

CONSOLIDATED BALANCE SHEETS

Kuraya Sanseido Inc. and its consolidated subsidiaries
March 31, 2003 and 2004

ASSETS	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
Current assets:			
Cash on hand and in bank (Notes 3 and 8)	¥ 70,153	¥ 70,646	\$ 666,472
Marketable securities (Note 4)	3	3	28
Notes and accounts receivable:			
Trade	340,233	338,035	3,189,009
Other	30,186	23,458	221,302
Allowance for doubtful accounts	(3,944)	(2,892)	(27,283)
Inventories	55,900	52,955	499,575
Deferred income taxes (Note 12)	4,126	3,633	34,274
Other current assets	1,895	1,808	17,057
Total current assets	498,552	487,646	4,600,434
Property, plant and equipment (Note 8):			
Land (Note 5)	48,403	46,805	441,557
Buildings and structures	78,246	76,591	722,557
Machinery and equipment	6,745	6,917	65,255
Vehicles, furniture and fixtures	9,053	9,106	85,905
Construction in progress	54	2,715	25,613
	142,501	142,134	1,340,887
Accumulated depreciation	(47,036)	(48,395)	(456,557)
Net property, plant and equipment	95,465	93,739	884,330
Investments and other assets:			
Investment securities (Notes 4 and 8)	11,956	15,004	141,547
Long-term loans receivable	399	325	3,066
Allowance for doubtful accounts	(5,180)	(5,790)	(54,623)
Software	1,817	5,189	48,953
Deferred income taxes (Note 12)	7,679	6,809	64,236
Deferred income taxes — land revaluation (Note 5)	8,456	7,975	75,236
Consolidation difference	1,987	1,156	10,906
Other	17,458	14,573	137,481
Total investments and other assets	44,572	45,241	426,802
	¥638,589	¥626,626	\$5,911,566

See accompanying notes.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
Current liabilities:			
Short-term bank loans (Notes 6 and 8)	¥ 12,299	¥ 7,339	\$ 69,236
Long-term debt due within one year (Notes 6 and 8)	969	735	6,934
Notes and accounts payable (Note 8):			
Trade	445,652	433,696	4,091,472
Other	4,550	6,795	64,104
Accrued expense	10,223	9,237	87,142
Income taxes payable (Note 12)	5,384	2,840	26,792
Other current liabilities	2,604	2,346	22,132
Total current liabilities	481,681	462,988	4,367,812
Long-term liabilities:			
Long-term debt (Notes 6 and 8)	20,462	15,201	143,406
Long-term accounts payable	—	6,062	57,189
Deferred income taxes — land revaluation (Note 5)	252	234	2,208
Employees' retirement benefits (Note 7)	16,420	9,956	93,924
Officers' retirement benefits	1,828	1,854	17,490
Other long-term liabilities	1,258	651	6,141
Total long-term liabilities	40,220	33,958	320,358
Minority interests	4,427	692	6,528
Contingent liabilities (Note 9)	—	—	—
Shareholders' equity (Note 10):			
Common stock, par value ¥50 per share:			
Authorized — 500,000,000 shares in 2003 and 2004			
Issued — 142,424,946 shares in 2003 and 147,736,054 shares in 2004	12,751	15,183	143,236
Capital surplus	25,919	30,064	283,623
Retained earnings	87,875	93,309	880,273
Revaluation surplus (Note 5)	(12,260)	(11,462)	(108,132)
Unrealized gains on certain investment securities (Note 4)	2,602	4,342	40,962
Treasury stock, at cost	(4,626)	(2,448)	(23,094)
Total shareholders' equity	112,261	128,988	1,216,868
	¥638,589	¥626,626	\$5,911,566

CONSOLIDATED STATEMENTS OF OPERATIONS

Kuraya Sanseido Inc. and its consolidated subsidiaries
Two years ended March 31, 2004

