

## Financial Section

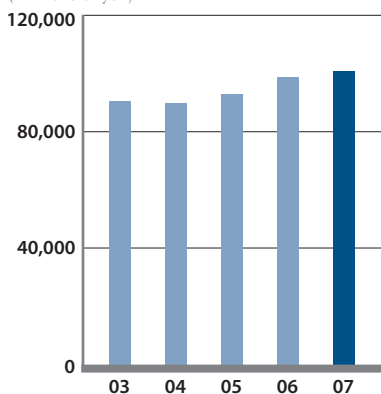
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## Financial Review

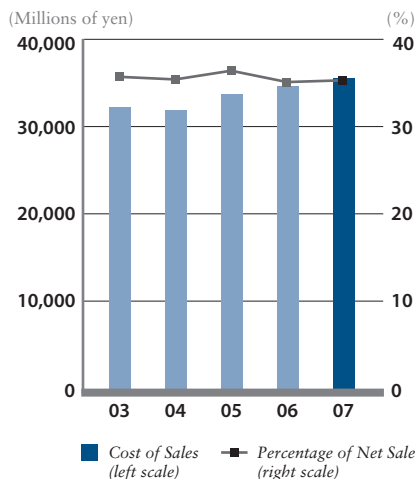
### Net Sales

(Millions of yen)



### Cost of Sales and Percentage of Net Sales

(Millions of yen)



### Net Sales

Consolidated net sales of the Santen Group for the year ended March 31, 2007 increased 2.1% year over year to ¥100,486 million. Net sales in our mainstay prescription pharmaceuticals business rose 1.8% to ¥91,849 million, which accounted for 91.4% of total sales, down 0.3 points from the previous year.

Sales of the Santen Group consist of those from four segments: prescription pharmaceuticals, over-the-counter (OTC) pharmaceuticals, medical devices and other business.

#### Prescription Pharmaceuticals

Prescription pharmaceutical sales can be broken down into ophthalmics, anti-rheumatics and other pharmaceuticals.

##### (Ophthalmics)

Domestic prescription ophthalmic sales were ¥71,272 million, almost level with the previous year. Although sales were affected by the National Health Insurance drug price reduction, our activities to provide medical information tailored to the changing needs of each medical institution contributed to the sales total.

Overseas prescription ophthalmic sales, after conversion into yen, increased 12.1% year over year to ¥10,880 million. In Europe, sales increased mainly in Northern and Eastern Europe and Germany, boosted by our value-add information efforts and the impact of foreign exchange rates. In the United States, sales declined due to intensified competition. In Asia, we increased awareness of the Santen brand and products through our promotional activities. As a result, sales increased in the key markets of China and South Korea.

##### (Anti-Rheumatics)

The disease modifying anti-rheumatic market shrank from the previous year due to the influence of the drug price reduction. *Rimatil*, *Azulfidine EN* and *Metolate* were selected as "Grade A—Highly Recommended" drugs in accordance with the Guidelines for the Management of Rheumatoid Arthritis announced by the Japan College of Rheumatology in April 2004 and continued to steadily penetrate into the market during the year under review. As a result, sales of anti-rheumatics increased 3.7% to ¥9,379 million.

#### OTC Pharmaceuticals

Sales of OTC pharmaceuticals rose 1.1% to ¥5,308 million. Although sales of eye drops for allergies and contact lenses declined, such factors were offset by our continued vigorous sales promotion of eye drops for eye fatigue, blurred vision or cool relief for fatigued eyes.

#### Medical Devices

Although the number of cataract surgeries in Japan increased slightly, sales of medical devices as a whole fell 15.9% to ¥537 million due to severe competition in the intraocular lens market.

#### Other Business

Sales in other business rose 23.5% to ¥2,792 million mainly fueled by an increase in the contract manufacturing of an anti-infective otic pharmaceutical for the United States.

#### Net Sales by Business Segment

|                              | Millions of yen |        |            |
|------------------------------|-----------------|--------|------------|
| Years ended March 31         | 2007            | 2006   | Change (%) |
| Prescription pharmaceuticals | <b>91,849</b>   | 90,251 | 1.8        |
| Ophthalmics                  | <b>82,152</b>   | 80,922 | 1.5        |
| Anti-rheumatics              | <b>9,379</b>    | 9,041  | 3.7        |
| Other pharmaceuticals        | <b>318</b>      | 288    | 10.4       |
| OTC pharmaceuticals          | <b>5,308</b>    | 5,248  | 1.1        |
| Medical devices              | <b>537</b>      | 639    | (15.9)     |
| Other                        | <b>2,792</b>    | 2,260  | 23.5       |
| <b>Total</b>                 | <b>100,486</b>  | 98,398 | 2.1        |

Note: Figures in parentheses indicate a decrease.

### Cost of Sales

Cost of sales increased 2.7% to ¥35,484 million due to an advance in sales. The ratio of cost of sales to net sales increased from 35.1% to 35.3%, resulting from a rise in cost percentage due to drug price reductions which offset our cost reduction efforts.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 4.0% to ¥44,590 million as a result of defensive strategies against domestic competition as well as the increased promotion activities in Asia and Europe. R&D expenditures decreased 2.2% from the previous year to ¥13,663 million.

### Operating Income

As a result of increased sales promotional activities, operating income decreased 2.8% to ¥20,412 million. The ratio of operating income to net sales decreased 1.0 percentage point to 20.3% from 21.3% in the previous year.

### Other Income and Expenses

Other net income for the year totaled ¥627 million.

Other income increased to ¥1,393 million due to rising in interest and dividend income as well as the sale of fixed assets.

Other expenses totaled ¥766 million due to foreign exchange losses at European subsidiaries despite the absence of an impairment loss and a special retirement premium, which occurred in the previous year.

### Income Taxes

Income taxes were ¥7,891 million. The effective tax rate, increased to 37.5% from 36.0% in the previous year mainly due to a decrease in the tax deduction for research spending.

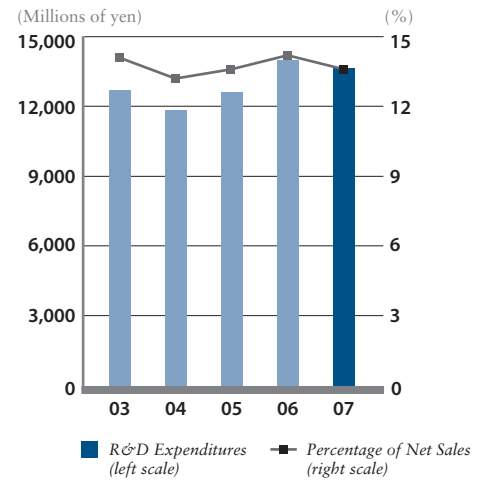
### Net Income

Net income increased 1.0% year over year to ¥13,148 million due to the absence of special losses, such as impairment losses, that occurred in the previous year. The ratio of net income to net sales was 13.1% compared with 13.2% the previous year. Net income per share rose from ¥150.26 the previous year to ¥151.58. Diluted net income per share rose from ¥150.01 to ¥151.31.

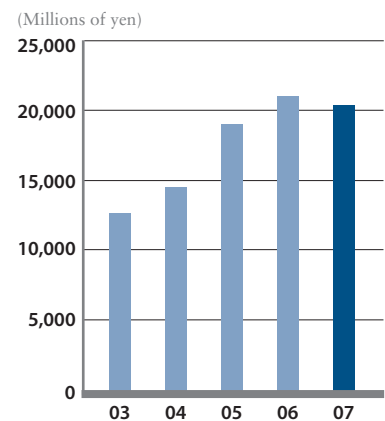
### Net Income per Share, Dividend and ROE

| Years ended March 31               | 2007          | 2006   | 2005   |
|------------------------------------|---------------|--------|--------|
| Net income per share-basic (yen)   | <b>151.58</b> | 150.26 | 125.85 |
| Net income per share-diluted (yen) | <b>151.31</b> | 150.01 | 125.71 |
| Dividend (yen)                     | <b>65</b>     | 60     | 50     |
| ROE (%)                            | <b>10.6</b>   | 11.5   | 10.4   |

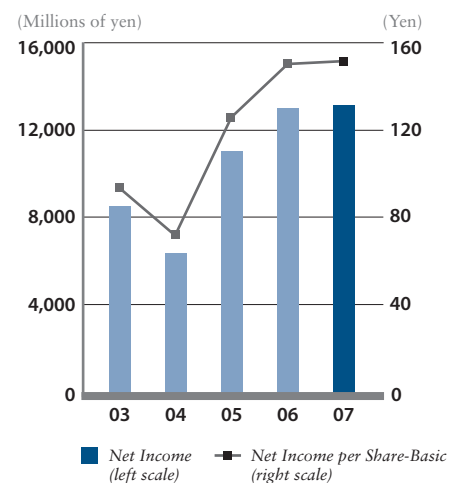
### R&D Expenditures and Percentage of Net Sales



### Operating Income

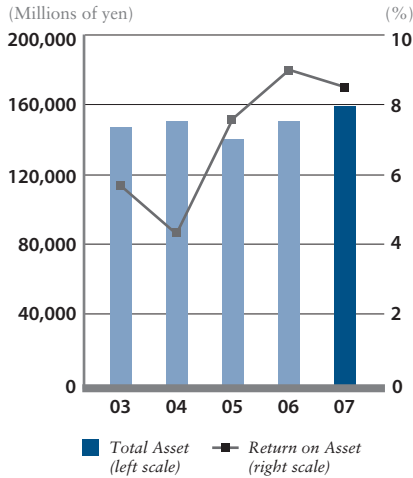


### Net Income and Net Income per Share-Basic

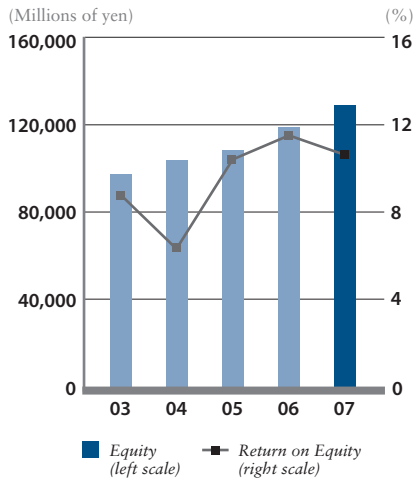


## Financial Condition

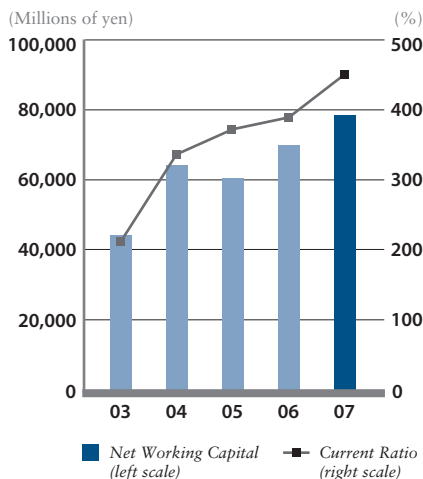
Total Assets and Return on Assets



Equity and Return on Equity



Net Working Capital and Current Ratio



### Assets

As of March 31, 2007, total assets were ¥159,099 million, up ¥8,641 million, or 5.7%, from the previous year-end. Current assets increased ¥6,927 million, or 7.4%, to ¥100,820 million, reflecting an increase in marketable securities due to the purchase of short-term financial instruments. Current assets to total assets increased 1.0 percentage point to 63.4% from 62.4% in the previous fiscal year. Net property, plant and equipment at year-end rose ¥90 million or 0.3% over the previous year-end to ¥30,485 million, reflecting an increase in construction in progress because of the launch of construction of the Suzhou Plant at our Santen Pharmaceutical (China) Co., Ltd. subsidiary.

