



**MITSUBISHI PAPER MILLS LIMITED**

Annual  
Report **2006**

During the period of more than a century since its establishment in 1898, the Mitsubishi Paper Mills Group has provided its customers with products backed by advanced technological capabilities and has developed products designed to meet the needs of the times, guided by a management philosophy that advocates contributing to society. The following management policies are inspired by this philosophy.

- 1. By increasing research and development capabilities, strength in production technology, cost competitiveness, and sales and service strength, to become a corporate group that lives up to the confidence placed in it by its customers in the world market of the 21st century.**
- 2. To concentrate management resources on business fields in which the Group excels, and on new businesses that take advantage of its unique technologies, in order to be a highly profitable corporate group.**
- 3. To be a corporate group that contributes to environmental conservation and the recycling of resources.**

The Group will continue its pursuit of a more affluent society and higher standards of industrial activity by addressing next-generation technical innovation that both creates new value and enables it to satisfy customer expectations.

As of March 31, 2006, the Group's total capital stock amounted to ¥30.8 billion (US\$262 million), its employees numbered 4,717, and it operated state-of-the-art paper mills at five locations in Japan, and two in Germany.

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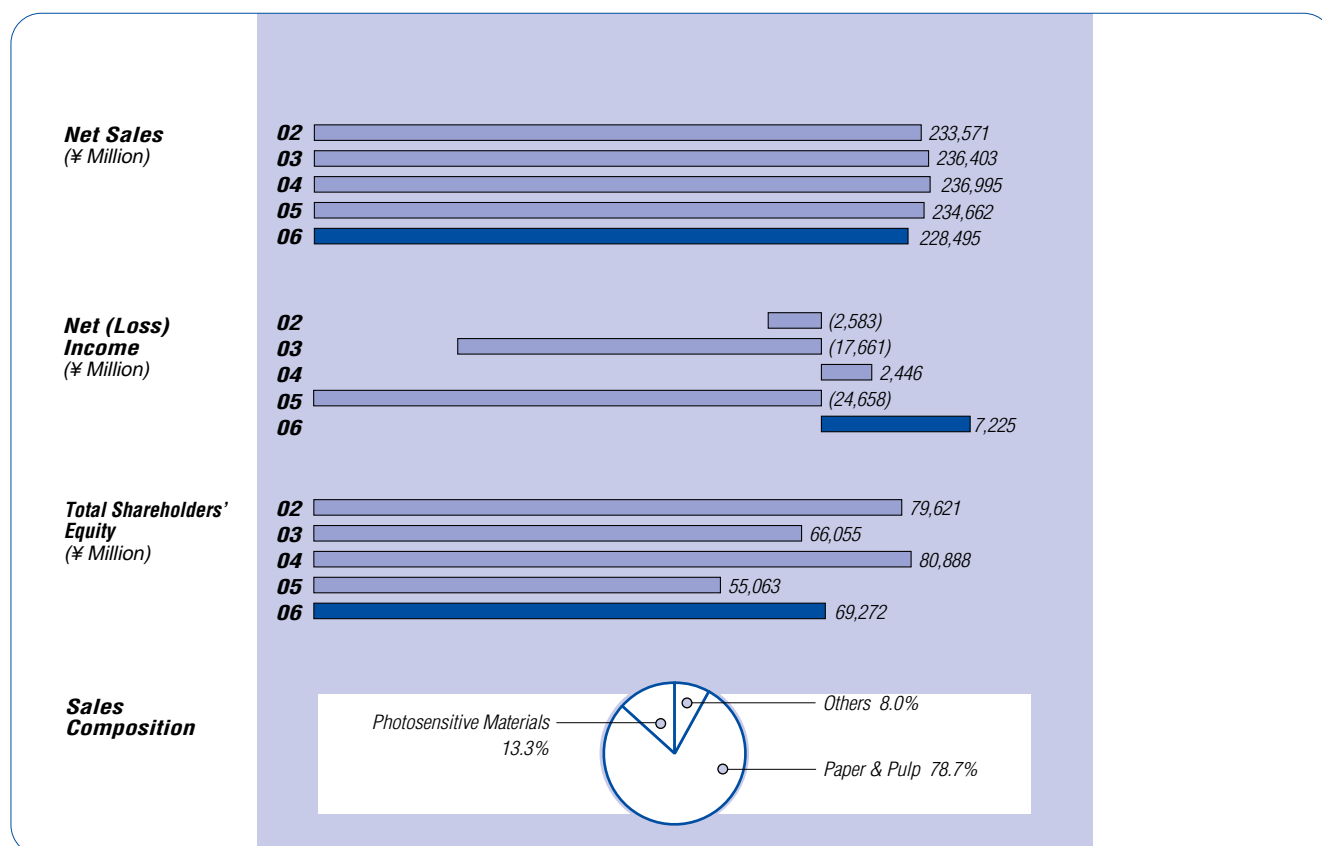
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**FINANCIAL HIGHLIGHTS (CONSOLIDATED)**

	Millions of yen (1)		Thousands of U.S. dollars (1) and (2)
	2006	2005	2006
<b>For the years ended March 31</b>			
Net sales	¥228,495	¥234,662	\$1,945,139
Net income (loss)	7,225	(24,658)	61,512
Net income (loss) per share (in yen and dollars)	22.16	(75.75)	0.19
Cash dividends per share (in yen and dollars)	—	—	—
<b>As at March 31</b>			
Total assets	¥314,869	¥319,469	\$2,680,420
Total shareholders' equity	69,272	55,063	589,706
Common stock	30,865	30,865	262,752
Number of shareholders	23,615	21,188	
Number of employees	4,717	4,902	

Notes: (1) In this annual report, Japanese yen (in millions) and U.S. dollars (in thousands) are indicated with fractions omitted.

(2) U.S. dollar amounts in this report represent translations of yen amounts at the rate of ¥117.47=U.S.\$1, as of March 31, 2006.





*Takeshi Sato, President*

### **Overview of the reporting term**

In November of 2005 Mitsubishi Paper Mills drew up the Phoenix Plan, a medium-term revival plan, and during the four remaining months of the reporting term we vigorously worked as a team to achieve the goals of the plan.

In the paper and pulp divisions, though demand for wood-free and coated paper, our main products, became relatively firm thanks to the expansion of the economy, market prices declined, particularly from early autumn, due to a build-up of inventory. We focused efforts on expanding the sales of our main products and developing new products, but sales in both volume and value term were down from the previous fiscal year.

In the photosensitive materials division, as demand fell worldwide for conventional photographic film, total sales decreased due to a decline in demand for traditional printing plate materials. However, the sales volume of photographic paper and photographic base paper rose over the levels of the previous year due mainly to favorable market conditions caused by the withdrawal of major players. As a result, net sales on a consolidated basis came to ¥228,495 million (US\$1,945 million), a 2.6% year-on-year decrease.

On the profit front, stagnant paper prices and a sharp rise in the cost of raw materials such as heavy oil were among the reasons for declining profit. Even so, ordinary income on a consolidated basis rose to ¥4,774 million (US\$40 million), up 182.7%

over the previous fiscal year. This was the result of various factors, including reductions in labor expenses through voluntary retirements implemented in the previous fiscal year, reduction of depreciation costs through the posting of a valuation loss on the Kitakami Mill (now Kitakami Hitec Paper Corp.) at the end of the previous fiscal year, steps to reduce logistics costs and other fixed costs, and improvements in production efficiency through increased yield and improved mixing. The Company posted an extraordinary gain through the sell-off of assets. Partially as a result of this extraordinary gain, we achieved a net income of ¥7,225 million (US\$61 million) on a consolidated basis. As a result, we attained our goals for ordinary income\* on a consolidated basis and a reduction in interest-bearing debt, and were able to bring Kitakami Hitec Paper Corp. into the black with respect to ordinary income in the fiscal year under review, which was its first year of independent operation.

On a non-consolidated basis, net sales were ¥151,935 million (US\$1,293 million), and net income was ¥3,511 million (US\$29 million).

### **Medium-to-long-term management strategies and issues**

The Group continues to face a challenging business environment. For example, the market for paper has weakened due to heavy global competition, and costs are up because raw material and fuel costs have soared and show no signs of coming back

down. There is no room for optimism, but by following through with the Phoenix Plan, our medium-term revival plan, through March 2008, we will have set up an operational foundation, solidified our footing on the road to future growth, and aim to leverage our technological development capabilities to establish a reputation for ourselves as a “distinctive papermaker.”

In terms of corporate governance, we have introduced an executive officer system, which separates the processes of management supervision and day-to-day implementation. This speeds up business decision-making and allows us to streamline the Board of Directors, as well as reinvigorating the entire organization. To further reinforce corporate governance and strengthen the supervisory capabilities of the Board, we have decided to appoint outside directors to the Board.

The Group as a whole is working to ensure that all employees, from managers to staff, adhere to all laws and ordinances by following the Code of Conduct of Mitsubishi Paper Mills, Ltd. In 2004, we set up a whistleblower hotline for the use of all Group employees worldwide. The Group will continue to work to strengthen its compliance system. In December 2005, we created an Internal Control Committee, headed by the President. We are working as one to enhance the reliability of our financial reports.

