

# Financial Statements

## Consolidated Balance Sheets March 31, 2004 and 2003 Seikagaku Corporation and Consolidated Subsidiaries

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2004	2003	2004
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	¥ 7,593	¥ 7,468	\$ 71,632
Short-term investments (Note 3)	3,210	2,303	30,283
Notes and accounts receivable—trade	5,804	5,989	54,755
Allowance for doubtful accounts	(11)	(11)	(104)
Inventories (Note 4)	3,860	4,380	36,415
Deferred tax assets (Note 9)	607	516	5,727
Other current assets	279	1,039	2,632
Total current assets	21,342	21,684	201,340
Property, plant and equipment—at cost:			
Land	711	716	6,708
Buildings and structures	11,318	11,486	106,774
Machinery and equipment	6,787	6,587	64,028
Construction in progress	810	116	7,641
Total	19,626	18,905	185,151
Accumulated depreciation	(10,638)	(10,038)	(100,359)
Net property, plant and equipment	8,988	8,867	84,792
Investments and other assets:			
Investments in an unconsolidated subsidiary	25	25	236
Investment securities (Note 3)	16,548	14,117	156,113
Goodwill	159	199	1,500
Deferred tax assets (Note 9)	479	871	4,519
Other assets	1,135	1,292	10,708
Allowance for doubtful accounts	(430)	(465)	(4,057)
Total investments and other assets	17,916	16,039	169,019
Total	¥ 48,246	¥ 46,590	\$ 455,151
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Current liabilities:			
Short-term borrowings (Note 6)		¥ 192	
Notes and accounts payable—trade	¥ 550	641	\$ 5,189
Notes and accounts payable—other	1,220	1,056	11,509
Accrued expenses	575	595	5,425
Accrued income taxes	764	1,116	7,208
Other current liabilities	38	31	358
Total current liabilities	3,147	3,631	29,689
Long-term liabilities—			
Retirement benefits (Note 7)	1,503	1,442	14,179
Total long-term liabilities	1,503	1,442	14,179
Shareholders' equity (Notes 8 and 13):			
Common stock—authorized, 80,000,000 shares; issued, 26,037,375 shares in 2004 and 2003	3,840	3,840	36,226
Additional paid-in capital	5,302	5,302	50,019
Retained earnings	33,918	32,372	319,981
Unrealized gain on available-for-sale securities	726	64	6,849
Foreign currency translation adjustments	(133)	(6)	(1,254)
Treasury stock—at cost, 40,086 shares in 2004 and 38,963 shares in 2003	(57)	(55)	(538)
Total shareholders' equity	43,596	41,517	411,283
Total	¥ 48,246	¥ 46,590	\$ 455,151

See Notes to Consolidated Financial Statements.

**Consolidated Statements of Income** Years Ended March 31, 2004 and 2003  
Seikagaku Corporation and Consolidated Subsidiaries

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2004	2003	2004
Net sales (Notes 10 and 12)	¥20,744	¥20,829	\$195,698
Cost of sales	6,538	6,630	61,679
Gross profit	14,206	14,199	134,019
Selling, general and administrative expenses (Note 11)	9,964	8,914	94,000
Operating income	4,242	5,285	40,019
Other income (expenses):			
Interest and dividend income	279	127	2,632
Loss on sales of short-term investments and investment securities	(67)	(515)	(632)
Foreign exchange loss	(403)	(279)	(3,802)
Loss on disposal of inventories	(373)		(3,519)
Other—net	(54)	(400)	(509)
Other expenses—net	(618)	(1,067)	(5,830)
Income before income taxes	3,624	4,218	34,189
Income taxes (Note 9):			
Current	1,650	1,629	15,566
Deferred	(144)	222	(1,358)
Total income taxes	1,506	1,851	14,208
Net income	¥ 2,118	¥ 2,367	\$ 19,981

	Yen		U.S. Dollars
Per share of common stock (Note 2.n):			
Net income	¥79.46	¥88.92	\$0.75
Cash dividends applicable to the year	30.00	20.00	0.28

See Notes to Consolidated Financial Statements.

