



Nippon Paper Group, Inc.

Annual Report 2007

*Expanding Our Potential to Generate Steady Growth*

<http://www.np-g.com/e/ir/>

Nippon Paper Group, Inc.

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*Japanese paper has a long history as an essential material in the lives of Japanese people. In recent years, Japanese paper has attracted international attention as an environmentally-friendly recyclable material.*

*In this annual report, we use the works of Eriko Horiki, a world-renowned artist, to demonstrate paper's immense appeal as a material.*

*Ms. Horiki continues to create innovative works that transcend traditional concepts and provide fresh ideas on how to use Japanese paper. This approach resonates with the philosophy of Nippon Paper Group as we seek to contribute to society and enrich lives through the manufacture paper products.*

*Cover photo: Commemoration of the 400th anniversary of the Edo Shogunate  
Kodama Workshop: light pillars, Tokyo*



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NIPPON PAPER GROUP, INC.

**Annual Report 2007**

For the Fiscal Year Ended March 31, 2007



NIPPON PAPER GROUP, INC.

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***Expanding Our Potential to Generate Steady Growth***

# ANNUAL REPORT 2007

Nippon Paper Group, Inc.

## *Expanding Our Potential to Generate Steady Growth*

### **Straight! Steady! Speedy!**

The Nippon Paper Group aims to be one of the top five pulp and paper groups worldwide.

#### *Cautionary note regarding forward-looking statements*

*Statements in this annual report concerning current plans, forecasts, strategies, beliefs, and other forward-looking information related to Nippon Paper Group, Inc. and companies comprising its corporate group, other than those of historical fact, are forecasts of future business performance based on the judgments of management at Nippon Paper Group, Inc. and group companies in light of currently available information. Accordingly, please refrain from making investment decisions based solely on forecasts of business performance in this annual report. Actual business performance may differ significantly from these forecasts due to changes in a variety of factors.*

Publisher Nippon Paper Group, Inc. <http://www.np-g.com/e/>  
Produced by No Limits, Inc.  
Washi as Architecture by Eriko Horiki

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©Yoshiharu Matsumura p64  
©Noboru Takahashi p1, p5, p35, p41, inside back cover

Washi Works and  
Photos courtesy of ERIKO HORIKI & ASSOCIATES Co., Ltd.

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## *A Story of Further Challenges and Innovations: The Nippon Paper Group*

NIPPON PAPER GROUP, INC.





2015

## Goals of Nippon Paper Group for 2015

Be one of the top **5** pulp and paper groups worldwide.

### Consolidated net sales

¥1.5–¥2.0 trillion

### Consolidated operating income

Stable domestic operating income of ¥100 billion,  
*plus operating income from overseas business*

### Consolidated operating income to net sales

8%–10%

### Business portfolio

Domestic business to account for 70%  
and overseas business for 30%

Pulp and paper business to account for 70%  
and non-pulp and paper business for 30%

Expand business in  
**three major markets**

of Asia, North America, and Europe

### Market capitalization

¥1 trillion

### Operating cash flow

¥150 billion

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## AT A GLANCE

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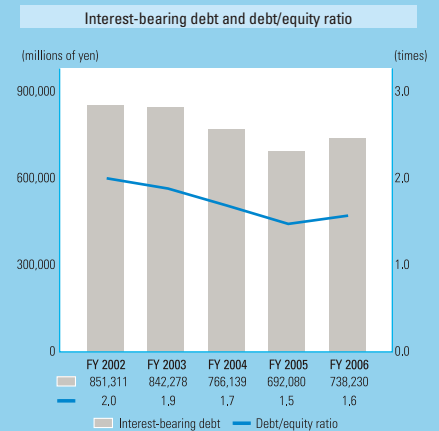
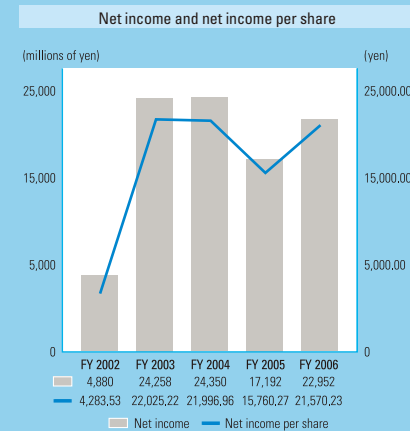
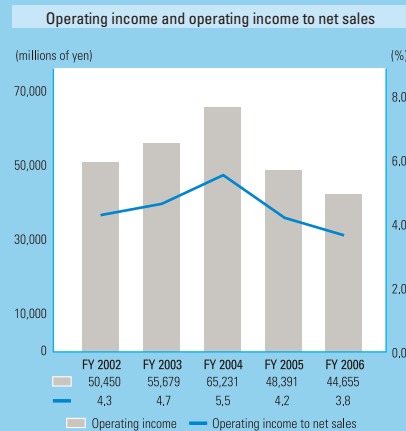
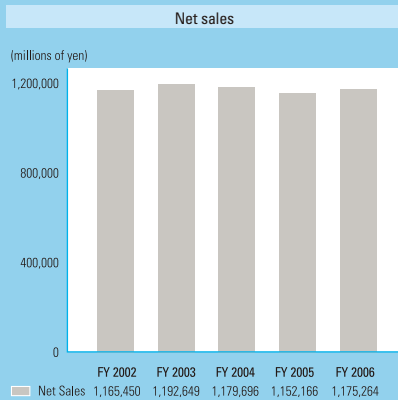
# Consolidated Financial Highlights

Nippon Paper Group, Inc.

	Millions of yen		Thousands of US dollars <sup>1</sup>	
	Fiscal 2004 April 1, 2004 – March 31, 2005	Fiscal 2005 April 1, 2005 – March 31, 2006	Fiscal 2006 April 1, 2006 – March 31, 2007	Fiscal 2006 April 1, 2006 – March 31, 2007
Net sales	¥ 1,179,696	¥ 1,152,166	¥ 1,175,264	\$ 9,959,864
Operating income	65,231	48,391	44,655	378,432
Ordinary income	62,801	49,403	47,088	399,051
Net income	24,350	17,192	22,952	194,508
Total assets	1,529,975	1,492,427	1,565,978	13,271,000
Net Assets	466,521	462,639	470,521	3,987,466
Interest-bearing debt <sup>2</sup>	766,139	692,080	738,230	6,256,186
		yen		US dollars
Net income per share	21,996.96	15,760.27	21,570.23	182.80
Cash dividends per share	8,000.00	8,000.00	8,000.00	67.80
Operating income to net sales (%)	5.5	4.2	3.8	
Return on equity (ROE) (%) <sup>3</sup>	5.6	3.9	5.2	
Return on invested capital (ROIC) (%) <sup>4</sup>	5.9	5.0	4.6	
Equity ratio (%)	28.9	29.5	28.6	
Return on assets (ROA) (%) <sup>5</sup>	4.7	3.8	3.5	
Number of employees	13,774	12,798	12,584	

Note:

1. Amounts in US dollars are included solely for convenience and are translated at a rate of ¥118=U.S.\$1.00, the approximate rate of exchange on March 31, 2007.
2. Interest-bearing debt = Short-term borrowings + Long-term debt
3. Return on equity (ROE)  
= Net income / Average shareholders' equity and valuation, translation adjustments and other × 100
4. Return on invested capital (ROIC)  
= (Ordinary income + Interest expense) / (Shareholders' equity and valuation, translation adjustments and other + Interest-bearing debt) × 100
5. Return on assets (ROA) = (Ordinary income + Interest expense) / Total assets × 100



## Profile

Nippon Paper Group, Inc.

*Nippon Paper Group is committed to doing business in ways that sustain today's lifestyles as well as the environment*

Nippon Paper Group, Inc. is the holding company for the Nippon Paper Group, which comprises Nippon Paper Industries Co., Ltd., Nippon Daishowa Paperboard Co., Ltd., and their 141 subsidiaries and 53 affiliates. The activities of Nippon Paper Group are carried out by four business divisions: the Pulp and Paper Division manufactures and sells paper, paperboard, household tissue, and pulp; the Paper-Related Division manufactures and sells processed paper products and chemical products; the Housing and Construction Materials Division manufactures, purchases, and sells lumber and construction materials; and the Other Division is responsible for the logistics business, beverages business, leisure business, and power generation business. The Pulp and Paper Division is positioned as the core business of Nippon Paper Group and accounts for the majority of sales and profits.

Pulp and Paper Division  
» page 12

Paper-Related Division  
» page 14

Housing and Construction Materials Division  
» page 16

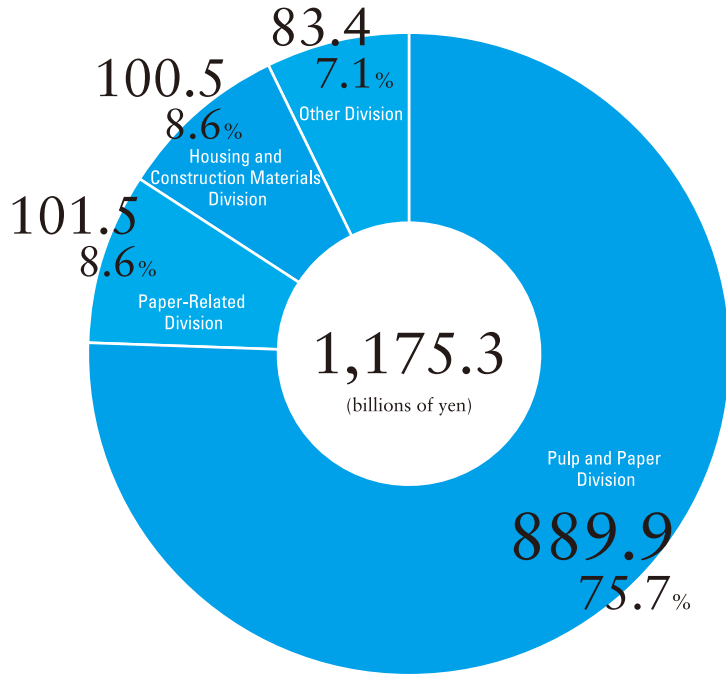
Other Division  
» page 18



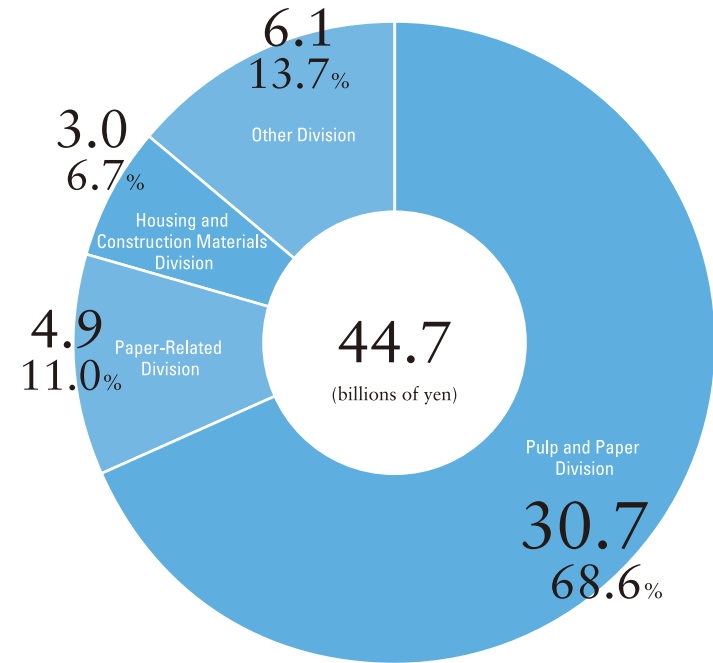
Wholesale power plant at  
Nippon Paper Industries' Kushiro Mill



# Net Sales and Operating Income by Business Segment



Net sales by business segment in fiscal 2006



Operating income by business segment in fiscal 2006

# Pulp and Paper Division



## Paper

- » Newsprint
- » Printing and publication paper
- » Business communication paper
- » Packaging paper
- » Paper for miscellaneous uses



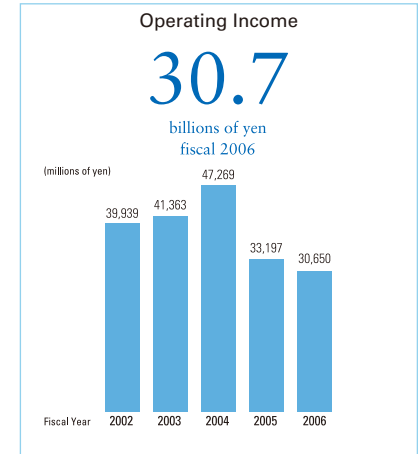
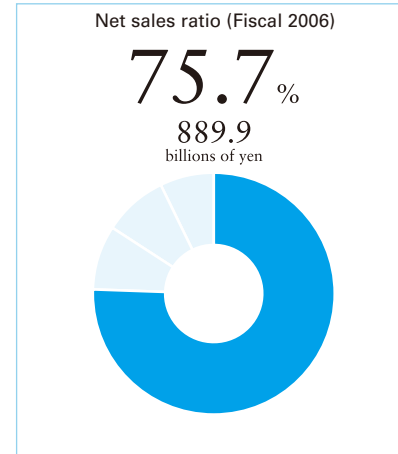
## Paperboard

- » Containerboard
- » White board
- » Chip board
- » Base stock for building material



## Household paper products

- » Facial tissue
- » Bathroom tissue
- » Paper towels
- » Diapers



\* The power-generation supply business was included in the Pulp and Paper Division in fiscal 2002 and in the Other Division from fiscal 2003 to 2006.

## Consolidated Subsidiaries and Equity-method Affiliates

- Nippon Paper Industries Co., Ltd. » page 42
- Nippon Daishowa Paperboard Co., Ltd. » page 44
- Nippon Daishowa Paperboard Tohoku Co., Ltd.
- Nippon Daishowa Paperboard Kanto Co., Ltd.
- Nippon Daishowa Paperboard Yoshinaga Co., Ltd.
- Nippon Daishowa Paperboard Nishinippon Co., Ltd.
- Nippon Paper Crecia Co., Ltd.\* » page 46
- NP Trading Co., Ltd. » page 48
- KOYO PAPER MFG. Co., Ltd.
- HAGA Paper Trading Co., Ltd.
- Kokuei Paper Co., Ltd.
- Kitakami Paper Co., Ltd.
- Daishowa North America Corporation
- Nippon Paper Industries USA Co., Ltd.
- North Pacific Paper Corporation\*\*
- Daishowa-Marubeni International Ltd.\*\*

\* CRECIA Corporation became Nippon Paper Crecia Co., Ltd. on August 1, 2006.  
\*\* Equity-method affiliates.



# Paper-Related Division



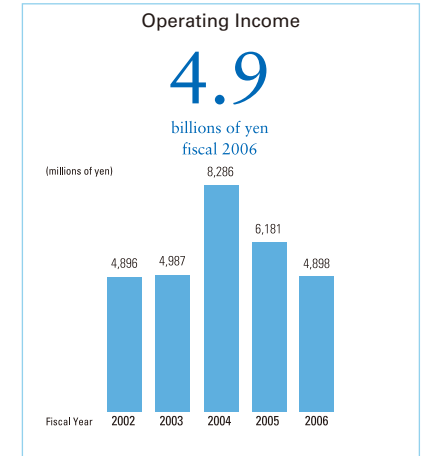
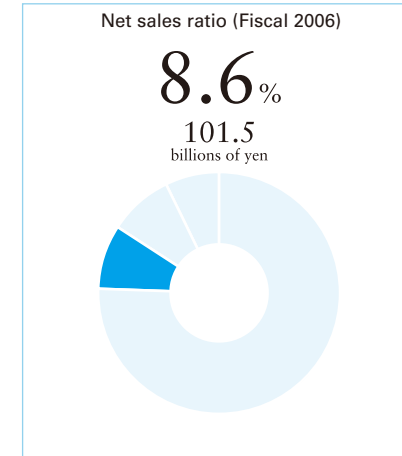
## Processed paper products

- » Liquid-packaging cartons
- » Filling machines and maintenance services
- » Paper bags
- » Adhesive paper



## Chemical products and functional materials

- » Dissolving pulp
- » Chemical products
- » Functional films
- » Drafting and copying media



## Consolidated Subsidiaries and Equity-method Affiliates

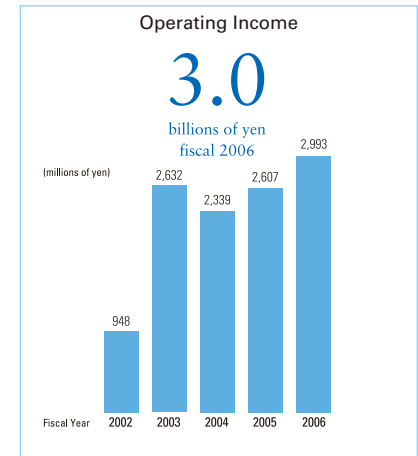
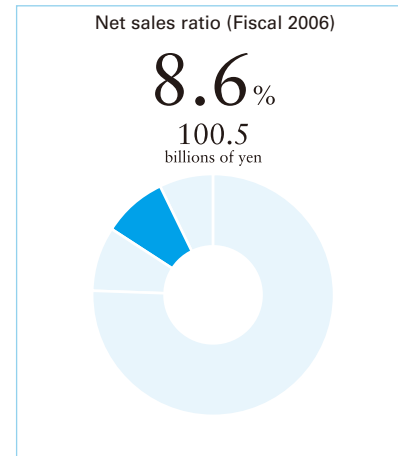
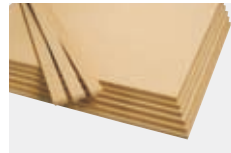
- NIPPON PAPER-PAK CO., LTD. » page 50
- Nippon Paper Chemicals Co., Ltd. » page 52
- Sakurai Co., Ltd.
- Nippon Seitai Corporation
- FLOWRIC CO., LTD.
- NIPPON TOKAN PACKAGE CO., LTD.\*
- LINTEC Corporation\*
- Daishowa Paper Converting Co., Ltd.\*
- Dixie Japan Co., Ltd.\*

\* Equity-method affiliates.

# Housing and Construction Materials Division



- » Lumber
- » Construction materials
- » Civil engineering business



## Consolidated Subsidiaries and Equity-method Affiliates

- Nippon Paper Lumber Co., Ltd. » page 54
- NIPPON PAPER UNITEC CO., LTD.\*
- Kokusaku Kiko Co., Ltd.
- Kunimoku House Co., Ltd.
- PAL CO., LTD.
- N&E CO., LTD.
- Daishowa Uniboard Co., Ltd.
- South East Fibre Exports Pty. Ltd.

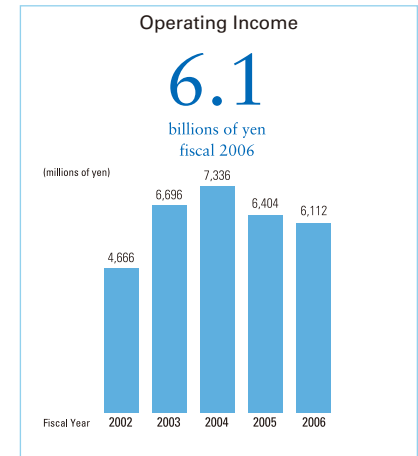
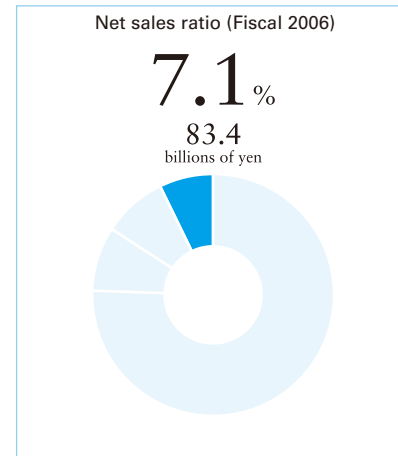
\* NIPPON PAPER UNITEC CO., LTD. and Daishowa Unitec Co., Ltd. (consolidated subsidiary until June 30, 2006) merged with Jujo Research Co., Ltd. (non-consolidated subsidiary) and Plant Design Research Center (non-consolidated subsidiary) and became NIPPON PAPER UNITEC CO., LTD. on July 1, 2006.



# Other Division



- » Beverages business
- » Warehousing and transportation businesses
- » Leisure business
- » Power generation business



\* The power-generation business was included in the Pulp and Paper Division in fiscal 2002 and in the Other Division from fiscal 2003 to 2006.

## Consolidated Subsidiaries and Equity-method Affiliates

- NANKO UNYU CO., LTD.
- IWAKUNI-KAIUN CO., LTD.
- Kyokushin Transport Co., Ltd.
- NIPPON PAPER LOGISTICS CO., LTD.
- Hotoku Co., Ltd.
- Daishowa Logistics Co., Ltd.
- SHIKOKU COCA-COLA BOTTLING CO., LTD.
- Nippon Paper Development Co., Ltd.
- Graphic Arts Communication
- Asahikawa Grand Hotel Co., Ltd.



## MESSAGE FROM THE PRESIDENT

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24 Message from the President



## To Our Shareholders



MASATOMO NAKAMURA

President

Nippon Paper Group, Inc.

A handwritten signature in black ink that reads "M. Nakamura". The signature is written in a cursive, flowing style.

### Performance review and outlook

In fiscal 2006, the initial year of our Second Medium-Term Business Plan, net sales grew ¥23.1 billion year-on-year, or 2.0%, to ¥1,175.3 billion, but operating income fell ¥3.7 billion, or 7.7%, to ¥44.7 billion, and ordinary income was down ¥2.3 billion, or 4.7%, at ¥47.1 billion.

Profits decreased for a second consecutive year. We attributed this mainly to a ¥30.9 billion increase in costs resulting from higher prices for heavy oil, woodchips, waste paper and other raw materials and fuel. We sought to compensate for the significant negative impact on profits by cutting costs and raising prices in major product categories. Our efforts, however, were unable to fully offset the downward pressure and avert the decrease in profits. Net income rose ¥5.8 billion year-on-year, or 33.5%, to ¥23.0 billion, due partly to a decline in extraordinary losses.

We expect raw material and fuel prices to remain high or increase further as a result of growing global demand for resources. We also believe competition will intensify as the paper market in Asia becomes increasingly borderless.

We at Nippon Paper Group are working to reduce our dependence on heavy oil by switching energy sources, to enhance our competitiveness by raising efficiency through the deployment of the latest manufacturing equipment, and to establish robust management and operating platforms to help us stay ahead in the international competition. These efforts include resolute action to move prices upward and working to establish an industry structure that will allow costs of externals to be reflected in product prices. Ultimately, we are pursuing a growth strategy that will enable us to become a presence to be reckoned with in overseas markets as laid out in our Group Vision 2015.

# Message from the President

## Business environment of Japan's pulp and paper industry

### Increasingly mature environment

Japan is the world's third largest producer and consumer of paper after the United States and China, and our home market has continued to expand as domestic paper demand has increased steadily in conjunction with growth in GDP. However, the Japanese economy is maturing and domestic economic growth is expected to be moderate. This will soon be further complicated when the population begins to decline. These factors mean that although the domestic market remains an important one for the pulp and paper industry, it has reached a plateau and demand will either remain flat or decline slightly going forward.

