Hisamitsu Pharmaceutical Co., Inc.

FINANCIAL REPORT

Fiscal 2003

Contents

Management Policies

(1) Fundamental Management Policies

Since it was founded, HISAMITSU PHARMACEUTICAL CO., INC. (the Company) has adopted the management philosophy, “Improving Quality of Life (QOL) for People in the World” through creation, manufacture and sale of pharmaceutical products derived from transdermal therapeutic system (TTS) technology, adhering to its motto of “Customers First”.

Under this philosophy, the Company is actively developing corporate activities to satisfy customers both at home and abroad through providing customers with pharmaceutical products properly meeting their needs and is finally exerting itself to maximize its enterprise value.

(2) Fundamental Profit-sharing Policy

The Company, recognizing that profit-sharing to shareholders is the most important task, maintains and continues rewarding shareholders with stable dividends, to which it occasionally adds either commemorative or special dividends, taking into consideration the business results. In addition to this, the Company flexibly takes such financial measures as acquiring treasury stock, which is considered as an effective profit-sharing policy to shareholders.

The Company applies its internal reserves principally for future business development, that is, promoting research and development (R&D), strengthening sales, expanding production facilities and developing overseas business activities.

(3) Target Management Ratio

In order to build up a strong corporate constitution enabling it to attain target sales as well as to ensure profits even under the rapidly changing market circumstances, the Company has settled on a target return on equity (ROE) of not less than 15% in its mid-term plans. The Company is taking every possible means to keep this target.

(4) Mid-term Strategies

In line with the fundamental management policies mentioned above, the Company aims at becoming a “pharmaceutical company oriented toward its own R&D” in its own way, aggressively trying to create new transdermal pharmaceuticals both for topical use and systemic use which properly meet the needs and concerns of medical institutions through TTS studies.

In its mid-term plans, the Company is intending to promote further growth in business, achieving the “target net income of ¥10,000 million ($84,926 thousand)” as well as keeping the “target ROE of not less than 15%”.

In order to build up its future assets, the Company actively tries to increase cash flows from operating activities, promote R & D of new transdermal pharmaceuticals both for topical use and systemic use as well as establish worldwide the Company’s brand including trade marks, designs, manufacturing technology and quality control system.

(5) Measures for Enhancing Corporate Governance

From a viewpoint of separating the functions of managerial decision-making and business execution, as well as intensifying each function, the Company introduced a corporate officer system in March this year. This will enable the Company to open up opportunities for putting the right talented persons in the right places and lead to a subsequent improvement in business performance and value for shareholders.

Aiming to raise the degree of managerial transparency, the Company endeavors to actively open its corporate information to the public and maintain smooth communications with shareholders and investors by means of positive investor relation (IR) activities.

(6) Concept and Policy of Reducing Investment Unit

The Company recognizes that reducing the investment unit may be necessary to expand the class of general investors as well as promote its stock circulation. However, at present, the Company has not yet determined any concrete plan and time for reducing the investment unit.

Review of Operations

(1) Overview of Fiscal 2003 ended February 28, 2003

1-1) Overall Business Performance

The basic Japanese economy throughout fiscal 2003 has assumed an aspect of long-lasting deflation, and it has not yet shown any signs of escaping from these unforeseen circumstances.

In the field of the ethical pharmaceutical industry, the Japanese Government has been implementing, since April 2002, reforms in the medical system such as cuts in the official pharmaceutical reimbursement prices and in medical treatment fees. The industry of over-the-counter (OTC) products also experienced a very severe business environment directly affected by the sluggish domestic economy.

Under these circumstances, with respect to ethical pharmaceuticals, the Company's medical representatives (MR) developed pharmaceutical information activities primarily focusing on the main products, topical analgesic and anti-inflammatory pharmaceuticals, to properly meet the needs of medical institutions.

Regarding OTC products, the Company concentrated on topical analgesic and anti-inflammatory pharmaceuticals to develop sales activities despite the continuing stagnant OTC market reflecting flat personal consumption.

The Company, specializing its R&D activities in TTS studies, strove to create new transdermal pharmaceuticals for topical use and systemic use.

In the production division, the Company constructed a new manufacturing plant in the Tosu site to increase production efficiency and product quality and, additionally, it tried to continuously follow the "ISO 14001" in order to safeguard the global environment.

With respect to the cable television broadcasting and other businesses, the Company and its subsidiaries (the Companies) continuously strove to improve business results rendering good services to customers.

As a result of the above operating activities, consolidated net sales for the Companies totaled ¥70,000 million ($594,480 thousand), a 0.7% increase over the previous year. As for consolidated income, operating income amounted to ¥17,055 million ($144,841 thousand), a 7.1% increase and net income amounted to ¥9,397 million ($79,805 thousand), a 9.2% increase over the previous year. All these figures were record highs for the Companies.

1-2) Business Performance by Segment

(Pharmaceuticals and related products businesses)

During the year under review, pharmaceuticals and related products businesses, especially the ethical pharmaceutical business, faced very difficult circumstances, which have been affected by lively disputes over reforms in the medical system. Despite this backdrop, the Company aggressively developed its pharmaceutical information activities to medical institutions focusing on disseminating and gathering information relating to pharmaceutical safety. Additionally, the Company tried to increase the market shares of its mainstay ketoprofen products consisting of MOHRUS TAPE and MOHRUS, which are transdermal patches and transdermal gel patches, respectively. For this purpose, the Company launched in October of last year a new ketoprofen patch, MOHRUS TAPE L, the size of which is twice as large as the conventional one.

Concerning ESTRANA, an estradiol patch effective for treating menopausal disorders, the Ministry of Health, Labor and Welfare granted the Company permission to expand its application to osteoporosis in April of last year and, since then, the Company has further enhanced its pharmaceutical information activities on ESTRANA to medical institutions.

Although severe competition was also continuing in the domestic market for OTC products, the Company made every effort to increase sales of the main products of SALONPAS through emphasizing the advantage of “Enhanced penetration into the skin by occlusion”, expanding the consumer base.

In order to meet diversifying customers’ needs, the Company aggressively launched onto the OTC market nine new products, which consisted of an analgesic and anti-inflammatory rolled gel patch, SALONSIP MAKIBARI, a medium-sized analgesic and anti-inflammatory patch, SALONPAS 30 CHUBAN, a nasal spray for relieving rhinitis, ALFAST BIEN SPRAY, skin-care products of LIFECELLA BIYOEKI MASK and LIFECELLA KYUTTO NINOUDE, and first-aid pads for lowering fever, DECO-DECO COOL NETSUTORI MAKURA and DECO-DECO COOL BAND TYPE. The two other new products were a new lotion and cream effective for athlete’s foot, BUTENALOCK EKI and BUTENALOCK CREAM, respectively. These switch OTC pharmaceuticals are characterized by initial compounding of butenafine hydrochloride as an active ingredient.

