

# MANAGEMENT'S DISCUSSION AND ANALYSIS

Unless otherwise noted, the financial information contained in this section is all based on the consolidated financial statements included in the annual report of Showa Sangyo Co. Ltd.

## OVERVIEW

The consolidated financial statement for the fiscal year ended March 31, 2000 is composed of figures for Showa Sangyo, 13 of its subsidiaries, and 2 affiliate companies.

The company's operations are divided into three business segments: Food Operations, which include flour milling, vegetable oils, cornstarch and corn sweeteners, household foods, and frozen foods; Animal Feed Operations, which deal with the production and marketing of animal feeds and eggs; and Other Operations, which include the warehousing division and business development. The percentages of sales for each segment this fiscal year were 73.2%, 22.8% and 4.0%, respectively.

## OPERATIONS

Both operating income and income for this fiscal year significantly increased despite our accounts for this fiscal year showing a slight drop in income. We believe that these results are some of the fruits of our mid-term management plan, the ReBorn Plan, Phase II.

This is the final year of the three-year plan that we hammered out three years ago. In this plan, we aimed for development of high value-added product materials and more efficient utilization of assets, as well as setting specific goals for sales,

operating income, net income, and interest-bearing debt. With these goals in place, we have been moving forward with increasing sales and reducing costs. Despite being short of meeting the individual goals in the results for the past three years at the end of this fiscal year, we believe that the plan was very effective, in that we were able to improve overall profitability.

## Net Sales

Net sales during this fiscal year were 188.25 billion yen, or 5.0% lower than the previous year.

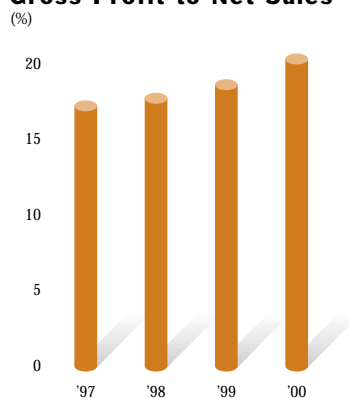
This fiscal year, we worked aggressively to increase sales. However, product prices fell mainly due to such factors as the strong yen, the falling Chicago Commodities Market and the ever intensifying competition. As a result, our sales figures decreased despite the sales volume increase.

Based on the ReBorn Plan, we also developed about 270 new products and put them on the market. These new products contributed about 6 billion-yen worth of sales this fiscal year. We plan to devote efforts to product development next year as well.

## Cost of sales

This fiscal year, our cost of sales decreased 11.29 billion yen, or

## Gross Profit to Net Sales



7.0%, to 150.01 billion yen. For this reason, our cost percentage improved from 81.4% to 79.7%.

The greatest contributing factor to this decline was an overall drop in prices, exemplified by the lowest prices in 25 years on the Chicago Commodities Exchange. Prices also fell for grains, the raw materials for our main products. Along with the effects of the appreciation of the yen, this led to a major drop in yen-based purchasing costs. The weighted average increase in the dollar-yen exchange rate between February 1999 and January 2000 increased by 18.14 yen over the previous fiscal year to 113.26 yen.

This fiscal year, the combined effects of our own cost reduction efforts and market factors led to a lower cost percentage.

### Selling Expenses and General Administrative Expenses

Although selling expenses and general administrative expenses for this fiscal year decreased 2% to 32.56 billion yen, due to our aggressive cost-cutting program, the percentage of selling expenses rose from 16.8% to 17.3%. This is because the rate of decrease in sales was larger than the rate of decrease in selling expenses and general administrative expenses.

This fiscal year, we decreased overall selling expenses 21.5% to

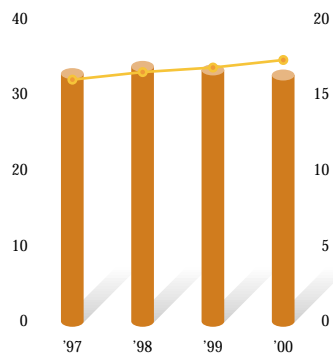
1.69 billion yen and personnel expenses 2.7% to 6.07 billion yen. Moreover, we also wrote off a total of 7.16 billion yen in depreciation. Of that amount, 1.77 billion yen were included in selling expenses and general administrative expenses, a decrease of 7.2% over the previous year.

Research expenses included in selling expenses and general administrative expenses were 1.73 billion yen this year. Realizing that Showa Sangyo's preeminence in the market is due to its ability to develop high value-added products, we initiated mid to long-term research programs for developing ingredients. This year, the best results emerged mainly from our biotechnology-related research at Tsukuba, and we plan to work hard to turn these results into commercially viable products. We the management want to maintain the research activities that allow us to gain the fullest advantage from each field and develop new products.

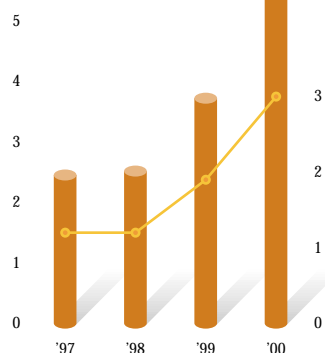
### Operating Income

Although sales decreased, decreases in the cost of sales and selling expenses were a main factor in our operating income increasing 52.7% over last year to 5.68 billion yen. Because of this, our operating income to sales rate also improved from 1.9% to 3.0%.

**SGA Expenses**  
(Billion ¥, %)



**Operating Income**  
(Billion ¥, %)



### Other Income and Expenses

The net amount of our other income and expenses for this fiscal year amounted to a loss of 2.72 billion yen, which is 7.3% larger than the loss incurred the previous year.

A look at the individual factors shows that a reduction in our interest-bearing debt caused a 25% drop in interest paid to 977 million yen. In addition, we concluded a contract to transfer ownership of our U.S. subsidiary, Granpac Foods Inc., which had been in the red for a long time and had been a source of anxiety, to another company. This involved a loss of 1.36 billion yen. Meanwhile, sale and disposal of machinery, equipment, and other tangible fixed assets yielded a loss for 328 million yen. In total, we posted a loss of 1.69 billion yen. This fiscal year, we have been proceeding with the sale of our stockholdings including revaluation and these have contributed an income of 736 million yen.

On the other hand, other net losses rose from last year's figure of 249 million yen to 1.11 billion yen.

The main factors included a 350 million-yen loss of value in golf club memberships, 100 million yen in executive retirement reserve funds, and 200 million-yen increase in other irrecoverable reserve funds.

### Income before Income Taxes

Our income before income taxes this fiscal year increased 1.78 billion yen to 2.96 billion yen.

### Income Taxes

Due to regular payments and the influence of tax effect accounting, our income tax burden was 1.58 billion yen at an effective tax rate of 53.4%.

As for the outstanding amount of current tax of 3.62 billion yen and deferred tax of 2.04 billion yen, these showed increases from previous year. These are the losses which associated with the transfer of the Granpac Foods' ownership, which did not qualify as a tax deductible item for this year. They will only qualify in the next fiscal year.

### Net Income

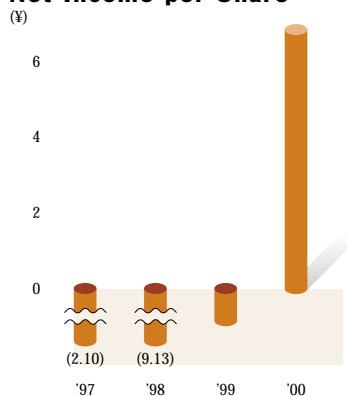
In contrast to the net loss of 164 million yen incurred in the previous fiscal year, this year's net income was 1.32 billion yen. Our basic net income per share was 6.85 yen, and ROE was 2.9%.

