68,607	**$ 612,521**

At March 31, 2006, annual maturities of long-term debt were as follows:

	Millions of yen	Thousands of U.S. dollars
Year Ending March 31		
2007	¥ 29,323	$ 250,624
2008	13,766	117,658
2009	19,738	168,701
2010	15,855	135,513
2011	5,341	45,649
2012 and thereafter	16,965	145,000
Total	¥ 100,988	$ 863,145

At March 31, 2006, property, plant and equipment with a total net book value of ¥86,344 million ($737,983 thousand) was pledged as collateral for long-term debt issued in Japan.

The unsecured long-term bank debt of ¥11,214 million ($ 95,846 thousand) contain the following financial restriction agreement during its payment period. The agreement provides that the amount of shareholder's equity ¥120,400 million ($1,029,060 thousand) at every end of fiscal year and semi-annual interim period.

6. Retirement and Pension Plans

The Company and certain consolidated subsidiaries have lump-sum severance payment plans and non-contributory trusted pension plans for employees. Additionally, the Company has a "Retirement Benefit Trust."

Under most circumstances, employees terminating their employment are entitled to retirement benefits determined based on the rate of pay at the time of termination, years of service and certain other factors. Such retirement benefits are made in the form of a lump-sum severance payment from the Company or from certain consolidated subsidiaries and annuity payments from a trustee. Employees are entitled to larger payments if the termination is involuntary, by retirement at the mandatory retirement age, by death, or by voluntary retirement at certain specific ages prior to the mandatory retirement age.

The liability for employees' retirement benefits at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Projected benefit obligation	¥ 32,002	¥ 30,201	$ 273,521
Fair value of plan assets	(23,659)	(21,350)	(202,214)
Unrecognized actuarial loss	(684)	(2,441)	(5,846)
Net liability	7,659	6,410	65,461
Prepaid benefit costs	235	169	2,009
Liability for retirement benefit	¥ 7,894	¥ 6,579	$ 67,470

The components of net periodic benefit costs for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Service cost	¥1,635	¥1,550	$13,974
Interest cost	561	560	4,795
Expected return on plan assets	(256)	(79)	(2,188)
Recognized actuarial loss	327	454	2,795
Amortization of transitional obligation		528	
Past period service cost of employees' retirement benefit	1,190		10,171
Net periodic benefit costs	¥3,457	¥3,013	$29,547

Past period service cost of employees' retirement benefit, ¥1,190 million ($10,171 thousand) (included in other expense) was caused by the revision of the calculation premises for employees' retirement in past years.

Assumptions used for the years ended March 31, 2006 and 2005 were set forth as follows:

	2006	2005
Discount rate	**2.0%**	2.0%
Expected rate of return on plan assets	**1.0%**	1.0%
Recognition period of actuarial gain/loss	**10 years**	10 years
Amortization period of subsidiaries' transitional obligation		5 years

7. Shareholders' Equity

Through May 1, 2006, Japanese companies are subject to the Commercial Code of Japan (the "Code").

The Code requires that all shares of common stock be issued with no par value and at least 50% of the issue price of new shares is required to be recorded as common stock and the remaining net proceeds are required to be presented as additional paid-in capital, which is included in capital surplus. The Code permits Japanese companies, upon approval of the Board of Directors, to issue shares to existing shareholders without consideration by way of a stock split. Such issuance of shares generally does not give rise to changes within the shareholders' accounts.

The Code also provides that an amount of 10% or more of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period (such as bonuses to directors) shall be appropriated as a legal reserve (a component of retained earnings) until the total of such reserve and additional paid-in capital equals 25% of common stock. The amount of total legal reserve and additional paid-in capital that exceeds 25% of the common stock may be available for dividends by resolution of the shareholders after transferring such excess in accordance with the Code. In addition, the Code permits the transfer of a portion of additional paid-in capital and legal reserve to the common stock by resolution of the Board of Directors.

The Code allows Japanese companies to purchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The aggregate purchased amount of treasury stock cannot exceed the amount available for future dividends plus the amount of common stock, additional paid-in capital or legal reserve that could be transferred to retained earnings or other capital surplus other than additional paid-in capital upon approval of such transfer at the annual general meeting of shareholders.

In addition to the provision that requires an appropriation for a legal reserve in connection with the cash outlays, the Code also imposes certain limitations on the amount of capital surplus and retained earnings available for dividends. The amount of capital surplus and retained earnings available for dividends under the Code was ¥ 63,555 million ($ 543,205 thousand) as of March 31, 2006, based on the amount recorded in the parent company's general books of account.

Dividends are approved by the shareholders at a meeting held subsequent to the end of the fiscal year to which the dividends are applicable. Semiannual interim dividends may also be paid upon resolution of the Board of Directors, subject to certain limitations imposed by the Code.

On May 1, 2006, a new corporate law (the "Corporate Law") became effective, which reformed and replaced the Code with various revisions that would, for the most part, be applicable to events or transactions which occur on or after May 1,2006 and for the fiscal years ending on or after May 1, 2006. The significant changes in the Corporate Law that affect financial and accounting matters are summarized below;

(a) Dividends

Under the Corporate Law, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the shareholders meeting. For companies that meet certain criteria such as; (1) having the Board of Directors, (2) having independent auditors, (3) having the Board of Corporate Auditors, and (4) the term of service of the directors is prescribed as one year rather than two years of normal term by its articles of incorporation, the Board of Directors may declare dividends (except for dividends in kind) if the company has prescribed so in its articles of incorporation.

