# New Challenge:
# Generics Expansion

Annual Report 2010　Year ended March 31, 2010

Nippon Chemiphar Co., Ltd.

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## Mission Statement

The goal of the Chemiphar Group is to make a difference in society by providing pharmaceutical drugs and healthcare-related services to help people become and remain healthy.

## Note about Forward-Looking Statements and Forecasts

Statements made in this annual report with respect to current plans, estimates, strategies and beliefs, and other statements of Chemiphar are forecasts about the future performance of Chemiphar. These forecasts are based on information currently available to management. Consequently, our forecasts are subject to known and unknown risks and uncertainties and may differ significantly from actual results. Items that may influence our forward-looking statements and forecasts include changes in the economy, business and competitive environment surrounding Chemiphar's business, and revisions to the Pharmaceutical Affairs Law and other related legislation, etc., as well as other items not limited to the above.

# Brief Check of FY2009

## Sales and Profits Rise

In the fiscal year ended March 31, 2010 (FY2009), net sales rose 7.5% YOY, and on the profit front, operating income was up 32.0%, while net income for the fiscal year surged by over 60%. These strong results reflect an increase in demand owing to the expansion of DPC hospitals* and growing sales at dispensing pharmacies, with a 21.8% jump in generics sales. In addition to this, our improved profitability comes on the back of efforts continued from the previous fiscal year, such as optimizing our expenses.

## Making Nihon Pharmaceutical Industry a Subsidiary

Along with the termination of our comprehensive capital and business alliance with Ranbaxy Laboratories Limited (India), in December 2009 we repurchased the 50% of Nihon Pharmaceutical Industry Co., Ltd.'s shares held by Ranbaxy. The company thereby became a subsidiary of Chemiphar, further strengthening the development and manufacturing capabilities of the Group and boosting our aim to become more efficient. The company became a consolidated subsidiary from the fourth quarter of FY2009.

## Forecasting a 30% Rise in Generics Sales in FY2010

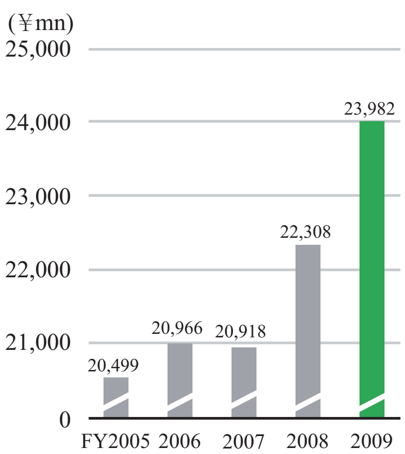
Benefiting from promotional measures by the government, we expect further growth in demand for generics and forecast net sales in this category to increase 29.8% YOY in FY2010. Consequently, we project consolidated net sales to rise 20.1% YOY, and operating income and net income to more than double compared with the previous term.

Earnings forecasts for this fiscal year take into account the effects expected as a result of Nihon Pharmaceutical Industry Co., Ltd. (NPI) having become a wholly owned subsidiary of Chemiphar, and the transfer of Chemiphar's Ibaraki factory to NPI, as we announced in May 2010.

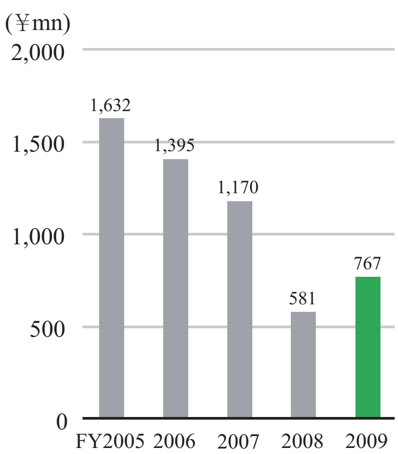
*The Diagnosis Procedure Combination (DPC) is a Japanese system—based on the Diagnosis-Related Group/Prospective Payment System (DRG/PPS) that went into effect in the United States in 1983—whereby hospital-treated illnesses are grouped into categories to facilitate cost comparisons and there is a *per diem* hospitalization fee aimed at reducing government medication-related outlays.

## Five-Year Financial Data

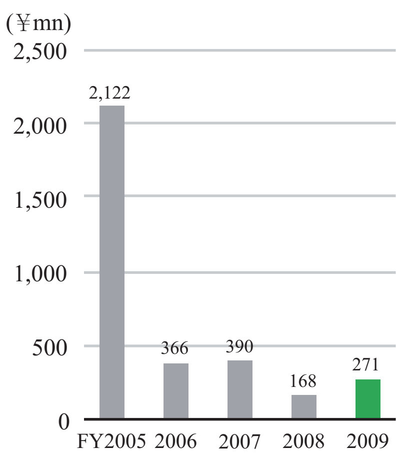
**Net Sales**




**Operating Income**




**Net Income**

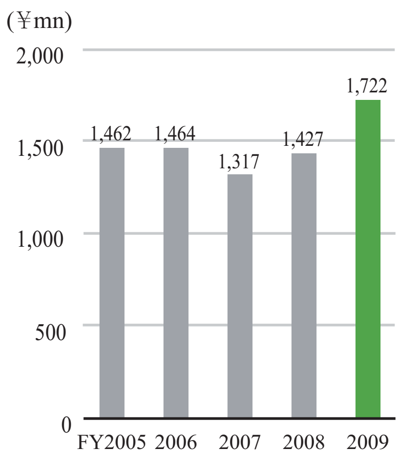


# Financial Highlights

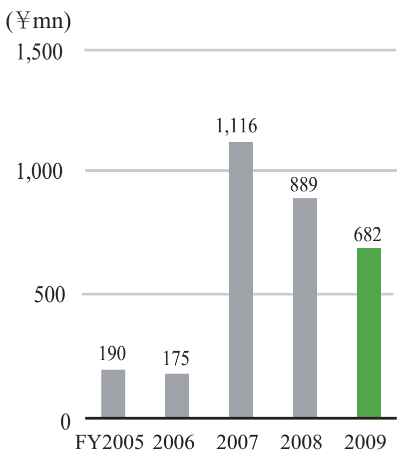
(¥mn)

| Fiscal Years | 2005 | 2006 | 2007 | 2008 | **2009** |
|---|---|---|---|---|---|
| **For the year:** | | | | | |
| Net sales | 20,499 | 20,966 | 20,918 | 22,308 | **23,982** |
| Operating income | 1,632 | 1,395 | 1,170 | 581 | **767** |
| Income before income taxes and minority interests | 2,705 | 946 | 917 | 498 | **557** |
| Net income | 2,122 | 366 | 390 | 168 | **271** |
| R&D expenses | 1,462 | 1,464 | 1,317 | 1,427 | **1,722** |
| **Per share data:** | | | | | |
| Net income (yen) | 55.57 | 9.59 | 10.22 | 4.41 | **7.10** |
| Net assets (yen) | 176.02 | 177.36 | 181.99 | 179.55 | **185.22** |
| Cash dividends (yen) | — | 2 | 3 | 3 | **3** |
| **At year end:** | | | | | |
| Total assets | 22,842 | 21,040 | 21,764 | 24,697 | **29,601** |
| Net assets | 6,722 | 6,771 | 6,943 | 6,848 | **7,866** |
| Shares outstanding (thousands) | 38,522 | 38,522 | 38,522 | 38,522 | **38,522** |
| Number of employees | 603 | 575 | 591 | 624 | **714** |
| **Ratios:** | | | | | |
| Operating income margin (%) | 8.0 | 6.7 | 5.6 | 2.6 | **3.2** |
| ROE (%) | 37.8 | 5.4 | 5.7 | 2.4 | **3.9** |
| Equity ratio (%) | 29.4 | 32.2 | 31.9 | 27.7 | **23.9** |

**R&D Expenses**

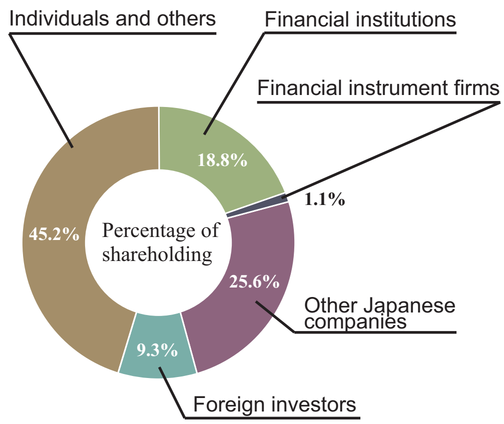



**Capital Expenditure**




**Composition of Shareholders**

(As of March 31, 2010)



# Message from the President

Since 2000, Nippon Chemiphar Co., Ltd. has made generics one of its business pillars, ahead of other Japanese makers of original pharmaceuticals. To capitalize on our advantage, besides the stable supply of assured-quality generics, by providing high-quality drug information we believe we can contribute to raising the level of confidence in generics and encourage their uptake to eventually help reduce people's medical costs.

In addition to generics, we are seeking to build a stronger position for Uralyt in the hyperuricemia market and R&D focused on scanning compounds. First we are focusing our attention on fully seizing our strong position in generics, and then we will take on the other two challenges.

In June 2010, we celebrated the 60th anniversary of our founding. We would like to offer our profound gratitude for the support of our shareholders.

August 2010

山口一城

Kazushiro Yamaguchi
President & CEO

# Interview

Generics has been a pillar of management for 10 years now. The president, Kazushiro Yamaguchi, explains the current and future business of Chemiphar, where management resources are concentrated on generics.

## Question 1: In recent years, along with the growth in generics, Chemiphar has experienced some difficulty in improving profitability; what efforts are you making in this area?

### Answer: We are sensing a response to the shift in profit-generation capacity through expanded sales and optimizing SG&A expenses.

In the past few years, due to a radical change in the composition of sales to high profitability core products and generics, we have seen the cost of sales ratio rising and a continued downtrend in earnings. However, besides the smooth expansion in sales of generics, as a result of the past two years of ongoing companywide action to improve earnings through our efforts to rein in fixed costs, we have seen a continuing shift toward the growth in generics sales feeding directly into increased profits.

To further strengthen our profit-generation capabilities, along with a continued expansion of sales of generics while curbing the cost of sales, it is essential to keep SG&A expenses in check. In terms of expanding sales, our target for generics sales is ¥30 billion in FY2012. As a major measure to cut cost of sales, our Ibaraki factory was transferred to our subsidiary Nihon Pharmaceutical Industry, advancing our efforts to streamline the Group’s aggregate production functions. We are continuing in our efforts to optimize SG&A costs, and striving to improve our profit generation abilities.

## Question 2: Would you please explain in more detail the spin-off of the Ibaraki factory?

### Answer: The Group aims to offer more competitive products through production efficiency and focus.

While utilizing our characteristics and strengths as a new-drug maker, to succeed in the increasingly competitive generics market, the whole Group must constantly seek to improve the productivity and efficiency of generics, and I think it is imperative that we vigorously promote the reform of our business structure.

However, the Group’s resources related to generics were divided between Chemiphar and our joint venture with Ranbaxy Laboratories Limited (India)—Nihon Pharmaceutical Industry (NPI). Such initiatives as this were difficult to quickly implement.

Under such circumstances, on December 8, 2009, we terminated our comprehensive capital and business alliance with Ranbaxy, and NPI once more became a Chemiphar subsidiary. We also took the opportunity to spin off our Ibaraki factory to NPI ownership. As such, our preparations to supply high-quality, cost-competitive products continue apace.

As a result, we are able to combine the expertise related to quality and manufacturing for new drug production of the Ibaraki factory and NPI's know-how, which had been at the core of our generic drug production. The reorganization creates a highly competitive production base for our new-drug and generics businesses.

## Question 3: What are your thoughts on the initiatives for FY2010?

### Answer: We aim for further growth in sales and earnings through the expansion of generics and from the consolidation of NPI.

Over the past few years, the growth rate in sales of our generics has been roughly double that of the market growth rate in sales of generics, and we are looking for a further 29.8% YOY advance this fiscal year. In the fiscal year ending March 2011 (FY2010), we expect to see expanded demand as a result of measures to promote generics. Besides the contribution from the steady sales growth of Amlodipine Chemiphar we have 16 new products scheduled for launch, and we believe they will lead to a further expansion in sales.

We expect the hospital market and the dispensing pharmacy market to act as the growth driver for generics, and we will continue to actively tackle the hospital market, centered on DPC hospitals. Specifically, while strengthening our efforts to emphasize large markets such as Tokyo, Nagoya and Osaka, we utilize the DPC Management Forum, which is attended by more than 200 people on each occasion, and through the regular supply of information provided in the publication of such magazines as *DPC Times* and *Medical Doctor*. In such ways, we continue to conduct business activities attentive to the needs of hospitals.

