



Consolidated Financial Statements

for the years ended 31 March 1999, 2000 and 2001

CHUGOKU MARINE PAINTS, LTD.

Report of Independent Certified Public Accountants

The Board of Directors
Chugoku Marine Paints, Ltd.

We have audited the accompanying consolidated balance sheets of Chugoku Marine Paints, Ltd. and its subsidiaries as of 31 March 2000 and 2001, and the related consolidated statements of income and shareholders' equity for each of the three years in the period ended 31 March 2001 and the statements of cash flows for the years ended 31 March 2000 and 2001, all expressed in Japanese Yen. Our audits were made in accordance with auditing standards, procedures and practices generally accepted and applied in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the consolidated financial position of Chugoku Marine Paints, Ltd. and its subsidiaries as of 31 March 2000 and 2001, and the consolidated results of their operations for each of the three years in the period ended 31 March 2001 and their cash flows for the years ended 31 March 2000 and 2001 in conformity with accounting principles and practices generally accepted in Japan (see Note 1) applied on a consistent basis.

As described in Note 2, effective for the year ended 31 March 2001, Chugoku Marine Paints, Ltd. and its subsidiaries have adopted new Japanese accounting standards for retirement benefits and financial instruments, and revised Japanese accounting standard for foreign currency translation.

The amounts expressed in U.S. dollars, which are provided solely for the convenience of the readers, have been translated on the basis set forth in Note 3 to the accompanying consolidated financial statements.

ChuoAoyama Audit Corporation

Hiroshima, Japan
28 June 2001

CHUGOKU MARINE PAINTS, LTD. AND ITS SUBSIDIARIES

Consolidated Balance Sheets
31 March 2000 and 2001

	Millions of Yen		Thousands of U.S. Dollars (Note 3)		Millions of Yen		Thousands of U.S. Dollars (Note 3)
	2000	2001	2001		2000	2001	2001
ASSETS				LIABILITIES AND SHAREHOLDERS' EQUITY			
Current Assets:				Current Liabilities:			
Cash on hand and in banks	¥ 7,650	¥ 6,208	\$ 50,064	Short-term loans (Note 7)	¥ 18,304	¥ 19,880	\$ 160,323
Short-term investments (Note 4)	295	-	-	Current portion of long-term debt (Note 7)	2,141	1,128	9,097
Trade notes and accounts receivable	14,514	17,241	139,040	Notes and accounts payable:			
Less, allowance for doubtful accounts	(471)	(359)	(2,895)	Trade	8,893	10,023	80,831
	14,043	16,882	136,145	Other	1,542	1,711	13,798
Inventories (Note 5)	7,794	8,759	70,637		10,435	11,734	94,629
Deferred income taxes (Note 12)	501	509	4,105	Income taxes payable (Note 12)	194	319	2,572
Other current assets	453	665	5,363	Deferred income taxes (Note 12)	66	89	718
Total current assets	30,736	33,023	266,314	Other current liabilities	1,396	1,156	9,322
				Total current liabilities	32,536	34,306	276,661
Investments and Advances:				Long-term Debt (Note 7)	4,158	3,979	32,089
Investments in securities (Notes 4 and 7)	9,868	8,199	66,121	Accrued Severance Indemnities (Note 8)	272	481	3,879
Investments in affiliates	6	12	97	Deferred Income Taxes on Revaluation of Land	2,242	2,284	18,420
Other	51	35	282	Deferred Income Taxes (Note 12)	245	140	1,129
	9,925	8,246	66,500	Other Liabilities	16	113	911
				Total liabilities	39,469	41,303	333,089
Property, Plant and Equipment (Note 8) :				Minority Interests in Consolidated Subsidiaries	629	544	4,387
Buildings and structures	11,915	12,562	101,307	Contingencies (Note 9)			
Machinery, equipment and vehicles	9,297	9,738	78,532	Shareholders' Equity (Note 11) :			
Tools, furniture and fixtures	2,621	2,665	21,492	Common stock, ¥50 (\$0.40) per value:			
	23,833	24,965	201,331	Authorized:			
Less, accumulated depreciation	(14,999)	(15,911)	(128,315)	31 March 2000-287,161,000 shares			
	8,834	9,054	73,016	31 March 2001-283,304,000 shares			
Land	14,265	14,363	115,831	Issued:			
Construction in progress	577	18	145	31 March 2000- 78,599,822 shares	11,626	-	-
	23,676	23,435	188,992	31 March 2001- 74,742,822 shares	-	11,626	93,758
Deferred Income Taxes (Note 12)	194	277	2,234	Additional paid-in capital	10,160	9,278	74,823
Other Assets	2,084	1,176	9,484	Retained earnings	7,943	5,786	46,661
				Foreign currency translation adjustments	(3,212)	(2,380)	(19,194)
	¥ 66,615	¥ 66,157	\$ 533,524	Total shareholders' equity	26,517	24,310	196,048
					¥ 66,615	¥ 66,157	\$ 533,524

The accompanying notes are an integral part of these statements.

CHUGOKU MARINE PAINTS, LTD. AND ITS SUBSIDIARIES

Consolidated Statements of Income
For the years ended 31 March 1999, 2000 and 2001

