TOKAI CARBON CO., LTD.

Annual Report 2005

For the Year ended December 31, 2005

Tokai Carbon Co., Ltd., headquartered in Tokyo, Japan, and listed at Tokyo Stock Exchange, is one of the world's major manufacturers of carbon and graphite for diverse applications: Carbon Black, Graphite Electrodes, Fine Carbon products, Friction Materials and Industrial Furnaces and Heating Elements.

Main use of *Carbon Black* is reinforcing agent of industrial rubber products, typically auto tires. Among other important uses are electro-conductive filler and coloring agent for printing ink, paint and plastics. *Graphite Electrodes* function as conductors of electricity that are consumed in an electric furnace in the steel-making process.

Fine Carbon products are a wide variety of specialty graphites which are characterized for excellent electric conductance, high heat resistance, mechanical strength and lubricant ability, and are applied as key parts in the manufacturing processes of electric appliances, semi-conductors, etc.

Friction materials are widely used in clutches and brakes of construction, agricultural, transportation and other industrial machinery. Industrial Furnaces and Heating Elements are manufactured by Tokai Konetsu Kogyo Co., Ltd. (subsidiary and a listed company at Tokyo Stock Exchange) for the purposes of heating, sintering, dissolving and heat-treating such objects as ceramics, electronic parts, metals, glass and powdered materials.

The company is renowned for a pioneer in the carbon industry with 88 years of history, and is recognized as having overall technological expertise and capability in its new product development. The company endeavors to be a forerunner of technological innovation in the rapidly advancing business world and to attain steady growth in its earnings.

CONSOLIDATED FINANCIAL HIGHLIGHTS

	Millions of Yen		Percentage Change	Thousands of U.S. Dollars
Years ended December 31	2005	2004	2005/2004	2005
For the year:				
Net sales	¥ 77,761	¥ 67,035	16.0%	$ 658,601
Operating income	10,778	9,414	14.5	91,285
Income before income taxes and minority interests	9,968	5,426	83.7	84,424
Net income	5,296	2,559	107.0	44,855
At Year-End:				
Total assets	¥149,749	¥124,944	19.9%	$1,268,307
Shareholders' equity	85,817	74,315	15.5	726,832
Per Share Date:	Yen			U.S. Dollars
Net income	¥ 26.20	¥ 12.22	114.4	$ 0.22
Total shareholders' equity	436.11	369.35	18.1	3.69
Cash dividends applicable to the year	6.00	5.00	20.0	0.05

Note: U.S.dollar amounts in this annual report are translated from Japanese yen, for convenience only, at the rate of ¥118.07=US$1, the approximate exchange rate at December 31,2005.

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Forward-Looking Statements
Forward looking statements made in this annual report concerning performance or business strategies have been determined according to assumptions and briefs based on information available at the time of publication and may contain elements of risk and uncertainty.

The Japanese economy during the year under review showed underlying strength, such as increased capital expenditures reflecting improved corporate profits and a gradual recovery in consumer spending, although there were sharp increases in the prices of raw materials including crude oil.

In this economic climate, the Group revised its product selling prices, with the understanding of customers, to accommodate price increases for materials that could not be otherwise absorbed, especially in petroleum oil, coal and coke—key materials for the Group's major product lines, such as carbon black and graphite electrodes. In July 2005, Tokai Carbon acquired ERFTCARBON GmbH of Germany, a company that produced and sold graphite electrodes with the third largest share in the European market. The purchase enabled Tokai Carbon to secure the commercial rights for graphite electrodes in Europe and neighboring nations. Immediately after the purchase, we reorganized and streamlined the businesses of ERFTCARBON according to market circumstances. On the production side, we became the first company in Japan to commercially produce graphite electrodes at a world largest 32 inches (800 mm) in diameter, and shipments have begun to customers in and outside Japan. On the facilities side, we enhanced the domestic production capacity of isostatic graphite—the mainstay of our Fine Carbon products. The production facilities of Tokai Konetsu Kogyo, a Group company, were also reorganized. Overseas, the Group made extensive efforts to meet active demand for carbon black in Asia by nearly completing a new production facility in Tianjin, China, and expanding a plant in Thailand in the year under review. The Group's R&D efforts showed developments in the area of carbon nanotubes as battery materials.

As a result, the Tokai Carbon Group's consolidated net sales increased 16.0% from the previous year to ¥77,761 million, due to brisk demand in the Carbon and Graphite Products segment, despite slower growth in sales of the Industrial Furnaces and Related Products segment. Operating income rose 14.5% to ¥10,778 million, owing to cost-cutting efforts and selling price revisions. Net income soared 107.0% to ¥5,296 million.

Having reorganized its production facilities, Tokai Konetsu Kogyo will be a wholly owned subsidiary of Tokai Carbon effective from July 1, 2006, through a stock-for-stock exchange agreement. The company's "industrial furnace and silicon carbide heating equipment" businesses will then form the fifth core line of business for the Group, and its expansion should accelerate within Japan and internationally.

The Group aims to gain a record-high profit again in fiscal 2006 by achieving continued growth in all product lines. The "T-2009" midterm plan, which starts in fiscal 2007, is expected to reflect an annual sales target of more than ¥100 billion.

The Group will continue to expand the line of businesses and enhance corporate earnings based on a firm footing. Your continued support and cooperation is greatly appreciated.

S. Ohtake

Shikio Ohtake
President

Carbon and Graphite Products

Business Achievements

Consolidated net sales for this segment during the year under review jumped 20.0% from the previous year to ¥70,779 million. Consolidated operating income surged 16.7% to ¥9,837 million, due to our continual cost-cutting measures and price revisions to accommodate soaring raw material prices.

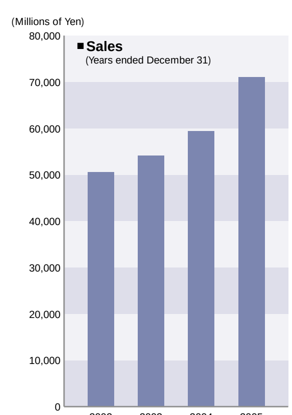
Review of Operations

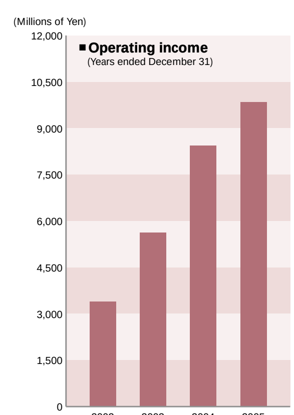
Carbon black enjoyed increased demand due to active production at tire makers—one of the major users of carbon black—in Japan and Thailand, where the Group has an affiliated company. Sales of carbon black increased owing to price revisions to accommodate surging raw material prices.

Graphite electrodes suffered weak domestic demand as a whole, although the specialty steel industry sustained favorable performance throughout the year. However, sales of graphite electrodes increased because of price revisions to absorb significant increases in raw material prices. Depreciation of the yen during the second half of the year under review promoted overseas exports, and the business achievements of recently acquired ERFTCARBON also helped to boost sales of graphite electrodes considerably.

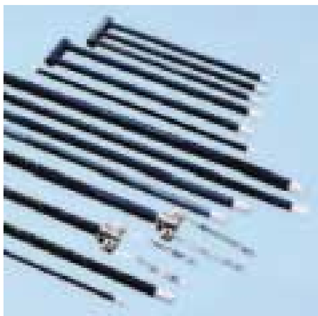
Fine carbon enjoyed increased sales to semiconductor-related customers overseas, especially in the United States and China, as the semiconductor industry—a main user of our fine carbon products—performed well, supported by brisk demand from automobile and information home appliance manufacturers. However, a significant decline in sales of products related to new energy sources resulted in an overall decrease in sales of fine carbon products.