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
Net sales	¥1,274,503	¥1,283,926	\$12,112,509
Costs and expenses:			
Cost of sales	1,159,580	1,167,121	11,010,575
Selling, general and administrative expenses	104,763	101,450	957,076
Total costs and expenses	1,264,343	1,268,571	11,967,651
Operating income	10,160	15,355	144,858
Other income (expenses):			
Research fee income	2,886	3,201	30,198
Interest and dividend income	261	217	2,047
Interest expense	(388)	(306)	(2,886)
Loss on devaluation of investment securities	(313)	(300)	(2,830)
Other, net (Note 11)	(1,405)	(3,073)	(28,991)
Total other income (expenses)	1,041	(261)	(2,462)
Income before income taxes and minority interests	11,201	15,094	142,396
Income taxes (Note 12):			
Current	7,804	6,328	59,698
Deferred	(2,131)	531	5,010
Total income taxes	5,673	6,859	64,708
Minority interests in net income of consolidated subsidiaries	512	356	3,358
Net income	¥ 5,016	¥ 7,879	\$ 74,330

	Yen		U.S. dollars (Note 1)
	2003	2004	2004
Amounts per share of common stock:			
Net income	¥36.48	¥55.19	\$0.52
Diluted net income	31.50	48.65	0.46
Cash dividends applicable to the period	12.00	12.00	0.11

See accompanying notes.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Kuraya Sanseido Inc. and its consolidated subsidiaries
Two years ended March 31, 2004

	Number of shares of common stock issued (Thousands)	Millions of yen		
		Common stock	Capital surplus	Retained earnings
Balance at March 31, 2002	136,706	¥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
Loss on reverse of revaluation surplus	—	—	—	107
Retirement of treasury stock	—	—	—	(238)
Balance at March 31, 2003	142,425	¥12,751	¥25,919	¥87,875
Conversion of convertible bond into stock	5,311	2,432	2,432	—
Retirement of treasury stock, net of the cost	—	—	1,713	—
Net income	—	—	—	7,879
Cash dividends paid (¥12.0 per share)	—	—	—	(1,645)
Bonuses to directors and statutory auditors	—	—	—	(151)
Reverse of revaluation surplus	—	—	—	(649)
Balance at March 31, 2004	147,736	¥15,183	¥30,064	¥93,309

	Thousands of U.S. dollars (Note 1)		
	Common stock	Capital surplus	Retained earnings
Balance at March 31, 2003	\$120,293	\$244,519	\$829,009
Conversion of convertible bond into stock	22,943	22,943	—
Retirement of treasury stock, net of the cost	—	16,161	—
Net income	—	—	74,330
Cash dividends paid (¥12.0 per share)	—	—	(15,519)
Bonuses to directors and statutory auditors	—	—	(1,425)
Reverse of revaluation surplus	—	—	(6,122)
Balance at March 31, 2004	\$143,236	\$283,623	\$880,273

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Kuraya Sanseido Inc. and its consolidated subsidiaries
Two years ended March 31, 2004

