Hisamitsu Pharmaceutical Co., Inc.

FINANCIAL REPORT

Fiscal 2001

Contents

Management Policies

(1) Fundamental Management Policies

Hisamitsu Pharmaceutical Co., Inc. (the Company) begins with a patch and patch-relating technology, namely, transdermal therapeutic system (TTS) technology. The Company adheres to its philosophy, “Improving Quality of Life (QOL) for People in the World” with the aid of TTS technology.

Since first entering the pharmaceutical industry in 1847, the Company has been engaged in the sale and manufacture of pharmaceuticals actively seeking to enhance people’s health through supplying the pharmaceuticals applied to the skin, particularly analgesic and anti-inflammatory patches. Thanks to our persistent efforts, the Company has now become a leading company for transdermal patches. SALONPAS, one of our mainstay products, is known as a pioneer in the realm of the transdermal patch. A registered trademark in over 100 countries, the name SALONPAS, is globally associated with a quality patch for reliving pains and inflammation.

Patches, which are able to cure diseases by simply applying to the skin, are lately attracting considerable attention from viewpoints of improving medication to treat patients as well as improving QOL for patients. Throughout the world, the Company’s transdermal patches are proudly hailed as an embodiment of the unique Japanese “therapeutic culture.” The efficacy of this “culture of patch therapy” and the impressive benefits that it brings are being conveyed throughout the world. Taking this as our corporate mission under the banner, Salonpas therapy, we are proceeding with the development of our business with this philosophy always in mind.

(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 declares to pay cash dividends for the current year, the payout ratio of which is not less than 10%, considering further enhancement of management, further development of business and necessary internal reserves, in addition to the difficult operating conditions surrounding the Company.

(3) Mid-term Strategies

The Company intends to become a pharmaceutical company oriented toward its own R&D in its own way, aggressively trying to create new transdermal pharmaceuticals for topical and systemic use meeting properly the needs of medical institutions through TTS studies.

The Company’s mid-term strategies are:

- To increase cash flows from operating activities through the aggressive development of sales activities of existing transdermal analgesic and anti-inflammatory products for ethical use and over-the-counter (OTC) use.

- To further specialize in R&D activities of new transdermal pharmaceuticals for topical and systemic use, intending to pursue high net profits and high corporate value.

- To promote global development of the Company’s new products based on the TTS technology.

Through these activities, the Company sets its mid-term goal in management to keep return on equity (ROE) of more than 15% and to increase net income up ¥10,000 million ($86,207 thousand) by the end of fiscal 2005.

(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, in order to raise the degree of managerial transparency, the Company is striving to actively open its information to the public as well as maintaining smooth communications with stockholders and investors through aggressive investor relation (IR) activities.

Review of Operations

(1) Overview of Fiscal 2001 ended February 28, 2001

Widespread economic depression in Japan has continued throughout fiscal 2001, ended February 28, 2001, and there were no signs of recovery due primarily to sluggish domestic demand due to low personal consumption and decreases in capital expenditures by industry.

The Japanese Government's policy of restraining health care costs has been strengthening year by year. The Government implemented reforms to the National Health Insurance (NHI) scheme, intending to increase the portion of health care costs shared by patients. As a result, effective April 1, 2000, the Government executed a cut in NHI drug reimbursement prices averaging 7.0% across the industry. These measures have adversely affected the business performance of the whole pharmaceutical industry, including the Company, for fiscal 2001.

The pharmaceutical industry has been experiencing keen competition due to the full-scale entry of foreign pharmaceutical manufactures into the domestic market for ethical pharmaceuticals. Additionally, the OTC product market has been stagnant, directly reflecting flat personal consumption due to the domestic economic depression, despite successive efforts by companies to diversify their existing products to differentiate them from others. This has further intensified sales competition in this market.

Against this harsh situation, the Company and its subsidiaries (the Companies) have been active in every operating field.

(Pharmaceuticals and related products segment)

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. The Company made improvements to both transdermal patch, MOHRUS TAPE, and transdermal gel patch, MOHRUS, to make them easy to use, and strove to promote them into medical institutions.

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 into the cosmetic market with facial gel packs, to which the Company's own transdermal technology has been applied. In January this year, the Company launched LIFECELLA MEN'S MASK to have a large assortment of facial packs as well as to cultivate new consumers. During the year the Company introduced onto the OTC market DEKO-DEKO COOL, a first-aid pad for cooling fever, and AIR-SALONPAS INDOMETHACIN, an analgesic and anti-inflammatory spray, 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.

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

During the year, the Company promoted the following activities relating to common stock.

