

KISSEI

ANNUAL REPORT 1999

Since its founding more than 50 years ago in 1946, Kissei Pharmaceutical Co., Ltd., has grown into one of Japan's leading pharmaceutical companies. Kissei's management vision is to develop and market innovative drugs that contribute to the health of people around the world. Accordingly, as an R&D-oriented pharmaceutical company, we are aggressively involved in the research and development of new drugs with superior safety and efficacy.

Through Kissei U.S.A., Inc., a U.S. subsidiary, and our London office, in the United Kingdom, we are making strong efforts toward development of new drugs in Japan, the United States, and Europe. Key products under development include Rizaben[®], tranilast for prevention of restenosis after percutaneous transluminal coronary angioplasty (PTCA); mitiglinide for diabetes; and KMD-3213 for urinary disturbance associated with benign prostatic hyperplasia (BPH). We are developing these products on our own or through licensed companies. We are also making steady progress in preparing for international development of other new compounds.

Kissei is striving to achieve continued stable growth as a valued company. To that end, we are further strengthening our R&D capabilities and domestic marketing structure so that we can offer in Japan and overseas drugs that are the result of innovative R&D, and thus contribute to the health of people around the world.

CONSOLIDATED FINANCIAL HIGHLIGHTS

Kissei Pharmaceutical Co., Ltd. and its subsidiaries Years ended 31st March 1998 and 1999

	Millions of Yen		Thousands of U.S. Dollars (Note)
	1998	1999	1999
For The Year:			
Net Sales	¥ 56,687	¥ 55,974	\$ 466,450
Operating Income	13,038	11,545	96,208
Net Income	5,439	5,334	44,450
At Year-End:			
Total Assets	137,353	138,934	1,157,783
Total Shareholders' Equity	92,778	97,234	810,283
Per Share Data (Yen and Dollars):			
Net Income			
Primary	¥93.3	¥91.5	\$0.762
Fully-Diluted	83.0	82.0	0.683
Cash Dividends	14.0	15.0	0.125

Note: U.S. dollar amounts are translated at the rate of ¥120=U.S.\$1, the approximate effective rate of exchange at 31st March 1999.

OVERVIEW *Japan's pharmaceutical industry is facing the imminent prospect of drastic change in the health insurance system, and companies are being called on to implement management based on global standards. The industry has entered a period of structural reform. In order to adapt to this environment and continue to grow, Kissei is implementing Project 21, a corporate reform plan aimed at achieving a high degree of efficiency in management. Although our results over the past few years have been less than satisfactory, we have succeeded in strengthening the Company so that it can continue to grow even in a changing environment. In the years ahead, we will work aggressively to improve our performance and contribute to society.*

REVIEW OF OPERATIONS During the year under review, the Japanese economy was sluggish. Concern about the financial system, as well as about employment and incomes, had an adverse influence on consumption.

Operating conditions in the pharmaceutical industry remained challenging. The September 1997 revision of Japan's Health Insurance Law increased the share of medical expenses paid by patients, leading to declines in visits to doctors and the volume of drugs dispensed. In addition, in April 1998, drug reimbursement prices were reduced for the third consecutive year.

In this difficult environment, we worked to effectively market our products, and, at the same time, to increase efficiency throughout management, including the rationalization of our production system and the enhancement of our information systems. However, the drug price revisions had a significant effect. Consolidated net sales were down 1.3%, to ¥56.0 billion, and consolidated net income declined 1.9%, to ¥5.3 billion.

The Company is treating the Year 2000 computer problem as an important management issue. From the viewpoint of customer service and continuity of operations, we have established a committee to verify systems, evaluate risks, and formulate remediation measures.

RESEARCH AND DEVELOPMENT As an R&D-oriented pharmaceutical company, we are focusing the majority of our resources on the development of original drugs. Currently, we are conducting aggressive R&D centered on four fields: the respiratory and cardiovascular systems, immunology and allergy, metabolism and endocrinology, and the urogenital system. In Japan, we have submitted new drug applications (NDAs) to the Ministry of Health and Welfare for Rizaben® for an indication expansion for prevention of restenosis after PTCA and Cabaser® for Parkinson's disease.

Internationally, we are developing Rizaben® (prevention of restenosis after PTCA), mitiglinide (diabetes), and KMD 3213 (urinary disturbance accompanying BPH) through licensed companies as well as by ourselves.

R&D PIPELINE IN JAPAN

(As of 1st June 1999)

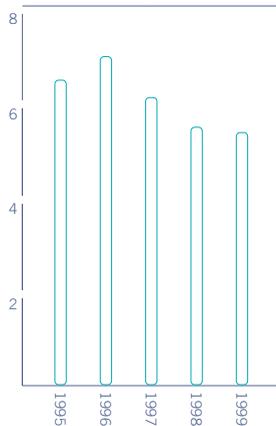
DEVELOPMENT STAGE	BRAND NAME DEVELOPMENT CODE	GENERIC NAME	THERAPEUTIC TARGET	PRODUCT ORIGIN
NDA	RIZABEN®	Tranilast	Restenosis after PTCA (additional indication)	Kissei
Pre-NDA	CABASER®	Cabergoline	Parkinson's disease	Jointly developed with Pharmacia & Upjohn
	PROZEI	Amprenavir	HIV infection	Jointly developed with Vertex Pharmaceuticals
	CABASER®	Cabergoline	Hyperprolactinemia	Jointly developed with Pharmacia & Upjohn
Phase III	KAD-1229	Mitiglinide	Non-insulin-dependent diabetes mellitus	Kissei
	KSS-694		Radiation-induced xerostomia (prevention and treatment)	MGI Pharma
Phase II	KMD-3213		Dysuria associated with benign prostatic hyperplasia	Kissei
	Ro 22-9194	Milacainide	Arrhythmia	Hoffman La Roche
	KIN-493	Oxcarbazepine	Diabetic pain	Novartis
	KCO-692	Clodronic acid	Osteoporosis	Leiras Oy
	KRH-594		Hypertension	Kissei
	OKY-046 DOMENAN®	Ozagrel	Dry cough (additional indication)	Kissei (Jointly developed with Ono Pharmaceutical)

