

Financial Statements

SEIKAGAKU CORPORATION AND CONSOLIDATED SUBSIDIARIES

Consolidated Balance Sheets

March 31, 2001 and 2000

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2001	2000	2001
Assets			
Current assets:			
Cash and cash equivalents	¥13,513	¥12,485	\$108,976
Short-term investments (Note 3)	1,058	6,836	8,532
Notes and accounts receivable—trade	6,866	5,959	55,371
Allowance for doubtful accounts	(33)	(35)	(266)
Inventories (Note 4)	3,648	3,847	29,419
Deferred tax assets (Note 9)	527	857	4,250
Prepaid expenses and other current assets	574	449	4,629
Total current assets	<u>26,153</u>	<u>30,398</u>	<u>210,911</u>
Property, plant and equipment—At cost:			
Land	714	672	5,758
Buildings and structures	10,062	9,588	81,145
Machinery and equipment	4,377	3,894	35,299
Construction in progress	495	840	3,992
Total	<u>15,648</u>	<u>14,994</u>	<u>126,194</u>
Accumulated depreciation	<u>(8,836)</u>	<u>(8,225)</u>	<u>(71,258)</u>
Net property, plant and equipment	<u>6,812</u>	<u>6,769</u>	<u>54,936</u>
Investments and other assets:			
Investments in unconsolidated subsidiaries	25	25	201
Investment securities (Note 3)	8,181	3,294	65,976
Money funds in trust		100	
Goodwill	482	792	3,887
Deferred tax assets (Note 9)	1,304	667	10,516
Other assets	1,592	1,683	12,839
Allowance for doubtful accounts	<u>(452)</u>	<u>(200)</u>	<u>(3,645)</u>
Total investments and other assets	<u>11,132</u>	<u>6,361</u>	<u>89,774</u>
Foreign currency statements translation adjustment		287	
Total	<u>¥44,097</u>	<u>¥43,815</u>	<u>\$355,621</u>
Liabilities and Shareholders' Equity			
Current liabilities:			
Short-term borrowings (Note 6)	¥ 11	¥ 484	\$ 89
Notes and accounts payable—trade	1,522	1,326	12,274
Notes and accounts payable—other	792	1,205	6,387
Accrued expenses	628	610	5,064
Accrued income taxes	582	1,243	4,694
Other current liabilities	<u>93</u>	<u>98</u>	<u>750</u>
Total current liabilities	<u>3,628</u>	<u>4,966</u>	<u>29,258</u>
Long-term liabilities:			
Retirement benefits (Note 7)	1,817	1,106	14,653
Other long-term liabilities	<u>1</u>	<u>36</u>	<u>8</u>
Total long-term liabilities	<u>1,818</u>	<u>1,142</u>	<u>14,661</u>
Shareholders' equity (Notes 8 and 14):			
Common stock, ¥50 par value—authorized, 80,000,000 shares; issued and outstanding, 26,037,375 shares in 2001 and 2000	3,840	3,840	30,968
Additional paid-in capital	5,302	5,302	42,758
Retained earnings	29,617	28,566	238,847
Net unrealized loss on available-for-sale securities	(9)		(73)
Foreign currency translation adjustments	<u>(98)</u>		<u>(790)</u>
Total	<u>38,652</u>	<u>37,708</u>	<u>311,710</u>
Treasury stock—at cost	<u>(1)</u>	<u>(1)</u>	<u>(8)</u>
Total shareholders' equity	<u>38,651</u>	<u>37,707</u>	<u>311,702</u>
Total	<u>¥44,097</u>	<u>¥43,815</u>	<u>\$355,621</u>