(1) In accordance with the resolution of the Board of Directors on February 24, 2000, the Company purchased 605 thousand shares of par value common stock out of profits for a total amount of ¥974 million ($8,396 thousand) from the stock market and retired them by the time of the 2000 annual meeting of stockholders on May 25, 2000.

(2) In accordance with the resolution of the Board of Directors on May 25, 2000, the Company made stock split at the ratio of one share of par value common stock into two shares on August 21, 2000. As a result, the Company issued 47,523 thousand additional shares of common stock.

(Cable television broadcasting and other segment)
The Companies continued to aggressively develop cable television broadcasting and other businesses in order to achieve successful results.

(2) Outlook for Fiscal 2002 ending February 28, 2002

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 accelerate 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.

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.

Additionally, the Companies are intending to further develop cable television broadcasting and other businesses to improve results.

It is too early to predict the consolidated results of operations for the next year ending February 28, 2002, but the Companies expect that, in the absence of unforeseen circumstances, both net sales and net income will show a moderate increase.

Financial Review

The consolidated financial statements included the accounts of the Company and its ten significant subsidiaries (the “Companies”), and investments in two affiliated companies were accounted for using the equity method.

The Company was only required to file non-consolidated financial statements in prior years, and, therefore, comparative consolidated financial statements for the prior year are not presented.

Results of Operations

Net Sales

(Pharmaceuticals and related products segment)

During fiscal 2001, ended February 28, 2001, the Companies have faced very difficult operating circumstances as a whole. With regard to ethical pharmaceuticals, the Government executed a cut in pharmaceutical reimbursement prices under the NHI scheme averaging 7.0% across the pharmaceutical industry. This reduction adversely affected the performance for fiscal 2001 of the whole pharmaceutical industry.

Under these circumstances, regarding ethical pharmaceuticals, the Company actively promoted pharmaceutical information activities meeting the diversifying healthcare needs of medical institutions, centering on its main products, such as analgesic and anti-inflammatory products for external use. Of these products, the Company aggressively disseminated and gathered product information for both ketoprofen patch, MOHRUS TAPE, and ketoprofen gel patch, MOHRUS, in order to enable them to steadily penetrate into medical institutions. Additionally, November of last year, the Company filed the application for additional indications for ESTRADIOL, a transdermal patch for treating menopause, to osteoporosis.

With respect to over-the-counter (OTC) products, the Company strove to principally promote the sale of analgesic and anti-inflammatory pharmaceuticals for external use despite the stagnant OTC market reflecting decreased personal consumption. The Company successfully launched new products consisting of DECO-DECO COOL, a first aid pad for cooling fever, in April last year, AIR SALONPAS INDOMETHACIN, an aerosol compounded concomitantly with l-menthol and indomethacin for relieving muscular pains and inflammation, in August last year and LIFECELLA MEN’S MASK, a facial gel pack for men’s use, in January this year.

In the pharmaceuticals and related products segment, the Companies recorded net sales of ¥63,180 million ($544,655 thousand).

(Cable Television Broadcasting Segment and Other Segment)

The Companies continued to aggressively develop the cable television broadcasting business, making an aggressive entry into the cable internet business. Net sales for the cable television broadcasting and other segment were ¥2,060 million ($17,759 thousand).

As a result, the consolidated net sales for the Companies totaled ¥65,240 million ($562,414 thousand).

Costs and Expenses

Cost of sales amounted to ¥20,068 million ($173,000 thousand), rendering the cost of sales as a percentage of net sales at 30.8%. Selling, general and administrative expenses totaled ¥25,746 million ($221,948 thousand), and R & D expenses amounted to ¥5,435 million ($46,854 thousand), with the ratio of R & D expenses to net sales at 8.3%.

Operating income was determined as ¥13,991 million ($120,612 thousand) by deducting costs and expenses from net sales, yielding the ratio of operating income to net sales of 21.4%.

Other expenses, net of other income, totaled ¥2,012 million ($17,345 thousand), primarily reflecting the lump-sum amortization of prior service cost under the contributory pension plan of ¥2,032 million ($17,517 thousand).

Net Income

Income before income taxes was ¥11,979 million ($103,267 thousand). Net income was ¥6,788 million ($58,517 thousand) by deducting current income taxes and minority interest in net income of consolidated subsidiaries and by adding deferred income taxes. The effective tax rate was approximately equal to 42.2%. Diluted net income per share of common stock was ¥72.70 ($0.63), and the Company paid its stockholders cash dividends per share of ¥7.00 ($0.06).

Financial Position

At February 28, 2001, total assets stood at ¥80,706 million ($695,741 thousand). Total current assets amounted to ¥38,029 million ($327,836 thousand), principally consisting of notes and accounts receivable of ¥18,538 million ($159,811 thousand) and cash and deposits of ¥11,246 million ($96,948 thousand).

