

Nippon Valqua Industries, Ltd.

Fiscal Year Ended March 31, 2005

Annual Report 2005

Contents



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

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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 Valqua is a contraction of the phrase that has been the Company's motto since its founding: "Value and Quality." Throughout that time, the Valqua Group has striven to develop and market products that offer real value, and that carry high levels of reliability and product quality. The Group's long-term strategy statement, the BEGIN[∞]2010 Plan, establishes goals to be attained by the year 2010, and sets out the "Valqua Way," which embodies a fundamental philosophy of creating corporate value and improving management quality, guided by the motto, "New Value & Quality—Speed & Spirit." Taking as its business domain the provision of new solutions to various industries, with high-performance sealing technology as its core competence, the Group emphasizes the value provided to customers. Valqua is pursuing thorough functionality, transparency, and efficiency, while striving to strengthen cash flows and heighten corporate value through improvement 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.

Cautionary Statement Regarding Forward-Looking Statements

This annual report contains forward-looking statements regarding plans, strategies and activities that the Valqua Group may implement or undertake in the future. These forward-looking statements reflect assumptions and beliefs held by management based on information available to it at the time this annual report was prepared and inherently carry risks and uncertainties. Actual results may thus differ substantially from expectations, due to the impact of various factors, including but not limited to: general economic conditions and specific market conditions characterizing the respective operating environments of group companies; exchange rates; and evolving trends in demand for the Group's products and services.

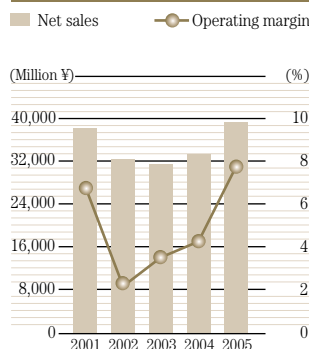
Five-Year Summary of Selected Financial Data

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

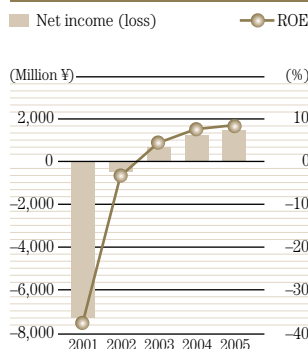
	Millions of yen (unless otherwise specified)					Thousands of U.S. dollars (unless otherwise specified)
	2005	2004	2003	2002	2001	2005
For the Year:						
Net sales	¥39,335	¥33,271	¥31,432	¥32,329	¥38,170	\$366,283
Gross profit	12,735	10,701	10,296	9,596	11,646	118,586
Selling, general and administrative expenses	9,670	9,269	9,178	8,877	9,035	90,044
Research and development expenses (included in the above)	997	972	905	670	821	9,287
Operating income	3,065	1,432	1,118	719	2,610	28,542
Net income (loss)	1,485	1,234	681	(491)	(7,275)	13,832
At Year-End:						
Total assets	37,760	36,347	34,118	36,941	42,572	351,620
Property, plant and equipment, net	13,206	12,839	13,834	15,052	15,886	122,970
Interest-bearing debt	8,984	9,108	10,394	12,808	14,999	83,654
Shareholders' equity	17,688	16,686	15,533	14,760	15,522	164,709
Per Share of Common Stock (Yen and U.S. Dollars):						
Net income (loss)						
—Basic	¥ 16.66	¥ 14.08	¥ 7.68	¥ (5.71)	¥ (84.60)	\$0.16
—Diluted	16.46	13.88	—	—	—	0.15
Shareholders' equity	201.71	192.94	180.65	171.68	180.51	1.88
Cash dividends	7.00	5.00	5.00	—	—	0.07
Financial Ratios:						
Operating margin	7.79%	4.30%	3.56%	2.22%	6.84%	
Net profit margin	3.78	3.71	2.17	(1.52)	(19.06)	
Equity ratio	46.8	45.9	45.5	40.0	36.5	
Return on equity (ROE)	8.6	7.7	4.5	(3.2)	(37.3)	
Return on total assets (ROA)	4.0	3.5	1.9	(1.2)	(15.2)	
Interest coverage (times)	18.5	5.4	9.5	—	5.3	
Debt/equity ratio (times)	0.51	0.55	0.67	0.87	0.97	

Note: U.S. dollar amounts are translated from yen, for convenience only, at the rate of ¥107.39=US\$1. Per share figures are stated in yen and dollars.

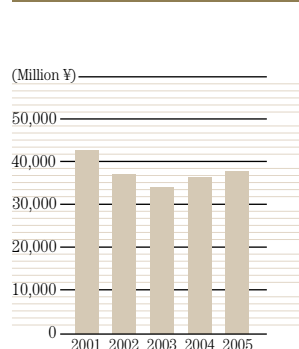
Net Sales and Operating Margin



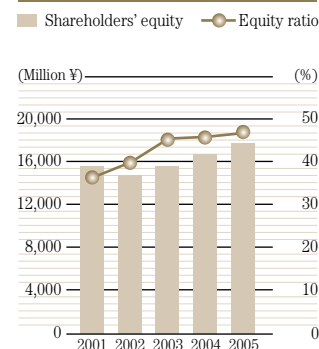
Net Income (Loss) and ROE



Total Assets



Shareholders' Equity and Equity Ratio





The Business Environment and Valqua's Performance

In the fiscal year ended March 31, 2005, the Japanese economy displayed solid recovery in the first half, fueled by surging corporate performance and growth in private-sector capital investment. In the second half, however, growth in exports stalled, and for the fiscal year as a whole, the recovery was only moderate. This was the second and final year of the New Valqua Stage Two (NV-S2) medium-term management plan, inaugurated in the fiscal year ended March 31, 2004, and the Valqua Group advanced despite the environment prevailing in this term with marketing programs directed at aggressive goals. To increase the level of customer satisfaction, the Group worked to expand its product lineup by bolstering its capabilities in the area of new-product development and strengthening alliances with prominent seal makers around the world.

The Group carved a foothold in the field of fluid control systems through M&A, and is aggressively moving forward with the development of operations both in and out of Japan.

In connection with its development strategy, the High Performance Polymer Division acquired land in Machida City, Tokyo, for a new facility. The new facility, to be called the MRT Center, will have systems that are integrated from development through sales. It will contribute to the acceleration of product development while strengthening the Group's operations in the fields of semiconductors, electronic information, and other cutting-edge technologies. The MRT Center will also include a Human Resource Development (HRD) Center that will foster the skills of both domestic and overseas group company employees. Construction of this facility commenced in June 2005 and is scheduled for completion in December. The HRD Center will focus on fostering individuals, for example, mission-oriented staff, international staff, and professional staff. Collectively, the individual skills of these individuals will emerge in team capabilities, forming a strong foundation for the Group's next major surge.

Performance in the fiscal year under review was boosted by the recovery in overall business conditions, as well as the expansion of the Group's product

lineup through the strengthening of domestic and overseas alliances and the development of new products. As a result, net sales grew ¥6,064 million, or 18.2%, to ¥39,335 million (US\$366 million). Declines in raw-materials prices and efforts to curtail operating expenses contributed to growth in operating income of ¥1,633 million, or 114.0%, to ¥3,065 million (US\$29 million), a new record high. After amortization of a net retirement benefit obligation at transition of ¥342 million (US\$3 million), and loss on disposal of obsolete inventories of ¥255 million (US\$2 million), net income increased ¥251 million, or 20.4%, to ¥1,485 million (US\$14 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 Group's management is providing a stable return to shareholders over the long term. Specifically, this entails providing stable dividends to shareholders based on the Group'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 Group's information infrastructure.

On the basis of the policy described above, an interim dividend of ¥2.5 per share and a year-end dividend of ¥4.5 per share were declared, for total dividends of ¥7 for the fiscal year under review. This represents a year-on-year increase of ¥2 and a payout ratio of 72.2%.

