

DAINIPPON PHARMACEUTICAL CO., LTD.

ANNUAL REPORT 2000

For the Year ended March 31, 2000



CORPORATE PROFILE

Dainippon Pharmaceutical Co., Ltd., as one of the pioneers of the modern pharmaceutical industry in Japan, has continuously striven to contribute to society with the research and development of better pharmaceuticals and in the supply of products to the health care world.

Since its foundation in 1897, the Company has used its perspectives and insights toward the creation of ever more helpful pharmaceuticals. Many of our quality products have won firm confidence and a reputation in the health care profession.



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P stands for pharmacy, and the circle represents a rising sun, symbolic of our ever-rising position in the pharmaceutical industry.



The goddess indicates that the pharmaceutical world was brightened by our inception. The child and the balance indicate purity and accuracy respectively. Combined, they represent the nature of our products.

FINANCIAL HIGHLIGHTS

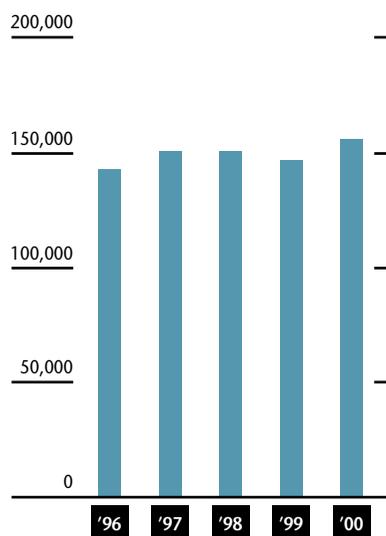
Dainippon Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
 Years ended March 31, 2000 and 1999

	Millions of Yen		Thousands of U.S. Dollars
	2000	1999	2000
Net sales	¥155,497	¥146,452	\$1,466,953
Net income	6,884	3,319	64,943
Total assets	171,064	172,978	1,613,811
Per share:			
	Yen		U.S. Dollars
Net income	¥40.93	¥19.73	\$0.39
Net income assuming full dilution	39.05	19.16	0.37
Cash dividends	8.50	7.50	0.08

Note: U.S. dollar amounts represent translation of yen, for convenience only at the rate of ¥106= US\$1 prevailing on March 31,2000.

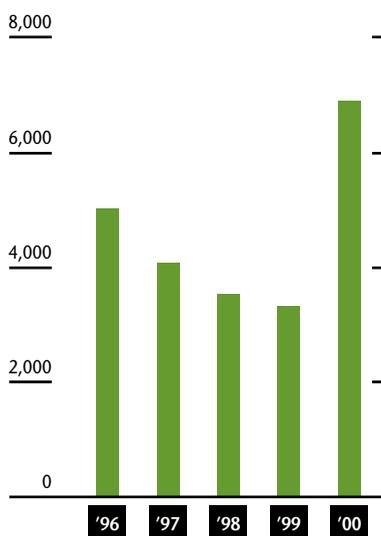
Net Sales

(Millions of Yen)



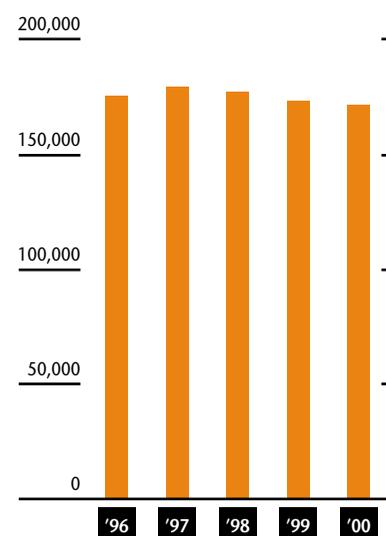
Net Income

(Millions of Yen)



Total Assets

(Millions of Yen)



Top management changes

■ On June 29, 1999, Takeshi Tomotake, the former president of Dainippon Pharmaceutical, became the chairman, and Kenjiro Miyatake, the former senior managing director, was appointed president.

■ In view of the increasingly tough operating environment, the new management team has taken steps to put the Company on course for further development.



Introduction of the corporate officer system

■ In June 1999, Dainippon Pharmaceutical introduced the corporate officer system to endow the Company with the speed and flexibility required for success in today's fast-paced, fiercely competitive markets. The new system is designed to sharpen the effectiveness of the board of directors by accelerating decision-making and clarifying responsibilities.

H i g h l i g h t s o f t h e Y e a r

Tie-up for antidiabetic

■ In February 2000, Dainippon Pharmaceutical and Takeda Chemical Industries, Ltd. concluded a license agreement covering Takeda's worldwide (excluding Japan, China, Taiwan and South Korea) development and distribution of AJ-9677, an antidiabetic invented by Dainippon.

■ Dainippon Pharmaceutical positions AJ-9677 as an international strategic product and at present is conducting clinical tests (Phase I) in Japan. Takeda is conducting clinical tests (Phase I) in the U.S.



The New GCP Support System starts operation

■ In April 1999, Dainippon Pharmaceutical started operation of the New GCP Support System which ensures reliability of clinical trials. This comprehensive system, developed jointly with Fujitsu Co., Ltd., executes integrated control of information from formulation of protocols for a clinical trial to completion of the clinical trial, enabling effective utilization of information.



10th anniversary of Zonisamide launch

■ June 1999 marked the 10th anniversary of the launch of *Zonisamide*, an antiepileptic agent developed in-house and marketed under the brand name *EXCEGRAN*[®] in Japan. This strongly selling product is among the most widely used drugs in the treatment of epilepsy.

Construction of new preparation plant completed

■ In April 1999, construction of a new preparation plant, located within our Suzuka Plant in Mie prefecture, was completed. The main activity of this new plant is manufacturing of *KADIAN*[®] (*Morphine sulfate*), a sustained release of morphine preparation for cancer pain treatment. This GMP-standards-compliant, state-of-the-art plant achieves automation and labor saving.

Licensing of a gastroprokinetic agent

■ In April 1999, Dainippon Pharmaceutical and Daewoong Pharmaceutical Co., Ltd. of South Korea signed an agreement covering licensing of Dainippon's in-house developed gastroprokinetic agent, *Mosapride Citrate*, to Daewoong. Daewoong expects this drug to become the top-selling gastroprokinetic agent in the South Korean market.

Tie-up on drug for atopic dermatitis

■ In December 1999, Dainippon Pharmaceutical and Sekisui Chemical Co., Ltd. concluded a license agreement under which Dainippon Pharmaceutical is granted the exclusive right to develop and distribute worldwide a series of high-concentration tocopherol acetates (vitamin E acetates) ointment that Sekisui is developing for the treatment of atopic dermatitis and other skin diseases.



FDA approval of Zonisamide

■ In March 2000, Dainippon Pharmaceutical received approval from the U.S. Food and Drug Administration (FDA) for marketing of *Zonisamide*, an antiepileptic agent developed in-house in the U.S. by a contract research organization. Since April 2000, *Zonisamide* has been distributed in the U.S. by Elan Pharmaceuticals of North America under the brand name *ZONEGRAN*[™].

Launch of *KADIAN*[®] (*Morphine sulfate*), a sustained release of morphine preparation for cancer pain treatment

■ On November 29, 1999, Dainippon Pharmaceutical launched *KADIAN*[®], an oral sustained release of morphine preparation for cancer pain treatment. One dose of *KADIAN*[®] a day maintains relief of cancer pain. *KADIAN*[®] is available in the form of capsule or sachet, the latter being effective for patients who have difficulty in swallowing a capsule. *KADIAN*[®] is expected to contribute greatly to enhancement of the quality of life of cancer patients.

■ Morphine preparations are positioned as important products for our marketing. With the addition of *KADIAN*[®], our line-up of morphine preparations now includes oral preparations, injection and suppository, providing greater options for relief of cancer pain.



A MESSAGE FROM THE MANAGEMENT

Results

During the fiscal year under review, a decisive recovery of the Japanese economy did not materialize. Despite signs of a modest upturn in private-sector capital investment due to progress in inventory adjustment, personal consumption remained lackluster, reflecting the weak labor market.

The ongoing global consolidation of the pharmaceutical industry fueled competition among companies. In Japan, downward pressure on drug prices continued as government sought to check rising health-care costs.

In these increasingly tough circumstances, Dainippon Pharmaceutical Co., Ltd. introduced the corporate officer system to accelerate decision-making. We marketed our products with the utmost vigor, rationalized production systems and strengthened R&D. At the same time, in order to achieve low-cost operations, we stepped up implementation of Project CR30 which targets an across-the-board 30% reduction in costs. As a result, operating income surged 59.4% to ¥12,686 million due to reduction in expenses, such as lower personnel costs as a result of reduction of the number of personnel, and net income soared 107.4% to ¥6,884 million, partly due to the lowering of the income tax rate and adoption of Accounting for Effects of Income Taxes from the year under review, while net sales increased 6.2% from the previous year, to ¥155,497 million.

In research and development, we concentrated on the discovery and development of highly original compounds with a large sales potential in the international market. Regarding Pharmaceutical Products Operations, Product Strategic Planning Division was newly established for speedy

strategic planning and quick decision of project managements of pharmaceutical products. In March 2000, we received an approval for manufacture of *MYSTAN*[®](*Clobazam*), an antiepileptic agent in Japan. *Zonisamide*, an antiepileptic agent developed in-house in the U.S., was approved by the U.S. Food and Drug Administration (FDA), and was launched in April 2000 by Elan Pharmaceuticals of North America. Moreover, development and distribution rights of AJ-9677, an antidiabetic, which we have positioned as an international strategic product, were licensed to Takeda Chemical Industries, Ltd.

