

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Six-Year Summary

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

	Millions of yen					Thousands of U.S. dollars (Note 1)	
	2002	2003	2004	2005	2006	2006	
<b>For the Year:</b>							
Net sales	¥1,222,222	¥1,274,503	¥1,283,926	¥1,665,816	¥1,921,714	\$16,424,906	
Gross profit	106,644	114,923	116,805	137,806	161,603	1,381,222	
Selling, general and administrative expenses	100,863	104,763	101,450	126,819	140,995	1,205,085	
Operating income	5,781	10,160	15,355	10,987	20,608	176,137	
Net income	2,951	5,016	7,879	8,730	20,843	178,145	
Depreciation and amortization	4,866	5,204	5,709	7,625	9,126	78,000	
Capital expenditures (payment base)	5,663	6,206	4,974	7,812	9,064	77,470	
<b>Per Share Data:</b>							
Net income (Note 2)	¥ 21.67	¥ 36.48	¥ 55.19	¥ 45.90	¥ 97.64	\$ 0.83	
Diluted net income	18.92	31.50	48.65	43.52	94.22	0.81	
Total shareholders' equity (Note 3)	823.75	828.14	893.84	904.59	1,051.97	8.99	
Cash dividends applicable to the period	12.00	12.00	12.00	12.00	15.00	0.13	
<b>At Year-End:</b>							
Total assets	¥ 644,248	¥ 638,589	¥ 626,626	¥ 848,416	¥ 993,491	\$ 8,491,376	
Interest-bearing debt	41,177	33,730	23,275	15,660	38,400	328,205	
Total shareholders' equity	110,650	112,261	128,988	168,104	242,413	2,071,906	
<b>Ratios:</b>							
Return on assets (Note 4)	0.9%	1.6%	2.4%	1.5%	1.1%		
Return on equity (Note 5)	2.5	4.5	6.5	5.9	10.2		
Number of employees	7,780	7,741	7,468	9,496	11,078		

Notes: 1. The U.S. dollar amounts in this report represent translations of Japanese yen, for convenience only, at the rate of ¥117.00 to U.S. \$1.00, the approximate exchange rate on March 31, 2006.

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

### Scope of Consolidation

The Mediceo Paltac Group (the "Group") consists of 39 consolidated subsidiaries and 5 affiliates, with Mediceo Paltac Holdings Co., Ltd. (the "Company") as the core. During the year ended March 31, 2006, the Group companies were engaged in the pharmaceutical wholesale business, the cosmetics and daily necessities wholesale business, and the medical-related business.

### Change in Business Classification

On October 1, 2005, PALTAC CORPORATION, which operates the cosmetics and daily necessities wholesale business, implemented an exchange of shares that made it a wholly owned subsidiary of the Company. As a result, the cosmetics and daily necessities wholesale business was added to the Company's two existing business segments, the pharmaceutical wholesale business and the medical-related business.

### Overview of Results

In the year ended March 31, 2006, the Japanese economy recovered moderately overall, as consumer spending and capital investment increased and

employment conditions improved.

On October 1, 2005, the Company implemented a management integration through an exchange of shares with PALTAC CORPORATION, a wholesaler of cosmetics and daily necessities, with the aim of forming a new type of wholesaler that can accurately meet the needs of customers. Currently, the Company is working to generate synergy and reduce costs through the management integration.

On July 13, 2005, the Company acquired 10.0 percent of the stock of SHIKOKU YAKUGYO CO., LTD. to strengthen its alliance with that company. On April 1, 2005, Chiyaku Co., Ltd. was made a wholly owned subsidiary to promote business operations that take advantage of the total capabilities of the Mediceo Paltac Group. On January 1, 2006, KURAYA SANSEIDO Inc. and Chiyaku Co., Ltd. merged, with KURAYA SANSEIDO as the surviving company and Chiyaku dissolved, in order to strengthen their business structure as well as further enhance management efficiency and logistics functions.

On December 26, 2005, the Company transferred 67.0 percent of the total outstanding shares of Oriental Pharmaceutical Co., Ltd. to Nichi-iko Pharmaceutical Co., Ltd. to enhance management resources.

The main business of SELMESTA CO., LTD. is sales of health foods to health

insurance unions, mutual aid associations and others, which is different from the business field of the Company. Therefore, on March 31, 2006, the Company transferred 90.0 percent of the outstanding shares of SELMESTA to FASALIA HOLDINGS CO., LTD., which plans to enter the same business field.