In the rapidly changing business environment that confronts Valqua today, corporate governance has become increasingly important. Ensuring fairness and transparency in corporate activities, and meeting corporate social responsibilities with regard to environmental protection and safety have become pressing management issues. In response, Valqua has reorganized its board of directors, instituted an executive officer system, and established flexible group management systems that clearly separate the roles of directors and executive officers.

Valqua has taken steps to tighten corporate governance, and because it regards legal and regulatory compliance as a fundamental management function,

is working to ensure this in all its business activities. One measure taken in this effort was the formulation and publication of a compliance manual, together with steps to ensure that all executives and employees are thoroughly familiar with its contents.

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. Capital investments in fiscal 2005 totaled ¥1,820 million (US\$16 million) on a cost of completed construction basis, chiefly in the High Performance Polymer Division for materials-related products, the Plant and Equipment Division for jointing sheet production facilities, and the Elastomer Division for high-performance fluoro-rubber and other elastomer products for the semiconductor industry.

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 New Valqua Stage Three (NV-S3), a two year medium-term management plan launched in April 2005. 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, 2005, planned capital investments in the construction and upgrade of facilities were ¥5,265 million (US\$49 million). Valqua 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, 2005.

Our Medium-Term Management Strategy

The Valqua Group has implemented a number of management measures directed at the realization of the goals set forth in its BEGIN∞2010 Plan, the Group's long-term strategy statement. Notable

among these are the Group's New Valqua Stage One (NV-S1) medium-term management plan, which was in effect for the three years ending with fiscal 2003, and New Valqua Stage Two (NV-S2), which covered fiscal years 2004 and 2005. Under both of these plans, the Group worked energetically to meet established management goals and to "become a company that continuously creates customer value on the basis of technology and brand power."

NV-S3 will guide the Group in the fiscal years ending March 31, 2006 and 2007 under the theme, "Building a solid foundation for the next leap forward," and pursue the fundamental policies below.

- (1) *Quickly develop a solutions business that is responsive to changes in the business environment and customer needs.*
- (2) *Expand the Group's business domain through the development of new products, the strengthening of alliances, and reinforcement of core products.*
- (3) *Further strengthen overseas businesses.*
- (4) *Develop human resources and energize organizations within the Group.*

Formulating the Human Resources Development Declaration and the Human Resources Development Policy

On the basis of these policies, the Valqua Group has established detailed action plans for each strategy. Targets for the last year of the new medium-term management plan (fiscal 2007) are for an operating margin of 10.0%, return on total assets (ROA) of 5.4%, and return on equity (ROE) of 10.2%.

Outlook

Despite a gradual recovery in private-sector domestic demand, lackluster business conditions are forecast for fiscal 2006 as a result of destabilizing conditions in the markets for materials and fluctuations in international currency exchange rates. The Valqua Group is forecast to post net sales of ¥41,000 million (US\$381 million), operating income of ¥3,370 million (US\$31 million), and net income of ¥1,650 million (US\$15 million).

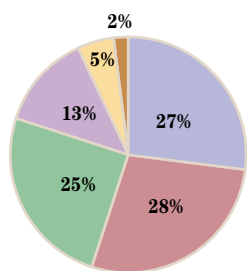
Fiscal 2006 is the first year of the Valqua Group's new NV-S3 medium-term management plan, and the Group will push forward with the implementation of its strategy-specific action plans. One significant measure will be the formulation of the Human Resources Development Declaration and the Human Resources Development Policy, and other measures to upgrade human resources, which are indispensable to further growth, thereby "building a solid foundation for the next leap forward."

In conclusion, as representative of Valqua's management, I would like to thank all Valqua's shareholders, customers, and business partners around the world for their support, as well as our employees for their constant cooperation.

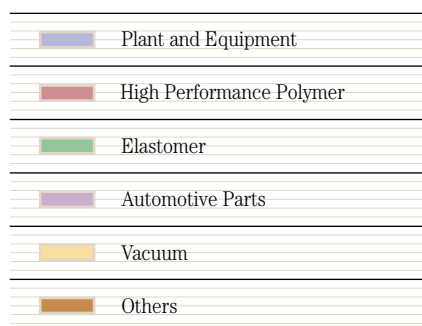


Toshikazu Takisawa
President and
Representative Director, CEO

Net Sales Breakdown



¥39,335 million



Plant and Equipment Division

As a result of expanded sales in the plant shutdown and general machinery markets, principally of non-asbestos products, the Plant and Equipment Division's net sales rose 12.8% to ¥10,789 million (US\$100 million). Capital investments in this division totaled ¥346 million (US\$3 million) for fiscal 2005, primarily in the expansion of production facilities for products such as graphite sheet, Valquatight, and new sealing products at Valqua Seal Products (Shanghai) Co., Ltd., which commenced last fiscal year.

High Performance Polymer Division

Net sales in the High Performance Polymer Division grew 31.2% to ¥11,061 million (US\$102 million), on strong performance by materials-related products, finished goods and lining materials in the semiconductor and plant-shutdown markets. In connection with its development strategy, this division has acquired land for a new business facility, to be called the MRT Center. Capital investments in this division totaled ¥1,163 million (US\$10 million), primarily for the acquisition of the MRT Center site.

Elastomer Division

Affected by favorable conditions in the semiconductor and liquid crystal markets, primarily fluoro-rubber products, and benefiting from growth in sales of conventional rubber products, net sales in the Elastomer Division grew 15.7% to ¥9,635 million (US\$89 million). Capital investments in this division totaled ¥196 million (US\$1 million), primarily in testing equipment and the upgrade and expansion of rubber-product manufac-

turing facilities at Valqua Seal Solutions and Valqua Elastomer, Ltd.

Automotive Parts Division

The Automotive Parts Division enjoyed healthy market conditions, and achieved growth in sales of automatic transmission parts and wiring harnesses. As a result, net sales increased 7.5% to ¥5,004 million (US\$46 million). Capital investments in this division were ¥61 million (US\$568 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 33.3% to ¥1,904 million (US\$17 million). Capital investments, primarily in the upgrade and expansion of R&D testing equipment and manufacturing facilities at Valqua Seiki, Ltd., totaled ¥43 million (US\$400 thousand).

Net sales in other businesses increased 9.9% year-on-year to ¥939 million (US\$8 million).

Valqua—For Excellence in Technology

In recent years, Valqua has been strengthening its alliances with prominent seal makers around the world. In 2001 the Company entered into a comprehensive business alliance with VAT Vakuumventile AG of Switzerland with regard to special molding technology for sealing materials used in gate valves for semiconductor manufacturing equip-

ment. Since that time, the Company has pursued an alliance strategy focused on enhancing competitiveness and expanding its product lineup.

In 2002, Valqua entered into operational alliances with prominent Taiwanese firms for the manufacturing and sale of sealing tape products and retainer rings, which are semiconductor-related products.

In 2003, the Company established a comprehensive business alliance with the world's leading sealing materials manufacturer, Garlock Sealing Technologies of the US. This alliance encompasses region-specific marketing, joint repositioning of manufacturing and procurement operations, and joint research and development. As a measure to increase competitiveness by reducing costs, the Company strengthened ties to sealing materials manufacturers in Singapore and India, which heightened its price competitiveness in Southeast Asia and the Middle East. Also in 2003, Valqua took a capital position in and established a comprehensive manufacturing and sales alliance with SINYUAN Industrial Material Co., Ltd., of Ningbo, China, a manufacturer of various plant and equipment sealing products, including exfoliated graphite gaskets and gland packing.

