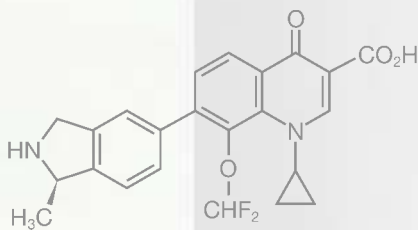


Annual Report

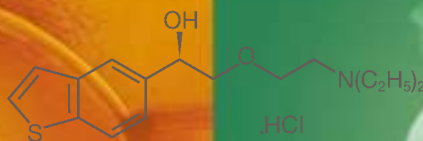
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FOR THE YEAR ENDED

MARCH 31, 2004

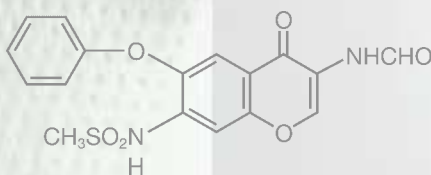


ANTI-INFECTIVE  
AGENTS



CNS AND  
CARDIOVASCULAR DRUGS

Toyama  
Chemical



ANTI-INFLAMMATORY  
AGENTS

# Building the Future through Progressive Research

## Profile

At Toyama Chemical Co., Ltd., we are working to strengthen our new drug development and manufacturing technologies by focusing on our ethical drugs business and investing management resources in the three core areas of anti-infective agents; central nervous system (CNS) and cardiovascular drugs; and anti-inflammatory agents. Our aim is to contribute to the further development of global health care through new drug development. In fiscal 2004, ended March 31, 2004, our discovery research and clinical development work generated important results. In June 2004, we signed a licensing agreement with U.S. firm Schering-Plough Corporation for the new-type quinolone synthetic antibacterial agent T-3811, which exhibits superior antibacterial potency, has a good safety profile and has been the focus of attention at international conferences on drug therapy. Preparations are under way to file this compound for approval. As a result of these and other efforts, Toyama Chemical has established a much more significant presence under its slogan, "Making Toyama Chemical a high-tech company."

Looking ahead, we are aiming to stabilize our earnings. We will achieve this by expanding sales through our sales affiliate Taisho Toyama Pharmaceutical Co., Ltd., which has now begun full-scale sales activities, and by expanding bulk supplies to partner companies and increasing royalty income, thereby maximizing the value of our advanced research and production technologies.

## Contents

1	Message from the President
9	Six-Year Financial Summary
10	Management's Discussion and Analysis of Operating Results and Financial Position
12	Consolidated Balance Sheets
14	Consolidated Statements of Operations
15	Consolidated Statements of Shareholders' Equity
16	Consolidated Statements of Cash Flows
17	Notes to Consolidated Financial Statements
29	Independent Auditors' Report
30	Business Risks
31	Corporate Information
33	Main Products
33	Investor Information

## Cautionary Statement with Respect to Forward-Looking Statements

Statements made in this annual report with respect to Toyama Chemical's plans, strategies and beliefs, and other statements that are not historical facts are forward-looking statements about the future performance of Toyama Chemical which are based on management's assumptions and beliefs in light of information currently available to it, and involve certain risks and uncertainties.

# Message from the President

**Katsuhiko Nakano**

*Director, President and Chief Executive Officer*



Competition is intensifying in the Japanese pharmaceutical industry. There is increasing pressure on drug prices following revisions to the Pharmaceutical Affairs Law and reforms aimed at strengthening the health insurance system. This is curbing market growth. The industry is also restructuring because of merger and acquisition (M&A) activities and the entry of overseas-based pharmaceutical firms following deregulation.

In this unfavorable domestic operating climate, Toyama Chemical is laying the foundations for growth and actively moving into overseas markets through technology partnerships. Companies are increasingly being valued for their expertise and know-how rather than for their product portfolios, so we are leveraging our strengths in research and production technologies and emphasizing business development based on our core research results, with the goal of further developing our business.

