Ken Mizutani, President

This "3S" strategy seeks steady business expansion and growth through determined and innovative initiatives—all guided by sustainable management practices.

As this was my first year as president, my initial feelings are relief at having seen it through to the close. I am especially grateful to our employees for working so hard. We set new records for both income and sales, thanks to steady increases in the export of joint-function improver to the U.S. and sales of our ophthalmic surgical aid in Japan. I think we can all be proud.

I would have to say that I feel fortunate to also have realized several of the ambitions that I had for the Company before taking on these responsibilities—such as the new, performance-based dividend policy that aims to raise returns to shareholders and formalization of share buy-backs as part of our strategic capital-management policy. In addition, to further clarify management responsibility in performance, we introduced a remuneration system for directors and corporate auditors that is partially linked to the share price. At the same time, we have abolished the retirement benefit system for directors and corporate auditors, which had elements of seniority-based remuneration and deferred remuneration.

We also raised the dividend moderately. And, finally, we became a member of the Japan Pharmaceutical Manufacturers Association. This is an organization made up primarily of the kind of major pharmaceutical companies in Japan that are making strong R&D efforts.

I believe that these measures will enhance Seikagaku's value for shareholders. But of course, the kind of growth that we all hope for must come from the development of new products, which is why I am pleased to report that in September 2006 we moved directly to the start of a Phase III clinical trial in the United States of Gel-200, a new joint-function improver using cross-linked hyaluronate hydrogel. It has been 19 years since we began to manufacture our original hyaluronic acid formulation, ARTZ®. In that time, we have sold nearly 170 million units in Japan and overseas.

Normally, a 20-year-old product would be considered obsolete. But, ARTZ® is very unusual in that unit sales volumes are still growing—even as government healthcare reforms continue to challenge the pharmaceutical industry. Some of the reasons are that ARTZ® is recognized as highly safe by medical institutions, and it serves primarily aged patients, whose numbers are growing. This year, I announced our expansion with the planned addition of Takahagi Plant's No. 4 Production Building, to be completed in 2008.

Similarly, SUPARTZ® sales in the U.S. have grown to capture more than 20% of the market since its launch in 2001. Completing the clinical trials of Gel-200 successfully will strengthen our competitiveness in the U.S. further.

The year in review

Looking at our overall performance for the year ended March 31, 2006, Seikagaku Corporation was able to achieve consolidated sales of ¥23,144 million, a 2.6% increase in consolidated net sales. Overseas sales contributed 26.3% of consolidated net sales and 18.7% on a non-consolidated basis.

Export sales to the U.S. market were driven by a sustained rise in demand for our flagship ARTZ®-series product SUPARTZ® for joint-function improvement, combined with inventory build-up by our sales partner. Elsewhere, increasingly severe market conditions resulted in lower sales to Austria and Taiwan. Overseas sales of ARTZ®-series products amounted to ¥3,772 million—over six times higher than the total in the year ended March 2001 (¥602 million).

In Japan, the aging population is expanding the market for hyaluronic acid formulation joint-function improvers. Unit sales of ARTZ® were buoyed by the rising market and increased sales to medical institutions. As a result, sales remained level despite the impact of the April 2006 National Health Insurance (NHI) reimbursement price reduction on the fourth quarter sales. (Considering the time lag between shipping and distribution, it was necessary to reduce our prices on products shipped to our domestic sales partners in March 2006 for products destined to go on sale in April.)

We also benefited from buoyant sales of our OPEGAN® series ophthalmic surgical aids, which for the first time since its launch maintained the highest market share throughout an entire year.

Consolidated operating income increased by only 1.7% to ¥6,901 million. The reason for the small increase was that the cost of head office relocation and higher marketing expenses offset the positive lift from lower R&D spending.

Consolidated income before income taxes increased by 31.7% to ¥7,548 million. The large change was the result of foreign currency exchange gains (primarily on long-term foreign currency loans) combined with a rebound from the extraordinary loss in the previous year's accounts stemming from withdrawal from a pension fund. These factors helped to boost consolidated net income to ¥4,678 million, a gain of 29.1% on the previous year.