We have positioned environmental protection as one of the foundations of our operations. We recognize that protecting the irreplaceable environment is an important duty of any business enterprise, and are working in various ways to fulfill this duty. Specifically, we are working to popularize the use of paper certified by the Forest Stewardship Council (FSC) by introducing FSC certified wood chips from Iwaizumi-cho in Iwate Prefecture in addition to the FSC certified wood chips we import. By installing a waste-to-energy (WTE) power generation facility at the Hachinohe Mill and a power generator using a gas-powered engine at the Takasago Mill, we are greatly reducing our carbon dioxide emissions. We are also contributing to the reduction of environmental burden, chiefly from discharged water, by using ECF (elemental chlorine free)

bleaching during pulp production at the Hachinohe Mill. We will continue to work toward comprehensive environmental load reduction by providing a product line that is both high in quality and environmentally friendly.

### Forecast

At present, the Group expects the business environment to remain challenging, as there are many areas of concern with respect to sales and raw material costs. To attain profitability, the Group will continue to put its strength behind the operational measures outlined in the Phoenix Plan.

For the current fiscal year, ending March 2007, we forecast net sales of ¥230.0 billion, ordinary income of ¥4.5 billion, and net income of ¥5.5 billion, all on a consolidated basis. On a non-consolidated basis, we forecast net sales of ¥155.0 billion, ordinary income of ¥3.3 billion, and net income of ¥5.0 billion.

\* Due to reclassification, ordinary income does not appear in the statements of operations.

June 2006

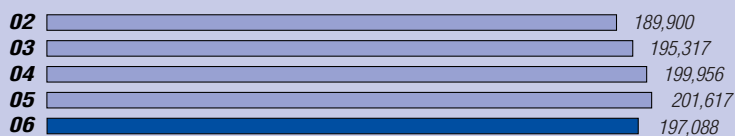


Takeshi Sato  
*President*

## BREAKDOWN OF OPERATIONS BY DIVISION

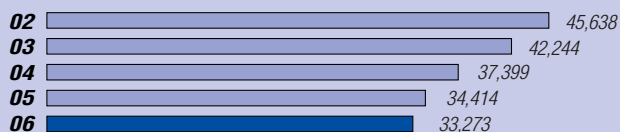
### PAPER AND PULP DIVISIONS

Net Sales (¥ Million)



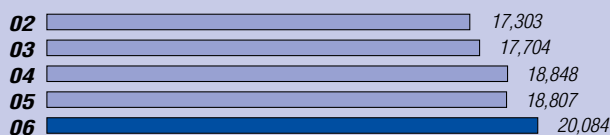
### PHOTOSENSITIVE MATERIALS DIVISION

Net Sales (¥ Million)



### OTHER DIVISIONS

Net Sales (¥ Million)



### Overseas Sales Breakdown

For the year ended March 31, 2006	Millions of yen	Thousands of U.S. dollars
Asia	¥ 8,648	\$ 73,624
Europe	31,445	267,685
Africa & Middle East	2,235	19,033
North America	15,116	128,680
Central & South America	1,434	12,214
Oceania	2,741	23,336
Others	697	5,938
<b>Total</b>	<b>¥62,319</b>	<b>\$530,512</b>

Accompanying the steady growth of the domestic economy, demand for our main products, wood-free paper and coated paper, remained relatively firm in the commercial printing field, which includes catalogs and flyers, thanks to growth in demand from the digital home appliance, housing, and travel industries. The market weakened from the start of autumn due to industry-wide concern over increases in inventory, leading to a year-on-year decline in prices.

In the market for business communication paper, demand for carbonless paper used for business forms was strong in the first half, largely as a result of the enactment of the Personal Information Protection Law, but gradually declined in the second half. Demand for thermal paper, especially for paper used in POS terminals and cash registers, remained firm, but sales of inkjet printing paper due to intensified competition.

With the growing popularity of digital cameras, demand for conventional photographic film declined worldwide, and several major manufacturers withdrew from the market. Taking advantage of the trend, Mitsubishi Paper Mills aggressively expanded its share of the photographic paper market, resulting in increases over the previous period in terms both of sales volume and revenue. Sales volume and revenue also increased over the previous period for photographic base paper, as we diversified our dealerships and expanded applications.

In printing plate materials, sales volume and revenue fell on a

For other divisions, including the operation of sports facilities, sales on a consolidated basis increased by 6.8% year-on-year, to ¥20,084 million (US\$170 million).

Under these conditions, we worked to develop new products, such as low density paper (Broad Series), and to improve our product quality. In addition, we focused on expanding sales of coated paper, our main product line, introduced our Real White Matte Paper, and increased the use of environment-friendly FSC-certified paper.

At our European subsidiaries, we continued to improve thermal paper sales, and strengthened screening for order acceptance amid severe business conditions, including fierce competition, falling market prices, and rising raw material costs. For the pulp business, sales in both volume and value terms fell year-on-year, owing to an increase in the volume used in-house.

As a result of the above, in the paper and pulp business, sales on a consolidated basis decreased by 2.2% from the previous fiscal year, to ¥197,088 million (US\$1,677 million).

year-on-year comparison. Sales of products for digital appliances grew, while those for traditional products declined sharply.

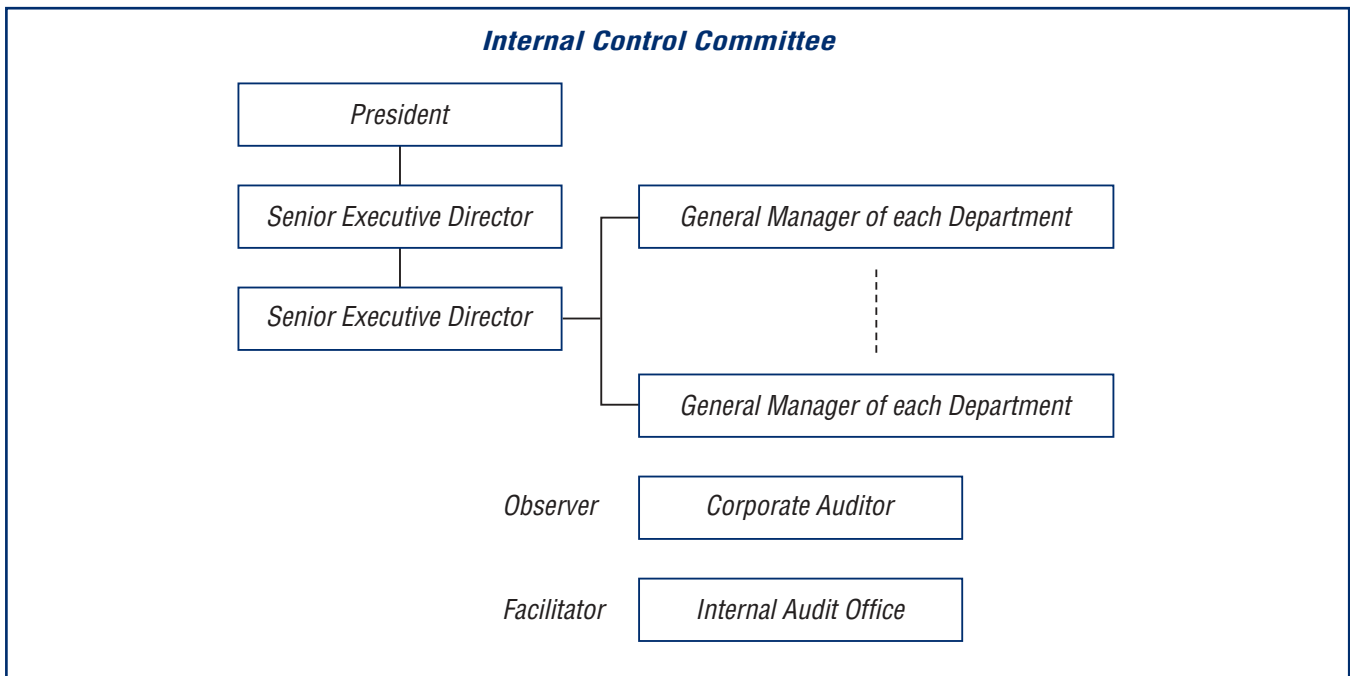
As a result, overall sales of the photosensitive materials division, on a consolidated basis, decreased by 3.3% from the previous fiscal year, to ¥33,273 million (US\$283 million).

## Compliance System

In December 2005, we created an Internal Control Committee, headed by President Takeshi Sato. This committee's goals are to enhance the reliability of the financial statements we will make public in order to fully meet the requirements of the Japanese version of the Sarbanes-Oxley Act (SOX). (It is widely believed that this will go into effect in 2008.) In addition, its goals are to make day-to-day operations more effective, and to enhance compliance with relevant laws and ordinances.

This committee will oversee the establishment of an internal control system for the entire Mitsubishi Paper Mills (MPM) group, and evaluate and support the projects to document the control system within the group companies and their departments to comply with the Japanese version of SOX. In Japan, the new Corporation Law has recently gone into effect, which indicates that the tide of corporate governance in this country has reached a turning point where enhancement of accountability to stakeholders has become a more urgent issue.

It is of critical importance to set up an internal control system to respond to these expectations, and we believe this will involve major effort. But rather than being reactive, we intend to increase the transparency of our operations by creating a trustworthy internal control system, thereby enhancing our enterprise value.



### ***Efforts to reduce carbon dioxide emissions***

Together with the Institute of Industrial Science at the University of Tokyo and Kokusai Kogyo Co., Ltd., Mitsubishi Paper Mills has completed development of a system that measures the growth of trees in plantations using satellite images. This will be the first such system in Japan to undergo practical testing. Joint development began in February 2003 and was expected to take 2 years.

