

A MESSAGE FROM THE PRESIDENT



Ken Mizutani
President

Determined to Make a Long-term Contribution to the Quality of Life Throughout the World

WE ACHIEVED FURTHER IMPROVEMENT IN CORPORATE VALUE UNDER THE NEW MANAGEMENT STRUCTURE. FROM A POSITION OF STABLE DOMESTIC AND OVERSEAS SALES, WE ARE MOVING FORWARD ON DEVELOPMENT OF OUR FUTURE EARNING BASE.

Taking Stock of Our Progress at the Dawn of a New Era

Following the general meeting of shareholders on June 24, 2005, the Board of Directors appointed me to succeed Mr. Enoki as president.

During his productive and valued tenure as president, my predecessor guided the remarkable growth in Japan, and more recently overseas, of our flagship product, the joint-function improver marketed as ARTZ[®] and ARTZ Dispo[®] (SUPARTZ[®] in the United States). He was responsible for bringing overseas sales from virtually nothing to one-quarter of our total sales. At the same time, he helped to strengthen Seikagaku's position in the domestic market. The Company successfully met and overcame a number of challenges, including growing competition, gradual cuts in reimbursement prices under the Japanese National Health Insurance (NHI)

system, the rise of generic products and changes to health insurance systems. Despite these challenges, we have maintained growth in supply volume that, in the year ended March 2005, stood at 12 million units.

It was against this background of achievement that Mr. Enoki passed the presidential baton to me. When I first joined Seikagaku 17 years ago, it was a steady, conservative company with a small workforce. ARTZ[®] had just gone onto the market, and sustained sales growth was reflected in a rising share price.

Five years ago, when our Japanese market share for ARTZ[®] and ARTZ Dispo[®] had reached 70%, I became head of the Central Research Laboratories. Progress was slow, because people simply accepted that the development of pharmaceuticals from glycoconjugates was a long process. My

team realized that the Company would never survive the tough times ahead if we continued with that slow-and-steady approach, and so we worked to turn the old structure into an organization that would allow us to focus our research and development efforts on specific themes pointing more directly toward innovative new products suitable for both domestic and international markets. To complement these efforts we began our participation in outside projects such as genetic research, and this has given me a strong appreciation for the importance of our collaborative research strategy.

Earlier in my career, I was in charge of sales. In that role, I had the opportunity to work closely with our sales organization to improve its organization and business performance, where I saw first hand the competitive strength of our data-rich sales support strategy.

Applying the experience I gained, I plan to work under the new management structure to ensure efficient management, further strengthen our growing overseas activities, and speed up the development of the new products that we need to drive our growth in the medium-term and long-term future. I will also target sustained improvement in our business performance and strive to achieve growth that matches the expectations of our shareholders and other stakeholders. The Board believes my experience within Seikagaku has prepared me to take the Company forward to the next plateau of achievement. I will do my best to prove them right.

Growth in Revenues and Income in the Year Ended March 2005

In the year ended March 2005, the Company's achievements were reflected in sales and income results that are among our best-ever performances. As these results indicate, we have made significant progress toward the strengthening of our corporate fundamentals. In March 2005, we were nominated for listing on the first section of the Tokyo Stock Exchange, the main securities market in Japan. At the same time, we implemented a series of capital-related measures designed to enhance our shareholder value. I hope shareholders have welcomed these moves.

Though Japan's domestic pharmaceuticals market is the second largest in the world, it has remained static or shown only marginal growth over the past few years. This reflects a

trend toward further strengthening of policies designed to curb health expenditure. In the current consolidated accounting year, we again faced a challenging business environment. For example, the pharmaceuticals industry as a whole faced cuts in NHI reimbursement prices averaging 4.2%. Overseas markets are meanwhile being affected by a variety of government-implemented measures, especially in the developed countries of North America and Western Europe, to bring down drug-related costs as part of their efforts to reduce their health expenditures. At the same time, our markets are becoming borderless, leading to escalating competition on a global scale.