## Consolidated Statements of Shareholders' Equity

Years Ended March 31, 2004 and 2003  
Seikagaku Corporation and Consolidated Subsidiaries

	Millions of Yen						
	Issued Number of Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Unrealized Gain (Loss) on Available-for-sale Securities	Foreign Currency Translation Adjustments	Treasury Stock
Balance, April 1, 2002	26,037,375	¥3,840	¥5,302	¥30,582	¥ (46)	¥ 153	¥ (3)
Net income				2,367			
Cash dividends, ¥20 per share				(521)			
Bonuses to directors and corporate auditors				(56)			
Unrealized gain on available-for-sale securities					110		
Net change in foreign currency translation adjustments						(159)	
Purchase of treasury stock							(52)
Balance, March 31, 2003	26,037,375	3,840	5,302	32,372	64	(6)	(55)
Net income				2,118			
Cash dividends, ¥20 per share				(520)			
Bonuses to directors and corporate auditors				(52)			
Unrealized gain on available-for-sale securities					662		
Net change in foreign currency translation adjustments						(127)	
Purchase of treasury stock							(2)
Balance, March 31, 2004	26,037,375	¥3,840	¥5,302	¥33,918	¥726	¥(133)	¥(57)

	Thousands of U.S. Dollars (Note 1)						
	Common Stock	Additional Paid-in Capital	Retained Earnings	Unrealized Gain on Available-for-sale Securities	Foreign Currency Translation Adjustments	Treasury Stock	
Balance, March 31, 2003	\$36,226	\$50,019	\$305,396	\$ (604)	\$ (57)	\$(519)	
Net income			19,981				
Cash dividends, \$0.19 per share			(4,906)				
Bonuses to directors and corporate auditors			(490)				
Unrealized gain on available-for-sale securities				6,245			
Net change in foreign currency translation adjustments					(1,197)		
Purchase of treasury stock						(19)	
Balance, March 31, 2004	\$36,226	\$50,019	\$319,981	\$ 6,849	\$(1,254)	\$(538)	

See Notes to Consolidated Financial Statements.

**Consolidated Statements of Cash Flows** Years Ended March 31, 2004 and 2003  
Seikagaku Corporation and Consolidated Subsidiaries

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2004	2003	2004
Operating activities:			
Income before income taxes	¥ 3,624	¥ 4,218	\$ 34,189
Adjustments for:			
Income taxes—paid	(1,867)	(1,191)	(17,613)
Depreciation and amortization	879	779	8,292
Loss on sales of short-term investments and investment securities	67	515	632
Foreign exchange loss	366	124	3,453
Bonuses to directors and corporate auditors	(52)	(56)	(491)
Changes in assets and liabilities:			
Decrease in notes and accounts receivable—trade	149	540	1,406
Decrease (increase) in inventories	447	(558)	4,217
Decrease (increase) in advance payments for research and development	566	(311)	5,340
Decrease in notes and accounts payable—trade	(82)	(90)	(774)
Increase (decrease) in accounts payable—other	349	(150)	3,292
Increase (decrease) in retirement benefits	61	(141)	575
Other—net	204	578	1,925
Net cash provided by operating activities	4,711	4,257	44,443
Investing activities:			
Proceeds from maturity of short-term investments	2,799	2,732	26,406
Purchases of short-term investments	(1,299)	(2,800)	(12,255)
Purchases of fixed assets	(1,538)	(982)	(14,509)
Proceeds from sales of investment securities	281	1,458	2,651
Purchases of investment securities	(4,048)	(8,875)	(38,189)
Other—net	(57)	1,141	(538)
Net cash used in investing activities	(3,862)	(7,326)	(36,434)
Financing activities:			
Decrease (increase) in short-term borrowings	(190)	187	(1,793)
Dividends paid	(519)	(521)	(4,896)
Other—net	(2)	(52)	(19)
Net cash used in financing activities	(711)	(386)	(6,708)
Foreign currency translation adjustments on cash and cash equivalents	(13)	143	(123)
Net increase (decrease) in cash and cash equivalents	125	(3,312)	1,178
Cash and cash equivalents, beginning of year	7,468	10,780	70,454
Cash and cash equivalents, end of year	¥ 7,593	¥ 7,468	\$ 71,632

See Notes to Consolidated Financial Statements.

## 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 generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

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, certain reclassifications have been made in the 2003 financial statements to conform to the classifications used in 2004.

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 ¥106 to \$1, the approximate rate of exchange at March 31, 2004. 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, 2004 and 2003 include the accounts of the Company and its significant five majority-owned subsidiaries (together, the "Group").

Investment in an unconsolidated subsidiary in 2004 and 2003 is stated at cost. If the equity method of accounting had been applied to the investment in this subsidiary, the effect on the accompanying consolidated financial statements would not be material.

