

# Financial Review

## REVIEW OF OPERATIONS

In the year ended March 31, 2003, the Japanese prescription ophthalmic pharmaceuticals market contracted slightly, impacted by National Health Insurance (NHI) drug price reductions in April 2002 and an increase in medical co-payments for elderly patients that went into effect in October 2002. Outside Japan, demand for prescription ophthalmic pharmaceuticals was strong in the United States and Europe. Demand in Asia also increased, particularly in China and Korea. The Japanese market for over-the-counter (OTC) pharmaceuticals also contracted, as deflation and intensifying competition led to lower retail prices.

To maintain our competitiveness amid this environment, we focused our management resources on our primary products and increased our promotional activities both quantitatively and qualitatively in our Japanese prescription ophthalmics business. In the United States, we reorganized the management structure of our local subsidiary in April 2002 and expanded the sales of the anti-infective ophthalmic *Quixin* (brand name in Japan: *Cravit*). In research and development, we accelerated the development of three glaucoma treatments. We also strengthened our research and development capabilities through the injection of resources in targeted therapeutic areas. At the same time, we continued to reduce production costs and have maintained our emphasis on maximizing returns on sales promotion and R&D expenses.

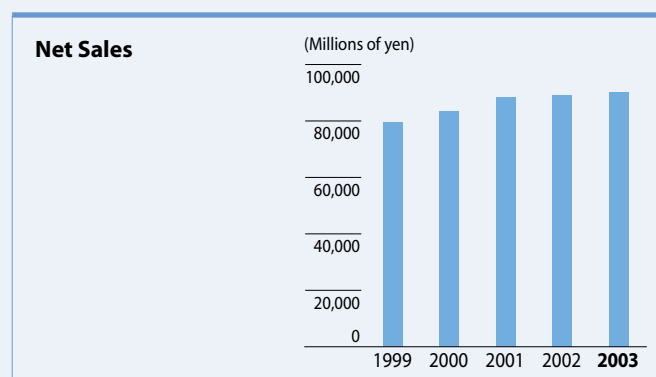
As a result, net sales for the year ended March 31, 2003 increased 1.4 percent, or ¥1,287 million, compared with the previous fiscal year to ¥90,253 million. Operating income increased 7.7 percent, or ¥907 million, to ¥12,697 million due to company-wide efforts to reduce cost of sales and other expenses. Income before income taxes decreased 21.5 percent, or ¥2,732 million, to ¥9,947 million due to the appropriation of a special premium payment incurred upon Santen's secession from a composite pension fund as an extraordinary loss. Net income increased by 60.3 percent, or ¥3,197 million, to ¥8,503 million due to a year-on-year decrease in income taxes in connection with the liquidation of a subsidiary.

## ● Net Sales

### Net Sales by Business Segment

(Millions of yen)

Year ended March 31	2003	2002	Change (%)
Prescription Pharmaceuticals	79,345	78,149	1.5
Ophthalmic	71,122	70,043	1.5
Anti-rheumatic	7,631	7,291	4.7
Others	591	815	(27.4)
OTC Pharmaceuticals	5,656	6,592	(14.2)
Medical Devices	918	916	0.3
Others	4,332	3,309	30.9
Total Sales	90,253	88,966	1.4



### Prescription Pharmaceuticals

Sales of prescription pharmaceuticals increased 1.5 percent, or ¥1,196 million, year-on-year to ¥79,345 million.

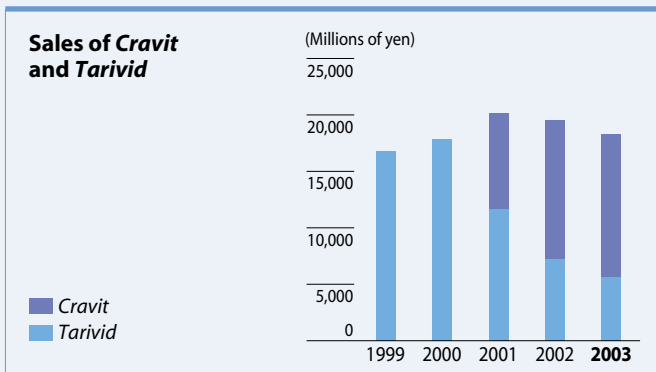
### Prescription Ophthalmic Pharmaceuticals

#### Japan

In the year ended March 31, 2003, Santen maintained its emphasis on increasing the market penetration of its products through effective marketing efforts tailored to meet the emerging needs of healthcare professionals. Despite these efforts, sales of prescription ophthalmic pharmaceuticals in Japan declined 0.6 percent, or ¥416 million, to ¥64,009 million. The factors behind this decrease include NHI drug price reductions and other measures to contain healthcare costs and intensifying competition.