The Corporate Law permits companies to distribute dividends-in kind (non-cash assets) to shareholders subject to a certain limitation and additional requirements.

Semiannual interim dividends may also be paid once a year upon resolution by the Board of Directors if the articles of incorporation of the company so stipulate. Under the Code, certain limitations were imposed on the amount of capital surplus and retained earnings available for dividends. The Corporate Law also provides certain limitations on the amounts available for dividends or the purchase of treasury stock. The limitation is defined as the amount available for distribution to the shareholders, but the amount of net assets after dividends must be maintained at no less than ¥3 million.

(b) Increases / decreases and transfer of common stock, reserve and surplus

The Corporate Law requires that an amount equal to 10% of dividends must be appropriated as a legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus) depending on the equity account charged upon the payment of such dividends until the total of aggregate amount of legal reserve and additional paid-in capital equals 25% of the common stock. Under the Code, the aggregate amount of additional paid-in capital and legal reserve that exceeds 25% of the common stock may be made available for dividends by resolution of the shareholders. Under the Corporate Law, the total amount of additional paid-in capital and legal reserve may be reversed without limitation of such threshold. The Corporate Law also provides that common stock, legal reserve, additional paid-in capital, other capital surplus and retained earnings can be transferred among the accounts under certain conditions upon resolution of the shareholders.

(c) Treasury stock and treasury stock acquisition rights

The Corporate Law also provides for companies to purchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The amount of treasury stock purchased cannot exceed the amount available for distribution to the shareholders which is determined by specific formula.

Under the Corporate law, stock acquisition rights, which were previously presented as a liability, are now presented as a separate component of shareholders' equity.

The Corporate Law also provides that companies can purchase both treasury stock acquisition rights and treasury stock. Such treasury stock acquisition rights are presented as a separate component of shareholders' equity or deducted directly from stock acquisition rights.

On December 9, 2005, the ASBJ published a new accounting standard for presentation of shareholders' equity. Under this accounting standard, certain items which were previously presented as liabilities are now presented as components of shareholders' equity. Such items include stock acquisition rights, minority interest, and any deferred gain or loss on derivatives accounted for under hedge accounting. This standard is effective for fiscal years endings on or after May 1, 2006.

8. Income Taxes

The Company and its domestic subsidiaries are subject to Japanese national and local income taxes which, in the aggregate, resulted in normal effective statutory tax rates of approximately 41%, 41% and 42% for the years ended March 31, 2006, 2005 and 2004. Foreign subsidiaries are subject to income tax of the countries in which they operate.

A reconciliation between the normal effective statutory tax rate for the years ended March 31, 2006, 2005 and 2004 and the actual effective tax rate reflected in the accompanying consolidated statement of income was as follows:

	2006	2005	2004
Normal effective statutory tax rate	**41%**	41%	42%
Expenses not deductible for income tax purposes	**1**	1	3
Fine by the European Commission (EC)			11
Current operating losses of subsidiaries	**3**		6
Loss on investments in subsidiaries		(1)	(48)
Equity in earnings of associated companies	**(1)**	(1)	(1)
Tax credit primarily for research and development expenses	**(3)**	(2)	
Per capita levy			1
Other—net	**(2)**	(2)	(1)
Actual effective tax rate	**39%**	36%	13%

The tax effects of significant temporary differences and tax loss carryforwards which resulted in deferred tax assets and liabilities at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets:			
Accrued enterprise taxes	¥ 595	¥ 555	$ 5,086
Accrued bonuses	1,626	1,566	13,897
Liabilities for retirement benefits	7,958	7,083	68,017
Investment securities	2,388	2,576	20,410
Tax loss carryforwards	1,006	1,119	8,598
Intercompany profits	4,634	4,568	39,607
Other	2,379	2,667	20,333
Less valuation allowance	(1,140)	(1,186)	(9,744)
Deferred tax assets	¥19,446	¥18,948	$ 166,204
Deferred tax liabilities:			
Unrealized gain on available-for-sale securities	¥22,755	¥14,097	$ 194,487
Tax purpose reserves regulated by Japanese tax law	869	899	7,427
Undistributed earnings of foreign subsidiaries	2,508	1,429	21,436
Securities contributed to employees' retirement benefit trust	4,585	4,567	39,188
Other	1,710	1,045	14,615
Deferred tax liabilities	¥32,427	¥22,037	$ 277,153
Net deferred tax liabilities	¥12,981	¥ 3,089	$ 110,949

9. Research and Development Costs

Research and development costs included in "Cost and Expenses" were ¥11,221 million ($95,906 thousand), ¥11,219 million and ¥11,085 million for the years ended March 31, 2006, 2005 and 2004, respectively.

10. Net Income per Share

The computation of net income per common share is based on the weighted average number of shares outstanding. The average number of common shares in the computation was 361,760,918, 361,650,372 and 361,953,638 for the years ended March 31, 2006, 2005 and 2004, respectively.