Investments and other assets increased ¥1,624 million, or 6.2%, to ¥27,794 million, reflecting a rise in the value of marketable securities. As a result, return on assets (ROA) for the year under review declined 0.5 percentage point to 8.5% from 9.0% the previous fiscal year.

### Liabilities

Total liabilities ended the year at ¥30,453 million, a decrease of ¥1,368 million, or 4.3%, from the previous year-end. Current liabilities decreased ¥1,742 million, or 7.2%, to ¥22,369 million. This primarily resulted from a decrease of ¥1,029 million, or 20.8%, in income taxes payable and a decline of ¥735 million, or 7.9%, in other accounts payable.

Non-current liabilities increased ¥374 million, or 4.9%, to ¥8,084 million primarily for retirement and severance benefits, and interest-bearing liabilities decreased ¥168 million, or 3.0%, to ¥5,446 million.

### Net Assets

Net Assets rose ¥10,009 million, or 8.4%, from the previous year-end to ¥128,646 million. This was primarily due to an increase in unrealized holding gains on securities. Equity ratio improved 1.9 percentage points to 80.8% from 78.9%. Return on equity (ROE) declined 0.9 percentage point to 10.6% from 11.5% mainly due to a slower growth rate in net income. Equity per share increased ¥113.56, or 8.3%, to ¥1,481.83.

### Capital and Liquidity

Santen Pharmaceutical is striving to maintain a healthy balance sheet and ensure the Company has appropriate liquidity and the necessary funds for its business activities. Net working capital—defined as the difference between current assets and current liabilities—increased ¥8,669 million, or 12.4%, from the previous year-end to ¥78,451 million, and the current ratio improved 62 percentage points to 451% from 389% at the previous year-end. Cash and cash equivalents at the end of the year increased ¥3,736 million, or 8.1%, from the previous year-end to ¥49,841 million. Cash generated by operating activities totaled ¥14,959 million, of which ¥5,846 million was used for investing activities and ¥5,691 million for financing activities.

## Cash Flows

### Cash Flows Summary

| Years ended March 31                     | Millions of yen |         |         |
|--|-----------------|---------|---------|
|  | 2007            | 2006    | Change  |
| Cash flows from operating activities     | <b>14,959</b>   | 20,879  | (5,920) |
| Cash flows from investing activities     | <b>(5,846)</b>  | (1,330) | (4,516) |
| Cash flows from financing activities     | <b>(5,691)</b>  | (5,900) | 209     |
| Cash and cash equivalents at end of year | <b>49,841</b>   | 46,105  | 3,736   |

Note: Figures in parentheses indicate decreases.

### Cash Flows from Operating Activities

Net cash provided by operating activities decreased ¥5,920 million from the previous year to ¥14,959 million. It is mainly because trade receivables and corporate tax payments increased despite an increase in income before income taxes.

### Cash Flows from Investing Activities

Net cash used in investing activities increased ¥4,516 million to ¥5,846 million. This was due to increases in payments on the acquisition of property, plant and equipment (construction in progress) because of the launch of construction of the Suzhou plant at a subsidiary in China, Santen Pharmaceutical (China) Co., Ltd., and the acquisition of investment securities.

### Cash Flows from Financing Activities

Net cash used in financing activities decreased ¥209 million to ¥5,691 million mainly due to the dividend payment.

As a result, the cash and cash equivalent balance at the end of the year totaled to ¥49,841 million, an increase of ¥3,736 million from the previous year.

## Risks Related to Our Business

### Forward-Looking Information and Factors That Might Affect Future Results

Any statements that we make, other than historical facts, contain forward-looking information based on our business plans and assumptions at the time of disclosure. Such forward-looking information includes, but is not limited to, our expected growth strategies, projected operating results, market forecasts and anticipated timing for developing, obtaining approval and bringing products to market. Our business, as well as each product we develop and market, is subject to various risks and uncertainties beyond our control. Therefore, these forward-looking statements might differ substantially from actual results.

Risks and uncertainties that could affect the Company's future results and financial conditions include, but are not limited to, the factors described below.

### External Factors

#### Regulatory Controls

Our prescription pharmaceuticals business is subject to government regulatory controls regarding healthcare programs and drug prices in Japan and other countries. Although our current operating and/or financial projections were made fully in consideration of drug price revisions in Japan to the extent possible, those revisions that may take place beyond the scope of our anticipated projections or other revisions in healthcare programs might also affect our operating and/or financial results. In April 2006, NHI drug price revisions went into effect resulting in an average 5.5% reduction for the prescription ophthalmic pharmaceuticals industry. In other countries and markets where we manufacture and sell our products, we continue to face a variety of regulatory controls over prices of prescription pharmaceuticals and government pressures for drug price reduction.

#### Social and Economic Conditions and Changes in the Law

Santen's future results might be affected by political and economic changes in key markets worldwide in which we operate. Our anticipated performance and financial conditions might also be affected by changes in applicable accounting principles, and laws and regulations concerning taxes, the Product Liability Law, the Antitrust Law, environmental laws and regulations and other factors.

#### Foreign Exchange

Overseas sales and expenses, as well as assets of overseas subsidiaries, affect our sales, profits and financial conditions depending on foreign exchange rate fluctuations. Overseas sales for the year ended March 31, 2007, accounted for 13.3% of our consolidated net sales.

### Competition

#### Effects of Generic Pharmaceuticals

Sales of generic pharmaceuticals in Japan and overseas might affect Santen's overall business results.

Although our mainstay products—including *Cravit*, *Rescula* and *Livostin*—are protected by patents, generic pharmaceuticals for products such as *Hyalein* and *Tarivid* have already been introduced into the Japanese market by other companies, which will intensify competition in generic pharmaceuticals.

### Dependency on Specific Products and Business Partners

#### Dependency on Mainstay Products

Total sales of *Hyalein* and *Cravit* accounted for 30% of Santen's consolidated net sales for the year ended March 31, 2007. Should any sales suspension or a decline in sales occur due to any unanticipated negative influences such as potential product defects or newly discovered side effects, our business results and financial performance might be negatively affected.

#### Dependency on In-Licensed Products

Many products that the Santen Group sells are licensed by other companies. We hold exclusive rights to manufacture and sell ophthalmic formulations such as *Cravit* and *Detantol*. We also have sales rights in Japan for *Timoptol*, *Timoptol XE* and *Livostin*, and exclusive sales rights in Japan for *Azulfidine EN* and *Rescula*. Should changes be made in the terms and conditions after the expiration of such contracts or should the agreements not be renewed, our business performance might be affected.

### **Dependency on Specific Business Partners**

In the United States, we have a distribution agreement with Johnson & Johnson Vision Care, Inc. (JJVCI), for certain prescription ophthalmics. In the event that JJVCI cannot achieve sufficient sales of such products we consigned, our financial results might be affected.

We depend on specific business partners for the supply of certain raw materials such as the active pharmaceutical ingredient for *Cravit* and containers for our over-the-counter (OTC) pharmaceuticals. If supply of these materials is interrupted or discontinued for any reason, our pharmaceutical production might be adversely affected. Should it subsequently affect the supply of our products and cause any interruption or discontinuance, it would adversely affect our business performance. The percentage of our business conducted with the top 10 wholesalers in Japan has reached 70% of our consolidated net sales. If our wholesale partners experience bankruptcy leading to a lending loss, our business performance might be adversely affected.

### **Research & Development Activities**

#### **Uncertainties in New Product Development**

Years are required to bring new drugs from initial research and development to final approval and marketing. Various uncertainties exist at every stage in the development process that could sidetrack a new product such as discontinuance of development or disapproval after the application is filed. It is difficult for us to accurately predict when new products, new indications or formulations under development will reach the approval stage and be ready for launching manufacturing and sales.

Forecasting a precise time line for project development and completion depends on a number of variable factors, including, but not limited to, delayed government reviews, conflicting or unusable clinical data that do not indicate differentiation from competitor products, safety and efficacy concerns, unexpected side effects, discontinued development and delayed product release, any of which might negatively affect projected sales of new drugs.

#### **Potentially Insufficient Returns on R&D Investment**

The creation and development of new pharmaceuticals, as well as the development of new indications and formulations, are critical for the future growth of Santen. Every year we invest significantly in research and development, and there is a possibility that future investments will not result in sales of new products sufficient to provide an adequate return.

#### **Issues of Alliances**

Forecasts for new pharmaceuticals include various assumptions of alliances in development and/or sales. Actual results of these alliances might affect our overall sales and financial conditions.

### **Other Factors**

#### **Production Interruptions or Delays**

The interruption or delay of production activities due to natural disasters or other catastrophes such as fire might affect our financial performance and conditions. Certain products are only manufactured at one location. If a specific plant is forced to halt production, supply of some products might be interrupted or delayed. When the Noto Peninsula earthquake occurred in March 2007, operation of the production line at the Noto Plant in Houdatsushimizucho, Hakui-gun, Ishikawa, Japan, was suspended for inspection for several days, which fortunately did not affect supply.

#### **Cancellation of Sales and Product Withdrawals**

If sales of products are cancelled, or if we withdraw products due to a batch defect, unexpected side effects, tampering or other causes, our overall financial results might be negatively affected.

#### **Litigation**

Our main business involves the production and sales of prescription pharmaceuticals. The nature of our business makes us vulnerable to litigation related to patents, the Product Liability Law, violation of the Antitrust Law and consumer-related and environmental lawsuits. If such legal actions take place, the proceedings might affect our overall performance and financial conditions. Currently, we are involved in no litigation that substantially impacts the management of our company.