In the dispensing pharmacy market, besides conventional regular visits by our MRs and systematic proposals for each chain pharmacy, we continue to focus on the use of mass-marketing such as direct mail and the Internet, and with the cooperation of wholesalers we are striving to build the most efficient and effective approach to this market.

Next, for our core product, Uralyt, we improved the formulation from a plain tablet to a film-coated tablet. We believe this will lead to better patient compliance and should also be useful in sales promotion activities. Unfortunately, however, we think a decline in the competitiveness of Soleton and Calvan is inevitable. As always, we will continue to work tirelessly to achieve our goals in terms of sales activities and the provision of information.

FY2010 is also the first full fiscal year in which we will be able to report consolidated net sales and earnings for NPI, which became a subsidiary last year. We expect this to be a positive factor contributing toward net sales and profit growth.

## Question 4: In three years' time, the Group is targeting a consolidated operating profit margin of 12% or higher. What are the concrete measures you are considering to achieve this?

### Answer: We are aiming to achieve this target through growth in generics sales and thorough cost control.

The so-called "2010 problem" in the pharmaceutical industry refers to the fact that from FY2010 many major drugs are facing patent expiries. We estimate patent expiration among drugs that we can bring onto the market to include 16 products in FY2010, 24 products in FY2011 and 13 products in FY2012. Among these, most will be developed in-house, including those that are joint-developed, and we expect them to contribute to both sales and profits. Currently, our own products account for 40% of generics sales but we expect this figure to rise to 50% by FY2012.

Moreover, as a result of our continuing efforts to optimize expenses, we have a system in place to tightly control fixed costs.

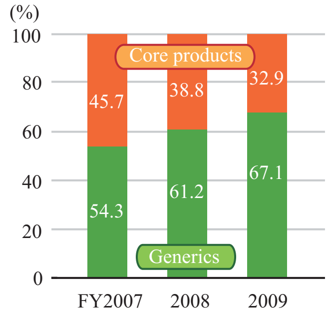
In FY2009, Chemiphar largely accomplished its goal to reform the profit structure to respond to the changing sales composition among core products and generics. This fiscal year I think we will cross the break-even point, and I expect the increase in net sales will directly pass on to increased profits and a shift to an ability to generate profits. From here on, I believe that through firmly taking ownership of large-scale generics sales at the same time as imposing appropriate cost controls, we can achieve an operating profit margin of 12%.

# Financial Focus

## Generics Sales to Total Sales

The percentage of our pharmaceutical sales accounted for by generics continues to increase each year. Sales of generics surpassed 50% of pharmaceutical sales for the first time in FY2006, and in FY2009 the figure reached 67.1%. We forecast that generics will exceed 70% of pharmaceutical sales in FY2010.

**Core Products, Generics as Ratio of Pharmaceutical Sales (Non-Consolidated)**



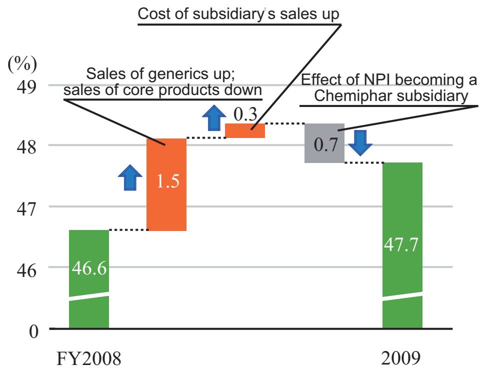

## Cost of Sales Increase

Cost of sales as a percentage of net sales rose 1.1 percentage points YOY.

There were three reasons for this. One is the effect of changes in product configuration. The percentage of sales accounted for by generics rose 5.9 percentage points, from 61.2% to 67.1%, which pushed up the cost-of-sales ratio around 1.5 percentage points. We also experienced cost increases at affiliated companies, raising the cost-of-sales ratio 0.3 percentage point.

As well as the above, although the cost-of-sales ratio rose 1.8 percentage points YOY, the incorporation of NPI into consolidated accounts from the fourth quarter resulted in a reduction of the figure by 0.7 percentage point, taking the cost-of-sales ratio for FY2009 to 47.7%, or up 1.1 percentage points YOY.

**Reasons for the Rise in the Cost-of-Sales Ratio**

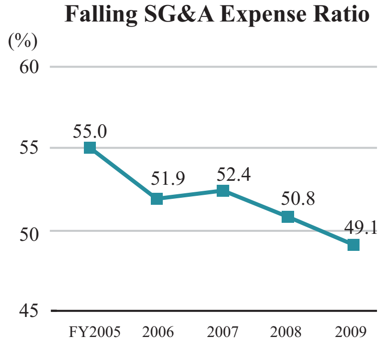



## Raising Cost Efficiency

While we saw growth in net sales for the period of 7.5% YOY, owing to expense optimization efforts we managed to hold the increase in SG&A expense to 3.8% and thereby were able to improve the SG&A expense ratio 1.7 percentage points.

Going forward, we look to control SG&A expense growth to within the rate of net sales growth, thus reducing the SG&A expense ratio.

**Falling SG&A Expense Ratio**



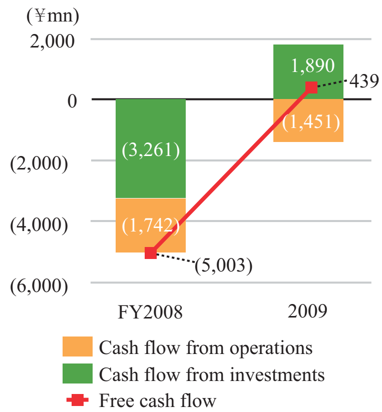

**SG&A Expenses**

| Year | Amount (¥mn) | % of Total Sales |
|---|---|---|
| FY2008 | 11,339 | 50.8 |
| FY2009 | 11,766 | 49.1 |

## Free Cash Flow

In FY2009, we saw a positive turnaround in free cash flow of ¥439 million. Net cash provided by operating activities amounted to ¥1,890 million. Major factors included income before depreciation of ¥1,256 million (income before income taxes and minority interests of ¥557 million and depreciation and amortization of ¥699 million). Net cash used in investing activities was ¥1,451 million. This included ¥868 million for the acquisition of shares in subsidiaries resulting in changes in the scope of consolidation, converting NPI to a consolidated subsidiary, and ¥648 million for purchases of property, plant and equipment for the Ibaraki factory.

**Cash Flows**




## Forecasts for FY2010

We forecast FY2010 net sales of ¥28,800 million (up 20.1% YOY). We are targeting a doubling or more in terms of profits, with operating income of ¥1,600 million (up 2.0 times) and net income of ¥600 million (up 2.2 times).

Sales of generics should surpass 70% of total sales in FY2010, and we anticipate the rate will increase further in the future. Through ongoing cost of sales reductions and suppressing growth in fixed costs, we believe we will see a steady rise in our profit margins from FY2010.

**Forecasts for FY2010**

(¥mn)

| | FY2009 | | FY2010 (Forecast) | | |
|---|---|---|---|---|---|
| | Amount | Distrib. (%) | Amount | Distrib. (%) | YOY |
| Total sales | 23,982 | 100.0 | 28,800 | 100.0 | 20.1(%) |
| Effect of wholly owning NPI* | about 200 | — | — | — | — |
| Effect of wholly owning NPI and transferring Ibaraki factory | — | — | about 1,200 | — | — |
| Operating income | 767 | 3.2 | 1,600 | 5.6 | 2x |
| Effect of wholly owning NPI | about 50 | — | — | — | — |
| Effect of transferring Ibaraki factory | — | — | about 600 | — | — |
| Net income | 271 | 1.1 | 600 | 2.1 | 2.2x |

* Nihon Pharmaceutical Industry Co., Ltd.

# Generics Expansion

FY2009 sales of generics grew 21.8% YOY, to ¥14,360 million, owing to four factors: (1) healthy conditions in the hospital market, (2) expanded sales to the dispensing pharmacy market thanks to measures to promote the use of generics, (3) further growth in sales of Amlodipine and (4) the launch of new products.

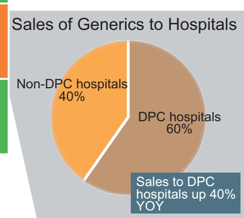
## Performance in the Hospital Market

With expanding demand from DPC hospitals for generics, Chemiphar's sales of generics (prescription basis) to hospitals, which account for 40% of sales, were up 27.8% YOY.

In particular, we are focusing on sales of generics to DPC hospitals, where we saw significant revenue growth of around 40% YOY, and this area has grown to account for about 60% of our sales of generics to hospitals. Going forward, we intend to continue to emphasize DPC hospitals as a target market as their use of generics is expected to increase.

**Sales of Generics* to Hospitals and Clinics**

| | YOY (%) | Distrib. (%) |
|---|---|---|
| Hospitals | 27.8 | 40 |
| Clinics | 17.8 | 60 |
| Total | 21.6 | 100 |



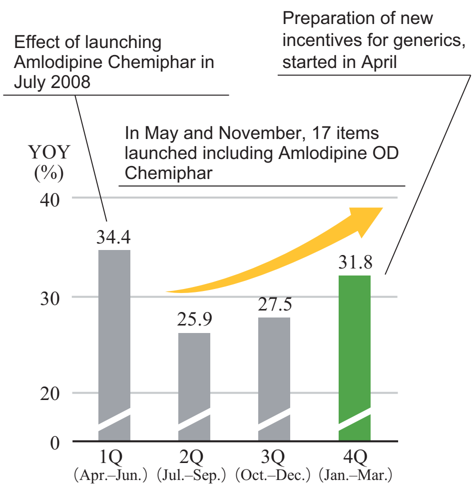

*Prescription basis

## Performance in the Dispensing Pharmacy Market

Measures to promote the use of generics include incentives to cover fees for medical services that are centered on dispensing pharmacies. These are having the effect of rapid growth in the generics market for dispensing pharmacies. Chemiphar's FY2009 sales of generics to dispensing pharmacies grew around 30% YOY and are a major factor in the continuing expansion of sales of generics over past years.

We believe we are well positioned in this market, given that out of 52,000 dispensing pharmacies nationwide, as of March 31, 2010, our generics were supplied to some 58% of these.

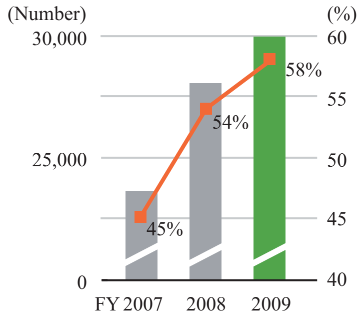
**Sale of Generics to Dispensing Pharmacies**



## Initiatives for Dispensing Pharmacies

- Efforts to have large chain pharmacies promote Chemiphar products.
- Publish monthly journal.
- Provide useful information on drugs in members' site linked to home page.
- Supply useful tools to support medical treatment.
- Have toll-free call center staffed by pharmacists.

**Penetration Ratio***

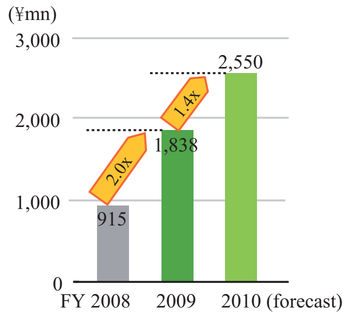



*Based on a total of 52,000 dispensing pharmacies.

## Amlodipine Chemiphar

In addition to the ordinary tablet form of Amlodipine Chemiphar, one of our core generic products, in November 2009 we launched an orally dissolving (OD) tablet version of the drug. Adding in sales of this new version brought FY2009 sales to ¥1,838 million, double the previous year, and contributed significantly to our generics sales growth.

**Amlodipine Sales Forecast**
(2.5mg/5mg: tablet, soluble form)




## New Product Launches

In the fiscal year under review we launched a total of 17 new products in May and November, bringing our overall product offerings up to around 150.

**Products Launched in May**

| Generic Name | Strength | Original Trade Name |
|---|---|---|
| Levoflo Xacin | 100mg | Cravit |
| Bicalutamide | 80mg | Casodex |
| Alendronate Solidum Hydrate | 5mg | Bonalon, Fosamax |
| Total | | |

**Products Launched in November**

| Generic Name | Strength | Original Trade Name |
|---|---|---|
| Amlodipine OD | 5mg, 10mg | Norvasc, Amlodipine |
| Meropenem | 0.25g, 0.5g | Meropen |
| Sarpogrelate | 50mg, 100mg | Anplag |
| Rebamipide | 100mg | Mucosta |
| Total | | |

Including additional dosage and administration products, total of 17 products launched.

