

TO OUR SHAREHOLDERS

Based on our management philosophy of “Contributing to people’s health and the advancement of society through creation of value in distribution,” the Mediceo Paltac Group is meeting a wide range of health needs as a new type of wholesale distributor that supports medical care, health and beauty. We will continue our efforts to maximize our corporate value as a new, multi-channel wholesaler that can accurately meet the needs of our customers.



Performance for the Past Fiscal Year: As a result of the benefits from the management reforms we have implemented and the recent management integration, we achieved the largest scale in Japan in terms of profit as well as sales.

In the year ended March 31, 2006, the market for prescription pharmaceuticals displayed steady growth due to increasing demand throughout the period for drugs to treat lifestyle diseases, although the prevalence of influenza and pollen allergies was not as severe as in the previous year. In the market for cosmetics and daily necessities, sales expanded steadily, led by sales at drugstores.

The Mediceo Paltac Group continued to promote the management reforms it has been undertaking. In addition, on October 1, 2005, MEDICEO Holdings Co., Ltd. implemented a management integration via the share exchange system with PALTAC CORPORATION (“Paltac”), a wholesaler of cosmetics and daily necessities. Net sales for the year ended March 31, 2006 totaled ¥1,921,714 million, an increase of 15.4 percent compared with the previous year, reflecting the addition of sales of Paltac, a newly consolidated subsidiary, for the second half of the period. The gross margin improved 0.14 points due to factors including our efforts to lock in reasonable profits in the selling prices of prescription pharmaceuticals. Operating income increased 87.6 percent to ¥20,608 million as a

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President and Chief Executive Officer



result of measures to hold down personnel costs and overhead expenses. Despite an impairment loss of ¥2,110 million due to the adoption of accounting standards for impairment of fixed assets starting in the past fiscal year, net income increased 138.8 percent to ¥20,843 million. Net income per share more than doubled to ¥97.64 from ¥45.90 in the previous fiscal year.

Cash dividends applicable to the fiscal year totaled ¥15.00 per share, which included the addition of a dividend of ¥3.00 per share in commemoration of the management integration.

As these results indicate, the benefits of the management reforms we have made and the results of the management integration are showing up in our performance, and the Mediceo Paltac Group is now at the top of the industry both in sales and in the absolute amount of profits. Becoming number one in the industry in Japan both in name and substance will add momentum to the growth of the Mediceo Paltac Group, and we are committed to maintaining this expansion and growth.

Restructuring the Group's Product Offerings and Business Structure: Maximizing synergy for effective corporate governance and organizational structures

We plan to generate synergy and create effective corporate governance and organizational structures from the new Mediceo Paltac Group structure. In order to do so, we have restructured the products handled by each group company and our business structure in regard to prescription pharmaceuticals, over-the-counter (OTC) pharmaceuticals and medical equipment, the businesses previously handled by Mediceo, and cosmetics and daily necessities, the businesses of Paltac.

In July 2005, we acquired 10.0 percent of the stock of SHIKOKU YAKUGYO CO., LTD. to strengthen our alliance with that company. In addition, to promote business development that takes advantage of the combined strengths of our group, we made Chiyaku Co., Ltd. a wholly owned subsidiary in April 2005. Chiyaku then merged with KURAYA SANSEIDO Inc. ("Kuraya Sanseido") in January 2006, with Kuraya Sanseido as the surviving firm, in order to increase management efficiency and enhance logistics functions.

In April 2006, Paltac merged with ALCOS Co., Ltd. ("Alcos"), one of our affiliates operating in the OTC pharmaceutical wholesale business in the Kyushu region, with Paltac as the surviving company and Alcos dissolved. In October 2006, Paltac will take over sales of OTC pharmaceuticals from Kuraya Sanseido and EVERLTH Co., Ltd. This move is aimed at strengthening marketing and reducing distribution costs in this business, as well as enhancing services provided to customers.

In the medical equipment business, Kuraya Sanseido transferred its medical equipment business in the hospital sales channel in Tokyo and three surrounding prefectures to MEDICEO MEDICAL CO., LTD. (formerly NAKAGAWA SEIKODO CO., LTD.) in April 2005 to unify this business. The objective of this transfer was to strengthen alliances within the Group and to make more efficient use of distribution and information functions.