In addition, the Company entered into a comprehensive alliance with Mitsubishi Corporation in the area of medical services in order to respond to the needs of medical institutions and to social changes.

The Company also constructed and began operation of the SAITAMA DISTRIBUTION CENTER in Kazo, Saitama Prefecture, to further strengthen and raise the efficiency of distribution functions.

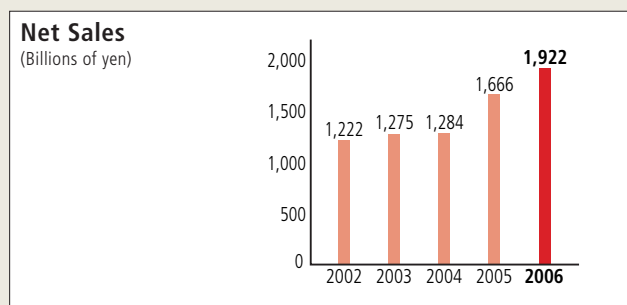
In the area of medical equipment, the portion of the medical equipment business of KURAYA SANSEIDO Inc. in the large hospital sales channel in the four prefectures of the Tokyo metropolitan area was transferred to and unified under wholly owned subsidiary NAKAGAWA SEIKODO CO., LTD. on April 1, with the aim of strengthening alliances and making efficient use of distribution and information functions within the Group. On July 1, the name of NAKAGAWA SEIKODO CO., LTD. was changed to MEDICEO MEDICAL CO., LTD.

As a result of these aggressive measures, net sales for the year ended March 31, 2006 increased 15.4 percent to ¥1,921,714 million, and net income increased 138.8 percent to ¥20,843 million.

## Sales and Income

### Net Sales

Consolidated net sales were ¥1,921,714 million, an increase of 15.4 percent year-on-year. The increase in net sales was significantly higher than the overall growth of the market because PALTAC CORPORATION became a consolidated subsidiary during the fiscal year.



### Sales by Business Segment

#### Pharmaceutical Wholesale Business

The market for prescription pharmaceuticals, the Company's core business, displayed steady growth due to increasing demand throughout the period for drugs to treat lifestyle diseases, although the prevalence of influenza and pollen allergies from January through March 2006 was not as severe as in the same

period of the previous year.

In response to this market environment, the Company worked to implement consistent policies across the Group and secure reasonable profits.

As a result, sales of the pharmaceutical wholesale business were ¥1,714,768 million. Business segment information was not disclosed for the previous fiscal year, but for reference the year-on-year increase was 3.6 percent.

#### Cosmetics and Daily Necessities Wholesale Business

Sales of cosmetics and daily necessities increased steadily, led by drugstores. In this wholesale business, demands are increasing for enhancement of high-quality intermediary distribution functions, and therefore the Company worked to strengthen its sales and distribution network and its merchandising capabilities.

As a result, sales of the cosmetics and daily necessities wholesale business for the six months from the start of its consolidation on October 1, 2005 were ¥196,423 million (for reference: a 6.8 percent increase year-on-year).

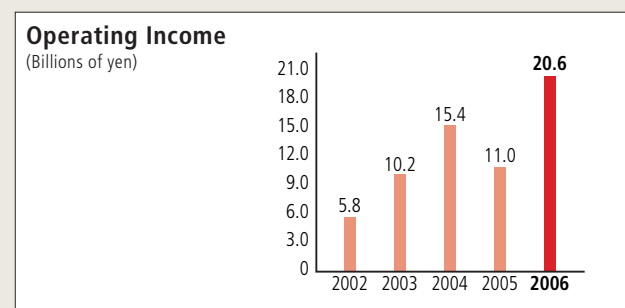
#### Medical-related Business

Sales of the medical-related business were ¥11,457 million (for reference: a 2.9 percent decrease year-on-year).

### Operating Income

Gross profit increased 17.3 percent to ¥161,603 million, as selling prices recovered from the decline following the revision of NHI drug prices in April 2004 and PALTAC CORPORATION was added as a consolidated subsidiary. Selling, general and administrative (SG&A) expenses were ¥140,995 million, an increase of 11.2 percent year-on-year. However, as a result of the Group's measures to reduce costs by integrating core business systems for marketing, distribution and accounting and reforming the retirement benefit system, SG&A expenses as a percentage of net sales declined from 7.6 percent in the previous fiscal year to 7.3 percent.

As a result, operating income was ¥20,608 million, an increase of 87.6 percent year-on-year, and the operating margin improved from 0.7 percent to 1.1 percent.



