

Operating Results and Financial Position

(1) Operating Results

1. Overview

The Japanese economy followed a steady recovery trend during the period under review, as evidenced by improving corporate earnings, rising capital investment, and a steady undertone in consumer spending. Overseas, meanwhile, economic growth continued in the East Asian economies, particularly China, and the U.S. economy also posted favorable figures.

In the steel industry, the TNSC Group's biggest single customer segment, demand for steel held firm, notably from automotive and shipbuilding companies, as well as from machinery manufacturers in response to the brisk pace of private-sector capital investment. Simultaneously, steel smelters completed their reduction of inventories of certain product categories: performance as a whole was thus favorable.

In the chemical industry, another of the Group's main customer segments, manufacturers were hit by high prices of raw materials, but demand from East Asian countries, notably China, continued to expand, and the business environment as a whole improved steadily in line with our projections.

In the electronics industry, despite a worsening of the oversupply situation in certain product categories in the first half of the reporting period, user demand recovered in the second half as consumer spending turned upward, and the industry was also buoyed by a number of positive factors including rising sales of flat-panel screen TVs, and the upcoming start of

terrestrial digital broadcasting for mobile terminals from April 2006. Thanks to these factors, demand as a whole saw an upturn.

Amid this situation, Taiyo Nippon Sanso Corporation took a number of steps to realize the targets set at the time of merger of the two founding companies. Specifically, in overseas developments, we pushed ahead with our production capacity expansion plan for California (an area where we had purchased sales rights from Air Liquide, Inc. in 2004) through the construction of a new plant. In growing markets like China and Vietnam, we invested aggressively in subsidiaries and affiliates for the establishment of new marketing offices, as well as in increasing our production capacity at existing plants.

In the Japanese market, we took measures to speed up the reorganization of our domestic operations so as to realize the benefits of the merger as soon as possible. We amalgamated three medical gas sales companies to create Nippon Megacare Corporation. To restructure and unify the Group's carbon dioxide business, Group members Nippon Tansan Company, Limited and Ekika Carbon Dioxide Co., Ltd. jointly set up a holding company under the name of Japan Liquid Carbonics Holding Co., Ltd., which will act as the holding company for the two founding enterprises.

We decided on a plan to integrate Group-member LPG sales companies that operate within the same geographical areas under the single brand name of Taiyo Nissan Energy, and began by putting this into practice in Kyushu.

To further strengthen our core industrial gases business, we acquired Nippoku Sanso K.K. in Hokkaido and Hitachi Oxygen Co., Ltd. in the northern Kanto region.

As a result of the above, the Group's gases business followed a firm trend, while sales of machinery and equipment were also brisk. As a consequence, total sales on a consolidated basis for the reporting period came to ¥397,308 million. A higher capacity utilization rate in gas production equipment during the reporting term helped to reduce costs per production unit, and earnings on a consolidated basis also benefited from a strong contribution by subsidiaries such as Matheson Tri-Gas, Inc., whose business performance improved in line with our expectations. As a result, operating profit came to ¥26,788 million, and recurring profit amounted to ¥27,115 million. Profits on the sale of idle landholdings were registered as extraordinary profit in the category of gains on the sale of property, plant and equipment, but as a result of the recording of impairment losses as extraordinary losses, net income for the reporting period was held down to ¥14,444 million.

2. Breakdown of Performance by Division

Gas Business

Both sales and shipment volumes of our mainstay products – oxygen, nitrogen, and argon – were largely strong, thanks to higher capacity utilization rates in our principal customer industries. Shipments of liquefied oxygen to the steel and shipbuilding industries recorded favorable levels. Nitrogen sales volume was also firm, including supply via small-scale on-site plants for our customers in the electronics industry, and shipments of liquefied nitrogen to customers in a wide range of industries, including chemicals, steel, and foodstuff processing. Growth was recorded in shipments of argon to manufacturers of

microcrystalline silicon, who enjoyed brisk shipments of 300mm silicon wafers, while a year-on-year increase in demand for argon for use in welding was also seen in a wide variety of industrial fields. Sales were at a high level in terms both of value and volume. Sales of specialty gases were good, thanks to a growth in demand in the United States and East Asia, among other markets.

