

Management's Discussion and Analysis

Five-Year Summary

MEDICEO Holdings Co., Ltd. and its consolidated subsidiaries
Years ended March 31

	Millions of yen				Thousands of U.S. dollars (Note 1)	
	2001	2002	2003	2004	2005	2005
For the Year:						
Net sales	¥1,073,016	¥1,222,222	¥1,274,503	¥1,283,926	¥1,665,816	\$15,568,374
Gross profit	96,741	106,644	114,923	116,805	137,806	1,287,897
Selling, general and administrative expenses	94,792	100,863	104,763	101,450	126,819	1,185,224
Operating income	1,949	5,781	10,160	15,355	10,987	102,682
Net income	1,337	2,951	5,016	7,879	8,730	81,589
Depreciation and amortization	4,025	4,866	5,204	5,709	7,625	71,262
Capital expenditures (payment base)	4,287	5,663	6,206	4,974	7,812	73,009
Per Share Data:						
Net income (Note 2)	¥ 9.80	¥ 21.67	¥ 36.48	¥ 55.19	¥ 45.90	\$ 0.43
Diluted net income	9.02	18.92	31.50	48.65	43.52	0.41
Total shareholders' equity (Note 3)	899.68	823.75	828.14	893.84	904.59	8.45
Cash dividends applicable to the period	12.00	12.00	12.00	12.00	12.00	0.11
At Year-End:						
Total assets	¥ 652,368	¥ 644,248	¥ 638,589	¥ 626,626	¥ 848,416	\$ 7,929,121
Interest-bearing debt	42,681	41,177	33,730	23,275	15,660	146,355
Total shareholders' equity	122,992	110,650	112,261	128,988	168,104	1,571,065
Ratios:						
Return on assets (Note 4)	0.4%	0.9%	1.6%	2.4%	1.5%	
Return on equity (Note 5)	1.1	2.5	4.5	6.5	5.9	
Number of employees	8,226	7,780	7,741	7,468	9,496	

Notes: 1. The U.S. dollar amounts in this report represent translations of Japanese yen, for convenience only, at the rate of ¥107.00 to U.S. \$1.00, the approximate exchange rate on March 31, 2005.

2. Net income per share = (Net income - Officers' bonuses) / (Average shares outstanding during the year - Average treasury stock during the year)

3. Total shareholders' equity per share = (Total shareholders' equity - Officers' bonuses) / (Shares outstanding at end of year - Treasury stock)

4. Return on assets = Operating income / Average total assets

5. Return on equity = Net income / Average total shareholders' equity

Overview of Results

In the pharmaceutical industry, despite factors including a reduction of National Health Insurance (NHI) drug prices in April 2004, the market overall showed moderate growth due to increased demand for influenza and allergy treatments.

The MEDICEO Group conducted regional sales activities tailored to each of its areas of operation while working to establish a nationwide network, and increased efficiency through further concentration of management resources to enhance corporate value. As part of these efforts, the MEDICEO Group made EVERLTH Co., Ltd. and ATOL Co., Ltd. wholly owned subsidiaries of KURAYA SANSEIDO Inc. on April 1, 2004 using the share exchange system. In addition, KURAYA SANSEIDO Inc. became an operating holding company and changed its corporate name to MEDICEO Holdings Co., Ltd. through a spin-off on October 1, 2004. At the same time, a restructured KURAYA SANSEIDO Inc. assumed the Company's pharmaceutical wholesale business and continued operations as before.

The MEDICEO Group worked to create a nationwide network and promoted area restructuring and other measures aimed at enhancing operating activities and making them more efficient. On April 1, 2004,

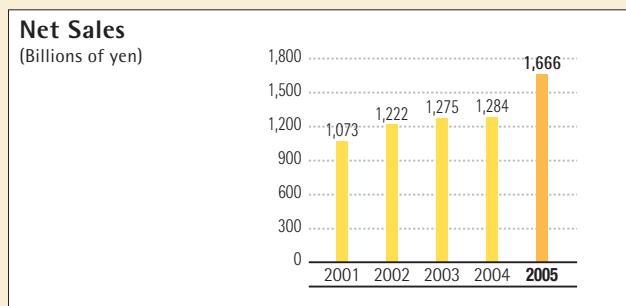
MEDICEO Holdings Co., Ltd (the "Company") transferred its business related to wholesale distribution of pharmaceuticals in Nagano Prefecture to YAMAHIRO Inc., which changed its name to YAMAHIRO KURAYA SANSEIDO Inc. In addition, the restructured KURAYA SANSEIDO Inc. transferred its wholesale distribution of prescription pharmaceuticals in Okayama and Hiroshima to EVERLTH Co., Ltd. on October 1, 2004, and assumed the pharmaceutical wholesale operations of Yurisanyakukan Co., Ltd. on February 1, 2005. On July 1, 2004, the Company took over business related to wholesale distribution of OTC pharmaceuticals from SENSU YAKUHIN CO., LTD. and USHIODA SANGOKUDO YAKUHIN CO., LTD. In the medical equipment field, the MEDICEO Group made NAKAGAWA SEIKODO CO., LTD. a wholly owned subsidiary of KURAYA SANSEIDO Inc. on May 1, 2004 by a simple exchange of shares, and merged the wholly owned subsidiary HOSSP CORPORATION into NAKAGAWA SEIKODO CO., LTD. on January 1, 2005. Furthermore, the Company transferred business related to the sale of clinical diagnostics in Kyoto and Shiga prefectures to IZUTSU PHARMACEUTICAL CO., LTD. on April 1, 2004.