The system estimates tree growth for the whole of a forested area by extracting the tree activity (vegetation index) from satellite images of the area and combining this with a vegetation growth model. A vegetation growth model is used to calculate the growth of the vegetation. This system also incorporates historic data on trees and information on soil and weather conditions into the model, thereby improving its accuracy. The resolution of Landsat satellite imaging is about 30 m (that is, two trees can be distinguished if they are 30 m or more apart), making it possible to photograph a wide range –180 km– in one image. In the past, logging plans were based on extrapolating the growth of a forest based on the actual growth of only part of the forest. This system, however, makes it possible to extrapolate growth for a larger area, including changes within the forested area, allowing more efficient forest management. We are planning to apply this system to the calculation of carbon dioxide sequestration.

Preliminary evaluation shows growth measurement accuracy comparable to those of standard methods ( $\pm 15\%$ ). We plan to make measurements using this system at the Mitsubishi Paper Mill Chile plantation (Chile Regions VIII and IX, about 10,000 hectares, FSC certified) and, by comparing these measurements against the amount of lumber after logging, determine accuracy and make necessary improvements.



Satellite image of forested areas in Chile

### ***Using domestic FSC certified chips***

In 2001, we became the first company in Japan to produce FSC certified paper, at our Hachinohe Mill. Until then, we had procured our FSC certified chips from our own plantation in Chile (Chile Region VIII and IX) and other certified forests overseas. In 2006, we have begun using domestic certified chips from Iwaizumi-cho in Iwate Prefecture as well as those we imported. This has been made possible by setting up a certified material management system, allowing us to ship only certified chips. This is the first time a Japanese paper mill has accepted certified chips from domestic FSC certified forests. Currently, we take in about 300 tons a year, but we plan to increase this when there is more FSC certified material available from the Tohoku area.

Iwaizumi-cho in Shimohei-gun, located in northeast Iwate Prefecture, is the largest town in the region by area, and 93% of its land is forest. About 5,300 hectares of forest, primarily owned by the local government, received certification by the FSC in 2003. Trees logged in the forests of Iwaizumi-cho are made into wood chips at one of our affiliates, then shipped to our mills. We have developed a traceability system that can track the whole process to make sure that other wood chips do not mingle in, all the way from the invoice.

FSC's (Forest Stewardship Council, headquartered in Germany) forest certification system certifies "appropriate forest management" from environmental, economic and societal viewpoints. Its goal is to spread sustainable forest management by labeling lumber and wood products from certified forests.

There are two kinds of certification: forest management (FM) certification and Chain of Custody (CoC) certification. The latter pertains to production, distribution and processing. Forest management certification certifies "appropriate forest management," and "CoC certification" certifies that products use lumber from certified forests.

**Adoption of the Phoenix Plan (Medium-Term Revival Plan)**

We are currently implementing the Phoenix Plan, a three-year operational plan drafted in fiscal 2005 and covering the period from November 2005 to March 2008.

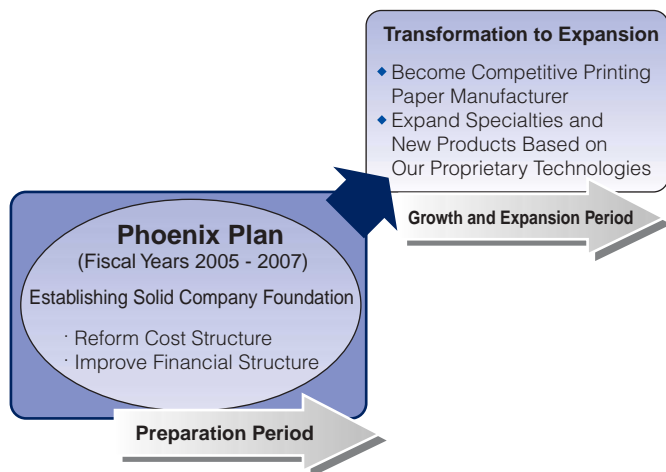
The background to the drafting of this plan consists of several years of efforts on our part to adapt to a rapidly changing and increasingly severe business environment. We further enhanced productivity, spun off our Kitakami Mill as Kitakami Hitec Paper Corp., and restructured our photo-sensitized printing materials business. We also undertook a thorough review of logistics costs as well as diverse measures to improve profitability, including cutting personnel costs through our first-ever voluntary retirement program.

However, after a prospective merger was called off, the Company was faced with a severe situation, making it necessary to further restructure the Group. This led us to draft and promulgate the Phoenix Plan.

Our aim is to become a “Distinctive Papermaker” by optimally leveraging our technical development capabilities. We aim to become a strongly competitive company with a high brand profile, expanding our presence in the specialty paper market, as well as developing and expanding new business areas.

We position this plan as laying the groundwork for future growth. We intend to build a resilient operational base by revising our cost structure and improving our financial position.

**Target of Phoenix Plan**



**1. Name of the Plan**

Phoenix Plan (Medium-Term Revival Plan)

**2. Period of the Plan**

November 2005–March 2008

**3. Positioning of the Plan**

We position this plan as laying the groundwork for future growth. We plan to build a resilient operational base by revising our cost structure and improving our financial position.

**4. Vision for the Group’s Future**

“A Distinctive Papermaker”

- Aim to become a competitive printing paper manufacturer
- Focus strategic investment on the Hachinohe Mill, offer products at competitive prices together with superior service
- Expand the specialty paper market, and develop and expand new business areas

Leverage the technology we have accumulated over the years, and build on it

**5. Five Policies for Revival**

- (1) High-cost structure
  - Revise cost structure
  - Reduce total costs by 5% (including personnel cost reduction of 20% at MPM)
  - Total cost reduction for FY2006-2007: ¥8.3 billion
- (2) Financial position
  - Reduce interest-bearing debt by 20% by selling off assets; reduce the interest burden
  - Total reduction of interest-bearing debt for FY2006-2007: ¥40 billion
- (3) Concentration on paper business and investments in new businesses
  - To strengthen the printing paper business, concentrate strategic investment of ¥20 billion on the Hachinohe Mill to enhance profitability (Total capital investment of ¥42.5 billion, of which strategic investment is ¥27.5 billion)
  - Total effect on earnings for FY2006-2007: ¥2.5 billion
  - Enhance ratio of new products
  - New product ratio for FY2007: 25%
  - Make optimal use of our technical development capability and develop new business areas
  - Increase growth rate of new business sales to 50%

#### (4) Kitakami Hitec Paper

- Implement thorough cost reduction measures
- Carefully lower production capacity of resin-coated paper in line with declining demand
- Expand production lineup
- Revenue up by more than ¥5 billion compared with FY2004
- Posting ordinary income by the end of FY2006

#### (5) Distribution

- Promote collaboration with Mitsubishi Corp.
- Strengthen total sales capability of Mitsubishi Paper Sales Co., Ltd.; effect transformation to agile and highly successful sales company
- Make more effective use of their status as an exclusive agent; thoroughly revise operations
- Mitsubishi Paper Sales Co., Ltd. profit for FY2007: ¥1 billion

## 6. Numerical Targets

### Plan (Consolidated Basis)

(¥ billions)

	Actual		Plan	
	FY2004	FY2005	FY2006	FY2007
Sales.....	234.6	230.0	230.0	235.0
Ordinary income.....	1.6	3.5	4.5	7.0
Sales - % of ordinary income.....	0.7%	1.5%	2.0%	3.0%
Interest bearing debt.....	193.9	174.0	164.0	154.0
Interest bearing debt - % of sales.....	83%	76%	71%	66%
ROA (R = Ordinary income).....	0.5%	1.1%	1.5%	2.3%
Shareholders' equity as a percentage of total assets....	17%	20%	22%	24%
Employees				
Start of period.....	5,260			
End of period.....	4,902	4,800	4,800	4,700

### Key Targets of Projects

PROJECT	Key Targets (compared with 2005)
Cost Structure	Productivity improvement and cost reduction → Total: ¥4.1 bil./'06 (incl. ¥0.7 bil. investment effect) and ¥8.4 bil./'07 (Incl. ¥2.5 bil. investment effect)
R&D System	Organizational Reform: Consolidate and improve technologies. Review R&D system
New Business Development	Establish new organizations: Promote 5 growing businesses → ¥5.0 bil. sales in '07
Management Decentralization	Corporate Spin-offs: Spin off all mills to implement reorganization
Business Process Re-Engineering (BPR)	Business Process Re-Engineering: Reduce volume of work → ¥600 mil. Reduction in '07 by improving operating efficiency
Paper Sales	Profit improvement: Ordinary profit of ¥1.0 bil. by Mitsubishi Paper Sales Collaboration with Mitsubishi Corporation (improved product portfolio and better understanding of customer needs)
Logistics	Establish new organization: New logistics company handles entire MPM logistics → Logistics cost reduction by ¥800 mil. in '07 = Total of ¥1,600 mil. reduction including ongoing measures
Human Resources	Introduction of new personnel system: System based on management-by-results and incentives → ¥1.0 bil. personnel cost reduction (Total: ¥1.8 bil.)
Corporate Governance	Separate responsibilities between board of directors and executive officers Strengthen corporate compliance, and enhance internal audit functions

## 7. Promotional Committees

Work toward thorough structural reform helped by promotion committees in charge of the following nine issues.

- (1) Cost structure
- (2) R&D system
- (3) New business development
- (4) Management decentralization (corporate spin-offs)
- (5) Business process reengineering (BPR)
- (6) Paper sales
- (7) Logistics
- (8) Human resources
- (9) Corporate governance

We will work on the above with unyielding resolve and unity of purpose. In these endeavors, we look forward to receiving the wholehearted support of our stakeholders, particularly our shareholders and customers.