11. Leases

(Lessee)

Finance Leases:

Total lease payments under finance leases that do not deem to transfer ownership of the leased property to the lessee were ¥289 million ($2,470 thousand), ¥356 million and ¥465 million for the years ended March 31, 2006, 2005 and 2004, respectively.

Pro forma information of leased property under finance leases that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2006 and 2005 were as follows:

As of March 31, 2006

	Buildings and Structures	Machinery and Equipment	Other Assets	Total
				Millions of yen
Acquisition cost	**¥196**	**¥1,925**	**¥4**	**¥2,125**
Accumulated depreciation	**102**	**806**	**4**	**912**
Net leased property	**¥ 94**	**¥1,119**	**¥0**	**¥1,213**

	Buildings and Structures	Machinery and Equipment	Other Assets	Total
				Thousands of U.S. dollars
Acquisition cost	**$1,675**	**$16,453**	**$34**	**$18,162**
Accumulated depreciation	**872**	**6,889**	**34**	**7,795**
Net leased property	**$ 803**	**$ 9,564**	**$ 0**	**$10,367**

As of March 31, 2005

	Buildings and Structures	Machinery and Equipment	Other Assets	Total
				Millions of yen
Acquisition cost	¥198	¥1,711	¥66	¥1,975
Accumulated depreciation	102	1,014	62	1,178
Net leased property	¥ 96	¥ 697	¥ 4	¥ 797

The amount of acquisition cost under finance leases includes the imputed interest expense.

Obligations under finance leases as of March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Due within one year	**¥ 300**	¥250	**$ 2,564**
Due after one year	**913**	547	**7,803**
Total	**¥1,213**	¥797	**$10,367**

The amount of obligations under finance leases includes the imputed interest expense.

Depreciation expense, which is not reflected in the accompanying consolidated statements of income, computed by the straight-line method was ¥289 million ($2,470 thousand), ¥356 million and ¥465 million for the years ended March 31, 2006, 2005 and 2004, respectively.

Operating Leases:

Obligations under non-cancelable operating leases as of March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Due within one year	**¥105**	¥ 97	**$ 897**
Due after one year	**14**	36	**120**
Total	**¥119**	¥133	**$1,017**

The amount of obligations under operating leases includes imputed interest expense.

There is not impairment of fixed assets divided by lease assets.

(Lessor)

Finance Leases:

These finance leases that do not transfer ownership of leased property to the lessee are subleases.

Future rental income under such finance leases as of March 31, 2006 and 2005 was as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Due within one year		¥2	
Due after one year			
Total		¥2	

The amount of future rental income under subleases includes the imputed interest income.

12. Derivatives

The Companies enter into foreign exchange forward contracts and foreign currency swaps, in the normal course of business, to reduce the exposure to fluctuations in foreign exchange rates. The Companies also enter into interest rate swap agreements as a means of managing interest rate exposure. The Companies do not hold or issue derivatives for trading or speculative purposes.

Foreign exchange forward contracts, interest rate swaps and foreign currency swaps are subject to market risk, which is the exposure created by potential fluctuations in market conditions. Because the counterparties to the Companies' derivatives are limited to major international financial institutions, the Companies do not anticipate any losses arising from credit risk. Derivative transactions entered into by the Companies have been made in accordance with internal policies which regulate the authorization of such transactions.

The Companies had the following derivatives contracts outstanding at March 31, 2006 and 2005:

	Millions of yen						Thousands of U.S. dollars		
	2006			2005			**2006**		
	Contract Amount	Fair Value	Unrealized Gain (Loss)	Contract Amount	Fair Value	Unrealized Gain (Loss)	Contract Amount	Fair Value	Unrealized Gain (Loss)
Foreign currency forward contracts:									
Selling U.S.$	**¥ 3,952**	**¥3,984**	**¥ (32)**	¥ 849	¥856	¥ (7)	**$ 33,778**	**$34,051**	**$ (273)**
Selling THB	**113**	**114**	**(1)**				**966**	**974**	**(8)**
Foreign currency swaps:									
Receiving Japanese yen,									
paying U.S.$	**2,500**	**(167)**	**(167)**	2,500	91	91	**21,368**	**(1,427)**	**(1,427)**
Interest rate swaps:									
Fixed rate payment,									
floating rate receipt	**15,000**	**(67)**	**(67)**	15,000	(312)	(312)	**128,205**	**(573)**	**(573)**
Floating rate payment,									
fixed rate receipt				3,000	(102)	(102)			

Foreign exchange forward contracts or interest rate swaps or foreign currency swaps which qualify for hedge accounting and such amounts which are assigned to the associated assets and liabilities and are recorded on the balance sheet are excluded from disclosure of market value information.

The contract or notional amounts above do not represent the amounts exchanged by the parties and do not measure the Companies' exposure to credit or market risk.

13. Related Party Transactions

The Company sells Cellulose acetate and polymer to Fuji Photo Film Co., Ltd. whose president has served as one of the Company's directors since June, 2005.

The sales to Fuji Photo Film Co., Ltd. for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Sales	¥9,675		$82,692

These balances due to Fuji Film Co.,Ltd. at March 31,2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Notes and accounts receivable	¥3,002		$25,658

14. Settlement Payment

During the year ended March 31, 2004 the following occurred:

a) In Europe, the Company was assessed a fine by the European Commission (EC) in connection with the Company's past sales of sorbic acid and potassium sorbate.

b) In the United States, the Company and Daicel (U.S.A.), Inc. reached settlement agreements with plaintiffs in civil lawsuits.

