



Takakazu Morita, President and Chief Executive Officer

I am very pleased to report the business performance of Santen Pharmaceutical Co., Ltd. for the year ended March 31, 2004. It was the first year of our 2003-2005 Medium-term Management Plan, and we have made steady progress toward our Plan goals. This Annual Report highlights some of our accomplishments, and demonstrates our continued dedication to strengthening and improving Santen for our shareholders and all other stakeholders.

#### EARNINGS SECURED IN LOW GROWTH MARKET

During the year under review, the size of the Japanese prescription ophthalmic pharmaceutical market remained at approximately the same level as the previous fiscal year. While the corneal disorder treatment market generated healthy growth, the prescription ophthalmic pharmaceutical market suffered the effects of fixed-rate co-payments of medical expenses for the elderly, effective since 2002, and increased co-payments for insured workers, introduced in April 2003. Overseas, the ophthalmic pharmaceutical markets in the United States and Europe continued to expand, but the Asian market remained flat overall. The over-the-counter (OTC) eye drops market in Japan experienced a drop in retail prices; nevertheless, the market grew slightly compared to the previous fiscal year, supported by expanded sales of eye drops for eye strain and for the relief of tired eyes.

Amidst these challenges, we expanded our efforts to build a business structure that will generate steady profits, even in the low growth market conditions we are facing in Japan. While net sales for the year totaled ¥89,858 million, a decline of 0.4% from the previous year, operating income improved 14.4% to ¥14,524 million. Net income for the year fell 25.7% to ¥6,321 million due to the extraordinary income tax adjustment recorded in the previous year. Consequently, return on equity (ROE) decreased by 2.5 percentage points, to 6.3% from the previous year.

#### CASH DIVIDENDS DOUBLED

The 92nd Annual Meeting of Shareholders, held on June 25, 2004, approved the year-end dividends of ¥30 per share. Combined with the interim cash dividend payment, annual dividends per share doubled from the previous year to ¥40. Santen will work to maintain and improve the dividend level, while maintaining capital efficiency and keeping a sound and flexible financial position.

#### STEADY ACCOMPLISHMENTS MADE DURING THE FIRST YEAR

Santen focused on the following three basic objectives of the 2003-2005 Medium-term Management Plan.

### Improve Profitability

One critical objective was to make the U.S. business profitable. To this end, we signed a U.S. distribution and supply agreement with Johnson & Johnson Vision Care, Inc. (JJVCI) for three prescription ophthalmic pharmaceutical agents in December 2003. JJVCI commenced sales of these products in February 2004. Through the partnership with this member company of the Johnson & Johnson Group, which has a well-established presence in the U.S. prescription pharmaceutical market, we expect our products to reach a broader range of targeted healthcare professionals more quickly than would previously have been possible. We will therefore be able to focus our efforts on strengthening our R&D, business development and strategic marketing capabilities in the U.S.

To sustain and improve our earnings base in the low growth market conditions in Japan, we believe it absolutely necessary to improve the quality of our medical representative (MR) activities – not just to meet, but to anticipate the needs of eye care and other healthcare professionals. In order to serve our customers more effectively, we expanded from 56 conventional sales offices in Japan to 89 satellite offices that offer closer proximity – and responsiveness – to our customers. During the year we also launched the Santen Activity Improved Navigator (SAIN), a sales force automation system, to improve the productivity of our MRs.

### Strengthen R&D

We have refocused our management resources, including manpower, on clinical development and have accelerated our product development. In the area of glaucoma treatments, the largest segment of the global prescription ophthalmic market, we began Phase clinical trials of the prostaglandin compound, tafluprost (development code: DE-085), in Japan, the U.S. and Europe. Olmesartan (development code: DE-092), an angiotensin receptor antagonist, is in Phase clinical trials in Japan and in preparation for Phase in the U.S. and Europe. In the anti-infective ophthalmics segment, we received marketing approval in March this year from the U.S. Food and Drug Administration (FDA) for *Iquix* for the treatment of bacterial corneal ulcers. *Iquix* is a self-preserved solution containing three times the fluoroquinolone concentration of *Quixin* (brand name in Japan: *Cravit*). In the area of rheumatoid arthritis treatments, we initiated Phase clinical trials in Japan for DE-096, an oral tumor necrosis factor (TNF) inhibitor.

### Reinforce Organizational Strength

Effective the year under review, we reduced the term of directors from two years to one. We also invited Mr. Kosei Furukawa, formerly Corporate Auditor, to join the Board of Directors as an outside director to further strengthen our corporate governance. In our ongoing commitment to personnel development, we continued the Santen Innovation Project (SIP), an in-house business school which provided strategy-oriented education and training programs to middle-management employees who will take on leading roles in Santen's self-driven reforms. Also during the year, we developed and introduced the Career Development Support Program.

### PROMOTING POWERFUL IMPLEMENTATION OF THE 2003-2005 MEDIUM-TERM MANAGEMENT PLAN

We expect Japan's prescription ophthalmic pharmaceutical market will remain stagnant in the year ending March 31, 2005. We estimate the National Health Insurance (NHI) drug price revisions, made in April 2004, will translate into an average 3.2% reduction in our prescription pharmaceuticals business. At the same time, we expect generic pharmaceuticals to continue influencing the Japanese prescription ophthalmic market. In recent years, we have witnessed mergers and acquisitions in the Japanese pharmaceutical industry. We anticipate this trend will gain momentum, further intensifying market competition between pharmaceutical companies, regardless of whether they are Japanese or foreign-owned.

Santen will continue to capitalize on its advantages as a company specializing in ophthalmic and anti-rheumatic pharmaceuticals. We will also continue our efforts to achieve the goals of our 2003-2005 Medium-term Management Plan as a top priority. On behalf of the members of the Board, I would like to extend my sincere appreciation for your support.



Takakazu Morita  
President and Chief Executive Officer

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