The MEDICEO Group also worked to promote unified sales initiatives in the prescription pharmaceuticals segment, and to reduce the cost of

sales ratio through measures such as expanding joint purchasing. In addition, the Group worked to reduce costs through measures such as integrating core business systems, and constructed and began operation of the Health Care Higashinippon Distribution Center in Saitama Prefecture to support the stable supply and efficient distribution of health care products.

Sales and Operating Income

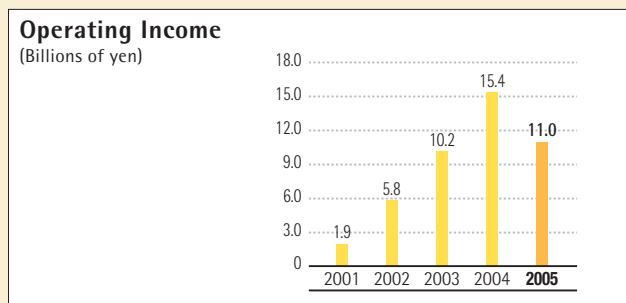
Consolidated net sales for the year ended March 31, 2005 increased 29.7 percent year-on-year to ¥1,665,816 million. The increase in net sales was significantly higher than the growth of the market as a whole because of the greater number of consolidated subsidiaries during the fiscal year, including EVERLTH Co., Ltd. and ATOL Co., Ltd.



Gross profit increased 18.0 percent to ¥137,806 million, due mainly to increased sales volume resulting from expansion of the MEDICEO Group. The ratio of gross profit to net sales decreased to 8.3 percent from 9.1 percent for the previous fiscal year, due to lower selling prices and unprecedented pressure on drug price margins in negotiations with some medical institutions and dispensing pharmacies.

Selling, general and administrative (SG&A) expenses increased 25.0 percent to ¥126,819 million. The ratio of SG&A expenses to net sales was 7.6 percent, compared to 7.9 percent for the previous fiscal year. The MEDICEO Group has moved to reduce SG&A expenses and benefit fully from increased sales by integrating core business systems for marketing, distribution and accounting, and by reforming its retirement benefit system.

Operating income decreased 28.4 percent to ¥10,987 million. The operating margin was 0.7 percent, compared to 1.2 percent for the previous fiscal year. Management expects that ongoing programs to integrate Group operations and raise efficiency will enhance economies of scale and lead to improvement in the operating margin.



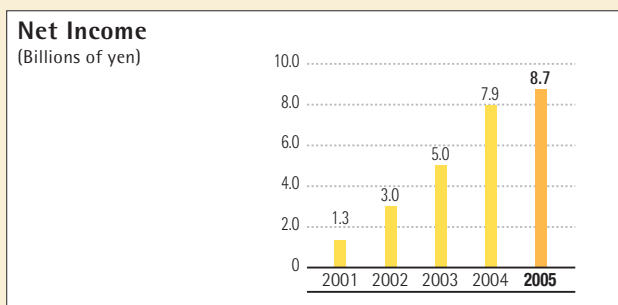
Other Income (Expenses)

Total other income (expenses) amounted to net other income of ¥8,318 million, compared to net other expense of ¥261 million for the previous fiscal year. Research fee income increased 32.8 percent to ¥4,252 million. Another primary factor in the year-on-year change was amortization of consolidation difference totaling ¥6,628 million, which represents amortization of goodwill related to newly consolidated subsidiaries. As discussed in Note 11 to the consolidated financial statements, the MEDICEO Group also generated gain on sale of property, plant and equipment totaling ¥2,131 million, and gain on sale of investment securities totaling ¥1,669 million. These one-time gains were offset by one-time expenses including ¥1,064 million in restructuring costs and ¥1,190 million for loss on dissolution of employees' pension fund plan in connection with changes to the retirement plan of a newly consolidated subsidiary. Reflecting the Company's consistent program of reducing interest-bearing debt, interest expense decreased 23.2 percent to ¥235 million. The interest coverage ratio was 50.2 times, compared to 50.9 times for the previous fiscal year.