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
Cash flows from operating activities:			
Income before income taxes	¥11,201	¥15,094	\$142,396
Adjustments to reconcile income before income taxes to net cash flows provided by operating activities:			
Depreciation and amortization	5,204	5,709	53,858
Amortization of consolidation difference	732	726	6,849
Loss on disposal of property, plant and equipment — net	862	1,771	16,708
(Increase) decrease in employees' retirement benefits — net	1,811	(6,464)	(60,981)
Increase (decrease) in officers' retirement benefits	(28)	26	245
Increase (decrease) in accrued employees' bonuses	818	(988)	(9,321)
Increase (decrease) in allowance for doubtful accounts	374	(443)	(4,179)
Increase (decrease) in allowance for returns	29	(6)	(57)
Interest expenses	388	306	2,887
Interest and dividend income	(261)	(217)	(2,047)
Loss on sale and devaluation of securities — net	286	296	2,792
Loss on sale and devaluation of golf memberships — net	182	37	349
(Increase) decrease in notes and accounts receivable — trade	(2,872)	1,464	13,811
(Increase) decrease in inventories	(2,315)	2,929	27,632
Increase (decrease) in notes and accounts payable	1,496	(11,956)	(112,792)
Increase (decrease) in accrued consumption taxes	225	(292)	(2,755)
Decrease in other current assets	1,488	6,788	64,038
Increase (decrease) in other current liabilities	(1,772)	7,968	75,170
Payment of officers' bonuses	(22)	(163)	(1,538)
Interest and dividends received	261	217	2,047
Cash paid for interest	(386)	(303)	(2,858)
Cash paid for income taxes	(6,183)	(8,873)	(83,708)
Gain on sale of businesses	—	(160)	(1,509)
Others	(9)	(219)	(2,065)
Net cash provided by operating activities	¥11,509	¥13,247	\$124,972

See accompanying notes.

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
Cash flows from investing activities:			
Payments for time deposits	¥ (1,659)	¥ (265)	\$ (2,500)
Maturity of time deposits	1,990	1,509	14,236
Payments for purchase of property, plant and equipment — net	(4,954)	(3,680)	(34,717)
Payments for purchase of investment securities	(452)	(117)	(1,104)
Proceeds from sale of investment securities	169	12	113
Decrease in loans receivable — net	(10)	(218)	(2,057)
Payments for purchase of investment in subsidiary	(230)	(12)	(113)
Proceeds from sale of businesses	—	397	3,745
Other, net	(1,394)	(1,866)	(17,603)
Net cash used in investing activities	(6,540)	(4,240)	(40,000)
Cash flows from financing activities:			
Decrease in short-term bank loans — net	(3,641)	(4,960)	(46,792)
Proceeds from long-term debt	800	400	3,774
Repayment of long-term debt	(1,406)	(1,030)	(9,717)
Repayment of convertible bonds	(4)	—	—
Proceeds from issuance of common stock	4	—	—
Purchase of treasury stock	(4,250)	(14)	(132)
Cash dividends paid	(1,610)	(1,645)	(15,519)
Cash dividends paid to minority shareholders	(16)	(21)	(199)
Net cash used in financing activities	(10,123)	(7,270)	(68,585)
Effect of exchange rate change on cash and cash equivalents	3	—	—
Net increase (decrease) in cash and cash equivalents	(5,151)	1,737	16,387
Cash and cash equivalents at beginning of year	73,934	68,375	645,047
Cash and cash equivalents in connection with merger of non-consolidated subsidiary	13	—	—
Cash and cash equivalents in connection with exclusion of consolidation for certain subsidiary	(421)	—	—
Cash and cash equivalents at end of year	¥68,375	¥70,112	\$661,434

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Kuraya Sanseido Inc. and its consolidated subsidiaries
Two years ended March 31, 2004

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, 2004, which was ¥106.00 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 Kuraya Sanseido Inc. and ten domestic subsidiaries in 2003 and 2004, which are significant.

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 affiliates are stated at cost, since net income 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, 2003 and 2004, 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 at the year incurred over three years using the straight-line method.

Effective April 1, 2004, Kuraya Sanseido Inc. amended its retirement benefit plan. The new plan consists of the defined benefit plan and defined contribution plan instead of tax-qualified pension plan and unfunded retirement plan, respectively. The Company adopted "Accounting for Amendment of Retirement Benefit Plan" pronounced by Financial Accounting Standards Foundation ("FASF").

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 "Accounting Standards for Net Income per Share" pronounced by FASF on September 25, 2002, the net income excludes the bonuses to directors and statutory auditors.

