Hisamitsu Pharmaceutical Co., Inc.

ANNUAL REPORT

Fiscal 2000

Contents

Management Policies

(1) Fundamental Management Policies

Throughout its history, Hisamitsu Pharmaceutical Co., Inc. (the Company) has been aiming at being “a company which devotes itself to better health for people” adhering to its philosophy, “Customers First”.

(2) Fundamental Profit Sharing Policy

The Company maintains a fundamental policy of rewarding stockholders with stable dividends, and at a new phase of business, it adds either special or commemoration dividends to regular dividends to distribute profits to stockholders. The Company uses its internal reserves principally for investments in research and development (R & D), strengthening sales, expanding production facilities and developing overseas business activities.

The Company declared cash dividends of ¥10.00 per share for the current year, which is the same amount as the previous year, considering further enhancement of management, further development of business and necessary internal reserves, in addition to the difficult operating conditions surrounding the Company.

(3) Medium-range Strategies

The Company intends to become a pharmaceutical company oriented toward its own R & D in its own way, aggressively trying to create new pharmaceuticals and pharmaceutical preparations through transdermal therapeutic system (TTS) studies.

The Company’s medium-range strategies are to increase cash flows from operating activities through the active development of domestic sales activities of existing transdermal analgesic and anti-inflammatory products for ethical use and over-the-counter (OTC) use and to build up future assets through R & D activities of new transdermal pharmaceuticals for topical use and systemic use as well as through the global development of the Company’s brand including trade marks, manufacturing technology and quality control.

Through these activities, the Company sets its medium-range goal in management to keep return on equity (ROE) more than 10%.

(4) Measures for Enhancing Corporate Governance

The Company, aiming to improve its corporate governance scheme, is clearly dividing the inherent functions of its board of directors into two, that is, the decision-making and supervising function and the business-executing function to promote quicker decision-making as well as to clarify the authority and responsibility of the board of directors.

Additionally, the Company is actively promoting personnel changes to nurture its staff and to activate its organization as well as to heighten the degree of organizational transparency.

Review of Operations

(1) Overview of Fiscal 2000 ended February 29, 2000

During the year ended February 29, 2000, there has been no reduction in pharmaceutical reimbursement prices under the National Health Insurance (NHI) system which the Government implemented in the three previous years. But nationwide there were lively deliberations on extensive reforms to the NHI system, including the NHI pharmaceutical reimbursement price system and the Company has, therefore, faced very unsettled operating conditions.

Against this harsh situation, the Company has been active in every operating field. With respect to ethical pharmaceuticals, the Company's medical representatives developed pharmaceutical information activities primarily focussing on topical analgesic and anti-inflammatory pharmaceuticals to properly meet the needs of medical institutions. Of these pharmaceuticals, the Company especially promoted aggressive gathering and disseminating of pharmaceutical information about MOHRUS TAPE, a transdermal patch, and MOHRUS, a transdermal gel patch.

Regarding over-the-counter (OTC) products, the Company also promoted sales activities concentrating on topical analgesic and anti-inflammatory pharmaceuticals despite the stagnant market reflecting flat personal consumption. Additionally, the Company attempted to steadily penetrate the cosmetic market for facial packs, to which the Company's own transdermal technology has been applied. The Company launched LIFECELLA ORANGE MASK and LIFECELLA ESTE MASK in April and October last year, respectively, to have a large assortment of facial packs as well as to cultivate new consumers. Also in October, the Company introduced onto the OTC market HISAMITSU KAYUMIDOME SPRAY, a medicine to relieve itching, and promoted its quick acceptance in the OTC market.

The Company primarily oriented its R & D activities toward creating new transdermal preparations, making steady progress on a long series of fundamental and applied studies. In
October last year, the Company succeeded in receiving manufacturing approval and a license for ESTRANA, a transdermal estradiol patch for treating menopause, which had been jointly developed with Novartis Pharma K.K.

In order to improve production efficiency and product quality, the Company enhanced and restructured its manufacturing facilities. In December last year, the Company's Kyushu Head Office and Tosu Plant acquired "ISO 14001" certification, which is an International Standard of the Environmental Management System.

Additionally, the Company endeavored to elevate the efficiency of its overall management as well as to improve the results of operations.

As a result, the total net sales of the Company for fiscal 2000 ended February 29, 2000 amounted to ¥54,627 million ($501,165 thousand), an 11.2% increase over the previous year. Operating income increased 12.7% over the previous year to ¥11,185 million ($102,615 thousand), and net income rose 15.6% to ¥4,478 million ($41,083 thousand).

(2) Outlook for Fiscal 2001 ending February 28, 2001

With respect to ethical pharmaceuticals, in April 2000, the Government executed a cut in pharmaceutical reimbursement prices averaging 7.0% across the industry, and it is anticipated that the domestic ethical pharmaceutical market will drastically shrink, depending on the trend of future reforms to the NHI pharmaceutical reimbursement price system. Under these unprecedented serious circumstances, the Company will aggressively continue providing pharmaceutical information to medical institutions and try to create new transdermal preparations to exactly meet medical needs.

Although the domestic OTC market has long been in a slump, the Company will actively promote increased sales of OTC products as well as develop new OTC products properly meeting the needs and concerns of its customers.

