SEIKAGAKU CORPORATION AND CONSOLIDATED SUBSIDIARIES

Consolidated Balance Sheets

March 31, 1999 and 1998

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	1999	1998	1999
Assets			
Current assets:			
Cash and cash equivalents	¥ 3,783	¥ 3,907	$ 31,264
Marketable securities (Note 3)	11,323	12,136	93,579
Other short-term investments (Note 4)	403	603	3,331
Notes and accounts receivable – trade (Note 13)	5,913	5,282	48,868
Allowance for doubtful receivables	(40)	(45)	(331)
Inventories (Note 5)	4,065	3,995	33,595
Prepaid expenses and other	404	360	3,339
Total current assets	25,851	26,238	213,645
Property, plant and equipment:			
Land	672	672	5,554
Buildings and structures	9,602	9,569	79,355
Machinery and equipment	4,131	4,168	34,140
Construction in progress		112	
Total	14,405	14,521	119,049
Accumulated depreciation	(7,858)	(7,247)	(64,942)
Net property, plant and equipment	6,547	7,274	54,107
Investments and other assets:			
Investment securities (Note 3)	3,881	3,898	32,074
Investments in subsidiaries and associated companies	27	149	223
Money funds in trust	700	700	5,785
Long-term deposit (Note 7)	2,450		20,248
Goodwill	951	1,287	7,860
Other assets	1,941	2,116	16,041
Allowance for doubtful receivables	(200)	(200)	(1,653)
Total investments and other assets	9,750	7,950	80,578
Foreign currency statements translation adjustment	79		653
Total	¥42,227	¥41,462	$348,983
Liabilities and Shareholders' Equity			
Current liabilities:			
Short-term bank borrowings (Note 8)	¥ 480	¥ 480	$ 3,967
Current portion of long-term debt (Note 8)	3,254		26,893
Notes and accounts payable – trade	1,147	1,022	9,479
Notes and accounts payable – other (Note 13)	908	807	7,504
Income taxes payable	1,061	1,219	8,769
Accrued expenses and other	707	614	5,843
Total current liabilities	7,557	4,142	62,455
Long-term liabilities:			
Long-term debt (Note 8)		3,358	
Retirement benefits for directors and corporate auditors (Note 9)	206	567	1,702
Liability for lease partnership – net (Note 10)		448	
Other		2	
Total long-term liabilities	206	4,375	1,702
Foreign currency statements translation adjustment		139	
Commitments (Note 6)			
Shareholders' equity (Notes 11 and 16):			
Common stock, ¥50 par value – authorized, 80,000,000 shares; issued and outstanding, 26,036,056 shares in 1999 and 26,037,077 shares in 1998	3,840	3,840	31,735
Additional paid-in capital	5,302	5,302	43,818
Retained earnings	25,323	23,664	209,281
Total	34,465	32,806	284,834
Treasury stock – at cost	(1)		(8)
Total shareholders' equity	34,464	32,806	284,826
Total	¥42,227	¥41,462	$348,983

See notes to consolidated financial statements.

SEIKAGAKU CORPORATION AND CONSOLIDATED SUBSIDIARIES

Consolidated Statements of Income and Retained Earnings

Years ended March 31, 1999 and 1998

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	1999	1998	1999
Net sales (Note 13 and 17)	¥19,493	¥16,933	$161,099
Cost of sales	6,093	5,493	50,355
Gross profit	13,400	11,440	110,744
Selling, general and administrative expenses (Notes 13 and 14)	8,984	8,414	74,248
Operating income	4,416	3,026	36,496
Other income (expenses):			
Interest and dividend income	512	753	4,231
Interest expense	(106)	(115)	(876)
Gain on sales of marketable securities and investment securities	376	488	3,108
Loss on sales of marketable securities and investment securities	(499)	(318)	(4,124)
Loss on devaluation of marketable securities and investment securities	(242)	(697)	(2,000)
Exchange gain	28	194	231
Income of lease partnership	848	95	7,008
Gain (loss) on derivative contracts – net (Note 15)	(769)	53	(6,355)
Other – net	47	(40)	388
Other income – net	195	413	1,611
Income before income taxes	4,611	3,439	38,107
Income taxes (Note 12)	2,392	2,498	19,768
Net income	2,219	941	18,339
Retained earnings, beginning of year	23,664	23,318	195,570
Increase due to addition of a newly consolidated subsidiary	26		215
Appropriations:			
Cash dividends	(521)	(521)	(4,306)
Bonuses to directors and corporate auditors	(65)	(74)	(537)
Retained earnings, end of year	¥25,323	¥23,664	$209,281