	Millions of Yen			Thousands of U.S. Dollars (Note 3)
	1999	2000	2001	2001
	¥	¥	¥	\$
Net sales	42,293	41,890	45,822	369,532
Cost of sales	27,009	27,059	30,597	246,750
Gross profit	15,284	14,831	15,225	122,782
Selling, general and administrative expenses	12,797	12,677	13,117	105,782
Income from operations	2,487	2,154	2,108	17,000
Other income/(expenses):				
Interest and dividend income	240	222	197	1,589
Interest expense	(703)	(633)	(679)	(5,476)
(Loss) gain on sales of short-term investments and investment in securities, net	(190)	26	13	105
Gain (loss) on sales of property, plant and equipment, net	1	359	(42)	(339)
Write-downs of short-term investments and investments in securities	(2,400)	(389)	(2,063)	(16,637)
Equity in earnings of affiliates	231	1	5	40
Foreign currency exchange loss, net	(400)	(14)	(68)	(548)
Royalty income	148	50	35	282
Past service costs for pension plan	(126)	(126)	-	-
Provision for allowance for doubtful accounts	(105)	-	(512)	(4,129)
Write-downs of membership rights	-	-	(213)	(1,718)
Other, net	128	(182)	33	266
	<u>(3,176)</u>	<u>(686)</u>	<u>(3,294)</u>	<u>(26,565)</u>
(Loss) income before income taxes and minority interests	(689)	1,468	(1,186)	(9,565)
Income taxes (Note 12) :				
Current	403	367	425	3,427
Deferred	-	(135)	(186)	(1,500)
	<u>403</u>	<u>232</u>	<u>239</u>	<u>1,927</u>
(Loss) income before minority interests	<u>(1,092)</u>	<u>1,236</u>	<u>(1,425)</u>	<u>(11,492)</u>
Minority interests in losses (earnings) of consolidated subsidiaries	1	(95)	(130)	(1,048)
Net (loss) income	<u>¥ (1,091)</u>	<u>¥ 1,141</u>	<u>¥ (1,555)</u>	<u>\$ (12,540)</u>
				U.S. Dollars (Note 3)
				Yen
Per share amounts :				
Net (loss) income:				
Basic	¥ (13.74)	¥ 14.39	¥ (20.28)	\$ (0.16)
Diluted	-	-	-	-
Cash dividends declared	6.5	6.5	4.0	0.03
Weighted average number of shares (in thousands)	79,439	79,304	76,672	

The accompanying notes are an integral part of these statements.

CHUGOKU MARINE PAINTS, LTD. AND ITS SUBSIDIARIES

**Consolidated Statements of Shareholders' Equity
For the years ended 31 March 1999, 2000 and 2001**

Millions of Yen

(Number of shares of common stock - thousand)	Common stock	Additional paid-in capital	Retained earnings	Foreign currency translation adjustments
Balance, 31 March 1998 (79,439)	¥ 11,626	¥ 10,160	¥ 5,292	¥ (548)
Net loss	-	-	(1,091)	-
Cash dividends	-	-	(259)	-
Special bonuses for employees in Shang-hai	-	-	(2)	-
Foreign currency translation adjustments	-	-	-	(1,126)
Balance, 31 March 1999 (79,439)	11,626	10,160	3,940	(1,674)
Net income	-	-	1,141	-
Cash dividends	-	-	(516)	-
Cumulative effect of adopting deferred tax accounting at 1 April, 1999	-	-	440	-
Unrealised gain on revaluation of land	-	-	3,213	-
Retirement of treasury stock (839)	-	-	(186)	-
Retained earnings of subsidiaries liquidated	-	-	(89)	-
Foreign currency translation adjustments	-	-	-	(1,538)
Balance, 31 March 2000 (78,600)	11,626	10,160	7,943	(3,212)
Net loss	-	-	(1,555)	-
Cash dividends	-	-	(511)	-
Unrealised gain on revaluation of land	-	-	27	-
Retirement of treasury stock (3,857)	-	(882)	-	-
Retained earnings of subsidiaries liquidated	-	-	(118)	-
Foreign currency translation adjustments	-	-	-	832
Balance, 31 March 2001 (74,743)	¥ 11,626	¥ 9,278	¥ 5,786	¥ (2,380)

Thousands of U.S. Dollars (Note 3)

	Common stock	Additional paid-in capital	Retained earnings	Foreign currency translation adjustments
Balance, 31 March 2000	\$ 93,758	\$ 81,936	\$ 64,056	\$ (25,903)
Net loss	-	-	(12,540)	-
Cash dividends	-	-	(4,121)	-
Unrealised gain on revaluation of land	-	-	218	-
Retirement of treasury stock	-	(7,113)	-	-
Retained earnings of subsidiaries liquidated	-	-	(952)	-
Foreign currency translation adjustments	-	-	-	6,709
Balance, 31 March 2001	\$ 93,758	\$ 74,823	\$ 46,661	\$ (19,194)

CHUGOKU MARINE PAINTS, LTD. AND ITS SUBSIDIARIES

Consolidated Statement of Cash Flows For the years ended 31 March 2000 and 2001

	Millions of Yen		Thousands of U.S. Dollars (Note3)
	2000	2001	
Cash Flows from Operating Activities:			
Income (loss) before income taxes and minority interests	¥ 1,468	¥ (1,186)	\$ (9,565)
Depreciation and amortisation	1,175	1,255	10,121
(Decrease) increase in allowance for doubtful accounts	(135)	642	5,178
Increase in retirement allowance	107	208	1,677
Interest and dividend income	(222)	(197)	(1,589)
Interest expense	633	679	5,476
Foreign currency exchange loss (gain), net	26	(123)	(992)
Write-downs of short-term investments and investments in securities	389	2,063	16,637
Write-downs of membership rights	-	213	1,718
(Gain) loss on sales of property, plant and equipment, net	(359)	42	339
Increase in trade notes and accounts receivable	(605)	(1,776)	(14,323)
Increase in inventories	(366)	(669)	(5,395)
Increase in trade notes and accounts payable	1,836	662	5,339
Other, net	(433)	(213)	(1,718)
Sub total	3,514	1,600	12,903
Interest and divided income received	212	204	1,645
Interest expense paid	(577)	(680)	(5,484)
Income taxes paid	(413)	(356)	(2,871)
Net cash provided by operating activities	2,736	768	6,193
Cash Flows from Investing Activities:			
Withdrawal of time deposits	245	408	3,290
Proceeds from sales of securities	114	-	-
Payments for purchases of investments in securities	(69)	(118)	(951)
Payments for purchases of property, plant and equipment	(1,431)	(1,040)	(8,387)
Proceeds from sales of property, plant and equipment	500	368	2,968
Other, net	27	(75)	(605)
Net cash used in investing activities	(614)	(457)	(3,685)
Cash Flows from Financing Activities:			
(Decrease) increase in short-term loans	(641)	1,117	9,008
Additions to long-term debt	500	1,000	8,065
Repayment of long-term debt	(1,003)	(2,192)	(17,677)
Contribution from minority shareholders	102	-	-
Cash dividends	(516)	(511)	(4,121)
Payment for purchases of treasury stock	(186)	(883)	(7,121)
Other, net	(46)	(35)	(282)
Net cash used in financing activities	(1,790)	(1,504)	(12,129)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(332)	105	847
Net decrease in cash and cash equivalents	-	(1,088)	(8,774)
Cash and Cash Equivalents of Newly Consolidated Subsidiaries	246	-	-
Cash and Cash Equivalents at Beginning of Year	6,849	7,095	57,218
Cash and Cash Equivalents at End of Year	¥ 7,095	¥ 6,007	\$ 48,444