Regarding overseas sales development, the Company’s International Business Department will play an important role in the global development of the Company’s brand including trade marks, manufacturing technology and quality control of products.

In order to promote global environmental protection, the Company intends to get “ISO 14001” certification for the Utsunomiya Plant following the Kyushu Head Office and Tosu Plant.

The Company, being fully aware of its responsibility as a pharmaceutical enterprise, will devote itself to improve its business performance through the strengthening of its sales, increasing productivity, speedier R & D activities, streamlining of management and building up of its corporate constitution.

At the board of directors’ meeting held on February 24, 2000, the Company resolved to acquire and retire 800 thousand shares of par value common stock out of profits within the limited total amount of ¥1,500 million by the time of the 2000 annual meeting of stockholders to be held on May 25, 2000. Subsequently, the Company purchased 605 thousand shares of common stock for a total amount of ¥974 million ($8,936 thousand) from the stock market and retired them.

It is too early to predict the non-consolidated results of operations for the next year ending February 28, 2001, but the Company expects, in the absence of unforeseen circumstances, net sales of ¥60,200 million and net income of ¥5,300 million, and will declare cash dividends of ¥10.00 per share, which is the same as for the current year.

Financial Review

Results of Operations

Although the Company has faced very unsettled operating conditions during fiscal 2000, ended February 29, 2000, it has been active in every operating field in order to further improve its business performance. As a result, net sales recorded a new high for the Company of ¥54,627 million ($501,165 thousand), a 11.2% increase over the previous year.

Briefly speaking, the record sales of the Company were principally due to the markedly increased sales of such products for ethical use as MOHRUS TAPE, a ketoprofen patch, and MOHRUS, a ketoprofen gel patch. During the year under review, the Company successfully launched LIFECELLA ORANGE MASK and LIFECELLA ESTE MASK, facial sheet packs, onto the cosmetic market and HISAMITSU KAYUMIDOME SPRAY, an anti-itching spray, onto the over-the-counter pharmaceutical market as well as ESTRANA, an estradiol patch for treating menopause, onto the ethical pharmaceutical market. The total sales of these new products also made a large contribution to the markedly increased net sales of the Company.

Cost of sales increased 4.8% over the previous year to ¥16,669 million ($152,927 thousand), whereas cost of sales as a percentage of net sales declined to 30.5%. This figure was 1.9% lower than the previous year of 32.4%, principally reflecting the markedly increased net sales.

Selling, general and administrative expenses climbed 16.0% to ¥21,848 million ($200,440 thousand), principally due to the increased selling expenses. R & D expenses also rose 10.5% to ¥4,925 million ($45,183 thousand), and the ratio of R & D expenses to net sales was 9.0%, which was approximately equal to the previous year (9.1%).

Operating income, despite the overall increases in costs and expenses, rose 12.7% to ¥11,185 million ($102,615 thousand), principally reflecting the markedly increased net sales.

Other expenses, net of other income, sharply fell 21.3% to ¥1,397 million ($12,816 thousand), primarily as the result of a significant decrease in loss on sales of securities.

Income before income taxes jumped 20.1% to ¥9,788 million ($89,799 thousand), and income taxes also jumped 24.2% to ¥5,310 million ($48,716 thousand), leaving net income of ¥4,478 million ($41,083 thousand), a 15.6% increase over the previous year. As a result, the effective tax rate was determined as 54.3%, which was higher than the previous year of 52.5%. Net income per share of common stock assuming dilution climbed 14.5% to ¥93.09 ($0.854), and the Company paid its stockholders cash dividends per share of ¥10.00 ($0.092).

Financial Position

At February 29, 2000, total assets amounted to ¥67,272 million ($617,174 thousand), a 2.2% increase over the previous year end. Total current assets amounted to ¥29,851 million ($273,862 thousand), a 7.1% increase, primarily reflecting markedly increased cash and cash equivalents which fully covered significantly decreased notes and accounts receivable.

Property, plant and equipment went down 2.5% to ¥31,341 million ($287,532 thousand), whereas investments and non-current receivables went up 3.9% to ¥6,080 million ($55,780 thousand).

Total current liabilities increased 16.3% to ¥20,533 million ($188,376 thousand), principally as the result of marked increases in long-term debt due within one year, accounts payable and income taxes payable.

Long-term debt due after one year sharply dropped 84.7% to ¥994 million ($9,119 thousand). This drop was mainly due to entering into a debt assumption agreement with the Mitsubishi Trust and Banking Corporation, paying the necessary amounts for redemption and interest payments on such bonds as Deutsche Mark guaranteed notes due 2000 and unsecured 1.0% bonds due 2001, as well as to transferring the current portion of long-term debt to current liabilities.

Total stockholders' equity grew 10.7% to ¥42,589 million ($390,725 thousand), primarily reflecting the overall increases in retained earnings. This growth significantly improved the ratio of stockholders' equity to total assets of 63.3%, as compared with the previous year end of 58.4%.

Cash Flows

Net cash provided by operating activities suddenly rose 82.2% to ¥11,587 million ($106,303 thousand), compared to cash provided by operating activities in the previous year of ¥6,359 million.

Investing activities used net cash of ¥3,566 million ($32,716 thousand), a 20.0% decrease from the previous year of ¥4,455 million, primarily reflecting a marked decrease in capital expenditures, an increase in investments in marketable securities and a significant increase in proceeds from sales of marketable securities.

