Hisamitsu Pharmaceutical Co., Inc.

# FINANCIAL REPORT

## Fiscal 2002

Contents

# Management Policies

## (1) Fundamental Management Policies
Hisamitsu Pharmaceutical Co., Inc. (the Company) begins with a patch and patch-relating technology, namely, transdermal therapeutic system (TTS) technology. The Company, adhering to its motto, “Customers First”, 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 TTS studies.

Under this philosophy, the Company is actively developing corporate activities to satisfy customers through providing customers with pharmaceutical products meeting their needs both at home and abroad and finally making efforts to enhance its market capitalization.

## (2) Fundamental Profit-sharing Policy
The Company, recognizing profit-sharing to shareholders as the most important task, maintains and continues rewarding shareholders with stable dividends and, additionally, it flexibly takes such financial measures as acquiring treasury stock, which is considered as effective profit-sharing 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) Mid-term Strategies
In line with the fundamental management policies, 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 meeting properly the needs of medical institutions through TTS studies.

The Company has settled the mid-term targets to achieve “net income of ¥10,000 million ($74,627 thousand) and return on equity (ROE) of 15% by the fiscal 2005 ending February 28, 2005”. Thanks to our persistent efforts, the Company has just attained the ROE target three years earlier than expected and it will make further efforts to achieve the net income target as well as to keep the ROE target of more than 15%. Additionally the Company has set a new mid-term target to achieve by fiscal 2006 ending February 28, 2006, expecting further growth.

In order to build up its future assets, the Company also aims at increasing cash flows from operating activities, promoting R & D of new transdermal pharmaceuticals for topical use and systemic use as well as establishing worldwide the Company’s brand including trade marks, designs, manufacturing technology and quality control system.

## (4) Measures for Enhancing Corporate Governance
The Company is striving to establish and maintain the management system meeting global standards in order to hold lively discussions in the board of directors’ meeting as well as to promote quicker decision-making there, and it is striving to further strengthen its corporate governance system.

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

## (5) 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 promoting its stock circulation. However, at present, the Company has not yet determined a concrete plan and time for reducing the investment unit.

# Review of Operations

## (1) Overview of Fiscal 2002 ended February 28, 2002

The Japanese economic depression has continued throughout fiscal 2002, and this has shown no signs of recovery due primarily to sluggish domestic demand coming from low personal consumption and decreases in capital expenditures by industry.

The Japanese Government has been strengthening the policy of restraining healthcare costs year by year and has been trying to implement radical reforms in the National Health Insurance (NHI) scheme, intending to increase the portion of health care costs shared by patients.

Despite these difficult operating conditions, the Company and its subsidiaries (the "Companies") have been active in every operating field.

(Pharmaceuticals and related products segment)

With respect to ethical pharmaceuticals, the Company's medical representatives (MR) developed pharmaceutical information activities primarily focusing on topical analgesic and anti-inflammatory pharmaceuticals to properly meet the needs of medical institutions. The Company made improvements both to transdermal patch, MOHRUS TAPE, and transdermal gel patch, MOHRUS, to make them easy to use, and strove to introduce them into as many medical institutions as possible. Additionally, the Company aggressively developed enlightening activities for ESTRANA, an estradiol-contained patch for treating menopause, emphasizing the efficacy of a hormone replacement therapy (HRT).

Regarding over-the-counter (OTC) products, the Company concentrated on topical analgesic and anti-inflammatory pharmaceuticals to develop sales activities through emphasizing the advantage of "Enhanced penetration into the skin by occlusion" despite the stagnant market reflecting flat personal consumption. In order to meet the diversifying customers' needs, the Company aggressively launched onto the OTC market six new products, which included an analgesic and anti-inflammatory rolled patch SALONPAS ROLL, an eye drop GANRYO ALFIRST, three masks for facial packs LIFECELLA WHITENING MASK, LIFECELLA TENNEN-DORO MASK and LIFECELLA KUBI-URUOI MASK, and a first-aid patch for cooling fever, DECO-DECO COOL S.

The Company primarily oriented its R & D activities toward creating new transdermal preparations for topical use and systemic use, making steady progress on a long series of fundamental and applied studies. On the other hand, the Company tried to promote clinical trials in Europe. For this purpose, the Company has been constructing a new plant for preparing products for clinical trials in the R & D center.

In the production division, the Company has recently constructed a new manufacturing plant in the Tosu area to increase production efficiency as well as product quality.

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

(Cable television broadcasting and other segment)
The Companies continued to aggressively develop the cable television broadcasting business (broadcasting area: cities of Kurume, Ohkawa and Yanagawa in Fukuoka prefecture and Saga city in Saga prefecture), as well as other businesses including production and sale of laboratory animals to expand the market. Moreover, the Companies strove to improve business results, promoting the streamlining of management.

As a result of the above operating activities in each business segment, the consolidated net sales for the Companies totaled ¥69,538 million ($518,940 thousand), an increase of 6.6% over the previous year. Regarding income, the consolidated operating income amounted to ¥15,921 million ($118,813 thousand), an increase of 13.8%, and net income amounted to ¥8,607 million ($64,231 thousand), a 26.8% increase over the previous year. All these figures were record highs for the Companies.