R&D PIPELINE OVERSEAS

DEVELOPMENT STAGE	GENERIC NAME DEVELOPMENT CODE	THERAPEUTIC TARGET	REGION/COUNTRY	COMPANY
Phase III	Tranilast	Restenosis after PTCA	U.S.A. Europe	SmithKline Beecham
Phase II	Mitiglinide	Non-insulin-dependent diabetes mellitus	U.S.A.	Purdue Pharma
	KAD-1229		Europe	Les Laboratoires Servier
Phase I	KMD-3213	Dysuria associated with benign prostatic hyperplasia	U.S.A.	Kissei

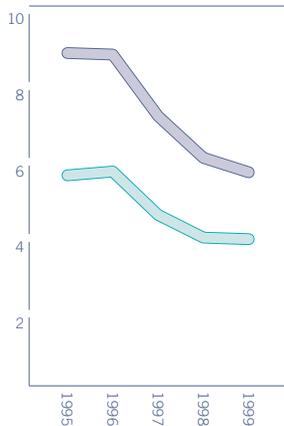
NET INCOME

(Billions of Yen)



RETURN ON EQUITY AND RETURN ON ASSETS

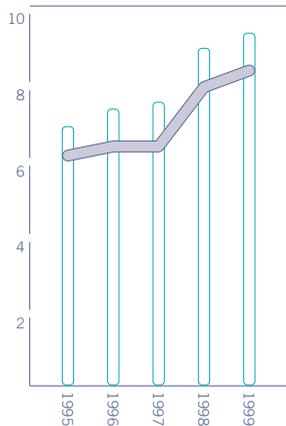
(%)



■ RETURN ON EQUITY
■ RETURN ON ASSETS

R&D EXPENDITURES

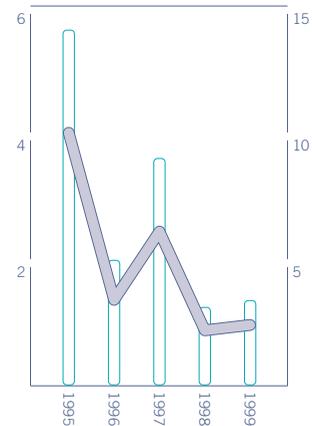
(Billions of Yen)



■ R&D EXPENDITURES
■ R&D EXPENDITURES AS PERCENT OF NET SALES

CAPITAL INVESTMENT

(Billions of Yen)



■ CAPITAL INVESTMENT
■ CAPITAL INVESTMENT AS PERCENT OF NET SALES

FINANCIAL REVIEW During the year under review, measures to limit medical expenditures had a significant effect on our results. Accompanying the revision of drug reimbursement prices under the National Health Insurance system, we have reduced the prices for our products, and this was the major factor influencing our performance. However, we maintained a high degree of profitability, with our operating income ratio at 20.6% for the year.

Total assets at year-end were ¥138.9 billion, and shareholders' equity was ¥97.2 billion. We maintained a strong financial condition, with a shareholders' equity ratio of 70.0% at year-end.

Return on equity was 5.6%, and return on assets 3.8%. In the years ahead, we will work to improve these management indicators by increasing net income.

Expenditures on R&D totaled ¥9.3 billion, or 16.6% of net sales, as we continued to invest strategically. We believe that investment in R&D holds the key to the Company's growth. The recent increase in our investment is attributable to overseas testing and research expenses.

Capital expenditures were ¥1.3 billion. The construction and preparation of marketing, production, and research facilities have, for the most part, been completed. We have no large-scale capital investment plans at this time.

OUTLOOK In Japan, the pharmaceutical industry's operating environment is in a period of change and is expected to remain challenging. In response to the changing environment, we will work to implement highly efficient management to achieve future growth.

In the fiscal year ending 31st March 2000, we will focus on achieving increases in sales and profits, with net sales reaching ¥56.6 billion and net income ¥5.8 billion. I would like to ask our shareholders and customers for their continued support in the years ahead.

June 1999



Mutsuo Kanzawa

President and Chief Executive Officer

CONSOLIDATED BALANCE SHEETS

Kissei Pharmaceutical Co., Ltd. and its subsidiaries At 31st March 1998 and 1999

ASSETS	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	1998	1999	1999
Current Assets:			
Cash on hand and in banks	¥ 25,156	¥ 25,271	\$ 210,592
Short-term investments in specified money trust	19,784	19,886	165,716
Marketable securities (Note 4)	17,216	19,974	166,450
Cash and cash equivalent	62,156	65,131	542,758
Notes and accounts receivable	23,006	22,622	188,516
Less: allowance for doubtful accounts	(194)	(157)	(1,308)
	22,812	22,465	187,208
Inventories (Note 5)	6,356	5,373	44,775
Other current assets	1,209	971	8,092
Total current assets	92,533	93,940	782,833
Investments and Advances:			
Investments in securities (Note 4)	8,403	8,663	72,192
Investments in unconsolidated subsidiaries	814	844	7,033
Leasehold deposits and guarantee deposits	495	561	4,675
Other investments and advances	1,270	1,154	9,617
	10,982	11,222	93,517
Property, Plant and Equipment (Note 6):			
Buildings and structures	27,157	27,147	226,225
Machinery and equipment	5,821	6,732	56,100
	32,978	33,879	282,325
Less: accumulated depreciation	(15,632)	(17,306)	(144,217)
	17,346	16,573	138,108
Land	12,979	12,977	108,142
Construction in progress	266	322	2,683
	30,591	29,872	248,933
Other Assets	3,247	3,900	32,500
	¥137,353	¥138,934	\$1,157,783

