

>>> INTERVIEW WITH PRESIDENT AND CEO

# SADATAKE KUMAKURA

*Adapting to changes in the pharmaceutical wholesale industry, in April 2004 Kuraya Sanseido launched a new business group, the MEDICEO Group, to establish a position as a national wholesaler. Starting in October 2004, the MEDICEO Group will consist of 16 consolidated companies, with an operating holding company at the center. In the following interview, President and CEO Sadatake Kumakura explains the purpose of this reorganization, as well as future growth strategies.*

**For the year ended March 31, 2004, Kuraya Sanseido posted growth in sales and income for the third consecutive year. What factors contributed to these positive results?**

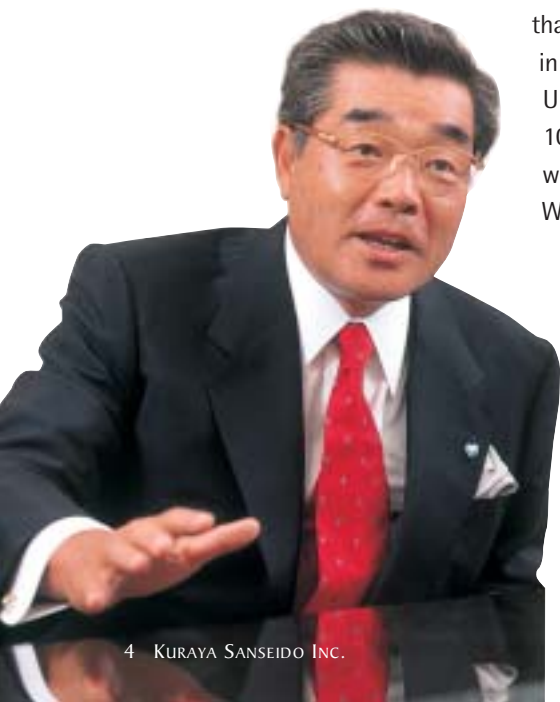
In the past fiscal year, we initiated a policy of establishing a new cost basis in our drive to be number one in our industry both in name and reality. The greatest weakness of our company has been a high level of selling, general and administrative (SG&A) expenses. We overhauled the fundamental structure of SG&A expenses to overcome this weakness. Key components of this effort were the integration of core systems and the introduction of a new personnel system. Because we were able to implement both measures at the beginning of the period, they contributed to results for the fiscal year.

System integration has been an issue since the merger. For more than two years, we worked to build new core systems that would enable efficient wholesale operations, and we completed this successfully. In October 2003, we began the staged integration of Group companies, which is moving ahead on schedule toward its completion in fall 2006. For the new personnel system, in April 2003 we shifted from a seniority-based wage system to one that is based on job standards and performance. This is rapidly bringing our personnel expenses under control, and was a factor in their decrease during the past fiscal year. The ratio of SG&A expenses to net sales has steadily declined for the past three years, and our success in setting up these basic structures will allow us to continue reducing these costs as planned.

**Please explain the background to the formation of the MEDICEO Group.**

The original impetus for our drive to become a national wholesaler was the entry of foreign manufacturers in the Japanese market. These companies generally have larger new drug pipelines than Japanese manufacturers, so we believed their market share in Japan would inevitably expand. One thing that foreign manufacturers all talked about was the high cost of pharmaceutical distribution in Japan. They pointed out that distribution in Japan costs more than in Europe and the United States, and asked why it costs 4-5 percent in the United States but as much as 9 or 10 percent in Japan. But since bypassing the wholesale system and conducting direct sales would cost even more, foreign manufacturers had no choice but to go through wholesalers. We thought that as long as they had to use a wholesaler, they would prefer an efficient one with nationwide operations, so we set out to become just such a wholesaler.

Subsequently, the division of prescription and dispensing functions took place, and the retail market began to shift from individual local pharmacies to nationwide dispensing pharmacy chains. This has further fueled the need for a national wholesale distributor. Furthermore, with the move to independent administration at public hospitals, medical institutions can now conduct nationwide bulk purchasing. Awareness that wholesale distributors will also need to be able to supply products on a national scale may prompt a wave of industry realignment. We have an advantage