## (2) Outlook for Fiscal 2003 ending February 28, 2003
Effective April 1, 2002, the Government executed a cut in NHI pharmaceutical reimbursement prices, an average of 6.3% across the industry. In addition to this reduction, an increased share of healthcare costs paid by patients will possibly be implemented from the coming April. It is, therefore, anticipated that the domestic ethical pharmaceutical market will drastically shrink, depending on the trend of further reforms in the NHI pharmaceutical reimbursement price system. Despite these unprecedented serious circumstances, the Company will aggressively continue providing pharmaceutical information to medical institutions and challenge to create new transdermal preparations to exactly meet medical needs.

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

Regarding overseas sales development, the Company is trying to develop clinical trials of the Company's products, especially MORUS TAPE, in the Europe and the U. S. as well as establish worldwide the Company's brand including trade marks, manufacturing technology and quality control of products.

Additionally, the Companies are intending to further accelerate sales activities in the cable television broadcasting segment and other businesses to achieve better results.

The Companies, being fully aware of their responsibility for corporate citizenship, will devote themselves to improve their business performance through the strengthening of their sales, increasing productivity, speedier R & D activities, streamlining of management and building up of their corporate constitution.

Referring to the consolidated results of operations for the next year ending February 28, 2003, the Companies are expecting that, in the absence of unforeseen circumstances, net sales will show approximately the same figure as the previous year but net income will show an increase of about 10% over the previous year.

Concerning cash dividends for the next year ending February 28, 2003, the Company has declared to reward shareholders with a dividend of ¥10.00 per share of common stock, which corresponds to an increase of ¥1.00 per share over the previous year.

# Financial Review

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

## (1) Results of Operations

**Net Sales**

(Pharmaceuticals and related products segment)

With regard to ethical pharmaceuticals, the Company actively promoted pharmaceutical information activities meeting the diversifying healthcare needs of medical institutions, centering on its core products, such as analgesic and anti-inflammatory products for external 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.

With respect to over-the-counter (OTC) products, although the OTC market has been very stagnant during fiscal 2002, the Company strove to principally promote the sale of analgesic and anti-inflammatory pharmaceuticals for external use. During the year, in order to keep up with customers’ diversifying needs, the Company successfully launched six new products consisting of an analgesic and anti-inflammatory rolled patch SALONPAS ROLL, an eye drop GANRYO ALFIRST, three masks for facial packs LIFECELLA WHITENING MASK, LIFECELLA TENNEN-DORO MASK, LIFECELLA KUBI-URUOI MASK and a first-aid pad for cooling fever DECO-DECO COOL S.

In the pharmaceuticals and related products segment, net sales recorded ¥67,224 million ($501,672 thousand), a 6.4% increase over the previous year.

(Cable Television Broadcasting and Other Segment)

The Companies continued to aggressively develop the cable television broadcasting business (broadcasting area: cities of Kurume, Ohkawa and Yanagawa in Fukuoka prefecture and Saga city in Saga prefecture), as well as other businesses including production and sale of laboratory animals to expand the market. Additionally, the Companies strove to improve business results, promoting the streamlining of management.

In the cable television broadcasting and other segment, net sales were ¥2,314 million ($17,268 thousand), a 12.9% increase over the previous year.

As a result, the consolidated net sales for the Companies totaled ¥69,538 million ($518,940 thousand), an increase of 6.6% over the previous year. Briefly speaking, this increase reflects the significantly increased sales of both ketoprofen patches MOHRUS TAPE and ketoprofen gel patches MOHRUS.

**Costs and Expenses**

Cost of sales amounted to ¥20,710 million ($154,552 thousand), a 3.2% increase over the previous year, rendering the cost of sales as a percentage of net sales at 29.8%. Selling, general and administrative expenses totaled ¥26,635 million ($198,769 thousand), a 3.5% increase and R & D expenses also increased 15.4% to ¥6,272 million ($46,806 thousand) with the ratio of R & D expenses to net sales at 9.0%.

Operating income was ¥15,921 million ($118,813 thousand), a 13.8% increase over the previous year, by deducting costs and expenses from net sales, yielding the ratio of operating income to net sales of 22.9%.

Other expenses, net of other income, totaled ¥258 million ($1,925 thousand), an 87.2% decrease from the previous year, primarily reflecting prior service cost under the contributory pension plan in the previous year due to the change in the method of accounting for severance and retirement benefits.

Net Income

Income before income taxes was ¥15,663 million ($116,888 thousand), a 30.8% increase over the previous year, and net income was ¥8,607 million ($64,231 thousand), a 26.8% increase, by deducting current income taxes, deferred income taxes and minority interest in net income of consolidated subsidiaries.

The effective tax rate was 44.6%. Net income per share of common stock was ¥91.99 ($0.69), a 26.3% increase over the previous year and the Company paid its shareholders cash dividends per share of ¥9.00 ($0.07).

