

**HISAMITSU PHARMACEUTICAL CO., INC.**  
**FINANCIAL REPORT**  
**Fiscal 2005**

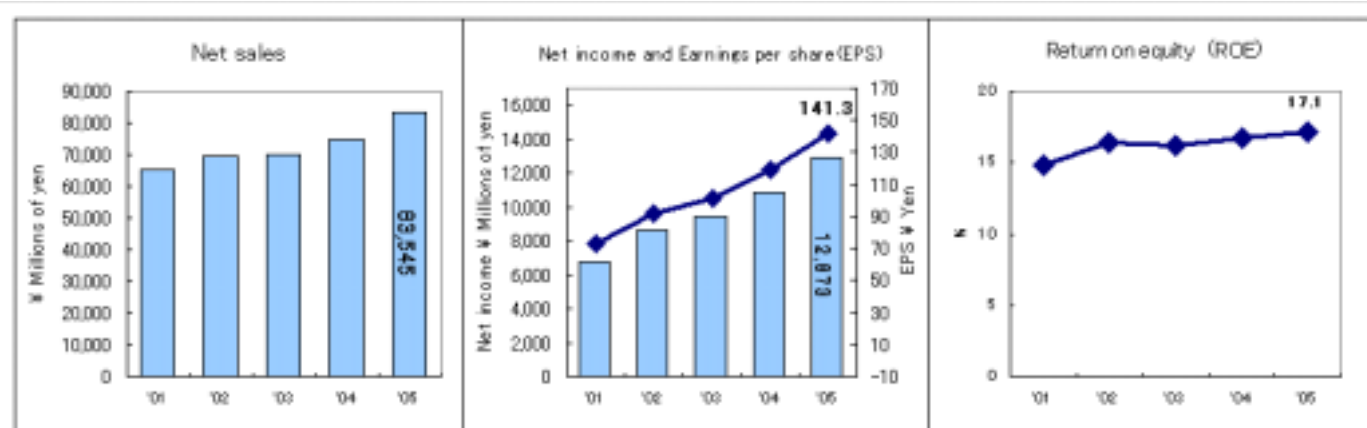
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# Financial Highlights

	2005 Year ended February: 28th	2004 29th	2005 28th
<b>Consolidated Balance Sheets</b>	Millions of yen		Thousands of U.S. dollars
<b>ASSET</b>	<b>111,064</b>	<b>97,219</b>	<b>1,060,378</b>
Current assets	61,085	47,950	583,206
Property, plant and equipment	35,168	36,620	335,765
Intangible assets	318	350	3,036
Investments and other non-current assets	14,493	12,299	138,371
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>111,064</b>	<b>97,219</b>	<b>1,060,378</b>
Current liabilities	22,287	19,872	212,784
Long-term liabilities	7,209	7,225	68,828
Minority interests	699	669	6,674
Shareholders' equity	80,869	69,453	772,093
<b>Consolidated Statements of Income</b>	Millions of yen		Thousands of U.S. dollars
Net sales	83,545	74,588	797,642
Operating income	21,495	17,990	205,222
Income before taxes	21,898	17,873	209,070
Net income	12,873	10,823	122,904
<b>Amounts per share of common stock</b>	Yen		U.S. dollars
Net income	141.30	118.77	1.35
Diluted income	141.30	118.77	1.35
Cash dividends applicable to the year	18.00	14.00	0.17
<b>Consolidated Statements of Cash Flows</b>	Millions of yen		Thousands of U.S. dollars
Net cash provided by operating activities	20,130	7,697	192,190
Net cash used in investing activities	(4,755)	(2,259)	(45,398)
Net cash used in financing activities	(1,267)	(2,397)	(12,097)
Effect of exchange rate changes on cash and cash equivalents	(48)	(110)	(458)
Net increase in cash and cash equivalents	14,060	2,931	134,237
Cash and cash equivalents at beginning of year	17,417	14,307	166,288
Increase in cash and cash equivalents due to changes in the scope of consolidation	-	179	-
Cash and cash equivalents at end of year	31,477	17,417	300,525
<b>Number of employees</b>	1,541	1,432	

Note: The US dollar amounts represent translations of Japanese yen, for convenience only, at the rate of US\$1 = ¥104.74



# Management Policies

## **(1) Fundamental Management Policies**

Since they were founded, the companies in the HISAMITSU PHARMACEUTICAL CO., INC. (the Company) group have actively conducted corporate activities and adopted the management philosophy of “Improving Quality of Life (QOL) for People in the World” through creation, manufacture and sale of pharmaceutical products, adhering to the basic policy of “Customers First”.

Under this philosophy, the Companies are actively developing corporate activities to satisfy customers, while actively seeking customers in an effort to increase enterprise value.

## **(2) Fundamental Profit-sharing Policy**

The Company recognizes returning profits to shareholders as its most important task, based on maintaining stable dividends, to which it occasionally adds either commemorative or special dividends, taking into consideration factors such as business results. In addition to this, the Company flexibly takes such financial measures as acquiring treasury stock, which is considered as an effective method of returning profits to shareholders.

The Company applies its internal reserves to strengthen its operating foundations by focusing investment on promoting research and development (R&D), expanding production facilities and developing overseas business activities.

## **(3) Approach and Policy of Reducing the Investment Unit**

The Company recognizes that reducing the investment unit is a vital issue for broadening our investor base and increasing liquidity. In the meeting of the Board of Directors held on February 15, 2004, a resolution was passed to lower the investment unit from 1,000 shares to 100 shares from June 1, 2005.

## **(4) Mid- to Long-term Management Strategies and Targeted Management Benchmarks**

In order to build up a strong corporate constitution enabling it to attain target sales as well as to ensure profits even in the rapidly changing market environment, the Company has established a mid-term management plan with February 2006 a target, with net income of ¥10 billion (\$95,475 thousand) and maintaining a return on equity (ROE) of not less than 15% as management benchmarks, aiming to ensure they are achieved.

Furthermore, in accordance with fundamental management policies, the Company is focusing its efforts on the creation of new pharmaceutical products and new preparations based on TDDS (Transdermal Drug Delivery System) research, with the aim of becoming an “R&D-based pharmaceutical company”.

Furthermore, through active operating activities, the Company aims to increase cash flow and promote R&D on new transdermal pharmaceuticals for topical use and systemic use, together with the global promotion of the Company’s brand including trademarks, designs, manufacturing technology and quality assurance systems in order to build up future assets.

## **(5) Basic Approach Regarding Corporate Governance and the State of Implementation of Related Measures**

### *(1) Basic Approach Regarding Corporate Governance*

In order to improve management transparency and ensure compliance in management, steps are being taken to strengthen corporate governance while implementing organizational reform for the creation of an organization capable of rapid responses to changes in the management environment as a key issue.

Furthermore, when conducting corporate activities, the Company aims for observance of laws and heightening of corporate ethics, while improving the relationship of trust with stakeholders as a good corporate citizen.

### *(2) State of Implementation of Corporate Governance Measures*

The Company continues to adopt a corporate auditor system, and is strengthening corporate governance together with the reduction of the number of directors and the implementation of a corporate officer system.

In May 2003, the number of directors was reduced from the previous figure of 13 to 9. Important management decisions are carried out in a management advisory council made up of major directors, while important resolutions are discussed and decided upon by the Board of Directors.

Management oversight and the separation of decision-making and execution have been implemented, and a corporate officer system was introduced in March 2003 with the aim of strengthening both of these functions to provide greater speed, transparency and strategic basis in management decisions.

The corporate auditor system was changed in May 2004 to make 2 of the 4 corporate auditors outside corporate auditors in order to ensure audits can be implemented with greater fairness.

In addition, the “Hisamitsu Corporate Charter” was established in June 2002 in an effort to ensure behavior based on high ethical standards and values. At the same time, a compliance promotion office has been established in order to promote thorough compliance throughout the entire company, and efforts are being made to improve and strengthen compliance regarding social responsibilities in the Hisamitsu Group such as corporate ethics, the environment and the protection of personal information.

Furthermore, the QBA Center (Quality of Brand Assurance Center) was established in October 2004, creating a consistent system for assuring reliability encompassing manufacturing, sales and post-marketing surveillance studies.

The Company has concluded an audit agreement with KPMG AZSA & Co. as the independent auditors responsible for financial auditing. Furthermore, we receive necessary advice from legal counsel regarding general legal issues that arise on a day-to-day basis.

In order to increase transparency in management, the Company works to actively disclose information, while also endeavoring to smoothly communicate with shareholders and investors through active investor relations.