Under these settlements, the Company and Daicel (U.S.A.), Inc. made total payments of ¥2,548 million, which were recorded in the accompanying consolidated statement of income for the year ended March 31, 2004.

15. Municipal Government Subsidies

The Companies received various incentives from municipal governments in the form of subsidies for purchases of property, plant and equipment. Such subsidies were accounted for as income as received. The same amount is charged to income and deducted from the cost of property, plant and equipment when the property, plant and equipment subject to the subsidies are acquired.

16. Expropriation

During the year ended March 31, 2005, in connection with expropriations for public expressway construction, the Companies signed an agreement with Hanshin Expressway Public Corporation to sell certain land and certain facilities related to its Sakai Plant which produced a gain for the Companies of ¥26,388 million ($246,617 thousand). Under Japanese tax regulations, the Companies are allowed to defer this gain by recording it as a deferred gain under long-term liabilities. When replacement property and plant facilities are acquired, the deferred gain is reversed and the same amount is credited against the cost of such property, plant and equipment.

17. Contingent Liabilities

Contingent liabilities at March 31, 2006 for loans guaranteed amounted to ¥ 3,986 million ($ 34,068 thousand). Loans guaranteed are principally those of unconsolidated subsidiaries, associated companies and employees.

Contingent liabilities at March 31, 2006 for cession of a trade notes amounted to ¥ 381 million ($ 3,256 thousand).

18. Subsequent Event

The following plan for appropriations of retained earnings for the year ended March 31, 2006 was approved at the Shareholders' General Meeting of the Company held on June 29, 2006:

	Millions of yen	Thousands of U.S. dollars
Cash dividends, ¥4 ($0.03) per share	¥ 1,448	$ 12,376
Bonuses of directors and corporate auditors	38	325

19. Segment Information

Information about operations in industry segments, geographic segments and sales to foreign customers of the Companies for the years ended March 31, 2006, 2005 and 2004 is as follows:

I Operations in Industry Segments

								Millions of yen
Year Ended March 31, 2006	Cellulosic Derivatives	Organic Chemicals	Plastics and Films	Pyrotechnic Devices	Functional Products and Others	Total	Corporate and Eliminations	Consolidated
Sales to outside customers	**¥55,899**	**¥84,435**	**¥142,556**	**¥44,090**	**¥ 8,540**	**¥335,520**		**¥335,520**
Intersegment sales	**2,222**	**10,989**	**37**		**10,267**	**23,515**	**¥ (23,515)**	
Total sales	**58,121**	**95,424**	**142,593**	**44,090**	**18,807**	**359,035**	**(23,515)**	**335,520**
Total cost and expenses	**47,290**	**85,947**	**129,421**	**37,473**	**17,490**	**317,621**	**(15,671)**	**301,950**
Operating income	**¥10,831**	**¥ 9,477**	**¥ 13,172**	**¥ 6,617**	**¥ 1,317**	**¥ 41,414**	**¥ (7,844)**	**¥ 33,570**
Total asset	**¥86,828**	**¥82,909**	**¥149,738**	**¥52,786**	**¥10,908**	**¥383,169**	**¥100,300**	**¥483,469**
Depreciation	**4,131**	**6,426**	**6,887**	**3,434**	**290**	**21,168**	**780**	**21,948**
Impairment loss on fixed assets		**895**	**15**			**910**	**240**	**1,150**
Capital investments	**30,154**	**5,461**	**6,960**	**12,678**	**340**	**55,593**	**6,358**	**61,951**

								Thousands of U.S. dollars
Year Ended March 31, 2006	Cellulosic Derivatives	Organic Chemicals	Plastics and Films	Pyrotechnic Devices	Functional Products and Others	Total	Corporate and Eliminations	Consolidated
Sales to outside customers	**$477,769**	**$721,667**	**$1,218,427**	**$376,838**	**$72,991**	**$2,867,692**		**$2,867,692**
Intersegment sales	**18,992**	**93,923**	**316**		**87,752**	**200,983**	**$(200,983)**	
Total sales	**496,761**	**815,590**	**1,218,743**	**376,838**	**160,743**	**3,068,675**	**(200,983)**	**2,867,692**
Total cost and expenses	**404,188**	**734,590**	**1,106,162**	**320,282**	**149,487**	**2,714,709**	**(133,940)**	**2,580,769**
Operating income	**$92,573**	**$81,000**	**$112,581**	**$56,556**	**$11,256**	**$353,966**	**$(67,043)**	**$286,923**
Total asset	**$742,120**	**$708,624**	**$1,279,812**	**$451,162**	**$93,231**	**$3,274,949**	**$857,265**	**$4,132,214**
Depreciation	**35,308**	**54,923**	**58,863**	**29,350**	**2,479**	**180,923**	**6,667**	**187,590**
Impairment loss on fixed assets		**7,650**	**128**			**7,778**	**2,051**	**9,829**
Capital investments	**257,726**	**46,675**	**59,487**	**108,359**	**2,906**	**475,153**	**54,342**	**529,495**