## (2) Financial Position

At February 28, 2002, total assets amounted to ¥82,893 million ($618,604 thousand), a 2.7% increase over the previous year. Total current assets amounted to ¥37,424 million ($279,283 thousand), a 1.6% decrease from the previous year. This principally reflected decreases in notes and accounts receivable, deferred tax assets and short-term investments despite a significant increase in cash and time deposits.

Property, plant and equipment, less accumulated depreciation, were ¥33,962 million ($253,448 thousand), which was approximately the same as the previous year. Intangible assets increased to ¥625 million ($4,664 thousand).

Investments and other non-current assets totaled ¥10,882 million ($81,209 thousand), a 28.9% increase, principally resulting from markedly increased investment securities.

Total current liabilities amounted to ¥20,048 million ($149,612 thousand), a 19.2% decrease from the previous year. This principally came from marked decreases in both short-term bank loans and income taxes payable. Working capital increased 31.5% to ¥17,376 million ($129,671 thousand), and the current ratio increased to 186.7%, compared to previous year of 153.2%.

Total long-term liabilities were ¥6,890 million ($51,418 thousand), a 12.0% increase over the previous year, primarily resulting from deferred tax liabilities relating to land revaluation despite significantly decreased long-term debt due after one year.

Total shareholders' equity increased 12.8% to ¥55,474 million ($413,985 thousand). This increase primarily came from retained earnings and gain on land revaluation despite increased treasury stock.

## (3) Cash Flows

Operating activities generated net cash of ¥13,078 million ($97,597 thousand), a 6.5% increase over the previous year. This principally resulted from markedly increased income before income taxes with an increase in net sales.

Investing activities used net cash of ¥6,589 million ($49,172 thousand), a 28.4% increase over the previous year, primarily reflecting payments for purchases of property, plant and equipment of ¥4,481 million ($33,441 thousand) and payment for purchase for investment securities of ¥3,168 million ($23,642 thousand). Major capital investments were made for the construction of a new manufacturing plant in the Tosu area as well as a new pilot plant to prepare products for clinical trials in the R & D center.

Financing activities consumed net cash of ¥5,527 million ($41,246 thousand), a 266.8% increase over the previous year. This is primarily due to repayments of short-term bank loans and payment for purchase of treasury stock.

As a result, cash and cash equivalents at end of year totaled ¥13,560 million ($101,194 thousand), an increase of ¥1,034 million ($7,716), compared to cash and cash equivalents at beginning of year, principally resulting from increased cash flows provided by operating activities with an increase in net sales of the Company.

# Consolidated Balance Sheets

HISAMITSU PHARMACEUTICAL CO., INC.
February 28, 2002 and 2001

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | **2002** | 2001 | **2002** |
| **ASSET** | | | |
| **Current assets:** | | | |
| Cash and time deposits (Note 3) | **¥ 12,882** | ¥ 11,246 | **$ 96,134** |
| Notes and accounts receivable: | | | |
| Trade notes (Note 15) | **3,106** | 4,991 | **23,179** |
| Trade accounts | **14,219** | 13,547 | **106,112** |
| Short-term investments (Note 4) | **877** | 1,345 | **6,545** |
| Inventories (Note 5) | **4,574** | 4,896 | **34,134** |
| Deferred tax assets (Note 11) | **308** | 972 | **2,298** |
| Other current assets | **1,489** | 1,120 | **11,112** |
| Less allowance for doubtful accounts | **(31)** | (88) | **(231)** |
| **Total current assets** | **37,424** | 38,029 | **279,283** |
| **Property, plant and equipment:** | | | |
| Land (Note 6) | **11,398** | 12,217 | **85,060** |
| Buildings and structures (Note 9) | **22,002** | 23,384 | **164,194** |
| Machinery and equipment (Note 9) | **15,719** | 15,891 | **117,306** |
| Tools, furniture and fixtures | **9,657** | 9,621 | **72,067** |
| Construction in progress | **3,816** | 1,423 | **28,478** |
| | **62,592** | 62,536 | **467,105** |
| Less accumulated depreciation | **(28,630)** | (28,573) | **(213,657)** |
| | **33,962** | 33,963 | **253,448** |
| **Intangible assets** | **625** | 273 | **4,664** |
| **Investments and other non-current assets:** | | | |
| Investment securities (Notes 4 and 9) | **6,384** | 3,694 | **47,642** |
| Investment in non-consolidated subsidiaries and affiliated companies (Note 4) | **712** | 706 | **5,313** |
| Deferred tax assets (Note 11) | **2,103** | 1,586 | **15,694** |
| Deferred tax assets relating to land revaluation (Note 6) | **—** | 641 | **—** |
| Other investments and other non-current Assets | **1,887** | 1,818 | **14,082** |
| Less allowance for doubtful accounts | **(204)** | (4) | **(1,522)** |
| | **10,882** | 8,441 | **81,209** |
| | **¥ 82,893** | **¥ 80,706** | **$ 618,604** |

See accompanying notes.

