

Notes to Consolidated Financial Statements

Kyorin Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2005 and 2004

1. Basis of Presentation of Consolidated Financial Statements

Kyorin Pharmaceutical Co., Ltd. (the "Company"), and its domestic subsidiaries maintain their accounting records and prepare their financial statements in accordance with accounting principles generally accepted in Japan, and its foreign subsidiaries maintain their books of account in conformity with those of their countries of domicile. The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company as required by the Securities and Exchange Law of Japan.

2. Summary of Significant Accounting Policies

(a) Basis of Consolidation and Accounting for Investments in Unconsolidated Subsidiaries and Affiliates

The accompanying consolidated financial statements include the accounts of the Company and significant companies controlled directly or indirectly by the Company. Companies over which the Company exercises significant influence in terms of their operating and financial policies are included in the consolidated financial statements on an equity basis. All significant intercompany balances and transactions are eliminated in consolidation.

Investments in subsidiaries and affiliates, which are not consolidated or accounted for by the equity method, are carried at cost or less. Where there has been a permanent decline in the value of such investments, the Company has written down the investments.

All consolidated subsidiaries close their books of account at December 31 for financial reporting purposes except for Kyobundo Co., Ltd., which closes its books as of February 28. The necessary adjustments are made to the financial statements of all the consolidated subsidiaries to reflect any significant transactions from January 1 to March 31 except for Kyobundo Co., Ltd., which reflects from March 1 to March 31.

The excess of cost over underlying net assets at fair value at the date of acquisition is amortized over a period of within 20 years on a straight-line basis except that when the excess is immaterial, it is fully charged to income in the year of acquisition. Such amortization is included in selling, general and administrative expenses.

(b) Foreign Currency Translation

Revenue and expense accounts of the foreign consolidated subsidiaries are translated using the average rate during the year, and the balance sheet accounts are translated into

yen at the exchange rates in effect at the balance sheet date. Translation adjustments are presented as a component of shareholders' equity in the accompanying consolidated financial statements.

(c) Cash Equivalents

All highly liquid investments with maturity of three months or less when purchased are considered cash equivalents.

(d) Inventories

Finished goods, work in process and semi-finished goods are stated at cost determined by the average method. Merchandise, raw materials and stored goods for samples are stated at the lower of cost or market determined by the average method. Stored goods except for samples are stated by the last purchase price method.

(e) Depreciation and Amortization

Depreciation of property, plant and equipment is calculated by the declining-balance method at rates based on the estimated useful lives of the respective assets. For buildings acquired after April 1998, the straight-line method is used. The useful lives of property, plant and equipment are summarized as follows:

Buildings and structures	3 to 50 years
Machinery, equipment and vehicles	4 to 17 years

Intangible assets are amortized by the straight-line method over their estimated useful lives. Computer software for internal use is capitalized as an asset and amortized by the straight-line method over the useful life of five years.

(f) Leases

Noncancelable leases are accounted for as operating leases (whether such leases are classified as operating or finance lease) except that leases which stipulate the transfer of ownership of the leased assets to the lessee are accounted for as finance leases.

(g) Short-Term Investments and Investment Securities

Securities other than equity securities issued by subsidiaries and affiliates are classified into held-to-maturity or other securities. Held-to-maturity securities are carried at amortized cost. Marketable securities classified as other securities are carried at fair value with changes in unrealized gain or loss, net of the applicable income taxes, directly included in shareholders' equity.

Nonmarketable securities classified as other securities are stated at cost. Cost of securities sold is determined by the moving average method.

(h) Research and Development Expenses

Research and development expenses are charged to income as incurred.

(i) Income Taxes

Deferred tax assets and liabilities are determined based on the differences between financial reporting and the tax bases of the assets and liabilities and are measured using the enacted tax rates and laws which will be in effect when the differences are expected to reverse.

(j) Retirement Benefits

Accrued retirement benefits for employees are provided mainly at an amount calculated based on the retirement benefit obligation and the fair value of the pension plan assets at balance sheet dates, as adjusted for unrecognized actuarial gain or loss and unrecognized prior service cost. The retirement benefit obligation is attributed to each period by the straight-line method over the estimated years of service of the eligible employees. Actuarial gain and loss are amortized in the following year in which the gain or loss is recognized primarily by the straight-line method over the average remaining years of service of the employees (10 years). Prior service cost is amortized as incurred by the straight-line method over the average remaining years of services of the employees (10 years).

