

INTERVIEW WITH PRESIDENT AND CEO SADATAKE KUMAKURA



“A focal point of our new medium-term management plan is establishing a customer-oriented business model, which has been a goal of the Mediceo Paltac Group, and reaping the benefits from it.”

The year ended March 31, 2008 was the final year of the three-year medium-term management plan. Can you give us a general overview of Mediceo Paltac’s accomplishments during these three years?

We met our targets and achieved satisfying results.

In the three years of the medium-term management plan, we pushed through reforms to deepen and expand our business, including realizing synergy and cost savings from the integration with PALTAC CORPORATION (now PALTAC KS CORPORATION, or “Paltac KS”). These changes were aimed at achieving the core objective of the plan — establishment of a customer-oriented business model for distribution. As a result, in the year ended March 31, 2008, the last year of the medium-term management plan, net sales exceeded the plan’s original target by about ¥80 billion, and we met virtually all of our targets for profit indicators.

In the Paltac business, which featured prominently in this period, we worked to maximize customer satisfaction and minimize distribution costs in sales of cosmetics and daily necessities. Focusing on drugstores, we achieved sales growth that outpaced the market, and continue to increase profits. We also concentrated the over-the-counter (OTC) pharmaceutical wholesale business at Paltac KS based on our customer-oriented approach in an effort to strengthen sales and reduce distribution costs. In my opinion, this has produced satisfactory results, including standardizing and integrating operations at Paltac KS with the cooperation of its employees.

In the Mediceo business of prescription pharmaceutical wholesale, despite the government’s policies to reduce healthcare costs, sales for the year ended March 31, 2008 exceeded the plan’s goal by about ¥12 billion. This is attributable to several factors. Absolute demand in the prescription pharmaceuticals market is increasing as the population in Japan continues to age, with the baby-boom generation now entering its sixties. In addition, we have worked as a group to adapt our sales approaches to the needs of our customers, and we have moved even more aggressively to market new products and drugs for lifestyle-related diseases.

In April 2008, you launched a new medium-term management plan for the three years ending in March 2011. What changes in the market landscape formed the premises of this plan?

Expansion of generic products and enhanced sales promotion to the growing pharmacy market

Looking at the market forecast, while we are assuming the aging of the baby-boom generation and the launch of breakthrough drugs due to technological innovations, the Ministry of Health, Labour and Welfare (MHLW) has announced its intention to expand the share of the generic drug market by the year ending March 2012 as part of government policies to contain healthcare costs. We are assuming that the MHLW will aim for a share of about 30 percent on a volume basis. So the market for lower-priced gener-

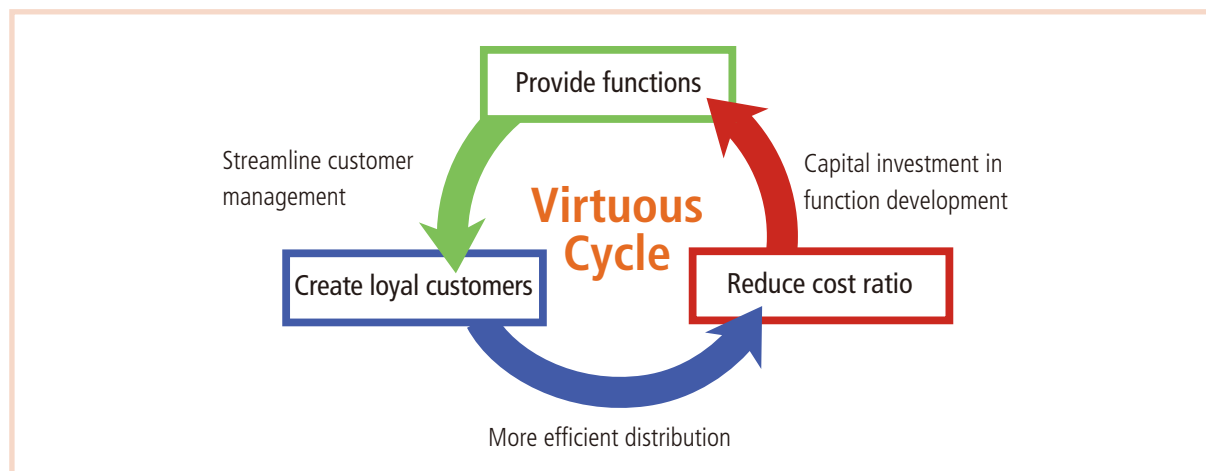
ic drugs will grow, and we have to assume that there will also be a decline in unit prices of pharmaceuticals that have been on the National Health Insurance (NHI) drug price list for a long time. Therefore, we are conservatively estimating total market growth of around 1 percent annually. In these conditions, Mediceo Paltac will need to participate fully in the market for generic drugs, which is expected to double. Moreover, because the growth of the overall market will be restrained, we must operate extremely efficiently and manage our operations to raise productivity in sales and distribution.