## Eleven-year Summary of Selected Financial Data

Years ended March 31

|   | 2007      | 2006     | 2005     | 2004     |
|---|-----------|----------|----------|----------|
| <b>For the year:</b>                                |           |          |          |          |
| Net sales   | ¥ 100,486 | ¥ 98,398 | ¥ 92,696 | ¥ 89,858 |
| Cost of sales                                       | 35,484    | 34,535   | 33,710   | 31,859   |
| Selling, general and administrative expenses        | 44,590    | 42,868   | 40,004   | 43,475   |
| Operating income                                    | 20,412    | 20,995   | 18,982   | 14,524   |
| Interest expense                                    | 91        | 94       | 182      | 366      |
| Income before income taxes                          | 21,039    | 20,342   | 18,436   | 13,775   |
| Income taxes  | 7,891     | 7,319    | 7,413    | 7,454    |
| Net income  | 13,148    | 13,023   | 11,023   | 6,321    |
| Capital expenditures                                | 3,556     | 2,106    | 4,907    | 3,226    |
| Depreciation and amortization                       | 4,761     | 4,824    | 4,750    | 4,521    |
| R&D expenditures                                    | 13,663    | 13,971   | 12,620   | 11,853   |
| <b>Per share data (yen and U.S. dollars):</b>       |           |          |          |          |
| Net income-basic                                    | ¥ 151.58  | ¥ 150.26 | ¥ 125.85 | ¥ 71.65  |
| Net income-diluted                                  | 151.31    | 150.01   | 125.71   | 71.64    |
| Equity  | 1,481.83  | 1,368.27 | 1,249.32 | 1,176.83 |
| Cash dividends, applicable to period                | 65.00     | 60.00    | 50.00    | 40.00    |
| <b>Cash Flows:</b>                                  |           |          |          |          |
| Net cash provided by operating activities           | ¥ 14,959  | ¥ 20,879 | ¥ 6,619  | ¥ 23,196 |
| Net cash (used in) provided by investing activities | (5,846)   | (1,330)  | (2,907)  | 5,246    |
| Net cash (used in) provided by financing activities | (5,691)   | (5,900)  | (12,712) | (12,122) |
| Interest coverage ratio (times)                     | 164.3     | 218.7    | 36.1     | 70.6     |
| Debt to cash flow ratio (%)                         | 36.4      | 26.9     | 104.0    | 54.7     |
| <b>At year-end:</b>                                 |           |          |          |          |
| Current assets                                      | ¥ 100,820 | ¥ 93,893 | ¥ 82,735 | ¥ 91,231 |
| Net property, plant and equipment                   | 30,485    | 30,395   | 32,676   | 37,237   |
| Total assets  | 159,099   | 150,458  | 139,980  | 150,238  |
| Long-term debt                                      | 5,446     | 5,614    | 6,882    | 12,686   |
| Equity  | 128,587   | 118,637  | 108,240  | 103,500  |
| Return on equity (ROE) (%)                          | 10.6      | 11.5     | 10.4     | 6.3      |
| Return on total assets (ROA) (%)                    | 8.5       | 9.0      | 7.6      | 4.3      |
| Equity ratio (%)                                    | 80.8      | 78.9     | 77.3     | 68.9     |
| Equity ratio on stock price basis (%)               | 165.3     | 163.0    | 142.3    | 101.8    |
| Price earnings ratio (PER) (times)                  | 20.0      | 18.8     | 18.3     | 24.3     |
| Issued shares (thousands)                           | 86,825    | 86,751   | 86,659   | 87,963   |
| Number of employees                                 | 2,409     | 2,312    | 2,308    | 2,335    |

Notes: 1. U.S. dollar amounts have been translated from yen, solely for the convenience of the reader, at the rate of ¥118.05 to U.S. \$1 prevailing on March 31, 2007.

2. See Notes 2. 13) and 11 of Notes to Consolidated Financial Statements in respect of per share data.

3. Net sales in the seven years ended March 31, 2007 to 2001 include royalty income which was presented as "Other, net" in "Other income (expenses)" through the fiscal year ended March 31, 2000.

4. Equity comprises shareholders' equity and accumulated gains (losses) on evaluation and translation.

| Millions of yen |          |          |          |          |          |          | Thousands of U.S. dollars |
|-----------------|----------|----------|----------|----------|----------|----------|---------------------------|
| 2003            | 2002     | 2001     | 2000     | 1999     | 1998     | 1997     | 2007                      |
| ¥ 90,253        | ¥ 88,966 | ¥ 88,449 | ¥ 83,577 | ¥ 79,639 | ¥ 77,957 | ¥ 75,216 | <b>\$ 851,213</b>         |
| 32,272          | 32,701   | 33,385   | 32,195   | 32,746   | 31,278   | 27,552   | <b>300,584</b>            |
| 45,284          | 44,475   | 38,546   | 33,894   | 30,294   | 30,535   | 27,984   | <b>377,716</b>            |
| 12,697          | 11,790   | 16,518   | 17,488   | 16,599   | 16,144   | 19,680   | <b>172,913</b>            |
| 480             | 465      | 430      | 462      | 588      | 654      | 624      | <b>768</b>                |
| 9,947           | 12,679   | 15,521   | 14,422   | 15,969   | 14,917   | 18,913   | <b>178,222</b>            |
| 1,444           | 7,373    | 7,807    | 6,481    | 7,864    | 7,594    | 9,915    | <b>66,849</b>             |
| 8,503           | 5,306    | 7,714    | 7,941    | 8,105    | 7,323    | 8,998    | <b>111,373</b>            |
| 7,046           | 6,586    | 4,943    | 2,510    | 3,443    | 5,898    | 16,725   | <b>30,116</b>             |
| 4,311           | 5,334    | 5,683    | 5,725    | 6,314    | 6,674    | 4,202    | <b>40,334</b>             |
| 12,719          | 12,187   | 10,511   | 9,221    | 7,335    | 7,731    | 6,213    | <b>115,740</b>            |
| ¥ 93.67         | ¥ 57.34  | ¥ 81.32  | ¥ 83.54  | ¥ 85.27  | ¥ 77.06  | ¥ 105.32 | <b>\$ 1.28</b>            |
| 85.97           | 53.07    | 75.01    | 77.04    | 78.63    | 71.01    | 99.87    | <b>1.28</b>               |
| 1,104.21        | 1,048.51 | 1,022.99 | 1,006.48 | 935.71   | 862.88   | 877.12   | <b>12.55</b>              |
| 20.00           | 20.00    | 20.00    | 12.00    | 12.00    | 12.00    | 12.00    | <b>0.55</b>               |
| ¥ 15,808        | ¥ 6,941  | ¥ 6,832  | ¥ 9,372  | ¥ 16,339 | ¥ 11,535 | ¥ 16,181 | <b>\$ 126,720</b>         |
| (9,951)         | (6,374)  | (3,172)  | 837      | (8,305)  | (9,537)  | (28,259) | <b>(49,518)</b>           |
| (6,507)         | (5,684)  | (7,193)  | (3,817)  | (3,857)  | (1,677)  | 18,610   | <b>(48,209)</b>           |
| 34.5            | 14.9     | 16.8     | 20.3     | 27.8     | 21.6     | 32.8     |                           |
| 145.8           | 352.5    | 367.3    | 274.7    | 173.8    | 270.6    | 196.6    |                           |
| ¥ 83,431        | ¥ 86,064 | ¥ 88,025 | ¥ 82,218 | ¥ 78,018 | ¥ 70,892 | ¥ 69,065 | <b>\$ 854,046</b>         |
| 40,850          | 42,159   | 36,684   | 37,416   | 39,638   | 43,425   | 47,278   | <b>258,243</b>            |
| 147,148         | 152,103  | 153,243  | 149,968  | 144,913  | 138,822  | 140,226  | <b>1,347,725</b>          |
| 23,047          | 24,467   | 25,482   | 26,491   | 27,496   | 31,168   | 31,807   | <b>46,133</b>             |
| 97,126          | 95,101   | 94,834   | 95,669   | 88,950   | 81,998   | 75,759   | <b>1,089,248</b>          |
| 8.8             | 5.6      | 8.1      | 8.6      | 9.5      | 9.3      | 11.9     |                           |
| 5.7             | 3.5      | 5.1      | 5.4      | 5.7      | 5.2      | 6.4      |                           |
| 66.0            | 62.5     | 61.9     | 63.8     | 61.4     | 59.1     | 54.0     |                           |
| 68.7            | 86.6     | 134.3    | 139.4    | 145.0    | 106.1    | 131.8    |                           |
| 12.3            | 25.3     | 27.3     | 26.3     | 25.9     | 20.1     | 21.6     |                           |
| 90,704          | 90,704   | 92,721   | 95,075   | 95,075   | 95,075   | 86,410   |                           |
| 2,500           | 2,463    | 2,167    | 2,093    | 2,037    | 2,010    | 1,910    |                           |

## Consolidated Balance Sheets

Santen Pharmaceutical Co., Ltd. and Subsidiaries  
As of March 31, 2007 and 2006

| ASSETS  | Millions of yen |          | Thousands of<br>U.S. dollars<br>(Note 3) |
|---|-----------------|----------|--|
|   | 2007            | 2006     | 2007                                     |
| <b>Current assets:</b>                                |                 |          |  |
| Cash and cash equivalents (Note 4)                    | ¥ 49,841        | ¥ 46,105 | \$ 422,203                               |
| Short-term investments (Note 4)                       | 1,868           | 180      | 15,825                                   |
| Trade receivables:                                    |                 |          |  |
| Notes   | 430             | 309      | 3,645                                    |
| Accounts  | 34,604          | 34,115   | 293,131                                  |
| Allowance for doubtful receivables                    | (0)             | (1)      | (2)                                      |
| Net trade receivables                                 | 35,034          | 34,423   | 296,774                                  |
| Inventories (Note 6)                                  | 10,358          | 9,838    | 87,741                                   |
| Deferred tax assets (Note 14)                         | 1,626           | 1,651    | 13,773                                   |
| Other current assets                                  | 2,093           | 1,696    | 17,730                                   |
| Total current assets                                  | 100,820         | 93,893   | 854,046                                  |
| <b>Property, plant and equipment (Notes 7 and 8):</b> |                 |          |  |
| Land  | 8,843           | 9,064    | 74,908                                   |
| Buildings and structures                              | 39,523          | 40,289   | 334,803                                  |
| Machinery and equipment                               | 10,230          | 10,982   | 86,661                                   |
| Tools, furniture and vehicles                         | 10,961          | 10,452   | 92,847                                   |
| Construction in progress                              | 1,806           | 275      | 15,302                                   |
| Total   | 71,363          | 71,062   | 604,521                                  |
| Accumulated depreciation                              | (40,878)        | (40,667) | (346,278)                                |
| Net property, plant and equipment                     | 30,485          | 30,395   | 258,243                                  |
| <b>Investments and other assets:</b>                  |                 |          |  |
| Investment securities (Note 4)                        | 21,020          | 17,716   | 178,057                                  |
| Goodwill  | 385             | 709      | 3,263                                    |
| Other intangibles                                     | 2,387           | 2,242    | 20,216                                   |
| Deferred tax assets (Note 14)                         | —               | 380      | —  |
| Other assets  | 4,002           | 5,123    | 33,900                                   |
| Total investments and other assets                    | 27,794          | 26,170   | 235,436                                  |
| Total assets  | ¥159,099        | ¥150,458 | \$1,347,725                              |

See accompanying notes to consolidated financial statements.