## OUR MILLS AND THEIR PRODUCT LINES



### SHIRAKAWA MILL

Address: 3, Aza Maeyamanishi, Nishigo-mura, Nishi-Shirakawa-gun, Fukushima 961-8054  
 Telephone: +81-248-22-8111  
 Products: Transformer board, Specialized chemicals



### KITAKAMI HITEC PAPER CORP.

Address: 35, Sasanagane, Aisari-cho, Kitakami-shi, Iwate 024-0051  
 Telephone: +81-197-67-3211  
 Products: Bleached kraft pulp, Toiletry tissue, Photographic basepaper, etc.



### HACHINOHE MILL

Address: Aza Aomoriyachi, O-aza Kawaragi, Hachinohe-shi, Aomori 031-1197  
 Telephone: +81-178-29-2111  
 Products: Bleached kraft pulp, Chemiground pulp, Coated paper, Uncoated paper, Real art paper, White coated board, etc.



### TAKASAGO MILL

Address: 105, Sakae-machi, Takasago-cho, Takasago-shi, Hyogo 676-8677  
 Telephone: +81-794-42-3101  
 Products: Bond & ledger paper, Tracing paper, Carbonless paper, Thermal paper, Inkjet printing paper, Cast-coated paper, etc.

### KYOTO MILL

Address: 6-6, Kaiden 1-chome, Nagaokakyo-shi, Kyoto 617-8666  
 Telephone: +81-75-951-1181  
 Products: Color photographic paper, Black and white photographic paper, Silver halide printing plates, Graphic arts films, Inkjet printing paper, etc.



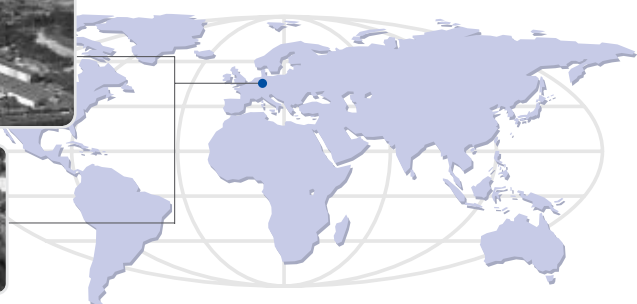
## OVERSEAS

### Mitsubishi HiTec Paper Bielefeld GmbH

Address: Niedernholz 23, D-33699 Bielefeld, Germany  
 Telephone: +49-521-2091-232  
 Products: Carbonless paper, Cast-coated paper, etc.  
 (Bielefeld, Germany)

### Mitsubishi HiTec Paper Flensburg GmbH

Address: Husumer Strasse 12 D-24941 Flensburg, Germany  
 Telephone: +49-461-8695-295  
 Products: Thermal paper, Inkjet printing paper, etc.  
 (Flensburg, Germany)



**SIX-YEAR SUMMARY (CONSOLIDATED)**

	Millions of yen						Thousands of U.S. dollars
	2006	2005	2004	2003	2002	2001	2006
<b>For the years ended March 31</b>							
Net sales	¥228,495	¥234,662	¥236,995	¥236,403	¥233,571	¥253,976	\$1,945,139
Operating income	6,484	4,326	4,631	1,837	4,931	9,536	55,199
Net income (loss)	7,225	(24,658)	2,446	(17,661)	(2,583)	1,803	61,512
Net income (loss) per share (in yen and dollars)	22.16	(75.75)	7.48	(54.21)	(7.92)	5.53	0.19
<b>As at March 31</b>							
Total assets	¥314,869	¥319,469	¥374,716	¥370,322	¥399,605	¥393,398	\$2,680,420
Total shareholders' equity	69,272	55,063	80,888	66,055	79,621	89,066	589,706

**CONSOLIDATED BALANCE SHEETS**

As at March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2006	2005	2006
<b>ASSETS</b>			
<b>Current assets:</b>			
Cash and bank deposits (Note 3 (12))	¥ 9,984	¥ 5,096	\$ 84,995
Receivables:			
Trade notes and accounts	61,196	62,280	520,952
Other	1,885	1,866	16,051
	63,081	64,146	537,003
Less: Allowance for doubtful accounts	(646)	(818)	(5,504)
	62,435	63,328	531,499
Inventories	40,056	39,939	340,992
Deferred income taxes (Note 9)	2,212	2,351	18,833
Other	1,627	1,844	13,854
Total current assets	116,315	112,560	990,174
<b>Property, plant and equipment (Note 7):</b>			
Land	22,778	25,549	193,904
Buildings and structures	102,378	104,034	871,532
Machinery and equipment	320,688	319,907	2,729,963
Construction in progress	1,126	880	9,591
Other	10,616	11,201	90,373
	457,588	461,573	3,895,365
Less: Accumulated depreciation	(323,373)	(317,310)	(2,752,821)
Accumulated impairment losses	(587)	(—)	(5,003)
Total property, plant and equipment	133,626	144,263	1,137,540
<b>Investments and other assets:</b>			
Investments in securities (Notes 5 and 7)	56,469	51,027	480,713
Investments in unconsolidated subsidiaries and affiliated companies	1,300	1,849	11,068
Long-term loans	456	315	3,887
Less: Allowance for doubtful accounts	(251)	(461)	(2,144)
Deferred income taxes (Note 9)	796	3,447	6,778
Other	6,155	6,467	52,401
Total investments and other assets	64,926	62,645	552,705
Total assets	¥314,869	¥319,469	\$2,680,420

The accompanying notes are an integral part of these financial statements.

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2006	2005	2006
<b>LIABILITIES, MINORITY INTERESTS AND SHAREHOLDERS' EQUITY</b>			
<b>Current liabilities:</b>			
Short-term bank loans	¥101,795	¥ 99,350	\$ 866,562
Commercial paper	—	10,000	—
Current portion of long-term debt (Note 6)	15,245	28,098	129,786
Payables:			
Trade notes and accounts	25,983	26,975	221,193
Other	4,187	4,163	35,643
Accrued expenses	12,912	13,190	109,925
Income taxes payable	326	720	2,776
Other	3,391	2,847	28,867
<b>Total current liabilities</b>	<b>163,841</b>	<b>185,345</b>	<b>1,394,755</b>
<b>Long-term debt:</b>			
Debentures and loans (Note 6)	53,485	54,404	455,310
Accrued post-employment benefits to employees (Note 8)	12,536	13,581	106,718
Accrued retirement benefits to directors and statutory auditors	239	848	2,037
Deferred income taxes (Note 9)	5,203	2,294	44,294
Other	2,882	2,514	24,535
<b>Total long-term debt</b>	<b>74,346</b>	<b>73,644</b>	<b>632,897</b>
<b>Minority interests in subsidiaries</b>	<b>7,407</b>	<b>5,416</b>	<b>63,061</b>
<b>Contingent liabilities (Note 10)</b>			
<b>Shareholders' equity:</b>			
Common stock			
Authorized : 500,000,000 shares at March 31, 2005			
: 900,000,000 shares at March 31, 2006			
Issued: 326,084,332 shares at March 31, 2006 and 2005	30,865	30,865	262,752
Additional paid-in capital	17,791	31,711	151,459
Retained earnings	5,010	(16,322)	42,657
Net unrealized gains on available-for-sale securities, net of tax	15,902	9,104	135,375
Foreign currency translation adjustment	(217)	(230)	(1,854)
Less: Treasury stock, at cost	(80)	(65)	(684)
<b>Total shareholders' equity</b>	<b>69,272</b>	<b>55,063</b>	<b>589,706</b>
<b>Total liabilities, minority interests and shareholders' equity</b>	<b>¥314,869</b>	<b>¥319,469</b>	<b>\$2,680,420</b>

The accompanying notes are an integral part of these financial statements.

**CONSOLIDATED STATEMENTS OF OPERATIONS**

For the years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2006	2005	2006
Net sales	¥228,495	¥234,662	\$1,945,139
Cost of sales	182,546	188,760	1,553,984
Gross profit	45,948	45,901	391,155
Selling, general and administrative expenses	39,464	41,575	335,955
Operating income	6,484	4,326	55,199
<b>Other income (expenses):</b>			
Interest and dividend income	701	744	5,974
Interest expenses	(2,553)	(2,947)	(21,734)
Gains (losses) on disposal of properties	4,201	(715)	35,765
Gains on sales of investments in securities	4,648	2,554	39,570
Write-down of investments in securities	(32)	(404)	(273)
Loss from plant restructuring	—	(1,147)	—
Loss from business restructuring	(652)	(28,446)	(5,554)
Impairment loss on fixed assets (Note 4)	(2,784)	—	(23,707)
Loss from adjustment of a subsidiary	(1,331)	—	(11,332)
Expense of environmental measure	(1,116)	—	(9,500)
Other, net	301	126	2,568
Total	1,383	(30,235)	11,716
Income (loss) before income taxes and minority interests	7,867	(25,909)	66,976
<b>Income taxes:</b>			
Current	531	722	4,523
Deferred (Note 9)	117	(1,920)	996
	648	(1,198)	5,520
<b>Minority interests in losses of consolidated subsidiaries</b>	<b>6</b>	<b>51</b>	<b>57</b>
Net income (loss)	¥ 7,225	¥ (24,658)	\$ 61,512
		Yen	U.S. dollars (Note 2)
<b>Amounts per share:</b>			
Net income (loss) — primary (Note 3 (11))	¥22.16	¥(75.75)	\$0.19
Cash dividends applicable to the year	—	—	—

The accompanying notes are an integral part of these financial statements.