# Initiatives for Uralyt

## Improved Formulation by Film Coating

We have seen a rise in awareness toward the treatment of urinary alkalinization since the publication of treatment guidelines for gout and hyperuricemia diagnosis. During FY2010, Uralyt tablets, used for urinary alkalinization, will be upgraded from uncoated tablets to film-coated tablets. This improvement makes the tablets easier to swallow and masks the taste of the drug, thereby raising patient compliance while reinforcing our aim to promote differentiation between our products and those of our competitors.

## Clinical Research Relating to Uralyt

Clinical research into hyperuricemia and uric acid is currently ongoing. In addition to research, we provide the latest reports and information of academic societies and such sources to doctors, pharmacists and other medical personnel to continue to update them on improvements in the treatment of hyperuricemia.

**Clinical Research on Uralyt**

| Subject | Progress |
|---|---|
| Parallel use of Allopurinol | Such use has been proved effective in patients with metabolic syndrome (as most recently reported at the Metabolic Syndrome Research Forum). Scheduled to be published in *Endocrine Research*. |
| Relationship between metabolic syndrome and urine pH | A report, based on available data, is under preparation for publication overseas. |
| Effect on leg cramps | Evidence has been collected and a report is being prepared to support Uralyt's efficacy in preventing such cramps. |
| Role in preventing kidney stones | Research is being prepared and is scheduled to be published by the end of FY2012. |

# Medium-Term Management Plan

The first three years of the medium-term management plan (FY2007–FY2011) announced in May 2007 have passed, and taking into account changing market conditions and our performance over the past three years, we have revised our projections for the final two years (FY2010–FY2011).

In recent years, competition in the market has grown in severity, but we have worked hard toward achieving our plan.

## Revision of Our Medium-Term Plan

Our management plan following revisions to our projections focuses on strengthening generics sales. We now forecast for the final year of the plan (FY2011) consolidated net sales of ¥34.2 billion, operating income of ¥3.8 billion and net income of ¥2.0 billion.

**Consolidated Projections Following Revisions (FY2010–FY2011)**

(¥bn)

| | FY2009 (Actual) | | FY2010 | | FY2011* | |
|---|---|---|---|---|---|---|
| | Amount | Distrib. (%) | Amount | Distrib. (%) | Amount | Distrib. (%) |
| Net sales | 23.98 | 100.0 | 28.80 | 100.0 | 34.2 | 100.0 |
| YOY % change | 7.5% | | 20.1% | | 18.8% | |
| Operating income | 0.77 | 3.2 | 1.60 | 5.6 | 3.8 | 11.0 |
| Net income | 0.27 | 1.1 | 0.60 | 2.1 | 2.0 | 5.5 |

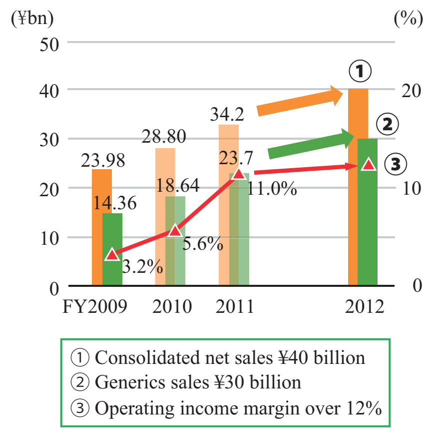
*FY2011 forecast: Sales expected to be 1.5 times greater than in FY2009; Operating profit margin rising to 10%.

## Looking Three Years Ahead

Although beyond the range of our current plan, here we disclose an outline of our projections for FY2012 in terms of "looking at the Group three years ahead."

Going beyond FY2010, in addition to expectations over the promotion of the use of generics and a series of large-scale drug patent expiries, we forecast a significant contribution from the growth in sales of generics. In FY2012 we forecast generics sales topping ¥30 billion, consolidated net sales of ¥40 billion and an operating profit margin of 12%.

**FY2012 Sales Forecast (Consolidated)**



## Toward Generics Sales of ¥30 billion

Our Group target is for generics sales of ¥30 billion in FY2012. To achieve this goal, we are making efforts to strengthen the entire generics supply chain across R&D, production and marketing.

## R&D

With regard to generics R&D, we stated in the current medium-term plan our aim of launching new products, the Company and the Group will build a system to carry out development. In line with this thinking, from next fiscal year, among drugs facing large-scale patent expiries, we plan to launch most of them as in-house products, including through joint development.

**Planned Expanded Product Lineup**

| | FY2010 | FY2011 | FY2012 |
|---|---|---|---|
| Expiring patents | Latanoprost (Xalatan), Rabeprazole (Pariet), and others | Edaravone (Radicut) Pioglitazone (Actos), Risedronate sodium (Benet), Donepezile (Aricept) and others | Paroxetine (Paxil), Losartan (Nu-lotan), Mosapride (Gasmotine) and others |
| Items | 16 | 24 | 13 |
| Ratio of original products | about 40% | about 45% | about 50% |

## Production

We had been producing new drugs at our Ibaraki factory, with our subsidiary NPI assigned to the manufacture of generics.

However, in recent years, owing to their promotion by the government, the demand for generics has grown and to respond to the need for increased production in line with higher sales, we have spun off our Ibaraki factory to NPI, thereby enhancing production capabilities and efficiency throughout the Group. This move is not simply a case of transplanting NPI’s expertise in the efficient production of generics to the Ibaraki factory; we aim to combine this with the know-how built up by the Ibaraki factory over many years of manufacturing quality new drugs.

On this initiative, for both new drugs and generics, with its high competitiveness in the market and reorganized manufacturing base, NPI is striving to increase business efficiency and corporate value.

**NPI's History and Future Schedule**

| Date | Item |
|---|---|
| 1960 | Nippon Pharmaceutical Industry (NPI) established. Began the manufacture and sale of OTC drugs. |
| 1969 | Becomes an affiliated company of Chemiphar. |
| Oct. 2002 | Chemiphar transfers 10% of NPI shares to Ranbaxy Laboratories Limited (RLL). |
| Nov. 2005 | Further 40% of NPI shares transferred to RLL; NPI becomes Chemiphar and RLL 50:50 joint venture. |
| Dec. 2009 | Terminating the alliance with RLL on good terms, Chemiphar bought back the 50% stake in NPI. |
| July 2010 | NPI becomes Chemiphar's wholly owned subsidiary through a share exchange. |
| Oct. 2010 (forecast) | Chemiphar's Ibaraki factory (Chikusei city) to be spun off to NPI and renamed as "Nippon Pharmaceutical Industry Tsukuba factory." |

**Financial Condition of NPI at End-FY2009**

(¥mn)

| Item | Amount |
|---|---|
| Net assets | 2,513 |
| Total assets | 4,478 |
| Net assets per share (yen) | 7,855 |
| Net sales | 3,478 |
| Operating income | 642 |
| Net income | 359 |
| Earnings per share (yen) | 1,122 |

## Sales and Marketing

Our MR headcount is largely as per plan, and to further develop the efficiency of our MR activity, we have selectively relocated staff to metropolitan areas, centered around Tokyo, Nagoya and Osaka.

Further, to efficiently cover medical institutions nationwide with a limited number of MRs we will continue to maintain and strengthen cooperation with national wholesalers.

Moreover, as a new-drug maker with existing networks of academic society and research groups, we can work with and utilize this resource to expand our sales of generics.

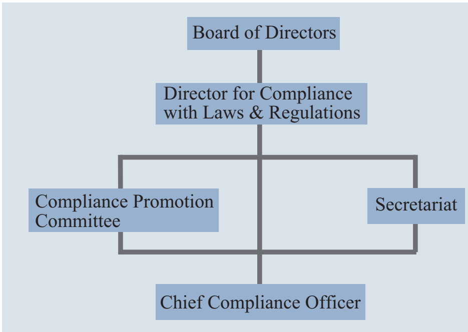
January 16, 2010: DPC management forum.

# Activities for Stakeholders

## Compliance

It is our position to maintain as a top priority compliance with laws and corporate ethics in our business operations. We formulate programs for compliance with laws and corporate ethics, and focus these efforts through committees on risk management, compliance with laws and regulations, and information security. Our internal reporting system, Nippon Chemiphar Hot Line, has been in place since 2002. In addition to this system, as well as distributing handbooks to all employees detailing standards of conduct for compliance, we are focusing on education via the person in each department responsible for compliance with laws and regulations.

**Compliance System**



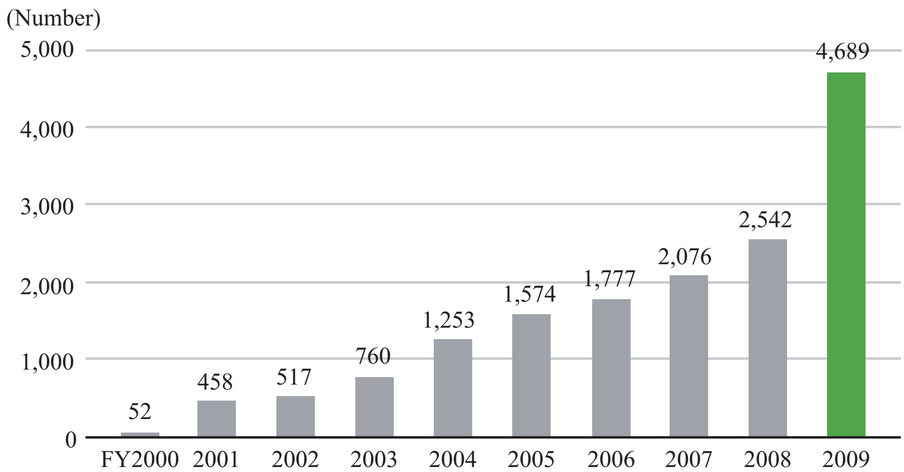

## For Patients and Medical Personnel

### Promoting the Proper Use of Medicines

Our approximately 260 MRs are deployed nationwide, working to provide medical personnel with accurate and prompt information regarding our drugs. Also, within our safety management department we established Customer Support to respond to inquiries from medical personnel and patients. The data accumulated through these activities is centrally managed and can be fed back to each department to provide information leading to the development of new and better products.

An MR providing information for a doctor.

**Number of Customer Support Consultations**



### Manufacturing Control and Quality Control

In making every effort to ensure manufacturing and quality control are properly carried out, we create procedure confirmation notes in accordance with Good Manufacturing Practice (GMP*) and Good Quality Practice (GQP**). Raw material procurement and storage, and product storage and transportation are conducted under ISO rating-manual verification procedures, as we strive to supply quality drugs under proper management.

*GMP: Material ordinance of product and quality control for medications.
**GQP: Material ordinance of quality control guidelines for medications.

### Holding Various Seminars

In addition to seminars for medical personnel, we hold public lectures for citizens to enhance a better understanding of prevention and treatment of lifestyle-related diseases. We also participate in educational activities through the Japan Pharmaceutical Manufacturers Association.

February 2010: A public lecture held by the Japanese Society of Gout and Nucleic Acid Metabolism.
Each lecture is attended by 100 to 150 members of the public.

## Community

### Setting up AEDs

To link social contribution projects to our 60th anniversary, we set up automated external defibrillators (AEDs) at three of our facilities. Employees at these facilities receive training and are committed to taking measures to save lives in the event of unforeseen circumstances for employees and local residents.

Guidance for using an AED.

AED set up at the head office.

### Providing a Playing Ground Free of Charge; Doing Clean-up Work

At the Ibaraki factory, we provide a field for the local baseball team free of charge. Also, for the beautification of the surrounding environment, we regularly carry out clean-up activities.

We provide a field for a baseball team.
The team has produced members for the Japan Youth Baseball team.

Clean-up activities.

## For Employees

### Nurturing Careers

We have introduced an extensive training program for each job category and depending on the employee's age. Additionally, to nurture careers, we conduct annual surveys and meetings with management for employees to support their career path according to their aspirations and aptitude.

Coaching for team leaders.

Role-playing for employees with five to seven years of experience.

### Balancing Work with Childcare and Nursing Care

To balance work with childcare and nursing care, we have established provisions for childcare and nursing care leave. Ten employees have used this childcare-leave system in the last three years.

### Sexual Harassment Prevention Manual

To prevent sexual harassment within and outside the organization we have put together a manual and instruction course. We have also built internal systems for reporting, counseling, prevention and improvement.