| LIABILITIES AND NET ASSETS                                     | Millions of yen |          | Thousands of<br>U.S. dollars<br>(Note 3) |
|--|-----------------|----------|--|
|  | 2007            | 2006     | 2007                                     |
| <b>Current liabilities:</b>                                    |                 |          |  |
| Current portion of long-term debt (Note 9)                     | ¥ 168           | ¥ 168    | \$ 1,423                                 |
| Trade accounts payable   | 6,089           | 5,631    | 51,581                                   |
| Other payables   | 8,573           | 9,308    | 72,616                                   |
| Accrued expenses   | 3,154           | 3,417    | 26,721                                   |
| Income taxes payable (Note 14)                                 | 3,917           | 4,946    | 33,184                                   |
| Other current liabilities                                      | 468             | 641      | 3,965                                    |
| Total current liabilities                                      | 22,369          | 24,111   | 189,490                                  |
| <b>Noncurrent liabilities:</b>                                 |                 |          |  |
| Long-term debt (Note 9)  | 5,278           | 5,446    | 44,710                                   |
| Retirement and severance benefits (Note 10)                    | 1,919           | 1,707    | 16,256                                   |
| Deferred tax liabilities (Note 14)                             | 427             | 20       | 3,615                                    |
| Other liabilities  | 460             | 537      | 3,902                                    |
| Total noncurrent liabilities                                   | 8,084           | 7,710    | 68,483                                   |
| <b>Contingent liabilities</b> (Note 15)                        |                 |          |  |
| Total liabilities  | 30,453          | 31,821   | 257,973                                  |
| <b>Net Assets</b> (Note 11):                                   |                 |          |  |
| Common stock (Note 12):  |                 |          |  |
| Authorized-151,493,354 shares<br>(151,493,354 shares in 2006)  |                 |          |  |
| Issued-86,825,303 shares<br>(86,751,203 shares in 2006)        | 6,382           | 6,319    | 54,062                                   |
| Capital surplus (Note 12)                                      | 7,077           | 7,014    | 59,950                                   |
| Retained earnings  | 111,645         | 104,134  | 945,744                                  |
| Treasury stock at cost:  |                 |          |  |
| 50,282 shares in 2007 and 45,090 shares in 2006                | (106)           | (90)     | (902)                                    |
| Total shareholders' equity                                     | 124,998         | 117,377  | 1,058,854                                |
| Unrealized gains on securities, net of taxes (Note 4)          | 5,203           | 3,996    | 44,074                                   |
| Unrealized gains on hedging derivatives, net of taxes (Note 5) | 3               | —        | 27                                       |
| Foreign currency translation adjustments                       | (1,617)         | (2,736)  | (13,707)                                 |
| Total accumulated gains (losses) on evaluation and translation | 3,589           | 1,260    | 30,394                                   |
| Stock subscription rights (Note 12)                            | 59              | —        | 504                                      |
| Total net assets   | 128,646         | 118,637  | 1,089,752                                |
| Total liabilities and net assets                               | ¥159,099        | ¥150,458 | \$1,347,725                              |

## Consolidated Statements of Income

Santen Pharmaceutical Co., Ltd. and Subsidiaries  
For the years ended March 31, 2007, 2006 and 2005

|   | Millions of yen |         |         | Thousands of<br>U.S. dollars<br>(Note 3) |
|---|-----------------|---------|---------|--|
|   | 2007            | 2006    | 2005    | 2007                                     |
| Net sales   | <b>¥100,486</b> | ¥98,398 | ¥92,696 | <b>\$851,213</b>                         |
| Cost of sales   | <b>35,484</b>   | 34,535  | 33,710  | <b>300,584</b>                           |
| Gross profit  | <b>65,002</b>   | 63,863  | 58,986  | <b>550,629</b>                           |
| Selling, general and administrative expenses  | <b>44,590</b>   | 42,868  | 40,004  | <b>377,716</b>                           |
| Operating income  | <b>20,412</b>   | 20,995  | 18,982  | <b>172,913</b>                           |
| Other income (expenses):  |                 |         |         |  |
| Interest and dividend income  | <b>460</b>      | 262     | 249     | <b>3,895</b>                             |
| Gain on insurance received  | <b>119</b>      | 74      | 114     | <b>1,010</b>                             |
| Dividends received from investment limited partnership                                      | <b>72</b>       | 136     | —       | <b>609</b>                               |
| Interest expense  | <b>(91)</b>     | (94)    | (182)   | <b>(768)</b>                             |
| Gain on sale of investment securities   | <b>—</b>        | 0       | 1       | <b>—</b>                                 |
| Gain on sale of fixed assets  | <b>251</b>      | 3       | 341     | <b>2,124</b>                             |
| Net gain on the change of the retirement benefits program (Note 10)                         | <b>—</b>        | —       | 316     | <b>—</b>                                 |
| Gains on marketable securities contributed to employees' retirement benefit trust (Note 10) | <b>—</b>        | —       | 211     | <b>—</b>                                 |
| Loss on impairment of fixed assets (Note 8)   | <b>—</b>        | (909)   | (823)   | <b>—</b>                                 |
| Loss on valuation of investment securities  | <b>—</b>        | —       | (51)    | <b>—</b>                                 |
| Restructuring charge for the logistics operations   | <b>—</b>        | (149)   | —       | <b>—</b>                                 |
| Restructuring charge for the U.S. business  | <b>—</b>        | —       | (441)   | <b>—</b>                                 |
| Other, net  | <b>(184)</b>    | 24      | (281)   | <b>(1,561)</b>                           |
| Income before income taxes  | <b>21,039</b>   | 20,342  | 18,436  | <b>178,222</b>                           |
| Income taxes (Note 14):   |                 |         |         |  |
| Current   | <b>7,902</b>    | 7,999   | 6,447   | <b>66,938</b>                            |
| Deferred  | <b>(11)</b>     | (680)   | 966     | <b>(89)</b>                              |
|   | <b>7,891</b>    | 7,319   | 7,413   | <b>66,849</b>                            |
| Net income  | <b>¥ 13,148</b> | ¥13,023 | ¥11,023 | <b>\$111,373</b>                         |
| <b>Per share data:</b>  |                 | Yen     |         | U.S. dollars<br>(Note 3)                 |
|   | <b>2007</b>     | 2006    | 2005    | <b>2007</b>                              |
| Net income-basic  | <b>¥ 151.58</b> | ¥150.26 | ¥125.85 | <b>\$ 1.28</b>                           |
| Net income-diluted  | <b>151.31</b>   | 150.01  | 125.71  | <b>1.28</b>                              |
| Cash dividends, applicable to the period  | <b>65.00</b>    | 60.00   | 50.00   | <b>0.55</b>                              |

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Changes in Net Assets

Santen Pharmaceutical Co., Ltd. and Subsidiaries  
For the years ended March 31, 2007, 2006 and 2005

|   | Millions of yen |                 |                   |                        |  |   |  |                           |
|---|-----------------|-----------------|-------------------|------------------------|--|---|--|---------------------------|
|   | Common stock    | Capital surplus | Retained earnings | Treasury stock at cost | Unrealized gains on securities, net of taxes | Unrealized gains on hedging derivatives, net of taxes | Foreign currency translation adjustments | Stock subscription rights |
| Balance at March 31, 2004                   | ¥ 6,214         | ¥ 6,909         | ¥ 91,845          | ¥ (40)                 | ¥ 1,426                                      | ¥ —   | ¥ (2,854)                                | ¥ —                       |
| Exercise of stock options                   | 34              | 34              |                   |                        |  |   |  |                           |
| Cash dividends paid                         |                 |                 | (4,397)           |                        |  |   |  |                           |
| Bonuses to directors and corporate auditors |                 |                 | (21)              |                        |  |   |  |                           |
| Net income                                  |                 |                 | 11,023            |                        |  |   |  |                           |
| Repurchase of treasury stock, net           |                 |                 |                   | (2,583)                |  |   |  |                           |
| Retirement of treasury stock                |                 |                 | (2,548)           | 2,548                  |  |   |  |                           |
| Other                                       |                 |                 |                   |                        | 623  |   | 27                                       |                           |
| Balance at March 31, 2005                   | ¥ 6,248         | ¥ 6,943         | ¥ 95,902          | ¥ (75)                 | ¥ 2,049                                      | ¥ —   | ¥ (2,827)                                | ¥ —                       |
| Exercise of stock options                   | 71              | 71              |                   |                        |  |   |  |                           |
| Cash dividends paid                         |                 |                 | (4,766)           |                        |  |   |  |                           |
| Bonuses to directors and corporate auditors |                 |                 | (25)              |                        |  |   |  |                           |
| Net income                                  |                 |                 | 13,023            |                        |  |   |  |                           |
| Repurchase of treasury stock, net           |                 |                 |                   | (15)                   |  |   |  |                           |
| Retirement of treasury stock                |                 |                 |                   |                        |  |   |  |                           |
| Other                                       |                 |                 |                   |                        | 1,947  |   | 91                                       |                           |
| Balance at March 31, 2006                   | ¥ 6,319         | ¥ 7,014         | ¥104,134          | ¥ (90)                 | ¥ 3,996                                      | ¥ —   | ¥ (2,736)                                | ¥ —                       |
| Exercise of stock options                   | 63              | 63              |                   |                        |  |   |  |                           |
| Cash dividends paid                         |                 |                 | (5,637)           |                        |  |   |  |                           |
| Net income                                  |                 |                 | 13,148            |                        |  |   |  |                           |
| Repurchase of treasury stock, net           |                 |                 |                   | (17)                   |  |   |  |                           |
| Retirement of treasury stock                |                 | 0               |                   | 1                      |  |   |  |                           |
| Other                                       |                 |                 |                   |                        | 1,207  | 3   | 1,119                                    | 59                        |
| <b>Balance at March 31, 2007</b>            | <b>¥ 6,382</b>  | <b>¥ 7,077</b>  | <b>¥111,645</b>   | <b>¥ (106)</b>         | <b>¥ 5,203</b>                               | <b>¥ 3</b>  | <b>¥ (1,617)</b>                         | <b>¥ 59</b>               |

|                                   | Thousands of U.S. dollars (Note 3) |                 |                   |                        |  |   |  |                           |
|-----------------------------------|------------------------------------|-----------------|-------------------|------------------------|--|---|--|---------------------------|
|                                   | Common stock                       | Capital surplus | Retained earnings | Treasury stock at cost | Unrealized gains on securities, net of taxes | Unrealized gains on hedging derivatives, net of taxes | Foreign currency translation adjustments | Stock subscription rights |
| Balance at March 31, 2006         | \$53,530                           | \$59,417        | \$882,120         | \$ (763)               | \$33,849                                     | \$ —  | \$ (23,174)                              | \$ —                      |
| Exercise of stock options         | 532                                | 532             |                   |                        |  |   |  |                           |
| Cash dividends paid               |                                    |                 | (47,749)          |                        |  |   |  |                           |
| Net income                        |                                    |                 | 111,373           |                        |  |   |  |                           |
| Repurchase of treasury stock, net |                                    |                 |                   | (142)                  |  |   |  |                           |
| Retirement of treasury stock      |                                    | 1               |                   | 3                      |  |   |  |                           |
| Other                             |                                    |                 |                   |                        | 10,225                                       | 27  | 9,467                                    | 504                       |
| <b>Balance at March 31, 2007</b>  | <b>\$54,062</b>                    | <b>\$59,950</b> | <b>\$945,744</b>  | <b>\$ (902)</b>        | <b>\$44,074</b>                              | <b>\$27</b>   | <b>\$ (13,707)</b>                       | <b>\$504</b>              |

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Cash Flows

Santen Pharmaceutical Co., Ltd. and Subsidiaries  
For the years ended March 31, 2007, 2006 and 2005