Promoting steady business expansion

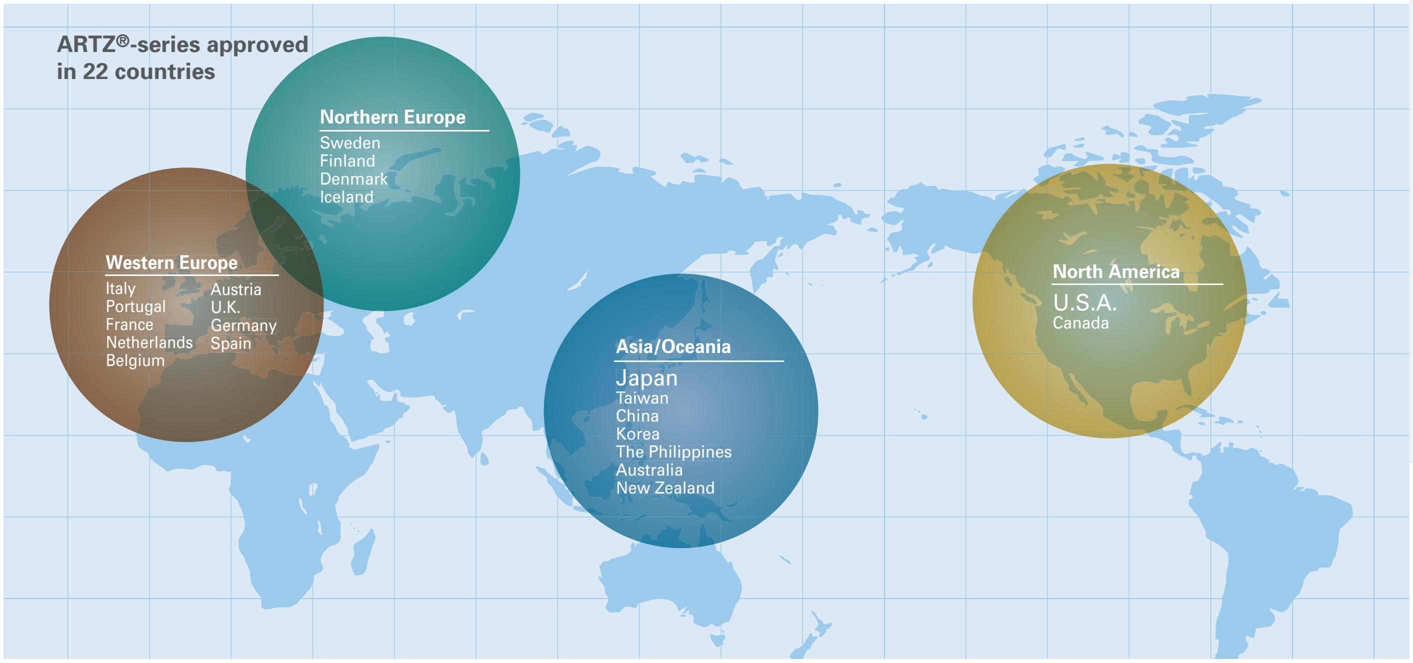
While our business brings us steady income and will continue to do so for some time, the trend toward a borderless market drives competition higher as companies change their sales focus from local markets to global markets.

We are a drug development company, and our overriding priority is to achieve a constant flow of new products that will deliver steady and sustainable business growth.

The process simply takes a lot of time, which is why "Speed" is the first component of our three-level strategy to steady business expansion.

The other two are "Specialization" and "Sustainability." This "3S" strategy seeks to achieve steady business expansion and growth in this environment through determined and innovative initiatives guided by sustainable management practices.

Through "Speed" our aim is to accelerate growth of market share for existing products in our core pharmaceutical business beyond the rate of demand growth while



speeding up the development of new products to reinforce our existing pipeline.

Our goal is to bring a continuing stream of new products to market as rapidly as possible. To achieve this, we will continue to enhance our time-line management and sharpen our focus on projects that are most likely to yield high-value, competitive products. We are disciplined about canceling projects with unpromising outlooks—and I know for the researchers, it is never easy. We are augmenting in-house drug development with licensing (both in and out) and cooperation with universities, companies and other organizations in Japan and overseas.