Consolidated Statements of Income

Years ended March 31, 2001 and 2000

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2001	2000	2001
Net sales (Notes 10 and 13)	¥19,450	¥22,017	\$156,855
Cost of sales.....	<u>6,597</u>	<u>6,395</u>	<u>53,202</u>
Gross profit.....	12,853	15,622	103,653
Selling, general and administrative expenses (Note 11).....	<u>8,979</u>	<u>9,310</u>	<u>72,411</u>
Operating income.....	<u>3,874</u>	<u>6,312</u>	<u>31,242</u>
Other income (expenses):			
Interest and dividend income	612	376	4,936
Gain (loss) on sales of marketable securities and investment securities	(439)	905	(3,540)
Loss on devaluation of marketable securities and investment securities...	(274)	(539)	(2,210)
Exchange gain (loss).....	35	(51)	282
Loss on derivative contracts (Note 12).....		(1,190)	
Provision for employees' retirement benefits in prior years.....		(768)	
Charge for full amount of transitional obligations for retirement benefits.....	(738)		(5,952)
Other-net.....	<u>(33)</u>	<u>(255)</u>	<u>(266)</u>
Other expenses-net.....	<u>(837)</u>	<u>(1,522)</u>	<u>(6,750)</u>
Income before income taxes.....	<u>3,037</u>	<u>4,790</u>	<u>24,492</u>
Income taxes (Note 9):			
Current.....	1,699	2,501	13,702
Deferred.....	<u>(295)</u>	<u>(281)</u>	<u>(2,379)</u>
Total.....	<u>1,404</u>	<u>2,220</u>	<u>11,323</u>
Net income	<u>¥ 1,633</u>	<u>¥ 2,570</u>	<u>\$ 13,169</u>
	Yen		U.S. Dollars
Per share of common stock (Note 2.n):			
Net income.....	¥62.72	¥98.70	\$0.51
Cash dividends applicable to the year.....	20.00	20.00	0.16

Consolidated Statements of Shareholders' Equity

Years ended March 31, 2001 and 2000

	Millions of Yen					
	Outstanding Number of Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Unrealized Loss on Available-for-sale Securities	Foreign Currency Translation Adjustments
Balance, April 1, 1999	26,037,375	¥3,840	¥5,302	¥25,323		
Cumulative effect of deferred taxes				1,255		
Net income.....				2,570		
Cash dividends, ¥20 per share				(521)		
Bonuses to directors and corporate auditors.....				(61)		
Balance, March 31, 2000	26,037,375	3,840	5,302	28,566		
Net income.....				1,633		
Cash dividends, ¥20 per share				(521)		
Bonuses to directors and corporate auditors.....				(61)		
Net unrealized loss on available-for-sale securities.....					¥(9)	
Foreign currency translation adjustments.....						¥(98)
Balance, March 31, 2001	<u>26,037,375</u>	<u>¥3,840</u>	<u>¥5,302</u>	<u>¥29,617</u>	<u>¥(9)</u>	<u>¥(98)</u>

	Thousands of U.S. Dollars (Note 1)				
	Common Stock	Additional Paid-in Capital	Retained Earnings	Unrealized Loss on Available-for-sale Securities	Foreign Currency Translation Adjustments
Balance, March 31, 2000	\$30,968	\$42,758	\$230,371		
Net income.....			13,169		
Cash dividends, \$0.16 per share			(4,201)		
Bonuses to directors and corporate auditors.....			(492)		
Net unrealized loss on available-for-sale securities.....				\$(73)	
Foreign currency translation adjustments.....					\$(790)
Balance, March 31, 2001	<u>\$30,968</u>	<u>\$42,758</u>	<u>\$238,847</u>	<u>\$(73)</u>	<u>\$(790)</u>