Thousands of  
U.S. dollars  
(Note 3)

|   | Millions of yen |                |                |                  |
|---|-----------------|----------------|----------------|------------------|
|   | 2007            | 2006           | 2005           | 2007             |
| <b>Cash flows from operating activities:</b>                        |                 |                |                |                  |
| Income before income taxes  | ¥21,039         | ¥20,342        | ¥18,436        | \$178,222        |
| Depreciation and amortization                                       | 4,761           | 4,824          | 4,750          | 40,334           |
| Loss on impairment of fixed assets (Note 8)                         | —               | 909            | 823            | —                |
| Increase (decrease) in retirement and severance benefits            | 160             | (212)          | (2,551)        | 1,359            |
| Interest and dividend income  | (460)           | (262)          | (249)          | (3,895)          |
| Gain on insurance received  | (119)           | (74)           | (114)          | (1,010)          |
| Interest expense  | 91              | 94             | 182            | 768              |
| (Increase) decrease in trade receivables                            | (414)           | 1,407          | (3,082)        | (3,511)          |
| (Increase) decrease in inventories                                  | (357)           | (18)           | 595            | (3,023)          |
| Increase (decrease) in trade accounts payable                       | 401             | (495)          | 1,066          | 3,395            |
| Other, net  | (1,820)         | 571            | (2,263)        | (15,417)         |
| Subtotal  | 23,282          | 27,086         | 17,593         | 197,222          |
| Interest and dividend income received                               | 460             | 266            | 247            | 3,898            |
| Interest expense paid   | (91)            | (95)           | (183)          | (771)            |
| Insurance received  | 222             | 129            | 198            | 1,882            |
| Income taxes paid   | (8,914)         | (6,507)        | (11,236)       | (75,511)         |
| Net cash provided by operating activities                           | 14,959          | 20,879         | 6,619          | 126,720          |
| <b>Cash flows from investing activities:</b>                        |                 |                |                |                  |
| Capital expenditures  | (3,556)         | (2,106)        | (4,907)        | (30,116)         |
| Purchase of investment securities                                   | (2,209)         | (58)           | (3,230)        | (18,707)         |
| Proceeds from sale of investment securities                         | —               | 20             | 1,059          | —                |
| Proceeds from sale of property, plant and equipment                 | 601             | 29             | 2,488          | 5,087            |
| Purchase of short-term investments                                  | (1,223)         | (804)          | (6,048)        | (10,361)         |
| Proceeds from sale of short-term investments                        | 554             | 1,547          | 7,722          | 4,691            |
| Other, net  | (13)            | 42             | 9              | (112)            |
| Net cash used in investing activities                               | (5,846)         | (1,330)        | (2,907)        | (49,518)         |
| <b>Cash flows from financing activities:</b>                        |                 |                |                |                  |
| Repayment of long-term debt   | (168)           | (1,268)        | (5,804)        | (1,423)          |
| Repurchase of treasury stock, net                                   | (17)            | (15)           | (2,583)        | (142)            |
| Dividends paid  | (5,632)         | (4,760)        | (4,393)        | (47,712)         |
| Other, net  | 126             | 143            | 68             | 1,068            |
| Net cash used in financing activities                               | (5,691)         | (5,900)        | (12,712)       | (48,209)         |
| <b>Effect of exchange rate changes on cash and cash equivalents</b> | <b>314</b>      | <b>75</b>      | <b>(42)</b>    | <b>2,657</b>     |
| <b>Net increase (decrease) in cash and cash equivalents</b>         | <b>3,736</b>    | <b>13,724</b>  | <b>(9,042)</b> | <b>31,650</b>    |
| <b>Cash and cash equivalents at beginning of year</b>               | <b>46,105</b>   | <b>32,381</b>  | <b>41,423</b>  | <b>390,553</b>   |
| <b>Cash and cash equivalents at end of year</b>                     | <b>¥49,841</b>  | <b>¥46,105</b> | <b>¥32,381</b> | <b>\$422,203</b> |

See accompanying notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

Santen Pharmaceutical Co., Ltd. and Subsidiaries

## 1. Basis of Presentation of Consolidated Financial Statements

The accompanying consolidated financial statements of Santen Pharmaceutical Co., Ltd. (the "Company") have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan ("Japanese GAAP"), which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

The accounts of the Company's overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles prevailing in the respective countries

of domicile. The accompanying consolidated financial statements have been restructured and translated into the English (with certain expanded disclosure and the inclusion of the consolidated statements of changes in net assets for the years ended March 31, 2006 and 2005) 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. Certain supplementary information included in the statutory Japanese language consolidated financial statements, but not required for fair presentation, is not presented in the accompanying consolidated financial statements.

## 2. Summary of Significant Accounting Policies

### 1) Principles of consolidation

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries (the "Companies"). All significant intercompany balances and transactions are eliminated on consolidation.

### 2) Use of estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

### 3) Short-term investments, investment securities and golf membership rights (see Note 4)

The Company and its domestic subsidiary have adopted "Accounting Standard for Financial Instruments" which was issued by the Business Accounting Council in Japan. In accordance with this standard, securities are classified into three categories; trading, held-to-maturity, or other securities.

Based on this classification, all trading securities and, any held-to-maturity and other securities with a maturity of less than one year, are included in current assets. All other securities are included in investment securities as noncurrent assets.

Those classified as other securities with an available market value are reported at fair value with unrealized holding gains, net of related taxes reported as a separate component of net assets. Realized gains and losses on sales of such securities are determined by the moving average cost method. Other securities with no available market value are carried at cost, which is determined by the moving average cost method.

In addition, this standard also requires the recognition of an impairment loss on golf membership rights, included in other assets, on the consolidated balance sheets, when the market value shows a substantial decline and is not judged to recover.

### 4) Derivative instruments (see Note 5)

Derivative instruments are stated at fair value, and accounted for using deferred hedge accounting. Recognition of gains or losses resulting from changes in fair values of derivative financial instruments are deferred until the related losses or gains on the hedged items are recognized if derivative financial instruments are used as hedges and meet certain hedging criteria. Foreign exchange contracts that meet the criteria are accounted for under the allocation method. The allocation method requires recognized foreign currency receivables or payables to be translated using the corresponding foreign exchange contract rates. Interest rate swaps that meet the criteria are accounted for under the special method, as regulated in the accounting standard, as if the interest rates under interest rate swaps were originally applied to underlying borrowings.

The Company has also developed a hedging policy to control various aspects of derivative instruments including authorization levels and transaction volumes. Based on this policy, the Company hedges the exposure risk arising from fluctuations in foreign currency exchange rates, interest rates, and prices of securities. The Company evaluates hedge effectiveness by comparing the cumulative changes in cash flows from hedged items and corresponding changes in hedging derivative instruments.

### 5) Allowance for doubtful receivables

Allowance for doubtful receivables is provided principally at an amount computed based on the actual ratio of bad debts in the past and the estimated uncollectible amounts based on the individual analysis of certain receivables.

### 6) Inventories (see Note 6)

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

### 7) Property, plant and equipment

Property, plant and equipment is stated at cost. Depreciation of buildings, acquired prior to April 1, 1998, and other property, plant and equipment is computed over the estimated useful lives of the

assets by the declining-balance method for the Company and its domestic subsidiary. Buildings (other than leasehold improvements), which were acquired on or after April 1, 1998, are depreciated using the straight-line method for the Company and its domestic subsidiary. Depreciation is computed over the estimated useful lives of the assets by the straight-line method for all overseas subsidiaries.

The principal estimated useful lives are as follows:

|                               |                |
|-------------------------------|----------------|
| Buildings and structures      | 31 to 50 years |
| Machinery and equipment       | 7 years        |
| Tools, furniture and vehicles | 4 to 10 years  |

### 8) Leases (see Note 7)

In Japan, finance leases other than those that are deemed to transfer the ownership of the leased assets to lessees are accounted for by a method similar to that applicable to ordinary operating leases.

### 9) Impairment of fixed assets (see Note 8)

In accordance with "Accounting Standards for Impairment of Fixed Assets" which was issued by the Business Accounting Council in Japan, fixed assets, such as property, plant and equipment and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset, or group of assets, to estimated undiscounted future cash flows expected to be generated. If the carrying amount of an asset, or group of assets, exceeds its estimated future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the greater of its net realizable value or value in use.

### 10) Retirement and severance benefits (see Note 10)

Employees of the Company and all domestic subsidiaries are generally entitled to lump-sum severance and, in certain cases, annuity payments on retirement, based on current rates of pay, length of service and certain other factors.

The Company and all domestic subsidiaries have adopted "Accounting Standard for Retirement Benefits" which was issued by the Financial Accounting Deliberation Council. In accordance with this standard, the allowance for retirement benefits for employees is provided based on the estimated retirement benefit obligation and the pension assets. Actuarial gains and losses are amortized, from the year in which the actuarial gains and losses are incurred, using the straight-line method, over the estimated average remaining service years of employees. Prior service cost is expensed as incurred.

In January 2005, due to the enforcement of the Defined Contribution Pension Plan Act in Japan, the Company has abolished its qualified pension plan and introduced a new retirement benefit scheme, which is a combination of lump-sum severance plan, cash balance and defined contribution pension plan and has adopted the Financial Accounting Standards Implementation Guidance No.1 "Accounting for Transfers between Retirement Benefit Plans" which was issued

by the Accounting Standards Board of Japan. The Company also established the retirement benefits trust in March 2005.

In addition, the Company has an unfunded retirement benefit plan for directors and corporate auditors. The amounts required under the plan have been fully accrued. Accrued severance indemnities for the members of the board and corporate auditors of the Company are provided based on internal regulations. The accrued provision for severance indemnities for members of the board and corporate auditors is not funded.

Certain overseas subsidiaries have defined contribution plans covering substantially all of their employees. The amounts contributed under the plans are charged to income.

### 11) Foreign currency translation

All monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange prevailing on the balance sheet date, except for those items covered by forward exchange contracts.

The Company and all domestic subsidiaries have adopted "Accounting Standard for Foreign Currency Transactions" which was issued by the Business Accounting Council in Japan.

Financial statements of overseas subsidiaries are translated into Japanese yen at year-end rates for all assets and liabilities and at weighted average rates for income and expense accounts. Adjustments resulting from the translation of financial statements are reflected under the caption, "Foreign currency translation adjustments", in net assets.

### 12) Research and development and computer software (see Note 13)

Research and development expenditures are charged to income when incurred.

Expenditures relating to computer software developed for internal use are charged to income when incurred except if they contribute to the generation of income or to future cost savings. Such expenditures are capitalized as an asset and are amortized using the straight-line method over their estimated useful life, five years.

### 13) Net income and dividends per share (see Note 11)

The computation of basic net income per share is based on the weighted average number of shares of common stock outstanding during each period. The average number of shares used in the computation is 86,735 thousand, 86,662 thousand and 87,390 thousand for the years ended March 31, 2007, 2006 and 2005, respectively.

The diluted net income per share assumes the dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock. The average number of shares used in the computation is 86,891 thousand, 86,808 thousand and 87,485

thousand for the years ended March 31, 2007, 2006 and 2005, respectively.

Cash dividends per share shown in the accompanying consolidated statements of income are the amounts applicable to the respective years.

**14) Income taxes (see Note 14)**

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, operating loss carry forwards and foreign tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

**15) Cash and cash equivalents**

Cash and cash equivalents mainly include cash on hand, readily available deposits and all highly liquid debt investments, generally with a maturity of three months or less, that are readily convertible to known amounts of cash and are so near maturity that they present insignificant risk of changes in value.

**16) New Accounting Pronouncements**

**(i) Accounting Standard for Presentation of Net Assets in the Balance Sheet**

Effective from the year ended March 31, 2007, the Company and its domestic subsidiary adopted new accounting standards, "Accounting Standard for Presentation of Net Assets in the Balance Sheet" (Statement No.5 issued by the Accounting Standards Board of Japan on December 9, 2005), and the implementation guidance for the accounting standard for presentation of net assets in the balance sheet (the Financial Accounting Standard Implementation Guidance No.8 issued by the Accounting Standards Board of Japan on December 9, 2005), (collectively, the "New Accounting Standards").

