

ANNUAL REPORT 2004

FISCAL YEAR ENDED MARCH 31, 2004



NIPPON VALQUA INDUSTRIES, LTD.

Profile

Nippon Valqua Industries, Ltd., founded in 1927, is a leading Japanese manufacturer of industrial packing and gaskets, producing rubber, fiber products, high-performance resins, and metal packing. As a pioneer in seal engineering in Japan, Valqua is a leading supplier of seal materials, and is also in the forefront of the fluorocarbon polymer industry.

The corporate name of the Valqua Group is a contraction of the phrase that has been the Company's motto since its founding — "Value and Quality." Throughout that time, Valqua has striven to develop and market products that offer real value, and that carry high levels of reliability and product quality. The Company's motto, "Create new corporate value and improve the quality of our business operations," is all the more meaningful in today's rapidly changing markets. While responding swiftly to the requirements of the new era, the Company is striving to build its corporate value, chiefly by expanding cash flows, and to improve management quality through a diverse reevaluation of management processes. The Valqua Group is laboring to provide optimum satisfaction to its stockholders, customers, employees, and all stakeholders in the communities where it operates.

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*Value and Quality:
Living up to the
challenge of tomorrow's
technology needs*

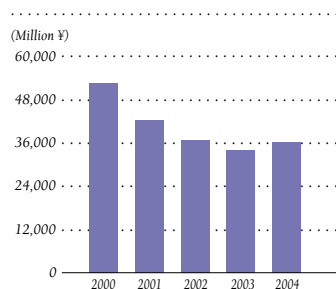
Five-Year Summary of Selected Financial Data

Nippon Valqua Industries, Ltd. and Consolidated Subsidiaries
Year Ended March 31

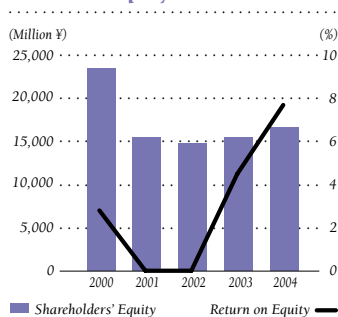
	Millions of yen					Thousands of U.S. dollars
	2004	2003	2002	2001	2000	2004
Net sales	¥33,271	¥31,432	¥32,329	¥38,170	¥36,729	\$314,947
Operating income	1,432	1,118	719	2,610	1,013	13,556
Net income (loss)	1,234	681	(491)	(7,275)	643	11,681
Total assets	36,347	34,118	36,941	42,572	52,906	344,065
Property, plant and equipment, net	12,839	13,834	15,052	15,886	18,929	121,535
Research and development expenses	972	905	670	821	966	9,201
Shareholders' equity	16,686	15,533	14,760	15,522	23,496	158,274
	Yen					U.S. dollars
Per share of common stock:						
Net income (loss)						
—Basic	¥ 14.08	¥ 7.68	¥ (5.71)	¥ (84.60)	¥ 7.52	\$0.13
—Diluted	13.88	—	—	—	—	0.13
Shareholders' equity	192.94	180.65	171.68	180.51	275.15	1.83
Cash dividends	5.00	5.00	—	—	3.00	0.05
Financial ratios:						
Operating income to net sales	4.30%	3.56%	2.22%	6.84%	2.76%	
Net income to net sales	3.71	2.17	—	—	1.75	
Equity ratio	45.9	45.5	40.0	36.5	44.4	
Return on equity	7.7	4.5	—	—	2.8	

Note: Yen amounts are translated into dollars, for convenience only, at the rate of ¥105.64=US\$1.

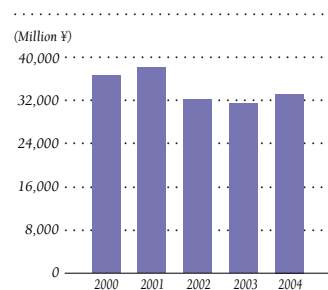
Total Assets



Shareholders' Equity and Return on Equity



Net Sales



The Business Environment and the Company's Performance

In the fiscal year ended March 31, 2004, the Japanese economy overall showed moderate recovery, driven by exports and capital investments. After a period of ups and downs, signs of recovery were seen primarily in the manufacturing industry, and the overall outlook for business conditions has become brighter.

Under these circumstances, in fiscal 2004, Valqua worked to achieve bold, new targets established in the Company's new medium-term management plan, New Valqua Stage Two (NV-S2). In the field of sealing products, the Company is working to enhance its new product development capabilities, thereby upgrading its ability to offer total solutions. With the objective of reinforcing its product lineup, Valqua has established alliances with the prominent U.S. seal maker, Garlock Sealing Technologies, as well as with SINYUAN Industrial Material Co., Ltd. of China. These alliances will strengthen the Company's marketing capabilities. Also, to improve and expand organizations and systems and further increase efficiency, the High Performance Polymer Division was spun off to become Valqua High Performance Polymers Co., Ltd.

In fiscal 2004, net sales increased ¥1,839 million, or 5.9%, to ¥33,271 million (US\$315 million), buoyed by the recovery in business conditions and in particular by the expansion of sales to high-tech industries. Falling costs and efforts to reduce expenses contributed to growth in operating income of ¥315 million, or 28.2%, to ¥1,432 million (US\$14 million). Other expenses of ¥1,300 million (US\$12 million) were posted, composed primarily of loss on disposal of fixed assets of ¥298 million (US\$3 million), provision of accrued retirement benefits to directors and statutory auditors of ¥148 million (US\$1 million), and amortization of net retirement benefit obligation at transition of ¥466 million (US\$4 million). Other income was ¥1,526 million (US\$14 million), of which the largest component was ¥1,293 million (US\$12 million) in gain on amendment of employees' pension plans. Net income rose ¥553 million, or 81.3%, to ¥1,234 million (US\$12 million).

Aiming to Create Greater Shareholder Value

Valqua works ceaselessly to achieve stable operating performance and a strong business base. The most important issue for the Company's management is providing a stable return to shareholders over the long term. Specifically, this entails providing stable dividends to shareholders based on the Company's business performance, while at the same time maintaining internal reserves to meet the need for investment in research and development, manufacturing facilities, and the Company's information infrastructure.

Guided by the commitment described above, a year-end dividend of ¥5 per share was declared for the fiscal year under review, for a payout ratio of 64.0%.

Capital Investments and Fund Raising

Valqua is pursuing a strategy of selection and concentration in its capital investments, which centers on strategic business and products and takes into account the investment efficiency of the entire Valqua Group. In fiscal 2004, capital investments totaled ¥608 million (US\$1 million) on a cost of completed construction basis, primarily in the areas of high-performance fluoro-rubber and other elastomer products for the semiconductor industry, production facilities for jointing sheets and other products, and automotive-related products such as oil sheet.

Valqua's plans for new facility construction and facility demolition take into account the manufacturing plans, demand forecasts, cash flow plans, and percentage of profit allocated to investment which are set forth in the Company's NV-S2 medium-term management plan, now in its second year, after beginning in April 2003. Fundamentally, consolidated subsidiaries handle their own facilities plans, but to achieve efficiency in the capital investments of the Group as a whole, Valqua loans general-purpose facilities to consolidated subsidiaries.

As of March 31, 2004, planned capital investments in the construction and upgrade of facilities were ¥1,668 million (US\$16 million). The Company plans to appropriate the necessary funds from cash on hand and loans.

With the exception of the exercise of stock options, which increased shareholders' equity, no equity financing was conducted in the fiscal year ended March 31, 2004.

Outlook for the Coming Term

The economic environment surrounding the Valqua Group saw fluctuations caused by exchange-rate changes and the steep rise in materials prices, but strong exports and improved corporate earnings ushered in capital investment and growth in consumer spending. Recovery is forecast, although it will be a gradual one.

The coming term will be the last year of Valqua's NV-S2 medium-term management plan, and the Company will push forward with aggressive strategic measures. The entire company will work in the coming year to develop its businesses on the basis of three principles: rededication to emphasis on the customer; effective management through operational selection and concentration; and building a robust, rugged corporate culture that will allow us to survive the age of megacompetition. On the basis of this fundamental strategy, the companies of the Group will formulate detailed market strategies, product strategies, and functional strategies, and will establish aggressive, challenging objectives to guide the realization of these strategies.

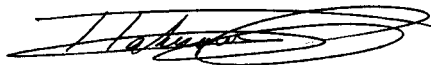
For the fiscal year ending March 31, 2005, forecasts are for net sales of ¥37,500 million (US\$355 million) and net income of ¥1,230 million (US\$12 million).