*(3) Details of remuneration for directors*

The remuneration for the Company's directors and independent auditors is as follows:

Directors	¥237 million (\$2,263 thousand)
Auditors	¥34 million (\$325 thousand) (including ¥6 million for outside directors)

(Note 1) Director remuneration includes employee salaries for directors who also serve as employees.

(Note 2) There are no outside directors.

*(4) Details of remuneration for independent auditors*

Remuneration to KPMG AZSA & Co., the Company's independent auditors:

Remuneration for audit	
based on the audit agreement	¥25 million (\$239 thousand)
Remuneration other than that shown above	¥10 million (\$95 thousand)

# Management Performance and Financial Position

## 1. Management Performance

### (1) Overview of Fiscal 2005 ended February 28, 2005

#### 1-1) Overall Business Performance

During fiscal 2005, the Japanese economy continued to show signs of recovery such as a gradual improvement in the employment situation and an improvement in corporate earnings, but the situation remains serious due to factors such as a decline in consumer spending stemming from structural deflation.

Various reforms to the medical system have been underway in the ethical pharmaceutical industry, such as cuts in the official pharmaceutical reimbursement prices (industry average of 4.2%) in April 2004.

The industry of over-the-counter (OTC) products also experienced a very harsh business environment due to the effects of the sluggish domestic economy.

Under these circumstances, with respect to ethical pharmaceuticals, the Company has developed pharmaceutical information activities primarily focusing on the mainstay products, which are topical analgesic and anti-inflammatory pharmaceuticals, to properly meet the needs of medical institutions. With respect to over-the-counter (OTC) products, although the market continues to face sluggish consumer spending, we worked to promote sales centered on topical analgesic and anti-inflammatory pharmaceuticals. We are focusing our research and development on TDDS research, and are developing new transdermal pharmaceuticals for topical use and systemic use. Regarding production, we are proceeding with upgrades and modifications to production facilities in order to increase efficiency and quality, while also endeavoring to maintain and improve ISO 14001 certification for protecting the global environment.

The Companies have also worked to improve customer service and increase performance in our cable television broadcasting and other businesses.

As a result of these operating activities, the Companies posted consolidated net sales of ¥83,545 million (\$797,642 thousand), a 12.0% increase over the previous year, and consolidated net income of ¥12,873 million (\$122,904 thousand), an 18.9% increase over the previous year. All these figures were record highs for the Companies.

#### 1-2) Business Performance by Segment

##### *(Pharmaceuticals and related products businesses)*

During the year under review, pharmaceuticals and related products businesses, especially the ethical pharmaceutical business, faced extremely uncertain circumstances due to cuts in the official pharmaceutical reimbursement prices and reforms in the medical system.

Under these circumstances, the Company is conducting accurate and detailed pharmaceutical information activities to medical institutions centering on topical analgesic and anti-inflammatory pharmaceuticals. This involves providing and gathering information on efficacy and safety, in addition to working on expanding the share of mainstay products consisting of MOHRUS TAPE ketoprofen transdermal patches, MOHRUS TAPE double-sized patches and MOHRUS transdermal gel patches.

Moreover, VOLLEY SPRAY (antifungal) that is directly sprayed on the affected area was released in July 2004, while the MOHRUS PATCH product was released in Hong Kong in November 2005 and KEPLAT (ketoprofen transdermal patches) was released in Italy in February 2005.

With respect to over-the-counter (OTC) products, as intense sales competition continues in the domestic market, advertising was revamped for mainstay products consisting of SALONPAS, AIR SALONPAS, and Feitas, with efforts being made to increase sales by expanding and developing the consumer base through an improved brand image.

In order to respond to the diverse needs of customers, LIFECELLA BIYOEKI MASK EYECARE, LIFECELLA BIYOEKI MASK E, and LIFECELLA BIYOEKI MASK WRINKLE CARE were released in the LIFECELLA series. Furthermore, a 21-piece item was added to the Feitas topical analgesic and anti-inflammatory pharmaceutical line, in an effort to develop a new consumer base.

As a result of these operating activities, consolidated net sales in the pharmaceuticals and related products businesses were ¥80,674 million (\$770,231 thousand), a 12.0% increase from the previous year.

*(Cable television broadcasting and other businesses)*

In the cable television broadcasting business, active investments are being made in an effort to expand users of cable television and cable Internet services in order to respond to the coming of digital terrestrial broadcasting and expand regions covered.

Furthermore, efforts are also being made to improve performance in other businesses, including production and sale of laboratory animals, by expanding sales channels and improving customer service, while also streamlining management.

As a result of these operating activities, consolidated net sales for cable television broadcasting and other businesses were ¥2,870 million (\$27,401 thousand), an 11.9% increase from the previous year.

### **1-3) R&D activities**

*(Pharmaceuticals and related products businesses)*

The Company has concentrated R&D on TDDS (Transdermal Drug Delivery System) for some time, and has achieved results inside and outside Japan. We are conducting joint R&D on fundamental technologies with outside organizations and working to expand the potential of transdermal treatments and commercialization technology.

Organizational reforms have been implemented, and together with a further improved patent strategy and faster development, functions for the effective management of R&D resources and achieving effective investment, have been strengthened by conducting development project feasibility assessments in the initial stages of development.

In the domestic field of ethical pharmaceuticals, the Ethical Drugs Division of SSP Co., Ltd. was acquired in April 2005 to acquire products under development such as NS-126 allergic rhinitis nasal drops (PIII tests are underway for this product jointly developed with Nippon Shinyaku) and 318-PW analgesic and anti-inflammatory patches (diclofenac gel patch, awaiting approval) and to strengthen the Company's contacts. Approval was also obtained for MOHRUS 60 (double the size of MOHRUS) in March 2005. A decision was also reached on the partner for joint development of HFT-290 (fentanyl TDDS) after PII testing was completed.

Overseas, approval was received for HKT-500 (MOHRUS TAPE) in Hong Kong in May 2004 and then in Italy in November. In addition, preparations are being made to apply for approval of a fentanyl TDDS generic product in the United States, and preparations for PIII tests of FS-67 (SALONPAS for overseas markets) and HKT-500 are also underway.

Consolidated subsidiary GenoFunction, Inc. that conducts genetic operations is commissioned to perform discovery and functional analysis of disease-related genes using siRNA technology.

*(Cable television broadcasting business and other businesses)*

No R&D activities are being conducted in the cable television business.

Some R&D is conducted in other businesses, but the amounts are small and do not merit special mention.

As a result of the above, R&D expenses for the consolidated fiscal year under review totaled ¥7,224 million (\$68,971 thousand).

#### **1-4) Issues to be addressed**

*(Pharmaceuticals and related products businesses)*

In the ethical pharmaceuticals business, promotion of policies aimed at lowering pharmaceuticals prices is expected to continue in the future as society rapidly ages. In such a harsh business environment, the Company aims to step up pharmaceutical information activities to medical institutions, in addition to creating new transdermal pharmaceuticals for topical use and systemic use that suit the needs of medical institutions and patients.

On May 21, 2004, the Company concluded an agreement to receive the spun-off Ethical Drugs Division of SSP Co., Ltd. On April 1, 2005, SSP Co., Ltd. spun off its Ethical Drugs Division, which was then absorbed by the Company. Based on this agreement, the Company completed the acquisition of all issued shares of Biomedics Co., Ltd., which took on the Ethical Drugs Division spun off from SSP. Biomedics Co., Ltd. changed its trade name, etc. and was launched anew as Hisamitsu Medical Co., Ltd. on April 1, 2005. With the acquisition of this Ethical Drugs Division, the Company aims to strengthen its sales force and R&D capabilities, while also further improving profitability and endeavoring to achieve further growth.

With respect to over-the-counter (OTC) products, amid a prolonged slump in the market and intensifying competition among companies, the Company is working to promote growth in sales of mainstay products of topical analgesic and anti-inflammatory pharmaceuticals, while ceaselessly making modifications to existing products and proceeding with development of new products to meet the needs of customers.

In our overseas business, we are working to establish the Company's brand including trademarks, designs, manufacturing technology and quality assurance systems, while further improving overseas manufacturing plants and promoting clinical tests overseas.

*(Cable television broadcasting business and other businesses)*

Regarding the cable television broadcasting business and other businesses including the production and sale of laboratory animals, the Companies are working to expand businesses and provide detailed services to customers, while endeavoring to further improve performance by streamlining management and strengthening our corporate constitution.



## **1-5) Business risks, etc.**

With regard to the performance of the Company, the following risks may have a material effect on the judgment of investors. All forward-looking items shown within this document are based on the judgment of the Company as of the end of the consolidated fiscal year under review.

