

Taking Our Original Vision to its Highest Level

Since our founding, we have been a consistent pioneer in glyco-science, a unique position for a pharmaceutical company. Glycoconjugates are mild. But medicines are not. That is why there are still so few medicines based on glycoconjugates—which we view as an opportunity. There is an emerging body of scientific evidence about the biological role of glycoconjugates that points to the direction of our research, and in the year under review, we moved our R&D to a new level with the appointment of a new Research and Development Director, a man with the highest industry credentials, to strengthen our R&D management system, facilitate closer mutual cooperation and set in place a more comprehensive approach to intellectual property rights.

Increased focus on development of new drugs is a core aspect of our “3S” strategy (speed, specialization and sustainability), which seeks steady business expansion and growth through determined and innovative initiatives—all guided by sustainable management practices. In short, we are managing our current products for optimum growth and profitability, while financing research into the products of tomorrow.

Our founder pursued a unique ideal of original medical products that did their job with minimum impact on body physiology. Seikagaku has nurtured this dream for 60 years. We took steps this year to turn this rich history into a bright future.

Ken Mizutani, President



The year in review

In the year ended March 31, 2007, net sales were up in all segments, leading to a new record. The lion's share of the increase came from Japanese sales of joint function improver ARTZ®, and there were also steady increases in exports of the joint-function improver to the U.S.

Total domestic and export net sales in the year ended March 31, 2007 increased by 5.2% to ¥24.4 billion. Operating income declined 19.3% to ¥5.6 billion, not as a result of any negative factor, but due to investment in the development of new drugs and an increase in sales expenses. Our R&D expenses related to progress in the development of new drugs rose by just over ¥1 billion.

Furthermore, operating expenses increased to some degree, due to extraordinary incentive payments, such as "milestones" paid to the companies with whom the Company forms sales alliances. Income before income taxes and net income for the year were ¥6.1 billion and ¥3.5 billion, respectively.

Strong sales in Japan

The overriding trend in Japan's pharmaceutical industry is toward the reduction of medical costs, as seen in the 6.7% average cut in National Health Insurance (NHI) reimbursement prices during

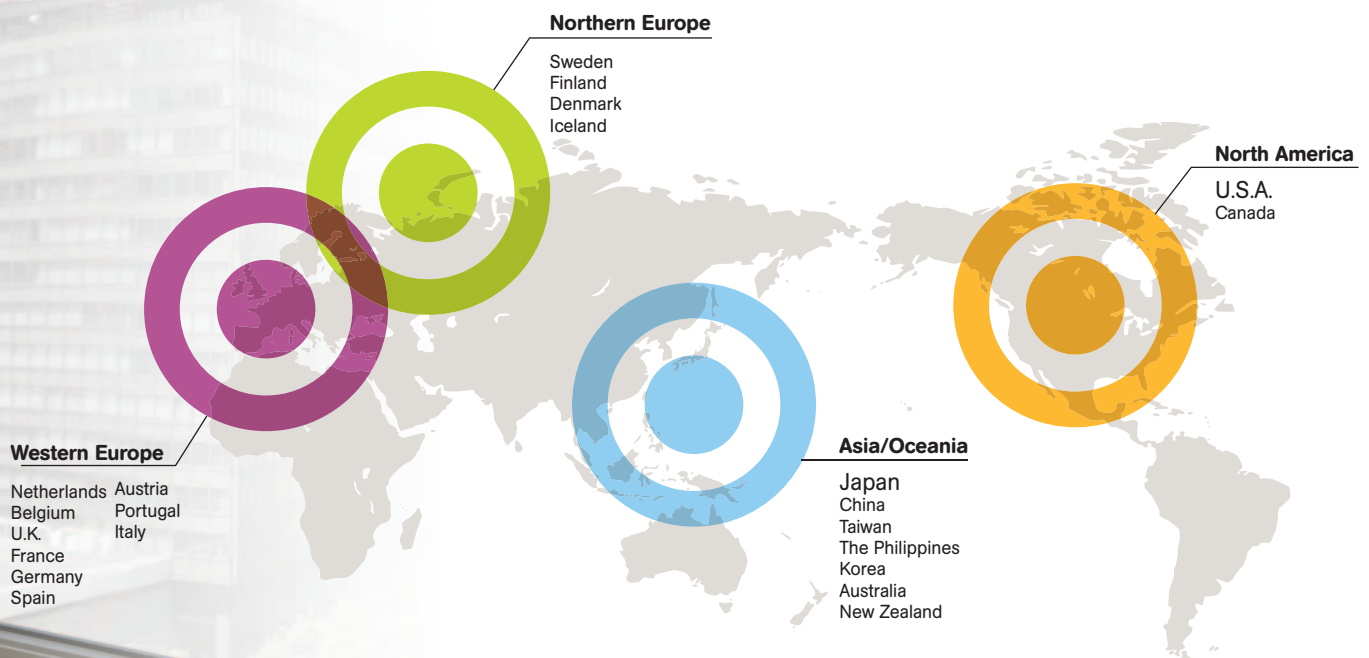
the most recent scheduled round that beginning April 2006. Despite the impact of the approximately 9% reimbursement price reduction for ARTZ® under the NHI system, unit sales were buoyed by events during the year.