The accompanying notes are an integral part of this statement.

CHUGOKU MARINE PAINTS, LTD. AND ITS SUBSIDIARIES

Notes to Consolidated Financial Statements

1. Basis of Presentation of Consolidated Financial Statements

The accompanying consolidated financial statements have been prepared based on the accounts maintained by Chugoku Marine Paints, Ltd. (the “Company”) and its subsidiaries in accordance with the provisions set forth in the Commercial Code of Japan and the Securities and Exchange Law, and in conformity with accounting principles and practices generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Accounting Standards.

Certain items presented in the consolidated financial statements submitted to the Director of Kanto Finance Bureau in Japan have been reclassified in these accounts for the convenience of readers outside Japan.

The consolidated financial statements are not intended to present the consolidated financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

Consolidated statements of cash flows were required to be prepared with effect for the years ended 31 March 2000 and 2001 in accordance with a new accounting standard.

2. Summary of Significant Accounting Policies

(1) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and all of its subsidiaries (collectively referred to as the “Companies”). All significant inter-company accounts and transactions are eliminated in consolidation.

The Company had 35 and 30 subsidiaries as at 31 March 2000 and 2001, respectively. Chugoku Paints (Singapore) Pte., Ltd. and Chugoku Marine Paints (U.S.A), Inc. have been excluded from consolidation as these companies were liquidated. Shinyu Co., Ltd., Shinko Co., Ltd. and Chugoku America Holdings, Inc. were merged into Ohtake Meishin Chemical Co., Ltd., CMP Planning Co., Ltd. and CMP Coatings, Inc., respectively.

The Company follows the method to value the entire portion of assets and liabilities of consolidated subsidiaries at fair market values at the time of acquiring controls over those companies.

Any difference between the cost of an investment in a subsidiary and the amount of underlying equity in net assets is treated as an asset or a liability, whichever is applicable, and amortised over a period of five years on a straight-line basis.

CHUGOKU MARINE PAINTS, LTD. AND ITS SUBSIDIARIES

Notes to Consolidated Financial Statements

The fiscal year-ends of subsidiaries are 31 December, except for Kobe Paints Co., Ltd., which have its year-end at 31 March. For consolidation purpose, the Company uses financial statements of these subsidiaries as of and for the year ended 31 December with necessary consolidation adjustments to reflect any significant transactions occurred between 31 December and 31 March, except for significant two subsidiaries, Chugoku Marine Sales, Ltd. and Chugoku Paint Industries Sales, Ltd., which tentatively close their accounts as at 31 March for consolidation purpose.

The Company accounts for its 50% or less owned affiliate by equity method. The Company has an affiliate (Chugoku-Jenson & Nicholson Ltd.) which has its fiscal year-end at 31 December. The equity method of accounting has been applied to the financial statements of this affiliate as of and for the year ended 31 December for consolidation purpose.

(2) Cash and Cash Equivalents

Cash and cash equivalents in the consolidated statement of cash flows are composed of cash on hand, bank deposits withdrawn on demand, and short-term investments with an original maturity of three months or less and which are readily convertible to cash and represent a minor risk of fluctuation in value.

(3) Translation of Foreign Currencies

Until the year ended 31 March 2000, the Companies translated non-current receivables denominated in foreign currencies at the historical exchange rates prevailing at the transaction dates.

Effective from the year ended 31 March 2001, the Companies adopted the revised Japanese accounting standard for foreign currency translation, which is effective for the periods beginning on or after 1 April 2000. Under the revised standard, all monetary assets and liabilities denominated in foreign currencies, whether long-term or short-term, are translated into Japanese yen at the exchange rates prevailing at the balance sheet date and resulting gains and losses are included in the determination of net income. The effects of this change were to decrease loss before income taxes and minority interests by ¥28 million (\$226 thousand) for the year ended 31 March 2001, as compared with the amount which would have been reported if the previous standard had been applied consistently.

Assets and liabilities of foreign consolidated subsidiaries and an affiliate accounted for by the equity method are translated into Japanese yen at the exchange rates in effect at the respective balance sheet dates. Translation adjustments result from the process of translating foreign currency financial statements into Japanese yen. These translation adjustments, which are not included in the determination of net income, are reported separately as a component of shareholders' equity.

(4) Short-term investments and Investments in Securities

Held-to-maturity securities are stated at amortised cost adjusted for the amortisation of premiums and the accretion of discounts to maturity.

CHUGOKU MARINE PAINTS, LTD. AND ITS SUBSIDIARIES

Notes to Consolidated Financial Statements

Other securities, both quoted and non-quoted, are stated at cost, which is determined by the moving-average method.

Effective 1 April 2000, the Companies adopted the new accounting standard for financial instruments and changed their valuation method of securities. As a result, held-to-maturity securities, which were previously carried at cost being determined by the moving-average method, are recorded at amortised cost.

The Companies reconsidered the holding purposes of securities outstanding at 1 April 2000 and reclassified securities from short-term investments in current assets to investments in securities in non-current assets. As a result of this reclassification, short-term investments decreased and investment in securities increased by ¥295 million (\$2,379 thousand).