Financing activities consumed net cash of ¥4,341 million ($39,825 thousand), a 103.8% increase, compared to cash used by financing activities in the previous year of ¥2,130 million. This increase principally resulted from increased repayment of long-term debt.

In consequence, cash and cash equivalents during the year rose ¥3,680 million ($33,762 thousand), resulting in cash and cash equivalents at the end of the year of ¥5,631 million ($51,661 thousand).

Five Year Summary

HISAMITSU PHARMACEUTICAL CO., INC.
Years ended February 28/29

	Millions of yen (except for per share amounts)				
	2000	1999	1998	1997	1996
Results of operations for the year:					
Net sales	**¥54,627**	¥49,114	¥46,858	¥40,468	¥36,583
Cost of sales	**16,669**	15,902	15,391	14,732	14,043
Selling, general and administrative expenses	**21,848**	18,830	17,995	14,119	13,314
Research and development expenses	**4,925**	4,458	3,916	4,045	3,951
Depreciation and amortization	**2,464**	2,483	2,225	2,305	2,182
Operating income	**11,185**	9,924	9,556	7,572	5,275
Other income (expense)	**(1,397)**	(1,776)	(2,224)	(2,673)	(1,539)
Income before income taxes	**9,788**	8,148	7,332	4,899	3,736
Net income	**4,478**	3,872	2,412	1,830	1,676
Per share of common stock (Yen):					
Net income assuming no dilution	**¥ 93.23**	¥ 81.46	¥ 51.37	¥ 38.98	¥ 35.70
Net income assuming dilution	**93.09**	81.30	—	—	—
Cash dividends applicable to the year	**10.00**	10.00	10.00	8.00	8.00
Financial position at the year end:					
Long-term debt	**¥ 994**	¥ 6,492	¥ 6,698	¥ 5,199	¥10,987
Stockholders' equity	**42,589**	38,473	34,181	32,209	30,815
Total assets	**67,272**	65,844	66,306	63,176	66,873
Working capital	**9,318**	10,203	6,036	4,216	7,983
Property, plant and equipment	**31,341**	32,131	32,807	30,025	29,673
Capital expenditures	**2,703**	3,427	3,951	2,946	3,017

Non-consolidated Balance Sheets

HISAMITSU PHARMACEUTICAL CO., INC.
February 28/29, 2000 and 1999

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2000	1999	**2000**
ASSETS			
Current assets:			
Cash and cash equivalents	**¥ 5,631**	¥ 1,951	**$ 51,661**
Marketable securities (Note 4)	**630**	2	**5,780**
Notes and accounts receivable	**18,974**	21,638	**174,073**
Inventories (Note 5)	**3,895**	3,644	**35,734**
Prepaid expenses	**708**	637	**6,495**
Other current assets	**129**	150	**1,183**
Less allowance for doubtful accounts	**(116)**	(161)	**(1,064)**
Total current assets	**29,851**	27,861	**273,862**
Property, plant and equipment (Note 7):			
Land	**13,296**	13,812	**121,981**
Buildings and structures	**19,602**	19,083	**179,835**
Machinery and equipment	**21,849**	21,180	**200,450**
Construction in progress	**1,011**	796	**9,275**
	55,758	54,871	**511,541**
Less accumulated depreciation	**(24,417)**	(22,740)	**(224,009)**
	31,341	32,131	**287,532**
Investments and non-current receivables:			
Investments in subsidiaries and affiliates	**1,198**	1,033	**10,991**
Investment securities (Notes 4 and 7)	**2,335**	2,098	**21,422**
Loans to subsidiaries and affiliates	**820**	870	**7,523**
Loans to employees	**205**	185	**1,881**
Other investments and non-current receivables	**2,132**	2,950	**19,559**
Less allowance for doubtful accounts	**(610)**	(1,284)	**(5,596)**
	6,080	5,852	**55,780**
	¥ 67,272	¥ 65,844	**$617,174**

See accompanying notes.

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2000	1999	**2000**
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Short-term bank loans (Note 7)	**¥ —**	¥ 400	**$ —**
Long-term debt due within one year (Note 7)	**2,299**	445	**21,092**
Notes and accounts payable	**13,775**	12,503	**126,376**
Income taxes payable (Note 10)	**2,686**	1,865	**24,642**
Notes payable construction	**162**	250	**1,486**
Reserve for loss on loan guarantees	**594**	658	**5,450**
Other current liabilities	**1,017**	1,537	**9,330**
Total current liabilities	**20,533**	17,658	**188,376**
Long-term debt due after one year (Note 7)	**994**	6,492	**9,119**
Retirement benefits (Note 8)	**2,957**	3,087	**27,128**
Other non-current liabilities	**199**	134	**1,826**
Contingent liabilities (Note 13)			
Stockholders' equity (Notes 11 and 14):			
Common stock, par value ¥50 per share:			
Authorized—100,000,000 shares			
Issued—48,063,166 shares in 2000	**8,414**	—	**77,193**
47,885,657 shares in 1999	**—**	8,329	**—**
Additional paid-in capital	**8,175**	8,078	**75,000**
Legal reserve	**990**	930	**9,083**
Retained earnings	**25,010**	21,136	**229,449**
Total stockholders' equity	**42,589**	38,473	**390,725**
	¥ 67,272	¥ 65,844	**$617,174**