The accompanying notes are an integral part of these statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	1998	1999	1999
Current Liabilities:			
Short-term bank loans (Note 6)	¥ 1,180	¥ 1,570	\$ 13,083
Current portion of long-term debt (Note 6)	45	45	375
Notes and payables:			
Trade	5,804	5,199	43,325
Construction and acquisition of properties	196	61	508
Other	1,986	1,655	13,792
	7,986	6,915	57,625
Income taxes payable (Note 7)	3,908	3,346	27,883
Accrued expenses and bonuses to employees	2,000	2,107	17,558
Reserve for accrued sales returns	110	86	717
Reserve for accrued sales rebates	512	455	3,792
Reserve for accrued sales promotion expenses	258	150	1,250
Employees' saving deposits	1,848	1,863	15,525
Other current liabilities	160	203	1,692
Total current liabilities	18,007	16,740	139,500
Long-Term Debt (Note 6)	24,899	23,271	193,925
Reserve for Retirement Pension Costs (Note 8)	493	454	3,783
Accrued Retirement Benefits to Directors and Corporate Auditors	1,176	1,235	10,292
Total liabilities	44,575	41,700	347,500
Commitments and Contingent Liabilities (Note 9)			
Shareholders' Equity:			
Common stock, par value ¥50 per Share:			
Authorized: 130,000,000 Shares			
Issued: 58,279,185 Shares at 31st March 1998 and 1999	24,220	24,220	201,833
Additional paid-in capital	24,110	24,110	200,917
Unappropriated retained earnings (Note 12)	44,452	48,916	407,633
Treasury stock	(4)	(12)	(100)
Total Shareholders' equity	92,778	97,234	810,283
	¥137,353	¥138,934	\$1,157,783

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF INCOME

Kissei Pharmaceutical Co., Ltd. and its subsidiaries For the years ended 31st March 1997, 1998 and 1999

	Millions of Yen			Thousands of U.S. Dollars (Note 3)
	1997	1998	1999	1999
Net Sales	¥59,108	¥56,687	¥55,974	\$466,450
Cost of Sales	18,168	15,901	16,120	134,333
Gross profit	40,940	40,786	39,854	332,117
Selling, General and Administrative Expenses (Notes 8, 9 and 11)	26,513	27,748	28,309	235,909
Operating income	14,427	13,038	11,545	96,208
Other Income (Expenses):				
Interest and dividend income	674	753	832	6,933
Interest expenses	(211)	(226)	(271)	(2,258)
Loss on sales or disposal of properties	(232)	(64)	(49)	(408)
Gain on sales of marketable securities	355	332	169	1,408
Gain on sales of investments in securities	78	-	-	-
Write-down of marketable securities and short-term investments in specified money trust	(169)	(531)	(30)	(250)
Write-down of investments in securities	(647)	(1,166)	(377)	(3,142)
Bonds issue expenses	(635)	-	-	-
Other, net	(266)	382	217	1,809
	(1,053)	(520)	491	4,092
Income before income taxes	13,374	12,518	12,036	100,300
Income Taxes (Note 7)	7,304	7,079	6,702	55,850
Net income	¥ 6,070	¥ 5,439	¥ 5,334	\$ 44,450
		Yen		U.S. Dollars (Note 3)
Per Share:				
Net income				
Primary	¥105.6	¥93.3	¥91.5	\$0.762
Fully-diluted	97.9	83.0	82.0	0.683
Cash dividends	15.0	14.0	15.0	0.125

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Kissei Pharmaceutical Co., Ltd. and its subsidiaries For the years ended 31st March 1997, 1998 and 1999

	Number of shares of common stock	Millions of Yen		
		Common stock	Additional paid-in capital	Unappropriated retained earnings
Balance at 31st March 1996	52,839,568	¥23,995	¥23,885	¥34,823
Stock split on 20th May 1996 (1 into 1.1)	5,283,956	—	—	—
Net income for the year ended 31st March 1997	—	—	—	6,070
Cash dividends paid	—	—	—	(883)
Officers' bonuses	—	—	—	(63)
Exercise of warrants	155,323	224	225	—
Conversion of convertible notes	338	1	0	—
Balance at 31st March 1997	58,279,185	24,220	24,110	39,947
Net income for the year ended 31st March 1998	—	—	—	5,439
Cash dividends paid	—	—	—	(874)
Officers' bonuses	—	—	—	(60)
Balance at 31st March 1998	58,279,185	24,220	24,110	44,452
Net income for the year ended 31st March 1999	—	—	—	5,334
Cash dividends paid	—	—	—	(815)
Officers' bonuses	—	—	—	(55)
Balance at 31st March 1999	58,279,185	¥24,220	¥24,110	¥48,916

	Number of shares of common stock	Thousands of U.S. Dollars (Note 3)		
		Common stock	Additional paid-in capital	Unappropriated retained earnings
Balance at 31st March 1998	58,279,185	\$201,833	\$200,917	\$370,433
Net income for the year ended 31st March 1999	—	—	—	44,450
Cash dividends paid	—	—	—	(6,792)
Officers' bonuses	—	—	—	(458)
Balance at 31st March 1999	58,279,185	\$201,833	\$200,917	\$407,633

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Kissei Pharmaceutical Co., Ltd. and its subsidiaries For the years ended 31st March 1997, 1998 and 1999

	Millions of Yen			Thousands of U.S. Dollars (Note 3)
	1997	1998	1999	1999
Cash Flows from Operating Activities:				
Net income	¥ 6,070	¥ 5,439	¥ 5,334	\$ 44,450
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortisation	3,157	3,263	3,417	28,475
Loss on sale or disposal of properties	232	64	49	408
Transfer from reserve for retirement pension cost	(4)	(11)	(39)	(325)
Transfer to (from) accrued retirement benefits to directors and corporate auditors	(21)	103	59	492
Write down of investments in securities	647	1,166	377	3,142
(Gain) on exchange of long-term debt	(179)	-	-	-
Changes in assets and liabilities:				
Decrease in notes and accounts receivable	786	1,607	347	2,891
Decrease/(increase) in inventories	781	(1,065)	983	8,192
Decrease in other current assets	1,346	1,859	238	1,983
(Decrease)/increase in notes and payables	1,512	135	(1,071)	(8,925)
(Decrease)/increase in income taxes payable	(3,077)	1,234	(562)	(4,683)
Decrease in accrued expenses and reserves	(201)	(27)	(82)	(683)
Increase/(decrease) in employees' saving deposits	(1,020)	(103)	15	125
Increase/(decrease) in other current liabilities	(140)	(156)	43	358
Other payments	(763)	(1,574)	(2,122)	(17,683)
Net cash provided by operating activities	9,126	11,934	6,986	58,217
Cash Flows from Investing Activities:				
Acquisition of properties	(3,589)	(1,244)	(1,341)	(11,175)
Increase in investments in and advances	(1,089)	(3,112)	(617)	(5,142)
Net cash used for investing activities	(4,678)	(4,356)	(1,958)	(16,317)
Cash Flows from Financing Activities:				
Borrowing of long-term loans from banks and other financial institutions	88	194	60	500
Cash dividends paid	(883)	(874)	(815)	(6,792)
Repayment of long-term loans from banks and other financial institutions	(93)	(63)	(62)	(516)
Redemption of bonds with warrants	(11,672)	(10,193)	-	-
Redemption of convertible notes	-	(762)	(1,626)	(13,550)
Increase/(decrease) in short-term bank loans	(30)	(130)	390	3,250
Proceeds from exercise of warrants	449	-	-	-
Proceeds from issue of convertible notes	25,000	-	-	-
Net cash provided by/(used for) financial activities	12,859	(11,828)	(2,053)	(17,108)
Net Change in Cash and Cash Equivalents	17,307	(4,250)	2,975	24,792
Cash and Cash Equivalents at Beginning of Year	49,099	66,406	62,156	517,966
Cash and Cash Equivalents at End of Year	¥ 66,406	¥ 62,156	¥ 65,131	\$ 542,758