As a result of the above operating activities, net sales in pharmaceuticals and related products businesses amounted to ¥67,536 million ($573,554 thousand), a 0.5% increase over the previous year.

(Cable television broadcasting and other businesses)
With respect to cable television broadcasting (service area: cities of Kurume, Ohkawa and Yanagawa in Fukuoka prefecture and cities of Saga and Tosu in Saga prefecture) and other businesses including production and sale of laboratory animals, the Companies devoted themselves to achieving better results through expanding their market share, offering good services to customers and streamlining the corporate structure.

As a result of the above operating activities, net sales in cable television broadcasting and other businesses amounted to ¥2,464 million ($20,926 thousand), a 6.5% increase over the previous year.

(Dividends)
Considering the business performance for the year under review as well as intending to reward the shareholders’ continued support, the Company paid cash dividends of ¥12.00 ($0.10) per share of common stock, corresponding to an increase of ¥3.00 ($0.03) over the previous year. The dividends consisted of the ordinary one for ¥10.00 ($0.08) and a commemorative one of ¥2.00 ($0.02) for celebrating the 155th anniversary of the foundation of the Company.

(2) Outlook for Fiscal 2004 ending February 28, 2004
(Pharmaceuticals and related products businesses)
With regard to ethical pharmaceuticals, the Government is planning to promote radical reforms in the medical system such as increasing the share of healthcare costs to be paid by patients. It is, therefore, anticipated that the domestic ethical pharmaceutical market would considerably shrink, depending on the trend of further reforms in the pharmaceutical reimbursement prices under the national health insurance system.

Despite these unprecedented serious circumstances, the Company will continue aggressively developing pharmaceutical information activities to medical institutions and challenging the creation of new transdermal pharmaceuticals for topical use and systemic use to exactly meet medical needs as well as patients' needs.

The domestic OTC market has long been in a slump, which makes sales competition among companies more and more acute. The Company is intending to increase sales of main OTC products such as topical analgesic and anti-inflammatory pharmaceuticals and improve consistently the existing OTC products as well as develop new OTC products properly meeting the needs and concerns of its customers.

Additionally, the Company is actively developing overseas business activities in order to establish worldwide the Company's brands including trade marks, designs, manufacturing technology and quality control system, to further strengthen the overseas manufacturing plants and to promote the overseas clinical trials of the Company's pharmaceutical products.

(Cable television broadcasting and other businesses)
The Companies are striving to further enhance sales activities in cable television broadcasting and other businesses, including production and sale of laboratory animals, to achieve better results.

(Outlook for consolidated results)
The Companies, being fully aware of their responsibility for corporate citizenship, will devote themselves to improve their business performance through strengthening of sales, expanding the production system and specializing of R & D activities in TTS studies to accelerate quicker launching of new pharmaceutical products onto the market. In addition to this, the Companies will strive to streamline their management and build up their corporate constitution.

Regarding the consolidated results of operations for the next year ending February 28, 2004, the Companies are expecting that net sales will increase to approximately ¥74,000 million ($616,667 thousand), a 5.7% increase over the previous year, but ordinary income will decrease slightly to ¥17,000 million yen ($141,667 thousand), a 1.4% decrease from the previous year, and that net income will increase to ¥9,700 million ($80,833 thousand), a 3.2% increase over the previous year. In these projections, U. S. dollar amounts are calculated, assuming US$1.00=¥120,00 for the next year.

However, it must be noted that these projections are made according to the Companies' judgments based on the information available at the present time and include latent risks and uncertainties. Actual results, therefore, could significantly differ from the projections.

(Dividends)
With regard to cash dividends for the next year ending February 28, 2004, the Company is planning to reward shareholders with a dividend of ¥14.00 ($0.12) per share of common stock, which corresponds to an increase of ¥2.00 ($0.02) per share over the previous year.

Financial Review

The consolidated financial statements include the accounts of the Company and its eleven (12 in 2002 and 10 in 2001) significant subsidiaries. Investments in two affiliated companies are accounted for using the equity method.

(1) Results of Operations

Overall Operating Activities

With respect to ethical pharmaceuticals, the Company actively developed pharmaceutical information activities meeting the diversifying healthcare needs of medical institutions, centering on its core products, such as analgesic and anti-inflammatory pharmaceuticals for topical use. Of these products, the Company aggressively disseminated and gathered product information about both ketoprofen patch MOHRUS TAPE and ketoprofen gel patch MOHRUS, in order to enable them to steadily introduce them into medical institutions.

Although the OTC market has been very stagnant throughout fiscal 2003, the Company strove to principally promote the sale of analgesic and anti-inflammatory patches for topical use, SALONPAS. During the year, in order to keep up with diversifying customers' needs, the Company successfully launched nine new products. Of these new products, BUTENALOCK EKI and BUTENALOCK CREAM are a lotion and cream effective for athlete's foot. These switch OTC pharmaceuticals are characterized by initial compounding of butenafine hydrochloride as an active ingredient.

The Companies continued to aggressively promote the cable television broadcasting and other businesses including production and sale of laboratory animals to expand the market. Additionally, the Companies pushed forward with the streamlining of management to improve business results.

Net Sales

As a result of the above operating activities, the consolidated net sales for the Companies totaled ¥70,000 million ($594,480 thousand), a 0.7% increase over the previous year. This primarily reflects the slightly increased sales in the pharmaceuticals and related products businesses.

Costs and Expenses

Cost of sales amounted to ¥21,175 million ($179,830 thousand), a 2.2% increase over the previous year, rendering the cost of sales as a percentage of net sales at 30.3%. Selling, general and administrative expenses totaled ¥25,219 million ($214,174 thousand), a 5.3% decrease from the previous year. In contrast, R & D expenses increased 4.4% to ¥6,551 million ($55,635 thousand) with the ratio of R & D expenses to net sales at 9.4%.

Operating income was ¥17,055 million ($144,841 thousand), a 7.1% increase, which was obtained by deducting costs and expenses from net sales, yielding the ratio of operating income to net sales of 24.4%.

Other expenses, net of other income, soared to ¥461 million ($3,915 thousand), a 78.7% increase over the previous year.

Net Income
Income before income taxes was ¥16,594 million ($140,926 thousand), a 5.9% increase over the previous year, and net income rose to ¥9,397 million ($79,805 thousand), a 9.2% increase, which was obtained by deducting current income taxes, deferred income taxes and minority interests in net income of consolidated subsidiaries.