Consolidated Statements of Cash Flows

Years ended March 31, 2001 and 2000

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2001	2000	2001
Operating activities:			
Income before income taxes.....	¥ 3,037	¥ 4,790	\$ 24,492
Adjustments for:			
Income taxes—paid.....	(2,354)	(2,287)	(18,984)
Depreciation and amortization.....	965	1,012	7,782
Provision for doubtful accounts.....	250	(4)	2,016
Loss (gain) on sales of marketable securities and investment securities	439	(905)	3,540
Loss on devaluation of marketable securities and investment securities...	274	539	2,210
Loss on derivative contracts.....		1,190	
Bonuses to directors and corporate auditors.....	(61)	(61)	(492)
Changes in assets and liabilities, net of effects from:			
Increase in notes and accounts receivable—trade.....	(884)	(69)	(7,129)
Decrease in inventories.....	230	188	1,855
Increase in notes and accounts payable—trade.....	165	144	1,331
Increase (decrease) in accounts payable—other.....	(434)	311	(3,500)
Increase in retirement benefits.....	711	899	5,734
Other—net.....	(36)	184	(290)
Net cash provided by operating activities.....	<u>2,302</u>	<u>5,931</u>	<u>18,565</u>
Investing activities:			
Proceeds from sales of short-term investment.....	1,565	15,698	12,621
Payments for purchases of short-term investment.....	(1,001)	(13,127)	(8,073)
Proceeds from sales of assets on sale-and-leaseback contracts.....	1,583		12,766
Payments for purchases of fixed assets	(2,187)	(951)	(17,637)
Proceeds from sales of investment securities.....	5,079	649	40,960
Payments for purchases of investment securities.....	(5,362)	(208)	(43,242)
Proceed from cancellation of long-term deposit.....		2,450	
Payment for cancellation of derivative contract.....		(1,190)	
Other—net.....	(7)	(127)	(56)
Net cash provided by (used in) investing activities.....	<u>(330)</u>	<u>3,194</u>	<u>(2,661)</u>
Financing activities:			
Increase (decrease) in short-term borrowings—net.....	(473)	4	(3,815)
Payment for redemption of convertible bond.....		(3,254)	
Dividends paid	(519)	(521)	(4,185)
Other—net.....	(14)	(4)	(113)
Net cash used in financing activities.....	<u>(1,006)</u>	<u>(3,775)</u>	<u>(8,113)</u>
Foreign currency translation adjustments on			
cash and cash equivalents	<u>62</u>	<u>(41)</u>	<u>500</u>
Net increase in cash and cash equivalents	<u>1,028</u>	<u>5,309</u>	<u>8,291</u>
Cash and cash equivalents, beginning of year	<u>12,485</u>	<u>7,165</u>	<u>100,685</u>
Cash and cash equivalents of newly			
consolidated subsidiaries, beginning of year		<u>11</u>	
Cash and cash equivalents, end of year	<u>¥13,513</u>	<u>¥12,485</u>	<u>\$108,976</u>

Notes to Consolidated Financial Statements

Years ended March 31, 2001 and 2000

1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles and practices generally accepted and applied in Japan, which are different in certain respects as to application and disclosure requirements of International Accounting Standards. The consolidated financial statements are not intended to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan. In addition, the notes to the consolidated financial statements include information which is not required under accounting principles generally accepted in Japan but is presented herein as additional information. Certain reclassifications have been made in the 2000 consolidated financial statements to conform to the classifications used in fiscal 2001.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which Seikagaku Corporation (the "Company") is incorporated and operates. The translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥124 to \$1, the approximate rate of exchange at March 31, 2001. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

2. Summary of Significant Accounting Policies

a. Consolidation — The consolidated financial statements as of March 31, 2001, include the accounts of the Company and its significant six (five in fiscal 2000) majority-owned subsidiaries (together, the "Group").

The fiscal years of all consolidated subsidiaries end on December 31. Accordingly, the accompanying consolidated financial statements include the accounts of the consolidated subsidiaries for the years ended December 31, 2000 and 1999. Significant transactions between December 31 and March 31 are reflected in the consolidated financial statements.

Investments in an unconsolidated subsidiary in fiscal 2001 and 2000 are stated at cost. If the equity method of accounting had been applied to such investments, the effect on the accompanying consolidated financial statements would not be material.

The excess of the cost of the Company's investments in consolidated subsidiaries made in prior years, over its equity in the net assets at the date of acquisition ("Goodwill"), is being amortized over a period of 5 years.

Effective April 1, 1999, the excess of the cost of an acquisition over the fair value of the net assets of an acquired subsidiary at the date of acquisition is being amortized over a period of 15 years.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Group is eliminated.

b. Cash Equivalents — Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value.

Cash equivalents include time deposits, certificate of deposits and mutual funds mainly investing in bonds that represent short-term investments, all of which mature or become due within three months of the date of acquisition.

c. Short-term Investments and Investment Securities

— Prior to April 1, 2000, marketable securities listed on stock exchanges were stated at the lower of cost, determined by the moving-average method, or market. Other securities were stated at cost determined by the moving-average method.