Under the New Accounting Standards, the balance sheet comprises assets, liabilities and net assets sections. Previously, the balance sheet comprised assets, liabilities and stockholders' equity sections. The net assets section comprises three subsections, which are shareholders' equity, accumulated gains (losses) on evaluation and translation and stock subscription rights, as applicable.

The stockholders' equity section in the balance sheet as of March 31, 2006 has been reclassified to conform to the 2007 presentation. Under the New Accounting Standards, the net assets section includes unrealized gains (losses) on hedging derivatives, net of taxes. Under the previous presentation rules, companies were required to present unrealized gains (losses) on hedging derivatives in the assets or liabilities section without considering the related income tax effects. Prior years' unrealized gains (losses) on hedging derivatives have not been restated since there were no material effects on the Company's consolidated financial statements.

**(ii) Accounting Standard for Statement of Changes in Net Assets**

Effective from the year ended March 31, 2007, the Company and its domestic subsidiary adopted the new accounting standard, "Accounting Standard for Statement of Changes in Net Assets" (Statement No.6 issued by the Accounting Standards Board of Japan on December 27, 2005), and the implementation guidance for the accounting standard for statement of changes in net assets (the Financial Accounting Standard Implementation Guidance No. 9 issued by the Accounting Standards Board of Japan on December 27, 2005), (collectively, the "Additional New Accounting Standards").

Accordingly, the Company prepared the statements of changes in net assets for the year ended March 31, 2007 in accordance with the Additional New Accounting Standards. Also, the Company voluntarily prepared the consolidated statement of changes in net assets for the years ended March 31, 2006 and 2005 in accordance with the Additional New Accounting Standards. Previously, consolidated statements of shareholders' equity were prepared for the purpose of inclusion in the consolidated financial statements although such statements were not required under Japanese GAAP.

**(iii) Accounting Standard for Share-based Payment**

Effective from the year ended March 31, 2007, the Company adopted new accounting standards, "Accounting Standard for Share-based Payment" (Statement No.8 issued by the Accounting Standards Board of Japan on December 27, 2005), and the implementation guidance for the accounting standard for share-based payment (the Financial Accounting Standard Implementation Guidance No.11 issued by the Accounting Standards Board of Japan on May 31, 2006). The effect of this adoption was to decrease operating income and income before income taxes by ¥59 million (\$504 thousand).

**3. Translation into United States Dollars**

The accompanying consolidated financial statements are expressed in Japanese yen and, solely for the convenience of the reader, have been translated into United States dollars at the rate of ¥118.05=US\$1, the approximate exchange rate prevailing

on March 31, 2007. The translation should not be construed as a representation that the Japanese yen have been, could have been, or could in the future be converted into United States dollars at that rate or any other rate.

#### 4. Short-term Investments and Investment Securities

The following is a summary of held-to-maturity debt securities and other securities with a market value at March 31, 2007 and 2006:

|                                    | Millions of yen                  |                               |                               |   |                                  |                               |                               |   |  |
|------------------------------------|----------------------------------|-------------------------------|-------------------------------|---|----------------------------------|-------------------------------|-------------------------------|---|--|
|                                    | 2007                             |                               |                               |   | 2006                             |                               |                               |   |  |
|                                    | Held-to-maturity debt securities |                               |                               |   | Held-to-maturity debt securities |                               |                               |   |  |
| Book value<br>(Carrying<br>amount) | Gross<br>unrealized<br>gains     | Gross<br>unrealized<br>losses | Estimated<br>fair value       | Book value<br>(Carrying<br>amount)      | Gross<br>unrealized<br>gains     | Gross<br>unrealized<br>losses | Estimated<br>fair value       |   |  |
| Bonds and debentures               | ¥ 1,000                          | ¥ 2                           | ¥ —                           | ¥ 1,002                                 | ¥1,000                           | ¥ 9                           | ¥ —                           | ¥ 1,009                                 |  |
|                                    | Other securities                 |                               |                               |   | Other securities                 |                               |                               |   |  |
|                                    | Cost                             | Gross<br>unrealized<br>gains  | Gross<br>unrealized<br>losses | Book value<br>(Estimated<br>fair value) | Cost                             | Gross<br>unrealized<br>gains  | Gross<br>unrealized<br>losses | Book value<br>(Estimated<br>fair value) |  |
| Equity securities                  | ¥10,904                          | ¥ 8,669                       | ¥ —                           | ¥ 19,573                                | ¥8,796                           | ¥6,647                        | ¥ —                           | ¥15,443                                 |  |

|                                    | Thousands of U.S. dollars        |                               |                               |   |  |
|------------------------------------|----------------------------------|-------------------------------|-------------------------------|---|--|
|                                    | 2007                             |                               |                               |   |  |
|                                    | Held-to-maturity debt securities |                               |                               |   |  |
| Book value<br>(Carrying<br>amount) | Gross<br>unrealized<br>gains     | Gross<br>unrealized<br>losses | Estimated<br>fair value       |   |  |
| Bonds and debentures               | \$ 8,471                         | \$ 15                         | \$ —                          | \$ 8,486                                |  |
|                                    | Other securities                 |                               |                               |   |  |
|                                    | Cost                             | Gross<br>unrealized<br>gains  | Gross<br>unrealized<br>losses | Book value<br>(Estimated<br>fair value) |  |
| Equity securities                  | \$ 92,368                        | \$73,433                      | \$ —                          | \$ 165,801                              |  |

Maturities of investments at March 31, 2007 and 2006 are as follows:

|                                       | Millions of yen         |                     |                         |                     | Thousands of U.S. dollars |                     |
|---------------------------------------|-------------------------|---------------------|-------------------------|---------------------|---------------------------|---------------------|
|                                       | 2007                    |                     | 2006                    |                     | 2007                      |                     |
|                                       | Bonds and<br>debentures | Other<br>securities | Bonds and<br>debentures | Other<br>securities | Bonds and<br>debentures   | Other<br>securities |
| Cash equivalents                      | ¥15,000                 | ¥ —                 | ¥ 9,300                 | ¥ —                 | \$127,065                 | \$ —                |
| Due within one year                   | —                       | —                   | —                       | —                   | —                         | —                   |
| Due after one year through five years | —                       | —                   | 1,000                   | —                   | —                         | —                   |
|                                       | ¥15,000                 | ¥ —                 | ¥ 10,300                | ¥ —                 | \$127,065                 | \$ —                |

#### 5. Derivative Instruments

The Company principally utilizes derivative instruments such as foreign exchange contracts and interest rate swaps to hedge the exposure risk arising from fluctuations in foreign currency exchange rates, interest rates and market price of securities.

The Company is exposed to the risk that the counterparties will

not be able to fully satisfy their obligations under contracts, but the Company believes that such risk is mitigated by the high credit ratings of the counterparties.

There is no outstanding derivative transaction for which hedge accounting was not applied at March 31, 2007 and 2006.

## 6. Inventories

Inventories at March 31 2007 and 2006 consist of the following:

|   | Millions of yen |        | Thousands of U.S. dollars |
|---|-----------------|--------|---------------------------|
|   | 2007            | 2006   | 2007                      |
| Merchandise                             | ¥ 2,973         | ¥2,680 | \$25,184                  |
| Finished goods                          | 4,948           | 5,151  | 41,914                    |
| Work in process and semi-finished goods | 910             | 749    | 7,705                     |
| Raw materials and supplies              | 1,527           | 1,258  | 12,938                    |
|   | ¥10,358         | ¥9,838 | \$87,741                  |

## 7. Leases

Finance leases, except for those in which ownership is deemed to be transferred to the lessee, are accounted for as operating leases.

### Finance leases:

Equivalent purchase amount, accumulated depreciation and future minimum lease payments on an "as if capitalized" basis at March 31, 2007 and 2006 are as follows:

|  | Millions of yen |         | Thousands of U.S. dollars |
|--|-----------------|---------|---------------------------|
|  | 2007            | 2006    | 2007                      |
| Machinery and equipment:                   |                 |         |                           |
| Equivalent purchase amount                 | ¥12,755         | ¥14,236 | \$108,045                 |
| Equivalent accumulated depreciation amount | 10,828          | 11,498  | 91,723                    |
| Equivalent balance at year-end             | 1,927           | 2,738   | 16,322                    |
| Tools:                                     |                 |         |                           |
| Equivalent purchase amount                 | 615             | 514     | 5,216                     |
| Equivalent accumulated depreciation amount | 393             | 287     | 3,332                     |
| Equivalent balance at year-end             | 222             | 227     | 1,884                     |
| Total:                                     |                 |         |                           |
| Equivalent purchase amount                 | 13,370          | 14,750  | 113,261                   |
| Equivalent accumulated depreciation amount | 11,221          | 11,785  | 95,055                    |
| Equivalent balance at year-end             | ¥ 2,149         | ¥ 2,965 | \$ 18,206                 |
| Future minimum lease payments:             |                 |         |                           |
| Due within one year                        | ¥ 951           | ¥ 948   | \$ 8,057                  |
| Due after one year                         | 1,319           | 2,123   | 11,172                    |
|  | ¥ 2,270         | ¥ 3,071 | \$ 19,229                 |

Lease payments, equivalent depreciation and equivalent interest expense for the three years ended March 31, 2007 are as follows:

|                             | Millions of yen |        |      | Thousands of U.S. dollars |
|-----------------------------|-----------------|--------|------|---------------------------|
|                             | 2007            | 2006   | 2005 | 2007                      |
| Lease payments              | ¥1,032          | ¥1,035 | ¥977 | \$8,744                   |
| Equivalent depreciation     | ¥ 970           | ¥ 969  | ¥911 | \$8,218                   |
| Equivalent interest expense | ¥ 47            | ¥ 61   | ¥ 68 | \$ 396                    |

**Operating leases:**

Future minimum rents under non-cancellable operating leases at March 31, 2007 and 2006 consist of the following:

|                     | Millions of yen |      | Thousands of U.S. dollars |
|---------------------|-----------------|------|---------------------------|
|                     | 2007            | 2006 | 2007                      |
| Due within one year | ¥134            | ¥107 | \$1,135                   |
| Due after one year  | 161             | 98   | 1,367                     |
|                     | ¥295            | ¥205 | \$2,502                   |

**8. Impairment of fixed assets**

The Company and all domestic subsidiaries account for impairment of fixed assets in accordance with the Financial Accounting Standard on Accounting for Impairment of Assets. The Company and all domestic subsidiaries review the recorded value of their property, plant and equipment and intangible assets to determine if the future cash flows to be derived from these

properties will be sufficient to recover the remaining recorded asset values.

The impairment losses recognized for the three years ended March 31, 2007, 2006 and 2005 are as follows:

|                          | Millions of yen |      |      | Thousands of U.S. dollars |
|--------------------------|-----------------|------|------|---------------------------|
|                          | 2007            | 2006 | 2005 | 2007                      |
| Land                     | ¥ —             | ¥433 | ¥700 | \$ —                      |
| Buildings and structures | —               | 372  | 73   | —                         |
| Others                   | —               | 104  | 50   | —                         |
|                          | ¥ —             | ¥909 | ¥823 | \$ —                      |

The Company and certain subsidiaries recorded impairment losses related to the write-down of land and buildings in connection with the logistics operations in the western area of Japan as a result of an outsourcing plan for the year ended March 31, 2006. The fair value of the land and buildings was determined by specific appraisal.

The Company decided to sell the rental land and buildings for the year ended March 31, 2005. As a result, the Company recognized an impairment loss. The fair value of the land and buildings was determined by using a purchase price offered by a third party.