### SEGMENT ANALYSIS

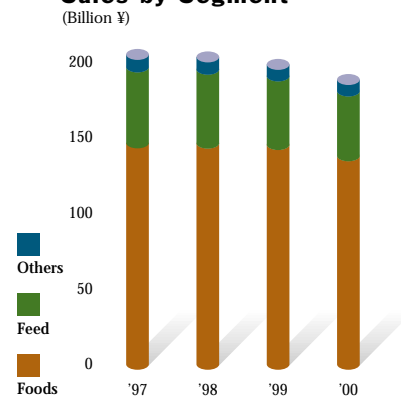
#### Food Operations Segment

Due to the composition of the Food Operations Segment, its

**Net Income per Share**



**Sales by Segment**



sales are always particularly susceptible to influences in the exchange markets for raw materials and grains, such as soybeans and corn. Furthermore, these raw materials are traded mainly on a dollar basis in international markets, so sales are exposed to the risk of fluctuations in the dollar-yen exchange rate. This is because trends in the yen-based purchasing price are usually passed on to the customer in the selling price.

This year's sales in the Food Operations Segment, which has Flour Milling, Vegetable Oils, Constarch and Corn Sweeteners, Household Foods, and Frozen Foods Divisions, were also subject to influences from a drop in the grain exchanges and the appreciation of the yen, so the drop in the unit prices for raw materials were passed on in the form of a drop in unit selling prices. For this reason, sales decreased 5.1% to 137.87 billion yen, despite their increase in volume.

On the other hand, operating expenses decreased 9.67 billion yen to 137.4 billion yen due to lower costs on the grain exchanges and the cost reduction activities under the ReBorn Plan. Because of this, operating income increased 122.3% over the previous fiscal year to 2.9 billion yen.

In the following, we will show the sales trends for each division on a non-consolidated basis for this segment.

#### • Flour Milling Division

This fiscal year, our product division invested actively in new products, especially premixes, and opened up new sales channels. This resulted in higher overall sales volume for such items as wheat flour and bran. However, the unit selling price drop, due to such factors as a drop in the price the government pays for wheat, the appreciation of the yen and intensified competition, lowered our income from sales from the previous year.

#### • Vegetable Oils Division

Sales for our vegetable oils division this fiscal year were below those of the previous year, due to a drop in the unit selling price caused by a drop in the current markets for raw material grains. Even though sales of vegetable oils increased by volume, income decreased. Due to a major drop in the price for defatted soybeans, income from defatted soybeans decreased sharply. However, sales of foods for commercial use were higher than the previous year, both by volume and by price, due to our efforts to develop new products and expand sales.

#### • Cornstarch and Corn Sweeteners Division

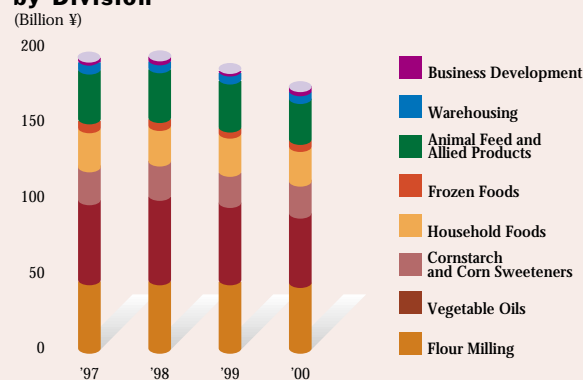
Due to favorable trends in shipments of starch sweeteners for

#### Non-consolidated Sales by Division

	Net Sales (Million ¥)			Sales Volume (t)		
	'99	'00	% change	'99	'00	% change
Flour Milling	34,556	33,276	-3.7	436,899	439,737	0.6
Vegetable Oils	38,780	34,849	-10.1	558,453	575,029	3.0
Cornstarch and Corn Sweeteners	15,854	15,147	-4.5	279,314	288,639	3.3
Household Foods	18,198	17,742	-2.5	71,729	75,520	5.3
Frozen Foods	3,330	3,257	-2.2	780*	783*	0.4
Animal Feed and Allied Products	22,525	20,049	-11.0	523,596	516,956	-1.3
Warehousing	4,249	4,199	-1.2			
Business Development	1,745	1,674	-4.1			
<b>Total</b>	<b>139,242</b>	<b>130,197</b>	<b>-6.5</b>	<b>1,869,991</b>	<b>1,895,881</b>	<b>1.4</b>

(\* thousand cases)

#### Non-consolidated Sales by Division





use in brewing low-malt beer, we were able to increase our sales volume for sweetening products. However, the sales volume for dried cornstarch remained the same as during the previous fiscal year. Since prices for our products fell due to influences from the grain exchanges, sales for our division as a whole were below those of the previous year.

**• Household Foods Division**

Household vegetable oils reaped the benefits of our efforts to expand sales of premium oils, especially canola oil, and the sales volume of these products increased over the previous year. In addition, the sales volumes for secondary processed wheat flour products were also above those for the previous year, as a result of our efforts to develop new products and expand sales. Even so, unit-selling prices fell due to a drop in the prices for raw materials.

The sales volume for gift sets decreased. As a result, sales for the Household Foods Division as a whole were lower than in the previous year.

**• Frozen Foods Division**

Our efforts to develop new products and expand sales in the Frozen Foods Division led to a slight increase in sales volume over the previous year. Selling prices, however, were below those of the previous year that sales figures also dropped from the previous year. The major factor in the decrease in

sales was sluggishness in the restaurant industry, due to the flat economy.

**Animal Feed Operations Segment**

Sales of mixed animal feeds in the Animal Feed Operations Segment are exposed to the risk of influences from the grain and currency exchanges, and eggs are subject to influences from the domestic egg market. Even though the domestic market for eggs rose, selling prices on mixed animal feeds were lowered three times in response to drops in the raw material grain exchanges. Overall sales for the Segment consequently decreased 5.5% to 42.86 billion yen. One of the indirect factors in the decrease in sales was a drop in the domestic production of livestock caused by an increase in imports.

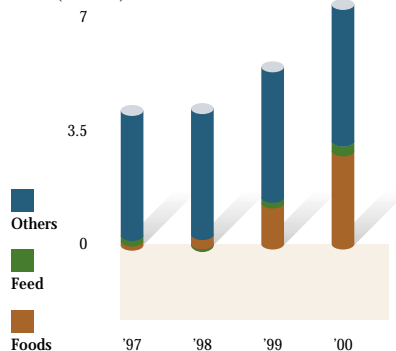
In addition, operating expenses decreased 6.5% to 42.72 billion yen, due to our promotion of production cost reduction measures and a decrease in contributions (reserve fund payments) to the mixed animal feed price stabilization fund. For this reason, operating profits rose 96.5% to 342 million yen.