Non-consolidated Statements of Income

HISAMITSU PHARMACEUTICAL CO., INC.
Years ended February 28/29, 2000, 1999 and 1998

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2000	1999	1998	**2000**
Net sales	**¥ 54,627**	¥ 49,114	¥ 46,858	**$501,165**
Costs and expenses:				
Cost of sales	**16,669**	15,902	15,391	**152,927**
Selling, general and administrative	**21,848**	18,830	17,995	**200,440**
Research and development	**4,925**	4,458	3,916	**45,183**
	43,442	39,190	37,302	**398,550**
Operating income	**11,185**	9,924	9,556	**102,615**
Other income (expense):				
Interest and dividend income	**86**	105	101	**789**
Interest expense	**(249)**	(314)	(399)	**(2,284)**
Bond and note issue expenses and discount	—	—	(122)	—
Foreign exchange gains	**92**	47	107	**844**
Loss on sales of property, plant and equipment	**(665)**	(436)	(129)	**(6,101)**
Loss on sales of securities	**(6)**	(466)	(51)	**(55)**
Loss on debt assumption	**(164)**	—	—	**(1,505)**
Loss on cancellation of swap contracts	**(99)**	—	—	**(908)**
Reversal of (provision for) losses on guarantees of loans to an affiliate	**63**	8	(386)	**578**
Write-down of investments in subsidiaries and affiliates	**(222)**	(170)	(1,203)	**(2,037)**
Prior service cost under the contributory pension plan	**(529)**	(267)	—	**(4,853)**
Other—net	**296**	(283)	(142)	**2,716**
	(1,397)	(1,776)	(2,224)	**(12,816)**
Income before income taxes	**9,788**	8,148	7,332	**89,799**
Income taxes (Note 10)	**5,310**	4,276	4,920	**48,716**
Net income	**¥ 4,478**	¥ 3,872	¥ 2,412	**$ 41,083**

	Yen			U.S. dollars (Note 1)
	2000	1999	1998	**2000**
Amounts per share of common stock:				
Net income assuming no dilution	**¥ 93.23**	¥ 81.46	¥ 51.37	**$ 0.855**
Net income assuming dilution	**93.09**	81.30	—	**0.854**
Cash dividends applicable to the year	**10.00**	10.00	10.00	**0.092**

See accompanying notes.

Non-consolidated Statements of Stockholders' Equity

HISAMITSU PHARMACEUTICAL CO., INC.
Years ended February 28/29, 2000, 1999 and 1998

	Shares of common stock	Millions of yen			
		Common stock	Additional paid-in capital	Legal reserve	Retained earnings
Balance at February 28, 1997	46,955,403	¥ 7,884	¥ 7,570	¥ 820	¥15,935
Net income	—	—	—	—	2,412
Cash dividends paid	—	—	—	—	(376)
Bonuses to directors and corporate auditors	—	—	—	—	(64)
Transfer to legal reserve	—	—	—	50	(50)
Balance at February 28, 1998	46,955,403	7,884	7,570	870	17,857
Net income	—	—	—	—	3,872
Cash dividends paid	—	—	—	—	(470)
Bonuses to directors and corporate auditors	—	—	—	—	(63)
Transfer to legal reserve	—	—	—	60	(60)
Shares issued upon exercise of warrants	930,254	445	508	—	—
Balance at February 28, 1999	47,885,657	8,329	8,078	930	21,136
Net income	—	—	—	—	**4,478**
Cash dividends paid	—	—	—	—	**(479)**
Bonuses to directors and corporate auditors	—	—	—	—	**(65)**
Transfer to legal reserve	—	—	—	**60**	**(60)**
Shares issued upon exercise of warrants	177,509	85	97	—	—
Balance at February 29, 2000	**48,063,166**	**¥ 8,414**	**¥ 8,175**	**¥ 990**	**¥25,010**

	Thousands of U.S. dollars (Note 1)			
	Common stock	Additional paid-in capital	Legal reserve	Retained earnings
Balance at February 28, 1999	$ 76,413	$ 74,110	$ 8,533	$193,908
Net income	—	—	—	**41,083**
Cash dividends paid	—	—	—	**(4,395)**
Bonuses to directors and corporate auditors	—	—	—	**(597)**
Transfer to legal reserve	—	—	**550**	**(550)**
Shares issued upon exercise of warrants	**780**	**890**	—	—
Balance at February 29, 2000	**$ 77,193**	**$ 75,000**	**$ 9,083**	**$229,449**

See accompanying notes.