The effective tax rate was calculated at 42.6%. Net income per share of common stock was ¥101.28 ($0.86), a 10.1% increase and the Company paid its shareholders cash dividends per share of ¥12.00 ($0.10).

(2) Financial Position
At February 28, 2003, total assets amounted to ¥89,379 million ($759,058 thousand), a 7.8% increase over the previous year. Total current assets amounted to ¥41,413 million ($351,703 thousand), a 10.7% increase, principally reflecting increases in cash and time deposits and in short-term investments.

Property, plant and equipment, less accumulated depreciation, rose to ¥37,164 million ($315,618 thousand), a 9.4% increase, primarily reflecting increases in buildings and structures and machinery and equipment. Intangible assets declined to ¥469 million ($3,983 thousand), a 25.0% decrease.

Investments and other non-current assets fell to ¥10,333 million ($87,754 thousand), a 5.0% decrease, principally resulting from markedly decreased investment securities.

Total current liabilities amounted to ¥21,596 million ($183,405 thousand), a 7.7% increase, principally coming from a marked increase in income taxes payable. Working capital grew to ¥19,817 million ($168,297 thousand), a 14.0% increase and the current ratio slightly increased to 191.8%, compared to previous year of 186.7%.

Total long-term liabilities were ¥7,076 million ($60,095 thousand), a 2.7% increase over the previous year. Minority interests were ¥476 million ($4,042 thousand), which was approximately the same as the previous year.

Total shareholders' equity rose to ¥60,231 million ($511,516 thousand), a 8.6% increase. This is primarily due to a marked increase in retained earnings, which far exceeded a marked increase in treasury stock.

(3) Cash Flows
Operating activities generated net cash of ¥14,740 million ($125,180 thousand), a 12.7% increase over the previous year, principally reflecting a marked decrease in income taxes paid despite increases in notes and accounts receivable and in inventories.

Investing activities used net cash of ¥9,194 million ($78,081 thousand), a 39.5% increase over the previous year, primarily reflecting marked increases in payments for purchases of property, plant and equipment and in payment for purchase for marketable securities. Major capital investments were made for the construction of a new manufacturing plant in the Tosu site as well as a plant specific for preparing new pharmaceutical candidates for clinical trials in the R & D center.

Financing activities consumed net cash of ¥4,544 million ($38,590 thousand), a 17.8% decrease from the previous year, primarily resulting from decreased repayment of short-term bank loans despite increased payment for purchase of treasury stock.

As a result, cash and cash equivalents at end of year totaled ¥14,307 million ($121,502 thousand), an increase of ¥747 million ($6,343), compared to cash and cash equivalents at beginning of year.

Consolidated Balance Sheets

HISAMITSU PHARMACEUTICAL CO., INC.
February 28, 2003 and 2002

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2002	2003
ASSETS			
Current assets:			
Cash and time deposits (Note 3)	¥ 14,341	¥ 12,882	$ 121,792
Notes and accounts receivable:			
Trade notes (Note 15)	3,532	3,106	29,996
Trade accounts	13,970	14,219	118,641
Short-term investments (Note 4)	2,048	877	17,393
Inventories (Note 5)	5,195	4,574	44,119
Deferred tax assets (Note 11)	726	308	6,165
Other current assets	1,729	1,489	14,684
Less allowance for doubtful accounts	(128)	(31)	(1,087)
Total current assets	41,413	37,424	351,703
Property, plant and equipment:			
Land (Note 6)	11,366	11,398	96,527
Buildings and structures (Note 9)	25,830	22,002	219,363
Machinery and equipment (Note 9)	18,706	15,719	158,862
Tools, furniture and fixtures	10,167	9,657	86,344
Construction in progress	2,513	3,816	21,342
	68,582	62,592	582,438
Less accumulated depreciation	(31,418)	(28,630)	(266,820)
	37,164	33,962	315,618
Intangible assets	469	625	3,983
Investments and other non-current assets:			
Investment securities (Notes 4 and 9)	5,319	6,384	45,172
Investment in non-consolidated subsidiaries and affiliated companies (Note 4)	694	712	5,894
Deferred tax assets (Note 11)	2,598	2,103	22,064
Other investments and other non-current assets	2,240	1,887	19,023
Less allowance for doubtful accounts	(518)	(204)	(4,399)
	10,333	10,882	87,754
	¥ 89,379	¥ 82,893	$ 759,058

See accompanying notes.

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2002	2003
LIABILITIES, MINORITY INTEREST AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Short-term bank loans (Note 9)	¥ 339	¥ 347	$ 2,879
Long-term debt due within one year (Note 9)	351	1,227	2,981
Notes and accounts payable:			
Trade	7,706	8,356	65,444
Construction	248	506	2,106
Other	6,003	7,169	50,981
Income taxes payable (Note 11)	5,675	1,227	48,195
Reserve for sales returns	199	197	1,690
Reserve for employees' bonuses	499	481	4,237
Other current liabilities	576	538	4,892
Total current liabilities	21,596	20,048	183,405
Long-term liabilities:			
Long-term debt due after one year (Note 9)	1,613	1,353	13,699
Deferred tax liabilities relating to land revaluation (Note 6)	1,955	1,955	16,603
Severance and retirement benefits (Note 10)	2,584	2,711	21,945
Directors' and corporate auditors' retirement benefits	866	804	7,355
Other non-current liabilities	58	67	493
Total long-term liabilities	7,076	6,890	60,095
Contingent liabilities (Note 15)			
Minority interests	476	481	4,042
Shareholders' equity (Notes 13 and 14):			
Common stock:			
Authorized—380,000,000 shares			
Issued—95,164,895 shares in 2003	8,474	—	71,966
—95,164,895 shares in 2002	—	8,474	—
Capital surplus	8,242	8,242	69,996
Retained earnings	47,470	38,976	403,142
Land revaluation difference (Note 6)	2,729	2,729	23,176
Net unrealized holding losses on securities	(390)	(43)	(3,312)
Foreign currency translation adjustments	(756)	(361)	(6,420)
Treasury stock, at cost			
3,100,330 shares in 2003	(5,538)	—	(47,032)
1,006,596 shares in 2002	—	(2,543)	—
Total shareholders' equity	60,231	55,474	511,516
	¥ 89,379	¥ 82,893	$759,058

