

# >>> To Our SHAREHOLDERS

*The fiscal year ended March 31, 2004 was the second year of Kuraya Sanseido's medium-term consolidated management plan. We achieved growth in both sales and earnings for the third consecutive year by shifting toward profit-focused management and fully utilizing our advantages in the areas of purchasing and distribution. On April 1, 2004, Kuraya Sanseido began operations as the MEDICEO Group, a new corporate entity that will provide the framework for further growth.*

## Overview of Results

In the pharmaceutical industry during the year ended March 31, 2004, an increase in the rate of co-payments by certain patients took effect in April 2003, and demand for influenza and pollen allergy medications decreased. However, expansion due to new products supported moderate growth in the market as a whole.

In this environment, to actively promote cooperation among Kuraya Sanseido Group companies and to enhance and strengthen its management base, we transferred business related to the wholesale of pharmaceuticals in Ibaraki, Tochigi and Gunma prefectures to USHIODA SANGOKUDO YAKUHIN CO., LTD. (Mito), took over that company's wholesale pharmaceutical business in Fukushima Prefecture, and acquired the wholesale over-the-counter drug business of HEISEI YAKUHIN CO., LTD. (Gifu).

IZUTSU PHARMACEUTICAL CO., LTD. (Kyoto) and HEISEI YAKUHIN CO., LTD. were both made wholly owned subsidiaries of the Company through a simple exchange of shares. Kuraya Sanseido also entered into a business alliance with YONYAKU CO., LTD. (Ehime Prefecture) and NAKAZAWA UJIKE PHARMACEUTICAL CO., LTD. (Kochi) covering all of their operations.

In addition to these developments, the Kuraya Sanseido Group continued to work toward the objectives of its medium-term consolidated management plan in its second year. In the ethical drugs segment, we worked to clearly specify final costs and set purchase prices at the beginning of the fiscal year, then to set and maintain selling prices arrived at from selling, general and administrative (SG&A) expenses in the final cost plus a fair profit. This helped us to ensure stable sales by enhancing our relationships of trust with customers.

Measures to strengthen sales included establishing a new operating base in the strategic Tokai region and introducing information terminals for marketing specialists (MSs) to improve their performance. We also worked to build stronger relationships with customers and to upgrade the skills of MSs in order to implement a new business model that combines scheduled deliveries and billing by volume used.

As a result of these factors, consolidated net sales totaled ¥1,283,926 million, an increase of 0.7 percent compared with the previous fiscal year. Gross profit increased 1.6 percent year-on-year to ¥116,805 million, reflecting our ability to maintain selling prices, enabling profit-focused management. Other factors included the advantages of the Company's supply and distribution system based around mega-distribution centers, and expansion of joint sales promotions and bulk purchasing with consolidated subsidiaries in the pharmaceutical wholesale business.

SG&A expenses decreased 3.2 percent year-on-year to ¥101,450 million due to the success of cost reduction measures such as the consolidation of sales branches, the integration of the Group's core systems for sales, distribution and accounting, and the introduction of a new personnel system, as well as an upturn in investment returns on tax-qualified pension plan assets.

Consequently, operating income was ¥15,355 million, a year-on-year increase of 51.1 percent. Net income rose 57.1 percent year-on-year to ¥7,879



million, as a gain on the transfer of the animal health products business offset expenses from special retirement benefits due to the early retirement program and the consolidation of sales branches, and a one-time loss on revision of the retirement benefit system. Cash dividends per share totaled ¥12.00 per share, the same as in the previous fiscal year.

## Increasing Group Value

The basic strategy of the medium-term consolidated management plan, scheduled for completion in March 2005, is boosting competitiveness by restructuring resources, operations and functions. The Kuraya Sanseido Group has been working to enhance its operations based on this strategy. We have also taken steps to build a foundation for strengthening and sharing functions throughout the Group in the future. In addition to our efforts to maintain the trust of our customers and reduce costs, other measures during the past fiscal year included introduction of a new personnel system based on job standards and fair evaluation of performance, the integration of core systems in the areas of sales, distribution and accounting, and the establishment of two new distribution centers in Kazo, Saitama Prefecture, that will specialize in handling ethical drugs and healthcare products, respectively. Furthermore, in April 2004, Kuraya Sanseido changed to a retirement benefit system consisting of a tax-qualified pension plan that replaced the former contract-based plan, as well as a newly introduced defined contribution pension plan and an unfunded lump-sum retirement benefit plan.

As the pharmaceutical wholesale industry undergoes a period of restructuring, the Kuraya Sanseido Group is working to further solidify its position as the industry leader while continuing to grow and develop. To this end, Kuraya Sanseido will become an operating holding company called MEDICEO Holdings Co., Ltd. on October 1, 2004. At that point, sixteen companies, including ATOL Co., Ltd. (Fukuoka) and EVERLTH Co., Ltd. (Hiroshima), which became consolidated subsidiaries in April 2004, and the new KURAYA SANSEIDO Inc., which will take over the pharmaceutical wholesale business, will commence business as the new MEDICEO Group.

We have formulated a new medium-term consolidated management plan for the three years from April 2004 to March 2007 to ensure a common strategic direction and target figures for the MEDICEO Group, and to establish a corporate structure capable of generating stable earnings.

The operating environment in the pharmaceutical wholesale industry is expected to change dramatically, with government reforms to the healthcare system reforms and the shift to independent administration at public hospitals. Under these conditions, the Kuraya Sanseido Group will increase operating efficiency and improve corporate value by deploying its industry leadership and maintaining its strengths in each of its businesses, while making the most of its enhanced capabilities and consolidating management resources. By doing so, we will carry out the objectives of the medium-term consolidated management plan and further improve results.

The MEDICEO Group has adopted a new management philosophy of "Contributing to people's health and the advancement of society through creation of value in distribution." Accordingly, we aim to increase our corporate value by strengthening our role and function in providing pharmaceutical products to medical institutions and other customers, and ultimately to patients and consumers. We ask for the continued trust and support of our shareholders and investors as we work to fulfill our mission.

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SADATAKE KUMAKURA  
President and Chief Executive Officer