## Anti-infective Ophthalmics

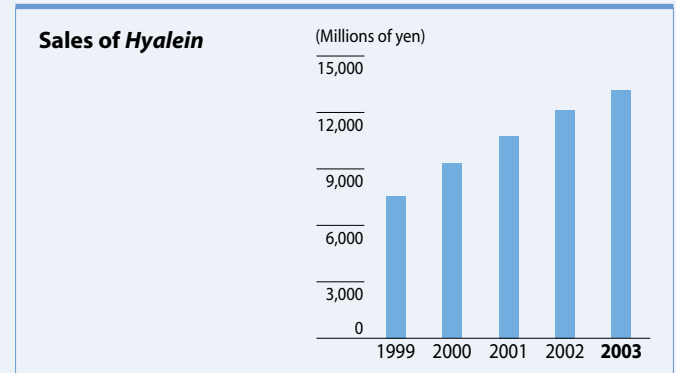
Santen's anti-infective ophthalmics category contains *Cravit* (levofloxacin ophthalmic solution) and *Tarivid* (ofloxacin ophthalmic solution). *Cravit* is an anti-infective ophthalmic solution in a class known as new quinolones, and is a potent, broad spectrum anti-infective with an excellent ability to penetrate ophthalmic tissue. Since its launch in April 2000, *Cravit* has rapidly earned a reputation among healthcare professionals as the first-line treatment for conjunctivitis, keratitis and other eye infections. The number of prescriptions written for *Cravit* steadily increased during the year, as we enhanced our promotional activities focusing on the importance of early treatment of eye infections. As a result, sales of *Cravit* rose 2.9 percent, or ¥353 million, to ¥12,691 million. The combined total sales of *Cravit* and *Tarivid* decreased 6.5 percent, or ¥1,265 million, to ¥18,257 million due to factors including a reduction in NHI drug prices and the stagnant market.



## Corneal Disorder Treatments

The number of patients with dry eye, a condition caused by quantitative and qualitative changes in tears, is increasing in correlation with heightened use of personal computers. *Hyalein* (sodium hyaluronate ophthalmic solution) is a treatment for corneal disorders associated with dry eye and other factors. *Hyalein*'s unique ability to improve the patient's quality of life, coupled with Santen's continued initiatives in educating the public about the need for early diagnosis and treatment of dry eye, have contributed to steady annual gains in sales since its launch in 1995. Santen's continuing efforts to educate the public on the importance of early diagnosis and treatment of dry eye, which included holding 25 lectures nationwide in cooperation with local ophthalmologists'

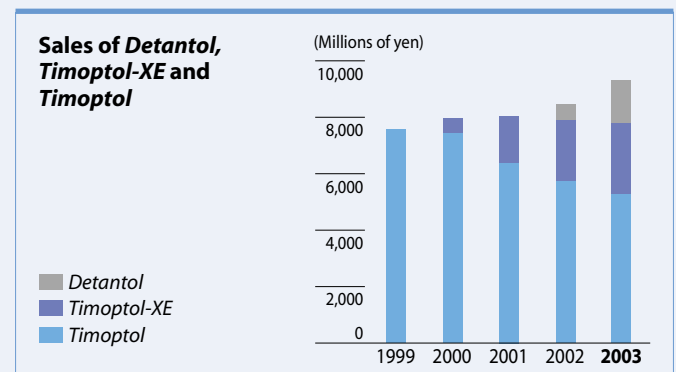
associations, resulted in an 8.5 percent, or ¥1,026 million, increase in sales of *Hyalein* to ¥13,156 million in the year ended March 31, 2003.



