

MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Strategy

The financial strategy of Kuraya Sanseido and its subsidiaries centers on creating sufficient liquidity and capital for operating needs and a sound balance sheet. Capital expenditures and investment in plant and equipment are evaluated according to clearly defined plans. Primary investment emphases include improved distribution and the research and development of new business models, services and products.

Operating Environment

In the pharmaceutical industry, an average 6.3 percent reduction in National Health Insurance (NHI) prices for drugs was implemented in April 2002, and healthcare cost control measures were taken in October 2002, including fixed rates for medical costs for the elderly. However, the overall market showed moderate growth due to expansion of demand for new drugs and influenza-related products.

Amid this environment, the Kuraya Sanseido Group took advantage of the strength of its broad product lineup composed of the products of many manufacturers to provide a stable supply of pharmaceutical products that meet customer needs. We also lowered the cost of sales through promotion of joint purchasing with Group companies. In addition, we worked to maintain steady profits by creating a new framework for the formation of a rational pricing system, and conducting marketing activities based on this framework. At the same time, we worked to lower the ratio of selling, general and administrative (SG&A) expenses to net sales and raise productivity with measures such as offering early retirement to employees and implementing a system for transfers within the Group.

To raise the efficiency of Group business activities and to respond accurately to diversifying customer needs, we took over businesses related to the wholesale of over-the-counter drugs of IZUTSU PHARMACEUTICAL CO., LTD. (Kyoto) and prescription pharmaceuticals of NISHIDA YAKUHIN CO., LTD. (Asahikawa). We also took over business related to the wholesale of pharmaceuticals of SENSHU YAKUHIN CO., LTD. (Akita) in Miyagi Prefecture.

Furthermore, we took over business related to the wholesale of pharmaceuticals of ATOL CO., LTD. (Fukuoka), with which we have a business tie-up, in the Tokyo region.

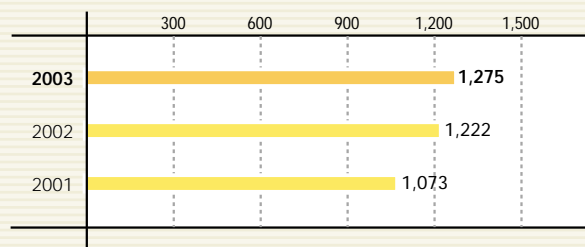
Also, USHIODA SANGOKUDO YAKUHIN CO., LTD. (Mito) was made a wholly owned subsidiary of the Company through a simple exchange of shares.

Additionally, with the ongoing separation of prescription and dispensing, we introduced a new business model for prescription pharmacies that incorporates planned delivery and billing proportionate to the volume used, and systematically implemented it on a nationwide level as part of our effort to create new functions as a pharmaceutical wholesaler. In this way, we worked to strengthen relationships with customers.

Sales and Operating Income

Consolidated net sales for the year ended March 31, 2003 increased 4.3 percent year-on-year to ¥1,274,503 million. Selling prices were stable as a result of the success of the Company's final cost formula and proprietary standard weighted price, which were created to formulate rational selling prices. In addition, demand due to colds and influenza increased, and the launch of major new products also contributed to sales growth.

Net Sales (Billions of yen)



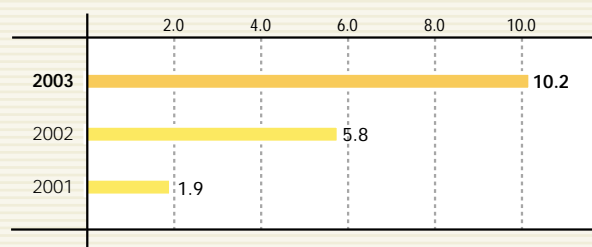
Gross profit increased 7.8 percent to ¥114,923 million. The ratio of gross profit to net sales increased to 9.0 percent from 8.7 percent for the previous fiscal year, reflecting the success of the Company's final cost formula and proprietary standard weighted price, and joint purchasing of more than 90 percent of prescription pharmaceuticals sold by the six Group wholesale companies.

SG&A expenses increased 3.9 percent to ¥104,763 million. The ratio of SG&A expenses to net sales improved

to 8.2 percent from 8.3 percent for the previous fiscal year, as the Company aggressively worked to strengthen cost competitiveness by reducing overhead costs, and curbed personnel costs through measures such as offering voluntary early retirement and introducing a job transfer program.

Operating income increased 75.7 percent to ¥10,160 million as a result of the improvement in the gross margin and success at restraining the increase in SG&A expenses.

Operating Income (Billions of yen)



Costs, Expenses and Income as a Percentage of Net Sales

Years ended March 31	2003	2002	Change
Cost of sales	91.0%	91.3%	(-0.3)
Gross profit	9.0	8.7	(+0.3)
SG&A expenses	8.2	8.3	(-0.1)
Operating income	0.8	0.5	(+0.3)
Income before income taxes & minority interests	0.9	0.5	(+0.4)
Net income	0.4	0.2	(+0.2)

Other Income (Expenses)

