

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OVERVIEW

During the fiscal year ended March 31, 2007 (FY Mar/07), the world economy was solid overall, despite some negative factors, including sharp increases in the price of crude oil in the first half of the period and a downturn in the U.S. housing market in the second half. The pace of growth in the U.S. economy slowed due to a decline in housing investment, but showed a firm trend overall, driven by personal consumption. Economies in Europe continued to recover in general, while Asian economies, led by China, continued expanding. Despite lack of strength in the household sector, the Japanese economy remained on a path of growth, albeit moderate, thanks to strength in the corporate sector.

Amid these conditions, Toray (the "Company") and its Group companies worked hard to achieve targets outlined under Project NT-II, its mid-term management reform program that began in April 2004. In October 2006, we launched our new mid-term business strategies, called Project Innovation TORAY 2010, which calls for even higher targets. Guided by the program and strategies, the Group strove exhaustively to expand operations and earnings by reinforcing its corporate structure and implementing business structure reforms. As a result of these efforts, revenue and earnings increased year-on-year. Toray Group achieved record-high figures for net sales (fourth consecutive year), operating income (third consecutive year), as well as net income (second consecutive year). Moreover, operating income exceeded ¥100 billion, a target set for early achievement under Project NT-II.

## INCOME ANALYSIS

### Net Sales

Consolidated net sales in FY Mar/07 amounted to ¥1,546.5 billion, up ¥119.0 billion, or 8.3%, from the previous fiscal year. Sales increased in all business segments.

### Sales by Business Segment

#### Fibers and Textiles

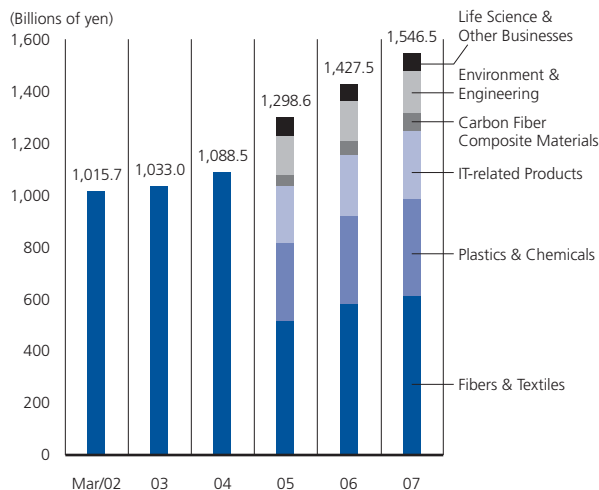
Total segment sales grew ¥27.2 billion, or 4.7%, to ¥607.8 billion.

Regarding the Company and its domestic consolidated subsidiaries, nylon fiber sales increased, driven by demand for use in woven fabric for apparel and carpet applications. Despite continued downturn trends in demand for filament yarn, sales of *Tetoron*\* polyester fiber were solid, backed by strong textile exports to Europe and North America, as well as firm demand for staple fiber in automotive applications. We also posted increased sales of *Toraylon*\* acrylic fiber, *Ecsaine*\* man-made suede and high-performance fibers, as well as increased sales from its garment businesses. In addition, special demand from the uniform business contributed to growth in overall sales of the Company and its domestic consolidated subsidiaries in this segment.

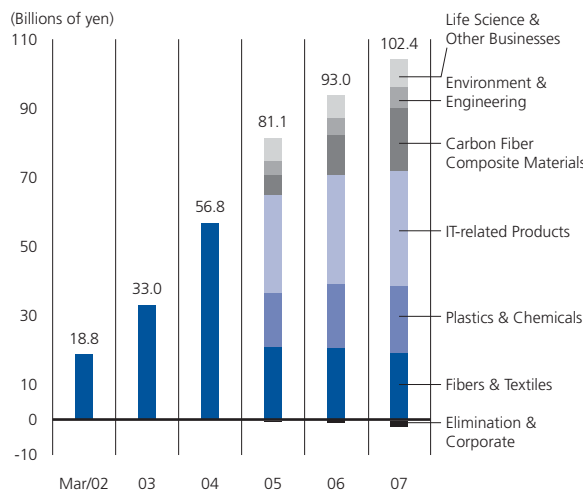
Overall sales of overseas consolidated subsidiaries in this segment also rose. Contributing factors included increased sales from the polypropylene spunbond operations in Korea, nylon fiber operations for airbag applications in Thailand, and filament yarn textile operations in China. During the period, the Group also commenced cotton-blended polyester textile operations in China.