The accompanying notes are an integral part of these statements.

1. BASIS OF PRESENTING THE CONSOLIDATED FINANCIAL STATEMENTS

The accounting records of KISSEI PHARMACEUTICAL CO., LTD. (the "Company") and its consolidated domestic subsidiaries (majority-The accompanying consolidated financial statements have been prepared from the accounts maintained by KISSEI PHARMACEUTICAL CO., LTD. (the "Company") and its subsidiaries in accordance with the provisions set forth in the Japanese Commercial Code (the "Code") and in conformity with accounting principles and practices generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Accounting Standards.

Certain items presented in the consolidated financial statements filed with the Ministry of Finance (the "MOF") in Japan have been reclassified for the convenience of readers outside Japan. In addition, the consolidated financial statements of cash flows are not required to be filed with the MOF, but have been prepared and included in the consolidated financial statements.

The consolidated financial statements are not intended to present the consolidated financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(1) Scope of Consolidation

The Company had six subsidiaries at 31st March 1999 (five at 31st March 1998 and four at 31st March 1997). The consolidated financial statements include the accounts of the Company and two of its subsidiaries for the year ended 31st March 1999 (two at 31st March 1998 and two at 31st March 1997) (together, referred to as the "Companies"). The consolidated subsidiaries are listed below:

Name of subsidiaries	Equity ownership percentage*	Paid-in capital
KISSEI SHOJI CO., LTD.	100%	¥50 million
KISSEI COMTEC CO., LTD.	100	50

*As at 31st March, 1999

The accounts of four (three for 1998 and two for 1997) subsidiaries were not consolidated since their total assets, net sales and net income (loss) in the aggregate are not significant, respectively, in relation to those of the consolidated financial statements of the Companies.

(2) Consolidation and Elimination

In preparing the accompanying consolidated financial statements, all significant inter-company transactions, account balances and unrealized profits among the Companies have been eliminated.

The Companies use a fiscal year ending 31st March of each year.

In eliminating investments in common stock of consolidated subsidiaries against the underlying equity in net assets of the subsidiaries, differences between the cost of investments and the underlying equity in net assets are not recognized because the Company has held 100% of the consolidated subsidiaries' equity since their foundation.

(3) Investments in Unconsolidated Subsidiaries

The investments in the four (three for 1998 and two for 1997) unconsolidated subsidiaries are carried at cost, cost being determined by the moving average method since the investments in these companies would have no significant effect on the consolidated net income if they were accounted for by the equity method.

(4) Cash and Cash Equivalents

Cash and cash equivalents include cash in banks, short-term investments in specified money trust, and marketable securities in conformity with Japanese accounting practice.

(5) Valuation of Securities

Securities with quoted market values are valued at the lower of cost or market, cost being determined by the moving average method. Securities without quoted market values are valued at cost, cost

being determined by the moving average method. Securities with quoted market values included in "Short-term investments in specified money trust" are valued at the lower of cost or market, cost being determined by the moving average method.

(6) Inventory Valuation

Inventories are stated at cost, cost being determined by the average method.

(7) Property, Plant and Equipment

Depreciation is computed on the declining-balance method at rates based on the estimated useful lives of assets, which are prescribed by Japanese tax laws. The range of useful lives is principally from 3 to 50 years for buildings and structures and from 2 to 20 years for machinery and equipment.

According to the recent amendment of the Japanese tax laws, the depreciation for the buildings (excluding leasehold improvements and auxiliary facilities attached to buildings), which have newly been acquired on or after 1st April 1998, has been computed by the straight-line method. This change did not have a significant impact on the consolidated results of operations.

The Companies has adopted the estimated useful lives of the buildings which decreased due to the amendment of Japanese income tax laws. As a result, depreciation expenses for the year ended 31st March 1999 increased by ¥90 million, operating income and net income decreased by ¥83 million, respectively, compared with the previous policy.

The cost of property and equipment retired or otherwise disposed of and accumulated depreciation in respect thereof are eliminated from the related accounts, and the resulting gain or loss is reflected in income.

Normal repairs and maintenance, including minor renewals and improvements, are charged to income as incurred.

(8) Amortisation

Amortisation of intangible assets and long-term prepaid expenses included in "Other Assets" is computed on the straight-line method, over a period prescribed by the Japanese tax laws.

Bond issue expenses are charged to income as incurred.

Research and development costs incurred for specific projects in search of new products and new technology are charged to income as incurred.

(9) Accounting for Consumption Tax

Consumption tax is imposed at the flat rate of 3% until 31st March 1997 and 5% from 1st April 1997 on all domestic consumption of goods and services (with certain exemptions).

The consumption tax withheld upon sale and consumption tax paid by the Companies on its purchases of goods and services is not included in the amounts of respective revenue and cost or expense items in the accompanying consolidated statements of income. The consumption tax withheld and consumption tax paid are recorded as assets or liabilities and the net balance is included in “Notes and payables—Other” of the balance sheets at 31st March 1998 and 1999.