Regarding cash flows, cash and cash equivalents at the end of the fiscal year under review were ¥32,672 million, compared with ¥24,244 million at the beginning of the year. Despite the redemption of the Company's first unsecured convertible bonds, the increase in income before income taxes and minority interests contributed to this increase in cash and cash equivalents.

Outlook for the Future

The operating environment for pharmaceutical companies is becoming harsher. In April 2000, a further NHI drug price revision took place. While the drive to curb healthcare costs is sure to continue in Japan, competition among pharmaceutical companies can be expected to intensify as they battle for supremacy in the global marketplace.

Regarding new products, *MYSTAN*[®], an antiepileptic, was launched in 2000. We intend to concentrate on achieving strong market penetration of *MYSTAN*[®], *GASMOTIN*[®](*Mosapride citrate*), a gastroprokinetic developed in-house, and *KADIAN*[®](*Morphine sulfate*), a drug for



Takeshi Tomotake, Chairman (Left),
and Kenjiro Miyatake, President

sustained release of morphine preparation for cancer pain treatment launched in 1999, while strengthening the presence of *EBASTEL®(Ebastine)*, an anti-allergy agent. To ensure that Dainippon is a source of highly valuable new drugs far in to the future, we are channeling our R&D efforts into selected fields that have excellent potential. In April 2000, we introduced the "area team system," which is a new, more streamlined approach to marketing. This system, with a simple organizational structure, facilitates strategic and effective marketing through integration of sales bases. Furthermore, in order to optimize production systems, we will fine-tune them according to the types of drugs, and, where desirable, make use of outsourcing. We intend to close Osaka Plant, which has been a production base since the Company was established, and transfer its operations to Suzuka Plant, our main factory, at the beginning of fiscal 2003.

The ultimate objective of these far-reaching changes is to achieve decisive reform of the profit structure. From now on, profitability,

not sales amount, will be applied as the key criteria in evaluating operations and in strategy-making. Regarding management indices, in addition to return on sales, we will also emphasize return on equity (ROE). Fiscal 2001 is the final year of the first 5 year business plan started in fiscal 1997. Among the mid-term business plan targets to be achieved in fiscal 2001 on non-consolidated basis are the ratio of operating income to net sales of 10% and 7.5% ROE.

June 2000

Takeshi Tomotake
Chairman

Kenjiro Miyatake
President

In 1997, coinciding with its centenary, Dainippon Pharmaceutical articulated a corporate vision, "*P-UP 21*," broadly setting out the direction the Company intends to take in the 21st century-Dainippon's second century.

I) "*P-UP 21*" corporate vision

The "*P-UP 21*" corporate vision clarifies the policies of Dainippon Pharmaceutical and the ideal configuration of the Company in 2011-15 years from the launch of "*P-UP 21*"..

"*P-UP 21*" has three main elements:

1) Principles

The following principles express the fundamental values and stance of Dainippon Pharmaceutical:

- Contribute to society by creating innovative pharmaceutical products that provide new values based on unceasing efforts in research and development
- Build a strong relationship with stakeholders through sound management and earn the trust of society by being an ethical enterprise

2) Domains

With the aim of achieving continuous growth through 2011, Dainippon Pharmaceutical selected four domains:

- (1) Pharmaceuticals for people
- (2) Food products that contribute to people's wellness
- (3) Support and services that contribute to people's wellness
- (4) Comprehensive support that contributes to animals' wellness

3) Target

The target shows what would be the desirable configuration of Dainippon Pharmaceutical in 2011. We aim to be a highly profitable enterprise which is trusted by customers and has a strong market presence.

II) The first mid-term business plan

The first mid-term business plan, for the five-year period from fiscal 1997 to 2001, puts "*P-UP 21*" into practice. The plan's objective is to place Dainippon Pharmaceutical on a firm new footing by thoroughly implementing the following five fundamental policy initiatives:

1) Cultivation of the ethical drug business

- Channel management resources into R&D to create innovative, highly effective pharmaceutical products suitable for the international market, concentrating on fields where needs are the greatest.
- Focus discovery research efforts on infectious diseases, vascular diseases, psycho-neurological diseases and immuno-inflammatory diseases.
- Promote efficient R&D





2) Promotion of low-cost operations

- Execute Project *CR30*

The target of Project *CR30*, launched in October 1997, is to reduce costs by 30% through optimum deployment of human resources and reduction of expenses, thereby achieving efficient, streamlined operations. The number of employees on non-consolidated basis is to be 2,400 in April 2002, down from 2,800 in 1997, but R&D and marketing operations are not within the scope of this personnel reduction plan.

3) Development of the individual talents of the workforce

- Support development of personnel through introduction of a new human resources system and skill development
- Introduce a system whereby well-defined goals are set for all personnel, so as to ensure achievement of organizational targets

4) Stepped-up promotion of strategic alliances

- Promote alliances with outstanding companies in Japan and overseas in order to expand the scale and scope of the Company's businesses, thereby achieving efficient utilization of management resources
- Promote tie-ups with venture companies all over the world in R&D to secure the basic technology for innovative drugs

5) Seeking new businesses

- Investigate new pharmaceutical-related businesses in which the Company's accumulated expertise can be deployed to advantage

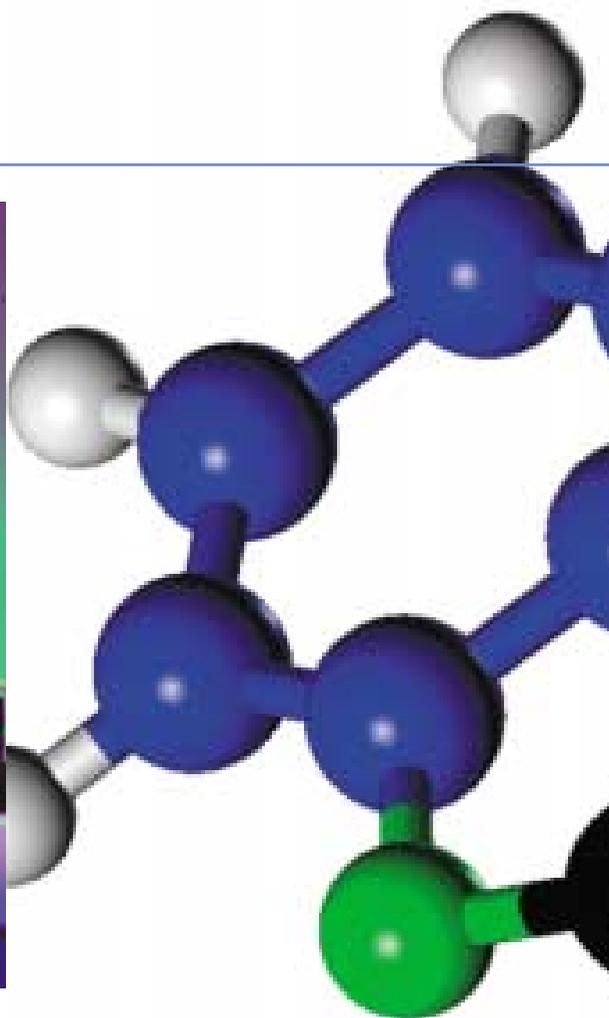


Dainippon Pharmaceutical is determined to survive and flourish far into the 21st century as an enterprise underpinned by a powerful commitment to R&D. For that purpose, we are inculcating these corporate principles throughout our operations. Moreover, each operation is tackling the above-mentioned strategic issues through "selection and focus" and with a stress on achieving "speed"-key words for Dainippon Pharmaceutical in the 21st century.

A drive for greater profitability is at the heart of the first mid-term business plan. The key management targets for fiscal 2001 on non-consolidated basis are a ratio of operating income to net sales of 10% and 7.5% return on equity (ROE).

In Dainippon Pharmaceutical's trademark "☉", the circle represents the "rising sun" that symbolize the national flag of "Japan". In the 21st century, we aim to become an enterprise that helps people throughout the world enjoy a healthier, more affluent life. Then, the circle will symbolize the "world".