As we expand our business in China, we have been building an infrastructure for local procurement, manufacturing, research and development, and sales. To promote the forging of alliances and the development of new products, and to meet the challenges of expanding procurement and manufacturing in China, we will be taking the separation of activities between Japan and China a step further in the field of research and development. Specifically, we are preparing for the startup of full-scale local research and development operations in fiscal 2005. In April 2004, at Shanghai Valqua Fluorocarbon Products Co., Ltd., Shanghai Fluoro-Resin Research Labo-

ratory commenced its operations and by summer Shanghai Seal Research Laboratory was launched at Valqua Seal Products (Shanghai) Co., Ltd. The opening of these research facilities will bring lower development costs and faster development of new products. We will be working to upgrade and expand our lineup of products designed to meet the needs of the consuming region, while improving product-supply and technical service systems, with the objective of achieving further expansion of our operations in China.

The Company's new medium-term management plan establishes a fundamental goal of "becoming a company that continuously creates customer value on the basis of technology and brand power." Dramatic advances in technological capabilities, research and development of new technologies and products, and enhancement of manufacturing technologies are designated as areas of emphasis. Together with this, we will strive to offer products that are adapted to the needs of our customers.

Lastly, on behalf of everyone at Valqua, I would like to request the continued support and cooperation of our shareholders, customers and business partners around the world.

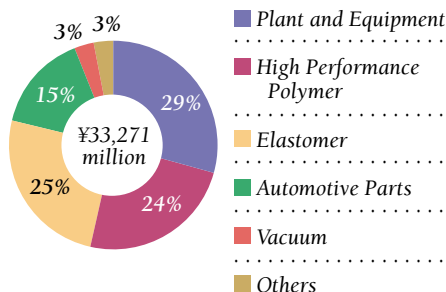


Toshikazu Takisawa
President and
Representative Director, CEO



Review of Operations

Net Sales Breakdown



Plant and Equipment Division

The expansion of overseas plant sales and an uptick in domestic shutdown contracts boosted net sales recorded by this division by 3.6% to ¥9,568 million (US\$91 million). Capital investment in this division totaled ¥217 million (US\$2 million) for fiscal 2004, primarily in the expansion of jointing sheet production facilities at Valqua Seal Products (Shanghai) Co., Ltd., commenced last fiscal year.

High Performance Polymer Division

Along with healthy sales to the liquid crystal and OA markets and steady growth in sales of materials-related products, the second half saw a recovery in demand in the semiconductor and communications markets, and chemical plant, a new business, also made a contribution. As a result, net sales posted by this division grew by 10.3% to ¥8,434 million (US\$80 million). Capital investment in this division primarily targeted R&D and the upgrade and expansion of manufacturing facilities at subsidiaries in China and Taiwan, and totaled ¥75 million (US\$710 thousand).

Elastomer Division

Overseas demand for conventional rubber products from construction machinery and hydraulic and pneumatic equipment markets rose, particularly in China, and sales of fluoro-rubber products to the semiconductor and liquid crystal industries showed stable growth. Total net sales of elastomer products increased 7.1% to ¥8,331 million (US\$79 million). Capital investments in this division totaled ¥107 million (US\$1 million), primarily in testing equipment and the upgrade and expansion of rubber-product manufacturing facilities at Valqua Seal Solutions and Valqua Elastomer, Ltd.

Automotive Parts Division

Despite the contraction of the domestic supply of friction material and the effects of market price competition, domestic and overseas automobile manufacturing was strong, and the volume of rubber product sales to the automatic transmission and hybrid vehicle sectors expanded. As a result, this division posted net sales growth of 0.2% to ¥4,655 million (US\$44 million). Capital investments in this division were ¥66 million (US\$624 thousand), chiefly in the upgrade and expansion of oil sheet product manufacturing facilities at Valqua Seal Solutions.

Vacuum Products Division and Other Businesses

The strength of the semiconductor and liquid crystal market, which is the principal source of demand for vacuum products, allowed net sales in the Vacuum Products Division to jump by 34.8% to ¥1,428 million (US\$14 million). Capital investments, primarily in the upgrade and expansion of R&D testing equipment and manufacturing facilities at Valqua Seiki, Ltd., totaled ¥117 million (US\$1 million).

Net sales in other businesses decreased 19.7% year-on-year to ¥855 million (US\$8 million).

International Operations

Basic Agreement with Major Chinese Sealing Material Maker



Valqua has taken a capital position in the major Chinese sealing material manufacturer, SINYUAN Industrial Material Co., Ltd. (Headquarters: Ningbo, Zhejiang Province; capital: RMB 13 million; annual sales: RMB 18 million), and has completed a comprehensive basic alliance agreement that includes product marketing.

SINYUAN Industrial Material manufactures various sealing products using exfoliated graphite, including C gaskets, spiral wound gaskets, and gland packing. Valqua will market the products of SINYUAN Industrial Material, primarily in Asia, and the two firms plan to pursue joint development of new products. This alliance with a major Chinese firm will strengthen Valqua's manufacturing,

marketing, and technical capabilities in the Chinese market, while at the same time taking the effectiveness of the alliance strategy set forth in our New Valqua Stage Two (NV•S2) medium-term management plan (adopted in April 2003) to a new level.

The products manufactured by SINYUAN Industrial Material, chiefly exfoliated graphite products, are very highly regarded in Europe and the U.S. for the high quality that results from their advanced, proprietary technology. In addition, the company is reducing costs by increasing the efficiency of its production lines.

Valqua Korea Co., Ltd. Established

Major Korean manufacturers of semiconductors, liquid crystal material, chemicals, and automobiles have in recent years been establishing manufacturing facilities in China. In this connection, the number of inquiries we are receiving regarding sealing materials is growing rapidly. In response, we have established a Korean sales subsidiary, Valqua Korea Co., Ltd. This firm will conduct direct sales to the semiconductor, liquid crystal, automobile, and chemical plant industries, and will use local sales agents for small lot items such as consumer electronics and appliances.

Valqua Wins Order for Seals for Korea's Large Helical Device

Valqua received an order from the Korea Basic Science Institute for seals to prevent thermal expansion damage to pipes in Korea's KSTAR nuclear fusion experimental device, and delivered the products in February 2004. These stainless steel seals are approximately two meters wide, rectangular in shape, with rounded corners, and seal various pipes to the reactor. They prevent the pipes from pulling away from the reactor or being damaged as a result of earthquake, equipment vibration, or thermal expansion.

Korea is a major participant in the International Thermonuclear Experimental Reactor (ITER) project with Japan, the U. S., and the European Union, and is scheduled to commence test operation of an experimental reactor in 2005. Valqua will be striving to build on this order from Korea to expand sales in connection with ITER.

Research and Development

As a technology oriented firm, it is essential that Valqua anticipate market needs and respond quickly. Through coordination between Corporate Research Division and Market Division, the Company is engaged in the development of technology that is geared to global markets and a variety of original products.

To meet the targets established in the BEGIN-2010 Plan, Valqua's long-term strategy statement, the Company pushed forward with research and development activities based on the technology strategy set forth in the plan. Specifically, it is concentrating management resources in growth markets such as the semiconductor, IT, and environmental businesses. In the processing business, which handles fluoro-resin, elastomer, and seals, design and materials processing technology is used to develop high-performance and highly profitable products that meet customers' highly advanced requirements. In addition, the Company is actively pursuing technological collaboration, outsourcing, and alliances with universities, producers of raw materials, manufacturers, and customers.

The Company has implemented organizational changes to increase the efficiency of its research and development programs. Research and development is conducted by the Products Development Division, which is engaged in short-term product development, and the Corporate Research Division, which is responsible for medium to long-term research and development.

Research and development expenses for fiscal 2004 were ¥972 million (US\$9 million). Research and development activities in the various divisions were as outlined below.

(1) Plant and Equipment Division

This division is engaged in the development of products and technologies using sealing materials design and processing technology, the Valqua Group's core technology. The principal success during fiscal 2004 was the expansion of the Company's line of environmentally friendly products such as non-asbestos gaskets and gland packing, and other asbestos-substitute products. Products developed and introduced to the market included the BlackHyper Gasket, a non-asbestos gasket that can be used at high temperatures; non-asbestos gland packing No. 7202W, which meets Food Sanitation Law and food additive standards for pumps and circulating equipment; non-asbestos gland packing No. VC-22 and No. VC-26 for general purpose valves. In addition, the Company is continuously engaged in basic

research into seal structure. As is shown by frequent presentations at scientific conferences, the Company has developed a number of reliable sealing materials for environmental uses and the semiconductor industry.