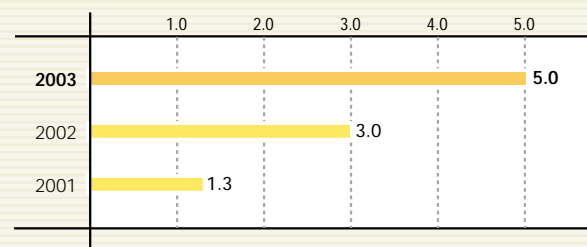
Total other income (expenses) increased 29.5 percent to ¥1,041 million. Research fee income increased 2.8 percent to ¥2,886 million. While the Company expensed additional retirement benefits for employees in connection with the early retirement program totaling ¥1,079 million, the amount was down from ¥2,435 million in the previous fiscal year. Loss on devaluation of investment securities, which is a non-cash charge resulting from the application of Japan's fair value accounting standards, decreased 58.0 percent to ¥313 million. Reflecting the Company's consistent program of reducing interest-bearing debt, interest expense decreased 26.1 percent to ¥388 million, and the interest coverage ratio stood at 26.9 times, compared to 11.5 times for the previous fiscal year.

Income before income taxes and minority interests increased 70.1 percent to ¥11,201 million.

Net Income

Income taxes net of deferrals increased 62.1 percent to ¥5,673 million, reflecting the increase in income before income taxes and minority interests. Net income therefore increased 70.0 percent to ¥5,016 million. Net income per share improved to ¥36.48, compared to ¥21.67 for the previous fiscal year, and fully diluted net income per share improved to ¥31.50 from ¥18.92 for the previous fiscal year.

Net Income (Billions of yen)



Dividends

By increasing profitability, the Company strives to generate higher retained earnings for use in future business development and strengthening of operations, while also providing stable dividends to shareholders. Cash dividends per share applicable to the fiscal year remained unchanged at ¥12.00.

Liquidity and Financial Position

Cash Flow Highlights

Years ended March 31	Millions of yen		
	2003	2002	Change
Net cash provided by operating activities	¥11,509	¥12,543	¥(1,034)
Net cash used in investing activities	(6,540)	(5,012)	(1,528)
Net cash used in financing activities	(10,123)	(4,356)	(5,767)
Cash and cash equivalents at end of year	68,375	73,934	(5,558)

Net cash provided by operating activities decreased 8.2 percent to ¥11,509 million. Income before income taxes and depreciation and amortization increased, but working capital also expanded. With the increase in net sales, inventories increased ¥2,315 million. Trade receivables increased as a result of higher net sales, the Company's reassessment of long-term receivables and strengthened sales collection. Working capital increased 71.6 percent to ¥16,871 million, and the current ratio was 1.04 to 1,

compared to 1.02 to 1 at March 31, 2002.

Net cash used in investing activities increased 30.5 percent to ¥6,540 million. Purchases of property, plant and equipment decreased 3.3 percent to ¥4,955 million, and mainly consisted of purchase of fixed assets for the Nishinippon Distribution Center and other facilities. Maturity of time deposits, net, generated less cash than in the previous fiscal year, decreasing ¥705 million to ¥331 million. Other, net represented a use of cash and increased ¥856 million to ¥1,394 million.

Net cash used in financing activities more than doubled to ¥10,123 million. Debt reduction was a principal factor as the Company strengthened its financial structure and reduced fixed interest expenses. Net decrease in short-term bank loans used cash totaling ¥3,641 million, and net repayment of long-term debt used cash totaling ¥606 million. The Company repurchased 5.9 million shares of its common stock totaling ¥4,250 million to increase shareholder value through a flexible capital policy.

As a result, cash and cash equivalents at the end of the year decreased 7.5 percent to ¥68,375 million.

Total assets at March 31, 2003 decreased 0.9 percent from a year earlier to ¥638,589 million, primarily reflecting depreciation adjustments to property, plant and equipment. Shareholders' equity increased 1.5 percent to ¥112,261 million. The return on average total shareholders' equity increased to 4.5 percent from 2.5 percent for the previous fiscal year, and the ratio of shareholders' equity to total assets stood at 17.6 percent, compared to 17.2 percent a year earlier.

Corporate Governance

The Kuraya Sanseido Group focuses on ensuring transparent and sound management while maximizing our corporate value.

The Board of Directors considers and decides on management policies and matters established by law, as well as other important management-related matters. The Board also supervises the status of overall business execution. The Board of Directors is composed of 12 directors. Board meetings are held once a month and are attended by auditors.

The Company uses the auditor system, and appoints two outside auditors among the five auditors. Corporate auditors conduct strict supervision of directors' execution of duties from the standpoints of legality and efficiency.

An Auditing Office reporting directly to the president

conducts regular company-wide internal audits, with the aim of appropriate management and improvement spanning all aspects of business operations.

The Company has adopted a corporate executive officer system to clearly separate management decision-making and supervision from business execution. In addition, a Management Meeting participated in by directors, executive officers and auditors is held, in principle, once a week to share information on management strategies and consider business solutions.

The Company has established an Action Guidelines Committee whose members include the Company's advising attorney. The Committee is drawing up "Action Guidelines" that will form standards for judgment and action in carrying out activities to realize our corporate philosophy. It has also created "Basic Points for Business" as standards for legal compliance and sound business activities.

Currently, the Company is conducting initiatives such as regular meetings with individual divisions aimed at ensuring thorough knowledge and practice of these standards in order to improve corporate ethics.

Outlook for the Fiscal Year Ending March 2004

Increases in patient co-payments and insurance rates due to revisions of the National Health Insurance Law, in addition to administrative reforms to the healthcare system such as separation of hospital functions and revision of diagnostic evaluation are forecast to further accelerate changes in the structure of the pharmaceutical industry.