	Yen		U.S. Dollars
Per share of common stock:			
Net income	¥85.24	¥36.13	$0.70
Cash dividends applicable to the year	20.00	20.00	0.17

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Years ended March 31, 1999 and 1998

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 and practices generally accepted and applied in Japan, which are different in certain respects as to application and disclosure requirements of International Accounting Standards. The consolidated financial statements are not intended to present the financial position and results of operations in accordance with accouting principles and practices generally accepted in countries and jurisdictions other than Japan. The consolidated statement of cash flows is not presented herein since it is not required as part of the basic financial statements under accounting principles generally accepted in Japan.

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, the notes to the consolidated financial statements include information which is not required under accounting principles generally accepted in Japan but is presented herein as additional information. Certain reclassifications have been made in the 1998 consolidated financial statements to conform to the classifications used in 1999.

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 ¥121 to $1, the approximate rate of exchange at March 31, 1999. 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 include the accounts of the Company and its significant four (three in 1998) majority-owned subsidiaries (together, the "Companies"). The fiscal years of all consolidated subsidiaries end December 31. Accordingly, the accompanying consolidated financial statements in 1999 include the account of the consolidated subsidiaries for the year ended December 31, 1998, except for the accounts of Seikagaku America Inc. The accounts of Seikagaku America Inc. for the nine months ended December 31, 1998, were newly included in the 1999 consolidation because the subsidiary merged with the other consolidated subsidiary, Associates of Cape Cod, Inc., as of January 1, 1999.

The accompanying consolidated 1998 financial statements include the accounts of the consolidated subsidiaries for the three months ended December 31, 1997, because the date of acquisition of the subsidiaries was deemed to be September 30, 1997. Investments in three unconsolidated subsidiaries (three unconsolidated subsidiaries and two associated companies which are owned 20% to 50% in 1998) are stated at cost. If the equity method of accounting had been applied to such investments, the effect on the accompanying consolidated financial statements would not be material.

The excess of the cost of the Company's investment in consolidated subsidiaries, over its equity in the net assets at the date of acquisition ("Goodwill"), is being amortized over a period of five years.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Companies is eliminated.

b. Cash Equivalents — The Company considers all highly liquid investments, including time deposits with a maturity of three months or less, to be cash equivalents.

c. Short-term Investments and Investment Securities — Marketable securities are stated at the lower of cost, determined by the moving-average method, or market. Other securities are stated at cost as determined by the moving-average method.

d. 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.

- **e. Depreciation** — Depreciation of property, plant and equipment is computed by the declining-balance method while the straight-line method is applied to buildings acquired after April 1, 1998, over the estimated useful lives of the assets.
- **f. 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.
- **g. Retirement and Pension Plans** — The Company has a funded non-contributory pension plan as its employees' retirement benefits plan. 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 pension plan was adopted effective January 1, 1983. Prior to February 1,1999, the prior service cost was amortized by the declining-balance method at an annual rate of 30%. Effective February 1, 1999, however, this cost is amortized at an annual rate of 50%. Normal costs and amortization of prior service cost are charged to income and funded currently.

  Certain overseas subsidiaries also have a funded contributory pension plan, 401(k) plan in the United States of America, covering substantially all of its employees.

  The Company also accrues retirement allowances for directors and corporate auditors, who customarily receive lump-sum payments subject to shareholders' approval. The annual provision for retirement allowance is calculated to state the liability at the amount that would be required if all directors or corporate auditors retired at each balance sheet date. The provision for the retirement allowance is not funded.
- **h. Research and Development Costs** — Research and development costs are charged to income as paid.
- **i. Income Taxes** — The Company provides for income taxes at the amount currently payable for each year. The tax effect of temporary differences between tax and financial reporting purposes is not recorded. Certain overseas subsidiaries provide for deferred income taxes relating to temporary differences in accordance with accounting principles generally accepted in the relevant country.
- **j. Appropriations of Retained Earnings** — Appropriations of retained earnings at each year end are reflected in the financial statements for the following year upon shareholders' approval.
- **k. Foreign Currency Financial Statements** — The balance sheet accounts of the consolidated overseas subsidiaries are translated into Japanese yen at the current exchange rates as of the balance sheet date except for shareholders' equity, which is translated at the historical exchange rate. Differences arising from such translation are shown as "Foreign currency statements translation adjustment" in the accompanying consolidated balance sheets. Revenue and expense accounts of the consolidated overseas subsidiaries are translated into Japanese yen at the average exchange rate.
- **l. Net Income per Share** — The computation of net income per share is based on the weighted average number of shares outstanding during each year. The average number of common shares used in the computation was 26,036,282 and 26,035,038 for the years ended March 31, 1999 and 1998, respectively.