**Other Operations Segment**

With respect to our other operations segments, the amount of cargo handled in Warehousing Division decreased from the previous year, as competition to obtain imported grains

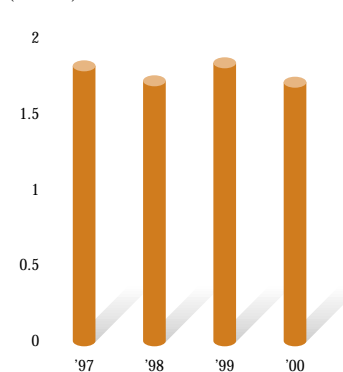
**Operating Income by Segment**

(Billion ¥)



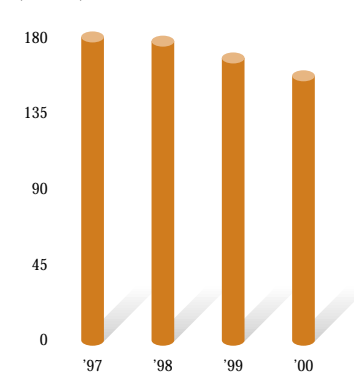
**R&D Expenditure**

(Billion ¥)



**Total Assets**

(Billion ¥)



continued to be fierce. Storage space, however, increased. As a result of these factors, sales were 7.52 billion yen, 0.5% below our previous consolidated statement fiscal year. Yet operating profits increased 4% to 4.14 billion yen, due to such factors as a decrease in depreciation expenses.

## FINANCIAL POSITION

Based on the ReBorn Plan, we have spent this fiscal year emphasizing more efficient use of assets and striving to sell off non-performing assets and compressing our assets in general, as well as placing importance on the reduction of interest-bearing debts. Due to these measures, we decreased our total assets 6.3%, or 10.621 billion yen, from the end of the previous fiscal year to 157.34 billion yen at the end of this fiscal year.

Viewed by item, our current assets were compressed by 6.84 billion yen, or 11.1%, to 54.59 billion yen. This was brought about mainly by reducing cash and cash equivalents by 3.75 billion yen and short-term loans to subsidiaries by 1.27 billion yen, and allocating them to reduce interest-bearing debt. An additional factor was a reduction in our overall inventory assets by 1.61 billion yen.

Our total investments and advances remained nearly unchanged at 16.59 billion yen, being only 1% higher than the previous year.

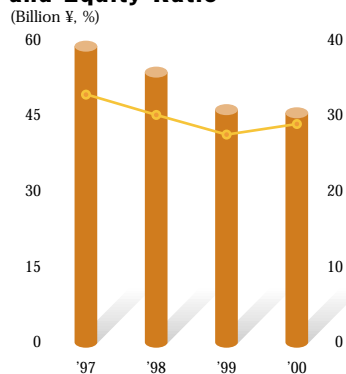
On the other hand, we reduced our tangible fixed assets by 4.6% to 85.36 billion yen. The reasons for this compression of tangible fixed assets include depreciation amounting to 6.97 billion yen. This is because we kept investment in facilities down to 5.1 billion yen and posted an extraordinary loss of 1.36 billion yen for the devaluation of tangible fixed assets after having completed the contract to sell our stock in the aforementioned Granpac Foods, Inc.

Meanwhile, a look at debt shows that the effects of our aggressive efforts to reduce interest-bearing debt were readily apparent. During this fiscal year, we reduced our interest-bearing debt a total of 9.9 billion yen, leaving a balance at the end of the year of 67 billion yen. First, as far as our current liabilities are concerned, we repaid 9.91 billion yen in short-term loans and redeemed 2 billion yen worth of commercial paper. This means that we no longer have any commercial paper outstanding at the end of the fiscal year. As a result of these measures, current liabilities decreased 7.27 billion yen, or 10.5%, to 62.26 billion yen.

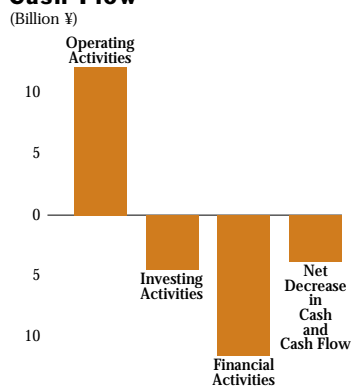
Also, since we redeemed in advance an outstanding balance of converted bonds of 582 million yen and repaid 429 million yen in long-term borrowing, and also reversed 1.19 billion yen of deferred tax liabilities, our total long-term liabilities were reduced 5.4% to 48.08 billion yen.

Finally, with respect to shareholders' equity, our retained

### Shareholders' Equity and Equity Ratio



### Cash Flow



earnings decreased by a net amount of 734 million yen to 17.93 billion yen, despite our net income of 1.32 billion yen. This decrease is mainly due to the loss of 1.37 billion yen in Swan Foods Oregon Inc., U.S. , a wholly owned subsidiary of Granpac Foods Inc., as well as to the 964-million-yen cash dividends paid out.

### **Liquidity and Sources of Funds**

In order to promote flexible development of an operational strategy at Showa Sangyo and to respond to changes in the business environment, we on the management team always take care to maintain sufficient liquidity.

This fiscal year, we generated 7.68 billion yen of free cash flow, improving our ability to invest in areas for increasing long-term stock values, and contributing to enhance our balance sheet.

Our cash and cash equivalents at the end of this fiscal year decreased 3.75 billion yen over the figures for the end of the previous year to 7.34 billion yen.

Usually, our main source of funds is cash flow from operations. This fiscal year, our operations generated 12.15 billion yen of cash flow. The biggest factors were 2.96 billion yen of income before income taxes and 7.16 billion yen in depreciation expenses.

Our cash outflow from investment activities amounted to 4.46

billion yen. The main reason was 4.4 billion yen of expenditures related to investment in facilities this fiscal year.


We had a cash outflow of 11.48 billion yen this fiscal year due to financial activities. Of this amount, 9.9 billion yen was related to reductions of interest-bearing debt carried out this year.

### **RISK MANAGEMENT**

Showa Sangyo is exposed to risks from fluctuations in exchange rates, interest rates, the markets for specific products and the stock market. In order to partially diminish or completely avoid these market risks, we have made use of a variety of derivative financial products. We, however, make no use whatsoever of these products for investment purposes or short-term trading purposes.

Moreover, we have set forth a strict administrative stance toward transactions in these products, requiring the approval of the managing director. In this way, our transactions in derivative financial products are all offset by assets on the balance sheet or by the risks inherent in the liabilities, and the details are laid out in Note 13 to the consolidated financial statement.

All the derivative financial products held by Showa Sangyo are non-listed, so they involve a credit risk to the partner financial



institutions, and theoretically, the company could possibly incur a loss if these financial institutions did not cover the debt. However, since the current holders of all these derivative financial products are highly rated financial institutions, the management team does not foresee any possibility of a loss arising from a credit risk.

Showa Sangyo may be subject to other non-financial or unquantifiable risks in the course of its normal business operations. These risks include country risks, credit risks and legal risks. However, since they are unpredictable, they are not noted in this annual report.

#### **Exchange Rate Risks**

Since we acquire raw materials from overseas mainly in dollar-based transactions, we are subject to exchange rate risks. In order to avoid these risks partly or entirely, we enter into foreign exchange forward contracts and currency option transactions as necessary.

#### **Interest Rate Risk**

Showa Sangyo is exposed to interest rate risk in the course of its investment and cash management activities. In order to avoid some of this risk, the company makes use of derivatives financial instruments.

#### **Stock Price Risk**

Showa Sangyo holds a variety of stocks, which are subject to the risk of price fluctuations in the stock market. At the end of this fiscal year, we had a total of 10.06 billion yen of listed stocks on our balance sheet, with a fair market price of 11.7 billion yen.