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, commercial papers 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

Short-term investments and investment securities are 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 held-to-maturity debt securities, are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity. 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.

### 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. Property, plant and equipment

Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment of the Company is computed substantially by the declining-balance method at rates based on the estimated useful lives of the assets, while the straight-line method is applied to buildings of the Company acquired on and after April 1, 1998. Property, plant and equipment of consolidated foreign subsidiaries are mainly depreciated by the straight-line method over the estimated useful lives of the assets. The range of useful lives is principally from 15 to 39 years for buildings and structures and from 5 to 15 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 non-contributory and contributory funded defined benefit pension plans 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.

The Company accounts for the liability for retirement benefits based on projected benefit obligations and plan assets at the balance sheet date.

Certain foreign subsidiaries also have defined contributory retirement plans, which mainly consist of a 401(k) plan in the United States of America, covering substantially all of their employees.

Retirement allowances for directors and corporate auditors of the Company are recorded to state the liability at the amount that would

be required if all directors and corporate auditors retired at each balance sheet date.

- i. Research and development costs  
Research and development costs are charged to income as incurred.
- j. Income taxes  
The provision for income taxes is computed based on the pretax income included in the consolidated statements of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted tax laws to the temporary differences.
- k. Appropriations of retained earnings  
Appropriations of retained earnings are reflected in the financial statements for the following year upon shareholders' approval.
- l. Foreign currency transactions  
All short-term receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rates at the balance sheet date. The foreign exchange gains and losses from translation are recognized in the income statement.
- m. Foreign currency financial statements  
The balance sheet accounts of the consolidated foreign subsidiaries are translated into Japanese yen at the current exchange rate as of the balance sheet date except for shareholders' equity, which is translated at the historical rates. Differences arising from such translation were shown as "Foreign currency translation adjustments" in a separate component of shareholders' equity.  
Revenue and expense accounts of consolidated foreign subsidiaries are translated into yen at the average exchange rate.
- n. Per share information  
Basic net income per share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period.  
The average number of common shares used in the computation was 25,997,509 shares for 2004 and 26,034,412 shares for 2003.  
Diluted net income per share is not disclosed because there are no dilutive securities in 2004 and 2003.  
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.
- o. New accounting pronouncements  
In August 2002, the Business Accounting Council issued a Statement of Opinion, "Accounting for Impairment of Fixed Assets," and in October 2003 the Accounting Standards Board of Japan ("ASB") issued ASB Guidance No. 6, "Guidance for Accounting Standard for Impairment of Fixed Assets." These new pronouncements are

effective for fiscal years beginning on or after April 1, 2005 with early adoption permitted for fiscal years ending on or after March 31, 2004.

The new accounting standard requires an entity to review its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.

The Company is currently in the process of assessing the effect of adoption of these pronouncements.

### 3 Short-term investments and investment securities

Short-term investments and investment securities as of March 31, 2004 and 2003, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Short-term investments:			
Debt securities	¥ 3,107	¥ 2,100	\$ 29,311
Other	103	203	972
<b>Total</b>	<b>¥ 3,210</b>	<b>¥ 2,303</b>	<b>\$ 30,283</b>
Investment securities:			
Equity securities	¥ 4,328	¥ 2,454	\$ 40,830
Debt securities	9,331	8,586	88,028
Other	2,889	3,077	27,255
<b>Total</b>	<b>¥16,548</b>	<b>¥14,117</b>	<b>\$156,113</b>

Information regarding the securities classified as available-for-sale at March 31, 2004 and 2003, was as follows:

	Millions of Yen			
	2004			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as available-for-sale:				
Equity securities	¥ 2,999	¥1,296	¥77	¥ 4,218
Debt securities	11,631	43	36	11,638
Other	3,013	21	45	2,989
Millions of Yen				
2003				
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as available-for-sale:				
Equity securities	¥2,206	¥369	¥230	¥2,345
Debt securities	9,331	66	11	9,386
Other	3,362	32	117	3,277

	Thousands of U.S. Dollars			
	2004			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as available-for-sale:				
Equity securities	\$ 28,292	\$12,226	\$726	\$ 39,792
Debt securities	109,726	406	340	109,792
Other	28,425	198	425	28,198

Available-for-sale securities and held-to-maturity securities whose fair value is not readily determinable as of March 31, 2004 and 2003, were as follows:

	Carrying Amount		
	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Available-for-sale:			
Equity securities	¥110	¥ 109	\$1,038
Other	3	3	29
Held-to-maturity	800	1,300	7,547
Total	¥913	¥1,412	\$8,614

Proceeds from sales of available-for-sale securities for the years ended March 31, 2004 and 2003, were ¥228 million (\$2,151 thousand) and ¥1,739 million, respectively. Gross realized gains and losses on these sales, computed on the moving average cost basis, were ¥1 million (\$9 thousand) and ¥68 million (\$642 thousand), respectively, for the year ended March 31, 2004 and ¥16 million and ¥531 million, respectively, for the year ended March 31, 2003.

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, 2004, are as follows:

	Millions of Yen		Thousands of U.S. Dollars	
	Available for Sale	Held to Maturity	Available for Sale	Held to Maturity
	2004	2003	2004	2003
Due in one year or less	¥ 2,407	¥800	\$ 22,708	\$7,547
Due after one year through five years	8,505		80,236	
Due after five years through ten years	1,090		10,283	
Due after ten years	555		5,236	
Total	¥12,557	¥800	\$118,463	\$7,547

#### 4. Inventories

Inventories at March 31, 2004 and 2003, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
	Merchandise	¥ 346	¥ 357
Finished products	1,646	2,055	15,528
Semi-finished products	143	222	1,349
Work in process	908	988	8,566
Raw materials and supplies	817	758	7,708
Total	¥3,860	¥4,380	\$36,415

#### 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 ¥501 million (\$4,726 thousand) and ¥772 million for the years ended March 31, 2004 and 2003, 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 for the years ended March 31, 2004 and 2003, was as follows:

	Millions of Yen		
	2004		
	Machinery and Equipment	Other	Total
Acquisition cost	¥2,269	¥29	¥2,298
Accumulated depreciation	1,746	21	1,767
Net leased property	¥ 523	¥ 8	¥ 531

	Millions of Yen		
	2003		
	Machinery and Equipment	Other	Total
Acquisition cost	¥3,270	¥72	¥3,342
Accumulated depreciation	2,427	53	2,480
Net leased property	¥ 843	¥19	¥ 862

	Thousands of U.S. Dollars		
	2004		
	Machinery and Equipment	Other	Total
Acquisition cost	\$21,406	\$273	\$21,679
Accumulated depreciation	16,472	198	16,670
Net leased property	\$ 4,934	\$ 75	\$ 5,009

Obligations, depreciation expense and interest expense under finance leases:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
	Due within one year	¥ 374	¥ 437
Due after one year	751	1,086	7,085
Total	¥1,125	¥1,523	\$10,613
Depreciation expense	¥ 381	¥ 593	\$ 3,594
Interest expense	53	75	500
Total	¥ 434	¥ 668	\$ 4,094

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, 2004 and 2003, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Due within one year	¥26	¥52	\$245
Due after one year		5	
Total	¥26	¥57	\$245

## 6. Short-term borrowings

Short-term borrowings consist of unsecured bank loans. The weighted average interest rate of short-term borrowings was 1.8% at March 31, 2003.

## 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' retirement benefits for the retirement and pension fund at March 31, 2004 and 2003, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Projected benefit obligation ....	¥ 5,281	¥5,132	\$ 49,821
Fair value of plan assets .....	(3,854)	(3,386)	(36,359)
Unrecognized prior service cost..	158	180	1,491
Unrecognized actuarial loss....	(317)	(681)	(2,991)
Net liability.....	¥ 1,268	¥1,245	\$ 11,962

The components of net periodic benefit costs for the years ended March 31, 2004 and 2003, are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Service cost .....	¥220	¥225	\$2,075
Interest cost .....	128	125	1,208
Expected return on plan assets.	(16)	(23)	(151)
Amortization of prior service cost.	(22)	(23)	(208)
Recognized actuarial loss.....	75	61	708
Net periodic benefit costs .....	¥385	¥365	\$3,632

Assumptions used for the years ended March 31, 2004 and 2003, are set forth as follows:

	2004	2003
Discount rate .....	2.5%	2.5%
Expected rate of return on plan assets.....	0.5%	0.7%
Amortization period of prior service cost .....	10 years	10 years
Recognition period of actuarial loss.....	10 years	10 years

The Company has another pension plan "Tokyo Pharmaceutical Welfare Pension Fund" which is a multiemployer's pension fund. The amounts contributed to the fund which were charged to income were ¥100 million (\$943 thousand) and ¥84 million for the years ended March 31, 2004 and 2003, respectively.