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| **Current liabilities:** | | | |
| Short-term bank loans (Note 9) | ¥ 347 | ¥ 3,122 | $ 2,590 |
| Long-term debt due within one year (Note 9) | 1,227 | 637 | 9,157 |
| Notes and accounts payable: | | | |
| Trade | 8,356 | 8,936 | 62,358 |
| Construction | 506 | 296 | 3,776 |
| Other | 7,169 | 7,514 | 53,500 |
| Income taxes payable (Note 11) | 1,227 | 3,404 | 9,157 |
| Reserve for sales returns | 197 | 194 | 1,470 |
| Reserve for employees' bonuses | 481 | 467 | 3,589 |
| Other current liabilities | 538 | 246 | 4,015 |
| **Total current liabilities** | 20,048 | 24,816 | 149,612 |
| **Long-term liabilities:** | | | |
| Long-term debt due after one year (Note 9) | 1,353 | 2,341 | 10,097 |
| Deferred tax liabilities relating to land revaluation (Note 6) | 1,955 | — | 14,590 |
| Severance and retirement benefits (Note 10) | 2,711 | — | 20,231 |
| Retirement benefits | — | 2,359 | — |
| Directors' and corporate auditors' retirement benefits | 804 | 768 | 6,000 |
| Other non-current liabilities | 67 | 685 | 500 |
| **Total long-term liabilities** | 6,890 | 6,153 | 51,418 |
| **Minority interests** | 481 | 555 | 3,589 |
| **Contingent liabilities** (Note 15) | | | |
| **Shareholders' equity** (Notes 13 and 14): | | | |
| Common stock: | | | |
| Authorized—380,000,000 shares | | | |
| Issued—95,164,895 shares in 2002 | 8,474 | — | 63,239 |
| —95,108,490 shares in 2001 | — | 8,460 | — |
| Additional paid-in capital | 8,242 | 8,227 | 61,507 |
| Gain (loss) on land revaluation (Note 6) | 2,729 | (894) | 20,366 |
| Retained earnings | 38,976 | 34,719 | 290,866 |
| Unrealized holding losses on securities | (43) | — | (321) |
| Translation adjustments | (361) | (468) | (2,694) |
| Treasury stock, at cost | (1,683) | (2) | (12,560) |
| Common stock purchased by a subsidiary | (860) | (860) | (6,418) |
| **Total shareholders' equity** | 55,474 | 49,182 | 413,985 |
| | ¥82,893 | ¥ 80,706 | $618,604 |

# Consolidated Statements of Income

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

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| **Net sales** | **¥ 69,538** | ¥ 65,240 | **$ 518,940** |
| **Costs and expenses:** | | | |
| Cost of sales | **20,710** | 20,068 | **154,552** |
| Selling, general and administrative | **26,635** | 25,746 | **198,769** |
| Research and development | **6,272** | 5,435 | **46,806** |
| | **53,617** | 51,249 | **400,127** |
| **Operating income** | **15,921** | 13,991 | **118,813** |
| **Other income (expense):** | | | |
| Interest and dividend income | **149** | 103 | **1,112** |
| Interest expense | **(77)** | (173) | **(575)** |
| Equity in earnings of affiliated companies | **47** | 50 | **351** |
| Gain on sales of property, plant and equipment | **267** | 2 | **1,993** |
| Gain on sales of investment securities | **—** | 8 | **—** |
| Reversal of allowance for doubtful accounts | **60** | — | **448** |
| Transition obligation for employees' retirement benefits | **318** | — | **2,373** |
| Governmental subsidy | **38** | 159 | **284** |
| Loss on sales and disposals of property, plant and equipment | **(502)** | (202) | **(3,746)** |
| Write-down of investment securities | **(434)** | (274) | **(3,239)** |
| Write-down of golf-club memberships | **(464)** | (168) | **(3,463)** |
| Prior service cost under the contributory pension plan | **—** | (2,032) | **—** |
| Provision for allowance for doubtful accounts | **(156)** | — | **(1,164)** |
| Other—net | **496** | 515 | **3,701** |
| | **(258)** | (2,012) | **(1,925)** |
| **Income before income taxes** | **15,663** | 11,979 | **116,888** |
| **Income taxes** (Note 11): | | | |
| Current | **4,216** | 5,771 | **31,463** |
| Deferred | **2,774** | (718) | **20,701** |
| **Minority interests in net income of consolidated subsidiaries** | **66** | 138 | **493** |
| **Net income** | **¥ 8,607** | ¥ 6,788 | **$ 64,231** |

| | Yen | | U.S. dollars (Note 1) |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| **Amounts per share of common stock** (Note 2): | | | |
| Net income | ¥ 91.99 | ¥ 72.82 | $ 0.69 |
| Diluted net income | 91.99 | 72.70 | 0.69 |
| Cash dividends applicable to the year | 9.00 | 7.00 | 0.07 |

See accompanying notes.