### *(1) Risks regarding legal regulations*

The pharmaceuticals and related products businesses that form the Company's principal businesses are subject to the effects of regulations such as the system of official pharmaceutical reimbursement prices and the medical insurance system. For example, the revisions made to official pharmaceutical reimbursement prices once every two years apply pressure to periodically lower sale prices, and there is a possibility that there will be a detrimental effect on the Company's performance when this cannot be covered by increased sales volume. The businesses are also subject to various regulations overseas.

### *(2) Risks stemming from dependence on certain products*

In the year ended February 2005, sales of MOHRUS TAPE, MOHRUS TAPE L and MOHRUS made up 66.4% of consolidated net sales. Because of this, there is a possibility that there will be a detrimental effect on the Company's performance if rights related to these products cannot be maintained or there are serious unexpected side-effects.

### *(3) Risks related to research and development*

The Company is conducting research and development regarding new products and new technologies. However, there is a possibility that there will be a detrimental effect on the Company's performance due to the termination of R&D activities because of factors such as anticipated effects not being obtained or R&D investment not being recovered even through sales.

### *(4) Risks regarding manufacturing and stocking*

Products are manufactured in the Company's plants using original technology. Some products and materials are dependent on specific vendors for their supply. Because of this, there is a possibility that there will be a detrimental effect on the Company's performance due to a stoppage of manufacturing or stocking for some reason.

### *(5) Risks related to environmental issues*

Some of the chemical substances used in the Company's R&D activities and manufacturing processes can have adverse effects on health and the surrounding environment. The Company is taking sufficient measures against this, but there is a possibility that there will be a detrimental effect on the Company's performance if it is judged that these substances had an adverse effect on the surrounding environment.

### *(6) Risks related to intellectual property*

In the event the Company's business activities violate the intellectual property such as patents of others, there is a possibility of suspension of business or a dispute. Furthermore, in the event there is a violation of intellectual property, there is a possibility of litigation, the result and process of which may have a detrimental effect on the Company's performance.

*(7) Risks related to litigation*

With regard to our business activities, there is a possibility that we will face litigation regarding side-effects of pharmaceuticals and product liability, the result and process of which may have a detrimental effect on the Company's performance.

*(8) Other risks*

In addition to the above, there are potential risks including those regarding the occurrence of natural disasters and system security.

**1-6) Important agreements, etc. in management**

*(Stock purchase and sale agreement)*

On May 21, 2004, the Company concluded an agreement with SSP Co., Ltd. that SSP's Ethical Drugs Division would be spun off and transferred to the wholly-owned subsidiary Biomedics Co., Ltd. on April 1, 2005, and that 100% of the shares of Biomedics Co., Ltd. would be acquired from SSP on that day.

Overview of the agreement

(1) Objective

In the ethical pharmaceuticals business, the Company is continuing to see growth centered on MOHRUS and MOHRUS TAPE topical analgesic and anti-inflammatory pharmaceuticals. SSP's Ethical Drugs Division has topical products that fall into the Company's strong area, and these is expected to undergo further growth using the Company's sales force. The research and development pipeline can also be strengthened.

(2) Name of the other company in the stock acquisition

SSP Co., Ltd.

(3) Name and size of the acquired company

Name: Biomedics Co., Ltd. (The name was changed to Hisamitsu Medical Co., Ltd. on April 1, 2005)

Business details: Manufacture and sale of ethical pharmaceuticals

Scale: Sales of ¥10,613 million

(Based on the performance of the ethical pharmaceuticals division in SSP Co., Ltd. in the year ended March 31, 2005)

Employees: Approximately 240

(4) Timing of stock acquisition: April 1, 2005

(5) Number of shares acquired, acquisition value and equity ratio after acquisition

Number of shares acquired: 300,000

Acquisition value: The total price is ¥14.6 billion, but slight adjustments will be made after confirming the acquired assets and liabilities.

Equity ratio after acquisition: 100%

(6) Financing of payment

Own funds and bank loans

## **(2) Outlook for Fiscal 2006 ending February 28, 2006**

### *(Outlook for consolidated results)*

Regarding the results of operations for the next year ending February 28, 2006, the Companies are expecting that consolidated net sales will increase to approximately ¥98,000 million, a 17.3% increase over the previous year, and that net income will increase to ¥13,900 million, a 7.9% increase over the previous year.

### *(Pharmaceuticals and related products businesses)*

The Company aims to step up pharmaceutical information activities to medical institutions, in addition to creating new transdermal pharmaceuticals for topical use and systemic use that suit the needs of medical institutions and patients. Furthermore, we will strengthen our sales force and R&D capabilities through the ethical pharmaceuticals division acquired from SS Co., Ltd on April 1, 2005.

With respect to over-the-counter (OTC) products, amid a prolonged slump in the market and intensifying competition among companies, the Company is working to promote growth in sales of mainstay products of topical analgesic and anti-inflammatory pharmaceuticals, while ceaselessly making modifications to existing products and proceeding with development of new products to meet the needs of customers.

In our overseas business, we are working to establish the Company's brand including trademarks, designs, manufacturing technology and quality assurance systems, while further improving overseas manufacturing plants and promoting clinical tests overseas.

### *(Cable television broadcasting and other businesses)*

Regarding the cable television broadcasting business and other businesses, including the production and sale of laboratory animals, the Companies are working to expand businesses and provide detailed services to customers, while endeavoring to further improve performance by streamlining management and strengthening our corporate constitution.

However, it must be noted that these projections were made according to the Companies' judgments based on the information available at the time and include latent risks and uncertainties. Actual results, therefore, could significantly differ from the projections.

## **(3) Dividends**

In response to the support shown by shareholders, dividends for fiscal 2005 were ¥16 (\$0.15) per share, an increase of ¥2 (\$0.02) compared to the previous year, and a ¥2 (\$0.02) commemorative dividend marking 40 years since the release of AIR SALONPAS was added to bring the total dividend payout to ¥18 (\$0.17) per share.

In response to the support shown by shareholders, the Company plans to raise the next dividend by ¥4 (\$0.04) to ¥22 per share.

## 2. Analysis of Financial Position and Management Performance

### (1) Analysis of the Financial Position in Fiscal 2005

The consolidated financial statements include the accounts for the Company and 12 subsidiaries of the Company. Investments in two affiliated companies are accounted for using the equity method.

#### *(1) Assets*

At February 28, 2005, total assets amounted to ¥111,064 million (\$1,060,378 thousand), an increase of ¥13,845 million (\$132,184 thousand) over the previous consolidated fiscal year. Property, plant and equipment decreased by ¥1,452 million (\$13,863 thousand) to ¥35,168 million (\$335,765 thousand) as a result of depreciation, but cash and time deposits increased by ¥13,727 million (\$131,058 thousand) to ¥31,106 million (\$296,983 thousand) due to increased cash flows from operating activities. Investment securities and investment in non-consolidated subsidiaries and affiliated companies increased by ¥1,861 million (\$17,768 thousand) to ¥9,504 million (\$90,739 thousand) due to purchases of bonds, etc.

#### *(2) Liabilities*

Income taxes payable increased by ¥1,687 million (\$16,107 thousand) to ¥4,915 million (\$46,926 thousand) due to increased net income before taxes and other adjustments, and accrued expenses increased by ¥1,129 million (\$10,779 thousand) to ¥6,695 million (\$63,920 thousand) due to increases in expenses such as advertising costs.

#### *(3) Minority interests*

Minority interests increased by ¥30 million (\$286 thousand) to ¥699 million (\$6,674 thousand) due to factors such as net income from the subsidiary, Saga City Vision Corporation.

#### *(4) Shareholders' equity*

Shareholders' equity increased by ¥11,416 million (\$108,994 thousand) to ¥80,869 million (\$772,093 thousand). This is a result of retained earnings increasing by ¥11,571 million (\$110,474 thousand) due to the posting of net income totaling ¥12,873 million (\$122,904 thousand) and payment of dividends totaling ¥1,271 million (\$12,135 thousand).

### (2) Analysis of Management Performance in Fiscal 2005

#### *(1) Sales*

Sales increased 12.0% from the previous year to ¥83,545 million (\$797,642 thousand). As a result of focusing our efforts on the growth of mainstay products, MOHRUS TAPE sales were 117% and MOHRUS TAPE L sales were 175% of the previous year's level, which contributed to the increase in sales.

#### *(2) Operating income*

Operating income increased 19.5% from the previous year to ¥21,495 million (\$205,222 thousand). The main factors leading to this are an increase in the proportion of sales of the Company's own products with a low cost ratio, together with a lower cost of sales ratio resulting from the effect of improved productivity and reduced manufacturing costs. Selling, general and administrative expenses increased in a similar amount to the increase in sales.