Consolidated Statements of Income

HISAMITSU PHARMACEUTICAL CO., INC.
Years ended February 28, 2003, 2002 and 2001

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2003	2002	2001	2003
Net sales	¥ 70,000	¥ 69,538	¥ 65,240	$ 594,480
Costs and expenses:				
Cost of sales	21,175	20,710	20,068	179,830
Selling, general and administrative expenses	25,219	26,635	25,746	214,174
Research and development	6,551	6,272	5,435	55,635
	52,945	53,617	51,249	449,639
Operating income	17,055	15,921	13,991	144,841
Other income (expense):				
Interest and dividend income	184	149	103	1,563
Interest expense	(183)	(77)	(173)	(1,554)
Equity in earnings of affiliated companies	72	47	50	611
Gain on sales of property, plant and equipment	—	267	2	—
Gain on sales of investment securities	—	—	8	—
Foreign exchange gain (loss)	(166)	29	(27)	(1,409)
Reversal of allowance for doubtful accounts	—	60	—	—
Transition obligation for employees' retirement benefits	—	318	—	—
Governmental subsidy	445	38	159	3,779
Loss on sales and disposals of property, plant and equipment	(488)	(502)	(202)	(4,144)
Write-down of investment securities	(560)	(434)	(274)	(4,756)
Write-down of golf-club memberships	—	(464)	(168)	—
Prior service cost under the contributory pension plan	—	—	(2,032)	—
Provision for allowance for doubtful accounts	(42)	(156)	—	(357)
Other—net	277	467	542	2,352
	(461)	(258)	(2,012)	(3,915)
Income before income taxes	16,594	15,663	11,979	140,926
Income taxes (Note 11):				
Current	7,740	4,216	5,771	65,732
Deferred	(664)	2,774	(718)	(5,639)
Minority interests in net income of consolidated subsidiaries	121	66	138	1,028
Net income	¥ 9,397	¥ 8,607	¥ 6,788	$ 79,805

	Yen			U.S. dollars (Note 1)
	2003	2002	2001	2003
Amounts per share of common stock (Note 2):				
Net income	¥ 101.28	¥ 91.99	¥ 72.82	$ 0.86
Diluted net income	101.28	91.99	72.70	0.86
Cash dividends applicable to the year	12.00	9.00	7.00	0.10

See accompanying notes.

Consolidated Statements of Shareholders' Equity

HISAMITSU PHARMACEUTICAL CO., INC.
Years ended February 28, 2003, 2002 and 2001

	Million of yen			Thousands of U.S. dollars (Note 1)
	2003	2002	2001	2003
Common stock:				
Balance at beginning of year	**¥ 8,474**	¥ 8,460	¥ 8,414	**$ 71,966**
Shares issued upon exercise of warrants (Note 14)	**—**	14 46	—	
Balance at end of year	**¥ 8,474**	¥ 8,474	¥ 8,460	**$ 71,966**
Capital surplus:				
Balance at beginning of year	**¥ 8,242**	¥ 8,227	¥ 8,175	**$ 69,996**
Shares issued upon exercise of warrants (Note 14)	**—**	15	52	**—**
Balance at end of year	**¥ 8,242**	¥ 8,242	¥ 8,227	**$ 69,996**
Retained earnings:				
Balance at beginning of year	**¥ 38,976**	¥ 34,719	¥ 27,662	**$ 331,006**
Net income	**9,397**	8,607	6,788	**79,805**
Cumulative effect of adopting tax effect accounting	**—**	—	1,783	**—**
Cash dividends paid	**(847)**	(666)	(481)	**(7,193)**
Bonuses to directors and corporate auditors	**(56)**	(61)	(59)	**(476)**
Retirement of common stock (Note 14)	**—**	—	(974)	**—**
Land revaluation adjustment (Note 6)	**—**	(3,623)	—	**—**
Balance at end of year	**¥ 47,470**	¥ 38,976	¥ 34,719	**$ 403,142**
Land revaluation difference:				
Balance at beginning of year	**¥ 2,729**	¥ (894)	¥ —	**$ 23,176**
Land revaluation, net of tax (Note 6)	**—**	3,623	(894)	**—**
Balance at end of year	**¥ 2,729**	¥ 2,729	¥ (894)	**$ 23,176**
Net unrealized holding losses on securities:				
Balance at beginning of year	**¥ (43)**	¥ —	¥ —	**$ (365)**
Valuation losses	**(347)**	(43)	—	**(2,947)**
Balance at end of year	**¥ (390)**	¥ (43)	¥ —	**$ (3,312)**
Foreign currency translation adjustments:				
Balance at beginning of year	**¥ (361)**	¥ (468)	¥ (478)	**$ (3,066)**
Adjustments from translation of foreign currency financial statements	**(395)**	107	10	**(3,354)**
Balance at end of year	**¥ (756)**	¥ (361)	¥ (468)	**$ (6,420)**
Treasury stock:				
Balance at beginning of year	**¥ (1,683)**	¥ (2)	¥ (1)	**$ (14,293)**
Treasury stock purchased	**(3,855)**	(1,681)	(1)	**(32,739)**
Balance at end of year	**¥ (5,538)**	¥ (1,683)	¥ (2)	**$ (47,032)**
Common stock purchased by a subsidiary:				
Balance at beginning of year	**¥ —**	¥ (860)	¥ (736)	**$ —**
Common stock purchased by a subsidiary	**—**	—	(124)	**—**
Balance at end of year	**¥ —**	¥ (860)	¥ (860)	**$ —**

	2003	2002	2001
Number of shares of common stock:			
Balance at beginning of year	**95,164,895**	95,108,490	48,063,166
Retirement of common stock (Note 14)	**—**	—	(605,000)
Shares issued upon exercise of warrants (Note 14)	**—**	56,405	127,419
Stock split (Note 14)	**—**	—	47,522,905
Balance at end of year	**95,164,895**	95,164,895	95,108,490

See accompanying notes.