Property, plant and equipment, less accumulated depreciation, were ¥33,963 million ($292,784 thousand) and intangible assets were ¥273 million ($2,353 thousand). Investments and other non-current assets totaled ¥8,441 million ($72,768 thousand), and major components included investment securities of ¥3,694 million ($31,845 thousand) and non-current deferred tax assets of ¥1,586 million ($13,672 thousand).

Total current liabilities amounted to ¥24,816 million ($213,931 thousand), primarily consisting of trade notes and accounts payable of ¥8,936 million ($77,034 thousand) and other notes and accounts payable of ¥7,514 million ($64,776 thousand). Working capital was calculated as ¥13,213 million ($113,905 thousand), and the current ratio as 153.2%.

Total long-term liabilities were ¥6,153 million ($53,043 thousand). Major components included long-term debt due after one year of ¥2,341 million ($20,181 thousand) and employees' retirement benefits of ¥2,359 million ($20,336 thousand). Unsecured 1.0% bonds, due 2001, issued with warrants are not included in liabilities in the balance sheet because the Company entered into a debt assumption agreement with a financial institution, paying the necessary amounts for redemption and interest payments on the bonds. However, the Company remains contingently liable for the bonds through June 25, 2001.

Total stockholders' equity amounted to ¥49,182 million ($423,983 thousand), primarily reflecting retained earnings of ¥34,719 million ($299,302 thousand), common stock of ¥8,460 million ($72,931 thousand) and additional paid-in capital of ¥8,227 million ($70,922 thousand), leaving the ratio of stockholders' equity to total assets of 60.9%.

Cash Flows

Cash and cash equivalents at end of year totaled ¥12,526 million ($107,983 thousand), an increase of ¥5,685 million ($49,009), compared to those at beginning of year. This primarily resulted from increased cash flows provided by operating activities with an increase in net sales of the Company.

Operating activities provided net cash of ¥12,280 million ($105,862 thousand). This principally came from income before income taxes of ¥11,979 million ($103,267 thousand) and depreciation and amortization of ¥2,851 million ($24,578 thousand) despite income taxes paid of 5,101 million ($43,974 thousand).

Investing activities used net cash of ¥5,130 million ($44,224 thousand), primarily reflecting payments for purchases of property, plant and equipment of ¥3,597 million ($31,009 thousand) and payment for purchase for investment securities of ¥1,350 million ($11,638 thousand). Major capital investments were made for the expansion and upgrading of the production and laboratory facilities, as well as the construction of a new storehouse with a fully computerized distribution system.

Financing activities consumed net cash of ¥1,507 million ($12,991 thousand). This is primarily due to repayment of long-term debt of ¥2,607 million ($22,474 thousand) and payment for purchase of treasury stock of ¥1,162 million ($10,017 thousand) for retirement despite net increase in bank loans of ¥2,586 million ($22,293 thousand).

Consolidated Balance Sheet

HISAMITSU PHARMACEUTICAL CO., INC.
February 28, 2001

	Millions of yen	Thousands of U.S. dollars (Note 1)
ASSET		
Current assets:		
Cash and deposits (Note 3)	¥11,246	$96,948
Notes and accounts receivable:		
Trade notes (Note 15)	4,991	43,026
Trade accounts	13,547	116,785
Marketable securities (Note 4)	1,345	11,595
Inventories (Note 5)	4,896	42,207
Deferred tax assets (Note 11)	972	8,379
Other current assets	1,120	9,655
Less allowance for doubtful accounts	(88)	(759)
Total current assets	**38,029**	**327,836**
Property, plant and equipment:		
Land (Note 6)	12,217	105,319
Buildings and structures (Note 9)	23,384	201,586
Machinery and equipment (Note 9)	15,891	136,991
Tools, furniture and fixtures	9,621	82,940
Construction in progress	1,423	12,267
	62,536	539,103
Less accumulated depreciation	(28,573)	(246,319)
	33,963	**292,784**
Intangible assets	**273**	**2,353**
Investments and other non-current assets:		
Investment securities (Notes 4 and 9)	3,694	31,845
Investment in non-consolidated subsidiaries and affiliates	706	6,086
Deferred tax assets (Note 11)	1,586	13,672
Deferred tax assets relating to land revaluation (Note 6)	641	5,526
Other investments and other non-current assets	1,818	15,673
Less allowance for doubtful accounts	(4)	(34)
	8,441	**72,768**
	¥ 80,706	**$695,741**

See accompanying notes.

