

TO OUR SHAREHOLDERS

In the year ended March 31, 2007, the first full year since the formation of the Mediceo Paltac Group, we quickly realized synergy from the management integration, and achieved net sales of more than ¥2 trillion as well as a substantial increase in operating income. Through business innovations and an information technology (IT) strategy based on the establishment of a customer-oriented business model, we will focus our efforts on maximizing corporate value as a multi-channel wholesaler that can propose the best solutions for a wide range of health-related needs to support medical care, health and beauty.



Sadatake Kumakura
President and Chief Executive Officer

Performance for the Past Fiscal Year: Synergy within the Mediceo Paltac Group increased both sales and profits, as we achieved net sales of more than ¥2 trillion.

Despite signs of weakness in manufacturing in certain sectors, the Japanese economy maintained its momentum during the year ended March 31, 2007, supported by factors such as indications of a pickup in consumer spending, increased capital investment and a broadening improvement in employment conditions.

The Mediceo Paltac Group continued working to improve its business structure for greater efficiency in sales activities with measures that included reorganizing the prescription pharmaceutical wholesale business and the cosmetics, daily necessities and over-the-counter (OTC) pharmaceutical wholesale business. As part of this effort, we further strengthened and improved customer service functions by transferring the OTC pharmaceutical wholesale business of KURAYA SANSEIDO Inc. and EVERLTH CO., LTD. to PALTAC CORPORATION (“Paltac”) in October 2006. We also worked to cut costs by strengthening and raising the efficiency of our sales infrastructure. In addition, we offered voluntary early retirement to employees of

prescription pharmaceutical wholesale companies, excluding MEDICEO MEDICAL CO., LTD. A total of 305 employees retired under the program as of September 30, 2006.

As a result of these initiatives, although sales in the Prescription Pharmaceutical Wholesale Business were flat, sales in the Cosmetics, Daily Necessities and OTC Pharmaceutical Wholesale Business nearly doubled, reflecting the effect of the integration with Paltac. Overall, consolidated net sales increased 12.8 percent to ¥2,166,763 million and operating income increased 34.8 percent to ¥27,776 million. Net income decreased 8.3 percent to ¥19,106 million, mainly because we took an impairment loss and made special retirement payments to employees who accepted early retirement or employment transfers. As a result, net income per share decreased to ¥82.86 from ¥97.64 for the previous fiscal year.

Cash dividends per share for the period totaled ¥15.00 per share, unchanged from the previous fiscal year.

The Beginning of the Era of Value-based “Megacompetition”

The Japanese pharmaceutical wholesale industry has undergone consolidation through mergers and acquisitions over the past decade, and has now converged into four major groups engaged in intense competition. As expansion of scale through M&A comes to an end and the market pie grows more slowly, the industry will enter an era of megacompetition in the true sense of the word, with the four large groups competing for market share and winners and losers becoming clear. This era of megacompetition can also be called the era of value-based competition. The outcome will be determined by the business strategies of each company, making this an era that demands true value.

To date, the Mediceo Paltac Group has established its corporate scale and configuration as Japan’s first multi-channel

wholesaler with a nationwide network. Next, we consolidated systems, integrated healthcare-related business into Paltac, and clearly defined the business scope of Group companies in each area to generate synergy in this collection of many companies. We also completed employee transfers, which had been a priority issue. These measures have produced positive results, as we achieved net sales of more than ¥2 trillion. We will continue to focus on these management reforms, but starting in the current fiscal year ending March 31, 2008 we will carry out innovations looking five and ten years ahead, and initiate activities to take the Mediceo Paltac Group to the next level.

Strongly Promoting the Business Innovation Committee (BIC)

The key to these activities is the BIC, which we launched on April 1, 2006, mainly for the purpose of reducing costs through productivity improvements from business innovations. This is the foundation of our establishment of a customer-oriented business model, the core objective of the medium-term management plan currently in progress. The BIC has three basic strategies: a “competitive strategy” to make cost reductions centered on distribution innovations; a “value strategy” to make inroads with customers by providing greater value amid fierce competition; and an “IT strategy” to improve internal operating efficiency and increase productivity throughout the Group, with management visibility as a key point. We have formed six innovation taskforces to promote these strategies.

The BIC spent its first year planning, and will finally move into the implementation stage in the current fiscal year. The BIC’s foremost tasks are “distribution innovation” to change the structure of distribution, the basic function of a wholesaler, and “management visibility” designed to raise the transparency

of management. The Mediceo Paltac Group currently has a total of about 300 branches, and each one carries inventory. If we consolidate these branches to about 30 locations with distribution functions, we can realize lower costs by reducing the number of distribution and sales bases and consolidating inventories. This will also enable customer-oriented distribution innovations with customer-specific packing. This is what we mean by “distribution innovation.” Each distribution base will set priorities and carry them out in succession. We expect to complete our nationwide map in about ten years.