Effective April 1, 2000, the Group adopted a new accounting standard for financial instruments, including short-term investments and investment securities.

The standard requires all applicable securities held by the Group to be classified and accounted for, depending on management's intent, as follows: (1) held-to-maturity debt securities which are expected to be held to maturity with the positive intent and ability to hold to maturity are reported at amortized cost and (2) available-for-sale securities which are not classified as the aforementioned securities are classified as available-for-sale securities. Marketable available-for-sale securities are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity. The cost of securities sold is determined based on the moving-average method. Non-marketable available-for-sale securities are stated at cost determined by the moving-average method. For other than temporary declines in fair value, non-marketable available-for-sale securities are reduced to net realizable value by a charge to income.

The effect of adoption of the new standard was to increase income before income taxes by ¥3 million (\$24 thousand).

Short-term investments classified as current assets decreased by ¥5,340 million (\$43,065 thousand) and investment securities increased by the same amount as of April 1, 2000.

d. Allowance for Doubtful Accounts — The allowance for doubtful accounts is stated in amounts considered to be appropriate based on the Company's past credit loss experience and an evaluation of potential losses.

e. Inventories — Merchandise and supplies are stated at cost determined by the moving-average method, and finished products, semi-finished products, raw materials

and work in process are stated at cost determined by the average method.

- f. Depreciation** — Depreciation of property, plant and equipment is computed by the declining-balance method while the straight-line method is applied to buildings of the Company acquired after April 1, 1998, over the estimated useful lives of the assets. The range of useful lives is principally from 15 to 38 years for buildings and structures and from 4 to 7 years for machinery and equipment.
- g. Leases** — All leases are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain “as if capitalized” information is disclosed in the notes to the lessee’s financial statements.
- h. Retirement and Pension Plans** — The Company has a funded non-contributory pension plan covering substantially all of its employees. The amount of benefits is generally determined on the basis of the current basic rates of compensation and length of service at the time of termination or mandatory retirement.

Effective April 1, 1999, the Company adopted a new accounting policy whereby the liability for employees was calculated as present value of projected future pension payments minus fair value of fund assets. The cumulative effect of ¥768 million in prior years was charged to income in fiscal 2000 and presented as “Provision for employees’ retirement benefits in prior years” on the consolidated statements of income.

Effective April 1, 2000, the Company adopted a new accounting standard for employees’ retirement benefits and accounted for the liability for retirement benefits based on the projected benefit obligations and plan assets at the balance sheet date.

The full amount of the transitional obligation of ¥738 million (\$5,952 thousand), determined as of the beginning of year, is charged to income and presented as other expense in the statement of income. As a result, net periodic benefit costs as compared with the prior method, increased by ¥955 million (\$7,702 thousand) and income before income taxes by ¥929 million (\$7,492 thousand).

Certain overseas subsidiaries also have a funded contributory retirement plan, a 401(k) plan in the United States of America, covering substantially all of their employees.

The Company also accrues retirement allowances for directors and corporate auditors who customarily receive lump-sum payments subject to shareholders’ approval. The annual provision for retirement allowance is calculated to state the liability at the amount that would be required if all directors or corporate auditors retired at each balance sheet date. The provision for the retirement allowance is not funded.