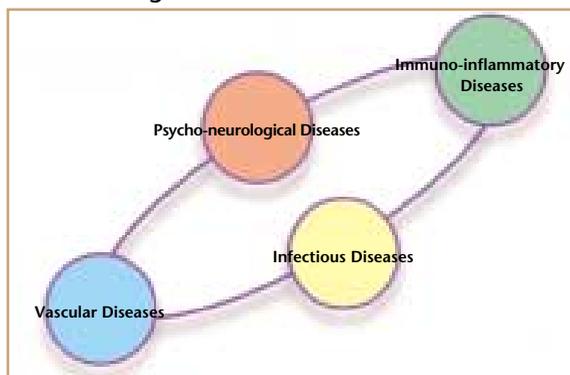
RESEARCH AND DEVELOPMENT

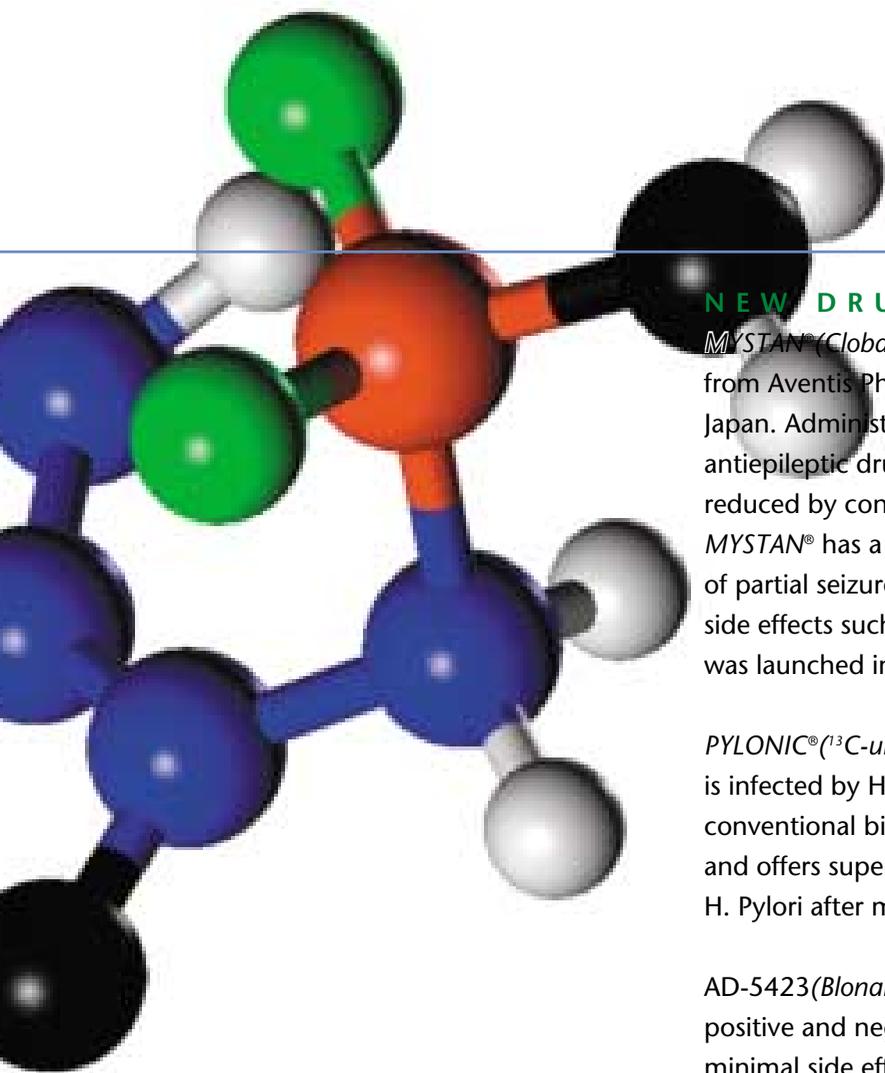


Successful, well-targeted R&D activities are essential for success in the field of ethical drugs, Dainippon Pharmaceutical's core business. R&D Operations' objective is to create innovative, highly efficacious drugs geared to the most pressing needs in the worldwide market. To this end, discovery research efforts are focused on vascular diseases, psycho-neurological diseases, immuno-inflammatory diseases and infectious diseases. R&D Operations is working to strengthen its capabilities by refining the technology it uses for discovery of innovative chemical entities and creation of innovative drugs.

Moreover, gains are being made in terms of the efficiency of R&D activities through strategic alliances that enable utilization of external resources. Development overseas and licensing are vigorously promoted with the aim of introducing winning products in the global marketplace.

Research Target Areas



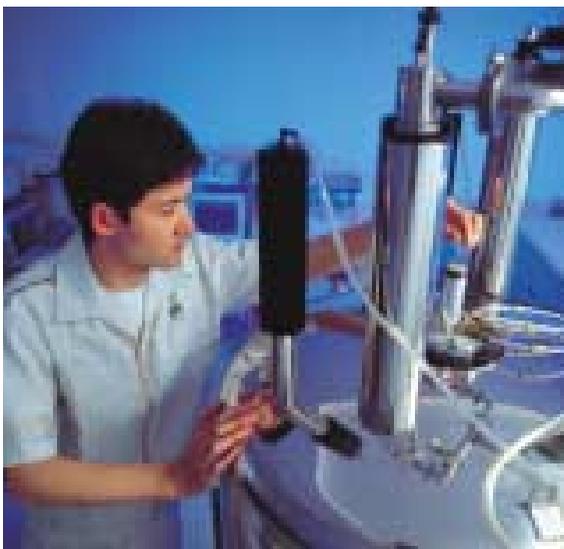


NEW DRUGS IN THE R&D PIPELINE

MYSTAN® (*Clobazam*), a benzodiazepine antiepileptic agent licensed from Aventis Pharma, was developed jointly with AZWELL, Inc. in Japan. Administration of **MYSTAN®** in combination with other antiepileptic drugs to refractory epileptics whose seizures are not reduced by conventional medication showed a high improvement rate. **MYSTAN®** has a wide antiepileptic spectrum and is effective for all types of partial seizures and most types of generalized seizures. Moreover, side effects such as drowsiness and dizziness are reduced. **MYSTAN®** was launched into the market at the end of May 2000.

PYLONIC® (^{13}C -*urea*) is a diagnostic drug that detects whether a patient is infected by *H. Pylori*, closely related to peptic ulcer. Unlike conventional biopsy methods, diagnosis using **PYLONIC®** is noninvasive and offers superior safety. It is also effective to confirm elimination of *H. Pylori* after medication.

AD-5423 (*Blonanserin*), an antipsychotic agent, is expected to improve positive and negative symptoms in schizophrenic patients and have minimal side effects, such as extrapyramidal symptoms, excessive sedative action and hypotensive action. Because the number of people



AJ-9677

Since diabetes and obesity can cause fatal cardiovascular diseases and the number of people suffering from diabetes and/or obesity are rapidly increasing worldwide, there is an urgent need for treatment of these two conditions. **AJ-9677**, a β_3 adrenergic receptor agonist, promotes lipolysis and thermogenesis, and improves the insulin resistance which is said to be induced by free fatty acid and/or $\text{TNF } \alpha$. In various experimental animal models, **AJ-9677** showed antidiabetic action, such as reduction of plasma glucose, free fatty acid and triglyceride, confirming that **AJ-9677** promotes energy metabolism. Unlike conventional antidiabetics, the mechanism of action for **AJ-9677** is via the β_3 adrenergic receptor, giving it excellent potential to become a new kind of drug for type 2 diabetes and obesity.

Clinical trials are currently being conducted in Japan by Dainippon Pharmaceutical and in the U.S. by Takeda Chemical Industries, Ltd.



diagnosed with schizophrenia is increasing worldwide and schizophrenia often becomes chronic, there is a pressing need for a drug which is both highly efficacious and very safe— AD-5423 fits that description.

QVAR™ (Beclomethasone dipropionate), is a pressurized, metered-dose inhaler, licensed from 3M. It uses a CFC-free propellant HFA-134a, which has no ozone-depleting potential. *QVAR™*'s smaller particles relative to those of CFC-BDP significantly improve delivery of medication to the large and small airways of the lungs and reduce the oropharyngeal deposition, which conceivably results in fewer adverse events. Inhaled steroids are an integral component in the management of asthma and their usage has been increasing in recent years.

AN-982 is an oral liquid preparation of *Morphine hydrochloride*. It is expected to be useful in providing fine adjustments to the optimum regular dose of morphine, and as a treatment of pain emergencies (rescue) for cancer patients when their pain breaks through their regular morphine treatment. Individual packaging of a liquid preparation is convenient for patients to carry, thereby enhancing compliance and also ensuring simplicity in terms of dispensing and control.

AURORIX® (Moclobemide), a selective and reversible inhibitor of monoamine oxidase A (MAO-A) licensed from Roche, is effective for the treatment of depression. Compared with conventional antidepressants, its hepatic toxicity is weak.

AS-3201 is expected to be effective for prevention or amelioration of diabetic complications such as neuropathy, retinopathy and nephropathy.

AJ-9677 improves insulin resistance with a novel mechanism of action, and is expected to be a promising drug for the treatment of diabetes and obesity.



New chemical entities at the preclinical stage include some in-house candidates such as AC-3933 for the treatment of cerebrovascular dementia or Alzheimer's disease, and licensed-in compounds such as DSE-9912 for the treatment of skin diseases, licensed from Sekisui Chemical Co., Ltd.

AS-3201

AS-3201 is an aldose reductase inhibitor and prevents complications due to accumulation of sorbitol in the cells of diabetics. AS-3201 is excellent in terms of long duration of action and tissue penetration to the target organs. It is expected to be effective for prevention or amelioration of diabetic complications. The increase of patients with diabetic complications is a major issue not only in terms of a lower quality of life for patients but also for society at large, due to the increase in healthcare costs and loss of labor.

R&D PIPELINE

Stage	Category	Product Name/Code Name	Generic Name	Remark
NDA's Filed	Antimalignant tumor	TIENEF®	Sonermin	Developed in-house
	Quinolone antibacterial	SPARA®*1	Sparfloxacin	Developed in-house
	Vasodilator	PRORENAL®*1	Limaprost alfadex	Co-developed with ONO
	Analgesic	MH-200*2	Morphine hydrochloride	Co-developed with Takeda, Sankyo, Shionogi and Tanabe
	Diagnostic	PYLONIC®	¹³ C-urea	Developed in-house
Phase III	Antipsychotic	AD-5423	Blonanserin	Developed in-house
	Bronchodilator aerosol	QVAR™	Beclomethasone dipropionate	Licensed from 3M
	Analgesic	AN-982	Morphine hydrochloride	Developed in-house
Phase II	Antidepressant	AURORIX®	Moclobemide	Licensed from Roche
	Aldose reductase inhibitor	AS-3201	—	Developed in-house
Phase I	Antidiabetic	AJ-9677	—	Developed in-house
	Anticancer	MGI-114	Irofulven	Licensed from MGI

* 1 Additional Indication

* 2 Additional Formulation

INTERNATIONAL OPERATIONS

Dainippon Pharmaceutical's international activities center on licensing of in-house developed products. Our current licensing activities are focused on *Zonisamide*, an antiepileptic agent, and *Sparfloxacin*, a new fluoroquinolone antibacterial agent. We are now exporting to Europe, the U.S. and markets in Asia, while, at the same time, strengthening cooperation with other companies through tie-ups. Drugs being developed overseas include *Mosapride citrate*, a gastroprokinetic agent, and AJ-9677, an antidiabetic.