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

For the years ended March 31, 2006 and 2005

	Number of shares (thousand)		Millions of yen		Thousands of U.S. dollars (Note 2)
	2006	2005	2006	2005	2006
<b>Common stock:</b>					
Beginning balance	326,084	326,084	¥ 30,865	¥ 30,865	\$ 262,752
Ending balance	326,084	326,084	¥ 30,865	¥ 30,865	\$ 262,752
<b>Additional paid-in capital:</b>					
Beginning balance			¥ 31,711	¥ 31,711	\$ 269,956
Gain on disposal of treasury stock			0	0	1
Amount of additional paid-in capital demolition			(13,919)	—	(118,498)
Ending balance			¥ 17,791	¥ 31,711	\$ 151,459
<b>Retained earnings:</b>					
Beginning balance			¥(16,322)	¥ 8,809	\$(138,948)
Net income (loss) for the year			7,225	(24,658)	61,512
Amount of additional paid-in capital demolition			13,919	—	118,498
Increase due to merger of unconsolidated subsidiary company			200	—	1,707
Bonuses to directors and statutory auditors			(13)	(10)	(113)
Increase due to exclusion of an affiliate from application of equity method			—	29	—
Decrease due to exclusion of consolidated subsidiaries			—	(0)	—
Cash dividends paid			—	(491)	—
Ending balance			¥ 5,010	¥(16,322)	\$ 42,657
<b>Net unrealized gains on available-for-sale securities, net of tax:</b>					
Beginning balance			¥ 9,104	¥ 9,900	\$ 77,509
Net unrealized gains on available-for-sale securities, net of tax for the year			6,797	(795)	57,866
Ending balance			¥ 15,902	¥ 9,104	\$ 135,375
<b>Foreign currency translation adjustments:</b>					
Beginning balance			¥ (230)	¥ (351)	\$ (1,964)
Foreign currency translation adjustments for the year			12	120	110
Ending balance			¥ (217)	¥ (230)	\$ (1,854)
<b>Treasury stock:</b>					
Beginning balance			¥ (65)	¥ (47)	\$ (559)
Cost of treasury stock purchased			(14)	(18)	(124)
Ending balance			¥ (80)	¥ (65)	\$ (684)

The accompanying notes are an integral part of these financial statements.

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2006	2005	2006
<b>I Cash flows from operating activities:</b>			
Income (loss) before income taxes and minority interests	¥ 7,867	¥(25,909)	\$ 66,976
Depreciation and amortization	12,967	15,710	110,391
Impairment loss on fixed assets	2,784	—	23,707
Loss from adjustment of a subsidiary	1,331	—	11,332
Expense of environmental measure	1,115	—	9,495
Write-down of investments in securities	32	404	274
Accrued post-employment benefit costs	(1,042)	(2,164)	(8,877)
Accrued retirement benefit costs for directors and statutory auditors	(438)	(3)	(3,732)
Interest and dividend income	(701)	(744)	(5,974)
Interest expenses	2,553	2,947	21,734
Gain or loss on disposal of properties	(4,470)	462	(38,056)
Loss from business restructuring	—	25,902	—
Gain on sale of investments in securities	(4,648)	(2,554)	(39,570)
Write-down of other investments	16	123	139
Decrease in trade accounts receivable	1,016	9,849	8,654
Increase or decrease in inventories	(29)	1,333	(249)
Decrease in trade accounts payable	(1,137)	(1,864)	(9,682)
Other, net	(1,909)	(2,397)	(16,252)
Sub-total	15,307	21,096	130,309
Interest and dividend received	700	738	5,965
Interest paid	(2,645)	(2,995)	(22,522)
Income taxes paid	(795)	(533)	(6,774)
Net cash provided by operating activities	12,566	18,305	106,978
<b>II Cash flows from investing activities:</b>			
Purchase of investment securities	(40)	(104)	(344)
Proceeds from sale of investment securities	12,959	4,736	110,323
Purchase of shares in an affiliated company and subsidiaries	(6)	(179)	(56)
Proceeds from sale of shares in an affiliated company and subsidiaries	754	—	6,423
Acquisition of property, plant and equipment	(8,222)	(9,750)	(69,995)
Proceeds from sale of property, plant and equipment	7,613	10,606	64,813
Loans	(796)	(1,670)	(6,784)
Proceeds from collection of loans	1,051	1,969	8,954
State subsidy received	—	989	—
Other, net	241	287	2,057
Net cash provided by investing activities	13,554	6,886	115,391
<b>III Cash flows from financing activities:</b>			
Increase or decrease in short-term bank loans	3,570	(9,707)	30,391
Decrease in issuance of commercial paper	(10,000)	(1,000)	(85,128)
Repayment of finance lease debt	(262)	(8,376)	(2,235)
Proceeds from long-term debt	13,345	1,162	113,603
Repayment of long-term debt	(18,171)	(6,108)	(154,694)
Proceeds from issue of bonds	974	10,000	8,298
Redemption of bonds	(11,000)	(10,000)	(93,640)
Acquisition of treasury stock	(15)	(19)	(130)
Payment of cash dividends	(4)	(501)	(36)
Other, net	0	(181)	7
Net cash used in financing activities	(21,563)	(24,732)	(183,565)
<b>IV Effect of foreign currency translation on cash and cash equivalents</b>	<b>1</b>	<b>90</b>	<b>12</b>
<b>V Net increase in cash and cash equivalents</b>	<b>4,559</b>	<b>549</b>	<b>38,816</b>
<b>VI Cash and cash equivalents at beginning of year</b>	<b>4,825</b>	<b>4,275</b>	<b>41,705</b>
<b>VII Increase in cash equivalents due to merger of unconsolidated subsidiary company</b>	<b>229</b>	<b>—</b>	<b>1,954</b>
<b>VIII Cash and cash equivalents at end of year (Note 3 (12))</b>	<b>¥ 9,614</b>	<b>¥ 4,825</b>	<b>\$ 81,846</b>

The accompanying notes are an integral part of these financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****1. Basis of Presenting the Consolidated Financial Statements**

The accompanying consolidated financial statements of Mitsubishi Paper Mills Limited (the “Company”) and its subsidiaries are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company as required by the Securities and Exchange Law of Japan.

Certain items presented in the consolidated financial statements submitted to the Director of Kanto Finance Bureau (a regional branch organization of Ministry of Finance in Japan) have been reclassified for the convenience of readers outside Japan.

**2. United States Dollar Amounts**

The Company maintains its accounting records in yen. The dollar amounts included in the consolidated financial statements and notes thereto represent the arithmetical results of translating yen to dollars on the basis of ¥117.47=U.S.\$1, the exchange rate as of March 31, 2006. The inclusion of such U.S. dollar amounts is solely for convenience and is not intended to imply that yen amounts have been or could be readily converted, realized or settled in U.S. dollars at that rate or any other rate.

**3. Summary of Significant Accounting Policies****(1) Scope of consolidation**

The Company had 39 subsidiaries as of March 31, 2006 (40 as of March 31, 2005). The consolidated financial statements include the accounts of the Company and 31 (30 for 2005) of its subsidiaries (together, hereinafter referred to as the “Companies”).

On April 1, 2005 the Company spun off the Kitakami Mill to make it a subsidiary under the name of Kitakami Hitec Paper Corporation: the subsidiary was included in the scope of consolidation effective from the reporting fiscal year.

The accounts of the remaining 7 (10 for 2005) unconsolidated subsidiaries are excluded from consolidation since the aggregate amounts of these subsidiaries in terms of combined assets, net sales, retained earnings and net income are immaterial in relation to those of the consolidated financial statements of the Companies.

**(2) Consolidation and elimination**

For the purposes of preparing the consolidated financial statements, all significant intercompany transactions, account balances and unrealized profits among the Companies have been eliminated.

Elimination of investments in shares of consolidated subsidiaries, together with the underlying equity in net assets of such subsidiaries, has been made to include equity in net income of subsidiaries subsequent to the date of acquisition in the consolidated statements of income. Any difference between the cost of an investment in a subsidiary and the amount of underlying equity in net assets of the subsidiary, unless specifically identified and reclassified to the applicable accounts from which the value originates, is treated as an asset or a liability, as the case may be, and amortized over a period of five years on a straight-line basis.

Assets and liabilities of subsidiaries are remeasured based on “full fair value method,” whereby full portion of the assets and liabilities of the subsidiaries is marked to fair value as of the acquisition of the control.

**(3) Investments in unconsolidated subsidiaries and affiliates**

The Company had 16 affiliates as of March 31, 2006 (16 for 2005).

However, the remaining 7 subsidiaries and 16 affiliates (16 for 2005) do not have material effect on net income and retained earnings in the consolidated financial statements and therefore, these investments are carried at cost.

#### **(4) Financial instruments**

##### **(i) Derivatives**

All derivatives are stated at fair value, with changes in fair value included in net profit or loss for the period in which they arise, except for those that are designated as “hedging instruments.”

##### **(ii) Securities**

Available-for-sale securities with market quotations are carried at fair value that are reasonably determinable based on current market quotes on balance sheet date, with net unrealized gains and losses, net of related tax, reported separately in shareholders’ equity. Realized gains or losses on securities sold are determined based on the moving-average method. If fair value is not available, securities are carried at cost, cost being determined by moving-average method.