								Millions of yen
Year Ended March 31, 2005	Cellulosic Derivatives	Organic Chemicals	Plastics and Films	Pyrotechnic Devices	Functional Products and Others	Total	Corporate and Eliminations	Consolidated
Sales to outside customers	¥50,132	¥79,087	¥133,390	¥36,605	¥ 7,121	¥306,335		¥306,335
Intersegment sales	1,942	11,083	49		10,082	23,156	¥(23,156)	
Total sales	52,074	90,170	133,439	36,605	17,203	329,491	(23,156)	306,335
Total cost and expenses	42,409	83,310	120,430	30,063	16,723	292,935	(15,153)	277,782
Operating income	¥ 9,665	¥ 6,860	¥ 13,009	¥ 6,542	¥ 480	¥ 36,556	¥ (8,003)	¥ 28,553
Total asset	¥57,894	¥82,321	¥135,949	¥39,730	¥10,323	¥326,217	¥ 87,276	¥413,493
Depreciation	4,127	7,062	6,770	3,069	348	21,376	840	22,216
Capital investments	4,398	5,209	10,583	4,449	190	24,829	850	25,679

Year Ended March 31, 2004	Cellulosic Derivatives	Organic Chemicals	Plastics and Films	Pyrotechnic Devices	Functional Products and Others	Total	Corporate and Eliminations	Consolidated
								Millions of yen
Sales to outside customers	¥48,180	¥74,916	¥119,299	¥32,541	¥6,804	¥281,740		¥281,740
Intersegment sales	1,785	9,816	46		9,293	20,940	¥(20,940)	
Total sales	49,965	84,732	119,345	32,541	16,097	302,680	(20,940)	281,740
Total cost and expenses	39,139	79,930	111,796	26,573	15,832	273,270	(12,737)	¥260,533
Operating income	¥10,826	¥ 4,802	¥ 7,549	¥ 5,968	¥ 265	¥ 29,410	¥ (8,203)	¥21,207
Total asset	¥55,103	¥84,530	¥128,172	¥32,418	¥8,372	¥308,595	¥ 72,890	¥381,485
Depreciation	4,254	7,861	7,491	3,000	406	23,012	1,164	24,176
Capital investments	4,440	4,586	5,615	5,559	392	20,592	1,274	21,866

Cellulosic derivatives include cellulose acetate, acetate tow for cigarette filters and water-soluble polymers. Organic chemicals include acetic acid and its derivatives, fine chemical products and optical resolution columns. Plastics and films include SAN and ABS resins and alloys, and packaging and performance films. Pyrotechnic devices include ammunition, solid propellants and rocket propulsion, aircrew emergency–escape systems and inflators for automobile air bag safety equipment. Functional products include membranes.

Cost and expenses of Corporate and Eliminations for the year ended March 31, 2006, 2005 and 2004 included unallocated corporate costs of ¥7,844 million ($67,043 thousand), ¥8,003 million and ¥8,203 million, respectively. The unallocated corporate costs consisted primarily of research and development costs and headquarters administration costs.

Assets of Corporate and Eliminations at March 31, 2006, 2005 and 2004 included ¥103,234 million ($882,342 thousand), ¥89,803 million and ¥75,289 million of corporate assets, respectively, consisting primary of cash and cash equivalents, investment in securities, research and development-related equipment and headquarters administration-related assets.

II Geographical Segments

Year Ended March 31, 2006	Japan	Asia	Other	Total	Corporate and Eliminations	Consolidated
						Millions of yen
Sales to outside customers	**¥264,621**	**¥54,480**	**¥16,419**	**¥335,520**		**¥335,520**
Intersegment sales	**42,455**	**7,964**	**460**	**50,879**	**¥(50,879)**	
Total sales	**307,076**	**62,444**	**16,879**	**386,399**	**(50,879)**	**335,520**
Operating expenses	**273,778**	**55,125**	**16,082**	**344,985**	**(43,035)**	**301,950**
Operating income	**¥ 33,298**	**¥ 7,319**	**¥ 797**	**¥ 41,414**	**¥ (7,844)**	**¥ 33,570**
Total assets	**¥308,288**	**¥69,577**	**¥19,885**	**¥397,750**	**¥ 85,719**	**¥483,469**

Year Ended March 31, 2006	Japan	Asia	Other	Total	Corporate and Eliminations	Consolidated
						Thousands of U.S. Dollars
Sales to outside customers	**$2,261,718**	**$465,641**	**$140,333**	**$2,867,692**		**$2,867,692**
Intersegment sales	**362,863**	**68,068**	**3,932**	**434,863**	**$(434,863)**	
Total sales	**2,624,581**	**533,709**	**144,265**	**3,302,555**	**(434,863)**	**2,867,692**
Operating expenses	**2,339,983**	**471,154**	**137,453**	**2,948,590**	**(367,821)**	**2,580,769**
Operating income	**$ 284,598**	**$ 62,555**	**$ 6,812**	**$ 353,965**	**$ (67,042)**	**$ 286,923**
Total assets	**$2,634,940**	**$594,675**	**$169,958**	**$3,399,573**	**$ 732,641**	**$4,132,214**