Zonisamide, an antiepileptic agent developed in-house, has a novel structure, a wide spectrum that covers various types of seizures, and proven efficacy for refractory seizures. *Zonisamide* has been on sale in Japan since 1989 under the brand name *EXCEGRAN*[®]. In 1992, Dainippon Pharmaceutical started in-house development of *Zonisamide* in the U.S. through a U.S. contract research organization that conducts clinical trials, and in March 2000 obtained approval for marketing of *Zonisamide* from the U.S. Food and Drug Administration (FDA). The marketing rights for *Zonisamide* in the U.S. have been licensed to Elan Pharmaceuticals of North America, a subsidiary of Elan Corporation, plc. Sales of *Zonisamide* in the U.S. started in April 2000 under the brand name *ZONEGRAN*[™]. In Europe, it has been licensed to Elan Corporation, plc. The development of *Zonisamide* in Europe is under way without major issues. We plan to introduce *Zonisamide* elsewhere in the world through licensing.

Sparfloxacin, a long-acting, new fluoroquinolone antibacterial agent, is very effective against *Streptococcus pneumoniae* and other bacteria that cause respiratory infections. Distribution of *Sparfloxacin* in the U.S. has been licensed to Mylan Laboratories Inc. *Sparfloxacin* has been on sale for several years in Europe—in France, Luxembourg and Germany, and in Asia—in India, the Philippines, Hong Kong, Indonesia, Singapore, China and South Korea, through licensees. In December 1999, application for additional applicable bacteria (*Chlamydia pneumoniae* and *Mycoplasma pneumoniae*) was registered in Japan. We intend to file applications for additional registrations in some countries.

Mosapride citrate is the world's first gastroprokinetic agent to work on serotonin 5-HT₄ receptors with less possibility of causing adverse reactions such as extrapyramidal symptom and Q-T interval extension.





Mosapride citrate has been on sale in Japan since October 1998. Overseas development is under way. In South Korea, *Mosapride citrate* has been licensed to Daewoong Pharmaceutical Co., Ltd., and the drug is expected to be launched in South Korea within a couple of years. In Europe and the U.S., AstraZeneca PLC. had been the licensee, but due to a change in product strategy consequent upon the merger of that company, Dainippon Pharmaceutical is seeking a new partner.

For AJ-9677, an antidiabetic currently under development, Dainippon Pharmaceutical signed a license agreement with Takeda Chemical Industries, Ltd. in February 2000, and has granted worldwide rights to Takeda, excluding certain countries in Asia. Takeda is promoting development of AJ-9677. Building on achievements in Japan, Europe and the U.S., we intend to develop AJ-9677 in China, Taiwan, South Korea and elsewhere in Asia through licensing.

Among drugs related to diabetes, we have AS-3201 which is a drug for diabetic complications. We intend to develop AS-3201 worldwide, alongside AJ-9677.



Dainippon Pharmaceutical U.S.A. Corp.

Established in 1988, this company is supporting in-house development of products in the U.S. and liaison with licensees.



Taiwan Dainippon Pharmaceutical Co., Ltd.

Established in 1963, this company manufactures and distributes ethical drugs and OTC drugs.



Dainippon Pharmaceutical London Office

The London Office was established in 1998 to coordinate drug development efforts in Europe. Its main activities include overseas development of new chemical entities which were originally developed in-house, licensing, and support of development of licensed compounds.



Dainippon Pharmaceutical Beijing Office

Established in 1998, the Beijing Office monitors sales and supports sales promotion activities. It is a gateway through which Dainippon Pharmaceutical can do business in China.

Pharmaceuticals

As a company handling pharmaceutical goods, Dainippon Pharmaceutical is very cognizant of the high ethical standards and responsibility we have toward our society. With our thorough information dissemination activities regarding the usefulness of our products, we are working to ensure appropriate use and wider application of our medicines under the basic concept: "Bringing Out a Smile in People." To accomplish this, we consider the following five points to be of crucial importance:

1. Develop activities to strengthen dissemination of essential information about pharmaceuticals
2. Establish a marketing strategy system focused on the market
3. Build a foundation for penetrating the markets with the company's in-house developed products and working to make them the leading products in their fields
4. Shift emphasis away from sales volume to concentrate on quality; moving toward profitable production
5. Promote sales activities that focus on ethical factors

In the ethical drugs business, we formed a new product strategy, sales promotion strategy, and organizational strategy, and outlined other initiatives under our medium-term business plan aimed at achieving a number of specific objectives. To be noted in particular among these initiatives is a detailed plan regarding "sales reform," which is currently being promoted by all sales personnel company-wide.

Under the "sales reform" initiative, we are carrying out the following four tasks: 1) introduction of IT in order to establish MR (medical representatives) support system and study of practical methods for utilization of IT, 2) restructuring of the objectives-management system through review of sales activities methods and tabulation of results, 3) adoption of an "area team system" and other measures to revamp the team structure and to clarify the role of the sales department, and 4) introduction of new standards for evaluating business activities and results. The new "area team sys-



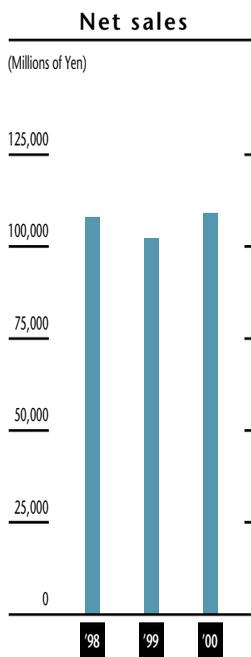
tem” and the new objectives-management system were introduced in April 2000.

The “area team system” is a region-based arrangement of sales groups to enable more efficient recognition of changing market needs under Japan’s 21st century medical care system. It is also a system designed to allow us to better respond to demands in the market where the division of medical practices and pharmaceutical practices is underway. As the system is a flat organizational structure, it provides a more transparent picture of the workings of the sales structure. Under this framework, Dainippon Pharmaceutical aims to build a strong sales group by increasing market awareness of each and every member of the sales department. The sales department has adopted the following three slogans by which to promote sales activities: 1) “Create a Flat and Transparent Organizational Structure,” 2) “Initiate and Accept Change without Apprehension,” and 3) “Always the Time for Learning.”

The environment surrounding the pharmaceutical market remained difficult in the year ended March 31, 2000, but this segment managed to post a sales increase of 6.7% from the year earlier to ¥108,981 million.

ETHICAL DRUGS

During the previous fiscal year, Dainippon Pharmaceutical launched its in-house developed gastroprokinetic *GASMOTIN*[®] (*Mosapride citrate*). Thanks to vigorous marketing and advertising efforts since the product’s introduction, its sales grew 180% in the year under review from the previous year to some ¥4,200 million. *GASMOTIN*[®] is the world’s first gastroprokinetic agent with selective serotonin 5-HT₄ receptor agonist activity. Because it does not show dopamine D₂ receptor antagonist activity and has less possibility to cause extrapyramidal side effects or prolonged QT intervals, *GASMOTIN*[®] has been regarded as an extremely useful drug. The company plans to make the product one of its

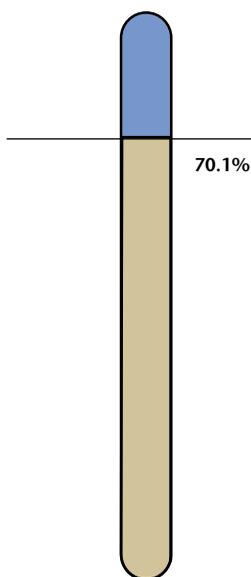


mainstay items.

Sales of *EBASTEL*[®] (*Ebastine*), a long-acting antiallergenic agent, increased markedly due to the greater-than-usual amount of pollen in the air in the term under review. Sales grew 22.4% from the previous year to ¥12,000 million, surpassing the ¥10,000 million mark and making the product one of Dainippon Pharmaceutical’s mainstay items. Due to its strong antihistaminic function, *EBASTEL*[®] offers superior effectiveness with only a single daily dose. Moreover, because of minimal side effects, such as soporific effect, the antiallergenic agent is steadily seeing wider use. The company aims to maintain the drug’s prominent position in the market.

In the area for antiepileptic agents, the company is continuing to develop drugs and assuring their stable supply, in addition to contributing to the medical treatment of epilepsy through the Japan Epilepsy Research Foundation. Among Dainippon Pharmaceutical’s antiepileptic drugs, sales of *EXCEGRAN*[®] (*Zonisamide*), which was developed in-house, rose by a firm 7.4% from the previous year to ¥2,900 million. Also, in May 2000, the company launched its ninth antiepileptic drug *MYSTAN*[®] (*Clobazam*), which was the first antiepileptic agent to be introduced to the Japanese market in 11 years. Due to its wide spectrum applicable for a wide range of types of epileptic seizures, *MYSTAN*[®] has been recognized as a highly useful adjunctive therapy. With these

2000 Sales Composition Ratio



product, the company aims to be a leading company in this area.

Dainippon Pharmaceutical is one of five firms in Japan licensed to manufacture and sell narcotics for medical use. The company's products in this area include *ANPEC*[®] (*Morphine hydrochloride*), a drug developed in-house for the relief of cancer pain. The product is available in a suppository preparation and injection form. Another product in this field is *KADIAN*[®] (*Morphine sulfate*). As *KADIAN*[®] is the first cancer painkiller that can be administered in a single dose once a day, it has won high marks from users as it offers patients a certain degree of relieve and helps improve their "quality of life." The company hopes this product will thoroughly permeate the market. The company is also continuing development of new drugs in this field, with the intention of expanding its line-up of products such that it can further contribute to medical treatment in this area.