In 2004, Valqua acquired a 60% share of ACL Co., Ltd. (name changed to Valqua ACL Co., Ltd., as a result of the acquisition) with the objective of establishing a presence in the fluid control system market, in which high market-ability is anticipated. Combining the proprietary fluid control system technology developed by ACL for the semiconductor and liquid crystal markets with the Valqua Group's domestic and overseas network will allow the Group to offer its customers total fluid control system solutions. In addition, the Company entered into a manufacturing and sales alliance with AWI Mach with regard to synthetic rubber sealing materials for use in automobile and construction machinery piping and waste-heat piping in refrigerators and other home appliances.

Valqua's objective in forming alliances is to expand its ability to offer solutions that will provide customer satisfaction, using more than just its own products. From this perspective, the Company is moving forward with the formation of business alliances with the world's

leading seal makers, and will in the future increase its emphasis on this alliance strategy.

High Points of the Year

New Plant and Human Resources Center Constructed

Valqua has acquired a site in Machida City, Tokyo, for a new plant (to be called the MRT Center). The MRT Center will be a strategic base for the development and marketing capabilities in the high performance polymer business, with a focus on fluoro-resins. The total investment will be approximately ¥2.8 billion (US\$26 million). Following completion, the Center will have a staff of approximately 200. Ground was broken in June 2005, and completion is scheduled for December of the same year.

The new plant will boast the latest plant and equipment, and will significantly shorten the supply chain for the promising line of products we will develop, which we expected will consist primarily of resin products. It will also integrate the manufacturing, sales, technology, and research and development functions for the high-performance resin business, creating an environment and a structure that will facilitate flexible response to customer needs.

A Human Resources Development Center will also be built at this plant, which will offer training to the domestic and overseas employees of the Valqua Group. The Human Resources Development Center will first apply its expertise to the development of a

curriculum, and will offer programs to strengthen group as well as individual skills and capabilities.

Sales of Valqua Arma-TS Seal Heteromorphic Sealing Materials Begin

Valqua has completed development and started sales of Valqua Arma-TS Seal heteromorphic sealing materials. These are anti-twisting and anti-defluxion seals for gate valves used in etching and CVD equipment for semiconductor dry etching.

In dry semiconductor etching, twisting and defluxion of gate valve O ring seals greatly increases down time on etching and CVD equipment, which is one of the primary causes of reduced productivity. Valqua Arma-TS Seal is a heteromorphic elastomer developed to eliminate twisting and defluxion of gate valve O ring seals.

The TS in the product name stands for "twisting stop," and the product's two most significant characteristics are that its structure when installed makes it resistant to defluxion, and that it is easy to install.

Research and Development Activities

As a technology-oriented enterprise, the Valqua Group puts the highest priority on increasing the level of customer satisfaction, and with the involvement of the Market Division, is engaged in the development of technology that is closely tied to the needs of global markets, and the development of original products, all with an emphasis on speed.



Valqua Arma-TS Seal

In accordance with its BEGIN ∞ 2010 long-term plan and New Valqua Stage Two (NV-S2) medium-term strategy, during this term Valqua moved forward with research and development focused on its core technologies, advanced seal technology and high-performance resin technology. Specifically, the focus was on the design of finished goods made from various materials, including fluoro-resins, elastomers, and inorganics, intended for growth fields such as the semiconductor, IT, environmental, and energy industries. In addition, the Company employed its technological expertise in materials processing and evaluation to develop high-performance products that meet the exacting demands of its customers. The Valqua Group energetically seeks technological collaboration and alliances with customers, universities, materials manufacturers, and processing firms.

Valqua's research and development organization is strengthening its market orientation and changing its structure to achieve increased speed. The Product Development Division has been split into an Advanced Industrial Development Division and a Basic Industrial Development Division, and the rapid development of products precisely designed for customers has been made priority. The Research Division is engaged in the development of new technology.

The Valqua Group's total research and development costs for fiscal 2005 were ¥997 million (US\$9 million).



The MRT Center

Revenues

In the fiscal year ended March 31, 2005, the Japanese economy displayed solid recovery in the first half, fueled by surging corporate performance and growth in private-sector capital investment. The U.S. economy remained strong, and the Chinese economy continued to grow. However, growth in exports slowed, and economic performance for the fiscal year as a whole was disappointing.

At Valqua, net sales reversed a declining trend, growing 18.2% to ¥39,335 million (US\$366 million), and operating income jumped 114.0% to ¥3,065 million (US\$ 29 million). Net sales in the Plant and Equipment Division rose 12.8% to ¥10,789 million (US\$100 million), accounting for 27% of the Company's total net sales. The High Performance Polymer Division achieved 31.2% expansion in net sales, to ¥11,061 million (US\$102 million), or 28% of total net sales. In the Elastomer Division, net sales grew 15.7% to ¥9,635 million (US\$89 million), or 25% of the total. The Automotive Parts Division's net sales increased 7.5% to ¥5,004 million (US\$46 million), amounting to 13% of total net sales. Sales in the Vacuum Products Division jump by 33.3% to ¥1,904 million (US\$17 million), or 5% of total net sales. Net sales in other businesses increased 9.9% year-on-year to ¥939 million (US\$8 million), which was 2% of total net sales.

Domestic net sales rose to ¥36,585 million (US\$341 million) and operating income increased to ¥2,571 million

(US\$24 million). This was the result of the general recovery of conditions in industry as a whole, together with increased sales resulting from the expansion of Valqua's product lineup and the development of new products, which were enabled by alliances.

As a result of an increased share of the Asian market, net sales in that region increased to ¥2,569 million (US\$24 million), and operating income grew to ¥201 million (US\$2 million). A substantial increase in sales in the North America region was seen, primarily in the semiconductor and liquid crystal markets. As a result, net sales rose to ¥181 million (US\$2 million), and operating income ¥133 million (US\$1 million). (The geographic segment figures above include inter-segment transactions.)

Results of Operations

Cost of sales rose to ¥26,600 million (US\$248 million), but this 17.9% increase compares favorably to the 18.2% rise in net sales, and cost of sales remained unchanged as a percentage of net sales. The increase in sales and control of cost of sales brought 19.0% growth in gross profit, which rose to ¥12,735 million (US\$119 million). Selling, general, and administrative expenses rose 4.3% to ¥9,670 million (US\$90 million), but as a percentage of gross profit declined to 75.9%, continuing the downward trend established last fiscal year. The ratio of selling, general, and administrative expenses to sales also decreased for the second consecutive fiscal year, falling from 27.9% in the previous fiscal year to

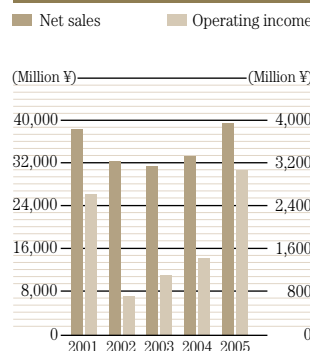
24.6%. The Company continued to expand its investments in research and development (included in SG&A), which were increased from ¥972 million in the previous fiscal year to ¥997 million (US\$9 million).

Interest and dividend income increased 6.7% to ¥16 million (US\$154 thousand) but interest expenses also rose, easing up 1.3% to ¥233 million (US\$2 million). Equity in earnings of affiliates surged 66.7% to ¥40 million (US\$374 thousand). The Company's net loss on sales or disposal of fixed assets decreased 99.2% to ¥2 million (US\$26 thousand), and amortization of net retirement benefit obligation at transition decreased 26.6% to ¥342 million (US\$3 million). As a result, the Company posted income before income taxes and minority interests of ¥2,118 million (US\$20 million).

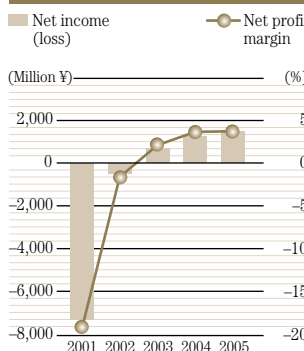
Current income taxes were ¥393 million (US\$4 million), and accrued deferred income taxes totaled ¥198 million (US\$2 million). After minority interests of ¥42 million (US\$393 thousand), net income increased 20.3% to ¥1,485 million (US\$14 million).