Year Ended March 31, 2005	Japan	Asia	Other	Total	Corporate and Eliminations	Consolidated
						Millions of yen
Sales to outside customers	¥244,897	¥48,754	¥12,684	¥306,335		¥306,335
Intersegment sales	39,185	6,081	315	45,581	¥(45,581)	
Total sales	284,082	54,835	12,999	351,916	(45,581)	306,335
Operating expenses	254,159	49,447	11,755	315,361	(37,579)	277,782
Operating income	¥29,923	¥5,388	¥1,244	¥36,555	¥(8,002)	¥28,553
Total assets	¥273,985	¥54,553	¥11,594	¥340,132	¥73,361	¥413,493

Year Ended March 31, 2004	Japan	Asia	Other	Total	Corporate and Eliminations	Consolidated
						Millions of yen
Sales to outside customers	¥228,551	¥43,447	¥9,742	¥281,740		¥281,740
Intersegment sales	33,314	4,955	245	38,514	¥(38,514)	
Total sales	261,865	48,402	9,987	320,254	(38,514)	281,740
Operating expenses	237,420	44,039	9,386	290,845	(30,312)	260,533
Operating income	¥24,445	¥4,363	¥601	¥29,409	¥(8,202)	¥21,207
Total assets	¥270,068	¥41,101	¥9,748	¥320,917	¥60,568	¥381,485

Major countries or areas in the categories Asia and Other are as follows:

Asia: Hong-Kong, Singapore, China, Thailand, Taiwan, Malaysia

Other: North America, Europe

Cost and expenses of Corporate and Eliminations for the year ended March 31, 2006, 2005 and 2004 included unallocated corporate costs of ¥7,844 million ($67,043 thousand), ¥8,003 million and ¥8,203 million, respectively. The unallocated corporate costs consisted primarily of research and development costs and headquarters administration costs.

Assets of Corporate and Eliminations at March 31, 2006, 2005 and 2004 included ¥103,234 million ($882,342 thousand), ¥89,803 million and ¥75,289 million of corporate assets, respectively, consisting primary of cash and cash equivalents, investment in securities, research and development-related equipment and headquarters administration-related assets.

III Sales to Foreign Customers

Sales to foreign customers for the years ended March 31, 2005, 2004 and 2003 consisted of the following:

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Asia	**¥ 76,705**	¥ 70,249	¥ 64,226	**$ 655,598**
Other	**31,336**	24,037	18,506	**267,829**
Total	**¥ 108,041**	¥ 94,286	¥ 82,732	**$ 923,427**

Major countries or areas in the categories Asia and Other are as follows:

Asia: China, Hong Kong, Thailand, Singapore, Korea, Taiwan

Other: North America, Europe, Africa, Oceania, the Middle East, Latin America

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of Daicel Chemical Industries, Ltd.:

We have audited the accompanying consolidated balance sheets of Daicel Chemical Industries, Ltd. and consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended March 31, 2006, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Daicel Chemical Industries, Ltd. and consolidated subsidiaries as of March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2006, in conformity with accounting principles generally accepted in Japan.

As discussed in Note 2 to the consolidated financial statements, Daicel Chemical Industries, Ltd. and consolidated subsidiaries adopted the new accounting standard for impairment of fixed assets as of April 1, 2005.

Our audits also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 1. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

Deloitte Touche Tohmatsu

June 29, 2006

Principal Subsidiaries and Affiliates

Domestic Operations

(As of July 31, 2006)

	Paid-in capital (Millions of yen)	The Company's equity ownership (%)	Principal business
Kyodo Sakusan Co., Ltd.	3,000	54	Manufacture and sale of acetic acid Joint-venture company with Mitsubishi Gas Chemical Co., Inc.; Denki Kagaku Kogyo K.K.; Chisso Corporation; and Kyowa Hakko Chemical Co., Ltd.
Dainichi Chemical Corp.	450	100	Manufacture and sale of industrial-use coating resins, non-tin anti-stain compounds, and fine chemicals
Polyplastics Co., Ltd.	3,000	55	Manufacture and sale of polyacetal resin, polybutylene terephthalate (PBT) resin, liquid crystal polymer, and polyphenylene sulfide resin Joint-venture company with Ticona Limited Liability Company of the United States
WinTech Polymer Ltd.*1	2,000	33	Manufacture and sale of polybutylene terephthalate (PBT) resin and glass fiber-reinforced PET (FR-PET) resin Joint-venture company with Teijin Limited
Dainippon Plastics Co., Ltd.	859	60	Manufacture and sale of plastic products
Daipla System Technology Co., Ltd.*2	120	60	Manufacture and sale of molds for injection molding
Sheedom Co., Ltd.*3	120	60	Manufacture and sale of plastic sheet products
Daicel Polymer Ltd.	100	100	Manufacture and sale of SAN resin, ABS resin, high-performance polymer alloy, and polystyrene sheet
Daicel-Degussa Ltd.	340	50	Manufacture and sale of polyamide 12 resin Joint-venture company with Degussa Japan Co., Ltd.
Daicel Pack Systems, Ltd.	45	100	Manufacture and sale of paper and plastic buffers, vacuum- and pressure-molded plastics, and industrial and food packaging
Daicel Value Coating Ltd.	40	100	Manufacture and sale of barrier films Custom coating business
Mikuni Plastics Co., Ltd.	315	100	Manufacture, processing, and sale of various plastic products
Daicel Novafoam Ltd.	97	100	Manufacture and sale of foamed plastics
Daicel Safety Systems Inc.	80	100	Manufacture of inflators for automobile air bags
Japan Shotshell Ltd.	150	100	Manufacture and sale of shotgun shells for sport shooting and hunting
Daicel Finance Ltd.	1,000	100	Supervision and implementation of finance and asset management operations for Daicel Group companies
Y.S. Logistics Service Co., Ltd.	267	92	Warehousing and transportation
Daicen Membrane-Systems Ltd.	30	55	Manufacture and sale of separation membranes, including ultrafiltration membrane modules, and design, manufacture, and sale of equipment and systems related to ultrafiltration membrane modules
Daicel FineChem Ltd.	70	100	Sale of water-soluble polymers, synthetic resins, and other industrial products, and manufacture, processing, and sale of resin-based construction materials as well as floor coverings and exterior furnishings Manufacture and sale of celluloid, acetate plastics products, and household products