For the other point, “management visibility,” we will introduce an optimized information system that allows Group companies real-time access to detailed management information and sales-related business data. This will enable us to understand the strengths and weaknesses of each Group company, and quickly carry out more accurate business innovations. Before these BIC strategies are carried out, we will first establish firm sales growth with the Group structure completed in the past fiscal year, and allocate profits generated from that sales growth to fund the BIC so that it can implement the innovations. When the BIC initiatives go into effect, sales will become even more solid, costs will be reduced, and we will create a virtuous cycle of profit expansion.

Mediceo Business: Fully Exercise Group Strengths to Expand Sales

To increase sales, we will further enhance and take maximum advantage of the strengths of the Mediceo Paltac Group. Concrete measures to achieve this are the *Total Solution Model, class A* and our alliance with Mitsubishi Corporation.

Total Solution Model

We designed the *Total Solution Model* to provide comprehensive support to large hospitals, thereby expanding our share of

Total Solution Model Supports Improved Hospital Management

Deepening Our Presence in Hospitals

34 locations added in the year ended March 2007

106 locations overall as of March 31, 2007

- Support standardization of care with clinical pathway
- Make management more visible
- Enhance sales skills
- Strengthen relationships with hospital managers



INCREASE SHARE

sales at each hospital and ensuring that Mediceo Paltac competes successfully on the basis of added value rather than price. Support for clinical pathway* management is a function that we can use to make solid inroads in hospitals. With this function, we analyze the actual usage of pharmaceuticals and other products, and conduct estimates of cost savings to create a list of standard drugs and diagnostic materials. By doing so, we can propose switches to conform to the budgets of each hospital, and even get involved in pharmaceutical selection. This allows us to depict hospital management in visual form (a “management dashboard”), and we believe this support function will enable us to establish a solid presence in hospitals.

As the first step, we focused on upgrading the skills of salespeople who can use this system, and they are now in the phase of establishing a firm presence in hospitals and building relationships with hospital managers. Our ultimate goal is to make Mediceo Paltac the main wholesaler, and if possible, create the conditions for single-company transactions. Currently, we have introduced the model at about 100 hospitals. Another result of the *Total Solution Model* is that some participating hospitals are using Mediceo Paltac for an increasing proportion of their wholesale transactions.

* Clinical pathway: A treatment schedule given to each patient, generally upon hospitalization, that shows the treatment, examinations and care necessary to cure the illness on the vertical axis and the time frame (dates) on the horizontal axis.

Further Inroads for *class A*

Healthcare system reforms currently in progress are designed to shift from hospital treatment to home and community healthcare. As a result, hospital functions will shift to treatment at home under the supervision of a personal doctor, pharmacy and nurse located near the patient in the community. Cultivating family pharmacists is a pillar of the healthcare system reforms, and we are responding to this with a strategy called *class A*. Rather than large chain pharmacies, *class A* is aimed at the best individual pharmacies or small chains of two or three stores in each community. In this program, we provide proposals and support to make stores more inviting to customers, including ideas for store layout and merchandising. We are making steady progress, and have introduced *class A* at about 1,700 stores. Even Japan's largest dispensing pharmacies only operate chain networks of some 200 stores, so having this system in use at 1,700 stores is a significant accomplishment.

As I said, to respond to the current healthcare system reforms, we need to undertake innovations that integrate main regional hospitals with private practitioners and pharmacies that

cooperate in treatment by sharing hospital and patient information. If we can leverage Mediceo Paltac's natural strengths in business with private practitioners to deal with these three parties as an integrated set through the *Total Solution Model* and *class A*, Mediceo Paltac will gain comprehensive coverage of the market. By doing so, I am confident that we will be a winner in the coming healthcare system reforms.

Progress of Business under the Alliance with Mitsubishi Corporation

The point of our alliance with Mitsubishi Corporation is to provide comprehensive medical services. A general trading company cooperates with partner firms as necessary in each of its business groups, but this alliance requires both companies to deal with all matters related to healthcare as their first priority. I have high expectations for the alliance, especially given Mitsubishi's commanding strength in healthcare among Japanese trading houses. Since the comprehensive agreement began in 2005, we have cooperated in four specific areas: 1) establishment of a supply processing and distribution (SPD) business, 2) development of private brand products, 3) study of businesses related to clinical testing, and 4) study of the pharmaceutical distribution business in China.