The Company shifted from the previous retirement pension plan, which consisted of the noncontributory funded pension plan and government Welfare Pension Insurance Plan, to the new retirement pension plan, which consisted of the defined contribution pension plan and defined benefit pension plan, and applied Accounting Procedures Concerning the Change in Retirement Benefit Plan (Corporate Accounting Principles Application Guideline 1) from January 1, 2005.

In addition, directors and corporate auditors of the Company and certain consolidated subsidiaries are customarily entitled to lump-sum payments under their respective unfunded retirement benefits plans. The provision for retirement benefits for these officers has been made at an estimated amount.

4. Cash and Cash Equivalents

Cash and cash equivalents at March 31, 2005 and 2004 for the consolidated statements of cash flows consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Cash and cash in banks	¥ 8,760	¥39,235	\$ 81,572
Short-term investments	3,010	4,221	28,029
Time deposits over three months	(10)	(10)	(93)
Short-term investments due over three months	(399)	(1,704)	(3,715)
Cash and cash equivalents at end of year	¥11,361	¥41,741	\$105,792

(k) Amounts Per Share

Presentation of diluted net income per share is not applicable as there were no potentially dilutive securities for the years ended March 31, 2005 and 2004.

(l) Appropriation of Retained Earnings

Under the Commercial Code of Japan, the appropriation of retained earnings with respect to a given financial period is made by resolution of the shareholders at a general meeting held subsequent to the close of such financial period. The accounts for that period do not, therefore, reflect such appropriations (see Note 17).

(m) Impairment of Fixed Assets

A new Japanese accounting standard "Impairment of Fixed Assets" was issued in August 2002 that is effective for fiscal years beginning on or after April 1, 2005. Early adoption is permitted. The new standard requires that tangible and intangible fixed assets be carried at cost less depreciation, and be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Companies would be required to recognize an impairment loss in their income statement if certain indicators of asset impairment exist and the book value of an asset exceeds the undiscounted sum of future cash flows of the asset. The Company is currently assessing the impact of this new accounting standard on its financial position and operating results.

3. U.S. Dollar Amounts

The translation of yen amounts into U.S. dollar amounts is included solely for convenience, as a matter of arithmetic computation only, at the rate of ¥107.39 = U.S.\$1, the approximate rate of exchange on March 31, 2005. The translation should not be construed as a representation that yen have been, could have been or could in the future be converted into U.S. dollars at the above or any other rate.

5. Marketable Securities and Investment Securities

Information regarding marketable securities classified as other securities as of March 31, 2005 and 2004 is as follows:

	Millions of yen			Thousands of U.S. dollars		
	Acquisition cost	2005 Carrying value	Unrealized gain (loss)	Acquisition cost	2005 Carrying value	Unrealized gain (loss)
Securities whose carrying value exceeds their acquisition cost:						
Stock	¥ 920	¥ 2,146	¥1,226	\$ 8,567	\$ 19,983	\$11,416
Debt securities:						
Government bonds	1,000	1,001	1	9,312	9,321	9
Corporate bonds	803	806	2	7,477	7,505	19
Other bonds	2,488	2,498	9	23,168	23,261	84
Other	6,040	6,069	29	56,244	56,514	270
Subtotal	11,252	12,521	1,269	104,777	116,594	11,817
Securities whose acquisition cost do not exceed their carrying value:						
Stock	—	—	—	—	—	—
Debt securities:						
Government bonds	1,000	999	(0)	9,312	9,303	(0)
Corporate bonds	102	102	(0)	950	950	(0)
Other bonds	10,211	10,102	(108)	95,083	94,068	(1,006)
Other	1,003	1,000	(3)	9,340	9,312	(28)
Subtotal	12,317	12,205	(112)	114,694	113,651	(1,043)
Total	¥23,570	¥24,727	¥1,156	\$219,480	\$230,254	\$10,765

	Millions of yen		
	Acquisition cost	2004 Carrying value	Unrealized gain (loss)
Securities whose carrying value exceeds their acquisition cost:			
Stock	¥ 527	¥4,813	¥4,285
Debt securities:			
Government bonds	—	—	—
Corporate bonds	901	905	4
Other bonds	1,398	1,413	14
Other	—	—	—
Subtotal	2,827	7,132	4,304
Securities whose acquisition cost do not exceed their carrying value:			
Stock	358	232	(126)
Debt securities:			
Government bonds	—	—	—
Corporate bonds	100	100	(0)
Other bonds	1,688	1,679	(9)
Other	—	—	—
Subtotal	2,146	2,011	(135)
Total	¥4,974	¥9,144	¥4,169