## Other Income (Expenses)

Total other income (expenses) amounted to net other income of ¥9,500 million, an increase of 14.2 percent from the previous fiscal year. Although amortization of consolidation difference decreased 16.0 percent year-on-year to ¥5,568 million, this factor was offset by a 59.5 percent decrease in restructuring costs of business establishments to ¥431 million and the absence of losses on the dissolution of the employees' pension fund and revision of the employees' retirement benefit plan that were recorded in the previous fiscal year.

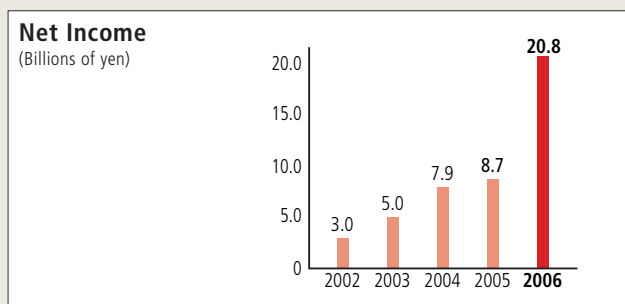
As a result, income before income taxes and minority interests increased 56.0 percent year-on-year to ¥30,109 million.

### Costs, Expenses and Income as a Percentage of Net Sales

Years ended March 31	2004	2005	2006	Increase (decrease) 2006 vs. 2005
Cost of sales	90.9%	91.7%	91.6%	(0.1)
Gross profit	9.1	8.3	8.4	0.1
SG&A expenses	7.9	7.6	7.3	(0.3)
Operating income	1.2	0.7	1.1	0.4
Income before income taxes and minority interests	1.2	1.2	1.6	0.4
Net income	0.6	0.5	1.1	0.6

## Net Income

Net income was ¥20,843 million, an increase of 138.8 percent compared with the previous fiscal year. Net income per share increased to ¥97.64 from ¥45.90 for the previous fiscal year, and fully diluted net income per share increased to ¥94.22 from ¥43.52 for the previous fiscal year.



## Dividends

The Mediceo Paltac 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. The year-end dividend applicable to the fiscal year ended March 31, 2006 totaled ¥9.00, which included the originally planned ordinary dividend of ¥6.00 plus a special dividend of ¥3.00 to commemorate the integration with PALTAC CORPORATION. As a result, cash dividends applicable to the fiscal year ended March 31, 2006 totaled ¥15.00 per share, an increase from ¥12.00 for the previous fiscal year.

## Financial Strategy

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

## Liquidity and Financial Position

Net cash provided by operating activities was ¥41,796 million, a year-on-year increase of 58.9 percent. The main components of cash from operating activities were income before income taxes and minority interests of ¥30,109 million (a year-on-year increase of 56.0 percent), depreciation and amortization of ¥9,126 million, loss on impairment of fixed assets of ¥2,110 million, and decrease in notes and accounts receivable – trade of ¥10,799 million. Amortization of consolidation difference was ¥5,568 million, total decrease in allowances was ¥3,190 million, and cash paid for income taxes was ¥3,700 million.

Net cash provided by investing activities was ¥4,366 million, a year-on-year decrease of 86.0 percent. The main components were ¥9,064 million in payments for purchase of property, plant and equipment, including the SAITAMA DISTRIBUTION CENTER, and payments of ¥3,103 million for purchase of investment securities, including an equity position in SHIKOKU YAKUGYO CO., LTD., while proceeds from sale of property, plant and equipment were ¥3,863 million, proceeds from sale of investment securities were ¥1,760 million and proceeds from acquisition of subsidiary stock due to a change in the scope of consolidation were ¥10,628 million.

Net cash used in financing activities was ¥22,375 million, compared to ¥8,516 million in the previous fiscal year. The main components were a ¥1,034 million net decrease in short-term bank loans, ¥3,114 million for repayment of long-term debt, ¥16,873 million for purchase of treasury stock, and ¥2,854 million in payments for cash dividends to shareholders and cash dividends of a wholly owned subsidiary from a share exchange.

As a result, cash and cash equivalents at the end of the period increased ¥23,787 million (20.0 percent) from the end of the previous fiscal year, to ¥142,908 million.