In these circumstances, the Kuraya Sanseido Group will strengthen sales by allocating sales staff to key strategic regions and further establish our framework for a rational pricing system, in accordance with the basic strategies of the medium-term consolidated management plan.

In addition, we will work to firmly establish our infrastructure and new personnel system through measures such as creating a new business model geared to the expected changes in the industry structure and integration of key systems. At the same time, we will seek to establish a new cost structure through an overhaul of sales activities and internal operations, including personnel reductions and business office consolidation. Through these measures, we will work to further raise our business efficiency.

For the fiscal year ending March 31, 2004, Kuraya Sanseido projects increases in consolidated net sales and consolidated net income.

CONSOLIDATED BALANCE SHEETS

Kuraya Sanseido Inc. and its consolidated subsidiaries
March 31, 2002 and 2003

ASSETS	Millions of yen		Thousands of U.S. dollars (Note 1)
	2002	2003	2003
Current assets:			
Cash on hand and in bank (Notes 3 and 8)	¥ 76,054	¥ 70,153	\$ 583,636
Marketable securities (Note 4)	39	3	25
Notes and accounts receivable:			
Trade	336,315	340,233	2,830,557
Other	31,860	30,186	251,131
Allowance for doubtful accounts	(3,048)	(3,944)	(32,812)
Inventories	53,692	55,900	465,058
Deferred income taxes (Note 12)	2,803	4,126	34,326
Other current assets	1,899	1,895	15,766
Total current assets	499,614	498,552	4,147,687
Property, plant and equipment (Note 8):			
Land (Note 5)	49,572	48,403	402,687
Buildings and structures	78,198	78,246	650,965
Machinery and equipment	6,583	6,745	56,115
Vehicles, furniture and fixtures	8,564	9,053	75,316
Construction in progress	276	54	449
	143,193	142,501	1,185,532
Accumulated depreciation	(43,756)	(47,036)	(391,314)
Net property, plant and equipment	99,437	95,465	794,218
Investments and other assets:			
Investment securities (Notes 4 and 8)	13,808	11,956	99,468
Long-term loans receivable	379	399	3,319
Allowance for doubtful accounts	(5,706)	(5,180)	(43,095)
Deferred income taxes (Note 12)	6,023	7,679	63,885
Deferred income taxes — land revaluation (Note 5)	8,626	8,456	70,349
Consolidation difference	2,752	1,987	16,531
Other	19,315	19,275	160,358
Total investments and other assets	45,197	44,572	370,815
	¥644,248	¥638,589	\$5,312,720

See accompanying notes.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen		Thousands of U.S. dollars (Note 1)
	2002	2003	2003
Current liabilities:			
Short-term bank loans (Notes 6 and 8)	¥ 15,940	¥ 12,299	\$ 102,321
Long-term debt due within one year (Notes 6 and 8)	4,376	969	8,062
Notes and accounts payable (Note 8):			
Trade	444,257	445,652	3,707,587
Other	9,966	4,550	37,854
Accrued expense	8,590	10,223	85,050
Income taxes payable (Note 12)	3,901	5,384	44,792
Other current liabilities	2,751	2,604	21,663
Total current liabilities	489,781	481,681	4,007,329
Long-term liabilities:			
Long-term debt (Notes 6 and 8)	20,861	20,462	170,233
Deferred income taxes (Note 12)	50	—	—
Deferred income taxes — land revaluation (Note 5)	259	252	2,097
Employees' retirement benefits (Note 7)	14,617	16,420	136,606
Officers' retirement benefits	1,860	1,828	15,208
Other long-term liabilities	1,396	1,258	10,465
Total long-term liabilities	39,043	40,220	334,609
Minority interests	4,774	4,427	36,830
Contingent liabilities (Note 9)	—	—	—
Shareholders' equity (Note 10):			
Common stock, par value ¥50 per share:			
Authorized – 500,000,000 shares in 2002 and 2003			
Issued – 136,705,869 shares in 2002 and 142,424,946 shares in 2003	11,153	12,751	106,082
Additional paid-in capital	24,321	25,919	215,632
Retained earnings	84,537	87,875	731,073
Revaluation surplus (Note 5)	(11,769)	(12,260)	(101,997)
Unrealized gains on certain investment securities (Note 4)	3,603	2,602	21,647
Treasury stock, at cost	(1,195)	(4,626)	(38,485)
Total shareholders' equity	110,650	112,261	933,952
	¥644,248	¥638,589	\$5,312,720

CONSOLIDATED STATEMENTS OF OPERATIONS

Kuraya Sanseido Inc. and its consolidated subsidiaries
Two years ended March 31, 2002 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2002	2003	2003
Net sales	¥1,222,222	¥1,274,503	\$10,603,186
Costs and expenses:			
Cost of sales	1,115,578	1,159,580	9,647,088
Selling, general and administrative expenses	100,863	104,763	871,572
Total costs and expenses	1,216,441	1,264,343	10,518,660
Operating income	5,781	10,160	84,526
Other income (expenses):			
Research fee income	2,808	2,886	24,010
Interest and dividend income	276	261	2,171
Interest expense	(525)	(388)	(3,228)
Loss on devaluation of investment securities	(746)	(313)	(2,604)
Other, net (Note 11)	(1,009)	(1,405)	(11,689)
Total other income (expenses)	804	1,041	8,660
Income before income taxes and minority interests	6,585	11,201	93,186
Income taxes (Note 12):			
Current	5,050	7,804	64,925
Deferred	(1,551)	(2,131)	(17,729)
Total income taxes	3,499	5,673	47,196
Minority interests in net income of consolidated subsidiaries	135	512	4,260
Net income	¥ 2,951	¥ 5,016	\$ 41,730