### Increasingly competitive environment

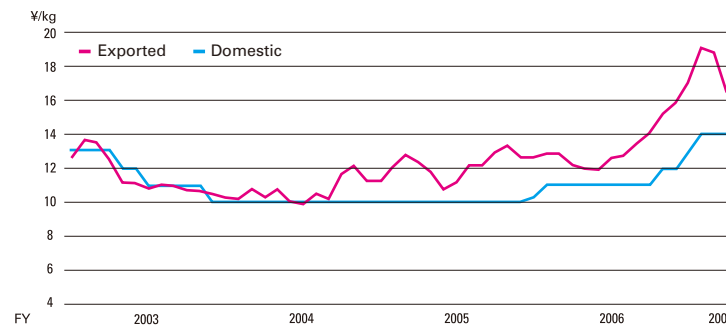
While the Japanese economy matures, the economies of its neighbors in Asia—notably that of China—have maintained high growth. Paper demand in these countries has exhibited remarkable growth similar to that of their economies, making them promising markets for Japan's pulp and paper industry. Meanwhile, manufacturers in the region are expanding production rapidly. This means that, although the position of Japan's pulp and paper industry in fast-growing Asia presents a significant opportunity, the increasingly borderless environment will also eventually lead to more-intense international competition.

### High raw material and fuel prices

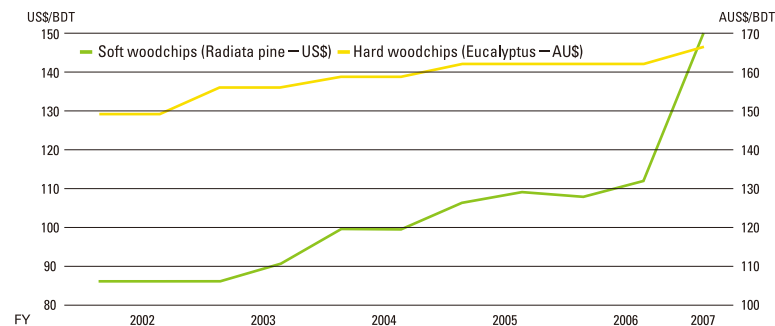
Rapid economic growth in emerging economies is precipitating materials-price inflation on a global scale. Heavy oil and coal prices have risen rapidly and robust demand in China has driven up prices for wastepaper. Other raw materials—including woodchips, pulp, filler, and chemicals—have all grown more expensive as well.

Higher raw-material and fuel prices are placing significant pressure on earnings throughout Japan's pulp and paper industry. In these circumstances, we see a growing need to switch to fuels with greater cost advantages and to secure stable supplies of wood resources and other raw materials.

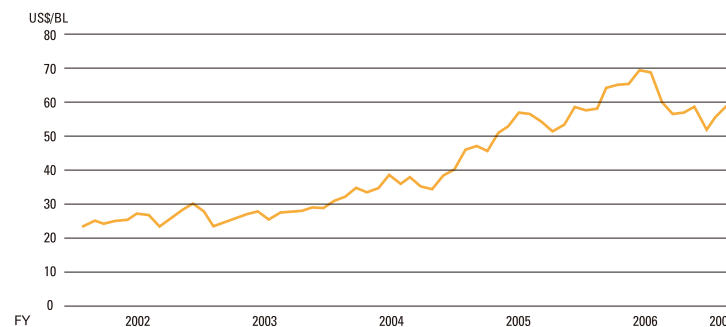
Old Newsprint



Woodchips



Dubai Crude Oil Price (Source: Platts)





### *Business challenges for Nippon Paper Group*

We at Nippon Paper Group launched our Second Medium-Term Business Plan in fiscal 2006 to strengthen our business fundamentals by concentrating business resources in our core domestic businesses. As part of the plan's priority measures, we are deploying the latest manufacturing equipment and switching fuels to reduce our heavy-oil consumption.

We also perceive the business challenges described below and need to prepare measures to respond to them.

#### **Enhance paper business competitiveness**

In our core paper business, we believe that in addition to our current policies, we need to take new initiatives to enhance our competitiveness further. To counter the negative impact on earnings of externalities such as the increasing international competition and higher raw-material and fuel prices mentioned above, we also need to raise productivity and establish competitive advantages.

#### **Strengthen the paperboard business**

The paperboard business is part of our core pulp and paper business, but we need to adopt sweeping measures to address its as-yet inadequate competitiveness, business scale, and other fundamental aspects.

In Japan, the maturing economy means the onset of stagnation in the market for containerboard, a mainstay product. Here, we believe our key challenges lie in enhancing productivity, establishing a framework for bringing stability to the industry, and expanding the paperboard business in growth-driving emerging Asian and other overseas markets.

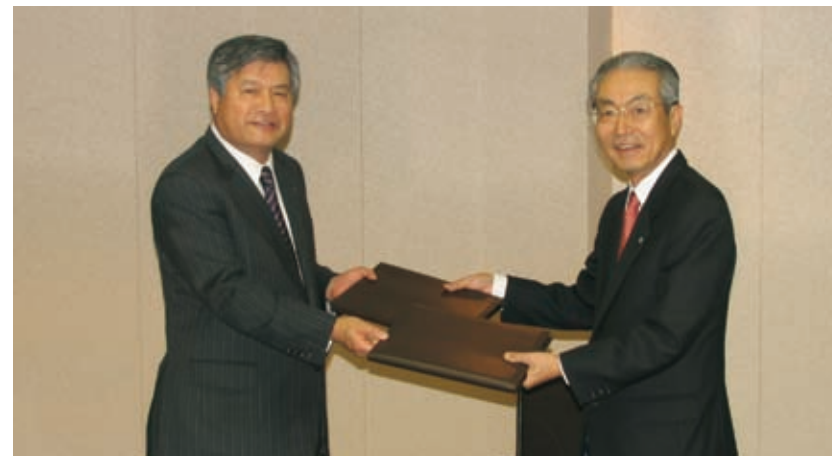
### *Two strategic alliances*

We concluded two strategic alliance agreements in fiscal 2006 with a view to meeting these business challenges.

We believe an alliance strategy is an important and effective means for enhancing our competitiveness. Mergers and business integrations can also have a major impact, but they tend to take longer to deliver beneficial results and may be hampered by legal constraints, including challenges grounded in the Antimonopoly Law. In contrast, our alliance strategy has the advantages of allowing us to build flexible, cooperative frameworks focusing on areas we want to strengthen, and to achieve benefits more quickly than possible through mergers or other similar actions. We also believe that business alliances have the potential to develop into tighter and more successful relationships over time as the partners deepen trust in one another through various cooperative initiatives.

#### **Strengthen the paper business: Alliance with Hokuetsu Paper Mills**

Nippon Paper Industries Co., Ltd., which handles the paper business for Nippon Paper Group, and Hokuetsu Paper Mills, Ltd. formed a strategic business alliance in December 2006.



President Miwa of Hokuetsu Paper Mills (left) and President Nakamura of Nippon Paper Industries

We believe this partnership will help us enhance the already robust competitiveness of our large printing paper plants located in coastal areas—Nippon Paper Industries' Ishinomaki and Iwakuni Mills and Hokuetsu's Niigata Mill—by allowing us to streamline logistics and procure raw materials jointly. We also intend to expand our presence outside Japan by

positioning lightweight coated paper, a specialty of both companies, as a strategic product for developing international markets, again jointly. Further, we believe our partnership will contribute to a stable home market, a prerequisite for stable earnings in Japan. To derive maximum benefit from the alliance, we will be implementing several initiatives.

#### Scope

- 1) Production and logistics
  - » Build a production framework to facilitate rapid deployment of new capital equipment; specifically, on-machine paper coaters N6 (Nippon Paper Industries Ishinomaki Mill) and N9 (Hokuetsu Niigata Mill)
  - » Supply one another with product on an OEM basis
  - » Work together to develop international markets
  - » Share shipping and distribution networks
- 2) Raw materials procurement
  - » Secure profitable and stable supplies of raw materials through co-development and co-procurement initiatives
  - » Reduce procurement costs by working together to strengthen logistics networks and boost operational efficiency while sharing technological expertise to switch to lower-cost raw materials
- 3) Technology
  - » Improve efficiency by sharing manufacturing and operations technology
  - » Explore joint initiatives to address shared technological issues in quality control, maintenance, the environment, and other similar areas

#### Strengthen the paperboard business: Alliance with Rengo and Sumitomo



Left to right: President Otsubo of Rengo, Former President Oka of Sumitomo Corporation and President Nakamura of the Nippon Paper Group

The Nippon Paper Group, Rengo Co., Ltd., and Sumitomo Corporation formed a strategic alliance in the paperboard business in March 2007.

Nippon Daishowa Paperboard Co., Ltd. forms the core of Nippon Paper Group's paperboard business and, with its business structure focused on containerboard production, ranks third domestically in this segment. Rengo, on the other hand, ranks second in domestic paperboard production and leads the industry in corrugated products. Rengo's specialization in corrugated products complements our group's high weighting in containerboard, making a partnership with Rengo the perfect opportunity to shore up Nippon Paper Group's paperboard business. We see the combination of Nippon Paper Group's and Rengo's businesses allowing us to create a well-balanced and powerful alliance covering the entire spectrum of the Japanese paperboard market from containerboard to corrugated products.

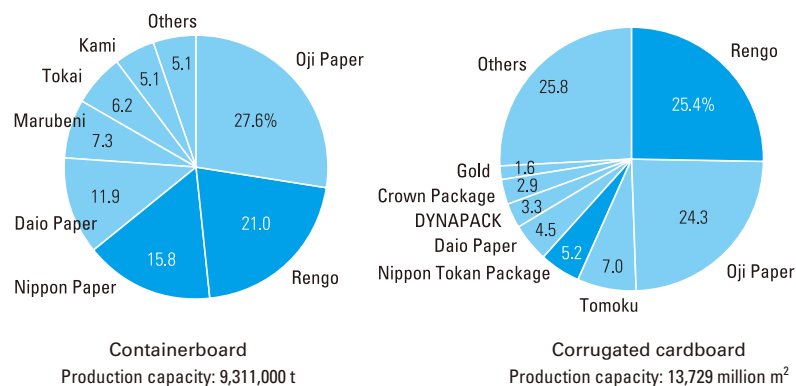
We intend this alliance to help us create an industry structure that will bring proper market discipline to the sector from the upstream wastepaper segment to the downstream corrugated-board segment and ensure fair profits for all sector players. We will also continue to deepen cooperation through the joint pursuit of alliance initiatives and actively consider new ways to strengthen the relationship even further.

### Share cross-holdings

The three companies will acquire and retain shares in one another to cement their strategic alliance:

- 1) Nippon Paper Group will acquire 5% of Rengo's outstanding common shares by March 31, 2008.
- 2) Rengo will acquire 3% of Nippon Paper Group's outstanding common shares by March 31, 2008.
- 3) Sumitomo will transfer shares in Rengo (1.5% of outstanding common shares) held by consolidated subsidiary Sumisho Paper to Nippon Paper Group in exchange for an equivalent value of shares in Nippon Paper Group (0.6% of outstanding common shares). The shares transferred to Nippon Paper Group will be included in its stake in Rengo.

Consolidation in the Containerboard and Corrugated Cardboard Segments by Corporate Group (FY2005)



### Operational initiatives

- 1) Joint scrap and build of paperboard facilities
  - » Evaluate and build an optimal paperboard production structure with focus on containerboard.
- 2) Comprehensive measures to reinforce partners' packaging businesses
  - » Launch measures designed to promote consolidation and forge new business alliances in the corrugated cardboard segment.
  - » Collaborate in the folding-carton and flexible-packaging businesses.

### 3) Joint procurement of raw materials

- » Build a comprehensive operational structure for the joint procurement of recovered paper.
- » Jointly explore ways to procure raw materials and energy more cost effectively.

### 4) Joint expansion of overseas businesses

- » Leverage the partners' existing overseas networks to expand overseas business and boost exports.
- » Identify overseas companies and projects as targets for co-investment.

### 5) Other initiatives (distribution, research and development, technology exchange, personnel exchange, and IT systems)

- » Harness OEM agreements to eliminate transportation overlaps.
- » Identify and implement joint research and development projects.
- » Exchange production technologies to enhance productivity, quality control, and operational efficiency.
- » Share information on personnel policies and technical training.
- » Explore joint development and application of IT systems and collaboration in electronic data interchange (EDI).

### Medium to long-term initiatives to enhance corporate structure

#### Fundamentally enhance productivity

We believe fundamental measures are needed in view of the changes in the business environment and intensifying international competition previously discussed and are revamping our domestic manufacturing framework as part of our efforts to bolster our corporate structure.

To ensure the survival of our production facilities in Japan, we are initiating a group-wide reorganization of our plants and working to increase productivity by requiring them to satisfy at least one of two conditions: be large enough to be internationally competitive, or have a regional specialization enabling small-lot production or have high margins by manufacturing specialty products.

We also believe these measures will contribute to improving the industry-wide capacity situation over the medium to long term and to establishing the industry structure we desire.



## Mergers and acquisitions

To enhance competitiveness, we will actively pursue M&A opportunities in line with our basic stance:

- » A prospective merger or acquisition partner must have the potential to generate significant synergies and economic streamlining so as to contribute toward a shared goal of creating the largest pulp and paper group in Asia and one of the top five groups in the world.
- » A prospective partner's business—in terms of market, products, and regions (in Japan and overseas)—must effectively complement our own, and both parties must perceive the need and see potential for substantial integration.

*Return to growth trajectory*

## Toward our Group Vision 2015 target

We believe future growth and development requires a long-term vision that transcends short-term policies and can be shared throughout the group, and we drafted our Group Vision 2015 in 2005 and set the numerical targets listed in the table (right) in this context.

Though the current business environment may hinder our efforts to achieve satisfactory profit levels over the short term, through the initiatives discussed above we are working hard to enhance our profitability, size, and global reach. We believe they will put us back on the growth trajectory laid out in our Group Vision 2015 and allow us to achieve our ultimate goal of placing ourselves firmly among the world's top five pulp and paper groups.

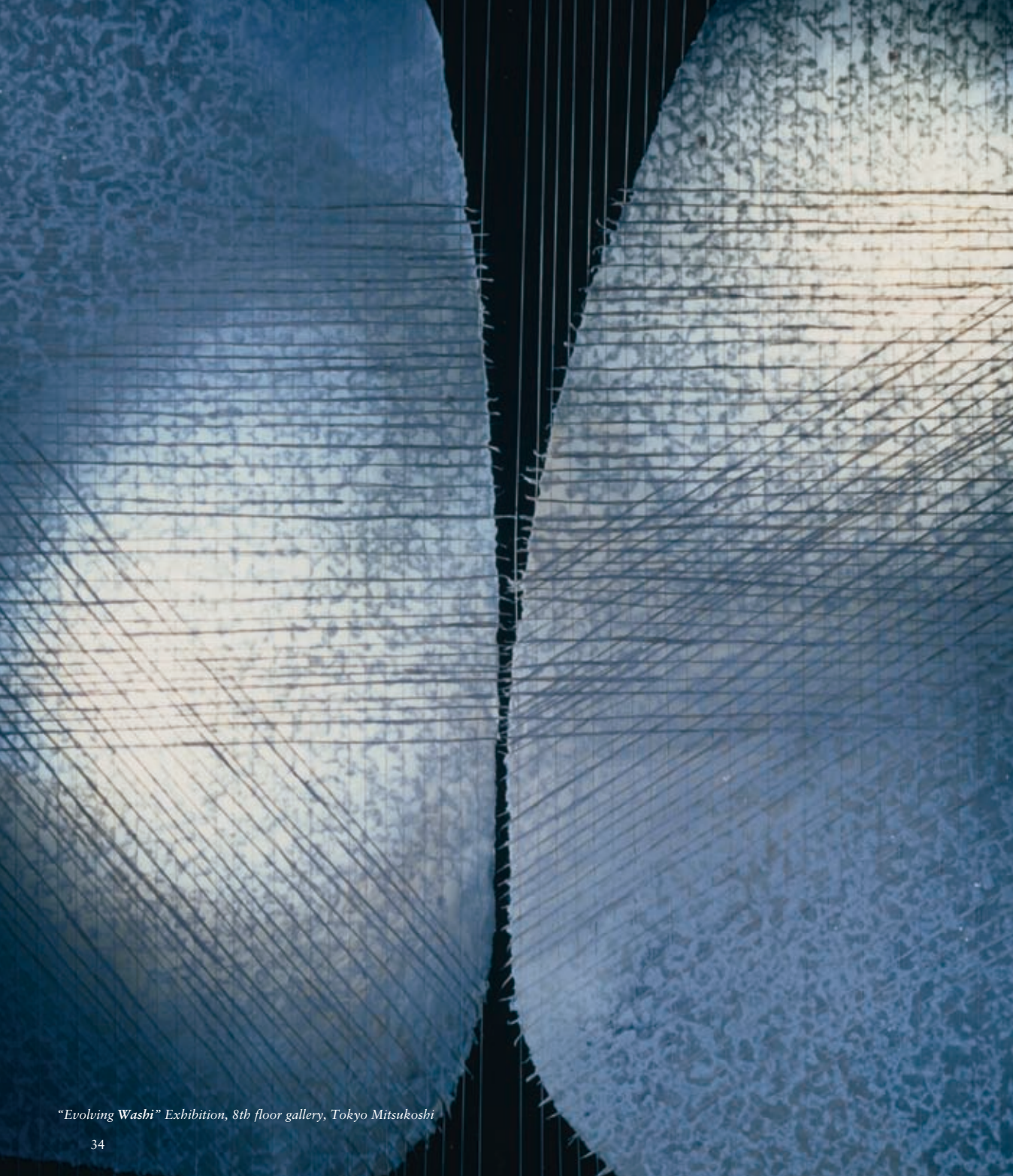
Embodying the spirit of Group Vision 2015, we are committed to coexisting with the community as a recycling-oriented company and contributing to society and culture by supplying paper—an essential of people's everyday lives.

## Group Position in 2015

<b>Consolidated net sales</b>	¥1.5–¥2.0 trillion
<b>Consolidated operating income</b>	Stable domestic operating income of ¥100 billion, plus operating income from overseas business
<b>Consolidated operating income to net sales</b>	8%–10%
<b>Business portfolio</b>	Domestic business to account for 70% and overseas business for 30% Pulp and paper business to account for 70% and non-pulp and paper business for 30% Expand business in three major markets of Asia, North America, and Europe
<b>Market capitalization</b>	¥1 trillion
<b>Operating cash flow</b>	¥150 billion

## Road Map to 2015

2006	<b>1st STEP</b>	Strengthen domestic core businesses
2007	Second Medium-Term Business Plan	
2008	Business Plan	
2009	<b>2nd STEP</b>	Achieve growth by expanding overseas business
2010	Third Medium-Term Business Plan	
2011	Business Plan	
2012	<b>3rd STEP</b>	Achieve growth by expanding overseas business
2013	Fourth Medium-Term Business Plan	
2014	Business Plan	
2015	<b>Group Vision 2015</b>	



*“Evolving Washi” Exhibition, 8th floor gallery, Tokyo Mitsukoshi*

## FEATURE 2007

Management issues we face and how we intend to deal with them

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# Initiatives to Secure Resources

## AMCEL acquisition



AMCEL afforested land

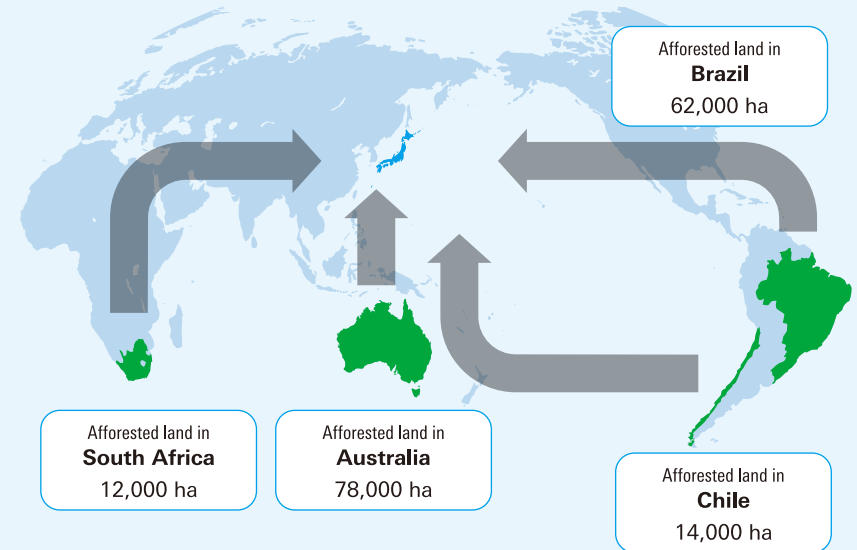
To meet an anticipated increase in global demand for woodchips and prepare for the full-scale overseas expansion of our pulp and paper business, we are committed to securing resources and developing a comprehensive framework for their stable procurement.

### Growing importance of securing wood resources

Demand for a variety of resources has increased in recent years as a result of economic growth in emerging countries.

Wood resources are essential for manufacturing paper, and as global competition to acquire them grows more intense, we need to ensure an appropriate level of independent resources and create a framework for procuring resources stably over the long term. Our Tree Farm Initiative, an overseas afforestation project, is designed to expand our afforested land reserves to some 200,000 hectares overseas.

## Nippon Paper Group's Tree Farm Initiative Afforestation Project (2006)



### Acquisition of AMCEL

Nippon Paper Group and Marubeni Corporation jointly acquired Amapa Florestal e Celulose S.A. and two other companies (“AMCEL”) involved in afforestation, woodchip production, and biomass-fuel exporting in Brazil from International Paper Company’s Brazilian subsidiary in 2006.

AMCEL owns some 130,000 hectares of plantable land, including 62,000 hectares of land that is already afforested. This is the largest single area of afforestation in which Japanese companies have ever been involved, and the acquisition increases our afforested land reserves to 166,000 hectares and opens the possibility of further expansion in the future.

### Advantages

We believe the greatest advantage of this acquisition is that the investment will have an immediate impact because infrastructure is already in place, including ports for shipping as well as standing forests ready for harvest.

The addition of afforestation operations in Brazil also reduces our exposure to geopolitical risks by diversifying our sourcing regions beyond Australia, Chile, and South Africa.



# Energy Shift

## Deployment of alternative-energy boilers



Biomass boiler at Nippon Paper Industries' Ishinomaki Mill

### High crude oil prices

The pulp and paper industry requires large amounts of energy for manufacturing. Heavy oil is one of the Nippon Paper Group's primary fuels, and recent increases in worldwide prices have put significant pressure on our earnings. We need to take drastic measures to address this because we expect the trend to persist.

### Deployment of alternative-energy boilers

We are installing biomass and waste boilers to end our overdependence on heavy oil with the ultimate goal of eliminating the use of oil in our operations.

The table below underscores the specifics: We have decided to install 10 alternative-energy boilers during our fiscal 2006–2008 Second Medium-Term Business Plan. Through this project, we foresee a reduction in our annual heavy oil consumption of 647,000 kiloliters, equivalent to 57% of the amount used in fiscal 2005.