## Glaucoma Treatments

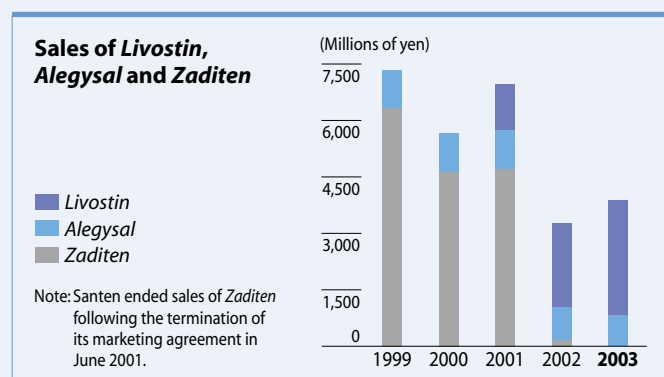
The market for glaucoma treatments continued to expand, reflecting the aging population. Launched in 2001, *Detantol* (bunazosin hydrochloride ophthalmic solution) has a novel mechanism of action different from existing glaucoma treatments. This mechanism promotes the outflow of fluid in the eye known as aqueous humor and reduces intraocular pressure by selectively blocking  $\alpha_1$  receptors in the local ocular area. Seminars to introduce the latest data in this field led to a substantial increase in the number of prescriptions during the year, and sales of *Detantol* increased 152.6 percent, or ¥905 million, to ¥1,498 million.

Sales of *Timoptol-XE*, launched in 1999 in a once-daily dosage formulation that effectively reduces intraocular pressure, increased 15.4 percent, or ¥332 million, to ¥2,477 million. Overall sales of the *Timoptol* line, including the original product *Timoptol*, decreased 1.6 percent, or ¥124 million, to ¥7,766 million.



## Anti-allergy Ophthalmics

The anti-allergy *Livostin* (levocabastine hydrochloride ophthalmic solution) was launched in 2001. This drug provides rapid relief from the itching that is a major symptom of allergic conjunctivitis. A focus on *Livostin's* superiority in our medical representatives' activities led to an increase of 36.1 percent, or ¥803 million, in sales of *Livostin* to ¥3,028 million. Total sales of anti-allergy ophthalmics, including *Alegysal* (pemirolast potassium ophthalmic solution), increased 19.0 percent, or ¥620 million, to ¥3,876 million.



## Overseas

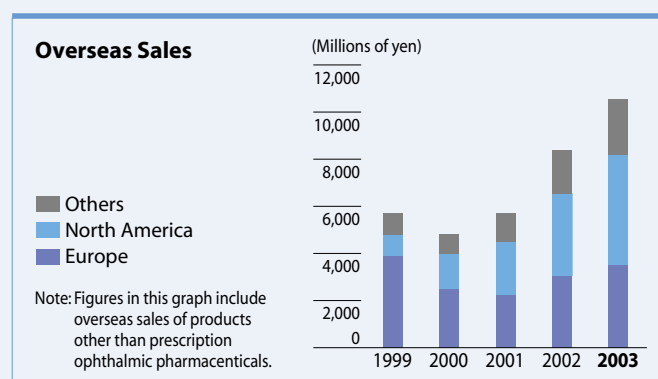
Overseas sales of prescription ophthalmic pharmaceuticals increased 26.6 percent, or ¥1,495 million, to ¥7,112 million.

In the United States, we continued our market penetration efforts on our three products: the anti-allergy ophthalmic *Alamast* (brand name in Japan: *Alegysal*), launched in July 2000; the anti-infective ophthalmic *Quixin* (brand name in Japan: *Cravit*), launched in November 2000; and the glaucoma treatment *Betimol*, which we started marketing in January 2001. In April 2002, we reorganized the management structure of our U.S. subsidiary Santen Inc. to streamline decision-making and strengthen sales and marketing. In the year ended March 31, 2003, Santen Inc. continued its efforts to increase the market share for *Quixin*, emphasizing the drug's superiority over other new quinolone anti-infectives, and sales of *Quixin* increased 156.7 percent, or ¥854 million, to ¥1,399 million.