In cases where the fair value of equity securities has declined significantly and such impairment of the value is not deemed temporary, those securities are written down to the fair value and the resulting losses are included in net profit or loss for the period.

##### **(iii) Hedge Accounting**

Unrealized gains or losses arising from changes in fair value of derivative financial instruments designated as “hedging instruments,” are carried as an asset or a liability until the profits and losses on the hedged items or transactions are recognized.

In accordance with the exceptional measure under the Japanese Accounting Standard for Foreign Currency Translation, the Companies do not record certain forward exchange contracts at market value but translates underlying foreign currency denominated assets or liabilities using the contractual rate under these contracts as long as such contracts meet the criteria for applying hedge accounting under the Japanese Accounting Standard for Financial Instruments.

Furthermore, in accordance with the special measure under the Accounting Standard for Financial Instruments, the Companies do not record certain interest rate swap arrangements at market value but charges or credits net cash flows from the swap arrangements to interest arising from the hedged borrowings, as long as these arrangements meet the specific criteria under the standard.

#### **(5) Inventories**

Finished products, merchandise and work in process are stated at cost, cost being determined by the average method. Other inventories are stated at cost, cost being determined by the moving average method.

#### **(6) Property, plant and equipment**

Depreciation is computed on the straight-line method for the property, plant and equipment, except for those other than the building held by the head office of the Company and certain consolidated subsidiaries, depreciation of which is computed on the declining-balance method. Estimated useful lives of assets used in computing depreciation are as follows:

Buildings and structures .....	31 to 47 years
Machinery and equipment .....	12 to 14 years

#### **(7) Allowance for doubtful accounts**

The Company and the consolidated domestic subsidiaries provide the allowance for doubtful accounts based on the bad debt loss ratio derived from their own loss history plus the amount of uncollectible receivables estimated on an individual basis.

Overseas consolidated subsidiaries provide the allowance for doubtful accounts based on the method prescribed by the respective countries’ regulation.

#### **(8) Accrued post-employment benefits to employees**

The Company and the domestic consolidated subsidiaries provide accrued post-employment benefits to employees based on the estimated actuarial present value of the projected benefit obligation and the estimated fair value of plan assets.

Overseas consolidated subsidiaries provide the accrued post-employment benefits to employees based on the method prescribed by the respective country’s regulation.

Unrecognized net actuarial gains or losses are amortized from the immediately following year on a straight-line basis over a term that does not exceed the average remaining service period of the employees who are expected to receive benefits under the plans (13 to 15 years). Unrecognized prior service costs are amortized on a straight-line basis over a term that does not exceed the average remaining service period of the employees who are expected to receive benefits under the plans (13 to 15 years).

#### **(9) Translation of foreign currency financial statements (Accounts of overseas subsidiaries and affiliates)**

The financial statements of overseas consolidated subsidiaries are translated into Japanese yen at the exchange rate prevailing at the respective balance sheet dates of those subsidiaries for assets and liabilities, and at the historical exchange rate for capital accounts and retained earnings. All income and expense accounts are translated at the average rate of exchange during the fiscal year of those subsidiaries. The resulting translation adjustments are included in Shareholders’ Equity as at March 31, 2006 and 2005.

**(10) Accounting for leases**

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

**(11) Net income or loss per share**

Net income or loss per share is based upon the weighted average number of common shares outstanding less the number of treasury stock during each year, appropriately adjusted for subsequent free distributions of common shares.

**(12) Cash and cash equivalents**

Cash and cash equivalents in the consolidated statement of cash flows are composed of cash on hands, bank deposits that are able to be withdrawn on demand and short-term investments with original maturity of three months or less that are exposed to minor value fluctuation risk.

Reconciliation of cash and cash equivalent of consolidated statement of cash flows and account balances of the consolidated balance sheets is shown below.

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Cash and bank deposits	¥9,984	¥5,096	\$84,995
Time deposits with maturity of over 3 months	(369)	(271)	(3,148)
Cash and cash equivalents	¥9,614	¥4,825	\$81,846

**(13) Change in Accounting Policy**

On August 9, 2002, the Business Accounting Council of Japan issued "Accounting Standards for Impairment of Fixed Assets," and on October 31, 2003 the Accounting Standards Board of Japan issued "Implementation Guidance for Accounting Standards for Impairment of Fixed Assets." The Company and its domestic consolidated subsidiaries applied the standard effective for fiscal years beginning April 1, 2005. As a result, income before income taxes decreased by ¥2,784 million (\$23,707 thousand).

**4. Impairment Loss on Fixed Assets**

The Company has recognized impairment loss of ¥2,784 million (\$23,707 thousand), for the following groups of assets as of March 31, 2006.

Location	Use	Category	Impairment loss	
			Millions of yen	Thousands of U.S. dollars
Principally Minato-ku, Tokyo	Idle assets	Land	¥1,376	\$11,717
	Idle assets	Buildings and structures, Machinery and equipment	617	5,260
Principally Sendai, Miyagi Pref.	Property for business use	Land	741	6,314
	Property for business use	Buildings and structures	48	414
Total			¥2,784	\$23,707

The Company assessed the impairment of each measurement unit of assets. Assessment is made on an individual basis for idle assets and on a measurement unit basis for assets for business use. The measurement unit, in principle, consists of a mill and peripheral facilities, which make up production units of the Company.

Due to the decline in real estate value and poor performance of assets, asset efficiency has worsened substantially. Therefore, the Company reduced the book value of assets in question to the recoverable amounts.

The recoverable amounts are determined using the net selling prices. The net selling prices are determined on the basis of the appraisal value by a real estate appraiser.

## 5. Investments in Securities

The acquisition cost, carrying amount, gross unrealized holding gains and gross unrealized holding losses for securities with fair value by security type at March 31, 2006 are as follows:

Available-for-sale securities:

	Millions of yen			
	2006			
	Cost	Carrying amount	Gross unrealized gains	Gross unrealized losses
Equity securities	¥20,106	¥50,999	¥31,164	¥270
Debentures	10	9	—	0
Others	2	4	2	—
	¥20,118	¥51,014	¥31,167	¥271

	Thousands of U.S. dollars			
	2006			
	Cost	Carrying amount	Gross unrealized gains	Gross unrealized losses
Equity securities	\$171,161	\$434,152	\$265,297	\$2,306
Debentures	85	84	—	1
Others	19	41	22	—
	\$171,265	\$434,278	\$265,320	\$2,307

The carrying amount of securities without fair value as at March 31, 2006 is summarized as follows:

Available-for-sale securities:

	Carrying amount	
	2006	
	Millions of yen	Thousands of U.S. dollars
Unlisted equity securities	¥5,454	\$46,436
	¥5,454	\$46,436

## 6. Debentures and Loans

Long-term debt as at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Loans from banks and other financial institutions secured by collaterals/mortgages	¥ 57,731	¥ 61,503	\$491,455
2.00% Unsecured debentures in yen due in November 2005	—	10,000	—
1.60% Mortgage debentures in yen due in September 2005	—	1,000	—
1.28% Unsecured debentures in yen due in November 2009	10,000	10,000	85,128
1.07% Unsecured debentures in yen due in September 2012	1,000	—	8,512
	68,731	82,503	585,096
Less: Portion due within one year	(15,245)	(28,098)	(129,786)
	¥ 53,485	¥ 54,404	\$455,310

Tentative schedule of repayment of loans and corporate debentures payable within 5 years:

	Millions of yen	Thousands of U.S. dollars
Within 1 year	¥15,245	\$129,786
Due after 1 year through 2 years	18,523	157,683
Due after 2 years through 3 years	10,781	91,780
Due after 3 years through 4 years	15,788	134,404
Due after 4 years through 5 years	7,293	62,086

### 7. Assets Pledged as Collateral

Assets pledged as collateral primarily for short-term loans and long-term debt and debentures at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Buildings and structures	¥28,240	¥29,165	\$240,408
Machinery and equipment	44,698	44,226	380,505
Land	12,440	12,697	105,902
Other	2,638	92	22,463
Investments in securities	8,659	1,714	73,714
	¥96,677	¥87,896	\$822,994

### 8. Post-Employment Benefits

Employees of the Company and the domestic consolidated subsidiaries excluding directors and auditors, with more than one year of service are generally entitled to lump-sum retirement benefits determined by reference to current basic rate of pay, length of service and conditions under which the terminations occur. In addition, the Company and certain consolidated subsidiaries have funded non-contributory pension plans.

The following table sets forth a reconciliation of projected benefit obligations, plan assets, funded status of the post-employment benefit plans and net liability recognized in the accompanying consolidated balance sheets at March 31, 2006 and 2005:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Projected benefit obligations	¥(36,967)	¥(37,098)	\$(314,697)
Fair value of plan assets	36,361	25,001	309,540
Funded status of the plans	(605)	(12,096)	(5,157)
Unrecognized net actuarial (gain) or loss* <sup>1</sup>	(9,234)	1,542	(78,608)
Unrecognized prior service cost (reduction of the obligations)* <sup>2</sup>	(2,696)	(2,918)	(22,953)
Unrecognized pension assets	—	(109)	—
Net liability recognized	¥(12,536)	¥(13,581)	\$(106,718)

\*1 In the Company, unrecognized net actuarial loss has occurred by the change of the period distribution method accompanying the revision of severance pay system.

\*2 In the Company, unrecognized prior service cost (reduction of the obligation) has occurred by the revision of severance pay system.