	Millions of yen	Thousands of U.S. dollars (Note 1)
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Short-term bank loans (Note 9)	¥3,122	$26,914
Long-term debt due within one year (Note 9)	637	5,491
Notes and accounts payable:		
Trade	8,936	77,034
Construction	296	2,552
Other	7,514	64,776
Income taxes payable (Note 11)	3,404	29,345
Reserve for sales returns	194	1,672
Reserve for employees' bonuses	467	4,026
Other current liabilities	246	2,121
Total current liabilities	**24,816**	**213,931**
Long-term liabilities:		
Long-term debt due after one year (Note 9)	2,341	20,181
Retirement benefits (Note 10)	2,359	20,336
Directors' and corporate auditors' retirement benefits	768	6,621
Other non-current liabilities	685	5,905
Total long-term liabilities	**6,153**	**53,043**
Minority interests	**555**	**4,784**
Contingent liabilities (Note 15)		
Stockholders' equity (Notes 13 and 14):		
Common stock, par value ¥50 per share:		
Authorized—180,000,000 shares		
Issued—95,108,490 shares	8,460	72,931
Additional paid-in capital	8,227	70,922
Loss on land revaluation (Note 6)	(894)	(7,707)
Retained earnings	34,719	299,302
Translation adjustments	(468)	(4,034)
Treasury stock, at cost	(2)	(17)
Common stock owned by subsidiary	(860)	(7,414)
Total stockholders' equity	**49,182**	**423,983**
	¥ 80,706	**$695,741**

Consolidated Statement of Income

HISAMITSU PHARMACEUTICAL CO., INC.
Year ended February 28, 2001

	Millions of yen	Thousands of U.S. dollars (Note 1)
Net sales	**¥ 65,240**	**$562,414**
Costs and expenses:		
Cost of sales	20,068	173,000
Selling, general and administrative	25,746	221,948
Research and development	5,435	46,854
	51,249	**441,802**
Operating income	**13,991**	**120,612**
Other income (expense):		
Interest and dividend income	103	888
Interest expense	(173)	(1,492)
Equity in earnings of affiliates	50	431
Gain on sales of property, plant and equipment	2	17
Gain on sales of investment securities	8	69
Governmental subsidy	159	1,371
Loss on sales and disposals of property, plant and equipment	(202)	(1,742)
Write-down of investment securities	(274)	(2,362)
Write-down of golf-club memberships	(168)	(1,448)
Prior service cost under the contributory pension plan (Note 10)	(2,032)	(17,517)
Other—net	515	4,440
	(2,012)	**(17,345)**
Income before income taxes	**11,979**	**103,267**
Income taxes (Note 11):		
Current	5,771	49,750
Deferred	(718)	(6,190)
Minority interests in net income of consolidated subsidiaries	**138**	**1,190**
Net income	**¥ 6,788**	**$58,517**

	Yen	U.S. dollars (Note 1)
Amounts per share of common stock (Note 2):		
Net income	¥ 72.82	$ 0.63
Diluted net income	72.70	0.63
Cash dividends applicable to the year	7.00	0.06

See accompanying notes.

Consolidated Statement of Stockholders' Equity

HISAMITSU PHARMACEUTICAL CO., INC.
Year ended February 28, 2001

	Million of yen	Thousands of U.S. dollars (Note 1)
Common stock:		
Balance at beginning of year	¥ 8,414	$ 72,534
Shares issued upon exercise of warrants (Note 14)	46	397
Balance at end of year	**¥ 8,460**	**$ 72,931**
Additional paid-in capital:		
Balance at beginning of year	¥ 8,175	$ 70,474
Shares issued upon exercise of warrants (Note 14)	52	448
Balance at end of year	**¥ 8,227**	**$ 70,922**
Loss on land revaluation:		
Balance at beginning of year	¥ —	$ —
Land revaluation, net of tax (Note 6)	(894)	(7,707)
Balance at end of year	**¥ (894)**	**$ (7,707)**
Retained earnings:		
Balance at beginning of year	¥27,662	$238,466
Net income	6,788	58,517
Cumulative effect of adopting tax effect accounting (Note 11)	1,783	15,371
Cash dividends paid	(481)	(4,147)
Bonuses to directors and corporate auditors	(59)	(509)
Retirement of common stock (Note 14)	(974)	(8,396)
Balance at end of year	**¥34,719**	**$299,302**
Translation adjustments:		
Balance at beginning of year	¥ (478)	$ (4,121)
Adjustments from translation of foreign currency financial statements	10	87
Balance at end of year	**¥ (468)**	**$ (4,034)**
Treasury stock:		
Balance at beginning of year	¥ (1)	$ (9)
Treasury stock purchased	(1)	(8)
Balance at end of year	**¥ (2)**	**$ (17)**
Common stock purchased by subsidiary:		
Balance at beginning of year	¥ (736)	$ (6,345)
Common stock purchased by subsidiary	(124)	(1,069)
Balance at end of year	**¥ (860)**	**$ (7,414)**
Number of shares of common stock:		
Balance at beginning of year	48,063,166	
Retirement of common stock (Note 14)	(605,000)	
Shares issued upon exercise of warrants (Note 14)	127,419	
Stock split (Note 14)	47,522,905	
Balance at end of year	**95,108,490**	

See accompanying notes.