In response to the steep rise in raw materials and fuel prices worldwide, we worked to transfer cost increases on to the selling prices.

Net Sales by Business Segment



Operating Income by Business Segment



\* Net sales and operating income by the reclassified business segment are only available for fiscal year ended March 31, 2005 onward.

**Plastics and Chemicals**

Total segment sales climbed ¥37.3 billion, or 11.0%, to ¥375.3 billion.

Overall sales in the Group's plastic resins business increased. Sales of the Group's engineering plastic resins grew steadily thanks to strong growth in demand for *Amilan*\* nylon resin, *Toraycon*\* PBT resin, *Torelina*\* PPS resin and other engineering plastics used mainly in automotive applications. We also recorded robust sales of *Toyolac*\* ABS resin, both in Japan and overseas. Steady expansion of our resin compound business in China also contributed to overall sales growth in this business.

Overall sales of our films business increased. Sales of the mainstay *Lumirror*\* polyester film continued to advance, reflecting strong demand in industrial applications both in Japan and overseas. Sales of *Torayfan*\* polypropylene film also expanded steadily thanks to applications in capacitors for hybrid cars, as well as packaging applications in overseas markets.

Sales from the chemicals business increased, owing mainly to the Group's efforts to expand sales of fine chemicals, such as xylene isomerization catalysts and *Thiokol LP*\* liquid polysulfide polymer used as a sealant.

In this business as well, we responded to the steep rises in raw materials and fuel prices worldwide by transferring cost increases on to our sales prices.

**IT-related Products**

Total segment sales grew ¥28.8 billion, or 12.3%, to ¥263.8 billion.

Sales in the IT-related plastics and films business increased, boosted by efforts to expand sales for such applications as flat panel displays and digital home electrical/electronic appliances.

The electronic materials business generated an increase in sales owing to growth in demand for polyimide coatings and printing materials, as well as higher sales of plasma-display-related materials.

Sales in the LCD materials business declined amid intensified competition, both in Japan and overseas, stemming from price declines for small and medium-sized LCD panels.

**Carbon Fiber Composite Materials**

Total sales in this segment jumped ¥15.9 billion, or 30.1%, to ¥68.6 billion.

Sales of carbon fiber *Torayca*\* and *Torayca*\* prepreg (carbon fiber sheets impregnated with epoxy resin) expanded strongly,

spurred by rapid growth in demand in aircraft applications, such as for the Boeing B787. Our carbon fiber business also benefited from a sharp increase in demand for applications in sports, such as golf shafts, fishing rods and high-end bicycles, as well as in civil engineering and other industrial applications, notably CNG tanks for natural gas vehicles. Sales of carbon fiber molded products (composites) also grew robustly in the IT devices field, such as for PC chassis, and in the industrial machinery field.

**Environment and Engineering**

Total segment sales rose ¥7.2 billion, or 4.7%, to ¥161.3 billion.

The water treatment business benefited from solid sales of the reverse osmosis membrane element *Romembra*\* in the Middle East and Europe. Our Japanese subsidiary in the construction business also reported increased revenue.

**Life Science and Other Businesses**

Total segment sales grew ¥2.6 billion, or 3.9%, to ¥69.7 billion.