Friction materials experienced sales gains to its major customers: construction machinery makers saw increased demand for mining machinery; agricultural machinery makers enjoyed demand growth due to active new housing starts in North America; and two-wheel vehicle manufacturers saw favorable demand for large-scale vehicles. Thanks also to a slight increase in product shipments from a Group subsidiary, sales of friction materials expanded as a whole.





Industrial Furnaces and Related Products

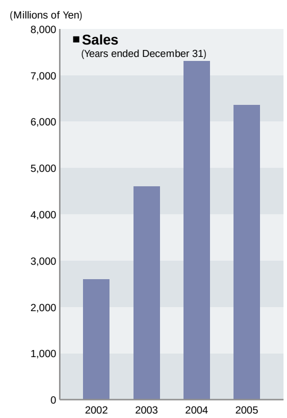


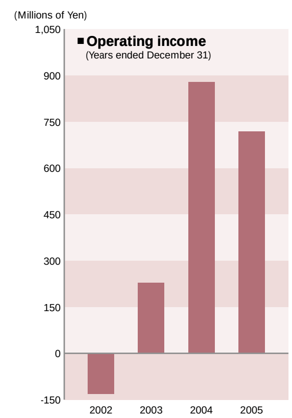
Business Achievements

Consolidated net sales for this segment fell 15.0% to ¥6,159 million, which led to an 18.1% decline in consolidated operating income to ¥719 million.

Review of Operations

Orders for *heating devices* decreased as part of the IT-related industry—the segment's major customer—restrained or postponed capital expenditures to meet intensifying price competition and growing diversity of demand. Sales of *heating elements* also decreased, affected by a temporary fall in production due to the reorganization of production facilities by Tokai Konetsu Kogyo.

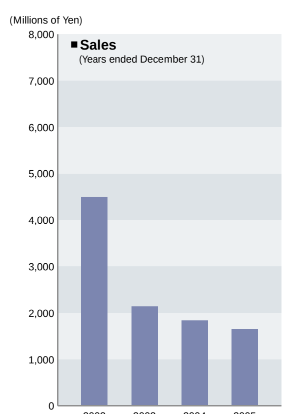


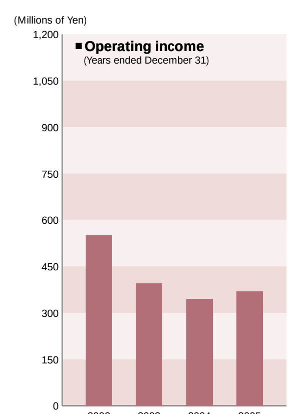


Other Businesses

Business Achievements

The Group's revenue from property leases and other businesses rose 1.3% from the previous year to ¥823 million. Operating income increased 7.0% to ¥369 million.





Board of Directors, Officers and Corporate Auditors

(As of March 30, 2006)

Board of Directors and Executive Officers

President

Shikio Ohtake

Senior Managing Executive Officer

Katsuhiko Namba

Managing Executive Officer

Takashi Takenaka
Kiyonari Nakai
Yoshinari Kudo
Nobuyuki Murofushi

Executive Officer

Hideki Saito
Hajime Nagasaka
Masaru Akiyama

Executive Officers

Executive Vice President

Hiroshi Yamazaki
Tetsuo Okazaki

Managing Executive Officer

Ryouji Murota
Ichiro Fukushima
Kohta Himeno

Executive Officer

Shigeto Mori
Hiroshi Hirama
Masahiro Saeki
Naoshi Takahashi
Yuji Serizawa

Corporate Auditors

Corporate Auditor

Tsunehisa Samukawa
Masahiro Kusaba
Toshio Nakada
Masanobu Dohki

Corporate Governance

Basic Policy for Corporate Governance

The Tokai Carbon Group recognizes that the purposes of managing a corporation should be to enhance the soundness and transparency of business management and ensure continual advancement of corporate value. With a top priority on strengthening corporate governance, we therefore strive to improve our management organization and the function of supervisory management.

Measures for Corporate Governance

Tokai Carbon's basic management policies and strategies are determined by its Board of Directors, which consists of nine directors. Their meetings are usually held once a month and otherwise as necessary to make decisions on matters required by law and important business issues or to share reports on the status of business operations. Since the Company introduced the executive officer system in March 1999, the Board of Directors selects and appoints executive officers who take charge of business operations at different departments of the Company to accelerate operational decision making and clarify responsibilities. The president and managing directors in charge of different business operations constitute the Board of Managing Directors, and it meets monthly to deliberate on managerial matters.

The Company also has the Board of Corporate Auditors, which consists of four auditors, two of which are outside auditors. Corporate auditors are required to conduct a fair and independent audit of the Company's business operations. They attend the meetings of the Board of Directors and the Board of Managing Directors and any other important meetings to oversee directors' decision making and the execution of business, and present their opinions. The meetings of the Board of Corporate Auditors are usually held once a month and otherwise as required.

For enhanced internal control, the Company also has the Auditing Office, which conducts internal audits on the entire business operations of the Group. The results of these audits are reported to the Group's representative directors.

Consolidated Balance Sheets

TOKAI CARBON Co., Ltd. and Consolidated Subsidiaries
December 31, 2005 and 2004

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2005	2004	2005
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	¥ 13,070	¥ 19,177	$ 110,697
Receivables:			
Trade notes and accounts	25,285	23,050	214,153
Unconsolidated subsidiaries and associated companies	1,215	792	10,291
Allowance for doubtful receivables	(66)	(81)	(560)
Inventories (Note 4)	19,743	14,445	167,214
Deferred tax assets (Note 10)	472	1,101	3,998
Prepaid expenses and other current assets	1,630	1,689	13,806
Total current assets	61,349	60,173	519,599
PROPERTY, PLANT AND EQUIPMENT (Notes 5 and 6):			
Land	7,175	7,401	60,769
Buildings and structures	38,805	37,356	328,661
Machinery and equipment	83,899	77,273	710,578
Furniture and fixtures	4,857	4,356	41,146
Construction in progress	6,730	1,612	57,000
Total	141,466	127,998	1,198,154
Accumulated depreciation	(100,657)	(95,327)	(852,520)
Net property, plant and equipment	40,809	32,671	345,634
INVESTMENTS AND OTHER ASSETS:			
Investment securities (Note 3)	42,762	27,562	362,175
Investments in and advances to unconsolidated subsidiaries and associated companies	1,712	1,089	14,500
Consolidation difference	518		4,387
Deferred tax assets (Note 10)	237	340	2,007
Other assets	2,362	3,109	20,005
Total investments and other assets	47,591	32,100	403,074
TOTAL	¥ 149,749	¥124,944	$1,268,307

See notes to consolidated financial statements.