# Consolidated Statements of Shareholders' Equity

Hisamitsu Pharmaceutical Co., Inc.
Years ended February 28, 2002 and 2001

| | Million of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | **2002** | 2001 | **2002** |
| **Common stock:** | | | |
| Balance at beginning of year | **¥ 8,460** | ¥ 8,414 | **$ 63,134** |
| Shares issued upon exercise of warrants (Note 14) | **14** | 46 | **105** |
| **Balance at end of year** | **¥ 8,474** | ¥ 8,460 | **$ 63,239** |
| **Additional paid-in capital:** | | | |
| Balance at beginning of year | **¥ 8,227** | ¥ 8,175 | **$ 61,395** |
| Shares issued upon exercise of warrants (Note 14) | **15** | 52 | **112** |
| **Balance at end of year** | **¥ 8,242** | ¥ 8,227 | **$ 61,507** |
| **Gain (loss) on land revaluation:** | | | |
| Balance at beginning of year | **¥ (894)** | ¥ — | **$ (6,671)** |
| Land revaluation, net of tax (Note 6) | **3,623** | (894) | **27,037** |
| **Balance at end of year** | **¥ 2,729** | ¥ (894) | **$ 20,366** |
| **Retained earnings:** | | | |
| Balance at beginning of year | **¥34,719** | ¥27,662 | **$259,097** |
| Net income | **8,607** | 6,788 | **64,231** |
| Cumulative effect of adopting tax effect accounting | **—** | 1,783 | **—** |
| Cash dividends paid | **(666)** | (481) | **(4,970)** |
| Bonuses to directors and corporate auditors | **(61)** | (59) | **(455)** |
| Retirement of common stock (Note 14) | **—** | (974) | **—** |
| Land revaluation adjustment (Note 6) | **(3,623)** | — | **(27,037)** |
| **Balance at end of year** | **¥38,976** | ¥34,719 | **$290,866** |
| **Unrealized holding losses on securities:** | | | |
| Balance at beginning of year | **¥ —** | ¥ — | **$ —** |
| Valuation losses | **(43)** | — | **(321)** |
| **Balance at end of year** | **¥ (43)** | ¥ — | **$ (321)** |
| **Translation adjustments:** | | | |
| Balance at beginning of year | **¥ (468)** | ¥ (478) | **$ (3,493)** |
| Adjustments from translation of foreign currency financial statements | **107** | 10 | **799** |
| **Balance at end of year** | **¥ (361)** | ¥ (468) | **$ (2,694)** |
| **Treasury stock:** | | | |
| Balance at beginning of year | **¥ (2)** | ¥ (1) | **$ (15)** |
| Treasury stock purchased | **(1,681)** | (1) | **(12,545)** |
| **Balance at end of year** | **¥(1,683)** | ¥ (2) | **$(12,560)** |
| **Common stock purchased by a subsidiary:** | | | |
| Balance at beginning of year | **¥ (860)** | ¥ (736) | **$ (6,418)** |
| Common stock purchased by a subsidiary | **—** | (124) | **—** |
| **Balance at end of year** | **¥ (860)** | ¥ (860) | **$ (6,418)** |

| | **2002** | 2001 |
|---|---|---|
| **Number of shares of common stock:** | | |
| Balance at beginning of year | **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** | 95,108,490 |

See accompanying notes.

# Consolidated Statements of Cash Flows

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

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | **2002** | 2001 | **2002** |
| **Cash flows from operating activities:** | | | |
| Income before income taxes | **¥15,663** | ¥11,979 | **$116,888** |
| Adjustments to reconcile net income before taxes to net cash provided by operating activities: | | | |
| Depreciation and amortization | **2,754** | 2,851 | **20,552** |
| Increase in allowance for severance and retirement benefits | **2,711** | — | **20,231** |
| Increase (decrease) in retirement benefits | **(2,359)** | 53 | **(17,605)** |
| Interest and dividend income | **(149)** | (103) | **(1,112)** |
| Interest expense | **77** | 173 | **575** |
| Equity in earnings of affiliated companies | **(47)** | (50) | **(351)** |
| Write-down of investment securities | **434** | 274 | **3,239** |
| Write-down of golf-club memberships | **464** | 168 | **3,463** |
| Loss on sales and disposal of property, plant and equipment | **502** | 202 | **3,746** |
| Decrease in notes and accounts receivable | **1,259** | 471 | **9,396** |
| (Increase) decrease in inventories | **358** | (727) | **2,672** |
| Increase in other current assets | **(365)** | (337) | **(2,724)** |
| Increase (decrease) in notes and accounts payable | **(559)** | 1,926 | **(4,172)** |
| Bonuses to directors and corporate auditors | **(61)** | (59) | **(455)** |
| Other | **(1,310)** | 630 | **(9,776)** |
| Subtotal | **19,372** | 17,451 | **144,567** |
| Interest and dividend income received | **181** | 102 | **1,351** |
| Interest paid | **(80)** | (172) | **(597)** |
| Income taxes paid | **(6,395)** | (5,101) | **(47,724)** |
| **Net cash provided by operating activities** | **13,078** | 12,280 | **97,597** |
| **Cash flows from investing activities:** | | | |
| Payments for purchases of property, plant and equipment | **(4,481)** | (3,597) | **(33,441)** |
| Proceeds from sales of property, plant and equipment | **1,760** | 81 | **13,134** |
| Payments for purchases of intangible assets | **(528)** | (186) | **(3,940)** |
| Payments for purchases of marketable securities | **(3,400)** | (3,300) | **(25,373)** |
| Proceeds from sales of marketable securities | **3,300** | 3,359 | **24,627** |
| Payments for purchases of investment securities | **(3,168)** | (1,350) | **(23,642)** |
| Other | **(72)** | (137) | **(537)** |
| **Net cash used in investing activities** | **(6,589)** | (5,130) | **(49,172)** |
| **Cash flows from financing activities:** | | | |
| Net increase (decrease) in bank loans | **(2,650)** | 2,586 | **(19,776)** |
| Proceeds from long-term debt | **173** | — | **1,291** |
| Repayment of long-term debt | **(749)** | (2,607) | **(5,590)** |
| Proceeds from exercise of warrants | **32** | 98 | **239** |
| Payment for purchase of treasury stock | **(1,728)** | (1,162) | **(12,895)** |
| Proceeds from sales of treasury stock | **61** | 183 | **455** |
| Cash dividends paid | **(666)** | (481) | **(4,970)** |
| Other | **—** | (124) | **—** |
| **Net cash used in financing activities** | **(5,527)** | (1,507) | **(41,246)** |
| **Effect of exchange rate changes on cash and cash equivalents** | **72** | 42 | **537** |
| **Net increase in cash and cash equivalents** | **1,034** | 5,685 | **7,716** |
| **Cash and cash equivalents at beginning of year** | **12,526** | 6,841 | **93,478** |
| **Cash and cash equivalents at end of year** (Note 3) | **¥ 13,560** | ¥ 12,526 | **$ 101,194** |