**9. Long-term Debt**

Long-term debt at March 31, 2007 and 2006 consists of the following:

|   | Millions of yen |        | Thousands of U.S. dollars |
|---|-----------------|--------|---------------------------|
|   | 2007            | 2006   | 2007                      |
| Unsecured yen syndicated loans from domestic banks, due in 2008, interest 1.06%           | ¥5,000          | ¥5,000 | \$42,355                  |
| Unsecured yen loans from domestic banks, due in installments through 2009, interest 4.75% | 446             | 614    | 3,778                     |
| Total   | 5,446           | 5,614  | 46,133                    |
| Current portion shown in current liabilities  | (168)           | (168)  | (1,423)                   |
|   | ¥5,278          | ¥5,446 | \$44,710                  |

As is customary in Japan, long-term bank loans are made under general agreements which provide that additional security and guarantees for present and future indebtedness will be given upon request of the bank under certain circumstances, and that

the bank shall have the right, as the obligations become due, or in the event of their default, to offset cash deposits against such obligations due to the bank. To date, the Company has not received such a request from its banks.

The aggregate annual maturities of long-term debt at March 31, 2007 are as follows:

| Years ending March 31 | Millions of yen | Thousands of U.S. dollars |
|-----------------------|-----------------|---------------------------|
| 2008                  | ¥ 168           | \$ 1,423                  |
| 2009                  | 5,168           | 43,778                    |
| 2010                  | 110             | 932                       |
| 2011 and thereafter   | —               | —                         |
| <b>Total</b>          | <b>¥5,446</b>   | <b>\$46,133</b>           |

In 2006, the Company entered into a commitment line contract with seven domestic banks. The maximum aggregate credit available to the Company is ¥16,000 million. The credit has not been used as of March 31, 2007.

## 10. Retirement and Severance Benefits

As discussed in Note 2, 10), the Company has abolished its qualified pension plan and introduced a new retirement benefit scheme, which is a combination of lump-sum severance, cash balance and defined contribution pension plans, since January 2005. In addition, the Company has set up an employees'

retirement benefit trust in March 2005.

The following table sets forth the details of benefit obligation, plan assets and funded status of the Companies at March 31, 2007 and 2006.

|   | Millions of yen  |           | Thousands of U.S. dollars |
|---|------------------|-----------|---------------------------|
|   | 2007             | 2006      | 2007                      |
| For employees:  |                  |           |                           |
| Benefit obligation at end of year   | <b>¥(11,371)</b> | ¥(10,838) | <b>\$ (96,322)</b>        |
| Fair value of plan assets at end of year  | <b>9,356</b>     | 8,939     | <b>79,253</b>             |
| Funded status (benefit obligation in excess of plan assets)                     | <b>(2,015)</b>   | (1,899)   | <b>(17,069)</b>           |
| Unrecognized actuarial loss   | <b>610</b>       | 655       | <b>5,166</b>              |
| For directors and corporate auditors:   |                  |           |                           |
| Accrued retirement benefit  | <b>(514)</b>     | (463)     | <b>(4,353)</b>            |
| Retirement and severance benefits recognized in the consolidated balance sheets | <b>¥ (1,919)</b> | ¥ (1,707) | <b>\$ (16,256)</b>        |

Retirement and severance costs of the Companies include the following components for the three years ended March 31, 2007.

|  | Millions of yen |        |        | Thousands of<br>U.S. dollars |
|--|-----------------|--------|--------|------------------------------|
|  | 2007            | 2006   | 2005   | 2007                         |
| For employees:   |                 |        |        |                              |
| Service cost   | ¥ 701           | ¥ 673  | ¥ 869  | \$ 5,939                     |
| Interest cost  | 218             | 208    | 217    | 1,845                        |
| Expected return on plan assets                             | (179)           | (154)  | (103)  | (1,514)                      |
| Recognized actuarial loss                                  | 79              | 76     | 111    | 668                          |
| Amortization of unrecognized prior service cost            | —               | —      | 572    | —                            |
| Net gains on the change of the retirement benefits program | —               | —      | (316)  | —                            |
| Contribution to defined contribution pension plan          | 807             | 770    | 491    | 6,840                        |
| Net periodic benefit cost                                  | ¥1,626          | ¥1,573 | ¥1,841 | \$ 13,778                    |
| For directors and corporate auditors:                      |                 |        |        |                              |
| Accrual for retirement benefit                             | ¥ 79            | ¥ 60   | ¥ 6    | \$ 670                       |

Assumptions used in the accounting for retirement and severance benefits for the three years ended March 31, 2007 are as follows:

|  | 2007                       | 2006                | 2005                |
|--|----------------------------|---------------------|---------------------|
| Method of attributing benefit to period of service | <b>Straight-line basis</b> | Straight-line basis | Straight-line basis |
| Discount rate                                      | <b>2.00%</b>               | 2.00%               | 2.00%               |
| Expected return on plan assets                     | <b>2.00%</b>               | 2.00%               | 2.00%               |
| Amortization period for actuarial losses*          | <b>14 years</b>            | 14 years            | 14 years            |

\* Amortized on a straight-line basis over the average remaining service period for employees in service starting from the year in which the losses occur.

All domestic subsidiaries have adopted the permitted alternative treatment, accruing for 100% of the amount required if all employees were to voluntarily terminate their employment as

of the balance sheet date, in accordance with the accounting standard for retirement benefits for small business entities.

## 11. Net Assets

As described in Note 2, 16) "New Accounting Pronouncements", net assets comprises three subsections, which are shareholders' equity, accumulated gains (losses) on evaluation and translation and stock subscription rights, as applicable. Japanese Corporate Law ("the Law") became effective on May 1, 2006, replacing the Japanese Commercial Code ("the Code").

Under the Japanese laws and regulations, the entire amount paid for new shares is required to be designated as common stock. However, a company may, by a resolution of the Board of Directors, designate an amount not exceeding one-half of the price of the new shares as additional paid-in capital, which is included in capital surplus.

Under the Law, in cases where dividend distribution of surplus is made, the smaller of an amount equal to 10% of the dividend

and the excess, if any, of 25% of common stock over the total of additional paid-in capital and legal earnings reserve must be set aside as additional paid-in capital or legal earnings reserve. Legal earnings reserve is included in retained earnings in the accompanying consolidated balance sheets and amounted to ¥1,551 million (\$13,142 thousand) and ¥1,551 million as of March 31, 2007 and 2006, respectively.

Cash dividends charged to retained earnings during the three years ended March 31, 2007 represent dividends paid out during the periods. The accompanying consolidated financial statements do not include any provision for the year end dividend of ¥35 (\$0.30) per share, aggregating ¥3,037 million (\$25,727 thousand) which was approved at the Company's shareholders' meeting on June 26, 2007 in respect of the year ended March 31, 2007.

## 12. Stock Options

The Company has stock-based compensation plans under which stock options are granted annually to directors and corporate officers at the market price on the date of the grant. The stock

options are fully exercisable after two years and have a span of ten years from the date of grant.

Stock options existing as of March 31, 2007 are as follows:

| Stock options granted | 1998                                   | 1999                                   | 2000                                   |
|-----------------------|--|--|--|
| Persons granted       | Directors:12                           | Directors:10<br>Management:6           | Directors and corporate officers:16    |
| Number of shares      | Common Stock 106,000                   | Common Stock 66,000                    | Common Stock 60,000                    |
| Date of grant         | July 1, 1998                           | July 8, 1999                           | July 10, 2000                          |
| Vesting conditions    | No provisions                          | No provisions                          | No provisions                          |
| Service period        | No provisions                          | No provisions                          | No provisions                          |
| Exercise period       | From June 27, 2000<br>to June 25, 2008 | From June 30, 2001<br>to June 28, 2009 | From June 30, 2002<br>to June 28, 2010 |
| Stock options granted | 2001                                   | 2002                                   | 2003                                   |
| Persons granted       | Directors and corporate officers:14    | Directors and corporate officers:14    | Directors and corporate officers:12    |
| Number of shares      | Common Stock 55,000                    | Common Stock 92,000                    | Common Stock 137,600                   |
| Date of grant         | July 9, 2001                           | July 5, 2002                           | July 4, 2003                           |
| Vesting conditions    | No provisions                          | No provisions                          | No provisions                          |
| Service period        | No provisions                          | No provisions                          | No provisions                          |
| Exercise period       | From June 29, 2003<br>to June 27, 2011 | From June 27, 2004<br>to June 25, 2012 | From June 27, 2005<br>to June 25, 2013 |
| Stock options granted | 2004                                   | 2005                                   | 2006                                   |
| Persons granted       | Directors and corporate officers:11    | Directors and corporate officers:15    | Directors and corporate officers:15    |
| Number of shares      | Common Stock 78,200                    | Common Stock 129,200                   | Common Stock 102,700                   |
| Date of grant         | July 5, 2004                           | July 4, 2005                           | July 4, 2006                           |
| Vesting conditions    | No provisions                          | No provisions                          | No provisions                          |
| Service period        | No provisions                          | No provisions                          | No provisions                          |
| Exercise period       | From June 26, 2006<br>to June 24, 2014 | From June 25, 2007<br>to June 23, 2015 | From June 28, 2008<br>to June 24, 2016 |

Number, movement and price of stock options as of March 31, 2007 are as follows:

**Before vesting options (Number of shares):**

| Stock options granted            | 1998     | 1999     | 2000     | 2001     | 2002     |
|----------------------------------|----------|----------|----------|----------|----------|
| Balance at April 1, 2006         | —        | —        | —        | —        | —        |
| Granted                          | —        | —        | —        | —        | —        |
| Vested                           | —        | —        | —        | —        | —        |
| <b>Balance at March 31, 2007</b> | <b>—</b> | <b>—</b> | <b>—</b> | <b>—</b> | <b>—</b> |

| Stock options granted            | 2003     | 2004     | 2005     | 2006     |
|----------------------------------|----------|----------|----------|----------|
| Balance at April 1, 2006         | —        | —        | —        | —        |
| Granted                          | —        | —        | —        | 102,700  |
| Vested                           | —        | —        | —        | 102,700  |
| <b>Balance at March 31, 2007</b> | <b>—</b> | <b>—</b> | <b>—</b> | <b>—</b> |

**After vesting options (Number of shares):**

| Stock options granted            | 1998          | 1999          | 2000          | 2001          | 2002          |
|----------------------------------|---------------|---------------|---------------|---------------|---------------|
| Balance at April 1, 2006         | 27,000        | 57,300        | 58,000        | 42,600        | 53,700        |
| Vested                           | —             | —             | —             | —             | —             |
| Exercised                        | 3,000         | 9,300         | 9,800         | 4,000         | 21,600        |
| <b>Balance at March 31, 2007</b> | <b>24,000</b> | <b>48,000</b> | <b>48,200</b> | <b>38,600</b> | <b>32,100</b> |

| Stock options granted            | 2003          | 2004          | 2005           | 2006           |
|----------------------------------|---------------|---------------|----------------|----------------|
| Balance at April 1, 2006         | 95,000        | 78,200        | 129,200        | —              |
| Vested                           | —             | —             | —              | 102,700        |
| Exercised                        | 22,100        | 4,300         | —              | —              |
| <b>Balance at March 31, 2007</b> | <b>72,900</b> | <b>73,900</b> | <b>129,200</b> | <b>102,700</b> |

**Price information (yen):**

| Stock options granted        | 1998  | 1999  | 2000  | 2001  | 2002  |
|------------------------------|-------|-------|-------|-------|-------|
| Option price                 | 1,540 | 2,480 | 2,705 | 2,299 | 1,326 |
| Weighted-average stock price | 2,845 | 3,306 | 3,201 | 2,879 | 3,129 |
| Fair value at grant date*    | —     | —     | —     | —     | —     |

| Stock options granted        | 2003  | 2004  | 2005  | 2006   |
|------------------------------|-------|-------|-------|--------|
| Option price                 | 1,176 | 1,743 | 2,480 | 2,715  |
| Weighted-average stock price | 3,020 | 2,795 | —     | —      |
| Fair value at grant date*    | —     | —     | —     | 579.05 |

\* Omitted due to stock options which had been granted before the Law became effective on May 1, 2006.