DIAGNOSTICS

Dainippon Pharmaceutical develops and markets in vitro diagnostics based on enzyme immunoassay (EIA) using microplate. *MARKIT*[®]-M *Haloperidol* and *MARKIT*[®]-M *Bromperidol* are used to measure blood levels of the antischizophrenic agents *Haloperidol* and *Bromperidol*, respectively. *MARKIT*[®]-M *EXCEGRAN* is designed to measure the blood level of the company's in-house developed



antiepileptic agent, *Zonisamide*. These three kits are useful tools for therapeutic drug monitoring (TDM).

MARKIT[®]-M *PA* is used to measure the blood level of prostate specific antigen (PSA), which is useful for the diagnosis of prostate cancer. In February 1999, the company introduced *MARKIT*[®]-M *PSA-ACT* for the measurement of α_1 -antichymotrypsin-complexed PSA. In March 1999, the company introduced *MARKIT*[®]-M *H-FABP*, the first kit in the world to measure heart-derived fatty acid binding protein, which is useful for the diagnosis of acute myocardial infarction. *MARKIT*[®]-F *LPL*, which is not a microplate-type kit, is used to measure lipoprotein lipase (LPL) in postheparin plasma (PHP) and is applied for the diagnosis of heterozygous or homozygous LPL deficiency in hypertriglyceridemia.

Dainippon Pharmaceutical was the first Japanese company to develop these seven immunoassay kits, and obtained governmental approval to manufacture them as in vitro diagnostics. They are used widely in hospitals and clinical assay laboratories throughout Japan.

The company is developing several kits for TDM concerning its pharmaceutical products. These include a kit for measuring blood levels of morphine, which is indicative of the relief of cancer pain; kits for measuring blood levels of *Pirmenol*, an arrhythmia agent; and *Sultopride*, a psychotropic agent. It is also currently developing a simple and rapid test called *RAPICHECK*[®] *H-FABP* for the diagnosis of acute myocardial infarction.

Amid such circumstances for our various products, we expect sales of pharmaceuticals in the fiscal year ending March 31, 2001, to rise slightly from the previous year to ¥111,300 million.

Animal Health Products

Under the concept “comprehensive support of the health of animals”, we have set the following three priority issues:

1. Secure and maintain a leading share in all target areas in Japan under the concept: “For the Health of Your Pet.”
2. Develop in-house products that can be marketed worldwide.
3. Establish a business base from which the company can secure a dominant position in the Japanese market for animal health products; consider active cooperation with animal health product firms around the world.

The company’s sales in this segment increased by a solid 6.9% from the previous year to ¥22,412 million.

ANIMAL HEALTH PRODUCTS

Sales of the company’s major product **CARDOMEC®**, a preventive against canine heartworm, remained nearly flat on year at ¥1,500 million due to increased competition with rival firms. Dainippon Pharmaceutical hopes to hold onto its current top market share in this product field, even though competition is sure to intensify as this particular market is quite large. The ease of administration featured by the company’s **CARDOMEC®** should help the product retain its top market ranking.

Sales of the company’s in-house developed antibacterial preparation **VICTAS®-S** has been increasing steadily for all three forms of the drug; a solution injection, tablet preparation, and MT cream. Many veterinary hospitals in Japan use antibacterial agents intended for humans in addition to products designed for pets. The company intends to highlight the effectiveness and animal-specific safety features of its product such that **VICTAS®-S** eventually replaces the agents currently in use at these hospitals.

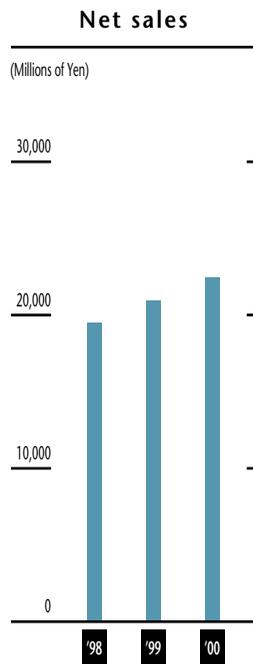


Sales of *ENACARD*[®], a drug for chronic heart failure in dogs, increased during the year under review. In the market for such medications, demand for drugs specifically for the treatment of elderly dogs saw notable growth. *ENACARD*[®] is the first product in this particular field. The efficacy of the product has been widely recognized by veterinarians through the company's information dissemination activities. Such efforts have effectively expanded the market for *ENACARD*[®].

New products released during the year under review were *VICTAS*[®]-S MT cream, a new fluoroquinolone preparation for otitis externa and skin infections in dogs, and *ISOFLU*[®], an inhalation-type anesthetic for animals. Both products helped contribute to overall sales of this segment.

FEEDS AND FEED ADDITIVES

The company's sales of prescription diets for dogs and cats, developed by Hill's Pet Nutrition, Inc., rose 9.2% from the previous year to ¥17,800 million. The product lines in the field are the *PRESCRIPTION DIET*[®] targeted for use in treatments prescribed by veterinarians and the *SCIENCE DIET*[®] aimed at the pet shop sector. As the *PRESCRIPTION DIET*[®] line includes a wide variety of products, it can be administered for the treatment of a broad range of diseases. The product line is highly regarded by veterinarians due to extensive scientific support for its effectiveness

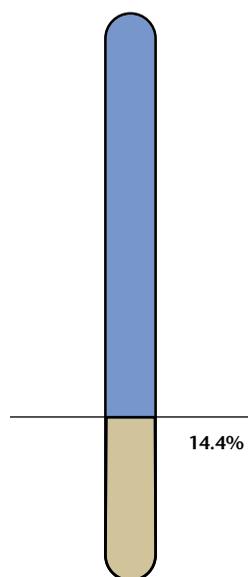


and has thus captured the top market share in this field. The *SCIENCE DIET*[®] has also won kudos from veterinarians and accounts for the largest share of the "premium food" product group.

Increasingly harsh competition in the markets for animal health products, special treatment agents, and pet food products is expected to dampen the company's sales. But sales of new products recently released to the market by Dainippon Pharmaceutical should help make up for any decline in sales of existing items.

As a result, sales for the year ending March 31, 2001, is estimated to remain little changed from the year earlier at around ¥22,300 million.

2000 Sales Composition Ratio



Other Products



In this segment, the company's basic concept is: "Offering foods for Human Health" and "Support and Services for Human Health."

The food additives business accounts for a large portion of this product segment. The diversification of consumers' eating habits has resulted in notable growth of the markets for dining out and processed foods, as well as an increase in demand for food materials derived from completely natural sources. Amid such changes, Dainippon Pharmaceutical has set the following three priorities for its food additives business

1. Restructuring of its strategy for food seasonings
2. Reinforce and expand polysaccharides business by realizing stronger development capabilities for new types of stabilizers and gelling agents in combination with various polysaccharides
3. Develop overseas market demand for the company's seasonings and polysaccharides

Also in this "other products" segment are industrial chemicals and materials for research use. Among industrial chemicals, to be noted is the rapid expansion of the market for electronic recording material due to the sharp growth of the information communications industry. The company has set the following two priorities for industrial chemicals:

1. Improve earnings and rebuild the production base.
2. Promote a R&D system that focuses more on user needs; reinforce R&D operations.

In the area of materials for research use, the company has set its fundamental plan to improve profit by introducing the most recent, advanced technologies and selecting sales products.

Sales for the "other products" segment grew 3.3% on year to ¥24,104 million, contributing to increase revenue.



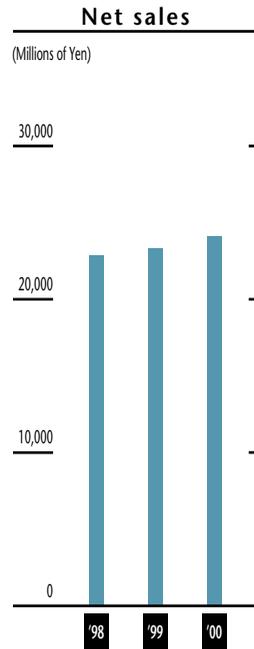
FOOD ADDITIVES

In the food additive product group of this segment, the company's major item *ECHO GUM*[®], a polysaccharide saw heated competition from an offensive by European products and sales thus remained basically unchanged from the year earlier at around ¥2,300 million. In contrast, demand for the company's seasonings, led by *AJIPOL*[®], increased as more and more consumers began seeking non-artificial products. *AJIPOL*[®] is a seasoning based on extract derived from fresh bone with meat of live-stock. As a result, sales of seasonings grew a healthy 17.9% from the previous year to ¥3,300 million.

OTHER PRODUCTS

In the industrial chemical product field, the company's *GARO*[®] series of sensitizers for use with photoresist saw a sharp expansion in demand along with the rapid growth in the information technology-related sectors. Dainippon Pharmaceutical is particularly noted as a major company of industrial chemicals for use with highly advanced Excimer lasers.

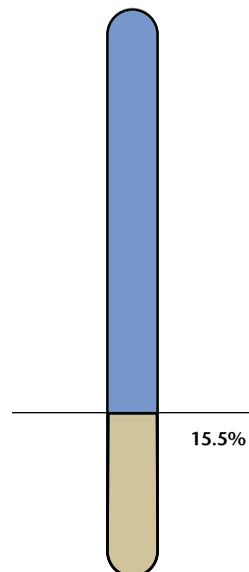
Moreover, in the area of materials for research use, the company imports and distributes a wide range of research reagents, cell culture-related products, and measuring devices for laboratories. The company handles more than 5,000 kinds of research reagents in immunology and molecular biology. Dainippon Pharmaceutical also supplies a wide variety of animal-derived cells, focused on human-derived primary cells.