For the SPD business, Mediceo Paltac acquired 34.0 percent of the common stock of Mitsubishi's wholly owned subsidiary Nihon Hospital Service Co., Ltd. (NHS). We will integrate our SPD-related know-how and functions with those of NHS to develop a highly functional, high-value-added SPD business that handles everything from pharmaceuticals to hospital supplies. In April 2007, we began work to concentrate the SPD business at NHS.

class A Supports Dispensing Pharmacies

In response to the growth of home healthcare...

class A

Support for functions required of new health insurance pharmacies
(Customer service/Merchandise/Cost handling/Information capabilities)



Alliance with Mitsubishi Corporation

• Establishment of SPD Business

- ▶ Contract renewals after April 2007 shifted to Nihon Hospital Service Co., Ltd.

• Development of Private Brand Products

- ▶ *Medi With* brand hygiene products began sales in March 2007

• Study of Businesses Related to Clinical Testing

- ▶ Sales of imported *Afinion* testing equipment scheduled to start in fall 2007

• Study of Pharmaceutical Business in China

- ▶ Preparing to make announcement

In private brand products, in March 2007, we launched the *Medi With* brand of hygiene products, which were well received by customers. We plan to steadily add new products under this brand, and quickly build sales to the ¥1 billion level. In clinical testing-related business, we plan to begin sales of imported *Afinion* testing equipment this fall. In the China business, we have conducting surveys and research, and are nearing the point where our direction will be clear and we can make an announcement. Both of these are developments that show promise for the future.



Medi With
メデイウイズ
The *Medi With* logo



The first five products in the *Medi With* lineup

Paltac Business: This Year's Primary Focus for Growth as a Business that Can Produce Results

By consolidating healthcare-related business and completing employee transfers, we have established the foundation for the Paltac business, which we believe will begin generating synergy at an early stage. The healthcare-related business had been unprofitable for many years at Mediceo, but turned around in the first year after the integration, and is now contributing to profits. Two years from now in 2009, sales of over-the-counter (OTC) pharmaceuticals will begin at convenience stores, home centers and other types of stores under the revised Pharmaceutical Affairs Law. The functions of the existing OTC pharmaceutical wholesale industry will not be sufficient to handle the sudden increase in customers. The Mediceo Paltac Group, which has over 1,000 sales representatives, will therefore wield considerable power, and I have high expectations that our accomplishments up to now will bear fruit. Even the largest OTC pharmaceutical wholesalers have only about 150 to 160 sales representatives, which indicates the unprecedented nature and overwhelming strength of Paltac's sales force. From this fiscal year through March 2009, I want to make the Paltac business the primary focus in the Group, and I believe it will be a business with good potential.

Corporate Governance: Thorough Employee Training to Instill Good Practices

The Mediceo Paltac Group seeks to earn the trust of all its stakeholders — shareholders, customers, employees, consumers and society — and fulfill its social responsibility by steadily conducting its business activities while ensuring sound, transparent management. In other words, we aim to realize our management philosophy of “contributing to people’s health and the advancement of society through creation of value in distribution.”

According to a May 2007 article in a Japanese business magazine on M&A success and failure, about 50 percent of merged companies see their stock prices decline after the merger. These are given as examples of failure, but the fact is that 50 percent of mergers are successful. The Mediceo Paltac Group ranked third in the list of successful mergers. Even in terms of corporate governance, while many companies have adopted systems such as the “company with committees” system and brought in outside directors, the Mediceo Paltac Group has long been well regarded for its management system. We have worked to enhance not only the form but the substance of corporate governance, and we are proud to be recognized for sound management.

Requirements for thorough internal control systems are also increasing. We plan to take steps to strengthen our internal controls, including measures to respond to the introduction of the Japanese version of the Sarbanes-Oxley Act.

Our Group’s slogan, “Bright and Energetic,” incorporates the Mediceo Paltac Group’s CSR philosophy and standards of conduct. We believe that practice is important in promoting the diffusion and sharing of this philosophy, and therefore the Group is using various case studies to conduct employee training at every level. Our goal is to ensure that the Mediceo Paltac Group maintains the trust of society.



Increasing Corporate Value

In last year’s annual report, I said that we are approaching the third step in the Mediceo Paltac Group’s growth process: establishing a new business model through business innovation and IT strategies. Until we realize this third step, our policy for use of capital will be to balance stable dividends with allocation of cash for investment in future growth. We are confident that with the completion of the third step, we will establish ourselves as a completely new and unprecedented type of wholesaler, and put the Mediceo Paltac Group on track for major growth.

I hope that our shareholders will continue to support the Mediceo Paltac Group with a long-term perspective, in expectation of significant returns in the future.

August 2007

Sadatake Kumakura
President and Chief Executive Officer