- i. Research and Development Costs** — Research and development costs are charged to income as incurred.
- j. Income Taxes** — Deferred income taxes are recorded to reflect the impact of temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. These deferred taxes are measured by applying currently enacted tax laws to the temporary differences.
- k. Appropriations of Retained Earnings** — Appropriations of retained earnings at each year end are reflected in the financial statements for the following year upon shareholders’ approval.
- l. Foreign Currency Transactions** — Short-term receivables and payables denominated in foreign currencies are translated into Japanese yen at year-end exchange rates and resulting exchange gains and losses are recognized in earnings.
- m. Foreign Currency Financial Statements** — The balance sheet accounts of the consolidated overseas subsidiaries are translated into yen at the current exchange rates as of the balance sheet date except for shareholders’ equity, which is translated at historical exchange rates. Prior to April 1, 2000, differences arising from such translation were shown as “Foreign currency translation adjustments” as either an asset or liability in the balance sheet. Effective April 1, 2000, such differences are shown as “Foreign currency translation adjustments” in a separate component of shareholders’ equity in accordance with the revised accounting standard for foreign currency transactions.
- Revenue and expense accounts of the consolidated overseas subsidiaries are translated into yen at the average rate of exchange during the respective fiscal year.
- n. Per Share Information** — The computation of net income per share is based on the weighted average number of shares of common stock outstanding during each year, retroactively adjusted for stock splits. The average number of common shares used in the computation was 26,036,490 shares for fiscal 2001 and 26,035,772 shares for fiscal 2000.
- Diluted net income per share of common stock assumes full conversion of the outstanding convertible bonds at the beginning of the year with an applicable adjustment for related interest expense, net of tax. Diluted net income per share is not disclosed because there is no dilutive securities in fiscal 2001, and it is anti-dilutive in fiscal 2000.
- Cash dividends per share presented in the accompanying consolidated statements of income are dividends applicable to the respective years including dividends to be paid after the end of the year.

3. Short-Term Investments and Investment Securities

Short-term investments and investment securities as of March 31, 2001 and 2000, consisted of the following:

	Millions of Yen		Thousands of
	2001	2000	U.S. Dollars
Short-term investments:			
Equity securities.....		¥2,322	
Debt securities.....	¥ 901	2,354	\$ 7,266
Other	157	2,160	1,266
Total	<u>¥1,058</u>	<u>¥6,836</u>	<u>\$ 8,532</u>
Investment securities:			
Equity securities.....	¥3,361	¥1,431	\$27,105
Debt securities.....	1,611	1,494	12,992
Other	3,209	369	25,879
Total	<u>¥8,181</u>	<u>¥3,294</u>	<u>\$65,976</u>

Information regarding each category of the securities classified as available-for-sale and held-to-maturity at March 31, 2001, was as follows:

	Millions of Yen			
	2001			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities.....	¥3,273	¥741	¥661	¥3,353
Debt securities.....	2,009	8	55	1,962
Other	3,788	33	458	3,363
Held-to-maturity.....	550	2		552

	Thousands of U.S. Dollars			
	2001			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities.....	\$26,395	\$5,976	\$5,331	\$27,040
Debt securities.....	16,202	65	444	15,823
Other	30,548	266	3,693	27,121
Held-to-maturity.....	4,436	16		4,452

Available-for-sale securities whose fair value is not readily determinable as of March 31, 2001, were as follows:

	Carrying Amount	
	Millions of Yen	Thousands of U.S. Dollars
Available-for-sale:		
Equity securities.....	¥ 8	\$65
Other	3	24
Total	<u>¥11</u>	<u>\$89</u>

Proceeds from sales of available-for-sale securities for the year ended March 31, 2001, were ¥4,643 million (\$37,444 thousand). Gross realized gains and losses on these sales, computed on the moving average cost basis, were ¥862 million (\$6,952 thousand) and ¥1,301 million (\$10,492 thousand), respectively.

The carrying values of debt securities and other investment by contractual maturities for securities classified as available-for-sale and held-to-maturity at March 31, 2001, are as follows:

	Millions of Yen		Thousands of U.S. Dollars	
	Available for Sale	Held to Maturity	Available for Sale	Held to Maturity
Due in one year or less.....	¥ 504	¥550	\$ 4,064	\$4,435
Due after one year through five years	2,287		18,444	
Due after five years through ten years.....	634		5,113	
Total	<u>¥3,425</u>	<u>¥550</u>	<u>\$27,621</u>	<u>\$4,435</u>

Carrying amounts and aggregate market values of current and non-current marketable equity securities included in short-term investments and investment securities at March 31, 2000, were as follows:

	Millions of Yen		
	Carrying Amount	Aggregate Market Value	Unrealized Gain
Short-term investments:			
Marketable securities:			
Equity securities.....	¥2,322	¥3,655	¥1,333
Debt securities and other..	3,414	3,505	91
Total	5,736	<u>¥7,160</u>	<u>¥1,424</u>
Investments for which market quotations are not available.....	1,100		
Total short-term investments..	<u>¥6,836</u>		
Investment securities:			
Marketable securities —			
equity securities	¥1,317	¥1,830	¥513
Total	1,317	<u>¥1,830</u>	<u>¥513</u>
Investments for which market quotations are not available.....	1,977		
Total investment securities	<u>¥3,294</u>		

Investment for which market quotations are not available principally consist of corporate bonds which there are no readily available markets from which to obtain or calculate the market value thereof.