Deliveries of ARTZ® to medical institutions increased faster than the market's expansion. This growth came from growing awareness of the technique of using hyaluronic acid preparations to treat osteoarthritis of the knees. One of the most famous Japanese broadcasting networks dealt with knee osteoarthritis on TV program for elderly people, and introduced hyaluronic acid injections as an aid to mobility. Stories like this are making more doctors and patients aware of this treatment.

Incidentally, this is the 20th anniversary of ARTZ®, the first such product of its kind. In recent years, it had posted 4%-to-6% yearly increases in deliveries to medical institutions in line with growth in the elderly population. But, in the year to March 2007, ARTZ® deliveries in Japan surged by 14.4%, year-on-year due to fortuitous television coverage and joint promotion with our sales partner.

Normally, after 20 years, any product in our industry is considered very long in the tooth. But, based on its reputation for safety, quality and effectiveness, ARTZ® is quite long-running product with many years of strong sales ahead.

ARTZ®-SERIES APPROVED IN 22 COUNTRIES



A MESSAGE FROM THE PRESIDENT

Overseas markets require a different approach

I think seeking new markets overseas is the same as creating a new medicine. Seikagaku can't ignore overseas markets. So, we will aggressively continue our overseas sales expansion. Of course, as a foundation for revenues the Japanese market remains an essential element of Seikagaku's business.

In the U.S., sales of SUPARTZ®, the U.S. brand name for ARTZ®, by Smith & Nephew (S&N), our marketing partner, are still lower than in Japan, but are steadily increasing—virtually all from growing market share. Using endorsements by major league baseball pitcher Randy Johnson, S&N is making a strong effort to boost sales of SUPARTZ®. Our export-based sales to the U.S. were limited to an 8% increase from the previous year, due to an inventory draw down by S&N. In the year to March 2008, export-based sales should move almost in parallel with local sales in the U.S.

For medium- to long-term development of the U.S. market, we are developing unique variations of our joint-function improver to help power growth. These efforts would give doctors and patients a wider range of treatment options that may lead to greater competitiveness and market share.

Multiple-shot-treatment is the norm for hyaluronic acid joint injections in the U.S. We have under development single-shot products with effectiveness equivalent to the current multiple-shot treatment. Such a product, Gel-200, is now undergoing Phase III clinical trials. In addition, we are continuing to promote the sale of the existing SPARTZ® products in close collaboration with S&N and seek new indications for use in patients with osteoarthritis of the shoulder to drive U.S. sales forward.

New formulations, new indications and expanding elderly populations in both Japan and the U.S. indicate a rise in medium- to long-term demand for hyaluronic acid joint injections. We will fill it with construction of the No. 4 Production Building at our Takahagi Plant in Japan. It is targeted for completion in January 2008. Over the next year, we will perform preparatory tasks, such as trial manufacturing and validation before it goes on stream in 2009.

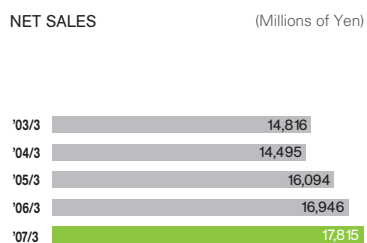
Looking at overseas markets other than the U.S., exports to the promising China market continued to expand, but we saw declines in Austria and Taiwan, where the market environment is increasingly tough.

PERFORMANCE REVIEW BY SEGMENT

SHARE OF NET SALES

Pharmaceuticals and Medical Devices

73.2%

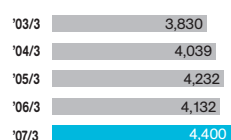


Domestic sales of ARTZ® were influenced by cuts in Japanese insurance reimbursement prices, but unit sales increased significantly due to sales promotion efforts by domestic sales partner, Kaken Pharmaceutical Co., Ltd. In overseas markets, sales of SUPARTZ® in the U.S. grew strongly. Sales of ARTZ® grew smoothly in China and Italy, but declined in Taiwan and Austria.