In December 2005, Mediceo Paltac Holdings Co., Ltd. ("Mediceo Paltac") transferred 67.0 percent of the shares of ORIENTAL PHARMACEUTICAL CO., LTD., a consolidated subsidiary in the business of manufacturing and sales of generic drugs, to Nichi-iko Pharmaceutical Co., Ltd., to expand management resources. In March

2006, Mediceo Paltac sold 90.0 percent of the shares of Selmesta Co., Ltd., a consolidated subsidiary primarily in the business of selling health foods to health insurance unions and mutual aid associations, to FASALIA Holdings Co., Ltd., which was planning to enter the same business.

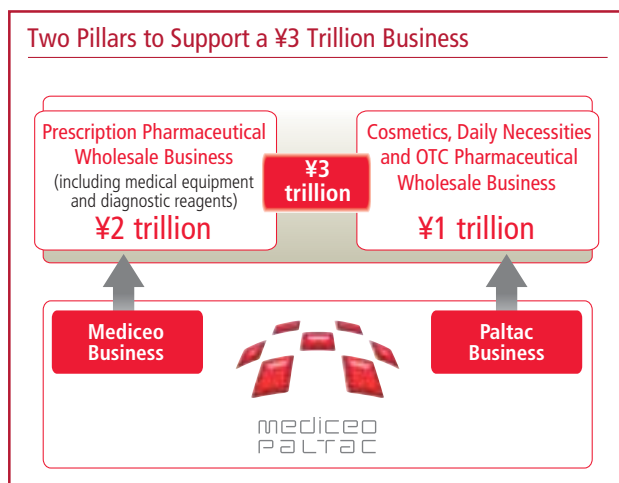
Along with this restructuring of our business network, effective from April 2006, we changed our previous business segments from Pharmaceutical Wholesale Business, Cosmetics and Daily Necessities Wholesale Business and Healthcare Related Business to the Prescription Pharmaceutical Wholesale Business (Mediceo business), Cosmetics, Daily Necessities and OTC Pharmaceutical Wholesale Business (Paltac business), and Related Businesses.

Promoting the Medium-Term Management Plan: Aiming for a customer-oriented distribution business model

The MEDICEO Group had been carrying out the medium-term management plan covering the period from April 2004 through March 2007, to provide a common strategic direction and numerical targets for Group companies, and to set guidelines for establishing a corporate infrastructure capable of securing stable profits. However, with our new start as the Mediceo Paltac Group, we drew up a new medium-term management plan for the period from the year ending March 2006 through the year ending March 2008, and the entire group is working to carry out the plan. We intend to conduct our

business operations based on the assumption of a scale of ¥3 trillion in net sales — ¥2 trillion in the Mediceo business and ¥1 trillion in the Paltac business including the addition of OTC pharmaceuticals.

The backbone of the new medium-term management plan is our fundamental objective of “Creating a customer-oriented distribution business model.” To achieve it, we will focus on three key points: Creation of a business environment with development potential; evolution into customer-driven logistics; and creation of new value that enriches people’s lives.





Business Development Outlook

Prescription Pharmaceuticals Business

In the six years since our start as Kuraya Sanseido in 2000, the annual growth of the prescription pharmaceutical market has been steady, including years with severe price competition. As a result of realignment over the past several years, four groups, including the Mediceo Paltac Group, now cover approximately 80 percent of the industry. This has created a favorable business environment with a very stable market compared to other industries. Meanwhile, customers are forming a group purchasing organization so that they have a degree of buying power commensurate with the larger size of wholesalers. Our group's ability to respond to these trends at an early stage has given us the most advantageous position among the four major wholesaling groups, and rather than competing on price, we must steadily provide a different level of service — in short, customer-driven service.

Hospital Business: Evolving the *Total Solution Model*

We designed the *Total Solution Model* to provide comprehensive support to hospitals in order to ensure that Mediceo Paltac is successful in competing on the basis of added value rather than price. Since fiscal 2004, we have been providing support for clinical pathway management. A clinical pathway is a treatment schedule given to each patient upon hospitalization. This method of standardizing treatments is determined by each individual hospital. However, comparison with national averages is of great interest to hospitals, and this type of service can only be provided by a national wholesaler. At present, the Mediceo Paltac Group has an unrivaled lead in this area. Our activities have been recognized by the Japanese Society for Clinical Pathway, and we are providing this service at 72 locations, primarily at medium-sized hospitals.

We plan to further broaden the targets of the *Total Solution Model* from medium-sized hospitals to large hospitals with acute beds. Through clinical pathway management support, we analyze the actual usage conditions of pharmaceuticals and other products, and conduct 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 each hospital, and plan to enhance the *Total Solution Model* to encompass proposals for drug selection.