#### **The Year 2000 Problem**

In the interest of maintaining the day-to-day continuity of our operations, we instituted company-wide measures to minimize the possibility of any effects on our business from the so-called Year 2000 Problem.

From December 31, 1999 to January 1, 2000, we assigned specialists knowledgeable about the problem to every important system. As of March 31, 2000, we were able to determine that the Year 2000 Problem had not affected our company in any significant way.

# Consolidated Balance Sheets

Showa Sangyo Co., Ltd. and Consolidated Subsidiaries

As of March 31, 1999 and 2000

ASSETS	Millions of yen		Thousands of U.S. dollars (Note 1-a)
	1999	2000	2000
<b>Current assets:</b>			
Cash and cash equivalents	¥ 11,093	¥ 7,340	\$ 69,147
Marketable securities (Note 3 and 4)	960	999	9,409
Accounts and notes receivables:			
Trade	29,824	28,890	272,157
Non-consolidated subsidiaries and affiliates	390	727	6,848
Less: Allowance for doubtful receivables	(201)	(263)	(2,476)
Inventories :			
Merchandise and finished goods	7,718	6,672	62,854
Raw materials and supplies	7,287	6,682	62,950
Work-in-progress	611	656	6,180
Short-term loans	1,928	659	6,210
Deferred tax assets (Note 6)	232	1,015	9,560
Prepaid expenses and other current assets	1,595	1,217	11,468
<b>Total current assets</b>	<b>61,437</b>	<b>54,594</b>	<b>514,307</b>
<b>Investments and advances:</b>			
Investment securities (Note 3 and 4)	9,437	10,584	99,707
Investments in and advances to non-consolidated subsidiaries and affiliates	4,351	5,201	48,995
Other investments and advances	4,502	3,369	31,740
Less: Allowance for doubtful receivables	(1,524)	(2,569)	(24,204)
<b>Total investments and advances</b>	<b>16,766</b>	<b>16,585</b>	<b>156,238</b>
<b>Property, plant and equipment (Note 4):</b>			
Land	20,708	20,679	194,807
Buildings and structures	87,666	86,704	816,810
Machinery and equipment	108,364	110,062	1,036,856
Construction in progress	392	27	253
	217,130	217,472	2,048,726
Less : Accumulated depreciation	(127,686)	(132,109)	(1,244,555)
<b>Total property, plant and equipment</b>	<b>89,444</b>	<b>85,363</b>	<b>804,171</b>
Foreign exchange adjustment	58	240	2,265
Other assets (Note 4)	254	556	5,243
<b>Total assets</b>	<b>¥167,959</b>	<b>¥ 157,338</b>	<b>\$ 1,482,224</b>

The accompanying notes are integral parts of these statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen		Thousands of U.S. dollars (Note 1-a)
	1999	2000	2000
<b>Current liabilities:</b>			
Short-term borrowing (Note 4)	¥ 43,045	¥ 33,135	\$ 312,153
Current portion of long-term borrowing (Note 4)	1,136	1,621	15,267
Accounts payable and notes: (Note 4)			
Trade	14,825	15,235	143,527
Non-consolidated subsidiaries and affiliates	480	383	3,608
Accrued taxes on income	901	2,923	27,542
Accrued expenses and other current liabilities	9,147	8,967	84,477
<b>Total current liabilities</b>	<b>69,534</b>	<b>62,264</b>	<b>586,574</b>
<b>Long-term liabilities:</b>			
Bonds (Note 4)	10,000	10,000	94,206
Convertible Bonds	582	-	-
Long-term borrowing (Note 4)	22,698	22,269	209,791
Retirement and severance benefit for employees (Note 5)	3,753	3,714	34,989
Retirement and severance benefit for directors and statutory auditors (Note 5)	1,025	1,100	10,357
Deffered tax liabilities (Note 6)	5,834	4,645	43,760
Other liabilities (Note 4)	6,932	6,356	59,878
<b>Total long-term liabilities</b>	<b>50,824</b>	<b>48,084</b>	<b>452,981</b>
<b>Consolidation adjustment</b>	<b>22</b>	<b>15</b>	<b>137</b>
<b>Minority interests</b>	<b>1,455</b>	<b>1,480</b>	<b>13,941</b>
<b>Contingent liabilities (Note 8)</b>			
<b>Shareholders' Equity:</b>			
Common stock, par value ¥50 per share:			
Authorized - 749,500,000 shares for 1999 and 2000			
Issued as at 31 March, 1999 - 192,858,898 shares (Note 7)	12,778	-	-
Issued as at 31 March, 2000 - 192,858,898 shares (Note 7)	-	12,778	120,377
Additional paid-in capital	11,600	11,600	109,276
Legal reserve (Note 7)	3,080	3,185	30,002
Retained earnings	18,667	17,933	168,940
Less: Treasury stock	(1)	(1)	(4)
<b>Total shareholders' equity</b>	<b>46,124</b>	<b>45,495</b>	<b>428,591</b>
<b>Total liabilities and shareholders' equity</b>	<b>¥167,959</b>	<b>¥157,338</b>	<b>\$1,482,224</b>

# Consolidated Statements of Income

Showa Sangyo Co., Ltd. and Consolidated Subsidiaries  
For the years ended March 31, 1999 and 2000

	Millions of yen		Thousands of U.S. dollars (Note 1-a)
	1999	2000	2000
Net sales	¥198,250	¥ 188,251	\$ 1,773,442
Cost of sales	161,300	150,014	1,413,224
Gross profit	36,950	38,237	360,218
Selling, general and administrative expenses	33,233	32,560	306,740
Operating income	3,717	5,677	53,478
Other income (expenses):			
Interest expenses	(1,302)	(977)	(9,205)
Interest and dividend income	288	233	2,199
Net loss on sale, disposition and revaluation of property, plant and equipment	(436)	(1,685)	(15,874)
Net gain (loss) on sale and revaluation of marketable securities and investment	(817)	736	6,937
Foreign currency exchange gain (loss)	(19)	85	805
Other, net	(249)	(1,112)	(10,479)
Total	(2,535)	(2,720)	(25,618)
Income before income taxes and minority interests	1,182	2,957	27,860
Income taxes (Note 6):			
Current	1,688	3,626	34,155
Deferred	(381)	(2,048)	(19,291)
Total	1,307	1,578	14,864
Income (loss) before minority interests	(125)	1,379	12,996
Minority interests	(39)	(58)	(552)
Net income (loss)	¥ (164)	¥ 1,321	\$ 12,444
Per share data (Note 2-i):			
Net income (loss)	¥ (0.85)	¥ 6.85	\$ 0.065
Diluted net income	-	-	-
Cash dividends, applicable to the year	¥ 5.00	¥ 6.00	\$ 0.057

The accompanying notes are integral parts of these statements.