Basic net income per share was ¥16.66 (US\$0.16), and diluted net income per share was ¥16.46 (US\$0.15). Cash dividends were increased from ¥5.00 per share to ¥7.00 (US\$0.07). The operating margin rose from 4.30% to 7.79%, the net profit margin increased from 3.71% to 3.78%, return on equity (ROE) rose from 7.7% to 8.6%, and return on total assets (ROA) grew from 3.5% to 4.0%. Interest coverage increased from 5.4 times to 18.5 times.

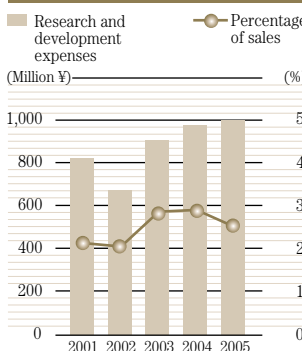
Net Sales and Operating Income



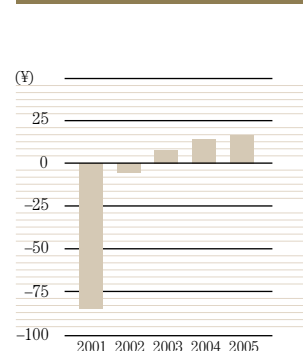
Net Income (Loss) and Net Profit Margin



Research and Development Expenses and as Percentage of Sales



Net Income (Loss) per Share



Financial Position

After a 30.7% decrease in the previous fiscal year, cash and time deposits rose by 56.6% to ¥2,715 million (US\$25 million). Notes and accounts receivable declined 4.5% to ¥11,724 million (US\$109 million), and other current assets were increased by 8.2% to ¥2,364 million (US\$22 million). Deferred income taxes increased 47.4% to ¥401 million (US\$4 million). As a result, total current assets rose 3.8% to ¥19,295 million (US\$180 million).

Short-term bank loans were reduced by 8.9% to ¥4,271 million (US\$40 million), and the current portion of long-term debt was reduced by 3.0% to ¥1,699 million (US\$16 million). Notes and accounts payable increased by 7.4% to ¥6,200 million (US\$58 million), accrued bonuses increased 17.7% to ¥498 million (US\$5 million), and accrued income taxes jumped 34.1% to ¥244 million (US\$2 million). Other current liabilities rose 19.9% to ¥1,351 million (US\$13 million). These factors resulted in 2.3% growth in total current liabilities, to ¥14,263 million (US\$133 million), yielding a current ratio of 1.4.

After an 84.6% jump in the previous fiscal year, total investments and other assets edged up 6.8% to ¥5,259 million (US\$49 million). Investments in securities were nearly doubled, rising 99.5% to ¥1,887 million (US\$18 million), prepaid pension expenses declined by 21.0% to ¥1,447 million (US\$13 million), and other assets were reduced 7.8% to ¥1,782 million (US\$17 million).

Property, plant, and equipment were

decreased by 4.8%, to ¥25,755 million (US\$239 million). Land was increased 27.5% to ¥4,442 million (US\$41 million). Buildings and structures eased down 1.0% to ¥12,309 million (US\$115 million), machinery, equipment and vehicles were reduced by 14.2% to ¥6,069 million (US\$57 million), and tools, furniture and fixtures dropped by 24.2% to ¥2,930 million (US\$27 million). Construction in progress fell from ¥189 million last fiscal year to ¥5 million (US\$44 thousand). Due to the vigorous retirement of facilities that resulted in the contraction of fixed assets, and the acquisition of sites for new plants at an investment of ¥957 million, net property, plant, and equipment after accumulated depreciation of ¥12,549 million (US\$117 million) increased 2.9% to ¥13,206 million (US\$123 million). As a result of the foregoing, total assets at March 31, 2005 were up ¥1,413 million from a year earlier, rising to ¥37,760 million (US\$352 million).

Retained earnings increased more than tripled, rising from ¥248 million last fiscal year to ¥1,062 million (US\$10 million). Foreign currency translation adjustments rose by 28.2% to ¥382 million (US\$4 million), and treasury stock at cost was increased to 47.1% to ¥50 million (US\$466 thousand). The exercise of stock options caused common stock and the capital surplus both to increase by ¥113 million. Shareholders' equity rose 6.0% to ¥17,688 million (US\$164 million).

The equity ratio rose from 45.9% in the previous fiscal year to 46.8%. Based on the number of shares outstanding at

March 31, 2005, shareholders' equity per share rose from ¥192.94 at the end of the previous fiscal year to ¥201.71 (US\$1.88). The debt/equity ratio declined from 0.55 times to 0.51 times.

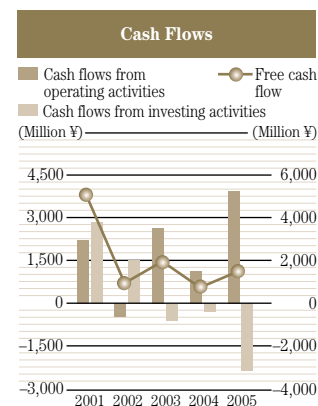
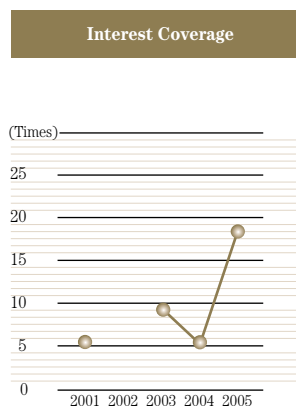
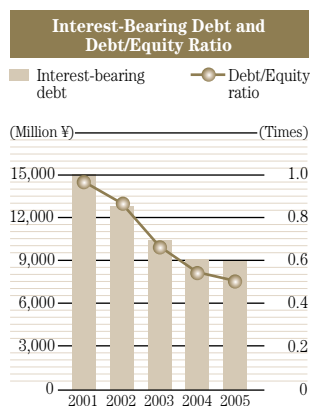
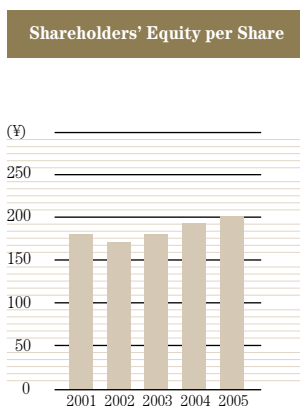
Cash Flows

Net cash provided by operating activities was ¥3,933 million (US\$37 million), a ¥2,803 million increase in comparison with the previous fiscal year. Principal sources of cash included income before income taxes and minority interests of ¥2,118 million (US\$20 million), and a decrease in notes and accounts receivable of ¥601 million (US\$6 million). Depreciation and amortization was ¥1,123 million (US\$10 million).

Net cash used in investing activities was ¥2,344 million (US\$22 million), up ¥2,063 million. Significant uses of cash included ¥1,503 million (US\$14 million) invested in the acquisition of sites for new plants and other purchases of property, plant and equipment, and investments in securities of ¥843 million (US\$8 million).

Net cash used in financing activities was ¥613 million (US\$6 million), down ¥991 million from the previous fiscal year. The principal use of cash was cash dividends paid to shareholders of ¥643 million (US\$6 million).

As a result of the foregoing, cash and cash equivalents at the end of the fiscal year were ¥2,710 million (US\$25 million), up ¥984 million from a year earlier.