## Environmental Initiatives

### ISO 14001

Our Ibaraki factory (name to change to Nippon Pharmaceutical Industries Tsukuba factory on October 1, 2010) obtained international environmental certification under ISO 14001 in 2002. We set up an Environmental Committee, which is tasked with moving the Group toward more environmentally friendly management systems.

Ibaraki factory.

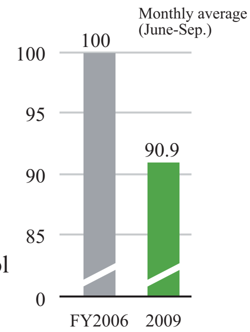
Main initiatives

- Document environmental policies, distribute to all employees and disseminate information, conduct appropriate education and training.
- Effectively reduce electricity and kerosene consumption to prevent global warming.
- Promote the reduction and recycling of waste and emissions for the efficient use of resources.
- Promote reduced water usage to prevent the depletion of resources.
- Strive to prevent environmental pollution caused by chemical substances.

## Cool Biz

To reduce electricity consumption we implement Cool Biz from June to September. In 2009, our electricity consumption was around 10% lower than in 2006, the year we initiated Cool Biz.

**Comparison of Power Consumption**

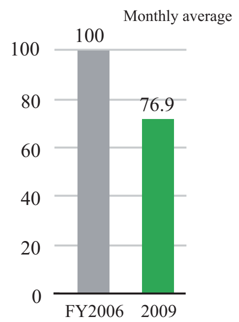



Before and after the introduction of Cool Biz at the headquarters (2006 = 100).

## Initiatives to Conserve Water

To conserve limited water resources, we took the opportunity offered by the renovation of our headquarters building to install water-saving toilets and valves. Compared with 2006, before the renovation work, our average monthly water usage is now around 23% lower.

**Comparison of Water Consumption**




Before and after the renovation of our headquarters (2006 = 100).

## Eco-Safe-Drive Campaign

From August 1 to September 30, 2009, we conducted an eco-safe-drive campaign with the goal of safe and accident-free driving while keeping fuel economy in mind. We plan to repeat the campaign several times a year in future.


Eco-Safe-Drive Campaign poster

## Introducing Hybrid Cars

To reduce $CO_2$, we have introduced seven hybrid cars to our fleet. We aim for our business operations to have a low environmental impact. We will continue to introduce such measures as is deemed necessary.

# Directors and Statutory Auditors

(As of June 29, 2010)

Kazushiro Yamaguchi
President and CEO

Director and Senior Managing Corporate Officer

Hiromichi Yata

Director and Managing Corporate Officer

Yasuo Kishi

Director and Managing Corporate Officer

Haruki Mori

Director and Corporate Officer

Masanori Kutsuwada

Director

Masaaki Hatakeyama

Corporate Auditor

Noboru Kato
(full-time)

Corporate Auditor

Tsuyoshi Takahashi

Corporate Auditor

Naoshige Shindou

# Consolidated Financial Section

This section is a reformatted version of the Japanese financial data. The information was audited in its original Japanese form.

# Consolidated Balance Sheets

Nippon Chemiphar Co., Ltd. and Consolidated Subsidiaries
March 31, 2010 and 2009

| ASSETS | Millions of yen 2010 | Millions of yen 2009 | Thousands of U.S. dollars (Note 1) 2010 |
|---|---|---|---|
| **Current assets:** | | | |
| Cash and deposits (Notes 3 and 14) | **¥ 3,906** | ¥ 1,902 | **$ 41,977** |
| Notes and accounts receivable–trade (Note 3) | **8,091** | 7,326 | **86,953** |
| Allowance for doubtful accounts | **(2)** | (1) | **(21)** |
| Inventories | **3,267** | 2,398 | **35,110** |
| Deferred tax assets (Note 11) | **537** | 388 | **5,771** |
| Other | **100** | 155 | **1,075** |
| Total current assets | **15,899** | 12,168 | **170,865** |
| **Property, plant and equipment:** | | | |
| Land | **5,550** | 5,478 | **59,645** |
| Buildings | **11,086** | 10,011 | **119,140** |
| Machinery, equipment and vehicles | **3,930** | 3,192 | **42,235** |
| Tools, furniture and fixtures | **1,819** | 1,684 | **19,549** |
| Lease assets (Note 10) | **270** | 64 | **2,902** |
| Construction in progress | **22** | 22 | **237** |
| | **22,677** | 20,451 | **243,708** |
| Accumulated depreciation | **(12,428)** | (11,219) | **(133,563)** |
| Net property, plant and equipment | **10,249** | 9,232 | **110,145** |
| **Investments and other assets:** | | | |
| Investment securities (Notes 3 and 4) | **1,083** | 1,348 | **11,639** |
| Long-term loans receivable | **9** | 10 | **97** |
| Long-term prepaid expenses | **3** | 11 | **32** |
| Goodwill | **421** | — | **4,524** |
| Intangible assets | **77** | 65 | **828** |
| Deferred tax assets (Note 11) | **419** | 341 | **4,503** |
| Lease and guarantee deposits | **157** | 154 | **1,687** |
| Long-term deposits (Note 3) | **1,000** | 1,100 | **10,747** |
| Deferred assets | **265** | 255 | **2,848** |
| Other | **19** | 13 | **204** |
| Total investments and other assets | **3,453** | 3,297 | **37,109** |
| Total assets | **¥29,601** | ¥24,697 | **$318,119** |

| LIABILITIES AND NET ASSETS | Millions of yen 2010 | Millions of yen 2009 | Thousands of U.S. dollars 2010 |
|---|---|---|---|
| **Current liabilities:** | | | |
| Short-term loans payable (Note 3) | **¥ 1,109** | ¥ 1,160 | **$ 11,918** |
| Current portion of bonds (Note 6) | **460** | 320 | **4,943** |
| Current portion of long-term loans payable (Note 6) | **2,471** | 1,697 | **26,556** |
| Lease obligations (Note 10) | **56** | 19 | **602** |
| Notes and accounts payable–trade (Note 3) | **3,808** | 3,410 | **40,924** |
| Notes payable–facilities | **292** | 216 | **3,138** |
| | **1,814** | 1,517 | **19,495** |
| Income taxes payable (Note 11) | **386** | 258 | **4,148** |
| Provision for sales promotion expenses | **298** | 312 | **3,203** |
| Other | **685** | 554 | **7,362** |
| Total current liabilities | **11,379** | 9,463 | **122,289** |
| **Non-current liabilities:** | | | |
| Bonds payable (Notes 3 and 6) | **1,125** | 690 | **12,090** |
| Long-term loans payable (Notes 3 and 6) | **6,557** | 5,497 | **70,467** |
| Lease obligations (Note 10) | **209** | 69 | **2,246** |
| Provision for retirement benefits (Note 7) | **622** | 313 | **6,685** |
| Provision for directors' retirement benefits | **254** | 227 | **2,730** |
| Deferred tax liabilities for land revaluation | **1,589** | 1,589 | **17,077** |
| Other | **—** | 1 | **—** |
| Total long-term liabilities | **10,356** | 8,386 | **111,295** |
| **Net assets (Note 9):** | | | |
| Capital stock: | | | |
| Authorized: 154,000,000 shares | | | |
| Issued: 38,522,301 shares in 2010 and 2009 | **4,305** | 4,305 | **46,265** |
| Capital surplus | **—** | — | **—** |
| Retained earnings | **1,065** | 910 | **11,446** |
| Treasury stock | **(159)** | (158) | **(1,709)** |
| Sub total | **5,211** | 5,057 | **56,002** |
| Valuation and translation adjustments: | | | |
| Valuation difference on available-for-sale securities | **(183)** | (244) | **(1,967)** |
| Revaluation surplus of land | **2,033** | 2,033 | **21,849** |
| Total valuation and translation adjustments | **1,850** | 1,789 | **19,882** |
| Subscription rights to shares | **4** | 2 | **43** |
| Minority interests | **801** | 0 | **8,608** |
| Total net assets | **7,866** | 6,848 | **84,535** |
| Total liabilities and net assets | **¥29,601** | ¥24,697 | **$318,119** |

See notes to consolidated financial statements.

# Consolidated Statements of Income

Nippon Chemiphar Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2010 and 2009

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| **Net sales (Note 16)** | **¥23,982** | ¥22,308 | **$257,732** |
| **Cost of sales** | **11,449** | 10,388 | **123,041** |
| Gross profit | **12,533** | 11,920 | **134,691** |
| **Selling, general and administrative expenses (Note 12)** | **11,766** | 11,339 | **126,448** |
| Operating income (Note 16) | **767** | 581 | **8,243** |
| **Other income (expenses):** | | | |
| Interest and dividends income | **30** | 38 | **322** |
| Interest expenses | **(235)** | (179) | **(2,526)** |
| Loss on valuation of investment securities | **(30)** | (54) | **(322)** |
| Other, net | **25** | 112 | **269** |
| | **(210)** | (83) | **(2,257)** |
| **Income before income taxes and minority interests** | **557** | 498 | **5,986** |
| **Income taxes (Note 11)** | | | |
| Current | **375** | 351 | **4,030** |
| Deferred | **(108)** | (21) | **(1,161)** |
| | **267** | 330 | **2,869** |
| Income before minority interests | **290** | 168 | **3,117** |
| **Minority interests in income** | **19** | (0) | **204** |
| **Net income** | **¥ 271** | ¥ 168 | **$ 2,913** |

See notes to consolidated financial statements.

# Consolidated Statements of Changes in Net Assets

Nippon Chemiphar Co., Ltd. and Consolidated Subsidiaries

Years ended March 31, 2010 and 2009

| | Millions of yen | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Shareholders' equity | | | | | Valuation and translation adjustments | | | | | |
| | Capital stock | Capital surplus | Retained earnings | Treasury stock, at cost | Total shareholders' equity | Valuation difference on available-for-sale securities | Revaluation surplus of land | Total valuation and translation adjustments | Subscription rights to shares | Minority interests | Total net assets |
| Balance at March 31, 2008 | ¥4,305 | ¥0 | ¥858 | ¥(149) | ¥5,014 | ¥(104) | ¥2,033 | ¥1,929 | ¥0 | ¥0 | ¥6,944 |
| Net income | | | 168 | | 168 | | | | | | 168 |
| Dividends from surplus | | | (115) | | (115) | | | | | | (115) |
| Purchase of treasury stock | | | | (15) | (15) | | | | | | (15) |
| Disposal of treasury stock | | (0) | (1) | 6 | 5 | | | | | | 5 |
| Net changes of items other than shareholders' equity | | | | | | (140) | 0 | (140) | 2 | (0) | (139) |
| Total changes of items during the year | | — | 52 | (9) | 43 | (140) | 0 | (140) | 2 | (0) | (96) |
| Balance at March 31, 2009 | ¥4,305 | ¥— | ¥910 | ¥(158) | ¥5,057 | ¥(244) | ¥2,033 | ¥1,789 | ¥ 2 | ¥ 0 | ¥6,848 |

| | Millions of yen | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Shareholders' equity | | | | | Valuation and translation adjustments | | | | | |
| | Capital stock | Capital surplus | Retained earnings | Treasury stock, at cost | Total shareholders' equity | Valuation difference on available-for-sale securities | Revaluation surplus of land | Total valuation and translation adjustments | Subscription rights to shares | Minority interests | Total net assets |
| Balance at March 31, 2009 | ¥4,305 | — | ¥ 910 | ¥(158) | ¥5,057 | ¥(244) | ¥2,033 | ¥1,789 | ¥2 | ¥0 | ¥6,848 |
| Net income | | | **271** | | **271** | | | | | | **271** |
| Dividends from surplus | | | **(115)** | | **(115)** | | | | | | **(115)** |
| Purchase of treasury stock | | | | **(2)** | **(2)** | | | | | | **(2)** |
| Disposal of treasury stock | | | **(1)** | **1** | **0** | | | | | | **0** |
| Net changes of items other than shareholders' equity | | | | | | **61** | | **61** | **2** | **801** | **864** |
| Total changes of items during the year | | — | **155** | **(1)** | **154** | **61** | | **61** | **2** | **801** | **1,018** |
| Balance at March 31, 2010 | **¥4,305** | — | **¥1,065** | **¥(159)** | **¥5,211** | **¥(183)** | **¥2,033** | **¥1,850** | **¥4** | **¥801** | **¥7,866** |

| | Thousands of U.S. dollars (Note1) | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Shareholders' equity | | | | | Valuation and translation adjustments | | | | | |
| | Capital stock | Capital surplus | Retained earnings | Treasury stock, at cost | Total shareholders' equity | Valuation difference on available-for-sale securities | Revaluation surplus of land | Total valuation and translation adjustments | Subscription rights to shares | Minority interests | Total net assets |
| Balance at March 31, 2009 | $46,265 | — | $9,779 | $(1,698) | $54,346 | $(2,622) | $21,849 | $19,227 | $21 | $0 | $73,594 |
| Net income | | | **2,913** | | **2,913** | | | | | | **2,913** |
| Dividends from surplus | | | **(1,235)** | | **(1,235)** | | | | | | **(1,235)** |
| Purchase of treasury stock | | | | **(21)** | **(21)** | | | | | | **(21)** |
| Disposal of treasury stock | | | **(11)** | **10** | **(1)** | | | | | | **(1)** |
| Net changes of items other than shareholders' equity | | | | | | **655** | | **655** | **22** | **8,608** | **9,285** |
| Total changes of items during the year | | — | **1,667** | **(11)** | **1,656** | **655** | | **655** | **22** | **8,608** | **10,941** |
| Balance at March 31, 2010 | **$46,265** | — | **$11,446** | **$(1,709)** | **$56,002** | **$(1,967)** | **$21,849** | **$19,882** | **$43** | **8,608** | **$84,535** |

See notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

Nippon Chemiphar Co., Ltd. and Consolidated Subsidiaries

Years ended March 31, 2010 and 2009

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| **Net cash provided by (used in) operating activities:** | | | |
| Income before income taxes and minority interests | **¥ 557** | ¥ 498 | **$ 5,986** |
| Depreciation and amortization | **699** | 582 | **7,512** |
| Amortization of goodwill | **22** | — | **236** |
| Increase in allowance for doubtful accounts | **3** | 17 | **32** |
| (Decrease) increase in provision for sales promotion expenses | **(18)** | 82 | **(193)** |
| Increase in provision for retirement benefits | **96** | 33 | **1,032** |
| Increase in provision for directors' retirement benefits | **3** | 26 | **32** |
| Interest and dividend income | **(30)** | (38) | **(322)** |
| Interest expenses | **235** | 179 | **2,526** |
| Loss on retirement of noncurrent assets | **10** | 11 | **107** |
| Loss on valuation of investment securities | **30** | 54 | **322** |
| Gain on sales of stocks of subsidiaries and affiliates | **—** | (212) | **—** |
| Increase in notes and accounts receivable–trade | **(397)** | (3,217) | **(4,267)** |
| Increase in inventories | **(108)** | (82) | **(1,161)** |
| Decrease in other current assets | **58** | 196 | **623** |
| Increase (decrease) in notes and accounts payable–trade | **933** | (1,025) | **10,027** |
| Increase in other current liabilities | **401** | 34 | **4,310** |
| (Decrease) increase in consumption taxes payable | **(18)** | 109 | **(193)** |
| Decrease in long-term prepaid expenses | **8** | 4 | **86** |
| Other, net | **(15)** | (56) | **(161)** |
| Subtotal | **2,469** | (2,805) | **26,534** |
| Interest and dividends income received | **32** | 41 | **344** |
| Interest expenses paid | **(238)** | (170) | **(2,558)** |
| Income taxes paid | **(373)** | (327) | **(4,008)** |
| Net cash provided by (used in) operating activities | **1,890** | (3,261) | **20,312** |
| **Net cash provided by (used in) investing activities:** | | | |
| Payment into time deposits | **(9)** | — | **(97)** |
| Proceeds from withdrawal of time deposits | **100** | — | **1,075** |
| Purchases of property, plant and equipment | **(648)** | (1,201) | **(6,964)** |
| Purchases of investment securities | **(6)** | (51) | **(65)** |
| Acquisition of shares in subsidiaries resulting in changes in scope of consolidation | **(868)** | — | **(9,328)** |
| Payment of loans receivable to employees | **(5)** | (4) | **(54)** |
| Proceeds from collection of lease and guarantee deposits | **5** | 16 | **54** |
| Proceeds from withdrawal of long-term deposits | **500** | — | **5,373** |
| Payment into long-term deposits | **(500)** | (500) | **(5,373)** |
| Other payments | **(12)** | (12) | **(129)** |
| Other proceeds | **—** | 6 | **—** |
| Other, net | **(8)** | 4 | **(86)** |
| Net cash used in investing activities | **(1,451)** | (1,742) | **(15,594)** |
| **Net cash provided by (used in) financing activities:** | | | |
| Net (decrease) increase in short-term loans payable | **(296)** | 696 | **(3,181)** |
| Proceeds from long-term loans payable | **3,800** | 5,300 | **40,838** |
| Repayment of long-term loans payable | **(1,981)** | (1,893) | **(21,290)** |
| Proceeds from issuances of bonds | **500** | 500 | **5,374** |
| Redemption of bonds | **(320)** | (320) | **(3,439)** |
| Cash dividends paid | **(114)** | (114) | **(1,225)** |
| Other, net | **(80)** | (15) | **(860)** |
| Net cash provided by financing activities | **1,509** | 4,154 | **16,217** |
| **Net increase (decrease) in cash and cash equivalents** | **1,948** | (849) | **20,935** |
| **Cash and cash equivalents, at beginning of year** | **1,902** | 2,751 | **20,441** |
| **Cash and cash equivalents, at end of year (Note 14)** | **¥ 3,850** | ¥ 1,902 | **$ 41,376** |

See notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

Nippon Chemiphar Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2010 and 2009

## 1. BASIS OF PRESENTING CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements have been prepared in accordance with the provisions set forth in the Financial Instruments and Exchange Law of Japan and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan, which differ in certain aspects of application and disclosure requirements from international financial reporting standards.

The consolidated financial statements issued domestically have undergone certain reclassifications and rearrangements in order that they might be presented in a form with which readers outside Japan are more familiar. In addition, certain reclassifications have been made in the 2009 financial statements to conform to the classifications used in 2010.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which Nippon Chemiphar Co., Ltd. (the Company) is incorporated and operates. The translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥93.05 to US$1, the approximate rate of exchange at March 31, 2010. Such translations should not be construed as representation that the Japanese yen amounts could be converted to U.S. dollars at that or any other rate.

As permitted by the Financial Instruments and Exchange Law of Japan, amounts of less than one million yen have been omitted. As a result, the totals shown in the accompanying consolidated financial statements (both in yen and U.S. dollars) do not necessarily agree with the sums of the individual amounts.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### a. Consolidation

The consolidated financial statements as of March 31, 2010, include the accounts of the Company and its three (two in 2009) subsidiaries (together, the Group).

Under the control or influence concept, those companies in the operations of which the Company, directly or indirectly, is able to exercise control are fully consolidated. The companies over which the Group exercises significant influence are accounted for by the equity method.

Nihon Pharmaceutical Industry Co., Ltd., which had been accounted for by the equity method until the year ended March 31, 2009, was included in the scope of consolidation due to the acquisition of its shares at the end of the third quarter for the year ended March 31, 2010. Nihon Pharmaceutical Industry Co., Ltd.'s statements of income for the fourth quarter were included in the Company's consolidated statements.

Investments in one (two in 2009) affiliated companies are accounted for by the equity method.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profits included in assets resulting from transactions within the Group have been eliminated.

### b. Cash equivalents

Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value. Cash equivalents include time deposits, demand deposits and other short-term investments with an original maturity of three months from the date of acquisition.

**c. Inventories**

Prior to April 1, 2008, inventories of the Company and its consolidated domestic subsidiaries are stated at cost determined by the first-in, first-out method.

Effective April 1, 2008, the Company and its domestic subsidiaries applied the "Accounting Standards for Measurement of Inventories ("Accounting Standard No. 9" issued by the Accounting Standard Board of Japan on July 5, 2006).

This standard requires that inventories held for sale in the ordinary course of business be measured at the lower of cost or net selling value, which is defined as the selling price less additional estimated manufacturing costs and estimated direct selling expenses. The replacement cost may be used in place of the net selling value, if appropriate. The effect on the financial result was not material for the year ended March 31, 2009.

**d. Investment securities**

In accordance with the accounting standard for financial instruments, the securities held by the Group are classified as (1) available-for-sale securities, which are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a component of valuation and translation adjustments under net assets; and (2) investments in affiliates not accounted for by the equity method, which are stated at cost.

Non-marketable available-for-sale securities are stated at cost determined by the moving-average method.

**e. Allowance for doubtful accounts**

The allowance for doubtful accounts is stated in amounts considered to be appropriate, based on past credit loss experience and an evaluation of potential losses in receivables outstanding.

**f. Property, plant and equipment**

Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment of the Group is computed by the declining-balance method, while the straight-line method is applied to buildings acquired on and after April 1, 1998.

For the year ended March 31, 2008, the Company and its domestic subsidiaries changed their depreciation methods for tangible fixed assets acquired on or after April 1, 2007, in accordance with fiscal 2007 amendments of the Corporation Tax Law.

Property, plant and equipment used under finance leases and capitalized, are depreciated over the lease terms of the respective assets.

**g. Intangible assets**

Intangible assets are carried at cost less accumulated amortization, which is calculated by the straight-line method.

Amortization of goodwill purchased is computed by the straight-line method over 5 years.

**h. Deferred charges**

Bond issuance costs are equally amortized over the years until the maturing dates.

### i. Land revaluation

Under the Law of Land Revaluation, the Company revalued the land owned for its business use on March 31, 2000, based on the enforcement ordinance concerning revaluation of land. The resulting revaluation surplus of land represents unrealized appreciation of land and is stated, net of income taxes, as a component of valuation and translation adjustments under net assets, and its related deferred tax liabilities are recorded under long-term liabilities. The difference between the carrying amount and its fair value at March 31, 2010 and 2009 was ¥1,133 million ($12,176 thousand) and ¥1,033 million, respectively.

### j. Loss on impairment of fixed assets

In accordance with the accounting standard for impairment of fixed assets, the Company and its consolidated subsidiaries periodically review their fixed assets for impairment by grouping them in income-generating units whenever there is any indication of a significant decline in the fair value against book value based on an independent appraisal. When the existence of any impairment for the group of the assets is identified, an impairment loss will be recognized and such amount is directly deducted from the related assets.

### k. Provision for retirement benefits

The Company has defined benefit pension plans, including a welfare pension fund and a defined benefit corporate pension plan, while its consolidated subsidiaries have established lump-sum payment plans for retirement benefits. In certain cases, additional severance indemnities may be paid to certain employees.

On October 1, 2009, the Company partially converted its tax-qualified requirement pension plan to a defined benefit corporate pension plan. The effect on the financial result was not material.

Pursuant to the Japanese accounting standard for employees' retirement benefits, the Company and its consolidated subsidiaries recorded the liability for retirement benefits as of March 31, 2010 and 2009, based on projected benefit obligations and the fair value of the pension plan assets at those dates. The actuarial gains or losses are amortized from the year following the year in which the gain or loss is incurred by the straight-line method over the average remaining years of service of the eligible employees (11 years in 2010 and 11 years in 2009).

### l. Provision for directors' retirement benefits

Provision for directors' retirement benefits is recorded based on the estimated amount calculated in accordance with Company rules.

### m. Provision for sales promotion expenses

Provision for sales promotion expenses is recorded based on the latest results to provide for future payment of sales promotion expenses in connection with the products and goods sold by the end of the current fiscal year.

### n. Leases

Prior to April 1, 2008, the Company and consolidated domestic subsidiaries accounted for finance leases which do not transfer ownership of the leased property to the lessee as operating leases. On March 30, 2007, the Accounting Standards Board of Japan (ASBJ) issued ASBJ Statement No.13, "Accounting Standard for

Lease Transactions" and ASBJ Guidance No.16, "Guidance on Accounting Standard for Lease Transactions." The new accounting standards require that all finance leasing transactions be capitalized.

Effective April 1, 2008, the Company and consolidated domestic subsidiaries adopted the new accounting standards for finance leases commencing after March 31, 2008 and capitalized assets used under such leases, except for certain immaterial or short-term finance leases, which are accounted for as operating leases. As permitted, finance leases which commenced prior to April 1, 2008 and have been accounted for as operating leases, continue to be accounted for as operating leases. The effect on the financial result was not material.