(10) Foreign Currency Translation

Foreign currencies and short-term receivables and payables denominated in foreign currencies held by the Companies are translated into Japanese yen at exchange rates prevailing at the respective balance sheet dates.

Long-term receivables and payables denominated in foreign currencies, including investments in securities, are translated at the historical rates prevailing at transaction dates.

When accounts denominated in foreign currencies are covered by forward exchange contracts, such accounts are translated at the contracted rates of exchange.

Any translation gains or losses are included in the determination of net income for the relevant year.

(11) Income Taxes

Income taxes are provided for based on the amount required by the tax returns for the financial year. No tax effect is recorded for timing differences in the recognition of certain revenue and expenses between tax and financial reporting.

(12) Allowances, Accrued Bonuses to Employees and Reserves for Accrued Expense Items

Certain accrued expenses which are essentially an estimate of amounts to be determined in future years, are provided by the Companies, which are subject to limits established by Japanese tax laws for allowable deductions. The basis of recognising such accrued expenses is as follows:

(i) Allowance for doubtful accounts

“Allowance for doubtful accounts” is provided in an amount equivalent to the maximum limit established by Japanese tax laws for allowing deductions (a prescribed percentage of the year-end balance of receivables), plus the amounts of individual accounts deemed uncollectible.

(ii) Accrued bonuses to employees

“Accrued bonuses to employees” is provided for in an amount based on an estimated amount which the Companies should pay to employees in Summer as applicable to their services for the six-month period ended on the balance sheet date.

(iii) Reserve for accrued sales returns

“Reserve for accrued sales returns” is computed on a basis of the maximum amount deductible under Japanese tax laws, which is determined by reference to actual experience in the preceding two years.

(iv) Reserve for accrued sales rebates

“Reserve for accrued sales rebates” is provided for in an amount equivalent to the expected amount payable by the Company to dealers in respect of the balance of accounts receivable at the balance sheet date. In estimating the amount of rebates, the Company applies the actual rebate rates allowed in the six month period preceding the balance sheet date. The reserve for accrued sales rebates is not deductible for tax purposes until paid.

(v) Reserve for accrued sales promotion expenses

“Reserve for accrued sales promotion expenses” is provided for in an amount which the Company expects to pay in relation to dealers’ inventories at the balance sheet date. In estimating the amount of sales promotion expenses, the Company applies the rate of such expenses against dealers’ inventories based on the experience in the six month period preceding the balance sheet date. The reserve for accrued sales promotion expenses is not deductible for tax purposes until paid.

(vi) Reserve for retirement pension costs

“Reserve for retirement pension costs” is provided for future amortisation of past service liabilities arising from the Company’s funded retirement pension plan which covers retirement benefits to employees of the Company. The balance of the reserve represents the present value of the past service liabilities of the pension plan. The reserve for retirement pension costs is not deductible for tax purposes until paid.

(vii) Accrued retirement benefits to directors and corporate auditors

“Accrued retirement benefits to directors and corporate auditors” is provided for in an amount equal to the liability the Company would have to pay if all directors and corporate auditors resigned at the balance sheet date. Provisions for accrued retirement benefits to directors and corporate auditors are not deductible for tax purposes until paid.

(13) Free Distribution of Shares

The Company has made free distributions of shares of common stock to shareholders by means of stock splits. In Japan, such free share distributions are distinguished from stock dividends paid out of retained earnings.

Appropriate retroactive adjustments have been made for the effect of such stock splits in computing net income on a per share basis.

(14) Appropriation of Retained Earnings

Under the Japanese Commercial Code and the Articles of Incorporation of the Company, the appropriation of retained earnings proposed by the Board of Directors is subject to approval by the shareholders at a meeting which must be held within three months after the end of each financial year. The appropriations of retained earnings reflected in the accompanying consolidated financial statements include the results of such appropriations applicable to the immediately preceding financial year as approved at the shareholders’ meeting, and effected, during the relevant year. Dividends are paid to shareholders on the shareholders’ register as at the end of each financial year. As is customary practice in Japan, the payment of bonuses to directors and corporate auditors is made out of retained earnings through appropriation, instead of being charged to income of the year.

The Japanese Commercial Code provides that interim cash dividends may be paid as a part of the annual dividend upon approval by the Board of Directors. The Company pays such interim dividends to its shareholders on the shareholders’ register at 30th September.

(15) Net Income and Dividends per Share

Net income per share of common stock is based upon the weighted average number of shares of common stock outstanding during each financial year appropriately adjusted for subsequent free distribution of shares (stock splits).

Cash dividends per share shown for each year in the accompanying consolidated statements of income represent dividends approved or declared as applicable to the respective years.

Fully-diluted net income per share is computed, based on the assumption that the convertible notes were fully converted into common stock on the date of issue or at the beginning of the respective years subsequent to the issue, with appropriate adjustments of related interest expenses (net of tax).

(16) Reclassification of Accounts

Prior years amounts have been reclassified to conform with the current year's presentation.

3. UNITED STATES DOLLAR AMOUNTS

The Companies maintains its accounting records in yen. The dollar amounts included in the consolidated financial statements and notes thereto represent the arithmetical results of translating yen to dollars on the basis of ¥120=U.S.\$1, the approximate

effective rate of exchange at 31st March 1999. The inclusion of such dollar amounts is solely for convenience and is not intended to imply that yen amounts have been or could be converted, realised or settled in dollars at ¥120=U.S.\$1 or at any other rate.