Consolidated Statements of Cash Flows

HISAMITSU PHARMACEUTICAL CO., INC.
Years ended February 28, 2003, 2002 and 2001

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2003	2002	2001	2003
Cash flows from operating activities:				
Income before income taxes	¥ 16,594	¥ 15,663	¥ 11,979	$ 140,926
Adjustments to reconcile net income before taxes to net cash provided by operating activities:				
Depreciation and amortization	3,128	2,754	2,851	26,565
Increase (decrease) in allowance for severance and retirement benefits	(128)	2,711	—	(1,087)
Increase (decrease) in retirement benefits	—	(2,359)	53	—
Interest and dividend income	(184)	(149)	(103)	(1,563)
Interest expense	183	77	173	1,554
Equity in earnings of affiliated companies	(72)	(47)	(50)	(611)
Write-down of investment securities	560	434	274	4,756
Write-down of golf-club memberships	—	464	168	—
Loss on sales and disposal of property, plant and equipment	488	502	202	4,144
(Increase) decrease in notes and accounts receivable	(93)	1,259	471	(790)
(Increase) decrease in inventories	(676)	358	(727)	(5,741)
Increase in other current assets	(248)	(365)	(337)	(2,106)
Increase (decrease) in notes and accounts payable	(511)	(559)	1,926	(4,340)
Bonuses to directors and corporate auditors	(56)	(61)	(59)	(476)
Other	(959)	(1,310)	630	(8,144)
Subtotal	18,026	19,372	17,451	153,087
Interest and dividend income received	186	181	102	1,580
Interest paid	(184)	(80)	(172)	(1,563)
Income taxes paid	(3,288)	(6,395)	(5,101)	(27,924)
Net cash provided by operating activities	14,740	13,078	12,280	125,180
Cash flows from investing activities:				
Payments for purchases of property, plant and equipment	(7,263)	(4,481)	(3,597)	(61,682)
Proceeds from sales of property, plant and equipment	47	1,760	81	399
Payments for purchases of intangible assets	(47)	(528)	(186)	(399)
Payments for purchases of marketable securities	(6,168)	(3,400)	(3,300)	(52,382)
Proceeds from sales of marketable securities	6,168	3,300	3,359	52,382
Payments for purchases of investment securities	(2,061)	(3,168)	(1,350)	(17,503)
Other	130	(72)	(137)	1,104
Net cash used in investing activities	(9,194)	(6,589)	(5,130)	(78,081)
Cash flows from financing activities:				
Net increase (decrease) in bank loans	5	(2,650)	2,586	42
Proceeds from long-term debt	868	173	—	7,372
Repayment of long-term debt	(1,450)	(749)	(2,607)	(12,314)
Proceeds from exercise of warrants	—	32	98	—
Payment for purchase of treasury stock	(3,214)	(1,728)	(1,162)	(27,295)
Proceeds from sales of treasury stock	—	61	183	—
Cash dividends paid	(847)	(666)	(481)	(7,193)
Other	94	—	(124)	798
Net cash used in financing activities	(4,544)	(5,527)	(1,507)	(38,590)
Effect of exchange rate changes on cash and cash equivalents	(255)	72	42	(2,166)
Net increase in cash and cash equivalents	747	1,034	5,685	6,343
Cash and cash equivalents at beginning of year	13,560	12,526	6,841	115,159
Cash and cash equivalents at end of year (Note 3)	¥ 14,307	¥ 13,560	¥ 12,526	$ 121,502

See accompanying notes.

Notes to Consolidated Financial Statements

HISAMITSU PHARMACEUTICAL CO., INC.
Years ended February 28, 2003, 2002 and 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 (the "Code") and the Securities and Exchange Law and in conformity with accounting principles and practices generally accepted in Japan ("Japanese GAAP"). The accounts of overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles and practices prevailing in the respective countries of domicile. Certain accounting principles and practices generally accepted in Japan are different from International Accounting Standards and standards in other countries in certain respects as to application and disclosure requirements. Accordingly, the accompanying consolidated financial statements are intended for use by those who are informed about Japanese accounting principles and practices.

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 filed with the Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law.

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 readers, using the prevailing exchange rate at February 28, 2003, which was ￥117.75 to US$1.00. 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. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements for the years ended February 28, 2003, 2002 and 2001 include the accounts of the Company and its eleven (12 in 2002 and 10 in 2001) significant subsidiaries (the "Companies"). All significant intercompany balances, transactions and profits have been eliminated.

The Company is required to consolidate all significant investees which are controlled through ownership of a majority of voting rights or the existence of certain other conditions.

The foreign subsidiaries are consolidated based on their financial statements for their fiscal year ended December 31, because the difference between the closing date of the subsidiaries and that of the Company does not exceed three months. Significant transactions occurring between December 31 and February 28 are adjusted on consolidation.

In the elimination of investments in subsidiaries, the assets and liabilities of the subsidiaries, including the portion attributable to minority shareholders, are evaluated using the 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, unconsolidated 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 the cost of an investment and equity in its net assets at the date of acquisition is charged or credited to income in the year of acquisition.

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

Short-term Investments and Investment Securities
Prior to March 1, 2001, marketable equity securities included in both current assets and investments were stated at cost. Cost was determined by the moving average method. Other securities were also stated at cost. If a decline in value below cost of an individual security was judged to be material and other than temporary, the carrying value was written down.

Effective March 1, 2001, the Companies adopted the new Japanese accounting standard for financial instruments, "Opinion Concerning Establishment of Accounting Standard for Financial Instruments", issued by the Business Accounting Deliberation Council on January 22, 1999).

Upon applying the new accounting standard, all companies are required to examine the intent of holding each security and classify those securities as (a) securities held for trading purposes (hereinafter, "trading securities"), (b) debt securities intended to be held to maturity (hereinafter, "held-to-maturity debt securities"), (c) equity securities issued by subsidiaries and affiliated companies, and (d) all other securities that are not classified in any of the above categories (hereinafter, "available-for-sale securities").

Trading securities are stated at fair market value. Gains and losses realized on disposal and unrealized gains and losses from market value fluctuations are recognized as gains and losses in the period of the change.

Held-to-maturity debt securities are stated at amortized cost. Equity securities issued by subsidiaries and affiliated companies which are not consolidated or accounted for using the equity method are stated at moving average cost.

Available-for-sale securities with available fair market values are stated at fair market value at the year-end. Unrealized gains and unrealized losses on these securities are reported, net of applicable income taxes, as a separate component of shareholders' equity. Realized gains and losses on sale of such securities are computed using moving average cost.

Debt securities with no available fair value are stated at amortized cost, net of the amount considered not collectible. Other securities with no fair market value are stated principally at moving average cost.

If the market value of held-to-maturity debt securities, equity securities issued by unconsolidated subsidiaries and affiliated companies, and available-for-sale securities declines significantly, such securities are stated at fair market value and the difference between fair market value and the carrying amount is recognized as loss in the period of the decline. If the fair market value of equity securities issued by unconsolidated subsidiaries and affiliated companies not on the equity method is not readily available, such securities should be written down to net asset value with a corresponding charge in the income statement in the event net asset value declines significantly. In these cases, such fair market value or the net asset value will be the carrying amount of the securities at the beginning of the next year.

Based on the examination of the intent of holding each security upon application of the new accounting standard at March 1, 2001, trading securities as well as held-to-maturity debt securities and available-for-sale securities maturing within one year from the balance sheet date are included in current assets, and other securities are included in investments and other non-current assets. As a result, at February 28, 2002 investment securities decreased by ¥73 million compared with what would have been reported under the previous accounting policy.