Sales amounts of securities classified as other securities and the related aggregate gain and loss for the years ended March 31, 2005 and 2004 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Proceeds from sales	¥2,854	¥ 51	\$26,576
Gains on sales	1,787	893	16,640
Losses on sales	—	—	—

The redemption schedule for securities with maturities classified as other securities as of March 31, 2005 is as follows:

	Millions of yen			
	Due in one year or less	Due after one year through five years	Due after five years through 10 years	Due after 10 years
Government bonds	¥ —	¥ —	¥ —	¥2,000
Corporate bonds	340	360	300	—
Other debt securities	2,700	5,300	1,500	4,700
Others	—	—	4,000	—
Total	¥3,040	¥5,660	¥5,800	¥6,700

	Thousands of U.S. dollars			
	Due in one year or less	Due after one year through five years	Due after five years through 10 years	Due after 10 years
Government bonds	\$ —	\$ —	\$ —	\$18,623
Corporate bonds	3,166	3,352	2,794	—
Other debt securities	25,142	49,353	13,968	43,766
Others	—	—	37,247	—
Total	\$28,308	\$52,705	\$54,009	\$62,389

Non-marketable securities classified as other securities consisted of unlisted securities of ¥2,181 million (\$20,309 thousand) and other securities of ¥1,611 million (\$15,001 thousand) at March 31, 2005 and unlisted securities of ¥1,649 million and other securities of ¥2,909 million at March 31, 2004.

6. Additional Paid in Capital and Retained Earnings

In accordance with the Commercial Code of Japan (the "Code"), the Company has provided a legal reserve, which was included in retained earnings. The Code provides that an amount equal to at least 10% of the amount to be disbursed as a distribution of earnings be appropriated to the legal reserve until the total of such reserve and the additional paid-in capital account equals 25% of the common stock account. The legal reserve amounted to ¥905 million (\$8,427 thousand) as of March 31, 2005 and 2004.

The Code provides that neither additional paid-in capital nor the legal reserve is available for dividends, but both may be used to reduce or eliminate a deficit by resolution of the shareholders or may be transferred to common stock by resolution of the Board of Directors. The Code also provides that if the total amount of additional paid-in capital and the legal reserve exceeds 25% of the amount of common stock, the excess may be distributed to the shareholders either as a return of capital or as dividends subject to the approval of the shareholders.

7. Research and Development Expenses

Research and development expenses, all of which were included in selling, general and administrative expenses, for the years ended March 31, 2005 and 2004 amounted to ¥12,698 million (\$118,242 thousand) and ¥8,219 million, respectively.

8. Loss on Sales and Disposal of Property, Plant and Equipment

Significant components of the loss on sales and disposal of property, plant and equipment were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Gain:			
Buildings	¥ 20	¥ —	\$ 186
Land	37	12	345
Other	1	—	9
Loss:	¥ 59	¥ 12	\$ 549
Buildings	¥(1,040)	¥ (61)	\$ (9,684)
Machinery and equipment	(282)	(1,545)	(2,626)
Other	(103)	(164)	(959)
	(1,426)	(1,771)	(13,279)
Total	¥(1,366)	¥(1,758)	\$(12,720)

9. Leases

The following pro forma amounts represent the acquisition costs (including the interest portion), accumulated depreciation and net book value of leased assets as of March 31,

2005 and 2004, which would have been reflected in the consolidated balance sheets if finance lease accounting had been applied to the finance leases currently accounted for as operating leases:

	2005		
	Millions of yen		
	Acquisition cost	Carrying value	Unrealized gain
Machinery and equipment	¥ 5	¥ 4	¥ 6
Other	1,765	1,065	699
Total	¥1,770	¥1,070	¥700

	Thousands of U.S. dollars		
	Acquisition cost	Carrying value	Unrealized gain
	Machinery and equipment	\$ 47	\$ 37
Other	16,435	9,917	6,509
Total	\$16,482	\$9,964	\$6,518

	2004		
	Millions of yen		
	Acquisition cost	Carrying value	Unrealized gain
Machinery and equipment	¥ 6	¥ 3	¥ 3
Other	1,951	1,024	926
Total	¥1,958	¥1,028	¥930

Lease payments relating to finance leases accounted for as operating leases amounted to ¥386 million (\$3,594 thousand) and ¥426 million, which were equal to the depreciation expense of the leased assets computed by the straight-line method over the lease terms assuming a nil residual value, for the years ended March 31, 2005 and 2004, respectively.