See accompanying notes.

# Notes to Consolidated Financial Statements

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

## 1. Basis of Consolidated Financial Statements

Hisamitsu Pharmaceutical Co., Inc. (the “Company”) and its consolidated domestic subsidiaries maintain their official accounting records in Japanese yen and in accordance with the provisions set forth in the Japanese Commercial Code (the “Code”) and 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 financial statements are intended for use by those who are informed about Japanese accounting principles and practices.

The accompanying financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of statements of shareholders’ equity) from the consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law. Some supplementary information included in the statutory Japanese language consolidated financial statements, but not required for fair presentation is not presented in the accompanying financial statements.

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, 2002, which was ￥134.00 to U.S. $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 include the accounts of the Company and its significant subsidiaries (the “Companies”). The accounts of twelve and ten subsidiaries have been consolidated in the years ended February 28, 2002 and 2001, respectively. All significant intercompany balances, transactions and profits have been eliminated.

The consolidated financial statements for the years ended February 28, 2002 and 2001 were prepared in accordance with the revised Accounting Principles for Consolidated Financial Statements (the New Accounting Principles), which are effective from years ending after March 31, 2000. Under the New Accounting Principles, companies are required to consolidate all significant investees which are controlled through substantial ownership of majority voting rights or the existence of certain 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..

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 expensed 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 of 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 ($545 thousand) 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 ($4,142 thousand).

**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, 2002 and 2001. Depreciation is provided over estimated useful lives as permitted by the Corporation Tax of Japan.

Depreciation of property, plant and equipment is determined by the declining balance method except that the straight line method is primarily adopted by the overseas consolidated subsidiaries.

**Intangible Assets**
Intangible assets are stated at cost less accumulated amortization and amortized by the straight line method. Amortization is provided over estimated useful lives as permitted by the Corporation Tax of Japan, except that the amortization of internally used software is determined using the straight line method over the estimated useful life 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 assets and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

The amount of deferred income taxes attributable to the net tax effects of the temporary differences at March 1, 2001 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 1996 pension plan and 1966 pension plan were expensed when incurred.

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

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, 2002 based on the estimated amounts of projected benefit obligation and the fair value of the plan assets at that date.

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 ($2,373 thousand). 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 ($149 thousand). Since the net transition gain of ¥318 million ($2,373 thousand) was included in other income, income before income taxes increased by ¥338 million ($2,522 thousand) 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 (the "New Accounting Standard"). Under the New Accounting Standard, long-term receivables and payables denominated in foreign currencies are also translated into Japanese yen at the year-end rate. The effect on the consolidated income statement of adopting the New Accounting Standard was immaterial.

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.

## 3. Cash and Cash Equivalents

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

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2002** | 2001 | **2002** |
| Cash and time deposits | **¥ 12,882** | ¥ 11,246 | **$ 96,134** |
| Less: Time deposits with maturities exceeding three months | **(99)** | (65) | **(739)** |
| Securities excluding free financial fund and money management fund | **(100)** | — | **(746)** |
| Add: Short-term highly liquid investments with maturities of not exceeding three months | **877** | 1,345 | **6,545** |
| Cash and cash equivalents | **¥ 13,560** | ¥12,526 | **$101,194** |

## 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, 2002.

(a) Held-to-maturity debt securities

Securities with available fair values exceeding book values:

| | Millions of yen | | |
|---|---|---|---|
| | Book value | Fair value | Difference |
| Government bonds | ¥ 751 | ¥ 751 | ¥ — |

| | Thousands of U.S. dollars | | |
|---|---|---|---|
| | Book value | Fair value | Difference |
| Government bonds | $ 5,604 | $ 5,604 | $ — |