Unit volumes of OPEGAN® grew satisfactorily, but sales declined slightly, due to cuts in insurance reimbursement prices and an inventory run up at the end of the previous fiscal year by domestic sales partner, Santen Pharmaceutical Co., Ltd. Total net sales in this segment through March 31, 2007 stood at ¥17,815 million, up 5.1% year on year.

Research Biologics and Diagnostics

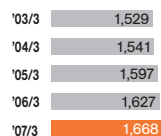
18.1%



Sales increased for endotoxin-detecting reagents used in dialysis treatments and quality control, as well as for research reagents, such as the Hyaluronan Assay Kit, a reagent kit used in basic research of hyaluronic acid. Sales of other research biologics and diagnostics remained steady, leading to a 6.5% increase in overall sales of these products to ¥4,400 million.

Bulk Products

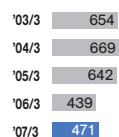
6.8%



In the wake of declining demand for use in nutritional drinks, sales of chondroitin sulfate decreased. However, sales of hyaluronic acid for medicinal use continued to be strong, leading to an increase in sales. As a result, total sales of bulk products came to ¥1,668 million, a 2.5% increase from the previous year.

Others

1.9%



Consolidated sales for this segment, which includes skin creams, ingredients for dietary supplements and royalties, rose by ¥32 million, to ¥471 million. The 7.3% increase was largely due to increased royalty payments.

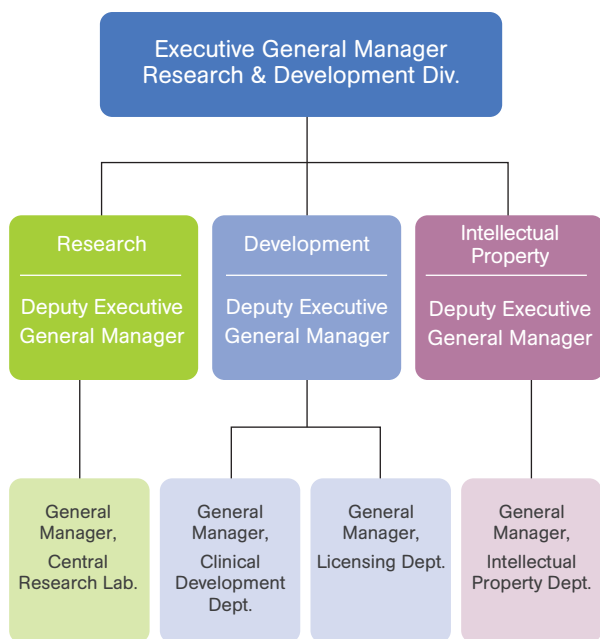
Upping the management ante in fine chemicals

You may have read of our plans to spin off our fine chemical business to create a new subsidiary, Seikagaku Biobusiness Corporation. Improving profitability in non-pharmaceutical business, as called for under Seikagaku's 3S strategy, will require an improved earnings structure, higher product competitiveness and a stronger business base. To achieve these in the most efficient manner, we have decided to spin off fine chemical business operations comprising bulk products, research biologics, and diagnostics, effective from October 2007. They can conduct business as a single independent company under a specialized management, with faster decision-making that is focused solely on its business environment. With this spin off, we aim to maximize the corporate value of the whole Group.

A closer examination of our R&D

Comparing the pipeline timetable in place four years ago with the current pipeline reveals a number of significant trends. Two themes have already obtained approval but their markets are quite small. Some have been retired, and only two of the original projects remain in the pipeline.

RESEARCH & DEVELOPMENT DIVISION



As recently as four years ago, we tended to place lower emphasis on the quality and balance of our themes than on the quantity. Today, we pursue all of them with equal drive. Progress is difficult, but we can say that Seikagaku's R&D level is improving year by year. We will aggressively continue to seek new themes based on our basic R&D policy on targeted substances and diseases.

Taking a broad look at our R&D, it seems clear that we must strive to reinforce in-house development and continue to actively introduce development themes of promise. In the year under review, we created the R&D Division to strengthen the management system and facilitate closer mutual cooperation. It consists of the Central Research Laboratories, Clinical Development Dept., Licensing Dept. and Intellectual Property Dept.

The new organization will speed up development and improve the originality of new pharmaceutical products. With the R&D Division to coordinate and guide every unit's efforts, we will make much more headway. Also, we will focus more on intellectual property rights.

To head the new division, we brought in a very talented and experienced research manager, a man with experience and knowledge of how to successfully create winning pharmaceuticals. From now on, we will concentrate on building up a really solid team of researchers, who can develop pharmaceuticals as a true medical company.