(2) Elastomer Division

This division conducts research and development into the high-performance elastomer materials and seal design technology that are combined in high-performance elastomer seals. Major achievements include a series of the gate seal plates that are baked onto plasma-resistant, high-purity fluoro-rubber used in gate valves for semiconductor manufacturing equipment, and the development of high-purity fluoro-rubber that is highly plasma-resistant and does not adhere to adjoining materials for use in semiconductor manufacturing equipment. Other successes included an environmentally friendly elastomer material and an elastomer material with no aromatizing characteristics that is suitable for food-related applications.

(3) High-Performance Polymer Division

This division is pursuing the development of functional membranes and other high-performance for semiconductor manufacturing-related materials, composite materials for IT-related high-frequency devices, and battery-related applications. Principal successes include the development of lining materials with superior purity for semiconductor manufacturing equipment, which greatly reduce the volume of cleaning chemicals required, a heat and plasma resistant polyimide material with superior purity, composite resin type high-frequency substrates with excellent cost performance characteristics, electronics materials compatible with lead-free solder, and adsorption membranes for precision equipment.

(4) Automotive Parts Division

In this division, manufacturing technology and products are primarily developed by the Production Engineering Division and group company Valqua Seal Solutions Co., Ltd. Principal successes include the development of manufacturing technology and systems that allow cost reductions and quality improvements, as well as non-asbestos products.

(5) Vacuum Products Division

The design of vacuum devices, and the development of related production technology and products, is primarily conducted by the Products Development Division and group

company Valqua Seiki, Ltd. Major achievements included the development of large rectangular gate valves used in liquid crystal substrate manufacturing, with Valqua's proprietary simple seal spin prevention structure.

Valqua—For Excellence In Technology New High-Performance Non-Asbestos Sheet Gasket Launched



The BlackHyper GF300 is an entirely new type of high-performance non-asbestos sheet gasket made primarily of graphite and polytetrafluoroethylene (PTFE). This new gasket went on sale December 1, 2003.

BlackHyper GF300 solves the problem earlier compressed non-asbestos fiber sheet gaskets (CFS) had at temperature ranges over 100 °C, and can be used at those temperatures. Earlier CFS used around 15% rubber as a binder, and the rubber would harden at high temperatures, leading to cracking and leaking. The temperatures at which they could be used, therefore, were limited. BlackHyper GF300 uses no rubber binder, but is instead made of a blend of heat resistant graphite and PTFE. These gaskets show no deterioration or degradation from heat, and so for the first time a non-asbestos sheet gasket with the same performance characteristics as asbestos jointing sheet is available.

Earlier expanded graphite sheet gaskets could be used at high temperatures, but because they contained no binder they were brittle and easily scratched. This made them difficult to handle, and they were never widely used. A flexible resin binder is used in BlackHyper GF300 gaskets, which solves the problem of brittleness and makes them easy to handle.

Because they are made of graphite and PTFE, which has excellent chemical resistance, these gaskets are suitable for applications where chemical resistance is required.

Financial Review

Revenues

Economic conditions improved substantially in the fiscal year ended March 31, 2004, despite a sharp increase in the price of crude oil and other raw materials. The U.S. economy experienced a strong recovery, and the Chinese economy continued its explosive growth. Several sectors of the Japanese economy showed recovery, and although deflation persisted, exports and private-sector capital investment took an upturn. At Valqua, net sales reversed a declining trend, growing 5.9% to ¥33,271 million (US\$315 million), and operating income jumped 28.1% to ¥1,432 million (US\$14 million).

The Plant and Equipment Division saw net sales increase by 3.6% to ¥9,568 million (US\$91 million), which accounted for 29% of the Company's total net sales. Net sales in the High Performance Polymer Division increased 10.3% to ¥8,434 million (US\$80 million), which represented 25% of total net sales, and in the Elastomer Division, rose 7.1% to ¥8,331 million (US\$79 million), which was 25% of the Company's total. The Automotive Parts Division's net sales increased 0.2% to ¥4,655 million (US\$44 million), amounting to 14% of total net sales. Sales in the Vacuum Products Division and other businesses increased 7.5% to ¥2,283 million (US\$22 million), which was 7% of total net sales.

Results of Operations

Valqua worked to reduce cost of sales through cost controls and enhancement of efficiency, but the increase in net sales resulted in a 6.8% rise in cost of sales to ¥22,570 million (US\$214 million). However, the effects of the Company's efforts could be seen in cost of sales as a percentage of net sales, which remained virtually constant despite the increase in net sales. This resulted in a 3.9% increase in gross profit to ¥10,701 million (US\$102 million). Selling, general, and administrative expenses edged up 1.0% to ¥9,269 million (US\$88 million), but declined as a percentage of gross profit from last fiscal year's 89.1% to 86.6%. The ratio of selling, general, and administrative expenses to sales decreased from 29.2% in the previous fiscal year to 27.9%. Research and development costs increased 7.4%, growing from ¥905 million in the previous fiscal year to ¥972 million (US\$9 million) in the period of this report.

Interest and dividend income fell 25.0% to ¥15 million (US\$142 thousand). However, interest expenses were also down, contracting 16.1% to ¥230 million (US\$2 million). The Company posted equity in earnings of affiliates of ¥24 million (US\$227 thousand), and a gain on amendment of employees' pension plans of ¥1,293 million (US\$12 million). Net loss on sales or disposal of fixed assets, at ¥238

million (US\$2 million), was up 48.8% from the previous fiscal year. Provision of accrued retirement benefits to directors and statutory auditors in the amount of ¥148 million (US\$1 million) was posted. As a result of the foregoing events, income before income taxes jumped 68.8% to ¥1,377 million (US\$16 million).

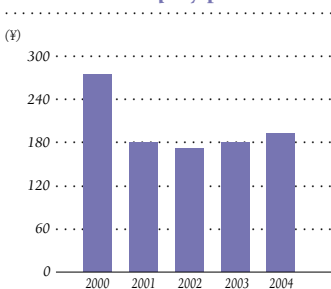
Current income taxes were ¥199 million (US\$2 million), and accrued deferred income taxes totaled ¥79 million (US\$748 thousand). After minority interests of ¥23 million (US\$218 thousand), net income soared 81.3% to ¥1,234 million (US\$12 million).

Financial Position

Cash and time deposits decreased by 30.7% to ¥1,734 million (US\$16 million). Notes and accounts receivable rose 10.3% to ¥12,279 million (US\$116 million), and inventories were unchanged. Deferred income taxes were ¥272 million (US\$3 million). Other current assets grew by 20.5% to ¥2,184 million (US\$21 million). Total current assets, therefore, increased 5.5% to ¥18,585 million (US\$176 million).

Short-term bank loans were down 15.5% to ¥4,689 million (US\$44 million), and the current portion of long-term debt increased 1.9% to ¥1,751 million (US\$17 million). Notes and accounts payable rose 14.0% to

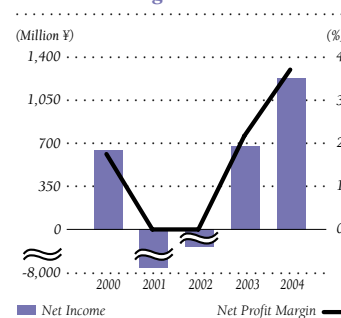
Shareholders' Equity per Share



Shareholders' Equity and Equity Ratio



Net Income (Loss) and Net Profit Margin



¥5,774 million (US\$54 million), and accrued bonuses increased 14.0% to ¥423 million (US\$4 million), while accrued income taxes shot up 225.0% to ¥182 million (US\$2 million). Other current liabilities rose 8.6% to ¥1,127 million (US\$11 million). Accordingly, total current liabilities edged up 1.5% to ¥13,946 million (US\$132 million), for a current ratio of 1.3.

Total investments and other assets shot up 84.6% to ¥4,923 million (US\$47 million), as investments in securities increased by 20.4% to ¥946 million (US\$9 million), a prepaid pension expense of ¥1,831 million (US\$17 million) was posted, and other assets rose 15.4% to ¥1,932 million (US\$18 million).

Property, plant, and equipment shrank again this fiscal year, contracting by 10.1% to ¥27,049 million (US\$256 million). Buildings and structures declined by a negligible 0.8% to ¥12,433 million (US\$118 million), while machinery, equipment and vehicles was down by a substantial 29.4% to ¥7,077 million (US\$67 million), and tools, furniture and fixtures was down by 4.7% to ¥3,865 million (US\$37 million). After plunging from ¥469 million to ¥2 million last fiscal year, construction in progress jumped again to ¥189 million (US\$2 million). After accumulated depreciation of ¥14,210 million (US\$135 million), net property, plant, and equipment

decreased 7.2% to ¥12,839 million (US\$122 million). Total assets, as a result of the foregoing, grew 6.5% to ¥36,347 million (US\$344 million).