4. Inventories

Inventories at March 31, 2001 and 2000, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2001	2000	2001
Merchandise	¥ 223	¥ 292	\$ 1,798
Finished products	1,590	1,361	12,823
Semi-finished products	437	624	3,524
Work in process	963	1,027	7,766
Raw materials and supplies	435	543	3,508
Total	<u>¥3,648</u>	<u>¥3,847</u>	<u>\$29,419</u>

5. Leases

(1) Finance Leases

The Company leases certain machinery, equipment and other assets under finance lease agreements. Total lease payments under finance lease arrangements that do not transfer ownership of the leased equipment were ¥752 million (\$6,065 thousand) and ¥720 million for the years ended March 31, 2001 and 2000, respectively.

Pro forma information of leased equipment such as acquisition cost, accumulated depreciation, obligations under finance leases, depreciation expense and interest expense of finance leases that do not transfer ownership of the leased equipment to the lessee on an "as if capitalized" basis as of March 31, 2001 and 2000, was as follows:

	Millions of Yen			Thousands of U.S. Dollars			Thousands of U.S. Dollars		
	2001			2000			2001		
	Machinery and Equipment	Other	Total	Machinery and Equipment	Other	Total	Machinery and Equipment	Other	Total
Acquisition cost	¥4,486	¥127	¥4,613	¥2,989	¥168	¥3,157	\$36,178	\$1,024	\$37,202
Accumulated depreciation	2,367	67	2,434	2,115	101	2,216	19,089	540	19,629
Net leased property	<u>¥2,119</u>	<u>¥ 60</u>	<u>¥2,179</u>	<u>¥ 874</u>	<u>¥ 67</u>	<u>¥ 941</u>	<u>\$17,089</u>	<u>\$ 484</u>	<u>\$17,573</u>

Obligations under finance leases:

	Millions of Yen		Thousands of U.S. Dollars
	2001	2000	2001
Due within one year	¥ 805	¥ 590	\$ 6,492
Due after one year	2,088	1,059	16,839
Total	<u>¥2,893</u>	<u>¥1,649</u>	<u>\$23,331</u>
Depreciation expense	¥ 672	¥ 615	\$ 5,419
Interest expense	90	87	726

Depreciation expense is computed principally by the declining-balance method. Interest expense is computed by the interest method.

(2) Operating Leases

The minimum rental commitments under non-cancelable operating leases at March 31, 2001 and 2000, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2001	2000	2001
Due within one year	¥60	¥51	\$484
Due after one year	15	66	121
Total	<u>¥75</u>	<u>¥117</u>	<u>\$605</u>

6. Short-Term Borrowings

Short-term borrowings are represented by principally unsecured bank loans. The weighted average interest rate of short-term borrowings was 11.9% and 1.5% at March 31, 2001 and 2000, respectively.

7. Retirement and Pension Plans

The Company has severance payment plans for employees, directors and corporate auditors.

Under most circumstances, employees terminating their employment are entitled to retirement benefits determined based on the rate of pay at the time of termination, years of service and certain other factors. Such retirement benefits are made in the form of a lump-sum severance payment from the Company and annuity payments from a trustee. Employees are entitled to larger payments if the termination is involuntary, by retirement at the mandatory retirement age, or by death.

Effective April 1, 2000, the Group adopted a new accounting standard for employees' retirement benefits.