## Financial Highlights

Toyama Chemical Co., Ltd. and Consolidated Subsidiaries  
For the Years Ended March 31, 2004 and 2003

	Millions of Yen (Except Per Share Amounts)		Thousands of U.S. Dollars (Except Per Share Amounts)
	2004	2003	2004
<b>OPERATING RESULTS:</b>			
Gross revenue	¥16,831	¥32,998	\$158,783
Net sales	16,227	24,983	153,083
Royalty income	604	8,015	5,700
Operating profit (loss)	(4,369)	2,225	(41,213)
Net loss	(4,900)	(5,166)	(46,220)
<b>PER SHARE DATA (IN YEN AND U.S. DOLLARS):</b>			
Net loss	¥ (24.91)	¥ (29.37)	\$ (0.235)
Cash dividends applicable to the year	—	—	—
<b>FINANCIAL POSITION:</b>			
Total shareholders' equity	¥31,031	¥37,166	\$292,743
Total assets	73,970	89,896	697,827
<b>OTHER DATA:</b>			
Research and development expenses	¥ 5,161	¥ 5,088	\$ 48,686
Research and development expenses as a percentage of gross revenue	30.7%	15.4%	

Note: U.S. dollar amounts represent translations of Japanese yen amounts at the rate of ¥106=US\$1, the approximate rate of exchange at March 31, 2004.

## Results for Fiscal 2004

Our fiscal 2004 results were extremely unfavorable. Despite increasing market competition, sales grew steadily for the new bag formulation of our mainstay injectable penicillin antibiotic PENTCILLIN, the loop diuretic LUPRAC and the injectable synthetic antibacterial agent PASIL. However, we recorded a decline in sales of the oral synthetic antibacterial agent OZEX and the oral cephem antibiotic TOMIRON, due to the delayed start of sales activities at Taisho Toyama Pharmaceutical. In addition, despite payments from the filing of the oral antirheumatic agent T-614

## *Aiming to Become Japan's Leading*

(brand name: Kolbet) and the out-licensing of TN-3262a (OZEX eye drops), royalty income declined substantially as the official signing of the re-licensing contract for the development and sales rights to T-3811, which had been scheduled for the fiscal year under review, has been delayed until fiscal 2005.

During fiscal 2004, we achieved consolidated gross revenue of ¥16,831 million, compared with ¥32,998 million in the previous period. This amount included ¥16,227 million in net sales and ¥604 million in royalty income. As products with high manufacturing costs accounted for a higher proportion of sales, we recorded a loss before income taxes and minority interests of ¥5,550 million, compared with income before income taxes and minority interests of ¥81 million in the previous period, and a net loss of ¥4,900 million, compared with ¥5,166 million.

### Progress in the Medium-Term Management Plan

Through our Medium-Term Management Plan 2003–2005, which began in July 2003, we aim to become Japan's leading drug development company in the field of infectious diseases.

In fiscal 2004, we achieved a major success when we announced a letter of intent for T-3811, which is expected to become a blockbuster anti-infective agent. T-3811 was originally licensed out to U.S. firm Bristol-Myers Squibb Company (BMS)

in 1998 and has since been undergoing global clinical development. Studies have already shown superior efficacy in the treatment of respiratory and surgical infections. In October 2003, Toyama Chemical reacquired all rights to the compound as BMS declined to renew the contract for commercial reasons. In June 2004, we successfully concluded a licensing agreement for T-3811 with U.S. firm Schering-Plough. We expect T-3811 to make a substantial revenue contribution, generating US\$325 million from milestone payments and sales from bulk supplies.

Although Toyama Chemical only invests around ¥5,000 million each year in research and development, we are relatively more productive than other companies, as evidenced by the origination of T-3811. In order to strengthen our technological capabilities, we are focusing our business in selected core areas and plan to build a pipeline that can deliver one new drug launch every two years. Thus far, we have streamlined our systems, spinning off sales operations with the establishment of Taisho Toyama Pharmaceutical during fiscal 2003 and terminating the sale of over-the-counter (OTC) products and industrial chemicals at the end of fiscal 2004. In the future, we plan to actively invest our management resources in research and development. By 2009, we aim to have expanded our research facilities and increased research staff numbers approximately twofold in a bid to accelerate drug development.

### *Stabilization of three profit bases*

Revenue from ethical drug sales through Taisho Toyama Pharmaceutical

Royalty income from the out-licensing of compounds developed in-house

Revenue from the bulk supplying of drugs and drug products to partner companies

# Drug Development Company in the Field of Infectious Diseases

## Research and Development

*Anti-infective agents*

*CNS and cardiovascular drugs*

*Anti-inflammatory agents*



# T-3811 T-5888 T-614

## Production

*Production systems linked to research divisions*

*Start of production on a contract basis*



## Sales and Marketing

*Sales through Taisho Toyama Pharmaceutical*



## Research and Development

Our goal is to develop new drugs as quickly as possible and make them rapidly available on global markets. We have efficiently focused our research resources in the three core areas of anti-infective agents; CNS and cardiovascular drugs; and anti-inflammatory agents. We have also constructed a clinical development system that encompasses Japan, the United States and Europe.