In Europe, we have achieved solid sales growth in Northern and Eastern Europe, as Finnish subsidiary Santen Oy further enhanced sales and marketing activities. Santen launched the anti-infective ophthalmic *Oftaquix* (brand name in Japan:

*Cravit*) in Germany in May 2002 and in the Scandinavian countries in June 2002.

In Asia, Santen imports and sells its products in ten countries and regions including China and Korea. In the year ended March 31, 2003, we launched the anti-infective ophthalmic *Cravit* in Thailand, Singapore and other countries. Sales in Asia continued to increase, particularly in China and Korea, led by our enhanced marketing efforts including the provision of scientific information to local healthcare professionals.



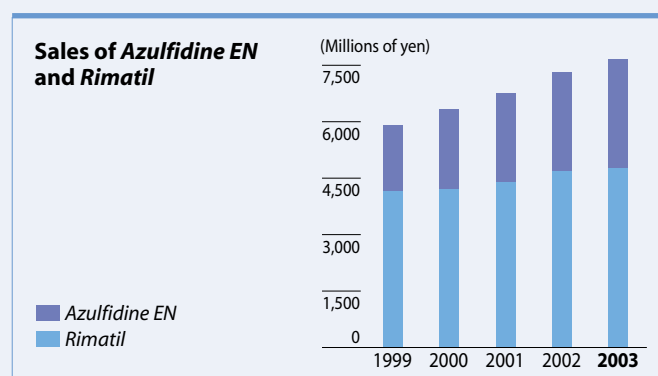
## Anti-rheumatic Pharmaceuticals

Santen markets two disease modifying anti-rheumatic drugs (DMARDs) in Japan, *Azulfidine EN* and *Rimatil*, as treatments for rheumatoid arthritis.



**Azulfidine EN**

Sales of anti-rheumatic pharmaceuticals increased 4.7 percent, or ¥340 million, to ¥7,631 million.



## Over-the-counter (OTC) Pharmaceuticals

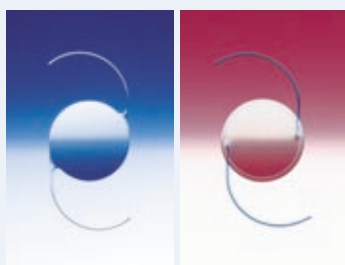
New products launched during the year include *Sante 40V*, a nutrition-fortified version of the *Sante 40* series used to treat blurred vision and eye strain, and *Sante Uruoi Contact*, which moistens the eye particularly when wearing disposable contact lenses. Sales of OTC pharmaceuticals decreased 14.2 percent, or ¥936 million, to ¥5,656 million due to a stagnant market and intensifying competition.



OTC eye drops launched during the year ended March 31, 2003

## Medical Devices

The medical devices business consists of intraocular lenses, phacoemulsification machines, surgical instruments and other devices related to cataract surgery.



Intraocular lenses used in cataract surgery

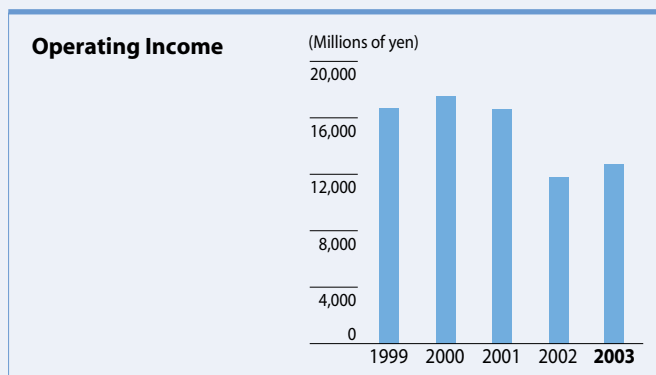
During the year ended March 31, 2003, the number of cataract surgeries in Japan increased marginally over the previous fiscal year. Higher sales of surgical instruments offset a decrease in sales of phacoemulsification machines. As a result, total sales of medical devices remained almost flat compared with the previous fiscal year at ¥918 million.