Consolidated Statement of Cash Flows

HISAMITSU PHARMACEUTICAL CO., INC.
Year ended February 28, 2001

	Millions of yen	Thousands of U.S. dollars (Note 1)
Cash flows from operating activities:		
Income before income taxes	¥ 11,979	$103,267
Adjustments to reconcile net income before taxes to net cash provided by operating activities:		
Depreciation and amortization	2,851	24,578
Increase in employees' retirement benefits	53	457
Increase in directors' and corporate auditors' retirement benefits	64	552
Interest and dividend income	(103)	(888)
Interest expense	173	1,492
Foreign exchange gain	(64)	(552)
Equity in earnings of affiliated companies	(50)	(431)
Write-down of investment securities	274	2,362
Write-down of golf-club memberships	168	1,448
Loss on sales and disposal of property, plant and equipment	202	1,741
Decrease in notes and accounts receivable	471	4,060
Increase in inventories	(727)	(6,267)
Increase in other current assets	(337)	(2,905)
Increase in notes and accounts payable	1,926	16,604
Bonuses to directors and statutory auditors	(59)	(509)
Other	630	5,431
Subtotal	17,451	150,440
Interest and dividend income received	102	879
Interest paid	(172)	(1,483)
Income taxes paid	(5,101)	(43,974)
Net cash provided by operating activities	**12,280**	**105,862**
Cash flows from investing activities:		
Payments for purchases of property, plant and equipment	(3,597)	(31,009)
Proceeds from sales of property, plant and equipment	81	698
Payments for purchases of intangible assets	(186)	(1,603)
Payments for purchases of marketable securities	(3,300)	(28,448)
Proceeds from sales of marketable securities	3,359	28,957
Payment for purchase of investment securities	(1,350)	(11,638)
Payments on loans receivable	(204)	(1,759)
Other	67	578
Net cash used in investing activities	**(5,130)**	**(44,224)**
Cash flows from financing activities:		
Net increase in bank loans	2,586	22,293
Repayment of long-term debt	(2,607)	(22,474)
Proceeds from exercise of warrants	98	845
Payment for purchase of treasury stock	(1,162)	(10,017)
Proceeds from sales of treasury stock	183	1,578
Cash dividends paid	(481)	(4,147)
Other	(124)	(1,069)
Net cash used in financing activities	**(1,507)**	**(12,991)**
Effect of exchange rate changes on cash and cash equivalents	42	362
Net increase in cash and cash equivalents	5,685	49,009
Cash and cash equivalents at beginning of year	6,841	58,974
Cash and cash equivalents at end of year	**¥ 12,526**	**$ 107,983**

See accompanying notes.

Notes to Consolidated Financial Statements

HISAMITSU PHARMACEUTICAL CO., INC.
Year ended February 28, 2001

1. Basis of Consolidated Financial Statements

Hisamitsu Pharmaceutical Co., Inc. (the "Company") and its consolidated domestic subsidiaries maintain their 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 accounts of overseas consolidated subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles and practices prevailing in the respective countries of domicile.

The accompanying consolidated financial statements are a translation of the audited 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 its consolidated subsidiaries and were filed with the Minister of Finance as required by the Securities and Exchange Law. The Company was only required to file non-consolidated financial statements in prior years, and, therefore, comparative consolidated financial statements for the prior years are not presented.

In preparing the accompanying consolidated financial statements, certain reclassifications have been made in the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan.

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 28, 2001, which was ¥116 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 at any rate of exchange.

2. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of the Company and its ten significant subsidiaries (the "Companies"). All significant intercompany balances, transactions and profits have been eliminated.

The consolidated financial statements for the year ended February 28, 2001 were prepared in accordance with the revised Accounting Principles for Consolidated Financial Statements (the Revised Accounting Principles), which are effective from years ended March 31, 2000. Under the Revised Accounting Principles, companies are required to consolidate all significant investees which are controlled through substantial ownership of majority voting rights or existence of certain conditions.

In the elimination of investments in subsidiaries, the assets and liabilities of the subsidiaries, including the portion attributable to minority shareholders, are evaluated using fair value at the time the Company acquired control of the respective subsidiaries.