New product update

We obtained approval to manufacture a medical device in Japan. In October 2006, we obtained from the Ministry of Health, Labour and Welfare approval for the manufacture of a medical device named MucoUp[®], which is used as an aid to endoscopic surgery for removal of tumors in the stomach or the large intestine. In April 2007, we concluded a distribution contract with Johnson & Johnson K.K. Medical Company in Japan, and the product went on the market in August 2007. Although the market is not large, this is the first in-house developed product in quite a long while, and we hope it contributes to enhancing patients' quality of life.

One-year performance outlook

For the year ending March 2008, sales of ARTZ[®] and SUPARTZ[®] are projected to increase continually in Japan and abroad.

Our unit deliveries of ARTZ[®] in the domestic market are likely to moderate, in the wake of the one-time spike in recognition of hyaluronic acid injections in the year to March 2007, but about a 7% increase in sales is projected. We aim to boost ARTZ[®] unit sales by a level in excess of market expansion, through efforts to stimulate the potential market for patients in early stages of the

A MESSAGE FROM THE PRESIDENT

disease and through the improved effectiveness of our direct-to-consumer advertising.

Following moderation of S&N's inventory trimming, U.S.-bound exports are projected to increase by 13% year on year, which is almost the rate of our export sales growth as a whole.

Worldwide income from operations, income before income taxes and net income for the year are estimated at ¥6.6 billion, ¥7.1 billion and ¥4.4 billion, respectively, on estimated net sales of ¥25.9 billion.

Rewarding shareholders

To sustain our shareholders as we pursue our growth strategies, and reward them for their patience, we have introduced a performance-based dividend. Instead of maintaining stable dividends, we will maintain a yearly dividend payout ratio of 30% in consolidated terms, with ¥20 per share as a basis, and aim higher in the future. We have maintained our yearly dividend per share at ¥25 since 2006. The payout ratio on a consolidated basis was 41%. Further, at the board meeting of May 11, 2007, a resolution was passed to allow the Company to buy back up to 500,000 common shares (up to ¥700 million), and we acquired all the

shares during a specified purchase period.

Strongly believing that shareholders benefit most when Seikagaku serves its local and global communities, we 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, 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



PRIORITY GOALS FOR CORPORATE VALUE IMPROVEMENT (3Ss)

Speed

Enhancement of pharmaceutical projects as a core business

- Maintain and increase the sales of hyaluronic acid drugs
 - Ensure growth potential in the domestic market
 - Increase the share in the U.S. market and develop new markets
 - Establish an increased production system
- R&D activities with an eye to speed
 - Enhance timeline management

Specialization

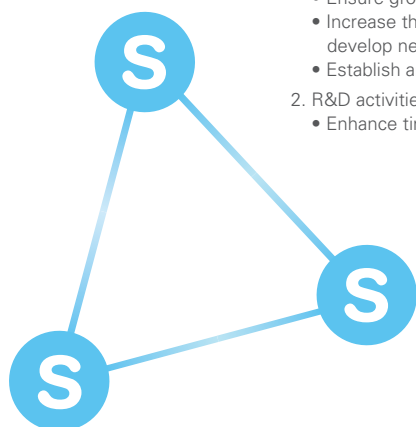
Ensuring the profitability of business other than pharmaceutical products

- Improve the cost structure and product competitiveness
- Improve the general management efficiency of consolidated companies

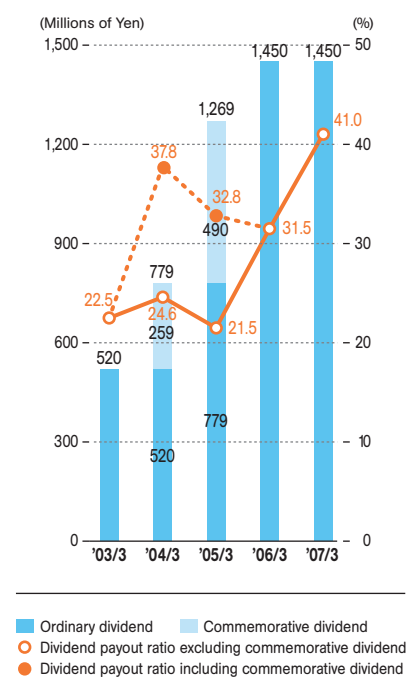
Sustainability

Fulfilling corporate social responsibility

Establish a management system to gain social trust



DIVIDEND PAYOUT/PAYOUT RATIO



*Dividend payout ratio is on a consolidated basis.