For computing diluted net income per share of common stocks, the average number of shares was increased by the number of shares that would have been outstanding assuming that 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, 2003 and 2004 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2003	2004	2004
Cash on hand and in bank	¥70,153	¥70,646	\$666,472
Time deposits over three months	(1,778)	(534)	(5,038)
Cash and cash equivalents	¥68,375	¥70,112	\$661,434

4. Market value information for securities

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

Year ended March 31, 2004	Millions of yen		
	Carrying value	Estimated fair value	Unrealized gain
Securities whose fair value exceeds their carrying value:			
Equity securities	¥3,843	¥12,303	¥8,460
Government bonds and corporate bonds	5	5	—
Others	—	—	—
	¥3,848	¥12,308	¥8,460
Securities whose carrying value exceeds their fair value:			
Equity securities	¥ 478	¥ 424	¥ (54)
Government bonds and corporate bonds	—	—	—
Others	—	—	—
	¥ 478	¥ 424	¥ (54)
Total	¥4,326	¥12,732	¥8,406

Year ended March 31, 2004	Thousands of U.S. dollars		
	Carrying value	Estimated fair value	Unrealized gain
Securities whose fair value exceeds their carrying value:			
Equity securities	\$36,255	\$116,066	\$79,811
Government bonds and corporate bonds	47	47	—
Others	—	—	—
	\$36,302	\$116,113	\$79,811
Securities whose carrying value exceeds their fair value:			
Equity securities	\$ 4,509	\$ 4,000	\$ (509)
Government bonds and corporate bonds	—	—	—
Others	—	—	—
	\$ 4,509	\$ 4,000	\$ (509)
Total	\$40,811	\$120,113	\$79,302

Year ended March 31, 2003	Millions of yen		
	Carrying value	Estimated fair value	Unrealized gain
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

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

	Millions of yen		Thousands of U.S. dollars
	2003	2004	2004
Two years ended March 31, 2004			
Sales value	¥208	¥15	\$142
Profit on sale	34	4	38
Loss on sale	7	—	—

(3) Securities without a market value and book value

	Millions of yen		Thousands of U.S. dollars
	2003	2004	2004
Two years ended March 31, 2004			
Held-to-maturity debt securities	¥ —	¥ —	\$ —
Other securities	1,407	1,373	12,953

(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	
	2003		2004		2004	
	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	¥3	¥5	¥3	¥5	\$28	\$47
Others	—	—	—	—	—	—
Total	¥3	¥5	¥3	¥5	\$28	\$47

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 statements of operations. 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, 2004 were as follows:

	Millions of yen	Thousands of U.S. dollars
Land before revaluation	¥60,975	\$575,236
Land after revaluation	41,658	393,000
Land revaluation excess (Net deferred tax)	11,462	108,132
Estimated fair value	35,366	333,642

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

The Company has credit agreements with 20 banks in order to support effective financing. The lines of credit and bank loans under the credit agreements at March 31, 2003 and 2004 are listed below.

	Millions of yen		Thousands of U.S. dollars
	2003	2004	2004
Lines of credit	¥ 70,200	¥72,300	\$682,075
Balance of bank loans	(10,995)	(6,615)	(62,405)
Net: Open lines of credit	¥ 59,205	¥65,685	\$619,670

Short-term bank loans including loans under the credit agreement at March 31, 2003 and 2004 were principally bearing annual interest rates of 1.03% and 0.96% per annum, respectively.

Long-term debt at March 31, 2003 and 2004 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2003	2004	2004
Unsecured domestic convertible bonds due 2008 at a rate of 0.9%	¥19,324	¥14,459	\$136,406
Loans from banks due serially through 2016 at interest rates of 1.00% to 3.60% per annum - secured	2,107	1,477	13,934
	21,431	15,936	150,340
Less amount due within one year	(969)	(735)	(6,934)
Amount due after one year	¥20,462	¥15,201	\$143,406

Domestic convertible bonds due 2008 provide, among other conditions, for (1) conversion prices of ¥916.0 (\$8.60) and (2) convertible period from October 1, 1996 to September 29, 2008.