Securities with available fair values not exceeding book values:

| | Millions of yen | | |
|---|---|---|---|
| | Book value | Fair value | Difference |
| Government bonds | ¥ 1,800 | ¥ 1,799 | ¥ (1) |

| | Thousands of U.S. dollars | | |
|---|---|---|---|
| | Book value | Fair value | Difference |
| Government bonds | $ 13,433 | $ 13,425 | $ (8) |

(b) Available-for-sale securities

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

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

| | Thousands of U.S. dollars | | |
|---|---|---|---|
| | Acquisition cost | Book value | Difference |
| Equity securities | $ 8,619 | $12,134 | $ 3,515 |

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

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

| | Thousands of U.S. dollars | | |
|---|---|---|---|
| | Acquisition cost | Book value | Difference |
| Equity securities | $ 18,336 | $ 14,336 | $ (4,000) |

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

(a) Available-for-sale securities:

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Non-listed equity securities (excluding securities traded over-the-counter) | ¥ 1,098 | $ 8,194 |
| Free financial fund | 240 | 1,791 |
| Money management fund | 501 | 3,739 |
| Total | ¥ 1,839 | $13,724 |

(b) Equity securities of subsidiaries and affiliated companies:

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Subsidiaries | ¥ 445 | $ 3,321 |
| Affiliated companies | 267 | 1,992 |
| Total | ¥ 712 | $ 5,313 |

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

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

| | Thousands of U.S. dollars | | |
|---|---|---|---|
| | Within one year | Over one year but within five years | Total |
| Government bonds | $ 746 | $ 18,284 | $ 19,030 |

D. Investment securities with available fair market values

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

| | Millions of yen | |
|---|---|---|
| | Carrying value | Market value |
| Investment securities | ¥ 3,357 | ¥ 3,527 |

E. Marketable securities and investment securities with no available fair market values

The following securities were not included in the above table and their carrying values at February 28, 2001 were as follows:

| | Millions of yen |
|---|---|
| Marketable securities: | |
| Marketable securities in investment trusts | ¥ 645 |
| Governmental securities fund | 300 |
| Free financial fund | 300 |
| Money management fund | 100 |
| Investment securities: | |
| Unlisted securities, excluding over-the-counter shares | 1,043 |
| Total | ¥ 2,388 |

## 5. Inventories

Inventories at February 28, 2002 and 2001 consisted of the following:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2002** | 2001 | **2002** |
| Goods and products | **¥ 3,318** | ¥ 3,479 | **$ 24,761** |
| Raw materials | **453** | 493 | **3,381** |
| Work in process | **258** | 246 | **1,925** |
| Supplies | **545** | 678 | **4,067** |
| | **¥ 4,574** | ¥ 4,896 | **$ 34,134** |

## 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 "Gain (loss) on land revaluation", net of tax.

Gain or loss on land evaluation was provided as a loss component in shareholders' equity in the previous year, but provided as a gain component in the year ended February 28, 2002. This resulted from the Company selling the land of the former Tokyo Head Office whose book value after revaluation was less than that before revaluation.

## 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, 2002 and 2001.

## 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 ¥1,276 million ($9,522 thousand) and ¥1,327 million at February 28, 2002 and 2001, respectively.

Lease payments for finance leases which do not transfer ownership to lessees amounted to ¥354 million ($2,642 thousand) and ¥288 million for the years ended February 28, 2002 and 2001, respectively.

Future minimum leases payments, including financing cost, required under such leases at February 28, 2002 and 2001 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Due within one year | ¥ 290 | ¥ 231 | $ 2,164 |
| Due after one year | 523 | 232 | 3,903 |
| | ¥ 813 | ¥ 463 | $ 6,067 |

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

Short-term bank loans are represented generally by notes maturing within one year. The annual interest rate at February 28, 2002 was 0.83%.

Long-term debt at February 28, 2002 and 2001 consisted of the following:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Unsecured long-term bank loans | ¥ 1,532 | ¥ 1,516 | $ 11,433 |
| Secured long-term bank loans | 1,048 | 1,462 | 7,821 |
| | 2,580 | 2,978 | 19,254 |
| Less amounts due within one year | (1,227) | (637) | (9,157) |
| | ¥ 1,353 | ¥ 2,341 | $ 10,097 |

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

At February 28, 2002 and 2001, assets pledged as collateral for short-term bank loans including long-term debt due within one year of ¥473 million ($3,530 thousand) and secured long-term bank loans were as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Buildings and structures | ¥ 477 | ¥ 1,049 | $ 3,560 |
| Machinery and equipment | 748 | 272 | 5,582 |
| Investment securities | 416 | 416 | 3,104 |
| | ¥1,641 | ¥ 1,737 | $ 12,246 |

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

| Years ending February 28/29 | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| 2004 | ¥ 339 | $ 2,530 |
| 2005 | 331 | 2,470 |
| 2006 | 174 | 1,298 |
| 2007 | 142 | 1,060 |
| Thereafter | 367 | 2,739 |
| | ¥ 1,353 | $ 10,097 |