  Fully diluted net income per share is computed assuming full conversion of outstanding convertible debentures at the beginning of the year with an applicable adjustment for related interest expense, net of tax, for such convertible debentures. Diluted net income per share is not disclosed because it is anti-dilutive.

3. Marketable Securities and Investment Securities

A summary of marketable and investment securities is shown below:

	Millions of Yen				Thousands of U.S. Dollars	
	1999		1998		1999	
	Carrying Amount	Aggregate Market Value	Carrying Amount	Aggregate Market Value	Carrying Amount	Aggregate Market Value
Marketable securities:						
Market quotations available:						
Stocks	¥2,364	¥2,708	¥2,546	¥2,775	$19,537	$22,380
Bonds and other	3,755	3,530	4,008	4,008	31,033	29,174
Total	6,119	¥6,238	6,554	¥6,783	50,570	$51,554
Market quotations not available	5,204		5,582		43,009	
Total marketable securities	¥11,323		¥12,136		$93,579	
Investment securities:						
Market quotations available:						
Stocks	¥1,394	¥1,870	¥1,514	¥1,578	$11,520	$15,454
Bonds and other	158	158	282	283	1,306	1,306
Total	1,552	¥2,028	1,796	¥1,861	12,826	$16,760
Market quotations not available	2,329		2,102		19,248	
Total investment securities	¥3,881		¥3,898		$32,074	

Securities for which market quotations are not available principally consist of money market funds and corporate bonds for which there are no readily-available markets from which to obtain or calculate the market value thereof.

4. Other Short-term Investments

Other short-term investments at March 31, 1999 and 1998, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	1999	1998	1999
Time deposits	¥ 3	¥ 3	$ 25
Asset-backed securities	400	600	3,306
Total	¥403	¥603	$3,331

5. Inventories

Inventories as of March 31, 1999 consisted of the following:

	Millions of Yen	Thousands of U.S. Dollars
	1999	1999
Merchandise	¥ 281	$ 2,322
Finished products	1,297	10,719
Semi-finished products	704	5,818
Work in process	1,148	9,488
Raw materials and supplies	635	5,248
Total	¥4,065	$33,595

6. 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 ¥813 million ($6,719 thousand) and ¥937 million for the years ended March 31, 1999 and 1998, 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 as of March 31, 1999 and 1998, was as follows:

	Millions of Yen						Thousands of U.S. Dollars		
	1999			1998			1999		
	Machinery and Equipment	Other	Total	Machinery and Equipment	Other	Total	Machinery and Equipment	Other	Total
Acquisition cost	¥3,175	¥169	¥3,344	¥4,042	¥137	¥4,179	$26,240	$1,396	$27,636
Accumulated depreciation	2,068	73	2,141	2,669	53	2,722	17,091	603	17,694
Net leased property	¥1,107	¥ 96	¥1,203	¥1,373	¥ 84	¥1,457	$9,149	$ 793	$9,942

Obligations under finance leases:

	Millions of Yen		Thousands of U.S. Dollars
	1999	1998	1999
Due within one year	¥ 610	¥ 662	$ 5,041
Due after one year	1,316	1,490	10,876
Total	¥1,926	¥2,152	$15,917
Depreciation expense	¥ 746	¥ 798	$ 6,165
Interest expense	102	119	843

Depreciation expense is computed by the straight-line method for the software and the declining-balance method for other assets. Interest expense is computed by the interest method.

(2). Operating Leases

The minimum rental commitments under non-cancelable operating leases at March 31, 1999 and 1998, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	1999	1998	1999
Due within one year	¥ 52	¥ 58	$ 430
Due after one year	235	181	1,942
Total	¥287	¥239	$2,372

7. Pledged Assets

At March 31, 1999, a long-term deposit of ¥2,450 million ($20,248 thousand) was pledged as collateral for an interest rate swap transaction. The notional amount of the transaction was ¥3,500million ($28,926 thousand).

8. Short-term Bank Borrowings and Long-term Debt

Short-term bank borrowings are represented by short-term notes payable. The weighted average interest rates of short-term bank borrowings were 1.5% and 1.6% at March 31, 1999 and 1998, respectively.