As for measuring devices, the company sells a variety of microplate readers, such as photometric, fluorescent and luminescent readers. The company also sells PCR thermal cyclers, nucleic acid extraction/purification devices and SNPs scoring system, which are widely used in genomic research. In 1998 the company released the *FLUCLET*[®], the first in-house automated device for analysis of circulation dynamics and the activity of the autonomic nervous system. The *FLUCLET*[®] enables an analysis of the autonomic nervous system in a matter of seconds by using Wavelet transformation from the date of electrocardiogram and blood pressure. The device has gained attention for use as a tool for basic medical research at university hospitals, pharmaceutical companies, and the human engineering sciences.

Amid such developments, Dainippon Pharmaceutical expects sales in this segment to increase slightly in the year ending March 31, 2001, to ¥24,400 million.

2000 Sales Composition Ratio



FINANCIAL SECTION

Five-year Summary of Selected Financial Data

Dainippon Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31

	Millions of Yen ^(*)					Thousands of U.S. Dollars ^(*) (Note 3)
	2000	1999	1998	1997	1996	2000
Results of Operations						
Net sales	¥155,497	¥146,452	¥150,292	¥150,537	¥142,732	\$1,466,953
Cost of sales	97,195	92,889	94,687	93,112	84,115	916,934
Selling, general and administrative expenses	45,616	45,603	47,554	48,667	48,366	430,340
Operating income	12,686	7,960	8,051	8,758	10,251	119,679
Income before income taxes and minority interests	13,595	9,438	9,305	11,877	12,489	128,255
Net income	6,884	3,319	3,524	4,064	5,019	64,943
Per share amounts (in Yen and U.S.Dollars):						
Net income	40.93	19.73	20.96	24.17	29.85	0.39
Net income assuming full dilution	39.05	19.16	20.14	23.06	28.22	0.37
Cash dividends	8.50	7.50	7.50	8.75	7.50	0.08
Financial Position						
Current assets	117,548	120,128	126,878	129,929	130,350	1,108,943
Net property, plant and equipment	31,188	32,640	29,931	28,900	28,502	294,226
Total assets	171,064	172,978	176,721	178,889	174,987	1,613,811
Current Liabilities	44,836	55,413	47,370	51,711	49,842	422,981
Long-term debt	17,005	17,005	27,725	27,859	29,001	160,424
Shareholders' equity	98,092	89,012	90,068	88,071	85,318	925,396
Other Statistics						
R&D expenses	12,079	12,276	12,369	12,892	12,674	113,953
Capital expenditures	2,041	5,699	4,525	3,810	5,238	19,255
Depreciation and amortization (Note 1)	3,936	3,629	3,397	3,282	3,026	37,132

(*) except "Per share amounts" information

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CONSOLIDATED BALANCE SHEETS

Dainippon Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
 Years ended March 31, 2000 and 1999

ASSETS	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	2000	1999	2000
Current Assets:			
Cash and time deposits.....	¥ 32,540	¥ 20,110	\$ 306,981
Short-term investments	—	5,000	—
Marketable securities (Notes 2 and 6)	4,108	16,820	38,755
Trade receivables:			
Notes	9,105	9,988	85,896
Accounts	50,990	50,135	481,038
Allowance for doubtful accounts	(348)	(421)	(3,283)
	59,747	59,702	563,651
Inventories (Notes 2 and 5)	18,005	17,598	169,858
Deferred income taxes (Note 8).....	1,694	—	15,981
Other current assets	1,454	898	13,717
Total Current Assets	117,548	120,128	1,108,943
Investments and Other Assets:			
Investments in non-consolidated subsidiaries and affiliates (Note 2)	684	575	6,453
Investments in securities (Notes 2 and 6)	13,089	13,355	123,481
Loans to employees	1,218	1,351	11,491
Deferred income taxes (Note 8).....	2,210	—	20,849
Other investments	5,127	4,929	48,368
Total Investments and Other Assets	22,328	20,210	210,642
Property, Plant and Equipment at Cost (Note 2):			
Land	5,208	5,208	49,132
Buildings	34,352	33,416	324,075
Machinery and equipment	33,455	31,170	315,613
Construction in progress	356	2,622	3,359
	73,371	72,416	692,179
Less accumulated depreciation	42,183	39,776	397,953
Net Property, Plant and Equipment	31,188	32,640	294,226
Total	¥171,064	¥172,978	\$1,613,811

The accompanying notes are an integral part of these statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	2000	1999	2000
Current Liabilities:			
Short-term borrowings (Note 7)	¥ 1,150	¥ 1,190	\$ 10,849
Current portion of long-term debt (Note 7)	—	9,869	—
Trade payables:			
Notes	4,819	16,990	45,462
Accounts	27,107	14,945	255,727
	31,926	31,935	301,189
Accrued income taxes (Notes 2 and 8)	3,585	3,731	33,821
Accrued expenses	5,526	5,768	52,132
Employees' saving deposits and other current liabilities	2,649	2,920	24,990
Total Current Liabilities	44,836	55,413	422,981
Long-term Debt (Note 7)	17,005	17,005	160,424
Retirement and Severance Benefits (Note 2)	10,613	11,103	100,123
Minority Interests	518	445	4,887
Shareholders' Equity (Note 9):			
Common stock of ¥50 par value			
Authorized—600,000,000 shares			
Issued and outstanding—168,180,971 shares			
in 2000 and 1999	13,442	13,442	126,811
Capital surplus	15,858	15,858	149,604
Retained earnings	68,794	59,713	649,000
	98,094	89,013	925,415
Less common stock held in treasury, at cost	2	1	19
Total Shareholders' Equity	98,092	89,012	925,396
Contingent Liabilities (Note 13):			
Total	¥171,064	¥172,978	\$1,613,811

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF INCOME

Dainippon Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2000 and 1999

	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	2000	1999	2000
Net Sales (Note 12)	¥155,497	¥146,452	\$1,466,953
Cost of Sales	97,195	92,889	916,934
Gross Profit	58,302	53,563	550,019
Selling, General and Administrative Expenses (Notes 2 and 10)	45,616	45,603	430,340
Operating Income (Note 12)	12,686	7,960	119,679
Other Income (Expenses):			
Interest and dividend income	1,346	1,584	12,698
Interest expense	(358)	(526)	(3,377)
Other, net	(79)	420	(745)
Income before Income Taxes and Minority Interests	13,595	9,438	128,255
Income Taxes (Notes 2 and 8)			
Current	7,019	6,097	66,217
Deferred	(375)	—	(3,537)
Minority Interests	67	22	632
Net Income	¥ 6,884	¥ 3,319	\$ 64,943

Per Share Amounts (Note 2):

	Yen		U.S. Dollars (Note 3)
Net income	¥40.93	¥19.73	\$0.39
Net income assuming full dilution	39.05	19.16	0.37
Cash dividends	8.50	7.50	0.08

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Dainippon Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
 Years ended March 31, 2000 and 1999

	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	2000	1999	2000
Common Stock (Note 9):			
Balance at beginning of year	¥ 13,442	¥ 13,442	\$ 126,811
Balance at end of year	<u>¥ 13,442</u>	<u>¥ 13,442</u>	<u>\$ 126,811</u>
Capital Surplus (Note 9):			
Balance at beginning of year	¥ 15,858	¥ 15,858	\$ 149,604
Balance at end of year	<u>¥ 15,858</u>	<u>¥ 15,858</u>	<u>\$ 149,604</u>
Retained Earnings (Note 9):			
Balance at beginning of year	¥ 59,713	¥ 58,228	\$ 563,330
Balance of legal reserve at beginning of year	—	2,541	—
Cumulative effect arising from the adoption of deferred tax accounting	3,512	—	33,132
Decrease due to exclusion of an affiliate from application of equity method	—	(3,060)	—
Net income	6,884	3,319	64,943
Cash dividends paid	(1,261)	(1,261)	(11,896)
Bonuses to directors and corporate auditors	(54)	(54)	(509)
Balance at end of year	<u>¥ 68,794</u>	<u>¥ 59,713</u>	<u>\$ 649,000</u>

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Dainippon Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2000 and 1999

	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	2000	1999	2000
Cash flows from operating activities:			
Income before income taxes and minority interests.....	¥13,595	¥ 9,438	\$128,255
Depreciation and amortization.....	3,936	3,629	37,132
Provision for retirement and severance benefits, less payments	(490)	(19)	(4,623)
Interest and dividend income.....	(1,346)	(1,584)	(12,698)
Interest expense.....	358	526	3,377
Loss on sales of short-term investments.....	1,451	—	13,689
Gain from sales of investment securities.....	(1,853)	(1,851)	(17,481)
Decrease (increase) in trade receivable.....	(45)	264	(425)
Decrease (increase) in inventories.....	(407)	675	(3,840)
Increase (decrease) in trade payables.....	(10)	1,446	(94)
Other, net.....	(1,135)	(2,616)	(10,707)
Sub total.....	14,054	9,908	132,585
Interest and dividend received.....	1,346	1,584	12,698
Interest paid.....	(417)	(560)	(3,934)
Income taxes paid.....	(7,165)	(5,499)	(67,594)
Net cash provided by operating activities.....	7,818	5,433	73,755
Cash flows from investing activities:			
Net decrease (increase) in marketable securities.....	8,430	(2,125)	79,528
Additions to property, plant and equipment.....	(1,765)	(6,608)	(16,651)
Payments for purchases of investment securities.....	(186)	(3,739)	(1,755)
Proceeds from sales of investment securities.....	1,900	1,998	17,925
Proceeds from sales of short-term investments.....	3,549	—	33,481
Other, net.....	(140)	487	(1,321)
Net cash provided by (used in) investing activities.....	11,788	(9,987)	111,207
Cash flows from financing activities:			
Net decrease in short-term borrowings.....	(40)	(500)	(377)
Redemption of convertible bonds.....	(9,869)	(785)	(93,104)
Dividends paid.....	(1,261)	(1,261)	(11,896)
Dividends paid to minority interests.....	(7)	(10)	(66)
Other, net.....	(1)	(0)	(10)
Net cash used in financing activities.....	(11,178)	(2,556)	(105,453)
Net increase (decrease) in cash and cash equivalents..	8,428	(7,110)	79,509
Cash and cash equivalents at beginning of year.....	24,244	31,354	228,717
Cash and cash equivalents at end of year (Note 4)	¥32,672	¥24,244	\$308,226

The accompanying notes are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Dainippon Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2000 and 1999

1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements are prepared from the consolidated financial statements presented for domestic reporting purposes. Dainippon Pharmaceutical Co., Ltd. (the "Company") and its consolidated subsidiaries maintain their accounts and records in accordance with the provisions set forth in the Japanese Commercial Code and in conformity with generally accepted accounting principles and practices in Japan.