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2005	2004	2005
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Short-term bank loans (Note 5)	¥ 10,869	¥ 7,125	$ 92,056
Current portion of long-term debt (Note 5)	207	416	1,753
Payables:			
Trade notes and accounts	12,142	10,845	102,837
Unconsolidated subsidiaries and associated companies	86	71	729
Income taxes payable	2,337	1,987	19,793
Accrued expenses	2,285	2,023	19,353
Loss contingency liabilities		495	
Other current liabilities	2,978	1,714	25,222
Total current liabilities	30,904	24,676	261,743
LONG-TERM LIABILITIES:			
Long-term debt (Note 5)	10,003	10,357	84,721
Liability for retirement benefits (Note 7)	2,154	966	18,243
Retirement allowances for directors and corporate auditors (Note 8)	382	303	3,235
Deferred tax liabilities (Note 10)	14,341	8,756	121,462
Other	861	848	7,292
Total long-term liabilities	27,741	21,230	234,953
MINORITY INTERESTS	5,287	4,723	44,779
CONTINGENT LIABILITIES (Notes 12 and 14)			
SHAREHOLDERS' EQUITY (Note 9):			
Common stock—authorized, 598,764,000 shares; issued, 204,089,391 shares in 2005 and 2004	15,436	15,436	130,736
Capital surplus—additional paid-in capital	10,876	10,875	92,115
Retained earnings	41,579	37,447	352,156
Net unrealized gain on available-for-sale securities	20,648	11,761	174,879
Foreign currency translation adjustments	424	(142)	3,591
Total	88,963	75,377	753,477
Treasury stock—at cost, 7,493,549 shares in 2005 and 3,083,735 shares in 2004	(3,146)	(1,062)	(26,645)
Total shareholders' equity	85,817	74,315	726,832
TOTAL	¥149,749	¥124,944	$1,268,307

Consolidated Statements of Income

TOKAI CARBON Co., Ltd. and Consolidated Subsidiaries
Years ended December 31, 2005 and 2004

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2005	2004	2005
NET SALES	¥77,761	¥67,035	$658,601
COST OF SALES	54,702	47,308	463,302
Gross profit	23,059	19,727	195,299
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	12,281	10,313	104,014
Operating income	10,778	9,414	91,285
OTHER INCOME (EXPENSES):			
Interest and dividends	287	360	2,431
Interest expense	(515)	(271)	(4,362)
Exchange gain	391	59	3,312
Equity in gains (losses) of associated companies	236	(6)	1,999
Gain on sales of property, plant and equipment	438		3,710
Loss on sales of property, plant and equipment		(999)	
Loss on litigation in Europe	(437)	(1,609)	(3,701)
Impairment loss on long-lived assets (Note 6)	(69)	(1,018)	(584)
Provision for loss contingency liability		(495)	
Restructuring expenses	(976)		(8,266)
Other—net	(165)	(9)	(1,400)
Other expenses—net	(810)	(3,988)	(6,861)
INCOME BEFORE INCOME TAXES AND MINORITY INTERESTS	9,968	5,426	84,424
INCOME TAXES (Note 10):			
Current	3,910	3,286	33,115
Deferred	332	(795)	2,812
Total	4,242	2,491	35,927
MINORITY INTERESTS IN NET INCOME	430	376	3,642
NET INCOME	¥5,296	¥ 2,559	$44,855

	Yen		U.S. Dollars (Note 1)
	2005	2004	2005
PER SHARE OF COMMON STOCK (Notes 2.o and 15):			
Net income	¥26.20	¥12.22	$0.22
Diluted net income	23.85	11.78	0.20
Cash dividends applicable to the year	6.00	5.00	0.05

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

TOKAI CARBON Co., Ltd. and Consolidated Subsidiaries
Years ended December 31, 2005 and 2004

	Thousands	Millions of Yen					
	Issued Number of Shares of Common Stock	Common Stock	Capital Surplus Additional Paid-in Capital	Retained Earnings	Unrealized Gain on Available-for-sale Securities	Foreign Currency Translation Adjustments	Treasury Stock
BALANCE, JANUARY 1, 2004	204,089	¥15,436	¥10,874	¥35,955	¥8,635	¥ 3	¥ (88)
Net income				2,559			
Cash dividends, ¥5.00 per share				(1,018)			
Bonuses to directors				(49)			
Increase in treasury stock (2,662 thousand shares)							(974)
Gain on sales of treasury stock			1				
Net increase in unrealized gain on available-for-sale securities					3,126		
Net decrease in foreign currency translation adjustments						(145)	
BALANCE, DECEMBER 31, 2004	204,089	¥15,436	¥10,875	¥37,447	¥11,761	¥(142)	¥(1,062)
Net income				5,296			
Cash dividends, ¥6.00 per share				(1,099)			
Bonuses to directors				(65)			
Increase in treasury stock (4,409 thousand shares)							(2,084)
Gain on sales of treasury stock			1				
Net increase in unrealized gain on available-for-sale securities					8,887		
Net increase in foreign currency translation adjustments						566	
BALANCE, DECEMBER 31, 2005	204,089	¥15,436	¥10,876	¥41,579	¥20,648	¥ 424	¥(3,146)

	Thousands of U.S. Dollars (Note 1)					
	Common Stock	Capital Surplus Additional Paid-in Capital	Retained Earnings	Unrealized Gain on Available-for-sale Securities	Foreign Currency Translation Adjustments	Treasury Stock
BALANCE, DECEMBER 31, 2004	$130,736	$92,106	$317,159	$ 99,610	$(1,203)	$ (8,995)
Net income			44,855			
Cash dividends, $0.05 per share			(9,308)			
Bonuses to directors			(550)			
Increase in treasury stock						(17,650)
Gain on sales of treasury stock		9				
Net increase in unrealized gain on available-for-sale securities				75,269		
Net increase in foreign currency translation adjustments					4,794	
BALANCE, DECEMBER 31, 2005	$130,736	$92,115	$352,156	$174,879	$ 3,591	$(26,645)

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

TOKAI CARBON Co., Ltd. and Consolidated Subsidiaries
Years ended December 31, 2005 and 2004

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2005	2004	2005
OPERATING ACTIVITIES:			
Income before income taxes and minority interests	¥ 9,968	¥ 5,426	$ 84,424
Adjustments for:			
Income taxes—paid	(3,723)	(3,521)	(31,532)
Depreciation and amortization	4,164	3,618	35,267
Amortization of consolidation differences	511	19	4,328
Decrease in liability for retirement benefits	(209)		(1,770)
Decrease in prepaid expense for pension cost	111	33	940
Increase in loss contingency liability		495	
Exchange loss		44	
Exchange gain	(194)		(1,643)
Equity in (gains) losses of associated companies	(236)	6	(1,999)
Gain on sales of securities		(248)	
Gain on sales of property, plant and equipment	(438)		(3,710)
Loss on litigation in Europe	437	1,609	3,701
Impairment loss on long-lived assets	69	1,018	584
Loss on sales of property, plant and equipment		999	
Loss on sales of subsidiaries securities		133	
Restructuring expenses	976	184	8,266
Decrease (increase) in trade notes and accounts receivable	316	(2,889)	2,676
(Increase) decrease in inventories	(2,189)	132	(18,540)
Increase in notes and accounts payable	784	1,967	6,640
Increase in provisional payment	966	3,209	8,182
Decrease in consumption tax payable	(259)		(2,194)
Decrease in interest and dividend receivables	79	22	669
Increase in interest payable		20	
Payment of a fine to the European Commission	(931)	(1,609)	(7,885)
Payment of settlement payment for civil suit		(424)	
Other—net	(482)	112	(4,080)
Total adjustments	(248)	4,929	(2,100)
Net cash provided by operating activities	9,720	10,355	82,324
INVESTING ACTIVITIES:			
Proceeds from repayment of time deposit (payment for time deposit)	326	(229)	2,761
Payment for purchase of property, plant and equipment	(8,977)	(4,358)	(76,031)
Proceeds from sales of property, plant and equipment	1,077	117	9,122
Payment for purchase of intangible fixed assets	(331)	(39)	(2,803)
Payment for purchase of investment securities	(408)		(3,456)
Proceeds from sales of investment securities	200	350	1,694
Increase in investment in consolidated subsidiary (Note 17)	(3,372)	(34)	(28,559)
Increase in investment in associated companies	(401)		(3,396)
Proceeds from minority interests		409	
Other	69	(20)	583
Net cash used in investing activities	(11,817)	(3,804)	(100,085)
FINANCING ACTIVITIES:			
Increase (decrease) in short-term bank loans—net	2,456	(11,760)	20,801
Proceeds from long-term debt		887	
Repayments of long-term debt	(3,537)	(1,159)	(29,957)
Proceeds from issuance of bonds with warrants		10,000	
Payment for purchase of treasury stock	(2,085)	(977)	(17,659)
Dividends paid	(1,162)	(1,077)	(9,842)
Other	3	4	26
Net cash used in financing activities	(4,325)	(4,082)	(36,631)
FOREIGN CURRENCY TRANSLATION ADJUSTMENTS ON CASH AND CASH EQUIVALENTS	315	(74)	2,668
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(6,107)	2,395	(51,724)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	19,177	16,782	162,421
CASH AND CASH EQUIVALENTS, END OF YEAR	¥ 13,070	¥ 19,177	$ 110,697