**o. Income taxes**

The provision for income taxes is computed based on the pretax income included in the consolidated statements of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

**p. Consumption tax**

Consumption tax imposed on the Company's and its subsidiaries' sales to customers is withheld by the Company and its subsidiaries at the time of sale and subsequently paid to the government. This consumption tax is not included in net sales in the accompanying statements of income, but is recorded as a liability, consumption tax payable. Consumption tax that is paid by the Company and its subsidiaries on the purchases of goods and services from outside the Group is also not included in costs or expenses in the accompanying statements of income, but is offset against consumption tax payable. The net balance is reflected as consumption tax payable under other current liabilities in the accompanying consolidated balance sheets at March 31, 2010 and 2009.

**q. Appropriation of retained earnings**

Appropriations of retained earnings are reflected in the financial statements for the following year upon shareholders' approval.

**r. Derivatives and hedging activities**

The Company has time deposits with options and interest rate swap contracts, but does not enter into derivatives for trading or speculative purposes. The exposure of time deposits with options is limited to the interest amounts to be received, while interest rate swaps are utilized to hedge the interest rate exposure of long-term debt and are accounted for by the hedge accounting method. Because the counterparties to these derivatives are limited to financial institutions with a high credit rating, the Company does not anticipate any losses arising from credit risk.

**s. Per-share information**

Basic net income per share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period.

Diluted net income per share is not disclosed since there are no potential shares outstanding.

## 3. FINANCIAL INSTRUMENTS

Effective from the year ended March 31, 2010, the Company and its subsidiaries adopted the revised Accounting Standard, “Accounting Standard for Financial Instruments” (Accounting Standards Board of Japan (“ASBJ”) Statement No. 10 revised on March 10, 2008) and the “Guidance on Disclosures about Fair Value of Financial Instruments” (ASBJ Guidance No.19 revised on March 10, 2008). Information on financial instruments for the year ended March 31, 2010, required pursuant to the revised accounting standards is as follows.

### (1) Qualitative information on financial instruments

#### a. Policies for using financial instruments

The Company and its subsidiaries limit their investment of temporary surpluses to highly secure financial assets and raise the funds through loans from banks and other institutions and by issuing corporate bonds. Derivatives are employed to hedge against the risks described below; the Company and its subsidiaries do not engage in speculative transactions.

#### b. Financial instruments and corresponding risk management systems

Notes and accounts receivable, which are claimable assets, involve credit risks on the part of customers. With regard to claimable assets, the Company and its subsidiaries manage claimable assets by transaction partners according to due date and balance.

Investment securities are subject to market price fluctuation risk. Regarding these risks, the Company and its subsidiaries have in place a system to determine periodically for each company the fair value and the financial condition of the issuer.

Trade notes and accounts payable, which are trade liabilities, generally arise in the course of operating activities, and the majority of these are payable within one year.

Long-term loans payable and bonds payable are principally taken out to fund long-term working capital. Floating-rate loans are subject to interest rate fluctuation risk, but for long-term loans the Company minimizes the risk of fluctuations in interest payments by fixing payment interest rates, employing derivative transactions (interest rate swap transactions) to hedge against such risk.

Trade liabilities and loans are subject to liquidity risk. To manage this risk, the Company and each of its subsidiaries create cash flow plans monthly

#### c. Supplemental information on fair values

The fair value of financial instruments is based on their market value. The fair value of financial instruments that have no available market value is determined by using a rational method of calculation. However, as variables are inherent in these value calculations, the resulting values may differ if different assumptions are used. Also, market risk related to derivative financial instruments is not included in the contract amounts of those instruments.

### (2) Fair values of financial instruments

Carrying values and fair values of the financial instruments on the consolidated balance sheet at March 31, 2010, are the following.

Assets

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| | 2010 | 2010 |
| Carrying value | | |
| Cash and deposits | ¥ 3,906 | $ 41,977 |
| Notes and account receivable–trade | 8,091 | 86,953 |
| Investment securities | 1,023 | 10,994 |
| Long-term deposits | 1,000 | 10,747 |
| Total | 14,020 | 150,672 |
| Fair value | | |
| Cash and deposits | 3,906 | 41,977 |
| Notes and account receivable–trade | 8,091 | 86,953 |
| Investment securities | 1,023 | 10,994 |
| Long-term deposits | 863 | 9,275 |
| Total | 13,884 | 149,210 |
| Difference | | |
| Cash and deposits | — | — |
| Notes and account receivable–trade | — | — |
| Investment securities | — | — |
| Long-term deposits | (137) | (1,472) |
| Total | ¥ (137) | $ (1,472) |

Liabilities

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| | 2010 | 2010 |
| Carrying value | | |
| Notes and account payable–trade | ¥ 3,808 | $ 40,924 |
| Short-term loans payable | 1,109 | 11,918 |
| Bonds payable | 1,585 | 17,034 |
| Long-term loans payable | 9,028 | 97,023 |
| Total | 15,530 | 166,900 |
| Fair value | | |
| Notes and account payable–trade | 3,808 | 40,924 |
| Short-term loans payable | 1,109 | 11,918 |
| Bonds payable | 1,584 | 17,023 |
| Long-term loans payable | 9,061 | 97,378 |
| Total | 15,562 | 167,243 |
| Difference | | |
| Notes and account payable–trade | — | — |
| Short-term loans payable | — | — |
| Bonds payable | (1) | (11) |
| Long-term loans payable | (33) | (355) |
| Total | ¥ (32) | $ (344) |

Method of calculating the fair value of financial instruments and matters related to available-for-sale securities and derivative transactions.

**a. Cash and deposits and notes and account receivable–trade**

As these instruments are settled within a short term and their fair values and book values are similar, their book values are assumed as their fair values.

**b. Investment securities**

The fair values of equity securities are determined by their prices on stock exchanges. See Note 4 for the description of securities by classification.

**c. Long-term deposits**

These amounts are based on valuations provided by financial institutions. For differences, only the "fair valuation amounts of derivative portions" are indicated in the table. These differences have minimal impact on profits and losses at the time of maturity.

**d. Notes and account payable–trade and short-term loans payable**

As these instruments are settled within a short term and their fair values and book values are similar, their book values are assumed as their fair values.

**e. Bonds payable**

For the fair values of bonds, the total amount of principal and interest is discounted to present value using the assumed rate of interest on newly issued bonds of the same type.

**f. Long-term loans payable**

For the fair values of long-term loans, the total amount of principal and interest is discounted to present value using the assumed rate of interest on new loans of the same type. The fair value of long-term debt is determined by discounting the total amount of principal and interest by the assumed interest rate on new borrowings of the same type. Exceptional accounting is employed on interest rate swaps on long-term debt with floating interest rates.

**Financial instruments for which fair value is not readily determinable**

The fair value of unlisted equity securities with a carrying amount of ¥45 million ($484 thousand) as of March 31, 2010, is not readily determinable.

Redemption schedule for receivables with maturity dates as of March 31, 2010, are summarized as follows:

| | Millions of yen | | | |
|---|---|---|---|---|
| | **2010** | | | |
| | 1 year or less | More than 1 year but less than 5 years | More than 5 years but less than 10 years | More than 10 years |
| Cash and deposits | **¥ 3,906** | ¥ — | ¥ — | ¥ — |
| Notes and account receivable–trade | **8,091** | — | — | — |
| Long-term deposits | — | **500** | — | **500** |
| Total | **¥ 11,997** | **¥ 500** | ¥ — | **¥ 500** |

| | Thousands of U.S. dollars | | | |
|---|---|---|---|---|
| | 2010 | | | |
| | 1 year or less | More than 1 year but less than 5 years | More than 5 years but less than 10 years | More than 10 years |
| Cash and deposits | **$ 41,977** | **$ —** | **$ —** | **$ —** |
| Notes and account receivable–trade | **86,953** | **—** | **—** | **—** |
| Long-term deposits | **—** | **5,373** | **—** | **5,373** |
| Total | **$ 128,931** | **$ 5,373** | **$ —** | **$ 5,373** |

## 4. INVESTMENT SECURITIES

Investment securities at March 31, 2010 and 2009 comprised the following:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| Available-for-sale securities: | | | |
| Marketable equity securities | **¥ 961** | ¥ 808 | **$10,328** |
| Unlisted equity securities | **45** | 99 | **484** |
| Others | **62** | 59 | **666** |
| Subtotal | **1,068** | 966 | **11,478** |
| Investments in affiliates | **15** | 382 | **161** |
| Total | **¥1,083** | ¥1,348 | **$11,639** |

The carrying amounts and aggregate fair values of investment securities at March 31, 2010 and 2009 were as follows:

| | Millions of yen | | | |
|---|---|---|---|---|
| | Cost | Unrealized gain | Unrealized loss | Fair value |
| March 31, 2010 | | | | |
| Available-for-sale: | | | | |
| Value posted in consolidated balance sheets exceeds acquisition price | **¥ 165** | **¥78** | **¥ —** | **¥ 243** |
| Acquisition price exceeds value posted in consolidated balance sheets | **1,083** | **—** | **365** | **718** |
| Other | **72** | **—** | **10** | **62** |
| | **¥1,320** | **¥78** | **¥375** | **¥1,023** |

| | Thousands of U.S. dollars | | | |
|---|---|---|---|---|
| | Cost | Unrealized gain | Unrealized loss | Fair Value |
| March 31, 2010 | | | | |
| Available-for-sale: | | | | |
| Value posted in consolidated balance sheets exceeds acquisition price | **$ 1,773** | **$838** | **$ —** | **$ 2,611** |
| Acquisition price exceeds value posted in consolidated balance sheets | **11,639** | **—** | **3,923** | **7,716** |
| Other | **774** | **—** | **107** | **667** |
| | **$14,186** | **$838** | **$4,030** | **$10,994** |

Available-for-sale securities whose fair value was not readily determinable at March 31, 2010 and 2009 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| Equity securities | **¥45** | ¥98 | **$484** |

Of those securities borrowed under stock lending agreements totaled ¥101 million ($1,085 thousand).

## 5. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING TRANSACTIONS

The Company has applied hedge accounting for interest rate swap contracts to hedge risks of changes of floating interest rate on long-term debt. The contract amount is ¥6,297 million ($67,673 thousand) and the amount of the contracts which term is more than one year is ¥4,637 million ($49,833 thousand). Interest rate swap contracts are used as hedge and meet certain hedging criteria, the net amount to be paid or received under the interest rate swap contract is added to or deducted from the interest on the assets or liabilities for which the swap contract was executed. Therefore, the fair value of long-term debt includes the fair value of the interest swap contracts.

## 6. LONG-TERM DEBTS

Long-term debts at March 31, 2010 and 2009, comprised the following:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| Corporate bonds | **¥ 1,585** | ¥ 1,010 | **$ 17,034** |
| Long-term loans | **9,028** | 7,194 | **97,023** |
| Total long-term debts | **10,613** | 8,204 | **114,057** |
| Less: current portion | **(2,931)** | (2,017) | **(31,499)** |
| | **¥ 7,682** | ¥ 6,187 | **$ 82,558** |

Corporate bonds at March 31, 2010 and 2009, comprised the following:

| Balance at March 31 | | | Millions of yen | | Thousands of U.S. dollars | Interest rate | |
|---|---|---|---|---|---|---|---|
| Issued by | Type | Issue date | 2010 | 2009 | 2010 | (%) | Maturity |
| Nippon Chemiphar Co., Ltd. | 2nd unsecured bonds | Sept. 15, 2005 | ¥ **30** | 90 | $ **322** | 0.68 | Sep. 15, 2010 |
| | 3rd unsecured bonds | Dec. 29, 2005 | **60** | 120 | **645** | 0.91 | Dec. 29, 2010 |
| | 4th unsecured bonds | Dec. 29, 2006 | **200** | 300 | **2,149** | 1.30 | Dec. 29, 2011 |
| | 5th unsecured bonds | Mar. 31, 2009 | **400** | 500 | **4,299** | 1.10 | Mar. 31, 2014 |
| | 6th unsecured bonds | Dec. 30, 2009 | **500** | — | **5,374** | 0.71 | Dec. 30, 2014 |
| Nihon Pharmaceutical Industry Co. Ltd. | 3rd unsecured bonds | Oct 31, 2007 | **395** | — | **4,245** | 1.40 | Mar. 31, 2015 |
| Total | | | **¥1,585** | ¥1,010 | **$17,034** | | |

Note: Balance at March 31, 2010, includes current portion amounting to ¥460 million ($4,943 thousand).