**The MEDICEO Group at the Start of Operations (April 1, 2004)**  
(Business alliance basis)

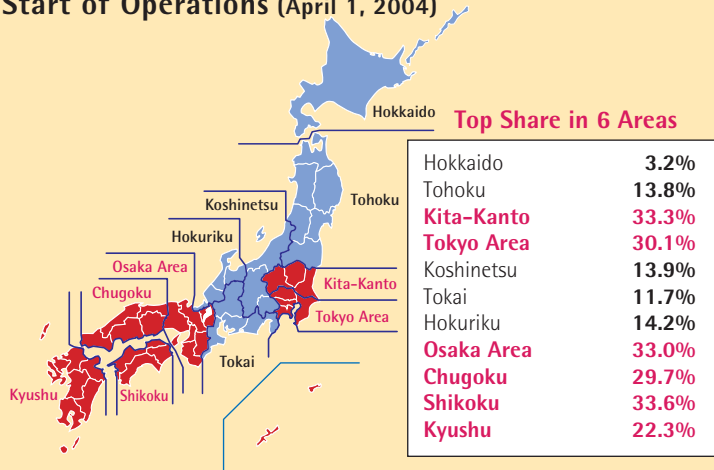
Number of Customers: 131,000  
Manufacturers Handled: 2,000

**MEDICEO Group Share**  
(Business alliance basis)

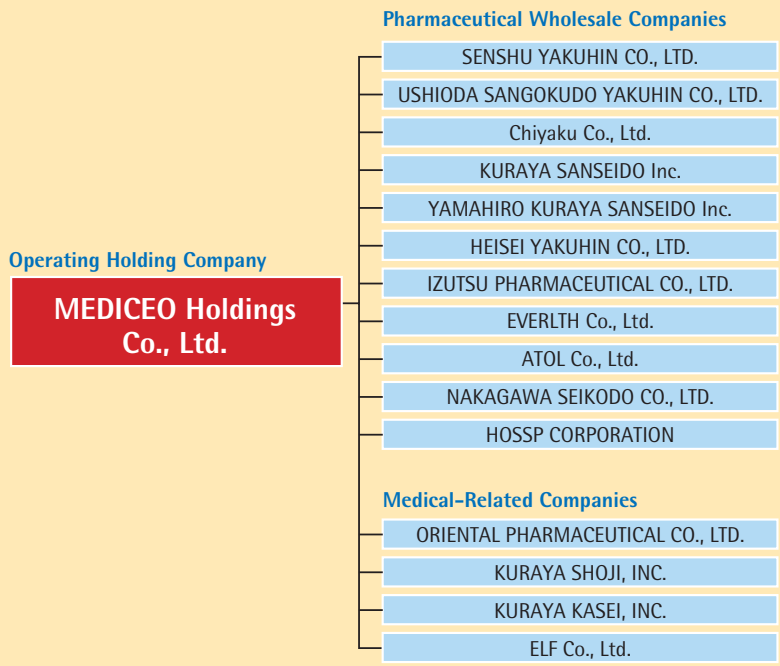
Nationwide Share 23.9%

- Covered by the MEDICEO Group
- Areas where the MEDICEO Group holds the top share

Note: Based on prescription pharmaceutical market data from CRECON Research & Consulting for the year ended March 31, 2003.



**Organization of the MEDICEO Group from October 1, 2004**



because we got an early start in integrating the MEDICEO Group, which has allowed us to establish a pharmaceutical supply network that extends to every prefecture of Japan except Okinawa.

**What are the advantages and strengths of the MEDICEO Group?**

Wholesalers are beginning to establish an important position in the pharmaceutical industry. As pharmaceutical manufacturers are battling for survival, they must concentrate their capital on research and development and overseas expansion, and are increasingly leaving domestic distribution to strong wholesalers. Another factor is that hospitals, our customers, are now required to report the number of acute and chronic beds, which will lead to a

further decrease in the number of hospital beds. In addition, our customers' operating environment is undergoing major changes, such as the implementation of the Diagnosis Procedure Combination and the requirement for public hospitals to have independent administrative bodies. In this changing environment, our customers have a critical need to improve their management operations. They want a wholesaler who will support their management improvement and who can offer business suggestions directly linked to management efficiency.

The MEDICEO Group has several strengths that allow it to respond to these market changes. First, we have already established various infrastructures in the Group, whereas in most cases, companies start doing this after the group is formed. As a result, we already have core systems in place, and we also introduced a personnel system that incorporates performance-based elements first at Kuraya Sanseido, and plan to implement it at other Group companies as well. All the systems have been established, including distribution centers and a system for implementing joint sales promotion plans. Group companies are able to take advantage of this solid infrastructure, which will allow us to quickly and steadily exploit the benefits of management integration.

Our second strength is economies of scale. Starting from October 2004, the MEDICEO Group will be structured with an operating holding company, MEDICEO Holdings Co., Ltd., as the parent company. MEDICEO Holdings will promote business strategies for the entire group and conduct bulk purchasing functions, and will also centralize administrative functions and other general back-office operations for Group companies. The MEDICEO Group will have 5,000 marketing specialists (MSs), who are in charge of sales, and we intend to make full use of this sales force, the largest and most powerful in Japan, to generate the highest level of revenues in our industry.