See notes to consolidated financial statements.

1. BASIS OF PRESENTING CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan. In addition, certain reclassifications have been made in the 2004 financial statements to conform to the classifications used in 2005.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which TOKAI CARBON Co., Ltd. (the "Company") is incorporated and operates. The translation of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥118.07 to $1, the approximate rate of exchange at December 31, 2005. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Consolidation

The consolidated financial statements as of December 31, 2005 include the accounts of the Company and its significant 20 (19 in 2004) subsidiaries (together, the "Group").

Under the control or influence concept, those companies in which the Company, directly or indirectly, is able to exercise control over operations are fully consolidated, and those companies over which the Group has the ability to exercise significant influence are accounted for by the equity method.

Investments in 4 (4 in 2004) associated companies are accounted for by the equity method. Investments in the remaining 2 (2 in 2004) unconsolidated subsidiaries are stated at cost. If the equity method of accounting had been applied to the investments in these companies, the effect on the accompanying consolidated financial statements would not be material.

The difference between the cost and underlying net equity of investments in consolidated subsidiaries and associated companies is deferred and amortized using the straight-line method over a certain period which is derived on an individual case basis, with the exception of minor differences which are charged or credited to income in the period of acquisition.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Group is eliminated.

In March 2005, the Group acquired 57.1% of the shares of MITOMO BRAKE CO., LTD., which has become a consolidated subsidiary of the Company during the year ended December 31, 2005.

In July 2005, the Group acquired all the shares of ERFTCARBON GmbH, which has become a consolidated subsidiary of the Company during the year ended December 31, 2005.

In October 2005, TOKAI CARBON EUROPE LTD., a consolidated subsidiary, liquidated GRAPHITE TECHNOLOGIES (PROPERTY) LTD., which was a subsidiary of TOKAI CARBON EUROPE LTD.

b. Cash Equivalents

Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value.

Cash equivalents include time deposits and mutual funds investing in bonds that represent short-term investments, and securities purchased under resale arrangements, all of which mature or become due within three months of the date of acquisition.

c. Inventories

Inventories of the Company and consolidated domestic subsidiaries are stated at cost, cost being determined by the average method. Inventories of foreign consolidated subsidiaries are stated principally at the lower of cost or market, cost being determined by the first-in, first-out method.

d. Marketable and Investment Securities

Marketable and investment securities are classified and accounted for, depending on management's intent, as follows: (1) held-to-maturity debt securities which are expected to be held to maturity with the positive intent and ability to hold to maturity are reported at amortized cost, and (2) available-for-sale securities, securities not classified as the aforementioned securities, are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity.

Non-marketable available-for-sale securities are stated at cost determined by the moving-average method. For other than temporary declines in fair value, available-for-sale securities are reduced to net realizable value by a charge to income.

e. Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment of the Company and its consolidated domestic subsidiaries is computed principally by the declining-balance method at rates based on the estimated useful lives of the assets, while the straight-line method is applied to the buildings of the Company and its domestic subsidiaries, and to the whole property, plant and equipment of consolidated foreign subsidiaries. Equipment held for lease is depreciated by the straight-line method over the respective lease periods.

The range of useful lives is principally from 2 to 60 years for buildings and structures, from 2 to 22 years for machinery and equipment, and from 4 to 12 years for furniture and fixtures.

f. Employees' Retirement Benefits

The Company and certain domestic consolidated subsidiaries have contributory funded pension plans. And other domestic consolidated subsidiaries have funded and unfunded retirement benefit plans.

Effective April 1, 2000, the Company adopted a new accounting standard for employees' retirement benefits and accounted for the liability for retirement benefits based on projected benefit obligations and plan assets at the balance sheet date.

The existing accounting standard for employees' retirement benefits prohibited recognition of any excess portion of plan assets exceeding the projected benefit obligation that had arisen due to an excess of the actual return of plan assets over the expected return or a reduction of benefits level. This standard was amended in March 2005 to allow recognition of such excess portion of plan assets from the year ended December 31, 2005. In accordance with the amended standard, the Group recognized excess plan assets due to actual return of plan assets exceeding the expected return. Such excess was recognized as actuarial gain and is being recognized over 10 years from the year ended December 31, 2005.

The effect of this change was to increase income before income taxes and minority interests for the year ended December 31, 2005 by ¥16 million ($136 thousand).

g. Retirement Allowances for Directors and Corporate Auditors

Retirement allowances for directors and corporate auditors are recorded to state the liability at the amount that would be required if all directors and corporate auditors retired at each balance sheet date.

h. Research and Development Costs

Expenditures for research and development activities are charged to income as incurred.

i. Leases

The Company and its consolidated domestic subsidiaries account for all leases as operating leases. Under Japanese accounting standards for leases, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the lessee's financial statements.

j. Income Taxes

The provision for income taxes is computed based on the pretax income included in the consolidated statements of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

k. Appropriations of Retained Earnings

Appropriations of retained earnings at each year end are reflected in the financial statements for the following year upon shareholders' approval.

l. Foreign Currency Transactions

All short-term and long-term monetary receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rates at the balance sheet date. The foreign exchange gains and losses from translation are recognized in the income statement to the extent that they are not hedged by forward exchange contracts.

m. Foreign Currency Financial Statements

The balance sheet accounts of the consolidated foreign subsidiaries are translated into Japanese yen at the current exchange rate as of the balance sheet date except for shareholders' equity, which is translated at the historical rate. Differences arising from such translation were shown as "Foreign currency translation adjustments" in a separate component of shareholders' equity.

Revenue and expense accounts of consolidated foreign subsidiaries are translated into yen at the average exchange rate.

n. Derivatives and Hedging Activities

The Group uses derivative financial instruments to manage its exposures to fluctuations in foreign exchange and interest rates. Foreign exchange forward contracts and interest rate swaps are utilized by the Group to reduce foreign currency exchange and interest rate risks. The Group does not enter into derivatives for trading or speculative purposes.