As a result of adopting the new accounting standard for financial instruments, including the effects on securities, the allowance for doubtful accounts, discounted trade notes and the revaluation of golf-club memberships, income before income taxes decreased by ¥555 million for the year ended February 28, 2002.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is provided in amounts sufficient to cover possible losses on collection. In prior years it was 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.

Effective for the year ended February 28, 2002, the Companies adopted a new accounting policy for 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 based on the percentage of the Companies' past doubtful debt loss against the balance of total 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 Law 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 Law of Japan, except that the amortization of internally used software is determined using the straight line method over the estimated useful life of five years.

Income Taxes
The Companies provided income taxes at the amounts currently payable for the year ended February 28, 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. Under the new accounting standard, the provision for income taxes is computed based on the pre-tax income included in the statements of income.

The asset 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 Companies provided the reserve for employees' bonuses in the portion of estimated future payments applicable to the current year.

Severance and Retirement Benefits
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. Prior to March 1, 2001 the liability for lump-sum payments was 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. Prior to March 1, 2001 the portion of the liability for the unfunded lump-sum benefit plan, which was no longer required due to the introduction of this plan, was 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.

Prior to March 1, 2001 both prior service costs for the 1996 pension plan and the 1966 pension plan were expensed when incurred.

Effective March 1, 2001, the Companies adopted the new accounting standard for employees' severance and retirement benefits, "Opinion on Setting Accounting Standard for Employees' Severance and Pension Benefits", issued by the Business Accounting Deliberation Council on June 16, 1998.

Under the new accounting standard, the liabilities and expenses for severance and retirement benefits are determined based on the amounts actuarially calculated using certain assumptions.

The Companies provided for employees' severance and retirement benefits at February 28, 2003 and 2002 based on the estimated amounts of projected benefit obligation and the fair value of the plan assets at those dates.

The excess of the total of the fair value of pension assets as of March 1, 2001 and the liabilities for severance and retirement benefits recorded as of March 1, 2001 over the projected benefit obligation (the "net transition gain") amounted to ¥318 million. All of the net transition gain was recognized as other income in the year ended February 28, 2002. Prior service costs are amortized in equal amounts principally over two years commencing from the date of change. Actuarial gains and losses are recognized as income or expense in equal amounts principally over five years commencing from the succeeding period.

As a result of the adoption of the new accounting standard, in the year ended February 28, 2002, severance and retirement benefit expenses decreased by ¥20 million Since the net transition gain of ¥318 million was included in other income, income before income taxes increased by ¥338 million compared with what would have been recorded under the previous accounting standard.

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 Japanese GAAP.

Foreign Currency Translation

Short-term receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rates at the balance sheet date. Prior to March 1, 2001, long-term receivables and payables denominated in foreign currencies were translated at historical exchange rates.

Effective March 1, 2001, the Companies adopted the revised accounting standard for foreign currency translation, "Opinion Concerning Revision of Accounting Standard for Foreign Currency Translation", issued by the Business Accounting Deliberation Council on October 22, 1999.

Under the revised accounting standard, long-term receivables and payables denominated in foreign currencies are also translated into Japanese yen at the year-end rate. The effect of adopting the revised accounting standard on the consolidated statement of income was not material.

Financial statements of consolidated overseas subsidiaries are translated into Japanese yen at the year-end rate, except that shareholders' equity accounts are translated at historical rates and income statement items resulting from transactions with the Company at the rates used by the Company.

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 dilutive warrants and stock split at the beginning of the year.

Treasury stock and reversal of statutory reserves
Effective March 1, 2002, the Company adopted the new accounting standard for treasury stock and reversal of statutory reserves (Accounting Standards Board Statement No. 1, "Accounting Standard for Treasury Stock and Reversal of Statutory Reserves", issued by the Accounting Standards Board of Japan on February 21, 2002). The effect of adopting the new accounting standard on the consolidated statement of income was not material.

Reclassifications
Certain reclassifications have been made in the 2002 and 2001 financial statements to conform to the presentation for 2003.

3. Cash and Cash Equivalents

Cash and cash equivalents at February 28, 2003, 2002 and 2001 for the consolidated statement of cash flows consisted of the following:

	Millions of yen			Thousands of U.S. dollars
	2003	2002	2001	**2003**
Cash and time deposits	**¥14,341**	¥12,882	¥11,246	**$121,792**
Add: Short-term highly liquid investments with maturities of not exceeding three months	**2,048**	877	1,345	**17,393**
Less: Time deposits with maturities exceeding three months	**(81)**	(99)	(65)	**(688)**
Securities excluding free financial fund and money management fund	**(2,001)**	(100)	—	**(16,995)**
Cash and cash equivalents	**¥14,307**	¥13,560	¥12,526	**$121,502**

4. Short-term Investments and Investment Securities

A. The following tables summarize acquisition costs, book values and fair values of securities with available fair values as of February 28, 2003 and 2002.

(a) Held-to-maturity debt securities

	Millions of yen		Thousands of U.S. dollars
	2003	2002	2003
Securities with available fair values exceeding book values:			
Government bonds:			
Book value	¥ 2,450	¥ 751	$ 20,807
Fair value	2,450	751	20,807
Difference	—	—	—

	Millions of yen		Thousands of U.S. dollars
	2003	2002	2003
Securities with available fair values not exceeding book values:			
Government bonds:			
Book value	¥ —	¥ 1,800	$ —
Fair value	—	1,799	—
Difference	—	(1)	—

(b) Available-for-sale securities

Securities with book values (fair values) exceeding acquisition costs:

	Millions of yen 2003		
	Acquisition cost	Book value	Difference
Equity securities	¥ 1,415	¥ 1,749	¥ 334

	Millions of yen 2002		
	Acquisition cost	Book value	Difference
Equity securities	¥ 1,155	¥ 1,626	¥ 471

	Thousands of U.S. dollars 2003		
	Acquisition cost	Book value	Difference
Equity securities	$ 12,018	$ 14,854	$ 2,836

Securities with book values (fair values) not exceeding acquisition costs:

	Millions of yen 2003		
	Acquisition cost	Book value	Difference
Equity securities	¥ 3,729	¥ 2,726	¥ (1,003)

	Millions of yen		
	2002		
	Acquisition cost	Book value	Difference
Equity securities	¥ 2,457	¥ 1,921	¥ (536)

	Thousands of U.S. dollars		
	2003		
	Acquisition cost	Book value	Difference
Equity securities	$ 31,669	$ 23,151	$ (8,518)

B. The following tables summarize book values of securities with no available fair values as of February 28, 2003 and 2002.