That is our challenge. We are not a big company. We cannot win if we pursue the sorts of projects such as cardiovascular drugs that the mega-pharmaceutical manufacturers undertake.

However, we think that our strength is our specialization, and we aim to be a leader in our targeted therapeutic area. Over our nearly 60 years of operation we have focused mainly on glycoscience, and this specialization extends to our development of pharmaceuticals. As a part of this policy, Seikagaku endowed a research chair at Osaka University in April 2006, the Department of Disease Glycomics, to explore the critical and timely theme, “the relationship between sugar chains and diseases.” The chair is headed by Professor Naoyuki Taniguchi, an internationally renowned figure in this field, actively engaged in biological research in Japan and abroad.

Through “Specialization,” we plan to ensure profitability in the non-pharmaceutical areas. Pharmaceutical bulk, reagents and diagnostic products all require highly specialized knowledge, and it is important to differentiate our products from those of our competitors. We are also taking steps to achieve a rapid improvement in the overall operating efficiency of our consolidated subsidiary in the United States that manufactures reagents and diagnostic products.

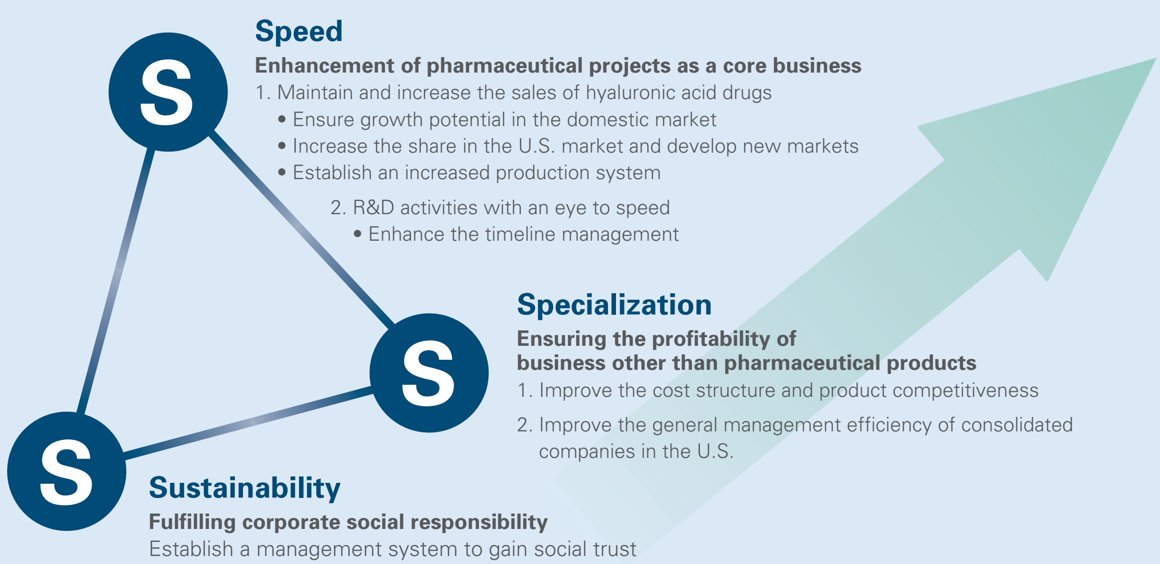
Through “Sustainability,” we will carry out all of the above while fulfilling our corporate social responsibilities. Today, the market also ties shareholder return to a company’s reputation. To maintain the trust of our stakeholders, including our shareholders, we have developed robust internal control systems, including compliance and risk management systems. We also maintain an active IR program designed, the purpose of which is to improve management transparency through fair and accurate disclosure of corporate information.

Performance forecast for 2007

Our consolidated forecast for the year ending March 31, 2007 calls for net sales of ¥24.0 billion, income before income taxes of ¥5.7 billion, and net income of ¥3.5 billion. Income will come under pressure from cost increases, especially in the areas of R&D expenses and selling, general and administrative expenses.