As a result of the above factors, income before income taxes and minority interests increased 27.9 percent to ¥19,305 million.

Net Income

Income taxes net of deferrals increased 53.1 percent to ¥10,503 million, reflecting additional payment of deferred income taxes during the fiscal year. Net income increased 10.8 percent to ¥8,730 million. Net income per share decreased to ¥45.90, compared to ¥55.19 for the previous fiscal year, and fully diluted net income per share decreased to ¥43.52 from ¥48.65 for the previous fiscal year. Earnings per share decreased despite higher net income because of the expansion of the MEDICEO Group, as the average number of shares outstanding on a consolidated basis for the fiscal year ended March 31, 2005 was 185,084,168 shares, compared to 138,028,164 shares for the previous fiscal year.



Costs, Expenses and Income as a Percentage of Net Sales

Years ended March 31	2003	2004	2005	Increase (decrease) 2005 vs. 2004
Cost of sales	91.0%	90.9%	91.7%	0.8
Gross profit	9.0	9.1	8.3	(0.8)
SG&A expenses	8.2	7.9	7.6	(0.3)
Operating income	0.8	1.2	0.7	(0.5)
Income before income taxes and minority interests	0.9	1.2	1.2	—
Net income	0.4	0.6	0.5	(0.1)

Dividends

The MEDICEO Group places high priority on returning profits to shareholders, and works to increase profitability to provide stable dividends while increasing retained earnings to use in developing business and strengthening operations. Cash dividends per share applicable to the fiscal year ended March 31, 2005 remained unchanged from the previous fiscal year at ¥12.00. The payout ratio for the fiscal year on an undiluted basis was 26.1 percent.

Financial Strategy

The financial strategy of the MEDICEO Group centers on creating sufficient liquidity and capital for operating needs and a sound balance sheet. Capital investment in plant and equipment is carried out according to clearly defined plans.

Liquidity and Financial Position

Net cash provided by operating activities increased 98.5 percent to ¥26,301 million. Changes in working capital resulting from the increased scale of the MEDICEO Group complemented the increase in income before income taxes and depreciation and amortization. The substantial increase in notes and accounts payable more than offset the use of cash to increase trade receivables, inventories and other current assets. Working capital more than doubled to ¥59,378 million from ¥24,658 million a year earlier, and the current ratio was 1.10 to 1, compared to 1.05 to 1 at March 31, 2004.

Net cash provided by investing activities totaled ¥31,279 million. In the previous fiscal year, investing activities used net cash totaling ¥4,240 million. The primary factor in the year-on-year change was proceeds from acquisition of subsidiary stock due to change in the scope of consolidation totaling ¥35,258 million, which resulted from the increase in scale of the MEDICEO Group as discussed above. Net payments for purchase of property, plant and equipment decreased 1.8 percent to ¥3,615 million.

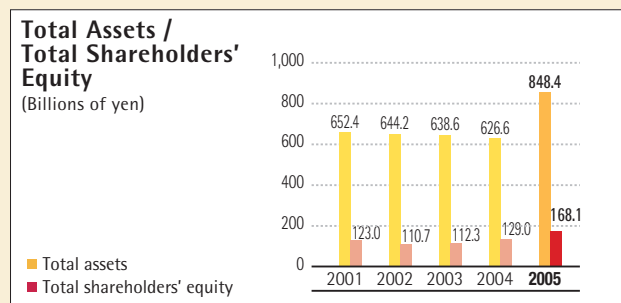
Net cash used in financing activities increased 17.1 percent to ¥8,516 million. The year-on-year change primarily resulted because the Company repurchased shares of stock totaling ¥1,106 million, up from ¥14 million in the previous fiscal year. Cash dividends paid also increased to ¥1,981 million from ¥1,645 million for the previous fiscal year. Debt reduction continued to strengthen the Company's financial structure and reduce fixed interest expenses. Net decrease in short-term bank loans used cash totaling ¥4,714 million, and net repayment of long-term debt used cash totaling ¥305 million.

As a result, cash and cash equivalents at the end of the year increased 69.9 percent from a year earlier to ¥119,121 million.