In the pharmaceuticals and medical products business, we reported an overall increase in sales despite difficult conditions, characterized by intensified competition and sales price declines stemming from the reduction of National Health Insurance (NHI) drug prices and prices reimbursement. In response, we expanded sales of such products as artificial kidneys, dialysis devices and *Toraymyxin*\*, a blood purification device for treating septicemia. Revenues from licensing also increased.

**Sales by Geographic Segment**

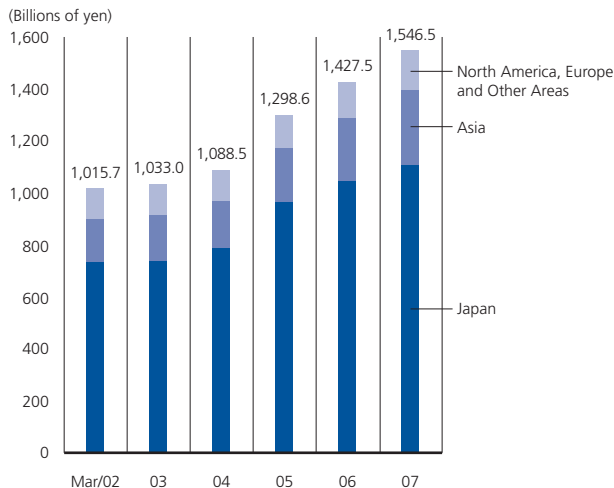
**Japan**

Sales of the Company and its domestic consolidated subsidiaries grew ¥61.6 billion, or 5.9%, to ¥1,104.9 billion, thanks mainly to increased revenues generated in the plastics and chemicals business and the IT-related products business. The share of this segment in consolidated net sales declined from 73.1% to 71.4%.

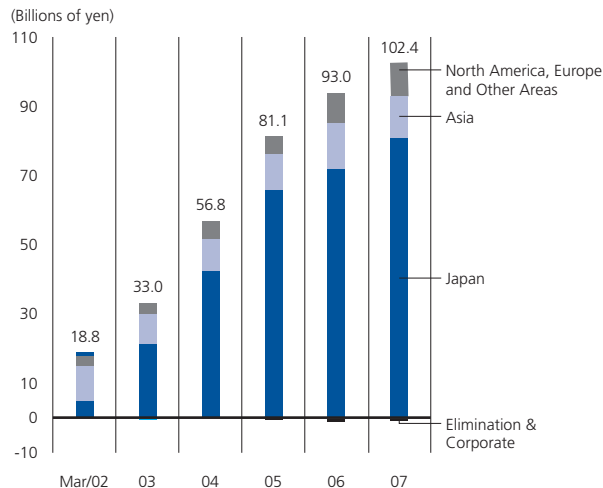
**Asia**

Sales of consolidated subsidiaries in China, Indonesia, Thailand, Malaysia, Korea and other Asian countries, excluding Japan, climbed ¥44.9 billion, or 18.3%, to ¥290.6 billion. This was attrib-

**Net Sales by Geographic Segment**



**Operating Income by Geographic Segment**



utable to growth in sales in Southeast Asia of fibers and textiles, as well as plastic resins, together with expansion of our IT-related films business in Korea. Sales of this segment accounted for 18.8% of consolidated net sales, up from 17.2%.

### **North America, Europe and Other Areas**

Sales of consolidated subsidiaries in the United States, United Kingdom, France, Italy, the Czech Republic and other countries in North America, Europe and other areas grew ¥12.4 billion, or 9.0%, to ¥151.0 billion. This was largely due to favorable growth of our carbon fiber composite materials business in response to growing demand, as well as increased production in the business by subsidiaries in the United States. The share of this segment in consolidated net sales edged up from 9.7% to 9.8%.