Nippon Paper Group launched commercial operation of the plan's first biomass boiler at Nippon Paper Industries' Ishinomaki Mill in October 2006, and the other nine alternative-energy boilers will gradually come on line at several group companies beginning in the second half of fiscal 2007.

### Combination of investment benefits and environmental initiatives

Conforming to the basic policies in the Nippon Paper Group Charter on the Environment, our "energy shift" investment will deliver both economic and environmental benefits: Besides cost savings attributable to the switch to lower-priced alternative energy sources, it promises to reduce our annual carbon dioxide emissions from fossil fuels by 775,000 tons, equivalent to 8.8% of our fiscal 2005 emissions. This will help us do our part to counter global warming, an important global environmental issue.

#### List of new boilers

Startup	Company	Mill	Type	Cost benefits ¥billion
Oct. 2006	Nippon Paper Industries	Ishinomaki	Biomass	1.6
Oct. 2007	Nippon Paper Industries	Fuji	Biomass	2.9
Jan. 2008	Nippon Paper Industries	Iwanuma	Alternative energy	3.4
Feb. 2008	Nippon Paper Industries	Iwakuni	Biomass	3.1
Apr. 2008	Nippon Daishowa Paperboard Tohoku	Akita	Coal	2.4
Apr. 2008	Nippon Daishowa Paperboard Yoshinaga	Yoshinaga	Alternative energy	2.1
Aug. 2008	Nippon Paper Industries	Shiraoi	Alternative energy	2.2
Sept. 2008	Nippon Paper Chemicals	Gotsu	Coal	1.2
Oct. 2008	Nippon Paper Industries	Asahikawa	Biomass	1.0
Jan. 2009	Nippon Daishowa Paperboard Nishinippon	Geibo	Alternative energy	3.1
Total				23.0

## News Releases

The following is a list of news items relevant to our feature article that were released between April 2006 and June 2007.

### 2006

- April 4 First Shipment of Green Triangle Bluegum Woodchips Loaded
- May 10 Launches Second Medium-Term Business Plan  
Paper Production Facilities Scrap-and-Build Plan
- June 8 Releases New Product: *Opera Cream HO*, Thin Paper for Books
- July 13 Releases New Product: *OPER Premier*
- September 27 Releases New Product: *U-Itimax mm*
- October 12 Overseas Afforestation Area Reaches 100,000 Hectares
- November 2 Completes AFS Forest Certification Procedures for Its Tree Farm in Australia
- November 28 Nippon Paper Industries Jointly Acquires Afforestation,  
Woodchips Production and Export Businesses in Brazil
- December 1 Strategic Alliance between Hokuetsu Paper Mills and Nippon Paper Industries

### 2007

- January 25 Develops System to Unify Management of Group Logistics
- March 2 Rengo, Nippon Paper Group, and Sumitomo Corporation  
Sign Strategic Alliance Agreement
- March 30 Basic Agreement on Merger between NP Trading Co., Ltd. and  
Mantsune Corporation
- April 20 First Revision to the Charter on the Environment in Six Years in Sync with  
New Establishment of the Environmental Action Plan
- April 24 Reorganizes Its Lineup of Recycled Paper and Discontinues  
Its 100% Waste Paper Products
- May 14 Launches a New PPC Paper Reflecting Its Environmental Concept,  
*Green Proportion™*
- May 31 Launches a Photocatalytic Matt Coated Paper *PDASH™*

\* Visit our website at <http://www.np-g.com/e/news/index.html> to view full news releases.



## MAJOR SUBSIDIARY PROFILES

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# Nippon Paper Industries Co., Ltd.



**NIPPON PAPER INDUSTRIES CO.,LTD.**

**Nippon Paper Industries Co., Ltd.**

Established	August 1, 1949
Paid-in Capital	¥104,873 million
Web Site	<a href="http://www.np-g.com/e/">http://www.np-g.com/e/</a>
Representative	President Masatomo Nakamura
Principal Products	Newsprint Printing and publication paper Business communication paper Packaging paper Paper for miscellaneous uses

Fiscal 2006 Net Sales ¥634.0 billion (including intercompany sales)



*M. Nakamura*

Masatomo Nakamura President

**Business environment**

Domestic paper shipments were strong in fiscal 2006, driven by demand from the commercial printing industry on the back of steady economic recovery. However, the industry environment became extremely difficult as crude oil prices remained high and prices for woodchips, wastepaper, papermaking chemicals, and other raw materials rose sharply due to strong demand and tight supply internationally.

**Company strengths**

Nippon Paper Industries' core mills are located along the coast, and given that Japan relies heavily on importing raw materials and fuel, this geographical advantage is a source of competitiveness. Our domestic paper business has the top market share for nearly all products, and, as the industry leader, we enjoy a powerful brand, strong market confidence, and top-level capabilities in manufacturing technology and product-developments.

**Review of fiscal 2006**

Nippon Paper Industries' sales in its home market (by volume) increased year-on-year in fiscal 2006 as a result of continued firm growth for coated paper. However, despite progress in efforts to raise prices in major product categories and in reducing costs, higher raw-material and fuel costs—for woodchips, wastepaper, and heavy oil—had a major impact on our earnings, and operating income and ordinary income both decreased year-on-year.

**Outlook**

We expect high raw-material and fuel prices to continue putting significant pressure on earnings in fiscal 2007. We also see our business environment remaining difficult as a result of an increase in depreciation due to 2007 tax-code reforms and higher capital expenditures.

We are responding to these challenges by working to strengthen our corporate structure. This includes enhancing

manufacturing efficiency through a major scrap-and-build program in conjunction with the installation of advanced coated paper manufacturing equipment at our Ishinomaki Mill and switching from heavy oil to biomass and other alternative fuels through the installation of alternative-energy boilers.

We are working to pass on to product prices any increases in raw-material and fuel costs that we are unable to offset through our own initiatives, and we seek to establish an industry structure capable of ensuring profits.



# Nippon Daishowa Paperboard Co., Ltd.



NIPPON DAISHOWA PAPERBOARD CO., LTD.

<b>Nippon Daishowa Paperboard Co., Ltd.</b>	
Established	August 28, 1913
Paid-in Capital	¥10,864 million
Web Site	<a href="http://www.nichidaiita.co.jp">http://www.nichidaiita.co.jp</a>
Representative	President Nobuyuki Otsuki
Principal Products (applications)	Containerboard (corrugated board) White board (packaging for confectionery and daily commodities, publishing, and catalogs) Other paperboard (gypsum board base paper and paper core) Specialty paper (plug wrap paper, teabag filter paper)
Fiscal 2006 Net Sales	¥158.4 billion (including intercompany sales)



*N. Otsuki*  
Nobuyuki Otsuki President

**Business environment**

Paperboard is and promises to remain an essential material for wrapping and packaging. Being made primarily from wastepaper, it is also an ideal product from a waste-management perspective as well as conducive to achieving the Japanese Ministry of the Environment’s zero-waste-concept “sound material-cycle society.”

Although we do not anticipate significant growth in domestic demand for paperboard, we believe the business environment will remain stable. In fiscal 2006, demand in the paperboard segment as a whole was affected by a general trend towards using less packaging, resulting in a meager 0.3% growth over 2005 despite steady containerboard demand from the beverage and digital consumer-electronics sectors. Meanwhile, even after a price hike in April market prices for paperboard remained stable thanks to manufacturers’ ongoing efforts to avoid overproduction.

On the cost side, we foresee persisting

hurdles as wastepaper prices skyrocket and crude-oil prices remain high, both factors that put profits under significant pressure.

**Company strengths**

Our mainstay mill is located on the outskirts of the Kanto region, a major paperboard-consuming market. This gives us advantages in both selling product and procuring wastepaper. Sales in other parts of the country are facilitated by mills sited in proximity to the localities they serve. Also, to help keep costs down, our mills each operate as independent business units responsible for their own profitability.

**Performance in fiscal 2006**

To maintain profit margins despite the serious input-cost inflation that continued from the previous fiscal year, we raised the prices of our mainstay products beginning in April 2006 to levels that we then worked hard to maintain. We also slashed costs by enhancing productivity through process

improvements and aggressive capital investments designed to reduce energy consumption and labor costs. Thanks to these efforts, we eventually met and then exceeded our profit targets for fiscal 2006.

**Outlook**

We are taking steps to achieve the goals set forth in the Second Medium-Term Business Plan. In production, one of these is the installation of alternative-energy boilers to diversify our fuel sources and reduce the effects of high crude-oil prices. In sales, we will continue working to maintain prices and exploring ways to reflect higher wastepaper costs in our pricing scheme. Also, in March 2007 the Nippon Paper Group, Rengo Co., Ltd., and Sumitomo Corporation concluded a strategic alliance agreement covering the paperboard business. At present we are moving from the in-depth examination phase to implementation and hope to achieve results as soon as possible.

# Nippon Paper Crecia Co., Ltd.



NIPPON PAPER CRECIA CO.,LTD.

<b>Nippon Paper Crecia Co., Ltd.</b>	
Established	April 2, 1963
Paid-in Capital	¥4,667 million
Web Site	<a href="http://www.crecia.co.jp">http://www.crecia.co.jp</a>
Representative	President Kazuhiro Sakai
Principal Products	Facial tissue Bathroom tissue Paper towels Pre-moistened wipes Health-care products Industrial-use wipes
Fiscal 2006 Net Sales	¥ 55.4 billion (including intercompany sales)



*Kazuhiro Sakai*

Kazuhiro Sakai President

### Business environment

Shipments of sanitary paper in 2006 were up a solid 1.7% year-on-year to 1,797,000 tons.

The household tissue segment entered a period of unprecedented price competition when a major competitor changed its sales strategy in early autumn 2004. In the spring and summer of 2006, companies in the segment raised prices, but resistance from retailers has been so strong that they have yet to return to desirable levels. Over this same period, fuel prices continued to rise and put downward pressure on profits, compelling all segment players to announce a second round of price hikes to take place over the spring and summer of 2007.

### Company strengths

Nippon Paper Crecia Co., Ltd. handles the two global brands Kleenex® and Scottie® based on an alliance with Kimberly-Clark Corporation and has continued to grow by leveraging its high level of technological

expertise and product quality. Our manufacturing facilities are located in the major consumer markets of metropolitan Tokyo and Kansai, giving us advantages over our competitors in logistics costs and flexibility.

### Performance in fiscal 2006

During the first half of fiscal 2006, hoarding demand arose ahead of the price hikes, and sales rose 5.9% year-on-year; in the second half, however, sales were off by 3.6% year-on-year as hoarding subsided and demand faded. Though the phased price hikes did contribute somewhat to second-half revenues, sales for the full year were up by only 0.9% to ¥55.4 billion. We went to great lengths to achieve large cost reductions, but the increases in fuel and other input costs, together with the delay in reflecting them in our own prices, resulted in a sizeable negative impact. Nonetheless, fiscal 2006 was much better than fiscal 2005.

### Outlook

Although we have announced a second price rise for household tissue to improve profitability, the future is difficult to discern given that crude-oil and other fuel costs remain high while those for pulp and other raw materials are rising rapidly.

We are working to quickly transform Nippon Paper Crecia into a competitive company through sweeping structural reforms that include optimizing our production framework from a logistics perspective, drastically cutting distribution costs, and offering an early retirement program.

At the same time we intend to bolster our sales capabilities by introducing new products more attuned to consumers' needs and desires, such as those presented at the Product Launch Press Events begun in February 2007. We are also acting to implement more-efficient distribution and logistics methods with reduced environmental impact.



# NP Trading Co., Ltd.



*Toshio Yamamoto*

Toshio Yamamoto President

### Business environment

NP Trading Co., Ltd. was established in April 2006 through the merger of group company San-Mic Shoji Co., Ltd. and Komine Nissho Co., Ltd., both trading companies specialized in paper and pulp products. In October 2007, NP Trading signed a basic agreement covering a merger with Mantsune Corporation, another trading company that carved out a position for itself as a paper specialist. The move not only propels our paper sales volume to a new level, but also expands our business scope to container board, film packing, and other parts of the packaging materials segment.

### Company strengths

NP Trading markets all products of the Nippon Paper Group, notably paper including converted and functional paper, chemicals, liquid crystal materials, and housing materials. We deal in a variety of products tailored to the needs of our



customers while pursuing a shared strategy with the other group companies.

NP Trading also operates as a specialty dealer for the paper industry, offering a diverse range of products encompassing pulp, wastepaper, industrial chemicals, and other raw materials used in papermaking, as well as equipment, operating supplies, films, and packaging materials.

Overseas markets are growing in importance to us, and NP Trading established a company in Bangkok in fiscal 2006 and another in China's Shenzhen Province in 2007 to augment our sales offices in Hong Kong, Singapore, Jakarta, and Kuala Lumpur.

### Performance in fiscal 2006

Rapidly realizing synergies from the merger, NP Trading saw net sales rise 3.7% and ordinary profit increase 15.4% year-on-year (based on the sum of pre-merger figures from both companies).



## NP TRADING CO., LTD.

### NP Trading Co., Ltd.

Established	July 11, 1979
Paid-in Capital	¥1 billion
Web Site	<a href="http://www.np-t.co.jp/index-e.html">http://www.np-t.co.jp/index-e.html</a>
Representative	President Toshio Yamamoto

Principal Products	Printing and publication paper/ Business communication paper/Newsprint/ Packaging paper/Specialty paper/ Containerboard/Whiteboard/Base paper for decorative laminates/Base paper for copper clad laminates/Cup stock/Special functional papers/ Special functional film/Polyvinyl laminated paper and saturating paper/Chemicals, mineral products and machinery for pulp and paper production/Pulp and Wastepaper/CMC, Lignin and Yeast extract/Fuel oil and RPF/Converting machines for resin and film/Housing materials/ Petrochemical products/Industrial materials
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Fiscal 2006 Net Sales	¥ 233.2 billion (including intercompany sales)
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### Outlook

In fiscal 2007 we are committed to deriving further synergies from the San-Mic-Komine Nissho merger and to completing another with Mantsune planned for October. In the meantime, our sales force will be ready in both our home and overseas markets to start selling product slated to come online this year at Nippon Paper Industries' Ishinomaki Mill.



# NIPPON PAPER-PAK CO., LTD.



NIPPON PAPER-PAK CO., LTD.

**NIPPON PAPER-PAK CO., LTD.**

Established	March 18, 1965
Paid-in Capital	¥4 billion
Web Site	<a href="http://www.nipponpaper-pak.com">http://www.nipponpaper-pak.com</a>
Representative	President Toshihiro Maeda
Principal Products and Services	Liquid-packaging cartons Filling machines and maintenance services Paper containers Film for food packaging Film for industrial packaging

Fiscal 2006 Net Sales ¥46.0 billion (including intercompany sales)



Toshihiro Maeda President

**Business environment**

As Japan's population reaches a plateau, total demand for beverages will flatten. In the liquid-packaging carton market, demand from the ready-to-drink (RTD) tea segment is robust, while that from the mainstay milk segment is slumping, and stiff competition from PET bottles and other alternative containers is suppressing the beverage carton market as a whole. Since 2005, prices for crude oil have skyrocketed and the yen has softened against other currencies. This has resulted in prices of milk carton board (mostly imported) and other raw materials climbing so dramatically that they are putting significant downward pressure on the company's profits. Meanwhile, the company faces mounting public pressure to increase the recycling of packaging and to enhance the safety and sanitation of food containers. Overseas, the sale of International Paper's beverage packaging division and other events signal the restructuring of the global beverage packaging industry, a change that

could affect Nippon Paper-Pak's efforts to expand overseas sales.

**Company strengths**

We offer an integrated service encompassing the supply of filling machines, packaging materials for them, and their maintenance. Our products range from gable-top containers for chilled distribution to "NS-Fuji Pak®" aseptic brick-type packages for room-temperature distribution.

**Performance in fiscal 2006**

Sales of liquid-packaging cartons exceeded those of the previous year in both volume and value thanks to sales expansion efforts and a mild winter; however, profits were down due to the skyrocketing board price and a weak yen. In the paper containers segment, sales of tissue carton blanks and other products were down slightly year-on-year, and net sales of film were also down as OEM contracts expired.

**Outlook**

In fiscal 2007, rising costs and a harsh sales environment threaten to make this year more difficult than last. On the production side, we will improve productivity through new cutting-edge equipment and will continue to step up our implementation of a cost-cutting project launched in 2005. On the sales side, we intend to raise product prices and work to expand sales with focus on NS-Fuji Pak®. In the investments area, we have decided to cancel a planned joint venture project with Elopak AS in Suzhou, China, on account of changes in the investment environment. Building on the momentum generated by successful contracts for NS-Fuji Pak® in Jilin Province, China, we will continue sales activities there to push the product in that market.

# Nippon Paper Chemicals Co., Ltd.



## NIPPON PAPER CHEMICALS CO.,LTD.

<b>Nippon Paper Chemicals Co., Ltd.</b>	
Established	October 1, 2002
Paid-in Capital	¥3 billion
Web Site	<a href="http://www.npchem.co.jp/english/">http://www.npchem.co.jp/english/</a>
Representative	President Toshio Inoue
Principal Products (applications)	Dissolving pulp (rayon, cellophane, cellulose derivatives, etc.)/Chlorinated polyolefin, Special polyolefinic resin (paints, inks, adhesives, etc.)/Lignin products (concrete admixtures, bonds, etc.)/Carboxymethyl cellulose (CMC) (thickeners, stabilizers, etc.)/Powdered cellulose (filter auxiliaries, food additives, etc.)/Yeast extract (foods, animal feed, etc.)/Ribonucleic acid (powdered milk, culture media, etc.)/Stevia extract, glycyrrhizin (natural sweeteners)/Functional films for LCDs
Fiscal 2006 Net Sales	¥32.8 billion (including intercompany sales)



*Toshio Inoue*

Toshio Inoue President

### Business environment

Sales of automotive paints remain strong, though Japanese paint manufacturers continue to shift production overseas on the back of slower growth in domestic production by Japanese automakers. In consumer electronics, Japan launched digital terrestrial broadcasting, helping fuel demand as people replace their old televisions with flat-panel models; yet at the same time, downward pressure on prices is increasing, making it more difficult to maintain profits.

The food products and consumer-commodities industries tend to emphasize environmentally friendly products using natural materials, but consumers' preference for lower prices is also firmly entrenched. In the building and construction segment, shipments of ready-mixed concrete remain flat due to a decrease in public works projects. Also, incidents involving faulty concrete have surfaced, making concrete durability a public concern and leading to changes in the properties desired of concrete admixtures.

### Company strengths

Three major strengths have earned us the trust and confidence of our customers: We operate a flexible, customer-oriented business through tight collaboration between our manufacturing, sales, and research arms; we have a flat organizational structure to enable rapid decision making; and we have built a product-development structure that emphasizes cultivating proprietary technologies in conjunction with technical support rooted in years of accumulated knowledge and experience.

### Performance in fiscal 2006

In the functional coatings segment, polyolefinic resin for automotive paints enjoyed steady domestic sales and increasing exports. In the functional film segment, the mainstay optical films for LCD panels remained strong, but demand for plate-making materials and transfer printing materials declined. The dissolving pulp (DP) segment benefited from the tight global supply and demand situation, which prompted increasing domestic sales volume and raised export prices dramatically. In the functional

chemicals segment, growing demand for high-performance concrete admixtures supported favorable performance of the company and its subsidiary Flowric Co., Ltd.

Since fuel prices have continued to rise sharply since fiscal 2005, we have worked to raise prices for almost all products except functional films; nevertheless, the pace of fuel-price increases outstripped our ability to reflect them in product prices, ultimately canceling them out and depressing profits.

### Outlook

Fiscal 2007 marks the second year of the Second Medium-Term Business Plan, making it an important year for future business development. To secure a strong business foundation that can bear capital investment for large construction projects (such as the new boiler at our Gotsu Works), we must expand sales of existing products and introduce new ones. Given the possibility of yet further rapid rises in fuel prices, we have little cause for being overly optimistic. We will have to work hard to improve our earning power to be able to keep up with market growth and changes.

# Nippon Paper Lumber Co., Ltd.



**NIPPON PAPER LUMBER CO., LTD.**

Nippon Paper Lumber Co., Ltd.	
Established	September 10, 1970
Paid-in Capital	¥440 million
Web Site	<a href="http://www.np-l.co.jp">http://www.np-l.co.jp</a>
Representative	President Masahiro Iwabuchi
Principal Products	Logs (softwood, hardwood) Lumber products, Glued lumber, Plywood Pulpwood Woodchips (for use in papermaking and engineered wood, and as fuel) Wastepaper Insulation materials
Fiscal 2006 Net Sales	¥ 103.7 billion (including intercompany sales)



*M. Iwabuchi*

Masahiro Iwabuchi President

**Business environment**

New housing starts in 2006 were up 4.4% year-on-year, the fourth year of increases and underpinned by Japan's longest sustained recovery since 1945. Strong demand in China, Europe, India, and the Near and Middle East kept lumber prices high globally and continued to benefit source countries. New housing starts in 2007 are expected to be on par with those in 2006, but the rising cost of raw materials cannot be completely passed on through housing prices, giving leading traders and distributors pause for concern about downward pressure on their profits.

**Company strengths**

A lumber industry leader, Nippon Paper Lumber achieves growth while leveraging the creditworthiness, funding, and business-development strengths of the whole the Nippon Paper Group. Our goal is to establish a sustainable lumber business model by handling all aspects of the business

from afforestation to manufacturing and trading lumber products and woodchips, and disposing of scrap wood. The far-reaching Nippon Paper Group network is a source of diverse news, information, and ideas from inside and outside the company that make up the basis of our business expansion.

**Performance in fiscal 2006**

In fiscal 2006 our objective was to strengthen sales of housing lumber and wood used in pallets and packaging. In the papermaking materials segment as well, we worked to centralize the collection of pulpwood and woodchips in Hokkaido. Our efforts to secure stable supplies of papermaking materials and expand collection of used materials contributed greatly to higher revenues: In fiscal 2006, Nippon Paper Lumber enjoyed both increased net sales and higher ordinary profits, up 18.1% and 15.2%, respectively, year-on-year.

**Outlook**

With lumber prices soaring and timber supplies growing tighter, we expect a very tough time ahead. Economic disparity between Japan's major urban centers and outlying rural areas and small cities is also becoming more pronounced, giving rise to concerns about companies in less affluent parts of the county becoming unable to meet their financial obligations and leaving us with uncollectible receivables. To adapt to these business environment changes, we will work to expand our business scope by broadening our procurement and marketing of plywood, finishing wood, and pallet and packaging wood; bolstering the housing lumber business; and tightening control of accounts receivable.





## CSR AND CORPORATE GOVERNANCE

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## CSR

### Nippon Paper Group's Social Responsibility

Nippon Paper Group aims to provide broad support to industry, culture, and local communities. With great emphasis on creating foundations for a wholesome society, we do our best not only to help conserve the environment, but also to give our employees safe and clean workplaces, prevent accidents, and uphold high ethical standards. We pursue a variety of corporate social responsibility (CSR) initiatives to achieve the four goals outlined in our corporate vision: achieving stable, quality profits for our shareholders; earning the trust and confidence of our customers; having positive, forward-looking employees; and maintaining corporate ethics.

