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ANNUAL REPORT 2006

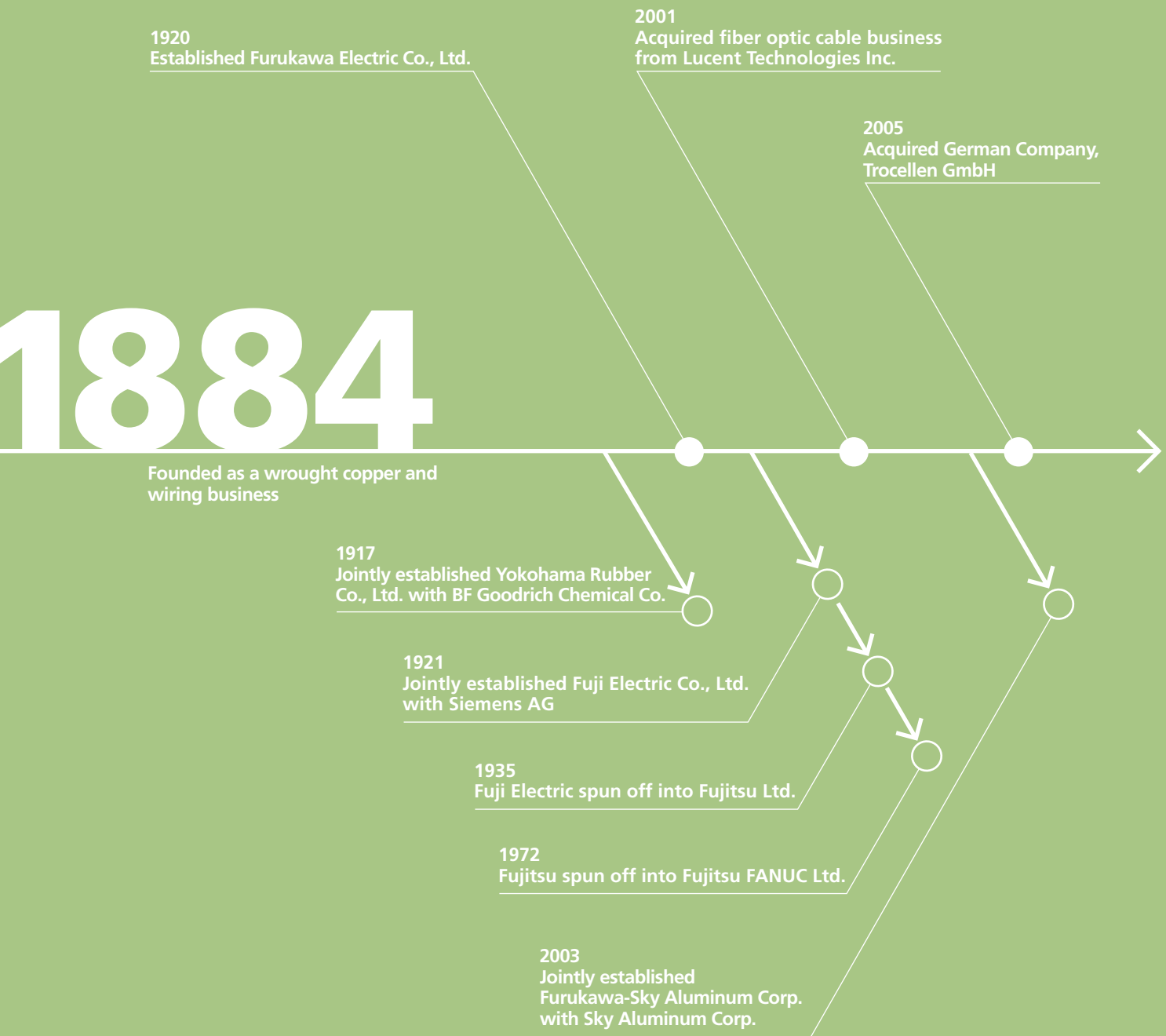
# to

# Innovate

**FURUKAWA ELECTRIC**

## Profile

Since its founding in 1884 as an electric wiring and nonferrous metals manufacturer, Furukawa Electric has consistently remained in step with progress in the fundamental technologies across society and industry. Today, based on our core competence in functional materials, such as nonferrous metals, photonics and plastics, our Group companies are actively represented across a broad spectrum of industries, including metals, machinery, electric wiring, rubber, chemicals, electric equipment, communications equipment, light metals and electronics. By leveraging the wealth of materials technology we have accumulated and related diversified applications, we will continue to supply products and technologies that contribute to the development of an affluent society, not only in Japan, but to worldwide markets in North and South America, Europe and Asia.