## Others

This segment mainly consists of contract manufacturing and royalty income. Sales under this segment increased 30.9 percent, or ¥1,024 million, to ¥4,332 million due to an increase in contract manufacturing of anti-infective ear medicine and because sales of *Thiola Tablet 100*, a metabolic improving and detoxicating agent, were reclassified from prescription pharmaceuticals to contract manufacturing in connection with the marketing of *Thiola* being transferred to another company.

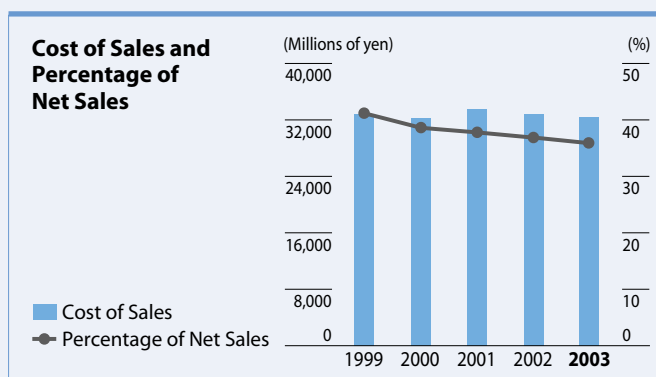
## Operating Income

Operating income increased 7.7 percent, or ¥907 million, year-on-year to ¥12,697 million. The ratio of operating income to net sales increased to 14.1 percent from 13.3 percent.

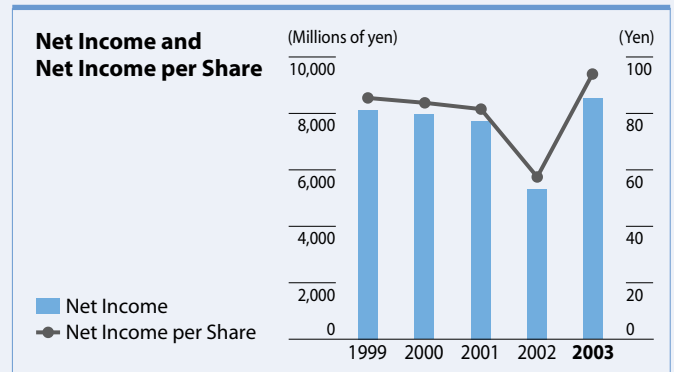
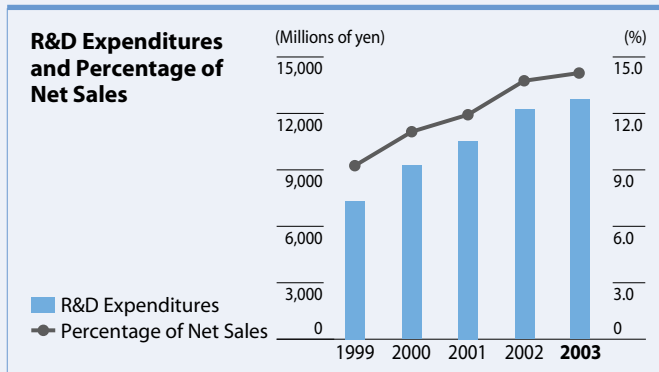


## Cost of Sales and Selling, General and Administrative (SG&A) Expenses

Cost of sales declined 1.3 percent, or ¥429 million, to ¥32,272 million as a result of increased net sales and lower lease expenses. The ratio of cost of sales to net sales improved to 35.8 percent from 36.8 percent.



SG&A expenses increased 1.8 percent, or ¥809 million, year-on-year to ¥45,284 million due to increased overseas sales and marketing expenses and a 4.4 percent, or ¥532 million, increase in R&D expenditures. The R&D expenditures increased due to enhanced clinical development activities worldwide and development of medical devices.



## ● Other Income (Expenses)

Net other expenses for the year totaled ¥2,750 million, compared to net other income of ¥889 million for the previous fiscal year.

Other income decreased 38.2 percent, or ¥794 million. Interest and dividend income decreased 11.8 percent, or ¥36 million, to ¥268 million due to lower interest rates in Japan. Other income also decreased because of the absence of the one-time receipt of ¥886 million that was recorded in the previous year in connection with compensation for damages awarded in the Princeton Notes lawsuit.