After ending the previous fiscal year with an accumulated deficit of ¥535 million, the Company closed out the fiscal year ended March 31, 2004 with retained earnings of ¥248 million (US\$2 million). Foreign currency translation adjustments declined by 17.9% to ¥298 million (US\$3 million), and treasury stock at cost increased 54.5% to ¥34 million (US\$322 thousand). Shareholders' equity at the end of the year was ¥16,686 million (US\$158 million), up 7.5% from the previous year. The equity ratio rose only slightly, increasing to 45.9% from 45.5% in the previous fiscal year. Based on the number of shares outstanding at March 31, 2004, shareholders' equity per share rose from ¥180.65 at the end of the previous fiscal year to ¥192.94 (US\$1.83).

Cash Flows

Cash flows from operating activities

Net cash provided by operating activities decreased by ¥1,512 million to ¥1,130 million (US\$11 million). The primary factor in this was an increase in notes and accounts receivable of ¥1,174 million (US\$11 million) that resulted from the growth in net sales. Income before income taxes and minority interests

grew by ¥561 million to ¥1,377 million (US\$13 million), while depreciation and amortization declined by ¥170 million to ¥1,049 million (US\$10 million).

Cash flows from investing activities

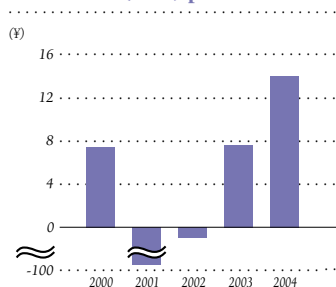
Net cash used in investing activities decreased by ¥300 million to ¥281 million (US\$3 million). This was primarily composed of purchases of property plant, and equipment of ¥587 million (US\$6 million), proceeds from sale of property, plant and equipment of ¥501 million (US\$5 million), and proceeds from sales of investments in securities of ¥423 million (US\$4 million).

Cash flows from financing activities

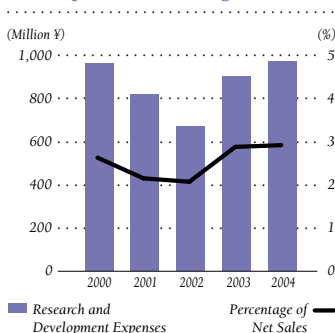
Net cash used in financing activities was ¥1,604 million (US\$15 million). Cash and deposits declined as a result of use as a source of free cash flow, the establishment of a commitment line contract, and the repayment of loans. In addition, cash dividends of ¥424 million (US\$4 million) were paid to shareholders.

As a result of the repayment of loans and other liabilities, and the payment of cash dividends to shareholders, cash and cash equivalents at the end of the year was down 30.8%, or ¥766 million, to ¥1,726 million (US\$16 million).

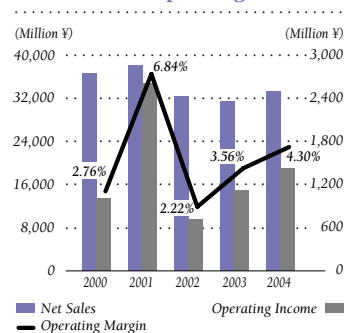
Net Income (Loss) per Share



Research and Development Expenses and Such Expenses as Percentage of Net Sales



Net Sales and Operating Income



Consolidated Balance Sheets

March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Assets			
Current assets:			
Cash and time deposits (Note 3)	¥ 1,734	¥ 2,501	\$ 16,414
Notes and accounts receivable	12,279	11,131	116,234
Allowance for doubtful receivables	(20)	(21)	(189)
	12,259	11,110	116,045
Inventories	2,136	2,137	20,220
Deferred income taxes (Note 12)	272	56	2,575
Other current assets	2,184	1,813	20,674
Total current assets	18,585	17,617	175,928
Property, plant and equipment (Note 5):			
Land	3,485	3,492	32,989
Buildings and structures	12,433	12,532	117,692
Machinery, equipment and vehicles	7,077	10,020	66,992
Tools, furniture and fixtures	3,865	4,054	36,587
Construction in progress	189	2	1,789
	27,049	30,100	256,049
Less accumulated depreciation	(14,210)	(16,266)	(134,514)
Property, plant and equipment, net	12,839	13,834	121,535
Investments and other assets:			
Investments in securities (Notes 4 and 5)	946	786	8,955
Investments in affiliates	119	119	1,126
Deferred income taxes (Note 12)	184	205	1,742
Prepaid pension expense (Note 6)	1,831	—	17,332
Other assets	1,932	1,674	18,289
Allowance for doubtful receivables	(89)	(117)	(842)
Total investments and other assets	4,923	2,667	46,602
Total assets	¥ 36,347	¥ 34,118	\$ 344,065

See accompanying notes to the consolidated financial statements.

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Liabilities, minority interests and shareholders' equity			
Current liabilities:			
Short-term bank loans (Note 5)	¥ 4,689	¥ 5,552	\$ 44,387
Current portion of long-term debt (Note 5)	1,751	1,719	16,575
Notes and accounts payable	5,774	5,064	54,657
Accrued bonuses	423	309	4,004
Accrued income taxes (Note 12)	182	56	1,723
Other current liabilities	1,127	1,038	10,668
Total current liabilities	13,946	13,738	132,014
Long-term liabilities:			
Long-term debt (Note 5)	2,668	3,123	25,256
Accrued retirement benefits to employees (Note 6)	240	808	2,272
Accrued retirement benefits to directors and statutory auditors (Note 6)	148	—	1,401
Deferred income taxes (Note 12)	256	4	2,423
Other long-term liabilities (Note 6)	2,097	609	19,850
Total long-term liabilities	5,409	4,544	51,202
Minority interests	306	303	2,897
Contingent liabilities (Note 8)			
Shareholders' equity (Notes 7 and 14):			
Common stock			
Authorized—340,000,000 shares			
Issued—86,563,668 shares in 2004 and 86,011,668 shares in 2003	13,154	13,101	124,517
Capital surplus	3,398	3,345	32,166
Retained-earnings (deficit)	248	(535)	2,348
Net unrealized holding gain on securities	218	7	2,064
Translation adjustments	(298)	(363)	(2,821)
Total shareholders' equity	16,720	15,555	158,274
Treasury stock, at cost: 183,245 shares in 2004 and 137,834 shares in 2003	(34)	(22)	(322)
Total shareholders' equity	16,686	15,533	157,952
Total liabilities, minority interests and shareholders' equity	¥36,347	¥34,118	\$344,065

Consolidated Statements of Income

Years ended March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Net sales	¥33,271	¥31,432	\$314,947
Cost of sales (Note 11)	22,570	21,136	213,650
Gross profit	10,701	10,296	101,297
Selling, general and administrative expenses (Note 11)	9,269	9,178	87,741
Operating income	1,432	1,118	13,556
Other income (expenses):			
Interest and dividend income	15	20	142
Interest expense	(230)	(274)	(2,177)
Equity in earnings of affiliates	24	—	227
Gain on return of substitutional portion of employees' Welfare Pension Fund Plan (Note 6)	—	1,346	—
Gain on amendment of employees' pension plans (Note 6)	1,293	—	12,240
Loss on sales or disposal of fixed assets, net	(238)	(160)	(2,253)
Amortization of net retirement benefit obligation at transition (Note 6)	(466)	(483)	(4,411)
Provision of accrued retirement benefits to directors and statutory auditors (Note 6)	(148)	—	(1,401)
Loss on devaluation of investments in securities (Note 4)	(53)	(409)	(502)
Other, net	(252)	(342)	(2,386)
	(55)	(302)	(521)
Income before income taxes and minority interests	1,377	816	13,035
Income taxes (Note 12):			
Current	199	125	1,884
Deferred	(79)	(15)	(748)
	120	110	1,136
Income before minority interests	1,257	706	11,899
Minority interests	23	25	218
Net income	¥ 1,234	¥ 681	\$ 11,681