Consolidated Balance Sheets

March 31, 2005 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
Assets			
Current assets:			
Cash and time deposits (Note 3)	¥ 2,715	¥ 1,734	\$ 25,283
Notes and accounts receivable	11,724	12,279	109,170
Allowance for doubtful receivables	(21)	(20)	(196)
	11,703	12,259	108,974
Inventories	2,112	2,136	19,664
Deferred income taxes (Note 6)	401	272	3,737
Other current assets	2,364	2,184	22,018
Total current assets	19,295	18,585	179,676
Property, plant and equipment (Note 5):			
Land	4,442	3,485	41,367
Buildings and structures	12,309	12,433	114,620
Machinery, equipment and vehicles	6,069	7,077	56,511
Tools, furniture and fixtures	2,930	3,865	27,283
Construction in progress	5	189	44
	25,755	27,049	239,825
Less accumulated depreciation	(12,549)	(14,210)	(116,855)
Property, plant and equipment, net	13,206	12,839	122,970
Investments and other assets:			
Investments in securities (Notes 4 and 5)	1,887	946	17,574
Investments in affiliates	109	119	1,017
Deferred income taxes (Note 6)	142	184	1,321
Prepaid pension expense (Note 7)	1,447	1,831	13,476
Other assets	1,782	1,932	16,592
Allowance for doubtful receivables	(108)	(89)	(1,006)
Total investments and other assets	5,259	4,923	48,974
Total assets	¥37,760	¥36,347	\$351,620

See accompanying notes to the consolidated financial statements.

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
Liabilities, minority interests and shareholders' equity			
Current liabilities:			
Short-term bank loans (Note 5)	¥ 4,271	¥ 4,689	\$ 39,775
Current portion of long-term debt (Note 5)	1,699	1,751	15,816
Notes and accounts payable	6,200	5,774	57,734
Accrued bonuses to employees	498	423	4,637
Accrued income taxes (Note 6)	244	182	2,276
Other current liabilities	1,351	1,127	12,576
Total current liabilities	14,263	13,946	132,814
Long-term liabilities:			
Long-term debt (Note 5)	3,014	2,668	28,063
Accrued retirement benefits to employees (Note 7)	306	240	2,852
Accrued retirement benefits to directors and statutory auditors	—	148	—
Deferred income taxes (Note 6)	583	256	5,426
Other long-term liabilities (Note 7)	1,598	2,097	14,880
Total long-term liabilities	5,501	5,409	51,221
Minority interests	308	306	2,876
Contingent liabilities (Note 8)			
Shareholders' equity (Notes 9 and 16):			
Common stock			
Authorized—340,000,000 shares			
Issued—87,753,668 shares in 2005 and 86,563,668 shares in 2004	13,268	13,154	123,546
Capital surplus	3,511	3,398	32,698
Retained-earnings	1,062	248	9,894
Net unrealized holding gain on securities (Note 4)	279	218	2,599
Translation adjustments	(382)	(298)	(3,562)
	17,738	16,720	165,175
Treasury stock, at cost: 236,021 shares in 2005 and 183,245 shares in 2004	(50)	(34)	(466)
Total shareholders' equity	17,688	16,686	164,709
Total liabilities, minority interests and shareholders' equity	¥37,760	¥36,347	\$351,620

Consolidated Statements of Income

Years ended March 31, 2005 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
Net sales	¥39,335	¥33,271	\$366,283
Cost of sales (Note 11)	26,600	22,570	247,697
Gross profit	12,735	10,701	118,586
Selling, general and administrative expenses (Note 11)	9,670	9,269	90,044
Operating income	3,065	1,432	28,542
Other income (expenses):			
Interest and dividend income	16	15	154
Interest expense	(233)	(230)	(2,173)
Equity in earnings of affiliates	40	24	374
Gain on amendment of employees' pension plans (Note 7)	—	1,293	—
Loss on sales or disposal of fixed assets, net	(2)	(238)	(26)
Amortization of net retirement benefit obligation at transition (Note 7)	(342)	(466)	(3,183)
Provision for accrued retirement benefits to directors and statutory auditors	—	(148)	—
Other, net	(426)	(305)	(3,964)
	(947)	(55)	(8,818)
Income before income taxes and minority interests	2,118	1,377	19,724
Income taxes (Note 6):			
Current	393	199	3,654
Deferred	198	(79)	1,845
	591	120	5,499
Income before minority interests	1,527	1,257	14,225
Minority interests	42	23	393
Net income	¥ 1,485	¥ 1,234	\$ 13,832

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Years ended March 31, 2005 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
Common stock:			
Balance at beginning of the year	¥13,154	¥13,101	\$ 122,491
Add:			
Exercise of stock options	114	53	1,055
Balance at end of the year	¥13,268	¥13,154	\$ 123,546
Capital surplus:			
Balance at beginning of the year	¥ 3,398	¥ 3,345	\$ 31,642
Add:			
Exercise of stock options	112	53	1,046
Gain on disposition of treasury stock	1	—	10
Balance at end of the year	¥ 3,511	¥ 3,398	\$ 32,698
Retained-earnings (deficit):			
Balance at beginning of the year	¥ 248	¥ (535)	\$ 2,307
Add:			
Net income	1,485	1,234	13,832
Appropriations:			
Cash dividends	(650)	(430)	(6,051)
Bonuses to directors and statutory auditors	(21)	(21)	(194)
Balance at end of the year	¥ 1,062	¥ 248	\$ 9,894
Net unrealized holding gain on securities:			
Balance at beginning of the year	¥ 218	¥ 7	\$ 2,033
Net change during the year	61	211	566
Balance at end of the year	¥ 279	¥ 218	\$ 2,599
Translation adjustments:			
Balance at beginning of the year	¥ (298)	¥ (363)	\$ (2,776)
Net change during the year	(84)	65	(786)
Balance at end of the year	¥ (382)	¥ (298)	\$ (3,562)

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended March 31, 2005 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
Cash flows from operating activities:			
Income before income taxes and minority interests	¥2,118	¥1,377	\$19,724
Adjustments for:			
Depreciation and amortization	1,123	1,049	10,456
Increase (decrease) in accrued retirement benefits to employees	66	(2,398)	613
Interest and dividend income	(16)	(15)	(154)
Interest expense	233	230	2,173
Equity in earnings of affiliates	(40)	(24)	(374)
Loss on sales or disposal of fixed assets, net	3	238	31
Loss on devaluation of investments in securities	—	53	—
Decrease (increase) in notes and accounts receivable	601	(1,174)	5,593
Increase in notes and accounts payable	333	730	3,100
Decrease (increase) in inventories	54	(10)	507
Other	(23)	1,335	(212)
Subtotal	4,452	1,391	41,457
Interest and dividend income received	24	19	231
Interest expense paid	(213)	(207)	(1,984)
Income taxes paid	(330)	(73)	(3,076)
Net cash provided by operating activities	3,933	1,130	36,628
Cash flows from investing activities:			
Decrease in time deposits, net	3	—	28
Purchases of property, plant and equipment	(1,503)	(587)	(13,999)
Proceeds from sales of property, plant and equipment	24	501	223
Purchases of intangible assets included in other assets	(35)	(454)	(325)
Purchases of investments in securities	(843)	(117)	(7,846)
Proceeds from sales of investments in securities	23	423	212
Other	(13)	(47)	(124)
Net cash used in investing activities	(2,344)	(281)	(21,831)
Cash flows from financing activities:			
Decrease in short-term bank loans, net	(417)	(548)	(3,880)
Proceeds from long-term debt	2,200	1,000	20,486
Repayment of long-term debt, including current portion	(1,944)	(1,717)	(18,101)
Cash dividends paid to shareholders	(643)	(424)	(5,992)
Cash dividends paid to minority shareholders of subsidiaries	(18)	(14)	(163)
Proceeds from issuance of common stock	226	107	2,100
Other	(17)	(8)	(157)
Net cash used in financing activities	(613)	(1,604)	(5,707)
Effect of exchange rate changes on cash and cash equivalents	8	(11)	75
Net increase (decrease) in cash and cash equivalents	984	(766)	9,165
Cash and cash equivalents at beginning of the year	1,726	2,492	16,069
Cash and cash equivalents at end of the year (Note 3)	¥2,710	¥1,726	\$25,234

See accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements

March 31, 2005

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.