Of these three core areas, most of our research involves investigations into anti-infective agents. We are working to generate promising drug compounds as successors to injectable synthetic antibacterial agent PASIL, which was launched in September 2002 as the first such compound to be produced in Japan. In fiscal 2004, the clinical trials necessary for U.S. filing were completed for T-3811, which appears ever more likely to become a blockbuster. Schering-Plough has therefore been able to start preparations for filing. As well as T-3811, we are also developing a number of other anti-infective agents, including TN-3262a, an eye-drop formulation of a new quinolone synthetic antibacterial agent that was jointly developed with Nidek Co., Ltd. TN-3262a has already been filed for approval.

In the area of CNS and cardiovascular drugs, T-588 is a treatment for Alzheimer's-type dementia and sequelae of cerebrovascular disorders. It may also prove effective against glaucoma. At the non-clinical stage, T-817MA is drawing attention at medical society meetings for its potent neuroprotective effect, and it could become an even bigger blockbuster than T-3811.

In the area of anti-inflammatory agents, T-614 (brand name: Kolbet), which was jointly developed with Eisai and is used for

## *Selected Research Candidates*

### T-614

**Highly efficacious antirheumatic agent that may be effective in cases not responsive to other drugs**

Disease-modifying antirheumatic drugs (DMARDs), which are used as pharmacotherapy to treat rheumatoid arthritis, control the immunological abnormalities thought to cause inflammatory disease, so they are now recommended for use during the early stages of rheumatoid arthritis. Clinical trials to date have demonstrated that T-614 is effective regardless of the degree of severity, disease duration and treatment history. The compound has been filed for approval in Japan.

### T-3811

**New-type quinolone synthetic antibacterial agent**

T-3811 has a different structure to conventional quinolones. It exhibits potent antibacterial activity against various pathogens, such as those causing respiratory infections, including multi-drug resistant strains. The drug also has significantly lower joint toxicity, so it may also be approved for pediatric use.

### T-5226 (AP-1 inhibitor)

**Antirheumatic agent that targets the transcription factor activator protein-1 (AP-1)**

By blocking AP-1, T-5226 can suppress both joint destruction and immunological abnormalities, thereby giving it the potential to become a basic remedy for rheumatoid arthritis. In March 2000, the Japan Science and Technology Corporation selected Toyama Chemical as the contract organization for the domestic development of this agent. The compound is scheduled for Phase I trials in 2005.

Development Code or Compound	Formulation	Therapeutic Category	Region	Development and Licensing	Stage	Remarks
T-614	Oral	Antirheumatic agent	Japan	Originally developed in-house by Toyama Chemical. Currently undergoing further joint development with Eisai Co., Ltd.	Filed	Brand name: Kolbet
			South Africa	Developed in-house by Toyama Chemical	Phase IIa completed	
			South Korea	Licensed out to Dong-A Pharmaceutical Co., Ltd.		
PASIL	Injection	New quinolone synthetic antibacterial agent	Japan	Currently undergoing further joint development with Mitsubishi Pharma Corporation	Filed	Additional indication for <i>Legionella</i> infection
TN-3262a	Eye drops	New quinolone synthetic antibacterial agent	Japan	Originally developed in-house by Toyama Chemical. Currently undergoing further joint development with Nidek. Licensed out to Otsuka Pharmaceutical Co., Ltd. (Sales and marketing only)	Filed	
			South Korea	Licensed out to Dong-A Pharmaceutical		
T-3811	Oral	New-type quinolone synthetic antibacterial agent	Japan	Originally developed in-house by Toyama Chemical. Currently undergoing further joint development with Taisho Pharmaceutical Co., Ltd.	Phase III	Generic name: Garenoxacin
	Injection				Phase I	
	Oral/injection		Worldwide, except Japan, South Korea and China	Licensed out to U.S. firm Schering-Plough	Preparing to file	
T-588	Oral	Treatment for Alzheimer's-type dementia and sequelae of cerebrovascular disorders	Japan	Developed in-house by Toyama Chemical	Phase II	
			United Kingdom		Phase IIa completed	
T-5226 (AP-1 inhibitor)	Oral	Antirheumatic agent	Japan	Developed in-house by Toyama Chemical	Non-clinical	

the treatment of rheumatoid arthritis, was filed for approval in September 2003. Over the next one or two years, we plan to add to our pipeline T-5226, which is expected to provide a basic remedy for rheumatoid arthritis.