Long-term debt at March 31, 1999 and 1998, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	1999	1998	1999
2-7/10% yen convertible debentures due 2000, redeemable before due date	¥3,254	¥3,358	$26,893
Less current portion	3,254		26,893
Total	Nil	¥3,358	Nil

The conversion price of the 2-7/10% yen convertible debentures was ¥6,513.20 per share at March 31, 1999. The conversion price is subject to adjustment in certain circumstances. Under certain conditions, the yen convertible debentures may be redeemed prior to maturity in whole or in part at prices declining from 102% to 100% of the principal amount.

The indenture agreements of the 2-7/10% yen convertible debentures provide for a restriction on the amount of cash dividends. At March 31, 1999, cash dividends were restricted to an amount not to exceed approximately ¥20,928 million ($172,959 thousand).

9. Retirement and Pension Plans

The net assets of the pension fund of the Company at November 30, 1998, the most recent date of available information, were ¥2,544 million ($21,025 thousand).

Total pension cost for the pension plans charged to income in the consolidated statements of income was ¥233 million ($1,926 thousand) for the year ended March 31, 1999.

10. Liability for Lease Partnership

The Company had invested in a partnership which was a lessor of an aircraft. The partnership was incorporated under the Japanese Commercial Code (the “Code”) for the purpose of capitalizing on the tax benefits accorded to leveraged leases. The Company’s share in the partnership was approximately 39%. The investment was redeemed at maturity in the year ended March 31, 1999.

The initial investment in the partnership was ¥400 million ($3,306 thousand) and the Company’s share of the income or loss of the partnership was recognized each fiscal year.

The initial investment, the accumulated recognized loss or income and the redemption of investment are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	1999	1998	1999
Initial investment	¥ 400	¥ 400	$ 3,306
Accumulated recognized loss or income:			
Accumulated loss of prior year	(848)	(943)	(7,008)
Income of the year	848	95	7,008
Total	400	(448)	3,306
Redemption of investment	(400)		(3,306)
Total	Nil	¥(448)	Nil

11. Shareholders’ Equity

The Code requires at least 50% of the issue price of new shares, with a minimum of the par value, to be designated as stated capital as determined by resolution of the Board of Directors. Proceeds in excess of amounts designated as stated capital are credited to additional paid-in capital.

The Code also requires companies to appropriate from retained earnings to legal reserve an amount equal to at least 10% of all cash payments which are made as an appropriation of retained earnings until the reserve equals 25% of stated capital. The amounts of legal reserve appropriated by the Company were included in the amounts of retained earnings in the accompanying consolidated balance sheets. Such legal reserves for the years ended March 31, 1999 and 1998, were ¥557 million ($4,603 thousand) and ¥498 million, respectively. This reserve is not available for dividends but may be used to reduce a deficit by resolution of the shareholders.

The Company may transfer portions of additional paid-in capital and legal reserve to stated capital by resolution of the Board of Directors. The Company may also transfer portions of unappropriated retained earnings, available for dividends, to stated capital by resolution of the shareholders.

Under the Code, the Company may issue new common shares to existing shareholders without consideration as a stock split pursuant to resolution of the Board of Directors. The Company may make such a stock split to the extent that the aggregate par value of the shares outstanding after the issuance does not exceed the stated capital. However, the amount calculated by dividing the total amount of shareholders’ equity by the number of outstanding shares after the issuance shall not be less than ¥50.

The Company is authorized to repurchase, at management's discretion, up to 2,600 thousand shares of the Company's stock for the purpose of canceling the shares by crediting such amounts against retained earnings. There were no repurchases for this purpose during fiscal 1999.

Dividends are approved by the shareholders at a meeting held subsequent to the fiscal year to which the dividend is applicable. However, a semiannual interim dividend may be paid upon resolution of the Board of Directors subject to limitations imposed by the Code.

Under the code, the amount available for dividends is based on retained earnings as recorded on the books of the Company. At March 31, 1999, retained earnings recorded on the books of the Company which are available for dividends, subject to approval by the shareholders and legal reserve requirements, totaled ¥25,163 million ($207,959 thousand).

12. 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 48% in 1999 and 51% in 1998. Overseas subsidiaries are subject to income taxes of the countries in which they operate. The actual effective tax rates in the accompanying consolidated statements of income differed from the normal effective statutory rates due principally to (1) non-recognition of the tax effects of temporary differences between tax and financial reporting and (2) certain expenses that are permanently non-deductible for tax purposes.