# Consolidated Statements of Shareholders' Equity

Showa Sangyo Co., Ltd. and Consolidated Subsidiaries  
For the years ended March 31, 1998, 1999 and 2000

	<i>Millions of yen</i>			
	Common stock	Additional Paid-in Capital	Legal reserve	Retained earnings
Balance at March 31, 1998	¥ 12,778	¥ 11,600	¥ 2,963	¥26,227
Net loss				(164)
Cash dividends paid				(1,160)
Bonuses to directors and statutory auditors				(18)
Transfer from retained earnings (Note 7)			117	
Transfer to legal reserve (Note 7)				(117)
Tax effect adjustment for the previous year				(5,981)
Redemption of treasury stock (Note 7)				(120)
Balance at March 31, 1999	¥ 12,778	¥ 11,600	¥ 3,080	¥18,667
Net income				1,321
Cash dividends paid				(964)
Bonuses to directors and statutory auditors				(18)
Transfer from retained earnings (Note 7)			105	
Transfer to legal reserve (Note 7)				(105)
Decrease due to a newly consolidated subsidiary (Note 1-b)				(1,371)
Increase due to companies newly accounted for by the equity method (Note 1-b)				403
Balance at March 31, 2000	¥ 12,778	¥ 11,600	¥ 3,185	¥17,933

	<i>Thousands of U.S. dollars (Note 1-a)</i>			
	Common stock	Additional Paid-in Capital	Legal reserve	Retained earnings
Balance at March 31, 1999	\$120,377	\$109,276	\$ 29,015	\$175,855
Net income				12,444
Cash dividends paid				(9,084)
Bonuses to directors and statutory auditors				(172)
Transfer from retained earnings (Note 7)			987	
Transfer to legal reserve (Note 7)				(987)
Decrease due to newly consolidated subsidiaries (Note 1-b)				(12,916)
Increase due to a company newly accounted for by the equity method (Note 1-b)				3,800
Balance at March 31, 2000	\$120,377	\$109,276	\$ 30,002	\$168,940

The accompanying notes are integral parts of these statements.

# Consolidated Statements of Cash Flows

Showa Sangyo Co., Ltd. and Consolidated Subsidiaries  
For the years ended March 31, 1999 and 2000

	Millions of yen		Thousands of U.S. dollars (Note 1-a)
	1999	2000	2000
<b>Cash flows from operating activities:</b>			
Income before income taxes	¥ 1,182	¥ 2,957	\$ 27,860
Adjustments to reconcile income before income taxes to net cash provided by operating activities:			
Depreciation and amortization	7,570	7,158	67,437
Amortization arisen from consolidation adjustment	(14)	(8)	(72)
Provision for (reversal of) retirement and severance benefit for employees	50	(39)	(372)
Provision for (reversal of) retirement and severance benefit for directors and statutory auditors	121	75	704
Provision for (reversal of) allowance for doubtful receivables	155	1,045	9,848
Interest and dividend income	(289)	(233)	(2,199)
Interest charges	1,303	977	9,205
Foreign currency exchange loss (gain)	19	(85)	(805)
Equity in earning of affiliates	-	(73)	(689)
Net loss (gain) on sale, revaluation and disposition of property, plant and equipment	436	1,685	15,874
Net loss (gain) on sale and revaluation of marketable securities	817	(736)	(6,937)
Net loss on revaluation of subsidiary stocks	12	-	-
(Increase) decrease in receivables, trade	999	585	5,515
(Increase) decrease in inventories	3,916	1,590	14,977
Increase (decrease) in payables, trade	(3,530)	(328)	(3,088)
	<u>12,747</u>	<u>14,570</u>	<u>137,259</u>
Interest and dividends received	288	240	2,258
Interest paid	(1,244)	(1,056)	(9,944)
Income taxes paid	(1,213)	(1,656)	(15,604)
Bonuses paid for directors and statutory auditors	(25)	(25)	(236)
Other, net	(172)	74	696
Net cash provided by operating activities	<u>10,381</u>	<u>12,147</u>	<u>114,430</u>
<b>Cash flows from investing activities:</b>			
(Increase) decrease in time deposit	(66)	17	160
Purchases of marketable securities	(317)	(423)	(3,988)
Proceeds from sale of marketable securities	394	464	4,372
(Increase) decrease in other short-term investments	1,468	1,268	11,949
Purchases of investment securities	(612)	(979)	(9,220)
Proceeds from sale of investment securities	652	376	3,542
Purchases of property, plant and equipment	(4,792)	(4,406)	(41,511)
Proceeds from sales and disposition of property, plant and equipment	(70)	289	2,724
(Increase) decrease in other long-term investment and advances	(1,040)	(1,070)	(10,084)
Net cash used in investing activities	<u>(4,383)</u>	<u>(4,464)</u>	<u>(42,056)</u>
<b>Cash flows from financing activities:</b>			
Increase (decrease) in short-term borrowing	(3,464)	(9,910)	(93,358)
Payment for financing leases	(70)	(66)	(618)
Proceeds from long-term borrowing	1,800	1,230	11,587
Repayment of long-term borrowing	(2,176)	(1,174)	(11,060)
Redemption of convertible bonds	-	(582)	(5,483)
Dividends paid	(1,160)	(964)	(9,084)
Dividends paid to minority shareholders	(11)	(17)	(162)
Redemption of treasury stocks	(120)	-	-
Net cash used in financing activities	<u>(5,202)</u>	<u>(11,483)</u>	<u>(108,178)</u>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<u>(5)</u>	<u>5</u>	<u>48</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	<u>791</u>	<u>(3,796)</u>	<u>(35,756)</u>
<b>Cash and cash equivalents at beginning of year</b>	<u>10,302</u>	<u>11,093</u>	<u>104,505</u>
<b>Increase in cash and cash equivalents from newly consolidated subsidiaries</b>	<u>-</u>	<u>42</u>	<u>399</u>
<b>Cash and cash equivalents at end of year</b>	<u>¥ 11,093</u>	<u>¥ 7,340</u>	<u>\$ 69,147</u>

The accompanying notes are integral parts of these statements.

# Notes to Consolidated Financial Statements

Showa Sangyo Co., Ltd. and Consolidated Subsidiaries

---

## Note 1:

### Basis of Presenting Consolidated Financial Statements

(a) The accompanying consolidated financial statements have been prepared from the consolidated financial statements in accordance with the provisions set forth in the Japanese Securities and Exchange Law and conform with generally accepted accounting principles in Japan. For the convenience of readers, however, the presentation of the financial statements and the information contained therein have been modified in certain respects.

The translations of yen amounts into dollar amounts also have been made solely for the convenience of the readers outside Japan and have been made at the rate of ¥106.15=U.S.\$1, the rate of exchange prevailing on 31st March 2000.

#### (b) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its 13 significant subsidiaries. Material inter company balances, transactions and profits have been eliminated in consolidation. Due to its growing significance, from the fiscal year ended 31st March 2000, Swan Foods Oregon Inc. was newly included into the consolidated subsidiaries.

Investments in few affiliates are accounted for by the equity method. Because of their growing significance,

the investments in Kashima Silo Co., Ltd., and Shibushi Silo Inc. are accounted for by the equity method from this period.

Investment in the remaining subsidiaries and affiliates are stated at cost. If the equity method of accounting had been applied to these investments, the effect of the accompanying consolidated financial statements would not be material. Earnings of these companies are recorded in the Company's books only to the extent that cash dividends are received.

The consolidated subsidiaries:

Shosan Shoji Co., Ltd.  
Shikishima Starch Co., Ltd.  
Kyushu Showa Sangyo Co., Ltd.  
Kida Flour Milling Co., Ltd.  
Naigai Flour Milling Co., Ltd.  
Fukushima Elite Food Co., Ltd.  
Niigata Elite Food Co., Ltd.  
Shosan Kaihatsu Co., Ltd.  
Shourei Co., Ltd.  
Showa Keiran Co., Ltd.  
Shosan Business Service Co., Ltd.  
GranPac Foods Inc.  
Swan Foods Oregon Inc.