	Yen		U.S. dollars (Note 1)
	2002	2003	2003
Amounts per share of common stock:			
Net income	¥21.67	¥36.48	\$0.30
Diluted net income	18.92	31.50	0.26
Cash dividends applicable to the period	12.00	12.00	0.10

See accompanying notes.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Kuraya Sanseido Inc. and its consolidated subsidiaries
Two years ended March 31, 2002 and 2003

	Number of shares of common stock issued (Thousands)	Millions of yen		
		Common stock	Additional paid-in capital	Retained earnings
Balance at March 31, 2001	136,705	¥11,153	¥24,321	¥83,241
Conversion of convertible bonds	—	—	—	—
Net income	—	—	—	2,951
Cash dividends paid (¥12.0 per share)	—	—	—	(1,640)
Bonuses to directors and statutory auditors	—	—	—	(15)
Balance at March 31, 2002	136,705	¥11,153	¥24,321	¥84,537
Increase due to merger	—	—	—	57
Conversion of convertible bond into stock	5,719	1,598	1,598	—
Net income	—	—	—	5,016
Cash dividends paid (¥12.0 per share)	—	—	—	(1,610)
Bonuses to directors and statutory auditors	—	—	—	(17)
Increase due to the increase in consolidated subsidiaries	—	—	—	23
Reverse of revaluation surplus	—	—	—	107
Loss on retirement of treasury stock	—	—	—	(238)
Balance at March 31, 2003	142,424	¥12,751	¥25,919	¥87,875

	Thousands of U.S. dollars (Note 1)		
	Common stock	Additional paid-in capital	Retained earnings
Balance at March 31, 2002	\$92,787	\$202,337	\$703,303
Increase due to merger	—	—	474
Conversion of convertible bond into stock	13,295	13,295	—
Net income	—	—	41,730
Cash dividends paid (\$0.10 per share)	—	—	(13,394)
Bonuses to directors and statutory auditors	—	—	(141)
Increase due to the increase in consolidated subsidiaries	—	—	191
Reverse of revaluation surplus	—	—	890
Loss on retirement of treasury stock	—	—	(1,980)
Balance at March 31, 2003	\$106,082	\$215,632	\$731,073

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Kuraya Sanseido Inc. and its consolidated subsidiaries
Two years ended March 31, 2002 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2002	2003	2003
Cash flows from operating activities:			
Income before income taxes	¥ 6,585	¥11,201	\$ 93,186
Adjustments to reconcile income before income taxes to net cash flows provided by operating activities:			
Depreciation and amortization	4,866	5,204	43,295
Amortization of consolidation difference	748	732	6,090
(Gain) loss on disposal of property, plant and equipment	(213)	862	7,171
(Increase) decrease in employees' retirement benefits — net	(1,278)	1,811	15,067
Increase (decrease) in officers' retirement benefits	71	(28)	(233)
Increase (decrease) in accrued employees' bonuses	(304)	818	6,805
Increase (decrease) in allowance for doubtful accounts	(1,197)	374	3,111
Increase (decrease) in allowance for returns	(81)	29	241
Interest expenses	525	388	3,228
Interest and dividend income	(276)	(261)	(2,171)
Loss on sale and devaluation of securities — net	745	286	2,379
Loss on sale and devaluation of golf memberships — net	185	182	1,514
(Increase) decrease in notes and accounts receivable — trade	3,004	(2,872)	(23,893)
(Increase) decrease in inventories	1,008	(2,315)	(19,260)
Increase (decrease) in notes and accounts payable	(409)	1,496	12,446
Increase in accrued consumption taxes	502	225	1,872
(Increase) decrease in other current assets	(2,561)	1,488	12,379
Increase (decrease) in other current liabilities	1,539	(1,772)	(14,742)
Payment of officers' bonuses	(20)	(22)	(183)
Interest and dividends received	309	261	2,171
Cash paid for interest	(521)	(386)	(3,211)
Cash paid for income taxes	(706)	(6,183)	(51,439)
Others	22	(9)	(74)
Net cash provided by operating activities	¥12,543	¥11,509	\$ 95,749

See accompanying notes.