### Charter on the Environment revised, Environmental Action Plan implemented

We revised our Charter on the Environment in March 2007 and established a new group-wide environmental action plan, the Green Action Plan 2010.

Previously, each of our operating companies had their own environmental charters and action plans, but we decided to place greater emphasis on the Nippon Paper Group Charter on the Environment and on our Environmental Action Plan in response to growing public awareness of the environment.

We intend these to serve as a foundation for the environmental activities of the group. Going forward, each group company will draw up its own environmental action plans in line with them while implementing specifics under the authority of integrated group-wide environmental management.

### Nippon Paper Group Charter on the Environment

The Nippon Paper Group is committed to helping preserve the global environment over the long term and contributing to the development of a recycling-based society by carrying out its corporate activities in recognition of the importance of biodiversity.

#### *Basic policy*

1. Act to counter global warming
2. Protect and develop forest resources
3. Increase use of recycled resources
4. Comply with environmental statutes and work to minimize our environmental impact
5. Develop environmentally friendly technologies and products
6. Engage in active environmental communication

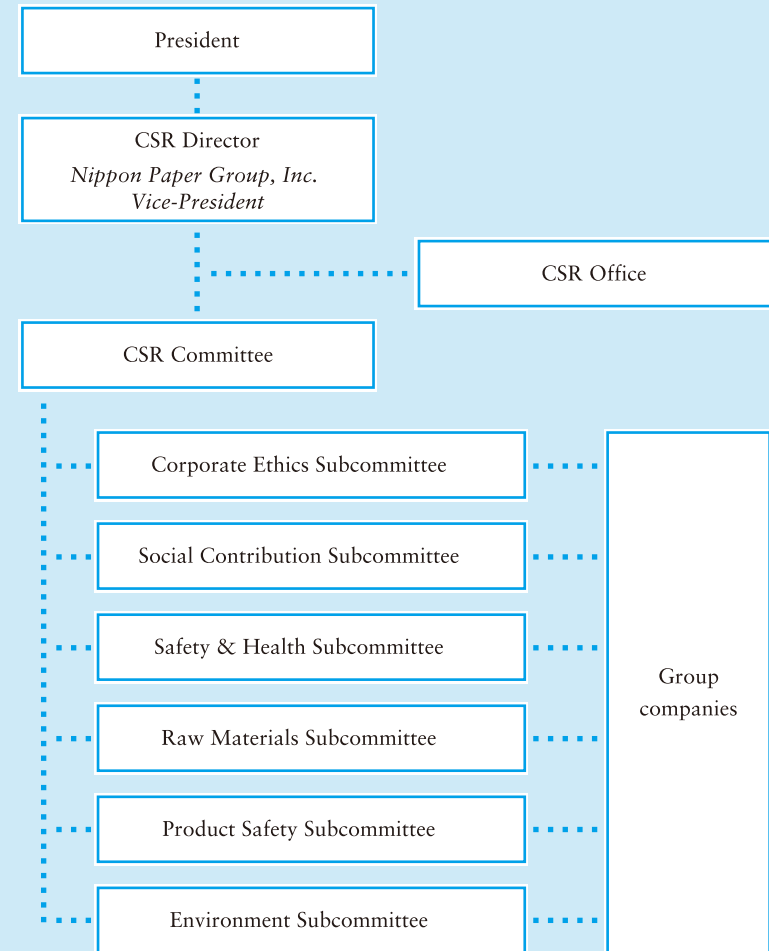
### Nippon Paper Group Environmental Action Plan

Nippon Paper Group companies will each establish their own specific environmental action plans and implementation programs in compliance with the philosophy and basic policy of the group's Charter on the Environment.

*Nippon Paper Group Environmental Action Plan*

Basic Policy in the Charter on the Environment	Green Action Plan 2010
<b>1. Act to counter global warming</b>	<ul style="list-style-type: none"> <li>» Reduce carbon dioxide emissions from fossil fuels by 10% from their fiscal 1990 levels on a per-product basis by fiscal 2010</li> <li>» Reduce fossil fuel consumption by 13% from its fiscal 1990 level on a per-product basis by fiscal 2010</li> <li>» Reduce greenhouse gas emissions</li> <li>» Manage company-owned forests in Japan based on sound practice designed to ensure carbon dioxide absorption and sequestration</li> </ul>
<b>2. Protect and develop forest resources</b>	<ul style="list-style-type: none"> <li>» Proceed with the Tree Farm Initiative, an overseas afforestation project that fosters sustainable sources of hardwood chips, to achieve an overseas afforestation area of 200,000 hectares by 2015</li> <li>» Acquire forest certification for all company-owned forests by 2008</li> <li>» Increase the proportion of material from certified or afforested forests to 100% of imported hardwood chips by 2008</li> <li>» Develop advanced technologies for boosting lumber cultivation</li> </ul>
<b>3. Increase use of recycled resources</b>	<ul style="list-style-type: none"> <li>» Increase the wastepaper usage rate to 50% or higher by fiscal 2008</li> <li>» Reduce final waste disposal to 4% or less of fiscal 1990 levels by fiscal 2010</li> <li>» Increase the ratio of products made from waste to 25% or more of total waste generated by fiscal 2010</li> </ul>
<b>4. Comply with environmental statutes and work to minimize our environmental impact</b>	<ul style="list-style-type: none"> <li>» Maintain and strengthen our environmental management systems</li> <li>» Define and manage voluntary control targets for preventing air, water, and soil pollution; noise; vibration; and foul odors</li> <li>» Control chemical substances appropriately by identifying substances whose use is to be prohibited or emissions, reduced</li> <li>» Accelerate the shift to transport modes, containers, and packing materials with low environmental impacts</li> <li>» Move ahead with green procurement of office equipment, supplies, and other needs</li> </ul>
<b>5. Develop environmentally friendly technologies and products</b>	<ul style="list-style-type: none"> <li>» Step up the research and development of environmentally safe, resource-saving products</li> <li>» Conduct research and development of technologies for reducing environmental impact at all stages of manufacturing</li> <li>» Continue to install and improve resource-saving equipment</li> </ul>
<b>6. Engage in active environmental communication</b>	<ul style="list-style-type: none"> <li>» Disclose environmental information to stakeholders in a timely manner through sustainability reports and on the website.</li> <li>» Engage actively in local environmental communication through dialogue with the public and the government</li> <li>» Play an active role and support environmental conservation activities and initiatives</li> </ul>

**CSR Promotion Structure**



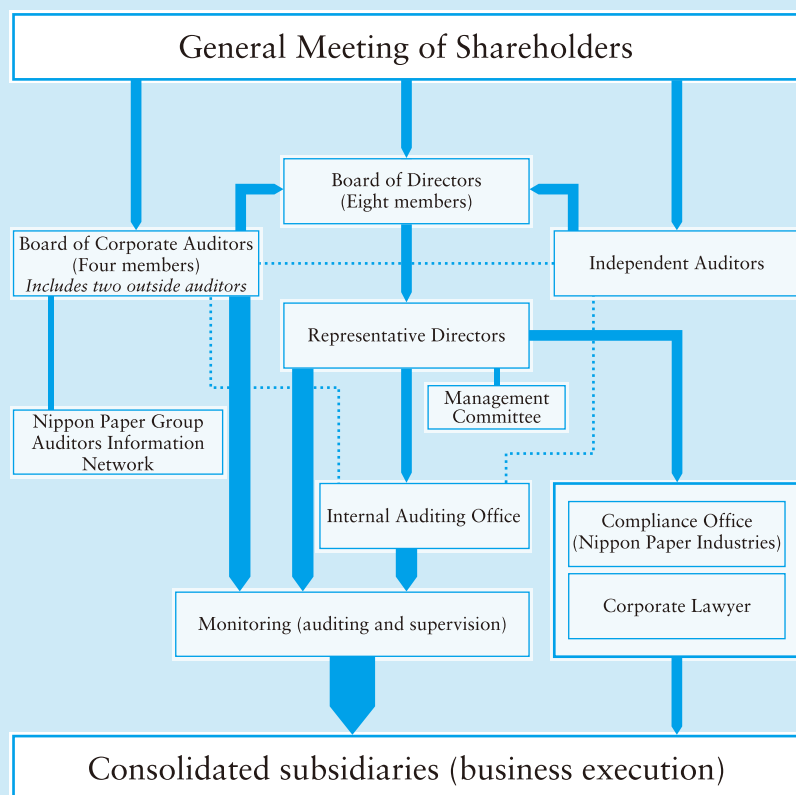
The Nippon Paper Group Charter on Environment is available on our website at [http://www.np-g.com/e/csr/ideology/enviro\\_commission.html](http://www.np-g.com/e/csr/ideology/enviro_commission.html).

## Corporate Governance

The Nippon Paper Group (the Group) seeks to enhance management transparency for its stakeholders—shareholders, investors, customers, suppliers, and local communities—while conducting business fairly and sustaining growth. As a holding company, Nippon Paper Group, Inc. (the Company) is primarily responsible for managing the corporate group, pursuing growth strategies, and monitoring the activities of group companies.

We believe accountability to all stakeholders constitutes the basis of corporate governance. We also seek to maintain robust governance by monitoring group companies to ensure that they maintain legal and regulatory compliance.

### Corporate Governance Structure



### Separation of governance and executive function

The Nippon Paper Group has established a number of boards and committees with specific, clearly defined roles. We maintain separation of governance by Nippon Paper Group, Inc. and the execution of business by its group companies. This model is based on the principle of group companies' freedom, independence, and responsibility for their own actions in the execution of their businesses while keeping our involvement minimal.

Our articles of incorporation set the number of Board of Directors at ten or fewer; we have eight internal directors and no outside directors as of June 2007. The Board of Directors determines basic management policies, matters required by laws and regulations as well as the articles of incorporation, and other important management issues of Nippon Paper Group and its group companies, while monitoring the business execution of the latter. In addition to the Board of Directors, we convene a Management Committee comprised of all Board of Director members and corporate auditors. The committee deliberates important matters related to basic management policies and strategies of the corporate group as a whole, as well as critical issues related to business execution at specific group companies. It also works to ensure rigorous legal and regulatory compliance.

### Auditing scheme

We have implemented a corporate auditor scheme in line with Japan's Corporation Law and other relevant laws and regulations to ensure proper auditing. We have two internal and two outside auditors as of June 2007; outside auditors are chosen from outside the Group. In principle, the Board of Corporate Auditors convenes once a month prior to the Board of Directors meeting to examine the legality and appropriateness of proposals to be tabled. Through these meetings, our corporate auditors rigorously monitor directors' execution of their duties as members of the Board of Directors, the Management Committee, and the Affiliate Company Presidents by reviewing and commenting on the briefs and documents they issue. Corporate auditors also interview directors and employees of the Company and perform on-site audits at its subsidiaries. They provide feedback based on the results of their auditing, encourage improvement on issues they have raised, and report on pertinent matters to directors.

Internal audits of operating companies are performed mainly by the Corporate Audit Office. For audits of Nippon Paper Group accounts pursuant to Japan's Corporation Law and Securities and Exchange Law, we employ Ernst & Young ShinNihon, an independent registered public accounting firm. Neither Ernst & Young ShinNihon nor its auditing employees hold interests in the Nippon Paper Group.



# Board of Directors and Corporate Auditors

(As of June 28, 2007)



## Chairman and Representative Director Takahiko Miyoshi

1939 Born  
1961 Joined Jujo Paper Co., Ltd.  
2001 Appointed director of  
Nippon Paper Group, Inc.  
2002 Appointed president and  
representative director of  
Nippon Paper Group, Inc.  
2005 Appointed chairman and  
representative director of  
Nippon Paper Group, Inc.



## President and Representative Director Masatomo Nakamura

*Concurrently President and  
Representative Director of Nippon  
Paper Industries Co., Ltd.*

1941 Born  
1963 Joined Jujo Paper Co., Ltd.  
2003 Appointed director of  
Nippon Paper Group, Inc.  
2005 Appointed president and  
representative director of  
Nippon Paper Group, Inc.



## Vice President Noboru Hasegawa

*In charge of Engineering and  
Research & Development;  
CSR Committee Chairman,  
concurrently Executive Vice President  
and Representative Director of  
Nippon Paper Industries Co., Ltd.*

1943 Born  
1966 Joined Jujo Paper Co., Ltd.  
2006 Appointed director of  
Nippon Paper Group, Inc.  
2007 Appointed vice president of  
Nippon Paper Group, Inc.



## Director Yukuo Fukunaga

*In charge of Finance; concurrently  
Senior Managing Director and  
General Manager of  
the Financial Division at  
Nippon Paper Industries Co., Ltd.*

1944 Born  
1968 Joined Jujo Paper Co., Ltd.  
2006 Appointed director of  
Nippon Paper Group, Inc.



## Director Yoshio Haga

*General Manager,  
Corporate Planning Division;  
concurrently Managing Director and  
General Manager of  
the Corporate Planning Division at  
Nippon Paper Industries Co., Ltd.*

1949 Born  
1974 Joined Jujo Paper Co., Ltd.  
2005 Appointed director of  
Nippon Paper Group, Inc.



## Director Masaru Motomura

*In charge of  
Personnel & General Affairs;  
concurrently Managing Director and  
General Manager of the Personnel &  
General Affairs Division at  
Nippon Paper Industries Co., Ltd.*

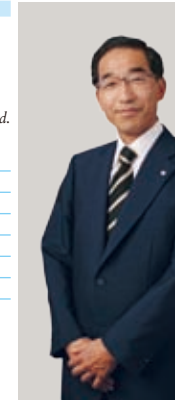
1950 Born  
1974 Joined Jujo Paper Co., Ltd.  
2005 Appointed director of  
Nippon Paper Group, Inc.



## Director Nobuyuki Otsuki

*Concurrently President and  
Representative Director of  
Nippon Daishowa Paperboard Co., Ltd.*

1943 Born  
1967 Joined Jujo Paper Co., Ltd.  
2004 Appointed director of  
Nippon Paper Group, Inc.  
2006 Appointed director of  
Nippon Paper Group, Inc.  
(current position)



## Director Kazuhiro Sakai

*Concurrently President and  
Representative Director of  
Nippon Paper Crecia Co., Ltd.*

1947 Born  
1970 Joined Jujo Paper Co., Ltd.  
2006 Appointed director of  
Nippon Paper Group, Inc.

## Senior Corporate Auditor Keisuke Ito

*Concurrently Senior Corporate Auditor of  
Nippon Paper Industries Co., Ltd.*

## Corporate Auditor Hirotoshi Ishikawa

*Concurrently Corporate Auditor of  
Nippon Paper Industries Co., Ltd.*

## Outside Corporate Auditor Yoshihiro Morikawa

*Concurrently Outside Corporate Auditor at  
Nippon Paper Industries Co., Ltd.*

## Outside Corporate Auditor Naoki Yanagida

*Concurrently Outside Corporate Auditor at  
Nippon Paper Industries Co., Ltd.*

## FINANCIAL SECTION

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# Consolidated Five-Year Summary

Nippon Paper Group, Inc. and Consolidated Subsidiaries

	Millions of yen				Thousands of US dollars (Note)	
	FY2002 April 1, 2002–March 31, 2003	FY2003 April 1, 2003–March 31, 2004	FY2004 April 1, 2004–March 31, 2005	FY2005 April 1, 2005–March 31, 2006	FY2006 April 1, 2006–March 31, 2007	FY2006 April 1, 2006–March 31, 2007
Net sales	¥ 1,165,450	¥ 1,192,649	¥ 1,179,696	¥ 1,152,166	<b>¥ 1,175,264</b>	<b>\$ 9,959,864</b>
Cost of sales	892,906	919,602	914,384	920,819	<b>948,852</b>	<b>8,041,119</b>
Operating income	50,450	55,679	65,231	48,391	<b>44,655</b>	<b>378,432</b>
Ordinary income	39,671	50,665	62,801	49,403	<b>47,088</b>	<b>399,051</b>
Net income	4,880	24,258	24,350	17,192	<b>22,952</b>	<b>194,508</b>
Total assets	1,630,126	1,637,366	1,529,975	1,492,427	<b>1,565,978</b>	<b>13,271,000</b>
Total current assets	455,445	476,649	443,177	412,657	<b>456,620</b>	<b>3,869,661</b>
Property, plant and equipment, net	924,597	900,013	843,346	811,110	<b>841,287</b>	<b>7,129,551</b>
Total investments and other assets	250,083	260,703	243,450	268,659	<b>268,069</b>	<b>2,271,771</b>
Liabilities	1,195,923	1,185,143	1,063,453	1,029,787	<b>1,095,456</b>	<b>9,283,525</b>
Net assets	434,203	452,222	466,521	462,639	<b>470,521</b>	<b>3,987,466</b>
Interest-bearing debt	851,311	842,278	766,139	692,080	<b>738,230</b>	<b>6,256,186</b>
Depreciation	83,223	81,259	74,971	70,106	<b>67,049</b>	<b>568,212</b>
Capital investment	76,904	57,423	55,353	69,687	<b>102,961</b>	<b>872,551</b>
Free cash flow	56,804	14,425	82,132	91,655	<b>(31,668)</b>	<b>(268,373)</b>
<b>Per share data</b>						U.S. dollars
Net income	yen					
Basic	4,283.53	22,025.22	21,996.96	15,760.27	<b>21,570.23</b>	<b>182.80</b>
Diluted	4,137.37	21,132.64	21,107.50	15,123.82	—	—
Net assets	374,133.23	392,140.80	404,369.11	413,525.41	<b>421,626.81</b>	<b>3,573.11</b>
Cash dividends	8,000.00	8,000.00	8,000.00	8,000.00	<b>8,000.00</b>	<b>67.80</b>
<b>Ratios</b>						
Operating income to net sales (%)	4.3	4.7	5.5	4.2	<b>3.8</b>	
Net income to net sales (%)	0.4	2.0	2.1	1.5	<b>2.0</b>	
Return on equity (ROE) (%)	1.2	5.8	5.6	3.9	<b>5.2</b>	
Return on invested capital (ROIC) (%)	4.2	4.9	5.9	5.0	<b>4.6</b>	
Equity ratio (%)	25.0	26.2	28.9	29.5	<b>28.6</b>	
Return on assets (ROA) (%)	3.2	3.8	4.7	3.8	<b>3.5</b>	
Debt/equity ratio (times)	2.0	1.9	1.7	1.5	<b>1.6</b>	
Number of employees	15,662	14,987	13,774	12,798	<b>12,584</b>	

Note: Amounts in US dollars are included solely for convenience and are translated at a rate of ¥118/\$, the approximate rate of exchange on March 31, 2007.

- Interest-bearing debt = Short-term borrowings + Long-term debt
- Free cash flow = Cash flows from operating activities + Cash flows from investing activities
- Return on equity (ROE) = Net income / Average shareholders' equity and valuation, translation adjustments and other × 100
- Return on invested capital (ROIC) = (Ordinary income + Interest expense) / (Shareholders' equity and valuation, translation adjustments and other + Interest-bearing debt) × 100
- Return on assets (ROA) = (Ordinary income + Interest expense) / Total assets × 100
- Debt / Equity ratio = (Interest-bearing debt – Cash and cash equivalents) / Shareholders' equity and valuation, translation adjustments and other



# Consolidated Financial Review

Nippon Paper Group, Inc. and consolidated subsidiaries

## Summary

Despite concern over high crude-oil prices and a slowdown in the US economy, the Japanese economy in fiscal 2006 experienced a moderate domestic-demand-led recovery on the back of increases in consumer spending and capital expenditures underpinned by strong corporate earnings. The paper segment enjoyed firm demand driven mainly by commercial printing thanks to the steady economic recovery, while the paperboard segment saw demand generally on par with that in fiscal 2005 on strong demand, despite unfavorable weather, from food processors.

Higher raw-material and fuel prices, however, put significant pressure on earnings as crude oil prices remained high and prices for woodchips, wastepaper, papermaking chemicals, and other raw materials increased amid continued strong demand and tight supply internationally.

In response, Nippon Paper Group pressed forward with efforts to move product prices upward and to lower costs by realizing the benefits of capital expenditures, improving yields and units of output, and reducing costs. However, these efforts were unable to fully compensate for the higher raw-material and fuel costs.

## Net sales, cost of sales, expenses, and profits

In this environment, consolidated net sales rose ¥23,098 million year-on-year, or 2.0%, to ¥1,175,264 million.

Cost of sales increased 3.0% to ¥948,852 million and the cost of sales ratio was 80.7%. Selling, general, and administrative (SG&A) expenses declined 0.7% to ¥181,756 million and the SG&A expense ratio was 15.5%. Operating income fell 7.7% to ¥44,655 million and the operating income margin declined 0.4 percentage points to 3.8%.

Other income and expenses had a net expense of ¥6,513 million. The main income item was a net gain on sales of investment securities of ¥3,851 million. Main expense items included interest expenses of ¥7,839 million, loss on impairment of fixed assets of ¥3,891 million, and supplementary retirement benefits of ¥2,503 million. Interest expenses increased ¥1,016 million due to an increase in interest-bearing debt from higher capital expenditures.

Income before income taxes and minority interests in consolidated subsidiaries declined 2.3% to ¥38,142 million, but net income rose 33.5% to ¥22,952 million.

Net income per share totaled ¥21,570.23, up from ¥15,760.27 in fiscal 2005. We aspire to meet the expectations of shareholders and investors by bolstering the Group's management and operating platforms, enhancing our earnings power, and increasing enterprise value. Our basic policy on distributing profits is to maintain a stable dividend in light of the Group's business performance and retained earnings. We paid an annual dividend of ¥8,000 per share in fiscal 2006.

## Review of Operations

### *Pulp and Paper Division*

Newsprint sales (by volume) decreased year-on-year. In contrast, sales of printing and business communication paper increased thanks to firm demand for commercial printing paper used in promotional materials. Sales of paper for plain paper copiers (PPC) also rose as paper-users tended to favor domestically produced products in light of environmental issues associated with imports.

For paperboard, despite strong sales to the processed foods and digital consumer electronics industries, sales volume was down slightly due to a slump in demand from the mainstay fruits and vegetables industry, which was hit by unfavorable weather.

In the household tissue business, sales volume increased, even though rush demand in advance of announced price increases in the first half of fiscal 2005 resulted in a backlash during the second half.

We raised prices for a variety of printing and business communication paper, paperboard, and household tissue products to reflect higher raw-material and fuel costs in product prices.

As a result of the foregoing, net sales in the pulp and paper division rose 3.4% year-on-year to ¥889,866 million, but operating income declined 7.7% to ¥30,650 million.

### *Paper-Related Division*

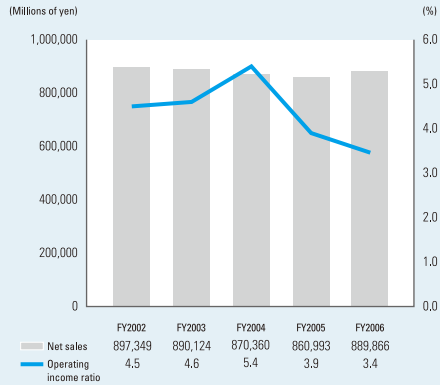
Sales of liquid packaging cartons (by volume) increased year-on-year, due partly to the impact of a mild winter. For chemical products, chlorinated polyolefin used in paint and concrete admixtures recorded firm sales. Dissolving pulp enjoyed strong sales volume both in Japan and for exports thanks to higher demand from rayon manufacturers. In the functional materials business, optical films for liquid crystal panels sold well, buoyed by robust demand for digital consumer electronics.