### *(3) Net income*

Net income increased by 18.9% from the previous year to ¥12,873 million yen (\$122,904 thousand). This reflected the growth of operating income. As a result, net income per share in the consolidated fiscal year under review was ¥141.3 (\$1.35), and the net return on equity was 17.1%. This value was calculated by deducting income taxes, deferred income taxes and minority interests in net income of consolidated subsidiaries.

### **(3) Analysis of Cash Flow in Fiscal 2005**

Operating activities generated net cash of ¥20,130 million (\$192,190 thousand), a ¥12,433 million (\$118,703 thousand) increase over the previous year, principally reflecting increased net income before taxes and other adjustments.

Investing activities used net cash of ¥4,755 million (\$45,398 thousand), a ¥2,496 million (\$23,830 thousand) increase over the previous year, principally reflecting increased payments for the purchase of investment securities and reduced cash from the sale of securities.

Financing activities used net cash of ¥1,267 million (\$12,097 thousand), a ¥1,130 million (\$10,789 thousand) decrease compared to the previous year, principally reflecting reduced payments for the acquisition of treasury stock.

As a result, cash and cash equivalents at end of year totaled ¥31,477 million (\$300,525 thousand), an increase of ¥14,060 million (\$134,237 thousand) over the previous year.

# Consolidated Balance Sheets

HISAMITSU PHARMACEUTICAL CO., INC.

February 29, 2004 and February 28, 2005

	Millions of yen		Thousands of U.S. Dollars (Note 1)
	2005	2004	2005
<b>ASSETS</b>			
<b>Current assets:</b>			
Cash and time deposits (Note 3)	¥31,106	¥17,379	\$296,983
Notes and accounts receivable:			
Trade notes (Note 14)	2,589	4,292	24,718
Trade accounts	17,316	18,177	165,324
Short-term investments (Note 4)	1,174	502	11,209
Inventories (Note 5)	5,837	5,192	55,728
Deferred tax assets (Note 11)	784	658	7,485
Other current assets	2,387	1,907	22,790
Less allowance for doubtful accounts	(108)	(157)	(1,031)
<b>Total current assets</b>	<b>61,085</b>	<b>47,950</b>	<b>583,206</b>
<b>Property, plant and equipment:</b>			
Land (Note 6)	11,309	11,371	107,972
Buildings and structures (Note 9)	27,358	26,886	261,199
Machinery and equipment (Note 9)	20,620	19,733	196,868
Tools, furniture and fixtures	10,291	10,442	98,253
Construction in progress	1,852	1,900	17,682
	71,430	70,332	681,974
Less accumulated depreciation	(36,262)	(33,712)	(346,209)
	35,168	36,620	335,765
<b>Intangible assets</b>	<b>318</b>	<b>350</b>	<b>3,036</b>
<b>Investments and other non-current assets:</b>			
Investment securities (Notes 4 and 9)	8,925	7,163	85,211
Investment in non-consolidated subsidiaries and affiliated companies (Note 4)	579	480	5,528
Long-term loans receivable	1,415	917	13,510
Deferred tax assets (Note 11)	1,804	1,919	17,224
Other investments and other non-current assets	2,088	2,249	19,934
Less allowance for doubtful accounts	(318)	(429)	(3,036)
	14,493	12,299	138,371
	<u>¥111,064</u>	<u>¥97,219</u>	<u>\$1,060,378</u>

See accompanying notes.

	Millions of yen		Thousands of U.S. Dollars (Note 1)
	2005	2004	2005
<b>LIABILITIES, MINORITY INTEREST AND SHAREHOLDERS' EQUITY</b>			
<b>Current liabilities:</b>			
Short-term bank loans (Note 9)	¥1,475	¥1,028	\$14,082
Long-term debt due within one year (Note 9)	154	361	1,470
Notes and accounts payable:			
Trade	7,554	7,909	72,121
Construction	111	122	1,060
Other	6,695	5,566	63,920
Income taxes payable (Note 11)	4,915	3,228	46,926
Allowance for sales returns	247	276	2,358
Accrued employees' bonuses	494	516	4,717
Other current liabilities	642	866	6,130
Total current liabilities	22,287	19,872	212,784
<b>Long-term liabilities:</b>			
Long-term debt due after one year (Note 9)	1,374	1,506	13,118
Deferred tax liabilities relating to land revaluation (Note 6)	1,887	1,894	18,016
Employees' severance and retirement benefits (Note 10)	2,800	2,709	26,733
Directors' and corporate auditors' retirement benefits	1,022	947	9,757
Consolidated difference	71	95	678
Other non-current liabilities	55	74	525
Total long-term liabilities	7,209	7,225	68,827
<b>Contingent liabilities (Note 14)</b>			
Minority interests	699	669	6,674
<b>Shareholders' equity (Note 13):</b>			
<b>Common stock:</b>			
Authorized - 380,000,000 shares			
Issued - 95,164,895 shares in 2005	8,474	—	80,905
- 95,164,895 shares in 2004	—	8,474	—
Capital surplus	8,242	8,242	78,690
Retained earnings	68,704	57,133	655,948
Land revaluation difference (Note 6)	2,781	2,790	26,551
Net unrealized holding gains on securities	1,067	1,084	10,187
Foreign currency translation adjustments	(1,116)	(1,037)	(10,654)
<b>Treasury stock (at cost)</b>			
4,504,702 shares in 2005	(7,283)	—	(69,534)
4,389,426 shares in 2004	—	(7,233)	—
Total shareholders' equity	80,869	69,453	772,093
	<u>¥111,064</u>	<u>¥97,219</u>	<u>\$1,060,378</u>

# Consolidated Statements of Income

HISAMITSU PHARMACEUTICAL CO., INC.

Years ended February 28, 2005, February 29, 2004 and February 28, 2003

	Millions of yen			Thousands of U.S. Dollars (Note 1)
	2005	2004	2003	2005
Net sales	¥83,545	¥74,588	¥70,000	\$797,642
Costs and expenses:				
Cost of sales	24,725	23,210	21,175	236,061
Selling, general and administrative expenses	30,101	25,943	25,219	287,388
Research and development	7,224	7,445	6,551	68,971
	<u>62,050</u>	<u>56,598</u>	<u>52,945</u>	<u>592,420</u>
Operating income	21,495	17,990	17,055	205,222
Other income (expense):				
Interest and dividend income	120	143	184	1,146
Interest expense	(34)	(29)	(183)	(325)
Equity in earnings of affiliated companies	98	60	72	936
Gain on sales of property, plant and equipment	2	10	—	19
Amortization of consolidated adjustment account	24	24	—	229
Foreign exchange loss	(13)	(63)	(166)	(124)
Reversal of allowance for doubtful accounts	100	95	—	955
Governmental subsidy	56	221	445	535
Advanced depreciation deduction of property, plant and equipment	—	(220)	(444)	—
Loss on sales and disposal of property, plant and equipment	(70)	(75)	(44)	(668)
Valuation loss on investment securities	(61)	(523)	(560)	(582)
Write-down of golf-club memberships	—	(20)	—	—
Provision for allowance for doubtful accounts	—	(3)	(42)	—
Other - net	181	263	277	1,727
	<u>403</u>	<u>(117)</u>	<u>(461)</u>	<u>3,848</u>
Income before income taxes	21,898	17,873	16,594	209,070
Income taxes (Note 11):				
Current	8,816	7,167	7,740	84,170
Deferred	40	(261)	(664)	382
Minority interests in net income of consolidated subsidiaries	169	144	121	1,614
Net income	<u>¥12,873</u>	<u>¥10,823</u>	<u>¥9,397</u>	<u>\$122,904</u>
				U.S. dollars (Note 1)
	Yen			
Amounts per share of common stock (Note 2):	2005	2004	2003	2005
Net income	¥141.30	¥118.77	¥101.28	\$1.35
Diluted net income	141.30	118.77	101.28	1.35
Cash dividends applicable to the year	18.00	14.00	12.00	0.17

See accompanying notes.



# Consolidated Statements of Shareholders' Equity

HISAMITSU PHARMACEUTICAL CO., INC.