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Years ended March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Common stock:			
Balance at beginning of the year	¥13,101	¥13,101	\$124,016
Add:			
Exercise of warrants	53	—	501
Balance at end of the year	¥13,154	¥13,101	\$124,517
Capital surplus:			
Balance at beginning of the year	¥ 3,345	¥ 3,345	\$ 31,664
Add:			
Exercise of warrants	53	—	502
Balance at end of the year	¥ 3,398	¥ 3,345	\$ 32,166
Retained-earnings (deficit):			
Balance at beginning of the year	¥ (535)	¥ (1,215)	\$ (5,064)
Add:			
Net income	1,234	681	11,681
Appropriations:			
Cash dividends	(430)	—	(4,070)
Bonuses to directors and statutory auditors	(21)	(1)	(199)
Balance at end of the year	¥ 248	¥ (535)	\$ 2,348
Net unrealized holding gain (loss) on securities:			
Balance at beginning of the year	¥ 7	¥ (60)	\$ 66
Net change during the year	211	67	1,998
Balance at end of the year	¥ 218	¥ 7	\$ 2,064
Translation adjustments:			
Balance at beginning of the year	¥ (363)	¥ (403)	\$ (3,436)
Net change during the year	65	40	615
Balance at end of the year	¥ (298)	¥ (363)	\$ (2,821)

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Cash flows from operating activities:			
Income before income taxes and minority interests	¥ 1,377	¥ 816	\$ 13,035
Adjustments for:			
Depreciation and amortization	1,049	1,219	9,930
Decrease in accrued retirement benefits to employees	(2,398)	(1,144)	(22,700)
Interest and dividend income	(15)	(20)	(142)
Interest expense	230	274	2,177
Equity in (earnings) losses of affiliates	(24)	3	(227)
Loss on sales or disposal of fixed assets, net	238	88	2,253
Loss on devaluation of investments in securities	53	409	502
(Increase) decrease in notes and accounts receivable	(1,174)	875	(11,113)
Increase in notes and accounts payable	730	395	6,910
(Decrease) increase in inventories	(10)	322	(95)
Other	1,335	(209)	12,637
Subtotal	1,391	3,028	13,167
Interest and dividend income received	19	20	180
Interest expense paid	(207)	(277)	(1,960)
Income taxes paid	(73)	(129)	(691)
Net cash provided by operating activities	1,130	2,642	10,696
Cash flows from investing activities:			
Decrease in time deposits, net	—	9	—
Purchases of property, plant and equipment	(587)	(699)	(5,557)
Proceeds from sales of property, plant and equipment	501	412	4,743
Purchases of intangible assets included in other assets	(454)	(253)	(4,298)
Purchases of investments in securities	(117)	(4)	(1,108)
Proceeds from sales of investments in securities	423	31	4,004
Proceeds from sale of investment in a subsidiary	—	(144)	—
Other	(47)	66	(445)
Net cash used in investing activities	(281)	(582)	(2,661)
Cash flows from financing activities:			
Decrease in short-term bank loans, net	(548)	(749)	(5,187)
Proceeds from long-term debt	1,000	665	9,466
Repayment of long-term debt, including current portion	(1,717)	(2,029)	(16,253)
Cash dividends paid to shareholders	(424)	—	(4,014)
Cash dividends paid to minority shareholders of subsidiaries	(14)	(14)	(132)
Proceeds from issuance of common stock	107	—	1,013
Other	(8)	(14)	(76)
Net cash used in financing activities	(1,604)	(2,141)	(15,183)
Effect of exchange rate changes on cash and cash equivalents	(11)	(8)	(104)
Net decrease in cash and cash equivalents	(766)	(89)	(7,252)
Cash and cash equivalents at beginning of the year	2,492	2,581	23,590
Cash and cash equivalents at end of the year (Note 3)	¥ 1,726	¥ 2,492	\$ 16,338

See accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements

March 31, 2004

1. Basis of Preparation

Nippon Valqua Industries, Ltd. (the "Company") and its domestic subsidiaries maintain their books of account in conformity with accounting principles generally accepted in Japan, and its overseas subsidiaries maintain their books of account in conformity with those of their countries of domicile.

The accompanying consolidated financial statements are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company as required by the Securities and Exchange Law of Japan.

In preparing the accompanying 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. Certain amounts in the prior years' financial statements have been reclassified to conform to the current year's presentation. Such reclassifications had no effect on consolidated net income or shareholders' equity.

The translation of yen amounts into U.S. dollar amounts is included solely for the convenience of readers outside Japan and has been made at ¥105.64 = U.S.\$1.00, the approximate exchange rate prevailing on March 31, 2004. The translation should not be construed as a representation that yen have been, could have been, or could in the future be, converted into U.S. dollars at the above or any other rate.

2. Summary of Significant Accounting Policies

(a) Principles of consolidation

The accompanying consolidated financial statements include the accounts of the Company and all subsidiaries which it controls directly or indirectly. Companies over which the Company exercises significant influence in terms of their operating and financial policies have been included in the consolidated financial statements on an equity basis. All significant intercompany balances and transactions have been eliminated in consolidation.

All assets and liabilities of subsidiaries are revalued on acquisition, if applicable. The difference between the cost of investments in subsidiaries and the equity in their net assets at their respective dates of acquisition is amortized over a foreseeable estimated period deemed reasonable or over a period of 5 years on a straight-line basis.

The financial statements of overseas subsidiaries whose fiscal year end is December 31 have been included in consolidation on the basis of a full fiscal year after making the appropriate adjustments for significant transactions during the period from their fiscal year end to the Company's balance sheet date.

(b) Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into yen at the rates of exchange in effect at the balance sheet date.

The resulting exchange loss or gain is charged or credited to income as incurred. All revenues and expenses associated with foreign currencies are translated at the rates of exchange prevailing when the transactions were made.

The financial statement accounts of the overseas consolidated subsidiaries (except for shareholders' equity) are translated into yen at the rates of exchange in effect at the balance sheet date. The components of shareholders' equity are translated at their respective historical rates of exchange. The differences resulting from these translations are presented as a component of shareholders' equity and minority interests in the accompanying consolidated financial statements.

(c) Allowance for doubtful receivables

The Company and its subsidiaries provide an allowance for doubtful receivables at an amount calculated based on their historical experience of bad debts on ordinary receivables plus an additional estimate of probable specific bad debts from customers experiencing financial difficulties.

(d) Securities

The accounting standard for financial instruments requires that securities be classified into three categories: trading, held-to-maturity debt or other securities. Under this standard, trading securities are carried at fair value and held-to-maturity debt securities are carried at amortized cost. Marketable securities classified as other securities are carried at fair value, which is calculated as the average market price during the last month of the fiscal year, with any changes in unrealized holding gain or loss, net of the applicable income taxes, included directly in shareholders' equity. Non-marketable securities classified as other securities are carried at cost. Cost of securities sold is determined by the moving average method.

(e) Inventories

Inventories are stated principally at cost determined by the average method.

(f) Property, plant and equipment

Property, plant and equipment is stated at cost. Depreciation is computed principally by the straight-line method at rates based on the estimated useful lives of the assets.

The principal estimated useful lives are summarized as follows:

Buildings and structures	3 to 50 years
Machinery, equipment and vehicles	2 to 17 years
Tools, furniture and fixtures	2 to 20 years

(g) Accrued retirement benefits

Accrued retirement benefits to employees have been provided principally at an amount calculated based on the retirement benefit obligation and the fair value of the pension plan assets, as adjusted for the unrecognized net retirement benefit obligation at transition, net unrecognized actuarial gain or loss and unrecognized prior service cost. The retirement benefit obligation is attributed to each period by the straight-line method over the estimated remaining years of service of the eligible employees.

The net retirement benefit obligation at transition is being amortized over a period of 5 years by the straight-line method.

Prior service cost is amortized in the year in which the gain or loss is recognized primarily by the straight-line method over the estimated average remaining years of service of the eligible employees (5 years).

Net unrecognized actuarial gain or loss is amortized commencing the year following the year in which the gain or loss is recognized primarily by the straight-line method over the estimated average remaining years of service of the eligible employees (5 years).

The directors and statutory auditors of the Company were customarily entitled to lump-sum payments under the Company's unfunded retirement benefit plan. Up to the year ended March 31, 2003, the Company had charged such lump-sum payments to income when they were paid. The Board of Directors of the Company resolved, at its meeting held on March 24, 2004, that the Company would abolish this lump-sum payment plan effective June 30, 2003 and would make lump-sum payments for the period up to June 30, 2003 to directors and statutory auditors upon their retirement subject to the approval of the shareholders at the annual general shareholders' meeting held on June 17, 2004.

At March 31, 2004, the Company recorded accrued retirement benefits to directors and statutory auditors of ¥148 million (\$1,401 thousand) for directors and statutory auditors who held on their respective positions when the Company's lump-sum payment plan was still in effect.

(h) Leases

Finance leases other than those which transfer the ownership of the leased property to the lessee are principally accounted for as operating leases.