---

## Note 2:

### Significant Accounting and Reporting Policies

#### (a) Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

#### (b) Marketable Securities

Marketable securities quoted on stock exchanges are stated at the lower of cost or market, cost being determined using the moving-average method principally. All other marketable securities are stated at cost, cost being determined using the moving-average method.

#### (c) Inventories

Inventories such as finished goods, merchandise and work-in-progress are stated at cost, cost being determined using the first-in first-out cost method principally. Raw materials and supplies are stated at cost, cost being determined using the moving-average method principally.

#### (d) Property, Plant and Equipment

Property, plant and equipment is stated at cost. Depreciation is computed under the declining balance method except for buildings and part of rental equipment which depreciated by the straight-line

method, based on the estimated useful lives of the assets as prescribed principally by Japanese Income Tax Law.

#### (e) Allowance for Doubtful Receivables

The allowance for doubtful receivables is provided in amounts at the maximum amount which can be charged to income under the Japanese Income Tax Law plus an amount estimated by reference to the collectibility of specifically identifiable bad debt.

#### (f) Bonuses

Bonuses to Company's employees, which are paid semiannually, are accrued the amount applied to the current period among the amounts expected to be paid for the following period. Bonuses to directors and statutory auditors, which are subject to approval at the general meeting of shareholders, are accounted for as an appropriation of retained earnings.

#### (g) Research and Development Expenses

Research and development expenses are charged to income as incurred.

**(h) Foreign Currency Transactions**

Foreign currency transactions relate principally to the importation of raw materials through Japanese trading companies, contracted for in U.S. dollars, for which the Company is obliged to bear any exchange risks involved in the transactions. Foreign currency transactions are translated into Japanese yen using the exchange rate in effect at the time of each transaction or at the applicable exchange rates under forward exchange contracts.

The current and non-current account balances

denominated in foreign currencies, excluding those under forward exchange contracts, are translated at the applicable historical rates in effect at the time of the transactions.

Gains or losses from foreign currency transactions are included in net income.

**(i) Per Share Data**

Per share amounts are computed by the weighted average number of shares of common stock during each year.

**Note 3:****Marketable Securities and Investment Securities**

Marketable securities and investment securities consisted of:

31st March	<i>Millions of yen</i>	<i>Thousands of U.S. dollars</i>
	<b>2000</b>	<b>2000</b>
Marketable securities:		
Book Value	¥ 999	\$ 9,409
Market Value	1,120	10,552
Investment securities:		
Book Value	¥ 10,584	\$ 99,707
Market Value	12,097	113,965

**Note 4:****Short-term and Long-term Debt**

Short-term debt at 31st March, 2000 was as follows:

	<i>Millions of yen</i>	<i>Thousands of U.S. dollars</i>
Loans from banks and other	¥ 33,135	\$ 312,153

The principal range of interest rates applicable to short-term debt at 31st March, 1999 and 2000 were from 0.7 per cent to 1.6 per cent and from 0.6 per cent to 1.3 per cent, respectively.

Long-term debt at 31st March, 2000 was as follows:

	<i>Millions of yen</i>	<i>Thousands of U.S. dollars</i>
Loans with and without collateral, principally from banks, due 2000 to 2015, with interest ranging from 0.3 per cent to 5.2 per cent.	¥ 23,889	\$ 225,058
2.125 per cent bonds due 2002	10,000	94,206
	33,889	319,264
Less: Portion due within one year	1,620	15,267
	¥ 32,269	\$ 303,997

The aggregate annual maturities of long-term borrowing during each of the years ending 31st March, 2004 and thereafter are as follows:

31st March	<i>Millions of yen</i>	<i>Thousands of U.S. dollars</i>
2001	¥ 1,620	\$ 15,267
2002	3,673	34,598
2003	6,496	61,192
2004 and thereafter	¥ 12,101	\$ 114,001

At 31st March, 2000, property, plant and equipment, net of accumulated depreciation, amounting to ¥51,558 million (\$485,709 thousand), marketable securities amounting to ¥42 million (\$396 thousand), investment securities amounting to ¥2,657 million (\$25,034 thousand) and other asset amounting to ¥23 million (\$220 thousand) were pledged as collateral for short-term debt, long-term debt, repayment obligations of deposits and trade account payable.

---

#### Note 5:

#### Retirement and Severance Indemnities

Employees whose service with the Company and its consolidated subsidiaries is terminated are, under most circumstances, entitled to lump-sum severance indemnities determined by reference to current basic rate of pay, length of service and conditions under which the termination occurs.

The Company has contributory funded pension plan for employees. Under this plan, 50% of the total retirement and severance benefits is paid by the Company with the remaining covered by pension plans which was established pursuant to the Japanese Welfare Pension Insurance Law. The plan assets aggregated ¥8,842 million (\$83,296 thousand) at 31st March, 1999. At March 31, 2000, the Company and its consolidated subsidiaries have provisions for 40% of accumulated benefit obligation.

The Company and its subsidiaries with bonuses paid to directors upon retirement have adopted the policy of accruing lump-sum severance indemnities for directors and statutory auditors based on the payment rules.

---

#### Note 6:

#### Income Taxes

The Japanese statutory tax rates applicable to income before income taxes for the fiscal years ended March 31, 1999 and 2000 were 47.0% and 42.0%, respectively. The difference represents the enacted tax rate change for the years starting on or after April 1, 1999. The difference between the statutory tax rates and effective tax rates reflects future tax effects of temporary differences as shown below.

	<i>1999</i>	<i>2000</i>
Statutory tax rate	47.0%	42.0%
Other non deductible expenses not qualifying for deduction	14.4	7.3
Dividends and other non taxable income	-4.1	-2.3
Effect from statutory tax rate change	3.8	-
Residents tax per capita basis	4.3	1.8
Effect from not appropriating refunded deferred tax assets	45.7	3.5
Others	-0.6	1.1
Effective tax rate	110.5	53.4

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at March 31, 2000 are presented below.

	<i>Millions of yen</i>	<i>Thousands of U.S. dollars</i>
Current:		
Deferred tax	1,015	9,560
	(Of which the major portion is due to tax adjustments related to fixed assets assessment.)	
Fixed:		
Deferred tax assets	76	717
	(Of which the major portion is due to tax adjustments related to accrued severance indemnities.)	
Deferred tax liabilities	4,645	43,760
	(Of which the major portion is due to tax adjustments related to reserve for advanced depreciation.)	

#### **Note 7:**

#### **Shareholders' Equity**

In accordance with the Japanese Commercial Code at least 50 per cent of the amount of converted bonds and the exercised stock purchase warrants must be credited to the common stock account.

The Japanese Commercial Code provides that an amount equivalent to at least 10% of any amount paid out as appropriation of retained earnings shall be appropriated to the legal reserve until this reserve equals 25% of the common stock account.

Legal reserve may be used to reduce or eliminate a deficit or may be transferred to stated capital through suitable shareholders and directors action, but is not available for the payment of dividends.

On October 26, 1998, the board of Directors of Showa Sangyo decided to redemption of treasury stock of 500,000 shares, resulting in 749,500,000 shares and 192,858,898 shares for numbers of registered authorizing stocks and issued stocks, respectively.

#### **Note 8:**

#### **Contingent Liabilities**

Contingent liabilities at 31st March, 1999 and 2000 for notes discounted and loans guaranteed in the ordinary course of business amounted to ¥2,120 million and ¥2,138 million (\$20,144 thousand), respectively.