Derivatives used for hedging purposes, if derivatives qualify for hedge accounting because of high correlation and effectiveness between the hedging instruments and the hedged items, gains or losses on derivatives are deferred until the maturity of the hedged transactions.

The foreign exchange forward contracts employed to hedge foreign exchange exposures for export sales are measured at the fair value.

The interest rate swaps are measured at the fair value and the unrealized gains/losses are recognized in income. Forward contracts applied for forecasted (or committed) transactions are also measured at the fair value but the unrealized gains/losses are deferred until the underlying transactions are completed.

o. Per Share Information

Basic net income per share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period.

Diluted net income per share reflects the potential dilution that could occur if securities were exercised or converted into common stock. Diluted net income per share of common stock assumes full conversion of the outstanding convertible bonds at the beginning of the year (or at the time of issuance) with an applicable adjustment for related interest expense, net of tax.

Cash dividends per share presented in the accompanying consolidated statements of income are dividends applicable to the respective years including dividends to be paid after the end of the year.

3. INVESTMENT SECURITIES

Investment securities as of December 31, 2005 and 2004 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Non-current:			
Marketable equity securities	¥42,759	¥27,559	$362,150
Trust fund investments and other	3	3	25
Total	¥42,762	¥27,562	$362,175

The carrying amounts and aggregate fair values of marketable and investment securities at December 31, 2005 and 2004 were as follows:

	Millions of Yen			
December 31, 2005	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as available-for-sale:				
Equity securities	¥7,564	¥34,906		¥42,470
Debt securities by contractual maturities for securities classified as available-for-sale	12		¥1	11

	Millions of Yen			
December 31, 2004	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as available-for-sale:				
Equity securities	¥7,354	¥19,960	¥41	¥27,273
Debt securities by contractual maturities for securities classified as available-for-sale	12		4	8

	Thousands of U.S. Dollars			
December 31, 2005	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as available-for-sale:				
Equity securities	$64,064	$295,638		$359,702
Debt securities by contractual maturities for securities classified as available-for-sale	102		$9	93

Available-for-sale securities whose fair value is not readily determinable as of December 31, 2005 and 2004 were as follows:

	Carrying Amount		
	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Available-for-sale:			
Equity securities	¥278	¥278	$2,355
Other	3	3	25
Total	¥281	¥281	$2,380

Proceeds from sales of available-for-sale securities for the year ended December 31, 2005 were ¥200 million ($1,694 thousand). Realized gains on these sales, computed on the moving average cost basis, were ¥0 million ($0 thousand) for the year ended December 31, 2005.

4. INVENTORIES

Inventories at December 31, 2005 and 2004 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Merchandise	¥ 5	¥ 5	$ 42
Finished products	3,925	3,528	33,243
Work in process	10,875	8,158	92,106
Raw materials and supplies	4,938	2,754	41,823
Total	¥19,743	¥14,445	$167,214

5. SHORT-TERM BANK LOANS AND LONG-TERM DEBT

Short-term bank loans at December 31, 2005 and 2004 consisted of notes to banks and bank overdrafts. The annual interest rates applicable to the short-term bank loans ranged from 0.5% to 10.00% and 0.487% to 6.0% at December 31, 2005 and 2004, respectively.

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

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Unsecured zero coupon yen convertible bonds, due 2008	¥10,000	¥10,000	$84,695
Long-term loans from banks and insurance companies due through 2009 at interest rates ranging from 1.55% to 7.34%	210	773	1,779
Less current portion	(207)	(416)	(1,753)
Long-term debt, less current portion	¥10,003	¥10,357	$84,721

Annual maturities of long-term debt at December 31, 2005 were as follows:

Year Ending December 31	Millions of Yen	Thousands of U.S. Dollars
2006	¥ 207	$ 1,753
2007	1	9
2008	10,001	84,704
2009	1	8
Total	¥10,210	$86,474

On August 10, 2004, the Company issued ¥10,000 million of zero coupon yen convertible bonds (convertible bond-type bonds with stock acquisition rights) due 2008.

The stock acquisition rights are exercisable on or after August 24, 2004 up to and including July 25, 2008 at a conversion price of ¥510 ($4.32) per share.

The carrying amounts of assets pledged as collateral for short-term bank loans of ¥100 million ($847 thousand) at December 31, 2005 were as follows:

	Millions of Yen	Thousands of U.S. Dollars
Property, plant and equipment—net of accumulated depreciation	¥5,767	$48,844

6. LONG-LIVED ASSETS

The Group groups the long-lived assets, principally based on the division of management accounting, but the leasehold improvements and idle assets are grouped by respective asset category.

The Group reviewed its long-lived assets for impairment as of the year ended December 31, 2005 and as a result, recognized an impairment loss of ¥72 million ($610 thousand) as an other expense for certain idle assets of Shizuoka land, and plant assets group of Kyoto plant and Techno-center. The carrying amount of the relevant asset group was written down to the recoverable amount. The recoverable amount of that group was measured at its value in net selling price. In addition, an impairment loss of ¥3 million ($25 thousand) of the restructuring of the business is included in restructuring expenses. Impairment loss of the restructuring of the business is for Kyoto plant and Techno-center.

7. RETIREMENT AND PENSION PLANS

Employees whose service with the Company and certain consolidated domestic subsidiaries is terminated are, under most circumstances, entitled to retirement and pension benefits determined by reference to basic rates of pay at the time of termination, length of service and conditions under which the termination occurs.

The liability (asset) for employees' retirement benefits at December 31, 2005 consisted of the following:

	Millions of Yen	Thousands of U.S. Dollars
Projected benefit obligation	¥ 7,277	$ 61,633
Fair value of plan assets	(6,078)	(51,478)
Unrecognized actuarial gain	386	3,269
Prepaid expense for pension cost	569	4,819
Net liability	¥ 2,154	$ 18,243

The components of net periodic benefit costs for the year ended December 31, 2005 are as follows:

	Millions of Yen	Thousands of U.S. Dollars
Service cost	¥439	$3,718
Interest cost	99	839
Expected return on plan assets	(102)	(864)
Amortization of actuarial gain	81	686
Other	56	474
Net periodic benefit costs	¥573	$4,853

Assumptions used for the year ended December 31, 2005 are set forth as follows:

Discount rate	2.0%
Expected rate of return on plan assets	2.0%
Recognition period of actuarial gain/loss	10 years

8. RETIREMENT ALLOWANCES FOR DIRECTORS AND CORPORATE AUDITORS

Retirement allowances for directors and corporate auditors are paid subject to approval of the shareholders in accordance with the Japanese Commercial Code (the "Code").

The Company recorded a liability for its unfunded retirement allowance plan covering all of its directors and corporate auditors. The annual provisions for retirement allowances for directors and corporate auditors for the years ended December 31, 2005 and 2004 were ¥67 million ($567 thousand) and ¥60 million, respectively.

9. SHAREHOLDERS' EQUITY

Japanese companies are subject to the Code.

The Code requires that all shares of common stock are recorded with no par value and at least 50% of the issue price of new shares is required to be recorded as common stock and the remaining net proceeds as additional paid-in capital, which is included in capital surplus. The Code permits Japanese companies, upon approval of the Board of Directors, to issue shares to existing shareholders without consideration as a stock split. Such issuance of shares generally does not give rise to changes within the shareholders' accounts.

The Code also provides that an amount at least equal to 10% of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period shall be appropriated as a legal reserve (a component of retained earnings) until such reserve and additional paid-in capital equals 25% of common stock. The amount of total additional paid-in capital and legal reserve that exceeds 25% of the common stock may be available for dividends by resolution of the shareholders. In addition, the Code permits the transfer of a portion of additional paid-in capital and legal reserve to the common stock by resolution of the Board of Directors.