Non-consolidated Statements of Cash Flows

HISAMITSU PHARMACEUTICAL CO., INC.
Years ended February 28/29, 2000, 1999 and 1998

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2000	1999	1998	**2000**
Cash flows from operating activities:				
Net income	**¥ 4,478**	¥ 3,872	¥ 2,412	**$ 41,083**
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	**2,464**	2,483	2,225	**22,606**
Loss on sales of property, plant and equipment	**665**	436	129	**6,101**
Loss on sales of securities	**(6)**	466	51	**(55)**
Provision for (reversal of) losses on guarantees of loans to an affiliate	**(63)**	(8)	386	**(578)**
Write-down of investments in subsidiaries and affiliates	**222**	170	1,203	**2,037**
Provision for (reversal of) retirement benefits	**(130)**	(690)	(48)	**(1,193)**
Changes in assets and liabilities:				
Decrease (increase) in notes and accounts receivable	**2,664**	(336)	(4,590)	**24,440**
(Increase) in inventories	**(251)**	(172)	(381)	**(2,303)**
Decrease (increase) in other current assets	**27**	307	(78)	**248**
Increase in notes and accounts payable	**1,426**	541	3,586	**13,083**
Increase (decrease) in income taxes payable	**821**	(1,390)	1,198	**7,532**
Increase (decrease) in other current liabilities	**(492)**	(82)	(212)	**(4,514)**
Other	**(238)**	762	235	**(2,184)**
Total adjustments	**7,109**	2,487	3,704	**65,220**
Net cash provided by operating activities	**11,587**	6,359	6,116	**106,303**
Cash flows from investing activities:				
Capital expenditures	**(2,703)**	(3,427)	(3,951)	**(24,798)**
Investments in subsidiaries and affiliates	**(388)**	(265)	21	**(3,560)**
Investments in marketable securities	**(4,753)**	(1,310)	(729)	**(43,606)**
Proceeds from sales of marketable securities	**3,874**	994	377	**35,541**
Loans to subsidiaries and affiliates	**(95)**	(444)	(320)	**(872)**
Collection on loans	**138**	16	283	**1,266**
Other	**361**	(19)	(340)	**3,313**
Net cash used in investing activities	**(3,566)**	(4,455)	(4,659)	**(32,716)**
Cash flows from financing activities:				
Increase (decrease) in short-term bank loans	**(400)**	(2,500)	(2,200)	**(3,670)**
Proceeds from long-term debt	**500**	400	1,850	**4,587**
Repayment of long-term debt	**(4,144)**	(513)	(4,495)	**(38,018)**
Cash dividends paid	**(479)**	(470)	(376)	**(4,394)**
Shares issued upon exercise of warrants	**182**	953	—	**1,670**
Net cash used in financing activities	**(4,341)**	(2,130)	(5,221)	**(39,825)**
Increase (decrease) in cash and cash equivalents	**3,680**	(226)	(3,764)	**33,762**
Cash and cash equivalents at beginning of year	**1,951**	2,177	5,941	**17,899**
Cash and cash equivalents at end of year	**¥ 5,631**	¥ 1,951	¥ 2,177	**$51,661**
Supplemental disclosures of cash flow information:				
Cash paid during the year:				
Interest	**¥ 249**	¥ 402	¥ 487	**$ 2,284**
Income taxes	**4,490**	4,724	2,700	**41,193**

See accompanying notes.

Notes to Non-consolidated Financial Statements

HISAMITSU PHARMACEUTICAL CO., INC.
Years ended February 28/29, 2000, 1999 and 1998

1.Basis of presenting non-consolidated financial statements

HISAMITSU PHARMACEUTICAL CO., INC. (the "Company") maintains its accounts and records in accordance with the provisions set forth in the Japanese Commercial Code and the Securities and Exchange Law and in conformity with accounting principles and practices generally accepted in Japan, which are different from the accounting and disclosure requirements of International Accounting Standards.

The accompanying non-consolidated financial statements are a translation of the audited non-consolidated financial statements of the Company which were prepared in accordance with accounting principles and practices generally accepted in Japan from the accounts and records maintained by the Company and were filed with the Minister of Finance ("MOF") as required by the Securities and Exchange Law.

In preparing the accompanying non-consolidated financial statements, certain reclassifications have been made in the non-consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan. The non-consolidated statements of cash flows have been prepared for the purpose of inclusion in the non-consolidated financial statements, although such statements are not customarily prepared in Japan and are not required to be filed with MOF.

The translation of the Japanese yen amounts into U.S. dollars are included solely for the convenience of the reader, using the prevailing exchange rate at February 29, 2000, which was ¥109 to U.S.$1. The convenience translations should not be construed as representations that the Japanese yen amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any other rate of exchange.

2. Significant accounting policies

Reporting entity

The financial statements include only the accounts of the Company. The accounts of its subsidiaries are not consolidated.

Cash and cash equivalents

Cash and cash equivalents consist of cash and time deposits due within one year.

Allowance for doubtful accounts

The allowance for doubtful accounts is provided in amounts sufficient to cover possible losses on collection. It is determined by adding individually estimated uncollectible amounts to an amount calculated by formula as permitted by the Corporation Tax Law of Japan with respect to the remaining receivables.

Securities

Marketable equity securities included in both current assets and investments are stated at cost. Cost is determined by the moving average method. Other securities, including investments in subsidiaries and affiliates, are also stated at cost. If a decline in value below cost of an individual security is judged to be material and other than temporary, the carrying value is written down.

Inventories

Inventories are stated at cost (first-in, first-out method).

Property, plant and equipment

Property, plant and equipment are carried at cost. Depreciation is provided over estimated useful lives as permitted by the Corporation Tax of Japan. Depreciation of property, plant and equipment is determined by the declining balance method and amortization of intangible fixed assets and prepaid expenses by the straight line method.