13. 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 agreement which is renewable upon expiration in March 1999. Transactions with and balances due from and to the customer for the years ended March 31, 1999 and 1998, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	1999	1998	1999
Transactions:			
Sales	¥12,002	¥11,284	$99,190
Sales commission	841	643	6,950
Balances due from and to:			
Notes and accounts receivable – trade	3,868	3,562	31,967
Notes and accounts payable – other	433	321	3,579

14. Research and Development Costs

Research and development costs charged to income were ¥4,245million ($35,083 thousand) and ¥4,349 million for the years ended March 31, 1999 and 1998, respectively.

15. Derivatives

The Company enters into foreign exchange forward contracts to hedge market risk resulting from the changes in foreign exchange rates associated with assets and liabilities denominated in foreign currencies. The Company also enters into interest rate swap contracts, interest rate swaption contracts and option contracts as a part of their trading activities. However, the Company has decided that it would not use any newly contracted derivative instruments subsequent to the year ended March 31, 1999, except for foreign exchange forward contracts.

Derivatives are subject to market risk which is the exposure created by potential fluctuations in market conditions, including foreign exchange or interest rates. Because the counterparties to these derivatives are limited to major financial institutions in Japan, the Company does not anticipate any losses arising from credit risk.

Derivative transactions entered into by the Company have been made in accordance with internal policies which regulate the authorization and credit limit amount. Prior to December 1, 1998, the Director who was in charge of accounting division was authorized to approve entering into derivative contracts, however, effective December 1, 1998, the President is authorized to approve entering into derivative contracts. The Accounting Department executes and controls the contracts. The performance and evaluation of derivatives is reported to the management periodically.

The Company had the following derivative contracts outstanding as of March 31, 1999 and 1998:

	Millions of Yen				Thousands of U.S. Dollars	
	1999		1998		1999	
	Contract or Notional Amount	Fair Value (Loss)	Contract or Notional Amount	Fair Value (Loss)	Contract or Notional Amount	Fair Value (Loss)
Interest rate swaps –						
Floating rate payment, floating rate receipt	¥3,500	¥(1,260)	¥11,500	¥(140)	$28,926	$(10,413)
Interest rate swaption—Selling—						
Fixed rate payment, floating rate receipt			10,000	(104)		

The contract or notional amounts of derivatives which are shown in the above table do not represent the amounts exchanged by the parties and do not measure the Company's exposure to credit or market risk.

As interest rate swaption has been exercised at the balance sheet date as of March 31, 1998, the amounts shown represent the interest swap contract values.

Forward exchange contracted amounts which are assigned to associated assets or liabilities are reflected on the balance sheet at year end are not subject to the disclosure of market value information.

Overseas subsidiaries do not utilize derivative instruments in any form.

16. Subsequent Event

On June 29, 1999, the shareholders of the Company authorized the following appropriations of retained earnings as of March 31, 1999:

	Millions of Yen	Thousands of U.S. Dollars
Appropriations:		
Transfer to legal reserve	¥ 33	$ 273
Cash dividends, ¥10 ($0.08)	260	2,149
Bonuses to directors and corporate auditors	61	504
Total	¥354	$2,926

17. Segment Information

Information regarding sales to foreign customers of the Companies for the years ended March 31, 1999 and 1998, is as follows:

	Millions of Yen		Thousands of U.S. Dollars
	1999	1998	1999
Sales to foreign customers (A)	¥2,208	¥1,204	$18,248
Consolidated sales (B)	19,493	16,933	161,099
(A)/(B)	11.3%	6.0%	11.3%

The Companies are mainly engaged in one industry segment which is the purchasing, manufacturing and selling of pharmaceutical products and related goods. In addition, the foreign operations of the Companies are not significant in terms of total sales, operating income and total assets. Therefore, information about operations in different industries and foreign operations have been omitted.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
Seikagaku Corporation:

We have examined the consolidated balance sheets of Seikagaku Corporation and consolidated subsidiaries as of March 31, 1999 and 1998, and the related consolidated statements of income and retained earnings for the years then ended, all expressed in Japanese yen. Our examinations were made in accordance with auditing standards, procedures and practices generally accepted and applied in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Seikagaku Corporation and consolidated subsidiaries as of March 31, 1999 and 1998, and the results of their operations for the years then ended in conformity with accounting principles and practices generally accepted in Japan applied on a consistent basis.

Our examinations 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 to the consolidated financial statements. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

Deloitte Touche Tohmatsu

June 29, 1999