(i) Computer software

Expenditures relating to the development of computer software intended for internal use are charged to income when incurred, unless these are deemed to contribute to the generation of future income or cost savings. Such expenditures are capitalized as assets and amortized by the straight-line method over their estimated useful life (5 years).

(j) Income taxes

Deferred income taxes are provided for temporary differences between the balances of assets and liabilities for financial reporting purposes and the corresponding balances for tax reporting purposes.

(k) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, deposits with banks withdrawable on demand, and short-term investments which are readily convertible to cash subject to an insignificant risk of any change in their value and which were purchased with an original maturity of three months or less.

(l) Hedge accounting

Derivative financial instruments are stated at fair value with any changes in fair value included in net income or loss for the period in which they arise, except for derivatives which meet the criteria for deferral hedge accounting under which realized gain or loss is deferred as an asset or a liability.

Interest-rate swaps which meet certain conditions are accounted for as if the interest rates applied to the swaps had originally applied to the underlying debt.

(m) Appropriation of retained earnings

Under the Commercial Code of Japan, the appropriation of retained earnings with respect to a given financial period is made by resolution of the shareholders at a general meeting held subsequent to the close of the financial period and the accounts for the period, therefore, do not reflect such appropriations.

(n) Change in presentation of accounts

Up to the year ended March 31, 2003, the Company presented expenses for rental assets as a component of selling, general and administrative expenses. However, effective the year ended March 31, 2004, the Company changed this classification to present these expenses as a component of other expenses. This change was made in order to achieve a more accurate presentation of the operating results of the Company because the corresponding rental revenue has been presented as a component of other income. As a result, operating income increased by ¥131 million (\$1,240 thousands); however, this change had no effect on income before income taxes and minority interests for the year ended March 31, 2004.

(o) New Accounting Pronouncement

A new Japanese accounting standard, "Impairment of Fixed Assets," was issued in August 2002 which will go into effect for fiscal years beginning on or after April 1, 2005. Early adoption is allowed from fiscal years beginning on or after April 1, 2004 and application from fiscal years ending from March 31, 2004 through March 30, 2005 is also permitted. The new standard requires that tangible and intangible fixed assets be carried at cost less depreciation and amortization, and be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. A company will be required to recognize an impairment loss in its income statement if certain indicators of asset impairment exist and if the book value of an asset exceeds the undiscounted sum of the future cash flows of the asset. The Company is currently assessing the impact of this new accounting standard on its financial position and results of operations.

3. Cash and Cash Equivalents

A reconciliation of cash and time deposits shown in the consolidated balance sheets to cash and cash equivalents shown in the consolidated statements of cash flows at March 31, 2004 and 2003 is presented as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Cash and time deposits	¥1,734	¥2,501	\$16,414
Time deposits with original maturities of more than three months	(8)	(9)	(76)
Cash and cash equivalents	¥1,726	¥2,492	\$16,338

4. Investments in Securities

(a) Information regarding marketable securities classified as other securities at March 31, 2004 and 2003 is summarized as follows:

	Millions of yen					
	2004			2003		
	Acquisition costs	Carrying value	Unrealized gain (loss)	Acquisition costs	Carrying value	Unrealized gain (loss)
Securities whose carrying value exceeds their acquisition costs:						
Equity securities	¥301	¥664	¥363	¥145	¥191	¥46
Securities whose carrying value does not exceed their acquisition costs:						
Equity securities	124	122	(2)	416	384	(32)
Total	¥425	¥786	¥361	¥561	¥575	¥14

	Thousands of U.S. dollars		
	2004		
	Acquisition costs	Carrying value	Unrealized gain (loss)
Securities whose carrying value exceeds their acquisition costs:			
Equity securities	\$2,849	\$6,285	\$3,436
Securities whose carrying value does not exceed their acquisition costs:			
Equity securities	1,174	1,155	(19)
Total	\$4,023	\$7,440	\$3,417

The Company recorded loss on devaluation of impaired investments in other securities of ¥2 million (\$19 thousand) and ¥409 million for the years ended March 31, 2004 and 2003, respectively.

(b) The carrying value of non-marketable other securities at March 31, 2004 and 2003 is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Other securities:			
Unlisted equity securities (other than equity securities traded on the over-the-counter market)	¥148	¥201	\$1,401
Other	10	10	95
	¥158	¥211	\$1,496

(c) Sales of securities classified as other securities for the years ended March 31, 2004 and 2003 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Proceeds from sales	¥424	¥ 5	\$4,014
Gain on sales	171	11	1,619

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

Short-term bank loans consisted principally of overdrafts at annual average interest rates of 1.3% and 1.4% at March 31, 2004 and 2003, respectively.

Long-term debt at March 31, 2004 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Loans from banks and insurance companies, at an annual average interest rate of 1.7%	¥ 4,419	¥ 4,842	\$ 41,831
Less current portion	(1,751)	(1,719)	(16,575)
	¥ 2,668	¥ 3,123	\$ 25,256

The aggregate annual maturities of long-term debt subsequent to March 31, 2004 are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2005	¥1,751	\$16,575
2006	1,165	11,028
2007	166	1,571
2008	110	1,041
2009	1,208	11,436
2010 and thereafter	19	180
	¥4,419	\$41,831

The assets pledged as collateral for short-term bank loans and long-term debt at March 31, 2004 were as follows:

	Millions of yen	Thousands of U.S. dollars
	Land	¥ 243
Buildings and structures	1,108	10,488
Investments in securities	465	4,402
Total	¥1,816	\$17,190

Short-term bank loans and long-term debt secured by such collateral at March 31, 2004 were as follows:

	Millions of yen	Thousands of U.S. dollars
	Short-term bank loans	¥100
Current portion of long-term debt	469	4,440
Long-term debt	383	3,625
Total	¥952	\$9,012

The assets pledged as foundation mortgages at March 31, 2004 were as follows:

	Millions of yen	Thousands of U.S. dollars
	Land	¥190
Buildings and structures	611	5,783
Machinery, equipment and vehicles	26	246
Total	¥827	\$7,828

Short-term bank loans and long-term debt secured by foundation mortgages at March 31, 2004 were as follows:

	Millions of yen	Thousands of U.S. dollars
	Short-term bank loans	¥200
Current portion of long-term debt	190	1,799
Long-term debt	51	483
Total	¥441	\$4,175

6. Accrued Retirement Benefits

The Company and its domestic subsidiaries have defined benefit plans, i.e., a welfare pension fund plan ("WFPF"), tax-qualified pension plans and lump-sum payment plans, covering substantially all employees who are entitled to lump-sum or annuity payments, the amounts of which are determined by reference to their basic rates of pay, length of service, and the conditions under which termination occurs. In addition to the retirement benefit plans described above, the Company and its domestic subsidiaries pay additional retirement benefits under certain conditions.

The Company has established an employees' retirement benefit trust for the payment of retirement benefits.

Pursuant to the enactment of the Defined Benefit Corporate Pension Plan Law, the Company and certain domestic subsidiaries obtained approval from the Minister of Health, Labour and Welfare ("MHLW") on August 1, 2002, for an exemption from future retirement benefit obligation with respect to the substitutional portion of the employees' WFPF which the Company and certain domestic subsidiaries operate on behalf of the Japanese government. The Company and these subsidiaries accounted for the separation of the substitutional portion from the corporate portion of the benefit obligation under their employees' WFPF as of the date of approval of the exemption, assuming that the transfer to the Japanese government of the substitutional portion of the benefit obligation and the related pension plan assets had been completed as of that date.

Pursuant to the enactment of the Defined Benefit Corporate Pension Plan Law, the Company and certain domestic subsidiaries obtained approval from the MHLW on March 31, 2004 for a change to a corporate pension plan fund. The Company and certain domestic subsidiaries transferred a portion of their lump-sum payment plans and the corporate portion of their WFPF to defined contribution pension plans in March 2004.

The following table sets forth the funded and accrued status of the plans and the amounts recognized in the consolidated balance sheets at March 31, 2004 and 2003 for the Company's and the subsidiaries' defined benefit plans:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Retirement benefit obligation	¥(8,619)	¥(12,130)	\$(81,588)
Plan assets at fair value	8,784	7,163	83,150
Unfunded retirement benefit obligation	165	(4,967)	1,562
Unrecognized net retirement benefit obligation at transition	351	933	3,323
Unrecognized actuarial loss	1,316	4,192	12,456
Unrecognized prior service cost	(241)	(966)	(2,281)
Net obligation	1,591	(808)	15,060
Prepaid pension expense	1,831	—	17,332
Accrued retirement benefits to employees	¥ (240)	¥ (808)	\$ 2,272

As permitted under the accounting standard for retirement benefits, certain domestic subsidiaries calculate accrued retirement benefits for their employees by simplified methods.