The third strength is region-based sales. The pharmaceutical wholesalers in the MEDICEO Group are all influential companies in their areas, and currently have the number-one share in six areas – Kita-Kanto, the Tokyo and Osaka areas, Chugoku, Shikoku and Kyushu. By specializing in sales, these companies are able to tailor their business to their respective regions and achieve high productivity. We will use this system to further enhance customer support and our ability to gather and provide information.

These strengths mean that doing business with the MEDICEO Group offers advantages for both manufacturers and customers. Their understanding of these advantages will ultimately be our greatest strength.

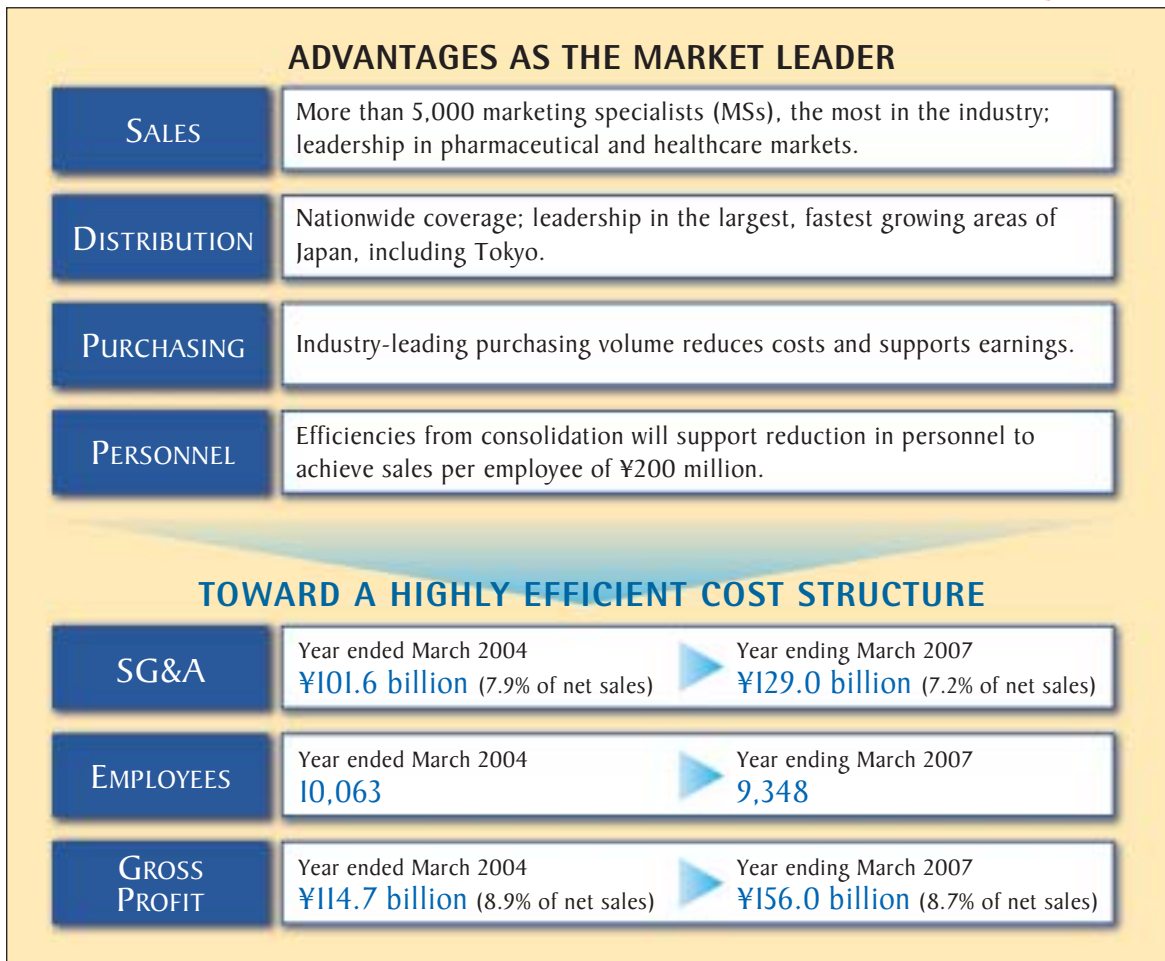
### **The vision of the medium-term consolidated management plan drawn up recently is establishing the MEDICEO brand. What is the MEDICEO brand?**

As I mentioned, the MEDICEO Group companies conduct region-oriented sales activities, and retaining their same corporate names and presidents makes it easier for them to join the Group.