4. MARKETABLE SECURITIES AND INVESTMENTS IN SECURITIES

Marketable securities (current assets) and investments in securities (non-current assets) at 31st March 1998 and 1999 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	1998	1999	1999
Marketable securities:			
Listed corporate shares	¥ 135	¥ 133	\$ 1,108
Bonds	6,275	9,042	75,350
Certificates of investment trust and other	10,806	10,799	89,992
	<u>¥17,216</u>	<u>¥19,974</u>	<u>\$166,450</u>
Investments in securities:			
Listed corporate shares	¥ 6,203	¥ 6,180	\$ 51,500
Bonds	2,000	2,000	16,667
Unlisted corporate shares	200	483	4,025
	<u>¥ 8,403</u>	<u>¥ 8,663</u>	<u>\$ 72,192</u>

Market value of listed corporate shares shown above, at 31st March 1998 and 1999 was as follows:

	Millions of Yen		Thousands of U.S. Dollars
	1998	1999	1999
Listed corporate shares included in:			
Current assets	¥ 137	¥ 187	\$ 1,558
Unrealised gains	¥ 2	¥ 54	\$ 450
Non-current assets	¥7,365	¥8,990	\$74,917
Unrealised gains	¥1,162	¥2,810	\$23,417

5. INVENTORIES

Inventories at 31st March 1998 and 1999, consisted of:

	Millions of Yen		Thousands of U.S. Dollars
	1998	1999	1999
Merchandise	¥ 978	¥ 673	\$ 5,608
Finished goods	2,023	1,465	12,208
Work-in-process	2,193	1,802	15,017
Raw materials	684	927	7,725
Supplies	478	506	4,217
	<u>¥6,356</u>	<u>¥5,373</u>	<u>\$44,775</u>

6. SHORT-TERM BANK LOANS AND LONG-TERM DEBT

Short-term bank loans outstanding at 31st March 1998 and 1999 were represented generally by one year notes issued by the Companies to banks. Short-term bank loans entered into during

the year ended 31st March 1998 and 1999 bore interest at an average annual rate of 1.41 % and of 1.39 %, respectively.

Information with respect to short-term bank loans outstanding for the years ended 31st March 1998 and 1999 is as follows:

	Millions of Yen		Thousands of U.S. Dollars
	1998	1999	1999
Maximum month-end balance	¥1,910	¥2,070	\$17,250
Average month-end balance	¥1,798	¥1,903	\$15,858

As is customary in Japan, substantially all of the notes are with banks, each of which has concluded basic agreements with the Companies to the effect that, with respect to all present or future loans with such bank, the Companies shall, under certain circumstances, provide collateral (including sums on deposit with such

bank), or guarantors therefor, immediately upon the bank's request, and that any collateral furnished pursuant to such agreement or otherwise will be applicable to all indebtedness to such bank. The Companies has not received any such requests to date.

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

	Millions of Yen		Thousands of U.S. Dollars
	1998	1999	1999
Loans with other financial institutions not secured bearing interests at rates ranging from 3.15% to 6.65% due from 1998 to 2031	¥ 707	¥ 705	\$ 5,875
0.7% convertible notes due 2006	9,849	9,738	81,150
0.8% convertible notes due 2008	14,388	12,873	107,275
	24,944	23,316	194,300
Less: current maturities due within one year	(45)	(45)	(375)
	¥24,899	¥23,271	\$193,925

The 0.7% convertible notes due 29th September 2006 were issued on 23rd August 1996 in the principal amount of ¥10,000 million. The notes can be repurchased at any time in their entirety at the option of the Company and may be redeemed in whole at a price of ¥104 from 1st October 2001 to 30th September 2002, ¥103 from 1st October 2002 to 30th September 2003, ¥102 1st October 2003 to 30th September 2004, ¥101 from 1st October 2004 to 30th September 2005, ¥100 from 1st October 2005 to 28th September 2006. The Company repurchased ¥151 million of the bonds during the year ended 31st March 1998. The holder of each convertible notes is entitled to convert ¥1,000,000 for shares at a current conversion price of ¥2,952 per share. The conversion price is subject to adjustment for subsequent stock splits and other circumstances.

The notes are convertible at any time prior to 28th September 2006. The number of shares which would be issued upon conversion of the notes outstanding at 31st March 1999 was 3,299 thousand shares.

The 0.8% convertible notes due 30th September 2008 were issued on 23rd August 1996 in the principal amount of ¥15,000 million. The notes can be repurchased at any time in their entirety at the option of the Company and may be redeemed in whole at a price of ¥105 from 1st October 2002 to 30th September 2003, ¥104 from 1st October 2003 to 30th September 2004, ¥103 1st October 2004 to 30th September 2005, ¥102 from 1st October 2005 to 30th September 2006, ¥101 from 1st October 2006 to 30th September 2007, ¥100 from 1st October 2007 to 29th September 2008. The Company repurchased ¥611 million of the bonds during the year ended 31st March 1998. The holder of each convertible notes is entitled to convert ¥1,000,000 for shares at a current conversion

price of ¥2,952 per share. The conversion price is subject to adjustment for subsequent stock splits and other circumstances.

The notes are convertible at any time prior to 29th September 2008. The number of shares which would be issued upon conversion of the notes outstanding at 31st March 1999 was 4,361 thousand shares.

The Companies' assets pledged as collateral for short-term loans at 31st March 1999 are summarised as follows:

	Millions of Yen	Thousands of U.S. Dollars
Property, plant and equipment, net of accumulated depreciation:		
Buildings and structures	¥1,379	\$11,492
Machinery and equipment	6	50
Land	167	1,391
	¥1,552	\$12,933

The aggregate annual maturities of long-term loans outstanding at 31st March 1999 are as follows:

	Millions of Yen	Thousands of U.S. Dollars
Year ending 31st March		
2000	¥ 45	\$ 375
2001	45	375
2002	66	550
2003 and thereafter	23,160	193,000
	¥23,316	\$194,300

7. INCOME TAXES

Income taxes in Japan applicable to the Companies for the years ended 31st March 1997, 1998 and 1999 consisted of corporate income tax (national), enterprise tax (local) and resident income taxes (local) at the approximate rates indicated below:

	Rates on taxable income		
	1997	1998	1999
Corporate income tax	37.5%	37.5%	34.5%
Enterprise tax	12.2	12.2	11.2
Resident income taxes	7.8	7.8	7.2
	<u>57.5%</u>	<u>57.5%</u>	<u>52.9%</u>
Statutory tax rate in effect to reflect the deductibility of enterprise tax when paid	51.2%	51.2%	47.6%

Income tax rates as shown in the accompanying consolidated statements of income differ from the above-mentioned statutory tax rates. The principal reason such differences arise is that entertainment expenses for purposes of sales promotion, etc. as defined by Japanese tax law are not allowable as tax deductions. In addition, the difference arises because no tax effects have been recognised on

certain timing differences between financial accounting and tax reporting, primarily in relation to accrued enterprise tax, accrued sales rebates, accrued sales promotion expenses, retirement pension costs and accrued retirement benefits to directors and corporate auditors, all of which are not deductible until paid.