At the current conversion price, a total of 15,784 thousand shares of common stock were issuable upon full conversion of the domestic bonds outstanding at March 31, 2004.

The annual maturities of long-term debt at March 31, 2004 were as follows:

	Millions of yen	Thousands of U.S. dollars
2005	¥ 735	\$ 6,934
2006	403	3,802
2007	194	1,830
2008	28	264
2009	14,474	136,547
Thereafter	102	963

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.

Effective April 1, 2004, Kuraya Sanseido Inc. amended its retirement benefit plan. The new plan consists of the defined benefit plan covering the contributory trustee employee pension plan and new pension plan, instead of the tax-qualified pension plan and the defined contribution plan instead of the unfunded retirement plan.

(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, 2003 and 2004.

	Millions of yen		Thousands of U.S. dollars
	2003	2004	2004
Projected benefit obligation	¥(35,900)	¥(30,269)	\$(285,557)
Fair value of plan assets	17,107	19,025	179,481
Plan assets less than projected benefit obligation	(18,793)	(11,244)	(106,075)
Experience adjustments of actuarial assumptions	2,373	1,288	12,151
Reserve for retirement benefits	¥(16,420)	¥ (9,956)	\$ (93,924)

Effects of providing the defined contribution plan instead of the unfunded retirement plan were as follows:

	Millions of yen	Thousands of U.S. dollars
Decrease in projected benefit obligation	¥7,811	\$73,689
Unamortized experience adjustments of actuarial assumption	376	3,547
Decrease in employees' retirement benefits	¥7,435	\$70,142

Loss on amendment to the pension plan amounted to ¥567 million (\$5,349 thousand). Assets in the amount of ¥8,002 million (\$75,491 thousand) will be contributed to the pension fund over a period of 4 years. The unpaid amount of ¥8,002 million (\$75,491 thousand) was recorded in other current liabilities and long-term accounts payable in 2004.

(3) Net pension expense

The components of net pension expense in 2003 and 2004 are listed below.

	Millions of yen		Thousands of U.S. dollars
	2003	2004	2004
Service costs	¥2,693	¥2,418	\$22,811
Interest cost on projected benefit obligation	1,066	1,058	9,981
Assumed return on plan assets	(597)	(433)	(4,085)
Experience adjustments of actuarial assumptions	1,886	1,795	16,934
Loss on amendment to defined contribution plan	—	567	5,349
Net pension expense	¥5,048	¥5,405	\$50,990

In addition to the pension expense above, additional retirement benefit on the early retirement plan is recorded in the amount of ¥1,362 million (\$12,849 thousand).

(4) Assumptions

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

	2003	2004
Discount rate	3.0%	2.5%
Assumed rate of return on plan assets	3.0%	2.5%
Amortization period for experience adjustments of actuarial assumptions	3 years	3 years

(5) Contributory trustee employee pension plan

Assets of the contributory trustee employee pension plan established by the pharmaceutical industry amount to ¥35,651 million (\$336,330 thousand) at March 31, 2004 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 ¥27,866 million (\$262,887 thousand) as well as certain bank loans at March 31, 2004.

	Millions of yen	Thousands of U.S. dollars
Land	¥6,272	\$59,170
Buildings and structures at net book value	2,730	25,755
Investment securities	959	9,047
Time deposits	160	1,509

9. Contingent liabilities

Contingent liabilities of the Company at March 31, 2004 were guarantees for loans from banks of unconsolidated subsidiaries, affiliates and others in the amount of ¥143 million (\$1,349 thousand).

10. Shareholders' equity

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 the legal reserve and capital surplus until an aggregated amount of the legal reserve and capital surplus equals 25% of common stock.