#### **Note 9:**

#### **Leases**

Lessor

Shosan Shoji Co., Ltd. leases industrial machinery and equipment, vehicles and tools which are classified as direct financing leases.

Net investments in direct financing leases at March 31, 2000 included in "Property, plant and equipment" in the accompanying consolidated balance sheets, were as follows:

	<i>Millions of yen</i>	<i>Thousands of U.S. dollars</i>
Gross investment		
in direct financing leases	¥ 799	\$ 7,531
Accumulated depreciation	(477)	(4,499)
Net investment	¥ 322	\$ 3,032

At March 31, 2000, the future lease payment to be received for each of the fiscal years were as follows: ¥135 million (US\$1,276 thousand) in 2001 and ¥85 million (US\$2,688 thousand) in 2002 and thereafter.

The income and accumulated depreciation of the leased property at March 31, 2000 were ¥146 million (US\$1,377 thousand) and ¥95 million (US\$892 thousand), respectively.

Lessee

Finance leases which do not transfer ownership to lessees are accounted for in the same manner as operating leases under accounting principles generally accepted in Japan.

Leases qualifying as capital leases at March 31, 2000 were as follows:

Acquisition costs, accumulated depreciation and net book value of the major leased are as follows:

	<i>Millions of yen</i>	<i>Thousands of U.S. dollars</i>
Machinery, vehicles and tools	¥ 1,771	\$ 16,688
Accumulated depreciation	(976)	(9,198)
	¥ 795	\$ 7,490

At March 31, 2000, the future minimum leases payments were as follows: ¥268 million (US\$2,525 thousand) in 2001 and ¥527 million (US\$4,965 thousand) in 2002 and thereafter.

## Note 10:

## Segment Information

Provided below is certain information in respect of the consolidated net sales and operating income of the Company segmented into three business categories "Foods," "Feed" and "Others." "Foods" includes flour, mixes, pasta, vegetable oil, defatted soybeans, cornstarch, cornstarch-based sweeteners and frozen foods. "Feed" includes formula and other animal feeds, eggs and livestock. "Others" includes warehousing, leasing of commercial buildings and insurance business.

Information by industry segment for the year ended 31st March 2000 is summarized as follows:

	<i>Millions of yen</i>			<i>Thousands of U.S. dollars</i>		
	<i>Foods</i>	<i>Feed</i>	<i>Others</i>	<i>Total</i>	<i>Elimination</i>	<i>Total</i>
Outside customers	¥ 137,872	¥ 42,856	¥ 7,523	¥ 188,251	¥ -	¥ 188,251
Intersegment	2,440	207	2,108	4,755	(4,755)	-
Total	140,311	43,064	9,631	193,006	(4,755)	188,251
Operating expenses	137,403	42,721	5,492	185,616	(3,042)	182,574
Operating income (loss)	2,909	342	4,139	7,390	(1,713)	5,677
Assets	99,269	16,613	25,428	141,310	16,028	157,338
Depreciation	4,912	494	1,598	7,004	153	7,157
Capital expenditures	3,307	817	908	5,032	165	5,197

	<i>Millions of yen</i>			<i>Thousands of U.S. dollars</i>		
	<i>Foods</i>	<i>Feed</i>	<i>Others</i>	<i>Total</i>	<i>Elimination</i>	<i>Total</i>
Net sales:						
Outside customers	\$ 1,298,837	\$ 403,733	\$ 70,872	\$ 1,773,442	\$ -	\$ 1,773,442
Intersegment	22,983	1,953	19,855	44,791	(44,791)	-
Total	1,321,820	405,686	90,727	1,818,233	(44,791)	1,773,442
Operating expenses	1,294,418	402,459	51,742	1,748,619	(28,655)	1,719,964
Operating income (loss)	27,402	3,227	38,985	69,614	(16,136)	53,478
Assets	935,179	156,506	239,548	1,331,233	150,991	1,482,224
Depreciation	46,279	4,658	15,058	65,995	1,442	67,437
Capital expenditures	31,151	7,692	8,558	47,401	1,551	48,952

---

**Note 11:**

---

**Derivative Financial Instruments**

The Companies enter into foreign currency forward, foreign currency options, interest rate swaps and interest rate floor agreements primarily to manage risks associated with the exposures of its assets and liabilities. The Companies do not use derivative financial instruments for trading purposes. Because of their hedging purposes and high correlation between the hedging instruments and the underlying exposure, all profits and losses of derivatives financial instruments are deferred to offset reciprocal changes in the value of underlying exposure.

The Companies' off-balance derivatives financial instruments positions are summarized as follows:

**Foreign Currency Forward and Foreign Currency Options Agreement**

Upon purchases of raw materials, the Companies use foreign currency forward or options agreements to reduce exposures against adverse fluctuations in foreign currency market. Most of these agreements have maturity of less than six months.

As of March 31, 2000, the aggregate principal amount in the foreign currency forward agreements was ¥2,426 million, and there was no outstanding currency options positions.

The fair values are based on quoted market prices.

**Interest Rate Swaps and Interest Rate Floor Agreements**

The Companies enter into interest rate swaps or interest rate floor agreements for the purposes of lowering its funding costs, accessing to a variety of fund resources and locking yields while investing in fixed income markets.

All the outstanding positions in such agreements have their maturity before the end of 2005. As of March 31, 2000, the aggregate notional amounts of interest rate swaps and interest rate floor agreements were ¥20,606 million and ¥1,200 million, respectively.

---

**Note 12:**

---

**Subsequent Event**

The following appropriations of retained earnings were approved at the general meeting of shareholders of the Company held in 29th June, 2000:

	<i>Millions of yen</i>	<i>Thousands of U.S. dollars</i>
Appropriations:		
Cash dividends (¥3.0 per share)	579	5,450
Transfer to legal reserve	58	546

The Company's Board of Directors also decided to retire treasury stocks in the amount less than or equal to ¥6 billion or 20,000,000 shares by the capital surplus.

## Report of Independent Public Accountants

---

Kenshin Audit Corp.  
Certified Public Accountants  
3-2-12 Uchikanda, Chiyoda-ku, Tokyo 101-0047, Japan  
TEL 03-3252-2728 FAX 03-3252-2726

To the Board of Directions of Showa Sangyo Co.,Ltd.

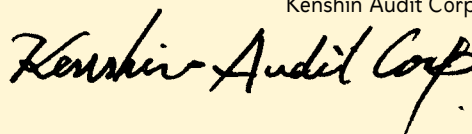
We have audited the consolidated balance sheets of Showa Sangyo Co.,Ltd. and its consolidated subsidiaries as of March 31, 1999 and 2000, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. We conducted our audit in accordance with auditing standards generally accepted 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 mentioned above, expressed in Japanese yen, present fairly the financial position of Showa Sangyo Co.,Ltd. and its consolidated subsidiaries as of March 31, 1999 and 2000, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

We have also recomputed the translation of the statements mentioned above at March 31, 2000 and for the year then ended into U.S. dollars on the basis described in Note 1 (a) of the Notes to Consolidated Financial Statements of the Company.