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2005 on noncancelable operating leases and finance leases accounted for as operating leases are summarized as follows:

Millions of yen	Thousands of U.S. dollars			
	Finance leases	Operating leases	Finance leases	Operating leases
Year ending March 31				
2006	¥304	¥101	\$2,831	\$ 940
2007 and thereafter	396	576	3,687	5,364
Total	¥700	¥678	\$6,518	\$6,313

10. Retirement Benefit Plans

The Company shifted from the previous retirement pension plan, which consisted of the noncontributory funded pension plan and government Welfare Pension Insurance Plan, to the new retirement pension plan, which consisted of the defined contribution pension plan and defined benefit pension plan, and applied Accounting Procedures Concerning the Change in Retirement Benefit Plan (Corporate Accounting Principles Application Guideline 1) from January 1, 2005.

On August 29, 2003, the Company received approval from the Ministry of Health, Labour and Welfare for an exemption from the obligation for benefits related to future employees services under the substitutional portion of the Welfare Pension Fund Plan.

The following table sets forth the funded and accrued status of the plans, and the amounts recognized in the consolidated balance sheets as of March 31, 2005 and 2004 for the Company's and the consolidated subsidiaries' defined benefit plans:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Retirement benefit obligation	¥(25,550)	¥(27,812)	\$(237,918)
Plan assets at fair value	17,862	8,738	166,328
Unfunded retirement benefit obligation	(7,688)	(19,073)	(71,590)
Unrecognized actuarial gain or loss	3,575	4,303	33,290
Unrecognized prior service cost	(275)	—	(2,561)
Net retirement benefit obligation	(4,389)	(14,770)	(40,870)
Prepaid pension cost	—	—	—
Accrued retirement benefits	¥ (4,389)	¥(14,770)	\$ (40,870)

The components of retirement benefit expenses for the years ended March 31, 2005 and 2004 are outlined as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Service cost	¥ 912	¥ 992	\$ 8,492
Interest cost	677	927	6,304
Expected return on plan assets	(220)	(318)	(2,049)
Amortization of actuarial gain or loss	511	581	4,758
Amortization of prior service cost	(7)	(30)	(65)
Gain on the release from the substitutional portion of the government's Welfare Pension Insurance Plan	—	(4,475)	—
Loss on retirement benefit plan changes	1,625	—	15,132
Other	58	—	540
Total	¥3,556	¥(2,323)	\$33,113

The assumptions used in accounting for the above plans are as follows:

	2005	2004
Discount rates	2.5%	2.5%
Expected return on plan assets	2.5%	3.0%

11. Pledged Assets

Assets pledged as collateral for guarantee deposits of at March 31, 2005 and 2004 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Cash and cash in banks	¥10	¥10	\$93
Investment securities	—	17	—
Total	¥10	¥27	\$93

12. Income Taxes

The significant components of the Company's deferred tax assets and liabilities as of March 31, 2005 and 2004 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Deferred tax assets:			
Accrued retirement benefits for employees	¥1,664	¥ 5,976	\$15,495
Accrued bonuses to employees	835	963	7,775
Accrued enterprise tax	—	171	—
Loss on disposal of inventories	49	20	456
Loss on devaluation of investment securities	294	394	2,738
Loss on disposal of property, plant and equipment	1,253	687	11,668
Depreciation and amortization	575	559	5,354
Accrued expenses for retirement benefit plan change	1,062	—	9,889
Tax loss carry forward	930	—	8,660
Other	648	425	6,034
Total deferred tax assets	¥7,314	¥ 9,199	\$68,107
Deferred tax liabilities:			
Reserve for special depreciation	(157)	(184)	(1,462)
One time revaluation for property, plant and equipment	(17)	(18)	(158)
Unrealized holding gain on securities	(475)	(1,716)	(4,423)
Other	(22)	(27)	(205)
Total deferred tax liabilities	(673)	(1,947)	(6,267)
Net deferred tax assets	¥6,641	¥ 7,252	\$61,840

Taxes on income consist of corporation, enterprise and inhabitants taxes. The aggregate statutory tax rate on income before income taxes was 41.3 % for 2005 and 42.0% for 2004.

The effective tax rate reflected in the consolidated statements of income for the year ended March 31, 2005 differed from the statutory tax rate for the following reasons:

	2005
Statutory tax rate	41.3%
Nondeductible entertainment expenses	10.5
Nondeductible per capita portion of inhabitant taxes	1.9
Nontaxable dividend income	(0.2)
Equity in earnings of affiliates	(3.5)
Other	(0.2)
Effective tax rate	49.8%

The reconciliation between the statutory tax rate and the effective tax rate has been omitted for the year ended March 31, 2004 because the difference was less than 5% of the statutory tax rate.