Nevertheless, net sales in the paper-related division fell 8.1% year-on-year to ¥101,459 million. This is due mainly to a change in our consolidation policy for subsidiaries in the corrugated board business, which have been treated as equity-method subsidiaries since October 2005, thus excluding their sales from consolidated paper-related segment sales.

In this environment, we sought to improve earnings and raise product prices to offset increased costs for carton board and plastic resins resulting from higher raw-material and fuel prices; nevertheless, operating income dropped 20.8% to ¥4,898 million.

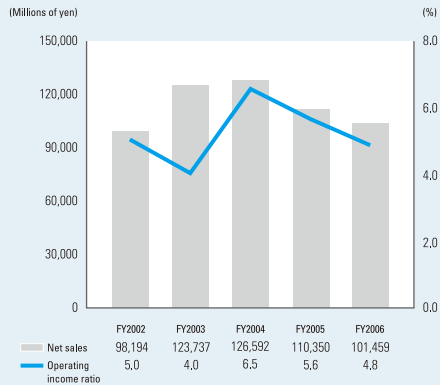
**Pulp and Paper Division**

Net sales and operating income ratio



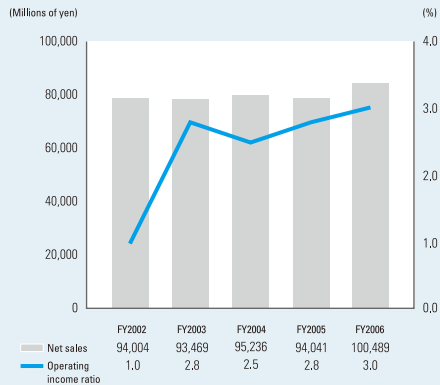
**Paper-Related Division**

Net sales and operating income ratio



**Housing and Construction Materials Division**

Net sales and operating income ratio



*Housing and Construction Materials Division*

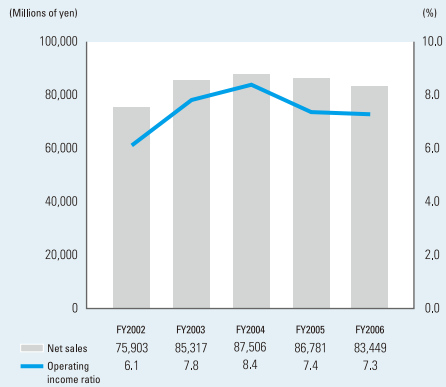
In the housing and construction materials business, new starts of wood homes were strong, and both sales and profits increased as a result of growth in sales volume and higher product prices to compensate for increased procurement costs on the back of tighter imported-material supplies. The civil engineering business performed well. As a result, net sales in the housing and construction materials division grew 6.9% year-on-year to ¥100,489 million, and operating income was up 14.8% to ¥2,993 million.

*Other Division*

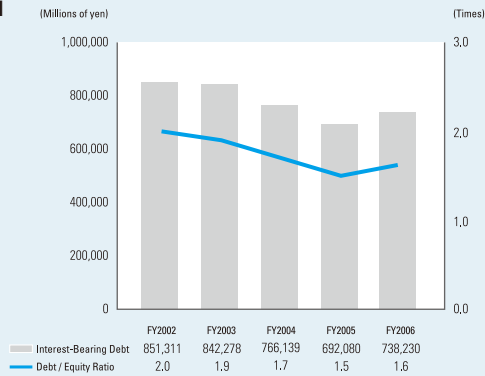
Our beverages business saw decreased sales and profits due to intensifying competition and a contraction in the overall market on negative growth in green tea beverages, the previous market drivers. Our power-generation, transport, leisure, and other businesses performed well. The division's net sales declined 3.8% year-on-year to ¥83,449 million, and operating income was down 4.6% at ¥6,112 million.

**Other Division**

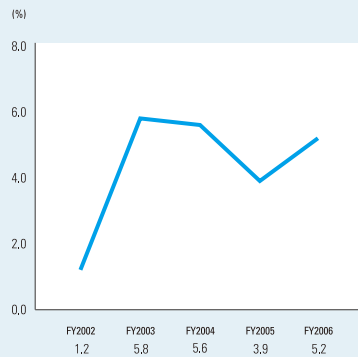
Net sales and operating income ratio



**Interest-Bearing Debt and Debt/Equity Ratio**



**Return on Equity (ROE)**



**Financial Position**

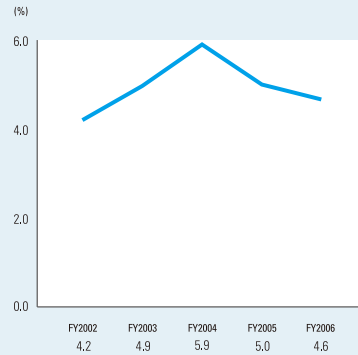
Consolidated assets totaled ¥1,565,978 million at the end of fiscal 2006, up ¥73,550 million from ¥1,492,427 million at the end of fiscal 2005. Current assets totaled ¥456,620 million, rising ¥43,963 million, due mainly to a sharp increase in trade receivables from ¥187,923 million to ¥224,808 million.

Property, plant, and equipment totaled ¥841,287 million, up ¥30,177 million. Investments and other assets declined ¥590 million to ¥268,069 million.

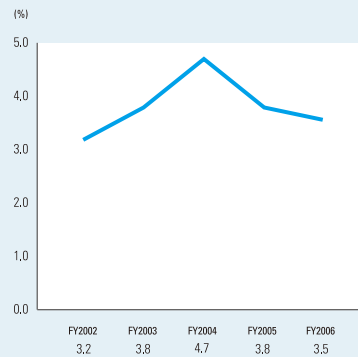
Current and long-term liabilities totaled ¥1,095,456 million, up ¥65,669 million, due mainly to interest-bearing debt rising from ¥692,080 million to ¥738,230 million as a result of moving ahead with capital expenditures.



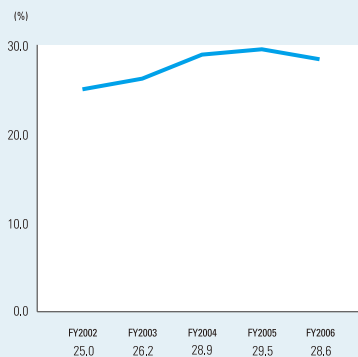
### Return on Invested Capital (ROIC)



### Return on Assets (ROA)



### Equity Ratio



### Cash Flows

Consolidated cash and cash equivalents increased ¥1,896 million year-on-year to ¥15,859 million at the end of fiscal 2006 as a result of covering an increase in capital expenditures with interest-bearing debt.

#### Cash flows from operating activities

Net cash provided by operating activities totaled ¥75,359 million, a decrease of ¥56,694 million year-on-year. Main items included income before income taxes and minority interests in consolidated subsidiaries of ¥38,142 million, depreciation of ¥67,049 million, and an increase in receivables of ¥27,182 million.

#### Cash flows from investing activities

Net cash used in investing activities ended in ¥107,028 million, an increase of ¥66,629 million year-on-year. Main items included payments of ¥94,902 million to purchase property, plant, and equipment and payments of ¥22,974 million to invest in other securities.

#### Cash flows from financing activities

Net cash provided by financing activities was ¥32,945 million, compared to net cash used of ¥96,550 million in fiscal 2005. The main item is an increase in interest-bearing debt of ¥41,981 million, compared to a decrease of ¥75,166 million in fiscal 2005.

Trends in cash flow indicators are shown in the table below.

	FY2002	FY2003	FY2004	FY2005	FY2006
Equity ratio (%)	25.0	26.2	28.9	29.5	<b>28.6</b>
Equity ratio based on market capitalization (%)	29.6	37.1	35.4	36.3	<b>28.5</b>
Interest-bearing debt/cash flow (times)	6.6	9.7	7.1	5.2	<b>9.8</b>
Interest coverage ratio (times)	9.8	8.0	12.6	17.8	<b>11.7</b>

• Equity ratio = Total shareholders' equity and valuation, translation adjustments and other / Total assets × 100

• Equity ratio based on market capitalization = Market capitalization / Total assets × 100

• Interest-bearing debt / cash flow (times) = Interest-bearing debt / Operating cash flow

• Interest coverage ratio = Operating cash flow / Interest paid

Note: 1. All indicators are calculated based on consolidated financial figures.

2. Market capitalization is calculated by multiplying the closing share price at year end by the number of shares outstanding at year end, not including treasury shares.

3. Calculations that include operating cash flow use cash flow from operating activities as recorded in the consolidated statements of cash flows. Interest-bearing debt includes all liabilities recorded in the consolidated balance sheets on which the company is paying interest. Calculations that include interest paid use interest paid as recorded in the consolidated statements of cash flows.

## Business Risks

Several risk factors could affect the Nippon Paper Group's business performance and financial position.

### (1) *Product demand and market conditions*

The activities of Nippon Paper Group are divided among four business divisions—the mainstay pulp and paper division, the paper-related division, the housing and construction materials division, and the other division. Products of these divisions are subject to the risk of fluctuations in demand depending on macroeconomic circumstances and the risk of fluctuations in product prices based on market trends.

### (2) *Manufacturing conditions*

Nippon Paper Group manufactures products based on forecasts that account mainly for demand and the production capacity of current facilities. We inspect all equipment on a regular basis to assure against accidents, but we still face the risk of fire, equipment failure or faults, interruption of raw-material and fuel supply, and other unforeseeable occurrences impairing our ability to supply product.

### (3) *Foreign exchange*

Nippon Paper Group's import and export operations are subject to foreign exchange risks. Expenditures for raw-material and fuel imports are higher than revenues from product exports. The yen's depreciation against the US dollar as well as Australian dollar could negatively impact on our performance. We use foreign exchange forward contracts and other instruments to hedge against this risk.

### (4) *Raw-material and fuel prices*

Nippon Paper Group is exposed to fluctuations in the prices of raw materials and fuels it procures in international and domestic markets.

### (5) *Stock prices*

Nippon Paper Group is exposed to the risk of fluctuations in the prices of marketable securities it owns, primarily stocks in partnering and affiliated companies. Stock prices can also influence our pension costs via downstream fluctuations in pension-asset values.

### (6) *Interest rates*

Nippon Paper Group is subject to the risk of fluctuations in interest rates associated with interest-bearing debt.

### (7) *Overseas business*

Nippon Paper Group is involved in the manufacture and sale of paper and pulp products, afforestation, and other businesses in overseas markets, primarily in North America, Northern Europe, China, and Australia. Though we work to avert risks associated with overseas businesses, unforeseen circumstances could affect our performance and financial position.

### (8) *Litigation*

Nippon Paper Group is committed to complying with all laws and regulations in conducting its business affairs; nevertheless, we are subject to the risk of litigation in conjunction with criminal and civil issues, anti-monopoly laws, product liability laws, intellectual property rights, and environmental, labor, and other issues.

### (9) *Fixed asset impairment*

Nippon Paper Group exposed to risk associated with decreases in the value of its fixed assets, primarily property, plant, and equipment.

### (10) *Natural disasters*

Nippon Paper Group could incur expenses associated with restoring facilities or opportunity losses resulting from production shutdowns in the event that manufacturing or logistics facilities are damaged in an earthquake or other natural disaster.

### (11) *Other changes in the business environment*

Nippon Paper Group is subject to risks associated with shifts in its business environment arising from contingencies other than those mentioned above.

# Consolidated Balance Sheets

## Nippon Paper Group, Inc. and Consolidated Subsidiaries

March 31, 2006 and 2007

Assets	Millions of yen		Thousands of U.S. dollars
	2006	2007	(Note 4)
<b>Assets</b>			<b>2007</b>
<b>Current assets:</b>			
Cash and cash equivalents	¥ 13,963	¥ 15,859	\$ 134,398
Marketable securities (Note 15)	75	270	2,288
Receivables:			
Notes and accounts receivable:			
Trade	187,923	224,808	1,905,153
Unconsolidated subsidiaries and affiliates	33,093	24,007	203,449
Other	11,393	17,703	150,025
Loans receivable from unconsolidated subsidiaries and affiliates	10,430	16,894	143,169
Allowance for doubtful receivables	(2,528)	(3,402)	(28,831)
Inventories (Note 5)	139,187	147,136	1,246,915
Deferred tax assets (Note 10)	4,336	3,666	31,068
Other current assets (Note 8)	14,782	9,676	82,000
Total current assets	412,657	456,620	3,869,661
<b>Property, plant and equipment:</b>			
Land	228,997	229,967	1,948,873
Buildings and structures	445,769	451,574	3,826,898
Machinery and equipment	1,845,541	1,865,330	15,807,881
Construction in progress	28,149	66,439	563,042
Other	20,963	20,939	177,449
	2,569,421	2,634,252	22,324,169
Less accumulated depreciation	(1,758,311)	(1,792,964)	(15,194,610)
Property, plant and equipment, net (Note 7)	811,110	841,287	7,129,551
<b>Investments and other assets:</b>			
Investments in and advances to unconsolidated subsidiaries and affiliates	113,437	111,569	945,500
Investments in securities (Notes 7 and 15)	102,987	105,229	891,771
Deferred tax assets (Note 10)	6,455	5,176	43,864
Other assets	92,601	85,048	720,746
Allowance for doubtful receivables	(46,822)	(38,953)	(330,110)
Total investments and other assets	268,659	268,069	2,271,771
<b>Total assets (Note 16)</b>	<b>¥ 1,492,427</b>	<b>¥ 1,565,978</b>	<b>\$ 13,271,000</b>

See notes to consolidated financial statements.

Liabilities and net assets	Millions of yen		Thousands of U.S. dollars
	2006	2007	(Note 4)
<b>Liabilities and net assets</b>			<b>2007</b>
<b>Current liabilities:</b>			
Short-term borrowings (Note 6):			
Loans payable and commercial paper	¥ 288,843	¥ 255,685	\$ 2,166,822
Unconsolidated subsidiaries and affiliates	1,317	1,988	16,847
Current portion of long-term debt (Notes 6 and 7):			
Bonds and loans payable	57,742	59,476	504,034
Notes and accounts payable:			
Trade (Note 7)	113,430	126,272	1,070,102
Unconsolidated subsidiaries and affiliates	27,762	28,924	245,119
Other	67,200	81,045	686,822
Accrued income taxes	3,495	4,996	42,339
Other current liabilities (Note 10)	27,662	23,452	198,746
Total current liabilities	587,455	581,841	4,930,856
<b>Long-term liabilities:</b>			
Long-term debt (Notes 6 and 7):			
Bonds and loans payable	344,176	421,079	3,568,466
Accrued retirement benefits (Note 8)	54,223	47,329	401,093
Deferred tax liabilities (Note 10)	40,016	41,071	348,059
Accrued environmental costs	986	985	8,347
Other long-term liabilities	2,929	3,148	26,678
Total long-term liabilities	442,332	513,615	4,352,669
<b>Contingent liabilities (Note 14)</b>			
<b>Net assets:</b>			
Shareholders' equity (Notes 11 and 19):			
Common stock:			
Authorized – 3,000,000 shares;			
Issued – 1,105,235.63 shares in 2007 and 2006	55,730	55,730	472,288
Capital surplus	252,441	252,442	2,139,339
Retained earnings	125,679	139,638	1,183,373
Less treasury stock, at cost:			
41,345.16 shares in 2007 and 40,967.52 shares in 2006	(18,199)	(18,366)	(155,644)
Total shareholders' equity	415,651	429,443	3,639,347
Valuation, translation adjustments and other:			
Net unrealized holding gain on other securities	24,352	16,174	137,068
Net deferred gain on hedges	—	1,864	15,797
Translation adjustments	312	1,081	9,161
Total valuation, translation adjustments and other	24,664	19,120	162,034
Minority interests in consolidated subsidiaries	22,323	21,956	186,068
Total net assets	462,639	470,521	3,987,466
<b>Total liabilities and net assets</b>	<b>¥ 1,492,427</b>	<b>¥ 1,565,978</b>	<b>\$ 13,271,000</b>

See notes to consolidated financial statements.



# Consolidated Statements of Income

## Nippon Paper Group, Inc. and Consolidated Subsidiaries

Fiscal years ended March 31, 2006 and 2007

	Millions of yen		Thousands of U.S. dollars
	2006	2007	(Note 4)
<b>Net sales</b> (Note 16)	¥ 1,152,166	<b>¥ 1,175,264</b>	<b>\$ 9,959,864</b>
<b>Cost of sales</b> (Notes 16 and 18)	920,819	<b>948,852</b>	<b>8,041,119</b>
<b>Gross profit</b>	231,347	<b>226,412</b>	<b>1,918,746</b>
<b>Selling, general and administrative expenses</b> (Notes 16 and 18)	182,955	<b>181,756</b>	<b>1,540,305</b>
<b>Operating income</b> (Note 16)	48,391	<b>44,655</b>	<b>378,432</b>
<b>Other income (expenses):</b>			
Interest expense	(6,823)	<b>(7,839)</b>	<b>(66,432)</b>
Interest and dividend income	2,507	<b>3,039</b>	<b>25,754</b>
Net gain on sales of investments in securities	1,552	<b>3,851</b>	<b>32,636</b>
Net (loss) gain on sales and disposal of property, plant and equipment	11,063	<b>(1,105)</b>	<b>(9,364)</b>
Equity in earnings of affiliates	1,696	<b>2,540</b>	<b>21,525</b>
Gain on changes in interests in consolidated subsidiaries	2,432	—	—
Loss on impairment of fixed assets (Note 9)	(10,269)	<b>(3,891)</b>	<b>(32,975)</b>
Provision for environmental expenditures	(986)	—	—
Provision for doubtful receivables	(2,361)	<b>(1,756)</b>	<b>(14,881)</b>
Loss on restructuring	(885)	—	—
Supplementary retirement benefits	(7,708)	<b>(2,503)</b>	<b>(21,212)</b>
Other, net	432	<b>1,153</b>	<b>9,771</b>
	(9,352)	<b>(6,513)</b>	<b>(55,195)</b>
<b>Income before income taxes and minority interests in consolidated subsidiaries</b>	39,038	<b>38,142</b>	<b>323,237</b>
<b>Income taxes</b> (Note 10):			
Current	6,124	<b>6,813</b>	<b>57,737</b>
Deferred	14,932	<b>7,643</b>	<b>64,771</b>
	21,056	<b>14,457</b>	<b>122,517</b>
<b>Minority interests in consolidated subsidiaries</b>	(790)	<b>(732)</b>	<b>(6,203)</b>
<b>Net income</b>	¥ 17,192	<b>¥ 22,952</b>	<b>\$ 194,508</b>
	Yen		U.S. dollars (Note 4)
<b>Amounts per share:</b>			
Net income:			
Basic	¥ 15,760.27	<b>¥ 21,570.23</b>	<b>\$ 182.80</b>
Diluted	15,123.82	—	—
Cash dividends	8,000.00	<b>8,000.00</b>	<b>67.80</b>

See notes to consolidated financial statements.

# Consolidated Statements of Changes in Net Assets

## Nippon Paper Group, Inc. and Consolidated Subsidiaries

	Millions of yen						Millions of yen					
	Shareholders' equity						Valuation, translation adjustments and other				Minority interests in consolidated subsidiaries	Total net assets
	Number of shares of issued common stock	Common stock	Capital surplus	Retained earnings	Less treasury stock, at cost	Total shareholders' equity	Net unrealized holding gain on other securities	Net deferred gain on hedges	Translation adjustments	Total valuation, translation adjustments and other		
Balance at March 31, 2005	1,105,235.63	¥ 55,730	¥ 252,443	¥ 133,653	¥ (5,749)	¥ 436,077	¥ 13,181	¥ —	¥ (6,382)	¥ 6,799	¥ 23,644	¥ 466,521
Cash dividends paid	—	—	—	(8,649)	—	(8,649)	—	—	—	—	—	(8,649)
Bonuses to directors and statutory auditors	—	—	—	(250)	—	(250)	—	—	—	—	—	(250)
Net income	—	—	—	17,192	—	17,192	—	—	—	—	—	17,192
Adjustment for tax effect accounting applied to a consolidated subsidiary's land revaluation	—	—	—	(16,266)	—	(16,266)	—	—	—	—	—	(16,266)
Purchases of treasury stock	—	—	—	—	(12,473)	(12,473)	—	—	—	—	—	(12,473)
Disposition of treasury stock	—	—	(2)	—	25	23	—	—	—	—	—	23
Changes in items other than shareholders' equity, net	—	—	—	—	—	—	11,170	—	6,694	17,865	(1,321)	16,543
Balance at March 31, 2006	1,105,235.63	¥ 55,730	¥ 252,441	¥ 125,679	¥ (18,199)	¥ 415,651	24,352	—	312	24,664	22,323	462,639
Cash dividends paid	—	—	—	(8,516)	—	(8,516)	—	—	—	—	—	(8,516)
Bonuses to directors and statutory auditors	—	—	—	(195)	—	(195)	—	—	—	—	—	(195)
Net income	—	—	—	22,952	—	22,952	—	—	—	—	—	22,952
Purchases of treasury stock	—	—	—	—	(183)	(183)	—	—	—	—	—	(183)
Disposition of treasury stock	—	—	0	—	16	16	—	—	—	—	—	16
Adjustments for merger of consolidated subsidiary and unconsolidated subsidiaries	—	—	—	(282)	—	(282)	—	—	—	—	—	(282)
Changes in items other than shareholders' equity, net	—	—	—	—	—	—	(8,177)	1,864	768	(5,543)	(366)	(5,910)
Balance at March 31, 2007	1,105,235.63	¥ 55,730	¥ 252,442	¥ 139,638	¥ (18,366)	¥ 429,443	¥ 16,174	¥ 1,864	¥ 1,081	¥ 19,120	¥ 21,956	¥ 470,521

	Thousands of U.S. dollars (Note 4)					Thousands of U.S. dollars (Note 4)					
	Shareholders' equity					Valuation, translation adjustments and other				Minority interests in consolidated subsidiaries	Total net assets
	Common stock	Capital surplus	Retained earnings	Less treasury stock, at cost	Total shareholders' equity	Net unrealized holding gain on other securities	Net deferred gain on hedges	Translation adjustments	Total valuation, translation adjustments and other		
Balance at March 31, 2006	\$ 472,288	\$ 2,139,331	\$ 1,065,076	\$ (154,229)	\$ 3,522,466	\$ 206,373	\$ —	\$ 2,644	\$ 209,017	\$ 189,178	\$ 3,920,669
Cash dividends paid	—	—	(72,169)	—	(72,169)	—	—	—	—	—	(72,169)
Bonuses to directors and statutory auditors	—	—	(1,653)	—	(1,653)	—	—	—	—	—	(1,653)
Net income	—	—	194,508	—	194,508	—	—	—	—	—	194,508
Purchases of treasury stock	—	—	—	(1,551)	(1,551)	—	—	—	—	—	(1,551)
Disposition of treasury stock	—	0	—	136	136	—	—	—	—	—	136
Adjustments for merger of consolidated subsidiary and unconsolidated subsidiaries	—	—	(2,390)	—	(2,390)	—	—	—	—	—	(2,390)
Changes in items other than shareholders' equity, net	—	—	—	—	—	(69,297)	15,797	6,508	(46,975)	(3,102)	(50,085)
Balance at March 31, 2007	\$ 472,288	\$ 2,139,339	\$ 1,183,373	\$ (155,644)	\$ 3,639,347	\$ 137,068	\$ 15,797	\$ 9,161	\$ 162,034	\$ 186,068	\$ 3,987,466

See notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

## Nippon Paper Group, Inc. and Consolidated Subsidiaries

Fiscal years ended March 31, 2006 and 2007

	Millions of yen		Thousands of U.S. dollars
	2006	2007	(Note 4)
<b>Operating activities</b>			<b>2007</b>
Income before income taxes and minority interests in consolidated subsidiaries	¥ 39,038	¥ 38,142	\$ 323,237
Adjustments to reconcile income before income taxes and minority interests in consolidated subsidiaries to net cash provided by operating activities:			
Depreciation	70,106	67,049	568,212
Amortization of goodwill	1,916	1,946	16,492
Increase in allowance for doubtful receivables	1,940	2,013	17,059
Decrease in accrued retirement benefits	(4,709)	(7,367)	(62,432)
(Decrease) increase in accrued environmental costs	986	(1)	(8)
Interest and dividend income	(2,507)	(3,039)	(25,754)
Interest expense	6,823	7,839	66,432
Equity in earnings of affiliates	(1,696)	(2,540)	(21,525)
Net gain on sales of investments in securities	(1,552)	(3,851)	(32,636)
Net loss (gain) on sales and disposal of property, plant and equipment	(11,063)	1,105	9,364
Gain on changes in interests in consolidated subsidiaries	(2,432)	—	—
Loss on impairment of fixed assets	10,269	3,891	32,975
Supplementary retirement benefits	7,708	2,503	21,212
Loss on restructuring	885	—	—
Bonuses paid to directors and statutory auditors	(270)	(209)	(1,771)
Changes in operating assets and liabilities:			
Receivables	20,696	(27,182)	(230,356)
Inventories	(7,903)	(5,844)	(49,525)
Payables	13,067	11,396	96,576
Other	12,687	248	2,102
	153,994	86,101	729,669
Interest and dividends received	3,202	3,446	29,203
Interest paid	(7,433)	(6,437)	(54,551)
Payment of supplementary retirement benefits	(7,782)	(2,764)	(23,424)
Expenditures for restructuring	(520)	(22)	(186)
Income taxes paid	(9,407)	(4,964)	(42,068)
Net cash provided by operating activities	¥ 132,054	¥ 75,359	\$ 638,636

See notes to consolidated financial statements.