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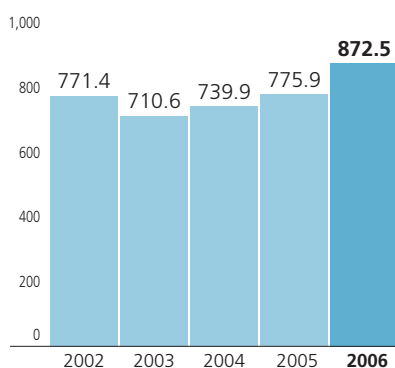
## Consolidated Financial Highlights

The Furukawa Electric and Its Consolidated Subsidiaries  
For the years ended March 31, 2006 and 2005

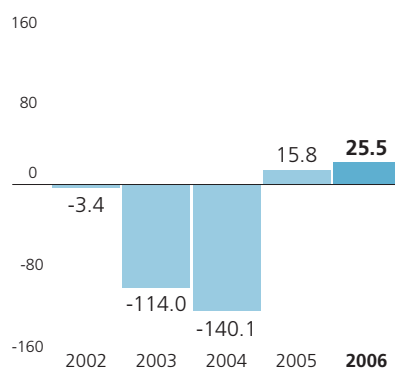
	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Net sales .....	¥ 872,536	¥ 775,894	\$ 7,457,573
Operating income .....	37,430	23,736	319,915
Net income .....	25,508	15,805	218,017
Per share of common stock (yen and U.S. dollars) :			
Basic .....	36.94	24.11	0.316
Diluted .....	36.92	22.59	0.316
Cash dividends paid .....	3	—	0.026
Total assets .....	1,052,256	991,358	8,993,641
Total shareholders' equity .....	223,244	175,846	1,908,068

**Note :** U.S. dollar amounts have been translated, for convenience only, at the rate of ¥117 to US\$1.

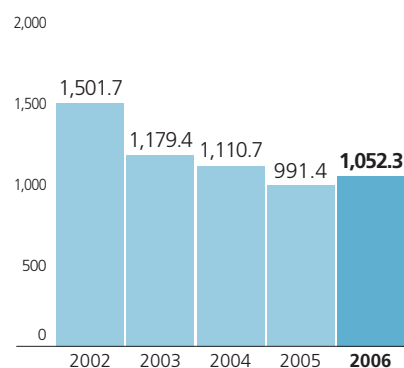
**Net sales** (Billions of yen)



**Net income** (Billions of yen)



**Total assets** (Billions of yen)



### Forward-Looking Statements

Statements made in this Annual Report with respect to Furukawa Electric's current plans, estimates, strategies, and beliefs and other statements which are not historical facts are forward-looking statements based on the Company's assumptions and expectations in light of currently available information, and therefore involve risks and uncertainties which may cause actual performance results to differ from those discussed in the forward-looking statements.

Potential risks may include, but are not limited to, general economic conditions, management environment, market demand, foreign exchange rates, and taxes and other system impacts. Therefore, no guarantee is presented or implied relative to the accuracy of the forward-looking statements in this Annual Report.

Achieving record-setting net sales  
on the way to  
**further**  
**growth**  
in the future



**Hiroshi Ishihara**  
President & Chief Executive Officer &  
Chief Operating Officer

## Q Furukawa Electric Group reported record net sales and returned all segments to profitability in fiscal 2006. What made this performance possible?

Fiscal 2006 marked the second year of the Furukawa Action Plan, and we made a concerted effort as a Group to expand sales and markets, lower costs of sales and reduce fixed costs. At the same time, we sought to carry forward efforts from the previous fiscal year by selling investment securities and real estate holdings, reducing interest-bearing debt and recovering shareholders' equity.

We accomplished record net sales as these efforts took effect amid a favorable business environment. We were also able to return the Telecommunications segment—which had remained in the red up to the previous fiscal year—to profitability based on a recovery in demand in the North American market and the benefits of the various structural reforms undertaken in the previous fiscal year. Thus for the first time since fiscal 2001, all our business segments returned to profitability.

As a result, consolidated net sales increased 12.5% from the previous year to ¥872.5 billion and operating income increased 57.7% to ¥37.4 billion. Other income rose 2.9 times from the previous fiscal year to ¥7.1 billion, as yen-denominated loans to an overseas subsidiary generated considerable foreign exchange gains, and net income totaled ¥25.5 billion in fiscal 2006.

Measures for Fiscal 2006	Actual Results for Fiscal 2006
Structural reform of the Telecommunications segment	→ Returned to profitability with operating income of ¥15.5 billion
Reduction of interest-bearing debt	→ Reduced by ¥46.9 billion Reduced by ¥149.4 billion over a two-year period
Deployment of strategic funds	→ Acquisition of Trocellen GmbH
<b>Financial Highlights for Fiscal 2006</b>	
Record high sales —¥872.5 billion, exceeded fiscal 2001	
All business segments returned to profitability —First time in five years since fiscal 2001	
Resumed dividend payment —¥3 per share: first time in three fiscal years	

## Q The Telecommunications segment returned to profitability. What were the major reasons and what do you expect to see as you look ahead?