Certain reclassifications of previously reported amounts have been made to conform the consolidated financial statements for the year ended March 31, 2004 to the 2005 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 ¥107.39 = U.S.\$1.00, the approximate exchange rate prevailing on March 31, 2005. 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 experi-

ence 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 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 5 years, which is within the estimated average remaining years of service of the eligible employees.

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

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 charged such lump-sum payments to income when they were paid. The Board of Directors of the Company resolved, at a 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 meeting of the shareholders held on June 17, 2004.

At March 31, 2004, the Company recorded accrued retirement benefits to directors and statutory auditors of ¥148 million 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) Business scale taxation

In accordance with a law on the amendment of local tax laws and so forth which went into effect on April 1, 2004, a domestic corporation with capital in excess of ¥100 million is subject to business scale taxation on the basis of the total amount of value added, the size of its capital and its taxable income. Based on the new accounting standard for business scale taxation, the Company and certain of its domestic subsidiaries have accounted for business scale taxation, with respect to the amounts of value added and capital, as a component of selling, general and administrative expenses. Consequently, selling, general and administrative expenses for the year ended March 31, 2005 increased by ¥42 million (\$392 thousand) and operating income, income before income taxes and minority interests, and net income for the year ended March 31, 2005 decreased by ¥42 million (\$392 thousand).

(l) Consolidated tax return

The Company and its wholly owned domestic subsidiaries obtained approval from the Japanese tax authorities to file a consolidated tax return effective the year ending March 31, 2006. Based on the related accounting standards, the Company and its wholly owned domestic subsidiaries have accounted for deferred income taxes as if they had adopted the consolidated tax return system effective the year ended March 31, 2005.

(m) 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.

(n) 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 unrealized 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.

(o) 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. (Refer to Note 16(2).)

(p) 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. Effective the year ended March 31, 2004, the Company reclassified 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 is presented as a component of other income. As a result, operating income increased by ¥131 million. This change, however, had no effect on income before income taxes and minority interests for the year ended March 31, 2004.

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, 2005 and 2004 is presented as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Cash and time deposits	¥2,715	¥1,734	\$25,283
Time deposits with original maturities of more than three months	(5)	(8)	(49)
Cash and cash equivalents	¥2,710	¥1,726	\$25,234

4. Investments in Securities

(a) Information regarding marketable securities classified as other securities at March 31, 2005 and 2004 is summarized as follows:

	Millions of yen					
	2005			2004		
	Acquisition costs	Carrying value	Unrealized gain (loss)	Acquisition costs	Carrying value	Unrealized gain (loss)
Securities whose carrying value exceeds their acquisition costs:						
Equity securities	¥1,259	¥1,723	¥464	¥301	¥664	¥363
Securities whose carrying value does not exceed their acquisition costs:						
Equity securities	15	13	(2)	124	122	(2)
Total	¥1,274	¥1,736	¥462	¥425	¥786	¥361

	Thousands of U.S. dollars		
	2005		
	Acquisition costs	Carrying value	Unrealized gain (loss)
Securities whose carrying value exceeds their acquisition costs:			
Equity securities	\$11,719	\$16,047	\$4,328
Securities whose carrying value does not exceed their acquisition costs:			
Equity securities	141	115	(26)
Total	\$11,860	\$16,162	\$4,302

The Company recorded a loss of ¥2 million on devaluation of impaired investments in marketable securities classified as other securities for the year ended March 31, 2004.

(b) The carrying value of non-marketable other securities at March 31, 2005 and 2004 is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Other securities:			
Unlisted equity securities (other than equity securities traded on the over-the-counter market)	¥141	¥148	\$1,316
Other	10	10	96
	¥151	¥158	\$1,412

(c) Sales of securities classified as other securities for the years ended March 31, 2005 and 2004 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Proceeds from sales	¥25	¥424	\$234
Gain on sales	22	171	208

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

Short-term bank loans consisted principally of overdrafts at annual average interest rates of 1.4% and 1.3% at March 31, 2005 and 2004, respectively.

Long-term debt at March 31, 2005 and 2004 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Loans from banks and insurance companies, at an annual average interest rate of 1.7%	¥ 4,713	¥ 4,419	\$ 43,879
Less current portion	(1,699)	(1,751)	(15,816)
	¥ 3,014	¥ 2,668	\$ 28,063

The aggregate annual maturities of long-term debt subsequent to March 31, 2005 are summarized as follows:

Year ending March 31,	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
2006	¥1,699		\$15,816
2007	469		4,367
2008	2,402		22,371
2009	112		1,041
2010	12		115
2011 and thereafter	19		169
	¥4,713		\$43,879

The assets pledged as collateral for short-term bank loans and long-term debt at March 31, 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Land	¥242		\$2,252
Buildings and structures	101		938
Investments in securities	205		1,909
Total	¥548		\$5,099

Short-term bank loans and long-term debt secured by such collateral at March 31, 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Short-term bank loans	¥160		\$1,490
Current portion of long-term debt	116		1,078
Long-term debt	123		1,151
Total	¥399		\$3,719

The assets pledged as foundation mortgages at March 31, 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Land	¥102		\$ 949
Buildings and structures	94		873
Machinery, equipment and vehicles	20		186
Total	¥216		\$2,008

Short-term bank loans and long-term debt secured by foundation mortgages at March 31, 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Short-term bank loans	¥250		\$2,328
Current portion of long-term debt	41		380
Long-term debt	91		849
Total	¥382		\$3,557

6. Income Taxes

Income taxes applicable to the Company and its domestic subsidiaries comprise corporation tax, inhabitants' taxes and enterprise tax which, in the aggregate, resulted in statutory tax rates of 39.5% and 40.9% for the years ended March 31, 2005 and 2004, respectively. Overseas subsidiaries are subject to the income taxes of the countries in which they operate.

A reconciliation of the statutory tax rates and the effective tax rates for the years ended March 31, 2005 and 2004 as a percentage of income before income taxes and minority interests is presented as follows:

	2005	2004
Statutory tax rates	39.5%	40.9%
Permanently non-deductible expenses	0.9	1.2
Permanently non-taxable income	(5.1)	(0.2)
Per capita portion of inhabitants' taxes	17.2	16.8
Valuation allowance	(24.6)	(53.5)
Decrease in deferred tax assets resulting from change in statutory tax rate	—	3.5
Effective tax rates	27.9%	8.7%

The tax effects of temporary differences which gave rise to significant portions of the deferred tax assets and liabilities at March 31, 2005 and 2004 are presented below:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Deferred tax assets			
Current assets:			
Accrued bonuses	¥ 189	¥ 163	\$ 1,757
Inventories	8	10	75
Accrued enterprise tax	37	—	342
Tax loss carryforwards	107	67	998
Other	60	32	565
Total deferred tax assets—current	401	272	3,737
Non-current assets:			
Allowance for doubtful receivables	34	42	314
Accrued retirement benefits	130	82	1,210
Contributions to retirement benefit trust	567	568	5,276
Long-term liability for transfer of pension plan assets	507	550	4,724
Depreciation	99	—	924
Loss on disposal of fixed assets	34	134	313
Loss on devaluation of investments	2,079	3,280	19,357
Tax loss carryforwards	1,030	173	9,590
Other	284	360	2,649
Gross deferred tax assets—noncurrent	4,764	5,189	44,357
Less valuation allowance	(4,343)	(4,395)	(40,439)
Total deferred tax assets—noncurrent	421	794	3,918
Deferred tax liabilities			
Current liabilities:			
Allowance for doubtful receivables	(3)	(4)	(30)
Non-current liabilities:			
Prepaid pension expense	(581)	(724)	(5,406)
Unrealized holding gain on securities	(183)	(143)	(1,705)
Other	(98)	—	(912)
Total deferred tax liabilities—noncurrent	(862)	(867)	(8,023)
Net deferred tax (liabilities) assets	¥ (43)	¥ 195	\$ (398)