8. EMPLOYEES' RETIREMENT PLAN

Employees of the Companies are, under most circumstances, entitled to receive either a lump sum payment or a pension or a combination thereof, in amounts which are determined by reference to current basic rates of pay, length of service and conditions under which the termination occurs. The Companies pays the full cost of the plan to a Japanese bank, which acts as trustee of such plan. Charges to income for the employees' retirement plan for the

three years ended 31st March 1999 were ¥515 million, ¥654 million and ¥698 million (\$5,817 thousand), respectively.

At the most recent valuation date of the fund assets at 31st March 1999, the assets of the pension fund aggregated ¥5,492 million (\$45,767 thousand) and the past service liabilities amounted to ¥501 million (\$4,175 thousand), which are being amortised over a 20 year period.

9. COMMITMENTS AND CONTINGENT LIABILITIES

(1) Finance Leases

All finance lease contracts other than those by which the ownership of the leased assets is to be transferred to lessees, are accounted for by the method similar to the operating lease method.

Lease rental expenses on finance lease contracts without ownership-transfer for the year ended 31st March 1997, 1998 and 1999 were summarised as follows:

	Millions of Yen			Thousands of U.S. Dollars
	1997	1998	1999	1999
Lease rental expenses	¥820	¥743	¥639	\$5,325

Assumed data as to acquisition cost, accumulated depreciation, net book value and depreciation expense of the leased assets (machinery and equipment), which included the portion of interest thereon, were summarised as follows:

	Millions of Yen	Thousands of U.S. Dollars
Acquisition cost	¥2,905	\$24,208
Accumulated depreciation	1,508	12,566
Net book value	<u>¥1,397</u>	<u>\$11,642</u>
Depreciation	¥ 639	\$ 5,325

Depreciation is computed on the straight-line method over the lease term of the leased assets with no residual value.

The amount of outstanding future lease payments due at 31st March 1998 and 1999, which included the portion of interest thereon, was summarised as follows:

	Millions of Yen		Thousands of U.S. Dollars
	1998	1999	1999
Future lease payments:			
Within one year	¥ 600	¥ 527	\$ 4,392
Over one year	951	870	7,250
Total	<u>¥1,551</u>	<u>¥1,397</u>	<u>\$11,642</u>

The amount of outstanding future lease payments on operating leases due at 31st March 1998 and 1999 was summarised as follows:

	Millions of Yen		Thousands of U.S. Dollars
	1998	1999	1999
Future lease receipts:			
Within one year	¥ 17	¥54	\$450
Over one year	—	7	58
Total	¥ 17	¥61	\$508

(2) Contingent Liabilities

The Company had contingent liabilities arising from notes discounted by banks in the ordinary course of business in the amount of ¥1,401 million (\$11,675 thousand) at 31st March 1999.

In addition, the Company was contingently liable for guarantee of loans borrowed by its unconsolidated subsidiaries in an amount of ¥14 million (\$117 thousand) at 31st March 1999.

10. SEGMENT INFORMATION

(1) Information by Industry Segment

The Companies operate principally in two industrial segments.

Industry Segment	Major Products/Services
1. Pharmacy	Manufacture and sale of pharmaceutical products
2. Other	<ul style="list-style-type: none"> • Manufacture and sale of foods • Manufacture and sale of computer software

The share of pharmacies' sales contributes to over 90% of total sales.

(2) Information by geographic segment

As the Companies are all incorporated in Japan, information by geographic segment is not existent.

(3) Export sales

Export sales information of the Companies for the three years ended 31st March 1999 has not been disclosed because its share of sales is less than 10% of total sales.

11. ANALYSIS OF SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

An analysis of selling, general and administrative expenses for each of the three years in the period ended 31st March 1999 is as follows:

	Millions of Yen			Thousands of U.S. Dollars
	1997	1998	1999	1999
Advertising and sales promotion expenses	¥ 4,198	¥ 3,836	¥ 3,529	\$ 29,408
Payroll costs	7,024	7,118	7,301	60,842
Research and development costs	7,460	8,873	9,284	77,367
Travelling expenses	1,460	1,483	1,508	12,567
Depreciation	671	754	766	6,383
Other	5,700	5,684	5,921	49,342
	¥26,513	¥27,748	¥28,309	\$235,909

12. SUBSEQUENT EVENT

The following appropriations of unappropriated retained earnings, which have not been reflected in the financial statements at 31st March 1999, were approved by the shareholders' meeting held on 29th June 1999:

	Millions of Yen	Thousands of U.S. Dollars
Retained earnings:		
Balance at 31st March 1999	¥48,916	\$407,633
Appropriations		
Cash dividends (¥8 per share)	466	3,883
Officers' bonuses	49	408
Balance to be carried forward	¥48,401	\$403,342

Coopers
& Lybrand

**Chuo
Audit
Corporation**
certified public accountants

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Kasumigaseki Building
32nd Floor
3-2-5 Kasumigaseki
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Tokyo 100-6088

telephone: (03)3581-6281

To the Board of Directors
KISSEI PHARMACEUTICAL CO., LTD.

We have audited the accompanying consolidated balance sheets of KISSEI PHARMACEUTICAL CO., LTD. and its consolidated subsidiaries as at 31st March 1999 and 1998, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended 31st March 1999, all expressed in Japanese yen. Our audits were made in accordance with auditing standards, procedures and practices generally accepted and applied in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly, the consolidated financial position of KISSEI PHARMACEUTICAL CO., LTD. and its consolidated subsidiaries as at 31st March 1999 and 1998, and the consolidated results of their operations and the cash flows for each of the three years in the period ended 31st March 1999 in conformity with accounting principles and practices generally accepted in Japan (see Note 1) applied on a consistent basis.

The amount expressed in U.S. dollars, provided solely for the convenience of the reader, have been translated on the basis set forth in Note 3 to the accompanying consolidated financial statements.