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2002	2003	2003
Cash flows from investing activities:			
Payments for time deposits	¥(6,281)	¥(1,659)	\$ (13,802)
Maturity of time deposits	7,317	1,990	16,556
Payments for purchase of property, plant and equipment — net	(5,124)	(4,954)	(41,215)
Payments for purchase of investment securities	(640)	(452)	(3,760)
Proceeds from sale of investment securities	11	169	1,406
(Increase) decrease in loans receivable — net	243	(10)	(83)
Payments for purchase of investment in subsidiary	—	(230)	(1,914)
Other, net	(538)	(1,394)	(11,597)
Net cash used in investing activities	(5,012)	(6,540)	(54,409)
Cash flows from financing activities:			
Increase (decrease) in short-term bank loans — net	610	(3,641)	(30,291)
Proceeds from long-term debt	1,811	800	6,656
Repayment of long-term debt	(3,625)	(1,406)	(11,697)
Repayment of bonds	(300)	—	—
Repayment of convertible bonds	—	(4)	(33)
Proceeds from issuance of common stock	—	4	33
Proceeds from sale of treasury stock	1	—	—
Purchase of treasury stock	(1,197)	(4,250)	(35,358)
Cash dividends paid	(1,640)	(1,610)	(13,394)
Cash dividends paid to minority shareholders	(16)	(16)	(133)
Net cash used in financing activities	(4,356)	(10,123)	(84,218)
Effect of exchange rate change on cash and cash equivalents	—	3	25
Net increase in cash and cash equivalents	3,175	(5,151)	(42,853)
Cash and cash equivalents at beginning of year	70,759	73,934	615,092
Cash and cash equivalents in connection with merger of unconsolidated subsidiary	—	13	108
Cash and cash equivalents in connection with exclusion of consolidation for certain subsidiary	—	(421)	(3,502)
Cash and cash equivalents at end of year	¥73,934	¥68,375	\$568,844

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Kuraya Sanseido Inc. and its consolidated subsidiaries
Two years ended March 31, 2003

1. Basis of presenting consolidated financial statements

Kuraya Sanseido Inc. and its consolidated subsidiaries (the "Company") maintain their accounts and records in accordance with the provisions set forth in the Japanese Commercial Code and the Securities and Exchange Law and in conformity with accounting principles and practices generally accepted in Japan, which are different from the accounting and disclosure requirements of International Accounting Standards.

The accompanying consolidated financial statements are a translation of the audited consolidated financial statements of the Company which were prepared in accordance with accounting principles and practices generally accepted in Japan from the accounts and records maintained by the Company and were filed with the Financial Services Agency as required by the Securities and Exchange Law.

In preparing the accompanying consolidated financial statements, certain reclassifications have been made in the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan.

The translations of the Japanese yen amounts into U.S. dollars are included solely for the convenience of the reader, using the prevailing exchange rate at March 31, 2003, which was ¥120.20 to U.S.\$1.00. 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

Consolidated financial statements included the accounts of the Company and twelve domestic subsidiaries in 2002 and 2003, which are significant.

One of the subsidiaries was merged into Kuraya Sanseido Inc. in 2003.

Kuraya Sanseido Inc. acquired substantial ownership of five subsidiaries in 2001. The consolidated financial statements include results of operations and cash flows of the one subsidiary for the year and of the three subsidiaries for six months.

All material intercompany transactions and accounts have been eliminated. In the elimination of investments in subsidiaries, the assets and liabilities of the subsidiaries, including the portion attributable to minority shareholders, are recorded using the fair value at the time the Company acquired control of the respective subsidiaries.

Equity method

Investments in non-consolidated subsidiaries and affiliates over which the Company has the ability to exercise significant influence over operating and financial policies of the investees, are accounted for using the equity method.

Investments in other non-consolidated subsidiaries and other affiliates are stated at cost, since net income, net sales and retained earnings in the aggregate of such companies are not material compared to those on a consolidated basis.

Consolidation difference

Consolidation difference is being amortized over mainly 5 years on a straight-line basis. Immaterial consolidation difference is charged to expense as incurred.

Cash flow statement

In preparing the consolidated statements of cash flows, cash on hand, readily available 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.

Marketable securities and investment securities

The Company adopted "Accounting Standards for Financial Instruments" issued by the Ministry of Finance ("MOF") on January 22, 1999. In accordance with the accounting standards, the Company's marketable and investment securities are considered as available-for-sale. Available-for-sale securities represent those securities that do not meet the classification of trading securities and held-to-maturity securities.

Available-for-sale securities are stated at fair value and the unrealized gains and losses are reported as a separate component of stockholders' equity. In cases where substantial impairment of value is recognized compared to fair value, the carrying amount is reduced to the fair value.

Inventories

Inventories are mainly stated at cost determined by the first-in, first-out (FIFO) method.

Property, plant and equipment

Depreciation of property, plant and equipment is computed by the declining-balance method with respect to the Company.

In accordance with revisions of the Corporation Tax Law, buildings acquired after March 31, 1998 are depreciated using the straight-line method.

Finance leases

Finance leases, except leases for which the ownership of the leased assets is considered to be transferred to the lessee, are accounted for in the same manner as operating leases.

Software costs

The Company included software in intangible assets and amortized it using the straight-line method over the estimated useful lives (five years).

Allowance for doubtful accounts

Allowance for doubtful accounts is recorded at an amount necessary to cover for possible losses from doubtful accounts based on the amount estimated to be uncollectable on an individual basis and from other accounts based on historical loss ratios.

Accrued employees' bonuses

At March 31, 2002 and 2003, the Company accrued the employees' bonuses based on estimated amounts to be paid in the subsequent period.

Employees' retirement benefits and pension

The Company adopted "Accounting Standards for Retirement Benefits" pronounced by MOF on June 16, 1998. In accordance with the accounting standards, allowance for employees' retirement benefits is recorded based on the projected benefit obligation less fair value of the pension plan assets. The experience adjustments of actuarial assumptions are amortized over three years using the straight-line method.

Officers' retirement benefits

The Company pays retirement benefits to officers in accordance with its internal rules.