In preparing these consolidated financial statements, certain reclassifications have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan, but no change has been

made in the application of accounting policies. In 2000, the Company and its consolidated subsidiaries adopted the Accounting Standard for Consolidated Statement of Cash Flows issued by the Business Accounting Deliberation Council. Accordingly, the consolidated statement of cash flows for the year ended March 31, 1999 has been restated in accordance with the new standard.

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries with minor exceptions. All significant intercompany balances and transactions have been eliminated in consolidation.

2. Significant Accounting Policies

(a) Marketable securities and investments in securities

Marketable securities and investments in marketable securities are stated at the lower of cost or market value, cost being determined by the moving average method.

Other investments in securities are carried at cost. (Note 6)

(b) Inventories

Inventories are stated at cost, being determined by the average method. (Note 5)

(c) Investments

Investments in non-consolidated subsidiaries and affiliates are stated at cost, and the Company's equity in undistributed earnings of these companies is not significant.

Other investments are carried at cost.

(d) Depreciation

Depreciation of buildings is computed under the straight-line method at rates based on the estimated useful lives of the assets.

Depreciation of machinery and equipment is computed under the declining-balance method at rates based on the estimated useful lives of the assets.

Ranges of useful lives used in the computation of depreciation are mainly as follows;

Buildings 7-50 years

Machinery and equipment 4-14 years

(e) Income taxes

Income taxes were provided for amounts currently payable for the year ended March 31, 1999 and no deferred taxes were recognized in the financial statements of the Company and its consolidated subsidiaries. Effective April 1, 1999, the Company and its consolidated subsidiaries adopted the new accounting standard which recognizes the future tax consequences of temporary differences between the carrying amount and tax basis of assets and liabilities. The amount of deferred income taxes attributable to the net tax effects of the temporary differences at April 1, 1999 is reflected as an adjustment of ¥3,512 million (\$33,132 thousand) to the retained earnings. Prior year's consolidated financial statements were not restated. The effect for the year ended March 31, 2000 was to

increase net income by ¥349 million (\$3,292 thousand). (Note 8)

(f) Research and development expenses

Research and development expenses are charged to income as incurred. (Note 10)

(g) Retirement and severance benefits

Upon retirement or termination of employment, employees are normally entitled to lump-sum and/or annuity payments based on current rate of pay and length of service.

The Company and one of the consolidated subsidiaries have non-contributory funded pension plans for qualified employees. The pension benefits under these plans cover approximately 70% of total benefits with respect to such employees. The balance of benefits is covered by the lump-sum plan which is unfunded.

The liabilities for retirement and severance benefits in the consolidated balance sheets are stated at the amount which would be required to be paid if all employees covered by the plans voluntarily terminated their employment at the balance-sheet date, less the amounts being funded under the pension plans.

In addition, directors and corporate auditors are customarily entitled to lump-sum payments under the unfunded retirement plan. Provisions of retirement and severance allowances for those officers have been made at the estimated amounts.

(h) Net income and cash dividends per share

Net income per share of common stock is based upon the weighted average number of shares of common stock outstanding during each year.

Net income per share of common stock assuming full dilution is based on the assumption of full conversion of the outstanding convertible bonds at the beginning of the years (or at the time of issuance if later) with an applicable adjustment for related interest expense net of tax.

Cash dividends per share shown for each year in the consolidated statements of income represent dividends declared as applicable to the respective period.

(i) Cash and cash equivalents

Cash and cash equivalents include all highly liquid investments, gen-

erally with original maturities of three months or less, that are readily convertible to known amounts of cash and are so near maturity that they present insignificant risk of changes in value because of changes in interest rates.

(j) *Foreign currency items*

Foreign currency amounts are translated into Japanese yen at year-end rates for current monetary assets and liabilities and at historical rates for all other assets and liabilities except for those hedged by forward exchange contracts. Revenue and expense items denominated in foreign currencies are translated at historical rates.

Exchange gains or losses are charged or credited to income as incurred.

3. Translation into United States Dollars

The accompanying consolidated financial statements presented herein are expressed in Japanese yen and, solely for the convenience of the readers, have been translated into United States dollars at the rate of ¥106=U.S.\$1, the approximate exchange rate on March 31,

(k) *Finance leases*

Under Japanese accounting principles for leases, finance leases that are deemed to transfer the ownership of the leased property to the lessee are capitalized, while other finance leases are permitted to be accounted for as operating lease transactions, if certain "as if capitalized" information is disclosed in the notes to the lessee's financial statements. Financial leases which are not deemed to transfer the ownership are accounted for in the same manner as operating leases for the Company and its consolidated subsidiaries. (Note 11)

2000. The translation should not be construed as representations that Japanese yen amounts have been, could have been, or could in the future be converted into United States dollars.

4. Cash and Cash Equivalents

Cash and cash equivalents at March 31, 2000 and 1999 for consolidated statements of cash flows consist of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2000	1999	2000
Cash and time deposits	¥32,540	¥20,110	\$306,981
Time deposits with maturity over three months	(79)	(101)	(745)
Marketable securities with a maturity of three months or less when purchased	211	4,235	1,990
Cash and cash equivalents	<u>¥32,672</u>	<u>¥24,244</u>	<u>\$308,226</u>

5. Inventories

Inventories at March 31, 2000 and 1999 comprise the following:

	Millions of Yen		Thousands of U.S. Dollars
	2000	1999	2000
Finished goods	¥10,041	¥10,892	\$ 94,726
Semi-finished goods and work in process	4,407	3,476	41,575
Raw materials and supplies	3,557	3,230	33,557
	<u>¥18,005</u>	<u>¥17,598</u>	<u>\$169,858</u>

6. Marketable Securities and Investments in Securities

The carrying value and aggregate market value of marketable securities (current assets) and investments in securities (non-current assets) at March 31, 2000 and 1999 comprise the following:

	Millions of Yen				Thousands of U.S. Dollars	
	2000		1999		2000	
	Current	Non-current	Current	Non-current	Current	Non-current
Carrying value	¥1,599	¥10,456	¥10,216	¥10,737	\$15,085	\$ 98,642
Aggregate market value	4,432	32,265	10,218	33,293	41,811	304,387
Net unrealized gain	<u>¥2,833</u>	<u>¥21,809</u>	<u>¥ 2</u>	<u>¥22,556</u>	<u>\$26,726</u>	<u>\$205,745</u>

7. Short-term Borrowings and Long-term Debt

Short-term borrowings are represented by unsecured loans from banks bearing interest of 0.59% to 2.49% at March 31, 2000 and 1999. Other current liabilities include deposits received from cus-

tomers in the amount of ¥738 million (\$6,962 thousand) and ¥783 million (\$7,387 thousand), bearing interest of 3.0% as of March 31, 2000 and 1999, respectively.

Long-term debt at March 31, 2000 and 1999 comprise the following:

	Millions of Yen		Thousands of U.S. Dollars
	2000	1999	2000
1.8% unsecured convertible bonds due 1999	¥ —	¥ 9,869	\$ —
1.9% unsecured convertible bonds due 2001	5,884	5,884	55,509
1.4% unsecured convertible bonds due 2003	11,121	11,121	104,915
	<u>17,005</u>	<u>26,874</u>	<u>160,424</u>
Less current portion	—	9,869	—
	<u>¥17,005</u>	<u>¥17,005</u>	<u>\$160,424</u>

The aggregate annual maturities of long-term debt at March 31 2000 are as follows:

Year ending March 31:	Millions of Yen	Thousands of U.S. Dollars
2001	—	—
2002	¥ 5,884	\$ 55,509
2003	—	—
2004	11,121	104,915
2005 and thereafter	—	—
	<u>¥17,005</u>	<u>\$160,424</u>

On June 26, 1989, the Company issued 1.9% unsecured convertible bonds due September 28, 2001 in an aggregate amount of ¥15,000 million (\$141,509 thousand). The conversion price per share of common stock is ¥2,270.1 (\$21.42) on March 31, 2000. Under the indentures, the conversion price is subject to adjustment in certain cases which include stock splits. The bonds are redeemable at the option of the Company, in whole or in part, at prices which range from 105% to 100% of the principal amount on any date after October 1, 1995. The 1.9%, maturing in 2001, convertible bond indentures provide that, if any other convertible bonds are secured by mortgage on property, plant and equipment in the future, the bonds should also be covered to the same degree by such mortgage, and so long as any of the above convertible bonds are outstanding, accumulated annual cash dividends may not exceed accumulated non-consolidated net income plus ¥5,500 million (\$51,887 thousand) after March 31, 1990.

On September 30, 1994, the Company issued 1.4% unsecured convertible bonds due September 30, 2003, in an aggregate amount of ¥12,000 million (\$113,208 thousand). The conversion

price per share of common stock is ¥1,093 (\$10.31) on March 31, 2000. Under the indentures, the conversion price is subject to adjustment in certain cases which include stock splits. The bonds are redeemable at the option of the Company, in whole or in part, at prices which range from 103% to 100% of the principal amount on any date after October 1, 1999. The 1.4%, maturing in 2003, convertible bond indentures provide that, if any other convertible bonds are secured by mortgage on property, plant and equipment in the future, the bonds should also be covered to the same degree by such mortgage.