The components of retirement benefit expenses for the years ended March 31, 2004 and 2003 are outlined as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Service cost	¥ 377	¥ 378	\$ 3,569
Interest cost	329	329	3,114
Expected return on plan assets	(162)	(159)	(1,534)
Amortization:			
Net retirement benefit obligation at transition	466	483	4,411
Actuarial loss	954	463	9,031
Prior service cost	(386)	(386)	(3,654)
Retirement benefit expenses	¥1,578	¥1,108	\$14,937

The retirement benefit expenses of certain domestic subsidiaries which calculated these by simplified methods have been included in service cost in the above table.

In addition to the retirement benefit expenses stated above, the Company and certain domestic subsidiaries paid additional retirement benefits of ¥2 million (\$19 thousand) and ¥30 million for the years ended March 31, 2004 and 2003, respectively.

In relation to the separation of the substitutional portion of the benefit obligation from the corporate portion of the benefit obligation under the employees' WFPF, the Company and certain domestic subsidiaries recognized gain on return of the substitutional portion of the employees' WFPF of ¥1,346 million for the year ended March 31, 2003. The pension plan assets to be transferred were estimated at ¥5,820 million at March 31, 2003.

The effect of the transfer of a portion of lump-sum payment plans to defined contribution pension plans in March 2004 is summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Decrease in retirement benefit obligation	¥3,276	\$31,011
Unrecognized net retirement benefit obligation at transition	(125)	(1,183)
Unrecognized actuarial loss	(524)	(4,961)
Unrecognized prior service cost	57	540
Decrease in accrued retirement benefits	¥2,684	\$25,407

The Company and certain domestic subsidiaries recognized related gain of ¥1,293 million (\$12,240 thousand). The pension plan assets to be transferred of ¥1,391 million (\$13,167 thousand) were recorded as a component of other long-term liabilities at March 31, 2004 and are to be transferred over the following seven year period.

The assumptions used in accounting for the defined benefit plans for the years ended March 31, 2004 and 2003 were as follows:

	2004	2003
Discount rates	2.5%	2.8%
Expected rates of return on plan assets	2.5%	2.8%

7. Shareholders' Equity

The Commercial Code of Japan (the "Code") provides that an amount equivalent to at least 10% of cash dividends paid and bonuses to directors and statutory auditors, and exactly 10% of interim cash dividends paid be appropriated to the legal reserve until the sum of additional paid-in capital and the legal reserve equals 25% of the common stock account. The Code also provides that neither additional paid-in capital nor the legal reserve are available for dividends, but may be used to reduce or eliminate a capital deficit by resolution of the shareholders or may be capitalized by resolution of the Board of Directors. The Code also stipulates that, to the extent that the sum of the additional paid-in capital account and the legal reserve exceeds 25% of the common stock account, the amount of any such excess is available for appropriation by resolution of the shareholders. Additional paid-in capital is included in capital surplus in the accompanying consolidated balance sheets and consolidated statements of shareholders' equity. The legal reserve of the Company was nil at March 31, 2004 and 2003.

8. Contingent Liabilities

At March 31, 2004, the contingent liabilities of the Company and its subsidiaries were as follows:

	Millions of yen	Thousands of U.S. dollars
Notes receivable endorsed	¥12	\$114
Guarantee of the bank loan of a customer	43	407

9. Leases

The following pro forma amounts represent the acquisition costs, accumulated depreciation and net book value of the leased assets at March 31, 2004 and 2003, which would have been reflected in the consolidated

balance sheets if finance lease accounting had been applied to the finance leases currently accounted for as operating leases:

	Millions of yen					
	2004			2003		
	Acquisition costs	Accumulated depreciation	Net book value	Acquisition costs	Accumulated depreciation	Net book value
Buildings and structures	¥ 3	¥ 2	¥ 1	¥ 11	¥ 6	¥ 5
Machinery, equipment and vehicles	1,029	194	835	679	118	561
Tools, furniture and fixtures	349	208	141	445	248	197
Other assets	509	191	318	548	138	410
Total	¥1,890	¥595	¥1,295	¥1,683	¥510	¥1,173

	Thousands of U.S. dollars		
	2004		
	Acquisition costs	Accumulated depreciation	Net book value
Buildings and structures	\$ 28	\$ 19	\$ 9
Machinery, equipment and vehicles	9,741	1,836	7,905
Tools, furniture and fixtures	3,304	1,969	1,335
Other assets	4,818	1,808	3,010
Total	\$17,891	\$5,632	\$12,259

Lease payments relating to finance leases accounted for as operating leases in the accompanying consolidated financial statements amounted to ¥304 million (\$2,878 thousand) and ¥216 million for the years ended March 31, 2004 and 2003, respectively. Depreciation of the leased assets computed by the straight-line method over the respective lease terms assuming a nil residual value amounted to ¥304 million (\$2,878 thousand) and ¥216 million for the years ended March 31, 2004 and 2003, respectively.

Future minimum lease payments subsequent to March 31, 2004 for finance leases are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2005	¥ 286	\$ 2,707
2006 and thereafter	1,009	9,552
Total	¥1,295	\$12,259

The acquisition costs and future minimum lease payments under finance leases presented in the above table include the imputed interest expense portion.

Future minimum lease payments subsequent to March 31, 2004 for operating leases are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2005	¥3	\$30
2006 and thereafter	1	10
Total	¥4	\$40

10. Derivative Financial Instruments

The Company utilizes interest-rate swaps in order to manage the risk arising from the fluctuation in interest rates which could have an adverse effect on the Company's financial condition. The Company does not hold or issue derivatives for speculative trading purposes.

The execution and management of derivative transactions are handled principally by the Finance Department of the Company and these are reported to and approved by the Board of Directors of the Company. The

notional principal balances of the interest-rate swap contracts are not actually exchangeable into cash, but are used only as a basis for the calculation of the exchanged amounts.

The Company is exposed to certain market risk arising from its interest-rate swap agreements and also to the risk of credit loss in the event of nonperformance by the counterparties; however, the Company does not anticipate nonperformance by any of these counterparties all of whom are domestic banks with high credit ratings.

The notional principal balances of the interest-rate swap contracts are not utilized in any way by the Company as benchmarks for market risk or credit risk.

The Company's policies for hedging activities are summarized as follows:

- (1) Hedging instruments and hedged items
- | | |
|----------------------|---------------------|
| Hedging instruments: | Interest-rate swaps |
| Hedged items: | Loans |

- (2) Policy on utilization of hedging instruments

The Company utilizes interest-rate swaps to manage risk arising from the fluctuation in interest rates up to the total balance of the underlying hedged items.

- (3) Assessment of effectiveness of hedges

The Company measures the effectiveness of its hedges by comparing the amount of fluctuation of the hedged items with that of the hedging instruments. The Company omits measuring the effectiveness of its interest-rate swaps which meet certain conditions and are accounted for as if the interest rates applied to the swaps had originally applied to the underlying debt.

At March 31, 2004 and 2003, all derivatives utilized by the Company met the criteria for deferral hedge accounting and the disclosure of fair value information has thus been omitted.

11. Research and Development Costs

Research and development costs included in cost of sales and selling, general and administrative expenses totalled ¥972 million (\$9,201 thousand) and ¥905 million for the years ended March 31, 2004 and 2003, respectively.

12. Income Taxes

Income taxes applicable to the Company and its domestic subsidiaries comprise corporate tax, inhabitants' taxes and enterprise tax which, in the aggregate, resulted in a statutory tax rate of 40.9% for the years ended March 31, 2004 and 2003. Overseas subsidiaries are subject to the income taxes of the countries in which they operate.

A reconciliation of the statutory tax rate and the effective tax rates for the years ended March 31, 2004 and 2003 as a percentage of income before income taxes and minority interests is presented as follows:

	2004	2003
Statutory tax rate	40.9%	40.9%
Permanently non-deductible expenses	1.2	1.7
Permanently non-taxable income	(0.2)	(0.1)
Per capita portion of inhabitants' taxes	16.8	4.3
Valuation allowance	(53.5)	(56.8)
Decrease in deferred tax assets resulting from change in statutory tax rate	3.5	23.4
Effective tax rates	8.7%	13.4%

In accordance with a law on amendments to local tax laws, etc. announced on March 31, 2003, the Company and its domestic subsidiaries have applied a statutory tax rate of 39.5% to the calculation of deferred tax assets and liabilities at March 31, 2004 and 2003 which are expected to be reversed on April 1, 2004 and thereafter.