Other expenses increased 238.8 percent, or ¥2,845 million. The primary factor in this increase was the appropriation of a special premium payment of ¥2,203 million as an extraordinary loss. This resulted on secession from a composite pension fund. Weak stock market conditions also resulted in an increase of 237.3 percent, or ¥423 million, in loss on valuation of securities to ¥602 million.

## ● Income Taxes

Income taxes for the year decreased 80.4 percent, or ¥5,929 million, to ¥1,444 million as a result of the liquidation of our European subsidiary, Santen Pharmaceutical BV. The ratio of income taxes to income before income taxes (effective tax rate) declined to 14.5 percent from 58.2 percent.

## ● Net Income

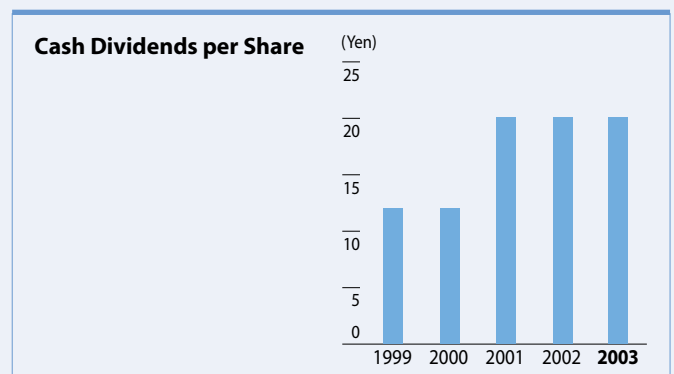
As a result, net income increased 60.3 percent, or ¥3,197 million, to ¥8,503 million. The ratio of net income to net sales improved to 9.4 percent from 6.0 percent. Net income per share increased to ¥93.67 from ¥57.34. Diluted net income per share increased to ¥85.97 from ¥53.07.

## ● Cash Dividends

Returning profits to shareholders in the form of cash dividends is an issue of key importance for Santen. Our corporate policy is to maintain a stable level of cash dividends while keeping an eye on our profit level.

Based on this philosophy, cash dividends per share for the year ended March 31, 2003 were set at ¥20.00, unchanged from the previous fiscal year.

We remain committed to maintaining solid liquidity and strengthening our financial condition with regard to the management of our internal reserves, allowing us to prepare for necessary investment in facilities and information technology (IT). At the same time, we plan to effectively utilize internal reserves for research and development and overseas business strategy to realize future growth.



## LIQUIDITY AND FINANCIAL CONDITION

### ● Capital Procurement and Liquidity Management

Santen emphasizes the maintenance of a sound balance sheet, appropriate liquidity, and sufficient capital for funding operations. Accordingly, we have committed lines of credit with financial institutions that provide flexibility in timing and amount for the acquisition of funds. We maintain internal liquidity at an appropriate level to ensure efficient capital deployment.

To improve capital efficiency and raise shareholder value, we repurchased 2,741,000 shares of our common stock at a total cost of ¥3,237 million in March 2003. This marked the third consecutive year in which we have repurchased our shares. An additional share repurchase of up to 4,000,000 shares and ¥5,000 million was approved at the 91st Annual General Meeting of Shareholders, held on June 26, 2003.

The redemption of convertible bonds totaling ¥19,945 million is scheduled for September 2003, and we entered into a contract in March 2003 for ¥10,000 million in unsecured long-term borrowings from financial institutions during the period to September 2003.

### ● Cash Flows

#### Cash Flows Summary

(Millions of yen)

Year ended March 31	2003	2002	Change
Cash Flows from Operating Activities	15,808	6,941	8,867
Cash Flows from Investing Activities	(9,951)	(6,374)	(3,577)
Cash Flows from Financing Activities	(6,507)	(5,684)	(823)
Cash and Cash Equivalents at End of Year	25,054	25,620	(566)

#### Cash Flows from Operating Activities

Net cash provided by operating activities increased 127.7 percent, or ¥8,867 million, to ¥15,808 million. Although income before income taxes decreased, trade receivables as of March 31, 2002, a bank holiday, included ¥6,172 million in accounts receivable that would have been settled had March 31, 2002 been a normal business day. Settlement therefore took place during the year to March 31, 2003, increasing net cash provided by operating activities. Reduction of inventories and

income taxes also contributed to the increase in net cash provided by operating activities.