(5) Derivatives

All derivatives are stated at fair value, with changes in fair value included in net profit or loss for the period in which they arise.

Effective 1 April 2000, the Company adopted the new Japanese accounting standard for financial instruments and changed its method of accounting for derivatives.

(6) Allowance for doubtful accounts

Allowance for doubtful accounts is provided in preparation for possible risk of uncorrectable accounts. The balance of the allowance for the general account is established by multiplying the year-end balance of general accounts by the historical bad debt ratio. In addition, the Companies specifically identify individual accounts, which have a concern of bad debt risk, and provide the allowance at the amount deemed to be uncorrectable.

Effective 1 April 2000, the Companies adopted the new Japanese accounting standard for financial instruments, and changed its method of providing allowance for doubtful accounts and of accounting for golf membership rights.

(7) Inventories

Inventories are stated at cost, which is determined by the moving-average method, except for certain subsidiaries that value inventories at the lower of cost or market, cost being determined by the first-in first-out method.

(8) Property, Plant and Equipment and Depreciation

The Company and its domestic subsidiaries provide for depreciation of “buildings and structures”, “machinery, equipment and vehicles” and “tools, furniture and fixtures” on the declining-balance method at rates based on their estimated useful lives prescribed by the Japanese tax laws, except for buildings (excluding building improvement) acquired on or after 1 April 1998 which are depreciated by the straight-line method. Overseas subsidiaries provide for depreciation of property, plant and equipment over their estimated useful lives primarily on the straight-line method.

CHUGOKU MARINE PAINTS, LTD. AND ITS SUBSIDIARIES

Notes to Consolidated Financial Statements

The range of useful lives is summarised as follows:

Buildings and structures	7 - 50 years
Machinery equipment and vehicles	4 - 17 years
Tools, furniture and fixtures	2 - 10 years

Normal repairs and maintenance, including minor renewals and improvements, are charged to income as incurred.

Effective 31 March 2000, the Company revalued its land used for operations in accordance with the Law Concerning the Revaluation of Land (the Law No. 34 promulgated on 31 March 1998 which was partially amended on 31 March 1999). The revaluation was made based on the value used for property tax levy with reasonable adjustments in accordance with the Article 2-3 of the enforcement ordinance of the Law No. 34. The result of the revaluation was as follows:

	Millions of yen	Thousands of U.S. Dollars
Carrying amount of land after revaluation	¥ 13,843	\$ 111,637
Carrying amount of land before revaluation	8,388	67,645
Revaluation difference	¥ 5,455	\$ 43,992

The tax effect of the revaluation difference is recorded as deferred income taxes on revaluation of land (non-current liability) and the remaining after-tax amount is credited to retained earnings. The fair value of the revalued land at 31 March 2001 was ¥1,379 million (\$11,121 thousand) lower than the carrying amount of land after revaluation.

Two overseas subsidiaries revalued their lands in accordance with local regulations and accounting standards. The revaluation resulted in the revaluation gain of ¥69 million (\$556 thousand) of which tax effect of ¥9 million (\$72 thousand) was included in deferred income taxes on revaluation of land and the remaining after-tax amount of ¥60 million (\$484 thousand) was credited to retained earnings.

(9) Intangible Assets

Intangible assets, included in other assets, are amortized on a straight-line basis over the period regulated by the Japanese tax laws, except for computer software for internal use which is amortized on a straight-line basis over the estimated useful lives (three to five years).

(10) Deferred Assets

Deferred Assets are amortised over the five-year period on a straight-line basis.

(11) Leases

Finance leases other than those, which are deemed to transfer the ownership of the leased assets to lessees, are accounted for by the method similar to that applicable to ordinary operating leases.

CHUGOKU MARINE PAINTS, LTD. AND ITS SUBSIDIARIES

Notes to Consolidated Financial Statements

(12) Accrued Bonuses

Certain subsidiaries provide for accrued bonuses based on the amount estimated to be paid.

(13) Retirement benefit Plans

The Companies, excluding certain overseas subsidiaries, provides for accrued severance indemnities in preparation for payments of retirement benefits to employees at an amount of projected benefit obligation attributed to the services rendered by the end of year reduced by pension plan assets at fair value at the end of year.

The Company has adopted a funded defined benefit plan covering all of its employees. Subsidiaries, excluding certain overseas subsidiaries, have adopted funded and/or unfunded defined benefit plans. In addition, the Companies may occasionally pay supplementary benefits to retired employees.

Effective 1 April 2000, the Companies adopted the new Japanese accounting standard for retirement benefits. The net transition obligation of ¥1,297 million (\$10,460 thousand) at date of the adoption is amortised on a straight-line basis over 15 years. Actuarial gains or losses are amortised on a straight-line basis over 10 years from the next year in which they arise. Until the year ended 31 March 2000, the Companies charged their contributions to the funded plans against income as incurred and/or provided for liabilities at 100% of amount that would be required to pay if all employees voluntarily retired at the balance sheet date. The effects of this change were to increase pension and severance costs by ¥69 million (\$556 thousand), to increase operating expenses by ¥196 million (\$1,581 thousand), to decrease other expenses by ¥126 million (\$1,016 thousand) and to decrease loss before income taxes and minority interests by ¥69million (\$556 thousand) for the year ended 31 March 2001, as compared with the amount which would have been reported if the previous standard had been applied consistently.

(14) Product Warranty Costs

Provision for estimated warranty costs is recorded based on the ratio of actual warranty costs incurred for the year against related annual sales amounts.

(15) Income Taxes

Income taxes of the Company and its domestic subsidiaries consist of corporate income taxes, local inhabitant taxes and enterprise tax.

For the year ended 31 March 2000, the Company and its subsidiaries adopted the deferred tax accounting in accordance with the amended regulations for preparation of consolidated financial statements. Deferred income taxes are determined using the asset and liability approach, whereby deferred tax assets and liabilities are recognized in respect of temporary difference between the tax basis of assets and liabilities and those as reported in the financial statements. The cumulative effect of adopting the deferred tax accounting at 1 April 1999 was charged to retained earnings.