*1 60% owned by Polyplastics Co., Ltd.
*2,3 100% owned by Dainippon Plastics Co., Ltd.

International Operations

	Paid-in capital	The Company's equity ownership (%)	Principal business
Xi'an Huida Chemical Industries Co., Ltd.*[4]	RMB88mil	30	Manufacture and sale of acetate tow for cigarette filters
Chiral Technologies, Inc.	US$8.8mil	100	Sale of chiral separation columns and provision of technical services related to optical active compounds
Chiral Technologies Europe S.A.S.	€2.1mil	100	Sale of chiral separation columns and provision of technical services related to optical active compounds
Daicel Nanning Food Ingredients Co., Ltd.*[5]	US$33.61mil	100	Manufacture and sale of sorbic acid and potassium sorbate
Polyplastics Taiwan Co., Ltd.*[6]	NT$1,590mil	41	Manufacture and sale of engineering plastics
Polyplastics Asia Pacific Sdn. Bhd.*[7]	RM159mil	55	Manufacture and sale of engineering plastics
PTM Engineering Plastics (Nantong) Co., Ltd.*[8]	RMB386mil	39	Manufacture and sale of engineering plastics Joint-venture company with Mitsubishi Gas Chemical Co.,Inc.; Korea Engineering Plastics Co.,Ltd.; and Ticona Limited Liability Company
Shanghai Daicel Polymers, Ltd.*[9]	RMB76.52mil	100	Sale and compounding of plastics
Daicel Polymer (Hong Kong) Ltd.*[10]	HK$1.0mil	100	Manufacture and sale of SAN resin, ABS resin, high-performance polymer alloy, and polystyrene sheet
Daicel Polymer Trading (Shanghai) Ltd.*[11]	RMB1.66mil	100	Sale of compound resin, polystyrene sheet and other chemical products
Topas Advanced Polymers GmbH*[12]	€0.1mil	80	Manufacture, sale and research of cyclic olefin copolymer
Topas Advanced Polymers, Inc.*[13]	US$0.01mil	80	Sale of cyclic olefin copolymer
Daicel Safety Systems America, LLC*[14]	US$15mil	66	Manufacture and sale of inflators for automobile air bags Joint-venture company with TG North America Corporation
Daicel Safety Systems Europe Sp. z o. o.	PLN5mil	100	Manufacture and sale of inflators for automobile air bags
Daicel Safety Systems (Jiangsu) Co., Ltd.*[15]	US$15mil	100	Manufacture and sale of inflators for automobile air bags
Daicel Safety Systems (Thailand) Co., Ltd.	THB270mil	100	Manufacture and sale of inflators for automobile air bags
Daicel Safety Technologies America, Inc	US$8.5mil	100	Manufacture of inflator components for automobile air bags
Daicel Safety Technologies (Thailand) Co., Ltd.	THB800mil	100	Manufacture of inflator components for automobile air bags
Daicel Chemical (China) Investment Co., Ltd.	US$43.75mil	100	Management of Manufacturing and marketing operations in China
Daicel Chemical (Asia) Pte. Ltd.	S$9.59mil	100	Management of marketing operations in Southeast Asia
Daicel (Hong Kong) Ltd.	HK$1.5mil	100	Management of marketing operations in Hong Kong and southern China
Daicel (U.S.A.), Inc.	US$51.9mil	100	Management of marketing operations in North America
Daicel (Europa) GmbH	€0.15mil	100	Management of marketing operations in Europe

*4 30% owned by Daicel Chemical (China) Investment Co., Ltd.
*5, *15 100% owned by Daicel Chemical (China) Investment Co., Ltd.
*6 75% owned by Polyplastics Co., Ltd.
*7 100% owned by Polyplastics Co., Ltd.
*8 70% owned by Polyplastics Co., Ltd.
*9 90% owned by Daicel Chemical Industries, Ltd and 10% owned by Daicel Chemical (China) Investment Co., Ltd.
*10 100% owned by Daicel Polymer Ltd.
*11 50% owned by Daicel Polymer Ltd. and 50% owned by Daicel Polymer (Hong Kong) Ltd.
*12 55% owned by Daicel Chemical Industries, Ltd and 45% owned by Polyplastics Co., Ltd.
*13 100% owned by Topas Advanced Polymers GmbH
*14 66% owned by Daicel (U.S.A.), Inc.