### **Overseas Sales**

Overseas sales, which included export sales of the Company and its domestic consolidated subsidiaries and sales (other than exports to Japan) of the overseas consolidated subsidiaries, grew ¥70.6 billion, or 12.0%, to ¥660.3 billion. Sales in Asia increased owing mainly to solid demand for fibers and textiles, as well as plastic resins, in Southeast Asia, as well as good performance by our IT-related films business in Korea. Sales in North America, Europe and other areas also increased, thanks to higher exports from Japan, as well as expansion of our carbon fiber composite materials business in Europe and the United States. Overseas sales accounted for 42.7% of consolidated net sales, up 1.4 percentage points year-on-year. Of this, sales in Asia amounted to ¥422.3 billion, or 27.3% of consolidated net sales, while sales in North America, Europe and other areas totaled ¥238.1 billion, or 15.4%.

### **Costs and Expenses**

The ratio of total costs and expenses to net sales for the year was 93.4%, down 0.1 percentage point from the previous fiscal year. Consolidated net sales grew 8.3%, and the cost of sales increased 8.6%. As a result, the cost of sales ratio edged up 0.2 percentage points, to 79.0%.

Selling, general and administrative expenses increased ¥12.4 billion, or 5.9%, to ¥222.6 billion. The ratio of selling, general and administrative expenses to net sales was down 0.3 percentage points, to 14.4%.

### **Operating Income and Net Income**

Operating income grew ¥9.4 billion, or 10.1%, to ¥102.4 billion from the previous fiscal year. Operating income to net sales edged up 0.1 percentage point to 6.6%. Operating income increased in the Plastics and Chemicals, IT-related Products, Carbon Fiber Composite Materials, Environment and Engineering, and Life Science and Other Businesses segments. However, the Fibers and Textiles segment posted a decline.

Operating income in the Fibers and Textiles segment declined ¥1.5 billion, or 7.0%, to ¥19.2 billion, due to the impact of high raw materials and fuel prices. Operating income in the Plastics and Chemicals segment grew ¥0.7 billion, or 4.0%, to ¥19.2 billion, largely due to the strong growth of sales in plastic resins business, mainly for automotive applications, as well as higher sales of fine chemical products. Operating income in the IT-related Products segment increased ¥2.2 billion, or 7.0%, to ¥33.5 billion, thanks to

healthy growth in sales of films for flat-panel displays, films for electronic components and materials related to plasma displays and semiconductors. Our IT-related equipments subsidiary in Japan also posted improved earnings. In the Carbon Fiber Composite Materials segment, operating income jumped ¥6.3 billion, or 53.0%, to ¥18.1 billion as the Group worked to expand sales mainly for aircraft, sports and industrial applications. Segment income also benefited from higher sales as expansion of manufacturing facilities led to increased production. In the Environment and Engineering segment, operating income grew ¥1.0 billion, or 21.0%, to ¥6.0 billion, owing mainly to solid performance in our water treatment and construction businesses. In the Life Science and Other Businesses segment, operating income grew ¥1.7 billion, or 26.3%, to ¥8.2 billion, thanks to sales expansion and higher licensing revenues in the pharmaceuticals and medical products business.

By geographic segment, operating income increased in Japan and North America, Europe and other areas, but declined in Asia. In Japan, operating income grew ¥9.0 billion, or 12.5%, to ¥80.7 billion, primarily as a result of higher profit from the plastics and chemicals and carbon fiber composite materials businesses. In Asia, operating income fell ¥1.4 billion, or 10.2%, to ¥12.1 billion. This was due mainly to a decline in profits from the fibers and textiles business stemming from high prices of raw materials and fuel. In North America, Europe and other areas, operating income grew ¥1.3 billion, or 15.4%, to ¥9.8 billion, largely due to growth in the carbon fiber composite materials business in Europe and the United States.

In net other income (expenses), the Group reported ¥20.7 billion in expenses, up ¥8.0 billion year-on-year. Interest and dividend income rose ¥0.7 billion to ¥3.2 billion, while interest expense grew ¥1.9 billion to ¥9.8 billion. As a result, net financial expenses increased ¥1.2 billion to ¥6.6 billion. Equity in earnings of unconsolidated subsidiaries and affiliated companies increased ¥2.1 billion over the previous fiscal year to ¥8.3 billion. Loss on impairment of fixed assets increased ¥13.1 billion to ¥14.9 billion, and gain on sales and loss on write-down of investment securities, net, came to a gain of ¥8.1 billion, an increase of ¥4.6 billion from the previous fiscal year.