Years ended February 28, 2005, February 29, 2004 and February 28, 2003

	Millions of yen			Thousands of U.S. Dollars (Note 1)
	2005	2004	2003	2005
<b>Common stock:</b>				
Balance at beginning of year	¥8,474	¥8,474	¥8,474	\$80,905
Balance at end of year	¥8,474	¥8,474	¥8,474	\$80,905
<b>Capital surplus:</b>				
Balance at beginning of year	¥8,242	¥8,242	¥8,242	\$78,690
Balance at end of year	¥8,242	¥8,242	¥8,242	\$78,690
<b>Retained earnings:</b>				
Balance at beginning of year	¥57,133	¥47,470	¥38,976	\$545,475
Net income	12,873	10,823	9,397	122,904
Cash dividends paid	(1,271)	(1,104)	(847)	(12,135)
Bonuses to directors and corporate auditors	(40)	(56)	(56)	(382)
Land revaluation adjustment (Note 6)	9	—	—	86
Balance at end of year	¥68,704	¥57,133	¥47,470	\$655,948
<b>Land revaluation difference:</b>				
Balance at beginning of year	¥2,790	¥2,729	¥2,729	\$26,637
Land revaluation, net of tax (Note 6)	(9)	61	—	(86)
Balance at end of year	¥2,781	¥2,790	¥2,729	\$26,551
<b>Net unrealized holding gains (losses) on securities:</b>				
Balance at beginning of year	¥1,084	¥(390)	¥(43)	\$10,349
Valuation gains (losses)	(17)	1,474	(347)	(162)
Balance at end of year	¥1,067	¥1,084	¥(390)	\$10,187
<b>Foreign currency translation adjustments:</b>				
Balance at beginning of year	¥(1,037)	¥(756)	¥(361)	\$(9,900)
Adjustments from translation of foreign currency financial statements	(79)	(281)	(395)	(754)
Balance at end of year	¥(1,116)	¥(1,037)	¥(756)	\$(10,654)
<b>Treasury stock:</b>				
Balance at beginning of year	¥(7,233)	¥(5,538)	¥(1,683)	\$(69,057)
Treasury stock purchased	(50)	(1,695)	(3,855)	(477)
Balance at end of year	¥(7,283)	¥(7,233)	¥(5,538)	\$(69,534)
	2005	2004	2003	
<b>Number of shares of common stock:</b>				
Balance at beginning of year	95,164,895	95,164,895	95,164,895	
Balance at end of year	95,164,895	95,164,895	95,164,895	

See accompanying notes.

# Consolidated Statements of Cash Flows

HISAMITSU PHARMACEUTICAL CO., INC.

Years ended February 28, 2005, February 29, 2004 and February 28, 2003

	Millions of yen			Thousands of U.S. Dollars (Note 1)
	2005	2004	2003	2005
<b>Cash flows from operating activities:</b>				
Income before income taxes	¥21,898	¥17,873	¥16,594	\$209,070
Adjustments to reconcile net income before taxes to net cash provided by operating activities:				
Depreciation and amortization	3,338	3,564	3,128	31,869
Increase (decrease) in allowance for severance and retirement benefits	93	123	(128)	888
Interest and dividend income	(120)	(143)	(184)	(1,146)
Interest expense	34	29	183	325
Equity in earnings of affiliated companies	(98)	(60)	(72)	(936)
Valuation loss on investment securities	61	523	560	582
Advanced depreciation deduction of property, plant and equipment	-	220	444	-
(Increase) decrease in notes and accounts receivable	2,549	(4,852)	(93)	24,336
(Increase) decrease in inventories	(666)	52	(676)	(6,359)
Increase in other current assets	(480)	(175)	(248)	(4,582)
Increase (decrease) in notes and accounts payable	(388)	287	(511)	(3,704)
Bonuses to directors and corporate auditors	(40)	(56)	(56)	(382)
Other	994	(166)	(915)	9,491
Subtotal	27,175	17,219	18,026	259,452
Interest and dividend income received	118	144	186	1,127
Interest paid	(34)	(29)	(184)	(325)
Income taxes paid	(7,129)	(9,637)	(3,288)	(68,064)
Net cash provided by operating activities	20,130	7,697	14,740	192,190
<b>Cash flows from investing activities:</b>				
Payments for purchases of property, plant and equipment	(2,178)	(3,274)	(7,263)	(20,794)
Proceeds from sales of property, plant and equipment	320	26	47	3,055
Payments for purchases of intangible assets	(120)	(24)	(47)	(1,146)
Payments for purchases of marketable securities	(1,301)	(2,983)	(6,168)	(12,421)
Proceeds from sales of marketable securities	502	2,983	6,168	4,793
Payments for purchases of investment securities	(1,964)	(251)	(2,061)	(18,751)
Proceeds from sales of investment securities	450	2,000	102	4,296
Other	(464)	(736)	28	(4,430)
Net cash used in investing activities	(4,755)	(2,259)	(9,194)	(45,398)
<b>Cash flows from financing activities:</b>				
Net increase (decrease) in bank loans	453	686	5	4,325
Proceeds from long-term debt	245	676	868	2,339
Repayment of long-term debt	(583)	(754)	(1,450)	(5,566)
Payment for purchase of treasury stock	(76)	(1,763)	(3,214)	(726)
Cash dividends paid	(1,271)	(1,105)	(847)	(12,135)
Other	(35)	(137)	94	(334)
Net cash used in financing activities	(1,267)	(2,397)	(4,544)	(12,097)
<b>Effect of exchange rate changes on cash and cash equivalents</b>	(48)	(110)	(255)	(458)
Net increase in cash and cash equivalents	14,060	2,931	747	134,237
Cash and cash equivalents at beginning of year	17,417	14,307	13,560	166,288
Increase in cash and cash equivalents due to changes in the scope of consolidation	-	179	-	-
Cash and cash equivalents at end of year (Note 3)	¥31,477	¥17,417	¥14,307	\$300,525

See accompanying notes.

# Notes to Consolidated Financial Statements

HISAMITSU PHARMACEUTICAL CO., INC.

Years ended February 28, 2005, February 29, 2004 and February 28, 2003

## 1. Basis of Consolidated Financial Statements

HISAMITSU PHARMACEUTICAL CO., INC. (the “Company”) and its consolidated domestic subsidiaries maintain their accounts and records in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan (“Japanese GAAP”), which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

The accounts of overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles prevailing in the respective countries of domicile. The accompanying consolidated financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of consolidated statements of shareholders' equity) from the consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law. Some supplementary information included in the statutory Japanese language consolidated financial statements, but not required for fair presentation, is not presented in the accompanying consolidated financial statements.

In the year ended February 28, 2005, the Company did not adopt early the new accounting standard for impairment of fixed assets (“Opinion Concerning Establishment of Accounting Standard for Impairment of Fixed Assets” issued by the Business Accounting Deliberation Council on August 9, 2002) and the implementation guidance for the accounting standard for impairment of fixed assets (the Financial Accounting Standard Implementation Guidance No. 6 issued by the Accounting Standards Board of Japan on October 31, 2003). The new accounting standard is required to be adopted effective March 1, 2006.

The translations of the Japanese yen amounts into U.S. dollars are included solely for the convenience of readers outside Japan, using the prevailing exchange rate at February 28, 2005, which was ¥104.74 to U.S. \$1. The convenience translations should not be construed as representations that the Japanese yen amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any other rate of exchange.

## 2. Summary of Significant Accounting Policies

### Consolidation

The consolidated financial statements for the years ended February 28, 2005, February 29, 2004 and February 28, 2003 include the accounts of the Company and its 12 (12 in 2004 and 11 in 2003) significant subsidiaries (the “Companies”). All significant intercompany balances, transactions and profits have been eliminated.

The Company is required to consolidate all significant investees which are controlled through ownership of a majority of voting rights or the existence of certain other conditions.

The foreign subsidiaries are consolidated based on their financial statements for their fiscal year ended December 31, because the difference between the closing date of the subsidiaries and that of the Company does not exceed three months. Significant transactions occurring between December 31 and February 28 are adjusted on consolidation.

In the elimination of investments in subsidiaries, the assets and liabilities of the subsidiaries, including the portion attributable to minority shareholders, are evaluated using the fair value at the time the Company acquired control of the respective subsidiaries.

### **Equity Method**

Investments in two affiliated companies are accounted for using the equity method. However, unconsolidated subsidiaries are not accounted for using the equity method, since the Company's equity in earnings in the aggregate are not material in relation to the consolidated net income and retained earnings.

### **Consolidation Difference**

The consolidation difference between the cost of an investment and equity in its net assets at the date of acquisition is amortized equally over 5 years. However, small amounts are charged or credited to income in the year of acquisition.

### **Cash and Cash Equivalents**

In preparing the consolidated statements of cash flows, cash on hand, readily-available bank deposits and short-term highly liquid investments with maturities not exceeding three months at the time of purchase are considered to be cash and cash equivalents.

### **Short-term Investments and Investment Securities**

The Companies classify securities as follows:

- (a) securities held for trading purposes (hereinafter, "trading securities");
- (b) debt securities intended to be held to maturity (hereinafter, "held-to-maturity debt securities");
- (c) equity securities issued by subsidiaries and affiliated companies; and
- (d) all other securities that are not classified in any of the above categories (hereinafter, "other securities").