Employees' retirement benefits for the retirement and pension fund at March 31, 2001, consisted of the following:

	Millions of Yen	Thousands of U.S. Dollars
Projected benefit obligation	¥4,424	\$35,677
Fair value of plan assets	(2,976)	(24,000)
Unrecognized prior service cost	226	1,823
Unrecognized actuarial loss	(96)	(774)
Net liability	¥1,578	\$12,726

The components of net periodic benefit costs for the plan in fiscal 2001 are as follows:

	Millions of Yen	Thousands of U.S. Dollars
Service cost	¥ 235	\$1,895
Interest cost	134	1,080
Expected return on plan assets	(82)	(661)
Amortization of prior service cost ..	(2)	(16)
Amortization of transitional obligation	739	5,960
Net periodic benefit costs	¥1,024	\$8,258

Assumptions used for the year ended March 31, 2001, are set forth as follows:

Discount rate	3.0%
Expected rate of return on plan assets	2.8%
Amortization period of prior service cost	10 years
Recognition period of actuarial loss	10 years
Amortization period of transitional obligation	1 year

The expense for the plan which was charged to income for the year ended March 31, 2000, was ¥336 million.

The Company has another pension plan "Tokyo Pharmaceutical Welfare Pension Fund" which is a multi-employee's pension fund. The amounts contributed to the

fund which were charged to income were ¥129 million (\$1,040 thousand) and ¥128 million for the years ended March 31, 2001 and 2000, respectively.

Liability for retirement benefits at March 31, 2001, for directors and corporate auditors are ¥239 million (\$1,927 thousand). The retirement benefits for directors and corporate auditors are paid subject to the approval of the shareholders.

Certain overseas subsidiaries also have a funded contributory retirement plan, a 401(k) plan in the United States of America covering substantially all of their employees. The amount contributed to the fund which was charged to income was ¥18 million (\$145 thousand) and ¥16 million for the years ended March 31, 2001 and 2000, respectively.

8. Shareholders' Equity

The Code requires at least 50% of the issue price of new shares, with a minimum of the par value, to be designated as stated capital as determined by resolution of the Board of Directors. Proceeds in excess of amounts designated as stated capital are credited to additional paid-in capital.

The Code also requires companies to appropriate from retained earnings to legal reserve an amount equal to at least 10% of all cash payments which are made as an appropriation of retained earnings until the reserve equals 25% of stated capital. The amount of legal reserves appropriated by the Company were included in retained earnings in the accompanying consolidated balance sheets. Such legal reserves for the years ended March 31, 2001 and 2000, were ¥675 million (\$5,444 thousand) and ¥616 million, respectively. This reserve is not available for dividends but may be used to reduce a deficit by resolution of the shareholders.

The Company may transfer portions of additional paid-in capital and legal reserve to stated capital by resolution of the Board of Directors. The Company may also transfer portions of unappropriated retained earnings, available for dividends, to stated capital by resolution of the shareholders.

Under the Code, the Company may issue new common shares to existing shareholders without consideration as a stock split pursuant to resolution of the Board of Directors. The Company may make such a stock split to the extent that the aggregate par value of the shares outstanding after the issuance does not exceed the stated capital. However, the amount calculated by dividing the total amount of shareholders' equity by the number of outstanding shares after the issuance shall not be less than ¥50.

The Company is authorized to repurchase, at management's discretion, up to 2,600 thousand shares of the Company's stock for the purpose of canceling the shares by debiting such amounts against retained earnings. There were no repurchases for this purpose during fiscal 2001 and 2000.

Dividends are approved by the shareholders at a meeting held subsequent to the fiscal year to which the dividend is applicable. However, a semiannual interim dividend may be paid upon resolution of the Board of Directors subject to limitations imposed by the Code.

Under the Code, the amount available for dividends is based on retained earnings as recorded on the books of the Company. At March 31, 2001, retained earnings recorded on the books of the Company which are available for dividends, subject to approval by the shareholders and legal reserve requirements, totaled ¥29,890 million (\$241,048 thousand).

9. Income Taxes

The Company is subject to Japanese national and local taxes based on income which, in the aggregate, resulted in a normal effective statutory tax rate of approximately 42% in fiscal 2001 and 2000. Overseas subsidiaries are subject to income taxes of the countries in which they operate.