	Millions of yen		Thousands of U.S. dollars
	2006	2007	(Note 4)
<b>Investing activities</b>			
Purchases of time deposits	¥ (155)	¥ (158)	\$ (1,339)
Withdrawals of time deposits	167	148	1,254
Proceeds from sales of marketable securities	210	75	636
Purchases of property, plant and equipment	(62,555)	(94,902)	(804,254)
Proceeds from sales of property, plant and equipment	22,437	5,660	47,966
Purchases of investments in other securities	(4,806)	(22,974)	(194,695)
Proceeds from sales of investments in other securities	3,150	3,361	28,483
(Increase) decrease in short-term loans	5,595	(69)	(585)
Long-term loans made	(3,350)	(655)	(5,551)
Collection of long-term loans	627	2,979	25,246
Other, net	(1,718)	(493)	(4,178)
Net cash used in investing activities	(40,398)	(107,028)	(907,017)
<b>Financing activities</b>			
Decrease in short-term borrowings	(30,167)	(34,846)	(295,305)
Proceeds from issuance of long-term debt	82,059	137,000	1,161,017
Repayment of long-term debt	(125,835)	(59,932)	(507,898)
Purchases of treasury stock	(12,424)	(183)	(1,551)
Proceeds from sales of treasury stock	23	16	136
Cash dividends paid	(8,983)	(8,868)	(75,153)
Principal payments under finance lease obligations	(1,223)	(239)	(2,025)
Net cash provided by (used in) financing activities	(96,550)	32,945	279,195
<b>Effect of exchange rate changes on cash and cash equivalents</b>	705	203	1,720
<b>Increase (decrease) in cash and cash equivalents</b>	(4,189)	1,480	12,542
<b>Cash and cash equivalents at beginning of year</b>	18,181	13,963	118,331
<b>Decrease due to exclusion of certain subsidiaries from consolidation</b>	(28)	—	—
<b>Increase due to merger of unconsolidated subsidiaries</b>	—	415	3,517
<b>Cash and cash equivalents at end of year</b>	¥ 13,963	¥ 15,859	\$ 134,398

See notes to consolidated financial statements.



# Notes to Consolidated Financial Statements

## Nippon Paper Group, Inc. and Consolidated Subsidiaries

March 31, 2007

### 1. Description of Business

Based on a resolution approved at the ordinary general meeting of shareholders held on June 29, 2004, Nippon Unipac Holding changed its name to Nippon Paper Group, Inc. (the “Company”) from October 1, 2004.

The Company was established as a business combination on March 30, 2001 by a transfer of shares of common stock from the shareholders of both Nippon Paper Industries Co., Ltd. (the “former Nippon Paper”) and Daishowa Paper Manufacturing Co., Ltd. (“Daishowa Paper”) to the Company in accordance with the procedures stipulated in the Commercial Code of Japan. As a result of this stock transfer, the former Nippon Paper and Daishowa Paper became wholly-owned subsidiaries of the Company. In addition, the Company acquired ownership of 100% of the shares of Japan Paperboard Industries Co., Ltd. as a result of an exchange of shares on October 1, 2002.

On April 1, 2003, the new Nippon Paper Industries Co., Ltd. (“Nippon Paper”) was established following the merger of the former Nippon Paper and Daishowa Paper, and Japan Paperboard Industries Co., Ltd. changed its name to Nippon Daishowa Paperboard Co., Ltd. Under this business structure, the paper and paperboard businesses, which are our core businesses, were combined, restructured, and launched under a new structural plan. The paper business belonged to Nippon Paper and the paperboard business belonged to Nippon Daishowa Paperboard Co., Ltd.

### 2. Summary of Significant Accounting Policies

#### (a) Basis of Preparation

The accompanying consolidated financial statements of the Company and consolidated subsidiaries are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to the 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 amounts in the financial statements of the fiscal year ended March 31, 2006 have been reclassified to conform to the presentation of the fiscal year ended March 31, 2007.

As permitted, amounts of less than one million yen have been omitted. As a result, the totals shown in the accompanying consolidated financial statements (both in yen and U.S. dollars) do not necessarily agree with the sums of the individual amounts.

#### (b) Consolidation

The accompanying consolidated financial statements include the accounts of the Company and all subsidiaries over which it exerts substantial control either through majority ownership of voting stock and/or by other means. All significant intercompany balances and transactions have been eliminated in consolidation.

In the consolidation of the former Nippon Paper and Daishowa Paper, the Company comprehensively applied the pooling-of-interest method to the former Nippon Paper and its subsidiaries as the acquiring group, and the purchase method to Daishowa Paper and its subsidiaries as the acquired group, after considering the ratio for the share transfer of each company as well as certain other factors.

Certain foreign subsidiaries are consolidated on the basis of fiscal periods ending December 31, a closing date which differs from that of the Company; however, the necessary adjustments have been made if the effect of the difference is deemed material.

Investments in equity method affiliates (companies over which the Company has the ability to exercise significant influence) are stated at cost plus equity in their undistributed earnings or losses. Consolidated net income includes the Company’s equity in the current net income or loss of such companies after the elimination of unrealized intercompany profits.

Goodwill is amortized on a straight-line basis over five or twenty years.

#### (c) Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments, generally with original maturities of three months or less, which are readily convertible to known amounts of cash and are so near maturity that they represent only an insignificant risk of any changes in their value resulting from interest-rate fluctuation.

#### (d) Securities

Under the Japanese accounting standard for financial instruments, securities are classified into three categories: trading, held-to-maturity or other securities, as follows:

- (i) trading securities are carried at fair value although the Company and consolidated subsidiaries had no such securities at either March 31, 2007 or 2006;
- (ii) held-to-maturity securities are carried at cost and amortized by the straight-line method; and
- (iii) marketable securities classified as other securities are carried at fair value with any changes in unrealized holding gain or loss, net of the applicable income taxes, included directly in net assets. Non-marketable securities classified as other securities are carried at cost. Costs of securities sold are determined by the moving average method.

*(e) Inventories*

Inventories are stated at cost determined principally by the moving average method or the average method.

*(f) Allowance for Doubtful Receivables*

Allowance for doubtful receivables is provided for future bad debt losses at an amount estimated based on past bad debt experience of normal receivables plus uncollectible amounts determined by reference to the collectibility of individual receivables.

*(g) Property, Plant and Equipment*

Property, plant and equipment are stated at cost. Depreciation is, in general, computed by the declining-balance method over the estimated useful lives of the respective assets, except for new buildings acquired after March 31, 1998 on which depreciation is calculated by the straight-line method. Significant renewals and betterments are capitalized at cost. Maintenance and repairs are charged to income as incurred.

*(h) Leases*

Noncancelable leases of domestic consolidated subsidiaries are accounted for as operating leases (whether such leases are classified as operating or finance leases) except that lease agreements which stipulate the transfer of ownership of the leased assets to the lessee are accounted for as finance leases.

*(i) Foreign Currency Translation*

All assets and liabilities denominated in foreign currencies other than those hedged by forward foreign exchange contracts, etc. are translated into yen at the current rates. All revenues and expenses associated with foreign currencies are translated at the rates of exchange prevailing when such transactions were made. Translation gain or loss is credited or charged to income as incurred.

The balance sheet accounts of foreign consolidated subsidiaries and affiliates are translated into yen at the rates of exchange in effect at their respective balance sheet dates, except for the components of net assets (excluding minority interests) which are translated at their historical exchange rates. Revenue and expense accounts are translated at the average rate of exchange in effect during the fiscal year. The resulting differences in translation are presented as translation adjustments and minority interests in consolidated subsidiaries as components of net assets in the accompanying consolidated financial statements.

*(j) Retirement Benefits*

Accrued retirement benefits for employees have been provided mainly at an amount calculated based on the retirement benefit obligation less the fair value of the pension plan assets as of the balance sheet dates, as adjusted for unrecognized actuarial gain or loss, and unrecognized prior service cost. The retirement benefit obligation is attributed to each fiscal year by the straight-line method over the estimated remaining years of service of the eligible employees.

Actuarial gain or loss is amortized in the year following the year in which the gain or loss is recognized primarily by the straight-line method over periods (10 years through 15 years) which are equal to or shorter than the average estimated remaining years of service of the eligible employees.

Prior service cost is being amortized as incurred by the straight-line method over periods (5 years through 15 years) which are equal to or shorter than the average estimated remaining years of service of the eligible employees.

In addition, directors and statutory auditors of the Company and its consolidated subsidiaries are customarily entitled to lump-sum payments under an unfunded retirement benefit plan. Accrued retirement benefits for these officers are accounted for based on the rules of the Company and its consolidated subsidiaries.

*(k) Accrued Environmental Costs*

Accrued environmental costs are provided at an estimated amount to dispose PCB (polychlorinated biphenyl) waste under the Law Concerning Special Measures against PCB Waste.

*(l) Research and Development Costs*

Research and development costs are charged to income as incurred.

*(m) Derivatives*

Certain consolidated subsidiaries have entered into various derivatives transactions in order to manage certain risks arising from adverse fluctuation in foreign currency exchange rates and interest rates. Unrealized gain or loss is principally deferred as an asset or a liability. Receivables and payables hedged by qualified forward foreign exchange contracts are translated at their corresponding contract rates.

*(n) Income Taxes*

The Company and consolidated subsidiaries have adopted tax-effect accounting in accordance with an accounting standard which requires recognition of income taxes by the liability method. Under the liability method, deferred tax assets and liabilities are determined based on the differences between the asset and liability amounts for financial reporting purposes and the asset and liability amounts for tax purposes, and are measured using the enacted tax rates and laws which will be in effect when these differences are expected to be reversed.

*(o) Appropriation of Retained Earnings*

Under the Corporation Law of Japan (“the Law”), the appropriation of retained earnings with respect to a given fiscal period is made by resolution of the shareholders at an ordinary general meeting held subsequent to the close of the fiscal period and, therefore, the accounts for such period do not reflect such appropriations. See Notes 11 and 19.

*(p) Amounts per Share*

Basic net income per share is computed based on the net income available for distribution to shareholders of common stock and the weighted-average number of shares of common stock outstanding during the fiscal year. Diluted net income per share is computed based on the net income available for distribution to shareholders of common stock and the weighted-average number of shares of common stock outstanding during each fiscal year after giving effect to the dilutive potential of shares of common stock to be issued upon the conversion of convertible bonds.

Cash dividends per share represent the cash dividends declared as applicable to the respective fiscal years.

**3. Accounting Changes**

- (i) Effective the year ended March 31, 2006, the Company and consolidated subsidiaries adopted an accounting standard for the impairment of fixed assets which requires that tangible and intangible fixed assets be carried at cost less depreciation, and be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Companies would be required to recognize an impairment loss in their statements of income if certain indicators of asset impairment exist and if the book value of an asset exceeds the undiscounted sum of future cash flows of the asset. The standard states that impairment losses should be measured as the excess of the book value over the higher of (1) the fair market value of the asset, net of disposition costs and (2) the present value of future cash flows arising from ongoing utilization of the asset and from disposal after asset use. The standard covers land, factories, buildings and other forms of property, plant and equipment as well as intangible assets. Fixed assets will be grouped at the lowest level for which there is identifiable cash flows that are independent of cash flows of other groups of assets.

As a result of the adoption of this accounting standard, a loss on impairment of fixed assets in the amount of ¥10,269 million was recognized and income before income taxes and minority interests in consolidated subsidiaries decreased by the same amount for the year ended March 31, 2006 from the corresponding amount which would have been recorded under the previous method.

Accumulated impairment losses are directly deducted from the respective fixed assets.

- (ii) Effective the year ended March 31, 2007, the Company and its consolidated subsidiaries have adopted “Accounting Standard for Business Combinations” (Business Accounting Council, October 31, 2003) and the related implementation guidance (Accounting Standards Board of Japan Guidance No. 10, December 27, 2005).

**4. U.S. Dollar Amounts**

Amounts in U.S. dollars are included solely for the convenience of the reader. The rate of ¥118 = U.S.\$1.00, the approximate rate of exchange in effect on March 31, 2007, has been used. This translation should not be construed as a representation that yen have been, could have been, or could in the future be, converted into U.S. dollars at the above or any other rate.



## 5. Inventories

Inventories at March 31, 2007 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	March 31,		March 31,
	2006	2007	2007
Merchandise and finished products	¥ 77,310	<b>¥ 83,259</b>	<b>\$ 705,585</b>
Work in process	16,429	<b>16,734</b>	<b>141,814</b>
Raw materials and supplies	45,447	<b>47,142</b>	<b>399,508</b>
	¥ 139,187	<b>¥ 147,136</b>	<b>\$ 1,246,915</b>

## 6. Short-Term Borrowings and Long-Term Debt

At March 31, 2007 and 2006, short-term borrowings consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	March 31,		March 31,
	2006	2007	2007
Loans from banks	¥ 205,843	<b>¥ 205,685</b>	<b>\$ 1,743,093</b>
Loans from unconsolidated subsidiaries and affiliates	1,317	<b>1,988</b>	<b>16,847</b>
Commercial paper	83,000	<b>50,000</b>	<b>423,729</b>
	¥ 290,161	<b>¥ 257,674</b>	<b>\$ 2,183,678</b>

Loans from banks are unsecured and generally represent 365-day notes. The weighted-average interest rates of the short-term bank loans outstanding at March 31, 2007 and 2006 were 1.03% and 0.54%, respectively.

Long-term debt at March 31, 2007 and 2006 is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	March 31,		March 31,
	2006	2007	2007
Loans from banks, insurance companies and others at rates ranging from 3.38% to 0.50% due through 2034:			
With collateral	¥ 62,158	<b>¥ 35,282</b>	<b>\$ 299,000</b>
Without collateral	219,760	<b>302,273</b>	<b>2,561,636</b>
0.81% unsecured corporate bonds in yen due 2010	20,000	<b>20,000</b>	<b>169,492</b>
0.50% unsecured corporate bonds in yen due 2007	20,000	<b>20,000</b>	<b>169,492</b>
0.91% unsecured corporate bonds in yen due 2008	20,000	<b>20,000</b>	<b>169,492</b>
0.51% unsecured corporate bonds in yen due 2006	10,000	—	—
0.89% unsecured corporate bonds in yen due 2009	30,000	<b>30,000</b>	<b>254,237</b>
1.10% unsecured corporate bonds in yen due 2012	20,000	<b>20,000</b>	<b>169,492</b>
1.79% unsecured corporate bonds in yen due 2011	—	<b>20,000</b>	<b>169,492</b>
1.97% unsecured corporate bonds in yen due 2017	—	<b>13,000</b>	<b>110,169</b>
	401,919	<b>480,556</b>	<b>4,072,508</b>
Less current portion	(57,742)	<b>(59,476)</b>	<b>(504,034)</b>
	¥ 344,176	<b>¥ 421,079</b>	<b>\$ 3,568,466</b>

Long-term debt maturities subsequent to March 31, 2007 are summarized as follows:

Fiscal year ending March 31:	Millions of yen	Thousands of U.S. dollars
2008	¥ 59,476	\$ 504,034
2009	56,016	474,712
2010	73,741	624,924
2011	55,570	470,932
2012 and thereafter	235,751	1,997,890
	¥ 480,556	\$ 4,072,508

## 7. Pledged Assets

Assets pledged as collateral for notes and accounts payable – trade of ¥171 million (\$1,449 thousand), the current portion of long-term debt of ¥3,600 million (\$30,508 thousand), and long-term debt of ¥31,682 million (\$268,492 thousand) at March 31, 2007 were as follows:

	Millions of yen		Thousands of U.S. dollars
	March 31,		March 31,
	2006	2007	2007
Property, plant and equipment, at net book value	¥ 435,404	<b>¥ 422,331</b>	<b>\$ 3,579,076</b>
Investments in securities	842	—	—
	¥ 436,246	<b>¥ 422,331</b>	<b>\$ 3,579,076</b>

## 8. Retirement Benefits

Certain consolidated subsidiaries have defined benefit plans, i.e., corporate pension fund plans, Welfare Pension Fund Plans, tax-qualified pension plans and lump-sum payment plans, covering substantially all employees who are entitled to lump-sum or annuity payments, the amounts of which are determined by reference to their basic rates of pay, length of service, and the conditions under which termination occurs.

The following table sets forth the funded and accrued status of the plans, and the amounts recognized in the consolidated balance sheets at March 31, 2007 and 2006 for the consolidated subsidiaries' defined benefit plans:

	Millions of yen		Thousands of U.S. dollars
	March 31,		March 31,
	2006	2007	2007
Retirement benefit obligation	¥ (185,212)	<b>¥ (183,468)</b>	<b>\$ (1,554,814)</b>
Plan assets at fair value	168,282	<b>161,066</b>	<b>1,364,966</b>
Unfunded retirement benefit obligation	(16,929)	<b>(22,402)</b>	<b>(189,847)</b>
Unrecognized actuarial gain	(23,965)	<b>(12,112)</b>	<b>(102,644)</b>
Unrecognized prior service cost	(10,023)	<b>(9,023)</b>	<b>(76,466)</b>
Net retirement benefit obligation	(50,917)	<b>(43,537)</b>	<b>(368,958)</b>
Prepaid pension cost	1,418	<b>2,020</b>	<b>17,119</b>
Accrued retirement benefits	¥ (52,335)	<b>¥ (45,557)</b>	<b>\$ (386,076)</b>

In addition, accrued retirement benefits for directors and statutory auditors of the Company and its consolidated subsidiaries in the amounts of ¥1,771 million (\$15,008 thousand) and ¥1,887 million have been included in accrued retirement benefits at March 31, 2007 and 2006, respectively.

The components of retirement benefit expense for the fiscal years ended March 31, 2007 and 2006 are outlined as follows:

	Millions of yen		Thousands of U.S. dollars
	Fiscal years ended March 31,		Fiscal year ended March 31,
	2006	2007	2007
Service cost	¥ 5,078	<b>¥ 5,400</b>	<b>\$ 45,763</b>
Interest cost	4,704	<b>4,457</b>	<b>37,771</b>
Expected return on plan assets	(2,185)	<b>(2,629)</b>	<b>(22,280)</b>
Amortization of unrecognized actuarial (gain) loss	2,579	<b>(602)</b>	<b>(5,102)</b>
Amortization of unrecognized prior service cost	(821)	<b>(797)</b>	<b>(6,754)</b>
Total	¥ 9,354	<b>¥ 5,828</b>	<b>\$ 49,390</b>

In addition to the above, supplementary retirement benefits of ¥2,583 million (\$21,890 thousand) and ¥7,772 million were recorded for the fiscal years ended March 31, 2007 and 2006, respectively. Supplementary retirement benefits have been included in other expenses except for ¥80 million (\$678 thousand) and ¥64 million which have been included in selling, general and administrative expenses for the fiscal years ended March 31, 2007 and 2006, respectively.

The assumptions used in accounting for the above plans were as follows:

	Fiscal years ended March 31,	
	2006	2007
Discount rate	mainly 2.5%	<b>mainly 2.5%</b>
Expected rate of return on plan assets	mainly 2.0%	<b>mainly 2.0%</b>

## 9. Loss on Impairment of Fixed Assets

Place	Assets	Millions of yen	Thousands of U.S. dollars	Notes
		Fiscal year ended	March 31, 2007	
Fuji City, Shizuoka, etc.	Land	¥ 1,671	\$ 14,161	Idle property
	Buildings and structures, machinery and equipment	2,220	18,814	Idle property
Total		¥ 3,891	\$ 32,975	

Place	Assets	Millions of yen		Notes
		Fiscal year ended	March 31, 2006	
Hitachinaka City, Ibaraki, etc.	Land	¥ 5,865		Idle property
	Buildings and structures, machinery and equipment	2,858		Idle property
Hasuda City, Saitama, etc.	Land	1,545		Property for rent
Total		¥ 10,269		

In order to determine whether an indicator of impairment of fixed assets exists, production properties are grouped mainly by mill while rental properties and idle properties are grouped at each asset. The recoverable value of rental property was calculated by discounting the estimated future cash flows from the property at 1.7%. The recoverable value of idle property was estimated based on third-party appraisals if material and mainly based on the net realizable value under Japanese inheritance tax law if immaterial.

As a result, loss on impairment of fixed assets of ¥3,891 million (\$32,975 thousand) was recognized on idle properties with no specific plan for future use for the fiscal year ended March 31, 2007. This amount consists of ¥1,671 million (\$14,161 thousand) on land, ¥189 million (\$1,602 thousand) on buildings and structures, and ¥2,030 million (\$17,203 thousand) on machinery and equipment.