Retirement allowances for directors and corporate auditors are paid subject to approval of the shareholders in accordance with the Japanese Commercial Code (the "Code"). The Company recorded a liability for its unfunded retirement allowance plan covering all of its directors and corporate auditors. The liability for retirement benefits at March 31, 2004 and 2003, for directors and corporate auditors was ¥235 million (\$2,217 thousand) and ¥197 million, respectively. The annual provisions for retirement allowances for directors and corporate auditors for the years ended March 31, 2004 and 2003 were ¥44 million (\$415 thousand) and ¥44 million, respectively.

Certain foreign subsidiaries have defined contributory retirement plans, which mainly consist of a 401(k) plan in the United States of America covering substantially all of their employees. The amount contributed to the plans which was charged to income was ¥32 million (\$302 thousand) and ¥31 million for the years ended March 31, 2004 and 2003, respectively.

## 8. Shareholders' equity

The Code required at least 50% of the issue price of new shares to be designated as stated capital as determined by resolution of the Board of Directors. Proceeds in excess of amounts designated as stated capital were credited to additional paid-in capital.

The Code provides that an amount at least equal to 10% of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period shall be appropriated as a legal reserve (a component of retained earnings) until such reserve and additional paid-in capital equals 25% of common stock. The amount of total additional paid-in capital and legal reserve that exceeds 25% of the common stock may be available for dividends by resolution of the shareholders. In addition, the Code permits the transfer of a portion of additional paid-in capital and legal reserve to the common stock by resolution of the Board of Directors.

The Code allows Japanese companies to repurchase treasury stock by a resolution of the shareholders at the general shareholders meeting and dispose of such treasury stock by resolution of the Board of Directors. The repurchased amount of treasury stock cannot exceed the amount available for future dividends plus amount of common stock,

additional paid-in capital or legal reserve to be reduced in the case where such reduction was resolved at the general shareholders meeting.

The amount of retained earnings available for dividends under the Code was ¥34,768 million (\$328,000 thousand) as of March 31, 2004, based on the amount recorded in the Company's general books of account. In addition to the provision that requires an appropriation for a legal reserve in connection with the cash payment, the Code imposes certain limitations on the amount of retained earnings available for dividends.

Dividends are approved by the shareholders at a meeting held subsequent to the fiscal year to which the dividends are applicable. Semiannual interim dividends may also be paid upon resolution of the Board of Directors, subject to certain limitations imposed by the Code.

## 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 2004 and 2003. On March 31, 2003, a tax reform law concerning enterprise tax was enacted in Japan which changed the normal effective statutory tax rate from approximately 42% to 40%, effective for the fiscal years beginning on or after April 1, 2004. The deferred tax assets and liabilities which will realize on or after April 1, 2004 are measured at the effective tax rate of 40% as at March 31, 2004 and 2003. 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, 2004 and 2003, are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Deferred tax assets (current):			
Research and development costs	¥ 243	¥ 10	\$ 2,292
Accrued bonuses	188	166	1,774
Other	213	340	2,009
Less valuation allowance	(32)		(301)
Total	¥ 612	¥ 516	\$ 5,774
Deferred tax liabilities (current)—Unrealized gain on available-for-sale securities	¥ 5		\$ 47
Net deferred tax assets (current)	¥ 607	¥ 516	\$ 5,727
Deferred tax assets (non-current):			
Retirement benefits	¥ 601	¥ 576	\$ 5,670
Tax loss carryforwards	279	14	2,632
Amortization	205	142	1,934
Other	308	331	2,906
Less valuation allowance	(152)	(63)	(1,434)
Total	¥1,241	¥1,000	\$11,708
Deferred tax liabilities (non-current):			
Unrealized gain on available-for-sale securities	¥ 479	¥43	\$ 4,519
Depreciation	282	84	2,660
Other	1	2	10
Total	¥ 762	¥ 129	\$ 7,189
Net deferred tax assets (non-current)	¥ 479	¥ 871	\$ 4,519

The normal effective tax rate reflected in the accompanying consolidated statements of income for the years ended March 31, 2004 and 2003, differs from the actual effective tax rate, primarily due to the effect of permanently non-deductible expenses, tax credits and net loss position of a consolidated subsidiary.