The legal reserve and capital surplus 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, 2004 comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2003	2004	2004
Gain on sale of investment securities–net	¥ 26	¥ 4	\$ 38
Loss on disposal of property, plant and equipment – net	(862)	(677)	(6,387)
Loss on devaluation of securities	(313)	(300)	(2,830)
Loss on devaluation of golf memberships	(132)	(37)	(349)
Restructuring costs	(45)	(1,477)	(13,934)
Additional retirement benefit for employees	(1,079)	(1,362)	(12,849)
Miscellaneous	1,000	776	7,320
	¥(1,405)	¥(3,073)	\$ (28,991)

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, 2003 and 2004.

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, 2003 and 2004 is presented as follows:

	2003	2004
Statutory tax rate	42.1%	42.1%
Non-deductible expenses for tax purposes	3.5	2.0
Minimum inhabitant taxes	1.7	1.1
Effect of change in tax rate for deferred taxes	2.2	—
Tax benefit for information technology (IT) investment	—	(4.3)
Others	1.1	4.5
Effective tax rate	50.6%	45.4%

Significant components of the deferred tax assets and liabilities of the Company as of March 31, 2003 and 2004 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2003	2004	2004
Deferred tax assets:			
Excess bad debt expenses	¥ 2,652	¥ 2,279	\$ 21,500
Excess bonuses accrued	2,541	2,453	23,142
Enterprise taxes	659	266	2,509
Retirement benefits	5,492	6,787	64,028
Disallowed provision for officers' retirement benefits	749	756	7,132
Other	3,691	3,216	30,340
Total deferred tax assets	15,784	15,757	148,651
Deferred tax liabilities:			
Excess tax depreciation	(1,128)	(1,196)	(11,283)
Unrealized gain on certain investment securities	(2,152)	(3,423)	(32,292)
Other	(699)	(696)	(6,567)
Total deferred tax liabilities	(3,979)	(5,315)	(50,142)
Net deferred tax assets	¥11,805	¥10,442	\$ 98,509

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, 2004 were ¥5,555 million (\$52,406 thousand), including ¥1,722 million (\$16,245 thousand) due within one year.
- (2) Lease payments for fiscal 2003 and 2004 were ¥2,436 million and ¥2,056 million (\$19,396 thousand), respectively.

14. Transactions with principal shareholder

The following are transactions between the Company and a principal shareholder of Kuraya Sanseido Inc. which owns more than 10% interest:

	Millions of yen	Thousands of U.S. dollars
Principal shareholder	Takeda Chemical Industries, Ltd.	
Common stock	¥63,540	\$599,434
Principal business	Pharmaceutical product manufacturer	
Percentage of total shares	13.93%	
Description of the Company's transactions:		
Purchase amounts from April 2003 to March 2004	¥189,413	\$1,786,915
Research fee income amounts from April 2003 to March 2004	520	4,906
Balance of accounts payable-trade, as of March 31, 2004	45,796	432,038
Balance of accounts receivable-other, as of March 31, 2004	3,452	32,566

15. 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, 2004.

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, 2004.

16. Subsequent events

- (1) On June 29, 2004, shareholders of Kuraya Sanseido Inc. approved the payment of a cash dividend of ¥6.00 (\$0.06) per share to shareholders of record at March 31, 2004, for a total payment of ¥864 million (\$ 8,150 thousand).
- (2) Exchange of Kuraya Sanseido Inc. common stock for Atol Co., Ltd. ("Atol") and Everlth Co., Ltd. ("Everlth") common stock.

On April 1, 2004, Kuraya Sanseido Inc. exchanged its common stock for the common stock of Atol and Everlth in order to enhance the efficiency of business activities and increase corporate value by providing business services through a national network and concentrating corporate resources. Atol and Everlth became wholly owned subsidiaries of Kuraya Sanseido Inc. under the exchange.

As a result, Kuraya Sanseido Inc. common shares issued increased by 35,681,868 shares and capital surplus increased by ¥33,684 million (\$317,774 thousand).