7. Accrued Retirement Benefits

The Company and its domestic subsidiaries have defined benefit plans, i.e., the 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 on March 31, 2004 for a change to their corporate pension plan fund and established a corporate pension plan in the form of a cash-balance plan effective March 31, 2004. 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, 2005 and 2004 for the Company's and the subsidiaries' defined benefit plans:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Retirement benefit obligation	¥(8,645)	¥(8,619)	\$(80,500)
Plan assets at fair value	8,604	8,784	80,116
Unfunded retirement benefit obligation	(41)	165	(384)
Unrecognized net retirement benefit obligation at transition	—	351	—
Unrecognized actuarial loss	1,122	1,316	10,450
Unrecognized prior service cost	60	(241)	558
Net obligation	1,141	1,591	10,624
Prepaid pension expense	1,447	1,831	13,476
Accrued retirement benefits to employees	¥ (306)	¥ (240)	\$ (2,852)

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

The components of retirement benefit expenses for the years ended March 31, 2005 and 2004 are outlined as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Service cost	¥ 215	¥ 377	\$ 1,998
Interest cost	206	329	1,920
Expected return on plan assets	(182)	(162)	(1,692)
Amortization:			
Net retirement benefit obligation at transition	342	466	3,183
Actuarial loss	484	954	4,503
Prior service cost	(292)	(386)	(2,719)
Retirement benefit expenses	¥ 773	¥1,578	\$ 7,193

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 for the year ended March 31, 2004.

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
Decrease in retirement benefit obligation	¥3,276
Unrecognized net retirement benefit obligation at transition	(125)
Unrecognized actuarial loss	(524)
Unrecognized prior service cost	57
Decrease in accrued retirement benefits	¥2,684

The Company and certain domestic subsidiaries recognized related gain of ¥1,293 million and recorded this as a component of other income for the year ended March 31, 2004. The pension plan assets to be transferred of ¥1,391 million were recorded as a component of other long-term liabilities at March 31, 2004 and are being transferred over the following seven-year period.

The assumptions used in accounting for the defined benefit plans for the years ended March 31, 2005 and 2004 were as follows:

	2005	2004
Discount rates	2.0%	2.5%
Expected rates of return on plan assets	2.0%	2.5%

8. Contingent Liabilities

At March 31, 2005, the contingent liabilities of the Company and its subsidiaries were as follows:

	Millions of yen	Thousands of U.S. dollars
Notes receivable endorsed	¥1	\$9

9. 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 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, 2005 and 2004.

10. Stock Option Plans

At various meetings of the shareholders of the Company, resolutions were passed granting stock acquisition rights under stock option plans to eligible recipients in accordance with the Commercial Code of Japan. The eligible recipients may exercise these stock acquisition rights at their exercise value as determined by the shareholders, subject to adjustment for certain events including stock splits. The Company will issue 1,000 shares upon the exercise of each stock acquisition right.

Outstanding stock acquisition rights at March 31, 2005 are summarized as follows:

Date of resolution	Number of shares outstanding	Exercise value	Exercise period
June 29, 2000	262,000	¥193	From June 30, 2002 to June 29, 2005
June 28, 2001	1,363,000	¥225	From June 29, 2003 to June 28, 2006
June 27, 2002	1,329,000	¥154	From July 1, 2004 to June 28, 2007
June 18, 2003	1,852,000	¥306	From July 1, 2005 to June 30, 2008
June 17, 2004	2,147,000	¥283	From July 1, 2006 to June 30, 2009

The conditions on exercise and restrictions on transfer are as follows:

1. In the event that a holder of stock acquisition rights dies, his/her heirs may exercise the deceased's stock acquisition rights.
2. Certain other conditions will be as prescribed in the agreement entered into between the Company and the stock acquisition right recipients based on resolutions approved at meetings of the Company's shareholders and resolutions of the Company's Board of Directors.
3. Stock acquisition rights are not permitted to be transferred, pledged or disposed of.

11. Research and Development Costs

Research and development costs included in cost of sales and selling, general and administrative expenses totaled ¥997 million (\$9,287 thousand) and ¥972 million for the years ended March 31, 2005 and 2004, respectively.

12. Leases

The following *pro forma* amounts represent the acquisition costs, accumulated depreciation and net book value of the leased assets at March 31, 2005 and 2004, 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					
	2005			2004		
	Acquisition costs	Accumulated depreciation	Net book value	Acquisition costs	Accumulated depreciation	Net book value
Buildings and structures	¥ —	¥ —	¥ —	¥ 3	¥ 2	¥ 1
Machinery, equipment and vehicles	1,028	315	713	1,029	194	835
Tools, furniture and fixtures	349	240	109	349	208	141
Other assets	480	247	233	509	191	318
Total	¥1,857	¥802	¥1,055	¥1,890	¥595	¥1,295

	Thousands of U.S. dollars		
	2005		
	Acquisition costs	Accumulated depreciation	Net book value
Buildings and structures	\$ —	\$ —	\$ —
Machinery, equipment and vehicles	9,571	2,933	6,638
Tools, furniture and fixtures	3,245	2,234	1,011
Other assets	4,473	2,300	2,173
Total	\$17,289	\$7,467	\$9,822

Lease payments relating to finance leases accounted for as operating leases in the accompanying consolidated financial statements amounted to ¥294 million (\$2,746 thousand) and ¥304 million for the years ended March 31, 2005 and 2004, respectively. Depreciation of the leased assets computed by the straight-line method over the respective lease terms assuming a nil residual value amounted to ¥294 million (\$2,746 thousand) and ¥304 million for the years ended March 31, 2005 and 2004, respectively.

Future minimum lease payments subsequent to March 31, 2005 for finance leases are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2006	¥ 279	\$2,594
2007 and thereafter	776	7,228
Total	¥1,055	\$9,822

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, 2005 for operating leases are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2006	¥ 1	\$11
2007 and thereafter	—	—
Total	¥ 1	\$11

13. 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 believes that the credit risk is minimal because it 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, 2005 and 2004, all derivatives utilized by the Company met the criteria for deferral hedge accounting and the disclosure of fair value information has thus been omitted.

14. Amounts per Share

Amounts per share at March 31, 2005 and 2004 and for the years then ended were as follows:

	Yen		U.S. dollars
	2005	2004	2005
Net assets	¥201.71	¥192.94	\$1.88
Net income:			
Basic	16.66	14.08	0.16
Diluted	16.46	13.88	0.15
Cash dividends	7.00	5.00	0.07

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.

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.

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

15. Segment Information

(1) Business segments

As the percentages of net sales, operating income and assets in the segment entitled "Industrial Parts and Materials" are in excess of 90% of the corresponding total figures for all business segments, the disclosure of business segment information for the years ended March 31, 2004 and 2005 has been omitted.

(2) Geographic segment information

Segment information by geographic area for the year ended March 31, 2005 is summarized as follows:

	Millions of yen					
	2005					
	Japan	Asia	North America	Total	Eliminations and corporate	Consolidated
External sales	¥36,585	¥2,569	¥181	¥39,335	¥ —	¥39,335
Intersegment sales	1,079	2,336	137	3,552	(3,552)	—
Total sales	37,664	4,905	318	42,887	(3,552)	39,335
Operating expenses	35,093	4,704	185	39,982	(3,712)	36,270
Operating income	¥ 2,571	¥ 201	¥133	¥ 2,905	¥ 160	¥ 3,065
Assets	¥35,598	¥4,654	¥189	¥40,441	¥(2,681)	¥37,760

	Thousands of U.S. dollars					
	2005					
	Japan	Asia	North America	Total	Eliminations and corporate	Consolidated
External sales	\$340,673	\$23,919	\$1,691	\$366,283	\$ —	\$366,283
Intersegment sales	10,046	21,758	1,268	33,072	(33,072)	—
Total sales	350,719	45,677	2,959	399,355	(33,072)	366,283
Operating expenses	326,777	43,801	1,730	372,308	(34,567)	337,741
Operating income	\$ 23,942	\$ 1,876	\$1,229	\$ 27,047	\$ 1,495	\$ 28,542
Assets	\$331,484	\$43,341	\$1,755	\$376,580	\$(24,960)	\$351,620

As the percentages of assets and net sales in the "Japan" segment at March 31, 2004 and for the year then ended were in excess of 90% of the corresponding total figures for all geographic segments, the disclosure of the corresponding information for the year ended March 31, 2004 has been omitted.