The aggregated annual maturities of bonds are as follows:

| Year ending March 31 | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| 2011 | ¥460 | $4,943 |
| 2012 | 370 | 3,976 |
| 2013 | 270 | 2,902 |
| 2014 | 270 | 2,902 |
| 2015 | 170 | 1,827 |

Long-term loans at March 31, 2010 and 2009 comprised the following:

| Balance at March 31 | Millions of yen | | Thousands of U.S. dollars | Interest rate | Repayment |
|---|---|---|---|---|---|
| | 2010 | 2009 | 2010 | (%) | Term |
| Current portion of long-term loans | **¥2,471** | ¥1,697 | **$26,556** | 1.5 | — |
| Long-term loans | **6,557** | 5,497 | **70,467** | 1.5 | 2011–2016 |
| Total | **¥9,028** | ¥7,194 | **$97,023** | | |

The aggregated annual maturities of long-term loans are as follows:

| Year ending March 31 | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| 2012 | ¥2,180 | $23,429 |
| 2013 | 1,801 | 19,355 |
| 2014 | 1,158 | 12,445 |
| 2015 | 418 | 4,492 |

The long-term loans include syndicate loan agreements amounting to ¥4,800 million ($51,585 thousand) and ¥4,000 million at March 31, 2010 and 2009, respectively. The agreement includes the following financial restriction provisions:

a. Operating income and ordinary income in the statements of income should not be negative for two consecutive years.

b. The amount of shareholders' equity in the balance sheets at every year end should be more than 75% of the level at March 31, 2008.

c. The amount of interest-bearing liabilities at each balance sheet date should be less than the amount of net sales in the consolidated statement of income for the year then ended.

If the Company or the Group fails to comply with the provisions, the Company is required to repay the principal and related interest expenses on all the contractual liabilities.

In addition, the Company has entered into commitment agreements with four financial institutions to enable efficient fund-raising activities. The status of the commitments based on the agreements at March 31, 2010, was as follows:

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Aggregated commitment amounts | **¥3,000** | **$32,241** |
| Used | — | — |
| Unused balance | **¥3,000** | **$32,241** |

## 7. PROVISION FOR RETIREMENT BENEFITS

The Company has a welfare pension fund and defined benefit corporate pension plans, while its consolidated subsidiaries have lump-sum payment plans. On October 1, 2009, the Company partially converted its tax-qualified requirement pension plan to a defined benefit corporate pension plan.

The liability for employees' retirement benefits at March 31, 2010 and 2009, comprised the following:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| Projected benefit obligation | **¥(4,493)** | ¥(4,416) | **$(48,286)** |
| Fair value of plan assets | **3,402** | 3,017 | **36,561** |
| Funded status | **(1,091)** | (1,399) | **(11,725)** |
| Unrecognized actuarial net loss | **667** | 1,030 | **7,168** |
| Unrecognized prior service cost | **(198)** | 56 | **(2,128)** |
| Reserve for employees' retirement benefits | **¥ (622)** | ¥ (313) | **$ (6,685)** |

The components of net periodic retirement benefit costs for the years ended March 31, 2010 and 2009, were as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| Service cost | **¥367** | ¥351 | **$3,944** |
| Interest cost | **108** | 106 | **1,161** |
| Expected return on plan assets | **(75)** | (91) | **(806)** |
| Recognized actuarial loss | **125** | 53 | **1,343** |
| Amortization of prior service cost | **(6)** | 6 | **(64)** |
| Net periodic retirement benefit costs | **¥519** | ¥427 | **$5,578** |

Assumptions used for the years ended March 31, 2010 and 2009, were set forth as follows:

| | **2010** | 2009 |
|---|---|---|
| Discount rate | **2.5%** | 2.5% |
| Expected rate of return on plan assets | **2.5%** | 2.5% |
| Recognition period of actuarial gain/loss | **11 years** | 11 years |
| Recognition period of prior service cost | **11 years** | 11 years |

## 8. STOCK OPTIONS

The stock option-related expense recognized and included in selling, general and administrative expenses for the year ended March 31, 2010, is ¥2 million ($21 thousand).

Following are details of the stock options the Company has as of March 31, 2010.

| | |
|---|---|
| Number of grantees | 6 directors<br>8 employees |
| Number of options | Common stock—41,000 shares |
| Date of grant | August 4, 2008 |
| Exercisable period | August 5, 2011—August 4, 2014 |
| Exercise price | ¥516 ($5.55) |
| Fair value at grant date | ¥146 ($1.57) |

## 9. NET ASSETS

Under 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 Japanese Companies Act (the Act), in cases where a dividend distribution of a surplus is made, the smaller of an amount equal to 10% of the dividend or 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.

Under the Act, legal earning reserve and additional paid in capital could be used to eliminate or reduce a deficit or could be capitalized by resolution of the shareholders' meeting.

Additional paid-in capital and legal earnings reserve may not be distributed as dividends. However, all additional paid-in-capital and the entire legal earnings reserve may be transferred to other capital surplus and retained earnings, respectively, which are potentially available for dividends.

The maximum amount that the Company can distribute as dividends is calculated based on the non-consolidated financial statements of the Company in accordance with the Act.

## 10. LEASE TRANSACTIONS

The Group leases certain equipment and other assets. Total lease payments for the years ended March 31, 2010 and 2009, were ¥158 million ($1,698 thousand) and ¥190 million, respectively. Pro forma information on leased property, such as acquisition cost, accumulated depreciation, obligation under finance leases, depreciation expense of finance leases that do not transfer ownership of the leased property to the lessee on an as-if-capitalized basis for the years ended March 31, 2010 and 2009, was as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| Acquisition cost: | | | |
| Machinery, equipment and vehicles | **¥134** | ¥ 51 | **$1,440** |
| Tools, furniture and fixtures | **442** | 646 | **4,750** |
| Other (software, etc.) | **158** | 158 | **1,698** |
| Total acquisition cost | **734** | 855 | **7,888** |
| Accumulated depreciation | **504** | 509 | **5,416** |
| Net leased property | **¥230** | ¥346 | **$2,472** |

The above acquisition cost includes related interest expenses as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| Obligations under finance leases: | | | |
| Due within one year | **¥126** | ¥153 | **$1,354** |
| Due after one year | **104** | 193 | **1,118** |
| Total | **¥230** | ¥346 | **$2,472** |

The above obligations under finance leases included related interest expenses.

Lease obligations at March 31, 2010 consisted of the following:

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Lease obligations | **¥265** | **$2,848** |
| Less current portion | **(56)** | **(602)** |
| Less obligations, less current portion | **¥209** | **$2,246** |

The future minimum payments required at March 31, 2010, were as follows:

| Years ending March 31 | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| 2012 | ¥57 | $613 |
| 2013 | 56 | 602 |
| 2014 | 45 | 484 |
| 2015 | 24 | 258 |

## 11. INCOME TAXES

The Group is subject to Japanese national and local income taxes which, in the aggregate, resulted in a normal effective statutory tax rate of approximately 40.7% for the years ended March 31, 2010 and 2009.

The tax effects of significant temporary differences and tax loss carryforwards which resulted in deferred tax assets and liabilities at March 31, 2010 and 2009, were as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| Deferred tax assets: | | | |
| Accrued enterprise tax | **¥ 36** | ¥ 15 | **$ 387** |
| Accrued bonuses | **249** | 219 | **2,676** |
| Allowance for doubtful accounts | **26** | 40 | **279** |
| Provision for sales promotion expenses | **119** | 127 | **1,279** |
| Provision for retirement benefits | **253** | 127 | **2,719** |
| Provision for directors' retirement benefits | **103** | 92 | **1,107** |
| Unrealized loss on available-for-sale securities | **124** | 167 | **1,333** |
| Other | **323** | 181 | **3,471** |
| Subtotal | **1,233** | 968 | **13,251** |
| Less valuation allowance | **(277)** | (240) | **(2,977)** |
| Total | **956** | 728 | **10,274** |
| Deferred tax liabilities: | | | |
| Deferred tax liabilities on revaluation of land | **1,589** | 1,589 | **17,077** |
| Total | **1,589** | 1,589 | **17,077** |
| Net deferred tax liabilities | **¥ (633)** | ¥ (861) | **$ (6,803)** |

The reconciliation between the normal effective statutory tax rates and the actual effective tax rates reflected in the accompanying consolidated statements of income for the years ended March 31, 2010 and 2009, were as follows:

| | **2010** | 2009 |
|---|---|---|
| Normal effective statutory tax rate | **40.7%** | 40.7% |
| Expenses not deductible for income tax purposes | **20.8** | 25.2 |
| Per capita inhabitant tax | **5.3** | 5.9 |
| Change in valuation allowance | **4.1** | (4.2) |
| Research and development cost tax credit | **(13.8)** | (8.4) |
| Other–net | **(9.1)** | 7.1 |
| Actual effective tax rate | **48.0** | 66.3 |

## 12. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Major components of selling, general and administrative expenses for the years ended March 31, 2010 and 2009, were as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| Advertising expenses | **¥ 220** | ¥ 281 | **$ 2,364** |
| Sales promotion expenses | **3,029** | 2,751 | **32,552** |
| Traveling expenses | **483** | 578 | **5,191** |
| Salaries and allowances | **3,574** | 3,477 | **38,409** |
| Commissions | **864** | 908 | **9,285** |
| Research and development costs | **1,722** | 1,427 | **18,506** |

## 13. AMOUNTS PER SHARE

Net assets per share at March 31, 2010 and 2009, and basic net income per share for the years then ended were as follows:

| | Yen | | U.S. dollars |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| Net assets | **¥185.22** | ¥179.55 | **$1.9905** |
| Basic net income | **7.10** | 4.41 | **0.0763** |

Diluted net income per share has not been disclosed because the Company does not issue any potentially dilutive common stock equivalents.

The underlying data for the calculation of net income per share for the years ended March 31, 2010 and 2009, is summarized as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| Net income | **¥ 271** | ¥ 168 | **$2,912** |
| Net income available for distribution to shareholders of common stock | **271** | 168 | **2,912** |
| Weighted average number of shares of common stock outstanding (thousand shares) | **38,125** | 38,137 | |

## 14. CASH AND CASH EQUIVALENTS

(1) The reconciliation between cash and cash equivalents reported in the consolidated statements of cash flows and cash and time deposits reported in the consolidated balance sheets is as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| Cash and time deposits | **¥3,906** | ¥1,902 | **$41,977** |
| Time deposits maturing over three months | **(56)** | — | **(601)** |
| Cash and cash equivalents | **¥3,850** | ¥1,902 | **$41,376** |

(2) The following table details major breakdown of assets and liabilities of a company that was previously accounted for by the equity method and is newly included in the consolidated financial statements for the year ended March 31, 2010 due to the acquisition of its shares.

**Acquisition of shares of Nihon Pharmaceutical Industry Co., Ltd. for the year ended March 31, 2010**

The following table summarizes the breakdown of Nihon Pharmaceutical Industry Co., Ltd.'s assets and liabilities when it was initially consolidated following the acquisition of 50% of the shares, the acquisition cost, cash and cash equivalents held by Nihon Pharmaceutical Industry Co., Ltd., and net cash and cash equivalents decreased by the acquisition of the shares of Nihon Pharmaceutical Industry Co., Ltd.:

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| | **2010** | **2010** |
| Current assets | **¥ 2,929** | **$ 31,478** |
| Non-current assets | **1,177** | **12,649** |
| Goodwill | **449** | **4,825** |
| Current liabilities | **(1,093)** | **(11,746)** |
| Non-current liabilities | **(668)** | **(7,179)** |
| Minority interests | **(781)** | **(8,393)** |
| Subtotal | **2,013** | **21,634** |
| Value of shares as listed in the consolidated balance sheets after applying the equity method and until gaining controlling interest | **(413)** | **(4,439)** |
| Acquisition cost of Nihon Pharmaceutical Industry Co., Ltd.'s shares at gaining controlling interest | **1,600** | **17,195** |
| Cash and cash equivalents held by Nihon Pharmaceutical Industry Co., Ltd. | **(732)** | **(7,867)** |
| Net cash and cash equivalents decreased by the acquisition of Nihon Pharmaceutical Industry Co., Ltd.'s shares | **¥ 868** | **$ 9,328** |

## 15. COMMITMENTS AND CONTINGENT LIABILITIES

The Group had the following commitments and contingent liabilities at March 31, 2010 and 2009:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2010** | 2009 | **2010** |
| Guarantee of bank loans | **¥ 10** | ¥ 28 | **$ 107** |
| Trade notes discounted | **2,148** | 2,362 | **23,084** |
| Securities borrowed | **102** | 102 | **1,096** |

## 16. SEGMENT INFORMATION

The Company's business is divided into pharmaceutical products and other business segments.