Together with the recovery in demand from prolonged stagnation in both Japanese and overseas markets, the major factors were lower cost of sales and reduced fixed costs.

Specifically, sales of FTTH-related\*1 optical fiber cables increased considerably and sales of optical components in photonics and network solutions also rose with the growing number of subscribers in the Japanese market. We also observed increased sales of our routers, which boast security functions that play an integral role in VPN development. In the European and U.S. markets, we

enjoyed favorable demand for optical cables and specialized fibers. In the domestic market, FTTH-related optical components and fusion splicers maintained strong sales from the previous fiscal year, while, in Europe and North America, optical amplifiers also demonstrated increased sales in photonics and network solutions.

In addition, the effects of the structural reforms that began in fiscal 2005—including our concerted effort to lower costs, reduce fixed costs and transfer manufacturing to affiliated companies in Japan and abroad—contributed significantly, returning us to profitability for the first time in four fiscal years.

Looking ahead, as the FTTx\*2 market expands in the North American region, we expect rising demand for optical fiber cables and other FTTx-related products. We



also forecast a considerable improvement in profits at OFS\*3, which had remained under harsh conditions until now. In the Japanese market, we expect our photonics products to play a major role in the next-generation telecommunications network that will be considered by Nippon Telegraph and Telephone Corporation starting in fiscal 2007, and we forecast positive demand and performance as robust investments by major carriers continue.

\*1 **FTTH**: Fiber To The Home, an overall term for laying optical fiber networks to homes.

\*2 **FTTx**: Fiber To The x, a collective term for laying optical fiber networks to users' locations. The "x" stands for H (Home), B (Building), C (Curb) and other locations.

\*3 **OFS**: General term for OFS Fitel, LLC, and OFS BrightWave, LLC, which are optical fiber and optical fiber cable companies acquired from the U.S. company Lucent Technologies in 2001.

## Q What is the expected impact of the acquisition of Trocellen?

In March 2005, Furukawa Electric established a Strategic Fund totaling ¥20 billion with the goal of utilizing the cash for future investments. In November 2005, we used this fund to acquire Trocellen GmbH, a cross-linked polyolefin maker, in a joint effort with Otsuka Chemical Co., Ltd. Sales of the related business doubled as a result of this acquisition, raising us from fourth to second place in global market share.

Based in Germany, Trocellen is a multinational company with bases in Europe, Asia and South America, and which enjoys a competitive edge, particularly in the supply of automotive products such as waterproof sheets, panels, steering wheels and interior components to major European automakers, an area in which strong growth in demand is expected. Furukawa Electric will use Trocellen's network as a springboard for expanding its business in the global market with an eye on strengthening its entry into the BRICs\*4 region.

\*4 **BRICs**: Brazil, Russia, India and China.

## Q What are the major aspects of the Medium-Term Management Plan announced in March 2006?

The Furukawa Survival Plan launched by the Furukawa Electric Group in March 2004 was intended to break away from harsh management conditions and was centered on the Medium-Term Management Plan up to fiscal 2007.

Due to the ensuing rebound in the market environment and the benefits of various measures laid out in the Plan, our financial results recovered beyond our projections, and the accomplishment of our initial goals is now within sight.

We therefore decided to embark on a transition into a new growth stage one year ahead of schedule, and formulated the 2006–2009 Medium-Term Management Plan, “*Innovations 09*” in March 2006. (See pages 8–11 for details of this plan)

The goal of *Innovations 09* is to achieve growth in areas such as automotive and photonics where we can demonstrate our strengths, with a focus on our core competencies in metal, photonic and plastic functional materials.



## Q You are targeting an operating income ratio of more than 7% for each segment. What are your plans for achieving these high profits, particularly for the growth fields of automotives and photonics?

In our automotive segment, we already possess unique electronic components with the top global market share, such as the steering roll connector (SRC) used in airbags. We also have promising new products such as the metal core substrate junction box, an innovative substrate that enables a greater number of components and wiring to be mounted within the same space while enhancing automobile performance, and a rudder angle sensor for torque that is essential for ESC motion control. We plan to accomplish higher profits in the future by investing in these types of electronic components to increase the number of components that command the top share of the global market.