Cash Flow Highlights

Years ended March 31	Millions of yen			Increase (decrease) 2005 vs. 2004
	2003	2004	2005	
Net cash provided by operating activities	¥11,509	¥13,247	¥26,301	¥13,054
Net cash provided by (used in) investing activities	(6,540)	(4,240)	31,279	35,519
Net cash used in financing activities	(10,123)	(7,270)	(8,516)	(1,246)
Cash and cash equivalents at end of year	68,375	70,112	119,121	49,009

Total assets at March 31, 2005 increased 35.4 percent from a year earlier to ¥848,416 million, primarily reflecting the increase in working capital and property, plant and equipment resulting from the increased scope of consolidation. Shareholders' equity increased 30.3 percent to ¥168,104 million, reflecting an increase in retained earnings and a substantial increase in capital surplus resulting from the exchange of shares used to effect expansion of the MEDICEO Group. The return on average total shareholders' equity decreased to 5.9 percent from 6.5 percent for the previous fiscal year, and the ratio of shareholders' equity to total assets stood at 19.8 percent, compared to 20.6 percent a year earlier.



Capital Investment

The MEDICEO Group's capital expenditures in the year ended March 31, 2005 totaled ¥7,812 million. Primary investments were ¥2,723 million for expansion of the SAITAMA DISTRIBUTION CENTER in the pharmaceutical wholesale business, and ¥1,566 million for investment in software related to the integration of core systems for sales and distribution operations. The MEDICEO Group funded the entire amount of capital investment using internal capital.

Outlook for the Fiscal Year Ending March 2006

The operating environment in the pharmaceutical wholesale business is expected to become increasingly challenging. Emphasis on reducing medical care costs will intensify in tandem with increased

awareness of the need to reform the NHI system as part of efforts to improve Japan's fiscal condition. The pharmaceutical wholesale business must further enhance its treatment management capabilities and improve its ability to meet diversifying customer needs. In addition, the move toward further deregulation of OTC pharmaceuticals is expected to significantly change distribution in that channel.

Under these conditions, the MEDICEO Group will further raise efficiency by improving the quality of basic functions and consolidating management resources through construction and enhancement of infrastructure for functions including delivery and distribution and information distribution. In addition, the Group will focus on achieving the goals of the medium-term consolidated management plan by consistently securing reasonable profits and strengthening community-based business activities to increase its corporate value.

MEDICEO Holdings and PALTAC CORPORATION, a leading wholesaler of cosmetics and daily necessities, agreed on May 13, 2005 to a management integration through an exchange of shares that will make PALTAC a wholly owned subsidiary of MEDICEO Holdings as of October 1, 2005. Effective from that date, MEDICEO Holdings plans to change its present corporate name to Mediceo Paltac Holdings Co., Ltd. The management integration between PALTAC and MEDICEO Holdings is aimed at creating a business structure for contributing to medical care, health and beauty. By speedily integrating the resources and expertise of PALTAC, the MEDICEO Group will further enhance distribution and service and create value in distribution as a new type of wholesaler that offers management benefits to business partners.

As a result, for the year ending March 31, 2006, the Company projects that consolidated net sales will increase 13.5 percent year-on-year to ¥1,890.0 billion and consolidated net income will increase 97.0 percent year-on-year to ¥17.2 billion.

Operating and Other Risks

Risks related to specific legal regulations

The Company and the MEDICEO Group handle various types of pharmaceuticals and related products, and conduct sales activities after receiving the necessary authorizations, registrations, designations and licenses from relevant local governments, pursuant to the Pharmaceutical Affairs Law and other laws.

Drug price standards

Prescription pharmaceuticals are subject to NHI drug price standards. The drug price standards stipulate the billing prices for pharmaceuticals covered by health insurance, and therefore function as an upper limit on selling prices. The drug price standards are, as a general principle, revised once every two years to reflect actual market prices. Because each revision lowers prices, the upper limit on

selling prices also declines with each revision of the drug price standards, which has a material effect on sales.

Revisions of drug price standards during the last five years were as follows:

NHI Drug Price Revisions

Implementation date	Average rate of decrease
April 1, 2000	7.0%
April 1, 2002	6.3%
April 1, 2004	4.2%

Sales discontinuations and product recalls

Business results may be affected in the event of situations such as the discontinuation of sales or recall of certain products due to defects, unforeseen side effects or tampering with certain products sold.

System risk

The business of the Company and the MEDICEO Group is heavily reliant on computer network systems. Loss of functions due to a natural disaster, accident, intrusion of a computer virus or other occurrences may result in significant obstacles to product distribution.

Default risk

Business results would be affected in the event that a default occurs due to customer bankruptcy, civil rehabilitation or similar issues in regard to the receivables associated with ongoing transactions between the Company and the MEDICEO Group and medical institutions.

Inventory risk

The MEDICEO Group has inventories from suppliers. Business results may be affected in the event that selling prices decline or products become unsaleable due to supplier bankruptcy, civil rehabilitation or similar issues.

Litigation risk

The Company and the MEDICEO Group may be a party to litigation related to product liability, the environment, labor or other matters in the course of conducting business activities.