(a) Available-for-sale securities:

	Millions of yen		Thousands of U.S. dollars
	2003	2002	2003
Non-listed equity securities (excluding securities traded over-the-counter)	¥ 394	¥ 1,098	$ 3,348
Free financial fund	—	240	—
Money management fund	—	501	—
Total	¥ 394	¥ 1,839	$ 3,348

(b) Equity securities of subsidiaries and affiliated companies:

	Millions of yen		Thousands of U.S. dollars
	2003	2002	2003
Subsidiaries	¥ 411	¥ 445	$ 3,490
Affiliated companies	283	267	2,404
Total	¥ 694	¥ 712	$ 5,894

C. Maturities of held-to-maturity debt securities at February 28, 2003 and 2002 are as follows:

	Millions of yen		
	2003		
	Within one year	Over one year but within five years	Total
Government bonds	¥ 2,001	¥ 449	¥ 2,450

	Millions of yen		
	2002		
	Within one year	Over one year but within five years	Total
Government bonds	¥ 100	¥ 2,450	¥ 2,550

	Thousands of U.S. dollars		
	2003		
	Within one year	Over one year but within five years	Total
Government bonds	$ 16,991	$ 3,816	$ 20,807

5. Inventories

Inventories at February 28, 2003 and 2002 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2003	2002	2003
Goods and products	¥ 3,661	¥ 3,318	$ 31,092
Raw materials	623	453	5,291
Work in process	363	258	3,083
Supplies	548	545	4,653
	¥ 5,195	¥ 4,574	$ 44,119

6. Land Revaluation

As at February 28, 2001, pursuant to the Law of Revaluation of Land and the revision thereof, certain land for business operations was revalued at fair market value. The related gain (loss) was reported in a separate component of shareholders' equity as "Land revaluation difference", net of tax.

The total market value of the revalued land at February 28, 2003 was lower than the total book value after revaluation, in the amount of ¥1,044 million ($8,866 thousand).

7. Derivative Transactions

Use of derivative transactions:
The Companies utilize forward currency exchange and interest rate swap transactions to control risks related to foreign currencies and interest 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 their 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, 2003 and 2002.

8. Lease Information

Finance leases which do not transfer ownership to lessees are accounted for in the same manner as operating leases in accordance with Japanese GAAP.

The original lease obligations of the Companies for machinery, equipment, tools, furniture, fixtures and software amounted to ¥1,595 million ($13,545 thousand) and ¥1,276 million at February 28, 2003 and 2002, respectively.

Lease payments for finance leases which do not transfer ownership to lessees amounted to ¥336 million ($2,853 thousand), ¥354 million and ¥288 million for the years ended February 28, 2003, 2002 and 2001, respectively.

Future minimum leases payments, including financing cost, required under such leases at February 28, 2003 and 2002 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2003	2002	2003
Due within one year	¥ 333	¥ 290	$ 2,827
Due after one year	518	523	4,396
	¥ 851	¥ 813	$ 7,223

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

Short-term bank loans are represented generally by notes maturing within one year. The average annual interest rate at February 28, 2003 was 0.95%.

Long-term debt at February 28, 2003 and 2002 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2003	2002	2003
Unsecured long-term bank loans	¥ 264	¥ 1,532	$ 2,242
Secured long-term bank loans	1,700	1,048	14,438
	1,964	2,580	16,680
Less amounts due within one year	(351)	(1,227)	(2,981)
	¥ 1,613	¥ 1,353	$ 13,699

The annual interest rates of the bank loans ranged from 0.0% to 4.92% and from 0.19% to 4.50% with the weighted average being 1.17% and 1.31% at February 28, 2003 and 2002, respectively.

At February 28, 2003 and 2002, assets pledged as collateral for short-term bank loans including long-term debt due within one year of ¥224 million ($1,902 thousand) and secured long-term bank loans were as follows:

	Millions of yen		Thousands of U.S. dollars
	2003	2002	2003
Buildings and structures	¥ 921	¥ 477	$ 7,820
Machinery and equipment	295	748	2,510
Investment securities	1,033	416	8,773
	¥ 2,249	¥ 1,641	$ 19,103

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

Years ending February 28/29	Millions of yen	Thousands of U.S. dollars
2005	¥ 358	$ 3,040
2006	515	4,374
2007	185	1,571
2008	160	1,359
Thereafter	395	3,355
	¥ 1,613	$ 13,699

10. Severance and Retirement Benefits

As explained in Note 2. Summary of Significant Accounting Policies, effective March 1, 2001, the Companies adopted the new accounting standard for employees' severance and retirement benefits, under which the liabilities and expenses for severance and retirement benefits are determined based on the amounts obtained by actuarial calculations.

The liabilities for severance and retirement benefits included in the liability section of the consolidated balance sheet as of February 28, 2003 and 2002 consisted of the following.

	Millions of yen		Thousands of U.S. dollars
	2003	2002	2003
Projected benefit obligation	¥(10,062)	¥ (8,697)	$(85,452)
Unrecognized prior service cost	—	(117)	—
Fair value of pension assets	5,536	5,559	47,015
Unrecognized actuarial differences	2,498	725	21,214
Accrued pension cost	(556)	(181)	(4,722)
Liability for severance and retirement benefits	¥ (2,584)	¥ (2,711)	$ (21,945)

Included in the consolidated statement of income for the years ended February 28, 2003 and 2002 are severance and retirement benefit expenses comprising the following:

	Millions of yen		Thousands of U.S. dollars
	2003	2002	2003
Severance costs—			
benefits earned during the year	¥ 590	¥ 598	$ 5,013
Interest cost on projected benefit obligation	216	203	1,833
Expected return on plan assets	(153)	(133)	(1,302)
Net transition gain	—	(318)	—
Recognized actuarial differences	145	—	1,232
Adjustment to prior service costs	(117)	(117)	(992)
Severance and retirement benefit expenses	¥ 681	¥ 233	$ 5,784

The discount rates used were 2.00% in 2003 and 2.50% in 2002. The rates of expected return on plan assets used by the Company are 2.90% for the 1996 pension plan and 2.30% for the 1966 pension plan. The estimated amount of all retirement benefits to be paid at future retirement dates is allocated equally to each service year using the estimated number of total service years.

Charges to income with respect to directors' and corporate auditors' retirement benefits amounted to ¥62 million ($526 thousand) and ¥55 million for the years ended February 28, 2003 and 2002, respectively.

11. Income Taxes

The Companies are subject to a number of taxes based on income, which, in the aggregate, indicate a statutory income tax rate in Japan of approximately 41.7% for the years ended February 28, 2003 and 2002.