**(1) Business segments**

Information about the business segments of the Group for the years ended March 31, 2010 and 2009 is as follows:

| | Millions of yen | | | | |
|---|---|---|---|---|---|
| | 2010 | | | | |
| | Pharmaceutical product business | Other business | Total | Eliminations (corporate) | Consolidated |
| I. Sales and operating income: | | | | | |
| a. Sales | | | | | |
| Sales to customers | **¥23,050** | **¥932** | **¥23,982** | **¥ —** | **¥23,982** |
| Intersegment sales | **3** | **140** | **143** | **(143)** | **—** |
| Total sales | **23,053** | **1,072** | **24,125** | **(143)** | **23,982** |
| Operating expenses | **22,309** | **1,048** | **23,357** | **(142)** | **23,215** |
| b. Operating income | **744** | **24** | **768** | **(1)** | **767** |
| II. Assets, depreciation, capital expenditures: | | | | | |
| Assets | **¥24,487** | **¥1,637** | **¥26,124** | **¥3,477** | **¥29,601** |
| Depreciation | **628** | **67** | **695** | **—** | **695** |
| Capital expenditures | **662** | **20** | **682** | **—** | **682** |

| | Thousands of U.S. dollars | | | | |
|---|---|---|---|---|---|
| | 2010 | | | | |
| | Pharmaceutical product business | Other business | Total | Eliminations (corporate) | Consolidated |
| I. Sales and operating income: | | | | | |
| a. Sales | | | | | |
| Sales to customers | **$247,716** | **$10,016** | **$257,732** | **$ —** | **$257,732** |
| Intersegment sales | **32** | **1,505** | **1,537** | **(1,537)** | **—** |
| Total sales | **247,748** | **11,521** | **259,269** | **(1,537)** | **257,732** |
| Operating expenses | **239,752** | **11,263** | **251,015** | **(1,526)** | **249,489** |
| b. Operating income | **7,996** | **258** | **8,254** | **(11)** | **8,243** |
| II. Assets, depreciation, capital expenditures: | | | | | |
| Assets | **$263,159** | **$17,593** | **$280,752** | **$37,367** | **$318,119** |
| Depreciation | **6,749** | **720** | **7,469** | **—** | **7,469** |
| Capital expenditures | **7,114** | **215** | **7,329** | **—** | **7,329** |

| | Millions of yen | | | | |
|---|---|---|---|---|---|
| | 2009 | | | | |
| | Pharmaceutical product business | Other business | Total | Eliminations (corporate) | Consolidated |
| I. Sales and operating income: | | | | | |
| a. Sales | | | | | |
| Sales to customers | ¥21,490 | ¥818 | ¥22,308 | ¥ — | ¥22,308 |
| Intersegment sales | — | 71 | 71 | (71) | — |
| Total sales | 21,490 | 889 | 22,379 | (71) | 22,308 |
| Operating expenses | 20,910 | 896 | 21,806 | (79) | 21,727 |
| b. Operating income | 580 | (7) | 573 | 8 | 581 |
| II. Assets, depreciation, capital expenditures: | | | | | |
| Assets | ¥21,145 | ¥1,563 | ¥22,708 | ¥1,989 | ¥24,697 |
| Depreciation | 512 | 68 | 580 | — | 580 |
| Capital expenditures | 864 | 25 | 889 | — | 889 |

### (2) Geographical segments

The geographical segments were not disclosed as there were no foreign consolidated subsidiaries or overseas branches for the years ended March 31, 2010 and 2009.

### (3) Overseas sales

Overseas sales information was not disclosed as export sales represented less than 10% of the consolidated sales for the years ended March 31, 2010 and 2009.

## 17. RELATED PARTY TRANSACTIONS

The related party transactions for the years ended March 31, 2010 and 2009, and the related account balances at each fiscal year end are as follows:

| | | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|---|
| | | **2010** | 2009 | **2010** |
| Japan Sopharchim Co., Ltd. | Purchase of merchandise and raw materials | **¥1,421** | ¥1,797 | **$15,271** |
| | Notes and accounts payable | **596** | 645 | **6,405** |
| Nippon Pharmaceutical Industry Co., Ltd. | Purchase of merchandise | **1,857** | 2,255 | **19,957** |
| | Notes and accounts payable | **—** | 794 | **—** |

The Company has 5% of voting rights in Japan Sopharchim Co., Ltd., which has 10.8% of voting rights in the Company.

In addition, the representative director of the Company has 67.5% of the voting rights in the Company.

At March 31, 2010, the Company owned 100% (50% at March 31, 2009) including 33.3% in terms of borrowed shares, of Nihon Pharmaceutical Industry Co., Ltd.

## 18. RENTAL PROPERTY

Effective March 31, 2010, the Company and its consolidated domestic subsidiaries adopted ASBJ Statement No. 20, "Accounting Standard for Disclosures about Fair Value of Investment and Rental Property" and ASBJ Guidance No.23, "Guidance on Accounting Standard for Disclosures about Fair Value of Investment and Rental Property," issued by the Accounting Standards Board of Japan on November 28, 2008.

The Company owns available-for-lease facilities in Tokyo and other areas. During the year ended March 31, 2010, rental income on this real estate amounted to loss of ¥17 million ($183 thousand). Rental income is recorded in net sales, whereas leasing expenses are principally recorded as cost of sales.

Pursuant to the new accounting standard and its corresponding guidance, information about fair value of rental property is disclosed as follows:

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| | **2010** | **2010** |
| Carrying value as of March 31, 2009 | **¥763** | **$ 8,200** |
| Decrease of book value during the year | **(13)** | **(140)** |
| Carrying value as of March 31, 2010 | **750** | **8,060** |
| Fair value as of March 31, 2010 | **595** | **6,394** |

(1) The carrying value represents the acquisition cost less accumulated depreciation.

(2) Fair values as of March 31, 2010, for principal properties are primarily real estate appraisal values as determined by an outside real estate appraiser. For other properties, fair values are determined by the Company based on appraisal amounts and indices that are judged to reflect market values.

## 19. SUBSEQUENT EVENTS

At meetings of the boards of directors of Nippon Pharmaceutical Industry Co., Ltd. (NPI), and the Company held on May 11, 2010, the decision was approved to convert NPI to a wholly owned subsidiary of Nippon Chemiphar, the wholly owning parent, through a share exchange, effective July 1, 2010. The boards also approved the transfer of the Company's Ibaraki factory to NPI ownership. In addition, at meetings of the boards of directors of the Company and NPI held on the same date, both boards resolved, with an effective date of October 1, 2010, to conduct an absorption-type company split, with the Company as the splitting company in absorption-type company split and NPI as the succeeding company in absorption-type company split. It was decided that Nippon Chemiphar's Ibaraki factory, located in the city of Chikusei, Ibaraki Prefecture, which engages in the manufacture of pharmaceuticals, diagnostic agents and healthcare products, would be transferred to NPI ownership after the share exchange converting NPI to a wholly owned subsidiary. The two companies signed an absorption-type company split agreement in this regard, on May 11, 2010. The Company conducted this share exchange in accordance with the procedures for a simplified share exchange, as provided by Paragraph 3, Article 796, of the Companies Act, without seeking approval of the general meeting of shareholders. Furthermore, the Company plans to conduct this absorption-type split in accordance with the procedure for a simplified company split, as provided by Paragraph 3, Article 784, of the Companies Act, without seeking approval of the general meeting of shareholders. With regard to the absorption-type company split, as provided by Paragraph 1, Article 319, of the Companies Act, NPI expects to receive from shareholders at the general meeting of shareholders a manifest from the shareholders in writing (agreeing to the proposal after the effective date of the share exchange).

**(1) Objective of this transaction**

The Company judges that to reinforce its consolidated operating structure and bolster the flexibility of its Group management, a radical restructuring of the Group's business would further enhance corporate value. Accordingly, the Company has resolved to carry through this absorption-type split and the accompanying share exchange as a preceding stage to accelerate decision-making and procedural implementation. Through this transaction, NPI will integrate its knowledge of the generic drug production function that is core to the Group to enhance the Company's Ibaraki factory. As a result, the factory will be reorganized into a production facility that has a high degree of market competitiveness in the generic drug business that goes beyond its own drug discovery, enabling centralized management of the Group's production function, promoting an optimal allocation of resources, including capital investment, and further raising management efficiency from the standpoint of integration of the production bases over the medium term, thereby striving to further enhance corporate value.

**(2) Matters relating to this share exchange**

**a. Allocations related to this share exchange**

The Company (Wholly owning parent company in share exchange): 1

Nihon Pharmaceutical Industry Co., Ltd. (Wholly owned subsidiary in share exchange): 38.4

Shares held by the Company in NPI (213,440 shares, as of May 11, 2010) shall not be allocated through the share exchange. The Company shall issue 4,091,904 new shares, and treasury shares shall not be employed in the share exchange.

**b. Calculation basis of share exchange ratio**

To ensure the fairness of the share exchange ratio, the Company retained an independent third party, Daiwa Securities Capital Markets Co., Ltd. (Daiwa Securities). Daiwa Securities assessed the value of the Company (listed company) shares based on market share price analysis, and the value of NPI (unlisted company) shares based on discounted cash flow (DCF) analysis and comparable companies analysis. The Company and NPI carefully reviewed the results and, taking into consideration the price at which it had bought back shares from Ranbaxy Laboratory Limited on December 8, 2009, they decided on a share exchange ratio. However, should there be significant changes in the underlying calculation, the share ratio would be subject to change following agreement by the Company and NPI.

**c. Overview of the wholly owning parent company in share exchange**

| | |
|---|---|
| Company name | Nippon Chemiphar Co., Ltd. |
| Head office | 2-2-3, Iwamoto-cho, Chiyoda-ku, Tokyo |
| President and CEO | Kazushiro Yamaguchi |
| Common stock | ¥4,305 million ($46,265 thousand) |
| Business | Research, manufacture and sale of ethical drugs |

**(3) Matters relating to this absorption-type split**

**a. Allocations related to this absorption-type split**

NPI will become a wholly owned subsidiary through share exchange on July 1, 2010. The absorption-type split to occur on a later effective date, shall result in a new issuance of 145,160 shares of common stock, all of which shall be allotted to the Company.

**b. Content of the splitting business**

(i) Business content of splitting division

Business related to the manufacture of pharmaceuticals, diagnostic agents and healthcare products by the Ibaraki plant

(ii) Production value of splitting division

¥7,854 million (fiscal year ended March 31, 2010)

The above-stated amount is based on selling prices, and does not include consumption taxes.

(iii) Assets and liabilities for division and their amounts (As of March 31, 2010)

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Assets: | | |
| Current assets | **¥ 62** | **$ 666** |
| Non-current assets | **1,480** | **15,905** |
| Total assets | **¥1,542** | **$16,572** |
| Liabilities: | | |
| Current liabilities | **¥ 56** | **$ 602** |
| Non-current liabilities | **35** | **376** |
| Total liabilities | **¥ 91** | **$ 978** |

Note: The above-stated amounts are to be confirmed after adjustments for changes occurring through the effective date.

**c. Overview of the parties to the company split (fiscal year ended March 31, 2010)**

| | Splitting company (the Company), consolidated | Succeeding company, non-consolidated |
|---|---|---|
| Company name | Nippon Chemiphar Co., Ltd. | Nihon Pharmaceutical Industry Co., Ltd. |
| Assets | ¥29,601 million ($318,119 thousand) | ¥4,479 million ($48,135 thousand) |
| Liabilities | ¥21,735 million ($233,584 thousand) | ¥1,965 million ($21,117 thousand) |
| Net Assets | ¥7,866 million ($84,535 thousand) | ¥2,514 million ($27,018 thousand) |
| Employees | 714 | 101 |

# Corporate Data

(As of March 31, 2010)

**Head Office:**
2-2-3, Iwamoto-cho, Chiyoda-ku, Tokyo 101-0032, Japan
**Tel.:** +81-3-3863-1211
**Fax:** +81-3-3864-5940
**URL:** http://www.chemiphar.co.jp

**Other Offices:**
Sapporo, Sendai, Tokyo, Yokohama, Kanetsu, Nagoya, Osaka, Hiroshima, Fukuoka

**Established:** June 16, 1950

**Capitalization:** ¥4,305 million

**Employees:** 714 (Consolidated)

**Subsidiaries:**
Nihon Pharmaceutical Industry Co., Ltd.
Safety Research Institute for Chemical Compounds Co., Ltd.
Shapro Inc.

**Affiliated Company:**
Japan Sopharchim Co., Ltd.

**Securities Exchange:** Tokyo Stock Exchange (First Section)

**Authorized Number of Shares:** 154,000,000

**Shares of Common Stock Issued:** 38,522,301

**Number of Stockholders:** 7,473

Nippon Chemiphar Co., Ltd.

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