The Company provides for lump-sum severance payments for officers in the amount which would be required if all officers retired at each year-end. Such provision is not funded.

Income taxes

Income tax payable is computed based on the pretax income included in the consolidated financial statements. The asset and liability method is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences.

Foreign currency translation

Monetary assets and liabilities of the Company are translated at the current exchange rates at the balance sheet date. The resulting foreign currency gains or losses are recognized as other income or expenses.

Amounts per share of common stock

The computations of net income per share of common stock are based on the average number of shares outstanding during each year. In accordance with "Standards for Net Income per Share" pronounced by the Financial Accounting Standards Foundation on September 25, 2002, the net income excludes the bonuses to directors and statutory auditors in 2003.

For computing diluted net income per share of common stock, the average number of shares was increased by the number of shares that would have been outstanding assuming Euro-yen convertible notes were converted at the beginning of the respective fiscal years and domestic convertible bonds were converted on the date of issuance (September 11, 1996) at the actual conversion rates in effect during the year. Cash dividends per share represent the actual amounts declared during the respective years.

3. Cash and cash equivalents

Cash and cash equivalents at March 31, 2002 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Cash on hand and in bank	¥76,054	¥70,153	\$583,636
Time deposits over three months	(2,120)	(1,778)	(14,792)
Cash and cash equivalents	¥73,934	¥68,375	\$568,844

4. Market value information for securities

(1) Available-for-sale securities with a market value

	Millions of yen		
	Carrying value	Estimated fair value	Unrealized gain
Year ended March 31, 2003			
Securities whose fair value exceeds their carrying value:			
Equity securities	¥2,701	¥8,154	¥5,453
Government bonds and corporate bonds	—	—	—
Others	—	—	—
	¥2,701	¥8,154	¥5,453
Securities whose carrying value exceeds their fair value:			
Equity securities	¥1,518	¥1,324	¥ (194)
Government bonds and corporate bonds	5	5	—
Others	—	—	—
	¥1,523	¥1,329	¥ (194)
Total	¥4,224	¥9,483	¥5,259

	Thousands of U.S. dollars		
	Carrying value	Estimated fair value	Unrealized gain
Year ended March 31, 2003			
Securities whose fair value exceeds their carrying value:			
Equity securities	\$22,471	\$67,837	\$45,366
Government bonds and corporate bonds	—	—	—
Others	—	—	—
	\$22,471	\$67,837	\$45,366
Securities whose carrying value exceeds their fair value:			
Equity securities	\$12,629	\$11,015	\$ (1,614)
Government bonds and corporate bonds	42	42	—
Others	—	—	—
	\$12,671	\$11,057	\$ (1,614)
Total	\$35,142	\$78,894	\$43,752

Year ended March 31, 2002	Millions of yen		
	Carrying value	Estimated fair value	Unrealized gain
Securities whose fair value exceeds their carrying value:			
Equity securities	¥3,144	¥10,686	¥7,542
Government bonds and corporate bonds	7	7	—
Others	—	—	—
	¥3,151	¥10,693	¥7,542
Securities whose carrying value exceeds their fair value:			
Equity securities	¥1,298	¥ 1,207	¥ (91)
Government bonds and corporate bonds	33	30	(3)
Others	—	—	—
	¥1,331	¥ 1,237	¥ (94)
Total	¥4,482	¥11,930	¥7,448

(2) Available-for-sale securities sold during the year

Two years ended March 31, 2003	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Sales value	¥24	¥208	\$1,730
Profit on sale	—	34	283
Loss on sale	—	7	58

(3) Securities without a market value and book value

Two years ended March 31, 2003	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Held-to-maturity debt securities	¥ —	¥ —	¥ —
Other securities	1,093	1,407	11,705

(4) Schedule for redemption of available-for-sale securities with a maturity and held-to-maturity debt securities

	Millions of yen				Thousands of U.S. Dollars	
	2002		2003		2003	
	Due within one year	Due after one year through five years	Due within one year	Due after one year through five years	Due within one year	Due after one year through five years
Bonds	¥39	¥5	¥3	¥5	\$25	\$42
Others	—	—	—	—	—	—
Total	¥39	¥5	¥3	¥5	\$25	\$42

5. Land revaluation

Under the "Law of Land Revaluation," promulgated on March 31, 1998 and revised on March 31, 2001, the Company elected a one-time revaluation of its own-use land to a value based on real estate appraisal information as of March 31, 2002.

The resulting land revaluation excess represents unrealized appreciation of land and is stated, net of deferred tax assets and liabilities, as revaluation surplus as a component of shareholders' equity. There is no effect on the statement of operation. Continuous readjustment is not permitted unless the land value subsequently declines significantly such that the amount of the decline in value should be removed from the land revaluation

excess account and related deferred tax assets and liabilities. The details of the one-time revaluation as of March 31, 2003 were as follows:

	Millions of yen	Thousands of U.S. dollars
Land before revaluation	¥63,649	\$529,526
Land after revaluation	43,244	359,767
Land revaluation excess (Net deferred tax)	12,260	101,997
Estimated fair value	40,274	335,058

6. Short-term bank loans and long-term debt

Short-term bank loans at March 31, 2002 and 2003 were principally bearing annual interest rates of 1.10% and 1.03% per annum, respectively.