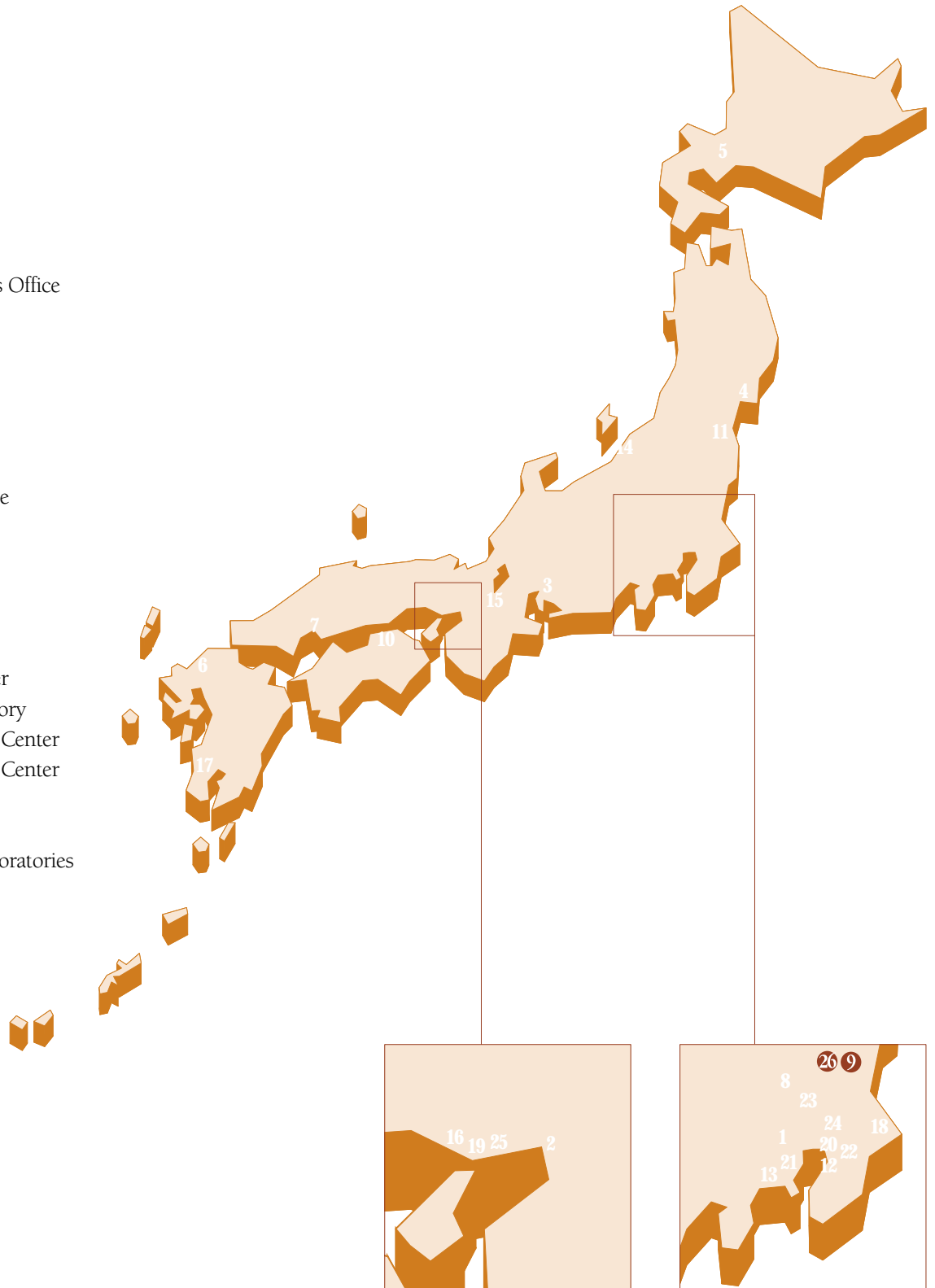
29th June, 2000  
Tokyo, Japan

Kenshin Audit Corp.



# DOMESTIC NETWORK

- Head Office
- Osaka Branch
- Nagoya Branch
- Sendai Branch
- Sapporo Branch
- Fukuoka Branch
- Hiroshima Branch
- Ohta Branch
- Mito Branch
- Takamatsu Business Office
- Fukushima Office
- Chiba Office
- Kanagawa Office
- Niigata Office
- Kyoto Office
- Kobe Office
- South Kyushu Office
- Kashima Plant
- Kobe Plant
- Funabashi Plant
- Tsurumi Plant
- Research and Development Center
- Bio Science Laboratory
- Food Development Center
- Food Development Center (Western Division)
- Animal Feed and Allied Products Laboratories



# CORPORATE DATA

## PRINCIPAL SHAREHOLDERS

The shares of common stock of the Company are listed on the Tokyo and Osaka Stock Exchanges. On 31st March, 2000, there were 14,401 shareholders listed on the Company's register of shareholders. The following table lists the ten largest shareholders appearing on the register at that date.

Name	Number of Shares Held (Unit : Thousand shares)	Percentage of Total Shares Outstanding
Nissho Iwai Corporation	17,545	9.1
The Dai-ichi Kangyo Bank, Limited	9,238	4.8
Nippon Fire & Marine Insurance Co.,Ltd.	8,711	4.5
The Chiba Bank, Ltd.	7,875	4.1
The Industrial Bank of Japan Ltd.	6,786	3.5
The Norinchukin Bank	5,515	2.9
I TOCHU Corporation	5,495	2.8
The Yasuda Fire and Marine Insurance Co., Ltd.	5,101	2.6
Yuasa Funashoku Co., Ltd.	5,049	2.6
Nissho Iwai Foods Co., Ltd.	4,070	2.1

## GENERAL INFORMATION ON SHARES

Fiscal year End : March 31

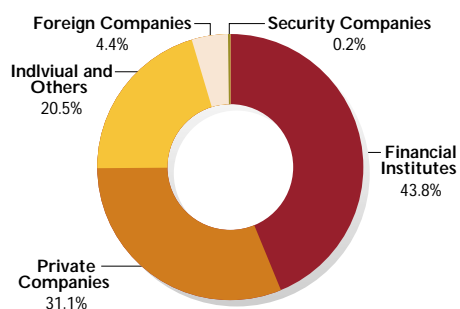
General Meeting of Shareholders : June

Stock Transfer Agent : The Toyo Trust & Banking Co., Ltd.

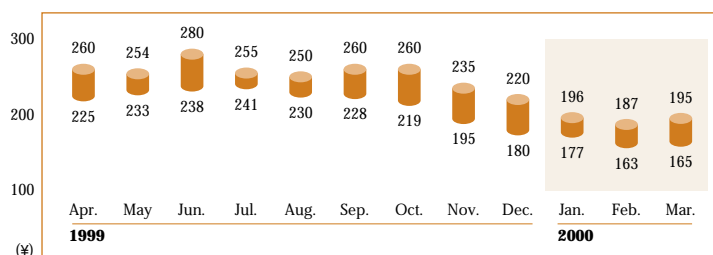
Share Handling Office : 4-3, Marunouchi 1-Chome, Chiyoda-ku, Tokyo, Japan

Newspaper for Public Notice : The Nihon Keizai Shimbun

## STOCKS BY SHAREHOLDERS



## MONTHLY STOCK PRICE



日本をおいしくする  
**SHOWA**

**Showa Sangyo Co., Ltd.**

Kamakuragashi Building  
2-1, Uchikanda 2-chome, Chiyoda-ku,  
Tokyo 101-8521, Japan

Phone : +81 3-3257-2036

Facsimile : +81 3-3257-2938

URL: <http://www.showa-sangyo.co.jp>



In the interest of protecting the environment, this annual report is printed on Eco-Mark certified recycled paper with soy ink.