(3) Overseas sales

Overseas sales, which include export sales of the Company and its domestic subsidiaries and sales (other than exports to Japan) of the overseas subsidiaries, for the year ended March 31, 2005 are summarized as follows:

	Millions of yen			
	2005			
	North America	Asia	Other areas	Total
Overseas sales	¥712	¥3,016	¥320	¥ 4,048
Consolidated net sales	—	—	—	39,335
Overseas sales as a percentage of consolidated net sales	1.8%	7.7%	0.8%	10.3%

	Thousands of U.S. dollars			
	2005			
	North America	Asia	Other areas	Total
Overseas sales	\$6,628	\$28,088	\$2,977	\$ 37,693
Consolidated net sales	—	—	—	366,283

The disclosure of the corresponding information for the year ended March 31, 2004 has been omitted as overseas sales were less than 10% of consolidated net sales for the year.

16. Subsequent Events

(1) Stock options

In accordance with the Commercial Code of Japan, an additional stock option plan for directors, statutory auditors and certain employees of the Company and certain directors and employees of certain subsidiaries was approved at the Company's annual general meeting of the shareholders held on June 21, 2005. Under the terms of this plan, 2,402,000 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 closing market price 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 date on which the stock options were issued, or on the immediately preceding date if no transactions were made on the date of issuance, the purchase price is to be the closing market price.

The options will become exercisable on July 1, 2007 and are scheduled to expire on June 30, 2010.

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, 2005, were approved at a shareholders' meeting held on June 21, 2005:

	Millions of yen	Thousands of U.S. dollars
	Year-end cash dividends (¥4.5=U.S.\$0.042 per share)	¥393
Bonuses to directors and statutory auditors	35	326

**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, 2005 and 2004, 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, 2005 and 2004, 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.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2005 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 21, 2005

Management

As of June 21, 2005

Board of Directors

*President and Representative Director,
Chief Executive Officer*

Toshikazu Takisawa

Senior Managing Directors

Shiro Hayashi

Kiyotaka Kurokawa

Director (external)

Minoru Kawashima

Corporate Auditors

Standing Auditor

Yasushi Rakuma

Auditors

Yoshiaki Mori

Mamoru Ueda (external)

Keishiro Nakagami (external)

Corporate Executive Officers

Senior Executive Officers

Robert Lo

Keiji Kato

Teruyoshi Joya

Haruka Hayashi

Hiroshi Hamada

Kenichi Kobayashi

Masaaki Kumada

Executive Officers

Takemi Shizawa

Tatsuzo Otsuka

Hiroyuki Kuroda

Toshio Teramura

Hideki Tanaka

Yoshimasa Masuda

Corporate Directory

Nippon Valqua Industries, Ltd.

As of March 31, 2005

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%	Manufacturing of metal products
Valqua Seal Solutions Co., Ltd.	Nara, Japan	¥90 million	100.0%	Manufacturing of rubber products and fiber products
Valqua Materials Co., Ltd.	Kagoshima, Japan	¥50 million	100.0%	Manufacturing of fiber products
Vans Co., Ltd.	Kanagawa, Japan	¥60 million	100.0%	Manufacturing 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%	Manufacturing of rubber products
Valqua Elastomer, Ltd.	Fukushima, Japan	¥25 million	100.0%	Manufacturing 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%	Manufacturing of rubber products
Valqua ACL Co., Ltd.	Tokyo, Japan	¥13 million	60.0%	Manufacturing of resin products (including fluid control devices)
Valqua Seal Products (Shanghai) Co., Ltd.	Shanghai, P.R.C	¥762 million	100.0%	Manufacturing of fiber products
Valqua Industries (Thailand), Ltd.	Samutprakarn, Thailand	B72,373 thousand	93.8%	Manufacturing of fiber products and metal products
Shanghai Valqua Fluorocarbon Products Co., Ltd.	Shanghai, P.R.C	¥500 million	70.0%	Manufacturing 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%	Manufacturing 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:				
PT.Indofacing Indonesia	East Java, Indonesia	Rp3,878 million	39.0%	Manufacturing of fiber products

Corporate Information

As of March 31, 2005

CORPORATE DATA

Name:

Nippon Valqua Industries, Ltd.

Head Office:

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1-1, Nishishinjuku 2-chome
Shinjuku-ku, Tokyo 163-0406, Japan
Telephone: 81 (3) 5325-3421
Facsimile: 81 (3) 5325-3436
<http://www.valqua.co.jp/>

Established:

January 21, 1927

Paid-in Capital:

¥13,268 million

Common Stock:

Authorized: 340,000,000 shares
Issued: 87,753,668 shares

Number of Shareholders:

13,725

Number of Employees:

365 (1,266 on a consolidated basis)

Branches:

Tokyo, Osaka

Global Network:

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Songjiang Export Processing Zone
Shanghai, People's Republic of China
Telephone: 86-21-5774-9766
Facsimile: 86-21-5774-9765

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Facsimile: 82-2-786-6719

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Facsimile: 86-21-5308-2478

Valqua Singapore Pte Ltd.

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Facsimile: 65-6352-2653

PT.Indofacing Indonesia

JL. Raya Banjar Sugihan No. 7
Tandes-Surabaya
East Java, Indonesia
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Facsimile: 62-31-740-5549

FJV Korea, Ltd.

39-5, Yusan-dong
Yangsan-city, Kyungnam
Korea
Telephone: 82-523-387-9351
Facsimile: 82-523-387-9304

INVESTOR INFORMATION

Stock Exchange Listing:

First Section of Tokyo Stock Exchange
(Securities code: 7995)

Fiscal Year-End:

March 31

Annual Shareholders' Meeting:

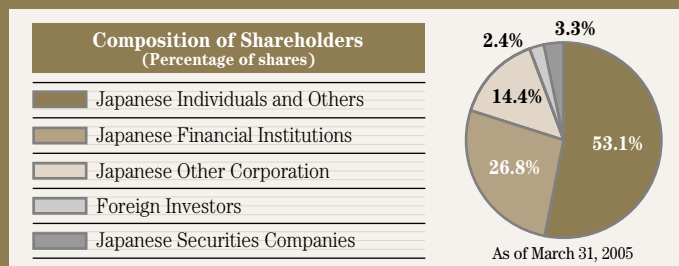
Held every June, in Tokyo

Transfer Agent:

The Sumitomo Trust & Banking Co., Ltd.
Stock Transfer Agency Division
4-4, Marunouchi 1-chome, Chiyoda-ku,
Tokyo 100-8233, Japan

Auditor:

Ernst & Young ShinNihon



Major Shareholders:

Shareholders	Share Held (Thousands)	Percentage of Total (%)
Japan Trustee Services Bank, Ltd. (Trust Account)	4,549	5.18
Sumitomo Mitsui Banking Corporation	2,689	3.06
The Master Trust Bank of Japan, Ltd. (Trust Account)	2,528	2.88
The Sumitomo Trust & Banking Co., Ltd.	2,000	2.28
Toshikazu Takisawa	1,633	1.86

(As of March 31, 2005)



NIPPON VALQUA INDUSTRIES, LTD.

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