Trading securities are stated at fair market value. Gains and losses realized on disposal and unrealized gains and losses from market value fluctuations are recognized as gains and losses in the period of the change.

Held-to-maturity debt securities are stated at amortized cost. Equity securities issued by subsidiaries and affiliated companies which are not consolidated or accounted for using the equity method are stated at moving average cost.

Other securities with available fair market values are stated at fair market value at the year-end. Unrealized gains and unrealized losses on these securities are reported, net of applicable income taxes, as a separate component of shareholders' equity. Realized gains and losses on sale of such securities are computed using moving average cost.

Debt securities with no available fair value are stated at amortized cost, net of the amount considered not collectible. Other securities with no fair market value are stated principally at moving average cost.

If the market value of held-to-maturity debt securities, equity securities issued by unconsolidated subsidiaries and affiliated companies, and other securities declines significantly, such securities are stated at fair market value and the difference between fair market value and the carrying amount is recognized as loss in the period of the decline. If the fair market value of equity securities issued by unconsolidated subsidiaries and affiliated companies not on the equity method is not readily available, such securities should be written down to net asset value with a corresponding charge in the income statement in the event net asset value declines significantly. In these cases, such fair market value or the net asset value will be the carrying amount of the securities at the beginning of the next year.

#### **Allowance for Doubtful Accounts**

The allowance for doubtful accounts is provided in amounts sufficient to cover possible losses on collection. It is determined by adding individually estimated uncollectible amounts to an amount calculated based on the percentage of the Companies' past bad debt losses against the balance of total receivables.

The allowance for doubtful accounts for the overseas consolidated subsidiaries is provided in amounts calculated from individually estimated uncollectible accounts.

#### **Allowance for Sales Returns**

The allowance for sales returns is provided in the limited amount calculated by formula as permitted by the Corporation Tax Law of Japan to cover possible losses on sales returns after the balance sheet date.

#### **Inventories**

Inventories are stated at cost (first-in, first-out method).

#### **Property, Plant and Equipment**

Property, plant and equipment are stated at cost less accumulated depreciation except that certain land was revalued at fair value as of February 28, 2001. Depreciation is provided over estimated useful lives as permitted by the Corporation Tax Law of Japan.

Depreciation of property, plant and equipment is determined by the declining balance method except that the straight line method is primarily adopted by the overseas consolidated subsidiaries.

#### **Intangible Assets**

Intangible assets are stated at cost less accumulated amortization and amortized by the straight line method. Amortization is provided over estimated useful lives as permitted by the Corporation Tax Law of Japan. Amortization of internally used software is determined using the straight line method over the estimated useful life of five years.

### **Income Taxes**

The Companies recognize tax effects of temporary differences in the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The provision for income taxes is computed based on the pre-tax income included in the statements of income.

The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

### **Accrued Employees' Bonuses**

The Companies accrue employees' bonuses for the portion of estimated future payments applicable to the current year.

### **Severance and Retirement Benefits (Lump-sum benefit plan)**

Under the terms of the Company's and domestic subsidiaries' retirement plans, substantially all employees are entitled to a lump-sum payment at the time of retirement. The amount of the retirement benefit is, in general, based on the length of service, base salary at the time of retirement and reason for retirement.

#### **(1996 pension plan)**

Commencing from July 1996, 30% of the above benefits are covered by a contributory funded pension plan. The benefits are payable either as a monthly pension or, under certain circumstances at the option of retiring employees, in a lump-sum amount.

#### **(1966 pension plan)**

The Company also has had a contributory funded pension plan since 1966 which covers retirement benefits for employees who retire at the mandatory retirement age or those with over 20 years of service who terminate their employment under certain circumstances. These employees are, in general, entitled to a lump-sum payment or an annuity.

### **Employees' Severance and Retirement Benefits**

In order to provide for retirement benefits of employees in the Company and domestic consolidated subsidiaries, the liability recorded at the end of the consolidated fiscal year is based on the projected benefit obligation and pension assets at the end of the consolidated fiscal year.

Actuarial differences are recognized over a certain period (5 years) within the average remaining service lives of employees from the following consolidated fiscal year. Prior service costs are recognized over a certain period (2 years) within the average remaining service periods of employees from the year they arise.

On April 26, 2004, the Company received approval from the Minister of Health, Labor and Welfare to be exempt from future payment obligations for the substitutional portion of the employees' pension fund. The amount estimated to be exempt (minimum actuarial liability) at February 28, 2005 is ¥1,178 million (\$11,247 thousand). Assuming the payment was made at that date, the expected gain in accordance with the "Practical Guideline for Accounting of Retirement Benefits (JICPA Accounting Committee Report No. 13) would have been ¥1,002 million (\$9,567 thousand).

### **Directors' and Corporate Auditors' Retirement Benefits**

Retirement benefits for directors and corporate auditors under the Company's unfunded plan are provided in the amount that would be required if they retired at the balance sheet date.

### **Finance Leases**

Finance leases which do not transfer ownership are accounted for in the same manner as operating leases in accordance with Japanese GAAP.

### **Foreign Currency Translation**

Short-term and long-term receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rates at the balance sheet date. Foreign exchange gains and losses are reflected in the statements of income.

Financial statements of consolidated overseas subsidiaries are translated into Japanese yen at the year-end rate, except that shareholders' equity accounts are translated at historical rates and income statement items resulting from transactions with the Company are translated at the rates used by the Company.

### **Net Income per Share of Common Stock**

Computations of net income per share of common stock, assuming no dilution, are based on the weighted average number of shares outstanding during each fiscal year.

For the purpose of computing net income per share assuming dilution, the average number of shares has been changed by the number of shares which would have been outstanding assuming the retirement of treasury stock and exercise of any dilutive warrants at the beginning of the year.

### **Treasury Stock and Reversal of Statutory Reserves**

Effective March 1, 2002, the Company adopted the new accounting standard for treasury stock and reversal of statutory reserves (Accounting Standards Board Statement No. 1, "Accounting Standard for Treasury Stock and Reversal of Statutory Reserves", issued by the Accounting Standards Board of Japan on February 21, 2002). The effect of adopting the new accounting standard on the consolidated statement of income was not material.

### **Reclassifications**

Certain reclassifications have been made in the 2004 and 2003 financial statements to conform to the presentation for 2005.

### 3. Cash and Cash Equivalents

Cash and cash equivalents at February 28, 2005, February 29, 2004 and February 28, 2003 for the consolidated statement of cash flows consisted of the following:

	Millions of yen		Thousands of U.S. dollars	
	2005	2004	2003	2005
Cash and time deposits.....	¥31,106	¥17,379	¥14,341	\$296,983
Add: Marketable securities .....	1,174	502	2,048	11,209
Less: Time deposits with maturities exceeding three months	(3)	(14)	(81)	(29)
Securities excluding free financial fund and money management fund	(800)	(450)	(2,001)	(7,638)
Cash and cash equivalents .....	<u>¥31,477</u>	<u>¥17,417</u>	<u>¥14,307</u>	<u>\$300,525</u>

### 4. Short-term Investments and Investment Securities

A. The following tables summarize acquisition costs, book values and fair values of securities with available fair values as of February 28, 2005 and February 29, 2004.

#### (a) Held-to-maturity debt securities

Securities with available fair values exceeding book values:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Government bonds and other debt securities:			
Book value .....	¥ 499	¥ 449	\$ 4,764
Fair value .....	500	449	4,774
Difference .....	<u>¥ 1</u>	<u>¥ 0</u>	<u>\$ 10</u>

Securities with available fair values not exceeding book values:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Corporate bonds and other debt securities:			
Book value.....	¥ 1,797	¥ —	\$ 17,157
Fair value.....	1,793	—	17,119
Difference .....	<u>¥ (4)</u>	<u>¥ —</u>	<u>\$ (38)</u>

#### (b) Other securities

Securities with book values (fair values) exceeding acquisition costs:

	Millions of yen		
	2005		
	Acquisition cost	Book value	Difference
Equity securities.....	<u>¥4,448</u>	<u>¥6,172</u>	<u>¥1,724</u>



	Millions of yen		
	2004		
	Acquisition cost	Book value	Difference
Equity securities.....	<u>¥3,728</u>	<u>¥ 5,727</u>	<u>¥1,999</u>

	Thousands of U.S. dollars		
	2005		
	Acquisition cost	Book value	Difference
Equity securities.....	<u>\$42,467</u>	<u>\$58,927</u>	<u>\$16,460</u>

Securities with book values (fair values) not exceeding acquisition costs:

	Millions of yen		
	2005		
	Acquisition cost	Book value	Difference
Equity securities.....	<u>¥765</u>	<u>¥750</u>	<u>¥(15)</u>

	Millions of yen		
	2004		
	Acquisition cost	Book value	Difference
Equity securities.....	<u>¥1,196</u>	<u>¥1,001</u>	<u>¥(195)</u>

	Thousands of U.S. dollars		
	2005		
	Acquisition cost	Book value	Difference
Equity securities.....	<u>\$7,304</u>	<u>\$7,161</u>	<u>\$(143)</u>

B. The following tables summarize book values of securities with no available fair values as of February 28, 2005.

(a) Other securities:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Unlisted stocks (excluding securities traded over-the-counter)	¥506	¥435	\$4,831
Free financial fund .....	332	8	3,170
Total .....	<u>¥838</u>	<u>¥443</u>	<u>\$8,001</u>

(b) Equity securities of subsidiaries and affiliated companies:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Subsidiaries .....	¥54	¥80	\$516
Affiliated companies .....	525	400	5,012
Total .....	<u>¥579</u>	<u>¥480</u>	<u>\$5,528</u>

C. Held-to-maturity debt securities at February 28, 2005 and 2004 mature as follows:

	Millions of yen		
	2005		
	Over 1 year but		
	Within 1 year	within 5 years	Total
Corporate bonds .....	¥ —	¥1,497	¥1,497
Other debt securities .....	800	—	800
	<u>¥ 800</u>	<u>¥1,497</u>	<u>¥2,297</u>

	Millions of yen		
	2004		
	Over 1 year but		
	Within 1 year	within 5 years	Total
Government bonds: .....	¥ 449	¥ —	¥ 449

	Thousands of U.S. dollars		
	2005		
	Over 1 year but		
	Within 1 year	within 5 years	Total
Corporate bonds .....	\$ —	\$ 14,293	\$ 14,293
Other debt securities .....	7,638	—	7,638
	<u>\$7,638</u>	<u>\$ 14,293</u>	<u>\$ 21,931</u>

## 5 . Inventories

Inventories at February 28, 2005 and February 29, 2004 consisted of the following:

	Millions of yen		Thousands of
	2005	2004	U.S. dollars
			2005
Goods and products .....	¥4,074	¥3,553	\$38,896
Raw materials .....	725	742	6,922
Work in process.....	354	279	3,380
Supplies .....	684	618	6,530
	<u>¥5,837</u>	<u>¥5,192</u>	<u>\$55,728</u>

## 6. Land Revaluation

At February 28, 2001, pursuant to the Law of Revaluation of Land and the revision thereof, certain land for business operations was revalued at fair market value. The related gain was reported in a separate component of shareholders' equity as "Land revaluation difference", net of tax.

The total market value of the revalued land at February 28, 2005 was lower than the total book value after revaluation, in the amount of ¥2,167 million (\$20,689 thousand).

## 7. Derivative Transactions

### Use of derivative transactions:

The Companies utilize forward currency exchange and interest rate swap transactions to control risks related to foreign currencies and interest rates.

Forward currency exchange contracts are used to hedge the risk of fluctuations in foreign currency exchange rates with respect to foreign currency transactions, and interest rate swap transactions are used to reduce the risk of fluctuations in interest rates in relation to notes payable.

The Companies principally use derivative transactions in connection with managing their market risk and not for speculation or dealing purposes. The Companies deal with highly rated domestic banks as counterparty to these transactions to minimize credit risk exposure.

Derivative transactions are, depending on materiality, subject to resolution of the Board of Directors or approval by the General Manager of the Finance and Accounting Department and contracted by the Finance and Accounting Department. The actual results of the derivative transactions are reported to the Board of Directors after the end of each year.

### Market values of derivative transactions:

The Companies had no derivative contracts outstanding at February 28, 2005 and February 29, 2004.

## 8. Lease Information

Finance leases which do not transfer ownership to lessees are accounted for in the same manner as operating leases in accordance with Japanese GAAP.

The original lease obligations of the Companies for machinery, equipment, tools, furniture, fixtures and software amounted to ¥1,686 million (\$16,097 thousand) and ¥1,783 million at February 28, 2005 and February 29, 2004, respectively.

Lease payments for finance leases which do not transfer ownership to lessees amounted to ¥506 million (\$4,831 thousand), ¥377 million and ¥336 million for the years ended February 28, 2005, February 29, 2004 and February 28, 2003, respectively.

Future minimum leases payments, including financing cost, required under such leases at February 28, 2005 and February 29, 2004 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Due within one year .....	¥268	¥320	\$2,559
Due after one year .....	518	488	4,945
	<u>¥786</u>	<u>¥808</u>	<u>\$7,504</u>

## 9. Short-term Bank Loans and Long-term Debt

Short-term bank loans are represented generally by notes maturing within one year. The average annual interest rates at February 28, 2005 and February 29, 2004 were 1.19% and 1.06%.

Long-term debt at February 28, 2005 and February 29, 2004 consisted of the following:

	<u>Millions of yen</u>		<u>Thousands of</u>
	<u>2005</u>	<u>2004</u>	<u>U.S. dollars</u>
Unsecured long-term bank loans.....	¥ 156	¥ 707	\$ 1,489
Secured long-term bank loans .....	1,372	1,160	13,099
	1,528	1,867	14,588
Less amounts due within one year.....	(154)	(361)	(1,470)
	<u>¥ 1,374</u>	<u>¥ 1,506</u>	<u>\$13,118</u>

The annual interest rates of the bank loans ranged from 0.0% to 4.51% and from 0.00% to 4.51% with the weighted average being 1.14% and 1.13% at February 28, 2005 and February 29, 2004, respectively.

At February 28, 2005 and February 29, 2004 assets pledged as collateral for short-term bank loans, including long-term debt due within one year, of ¥150 million (\$1,432 thousand) and ¥251 million, respectively, and secured long-term bank loans were as follows:

	<u>Millions of yen</u>		<u>Thousands of</u>
	<u>2005</u>	<u>2004</u>	<u>U.S. dollars</u>
Buildings and structures .....	¥ 935	¥ 1,016	\$ 8,927
Machinery and equipment .....	277	339	2,645
Investment securities .....	1,733	1,118	16,545
	<u>¥ 2,945</u>	<u>¥ 2,473</u>	<u>\$ 28,117</u>

The annual maturities of long-term debt are as follows:

<u>Years ending February 28/29</u>	<u>Millions of yen</u>	<u>Thousands of</u>
		<u>U.S. dollars</u>
2007 .....	¥ 211	\$ 2,015
2008 .....	180	1,719
2009 .....	240	2,291
2010 .....	108	1,031
Thereafter .....	635	6,062
	<u>¥ 1,374</u>	<u>\$ 13,118</u>

## 10 . Severance and Retirement Benefits

The liabilities for employees' severance and retirement benefits included in the liability section of the consolidated balance sheet as of February 28, 2005 and February 29, 2004 consisted of the following.

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Projected benefit obligation .....	¥(11,302)	¥(10,699)	\$(107,905)
Unrecognized prior service obligations.....	(173)	—	(1,652)
Fair value of pension assets .....	8,754	6,544	83,578
Unrecognized actuarial differences.....	989	1,969	9,442
Accrued pension cost .....	(1,068)	(523)	(10,196)
Employees' severance and retirement benefits.....	<u>¥(2,800)</u>	<u>¥(2,709)</u>	<u>\$(26,733)</u>

Included in the consolidated statements of income for the years ended February 28, 2005, 2004 and 2003, are severance and retirement benefit expenses comprising the following:

	Millions of yen			Thousands of U.S. dollars
	2005	2004	2003	2005
Severance costs— benefits earned during the year	¥ 517	¥ 665	¥590	\$4,936
Interest cost on projected benefit obligation.....	212	200	216	2,024
Expected return on plan assets.....	(200)	(153)	(153)	(1,909)
Recognized actuarial differences.....	388	529	145	3,704
Adjustment to prior service costs.....	(123)	—	(117)	(1,174)
Severance and retirement benefit expenses.....	<u>¥ 794</u>	<u>¥ 1,241</u>	<u>¥681</u>	<u>\$7,581</u>

The discount rates used were 2.00% in 2005 and 2.00% in 2004. The rates of expected return on plan assets used by the Company are 2.90% for the 1996 pension plan and 2.30% for the 1966 pension plan. The estimated amount of all retirement benefits to be paid at future retirement dates is allocated equally to each service year using the estimated number of total service years.

Prior service costs are recognized as an expense in equal amounts over two years commencing from the date they arise, and actuarial gains and losses are recognized in the income statement as an expense in equal amounts over five years, commencing from the following year.