As is customary in Japan, short-term and long-term bank loans are made under general agreements which provide that security and guarantees for future and present indebtedness will be given upon request of the bank, and that the bank shall have the right, as the obligations become due, or in case of default, to offset cash deposits against such obligations due to the bank.

None of the lenders has ever exercised these rights against debts of the Company and its consolidated subsidiaries.

8. Income Taxes

The Company and its subsidiaries are subject to a number of taxes which, in the aggregate, indicate a statutory tax rate in Japan of approximately 42.0% for the year ended March 31, 2000 and

approximately 47.0% for the year ended March 31, 1999. This rate was used in calculating the tax effects of temporary differences as of April 1, 1999 and March 31, 2000.

Reconciliation of the differences between the statutory tax rate and the effective tax rate for the year ended March 31, 2000 is as follows :

Statutory tax rate	42.0%
Increase (reduction) in taxes resulting from:	
Expenses not deductible for tax purposes	8.3
Non-taxable dividend income	(3.6)
Other	2.1
Effective tax rate	48.8

Significant components of deferred tax assets and liabilities as of March 31, 2000 are as follows :

	Millions of Yen	Thousands of U.S. Dollars
Deferred tax assets :		
Retirement and severance benefits	¥1,861	\$17,557
Accrued expenses	1,275	12,028
Other	826	7,792
Total deferred tax assets	¥3,962	\$37,377
Deferred tax liabilities :		
Deferred gain on sales of fixed assets	¥ (54)	\$ (509)
Other	(4)	(38)
Total deferred tax liabilities	¥ (58)	\$ (547)
Net deferred tax assets	¥3,904	\$36,830

9. Shareholders' Equity

The Japanese Commercial Code provides that an amount equivalent to at least 10% of the total amount such as cash dividends and bonuses to directors and corporate auditors paid by a Japanese company be appropriated as a legal reserve until such legal reserve equals 25% of stated capital. This reserve amounted to ¥2,837 million (\$26,764 thousand) and ¥2,704 million (\$25,509 thousand) at March 31, 2000 and 1999, respectively. This reserve, included in retained earnings, is not available for distribution as dividends but may be used to reduce a deficit or be transferred to stated capital.

Under the Japanese Commercial Code, at least one-half of the issue price of new shares, with a minimum of the par value thereof, is required to be designated as stated capital. The portion which is to be designated as stated capital is determined by resolution of the Board of Directors. Proceeds in excess of the amounts designated as

stated capital have been credited to additional paid-in capital included in capital surplus.

Cash dividends charged to retained earnings during the years ended March 31, 2000 and 1999 represent dividends paid out during the years.

The accompanying 2000 fiscal year consolidated financial statements do not include any provision for the dividends of ¥4.75 (\$0.04) per share aggregating ¥799 million (\$7,538 thousand) applicable to the six months ended March 31, 2000, approved on June 29, 2000.

However, cash dividends per share shown in the accompanying statements of income reflect dividends approved at the general meeting of shareholders after the end of the relevant fiscal year.

10. Research and Development Expenses

Research and development expenses included in selling, general and administrative expenses for the years ended March 31, 2000 and 1999 were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2000	1999	2000
	¥12,079	¥12,276	\$113,953

11. Leases

At March 31, 2000, assets leased under non-capitalized financial leases are as follows:

	Millions of Yen	Thousands of U.S. Dollars
Machinery and equipment		
Acquisition cost	¥2,205	\$20,802
Less accumulated depreciation	1,233	11,632
Net	¥ 972	\$ 9,170

Depreciation expense for the year ended March 31, 2000 amounted to ¥516 million (\$4,868 thousand). The above “as if capitalized” depreciation is calculated using the straight-line method over the lease terms.

Future minimum lease payments, inclusive of interest, under such leases at March 31, 2000 are as follows:

	Millions of Yen	Thousands of U.S. Dollars
Due within one year	¥442	\$4,170
Due after one year	530	5,000
Total	¥972	\$9,170

Lease expenses for the year ended March 31, 2000 amounted to ¥516 million (\$4,868 thousand).

12. Segment Information

The Company and its consolidated subsidiaries operate principally in the manufacture and sales of three business segments—pharmaceuticals, animal health products and other products.

The business segment information of the Company and its consolidated subsidiaries for the year ended March 31, 2000, is as follows:

	Millions of Yen					
	2000					
	Pharmaceuticals	Animal health Products	Other Products	Total	Eliminations	Consolidated
I Sales and Operating income						
Sales to customers	¥108,981	¥22,412	¥24,104	¥155,497	¥ —	¥155,497
Inter-segment sales/transfers	—	—	1,602	1,602	(1,602)	—
Total	108,981	22,412	25,706	157,099	(1,602)	155,497
Operating expenses	95,342	21,849	24,340	141,531	1,280	142,811
Operating income	13,639	563	1,366	15,568	(2,882)	12,686
II Identifiable assets, depreciation and capital expenditures						
Identifiable assets	93,141	7,624	13,810	114,575	56,489	171,064
Depreciation	2,737	96	151	2,984	215	3,199
Capital expenditures	1,659	76	136	1,871	170	2,041
	Thousands of U.S. Dollars					
	2000					
	Pharmaceuticals	Animal health Products	Other Products	Total	Eliminations	Consolidated
I Sales and Operating income						
Sales to customers	\$1,028,123	\$211,434	\$227,396	\$1,466,953	\$ —	\$1,466,953
Inter-segment sales/transfers	—	—	15,113	15,113	(15,113)	—
Total	1,028,123	211,434	242,509	1,482,066	(15,113)	1,466,953
Operating expenses	899,453	206,123	229,623	1,335,199	12,075	1,347,274
Operating income	128,670	5,311	12,886	146,867	(27,188)	119,679
II Identifiable assets, depreciation and capital expenditures						
Identifiable assets	878,689	71,925	130,283	1,080,897	532,914	1,613,811
Depreciation	25,821	906	1,425	28,152	2,027	30,179
Capital expenditures	15,651	717	1,283	17,651	1,604	19,255

Each business segment comprises the following:

Business Segment	Major Product
Pharmaceuticals	Cardiovascular system drugs Antibacterial and antibiotic agents Central nervous system and antiallergic drugs Nutrients, hormones and vitamins Diagnostics
Animal health Products	Animal health products Feeds and feed additives
Other Products	Food additives Other products (industrial chemicals, research reagents and instruments, etc.)

Geographical segment information and overseas sales information are not disclosed, because none of the Company's consolidated subsidiaries is located outside Japan, and the overseas sales of the

Company and its consolidated subsidiaries for the year ended March 31, 2000 were less than 10% of consolidated net sales.

13. Contingent Liabilities

Contingent liabilities for guarantees of indebtedness of an affiliate, and employees' housing loans guaranteed at March 31, 2000 were as follows:

	Millions of Yen	Thousands of U.S. Dollars
	2000	2000
Guarantees of indebtedness	¥1,582	\$14,925
Loans guaranteed	70	660

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To The Board of Directors of
Dainippon Pharmaceutical Co., Ltd.

We have examined the consolidated balance sheets of Dainippon Pharmaceutical Co., Ltd. and its consolidated subsidiaries as of March 31, 2000 and 1999, and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended, all expressed in Japanese yen. Our examinations were made in accordance with auditing standards, procedures and practices generally accepted in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of Dainippon Pharmaceutical Co., Ltd. and its consolidated subsidiaries as of March 31, 2000 and 1999, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles and practices generally accepted in Japan applied on a consistent basis.

As explained in Note 2 (e) to the consolidated financial statements, since April 1, 1999, the new accounting standard on Accounting for Effects of Income Taxes has been adopted by the Company and its consolidated subsidiaries.

Osaka, Japan
June 29, 2000



Seiwa Audit Corporation

CORPORATE INFORMATION

Dainippon Pharmaceutical Co., Ltd. and Consolidated Subsidiaries

CORPORATE DATA (As of March 31, 2000)

Foundation

May 14, 1897

Capital

13,442 million yen

Number of Employees

2,682

Head Office

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103-0023

Tel 03-3270-2011

Osaka Plant

5-51 Ebie 1-chome, Fukushima-ku,

Osaka 553-0001

Tel 06-6454-8151

Suzuka Plant

1450 Yasuzuka-cho, Suzuka City 513-0818

Tel 0593-82-8951

Research Laboratories

33-94 Enoki-cho, Suita City 564-0053

Tel 06-6337-5876

Branch Offices

Sapporo, Sendai, Tokyo 1st, Tokyo 2nd,

Yokohama, Koshin-etsu, Nagoya, Kyoto, Osaka,

Hiroshima, Takamatsu, Fukuoka

CONSOLIDATED SUBSIDIARIES

Gokyo Trading Co., Ltd.

Nichiei Sangyo Co., Ltd.

Marupi Drug Co., Ltd.

Marupi Butsuryu Service Co., Ltd.

BOARD OF DIRECTORS (As of June 29, 2000)

Chairman and
Representative Director

Takeshi Tomotake

President and
Representative Director

Kenjiro Miyatake

Managing Directors

Keiji Ohtsu

Yutaka Sekine

Tadashi Inoue

Directors

Tomio Fujiwara

Toshiro Funakura

Tadahiko Karasawa

Hisashi Fujita

Ichiro Murayama

Noriaki Shimokawa

Full-Time Corporate Auditors

Mutsuo Harada

Hiroshi Murase

Corporate Auditors

Michihiro Ishii

Koichi Yoshida

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