Equity Method

Investments in two affiliated companies are accounted for using the equity method. However, non-consolidated subsidiaries are not accounted for using the equity method, since the Company's equity in earnings in the aggregate is not material in relation to the consolidated net income and retained earnings. The consolidation difference between cost of an investment and equity in its net assets at the date of acquisition is expensed in the year of acquisition.

Cash and Cash Equivalents and Cash Flow Statements

In preparing the consolidated statements of cash flows, cash on hand, readily-available deposits and short-term highly liquid investments with maturities of not exceeding three months at the time of purchase are considered to be cash and cash equivalents.

Marketable Securities and Investment 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 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.

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.

The allowance for doubtful accounts for the overseas consolidated subsidiaries is provided in amounts calculated from individually estimated uncollectible accounts.

Allowance for Sales Returns

The allowance for sales returns is provided in the limited amount calculated by formula as permitted by the Corporation Tax Law of Japan to cover possible losses on sales returns after the balance sheet date.

Inventories

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

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation except that certain land was revalued at fair value as of February 28, 2001. 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 except that the straight line method is primarily adopted by the overseas consolidated subsidiaries.

Intangible Assets

Intangible assets are stated at cost less accumulated amortization and amortized by the straight line method. Amortization is provided over estimated useful lives as permitted by the Corporation Tax of Japan, except that the amortization of internally used software is determined using the straight line method over the estimated useful life (five years).

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

The Companies provided income taxes at the amounts currently payable for the year ended February 29, 2000. Effective March 1, 2000, the Companies adopted the new accounting standard, which recognizes tax effects of temporary differences between the carrying amounts of assets and liabilities for tax and financial reporting. The assets and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

The amount of deferred income taxes attributable to the net tax effects of the temporary differences at March 1, 2000 is reflected as an adjustment to the retained earnings brought forward from the previous year.

Reserve for Employees' Bonuses

The Company and its domestic consolidated subsidiaries provided the reserve for employees' bonuses in the portion of estimated future payments applicable to the current year.

Retirement Benefits and Pension Plan

Lump-sum benefit plan

Under the terms of the Company's and domestic subsidiaries' retirement plans, 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 portion of the liability for the unfunded lump-sum benefit plan, which is no longer required due to the introduction of this plan, is 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.

Both prior service costs for 1996 pension plan and 1966 pension plan are expensed when incurred.

Directors' and corporate auditors' retirement benefits

Retirement benefits for directors and corporate auditors under the Company's unfunded plan are provided 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 and non-current receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rates in effect at the balance sheet date, except for those hedged by forward exchange contracts. The resulting exchange gains and losses are credited or charged to income.

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.

The assets and liabilities of consolidated overseas subsidiaries are translated into Japanese yen at the exchange rates in effect at the balance sheet date. Revenue and expense accounts are translated at the average exchange rates prevailing during the year.

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 changed by the number of shares which would have been outstanding assuming the retirement of treasury stock, exercise of warrants and stock split at the beginning of the year.

3. Cash and Cash Equivalents

Cash and cash equivalents at February 28, 2001 for the consolidated statement of cash flows consisted of the following:

	Millions of yen	Thousands of U.S. dollars
Cash and deposits	¥ 11,246	$ 96,948
Add: Marketable securities	1,345	11,595
Less: Time deposits with maturities over three months	(65)	(560)
Cash and cash equivalents	¥ 12,526	$107,983

4. Marketable Securities and Investment Securities

The aggregate carrying values and market values of marketable securities and investment securities at February 28, 2001 were as follows:

	Millions of yen		Thousands of U.S. dollars	
	Carrying value	Market value	Carrying value	Market value
Marketable securities	¥ —	¥ —	$ —	$ —
Investment securities	3,357	3,527	28,940	30,405
	¥ 3,357	¥ 3,527	$28,940	$30,405

The above table does not include the following marketable securities and investment securities:

	Millions of yen	Thousands of U.S. dollars
Marketable securities:		
Marketable securities in investment trusts	¥ 645	$5,561
Governmental securities fund	300	2,586
Free financial fund	300	2,586
Money management fund	100	862
Investment securities:		
Unlisted securities, excluding over-the-counter shares	¥1,043	$8,991

5. Inventories

Inventories at February 28, 2001 consisted of the following:

	Millions of yen	Thousands of U.S. dollars
Goods and products	¥ 3,479	$ 29,991
Raw materials	493	4,250
Work in process	246	2,121
Supplies	678	5,845
	¥ 4,896	$ 42,207

6. Land Revaluation

As at February 28, 2001, pursuant to the Law of Revaluation of Land and the Revision thereof (the “Law”), certain land for business operations was revalued at fair market value. Due to the revaluation, land was reduced by ¥1,535 million ($13,233 thousand) to ¥11,774 million ($101,500 thousand) as at February 28, 2001, and the related loss was reported in a separate component of stockholders’ equity as “Loss on land revaluation”, net of tax.