Business for Pharmacies: Introducing *Class A* in addition to *mediceo-epi*

The separation of prescription and dispensing has exceeded 50 percent, and dispensing pharmacies now account for more than 30 percent of our net sales. Our *mediceo-epi* system is a contract model for dispensing pharmacies that combines planned deliveries and usage-based payment. To date, the system has been introduced at approximately 2,000 locations. It is steadily becoming established, and we feel that it is producing

the desired effect. The original purpose of *mediceo-epi* was to lower our costs by reducing the frequency of deliveries, but the system is also serving to improve the cash flow and operations of the customers who have adopted it.

As a customer retention strategy targeting individually owned stores and small chains, we are introducing *Class A*, a system in which we propose ways to make stores more inviting to end users, including ideas for store layout and merchandising. We plan to build a network of 5,000 store locations using this system.

Comprehensive Business Alliance with Mitsubishi Corporation

In September 2005, we formed a comprehensive business alliance in the area of medical services with Mitsubishi Corporation, which is aggressively developing its management support business for medical institutions that integrates information technology, distribution, finance and other services. The business alliance will encompass four specific areas: 1) Joint study of the pharmaceutical distribution business in China, 2) Joint establishment of a supply processing and distribution (SPD) business, 3) Joint development of private brand (PB) products, and 4) Joint study of businesses related to clinical testing.

We decided in June 2006 to integrate the SPD businesses of Kuraya Sanseido Inc. and MEDICEO MEDICAL CO., LTD. with Nihon Hospital Service Co., Ltd. (NHS), a subsidiary of Mitsubishi Corporation. This alliance is gaining industry attention as the first between a trading company and Japan's largest pharmaceutical wholesaler. The tie-up is expected to yield a variety of benefits. In addition, we are currently studying seven other possible alliance areas in the medical services business, where significant growth is expected.

Cosmetics, Daily Necessities and OTC Pharmaceuticals

In October 2006, we will complete consolidation of the OTC pharmaceuticals business at Paltac. Putting this business under Paltac's advanced and completed system consisting of a nationwide network of 47 sales bases and 21 distribution bases will allow Paltac to use that same system to provide the same quality and service as it does in its other businesses. While approximately 10,000 OTC pharmaceutical customers will be added to the 3,000 customers Paltac currently serves, OTC pharmaceuticals have a higher average unit price than cosmetics and daily necessities, and they are not bulky merchandise. Therefore, the addition of this business will give Paltac a significant boost in overall productivity, and is expected to facilitate customer-oriented service.

CSR: Toward a Mediceo Paltac Group that is Trusted by Society

The Mediceo Paltac Group steadily carries out its business operations while ensuring sound, transparent management. We believe we can meet our corporate social responsibility (CSR) by fulfilling the Group's management philosophy — "Contributing to people's health and the advancement of society through creation of value in distribution" — in order to earn the trust of all our stakeholders, consisting of shareholders, customers, employees, consumers and society at large.

To implement and strengthen these CSR activities, we established the CSR Committee in October 2005. Taking the creation of a CSR system with identical standards across the Mediceo Paltac Group as its basic vision, the committee established the philosophy mentioned above as the fundamental CSR concept for the Mediceo Paltac Group, which was incorporated into our slogan, "Bright and Energetic." Under this slogan, the CSR Committee will implement activities at all Group companies with the aim of ensuring that the Mediceo Paltac Group is trusted by society.

Increasing the Group's Corporate Value

We see the growth process of the Mediceo Paltac Group as having three steps. Step one, which we have already completed, was establishing the scale and form of the company. Step two involves further strengthening the form built up in step one through measures such as integrating systems and transferring seconded employees, and establishing the corporate governance and organizational structures. We are working to complete this step in the current fiscal year. Step three is establishing a new business model through business reforms and IT strategies. We are confident that by accomplishing this third step, we will establish a completely new type of wholesaler never before seen in the world, and this will put the Mediceo Paltac Group on track for major growth.

Becoming the Mediceo Paltac Group has enhanced our capital efficiency and increased the cash we hold. When we secure net cash equivalent to one month of net sales, I intend to increase the weight we place on shareholder returns. We have not yet reached that point, but I hope you will look forward to the substantial growth of the Mediceo Paltac Group. I would like to ask our shareholders and investors for their continued exceptional understanding and support.

August 2006



Sadatake Kumakura
President and Chief Executive Officer