CHUGOKU MARINE PAINTS, LTD. AND ITS SUBSIDIARIES

Notes to Consolidated Financial Statements

In the year ended 31 March 1999, income taxes of the Company and its domestic subsidiaries were provided for at an amount currently payable based on the tax returns filed with tax authorities. Also, certain overseas subsidiaries accounted for income taxes on the basis of interperiod allocation whereby tax effects on temporary differences between tax and financial reporting were recognized

(16) Consumption Taxes

The consumption taxes paid and withheld on purchase and sales of goods and services are not included in the amounts of respective cost, expense or revenue in the accompanying consolidated statements of income. Net balance of consumption taxes withheld and paid is included in "other current assets" or "other current liabilities" in the consolidated balance sheets.

(17) Net Income and Cash Dividends Per Share

Basic net income per share of common stock is based on the weighted average number of shares of common stock outstanding during each period. The diluted net income per share for the years ended 31 March 1999, 2000 and 2001 were not presented, as the Company had no dilutive potential common shares.

Cash dividends per share include those declared by the Companies in the respective periods. Dividends are charged to retained earnings in the year in which they are paid.

(18) Accounting Changes

Effective 1 April 2000, the Company adopted the new Japanese accounting standard for financial instruments and changed its method of valuation of securities, of accounting for derivatives, of providing allowance for doubtful accounts and of accounting for golf membership rights. The effects of these changes were to increase loss before income taxes and minority interests by ¥745 million (\$6,008 thousand) for the year ended 31 March 2001, as compared with the amount which would have been reported if the previous standard had been applied consistently.

3. United States Dollar Amounts

Amounts in U.S. dollars are included solely for the convenience of readers outside Japan. The rate of ¥124 = U.S.\$1, the rate of exchange at 30 March 2001, has been used in translation. The inclusion of such amounts is not intended to imply that Japanese yen has been or could be readily converted, realized or settled in U.S. dollars at this rate or any other rate.

CHUGOKU MARINE PAINTS, LTD. AND ITS SUBSIDIARIES

Notes to Consolidated Financial Statements

4. Investments in Debt and Equity Securities

Investments in debt and equity securities at 31 March 2000, which were primarily stated at cost, included in short-term investments (current assets) and investments in securities (non-current assets) are summarised as follows:

	Millions of Yen		
	Carrying value	Market value	Unrealized gain (loss)
Short-term investments:			
Equity securities	¥ 295	¥ 297	¥ 2
Investments in securities:			
Equity securities	9,364	6,941	(2,423)
Debt securities	11	11	-
	<u>9,375</u>	<u>6,952</u>	<u>(2,423)</u>
	<u>¥ 9,670</u>	<u>¥ 7,249</u>	<u>¥ (2,421)</u>

Held-to-maturity debt securities at 31 March 2001, which have readily determinable fair value, are summarised as follows:

	Millions of yen			Thousands of U.S. Dollars		
	Cost	Fair value	Gross unrealised gains (losses)	Cost	Fair value	Gross unrealised gains (losses)
Securities with unrealised holding gains	¥ 8	¥ 8	-	\$ 65	\$ 65	-
Securities with unrealised holding losses	3	3	-	24	24	-
	<u>¥ 11</u>	<u>¥ 11</u>	<u>-</u>	<u>\$ 89</u>	<u>\$ 89</u>	<u>-</u>

All investments in debt securities at 31 March 2001 are due after one year through five years.

5. Inventories

Inventories at 31 March 2000 and 2001 were comprised of the followings:

	Millions of Yen		Thousands of U.S. Dollars
	2000	2001	2001
Finished products	¥ 4,744	¥ 5,070	\$ 40,887
Semi-finished products	224	277	2,234
Raw materials	2,208	2,855	23,024
Work in process	557	470	3,790
Supplies	61	87	702
	<u>¥ 7,794</u>	<u>¥ 8,759</u>	<u>\$ 70,637</u>

CHUGOKU MARINE PAINTS, LTD. AND ITS SUBSIDIARIES

Notes to Consolidated Financial Statements

6. Leases

Pro forma information for property held under finance leases other than those, which are deemed to transfer the ownership of the leased assets to lessees, and other relevant information are summarised below.

(1) Lease transactions as lessee

Finance leases

- a) Pro forma information relating to acquisition cost, accumulated depreciation and net book value on an “as if capitalised” basis at 31 March 2000 and 2001 is as follows:

	Millions of Yen					
	2000			2001		
	Machinery, equipment and vehicles	Tools, furniture and fixtures	Total	Machinery, equipment and vehicles	Tools, furniture and fixtures	Total
Acquisition cost	¥ 109	¥ 700	¥ 809	¥ 57	¥ 539	¥ 596
Accumulated depreciation	76	287	363	37	300	337
Net book value	<u>¥ 33</u>	<u>¥ 413</u>	<u>¥ 446</u>	<u>¥ 20</u>	<u>¥ 239</u>	<u>¥ 259</u>

	Thousands of U.S. Dollars		
Acquisition cost	\$ 460	\$ 4,347	\$ 4,807
Accumulated depreciation	299	2,419	2,718
Net book value	<u>\$ 161</u>	<u>\$ 1,928</u>	<u>\$ 2,089</u>

The pro forma acquisition cost information is calculated at the amount including interest expense portion, as the balance of outstanding future lease payments is immaterial to the year-end balance of property, plant and equipment.

- b) Pro forma information relating to outstanding future lease payments on an “as if capitalised” basis at 31 March 2000 and 2001 is as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2000	2001	2001
Due within one year	¥ 164	¥ 105	\$ 847
Due after one year	282	154	1,242
	<u>¥ 446</u>	<u>¥ 259</u>	<u>\$ 2,089</u>

The pro forma information for the outstanding future lease payments is calculated at the amount including interest expense portion, as the balance of outstanding future lease payments is immaterial to the year-end balance of property, plant and equipment.