At March 31, 2004, a subsidiary in the United States of America has tax loss carryforwards of approximately ¥742 million (\$7,000 thousand) which are available to offset future federal income taxes by the Internal Revenue Code, expiring in 2023 and 2024. In addition, at March 31, 2004, the subsidiary has tax loss carryforwards of approximately ¥813 million (\$7,670 thousand) which are available to offset future state income taxes. The expiration of the tax loss carryforwards for state tax is 2008 for ¥377 million (\$3,557 thousand) and 2009 for ¥436 million (\$4,113 thousand).

## 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 ¥10,826 million (\$102,132 thousand) and ¥11,116 million for the years ended March 31, 2004 and 2003, respectively.

## 11. Research and development costs

Research and development costs charged to income were ¥4,766 million (\$44,962 thousand) and ¥4,134 million for the years ended March 31, 2004 and 2003, respectively.

## 12. Segment information

The Group is mainly engaged in one industry segment which is the purchasing, manufacturing and selling of pharmaceutical products and related goods.

Information about geographic segments and sales to foreign

customers of the Group for the years ended March 31, 2004 and 2003, is as follows:

(1) Geographical segments

The geographical segments of the Group for the years ended March 31, 2004 and 2003 are summarized as follows:

	Millions of Yen				Consolidated
	2004	2003	2004	2003	
	Japan	North America	Other	Eliminations/Corporate	
Sales to customers	¥18,461	¥1,523	¥760		¥20,744
Interarea transfer	69	244	6	¥ (319)	
Total sales	18,530	1,767	766	(319)	20,744
Operating expenses	14,261	2,023	557	(339)	16,502
Operating income (loss)	¥ 4,269	¥ (256)	¥209	¥ 20	¥ 4,242
Total assets	¥49,814	¥4,183	¥442	¥(6,193)	¥48,246

	Millions of Yen				Consolidated
	2004	2003	2004	2003	
	Japan	North America	Other	Eliminations/Corporate	
Sales to customers	¥18,628	¥1,567	¥634		¥20,829
Interarea transfer	77	246	2	¥ (325)	
Total sales	18,705	1,813	636	(325)	20,829
Operating expenses	13,449	1,881	530	(316)	15,544
Operating income (loss)	¥ 5,256	¥ (68)	¥106	¥ (9)	¥ 5,285
Total assets	¥47,692	¥5,035	¥586	¥(6,723)	¥46,590

	Thousands of U.S. Dollars				Consolidated
	2004	2003	2004	2003	
	Japan	North America	Other	Eliminations/Corporate	
Sales to customers	\$174,160	\$14,368	\$7,170		\$195,698
Interarea transfer	651	2,302	56	\$ (3,009)	
Total sales	174,811	16,670	7,226	(3,009)	195,698
Operating expenses	134,538	19,085	5,254	(3,198)	155,679
Operating income (loss)	\$ 40,273	\$ (2,415)	\$1,972	\$ 189	\$ 40,019
Total assets	\$469,943	\$39,462	\$4,170	\$(58,424)	\$455,151

(2) Sales to foreign customers

Information regarding sales to foreign customers of the Group for the years ended March 31, 2004 and 2003, is as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Sales to foreign customers (A)	¥ 4,648	¥ 4,380	\$ 43,849
Consolidated sales (B)	20,744	20,829	195,698
(A)/(B)	22.4%	21.0%	22.4%

## 13. Subsequent events

a. Appropriations of retained earnings

On June 29, 2004, the shareholders of the Company authorized the following appropriations of retained earnings at March 31, 2004:

Appropriations:

	Millions of Yen	Thousands of U.S. Dollars
Cash dividends, ¥20 (\$0.19) per share	¥520	\$4,906
Bonuses to directors and corporate auditors	52	490
Total	¥572	\$5,396

b. Stock split

At the Company's Board of Directors meeting held on April 22, 2004, the directors resolved a stock split to be effected on July 20, 2004, in the form of a free share distribution to shareholders of record on May 31, 2004, at the rate of 0.5 share for each outstanding share. Stated capital will not be changed as a result of this stock split.

# Independent Auditors' Report

**Deloitte.**

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To the Board of Directors of  
Seikagaku Corporation:

We have audited the accompanying consolidated balance sheets of Seikagaku Corporation and consolidated subsidiaries as of March 31, 2004 and 2003, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Seikagaku Corporation and consolidated subsidiaries as of March 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

Our audits 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, 2004