## Cash Flow Highlights

Years ended March 31	Millions of yen			Increase (decrease) 2006 vs. 2005
	2004	2005	2006	
Net cash provided by operating activities	¥13,247	¥26,302	¥41,796	¥15,494
Net cash provided by (used in) investing activities	(4,240)	31,279	4,366	(26,913)
Net cash used in financing activities	(7,270)	(8,516)	(22,375)	(13,859)
Cash and cash equivalents at end of year	70,112	119,121	142,908	23,787

## Assets and Liabilities

Total assets at March 31, 2006 increased 17.1 percent from a year earlier to ¥993,491 million.

Current assets increased 15.0 percent from a year earlier to ¥774,082 million. The addition of newly consolidated subsidiaries was the main factor in the ¥100,765 million increase in current assets, which mainly consisted of a ¥23,632 million increase in cash in hand and in banks, a ¥51,788 million increase in trade notes and accounts receivable, an ¥18,381 million increase in inventories and a ¥4,763 million increase in accounts receivable.

Property, plant and equipment as of March 31, 2006 totaled ¥151,268 million, a 23.4 percent increase, and investments and other assets totaled ¥62,002 million, a 34.5 percent increase from the previous fiscal year end. The total increase from the addition of newly consolidated subsidiaries was ¥45,825 million, which mainly consisted of a ¥36,496 million increase in property, plant and equipment and a ¥6,910 million increase in investment securities.

Total current liabilities increased 14.2 percent from a year earlier to ¥701,270 million. The increase from the addition of newly consolidated subsidiaries was ¥85,202 million. This mainly consisted of a ¥48,612 million increase in notes and accounts payable, a ¥22,579 million increase in short-term bank loans, a ¥4,865 million increase in long-term debt due within one year, and a ¥2,232 million increase in income taxes payable.

Working capital increased 22.6 percent compared to the end of the previous fiscal year to ¥72,812 million. The current ratio was 1.104 times, compared to 1.097 times a year earlier.

Total long-term liabilities were ¥49,808 million, a 24.1 percent decrease from a year earlier. The decrease was mainly due to a ¥7,387 million decrease in convertible bonds and a ¥16,834 million decrease in consolidated adjustment account related to the addition of newly consolidated subsidiaries. Total interest-bearing debt at the end of the period was ¥38,400 million.

Total shareholders' equity at March 31, 2006 was ¥242,413 million, a 44.2 percent increase from a year earlier. The main components of the increase were a ¥7,387 million increase in common stock and capital surplus due to conversion of the Company's convertible bonds, a ¥59,916 million increase in capital surplus due to the Company's exchange of shares, a ¥20,843 million increase in retained earnings reflecting net income for the period, a ¥2,851 million decrease in retained earnings due to payment of cash dividends, a ¥5,194 million increase in unrealized gain on available-for-sale securities, and a ¥16,236 million decrease in treasury stock. The ratio of shareholders' equity to total assets increased to 24.4 percent from 19.8 percent at the end of the previous fiscal year, and the return on average total shareholders' equity increased to 10.2 percent from 5.9 percent a year earlier.

## Capital Investment

Capital expenditures in the year ended March 31, 2006 totaled ¥9,064 million. Software investment was ¥1,176 million. The Company made investments

to further strengthen and enhance the efficiency of distribution functions primarily in the pharmaceutical wholesale business and the cosmetics and daily necessities wholesale business.

Capital expenditures by business segment are as follows.

In the pharmaceutical wholesale business, the Company made investments of ¥5,845 million in construction of the SAITAMA DISTRIBUTION CENTER. In addition, the Company invested ¥1,158 million in software to integrate core systems for sales, distribution and other operations.

In the cosmetics and daily necessities wholesale business, the Company invested ¥3,201 million in the construction of PALTAC CORPORATION's RDC Chugoku (provisional name), which is scheduled for completion in November 2006.

In the medical-related business, the Company invested ¥18 million for repair and maintenance of general office facilities.

The Company used bank loans to fund a portion of the capital expenditures.

## Outlook for the Fiscal Year Ending March 2007

Having made a new start as Mediceo Paltac Holdings Co., Ltd., the Company will work intensively to rapidly integrate the management expertise of MEDICEO and PALTAC. In doing so, the Company aims to become a new type of multi-channel wholesaler, further strengthening its distribution functions and increasing its ability to provide solutions in order to be of service to the management of its customers.

In addition, the Company has formulated a new medium-term management plan covering the three years from the year ending March 2006 to the year ending March 2008. Based on this management plan, the Mediceo Paltac Group will aim to reach its targets by working to generate synergy from the integration with PALTAC CORPORATION and reducing costs.