### Production Systems

At Toyama Chemical, we emphasize product quality control and are actively working to improve all our production technologies used in-house, for example, by improving our competitive capabilities in terms of technology, quality, safety and cost. At the Toyama Factory, we mainly manufacture antibiotics, producing penicillin injections, cephem internal antibiotics and general internal products. These products are manufactured in separate buildings, right through to the final packaging stages. The general internal drug line is a highly automated system that includes unmanned transport systems and other facilities. In order to safely produce high-quality products, our quality control and manufacturing management systems comply with current Good Manufacturing Practice (cGMP) guidelines and we have also developed production hardware to support these systems. At the 2nd Toyama Factory, we manufacture investigational drugs in compliance with cGMP guidelines in a bid to accelerate the various drug development procedures. This expertise in

production technology has allowed us to build a successful track record in out-licensing compounds.

In the future, we plan to contribute to new drug development through continued improvements in our production technologies, while strengthening the links between the production and R&D divisions. We aim to leverage our production technologies to expand our contract-basis manufacturing operations and to continue establishing independent production systems.

### Taisho Toyama Pharmaceutical

Taisho Toyama Pharmaceutical is a sales company established in October 2002 through the merger of the ethical drugs sales divisions at Toyama Chemical and Taisho Pharmaceutical, with a view to strengthening our ethical drug sales capabilities. The company has now begun full-scale sales activities, having completed during fiscal 2004 such preparatory stages as unifying the sales styles of each company's medical representatives (MRs), reviewing sales territories, decreasing channel inventories and liaising with client wholesalers.



## *Taisho Toyama Pharmaceutical*

Toyama Chemical and Taisho Pharmaceutical have jointly established Taisho Toyama Pharmaceutical, which combines the two companies' domestic ethical drug sales and marketing functions.

#### COMPANY PROFILE

- Paid-In Capital: ¥1 billion
- Percentage of Shares Held by Each Company:  
Taisho Pharmaceutical, 55%  
Toyama Chemical, 45%
- Number of Employees: 1,256

(As of April 1, 2004)

A worker in a white protective suit and mask is working on a car engine. The worker is wearing a white hooded suit, a white mask covering their nose and mouth, and safety glasses. They are leaning over the open hood of a car, with their hands near the engine compartment. The background is dark and out of focus, showing parts of the car's interior and exterior.

## ISO 14001

Since making our environmental declaration in 1996, we have actively implemented measures to protect the environment. We began building an environmental management system (EMS) in 1999, defined our basic policy and strategy on the environment in 2000, and have obtained ISO 14001 certification for the Toyama Works. Furthermore, we aim to achieve ISO 14001 certification for all company systems, including the head office, by 2006.


## Corporate Governance and Compliance

In line with our corporate vision of contributing to the further development of global health care through new drug development, we have positioned the improvement of enterprise value as one of the most important challenges facing management and have been working to improve our corporate governance systems over a long period of time. We moved to a “committee system” in June 2003, and have developed more transparent management practices and built highly effective systems for business administration.

In addition, we have formulated the Compliance Policy and established the Compliance Committee under the control of the Chief Executive Officer. We have also appointed a Compliance Director and established the Legal & Compliance Division to ensure that corporate activities are pursued in accordance with the Compliance Policy.



## Outlook for Fiscal 2005

In fiscal 2005, ending March 31, 2005, we expect sales of mainstay products oral cephem antibiotic TOMIRON and synthetic antibacterial agent OZEX to recover, arresting the previous decline, as Taisho Toyama Pharmaceutical has now begun full-scale sales activities. We also forecast a return to sales growth for the injectable antibiotic PENTCILLIN, thanks to revenue

contributions from the new bag formulation. We expect steady sales growth for the loop diuretic LUPRAC and injectable synthetic antibacterial agent PASIL, which was introduced in September 2002. In June 2004, we successfully concluded a licensing agreement for the new-type quinolone synthetic antibacterial T-3811 with U.S. firm Schering-Plough and anticipate royalty income of US\$80 million from this agreement.

By securing these revenues, efficiently investing in new drug launches and pursuing management reforms, in fiscal 2005 we expect to achieve consolidated gross revenue of ¥24,800 million and net income of ¥500 million.

Toyama Chemical intends to overcome the fierce competition in the global pharmaceutical market and achieve new growth through further improvements to its new drug development capabilities, a key area of expertise. We also aim to originate blockbuster drugs as quickly as possible and increase our presence under the slogan, “Making Toyama Chemical a high-tech company.”