Ordinarily, integration of companies takes the form of a merger. Although mergers can quickly bring about the benefits from management integration, one drawback is that they require uniform wages. To preserve regional wage differences while generating the same benefits as a merger, the best method in terms of management efficiency is bringing all systems, logistics and personnel together in a single framework, with an operating holding company at the center. This framework that achieves management efficiency while maintaining regional wage differences is the MEDICEO brand. The companies in the Group can take full advantage of the benefits generated from this shared framework as they work to increase their regional market shares. As a result, I believe the Group as a whole will be able to grow steadily.

### **What measures are you taking to raise the Group's overall strength by increasing the efficiency of the cost structure in areas such as marketing, distribution and purchasing?**

We will continue pursuing a profit-oriented strategy. MEDICEO Holdings will carry out initiatives that affect the entire Group, such as expansion of bulk purchasing and implementation of unified sales promotion plans, and will continue to ensure compliance with our original standard weighted pricing system at Group companies. In workforce reductions, we plan to reduce the number of employees by 715 over three years and 1,200 by the end of the long-term vision in five years. After we complete system integration in autumn 2006, the cost benefits of this should become clear. Firmly establishing the MEDICEO Group framework at Group companies will take time, but we expect this effort to yield steady results.



Note: Amounts for the year ended March 2004 are estimates from the medium-term consolidated management plan announced on March 12, 2004.

**What are your growth strategies in the OTC and medical equipment businesses, two strategic areas outside of the ethical drug business?**

*OTC Business*

Under government policies to improve the finances of the National Health Insurance system, the consumer healthcare market is likely to grow further. Currently, the over-the-counter market accounts for 25 percent of total drug sales in the United States, but only 12 percent in Japan. We foresee the market expanding to twice its present size in the future, and believe we can leverage the successful experience we have accumulated in the ethical drug business in this market, too. If the large number of OTC wholesalers diminishes in the future, as we have seen happen in the ethical drug market, the business environment will change dramatically. In addition, retailers and drugstores, our customers in this area, do business on a national scale, yet there is still no national wholesaler. Because of these factors, there will certainly be a need for national wholesalers in the consumer healthcare field.

*Medical Equipment Business*

The medical equipment business is similar to the ethical drug business in that our customers are hospitals, clinics and pharmacies, so there is no need to develop new customers. The combination of NAKAGAWA SEIKODO CO., LTD., a medical equipment wholesaler that became a wholly owned subsidiary in May 2004, and Kuraya Sanseido's medical equipment division, together will have the highest sales in the industry.

Currently, the size of the medical equipment market is about ¥2.6 trillion, but there are as many as 300,000 companies registered to handle medical equipment. As the leader in this field, the MEDICEO Group plans to build the medical equipment business into a revenue-generating business. We expect to be able to establish a revenue

base in this area earlier than in the consumer healthcare business, and intend to create the structure for this by the next fiscal year.

### **How do you plan to develop *medks-epi* and the Total Solution Model?**

#### *medks-epi*

The *medks-epi* system is a contract model for dispensing pharmacies that combines planned deliveries and usage-based payment. Through the end of March 2004, *medks-epi* has been introduced at 1,437 locations. We have not yet reached our target of 3,000 locations, but having the system in place at more than 1,000 locations clearly shows that it has become a well-established model. The original purpose of *medks-epi* was to lower our costs by reducing the frequency of deliveries. But as the system has been implemented, another trend has emerged: the cash flow of customers who have adopted *medks-epi* has improved and their operations run more smoothly. For the year ending March 2005, we will try once again to introduce *medks-epi* at 3,000 locations, and will also seek to improve its quality and phase in its establishment at Group companies.