Loss on impairment of fixed assets of ¥10,269 million was recognized on idle properties with no specific plan for future use and on properties for rent with deteriorated profitability for the fiscal year ended March 31, 2006. This amount consists of ¥7,411 million on land, ¥1,135 million on buildings and structures, ¥1,163 million on machinery and equipment and ¥558 million on intangible assets, etc.

## 10. Income Taxes

The Company and its domestic consolidated subsidiaries are subject to taxes based on earnings, i.e. corporation tax, inhabitants' taxes and enterprise tax, which, in the aggregate, resulted in a statutory tax rate of approximately 40.7% for the fiscal years ended March 31, 2007 and 2006.

The effective tax rates reflected in the consolidated statements of income for the fiscal years ended March 31, 2007 and 2006 differ from the statutory tax rate for the following reasons:

	Fiscal years ended March 31,	
	2006	2007
Statutory tax rate	40.7%	<b>40.7%</b>
Effect of:		
Non-deductible items such as entertainment expenses	2.2	<b>2.0</b>
Non-taxable dividends received	0.4	<b>(0.9)</b>
Equity in earnings of affiliates	(1.8)	<b>(2.7)</b>
Amortization of goodwill	2.0	<b>2.0</b>
Inhabitants' per capita taxes	0.8	<b>0.8</b>
Increase in valuation allowance	12.9	<b>5.9</b>
Gain on changes in interests in consolidated subsidiaries	(2.6)	—
Devaluation loss on a consolidated subsidiary and affiliates	—	<b>(9.9)</b>
Other, net	(0.7)	<b>0.0</b>
Effective tax rates	53.9%	<b>37.9%</b>

The significant components of the deferred tax assets and liabilities held by the Company and its consolidated subsidiaries at March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars
	March 31,		March 31,
	2006	2007	2007
<b>Deferred tax assets:</b>			
Accrued bonuses	¥ 3,631	<b>¥ 3,583</b>	<b>\$ 30,364</b>
Accrued enterprise tax	108	<b>522</b>	<b>4,424</b>
Allowance for doubtful receivables	8,894	<b>7,199</b>	<b>61,008</b>
Accrued retirement benefits	30,030	<b>26,699</b>	<b>226,263</b>
Accrued officers' retirement benefits	746	<b>705</b>	<b>5,975</b>
Loss on investment securities	2,143	<b>1,603</b>	<b>13,585</b>
Tax loss carryforwards	9,261	<b>13,265</b>	<b>112,415</b>
Loss on revaluation of land	16,266	<b>15,699</b>	<b>133,042</b>
Loss on impairment of fixed assets	3,319	<b>2,182</b>	<b>18,492</b>
Unrealized profit eliminated in consolidation	638	<b>853</b>	<b>7,229</b>
Other	3,461	<b>6,015</b>	<b>50,975</b>
Gross deferred tax assets	78,502	<b>78,330</b>	<b>663,814</b>
Valuation allowance	(32,578)	<b>(38,839)</b>	<b>(329,144)</b>
Total deferred tax assets	45,924	<b>39,491</b>	<b>334,669</b>
<b>Deferred tax liabilities:</b>			
Tax reserves	(12,339)	<b>(12,411)</b>	<b>(105,178)</b>
Accumulated depreciation	(1,621)	<b>(1,583)</b>	<b>(13,415)</b>
Gain on revaluation of land, etc.	(43,637)	<b>(43,954)</b>	<b>(372,492)</b>
Unrealized holding gain on other securities	(16,774)	<b>(11,295)</b>	<b>(95,720)</b>
Other	(777)	<b>(2,476)</b>	<b>(20,983)</b>
Total deferred tax liabilities	(75,149)	<b>(71,721)</b>	<b>(607,805)</b>
Net deferred tax liabilities	¥ (29,225)	<b>¥ (32,230)</b>	<b>\$ (273,136)</b>

Deferred tax liabilities included in other current liabilities at March 31, 2007 and 2006 amounted to ¥1 million (\$8 thousand) and ¥0 million, respectively.

## 11. Shareholders' Equity

The new Corporation Law of Japan (the "Law"), which superseded most of the provisions of the Commercial Code of Japan, went into effect on May 1, 2006. The Law provides that an amount equal to 10% of the amount to be disbursed as distributions of capital surplus (other than the capital reserve) and retained earnings (other than the legal reserve) be transferred to the capital reserve and the legal reserve, respectively, until the sum of the capital reserve and the legal reserve equals 25% of the capital stock account. Such distributions can be made at any time by resolution of the shareholders, or by the Board of Directors if certain conditions are met.

The legal reserve amounting to ¥432 million (\$3,661 thousand) and ¥432 million was included in retained earnings at both March 31, 2007 and 2006, respectively.

## 12. Supplemental Cash Flow Information

Assets and liabilities included in (excluded from) the consolidated balance sheets at March 31, 2007 and 2006 as a result of business combinations of certain subsidiaries were as follows:

	Millions of yen		Thousands of U.S. dollars
	March 31,		March 31,
	2006	2007	2007
Current assets	¥ (9,129)	<b>¥ 15,981</b>	<b>\$ 135,432</b>
Non-current assets	(11,251)	<b>4,642</b>	<b>39,339</b>
Total assets	¥ (20,381)	<b>¥ 20,624</b>	<b>\$ 174,780</b>
Current liabilities	¥ (4,968)	<b>¥ 5,970</b>	<b>\$ 50,593</b>
Non-current liabilities	(1,386)	<b>2,682</b>	<b>22,729</b>
Total liabilities	¥ (6,354)	<b>¥ 8,653</b>	<b>\$ 73,331</b>



### 13. Leases

#### (a) As Lessee

- (i) The following *pro forma* amounts represent amounts equivalent to the acquisition costs, accumulated depreciation and net book value of the leased assets at March 31, 2007 and 2006, which would have been reflected in the balance sheets if finance lease accounting had been applied to the finance leases currently accounted for as operating leases:

	Millions of yen		Thousands of U.S. dollars
	March 31,		March 31,
Amount equivalent to:	2006	2007	2007
Acquisition costs:			
Machinery and equipment	¥ 7,622	¥ 7,154	\$ 60,627
Accumulated depreciation:			
Machinery and equipment	¥ 4,354	¥ 4,362	\$ 36,966
Net book value:			
Machinery and equipment	¥ 3,268	¥ 2,791	\$ 23,653

Lease expenses relating to finance leases accounted for as operating leases for the fiscal years ended March 31, 2007 and 2006 amounted to ¥1,294 million (\$10,966 thousand) and ¥1,429 million, respectively.

The *pro forma* depreciation of the finance leases accounted for as operating leases for the fiscal years ended March 31, 2007 and 2006 amounted to ¥1,294 million (\$10,966 thousand) and ¥1,429 million, respectively, and was computed by the straight-line method over the respective lease terms of the assets with no residual value.

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2007 for finance leases accounted for as operating leases are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Fiscal year ending March 31:		
2008	¥ 1,815	\$ 15,381
2009 and thereafter	4,614	39,102
Total	¥ 6,430	\$ 54,492

- (ii) Future minimum lease payments subsequent to March 31, 2007 for noncancelable operating leases are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Fiscal year ending March 31:		
2008	¥ 348	\$ 2,949
2009 and thereafter	182	1,542
Total	¥ 531	\$ 4,500

#### (b) As Lessor

- (i) The following amounts represent the acquisition costs, accumulated depreciation and net book value of the leased assets relating to finance leases accounted for as operating leases at March 31, 2007 and 2006:

	Millions of yen		Thousands of U.S. dollars
	March 31,		March 31,
	2006	2007	2007
Acquisition costs:			
Machinery and equipment	¥ 5	¥ —	\$ —
Accumulated depreciation:			
Machinery and equipment	¥ 4	¥ —	\$ —
Net book value:			
Machinery and equipment	¥ 0	¥ —	\$ —

Lease income relating to finance leases accounted for as operating leases in the accompanying consolidated financial statements totaled ¥0 million (\$0 thousand) and ¥1 million for the fiscal years ended March 31, 2007 and 2006, respectively. Depreciation of the assets leased under finance leases accounted for as operating leases totaled ¥0 million (\$0 thousand) and ¥1 million for the fiscal years ended March 31, 2007 and 2006, respectively.

Future minimum lease income (including the interest portion thereon) subsequent to March 31, 2007 for finance leases accounted for as operating leases is summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Fiscal year ending March 31:		
2008	¥ 92	\$ 780
2009 and thereafter	469	3,975
Total	¥ 561	\$ 4,754

- (ii) Future minimum lease income subsequent to March 31, 2007 for noncancelable operating leases is summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Fiscal year ending March 31:		
2008	¥ 218	\$ 1,847
2009 and thereafter	2,432	20,610
Total	¥ 2,650	\$ 22,458

#### 14. Contingent Liabilities

The Company's consolidated subsidiaries had the following contingent liabilities at March 31, 2007:

	Millions of yen	Thousands of U.S. dollars
As guarantors of indebtedness of unconsolidated subsidiaries, affiliates and other	¥ 36,772	\$ 311,627

#### 15. Securities

- (a)(i) Marketable securities classified as held-to-maturity debt securities and other securities at March 31, 2007 are summarized as follows:

##### Marketable held-to-maturity debt securities

	Millions of yen			Thousands of U.S. dollars		
	March 31, 2007	March 31, 2007	March 31, 2007	March 31, 2007	March 31, 2007	March 31, 2007
	Carrying value	Estimated fair value	Unrealized loss	Carrying value	Estimated fair value	Unrealized loss
Securities whose carrying value exceeds their fair value:						
Government bonds	¥ 270	¥ 269	¥ (0)	\$ 2,288	\$ 2,280	\$ (0)
Total	¥ 270	¥ 269	¥ (0)	\$ 2,288	\$ 2,280	\$ (0)

##### Marketable other securities

	Millions of yen			Thousands of U.S. dollars		
	March 31, 2007	March 31, 2007	March 31, 2007	March 31, 2007	March 31, 2007	March 31, 2007
	Cost	Carrying value	Unrealized gain (loss)	Cost	Carrying value	Unrealized gain (loss)
Securities whose carrying value exceeds their cost:						
Equity securities	¥ 31,032	¥ 61,457	¥ 30,424	\$ 262,983	\$ 520,822	\$ 257,831
Subtotal	31,032	61,457	30,424	262,983	520,822	257,831
Securities whose cost exceeds their carrying value:						
Equity securities	19,076	14,755	(4,321)	161,661	125,042	(36,619)
Subtotal	19,076	14,755	(4,321)	161,661	125,042	(36,619)
Total	¥ 50,109	¥ 76,212	¥ 26,103	\$ 424,653	\$ 645,864	\$ 221,212

- (ii) Sales of securities classified as other securities amounted to ¥7,067 million (\$59,890 thousand) with an aggregate gain of ¥3,855 million (\$32,669 thousand) and loss of ¥4 million (\$34 thousand) for the fiscal year ended March 31, 2007.
- (iii) The redemption schedule at March 31, 2007 for securities with maturity dates classified as other securities and held-to-maturity debt securities is summarized as follows:

	Millions of yen			Thousands of U.S. dollars		
	March 31, 2007	March 31, 2007	March 31, 2007	March 31, 2007	March 31, 2007	March 31, 2007
	Due in one year or less	Due after one year through five years	Due after five years	Due in one year or less	Due after one year through five years	Due after five years
Government bonds	¥ 270	¥ —	¥ —	\$ 2,288	\$ —	\$ —
Corporate bonds	—	1	—	—	8	—
Total	¥ 270	¥ 1	¥ —	\$ 2,288	\$ 8	\$ —

(iv) Non-marketable securities classified as held-to-maturity debt securities and other securities at March 31, 2007 are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
	March 31, 2007	March 31, 2007
Carrying value		
<b>Held-to-maturity debt securities:</b>		
Corporate bonds	¥ 1	\$ 8
Subtotal	1	8
<b>Other securities:</b>		
Unlisted equity securities	28,015	237,415
Other	999	8,466
Subtotal	29,015	245,890
<b>Total</b>	<b>¥ 29,016</b>	<b>\$ 245,898</b>

(b)(i) Marketable securities classified as held-to-maturity debt securities and other securities at March 31, 2006 are summarized as follows:

#### Marketable held-to-maturity debt securities

	Millions of yen		
	March 31, 2006		
	Carrying value	Estimated fair value	Unrealized loss
<b>Securities whose carrying value exceeds their fair value:</b>			
Government bonds	¥ 270	¥ 269	¥ (0)
<b>Total</b>	<b>¥ 270</b>	<b>¥ 269</b>	<b>¥ (0)</b>

#### Marketable other securities

	Millions of yen		
	March 31, 2006		
	Cost	Carrying value	Unrealized gain (loss)
<b>Securities whose carrying value exceeds their cost:</b>			
Equity securities	¥ 29,324	¥ 69,368	¥ 40,043
<b>Subtotal</b>	<b>29,324</b>	<b>69,368</b>	<b>40,043</b>
<b>Securities whose fair value exceeds their carrying value:</b>			
Equity securities	1,032	909	(122)
<b>Subtotal</b>	<b>1,032</b>	<b>909</b>	<b>(122)</b>
<b>Total</b>	<b>¥ 30,357</b>	<b>¥ 70,277</b>	<b>¥ 39,920</b>

(ii) Sales of securities classified as other securities amounted to ¥3,072 million with an aggregate gain of ¥1,597 million for the fiscal year ended March 31, 2006.

(iii) The redemption schedule at March 31, 2006 for securities with maturity dates classified as other securities and held-to-maturity debt securities is summarized as follows:

	Millions of yen		
	March 31, 2006		
	Due in one year or less	Due after one year through five years	Due after five years
<b>Government bonds</b>	¥ —	¥ 270	¥ —
<b>Corporate bonds</b>	75	1	—
<b>Total</b>	<b>¥ 75</b>	<b>¥ 271</b>	<b>¥ —</b>

(iv) Non-marketable securities classified as held-to-maturity debt securities and other securities at March 31, 2006 are summarized as follows:

	Millions of yen
	March 31, 2006
Carrying value	
<b>Held-to-maturity debt securities:</b>	
Corporate bonds	¥ 76
Subtotal	76
<b>Other securities:</b>	
Unlisted equity securities	31,435
Other	1,002
Subtotal	32,438
<b>Total</b>	<b>¥ 32,514</b>

## 16. Segment Information

### (a) Business segments

The Company and its consolidated subsidiaries are primarily engaged in the manufacture and sale of products in three major business segments: pulp and paper division, paper related division and housing and construction materials division. The results of other businesses are reported in the “Other division.”

The business segment information of the Company and its consolidated subsidiaries for the fiscal years ended March 31, 2007 and 2006 is summarized as follows:

Millions of yen							
Fiscal year ended March 31, 2007							
	Pulp and paper division	Paper related division	Housing and construction materials division	Other division	Total	Eliminations or corporate	Consolidated
<b>(i) Sales and operating income:</b>							
Sales to third parties	¥ 889,866	¥ 101,459	¥ 100,489	¥ 83,449	¥ 1,175,264	¥ —	¥ 1,175,264
Intercompany sales and transfers	3,370	9,256	54,140	45,679	112,445	(112,445)	—
Net sales	893,236	110,715	154,630	129,128	1,287,710	(112,445)	1,175,264
Operating expenses	862,585	105,817	151,636	123,016	1,243,055	(112,445)	1,130,609
Operating income	¥ 30,650	¥ 4,898	¥ 2,993	¥ 6,112	¥ 44,655	¥ —	¥ 44,655
<b>(ii) Total assets, depreciation, loss on impairment of fixed assets and capital expenditures:</b>							
Total assets	¥ 1,153,653	¥ 120,142	¥ 66,858	¥ 108,950	¥ 1,449,605	¥ 116,372	¥ 1,565,978
Depreciation	55,942	4,638	1,109	5,359	67,049	—	67,049
Loss on impairment of fixed assets	3,215	—	569	107	3,891	—	3,891
Capital expenditures	¥ 89,513	¥ 7,296	¥ 856	¥ 5,295	¥ 102,961	¥ —	¥ 102,961

Thousands of U.S. dollars							
Fiscal year ended March 31, 2007							
	Pulp and paper division	Paper related division	Housing and construction materials division	Other division	Total	Eliminations or corporate	Consolidated
<b>(i) Sales and operating income:</b>							
Sales to third parties	\$ 7,541,237	\$ 859,822	\$ 851,602	\$ 707,195	\$ 9,959,864	\$ —	\$ 9,959,864
Intercompany sales and transfers	28,559	78,441	458,814	387,110	952,924	(952,924)	—
Net sales	7,569,797	938,263	1,310,424	1,094,305	10,912,797	(952,924)	9,959,864
Operating expenses	7,310,042	896,754	1,285,051	1,042,508	10,534,364	(952,924)	9,581,432
Operating income	\$ 259,746	\$ 41,508	\$ 25,364	\$ 51,797	\$ 378,432	\$ —	\$ 378,432
<b>(ii) Total assets, depreciation, loss on impairment of fixed assets and capital expenditures:</b>							
Total assets	\$ 9,776,720	\$ 1,018,153	\$ 566,593	\$ 923,305	\$ 12,284,788	\$ 986,203	\$ 13,271,000
Depreciation	474,085	39,305	9,398	45,415	568,212	—	568,212
Loss on impairment of fixed assets	27,246	—	4,822	907	32,975	—	32,975
Capital expenditures	\$ 758,585	\$ 61,831	\$ 7,254	\$ 44,873	\$ 872,551	\$ —	\$ 872,551
Millions of yen							
Fiscal year ended March 31, 2006							
	Pulp and paper division	Paper related division	Housing and construction materials division	Other division	Total	Eliminations or corporate	Consolidated
<b>(i) Sales and operating income:</b>							
Sales to third parties	¥ 860,993	¥ 110,350	¥ 94,041	¥ 86,781	¥ 1,152,166	¥ —	¥ 1,152,166
Intercompany sales and transfers	8,813	8,183	39,769	39,585	96,352	(96,352)	—
Net sales	869,806	118,534	133,811	126,367	1,248,519	(96,352)	1,152,166
Operating expenses	836,609	112,352	131,203	119,962	1,200,128	(96,352)	1,103,775
Operating income	¥ 33,197	¥ 6,181	¥ 2,607	¥ 6,404	¥ 48,391	¥ —	¥ 48,391
<b>(ii) Total assets, depreciation, loss on impairment of fixed assets and capital expenditures:</b>							
Total assets	¥ 1,113,446	¥ 93,276	¥ 61,191	¥ 107,898	¥ 1,375,813	¥ 116,613	¥ 1,492,427
Depreciation	58,116	4,829	1,160	5,999	70,106	—	70,106
Loss on impairment of fixed assets	9,669	374	29	195	10,269	—	10,269
Capital expenditures	¥ 55,589	¥ 7,804	¥ 1,188	¥ 5,104	¥ 69,687	¥ —	¥ 69,687



**(b) Geographic segments**

Since sales recognized by companies located in Japan constituted 90% or more of consolidated sales for the fiscal years ended March 31, 2007 and 2006, geographical segment information has not been presented.

**(c) Overseas sales**

Since overseas sales represented less than 10% of consolidated sales for the years ended March 31, 2007 and 2006, no disclosure of overseas segment information has been presented.

**17. Derivatives**

Certain subsidiaries have entered into interest-rate swaps to reduce their interest expense or their exposure to adverse fluctuation in interest rates relating to loans and bonds payable.

The amounts presented below exclude the forward foreign exchange contracts entered into to hedge receivables and payables denominated in foreign currencies which have been translated and are reflected at their corresponding contracted rates in the accompanying consolidated balance sheets.

Summarized below are the contract amounts and estimated fair value of the consolidated subsidiaries' derivatives positions at March 31, 2007 and 2006:

	Millions of yen				Thousands of U.S. dollars	
	March 31,				March 31,	
	2006		2007		2007	
	Contract amount	Estimated fair value	Contract amount	Estimated fair value	Contract amount	Estimated fair value
<b>Interest-rate swaps:</b>						
Receive/fixed; pay/floating	¥ 1,500	¥ 19	¥ —	¥ —	\$ —	\$ —

The following methodologies and assumptions were used by certain consolidated subsidiaries in estimating the fair value of their derivatives positions:

Interest-rate swaps: Estimated fair value as provided by the respective financial institutions

**18. Research and Development Costs**

Included in cost of sales and selling, general and administrative expenses were ¥6,803 million (\$57,653 thousand) and ¥7,064 million of research and development costs for the fiscal years ended March 31, 2007 and 2006, respectively.

**19. Subsequent Events**

(a) The following appropriation of retained earnings of the Company, which has not been reflected in the accompanying consolidated financial statements for the fiscal year ended March 31, 2007, was approved at an annual general meeting of shareholders held on June 28, 2007:

	Millions of yen	Thousands of U.S. dollars
Year-end cash dividends		
(¥4,000.00 = U.S.\$33.898 per share)	¥ 4,257	\$ 36,076
	¥ 4,257	\$ 36,076

**(b) Issuance of bonds**

- (1) Based on a resolution approved at the Board of Directors' meeting held on March 30, 2007, the Company launched its 9th issue of unsecured corporate bonds of ¥10 billion guaranteed by Nippon Paper Industry Co., Ltd. on May 25, 2007:
- (2) Interest rate: 1.96% per year
- (3) Issue price: ¥100 par value
- (4) Date of issuance: May 25, 2007
- (5) Maturity date: May 25, 2017 (these are 10-year bonds)

# Report of Independent Auditors

## The Board of Directors

Nippon Paper Group, Inc.

We have audited the accompanying consolidated balance sheets of Nippon Paper Group, Inc. and consolidated subsidiaries as of March 31, 2007 and 2006, and the related consolidated statements of income, changes in net assets, and cash flows for the years then ended, all expressed in yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Nippon Paper Group, Inc. and consolidated subsidiaries at March 31, 2007 and 2006, 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.