The useful lives of buildings (excluding building fixtures) were shortened in the current year in accordance with a tax law revision in 1998. This change increased depreciation expense by ¥65 million ($596 thousand) and decreased operating income and income before income taxes each by ¥59 million ($541 thousand) as compared with the useful lives used in the previous year.

Bond and note issue expenses and bond issue discounts

Bond and note issue expenses and bond issue discounts are charged to income as incurred.

Income taxes

Income taxes are provided in amounts currently payable for each period based on taxable income and for the amortization of unrealized exchange gains resulting from the application of the forward exchange contract rates to guaranteed notes denominated in foreign currencies. Other tax effects resulting from timing differences in recognizing revenues and expenses for financial statements and tax returns are not recorded.

Reserve for employees' bonuses

Prior to the year ended February 29, 2000 the reserve for employees' bonuses was provided in amounts based on the bonus payment period as permitted by the Corporation Tax Law of Japan. In line with a tax law revision in 1998, the Company changed the method of accounting for this reserve to be provided in the portion of estimated future payments applicable to the current year. The effect of this change was not material.

Retirement benefits

Lump-sum benefit plan

Under the terms of the Company's retirement plan, substantially all employees are entitled to a lump-sum payment at the time of retirement. The amount of the retirement benefit is, in general, based on the length of service, base salary at the time of retirement and reason for retirement. The liability for lump-sum payments is stated at the amount which would be required if all eligible employees voluntarily retired at the balance sheet date.

1996 pension plan

Commencing from July 1996, 30% of the above benefits are covered by a contributory funded pension. The benefits are payable either as a monthly pension or, under certain circumstances at the option of retiring employees, in a lump-sum amount. The Company's contributions to the plan include amortization of prior service costs at 50% of the remaining balance per year. The portion of the liability for the unfunded lump-sum benefit plan, which is no longer required due to the introduction of this plan, is being reversed at the same rate as amortization of prior service costs.

1966 pension plan

The Company also has had a contributory funded pension plan since 1966 which covers retirement benefits for employees who retire at the mandatory retirement age or those with over 20 years of service who terminate their employment under certain circumstances. These employees are, in general, entitled to a lump-sum payment or an annuity. The Company's contributions to the plan include amortization of prior service costs at 50% of the remaining balance per year.

Since the yield on investments of the pension plan was less than projected, the Company changed its expected interest rate from 5.5% to 2.3% in the year ended February 29, 2000. Additional prior service costs incurred as a result of this change of ¥529 million ($4,853 thousand) are stated as prior service cost under the contributory pension plan in the statements of income.

Directors' and corporate auditors' plan

Retirement benefits for directors and corporate auditors under the Company's unfunded plan are included in the liability for retirement benefits in the amount that would be required if they retired at the balance sheet date.

Finance leases

Finance leases which do not transfer ownership are accounted for in the same manner as operating leases in accordance with generally accepted accounting principles in Japan.

Foreign currency translation

Current receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rate in effect at the balance sheet date. The resulting exchange gains and losses are credited or charged to income. Non-current receivables and payables denominated in foreign currencies are translated at historical rates, except for those hedged by forward exchange contracts.

Guaranteed notes payable denominated in foreign currencies and hedged by forward exchange contracts are translated into Japanese yen at the contracted forward exchange rates. The discount on forward contracts is deferred and amortized over the life of the forward contracts.

Net income per share of common stock

Computations of net income per share of common stock assuming no dilution are based on the weighted average number of shares outstanding during each fiscal year.

For the purpose of computing net income per share assuming dilution, the average number of shares has been increased by the number of shares which would have been outstanding assuming the exercise of warrants at the beginning of each fiscal year or at the date of issuance. Net income per share assuming dilution for 1998 is not shown since the results are not dilutive.

3. Accounting change

In the year ended February 28, 1998 and prior years, prior service cost was charged to income when paid. Commencing with the year ended February 28, 1999, to strengthen the financial position of the plan, the Company changed the method of accounting to expense prior service cost when incurred, considering that the investment performance of fund assets has worsened and anticipating recurring prior service cost in the future. The effect of this change was to decrease income before income taxes by ¥267 million.

4. Marketable securities and investment securities

The aggregate carrying values and market values of marketable securities and investment securities at February 28/29, 2000 and 1999 were as follows:

	Millions of yen				Thousands of U.S. dollars	
	2000		1999		**2000**	
	Carrying value	Market value	Carrying value	Market value	Carrying value	Market value
Marketable securities ···	**¥ 1**	**¥ 1**	¥ 2	¥ 2	**$ 9**	**$ 9**
Investment securities ···	**2,335**	**3,078**	2,098	2,686	**21,422**	**28,239**
	¥ 2,336	**¥ 3,079**	¥ 2,100	¥ 2,688	**$21,431**	**$28,248**

Additional marketable securities in investment trusts of ¥629 million ($5,771 thousand) were included in marketable securities at February 29, 2000.

5. Inventories

Inventories at February 28/29, 2000 and 1999 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2000	1999	**2000**
Finished products ······················	**¥ 2,830**	¥ 2,667	**$ 25,963**
Work in process ························	**257**	240	**2,358**
Raw materials and supplies ·········	**808**	737	**7,413**
	¥ 3,895	¥ 3,644	**$ 35,734**

6. Derivative transactions

The Company enters into forward currency exchange and interest rate swap transactions to control risks related to foreign currencies and interests rates. Forward currency exchange contracts are used to hedge the risk of fluctuations in foreign currency exchange rates with respect to foreign currency transactions, and interest rate swap transactions are used to reduce the risk of fluctuations in interest rates in relation to notes payable.