The Company and its consolidated subsidiary calculate enterprise taxes based on "amount of added value" and "amount of capital," and they are included in selling, general and administrative expenses for the year ended March 31, 2005 pursuant to "Practical Treatment for Presentation of External Based-Corporate Enterprise Taxes in the Statement of Income" (Accounting Standards Board, February 13, 2004). As a result, selling, general and administrative expenses increased ¥60 million (\$559 thousand) for the year ended March 31, 2005.

13. Related Party Transactions

The Company purchased medical products from an affiliate, Nisshin Kyorin Pharmaceutical Co., Ltd., for ¥3,276 million (\$30,506 thousand) and ¥3,536 million in the aggregate during the years ended March 31, 2005 and 2004, respectively. The terms of the transactions referred to above were negotiated and determined on an impartial basis.

The Company purchased treasury stock from a big holder of the Company shares, Apricot Co., Ltd., through a takeover bid for ¥8,913 million for the year ended March 31, 2004.

14. Segment Information

(1) Business Segments

Information regarding business segments is omitted in consolidated financial reports for the years ended March 31, 2005 and 2004 because sales, operating income and total assets in the pharmaceuticals segment are more than 90% in all business segments.

(2) Geographical Segments

Information regarding geographical areas is omitted for the years ended March 31, 2005 and 2004 because sales and total assets in the Japan area are more than 90% in all geographical areas.

(3) Overseas Sales

Overseas sales for the years ended March 31, 2005 and 2004 are summarized as follows:

	2005			
	Millions of yen			
	North America	Europe	Asia and Middle East	Total
Overseas sales	¥8,008	¥228	¥601	¥ 8,838
Consolidated net	—	—	—	66,296

	Thousands of U.S. dollars			
Overseas sales	\$74,569	\$2,123	\$5,596	\$ 82,298
Consolidated net sales	—	—	—	617,339
Overseas sales as a percentage of consolidated net sales	12.1%	0.3%	0.9%	13.3%

	2004			
	Millions of yen			
	North America	Europe	Asia and Middle East	Total
Overseas sales	¥7,988	¥263	¥280	¥8,533
Consolidated net sales	—	—	—	65,061
Overseas sales as a percentage of consolidated net sales	12.3%	0.4%	0.4%	13.1%

15. Contingent Liabilities

The Company was contingently liable as guarantors of indebtedness of the Company's employees in the aggregate amount of ¥9 million (\$84 thousand) at March 31,

2005 and ¥11 million at March 31, 2004.

16. Amounts Per Share

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Basic net income	¥ 26.48	¥ 68.76	\$ 0.25
Cash dividends	18.00	18.00	0.17
Net assets	1,218.22	1,234.80	11.34

Basic net income per share was computed based on the net income available for distribution to shareholders of common stock and the weighted average number of shares of common stock outstanding during the year. Diluted net income per share has been omitted because no potentially dilutive instruments were outstanding during the years ended March 31, 2005 and 2004.

Cash dividends per share represent the cash dividends declared as applicable to the year.

The amount per share of net assets is computed based on the net assets available for distribution to the shareholders and the number of shares of common stock outstanding at the year-end.

The amounts of net income per share for the years ended March 31, 2005 and 2004 were calculated based on the following:

	Millions of yen	
	2005	2004
Net income	¥2,013	¥5,692
Net income not available to common shareholders	44	41
(Of which the amount appropriated as bonuses to directors and corporate auditors)	(44)	(41)
Net income available to common stock	1,968	5,650

	Thousands of shares	
Average number of common stock outstanding	74,323	82,179

	Thousands of U.S. dollars	
	2005	2004
Net income	\$18,745	\$53,003
Net income not available to common shareholders	410	382
(Of which the amount appropriated as bonuses to directors and corporate auditors)	(410)	(382)
Net income available to common stock	18,326	52,162

	Thousands of shares	
Average number of common stock outstanding	74,323	82,179

17. Subsequent Events

The following appropriations of retained earnings, which have not been reflected in the accompanying financial statements for the year ended March 31, 2005, were approved at the annual general shareholders' meeting held on June 24, 2005:

	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥18.00 = U.S.\$0.17 per share)	¥668	\$6,220
Bonuses to directors and corporate auditors	40	372
	¥708	\$6,593