The net periodic post-employment benefit cost for the years ended March 31, 2006 and 2005 included the following components:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Service cost	¥1,746	¥1,745	\$14,864
Interest cost	834	867	7,102
Expected return on plan assets	(471)	(482)	(4,017)
Amortization of net actuarial (gain) or loss	213	179	1,816
Amortization of prior service cost (reduction of the obligations)	(222)	(204)	(1,890)
	¥2,099	¥2,105	\$17,874

Assumptions used in calculation of the above information were as follows:

As of March 31,	2006	2005
Discount rate	2.5%	2.5%
Expected rate of return on plan assets	4.0%	4.0%
Method of attributing the projected benefits to periods of services	mainly point basis	mainly point basis
Amortization of unrecognized prior service cost	13~15 years	13~15 years
Amortization of unrecognized net actual gain or loss	13~15 years	13~15 years

## 9. Deferred Income Taxes

The statutory tax used for calculating deferred tax assets and liabilities for the years ended March 31, 2006 and 2005 was primarily 40.7%.

At March 31, 2006 and 2005, significant components of deferred tax assets and liabilities were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets:			
Accrued enterprise tax	¥ 66	¥ 127	\$ 569
Accrued expenses	1,333	1,489	11,354
Accrued post-employment benefits	7,180	7,212	61,125
Allowance for doubtful accounts	225	297	1,921
Loss from revaluation of fixed asset	977	9,533	8,318
Unrealized gain on property, plant and equipment	1,496	1,667	12,741
Unrealized losses on available-for-sale securities	—	0	—
Tax loss carryforwards	15,207	9,691	129,460
Others	1,835	1,825	15,624
Sub-total deferred tax assets	28,323	31,844	241,113
Valuation allowance	(17,152)	(20,264)	(146,014)
Total deferred tax assets	11,171	11,580	95,099
Deferred tax liabilities:			
Reserve based on Special Taxation Measures Law	(58)	(82)	(500)
Consolidation adjustment to book value of subsidiaries' assets	(547)	(838)	(4,664)
Unrealized gains on available-for-sale securities	(12,557)	(6,957)	(106,898)
Others	(202)	(198)	(1,723)
Total deferred tax liabilities	(13,366)	(8,076)	(113,785)
Net deferred tax assets (liabilities)	¥ (2,195)	¥ 3,504	\$ (18,686)

At March 31, 2006, reconciliation of the statutory tax rate to the effective income tax rate was as follows. Due to the posting of a loss before income taxes for the year ended March 31, 2005, description regarding reconciliation of the statutory tax rate to the effective income tax rate was omitted.

	2006
Statutory tax rate	40.7%
Permanently non-deductible expenses	2.8
Permanently non-taxable income	(1.8)
Per capita inhabitant tax	1.3
Valuation allowance	(38.1)
Current operating losses of subsidiaries	3.8
Other	(0.5)
Effective income tax rate	8.2%

## 10. Contingent Liabilities

As at March 31, 2006 the Companies were contingently liable for guarantees of loans, primarily of their employees and unconsolidated subsidiaries and affiliates, in the aggregate amount of ¥4,984 million (\$42,433 thousand), and also liable for retrogressive obligation of credit securitization in the aggregate amount of ¥2,538 million (\$21,609 thousand).

**11. Leases**

Finance leases, except those leases for which the ownership of the leased assets is considered to be transferred to the lessee, were as follows:

(1) Equivalent of purchase price, accumulated depreciation and book value of leased properties

	Millions of yen						Thousands of U.S. dollars		
	2006			2005			2006		
	Machinery equipment and vehicles	Other	Total	Machinery equipment and vehicles	Other	Total	Machinery equipment and vehicles	Other	Total
Purchase price equivalent	¥725	¥1,270	¥1,996	¥485	¥1,317	¥1,803	\$6,175	\$10,819	\$16,994
Accumulated depreciation equivalent	262	823	1,086	201	714	915	2,238	7,014	9,253
Book value equivalent	¥462	¥ 446	¥ 909	¥284	¥ 603	¥ 887	\$3,936	\$ 3,805	\$ 7,741

(2) Lease commitments

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Due within one year	¥363	¥328	\$3,095
Due after one year	545	558	4,645
Total	¥909	¥887	\$7,741

(3) Lease expenses and depreciation equivalents

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Lease expenses	¥530	¥457	\$4,517
Depreciation equivalents	530	457	4,517

Non-cancelable operating lease commitments were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Due within one year	¥ 7	¥15	\$61
Due after one year	3	8	33
Total	¥11	¥23	\$95

## 12. Segment Information

### (1) Industry segment information

The Companies operate primarily in the production and sales of paper, pulp, photosensitive materials and others.

Paper and pulp:

Coated paper, premium-quality paper, writing and printing paper, bleached kraft pulp

Photosensitive materials:

Photographic paper, printing and platemaking materials, related equipment and pharmaceuticals

Other:

Operation of swimming clubs and bowling alleys, real estate, storage and transport, as well as machinery design, installment and maintenance

Industry segment information for the years ended March 31, 2006 and 2005, was as follows:

Year ended March 31, 2006	Millions of yen					
	Paper and pulp	Photosensitive materials	Other	Total	Eliminations/ Headquarters	Consolidated
1 Sales and operating income:						
Sales to unaffiliated customers	¥192,783	¥28,754	¥ 6,957	¥228,495	¥ —	¥228,495
Intersegment sales and transfers	4,304	4,519	13,126	21,950	(21,950)	—
Total sales	197,088	33,273	20,084	250,446	(21,950)	228,495
Operating expenses	192,175	32,501	19,357	244,033	(22,022)	222,011
Operating income	4,913	772	727	6,412	71	6,484
2 Assets, depreciation and capital expenditures:						
Assets	256,291	35,400	15,938	307,631	7,237	314,869
Depreciation	11,138	1,337	494	12,970	(2)	12,967
Impairment loss on fixed assets	1,797	987	—	2,784	—	2,784
Capital expenditures	6,678	693	110	7,482	(51)	7,431

Year ended March 31, 2006	Thousands of U.S. dollars					
	Paper and pulp	Photosensitive materials	Other	Total	Eliminations/ Headquarters	Consolidated
1 Sales and operating income:						
Sales to unaffiliated customers	\$1,641,131	\$244,778	\$ 59,228	\$1,945,139	\$ —	\$1,945,139
Intersegment sales and transfers	36,644	38,469	111,747	186,862	(186,862)	—
Total sales	1,677,776	283,248	170,976	2,132,001	(186,862)	1,945,139
Operating expenses	1,635,951	276,675	164,783	2,077,410	(187,471)	1,889,939
Operating income	41,825	6,572	6,192	54,590	609	55,199
2 Assets, depreciation and capital expenditures:						
Assets	2,181,762	301,361	135,683	2,618,807	61,613	2,680,420
Depreciation	94,817	11,381	4,212	110,411	(19)	110,391
Impairment loss on fixed assets	15,299	8,407	—	23,707	—	23,707
Capital expenditures	56,855	5,902	941	63,699	(435)	63,263

Year ended March 31, 2005	Millions of yen					
	Paper and pulp	Photosensitive materials	Other	Total	Eliminations/ Headquarters	Consolidated
1 Sales and operating income:						
Sales to unaffiliated customers	¥197,744	¥30,685	¥ 6,233	¥234,662	¥ —	¥234,662
Intersegment sales and transfers	3,873	3,729	12,574	20,177	(20,177)	—
Total sales	201,617	34,414	18,807	254,839	(20,177)	234,662
Operating expenses	194,308	38,238	18,006	250,553	(20,217)	230,335
Operating income (loss)	7,308	(3,823)	800	4,285	40	4,326
2 Assets, depreciation and capital expenditures:						
Assets	251,334	38,439	17,954	307,729	11,739	319,469
Depreciation	11,819	3,397	526	15,744	(33)	15,710
Capital expenditures	6,614	2,766	127	9,509	(42)	9,466

**(2) Information by geographic segment**

Segment information by geographical area for the years ended March 31, 2006 and 2005, was as follows:

Millions of yen

Year ended March 31, 2006	Japan	Europe	U.S.A.	Total	Eliminations/ Headquarters	Consolidated
1 Sales and operating income:						
Sales to unaffiliated customers	¥175,433	¥43,094	¥9,967	¥228,495	¥ —	¥228,495
Intersegment sales and transfers	6,759	1,461	25	8,246	(8,246)	—
Total sales	182,192	44,556	9,993	236,742	(8,246)	228,495
Operating expenses	176,703	44,061	9,896	230,661	(8,649)	222,011
Operating income	5,489	495	96	6,081	403	6,484
2 Assets	257,863	30,116	3,980	291,959	22,909	314,869

Thousands of U.S. dollars

Year ended March 31, 2006	Japan	Europe	U.S.A.	Total	Eliminations/ Headquarters	Consolidated
1 Sales and operating income:						
Sales to unaffiliated customers	\$1,493,428	\$366,855	\$84,855	\$1,945,139	\$ —	\$1,945,139
Intersegment sales and transfers	57,542	12,444	216	70,203	(70,203)	—
Total sales	1,550,971	379,299	85,071	2,015,342	(70,203)	1,945,139
Operating expenses	1,504,242	375,084	84,248	1,963,575	(73,635)	1,889,939
Operating income	46,728	4,215	823	51,767	3,432	55,199
2 Assets	2,195,139	256,377	33,881	2,485,398	195,022	2,680,420

Millions of yen

Year ended March 31, 2005	Japan	Europe	U.S.A.	Total	Eliminations/ Headquarters	Consolidated
1 Sales and operating income:						
Sales to unaffiliated customers	¥181,129	¥42,735	¥10,797	¥234,662	¥ —	¥234,662
Intersegment sales and transfers	7,998	878	80	8,958	(8,958)	—
Total sales	189,128	43,614	10,878	243,620	(8,958)	234,662
Operating expenses	186,034	42,869	10,769	239,673	(9,337)	230,335
Operating income	3,093	744	109	3,947	379	4,326
2 Assets	262,834	31,537	3,700	298,072	21,397	319,469

**(3) Overseas sales**

Export sales and sales by overseas subsidiaries for the years ended March 31, 2006 and 2005, was as follows:

	Millions of yen		Thousands of U.S. dollars	Percentage of such sales against consolidated net sales	
	2006	2005	2006	2006	2005
Overseas sales:					
Europe	¥31,445	¥36,151	\$267,685	13.8%	15.4%
Asia	8,648	8,021	73,624	3.8%	3.4%
U.S.A	15,116	16,506	128,680	6.6%	7.0%
Others	7,109	4,844	60,522	3.1%	2.1%
Total	¥62,319	¥65,523	\$530,512	27.3%	27.9%

### 13. Additional Information

#### Transfer of fixed assets

The transfer contract of fixed assets concluded on March 17, 2006 is as follows.


