



A MESSAGE FROM THE PRESIDENT

BUSINESS RESULTS

During the fiscal year just ended, we faced a moribund domestic economy, growing competition and a new cycle of reductions in Japanese National Health Insurance (NHI) reimbursement prices. Seikagaku moved against these headwinds by aggressively winning customers through fresh initiatives in marketing and sales and by growing its overseas sales. For the year ended March 31, 2003 (fiscal 2002), sales and income increased compared with the previous year's figures. Consolidated net sales were up by 8.9% to ¥20,829 million, operating income climbed 35.8% to ¥5,285 million and net income rose 54.3% to ¥2,367 million. These results were in line with forecasts.

Looking at the factors that influenced these results, the growth in sales was attributed to large increases in overseas sales of SUPARTZ® (the U.S. brand name for the joint function improver ARTZ Dispo®) and diagnostic reagents. Another factor was an increase in the sales volume of domestic pharmaceutical sales, which more than offset a 10% reduction in reimbursement prices under the NHI.

Export sales of SUPARTZ®, introduced in the U.S. market in April 2001, surged in the last quarter of fiscal 2001 following listing for U.S. Medicare insurance reimbursement. In fiscal 2002, strong market growth helped to push our total overseas sales to ¥4,380 million. This performance carried the export sales ratio from 15.6% in fiscal 2001 to 21.0% in fiscal 2002.

Negative factors in fiscal 2002 included an increase in non-operating losses of ¥184 million, from currency exchange losses associated with construction of the new multi-purpose facility for Associates of Cape Cod, Inc. (ACC) in the U.S. Extraordinary losses declined for the second year in a row on improvements in appraisal losses, which offset an increase in losses on sale of negotiable securities. We are upgrading our investment securities portfolio. This process is the main reason for increased losses on sales of investment securities. The benefits of these efforts are already emerging, and valuation losses on investment securities were lower than in the previous year. It is our intention to secure maximum growth over the long term through balanced management of sales growth, cost control and new product development.

OUTLOOK

We base our forecast of sales growth for the year ending March 31, 2004 on anticipated increases in overseas sales and stability in the NHI reimbursement prices for our products. R&D costs must necessarily increase as clinical trials move into the later stages and we step up product licensing agreements. Both items, although costly in the short run, assure a steady flow of new products to drive future sales growth. Our conservative projection calls for net income to remain around the current level of ¥2,300 million, despite an increase of ¥1,300 million in R&D expenditures. With the stock market's tentative recovery, and the near completion of the investment portfolio realignment, further large extraordinary losses are unlikely. As a result, anticipated net sales of ¥21,400 million combined with reductions in extraordinary losses should offset R&D spending with only minor impact on profits.

Following the initial publication of the outlook for the year ending March 2004, the Bovine Spongiform Encephalopathy (BSE) outbreak occurred in Canada. As a safety precaution, we disposed of ¥373 million worth of Canadian bovine products, used as raw materials in producing chondroitin sulfate for sale as pharmaceutical bulks. We anticipate that such losses will occur as extraordinary losses, however, with increased efforts to reduce expenses, we have determined that a revision of the business performance forecast will not be necessary.

LEVERAGING STRENGTHS FOR A PROSPEROUS FUTURE

The current profit ratio is 11.4%, and the balance sheet is very healthy. Total assets are ¥46.6 billion. Total shareholders' equity is around 90%, and we are essentially debt free, with sufficient assets to comfortably fund strategic investments and sustain a vigorous program of research and development.

Even though we have been very successful with one product, sodium hyaluronate, we have yet to develop a successor that meets our specifications for high-level profitability and growth.

We believe that the ultimate key to strong, sustained growth is finding unique and effective products with large markets, but this is a laborious, uncertain and long-term process.

Therefore, we plan to leverage our strengths—strong and stable sales in Japan and promising opportunities to accelerate growth overseas—to provide revenue growth and a steady source of funds necessary to carry out new-product research and development.

We have crystallized this thinking into a formal, three-element strategy to support renewed growth and profitability.