As a result of the above, sales of the Gas Business (excluding intra-Group transactions) came to ¥268,284 million, while operating profit for this business amounted to ¥21,494 million.

Machinery & Equipment Business

Sales of electronic equipment and materials posted a favorable trend, with the largest portion of demand coming from the electronics industry, our main customer segment, thanks to increased capital investment. On the other hand, sales of manufacturing equipment for compound semiconductors declined, owing to the scaling-down of capital investment plans by semiconductor chip makers.

In air separation plants, sales were strong thanks to continued healthy capital investment levels by Japanese electronics companies and steel makers, while in overseas business, too, the Group received a brisk inflow of orders from Korean and Taiwanese steel and petrochemical companies for large air separation units. As a result, total sales of air separation plants during the reporting term were favorable. Sales of cutting and welding equipment were at a high level as a result of high capacity utilization rates in user industries such as steel smelting, shipbuilding, and construction machinery. Laser cutting

equipment and NC cutters were in particularly strong demand on both the Japanese and overseas markets.

As a result, sales of plants and equipment (excluding intra-Group transactions) came to ¥113,626 million, while operating profit was ¥5,901 million.

Housewares Business

Demand for the Company's housewares products, which are manufactured and sold primarily by Thermos K.K., was strong during the term under review. This was largely thanks to continued good sales of sports-use insulated flasks, as well as good sales of autumn and winter goods such as our Lunch Jar, stimulated by the particularly cold weather toward the end of 2005.

As a result, sales of the Housewares Business (excluding intra-Group transactions) amounted to ¥15,397 million, with operating profit at ¥1,859 million.

Supplementary Information

Year-on-year comparisons

Taiyo Nippon Sanso came into being on October 1, 2004 as a result of a merger between Taiyo Toyo Sanso Co., Ltd. and Nippon Sanso Corporation. As the latter was the surviving entity, the consolidated business results for the full year ended March 31, 2005 do not include the results for Taiyo Toyo Sanso for the first half of the year (from April 1, 2004 to September 30, 2004). If the results for Taiyo Toyo Sanso for the first half of the year were added, the full-year results would be sales of

¥364,953 million, operating profit of ¥23,790 million, recurring profit of ¥24,347 million, and net income of ¥13,422 million.

(¥ million)

	FY2005	FY2004 (pro forma basis)	Increase	YoY percentage change
Sales	397,308	364,953	32,354	8.9%
Operating profit	26,788	23,790	2,997	12.6%
Recurring profit	27,115	24,347	2,768	11.4%
Net income	14,444	13,422	1,022	7.6%

For fiscal 2004 (the previous term ended March 2005), transactions between the two founding companies (and their group companies) during the first-half period are eliminated for calculation of consolidated figures on a pro forma basis.

Year-on-year comparison by segment

(¥ million)

	FY2005	FY2004	YoY increase/ decrease
Sales (excl. intra-Group transactions)	397,308	364,953	32,354
Gases	268,284	251,578	16,706
Machinery & equipment	113,626	97,496	16,129
Others	15,397	15,878	(481)
Operating profit	26,788	23,790	2,997
Gases	21,494	18,496	2,998
Machinery & equipment	5,901	5,943	(41)
Others	1,859	1,938	(78)
Eliminations and corporate	(2,467)	(2,587)	119

3. Forecasts for the Fiscal 2006 Full Term

The outlook for the business environment of the TNSC Group is not entirely bright, in spite of continuing strong production levels in the principal customer industries of steel, chemicals, and electronics, in view of the possible negative impact of rising

prices of raw materials and fuel, and the upward trend of interest rates.

In these circumstances, we aim to take steps to facilitate the realization of maximum synergy from the merger as a means of pushing up earnings.

For the fiscal 2006 full term, we forecast business performance, on a consolidated basis, as follows: sales at ¥430,000 million, recurring profit at ¥30,000 million, and net income at ¥16,000 million. We plan to pay an annual dividend of ¥10 per share.