The Code allows Japanese companies to repurchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The repurchased amount of treasury stock cannot exceed the amount available for future dividend plus amount of common stock, additional paid-in capital or legal reserve to be reduced in the case where such reduction was resolved at the shareholders meeting.

In addition to the provision that requires an appropriation for a legal reserve in connection with the cash payment, the Code imposes certain limitations on the amount of retained earnings available for dividends. The amount of retained earnings available for dividends under the Code was ¥30,933 million ($261,989 thousand) as of December 31, 2005, based on the amount recorded in the parent company's general books of account.

Dividends are approved by the shareholders at a meeting held subsequent to the fiscal year to which the dividends are applicable. Semiannual interim dividends may also be paid upon resolution of the Board of Directors, subject to certain limitations imposed by the Code.

10. INCOME TAXES

The Company and its domestic subsidiaries are subject to Japanese national and local income taxes which, in the aggregate, resulted in normal effective statutory tax rate of approximately 40% and 42% for the years ended December 31, 2005 and 2004, respectively.

On March 31, 2003, a tax reform law concerning enterprise tax was enacted in Japan which changed the normal effective statutory tax rate from 42% to 40%, effective for years beginning on or after January 1, 2005.

The tax effects of significant temporary differences and loss carryforwards which resulted in deferred tax assets and liabilities at December 31, 2005 and 2004 are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Deferred tax assets:			
Depreciation and amortization	¥ 217	¥ 253	$ 1,838
Impairment loss on long-lived assets	435	407	3,684
Loss on sales of property, plant and equipment		399	
Retirement and severance benefits	351	361	2,973
Allowance for officers' retirement benefits	153	121	1,296
Accrued enterprise tax	185	174	1,567
Unrealized gain on sale of assets eliminated in consolidation	208	173	1,762
Provision for loss contingency liability		198	
Loss carryforward of subsidiaries	823	915	6,970
Valuation loss on investment securities	297	297	2,515
Other	389	438	3,295
Less valuation allowance	(1,156)	(1,198)	(9,791)
Deferred tax assets	1,902	2,538	16,109
Deferred tax liabilities:			
Net unrealized gain on available-for-sale securities	13,962	7,966	118,252
Deferred profits on property for income tax purposes	1,313	1,534	11,121
Prepaid expense for pension cost	227	272	1,923
Other	32	81	270
Deferred tax liabilities	15,534	9,853	131,566
Net deferred tax liabilities	¥13,632	¥ 7,315	$115,457

Net deferred tax liabilities presented in the consolidated balance sheets at December 31, 2005 and 2004 are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Current assets—deferred tax assets	¥ (472)	¥(1,101)	$ (3,998)
Investments and other assets—deferred tax assets	(237)	(340)	(2,007)
Long-term liabilities—deferred tax liabilities	14,341	8,756	121,462
Deferred tax liabilities	¥13,632	¥ 7,315	$115,457

A reconciliation between the normal effective statutory tax rates and the actual effective tax rates reflected in the accompanying consolidated statements of income for the years ended December 31, 2005 and 2004 is as follows:

	2005	2004
Normal effective statutory tax rate	40.0%	42.0%
Expenses not deductible for income tax purposes	1.0	1.4
Income not taxable for income tax purposes	(0.1)	(0.3)
Amortization of consolidation differences	2.0	
Fluctuation of valuation allowance	0.3	5.5
Tax credit for experimental and research expense	(1.5)	(2.3)
Other—net	0.8	(0.4)
Actual effective tax rate	42.5%	45.9%

11. RESEARCH AND DEVELOPMENT COSTS

Research and development costs charged to income were ¥1,525 million ($12,916 thousand) and ¥1,291 million for the years ended December 31, 2005 and 2004, respectively.

12. LEASES

The Group has lease agreements whereby the Group acts both as a lessee and a lessor. Finance lease contracts (both as a lessee and as a lessor) other than those which are deemed to transfer the ownership of the leased assets to lessees are accounted for by the method that is applicable to ordinary operating leases.

Certain key information on such lease contracts of the Group as a lessee and a lessor for the years ended December 31, 2005 and 2004 is as follows:

As a lessee

	Millions of Yen					
	2005			2004		
	Machinery and Equipment	Furniture and Fixtures	Total	Machinery and Equipment	Furniture and Fixtures	Total
Acquisition cost	¥11	¥45	¥56	¥10	¥27	¥37
Accumulated depreciation	5	14	19	6	12	18
Net leased property	¥ 6	¥31	¥37	¥ 4	¥15	¥19

	Thousands of U.S. Dollars		
	2005		
	Machinery and Equipment	Furniture and Fixtures	Total
Acquisition cost	$93	$381	$474
Accumulated depreciation	43	118	161
Net leased property	$50	$263	$313

Future minimum lease payments:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Due within one year	¥10	¥ 6	$ 84
Due after one year	27	13	229
Total	¥37	¥19	$313

Paid lease fees and depreciation expense:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Paid lease fees	¥9	¥8	$76
Depreciation expense	9	8	76

The acquisition cost and future minimum lease payments include the imputed interest expense portion.
Depreciation is based on the straight-line method over the lease term of the lease assets.

As a lessor

	Millions of Yen						
	2005			2004			
	Machinery and Equipment	Furniture and Fixtures	Total	Machinery and Equipment	Furniture and Fixtures	Software	Total
Acquisition cost	¥57	¥13	¥70	¥61	¥17	¥3	¥81
Accumulated depreciation	36	6	42	46	7	3	56
Net leased property	¥21	¥ 7	¥28	¥15	¥10		¥25

	Thousands of U.S. Dollars		
	2005		
	Machinery and Equipment	Furniture and Fixtures	Total
Acquisition cost	$483	$110	$593
Accumulated depreciation	305	51	356
Net leased property	$178	$ 59	$237

Future minimum lease income:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Due within one year	¥10	¥14	$ 85
Due after one year	20	14	169
Total	¥30	¥28	$254

The minimum rental commitments under noncancelable operating leases at December 31, 2005 and 2004 were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Due within one year	¥1		$ 9
Due after one year	5		42
Total	¥6		$51

13. DERIVATIVES

The Group enters into foreign exchange forward contracts to hedge foreign exchange risk associated with certain assets and liabilities denominated in foreign currencies. The Group enters into interest rate swap contracts as derivative financial instruments. Interest rate swap transactions are made in order to minimize the risk of interest rate increases on floating rate borrowing. The Group does not hold or issue derivatives for trading purposes.

Because the counterparties to these derivatives are limited to major international financial institutions, the Group does not anticipate any losses arising from credit risk.

All derivative transactions the Group enters into are approved by directors in charge. The conditions of such transactions are reported periodically to the Board of Directors.

Fair Value of Derivative Financial Instruments

The fair value of the Group's derivative financial instruments at December 31, 2005:

	Millions of Yen		
	2005		
	Contract Amount	Fair Value	Unrealized Loss
Interest rate swaps—Pay fixed/receive floating	¥1,363	¥(14)	¥(14)
Total	¥1,363	¥(14)	¥(14)

	Thousands of U.S. Dollars		
	2005		
	Contract Amount	Fair Value	Unrealized Loss
Interest rate swaps—Pay fixed/receive floating	$11,544	$(119)	$(119)
Total	$11,544	$(119)	$(119)

Foreign currency forward contracts which qualify for hedge accounting for the years ended December 31, 2005 and 2004 and such amounts which are assigned to the associated assets and liabilities and are recorded on the balance sheets at December 31, 2005 and 2004, are excluded from the disclosure of market value information.