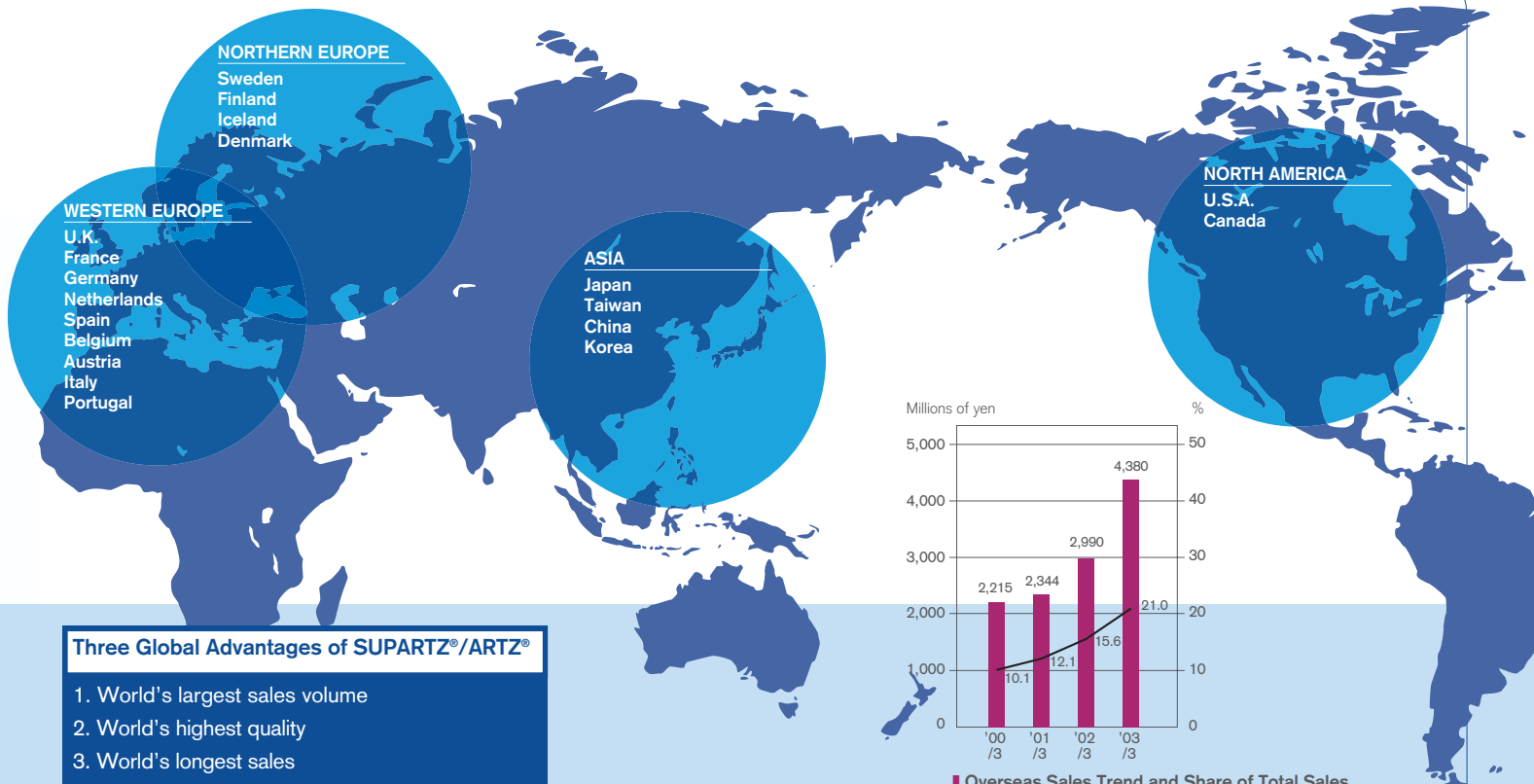
THREE STEPS TO SUSTAINED INCOME GROWTH

In last year's annual report, I spoke about the three steps, which I consider necessary for the development of future business. More precisely, I defined Step One as "securing a foundation for basic earnings by firmly maintaining the sales level for existing products and improving the respective business areas," Step Two as "expanding overseas sales," and Step Three as "developing new products." The following report outlines progress on these three steps over the past year.