CHUO AUDIT CORPORATION



Tokyo, Japan
29th June 1999

CONSOLIDATED FINANCIAL SUMMARY

Kissei Pharmaceutical Co., Ltd. and its subsidiaries Years ended 31st March

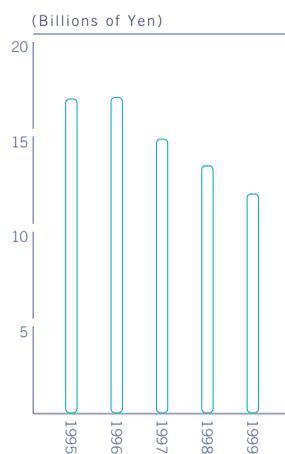
	Millions of Yen Except Per Share Data					Thousands of U.S. Dollars Except Per Share Data
	1995	1996	1997	1998	1999	1999
Net Sales	¥ 56,234	¥ 57,926	¥ 59,108	¥ 56,687	¥ 55,974	\$ 466,450
Gross Profit	42,395	42,931	40,940	40,786	39,854	332,117
Operating Income	16,568	16,619	14,427	13,038	11,545	96,208
Net Income	6,434	6,931	6,070	5,439	5,334	44,450
Total Assets	119,298	126,891	142,627	137,353	138,934	1,157,783
Total Shareholders' Equity	76,423	82,696	88,270	92,778	97,234	810,283
Per Share (Yen and Dollars):						
Net Income						
Primary	¥135.7	¥132.9	¥105.6	¥93.3	¥91.5	\$0.762
Fully-Diluted	—	—	97.9	83.0	82.0	0.683
Cash Dividends	14.0	16.0	15.0	14.0	15.0	0.125
R&D Expenditures	¥ 6,809	¥ 7,271	¥ 7,460	¥ 8,873	¥ 9,284	\$ 77,367
(% of Net Sales)	12.1%	12.6%	12.6%	15.7%	16.6%	16.6%
Capital Investment	5,605	1,982	3,589	1,244	1,341	11,175
(% of Net Sales)	10.0%	3.4%	6.1%	2.2%	2.4%	2.4%
Current Ratio	426.3%	267.7%	364.1%	514.0%	561.2%	561.2%
Return on Equity	8.75%	8.71%	7.10%	6.00%	5.61%	5.61%
Return on Assets	5.54%	5.63%	4.50%	3.89%	3.86%	3.86%
Number of Shares Issued (Thousands) . .	47,992	52,839	58,279	58,279	58,279	
Number of Employees	1,592	1,696	1,693	1,697	1,663	

Note: U.S. dollar amounts are translated at the rate of ¥120=U.S.\$1, the approximate effective rate of exchange at 31st March 1999.

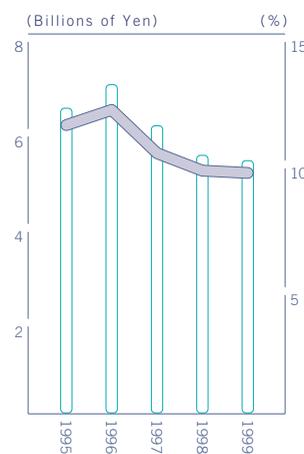
NET SALES



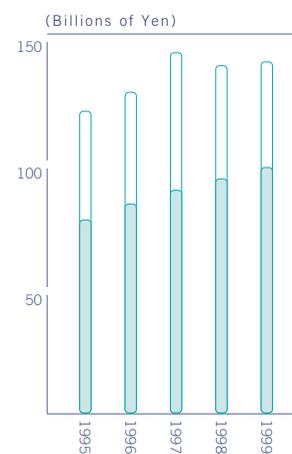
OPERATING INCOME



NET INCOME



TOTAL ASSETS AND TOTAL SHAREHOLDERS' EQUITY



BOARD OF DIRECTORS*Chairman:*

Kunio Kanzawa

Vice Chairman:

Eiichi Takagi

President and Chief Executive Officer:

Mutsuo Kanzawa

Executive Director:

Masamichi Sasaki

Managing Directors:

Masanori Iwadare

Tokumi Tamura

Directors:

Yoshiharu Tadokoro

Hiroshi Saito

Toyotsugu Hiyoshi

Yukiyoshi Ajisawa

Haruo Suzawa

Katsuki Taoka

Yoshikazu Kurashina

Toshiaki Usuda

Masayuki Takeuchi

Keiichiro Yanagisawa

Shigeo Arikawa

Seiichiro Furihata

Auditors:

Yoshiyuki Yamada

Yoshinobu Kubota

Hideo Saito

KISSEI PHARMACEUTICAL CO., LTD.*Head Office:*

19-48, Yoshino, Matsumoto, Nagano 399-8710, Japan

Phone. (0263) 25-9081

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Chuo-ku, Tokyo 103-0022, Japan

Phone. (03) 3279-2761

Tokyo Head Office (Koishikawa):

1-3, Koishikawa 3-chome,

Bunkyo-ku, Tokyo 112-0002, Japan

Phone. (03) 5684-3530

Established:

August 9, 1946

Capital:

¥24,220 million

Number of Employees:

1,474

Central Research Laboratories:

Hotaka

Pharmaceutical Laboratories:

Hotaka

Second Research Laboratories:

Hotaka

Plants:

Matsumoto, Shiojiri

Distribution Centers:

Shiojiri, Sapporo, Fukuoka

Information Center:

Matsumoto

Branches:

Sapporo, Sendai, Kan-etsu, Tokyo, Yokohama,

Matsumoto, Nagoya, Kyoto, Osaka, Takamatsu,

Hiroshima, Fukuoka

Offices:

Sendai-daini, Koriyama, Takasaki, Utsunomiya, Mito,

Niigata, Tama, Chiba, Atsugi, Gifu, Mie, Shizuoka,

Kanazawa, Kita Osaka, Sakai, Kobe, Himeji, Okayama,

Kitakyushu, Nagasaki, Kumamoto, Kagoshima, Okinawa

Overseas Office:

London

Affiliated Companies:

Kissei U.S.A., Inc.

Kissei Shoji Co., Ltd.

Kissei Comtec Co., Ltd.

Kissei Technos Co., Ltd.

Jonan Paperware Co., Ltd.

Mitsui Kanko Co., Ltd.

 KISSEI PHARMACEUTICAL CO., LTD.

19-48, Yoshino, Matsumoto, Nagano 399-8710, Japan