We look forward to the continued support and encouragement of all our shareholders and investors, and from all other stakeholders in Toyama Chemical.

September 2004



Katsuhiko Nakano  
Director, President and Chief Executive Officer

## Six-Year Financial Summary

Toyama Chemical Co., Ltd. and Consolidated Subsidiaries  
Years Ended March 31,

	Millions of Yen (Except Per Share Amounts)					
	2004	2003	2002	2001	2000	1999
<b>OPERATING RESULTS:</b>						
Gross revenue	¥16,831	¥32,998	¥28,345	¥36,672	¥46,802	¥45,094
Net sales	16,227	24,983	28,263	35,460	45,579	43,185
Royalty income	604	8,015	82	1,212	1,223	1,909
Cost of sales	12,112	11,407	11,513	13,880	16,256	15,131
Selling, general and administrative expenses	9,088	19,366	19,981	24,306	27,097	25,574
Operating profit (loss)	(4,369)	2,225	(3,149)	(1,514)	3,449	4,389
Income (loss) before income taxes and minority interests	(5,550)	81	(3,937)	(4,119)	(7,177)	3,724
Net income (loss)	(4,900)	(5,166)	(2,665)	(2,778)	(4,648)	1,062
<b>PER SHARE DATA (IN YEN):</b>						
Net income (loss)	¥ (24.91)	¥ (29.37)	¥ (17.74)	¥ (18.52)	¥ (31.03)	¥ 7.09
Cash dividends applicable to the year	—	—	—	—	5.00	5.00
<b>FINANCIAL POSITION:</b>						
Total shareholders' equity	¥31,031	¥37,166	¥23,568	¥24,949	¥27,067	¥31,578
Total assets	73,970	89,896	85,686	91,434	89,104	80,555
<b>OTHER DATA:</b>						
Research and development expenses	¥ 5,161	¥ 5,088	¥ 4,893	¥ 6,017	¥ 7,046	¥ 6,617
Depreciation and amortization	1,685	2,130	2,256	2,525	2,711	1,814
Capital expenditures	288	239	471	696	2,009	1,752
<b>FINANCIAL RATIOS (%):</b>						
Net income margin <sup>(1)</sup>	—	—	—	—	—	2.4%
Return on equity (ROE) <sup>(2)</sup>	—	—	—	—	—	3.3
Equity ratio <sup>(3)</sup>	42.0%	41.3%	27.5%	27.3%	30.4%	39.1
Research and development expenses as a percentage of gross revenue	30.7	15.4	17.3	16.4	15.1	14.7
<b>NUMBER OF EMPLOYEES</b>	<b>911</b>	1,635	1,662	1,670	1,721	1,960

Notes: (1) Net income margin = Net income ÷ Gross revenue × 100

(2) ROE = Net income ÷ Average shareholders' equity × 100

(3) Equity ratio = Total shareholders' equity ÷ Total assets × 100

## Management's Discussion and Analysis of Operating Results and Financial Position

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### Financial Policy

Toyama Chemical's financial policy focuses on securing adequate financing and liquidity for its business operations and maintaining a healthy balance sheet. Maintaining a strong level of current assets is a major factor in the Company's liquidity position. With a long-term perspective, Toyama Chemical promotes financial management that supports business-creating plans and meets long-term funding requirements.

Toyama Chemical's basic policy is that long-term debt should meet fundamental funding requirements, such as for capital expenditures, and that short-term loans are raised to meet the Company's working capital requirements.

Toyama Chemical aims to achieve stable and effective funding and aggressively promotes direct fund procurement, such as through the issuance of bonds.

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### Financial Position (At March 31, 2004)

**Current assets:** Total current assets amounted to ¥40,249 million, a decrease of ¥15,943 million from a year earlier. This was largely due to a decline in trade accounts receivable.

**Current liabilities:** The Company had total current liabilities of ¥18,077 million, a decrease of ¥10,733 million from a year earlier. This was primarily due to the net repayment of ¥7,900 million in short-term bank loans, including assets from the partial disposal of some receivables through the liquidization of receivables implemented in March 2004. A further ¥8,000 million in short-term bank loans was converted to long-term debt, and convertible bonds due within one year were transferred from long-term liabilities to current liabilities.

**Net working capital:** Net working capital totaled ¥22,172 million, a decrease of ¥5,210 million from the previous year-end. This was largely due to the liquidization of some receivables and a decline in trade accounts receivable accompanying the transfer of sales functions to Taisho Toyama Pharmaceutical. Surplus working capital was used for the repayment of short-term bank loans. As a result, there has not been any substantial change in the Company's short-term solvency position.