As a result, income before income taxes and minority interests grew ¥1.4 billion to ¥81.7 billion. Net income rose ¥11.2 billion to ¥58.6 billion, after deducting income taxes and minority interests in earnings of consolidated subsidiaries. Net income per share rose ¥8.12 to ¥41.84. The Company declared a year-end cash dividend of ¥5.00 per share, taking into account its earnings performance in FY Mar/07 and the outlook for FY Mar/08. Added to the interim cash dividend, this brought total annual dividends to ¥10.00 per share, up ¥2.00 from the previous year.

## FINANCIAL POSITION

### Assets

At March 31, 2007, total assets stood at ¥1,674.4 billion, up ¥137.0 billion, or 8.9%, from the end of the previous fiscal year. This was mainly the result of increases in trade receivables (total of notes and accounts receivable), inventories and property, plant and equipment. Overseas assets accounted for 30.7% of total assets, up 2.8 percentage points.

### Current Assets

Current assets grew ¥65.2 billion, or 9.9%, to ¥727.5 billion. Liquid assets, including cash, time deposits and short-term investment securities, decreased ¥14.9 billion, or 17.1%, to ¥72.2 billion. Trade receivables increased ¥31.5 billion, or 12.2%, to ¥288.9 billion. Inventories increased ¥38.6 billion, or 14.6%, to ¥302.9 billion.

### Property, Plant and Equipment

Property, plant and equipment, net, increased ¥57.2 billion, or 9.7%, to ¥643.4 billion. Capital expenditures rose ¥22.3 billion, or 21.4%, to ¥126.4 billion, based on the policy of investing selectively in prospective growth areas while streamlining and modernizing production facilities to enhance production efficiency.

In the Fibers and Textiles segment, capital expenditures totaled ¥23.4 billion and included establishment and expansion of power generation facilities at P.T. Easterntex and P.T. Indonesia Toray Synthetics. In the Plastics and Chemicals segment, capital expenditures amounted to ¥29.3 billion, which included additional ABS resin facilities at Toray Plastics (Malaysia) Sdn. Berhad. Capital expenditures in the IT-related Products segment totaled ¥31.2 billion and included additional TAB and COF tape production facilities at STEMCO, Ltd., as well as additional film processing facilities for electronic circuits at Toray Saehan Inc. In the Carbon Fibers Composite Materials segment, capital expenditures totaled ¥36.0 billion, which included additional carbon fiber production facilities at the Company and Société des Fibres de Carbone S.A. In the Environment and Engineering segment, capital expenditures amounted to ¥4.5 billion, while in the Life Science and Other Businesses segment, capital expenditures totaled ¥3.8 billion.

### Liabilities

Total liabilities rose ¥78.1 billion, or 8.2%, to ¥1,024.8 billion, due mainly to the issuance of corporate bonds.

Total interest-bearing liabilities — consisting of short-term bank loans, current portion of long-term debt, commercial paper and long-term debt — grew ¥52.5 billion, or 10.8%, to ¥536.9 billion.

### Net Assets

Net assets came to ¥649.7 billion and net assets less minority interests in consolidated subsidiaries stood at ¥590.0 billion. As a result, net assets per share rose ¥38.09 to ¥421.51. The equity ratio grew 0.3 percentage points to 35.2%, and the debt/equity ratio edged up 0.01 point to 0.91.

## CASH FLOWS

In FY Mar/07, net cash used in investing activities exceeded net cash provided by operating activities by ¥46.6 billion. This was mainly due to capital expenditures exceeding depreciation and amortization, as well as increases in trade receivables and inventories. Net cash provided by financing activities, such as proceeds from bond issuances, was ¥30.3 billion. As a result, cash and cash equivalents at the fiscal year-end stood at ¥72.1 billion, down ¥14.9 billion from the end of the previous fiscal year.