On June 26, 2007, the Company's shareholders' meeting approved that the Company's stock subscription rights as stock options would be allotted to directors and corporate officers of the Company.

These stock subscription rights are exercisable from June 27, 2009 to June 26, 2017. The total number of stock subscription rights is limited in aggregate to 99,300 common shares.

### 13. Research and Development Expenditures

Research and development expenditures charged to income for the years ended March 31, 2007, 2006 and 2005 amounted to ¥13,663 million (\$115,740 thousand), ¥13,971 and ¥12,620 million, respectively.

### 14. Income Taxes

The Company and its domestic subsidiaries are subject to a number of taxes based on earnings which, in the aggregate, resulted in an average normal tax rate of approximately 40.4% for

the three years ended March 31, 2007. Overseas subsidiaries are subject to income taxes of the countries in which they operate.

The effective rates for the years ended March 31, 2007, 2006 and 2005 differ from the normal tax rates for the following reasons:

|  | <b>2007</b>   | 2006   | 2005   |
|--|---------------|--------|--------|
| Normal tax rate  | <b>40.4 %</b> | 40.4 % | 40.4 % |
| Change in valuation allowance allocated to income tax expenses | <b>1.5</b>    | 0.6    | 2.7    |
| Expenses not deductible for tax purposes                       | <b>1.4</b>    | 1.7    | 1.6    |
| Per capita inhabitants' tax                                    | —             | 0.4    | 0.4    |
| Lower tax rates of subsidiaries                                | <b>(0.4)</b>  | (0.7)  | 0.6    |
| Tax credit for research and development expenses               | <b>(5.8)</b>  | (6.4)  | (5.7)  |
| Others   | <b>0.4</b>    | 0.0    | 0.2    |
| Effective tax rate   | <b>37.5 %</b> | 36.0 % | 40.2 % |

The tax effects of temporary differences and tax loss carryforwards that give rise to significant portions of the deferred tax assets and deferred tax liabilities at March 31, 2007 and 2006 are presented below:

|  | Millions of yen |         | Thousands of<br>U.S. dollars |
|--|-----------------|---------|------------------------------|
|  | <b>2007</b>     | 2006    | <b>2007</b>                  |
| Deferred tax assets:                         |                 |         |                              |
| Tax loss carryforwards                       | <b>¥ 6,430</b>  | ¥ 5,943 | <b>\$ 54,468</b>             |
| Retirement and severance benefits            | <b>2,111</b>    | 1,961   | <b>17,880</b>                |
| Accrued expenses                             | <b>1,202</b>    | 1,039   | <b>10,180</b>                |
| Depreciation and amortization                | <b>827</b>      | 191     | <b>7,009</b>                 |
| Deferred assets for tax purposes             | <b>480</b>      | 271     | <b>4,065</b>                 |
| Accrued enterprise taxes                     | <b>316</b>      | 428     | <b>2,678</b>                 |
| Loss on impairment of golf membership rights | <b>208</b>      | 222     | <b>1,761</b>                 |
| Loss on impairment of fixed assets           | <b>148</b>      | 514     | <b>1,250</b>                 |
| Loss on valuation of inventories             | <b>73</b>       | 60      | <b>621</b>                   |
| Loss on valuation of securities              | <b>44</b>       | 44      | <b>373</b>                   |
| Unrealized profits of other intangibles      | <b>42</b>       | 67      | <b>359</b>                   |
| Other  | <b>953</b>      | 1,368   | <b>8,072</b>                 |
| Subtotal                                     | <b>12,834</b>   | 12,108  | <b>108,716</b>               |
| Valuation allowance                          | <b>(7,907)</b>  | (7,152) | <b>(66,976)</b>              |
| Total gross deferred tax assets              | <b>4,927</b>    | 4,956   | <b>41,740</b>                |
| Deferred tax liabilities:                    |                 |         |                              |
| Net unrealized holding gains on securities   | <b>(3,532)</b>  | (2,698) | <b>(29,919)</b>              |
| Reserve for special depreciation             | <b>(176)</b>    | (227)   | <b>(1,491)</b>               |
| Other  | <b>(20)</b>     | (20)    | <b>(172)</b>                 |
| Total gross deferred tax liabilities         | <b>(3,728)</b>  | (2,945) | <b>(31,582)</b>              |
| Net deferred tax assets                      | <b>¥ 1,199</b>  | ¥ 2,011 | <b>\$ 10,158</b>             |

Net deferred tax assets at March 31, 2007 and 2006 are reflected in the accompanying consolidated balance sheets under the following captions:

|  | Millions of yen |         | Thousands of<br>U.S. dollars |
|--|-----------------|---------|------------------------------|
|  | 2007            | 2006    | 2007                         |
| Current assets - deferred tax assets               | <b>¥ 1,626</b>  | ¥ 1,651 | <b>\$ 13,773</b>             |
| Investments and other assets - deferred tax assets | —               | 380     | —                            |
| Noncurrent liabilities - deferred tax liabilities  | <b>(427)</b>    | (20)    | <b>(3,615)</b>               |
| Net deferred tax assets                            | <b>¥ 1,199</b>  | ¥ 2,011 | <b>\$ 10,158</b>             |

### 15. Contingent Liabilities

At March 31, 2007, the Company has provided guarantees to financial institutions covering employee loans totaling ¥449 million (\$3,800 thousand).

### 16. Segment Information

The Companies operate predominantly in a single industry segment: the production, sale and marketing of pharmaceuticals. Intercompany sales between geographic areas are recorded at cost plus a markup and intercompany sales and profits are

eliminated on consolidation. Corporate assets are composed mainly of cash and cash equivalents, short-term investments and investment securities.

Information by geographic area and overseas sales are as follows:

|                            | Millions of yen |          |          | Thousands of<br>U.S. dollars |
|----------------------------|-----------------|----------|----------|------------------------------|
|                            | 2007            | 2006     | 2005     | 2007                         |
| <b>Geographic areas:</b>   |                 |          |          |                              |
| Net sales:                 |                 |          |          |                              |
| Japan:                     |                 |          |          |                              |
| External customers         | <b>¥ 90,695</b> | ¥ 89,882 | ¥ 85,837 | <b>\$ 768,276</b>            |
| Intersegment               | <b>1,167</b>    | 986      | 549      | <b>9,888</b>                 |
| Total                      | <b>91,862</b>   | 90,868   | 86,386   | <b>778,164</b>               |
| Europe:                    |                 |          |          |                              |
| External customers         | <b>9,186</b>    | 8,156    | 6,375    | <b>77,816</b>                |
| Intersegment               | <b>2,028</b>    | 1,988    | 1,624    | <b>17,182</b>                |
| Total                      | <b>11,214</b>   | 10,144   | 7,999    | <b>94,998</b>                |
| Other:                     |                 |          |          |                              |
| External customers         | <b>605</b>      | 360      | 484      | <b>5,121</b>                 |
| Intersegment               | <b>2,611</b>    | 2,859    | 2,570    | <b>22,115</b>                |
| Total                      | <b>3,216</b>    | 3,219    | 3,054    | <b>27,236</b>                |
| Corporate and eliminations | <b>(5,806)</b>  | (5,833)  | (4,743)  | <b>(49,185)</b>              |
| Consolidated               | <b>¥100,486</b> | ¥ 98,398 | ¥ 92,696 | <b>\$ 851,213</b>            |

|   | Millions of yen                                   |          |          | Thousands of<br>U.S. dollars |
|---|---|----------|----------|------------------------------|
|   | 2007  | 2006     | 2005     | 2007                         |
| Operating income (loss):  |   |          |          |                              |
| Japan   | ¥ 21,768  | ¥ 22,623 | ¥ 22,169 | \$ 184,399                   |
| Europe  | 980   | 951      | (150)    | 8,300                        |
| Other   | (755)   | (708)    | (743)    | (6,394)                      |
| Corporate and eliminations                                      | (1,581)   | (1,871)  | (2,294)  | (13,392)                     |
| Consolidated  | ¥ 20,412  | ¥ 20,995 | ¥ 18,982 | \$ 172,913                   |
| Assets:   |   |          |          |                              |
| Japan   | ¥125,822  | ¥127,647 | ¥123,067 | \$1,065,836                  |
| Europe  | 10,635  | 8,744    | 8,604    | 90,086                       |
| Other   | 4,880   | 5,217    | 5,155    | 41,341                       |
| Corporate and eliminations                                      | 17,762  | 8,850    | 3,154    | 150,462                      |
| Consolidated  | ¥159,099  | ¥150,458 | ¥139,980 | \$1,347,725                  |
| The main countries included in Europe and Other are as follows: |   |          |          |                              |
| Europe:   | Finland, Germany and Sweden                       |          |          |                              |
| Other:  | United States of America, China, Korea and Taiwan |          |          |                              |
| <b>Overseas sales:</b>  |   |          |          |                              |
| Europe  | ¥ 6,917   | ¥ 6,089  | ¥ 4,794  | \$ 58,592                    |
| North America   | 2,129   | 1,916    | 1,704    | 18,034                       |
| Other   | 4,288   | 3,608    | 2,752    | 36,322                       |
| Total   | ¥ 13,334  | ¥ 11,613 | ¥ 9,250  | \$ 112,948                   |
| Consolidated net sales  | ¥100,486  | ¥ 98,398 | ¥ 92,696 | \$ 851,213                   |
| Percentage of overseas sales to consolidated net sales          | 13.3%   | 11.8%    | 10.0%    | 13.3%                        |

The main countries included in Europe, North America and Other are as follows:

  Europe: Finland, Russia, Sweden, Germany and Norway

  North America: United States of America and Canada

  Other: Korea, China and Taiwan

Overseas sales represent the total amount of export sales of the Company and domestic subsidiaries and sales of overseas subsidiaries (intercompany sales between consolidated subsidiaries are eliminated upon consolidation).

## Independent Auditors' Report



**To the Board of Directors of  
Santen Pharmaceutical Co., Ltd.:**

We have audited the accompanying consolidated balance sheets of Santen Pharmaceutical Co., Ltd. and consolidated subsidiaries as of March 31, 2007 and 2006, and the related consolidated statements of income, changes in net assets and cash flows for each of the three years in the period ended March 31, 2007, expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Santen Pharmaceutical Co., Ltd. and subsidiaries as of March 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2007, in conformity with accounting principles generally accepted in Japan.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2007 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 3 to the consolidated financial statements.

*KPMG AZSA & Co.*

Osaka, Japan  
June 26, 2007