The Company principally uses derivative transactions in connection with managing its market risk and not for speculation or dealing purposes. The Company deals with highly rated domestic banks as counterparty to these transactions to minimize credit risk exposure.

Derivative transactions are entered into by the administrative division in accordance with established policies approved by the Board of Directors, and the actual results of the derivative transactions are reported to the Board of Directors after the end of each year.

Outstanding positions as of February 29, 2000 were as follows:

Forward currency exchange transactions:

	Millions of yen						Thousands of U.S. dollars
	2000			1999			**2000**
Type of transaction	Contracted amount	Current market amount	Unrealized gain	Contracted amount	Current market amount	Unrealized gain	Unrealized gain
Purchase							
Deutsche Marks ···	**¥ —**	**¥ —**	¥ —	¥ 23	¥ 24	**¥ 1**	**$ —**

The market value amounts are based on the year end forward rate. Forward currency exchange contracts for which the forward rates were used to translate year end receivables or payables denominated in foreign currencies are excluded from the above schedule.

Interest rate swap transactions:

	Millions of yen				Thousands of U.S. dollars
	2000		1999		**2000**
Type of transaction	Principal amount of contract	Amount of principal due over one year	Principal amount of contract	Amount of principal due over one year	Principal amount of contract
Variable rate received for fixed rate ···	**¥ —**	**¥ —**	¥ 4,885	¥ 4,885	**$ —**

The contracted amounts of principal represent the principals of the swap transactions and are not appropriate to be used for the measurement of market and credit risks.

The Company cancelled the derivative transactions since it no longer had notes and bonds denominated in foreign currencies to be hedged at the year end due to entering into a debt assumption agreement with a financial institution.

7. Short-term loans and long-term debt

Short-term bank loans are represented generally by notes maturing within one year. Annual interest rates at February 29, 2000, ranged from 0.59% to 3.49%.

Long-term debt at February 28/29, 2000 and 1999 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2000	1999	**2000**
Secured bank loans due through 2003	**¥ 2,905**	¥ 2,856	**$ 26,651**
Unsecured bank loans due 2003	**388**	407	**3,560**
Deutsche Mark guaranteed notes due 2000 with interest floating at the London Interbank Offering rate plus 0.25%	—	2,424	—
Unsecured 1.0% bonds with stock purchase warrants payable in yen, due 2001	—	1,250	—
	3,293	6,937	**30,211**
Less amounts due within one year	**2,299**	445	**21,092**
	¥ 994	¥ 6,492	**$ 9,119**

The annual interest rates of the secured bank loans ranged from 0.59% to 3.49% with the weighted average being 2.50% at February 29, 2000.

The unsecured 1.0% bonds were issued with detachable warrants that entitle the holder to purchase shares of common stock at an exercise price per share of ¥957 ($8.78). These warrants are exercisable through June 25, 2001.

If all the outstanding warrants had been exercised at February 29, 2000, 197 thousand additional shares of common stock would have been issued.

At February 29, 2000 assets pledged as collateral for secured long-term bank loans (including amounts due within one year) and for the bank guarantee of the Deutsche Mark notes were as follows:

	Millions of yen	Thousands of U.S. dollars
Land	**¥ 7,319**	**$ 67,147**
Buildings—net of accumulated depreciation	**219**	**2,009**
Investment securities	**105**	**963**
	¥ 7,643	**$ 70,119**

The annual maturities of long-term debt are as follows:

Years ending February 28/29	Millions of yen	Thousands of U.S. dollars
2002	¥ 460	$ 4,220
2003	521	4,780
2004	13	119
	¥ 994	$ 9,119

Contingent liability for debt assumption

The Company entered into a debt assumption agreement with the Mitsubishi Trust and Banking Corporation on January 13, 2000, and paid the necessary amounts for redemption and interest payments on certain bonds. Consequently, although the bonds are not included in liabilities in the balance sheet, the Company remains contingently liable for the following bonds:

	(Millions of yen) Ending balance	Redemption date
Deutsche Mark guaranteed notes due 2000 ·································	¥ 2,424 (40 million DM)	November 30, 2000
Unsecured 1.0% bonds due 2001 ······	¥ 1,250	June 25, 2001

8. Retirement benefits

Pension assets and unamortized prior service costs under the contributory funded pension plan established in 1996 amounted to ¥2,016 million ($18,495 thousand) and ¥1,244 million ($11,412 thousand), respectively, at February 29, 2000.

Pension assets and unamortized prior service costs under the contributory funded pension plan established in 1966 amounted to ¥1,026 million ($9,413 thousand) and ¥630 million ($5,780 thousand), respectively, at February 29, 2000.

Charges to income with respect to the employees' lump-sum retirement benefits plan and the funded pension plans amounted to ¥781 million ($7,165 thousand), ¥986 million and ¥404 million in 2000, 1999 and 1998, respectively. The reversal of reserve for retirement benefits amounted to ¥169 million ($1,550 thousand) for the year ended February 29, 2000.