Long-term debt at March 31, 2002 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Unsecured domestic convertible bonds due 2008 at a rate of 0.9%	¥19,324	¥19,324	\$160,765
Unsecured domestic convertible bonds due 2003 at a rate of 0.8%	3,201	—	—
Loans from banks due serially through 2016 at interest rates of 1.07% to 3.25% per annum - secured	2,712	2,107	17,530
	25,237	21,431	178,295
Less amount due within one year	(4,376)	(969)	(8,062)
Amount due after one year	¥20,861	¥20,462	\$170,233

Domestic convertible bonds due 2008 provide, among other conditions, for (1) conversion prices of ¥916.0 (\$7.62) and (2) convertible period from October 1, 1996 to September 29, 2008.

At the current conversion prices, a total of 21,096 thousand shares of common stock were issuable upon full conversion of the domestic bonds outstanding at March 31, 2003.

The annual maturities of long-term debt at March 31, 2003 were as follows:

	Millions of yen	Thousands of U.S. dollars
2004	¥ 969	\$ 8,062
2005	602	5,008
2006	270	2,246
2007	121	1,007
2008	28	233
Thereafter	19,441	161,738

7. Employees' retirement benefits

(1) Overview of retirement benefit plan

The Company has defined retirement benefit plans covering a contributory trustee employee pension plan established by the pharmaceutical industry, tax-qualified pension plans and unfunded retirement plans.

(2) Retirement benefits

The following table reconciles the net fund status of plan to retirement benefits recorded in the consolidated balance sheets at March 31, 2002 and 2003.

	Millions of yen		Thousands of
	2002	2003	U.S. dollars
Projected benefit obligation	¥(36,233)	¥(35,900)	\$(298,669)
Fair value of plan assets	20,188	17,107	142,321
Plan assets less than projected benefit obligation	(16,045)	(18,793)	(156,348)
Experience adjustments of actuarial assumptions	1,428	2,373	19,742
Reserve for retirement benefits	¥(14,617)	¥(16,420)	\$136,606

(3) Net pension expense

The components of net pension expense in 2002 and 2003 are listed below.

	Millions of yen		Thousands of
	2002	2003	U.S. dollars
Service costs	¥2,663	¥2,693	\$22,404
Interest cost on projected benefit obligation	1,140	1,066	8,869
Assumed return on plan assets	(662)	(597)	(4,967)
Experience adjustments of actuarial assumptions	940	1,886	15,691
Net pension expense	¥4,081	¥5,048	\$41,997

(4) Assumptions

Projected benefit obligation is determined on the basis of employees' evaluation, their length of service and other certain factors. Other significant assumptions used in the calculation of projected benefit obligation and pension expense are listed below.

	2002	2003
Discount rate	3.0%	3.0%
Assumed rate of return on plan assets	3.0%	3.0%
Amortization period for experience adjustments of actuarial assumptions	3 years	3 years
Amortization period for cumulative effect of a change in accounting	—	—

(5) Contributory trustee employee pension plan

Assets of the contributory trustee employee pension plan established by the pharmaceutical industry amount to ¥32,560 million (\$270,882 thousand) at March 31, 2003 based on the proportion of the Company's payments to the fund.

8. Pledged assets

The Company pledged the following assets to secure trade payables in the amount of ¥42,261 million (\$351,589 thousand) as well as certain bank loans at March 31, 2003.

	Millions of yen		Thousands of
	2002	2003	U.S. dollars
Land	¥6,458		\$53,727
Buildings and structures at net book value	3,086		25,674
Investment securities	825		6,864
Time deposits	255		2,121

9. Contingent liabilities

Contingent liabilities of the Company at March 31, 2003 were guarantees for loans from banks of unconsolidated subsidiaries, affiliates and others in the amount of ¥835 million (\$6,947 thousand).

10. Shareholders' equity

The Japanese Commercial Code provided that an amount equal to at least 10% of appropriations paid in cash be appropriated as a legal reserve until such reserve equals 25% of common stock. The Japanese Commercial Code, amended effective on October 1, 2001, provides that an amount equal to at least 10% of appropriations paid in cash be appropriated as a legal reserve and additional paid-in capital until an aggregated amount of additional paid-in capital and the legal reserve equals 25% of common stock.

The legal reserve and additional paid-in capital may be used to reduce a deficit by resolution of the shareholders or may be capitalized by resolution of the Board of Directors.

11. Other income (expenses)

Other income (expenses) – "Other, net" in the accompanying consolidated statements of operations for the two years ended March 31, 2003 comprised the following:

	Millions of yen		Thousands of
	2002	2003	U.S. dollars
Gain on sale of investment securities	¥ 1	¥ 34	\$ 283
Gain (loss) on disposal of property, plant and equipment – net	213	(862)	(7,171)
Loss on devaluation of golf memberships	(185)	(132)	(1,098)
Restructuring costs	—	45	374
Additional retirement benefit for employees	(2,435)	(1,079)	(8,977)
Miscellaneous	1,397	589	4,900
	¥(1,009)	¥(1,405)	\$(11,689)

12. Income taxes

The Company is subject to a number of income taxes, which, in the aggregate, indicate statutory tax rates in Japan of approximately 42.1% for the years ended March 31, 2001 and 2002.