Corporate Data

Incorporated	September 8, 1919

Common Stock

Authorized:	1,450,000,000 shares
Issued:	364,942,682 shares
Capital:	¥36,275 million
Listings:	Tokyo Stock Exchange and Osaka Securities Exchange
Transfer Agent:	The Chuo Mitsui Trust & Banking Co., Ltd. 33-1, Shiba 3-chome, Minato-ku, Tokyo 105-8574, Japan
Number of Shareholders:	24,351

(As of March 31, 2006)

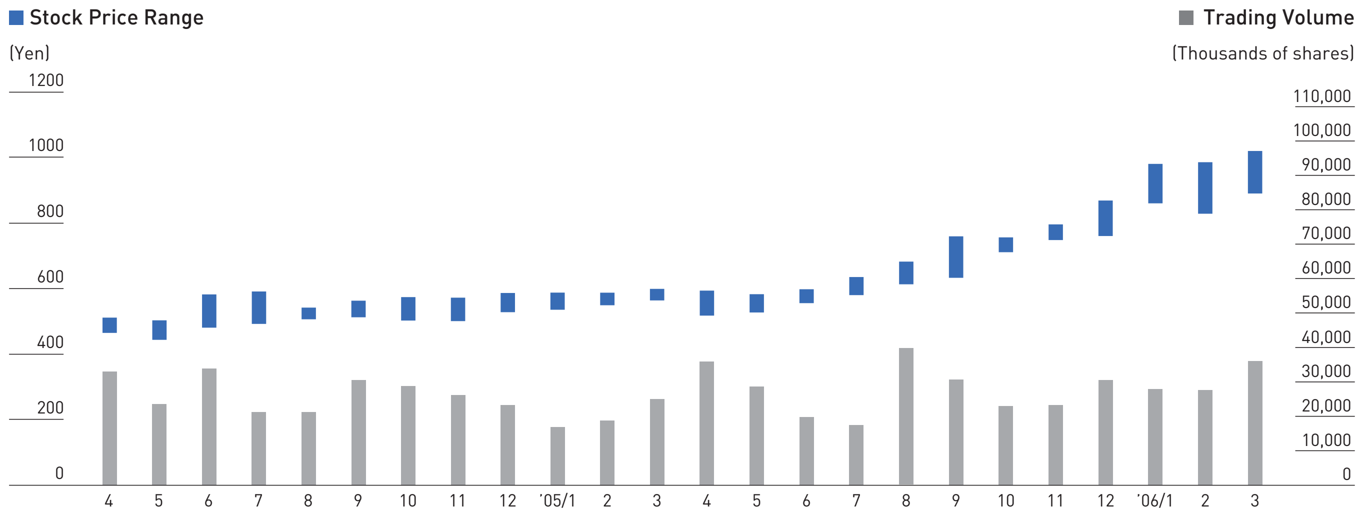
Independent Auditor	Deloitte Touche Tohmatsu
Osaka Head Office	1, Teppo-cho, Sakai-ku, Sakai, Osaka 590-8501, Japan Tel : +81-72-227-3111 Fax: +81-72-227-3000
Tokyo Head Office	2-18-1, Konan Minato-ku, Tokyo 108-8230, Japan Tel : +81-3-6711-8111 Fax: +81-3-6711-8100
Osaka Sales Office	3-13, Azuchi-machi 2-chome, Chuo-ku, Osaka 541-0052, Japan Tel : +81-6-6263-4811 Fax: +81-6-6263-4826

(As of July 31, 2006)

Stock Information

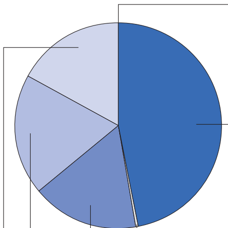
(As of March 31, 2006)

Stock Price Range & Trading Volume



Note: Share price and trading volume reflect Company shares traded on the Tokyo Stock Exchange.

Composition of Stockholders



	Thousands of shares	%
Government & local public entities	13	0.0
Financial institutions	171,287	46.9
Securities companies	1,387	0.4
Other domestic corporations	60,953	16.7
Foreign investors	69,203	19.0
Individual & other investors	62,098	17.0

Note: Treasury stock is included in the "Individual & other investors" category.

Major Shareholders (Top10)

Name of shareholder	Number of shares (unit: 1,000 shares)	Ratio of shareholder voting rights (%)
The Master Trust Bank of Japan, Ltd. (Trust Account)	40,692	11.3%
Japan Trustee Services Bank, Ltd. (Trust Account)	35,698	9.9%
Nippon Life Insurance Company	16,813	4.7%
Toyota Motor Corporation	15,000	4.2%
Nippon Life Insurance Company (Special pension fund account)	9,804	2.7%
Mitsui Sumitomo Insurance Co., Ltd.	9,003	2.5%
Trust & Custody Services Bank, Ltd. (Trust Account B)	8,861	2.5%
Fuji Photo Film Co., Ltd.	7,678	2.1%
Mitsui & Co., Ltd.	7,560	2.1%
Sumitomo Mitsui Banking Corporation	7,096	2.0%

DAICEL CHEMICAL INDUSTRIES, LTD.

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