The tax effects of significant temporary differences which resulted in deferred tax assets and liabilities at March 31, 2001 and 2000, are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2001	2000	2001
Deferred tax assets (current):			
Loss on devaluation of marketable securities		¥353	
Loss on devaluation of inventory	¥ 137	5	\$ 1,105
Research and development cost	120	116	968
Accrued bonuses	105	81	847
Accrued enterprise taxes	54	112	435
Sales discount		102	
Other	111	88	895
Total	¥ 527	¥857	\$ 4,250
Deferred tax assets (non-current):			
Retirement benefits	¥ 763	¥464	\$ 6,153
Loss on devaluation of investment securities	335	12	2,702
Other	206	191	1,661
Total	¥1,304	¥667	\$10,516

A reconciliation between the normal effective statutory tax rate for the years ended March 31, 2001 and 2000, to the actual effective tax rate reflected in the accompanying consolidated statements of income is as follows:

	2001	2000
Normal effective statutory tax rate	42.0%	42.0%
Amortization of goodwill	4.5	2.9
Other-net	(0.3)	1.4
Actual effective tax rate	46.2%	46.3%

10. Transactions with a Significant Customer

The Company sells a major portion of its main product, ARTZ, to a pharmaceutical company in Japan under a sales agent agreement.

Sales to the customer were ¥11,686 million (\$94,242 thousand) and ¥13,247 million for the years ended March 31, 2001 and 2000, respectively.

11. Research and Development Costs

Research and development costs charged to income were ¥3,789 million (\$30,556 thousand) and ¥3,844 million for the years ended March 31, 2001 and 2000, respectively.

12. Derivatives

Derivative transactions entered into by the Company have been made in accordance with internal policies which regulate the authorization and credit limit amounts. The President's approval is required to enter into derivative contracts and the Accounting Department executes and controls the contracts. The performance and evaluation of derivatives is reported to management periodically.

The Company had interest rate swap contracts and interest rate swaption contracts as a part of their trading activities. The contracts were terminated in fiscal 2000, resulting in the loss of ¥1,190 million.

The Company also used foreign exchange forward contracts to hedge foreign exchange risk associated with certain assets and liabilities denominated in foreign currencies in fiscal 2000.

There were not derivative contracts outstanding at March 31, 2000.

The Group did not utilize any derivative instruments in fiscal 2001.

13. Segment Information

Information regarding sales to foreign customers of the Group for the years ended March 31, 2001 and 2000, is as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2001	2000	2001
Sales to foreign customers (A)	¥ 2,344	¥ 2,215	\$ 18,903
Consolidated sales (B)	19,450	22,017	156,855
(A)/(B)	12.1%	10.1%	12.1%

The Group is mainly engaged in one industry segment which is the purchasing, manufacturing and selling of pharmaceutical products and related goods. In addition, the foreign operations of the Group are not significant in terms of total sales, operating income and total assets. Therefore, information about operations in different industries and foreign operations have been omitted.

14. Subsequent Event

On June 28, 2001, the shareholders of the Company authorized the following appropriations of retained earnings as of March 31, 2001:

	Millions of Yen	Thousands of U.S. Dollars
Appropriations:		
Transfer to legal reserve	¥ 31	\$ 250
Cash dividends, ¥10 (\$0.08) per share	261	2,105
Bonuses to directors and corporate auditors	48	387
Total	¥340	\$2,742

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**Deloitte
Touche
Tohmatsu**

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
Seikagaku Corporation:

We have examined the consolidated balance sheets of Seikagaku Corporation and consolidated subsidiaries as of March 31, 2001 and 2000, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. Our examinations were made in accordance with auditing standards, procedures and practices generally accepted and applied in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Seikagaku Corporation and consolidated subsidiaries as of March 31, 2001 and 2000, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles and practices generally accepted in Japan applied on a consistent basis.

As described in Note 2, effective April 1, 2000, the consolidated financial statements have been prepared in accordance with new accounting standards for employees' retirement benefits and financial instruments and a revised accounting standard for foreign currency transactions.

Our examinations also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 1. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

Deloitte Touche Tohmatsu

June 29, 2001