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- c) Total lease payments for the years ended 31 March 1999, 2000 and 2001 were ¥202 million, ¥131 million and ¥181 million (\$1,460 thousand), respectively. Depreciation expense, which is not reflected in the accompanying consolidated statements of income, computed by the straight-line method over the lease term with no residual value, would have been the same as the lease payments for the year ended 31 March 1999, 2000 and 2001.

Operating leases

The amounts of outstanding future lease payments for operating lease transactions at 31 March 2000 and 2001 are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2000	2001	2001
Due within one year	¥ 140	¥ 58	\$ 468
Due after one year	516	540	4,355
Total	¥ 656	¥ 598	\$ 4,823

(2) Lease transactions as lessor

- a) Acquisition cost, accumulated depreciation and net book value at 31 March 2000 were ¥66 million, ¥47 million and ¥19 million, respectively.
- b) Pro forma information relating to outstanding future lease payments on an “as if capitalised” basis at 31 March 2000 is as follows:

	Millions of yen
Due within one year	¥ 10
Due after one year	8
	¥ 18

The pro forma information for outstanding future lease payments is calculated at the amount including interest income portion, as the total of outstanding future lease payment balance and estimated residual value balance is immaterial to the year-end balance of trade receivables.

- c) Lease payments received and depreciation expense for the years ended 31 March 1999, 2000 and 2001 are as follows:

	Millions of yen			Thousands of U.S. Dollars
	1999	2000	2001	2001
Lease payments received	¥ 11	¥ 10	¥ 8	\$ 65
Depreciation expense	10	10	8	65

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7. Short-term Loans and Long-term Debt

Short-term loans from banks outstanding at 31 March 2000 and 2001 are primarily represented by 6-month notes issued by the Company to banks, bearing interest generally at annual rates of 0.795% to 6.902% at 31 March 2000 and 0.86 % to 9.5 % at 31 March 2001. Customarily, these notes are renewed at maturity subject to re-negotiation of interest rates and other factors.

Long-term debt at 31 March 2000 and 2001 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2000	2001	2001
Loans form banks and an insurance company			
Due 2001 to 2008 with mortgage and collateral at interest rates indicated below (*1)	¥ 6,299	¥ 5,107	\$ 41,186
Less, portion due within one year	<u>(2,141)</u>	<u>(1,128)</u>	<u>(9,097)</u>
	<u>¥ 4,158</u>	<u>¥ 3,979</u>	<u>\$ 32,089</u>

(*1) Interest rates on loans from banks and an insurance company are within the range as follows:

at 31 March 2000.....2.4 % to 3.3 %

at 31 March 2001.....1.8 % to 3.3 %

The aggregate annual maturities of long-term debt at 31 March 2001 are as follows:

	Millions of Yen	Thousands of U.S. Dollars
Years ending 31 March:		
2003	¥ 2,128	\$ 17,161
2004	836	6,742
2005	5	40
2006	1,003	8,089
2007 and thereafter	7	57
	<u>¥ 3,979</u>	<u>\$ 32,089</u>

The Companies' assets pledged as collateral for long-term debt at 31 March 2001 are summarised as follows:

	Millions of Yen	Thousands of U.S. Dollars
Property, plant and equipment at net book value:		
Land	¥ 1,264	\$ 10,193
Other	1,545	12,460
	<u>2,809</u>	<u>22,653</u>
Investments in securities	5,098	41,113
	<u>¥ 7,907</u>	<u>\$ 63,766</u>

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8. Retirement Benefit Plan

The funded status of the Companies at 31 March 2001 were summarised as follows:

	Millions of Yen	Thousands of U.S. Dollars
Projected benefit obligation	¥ 5,559	\$ 44,831
Unrecognised net actuarial losses	(224)	(1,807)
Unrecognised net transition obligation	(1,211)	(9,766)
Plan assets at fair value	(3,643)	(29,379)
Accrued severance indemnities	¥ 481	\$ 3,879

Pension and severance costs of the Companies included the following components for the year ended 31 March 2001:

	Millions of yen	Thousands of U.S. Dollars
Service cost	¥ 433	\$ 3,492
Interest cost	168	1,355
Expected return on plan assets	(123)	(992)
Amortisation of net transaction obligation	86	693
	¥ 564	\$ 4,548

Pension benefits are attributed to periods of employee service based on years-of-service by the straight-line method.

Assumptions used in the accounting for the defined benefit plans for the year ended 31 March 2001 are as follows:

Discount rate	3.5%
Long-term rate of return on plan assets	3.5%

9. Contingencies

The Companies were contingently liable for outstanding discounted notes of ¥4,088 million (\$32,968 thousand) and endorsed notes of ¥47 million (\$379 thousand) at 31 March 2001.

At 31 March 2001, the Company provided guarantees to an intermediary trading company for ¥930 million (\$7,500 thousand) to assure the collection of its accounts receivable from contracted sales agents/distributors.

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10. Derivative financial instruments

(1) Status of transaction

a) Nature and purpose of transactions

The Companies utilise an interest rate swap transaction to reduce costs for debt financed at a fixed interest rate. The Companies receive interest at a fixed rate and pay interest at a variable rate to convert interest payment of long-term borrowing from fixed-rate basis to variable-rate (LIBOR) basis.

The Companies also utilise a foreign exchange forward contract to reduce risk from exchange rate fluctuation primarily in export sales denominated in U.S. Dollars conducted through ordinary course of operations.

b) Policy to use transactions

The Companies utilise interest-related derivative financial instruments within the limit not exceeding the borrowings, and do not use them for speculative transactions or highly leveraged transactions.