## 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, 2002 consisted of the following.

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Projected benefit obligation | ¥ (8,697) | $ (64,903) |
| Unrecognized prior service cost | (117) | (873) |
| Fair value of pension assets | 5,559 | 41,485 |
| Unrecognized actuarial differences | 725 | 5,411 |
| Accrued pension cost | (181) | (1,351) |
| Liability for severance and retirement benefit | ¥ (2,711) | $ (20,231) |

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

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Severance costs–benefits earned during the year | ¥ 598 | $ 4,463 |
| Interest cost on projected benefit obligation | 203 | 1,515 |
| Expected return on plan assets | (133) | (993) |
| Net transition gain | (318) | (2,373) |
| Adjustment to prior service costs | (117) | (873) |
| Severance and retirement benefit expenses | ¥ 233 | $ 1,739 |

The discount rate is 2.50%. 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. Prior service costs are recognized as an expense in equal amounts over two years commencing from the date of the change, and actuarial gains and losses are recognized in the income statement as an expense in equal amounts over five years, commencing from the following year.

Charges to income with respect to directors' and corporate auditors' retirement benefits amounted to ¥55 million ($410 thousand) and ¥66 million for the years ended February 28, 2002 and 2001, respectively.

## 11. Income Taxes

The Companies are subject to a number of taxes based on income, which, in the aggregate, indicate a statutory rate in Japan of approximately 41.7% for the years ended February 28, 2002 and 2001.

The following table summarizes the significant differences between the statutory tax rate and the Companies' effective tax rates for financial statement purposes for the years ended February 28, 2002 and 2001:

| | 2002 | 2001 |
|---|---|---|
| Statutory tax rate | 41.7% | 41.7% |
| Non-deductible expenses | 3.0 | 3.1 |
| Non-taxable dividend income | (0.1) | (0.1) |
| Per capita inhabitants' tax | 0.1 | 0.1 |
| Other | (0.1) | (2.6) |
| Effective tax rate | 44.6% | 42.2% |

Significant components of the Companies' deferred tax assets as of February 28, 2002 and 2001 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Deferred tax assets: | | | |
| Excess severance and retirement benefits | ¥ 758 | ¥ — | $ 5,657 |
| Excess retirement benefits | — | 671 | — |
| Valuation loss on investment securities | 566 | 355 | 4,224 |
| Directors' and corporate auditors' retirement benefits | 336 | 321 | 2,507 |
| Accrued enterprise tax | 105 | 307 | 784 |
| Long-term accounts payable | — | 276 | — |
| Accrued expenses | 7 | 266 | 52 |
| Valuation loss on investment in capital | 330 | 103 | 2,463 |
| Excess employees' bonuses accrued | 104 | 61 | 776 |
| Net unrealized holding loss on securities | 31 | — | 231 |
| Losses carried forward | 84 | 153 | 627 |
| Other | 174 | 136 | 1,298 |
| Total deferred tax assets | 2,495 | 2,649 | 18,619 |
| Valuation allowance | (84) | (91) | (627) |
| Net deferred tax assets | ¥ 2,411 | ¥ 2,558 | $ 17,992 |

## 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, 2002 and 2001 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, 2002 and 2001 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, 2002 and 2001 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 share 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.

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 reserve until the total amount of legal reserve and additional paid-in capital equals 25% of common stock. The legal 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 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 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.

## 14. Common Stock

(1) Exercise of warrants

As a result of exercise of the outstanding warrants, 56,405 additional shares of common stock were issued during the year ended February 28, 2002.

(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, 2002 were as follows:

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Notes receivable discounted | ¥ 52 | $ 388 |

## 16. Subsequent Events

(1) Appropriation of retained earnings

At the 2002 annual meeting of shareholders held on May 23, 2002, the appropriation of retained earnings for the year ended February 28, 2002 was duly approved as follows:

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Cash dividends– ¥9.00 ($0.07) per share | ¥ 847 | $ 6,321 |
| Bonuses to directors and corporate auditors | 56 | 418 |

(2) Reduction in additional paid-in capital and legal reserve

At the 2002 annual meeting of shareholders mentioned above, it was duly approved that the amount of total additional paid-in capital and legal reserve which exceeds 25% of the Company's stated capital was transferred to retained earnings in accordance with the revised Code. As a result of this transfer, the additional paid-in capital was reduced to ¥2,118 million ($15,806 thousand) and legal reserve to zero.

(3) 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 ($208,955 thousand) for a period of time ranging from the termination of the 2002 annual meeting of shareholders to the 2003 annual meeting of shareholders.

# 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, 2002 and 2001, and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended, 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, 2002 and 2001, and the consolidated results of their operations and their cash flows for the years then ended, 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, in the year ended February 28, 2002, HISAMITSU PHARMACEUTICAL CO., INC. and subsidiaries adopted new Japanese accounting standards for employees' severance and retirement benefits, financial instruments and foreign currency translation.

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

Fukuoka, Japan
May 23, 2002

Asahi & Co.