Hospitals and clinics currently have a larger combined share of the market than pharmacies. We expect these shares to be about even by the year ending March 2010, with the pharmacy market becoming larger than the combined hospital and clinic markets five years from now. This trend points to the need to strengthen our sales promotions to pharmacies and pharmacy chains. In the pharmacy market, I believe a new role will emerge for wholesalers to support pharmacy management needs, beyond our traditional business of selling pharmaceuticals. This is an area of strength for Mediceo Paltac, and I believe we will be able to increase our presence considerably in the pharmacy market.

Shifting to function-based competition from price competition

Until recently, pharmaceutical wholesale companies competed mainly on the basis of price. Margins were wide enough to enable price differentiation, allowing the market to support more competitors. Now the price differentials are becoming smaller, and the number of wholesalers has essentially shrunk to four companies. In other words, price competition is already becoming impractical.

The industry is now moving toward competition based not on price but on the functions we can offer the customer. We will have to deliver functions that not only meet customers' apparent needs, but also address their true underlying needs to help them operate more efficiently. Moreover, by creating loyal customers, we will raise the Mediceo Paltac Group's market share and distribution will become more efficient, thus improving our customers' cost efficiency as well as our own. We will then be able to use the profits from this improved cost efficiency as capital to invest in new function development, creating a virtuous cycle.



Mediceo Paltac has been providing its customers with functions such as our *MEDICEO-epi*, *Total Solution* and *class A* programs. This area is where we are strongest, and I believe that if we continue steadily in the direction we have been moving, the Mediceo Paltac Group will have a very bright future, even in a challenging market environment. This was a premise in creating our medium-term management plan for the three years ending March 2011.

Distribution reform is currently an issue in the prescription pharmaceutical wholesale industry. What impact will the new medium-term management plan have on this?

Steadfast commitment to reforming distribution

The current state of the prescription pharmaceutical distribution process is such that improper business practices have been taking place under the public health insurance system, and corrective measures are needed. As an industry leader, Mediceo Paltac has addressed this issue, but the distribution reforms now under consideration have a much different character than those that were previously implemented. The difference is that the role of the national government in improving pharmaceutical distribution has been clearly stated, and the issue is being taken up by the Central Social Insurance Medical Council (CSIMC). This signifies that this is not an industry-level problem, but must be corrected from a national perspective, and the approach to reform will require deep and careful thought. Mediceo Paltac is steadfastly committed to tackling distribution reform initiatives.



What are the key points of the new medium-term management plan?

Implementing and reaping the benefits from the establishment of a customer-oriented business model

A focal point of the plan is establishing a customer-oriented business model, which has been a goal of the Mediceo Paltac Group, and reaping the benefits from it. The Business Innovation Committee (BIC), which was launched in April 2006 for the primary purpose of increasing productivity and reducing costs through business process innovations, has planned and devised basic strategies for all business units, including management, administration, sales, distribution and information systems. The period of the new medium-term management plan will be the implementation stage. In implementing these strategies, we will make considerable investments, so we want to concentrate on realizing their benefits as quickly as possible.

The objective of the BIC is creation of value in distribution. We have three basic strategies for doing so: A competitive strategy — to make cost reductions focusing 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 a key point. Among these, the most important point is distribution innovations to change the structure of distribution, which is the core function of a wholesaler. We are aiming for customer-oriented distribution innovations by providing customer-specific packaging and lowering costs through consolidation of distribution and sales bases, consolidation of inventories and other measures.

Another point is that since these changes will be accompanied by large-scale investments over a long period, we wanted to

clarify the return we expect. To that end, we created a five-year vision, and a three-year medium-term management plan that clearly defines strategies to realize that vision.

What is your thinking on corporate social responsibility (CSR) and employee development and education?