**Property, plant and equipment:** Net property, plant and equipment totaled ¥23,833 million, a decline of ¥1,026 million from a year earlier.

**Investments and other assets:** The Company had total investments and other assets of ¥9,888 million, an increase of ¥1,043 million compared with the previous year-end. This was primarily due to an appraisal gain of ¥1,482 million recorded on the mark-to-market valuation of investment securities at the end of the year.

**Long-term liabilities:** Total long-term liabilities were ¥24,741 million, an increase of ¥1,281 million from a year earlier. As mentioned previously, a total of ¥8,000 million in short-term bank loans was converted to long-term debt in order to stabilize funding from financial institutions, and convertible bonds due within one year were transferred from long-term liabilities to current liabilities. In addition, deferred tax liabilities—land revaluation rose ¥2,103 million, the result of a re-consideration of the possibility of generating a return on each landholding at the end of the current fiscal year, in line with the clarified procedures specified in Audit Committee Report No. 70 of the Japan Institute of Certified Public Accountants (JICPA) published in February 2004.

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### Cash Flows (For Fiscal 2004)

In fiscal 2004, ended March 31, 2004, net cash provided by operating activities amounted to ¥4,974 million, compared with ¥1,120 million in the previous period. This was largely due to a substantial decrease in trade receivables, which more than offset the effect of an increase in inventories and a decrease in other payables. Net cash used in investing activities was ¥5,612 million, compared with net cash provided by investing activities of ¥2,707 million in the previous period, primarily due to purchases of securities. Net cash used in financing activities totaled ¥8,502 million, compared with net cash provided by financing activities of ¥9,363 million in the previous period, partly due to the repayment of short-term loans. As a result of the aforementioned factors, cash and cash equivalents, end of year, amounted to ¥16,938 million, a decrease of ¥9,142 million over the previous fiscal year-end.

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**Analysis of Operating Results**  
**(For Fiscal 2004)**

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**Gross revenue and selling, general and administrative expenses:** In fiscal 2004, net sales amounted to ¥16,227 million and royalty income reached ¥604 million, creating gross revenue of ¥16,831 million. Selling, general and administrative expenses totaled ¥9,088 million. A simple comparison with the previous year's figures is not possible because ethical drug sales were shifted from sales to distributors to sales to Taisho Toyama Pharmaceutical when the latter company began full-scale operations in April 2003. Toyama Chemical has assigned Group staff involved in sales, such as MRs, to Taisho Toyama Pharmaceutical, and transferred related selling expenses, including employee costs, to that same company. Toyama Chemical now supplies products to Taisho Toyama Pharmaceutical at prices that less than compensate for the amount transferred in selling expenses. The Company's net sales and selling, general and administrative expenses have both declined substantially. Royalty income was affected by the delayed signing of a formal contract with U.S. firm Schering-Plough for the re-licensing of development and sales rights to new-type quinolone synthetic antibacterial agent T-3811 (generic name: garenoxacin), which had been scheduled to generate royalty income in fiscal 2004, but which now has been delayed until fiscal 2005.

**Cost of sales:** Cost of sales was ¥12,112 million, an increase of ¥705 million from the previous period, largely due to a change in the proportion of sales accounted for by products with high manufacturing costs.

**Operating profit (loss):** As a result of the aforementioned factors, the Company recorded an operating loss of ¥4,369 million.

**Other income (expenses):** Other expenses—net reached ¥1,181 million, a decrease of ¥963 million from the previous period. This change was due to: a reduction in loss on devaluation of investment securities related to investment security disposal gains and investment security interest; equity in losses of associated company of ¥301 million related to equity-method affiliate Taisho Toyama Pharmaceutical; and a loss on disposal of software and other assets that were made obsolete by the transfer of the Company's sales functions to Taisho Toyama Pharmaceutical.

**Income taxes:** The Company made use of its tax loss carryforwards, so the only income taxes incurred were mainly per capita resident taxes. Total income taxes amounted to a rebate of ¥310 million, as the rebate within deferred income taxes was greater than the amount of current income taxes.

**Minority interests in net income (loss) of consolidated subsidiaries:** The Company recorded minority interests in net loss of consolidated subsidiaries of ¥340 million, largely due to a one-off loss related to the business restructuring of consolidated subsidiary Taiyo Sangyo Co., Ltd.