Charges to income with respect to directors' and corporate auditors' retirement benefits amounted to ¥75 million (\$716 thousand), ¥255 million and ¥62 million for the years ended February 28, 2005, February 29, 2004 and February 28, 2003, respectively.

## 11 . Income Taxes

The Companies are subject to a number of taxes based on income, which, in the aggregate, indicate a statutory income tax rate in Japan of approximately 41.7% for the years ended February 28, 2005, February 29, 2004 and February 28, 2003.

The following table summarizes the significant differences between the statutory income tax rate and the Companies' effective tax rates for financial statement purposes for the years ended February 28, 2005 and February 29, 2004.

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Statutory tax rate.....	41.7%	41.7%	41.7%
Non-deductible expenses .....	1.5	1.2	1.6
Non-taxable dividend income .....	(0.1)	(0.1)	(0.1)
Per capita inhabitants' tax.....	0.1	0.1	0.1
Less special tax deduction for experimental and research expenses	(3.8)	(5.1)	-
Other.....	1.0	0.8	(0.7)
Effective tax rate after applying tax effect.....	<u>40.4%</u>	<u>38.6%</u>	<u>42.6%</u>

Significant components of the Companies' deferred tax assets as of February 28, 2005 and February 29, 2004 are as follows:

	<u>Millions of yen</u>		<u>Thousands of U.S. dollars</u>
	<u>2005</u>	<u>2004</u>	<u>2005</u>
Deferred tax assets:			
Excess severance and retirement benefits.....	¥543	¥713	\$5,184
Valuation loss on investment securities.....	554	392	5,289
Directors' and corporate auditors' retirement benefits	413	383	3,943
Accrued enterprise tax.....	470	361	4,487
Allowance for doubtful accounts .....	123	267	1,174
Valuation loss on investment in capital.....	493	557	4,707
Excess employees' bonuses accrued .....	198	183	1,891
Losses carried forward.....	573	439	5,471
Other .....	470	457	4,488
Total deferred tax assets .....	<u>3,837</u>	<u>3,752</u>	<u>36,634</u>
Valuation allowance .....	<u>(573)</u>	<u>(445)</u>	<u>(5,471)</u>
Net deferred tax assets .....	<u>¥3,264</u>	<u>¥3,307</u>	<u>\$31,163</u>
Deferred tax liabilities:			
Net unrealized holding gains on securities.....	¥(676)	¥(730)	\$ (6,454)
Total deferred tax liabilities.....	<u>(676)</u>	<u>(730)</u>	<u>(6,454)</u>
Net deferred tax assets .....	<u>¥2,588</u>	<u>¥2,577</u>	<u>\$ 24,709</u>

The aggregate statutory income tax rate was reduced for the years commencing on April 1, 2004 or later due to the revised local tax law. At February 28, 2005, the Company and consolidated domestic subsidiaries applied the reduced aggregate statutory income tax rate of 40.4% for calculating deferred tax assets and liabilities that are expected to be recovered or settled in the years commencing on March 1, 2005 or later. The effect on net income of adopting the new accounting standard was not material.

## **12. Segment Information**

The Companies are primarily engaged in the manufacture and sale of pharmaceuticals in Japan and overseas.

### **(1) Business segments**

The operations of the Companies are classified into three business segments, which are “pharmaceuticals and related products”, “cable television broadcasting” and “other”.

Since more than 90% of the consolidated net sales and operating income for the years ended February 28, 2005, February 29, 2004 and February 28, 2003 were from the pharmaceuticals and related products segment, the disclosure of business segment information is not required.

### **(2) Geographic areas**

Since more than 90% of the consolidated net sales and operating income for the years ended February 28, 2005, February 29, 2004 and February 28, 2003 were made in Japan, the disclosure of segment information by geographic area is not required.

### **(3) Overseas sales**

Since overseas sales for the years ended February 28, 2005, February 29, 2004 and February 28, 2003 were not more than 10% of the consolidated net sales, the disclosure of overseas sales information is not required.

## **13. Shareholders' Equity**

Under the Commercial Code, the entire amount of the issue price of shares is required to be accounted for as common stock, although a company may, by resolution of its board of directors, account for an amount not exceeding 50% of the issue price of the new shares as additional paid-in capital, which is included in capital surplus.

The Code provides that an amount equal to at least 10% of cash dividends and other cash appropriations shall be appropriated and set aside as a legal earnings reserve until the total amount of legal earnings reserve and additional paid-in capital equals 25% of common stock. The legal earnings reserve and additional paid-in capital may be used to eliminate or reduce a deficit by resolution of the shareholders' meeting or may be capitalized by resolution of the Board of Directors. On condition that the total amount of legal earnings reserve and additional paid-in capital remains being equal to or exceeding 25% of common stock, they are available for dividends by the resolution of shareholders' meeting. Legal earnings reserve is included in retained earnings in the accompanying financial statements.

The maximum amount that the Company can distribute as dividends is calculated based on the unconsolidated financial statements of the Company in accordance with the Code.

### (Number and amount of treasury stock)

At February 28, 2005, the Companies held 4,504,702 shares of treasury stock in the amount of ¥7,283 million (\$69,534 thousand), as shown in the consolidated balance sheets. This amount included ¥526 million (\$5,022 thousand) which was not deducted from the minority interests.

### 14. Contingent Liabilities

Contingent liabilities at February 28, 2005 were as follows:

	<u>Millions of yen</u>	<u>Thousands of U.S. dollars</u>
Notes receivable discounted.....	<u>¥17</u>	<u>\$162</u>

### 15. Subsequent Events

#### (Appropriations of retained earnings)

At the 2005 annual meeting of shareholders held on May 26, 2005, the appropriations of retained earnings for the year ended February 28, 2005 were duly approved as follows:

	<u>Millions of yen</u>	<u>Thousands of U.S. dollars</u>
Cash dividends -		
¥18.00 (\$0.17) per share	¥1,633	\$15,591
Bonuses to directors and corporate auditors	60	573

#### (Material subsequent event)

Consolidated fiscal year (March 1, 2004 – February 28, 2005)

1. Based on an agreement to purchase the shares of Biomedics Co., Ltd. concluded between the Company and SSP Co., Ltd. on May 21, 2004, the Company took over the Ethical Drugs Division of SSP Co., Ltd. by acquiring 100% of the 300,000 shares issued by Biomedics Co., Ltd. (The name was changed to Hisamitsu Medical Co., Ltd. on April 1, 2005) to which the Ethical Drugs Division had been spun off. The total price of the transfer was ¥14.6 billion, but some minor adjustments are scheduled to take place after the assets and liabilities transferred from SSP Co., Ltd. to Biomedics Co., Ltd. have been finalized.

2. The Company concluded a loan agreement with a syndicate for which UFJ Bank Limited is the arranger and agent in order to provide future operating capital (including capital related to the transfer of the Ethical Drugs Division of SSP Co., Ltd). The details of the syndicate loan are as follows.

- (1) Date of conclusion of agreement: April 26, 2005
- (2) Date of execution of loan: April 28, 2005
- (3) Amount borrowed: ¥10 billion
- (4) Repayment method: Equal payments of principal every 6 months plus interest  
The date of the final repayment is April 30, 2007
- (5) Interest rate: Japanese yen 6-month TIBOR +0.25%
- (6) Collateral/ guarantee: None



## Independent Auditors' Report

To the Shareholders and Board of Directors  
Hisamitsu Pharmaceutical Co., Inc.:

We have audited the accompanying consolidated balance sheets of Hisamitsu Pharmaceutical Co., Inc. and consolidated subsidiaries as of February 28/29, 2005 and 2004, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended February 28, 2005, expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Hisamitsu Pharmaceutical Co., Inc. and subsidiaries as of February 28/29, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended February 28, 2005, in conformity with accounting principles generally accepted in Japan.

Without qualifying our opinion, we draw attention to the following.

- (1). As discussed in Note 15 (material subsequent event 1), the Company took over the Ethical Drugs Division of SSP Co., Ltd. by acquiring 100% of the 300,000 shares issued by Biomedics Co., Ltd. (The name was changed to Hisamitsu Medical Co., Ltd. on April 1, 2005) based on an agreement concluded between the Company and SSP Co., Ltd. on May 21, 2004.
- (2). As discussed in Note 15 (material subsequent event 2), the Company concluded a loan agreement with a syndicate for which UFJ Bank Limited is the arranger and agent.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended February 28, 2005 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 1 to the consolidated financial statements.

*KPMG AZSA & Co.*  
Fukuoka, Japan  
May 26, 2005

*KPMG AZSA & Co.*