CSR focal points, employee development and education and enhancing employee satisfaction

In our new medium-term management plan for the three years ending March 2011, we place additional emphasis on CSR to ensure the realization of our management philosophy of “contributing to people’s health and the advancement of society through creation of value in distribution.” In particular, the plan clearly states that the Mediceo Paltac Group’s social mission as a nationwide multi-channel wholesaler of pharmaceuticals and daily necessities is to speedily provide a stable supply of these products. Moreover, our employees are the ones who will carry out the new medium-term management plan, and we can only maximize customer satisfaction through the growth of our employees and enhancement of employee satisfaction. Therefore, I believe that the growth of our employees will contribute to higher corporate value.



Management Philosophy

Contributing to people’s health and the advancement of society through creation of value in distribution.

CSR Areas of Focus in the Medium-Term Management Plan (April 2008 to March 2011)

1. Close attention to compliance, pharmaceutical management, disaster prevention, information management and environmental preservation
2. Improvement of work attitudes as an honest company with a strong sense of ethics
3. Universal service and response to emergencies in pharmaceutical supply

Please discuss the concrete numerical targets of your five-year vision.

Aim to be a corporate group with growth potential by developing new wholesale functions to maximize customer satisfaction.

Our targets for five years from now, the year ending March 31, 2013, are net sales of ¥3 trillion, an SG&A expense ratio of 6.2 percent, and an operating margin of 2 percent. One of the most important indicators in this five-year vision is top-line sales growth, which we aim to increase by 4 percent or more annually on a consolidated basis.

Our operating cash flow target for the five-year period is ¥167 billion. We plan to invest ¥66 billion in distribution centers for the Mediceo business and ¥30 billion for the Paltac business. We are also planning to make other investments totaling ¥12 billion, including investment in next-generation information systems. We will cover all of these investments with cash flow generated over the next five years, and plan to use surplus funds to pay dividends to shareholders and allot the rest to retained earnings.

What are the business strategies for the Mediceo business and Paltac business in the new medium-term management plan?

Medium-Term Plan for the Mediceo Business

Because of the deteriorating finances of the National Health Insurance system, the government is implementing policies to restrain healthcare expenses, including promotion of the use of generic drugs and the Diagnosis Procedure Combination (DPC) system. Consequently, the operating environment for medical institutions and pharmacies is likely to become more severe. Pharmaceutical wholesalers, in addition to providing a stable, uniform supply of prescription pharmaceuticals and other life-related products, will also increasingly be asked to support the management streamlining efforts of medical institutions and pharmacies.

Given this backdrop, we have set four medium-term business policies for the Mediceo business:

- (1) Offer solutions that increase customer satisfaction.
- (2) Strengthen logistics to create and broaden our demand chain.
- (3) Contribute to the market penetration of prescription pharmaceuticals with a focus on new drugs.
- (4) Diversify revenue sources using merchandise strategies.

While working to maximize customer satisfaction, we will carry out business innovations with a focus on boosting productivity. Specifically, we will not only address the apparent needs of medical institutions and pharmacies, but also uncover their underlying needs in the strategic areas of sales, logistics, merchandise and business administration, and implement measures to respond to those needs as a core strategy.

Medium-Term Plan for the Paltac Business

Challenging conditions continue in the cosmetics, daily necessities and OTC pharmaceutical wholesale market as diversifying customer needs have led to an increase in new products, shorter product life cycles and declining prices. The needs of retailers, the customers of the Paltac business, are optimization of display merchandise and store solutions aimed at increasing the operating profits of individual stores. These requirements can be expected to increase and become more sophisticated.

Accordingly, we will implement our medium-term business policy, "Intermediate Distribution Innovation — Enhance Our Top-Level Functions as a National Wholesaler," which is designed to maximize customer satisfaction and minimize distribution costs with the following five objectives:

- (1) Improve store solution functions and create new sales functions.
- (2) Aim for distribution precisely tailored to customers' needs to help them reduce costs.
- (3) Expand our multi-channel wholesaling model nationwide.