In the prescription pharmaceutical wholesale business, NHI drug prices were reduced by an average of 6.7 percent on April 1, 2006, and it is assumed that this will have an effect on changes in purchase prices and selling prices. The Group will gain the understanding of supplying manufacturers regarding its strengths, such as information gathering and provision, to conduct aggressive purchase price negotiations, and will also conduct detailed, regionally based sales activities in working to form market prices that take economic principles into account.

In the cosmetics, daily necessities and OTC pharmaceutical wholesale business, with regard to the OTC pharmaceutical wholesale business, PALTAC CORPORATION and OTC pharmaceutical wholesaler ALCOS Co., Ltd. (Shimemachi, Kasuya-gun, Fukuoka), a wholly owned subsidiary of Mediceo Paltac Holdings with sales bases in the Kyushu area, merged on April 1, 2006, with PALTAC CORPORATION the surviving company and ALCOS Co., Ltd. dissolved. In addition, PALTAC CORPORATION will take over sales of OTC pharmaceuticals from KURAYA SANSEIDO Inc. and EVERLTH Co., Ltd. on October 1, 2006. These moves are aimed at strengthening marketing and reducing dis-

tribution costs in this business, as well as reinforcing and enhancing services provided to customers.

With a view to widening the independence and the future options of employees in the Group, the Company will offer voluntary early retirement to employees who wish to take jobs in new fields. In addition, the Company plans to transfer loan employees between consolidated subsidiaries to raise the management vitality of Group companies. The Company expects to book the one-time charges associated with these programs as extraordinary losses.

As a result, for the year ending March 31, 2007, the Company projects consolidated net sales of ¥2,192.0 billion (a year-on-year increase of 14.1 percent), consolidated ordinary income of ¥36.0 billion (a year-on-year increase of 10.0 percent) and consolidated net income of ¥16.4 billion (a year-on-year decrease of 21.3 percent).

## Risk Information

With regard to the information on business, management and other conditions presented in this report, the following risks may exert a significant influence on investor decisions. Forward-looking statements in the following text are based on the judgment of the Mediceo Paltac Group as of March 31, 2006.

### Risks related to specific legal regulations, etc.

The pharmaceutical wholesale business and the medical-related business handle various types of pharmaceuticals and related products. Therefore, they conduct sales activities after receiving the necessary authorizations, registrations, designations and licenses from the local governments where business sites are located, pursuant to the Pharmaceutical Affairs Law and other laws.

### Medical system reform

In Japan, fiscal reconstruction is an urgent issue, and medical system reforms are being implemented as part of this. Depending on their content, these reforms may affect the business results of the pharmaceutical wholesale business and the medical-related business.

### Drug price standards

Prescription pharmaceuticals, which are the main products handled by the Mediceo Paltac Group, are subject to National Health Insurance (NHI) drug price standards. The drug price standards stipulate the range of pharmaceuticals that can be used under health insurance coverage and their billing prices. Accordingly, they function as an upper limit on selling prices.

Revisions of NHI drug prices during the last five years were as follows.

Implementation date	Average rate of decrease
April 1, 2002	6.3%
April 1, 2004	4.2%
April 1, 2006	6.7%

### Investment cost and unit selling prices

By merging with other wholesalers, Mediceo Paltac Holdings Co., Ltd. and the Mediceo Paltac Group are expanding their competitive scale and scope. Increased investment costs associated with improvement and expansion of the distribution and information systems to handle these expansions or a larger than expected decrease in unit selling prices may affect business results.

### Sales discontinuations, product recalls, etc.

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

### System trouble

The business of Mediceo Paltac Holdings Co., Ltd. and the Mediceo Paltac Group is heavily reliant on computer network systems. Discontinuation 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 the bankruptcy or civil rehabilitation, etc. of customers, in regard to the credits associated with ongoing transactions that Mediceo Paltac Holdings Co., Ltd. and the Mediceo Paltac Group conduct with medical institutions.

### Merchandise inventory risk

Business results may be affected in the event that merchandise inventory held by Mediceo Paltac Holdings Co., Ltd. and Mediceo Paltac Group companies declines in value or becomes unsaleable due to the bankruptcy or civil rehabilitation, etc. of suppliers.

### Litigation risk

Mediceo Paltac Holdings Co., Ltd. or Mediceo Paltac Group companies may be parties to litigation requesting payment of damages in the course of conducting business activities.

Various risks other than these exist, and the risks described here are not all of the risks of Mediceo Paltac Holdings Co., Ltd. and Mediceo Paltac Group companies.