Overseas markets, especially the United States, will continue to be a prime area of focus for us. In 2007, exports of SUPARTZ® to the United States are likely to trend down

Priority goals for corporate value improvement (3Ss)



in reaction to a local inventory build-up that took place in the year ended March 2006. However, we expect to maintain sales growth by working with our marketing partner, Smith & Nephew, to boost local sales volumes. Growth in the sales of the consolidated subsidiary will also contribute.

In Japan, we anticipate an impact from the approximate 9% reimbursement price reduction for ARTZ® and OPEGAN® products in April 2006 under the Japanese National Health Insurance (NHI) system. As long as we are subject to this insurance system, we will always be affected by reimbursement price reductions. However, as we have done in the past, we will offset the reduction by raising our unit sales in partnership with Kaken Pharmaceutical Co., Ltd. and Santen Pharmaceutical Co., Ltd.

Latest product pipeline developments

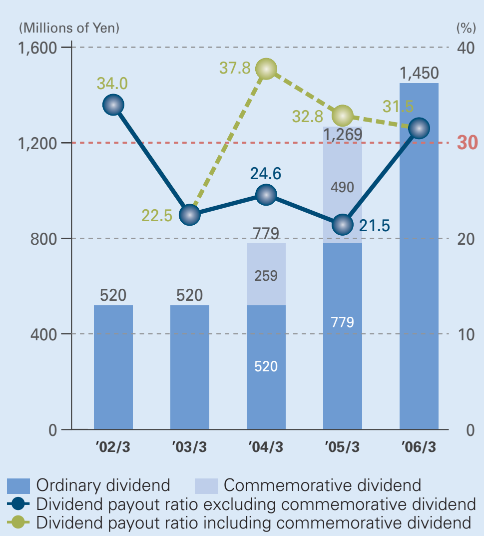
I am proud to announce some late-breaking news about our product pipeline that occurred between the close of the fiscal year and the publication date of this report.

In addition to Gel-200, which as I announced above, has gone straight into a Phase III clinical trial in the U.S., we have news on licensing and manufacturing approval.

In September 2006, we concluded a licensing agreement with Can-Fite BioPharma Ltd. in Israel for a compound that selectively stimulates the adenosine A3 receptor that is highly expressed in pathological inflammatory cells. With this unique mechanism, we intend to develop the drug for the treatment of rheumatoid arthritis primarily and expect to commence Phase I clinical trials in Japan in 2008.

Also in October, we received approval by the Ministry of Health, Labour and Welfare (MHLW) in Japan for manufacturing MucoUp®, our aid for endoscopic mucosal resection.

Dividend Payout/Payout Ratio



*Dividend payout ratio is on a consolidated basis.

Rewarding shareholders

To sustain our shareholders throughout this process I have outlined above, and reward them for their patience, we have drastically overhauled our system of shareholder returns. In particular, instead of maintaining stable dividends, which are pegged to the lowest profit level, even if profits rise, we are promoting higher shareholder returns by establishing as a management target a 30% dividend payout ratio (with a nominal basic level of ¥20). For the year ended March 2006, under the new policy, the dividend grows to ¥25 and the total amount paid out for 2006 climbs to ¥1,450 million. This figure is nearly three times more than three years ago. I have announced already that we intend to pay a dividend of ¥25 for 2007.

To encourage investment, we have changed our share-trading unit, implemented two stock splits, and implemented share buy-back schemes. The number of shareholders holding share trading units as of March 31, 2006 was 10,796, approximately five times more than at March 31, 2003.

We have clarified the system of remuneration for directors and corporate auditors, including abolishment of their retirement benefits and introduction of a system partially linking their remuneration to the share price. In this way, they are encouraged to be ever mindful of their responsibilities for ensuring good company performance.

Seikagaku Corporation will continue to contribute to improvement in the quality of life for people everywhere by focusing on the development and supply of innovative pharmaceuticals and other products, especially in the field of glycoscience. We are fully aware of our social mission and responsibilities as a company listed on the First Section of the Tokyo Stock Exchange, and we will work to raise our corporate value by continuing to ensure high ethical standards and compliance with laws and regulations throughout our organization, and by strengthening our relationship of trust with shareholders and other stakeholders.

Ken Mizutani, President