Mediceo Business Five-Year Vision

With Nationwide Expansion of Sales Area Complete, Aim for Net Sales of ¥2 Trillion or More

	Year Ended March 2008	Year Ending March 2013 (Target)
Net Sales	¥1,714.1 billion	▶ ¥2 trillion +
SG&A Ratio	6.95%	▶ 5% level
Operating Margin	1.24%	▶ 2% or higher

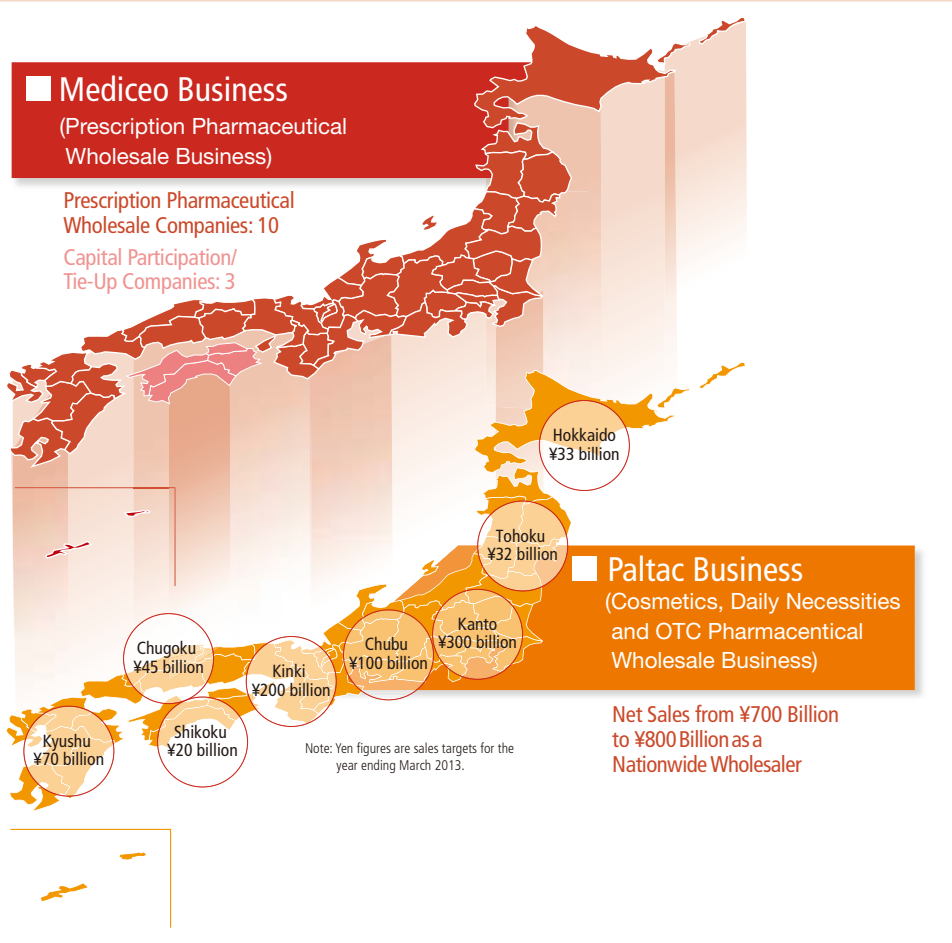
Paltac Business Five-Year Vision

Become a Nationwide Wholesaler and Expand Scale Through Management Integration with Kobashou

	Year Ended March 2008	Year Ending March 2013 (Target)
Net Sales	¥535.9 billion	▶ ¥800.0 billion
SG&A Expenses (SG&A Ratio)	¥44.6 billion (8.32%)	▶ ¥56.9 billion (7.11%)
Operating Income (Operating Margin)	¥6.5 billion (1.22%)	▶ ¥13.0 billion (1.63%)

- (4) Enhance profitability by reducing costs and increasing productivity.
- (5) Create a solid business foundation with the aim of aggressive growth.

In addition, we will continue to assimilate the know-how of the former KOBASHOU.CO., LTD. while putting our full effort into these measures.



Finally, do you have any message for shareholders, including your thoughts on shareholder returns?

Aiming for a 25 percent consolidated dividend payout ratio in the year ending March 2011

Our policy up to now has been to maintain stable dividends. However, to reward the shareholders and investors who place their expectations in our company, we plan to incrementally increase the level of dividends, and are targeting a consolidated dividend payout ratio of 25 percent in the year ending March 2011. We will effectively use retained earnings for reforms to deepen and expand businesses that adapt to change. We will also implement share repurchases and other measures as appropriate for a flexible approach to capital deployment that accommodates changes in the business environment, taking into account our financial condition, stock price trends and other factors.

The Mediceo Paltac Group's evolution has finally entered the growth stage. As we move ahead to become an attractive corporate group that is poised for significant growth, I hope that our shareholders will continue giving their support with a long-term perspective, in expectation of substantial returns in the future.