7. Derivative Transactions

Status of derivative transactions:

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

Derivative transactions are, depending on materiality, subject to resolution of the Board of Directors or approval by the General Manager of the Finance and Accounting Department and contracted by the Finance and Accounting Department. The actual results of the derivative transactions are reported to the Board of Directors after the end of each year.

Market values of derivative transactions

The Companies had no derivative contracts outstanding at February 28, 2001.

8. Lease Information

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.

The original lease obligations of the Companies amounted to ¥1,327 million ($11,440 thousand) for the year ended February 28, 2001.

Lease payments for finance leases which do not transfer ownership to lessees amounted to ¥288 million ($2,483 thousand) in 2001. Future minimum leases payments, including financing cost, required under such leases at February 28, 2001 are as follows:

	Millions of yen	Thousands of U.S. dollars
Due within one year	¥ 231	$ 1,991
Due after one year	232	2,000
	¥ 463	$ 3,991

9. Short-term Bank Loans and Long-term Debt

Short-term bank loans are represented generally by notes maturing within one year. Annual interest rates at February 28, 2001, ranged from 0.73% to 0.99%.

Long-term debt at February 28, 2001 consisted of the following:

	Millions of yen	Thousands of U.S. dollars
Unsecured long-term bank loans	¥ 1,516	$ 13,069
Secured long-term bank loans	1,462	12,603
	2,978	$ 25,672
Less amounts due within one year	(637)	(5,491)
	¥ 2,341	$ 20,181

The annual interest rates of the bank loans ranged from 0.73% to 3.49% with the weighted average being 1.71% at February 28, 2001.

At February 28, 2001 assets pledged as collateral for short-term bank loans of ¥162 million ($1,396 thousand) and for secured long-term bank loans were as follows:

	Millions of yen	Thousands of U.S. dollars
Buildings and structures	¥ 1,049	$ 9,043
Machinery and equipment	272	2,345
Investment securities	416	3,586
	¥ 1,737	$ 14,974

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

Years ending February 28/29	Millions of yen	Thousands of U.S. dollars
2003	¥ 619	$ 5,336
2004	734	6,328
2005	321	2,767
2006	305	2,629
Thereafter	362	3,121
	¥ 2,341	$ 20,181

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 with warrants that are exercisable at an price per share of ¥957 ($8.250) through June 25, 2001.

	(Millions of yen) Ending balance	Redemption date
Unsecured 1.0% bonds, due 2001 issued with warrants ·····················	¥ 1,250	June 25, 2001

If all the outstanding warrants had been exercised at February 28, 2001, 127 thousand additional shares of common stock would have been issued.

10. Retirement Benefits and Pension Plan

Pension assets and unamortized prior service costs under the contributory funded pension plan established in 1996 amounted to ¥3,462 million ($29,845 thousand) and ¥640 million ($5,517 thousand), respectively, at February 28, 2001.

Pension assets and unamortized prior service costs under the contributory funded pension plan established in 1966 amounted to ¥1,368 million ($11,793 thousand) and ¥338 million ($2,914 thousand), respectively, at February 28, 2001.

Charges to income with respect to the employees' lump-sum retirement benefits plan and the funded pension plans amounted to ¥1,597 million ($13,767 thousand) in 2001. The reversal of reserve for retirement benefits amounted to ¥82 million ($707 thousand) for the year ended February 28, 2001.

Charges to income with respect to directors' and corporate auditors' retirement benefits amounted to ¥66 million ($569 thousand) for the year ended 2001.

Prior service cost for the Company's 1996 pension plan was charged to income when paid. Since the yield on investments of the pension plan was lowered, the Company changed its expected rate from 5.5% to 2,9% from the current year. Additionally prior service cost incurred as a result of this change was stated as 'Prior service cost under the contributory pension plan' in the other income (expense) in the consolidated statements of income.

11. Income Taxes

The Company is subject to a number of taxes based on income, which, in the aggregate, indicate a statutory rate in Japan of approximately 42% for the year ended February 28, 2001.