Continuing to Maintain Domestic Sales Revenues

We achieved most of the goals identified for Step One by maintaining sales levels for pharmaceuticals in the domestic market. Many aspects of the domestic market environment are unfavorable for our flagship products, ARTZ® and ARTZ Dispo®. Negative factors include the industry trend toward the use of generic products and an increase in the patient co-payment share under the NHI scheme. Despite these challenges, we have continued to maintain sales volumes for both ARTZ® and ARTZ Dispo®, thanks to four key advantages. First, we have a skillful and creative marketing partner in the form of Kaken Pharmaceutical Co., Ltd. Second, the number of aged people, who are the main users of ARTZ®, continues to grow. Third, we are able to provide unmatched volumes of research and clinical data. Fourth, we have an excellent reputation among the academic and medical community.

The market environment is keenly competitive for OPEGAN® and OPEGAN Hi®, which are used in cataract surgery, and competition has intensified. However, we have been able to maintain sales volumes in this area



Three Global Advantages of SUPARTZ®/ARTZ®

- 1. World's largest sales volume
- 2. World's highest quality
- 3. World's longest sales

by cooperating closely with our marketing partner, Santen Pharmaceuticals Co., Ltd., which specializes in ophthalmologic products. In the year ended March 31, 2003, accelerating growth in the number of cataract operations was reflected in a double-digit increase in sales revenues compared with the previous year's level.

Making Research Reagents Profitable

Our efforts to improve earnings from existing business areas include the restructuring of our research reagent business. This process, which began in April 2002, has included the selective reduction, on the basis of profitability, of the range of products that we manufacture. We have also completed measures to improve organizational efficiency by integrating development, production and sales in one location. In January 2003, we rationalized our pricing. We have made excellent progress with this plan over the past year, and we expect our research reagent business to move into the black in the year ended March 31, 2004.

Further Expansion of Overseas Sales

ARTZ® products (also marketed as SUPARTZ®) are currently sold in 18 countries, and soon in 19, following their expected launch in the Philippines in the fall of 2003.

SUPARTZ® is marketed by our sales partner, Smith & Nephew Inc. in the U.S. and some EU countries. Especially in the U.S., sales have grown steadily, and in less than two years following its launch, the product has gained a 10% market share in that country. Further growth in sales of SUPARTZ® will be an important factor for our overall performance in the foreseeable future. We expect SUPARTZ® to capture 25% of the U.S. market by 2007 for sodium hyaluronate preparations for treatment of osteoarthritis.

EXTENDING AND FILLING THE NEW PRODUCT PIPELINE

While the increase in sales of SUPARTZ® in the U.S. will be the main driving force for growth in the immediate future, the key to our next growth step will obviously be the development and introduction of new products. We are currently making steady progress with clinical development projects exploring six themes (see page 03). Most of these products are about to enter the later stages of clinical trials.

We are also working to expand our product pipeline by actively in-licensing novel products for development in addition to our internal drug discovery programs. Examples of new areas of collaboration include an agreement signed in

August 2002 with AnGes MG (Osaka, Japan) concerning the joint development of NFκB decoy oligonucleotides preparations for use in the treatment of rheumatoid arthritis and osteoarthritis. In April 2003, we concluded a licensing agreement with BioTie Therapies Corporation of Finland, allowing us to develop an anti-inflammatory drug based on that company's anti-VAP-1 monoclonal antibodies.

We believe that the time has come to increase our already high research and development commitment in order to bring new drugs to market as quickly as possible. We intend to lift our research and development expenditure from the existing level of ¥4 billion to ¥5 billion. We see this as forward investment based on our keen awareness that the development and introduction of new products is crucial to our future growth and earning power.

We are making excellent progress with the above three steps, and we are determined to continue the steady expansion and development of our business activities.


 President
Shirow Enoki