In the photonics segment, we boast the number one share of the global market in pump lasers, and we plan to develop new optical components based on this core laser technology. For example, we are seeking early commercialization of tunable wavelength devices, for which there is high

demand from customers as a next-generation technology. We will specifically concentrate on developing and expanding sales of next-generation devices that are pioneering the way into the coming tunable wavelengths era, including Reconfigurable Optical Add/Drop Multiplexers (ROADM) that enable

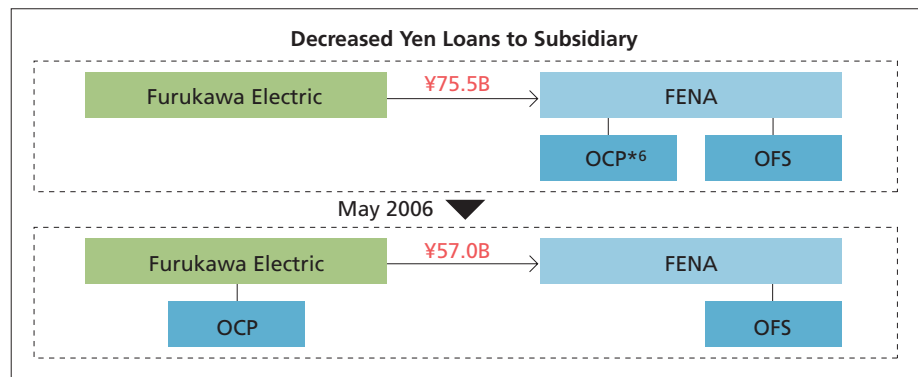


bandwidth switching, temperature-dependent surface emitting laser arrays and tunable DFB lasers that offer a broad range choice of WDM wavelengths.

## Q What is your future policy on foreign exchange gain/loss caused by yen-denominated loans to OFS as reported in the non-operating income/loss section?

Yen-denominated loans to OFS via managing company FENA\*<sup>5</sup> totaled ¥75.5 billion as of the end of fiscal 2006. This was due to our decision that it would be more advantageous for Furukawa Electric to extend a loan to OFS, in view of prevailing conditions that included low interest rates in Japan, preferential rates on loans enjoyed by Furukawa Electric, and foreign exchange risk between Japan and the United States. At present, a valuation loss has emerged due to subsequent fluctuations in the exchange rate. However, as an intra-Group loan, there is no impact on consolidated cash outflow.

We have already received a partial payment in May 2006 in the form of a transfer of stock in Optical Communication Products, Inc. owned by FENA, and we reduced the outstanding amount of the loan to ¥57.0 billion.



\*<sup>5</sup> FENA: FURUKAWA ELECTRIC NORTH AMERICA, INC.

\*<sup>6</sup> OCP: Optical Communication Products, Inc.

## Q What is your response to fluctuations in bare metal prices?

Furukawa Electric's copper and aluminum-related businesses involve rolling and extruding processes, and we have hedged against the risks of fluctuating bare metal prices. As a hedging measure, we have adopted a sliding price system in which fluctuations in the rare metal prices are automatically added to the selling price for most of our products. We are promoting the introduction of this system into product fields that have not yet adopted it.



## Q What is your position on Corporate Social Responsibility (CSR)?

Furukawa Electric is committed to legal compliance and undertakes environmental preservation activities as part of its CSR activities. In June 2004, we formulated the Furukawa Electric Group Action Guidelines and proceeded to establish an internal reporting system. We began full-scale compliance activities in July 2005. These efforts were quickly followed by the discovery of inappropriate management of employee work hours, such as service overtime, for which we paid two years of previously unpaid salaries. We deeply regret this development, which occurred as we were strengthening our system of compliance. We extend our sincere apology to shareholders and other stakeholders. We have vowed that such an incident will not be repeated, and we plan to further reinforce our compliance and risk control efforts to ensure sound management at all Group companies.

With respect to environmental preservation, we have set clear targets and time frames in which to accomplish them in our goal of creating a recycling-oriented society, and we endeavor to lower the impact on the environment and enhance recycling of resources through the concerted effort of Group companies. We are also actively involved in measures to reduce environmental risk such as the management of chemical substances contained in our products and soil pollution surveys.



## Q What is your position on dividend payments?

Due to the substantial reduction in shareholders' equity due to a profound decline in financial performance, Furukawa Electric was unable to pay dividends for two consecutive years in fiscal 2004 and 2005, arousing significant shareholder concern.

In fiscal 2006, we decided to pay a dividend of ¥3 per share after balancing considerations on our return to the black in terms of non-consolidated operating income and the continued need for strengthening our financial position.

We intend to uphold our basic principle of stable dividend payments while maintaining a firm outlook on profit trends from a long-term perspective and paying due consideration to future business development.

**Hiroshi Ishihara**  
President & Chief Executive Officer &  
Chief Operating Officer

A handwritten signature in black ink, reading "H. Ishihara". The signature is fluid and cursive, written in a professional style.