The following table summarizes the significant differences between the statutory tax rate and the Company's effective tax rate for financial statement purposes for the year ended February 28, 2001:

Statutory tax rate	41.7%
Non-deductible expenses	3.1
Non-taxable dividend income	(0.1)
Per capita inhabitant tax	0.1
Other	(2.6)
Effective tax rate	42.2%

Significant components of the Company's deferred tax assets as of February 28, 2001 are as follows:

	Millions of yen	Thousands of U.S. dollars
Deferred tax assets:		
Retirement benefits	¥ 671	$ 5,784
Valuation loss on investment securities	355	3,060
Directors' and corporate auditors' retirement benefits	321	2,767
Accrued enterprise tax	307	2,647
Long-term accounts payable	276	2,379
Accounts payable	266	2,293
Valuation loss on investment in capital	103	888
Excess employees' bonuses accrued	61	526
Deficit brought forward	153	1,319
Other	136	1,172
Total deferred tax assets	2,649	22,835
Valuation allowance	(91)	(784)
Net deferred tax assets	¥2,558	$22,051

12. Segment Information

The Companies are primarily engaged in the manufacture and sale of pharmaceuticals in Japan and overseas.

(1) Business segment

The operations of the Companies are classified into three business segments, which include 'pharmaceuticals and related products', 'cable television broadcasting' and 'other'.

As more than 90% of the consolidated net sales and operating income for the year ended February 28, 2001 were from the pharmaceuticals and related products segment, the disclosure of business segment information has been omitted.

(2) Geographic area

As more than 90% of the consolidated net sales and operating income for the year ended February 28, 2001 were made in Japan, the disclosure of segment information by geographic area has been omitted.

(3) Overseas sales

As overseas sales for the year ended February 28, 2001 were not more than 10% of the consolidated net sales, the disclosure of overseas sales information has been omitted.

13. 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.

The maximum amount that the Company can distribute as dividends is calculated based on the non-consolidated financial statements of the Company in accordance with the Commercial Code of Japan.

14. Common Stock

(1) Retirement of common stock

In accordance with the resolution of the Board of Directors on February 24, 2000, the Company purchased 605 thousand shares of par value common stock out of profits for a total amount of ¥974 million ($8,396 thousand) from the stock market and retired them by the time of the 2000 annual meeting of stockholders held on May 25, 2000.

(2) Exercise of warrants

As a result of exercise of the outstanding warrants, 127,419 additional shares of common stock were issued during the year ended February 28, 2001.

(3) Stock split

In accordance with the resolution of the Board of Directors on May 25, 2000, the Company made stock split as follows:

Effective date of stock split: August 21, 2000.

Split ratio: Split one share of par value common stock into two shares

As a result of the stock split, 47,523 thousand additional shares of common stock were issued.

15. Contingent Liabilities

Contingent liabilities at February 28, 2001 were as follows:

	Millions of yen	Thousands of U.S. dollars
Notes receivable discounted …………………	¥ 37	$ 319
Guarantee of loans of subsidiaries and affiliates …………………	1,303	11,233
Debt assumption agreement (Note 9) ……	1,250	10,776

16. Subsequent Events

(1) Appropriation of retained earnings

At the 2001 annual meeting of stockholders held on May 24, 2001, the appropriation of retained earnings for the year ended February 28, 2001 was duly approved as follows:

	Millions of yen	Thousands of U.S. dollars
Cash dividends—		
¥7.00 ($0.06) per share	¥ 666	$ 5,741
Bonuses to directors		
and corporate auditors	61	526
Reserve for retirement of common stock	3,000	25,862

(2) Establishment of a new subsidiary

On April 25, 2001, the Company established GenoFunction, Inc., a wholly-owned subsidiary, as follows:

a) Capital: ¥1,200 million ($10,345 thousand)
b) Issued common stock: 24,000 shares of common stock

This subsidiary primarily promotes comprehensive gene discovery using hybrid ribozyme and viral vectors, as well as contract research on gene function analysis.

Report of Independent Certified Public Accountants

To the Stockholders and the Board of Directors of
HISAMITSU PHARMACEUTICAL CO., INC.

We have audited the accompanying consolidated balance sheet of HISAMITSU PHARMACEUTICAL CO., INC. (a Japanese corporation) and subsidiaries as of February 28, 2001, and the related consolidated statements of income, stockholders' equity and cash flows for the year ended February 28, 2001, 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 consolidated financial statements referred to above present fairly the consolidated financial position of HISAMITSU PHARMACEUTICAL CO., INC. and subsidiaries as of February 28, 2001, and the consolidated results of their operations and their cash flows for the year ended February 28, 2001, in conformity with accounting principles generally accepted in Japan.

Also, in our opinion, the U.S. dollar amounts in the accompanying consolidated financial statements have been translated from Japanese yen on the basis set forth in Note 1.

Fukuoka, Japan
May 25, 2001

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 consolidated financial statements and the auditors' report presented above are for users familiar with Japanese accounting principles, auditing standards and their application in practice.