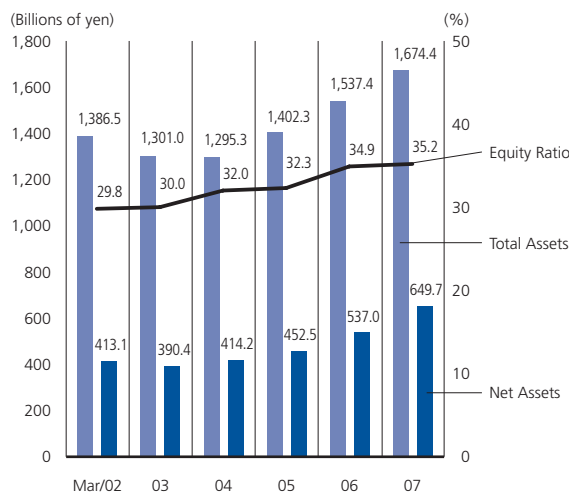
### Cash Flows from Operating Activities

Net cash provided by operating activities amounted to ¥77.5 billion, down ¥38.5 billion from the previous fiscal year. This was due to income before income taxes and minority interests of ¥81.7 billion, depreciation and amortization of ¥72.7 billion, increase in trade receivables of ¥23.5 billion, increase in inventories of ¥32.1 billion, and income taxes paid of ¥20.9 billion led to lower cash flows.

### Cash Flows from Investing Activities

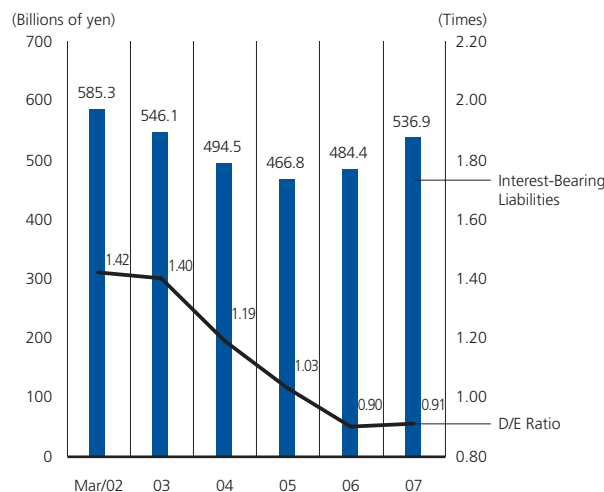
Net cash used in investing activities totaled ¥124.1 billion, down ¥1.6 billion. This stemmed from proceeds from sales of investment securities of ¥11.0 billion, capital expenditures totaled ¥123.4 billion and purchases of investment securities ¥11.6 billion.

**Total Assets and Net Assets**



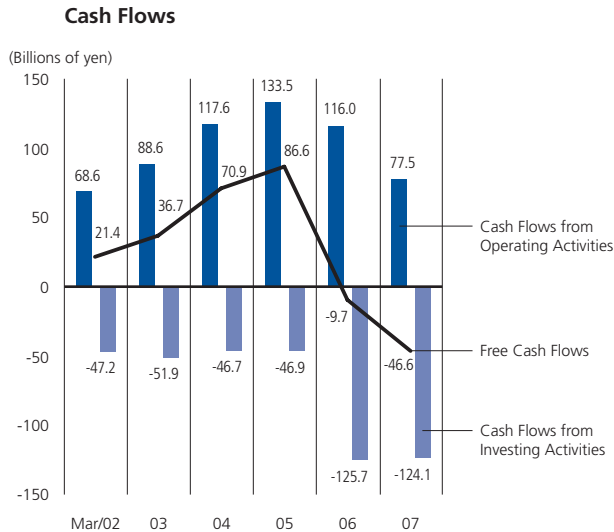
\* By adoption of new accounting standard for presentation of net assets, "minority interests in consolidated subsidiaries" and "net deferred gains on hedges" are included in net assets for the year ended March 31, 2007.