#### Cash Flows from Investing Activities

Net cash used in investing activities increased 56.1 percent, or ¥3,577 million, to ¥9,951 million. Capital expenditures increased 7.0 percent, or ¥460 million, to ¥7,046 million. Major capital expenditure items include the expansion of the Nara Research and Development Center and the construction of production lines for a new eye drop container at the Noto and Shiga plants. A shift of cash from deposits to commercial paper and other investment securities also contributed to an increase in net cash used in investing activities.

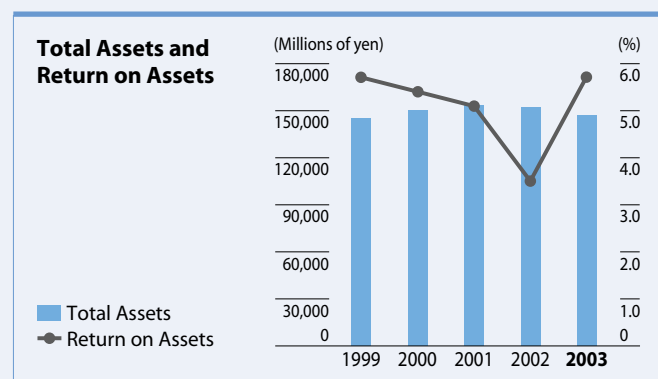
#### Cash Flows from Financing Activities

Net cash used in financing activities increased 14.5 percent, or ¥823 million, to ¥6,507 million, due largely to the repayment of long-term debt totaling ¥1,000 million.

The above factors resulted in a decrease of 2.2 percent, or ¥566 million, in cash and cash equivalents at the end of the year to ¥25,054 million.

### ● Assets, Liabilities and Shareholders' Equity

As of March 31, 2003, total assets stood at ¥147,148 million, a decrease of 3.3 percent, or ¥4,955 million, from the previous fiscal year end. Return on assets increased to 5.8 percent from 3.5 percent.



Current assets decreased 3.1 percent, or ¥2,633 million, to ¥83,431 million.

Despite the effect of net income and a decrease in trade receivables, cash and cash equivalents decreased 2.2 percent, or ¥566 million, to ¥25,054 million, due to the use of cash in funding capital expenditures and the share repurchase program. Trade receivables decreased 17.5 percent, or ¥6,899 million, to ¥32,516 million.

Net property, plant and equipment decreased 3.1 percent, or ¥1,309 million, to ¥40,850 million, due mainly to depreciation and amortization. Construction in progress decreased ¥3,233 million, reflecting the completion of the Nara Research and Development Center expansion project and the sale of some production facilities at the Noto Plant to a lease company. Buildings and structures increased with the completion of the Nara Research and Development Center expansion. Capital expenditures (on an acquisition basis) decreased 51.5 percent, or ¥4,382 million, to ¥4,134 million.

Investments and other assets decreased 4.2 percent, or ¥1,013 million, to ¥22,867 million due primarily to a decrease in goodwill.

Total liabilities, which is the sum of current and noncurrent liabilities, decreased 12.2 percent, or ¥6,980 million, to ¥50,022 million.

Current liabilities increased 50.5 percent, or ¥13,303 million, to ¥39,637 million, as we transferred ¥19,945 million in convertible bonds due in September 2003 to current liabilities.

As a result, net working capital on March 31, 2003 decreased to ¥43,794 million from ¥59,730 million. The current ratio also decreased to 210 percent from 327 percent. Noncurrent liabilities decreased 66.1 percent, or ¥20,283 million, to ¥10,385 million, as we transferred convertible bonds to be redeemed within a year to current liabilities.

Shareholders' equity increased 2.1 percent, or ¥2,025 million, to ¥97,126 million. The shareholders' equity ratio increased to 66.0 percent from 62.5 percent, while return on equity improved to 8.8 percent from 5.6 percent. Net assets per share at the end of the year totaled ¥1,104, up from ¥1,049 at the previous year end.