The reconciliation between the statutory tax rate and the effective tax rate of the Company for financial statement purposes for the years ended March 31, 2002 and 2003 is presented as follows:

	2002	2003
Statutory tax rate	42.1%	42.1%
Non-deductible expenses for tax purposes	5.3	3.5
Minimum inhabitant taxes	3.0	1.7
Effect of change in tax rate for deferred taxes	—	2.2
Others	2.7	1.1
Effective tax rate	53.1%	50.6%

In connection with amendment of the Inhabitant Tax Codes, the statutory tax rate was changed for non-current deferred tax assets and liabilities.

Significant components of the deferred tax assets and liabilities of the Company as of March 31, 2002 and 2003 are follows:

	Millions of yen		Thousands of U.S. dollars
	2002	2003	2003
Deferred tax assets:			
Excess bad debt expenses	¥ 2,330	¥ 2,652	\$ 22,063
Excess bonuses accrued	1,842	2,541	21,140
Enterprise taxes	325	659	5,483
Retirement benefits	4,779	5,492	45,690
Disallowed provision for retirement benefits for directors	783	749	6,231
Other	3,638	3,691	30,707
Total deferred tax assets	13,697	15,784	131,314
Deferred tax liabilities:			
Excess tax depreciation	(1,053)	(1,128)	(9,384)
Unrealized gain on certain investment securities	(3,135)	(2,152)	(17,904)
Other	(733)	(699)	(5,815)
Total deferred tax liabilities	(4,921)	(3,979)	(33,103)
Net deferred tax assets	¥ 8,776	¥11,805	\$ 98,211

13. Non-capitalized financial leases

Finance leases which do not transfer ownership to lessees are not capitalized and are accounted for in the same manner as operating leases. Certain information for such non-capitalized finance leases was as follows:

- (1) Future minimum lease payments at March 31, 2003 were ¥6,006 million (\$49,967 thousand), including ¥1,903 million (\$15,832 thousand) due within one year.
- (2) Lease payments for fiscal 2002 and 2003 were ¥2,587 million and ¥2,436 million (\$20,266 thousand), respectively.

14. Segment information

The Company is mainly engaged in the sale of pharmaceutical supplies. Sales of such business segment exceeded 90% of consolidated net sales for the two years ended March 31, 2003.

Information by location and overseas sales was not disclosed because domestic sales of Kuraya Sanseido Inc. and its domestic consolidated subsidiaries exceeded 90% of consolidated net sales for the two years ended March 31, 2003.

15. Subsequent events

- (1) On June 26, 2003, shareholders of Kuraya Sanseido Inc. approved the payment of a cash dividend of ¥6.00 (\$0.05) per share to shareholders of record at March 31, 2003, in a total payment of ¥812 million (\$6,757 thousand).
- (2) On May 13, 2003, the board of directors of Kuraya Sanseido Inc. approved the plan of accepting early retirements for certain employees in order to improve productivity. Kuraya Sanseido Inc. will pay additional retirement benefits estimated at ¥1,500 million (\$12,479 thousand) and support their employment.

Number of employees: 120

Applicable employees: Age ranging from 40 to 58 years old with at least 10 years of service at September 30, 2003.

Date of retirement: September 30, 2003.

- (3) Agreement of exchange of common stock of Kuraya Sanseido Inc. for common stocks of Izutsu Pharmaceutical Co., Ltd. ("Izutsu") and Heisei Yakuin Co., Ltd. ("Heisei")
 1. Exchange for common stock of Izutsu

On May 13, 2003, the board of directors of Kuraya Sanseido Inc. approved the agreement of exchange of common stock of Kuraya Sanseido Inc. for common stock of Izutsu. On June 24, 2003, shareholders of Izutsu approved the agreement. Kuraya Sanseido Inc. will exchange on September 1, 2003 at an exchange ratio of each of common shares of Kuraya Sanseido Inc. for 1.368 of a share of common stock of Izutsu.
 2. Exchange for common stock of Heisei

On May 13, 2003, the board of directors of Kuraya Sanseido Inc. approved the agreement of exchange of common stock of Kuraya Sanseido Inc. for common stock of Heisei. On June 27, 2003, shareholders of Heisei approved the agreement. Kuraya Sanseido Inc. will exchange on September 1, 2003 at an exchange ratio of each of common shares of Kuraya Sanseido Inc. for 0.979 of a share of common stock of Heisei.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders and the Board of Directors of Kuraya Sanseido Inc.:

We have audited the accompanying consolidated balance sheets of Kuraya Sanseido Inc. and subsidiaries as of March 31, 2002 and 2003, and the related consolidated statements of operations, shareholders' equity and cash flows for the two years ended March 31, 2003. 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.

Our audits were made in accordance with auditing standards, procedures and practices generally accepted and applied 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 the 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 statements referred to above present fairly the consolidated financial position of Kuraya Sanseido Inc. and subsidiaries as of March 31, 2002 and 2003, and the consolidated results of their operations and their cash flows for the two years ended March 31, 2003, in conformity with accounting principles generally accepted in Japan applied on a consistent basis during the periods.

Also, in our opinion, the U.S. dollar amounts in the accompanying consolidated financial statements have been translated from Japanese yen on the basis set forth in Note 1.

The Shinyo Audit Corporation

Tokyo, Japan
June 26, 2003

Statement on Accounting Principles and Auditing Standards

See Note 1 to the consolidated financial statements which explains the basis of presentation of the consolidated financial statements of Kuraya Sanseido Inc. and its consolidated subsidiaries under Japanese accounting principles and practices.