The tax effects of temporary differences which gave rise to significant portions of the deferred tax assets and liabilities at March 31, 2004 and 2003 are presented below:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Deferred tax assets:			
Loss on devaluation of investments in securities	¥ 3,279	¥ 3,575	\$ 31,039
Contributions to retirement benefit trust	568	622	5,377
Allowance for doubtful receivables	42	34	398
Accrued retirement benefits	82	839	776
Accrued bonuses	163	63	1,543
Tax loss carryforwards	240	785	2,272
Long-term liability for transfer of pension plan assets	550	—	5,206
Other	537	183	5,083
Gross deferred tax assets	5,461	6,101	51,694
Less valuation allowance	(4,395)	(5,840)	(41,604)
Total deferred tax assets	1,066	261	10,090
Deferred tax liabilities:			
Prepaid pension expense	(724)	—	(6,853)
Other	(147)	(6)	(1,392)
Total deferred tax liabilities	(871)	(6)	(8,245)
Net deferred tax assets	¥ 195	¥ 255	\$ 1,845

13. Amounts per Share

Amounts per share at March 31, 2004 and 2003 and for the years then ended were as follows:

	Yen		U.S. dollars
	2004	2003	2004
Net income:			
Basic	¥ 14.08	¥ 7.68	\$0.13
Diluted	13.88	—	0.13
Cash dividends applicable to the year	5.00	5.00	0.05
Net assets	192.94	180.65	1.83

Basic net income per share has been computed based on the net income attributable to shareholders of common stock and the weighted-average number of shares of common stock outstanding during the year. Diluted net income per share has been computed based on the amount of net income attributable to the shareholders of common stock and the weighted-average number of shares of common stock outstanding during each year after giving effect to the dilutive potential of the shares of common stock to be issued upon the exercise of stock options issued by the Company. The amount per share of net assets has been computed based on the net assets available for distribution to shareholders of common stock and the number of shares of common stock outstanding at the year end.

No diluted net income per share is presented for the year ended March 31, 2003 as the effect of exercise of stock options would have been antidilutive.

Cash dividends per share represent the cash dividends proposed by the Board of Directors as applicable to the respective years.

14. Subsequent Events

(1) Stock options

In accordance with the Commercial Code of Japan, an additional stock option plan for directors, statutory auditors, certain key employees of the Company and directors of certain subsidiaries was approved at the annual general meeting of the shareholders held on June 17, 2004. Under the terms of this plan, 2,405,000 shares of common stock have been reserved for issuance at a specified exercise price per share. This stock option plan provides that the purchase price will be 1.05 times the average amount of the closing market prices of the Company's shares on the Tokyo Stock Exchange for all trading days, excluding days when no transactions were made, for the month immediately preceding the month of the date of issuance of the stock options. However, if the amount calculated by the above formula is less than the closing market price of the shares on the Tokyo Stock Exchange on the day on which the stock options were issued, or on the immediately preceding day if no transactions were made on the day of issuance, the purchase price is to be the closing market price.

The options will become exercisable on July 1, 2006 and are scheduled to expire on June 30, 2009.

The exercise price is subject to adjustment in the case of stock splits or a stock issuance at a price which is less than fair value.

(2) Appropriations of retained earnings

The following appropriations of retained earnings of the Company, which have not been reflected in the accompanying consolidated financial statements for the year ended March 31, 2004, were approved at a shareholders' meeting held on June 17, 2004:

	Millions of yen	Thousands of U.S. dollars
	Year-end cash dividends (¥5 = U.S.\$0.047 per share)	¥431
Bonuses to directors and statutory auditors	20	189

The Board of Directors
Nippon Valqua Industries, Ltd.

We have audited the accompanying consolidated balance sheets of Nippon Valqua Industries, Ltd. and its subsidiaries as of March 31, 2004 and 2003, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Nippon Valqua Industries, Ltd. and its subsidiaries at March 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

Supplementary Information

As discussed in Note 2(n), effective the year ended March 31, 2004, the Company has changed the classification of expenses related to rental assets in the consolidated statement of income.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2004 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 1.

June 17, 2004

Ernst & Young ShinNihon

Corporate Directory

Nippon Valqua Industries, Ltd.
As of March 31, 2004

Company Name	Location	Paid-in Capital	Percentage Owned (%)	Principal Business
Consolidated Subsidiaries:				
Valqua Techno Co., Ltd.	Tokyo, Japan	¥30 million	100.0%	Sales agent for Valqua products
Valqua High Performance Polymers Co., Ltd.	Tokyo, Japan	¥310 million	100.0%	Sales of resin products
Valqua Seiki, Ltd.	Aichi, Japan	¥300 million	100.0%	Production of metal products
Valqua Seal Solutions Co., Ltd.	Nara, Japan	¥90 million	100.0%	Production of rubber products and fiber products
Valqua Materials Co., Ltd.	Kagoshima, Japan	¥50 million	100.0%	Production of fiber products
Vans Co., Ltd.	Kanagawa, Japan	¥60 million	75.5%	Production of resin products
Valqua SES Co., Ltd.	Chiba, Japan	¥30 million	100.0%	Sales agent for Valqua products
Valqua Business Service Co., Ltd.	Tokyo, Japan	¥30 million	100.0%	Administrative services for the Valqua Group
Kyushu Valqua Co., Ltd.	Fukuoka, Japan	¥30 million	100.0%	Production of rubber products
Valqua Elastomer, Ltd.	Fukushima, Japan	¥25 million	100.0%	Production of rubber products
Valqua Kohsan Co., Ltd.	Osaka, Japan	¥20 million	100.0%	Leasing and management of real-estate
Sanwa Industries, Ltd.	Aichi, Japan	¥21 million	55.0%	Production of rubber products
Valqua Seal Products (Shanghai) Co., Ltd.	Shanghai, P.R.C	¥762 million	100.0%	Production of fiber products
Valqua Industries (Thailand), Ltd.	Samutprakarn, Thailand	B72,073 thousand	94.2%	Production of fiber products and metal products
Shanghai Valqua Fluorocarbon Products Co., Ltd.	Shanghai, P.R.C	¥500 million	70.0%	Production of resin products
Valqua America Inc.	California, U.S.A.	US\$1,260 thousand	100.0%	Sales agent for Valqua products
Taiwan Valqua Industries, Ltd.	Kaohsiung, Taiwan	NT\$36 million	55.0%	Production of fiber products and metal products
Taiwan Valqua Engineering International, Ltd.	Taipei, Taiwan	NT\$11 million	100.0%	Sales agent for Valqua products
Valqua Korea Co., Ltd.	Seoul, Korea	W400 million	87.5%	Sales agent for Valqua products
Valqua (Shanghai) Trading Co., Ltd.	Shanghai, P.R.C	Y1,655 thousand	100.0%	Sales agent for Valqua products
Valqua Singapore Pte Ltd.	United Square, Singapore	S\$219 thousand	100.0%	Sales agent for Valqua products
Equity-Method Affiliated Company:				
Atsugi Hyuutekku Co., Ltd	Osaka, Japan	¥80 million	25.0%	Production of sealing products and industrial products
PT.Indofacing Indonesia	East Java, Indonesia	Rp3,878 million	39.0%	Production of fiber products

Management

As of June 17, 2004

Board of Directors

President and Representative
Director, Chief Executive Officer
Toshikazu Takisawa

Senior Managing Directors

Shiro Hayashi
Kiyotaka Kurokawa

Director

Minoru Kawashima

Corporate Auditors

Standing Auditor
Yasushi Rakuma

Auditors

Yoshiaki Mori
Mamoru Ueda
Keishiro Nakagami

Corporate Executive Officers

Senior Executive Officers

Robert Lo
Nobuya Igarashi
Keiji Kato
Teruyoshi Joya
Haruka Hayashi
Hiroshi Hamada

Executive Officers

Masaaki Kumada
Kenichi Kobayashi
Takemi Shizawa
Tatsuzo Otsuka
Toshio Teramura
Hiroyuki Kuroda
Toshiyuki Tanaka

As of March 31, 2004

Established: January 21, 1927

Common Stock:

Authorized: 340,000,000 shares
Issued: 86,563,668 shares

Number of Shareholders: 14,061

Paid-in Capital: ¥13,154 million

Stock Listing: Tokyo

Transfer Agent:

The Sumitomo Trust & Banking Co., Ltd.

Number of Employees:

Parent company	337
Domestic subsidiaries	818
Overseas subsidiaries	432
Total	1,587

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Value & Quality



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