The increase in capital surplus was accounted for in accordance with the Japanese Institute of Certified Public Accountants (JICPA) Accounting Committee Research Report No. 6, "Consolidation Procedures in Creation of Parent-Subsidiary Relationships by Means of System of Exchange and Transfer of Stocks," issued in February 2001.

The share exchange ratio was 0.93 shares of Kuraya Sanseido Inc. common stock per share of Atol and Everlth common stock, respectively. Common shares were issued to the shareholders of Atol and Everlth based on this exchange ratio. However, the 193,000 shares of Atol and 140,000 shares of Everlth held by Kuraya Sanseido Inc. were not exchanged.

Financial information of Atol

	Millions of yen	Thousands of U.S. dollars
Common stock:	¥3,966	\$37,415
Principal business:	Pharmaceutical product wholesaler	
Financial results for the year ended March 31, 2004:		
Sales	¥176,916	\$1,669,019
Operating income	2,245	21,179
Net income	1,263	11,915
Total assets, total liabilities and shareholders' equity at March 31, 2004:		
Total assets	¥95,385	\$899,858
Total liabilities	59,440	560,755
Total shareholders' equity	35,945	339,104

Financial information of Everlth

	Millions of yen	Thousands of U.S. dollars
Common stock:	¥1,510	\$14,245
Principal business:	Pharmaceutical product wholesaler	
Financial results for the year ended March 31, 2004:		
Sales	¥140,263	\$1,323,236
Operating income	1,055	9,953
Net income	1,152	10,868
Total assets, total liabilities and shareholders' equity at March 31, 2004:		
Total assets	¥81,859	\$772,255
Total liabilities	47,181	445,104
Total shareholders' equity	34,678	327,151

- (3) Exchange of Kuraya Sanseido Inc. common stock for Nakagawa Seikodo Co., Ltd. ("Nakagawa Seikodo") common stock

On May 1, 2004, Kuraya Sanseido Inc. exchanged its common stock for the common stock of Nakagawa Seikodo in order to support business activities under its management strategy. Nakagawa Seikodo became a wholly owned subsidiary of Kuraya Sanseido Inc.

As a result, Kuraya Sanseido Inc. common shares issued and outstanding increased by 1,918,059 shares and capital surplus increased by ¥467million (\$4,406 thousand).

The increase in capital surplus was accounted for in accordance with JICPA Accounting Committee Research Report No. 6, "Consolidation Procedures in Creation of Parent-Subsidiary Relationships by Means of System of Exchange and Transfer of Stocks," issued in February 2001.

The share exchange ratio was 3.419 shares of Kuraya Sanseido Inc. common stock per share of Nakagawa Seikodo common stock. Common shares were issued to shareholders of Nakagawa Seikodo based on this exchange ratio.

Financial information of Nakagawa Seikodo

	Millions of yen	Thousands of U.S. dollars
Common stock:	¥281	\$2,651
Principal business:	Pharmaceutical product wholesaler	
Financial results for the year ended March 31, 2004:		
Sales	¥27,247	\$257,047
Operating income	52	491
Net income	195	1,840
Total assets, total liabilities and shareholders' equity at March 31, 2004:		
Total assets	¥14,007	\$132,142
Total liabilities	11,944	112,679
Total shareholders' equity	2,063	19,462

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, 2003 and 2004, and the related consolidated statements of operations, shareholders' equity and cash flows for the two years ended March 31, 2004. 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Kuraya Sanseido Inc. and subsidiaries as of March 31, 2003 and 2004, and the consolidated results of their operations and their cash flows for the two years ended March 31, 2004, in conformity with accounting principles generally accepted in Japan.

As discussed in Note 16 to the consolidated financial statements, Kuraya Sanseido Inc. exchanged its common stock for common stocks of Atol Co., Ltd. and Everlth Co., Ltd. on April 1, 2004 whereby Atol Co., Ltd. and Everlth Co., Ltd. are wholly owned subsidiaries of Kuraya Sanseido Inc.

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 29, 2004

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.