14. CONTINGENT LIABILITIES

At December 31, 2005, the Group guaranteed borrowings of affiliated companies in the amount of ¥476 million ($4,032 thousand).

15. NET INCOME PER SHARE

Reconciliation of the differences between basic and diluted net income per share (“EPS”) for the years ended December 31, 2005 and 2004 is as follows:

	Millions of Yen	Thousands of Shares	Yen	U.S. Dollars
Year Ended December 31, 2005	Net Income	Weighted-average Shares	EPS	
Basic EPS—Net income available to common shareholders	¥5,216	199,093	¥26.20	$0.22
Effect of dilutive securities—Convertible bonds		19,608		
Diluted EPS—Net income for computation	¥5,216	218,701	¥23.85	$0.20

	Millions of Yen	Thousands of Shares	Yen
Year Ended December 31, 2004	Net Income	Weighted-average Shares	EPS
Basic EPS—Net income available to common shareholders	¥2,486	203,406	¥12.22
Effect of dilutive securities—Convertible bonds		7,661	
Diluted EPS—Net income for computation	¥2,486	211,067	¥11.78

16. SUBSEQUENT EVENTS

(1) Appropriations of Retained Earnings

The following appropriations of retained earnings at December 31, 2005 were approved at the Company's shareholders meeting held on March 30, 2006:

	Millions of Yen	Thousands of U.S. Dollars
Year-end cash dividends, ¥3.00 ($0.03) per share	¥590	$4,997
Bonuses to directors	45	381

(2) Stock for Stock Exchange Agreement with Tokai Konetsu Kogyo Co., Ltd.

The Company and Tokai Konetsu Kogyo Co., Ltd., respectively, passed a resolution at the respective Board of Directors meetings on February 21, 2006, to turn Tokai Konetsu Kogyo Co., Ltd. into a wholly owned subsidiary of the Company through a stock for stock exchange and entered into a stock for stock exchange agreement.

a. Purpose of stock for stock exchange
The purpose of this agreement is to reinforce our cost competitiveness through synergies of combining the silicon carbide business and the manufacturing and use technologies of high temperature industrial furnaces of both companies, as well as to enhance the technology development capabilities.

b. The agreement is pursuant to Article 358 Paragraph 1 (simplified stock for stock exchange) of the Code.

c. Stock for stock exchange ratio
A share of 0.98 of the Company common stock will be allocated for each share of Tokai Konetsu Kogyo Co., Ltd. common stock. Shares of 1,245,891 of common stock will be issued, and shares of 8,245,891 will be allocated after combining the new shares with shares of 7,000,000 of common stock held by the Company (treasury stock).

d. Schedule
March 30, 2006: Shareholder approval of stock for stock exchange agreement (Tokai Konetsu Kogyo Co., Ltd.)
June 27, 2006: Delisting of Tokai Konetsu Kogyo Co., Ltd. shares
July 1, 2006: Stock for stock exchange

17. SUPPLEMENTARY CASH FLOW INFORMATION

The following is a summary of the assets and liabilities of subsidiaries which were included in consolidation upon acquisition of their stock for the year ended December 31, 2005:

	Millions of Yen	Thousands of U.S. Dollars
	2005	2005
Current assets	¥6,025	$51,029
Non-current assets	2,654	22,478
Total assets	¥8,679	$73,507
Current liabilities	¥2,014	$17,058
Non-current liabilities	4,316	36,554
Total liabilities	¥6,330	$53,612

18. SEGMENT INFORMATION

Information about industry segments, geographical segments and sales to foreign customers of the Company and consolidated subsidiaries for the years ended December 31, 2005 and 2004 is as follows:

(1) Industry Segments
a. Sales and Operating Income

	Millions of Yen				
	2005				
	Carbon and Graphite Products	Industrial Furnaces and Related Products	Others	Elimination/ Corporate	Consolidated
Sales to customers	¥70,779	¥6,159	¥ 823		¥77,761
Intersegment sales	248	200	830	¥(1,278)	
Total sales	71,027	6,359	1,653	(1,278)	77,761
Operating expenses	61,190	5,640	1,284	(1,131)	66,983
Operating income	¥ 9,837	¥ 719	¥ 369	¥ (147)	¥10,778

b. Assets, Depreciation, Impairment Loss on Long-lived Assets and Capital Expenditures

	Millions of Yen				
	2005				
	Carbon and Graphite Products	Industrial Furnaces and Related Products	Others	Elimination/ Corporate	Consolidated
Assets	¥88,703	¥10,783	¥4,321	¥45,942	¥149,749
Depreciation	3,757	199	404	(196)	4,164
Impairment loss on long-lived assets		4	69		73
Capital expenditures	9,257	1,131	179	(40)	10,527

a. Sales and Operating Income

	Thousands of U.S. Dollars				
	2005				
	Carbon and Graphite Products	Industrial Furnaces and Related Products	Others	Elimination/ Corporate	Consolidated
Sales to customers	$599,467	$52,164	$ 6,970		$658,601
Intersegment sales	2,100	1,694	7,030	$(10,824)	
Total sales	601,567	53,858	14,000	(10,824)	658,601
Operating expenses	518,252	47,768	10,875	(9,579)	567,316
Operating income	$ 83,315	$ 6,090	$ 3,125	$ (1,245)	$ 91,285

b. Assets, Depreciation, Impairment Loss on Long-lived Assets and Capital Expenditures

	Thousands of U.S. Dollars				
	2005				
	Carbon and Graphite Products	Industrial Furnaces and Related Products	Others	Elimination/ Corporate	Consolidated
Assets	$751,275	$91,327	$36,597	$389,108	$1,268,307
Depreciation	31,820	1,685	3,422	(1,660)	35,267
Impairment loss on long-lived assets		34	584		618
Capital expenditures	78,403	9,579	1,516	(339)	89,159

a. Sales and Operating Income

	Millions of Yen				
	2004				
	Carbon and Graphite Products	Industrial Furnaces and Related Products	Others	Elimination/ Corporate	Consolidated
Sales to customers	¥58,979	¥7,243	¥ 813		¥67,035
Intersegment sales	464	64	1,020	¥(1,548)	
Total sales	59,443	7,307	1,833	(1,548)	67,035
Operating expenses	51,012	6,429	1,488	(1,308)	57,621
Operating income	¥ 8,431	¥ 878	¥ 345	¥ (240)	¥ 9,414

b. Assets, Depreciation, Impairment Loss on Long-lived Assets and Capital Expenditures

	Millions of Yen				
	2004				
	Carbon and Graphite Products	Industrial Furnaces and Related Products	Others	Elimination/ Corporate	Consolidated
Assets	¥73,001	¥10,344	¥5,045	¥36,554	¥124,944
Depreciation	3,052	136	431	(1)	3,618
Impairment loss on long-lived assets		50	1,017		1,067
Capital expenditures	3,872	334	133		4,339

(2) Geographical Segments

The geographical segments of the Company and its consolidated subsidiaries for the years ended December 31, 2005 and 2004 are summarized as follows:

	Millions of Yen				
	2005				
	Japan	Europe	Others	Eliminations/ Corporate	Consolidated
Sales to customers	¥ 60,238	¥8,213	¥ 9,310		¥ 77,761
Interarea transfer	2,489	21	221	¥ (2,731)	
Total sales	62,727	8,234	9,531	(2,731)	77,761
Operating expenses	53,509	7,385	8,679	(2,590)	66,983
Operating income	¥ 9,218	¥ 849	¥ 852	¥ (141)	¥ 10,778
Assets	¥136,954	¥9,166	¥15,119	¥(11,490)	¥149,749

	Thousands of U.S. Dollars				
	2005				
	Japan	Europe	Others	Eliminations/ Corporate	Consolidated
Sales to customers	$ 510,189	$69,560	$ 78,852		$ 658,601
Interarea transfer	21,081	178	1,871	$(23,130)	
Total sales	531,270	69,738	80,723	(23,130)	658,601
Operating expenses	453,198	62,547	73,507	(21,936)	567,316
Operating income	$ 78,072	$ 7,191	$ 7,216	$ (1,194)	$ 91,285
Assets	$1,159,939	$77,632	$128,051	$(97,315)	$1,268,307

	Millions of Yen			
	2004			
	Japan	Others	Eliminations/ Corporate	Consolidated
Sales to customers	¥ 58,942	¥ 8,093		¥ 67,035
Interarea transfer	1,777	200	¥(1,977)	
Total sales	60,719	8,293	(1,977)	67,035
Operating expenses	52,037	7,391	(1,807)	57,621
Operating income	¥ 8,682	¥ 902	¥ (170)	¥ 9,414
Assets	¥120,935	¥11,673	¥(7,664)	¥124,944

Sales of "Europe" is separately shown for the year ended December 31, 2005, since sales in the region are expected to increase continuously hereafter. Information by the current three geographical segments for the year ended December 31, 2004 is as follows:

	Millions of Yen				
	2004				
	Japan	Europe	Others	Eliminations/ Corporate	Consolidated
Sales to customers	¥ 58,942	¥1,414	¥ 6,679		¥ 67,035
Interarea transfer	1,777	14	200	¥(1,991)	
Total sales	60,719	1,428	6,879	(1,991)	67,035
Operating expenses	52,037	1,448	5,957	(1,821)	57,621
Operating income (loss)	¥ 8,682	¥ (20)	¥ 922	¥ (170)	¥ 9,414
Assets	¥120,935	¥1,239	¥10,439	¥(7,669)	¥124,944

(3) Sales to Foreign Customers

	Millions of Yen			
	2005			
	Asia	Europe	Others	Total
Overseas sales	¥15,403	¥8,207	¥5,485	¥29,095
Net sales				77,761
Ratio of overseas sales to net sales	19.8%	10.5%	7.1%	37.4%

	Thousands of U.S. Dollars			
	2005			
	Asia	Europe	Others	Total
Overseas sales	$130,457	$69,510	$46,455	$246,422
Net sales				658,601

	Millions of Yen		
	2004		
	Asia	Others	Total
Overseas sales	¥14,124	¥6,604	¥20,728
Net sales			67,035
Ratio of overseas sales to net sales	21.1%	9.8%	30.9%

Overseas sales of "Europe" is separately shown for the year ended December 31, 2005, since sales of the region are expected to increase continuously hereafter.

Overseas sales of "Europe" included in "Others" for the year ended December 31, 2004 was ¥2,323 million.

Notes: The countries included in each segment are as follows:
(1) Asia: Korea, China, Thailand, Indonesia, etc.
(2) Europe: Germany, United Kingdom, Italy, Sweden, etc.
(3) Others: North and South America, Middle East, Africa, Oceania

Deloitte.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
TOKAI CARBON Co., Ltd.:

We have audited the accompanying consolidated balance sheets of TOKAI CARBON Co., Ltd. (the "Company") and consolidated subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of TOKAI CARBON Co., Ltd. and consolidated subsidiaries as of December 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.

As discussed in Note 16(2), on February 21, 2006, the Company and Tokai Konetsu Kogyo Co., Ltd. entered into an agreement that Tokai Konetsu Kogyo Co., Ltd. became a wholly owned subsidiary of the Company through a stock for stock exchange.

Our audits also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 1. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

Deloitte Touche Tohmatsu

March 30, 2006

Member of
Deloitte Touche Tohmatsu

CORPORATE DATA (as of December 31, 2005)

Company Name	TOKAI CARBON CO., LTD.
Head Office	Aoyama Bldg. 2-3, Kita-Aoyama1-Chome, Minato-ku, Tokyo 107-8636, Japan Tel: 03-3746-5100 Fax: 03-3405-7205
Date of Foundation	April 8, 1918
Paid-in Capital	15,436 million
Number of Employees	1,725 (on a consolidated basis)

Network

Branches
Osaka Branch (Osaka)
Nagoya Branch (Aichi)
Fukuoka Branch (Fukuoka)

Laboratories
Fuji Research Laboratory (Shizuoka)
Chita Research Laboratory (Aichi)
Hofu Research Laboratory (Yamaguchi)
Tanoura Research Laboratory (Kumamoto)

Industrial Complex
Shonan Industrial Complex (Kanagawa)
Chigasaki R&D Center
Chigasaki Plant
Chigasaki Second Plant

Plants
Ishinomaki Plant (Miyagi)
Chita Plant (Aichi)
Shiga Plant (Shiga)
Hofu Plant (Yamaguchi)
Kyusyu Wakamatsu Plant (Fukuoka)
Tanoura Plant (Kumamoto)

Oversea Office
Shanghai Representative Office(China)

Oversea Affiliated Companies
Thai Tokai Carbon Product Co., Ltd. (Thailand)
ERFTCARBON GmbH (Germany)
Tokai Carbon (Tianjin) Co., Ltd. (China)
Tokai Carbon U.S.A., Inc. (U.S.A.)
Tokai Carbon Europe Ltd. (U.K.)
Tokai Carbon Italia S.R.L. (Italy)
Svensk Specialgrafit AB (Sweden)
MWI, Inc. (U.S.A.)
Tokai Carbon Korea Co., Ltd. (Korea)
SGL Tokai Carbon Ltd., Shanghai (China)

INVESTOR INFORMATION (as of December 31, 2005)

Common Stock	Authorized Shares	598,764,000 shares
	Outstanding Shares	204,089,391 shares
Stock Exchange Listing	First Section of the Tokyo Stock Exchange	
Securities Code Number	5301	
Fiscal Year End	December 31	
Number of Shareholders	22,557	
Transfer Agent	Mitsubishi UFJ Trust and Banking Corporation	

Major Shareholders

	Number of shares held (Thousands of shares)	Percentage of total shares issued (%)
Japan Trustee Service Bank, Ltd. (Trust Account)	21,896	10.72
The Master Trust Bank of Japan, Ltd. (Trust Account)	13,725	6.72
Mitsubishi UFJ Trust and Banking Corporation	6,990	3.42
The Master Trust Bank of Japan, Ltd. (Mitsubishi Chemical Corporation Retirement Benefit Trust Account)	5,900	2.89
Mitsubishi Corporation	5,844	2.86
Tokio Marine & Nichido Fire Insurance Co., Ltd.	5,835	2.85
The Bank of Tokyo-Mitsubishi, Ltd.	5,102	2.49
The Chase Manhattan Bank, N.A.London	4,585	2.24
The Bank of New York Europe Limited Lux Branch Account Client	4,192	2.05
The Bank of New York Europe GCM Client Accounts EISG	3,568	1.74

TOKAI CARBON CO., LTD.

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