**Interest-Bearing Liabilities and D/E Ratio**



**Cash Flows from Financing Activities**

Net cash provided by financing activities was ¥30.3 billion, up ¥35.3 billion. This was the result of proceeds from long-term debt of ¥129.5 billion, net decrease in short-term debt of ¥39.2 billion, repayment of long-term debt totaling ¥46.4 billion, and cash dividends paid of ¥14.0 billion.



**BUSINESS RISKS**

Operational and other risks faced by Toray Group that could have a major influence on the decisions of investors are described below. Toray Group works constantly to avoid such potential risks, minimize the impact, and build a system to enable swift responses and accurate information disclosure on the occurrence of unforeseen situations.

Please note that the risks described below are those identified by Toray Group when this annual report was produced, and do not represent all the operational and other risks that could affect Toray Group.

**(1) Domestic and overseas demand and market trends**

Toray Group's major products include items for which demand could suddenly decline due to worldwide supply-demand conditions, as well as items subject to significant price fluctuations. Price fluctuations, stemming from the reduction of National Health Insurance (NHI) drug prices and reimbursement prices, also affect the pharmaceuticals and medical products businesses. A decline in demand for, or falling prices of, such items could have a negative impact on Toray Group's results of operations and financial conditions.

**(2) Foreign currency exchange rate fluctuations**

Foreign currency exchange rate fluctuations affect Toray Group's consolidated financial statements when the financial statements of the overseas operations presented in local currencies are translated into yen. Toray Group takes measures, such as entering forward exchange contracts, to alleviate risks associated with transactions denominated in foreign currencies. However, unforeseen exchange rate fluctuations could have an impact on Toray Group's results of operations and financial conditions.

**(3) Rising prices of fuel and raw materials**

The prices of petrochemical raw materials and fuel used by Toray Group are subject to significant fluctuations. If Toray Group is unable to fully pass the increases in such prices on to its product prices, or cannot raise its product prices due to lack of progress in shifting to high value-added products, its results of operations and financial conditions could be negatively affected.

**(4) Overseas operations**

Toray Group is developing a broad geographical presence, with operations in various countries of Asia, Europe, and the Americas. Some of the major potential risks associated with various regions are summarized below. If such risks were to become reality, Toray Group's results of operations and financial conditions could be negatively affected.

- Unforeseen introduction, changes or abolition of laws and regulations such as changes in taxation system
- Unforeseen economic or political events
- Social upheaval, including acts of terror or war

**(5) Product liability**

Toray Group strives to supply the world's best-in-class products quality. However, it cannot always guarantee against a major unforeseen quality problem. If quality-related serious situations were to occur, Toray Group's results of operations and financial conditions could be negatively affected.

**(6) Lawsuit**

In the course of conducting its wide range of business activities, Toray Group faces the risk of being targeted by legal action pertaining to various matters such as intellectual property, product liability, environment, and labor issues. If Toray Group were subject to a major lawsuit, its results of operations and financial conditions could be negatively affected.

**(7) Laws and regulations**

Various laws and regulations apply in the countries and regions where Toray Group conducts its business. In addition to investment approval protocols and import / export controls, these laws and regulations include regulations related to environment, commercial trading, labor, intellectual property, taxation, and foreign exchange. Any changes in such laws and regulations could affect Toray Group's results of operations and financial conditions.

**(8) Natural disasters and accidents**

Toray Group places top priority on safety, accident prevention, and environmental preservation. To minimize losses caused by suspension of production, Toray Group conducts regular accident prevention inspections, and maintenance of its manufacturing facilities, and safety activities. However, the advent of a major natural disaster or unprecedented accident could cause damage to Toray Group's manufacturing facilities, which could have a negative impact on its results of operations and financial conditions.