The following table summarizes the significant differences between the statutory income tax rate and the Companies' effective tax rates for financial statement purposes for the years ended February 28, 2003 and 2002:

	2003	2002
Statutory tax rate	41.7%	41.7%
Non-deductible expenses	1.6	3.0
Non-taxable dividend income	(0.1)	(0.1)
Per capita inhabitants' tax	0.1	0.1
Other	(0.7)	(0.1)
Effective tax rate	42.6%	44.6%

Significant components of the Companies' deferred tax assets as of February 28, 2003 and 2002 are as follows:

	Millions of yen 2003	2002	Thousands of U.S. dollars 2003
Deferred tax assets:			
Excess severance and retirement benefits	¥ 595	¥ 758	$ 5,052
Valuation loss on investment securities	477	566	4,051
Directors' and corporate auditors' retirement benefits	361	336	3,070
Accrued enterprise tax	507	105	4,306
Accrued expenses	—	7	—
Valuation loss on investment in capital	620	330	5,266
Excess employees' bonuses accrued	73	104	617
Net unrealized holding loss on securities	279	31	2,370
Losses carried forward	44	84	375
Other	412	174	3,495
Total deferred tax assets	3,368	2,495	28,602
Valuation allowance	(44)	(84)	(375)
Net deferred tax assets	¥ 3,324	¥ 2,411	$ 28,227

The aggregate statutory income tax rate will be reduced for the years commencing on April 1, 2004 or later due to the revised local tax law. At March 31, 2003, the Company and consolidated domestic subsidiaries applied the reduced aggregate statutory income tax rate of 40.4% for calculating deferred tax assets and liabilities that are expected to be recovered or settled in the years commencing on March 1, 2005 or later. The effect on net income of adopting the new accounting standard was not material.

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 are "pharmaceuticals and related products", "cable television broadcasting" and "other".

Since more than 90% of the consolidated net sales and operating income for the years ended February 28, 2003 and 2002 were from the pharmaceuticals and related products segment, the disclosure of business segment information is not required.

(2) Geographic area

Since more than 90% of the consolidated net sales and operating income for the years ended February 28, 2003 and 2002 were made in Japan, the disclosure of segment information by geographic area is not required.

(3) Overseas sales

Since overseas sales for the years ended February 28, 2003 and 2002 were not more than 10% of the consolidated net sales, the disclosure of overseas sales information is not required.

13. Shareholders' Equity

Under the Code, the entire amount of the issue price of shares is required to be accounted for as common stock, although a company may, by resolution of its board of directors, account for an amount not exceeding 50% of the issue price of the new shares as additional paid-in capital, which is included in capital surplus.

Effective October 1, 2001, the Code provides that an amount equal to at least 10% of cash dividends and other cash appropriations shall be appropriated and set aside as a legal earnings reserve until the total amount of legal earnings reserve and additional paid-in capital equals 25% of common stock. The legal earnings reserve and additional paid-in capital may be used to eliminate or reduce a deficit by resolution of the shareholders' meeting or may be capitalized by resolution of the Board of Directors. On condition that the total amount of legal earnings reserve and additional paid-in capital remains being equal to or exceeding 25% of common stock, they are available for dividends by the resolution of shareholders' meeting. Legal earnings reserve is included in retained earnings in the accompanying financial statements.

The maximum amount that the Company can distribute as dividends is calculated based on the unconsolidated financial statements of the Company in accordance with the Code.

(Reduction in additional paid-in capital and legal earnings reserve)
At the 2002 annual meeting of shareholders held on May 23, 2002, it was duly approved that the total of additional paid-in capital and legal earnings reserve which exceeds 25% of the Company's stated capital be transferred to retained earnings in accordance with the revised Code. As a result of this transfer, additional paid-in capital was reduced to ¥2,118 million and legal earnings reserve was reduced to zero.

(Acquisition of treasury stock)
At the 2002 annual meeting of shareholders mentioned above, it was duly approved that, in accordance with the Code, the Company could acquire 14,000 thousand shares of common stock within the limited total amount of ¥28,000 million for a period of time ranging from the termination of the 2002 annual meeting of shareholders to the 2003 annual meeting of shareholders.

The Company purchased 2,000 thousand shares of common stock out of profits for the total amounts of ¥2,768 million ($23,507 thousand) from the stock market for a period of time ranging from the termination of the 2002 annual meeting of shareholders to the end of the year.

(Number and amount of treasury stock)
At February 28, 2003, the Companies held the treasury stock of 3,100,330 shares of common stock in the amount of ¥5,538 million ($47,032 thousand), as shown in the consolidated balance sheets. This amount included ¥678 million ($5,758 thousand) which was not deducted from the minority interests.

14. Common Stock

(1) As a result of exercise of the outstanding warrants, 56,405 and 127,419 additional shares of common stock were issued during the years ended February 28, 2002 and 2001, respectively.

(2) 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 common stock out of profits for a total amount of ¥974 million from the stock market and retired them by the time of the 2000 annual meeting of shareholders held on May 25, 2000.

(3) Stock split
In accordance with the resolution of the Board of Directors on May 25, 2000, the Company authorized a stock split as follows:
Effective date of stock split: August 21, 2000.
Split ratio: Split one share of 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, 2003 were as follows:

	Millions of yen	Thousands of U.S. dollars
Notes receivable discounted	¥ 39	$ 331

16. Subsequent Events

(Appropriation of retained earnings)
At the 2003 annual meeting of shareholders held on May 22, 2003, the appropriation of retained earnings for the year ended February 28, 2003 was duly approved as follows:

	Millions of yen	Thousands of U.S. dollars
Cash dividends– ¥12.00 ($0.102) per share	¥ 847	$ 7,193
Bonuses to directors and corporate auditors	56	476

Report of Independent Certified Public Accountants

**To the Shareholders and the Board of Directors of
Hisamitsu Pharmaceutical Co., Inc.**

We have audited the accompanying consolidated balance sheets of Hisamitsu Pharmaceutical Co., Inc. (a Japanese corporation) and subsidiaries as of February 28, 2003 and 2002, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended February 28, 2003, 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, 2003 and 2002, and the consolidated results of their operations and their cash flows for each of the three years in the period ended February 28, 2003 in conformity with accounting principles generally accepted in Japan (Note 1) applied on a consistent basis during the periods, except as noted in the following paragraph.

As explained in Note 2, Hisamitsu Pharmaceutical Co., Inc. and subsidiaries prospectively adopted new Japanese accounting standards for financial instruments and employees' severance and retirement benefits and the revised Japanese accounting standards for foreign currency translation in the year ended February 28, 2002.

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.

Asahi & Co.
Fukuoka, Japan
May 22, 2003