The Companies also utilise foreign-currency-related derivative financial instruments within the limit not exceeding accounts receivable and payable denominated in foreign currency and contracted sales or purchase amounts, and do not use them for speculative transactions.

c) Risks in transactions

Interest-related derivative financial instruments are exposed to risk from market rate fluctuation. Counter parties are highly creditworthy domestic banks and, therefore, the Companies do not expect losses due to non-performance of counter parties.

d) Risk management

Derivative transactions are executed and managed centrally by the Financing Group of the Tokyo Administration Department based on the segregation of duty concept. Significant amount of borrowings and related interest rate swap agreements are subject to resolution of the Board of Directors meeting.

e) Other

The contract or notional amount shown in the “Fair value etc. of transaction” below is not indicative of the quantity of market risk.

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(2) Fair value etc. of transactions

Contract or notional amount, fair value and valuation gain or loss of derivative financial instruments at 31 March 2000 and 2001 are summarised as follows:

	Millions of yen					
	2000			2001		
	Contract or notional amount	Fair value	Valuation gain (loss)	Contract or notional amount	Fair value	Valuation gain (loss)
Foreign currency exchange forward contracts:						
To sell U.S. Dollars	-	-	-	¥ 467	¥ 471	¥ (4)
To buy Singapore Dollars	-	-	-	10	10	-
To buy Japanese yen	-	-	-	15	15	-
Interest rate swap:						
Receipt in fixed rate and payment in variable rate	¥ 1,000	¥ 23	¥ 23	-	-	-
				Thousands of U.S. Dollars		
Foreign currency exchange forward contracts:						
To sell U.S. Dollars				\$ 3,766	\$ 3,798	\$ (32)
To buy Singapore Dollars				81	81	-
To buy Japanese yen				121	121	-

The fair value is quoted from financial institutions with which the Companies make foreign currency exchange forward contracts and interest rate swap contracts.

Excluded from the above disclosure are foreign currency exchange forward contracts relating to receivables and payables denominated in foreign currency of which yen settlement amounts are fixed at the contracted forward rates and are recorded at such amounts in the balance sheets.

11. Shareholders' Equity

Under the Commercial Code of Japan (the "Code"), the entire amount of the issue price of new shares is required to be capitalized as stated capital, although the Company may, by resolution of the Board of Directors, capitalise an amount not exceeding one-half of the issue price of the new shares (subject in all cases, however, to the remainder being not less than the total par value of such new shares) as additional paid-in capital.

The Code provides that an amount equivalent to at least 10% of cash payments for appropriation of retained earnings be appropriated as legal reserve until such reserve equals 25% of stated capital. The legal reserve may be used to reduce a deficit or may be transferred to stated capital through appropriate shareholder and director actions, but is not available for dividend payment.

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Under the Code, the appropriation of retained earnings (including year-end cash dividend payment) proposed by the Board of Directors should be approved at shareholders' meeting, which must be held within three months after the end of each fiscal year. The appropriation of retained earnings reflected in the accompanying consolidated financial statements represents the results of such appropriations applicable to the immediately preceding fiscal year but which were approved at the shareholders' meeting and disposed of during the current year.

As is customary practice in Japan, the payment of bonuses to directors and corporate auditors is made out of retained earnings instead of being charged to income for the year and constitutes a part of the appropriations cited above.

12. Income Taxes

The Companies are subject to a number of different taxes based on income which, in aggregate, result in statutory income tax rates of approximately 41.1% and 41.7% for the years ended 31 March 2000 and 2001, respectively.

Reconciliation of the difference between the statutory income tax rates and the effective income tax rates for the year ended 31 March 2000 and 2001 is as follows:

	2000	2001
Statutory income tax rate	41.1 %	41.7 %
Increase (decrease) in taxes resulting from:		
Difference in statutory income tax rate between parent and subsidiaries	(6.7)	6.0
Entertainment expenses and other which are permanently non tax-deductible	3.8	(3.4)
Dividend income and other which are permanently non taxable	-	2.1
Dividend of retained earnings	-	(25.4)
Tax loss carryforwards incurred / expired	-	(20.6)
Valuation allowance provided on deferred tax assets	(14.0)	(19.6)
Other	(8.4)	(1.0)
Effective income tax rate	<u>15.8 %</u>	<u>(20.2) %</u>

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Significant components of deferred tax assets and liabilities at 31 March 2000 and 2001 are as follows:

	Millions of yen		Thousands of U.S. Dollars
	2000	2001	2001
Deferred tax assets:			
Excess provision for retirement allowance	¥ 69	¥ 146	\$ 1,177
Non tax deductible interest computed on debt for acquiring land	100	-	-
Write-down of short-term investments	79	-	-
Write-down of investments in securities	-	363	2,927
Write-down of membership rights and excess provision for allowance for doubtful accounts	-	295	2,379
Tax loss carryforwards	779	1,036	8,355
Other	394	380	3,065
	1,421	2,220	17,903
Less, valuation allowance	(710)	(1,381)	(11,137)
Total deferred tax assets	711	839	6,766
Deferred tax liabilities:			
Reserve for advanced depreciation	(154)	(121)	(976)
Other	(173)	(161)	(1,298)
Total deferred tax liabilities	(327)	(282)	(2,274)
Net deferred tax assets	¥ (384)	¥ 557	\$ 4,492

13. Segment Information

The Companies primarily operate in two industry segments: paint-related business (“Paints”) and other business (“Other”), and three geographic areas “Domestic”, “Asia” and “Other”.