Reason for transfer

Although the properties in question were used for a research institute and welfare facilities of the Company, the Company decided to sell off the properties with the aim of liquidation of the Company's assets under its management reform program.

Buyer	Nomura Real Estate Development Co., Ltd.
Category of property for transfer	Land (1-3500-1, Higashi-Kanamachi, Katsushika-ku, Tokyo, among others)
Transfer Date	September 30, 2006
Transfer Price	¥7,120 million (\$60,611 thousand)

**REPORT OF INDEPENDENT AUDITORS ON CONSOLIDATED FINANCIAL STATEMENTS**

ChuoAoyama PricewaterhouseCoopers

PRICEWATERHOUSECOOPERS Kasumigaseki Bldg. 32nd Floor  
3-2-5, Kasumigaseki, Chiyoda-ku,  
Tokyo 100-6088, Japan**Report of Independent Auditors**

To the Board of Directors of  
Mitsubishi Paper Mills Limited

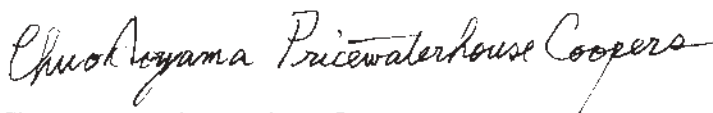
We have audited the accompanying consolidated balance sheets of Mitsubishi Paper Mills Limited and its subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese Yen. These 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated 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 Mitsubishi Paper Mills Limited and its subsidiaries as of March 31, 2006 and 2005, 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 described in Note 3 (13), effective for the year ended March 31, 2006, Mitsubishi Paper Mills Limited and its domestic subsidiaries have adopted the Japanese accounting standards for impairment of fixed assets.

The amounts expressed in U.S. dollars, which are provided solely for the convenience of the reader, have been translated on the basis set forth in Note 2 to the accompanying consolidated financial statements.



ChuoAoyama PricewaterhouseCoopers  
Tokyo, Japan  
June 29, 2006

**Managing Executive Officers**



**Takeshi Sato**  
*President (Representative Director)  
and Chief Executive Officer*



**Shunichi Tokuda**  
*Representative Director and  
Senior Managing Executive  
Officer*



**Masaaki Iguchi**  
*Representative Director and  
Senior Managing Executive  
Officer*



**Fumihiko Ishizuka**  
*Managing Executive  
Officer*



**Nobuo Saito**  
*Managing Executive  
Officer*



**Kazuo Nakase**  
*Director and Managing  
Executive Officer*



**Takefumi Suzuki**  
*Director and Managing  
Executive Officer*



**Junichi Tachibana**  
*Director and Managing  
Executive Officer*

**President (Representative Director) and Chief Executive Officer**

Takeshi Sato

**Representative Director and Senior Managing Executive Officers**

Shunichi Tokuda

In charge of President's Office, Forestry Department, Internal Audit Office, and also responsible for Compliance  
General Manager, President's Office

Masaaki Iguchi

In charge of Corporate Research Center, New Product Development Department, Technology and Environmental Department, Intellectual Property Department, Purchasing Department

**Managing Executive Officers**

Fumihiko Ishizuka  
President, Kitakami Hitec Paper Corp.

Nobuo Saito  
General Manager, Kyoto Mill

**Director and Managing Executive Officers**

Kazuo Nakase  
In charge of Paper Division, German Operation Department, Shirakawa Mill  
General Manager, Paper Division

Takefumi Suzuki  
In charge of Digital Imaging Division  
General Manager, Digital Imaging Division

Junichi Tachibana  
In charge of General Affairs and Personnel Department, Finance and Accounting Department, Information Systems Department, Kitakami Office

**Director**

Tomohisa Shinagawa

**Senior Executive Officers**

Toshifumi Mori  
President, Mitsubishi Paper Holding (Europe) GmbH

Yutaka Ashie  
General Manager, Takasago Mill

Kunio Suzuki  
General Manager, Hachinohe Mill

**Executive Officers**

Takao Senga  
General Manager, Corporate Research Center

Kanji Itakura  
General Manager, Corporate Planning Department  
General Manager, Affiliated Companies Administration Department

Mitsuo Ushijima  
General Manager, Commercial Printing Paper Sales Department  
General Manager, Information Sharing Office

Hiroshi Nozawa  
General Manager, General Affairs and Personnel Department

**Corporate Auditors**

Toru Hosokawa  
Satoshi Takeuchi  
Yasushi Okada  
Yasuharu Takamatsu

(as of August 1, 2006)

**Established:**

April 1, 1898

**Head Office:**4-2, Marunouchi 3-chome, Chiyoda-ku, Tokyo 100-0005, Japan  
Telephone:

- +81-3-3213-3751 (*Information*)
- +81-3-3213-3641 (*President's Office*)
- +81-3-3213-3729 (*Commercial Printing Paper Sales Dept. Paper Division*)
- +81-3-3213-3733 (*Business Communication & Specialty Paper Sales Dept. Paper Division*)
- +81-3-3213-3728 (*Sales Administration Dept. Paper Division*)
- +81-3-3213-3735 (*Ink Jet Media Dept. Digital Imaging Division*)
- +81-3-3213-3744 (*Graphic Systems Dept. Digital Imaging Division*)
- +81-3-3213-3741 (*Photo & Base Paper Dept. Digital Imaging Division*)
- +81-3-3213-3749 (*Sales Dept. New Product Development Division*)
- +81-3-3213-3745 (*Purchasing Dept.*)
- +81-3-3213-3646 (*Forestry Dept.*)

**Facsimile:**

- +81-3-3214-2338 (*Information*)
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- +81-3-3215-8157 (*Business Communication & Specialty Paper Sales Dept. Paper Division*)
- +81-3-3214-2339 (*Sales Administration Dept. Paper Division*)
- +81-3-3213-6715 (*Ink Jet Media Dept. Digital Imaging Division*)
- +81-3-3214-5936 (*Graphic Systems Dept. Digital Imaging Division*)
- +81-3-3214-3976 (*Photo & Base Paper Dept. Digital Imaging Division*)
- +81-3-3214-5506 (*Sales Dept. New Product Development Division*)
- +81-3-3214-3804 (*Purchasing Dept.*)
- +81-3-3214-3804 (*Forestry Dept.*)

**Sales Branches:**

Osaka

**Corporate Research Center:**Tsukuba R&D Laboratory  
Kyoto R&D Laboratory  
Process Development Laboratory**Mills:**

Takasago, Kyoto, Hachinohe, Shirakawa

**Major Subsidiaries:****Sales**Mitsubishi Paper Sales Co., Ltd.  
Diamic Co., Ltd.**Manufacturers**Kitakami Hitec Paper Corp.  
Takasago Paper Processing Co., Ltd.  
Hachinohe Paper Processing Co., Ltd.  
Toho Tokushu Pulp Co., Ltd.  
Asahi Diazo-Sensitive Paper Co., Ltd.  
Ostrich Dia Co., Ltd.  
Kyoryo Chemical Co., Ltd.**Shipping**Hananoki Logistic Co., Ltd.  
Naniwa Express Co., Ltd.**Wood Materials**Hachinohe Forest Products Co., Ltd.  
Hokuryo Forest Products Co., Ltd.**Others**Ryoshi Co., Ltd.  
Ryoko Engineering Co., Ltd.  
Hachiryo Co., Ltd.  
Hokuryo Co., Ltd.  
Mitsubishi Paper Engineering Co., Ltd.  
Hakuryo Co., Ltd.  
Sansei Shisetsu Kaihatsu Co., Ltd.  
MPM Shared-service Co., Ltd.**Overseas**Mitsubishi Imaging (MPM), Inc. (New York, U.S.A.)  
Mitsubishi Paper Holding (Europe) GmbH (Düsseldorf, Germany)  
Mitsubishi Paper GmbH (Düsseldorf, Germany)  
Mitsubishi HiTec Paper Bielefeld GmbH (Bielefeld, Germany)  
Mitsubishi HiTec Paper Flensburg GmbH (Flensburg, Germany)

**mitsubishi paper mills limited**

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