## Supplemental Information

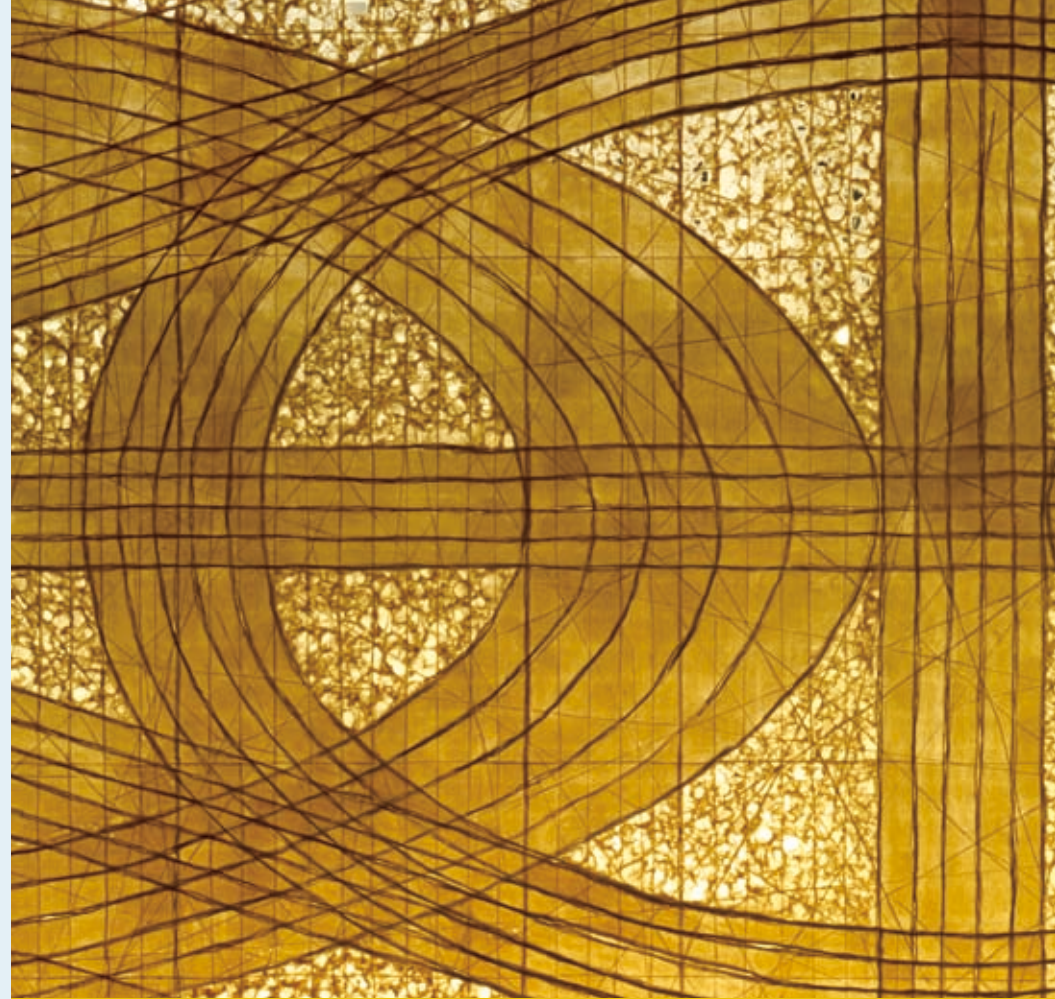
As described in Note 3(i), effective the year ended March 31, 2006, the Company adopted an accounting standard for the impairment of fixed assets.

As described in Note 19(b), the Company issued its 9th issue of unsecured bonds on May 25, 2007 based on a resolution of the Board of Directors at a meeting held on March 30, 2007.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2007 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 4.

*Ernst & Young Shin Nihon*

June 28, 2007



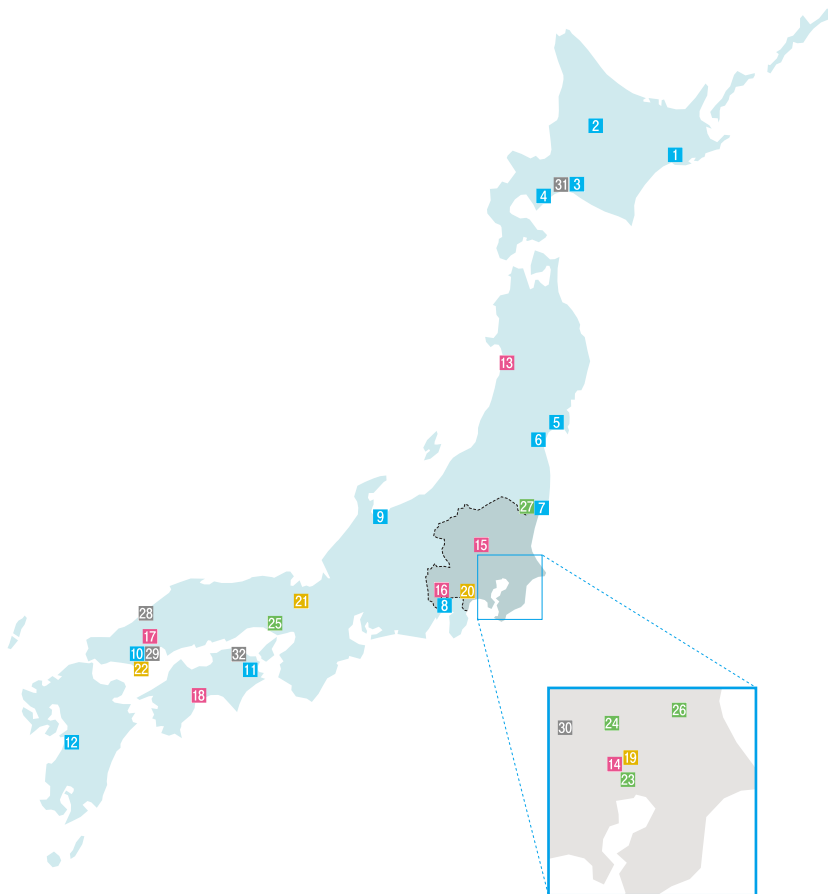
## GLOBAL NETWORK

110 Domestic Network

112 Overseas Network

# Domestic Network

## Head Offices and Production Sites of Major Subsidiaries



### Pulp and Paper Division

#### Nippon Paper Industries Co., Ltd.

Shin Yurakucho Building  
1-12-1 Yurakucho, Chiyoda-ku, Tokyo 100-0006, Japan  
Tel: +81-3-3218-8000 Fax: +81-3-3216-4753

### Production Facilities

- 1 Kushiro Mill (Hokkaido)
- 2 Asahikawa Mill (Hokkaido)
- 3 Yufutsu Mill (Hokkaido)
- 4 Shiraio Mill (Hokkaido)
- 5 Ishinomaki Mill (Miyagi)
- 6 Iwanuma Mill (Miyagi)
- 7 Nakoso Mill (Fukushima)
- 8 Fuji Mill (Shizuoka)
- 9 Fushiki Mill (Toyama)
- 10 Iwakuni Mill (Yamaguchi)
- 11 Komatsushima Mill (Tokushima)
- 12 Yatsushiro Mill (Kumamoto)

#### Nippon Daishowa Paperboard Co., Ltd.

Nihonbashi Asahi Seimeikan  
2-1-3 Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan  
Tel: +81-3-3242-7311 Fax: +81-3-3242-7312

- 13 Nippon Daishowa Paperboard Tohoku Co., Ltd. (Akita)
- 14 Nippon Daishowa Paperboard Kanto Co., Ltd. Soka Mill (Saitama)
- 15 Nippon Daishowa Paperboard Kanto Co., Ltd. Ashikaga Mill (Tochigi)
- 16 Nippon Daishowa Paperboard Yoshinaga Co., Ltd. (Shizuoka)
- 17 Nippon Daishowa Paperboard Nishinippon Co., Ltd. Geibo Mill (Hiroshima)
- 18 Nippon Daishowa Paperboard Nishinippon Co., Ltd. Kochi Mill (Kochi)

#### Nippon Paper Crecia Co., Ltd.

Shinjuku Square Tower  
6-22-1 Nishishinjuku, Shinjuku-ku, Tokyo 163-1113, Japan  
Tel: +81-3-5323-0260 Fax: +81-3-5323-0263

- 19 Tokyo Mill (Saitama)
- 20 Kaisei Mill (Kanagawa)
- 21 Kyoto Mill (Kyoto)
- 22 Iwakuni Mill (Yamaguchi)

#### NP Trading Co., Ltd.

Kamakuragashi Building  
2-2-1, Uchikanda, Chiyoda-ku, Tokyo 101-8536, Japan  
Tel: +81-3-3252-1654 Fax: +81-3-5256-2086

### Paper-Related Division

#### Nippon Paper-Pak Co., Ltd.

Iidabashi Rainbow Building  
11 Ichigaya-Funagawaracho, Shinjuku-ku, Tokyo 162-0826, Japan  
Tel: +81-3-3269-8631 Fax: +81-3-3267-6587

- 23 Soka Paper-Pak Co., Ltd. (Saitama)
- 24 Egawa Paper-Pak Co., Ltd. (Ibaraki)
- 25 Miki Paper-Pak Co., Ltd. (Hyogo)
- 26 Ishioka Kako Co., Ltd. (Ibaraki)
- 27 Nakoso Film Co., Ltd. (Fukushima)

#### Nippon Paper Chemicals Co., Ltd.

JS Ichigaya Building  
5-1 Gobancho, Chiyoda-ku, Tokyo 102-0076, Japan  
Tel: +81-3-5216-9111 Fax: +81-3-5216-8516

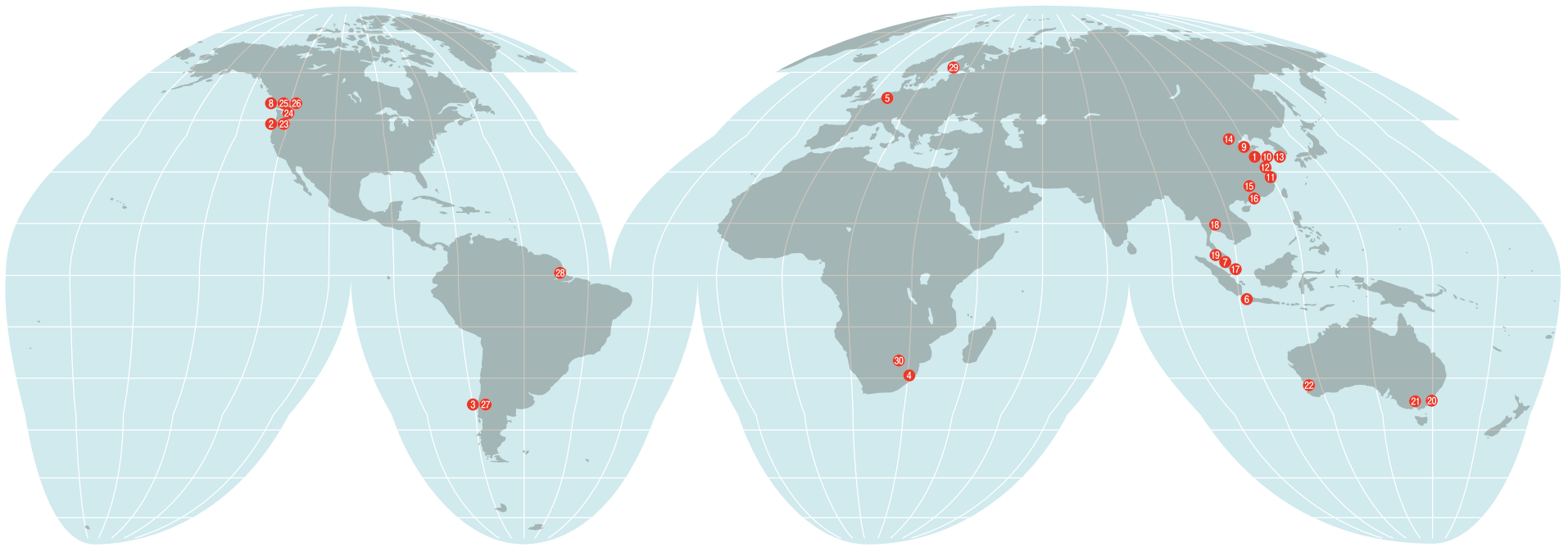
- 28 Gotsu Works (Shimane)
- 29 Iwakuni Works (Yamaguchi)
- 30 Higashimatsuyama Works (Saitama)
- 31 Yufutsu Works (Hokkaido)
- 32 Komatsushima Works (Tokushima)

### Housing and Construction Materials Division

#### Nippon Paper Lumber Co., Ltd.

Keitoku Building  
1-9-5 Oji, Kita-ku, Tokyo 114-8552, Japan  
Tel: +81-3-5390-2011 Fax: +81-3-5390-2020

# Overseas Network



## Overseas Offices

### Pulp and Paper Division

#### Nippon Paper Group, Inc.

**China Office 1**  
Room 2708, New Town Center, No. 83,  
Lou Shan Guan Road, Shanghai, 200336, China  
Tel: +86-21-6145-3235 Fax: +86-21-6145-3237

**Longview Office 2**  
P.O.Box 699, 3001 Industrial Way, Longview,  
WA 98632, U.S.A.  
Tel: +1-360-636-7110 Fax: +1-360-423-1514

#### Nippon Paper Industries Co., Ltd.

**Concepción Office 3**  
Cochrane 361, Concepción, Chile  
Tel: +56-41-2-244300 Fax: +56-41-2-259541

**Pietermaritzburg Office 4**  
c/o The Central Timber Co-operative Ltd.,  
171 Burger Street, Pietermaritzburg 3201  
Republic of South Africa  
Tel: +27-33-3924-215 Fax: +27-33-3426-410

**Europe Office 5**  
Strawinskylaan 707 (WTC-A tower),  
1077 XX Amsterdam Z.O., The Netherlands  
Tel: +31-20-5711-878 Fax: +31-20-5711-879

#### NP Trading Co., Ltd.

**Jakarta Office 6**  
Nusantara Building 14th Floor, Ji.M.H.  
Thamrin No.59, Jakarta 10350, Indonesia  
Tel: +60-3-2070-0693 Fax: +60-3-2070-0695

**Malaysia Office 7**  
Unit 4. 1A, 4th Floor, Menara Aik Hua, Changkat  
Raja Chulan, 50200 Kuala Lumpur, Malaysia  
Tel: +62-21-3193-5434 Fax: +62-21-3193-5572

### Housing and Construction Materials Division

#### Nippon Paper Lumber Co., Ltd.

**Vancouver Office 8**  
Suite 700, 510, Burrard Street, Vancouver, B.C.  
V6A 3A8, Canada  
Tel: +1-604-801-6148 Fax: +1-604-801-6658



## Major Overseas Subsidiaries and Affiliates

### Asia

**Shouguang Liben Paper Making Co., Ltd.** ⑨  
595 Shengcheng Road, Shouguang, Shandong,  
262700, China  
Tel: +86-536-215-8412 Fax: +86-536-215-8417

**Shanghai JP Co., Ltd.** ⑩  
173 Hongcao Road(S), Shanghai, 200233,  
China  
Tel: +86-21-6408-9900 Fax: +86-21-6408-6677

**Zhejiang Nippon Paper Co., Ltd.** ⑪  
Pinghu Zhejiang, 314214, China  
Tel: +86-573-597-8658 Fax: +86-573-597-8000

**Everwealth Paper Industries (Shanghai) Co., Ltd.** ⑫  
2 Xinjie Road, Xin Qiao Township Industrial  
Park, Song Jiang, Shanghai, 201612, China  
Tel: +86-21-5764-5189 Fax: +86-21-5764-5118

**Nippon Paper Industries Trading (Shanghai) Co., Ltd.**  
• **Shanghai office** ⑬  
Room 2709, New Town Center, No. 83, Lou  
Shan Guan Road, Shanghai, 200336, China  
Tel: +86-21-6145-3260 Fax: +86-21-6145-3237

• **Beijing office** ⑭  
Room 904A, Avic, No. 10B Central Road, East  
3rd Ring Road, Chaoyang District, Beijing,  
100022, China  
Tel: +86-10-6566-7148 Fax: +86-10-6566-7145

**San-Mic Trading Co., (Shenzhen) Ltd.** ⑮  
Room 3011, News Building 1st, NO.1002  
Shennanzhong Rd.,  
Futian Area, Shenzhen City P.R.O., China  
Tel: +86-755-2595-1177 Fax: +86-755-2595-1186

**San-Mic Trading Co., (H.K.) Ltd.** ⑯  
Unit 1901, 19th Floor, Causeway Bay Plaza2,  
No.463-483, Lockhart Road,  
Causeway Bay, Hong Kong  
Tel: +852-2504-5995 Fax: +852-2504-1953

**San-Mic Trading Co., (S) Pte. Ltd.** ⑰  
79 Robinson Road #14-03,  
CPF Building, Singapore  
Tel: +65-6222-0318 Fax: +65-6225-1978

**San-Mic Trading (Thailand) Co., Ltd.** ⑱  
SG Tower, 161/1 Floor 12, Room 1202, Soi  
Mahadlek Luang 3, Rajdamni Road, Lumpini,  
Pathumwan, Bangkok, Thailand, 10330

**N.A.K. Manufacturing (M) Sdn. Bhd.** ⑲  
Lot 19-11, Bersatu Industrial Complex,  
Kawasan Perindustrian Balakong, 43200  
Cheras, Selangor Darul Ehsan, Malaysia  
Tel: +60-3-9074-7900 Fax: +60-3-9074-7889

### Oceania

**South East Fibre Exports Pty. Ltd.** ⑳  
P.O.Box 189, Jews Head, Edrom Road,  
Eden, N.S.W. 2551, Australia  
Tel: +61-2-6496-0222 Fax: +61-2-6496-1204

**Nippon Paper Treefarm Australia Pty. Ltd.** ㉑  
Level 6,456 Lonsdale Street,  
Melbourne, VIC 3000, Australia  
Tel: +61-3-9252-2700 Fax: +61-3-9642-2705

**WA Plantation Resources Pty. Ltd.** ㉒  
Level 5, BGC Centre, 28 The Esplanade  
Perth, WA 6000, Australia  
Tel: +61-8-9420-8300 Fax: +61-8-9322-7895

### North and South America

**North Pacific Paper Corporation** ㉓  
P.O.Box 2069, 3001 Industrial Way,  
Longview, WA 98632, U.S.A.  
Tel: +1-360-636-6400 Fax: +1-360-423-1514

**Nippon Paper Industries USA Co., Ltd.** ㉔  
P.O.Box 271, 1815 Marine Drive,  
Port Angeles, WA 98362, U.S.A.  
Tel: +1-360-457-4474 Fax: +1-360-452-6576

**Daishowa North America Corporation** ㉕  
Suite 1140-1040, West Georgia Street,  
Vancouver, B.C. V6E 4H1, Canada  
Tel: +1-604-801-6628 Fax: +1-604-801-6658

**Daishowa-Marubeni International Ltd.** ㉖  
Suite 700-510 Burrard Street,  
Vancouver, B.C. V6C 3A8, Canada  
Tel: +1-604-684-4326 Fax: +1-604-684-0512

**Volterra S.A.** ㉗  
Cochrane 361, Concepción, Chile  
Tel: +56-41-2-244300 Fax: +56-41-2-259541

**Amapa Florestal e Celulose S.A.** ㉘  
Rua Claudio Lucio Monteiro, S/N, 68925-000,  
Santana AP, Brazil  
Tel: +55-96-3281-8024 Fax: +55-96-3281-8039

### Europe

**Jujo Thermal Oy** ㉙  
P.O.Box 92, FIN-27501 Kauttua, Finland  
Tel: +358-10-303-200 Fax: +358-10-303-2419

### Africa

**Nippon-SC Tree Farm S.A. (Pty) Ltd.** ㉚  
P.O.Box 2253, Parklands 2121,  
Republic of South Africa  
Tel: +27-11-784-9120 Fax: +27-11-784-9122



## Investor Information

### Company name

Nippon Paper Group, Inc.

### Company code

3893

### Stock listings

Tokyo Stock Exchange, Osaka Securities Exchange, and Nagoya Stock Exchange

### Shares issued and outstanding (As of March 31, 2007)

1,105,235.63

### Major Shareholders (10 Largest)

(As of March 31, 2007)

Name	Shares held	Shareholding (%)
Japan Trustee Services Bank, Ltd. (Trust Account)	85,526	8.0
The Master Trust Bank of Japan, Ltd. (Trust Account)	53,640	5.0
Nippon Life Insurance Company	37,456	3.5
Mizuho Corporate Bank, Ltd.	31,314	2.9
Mitsui Life Insurance Company Limited	22,589	2.1
Mizuho Bank, Ltd.	21,467	2.0
Daio Paper Corporation	20,689	1.9
Sumitomo Mitsui Banking Corporation	19,938	1.9
Japan Trustee Services Bank, Ltd. (Trust Account 4)	17,170	1.6
The Norinchukin Bank	17,000	1.6

### Note:

- The company holds 40,967 shares of treasury stock excluded from calculations.
- Shareholding percentage is calculated with treasury stock excluded.
- Holdings of less than one share omitted.

### Fiscal year

From April 1 to March 31

### Ordinary general meeting of shareholders

Within three months of the day following the fiscal year-end

### Administration office of register and transfer agent (mail address and telephone information)

Stock Transfer Agency Department

The Chuo Mitsui Trust and Banking Company, Limited

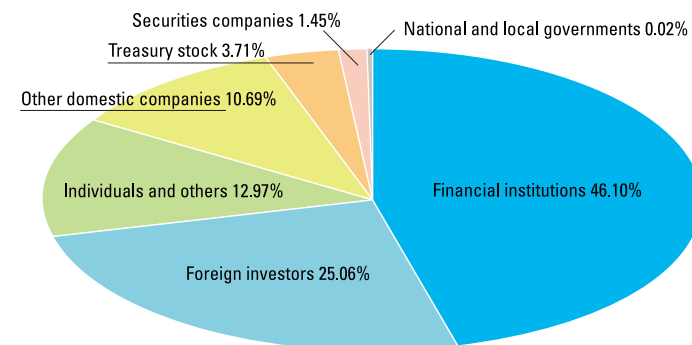
2-8-4 Izumi, Suginami-ku, Tokyo 168-0063

Tel: 0120-78-2031 (Toll free in Japan)

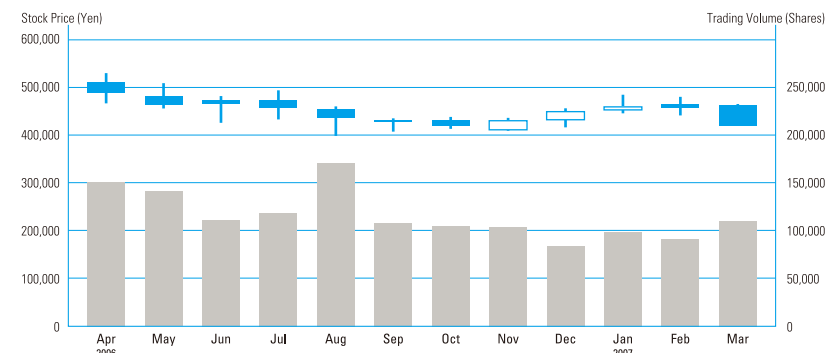
### Independent auditor

Ernst & Young ShinNihon

### Percentage of Shares Held by Shareholder Category (As of March 31, 2007)



### Stock Price and Trading Volume



# Investor Information

## Nippon Paper Group, Inc., Investor Relations Office

Shin-Yuraku-cho building  
1-12-1 Yuraku-cho, Chiyoda-ku, Tokyo 100-0006, Japan  
Tel: +81-3-3218-9347  
Fax: +81-3-3216-5662

### IR Mail

Nippon Paper Group's press releases, financial releases or results, and other communications are available via email notices.  
Subscribe to NPG's investor news at our IR site.

### IR Website

URL: <http://www.np-g.com/e/ir/>

### Sustainability Report

Nippon Paper Group will publish its Sustainability Report 2007 in September 2007.


### Inquiries

#### Nippon Paper Group, Inc., CSR Office

Tel: +81-3-3218-9321 Fax: +81-3-3216-1366  
URL: <http://www.np-g.com/e/csr/>

Paper is used in this report (Nippon Paper Industries Co., Ltd.)

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*We hope the future activities of  
Nippon Paper Group  
will meet your expectations.*

NIPPON PAPER GROUP, INC.

[www.np-g.com/e/](http://www.np-g.com/e/)