**Net loss:** The Company recorded a net loss of ¥4,900 million, a reduction of ¥266 million from the previous period.

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**Key Factors Affecting Operating Results**

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**National Health Insurance (NHI) drug price revision:** NHI drug prices were revised downward by an industry average of 4.2% in April 2004. The price reduction for Toyama Chemical Group products was approximately 3.9%.

**Prices of products supplied to Taisho Toyama Pharmaceutical:** The prices of products supplied to Taisho Toyama Pharmaceutical may be amended if there is significant variation from the initial expectations for Toyama Chemical Group sales by Taisho Toyama Pharmaceutical and/or the amount of expenses at Taisho Toyama Pharmaceutical borne by the Toyama Chemical Group.

**Construction of a drug substance manufacturing plant and GLP-compliant experimental facilities:** Around 2005, the Toyama Chemical Group plans to build a drug substance manufacturing plant for new-type quinolone synthetic antibacterial agent T-3811, which will provide a core revenue stream. In addition, the Company plans to refurbish its aging research facilities over the next two to three years in order to make them Good Laboratory Practice (GLP)-compliant.

**Extraordinary charges related to welfare pension fund withdrawal:** The Company participates in the Tokyo Pharmaceutical Industry Welfare Pension Fund (*Toyaku Kikin*) and expects to incur approximately ¥1,000 million in extraordinary expenses if, in the future, it transfers a high number of employees to Taisho Toyama Pharmaceutical and therefore withdraws from this welfare pension fund.

## Consolidated Balance Sheets

Toyama Chemical Co., Ltd. and Consolidated Subsidiaries  
March 31, 2004 and 2003

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2004	2003	2004
<b>Assets</b>			
<b>CURRENT ASSETS:</b>			
Cash and cash equivalents	<b>¥16,938</b>	¥26,080	<b>\$159,792</b>
Short-term investments (Note 3)	<b>5,801</b>	1,329	<b>54,727</b>
Receivables:			
Trade notes	<b>357</b>	1,986	<b>3,369</b>
Trade accounts	<b>479</b>	14,813	<b>4,522</b>
Unconsolidated subsidiaries and associated companies	<b>3,555</b>	121	<b>33,535</b>
Other	<b>918</b>	810	<b>8,658</b>
Allowance for doubtful accounts	<b>(6)</b>	(20)	<b>(60)</b>
Inventories (Note 4)	<b>10,486</b>	8,817	<b>98,928</b>
Deferred tax assets (Note 10)	<b>862</b>	824	<b>8,130</b>
Other current assets	<b>859</b>	1,432	<b>8,100</b>
Total current assets	<b>40,249</b>	56,192	<b>379,701</b>
<b>PROPERTY, PLANT AND EQUIPMENT (Note 7):</b>			
Land (Note 5)	<b>12,794</b>	12,834	<b>120,702</b>
Buildings and structures	<b>26,825</b>	26,768	<b>253,070</b>
Machinery and equipment	<b>25,455</b>	25,459	<b>240,141</b>
Construction in progress	<b>14</b>	282	<b>136</b>
Other	<b>2,497</b>	2,602	<b>23,550</b>
Total	<b>67,585</b>	67,945	<b>637,599</b>
Accumulated depreciation	<b>(43,752)</b>	(43,086)	<b>(412,757)</b>
Net property, plant and equipment	<b>23,833</b>	24,859	<b>224,842</b>
<b>INVESTMENTS AND OTHER ASSETS:</b>			
Investment securities (Notes 3 and 7)	<b>4,818</b>	3,193	<b>45,450</b>
Investments in unconsolidated subsidiaries and associated companies (Note 6)	<b>673</b>	537	<b>6,351</b>
Long-term prepaid expenses	<b>1,053</b>	807	<b>9,931</b>
Deferred tax assets (Note 10)	<b>1,004</b>	1,296	<b>9,472</b>
Other	<b>2,511</b>	3,294	<b>23,697</b>
Allowance for doubtful accounts	<b>(171)</b>	(282)	<b>(1,617)</b>
Total investments and other assets	<b>9,888</b>	8,845	<b>93,284</b>
<b>TOTAL</b>	<b>¥73,970</b>	¥89,896	<b>\$697,827</b>

See notes to consolidated financial statements.