Under these circumstances, our worldwide sales in the current year, ended March 2005, amounted to ¥22,565 million, a year on year increase of 8.8%. This growth was the result of the following factors:

- **Increased overseas sales**

Smith and Nephew, Inc. (S&N), our sales partner in the U.S., increased its sales representatives and dramatically strengthened its sales structure. As a result, market penetration of SUPARTZ[®] continues to surge ahead in that market. Accordingly, shipments of inventories to S&N, allocable to our sales, also increased.

Our sales in China and Italy started to improve after we switched to sales partners with in-depth knowledge of local markets.

Associates of Cape Cod, Inc. (ACC), a consolidated subsidiary, achieved growth in sales of its endotoxin- and glucan-assay contract testing services.

For the above reasons, consolidated overseas sales increased by 29.2%, and the ratio of overseas sales to total sales grew to 26.6%.

- **Increased sales of pharmaceuticals in the domestic market**

Sales of ARTZ[®] and OPEGAN[®] products (ARTZ[®] and ARTZ Dispo[®], OPEGAN[®] and OPEGAN Hi[®], respectively) increased despite a reduction of approximately 8% in NHI reimbursement prices at the start of the fiscal year. This expansion reflects is being driven by a steady growth of the aged population, which is the largest market for these products.

Operating income increased by 59.9% year on year to

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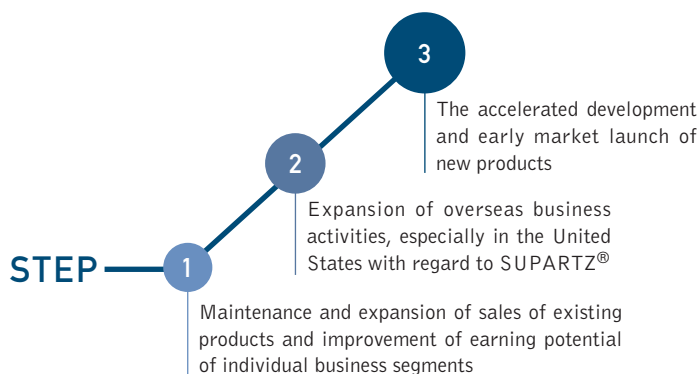
¥6,785 million, reflecting a reduction in selling, general and administrative expenses, especially R&D expenditure. Income before income taxes was 58.1% higher at ¥5,730 million, thanks to the reduction of exchange losses relating to long-term foreign currency loans and other items.

Net income increased by 71.2% year on year to ¥3,625 million. This figure reflects an extraordinary loss resulting from a special contribution of ¥1,008 million related to the withdrawal from the Tokyo Pharmaceutical Welfare Pension Fund and from a ¥241 million inventory asset disposal necessitated by an outbreak of BSE (bovine spongiform encephalopathy) in the U.S.

Medium/Long-term Development Plans Centering on Three Steps

Sustained progress toward medium-term and long-term development through the following three steps is still vital to our future.

Our efforts to achieve these goals will benefit from the continuing growth of Japan's aged population, since aged people are the main users of ARTZ[®] and OPEGAN[®] products in Japan. However, we will inevitably be affected by the growth of competing products, and by biennial NHI reimbursement price reductions.



As far as the second goal is concerned, thanks to the efforts of our sales partner, S&N, to strengthen its marketing organization, its sales of SUPARTZ[®] in the U.S. are increasing steadily. On the other hand, there has been serious deterioration in the financial state of the health insurance sector in the United States, and sales of SUPARTZ[®]

could be affected by reform of the Medicare public health insurance scheme.

In this environment, we need to maintain domestic sales of ARTZ[®] and OPEGAN[®] products by emphasizing the effectiveness, safety and quality of our products, while working to expand sales of SUPARTZ[®] in the United States. One of the steps that we took to achieve these goals was the establishment of the Pharmaceutical Information Department in April 2005 to promote effective sales promotion through the centralization of investigation and analysis of scientific information regarding our products. The department will lead our efforts to provide our sales partners with scientific data to support their marketing activities.

With regard to the third goal, we are an organization of just over 500 people, of which about 180 take part in research and development. Instead of trying to copy the major companies, we must work in our own way to bring new pharmaceuticals to market. We will continue to focus on glycoconjugates. Japan is extremely advanced in glycoscience, but we still may need some breakthroughs for the development of glycoconjugate-based pharmaceuticals. I want to raise Seikagaku's expertise as a glycoscience company by working to advance this field through participation in industry-academia projects, and by linking those efforts to drug R&D that will lead eventually to the introduction of new products.