Major products of each industry segment are as follows:

Industry segment	Major products
Paints	Marine paints, Synthetic Resin Paints, Thinner and Other Paints, Contracted Painting Works, Painting Technical Assistance
Other	Rent and Management of Real Estate, Development of Computer Software, Financial Service, Building Security Service

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Geographic Segments

	Millions of Yen											
	1999						2000					
	Domestic	Asia (c)	Other (d)	Total	Elimination or Corporate	Consolidated	Domestic	Asia (c)	Other (d)	Total	Elimination or Corporate	Consolidated
Net sales:												
External sales	¥ 27,166	¥ 9,988	¥ 5,139	¥ 42,293	-	¥ 42,293	¥ 28,507	¥ 9,749	¥ 3,634	¥ 41,890	-	¥ 41,890
Intersegment sales or transfer	1,194	1,454	261	2,909	¥ (2,909)	-	1,116	1,786	238	3,140	¥ (3,140)	-
Total	28,360	11,442	5,400	45,202	(2,909)	42,293	29,623	11,535	3,872	45,030	(3,140)	41,890
Operating expenses (a)	26,368	9,970	5,441	41,779	(1,973)	39,806	27,213	10,613	3,960	41,786	(2,050)	39,736
Income (loss) from operations	¥ 1,992	¥ 1,472	¥ (41)	¥ 3,423	¥ (936)	¥ 2,487	¥ 2,410	¥ 922	¥ (88)	¥ 3,244	¥ (1,090)	¥ 2,154
Assets (b)	¥ 42,037	¥ 16,224	¥ 5,436	¥ 63,697	¥ (1,280)	¥ 62,417	¥ 47,885	¥ 17,418	¥ 4,849	¥ 70,152	¥ (325)	¥ 69,827
	2001											
	Millions of Yen						Thousands of U.S. Dollars					
Net sales:												
External sales	¥ 29,485	¥ 12,471	¥ 3,866	¥ 45,822	-	¥ 45,822	\$ 237,782	\$ 100,573	\$ 31,177	\$ 369,532	-	\$ 369,532
Intersegment sales or transfer	1,402	1,575	458	3,435	¥ (3,435)	-	11,307	12,701	3,694	27,702	\$ (27,702)	-
Total	30,887	14,046	4,324	49,257	(3,435)	45,822	249,089	113,274	34,871	397,234	(27,702)	369,532
Operating expenses (a)	28,931	13,343	4,325	46,599	(2,885)	43,714	233,315	107,605	34,879	375,799	(23,267)	352,532
Income (loss) from operations	¥ 1,956	¥ 703	¥ (1)	¥ 2,658	¥ (550)	¥ 2,108	\$ 15,774	\$ 5,669	\$ (8)	\$ 21,435	\$ (4,435)	\$ 17,000
Assets (b)	¥ 49,121	¥ 17,462	¥ 4,064	¥ 70,647	¥ (4,490)	¥ 66,157	\$ 396,137	\$ 140,823	\$ 32,774	\$ 569,734	\$ (36,210)	\$ 533,524

(a) Expenses which are not attributable to any geographic segments represent primarily expenses incurred at the Company's administration department and included in "Elimination or Corporate" column. Such expenses amounted to ¥1,046 million, ¥1,053 million and ¥988 million (\$7,968 thousand) for the years ended 31 March 1999, 2000 and 2001, respectively.

(b) Corporate assets, which are included in "Elimination or Corporate" column, are comprised primarily of cash, short-term investments and investments in securities held by the Company and other assets held at its administration department. Balances of those assets were ¥12,677 million, ¥13,623 million and ¥9,524 million (\$76,806 thousand) at 31 March 1999, 2000 and 2001, respectively. Foreign currency translation adjustments are not included in corporate assets at 31 March 2001, as they are presented in shareholders' equity at 31 March 2001 while they were presented in assets at 31 March 1999 and 2000 in the consolidated balance sheets.

(c) Primarily included are China, Singapore, Hong Kong, Korea, Taiwan, Thailand, Malaysia, Indonesia and Oceania.

(d) Primarily included are Netherlands and U.S.A.

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As described in “(13) Retirement Benefit Plans” of “2. Summary of Significant Accounting Policies”, effective 1 April 2000, the Companies adopted the new Japanese accounting standard for retirement benefits and changed its method of providing accrued severance indemnities. The effects of this change on income from operations presented in the industry segment and geographic segment information are as follows:

	Millions of yen						
	Industry segment			Geographic segment			
	Paints	Other	Total	Domestic	Asia	Other	Total
Increase in pension and severance costs	¥ 196	-	¥ 196	¥ 196	-	-	¥ 196
Income from operations which would have been reported if the previous standard had been applied consistently	2,940	¥ 351	3,291	2,152	¥ 703	¥ (1)	2,854
	Thousands of U.S. Dollars						
Increase in pension and severance costs	\$ 1,581	-	\$ 1,581	\$ 1,581	-	-	\$ 1,581
Income from operations which would have been reported if the previous standard had been applied consistently	23,710	\$ 2,830	26,540	17,355	\$ 5,669	\$ (8)	23,016

Overseas and export sales for the years ended 31 March 1999, 2000 and 2001 are summarised as follows:

	Millions of Yen			Thousands of U.S. Dollars
	1999	2000	2001	2001
Overseas and export sales:				
Asia	¥ 10,075	¥ 9,940	¥ 12,528	\$ 101,032
Other	5,163	3,592	3,863	31,153
	<u>¥ 15,238</u>	<u>¥ 13,532</u>	<u>¥ 16,391</u>	<u>\$ 132,185</u>
Consolidated net sales	¥ 42,293	¥ 41,890	¥ 45,822	\$ 369,532
Percentage of overseas and export sales to consolidated net sales:				
Asia	23.8%	23.7%	27.3%	
Other	12.2	8.6	8.4	
	<u>36.0%</u>	<u>32.3%</u>	<u>35.8%</u>	

Overseas and export sales represent the total amount of export sales of the Company and domestic subsidiaries and sales of the overseas subsidiaries

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14. Supplementary Cash Flow Information

Cash and cash equivalents at 31 March 2000 and 2001 consisted of the following:

	Millions of yen		Thousands of
	2000	2001	U.S. Dollars
Cash on hand and in banks	¥ 7,650	¥ 6,208	\$ 50,064
Less, time deposits with deposit term of over three months	(555)	(201)	(1,620)
Cash and cash equivalents	¥ 7,095	¥ 6,007	\$ 48,444

15. Reclassification

Certain reclassifications of previously reported amounts have been made to the consolidated balance sheet at 31 March 2000 and the consolidated statements of income and cash flows for the year then ended to conform to the current year presentation. Such reclassifications have no effect on net assets, net income and cash flows.