Charges to income with respect to directors' and corporate auditors' retirement benefits amounted to ¥133 million ($1,222 thousand), ¥72 million and ¥73 million for the years 2000, 1999 and 1998, respectively.

At February 29, 2000 the provision for retirement benefits for directors and corporate auditors is included in the liability for retirement benefits in the amount of ¥702 million ($6,440 thousand).

9. Finance leases

Lease payments for non-capitalized finance leases for the years ended February 28/29, 2000, 1999 and 1998 were ¥264 million ($2,422 thousand), ¥244 million and ¥245 million, respectively.

Future minimum leases payments, including financing cost, required under such leases at February 29, 2000 are as follows:

	Millions of yen	Thousands of U.S. dollars
Due within one year ·····························	¥ 281	$ 2,578
Due after one year ································	429	3,936
	¥ 710	$ 6,514

10. Income taxes

Taxes on income consist of corporation, enterprise and inhabitants taxes. The aggregate normal statutory rate of taxes on income was approximately 47%, 51% and 51% for the years ended February 28/29, 2000, 1999 and 1998, respectively. Primarily as a result of (1) expenses not deductible for tax purposes and (2) the effects of timing differences in recognizing revenues and expenses for financial statements and tax returns, the actual effective tax rates differed from the aggregate normal statutory rates.

11. Stockholders' equity

The Commercial Code of Japan provides that an amount equal to at least 10% of cash dividends and other cash appropriations shall be set aside as a legal reserve until such reserve equals 25% of the amount of common stock. This reserve is not available for dividends but may be used to reduce a deficit by resolution of the stockholders or may be capitalized by resolution of the Board of Directors.

12. Related party transactions

Sales to non-consolidated subsidiaries and affiliates for the year ended February 28/29, 2000 and 1999, were ¥735 million ($6,743 thousand) and ¥475 million, respectively.

Receivables from and payables to non-consolidated subsidiaries and affiliates at February 28/29, 2000 and 1999, were as follows:

	Millions of yen		Thousands of U.S. dollars
	2000	1999	**2000**
Trade accounts receivable	**¥ 1,420**	¥ 1,725	**$13,028**
Trade accounts payable	**131**	72	**1,202**

13. Contingent liabilities

Contingent liabilities at February 29, 2000 were as follows:

	Millions of yen	Thousands of U.S. dollars
Notes receivable discounted	**¥ 100**	**$ 917**
Guarantee of loans of subsidiaries and affiliates	**1,179**	**10,816**
Debt assumption agreements (See Note 7)	**3,674**	**33,706**

Guarantee of loans of subsidiaries and affiliates is shown after deducting the reserve for loss on loan guarantees of ¥594 million ($5,450 thousand).

14. Subsequent events

(1) At the 2000 annual meeting of stockholders held on May 25, 2000, the appropriation of retained earnings for the year ended February 29, 2000 was duly approved as follows:

	Millions of yen	Thousands of U.S. dollars
Cash dividends—		
¥10.00 ($0.092) per share …………………	**¥ 481**	**$ 4,409**
Bonuses to directors		
and corporate auditors ………………………	**59**	**541**
Reserve for retirement of common stock …	**1,870**	**17,156**
Transfer to legal reserve ………………………	**60**	**550**

(2) At the board of directors held on February 24, 2000, the Company resolved to acquire and retire 800 thousand shares of par value common stock out of profits within the limited total amount of ¥1,500 million by the time of the 2000 annual meeting of stockholders to be held on May 25, 2000. During the period, the Company purchased 605 thousand shares of common stock for a total amount of ¥974 million ($8,936 thousand) from the stock market and retired them.

Report of Independent Certified Public Accountants

The Board of Directors
HISAMITSU PHARMACEUTICAL CO., INC.

We have audited the accompanying non-consolidated balance sheets of HISAMITSU PHARMACEUTICAL CO., INC., a Japanese corporation, at February 28/29, 2000 and 1999, and the related non-consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended February 29, 2000, expressed in Japanese yen. Our audits were made in accordance with generally accepted auditing standards 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 non-consolidated financial statements referred to above present fairly the non-consolidated financial position of HISAMITSU PHARMACEUTICAL CO., INC. at February 28/29, 2000 and 1999, and the non-consolidated results of its operations and its cash flows for each of the three years in the period ended February 29, 2000, in conformity with accounting principles generally accepted in Japan applied on a consistent basis, except for the change in the method of accounting for prior service cost of a pension plan in 1999 as referred to in Note 3.

We have also reviewed the translation of the 2000 financial statements into U.S. dollars on the basis described in Note 1. In our opinion, such U.S. dollar amounts have been properly translated on such basis.

Fukuoka, Japan
May 26, 2000

Asahi & Co.
(Member Firm of Andersen Worldwide SC)

Statement on Accounting Principles and Auditing Standards

This statement is to remind users that accounting principles and auditing standards and their application in practice may vary among nations and therefore could affect, possibly materially, the reported financial position and results of operations. The accompanying financial statements are prepared based on accounting principles generally accepted in Japan, and the auditing standards and their application in practice are those generally accepted in Japan. Accordingly, the accompanying non-consolidated financial statements and the auditors' report presented above are for users familiar with Japanese accounting principles, auditing standards and their application in practice.