While our core focus will continue to be the maintenance of hyaluronic acid products, I believe that we should look closely at the potential for development by expanding the scope of our activities to include such areas as low-molecular weight compounds that modulate the functions of glycoconjugates and related enzymes.

Our efforts to bring new products to market as quickly as possible include our aggressive in-licensing activities, based on novel drug candidates with new concepts originating in other companies or research institutes. Such an approach requires a clearly defined R&D strategy and strong organizational capabilities that are combined with appropriate R&D investment. For example, we will continue to strengthen our R&D workforce, including mid-career recruitment.

Progress in R&D during the year ended March 31, 2005 included filing of an approval application for a surgical aid material used to excise polyps and cancers via endoscopes. The

application, which was filed with the Ministry of Health, Labour and Welfare in July 2004, covers the use of the product as a new medical device. We also signed an option agreement with Carna Biosciences, Inc., a Japanese bio-venture company based in Kobe, concerning the development, manufacturing and exclusive worldwide sales of a drug candidate with potential use in the treatment of psoriasis.

Performance Forecasts for the Year to March 2006: Net Sales of ¥22.6 Billion, Net Income of ¥3.4 Billion

We expect growth in Japan and overseas sales of ARTZ[®] products to slow somewhat in the year to March 2006. The reasons for this view include a build-up of SUPARTZ[®] inventories by S&N in the United States during the year ended March 31, 2005, as well as the exclusion of hyaluronic acid preparations from medical insurance reimbursements in Austria, which is a major market in Europe.

Prospects for ARTZ[®] products in Japan are brighter, with sales growth forecast following the strengthened competitiveness of ARTZ[®] products against similar products on the approval in May 2005 of a new indication for these products for knee pain of chronic rheumatoid arthritis.

There will be a downward price adjustment in March 2006, ahead of the next reduction in NHI reimbursement price in Japan, scheduled for April 2006. We anticipate some negative impact on sales toward the end of the term.

In addition, we anticipate declines in the revenues of a consolidated subsidiary in the United States, and royalty income is also expected to be lower. With regard to profit, we also anticipate an increase in selling, general and administrative expenses, such as R&D expenditure and costs relating to the relocation of our head office. After taking these factors into account, we are predicting net sales of ¥22.6 billion, income before income taxes of ¥5.6 billion, and net income of ¥3.4 billion in the year to March 2006.

Management Focus on Improvement of Shareholder Return and Compliance

As I stated earlier in this report, our shares were designated for listing on the first section of the Tokyo Stock Exchange on March 1, 2005. We are very pleased to have achieved this goal less than one year after our listing on the second section

of the market. To mark this achievement, shareholders approved a commemorative dividend and final dividend of ¥10 yen each. Following the interim dividend of ¥10, this brought the total dividend for the year ended March 31, 2005 to ¥30 (see Note 3 p.1).

We are also working to create an environment in which as many people as possible find it conducive to invest in our shares. For example, we have implemented two 1:1.5 stock splits for shareholders registered at the end of May 2004 and the end of March 2005, in order to improve the marketability of our stock by increasing the number of shares issued.

With our move to a new, centrally located and unified head office in Tokyo in May 2005, we now have a better environment for staff communication. With today's emphasis on CSR, companies must obviously focus more effort on compliance and other issues. Seikagaku has always acted in good faith in these areas. In keeping with our strong commitment to the improvement of shareholder returns, and responsible corporate governance, we have strengthened our management monitoring systems by appointing outside directors. We are also working actively to improve management transparency.

We are determined to make a continuing contribution to the improvement of the quality of life for people throughout the world by using our knowledge of glycoscience to develop and supply innovative pharmaceuticals and other products. To further human resource development, in order to increase employee motivation, we are going to work on being an attractive company in all respects.

We will work to enhance our corporate value by maintaining high ethical standards, ensuring compliance with all laws and regulations, and strengthening our relationship of trust with all stakeholders, including our shareholders.

Ken Mizutani, President