#### *Total Solution Model*

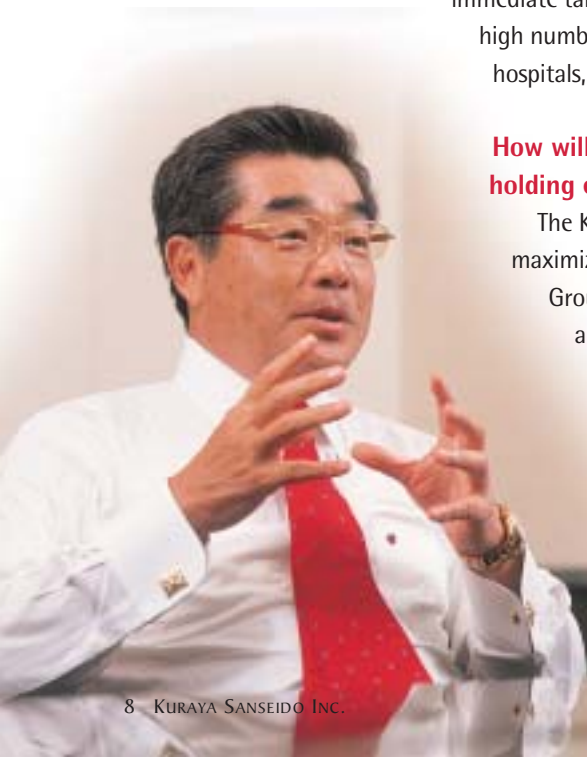
In the cost structure of hospitals, drug purchases account for about 20 percent of costs. Until now pharmaceutical wholesalers have generally not been able to provide support for the other 80 percent, which includes non-medical operations such as linen and food related work and medical coding and billing. By offering comprehensive support, we will reduce the burden of work on hospitals. This will help us to maintain our current share of sales to hospitals and ensure that the MEDICEO Group is on the winning side in non-price and added-value competition, rather than just price competition.

The centerpiece of the Total Solution Model will be recommending brands of pharmaceuticals and diagnostic materials for hospitals. In order to implement Diagnosis Procedure Combination and reduce medical errors, preparing a critical path that combines standardized treatment and pharmaceutical usage plans and procedures is becoming an important issue for hospitals, and we will provide support in that effort. Specifically, we will analyze how pharmaceuticals and other products are used and perform estimates of cost savings to create a list of standard brands of pharmaceutical products and diagnostic materials. By doing so, we can propose brand switches to conform to the budgets of hospitals.

We have been getting very good responses to the Total Solution Model in a one-year pilot project with numerous hospitals, and are now about to enter the phase of seriously implementing and expanding it. Our immediate target is to introduce the model in the current fiscal year at 30 of the 500 hospitals with a high number of acute beds. The Total Solution Model is designed for thorough incorporation into hospitals, so we plan to start out small and gradually expand it.

### **How will you conduct effective corporate governance under the new operating holding company?**

The Kuraya Sanseido Group carries out its business activities based on the policy of maximizing corporate value while ensuring sound, transparent management. The MEDICEO Group will also adhere to the same fundamental policies. Moreover, we will quickly establish a system for sharing Group company information in real time. In particular, we will accelerate the speed of transmitting negative and risk-related information by establishing a crisis management system that facilitates the exchange of information.



**Vision of the New Medium-Term Consolidated Management Plan (April 2004–March 2007)**

**Establishment of the MEDICEO Brand**

By working to reinforce and strengthen sales, purchasing and distribution functions and information systems, and meeting the wide-ranging needs of customers and partners, we will work to raise trust in the MEDICEO Group, further increase corporate value and expand its business domain.

**Consolidated Management Targets (Year ending March 2007)**

(Figures in parentheses are percentages of net sales)

<b>Net sales</b>	<b>¥1,780 billion</b>
<b>Operating income</b>	<b>¥27 billion (1.5%)</b>
<b>Net income</b>	<b>¥23 billion (1.3%)</b>
<b>Return on assets*</b>	<b>3.0%</b>
<b>Return on equity**</b>	<b>10.5%</b>

\* Return on assets = Operating income / Average total assets

\*\*Return on equity = Net income / Average total shareholders' equity

**MEDICEO Brand Logo**



**Use of Human Form for the Letter "I"**

- > A company deeply involved with human life and health
- > Corporate stance of promoting active, full lifestyles

**Use of Red**

- > Symbolizes an energetic corporate group
- > A group full of warmth and caring for people

**How do you envision the future of the MEDICEO Group? In this regard, what will you do to raise shareholder value?**

This year, Kuraya Sanseido for the first time made *Forbes* magazine's list of the World's 2,000 Leading Companies, entering at number 1,417. Among pharmaceutical manufacturers, Pfizer Inc. ranked 24th and Takeda Chemical Industries, Ltd. (currently Takeda Pharmaceutical Company Limited) was 226th. We were extremely pleased to be recognized as one of the world's leading companies.

As we embark on a new start as the MEDICEO Group, we believe we have grown into a socially essential corporate group. As we go forward, I want to build a structure in which we can grow steadily as a company with a valued presence in society. I believe that forming a corporate group that grows continually, one step at a time, rather than sharply, is our responsibility to all our stakeholders, including shareholders, customers, employees, consumers and society.

To live up to the expectations and trust of our shareholders, I believe it is important to expand earnings, pay stable dividends, and maintain or increase our stock price. I pledge to manage the MEDICEO Group so that loyal shareholders who support us and hold our stock for the long term will be rewarded.