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2004	2003	2004
<b>Liabilities and Shareholders' Equity</b>			
<b>CURRENT LIABILITIES:</b>			
Short-term bank loans (Note 7)	¥ 4,687	¥20,566	\$ 44,214
Current portion of long-term debt (Note 7)	8,270	344	78,014
Payables:			
Trade notes	2,282	2,489	21,533
Trade accounts	941	1,086	8,876
Unconsolidated subsidiaries and associated companies	58	2	551
Other	581	3,120	5,484
Accrued income taxes	12	90	110
Other accrued expenses	334	647	3,153
Allowance for loss on sales returns	4	22	39
Other current liabilities	908	444	8,560
Total current liabilities	18,077	28,810	170,534
<b>LONG-TERM LIABILITIES:</b>			
Long-term debt (Note 7)	9,632	10,148	90,864
Liability for retirement benefits (Note 8)	12,598	12,899	118,851
Deferred tax liabilities—land revaluation (Note 5)	2,468	365	23,287
Other long-term liabilities	43	48	403
Total long-term liabilities	24,741	23,460	233,405
MINORITY INTERESTS	121	460	1,145
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b> (Notes 14 and 15)			
<b>SHAREHOLDERS' EQUITY (Note 9):</b>			
Common stock—authorized, 348,000,000 shares; issued, 197,147,537 shares in 2004 and 2003	22,397	22,397	211,294
Additional paid-in capital	21,531	21,531	203,122
Accumulated deficit	(11,998)	(7,098)	(113,187)
Land revaluation surplus (difference) (Note 5)	(1,565)	538	(14,767)
Net unrealized gain (loss) on available-for-sale securities	884	(16)	8,337
Treasury stock—at cost, 537,513 shares in 2004 and 452,953 shares in 2003	(218)	(186)	(2,056)
Total shareholders' equity	31,031	37,166	292,743
<b>TOTAL</b>	<b>¥73,970</b>	<b>¥89,896</b>	<b>\$697,827</b>

## Consolidated Statements of Operations

Toyama Chemical Co., Ltd. and Consolidated Subsidiaries  
Years Ended March 31, 2004 and 2003

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2004	2003	2004
NET SALES (Notes 14 and 17)	<b>¥16,227</b>	¥24,983	<b>\$153,083</b>
ROYALTY INCOME (Notes 11 and 17)	<b>604</b>	8,015	<b>5,700</b>
Gross revenue	<b>16,831</b>	32,998	<b>158,783</b>
COST OF SALES (Notes 8, 12 and 14)	<b>12,112</b>	11,407	<b>114,261</b>
Gross profit	<b>4,719</b>	21,591	<b>44,522</b>
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (Notes 8, 12, 13, 14 and 17)	<b>9,088</b>	19,366	<b>85,735</b>
Operating profit (loss)	<b>(4,369)</b>	2,225	<b>(41,213)</b>
OTHER INCOME (EXPENSES):			
Interest expense	<b>(570)</b>	(672)	<b>(5,374)</b>
Interest and dividend income	<b>123</b>	132	<b>1,161</b>
Write-down of inventories	<b>(251)</b>	(172)	<b>(2,364)</b>
Gain on sales of property, plant and equipment	<b>86</b>		<b>808</b>
Gain on sales of investment securities	<b>97</b>		<b>912</b>
Loss on disposal of software	<b>(162)</b>		<b>(1,525)</b>
Loss on devaluation of golf club memberships	<b>(20)</b>	(22)	<b>(189)</b>
Loss on devaluation of investment securities	<b>(112)</b>	(845)	<b>(1,060)</b>
Equity in losses of associated company	<b>(301)</b>	(7)	<b>(2,839)</b>
Business alliance related expense		(374)	
Other—net	<b>(71)</b>	(184)	<b>(677)</b>
Other expenses—net	<b>(1,181)</b>	(2,144)	<b>(11,147)</b>
INCOME (LOSS) BEFORE INCOME TAXES AND MINORITY INTERESTS	<b>(5,550)</b>	81	<b>(52,360)</b>
INCOME TAXES (Note 10):			
Current	<b>35</b>	104	<b>329</b>
Deferred	<b>(345)</b>	5,115	<b>(3,256)</b>
Total income taxes	<b>(310)</b>	5,219	<b>(2,927)</b>
MINORITY INTERESTS IN NET INCOME (LOSS)	<b>(340)</b>	28	<b>(3,213)</b>
NET LOSS	<b>¥ (4,900)</b>	¥ (5,166)	<b>\$ (46,220)</b>
		Yen	U.S. Dollars (Note 1)
PER SHARE OF COMMON STOCK—Net loss (Note 2.o)	<b>¥ (24.91)</b>	¥ (29.37)	<b>\$ (0.235)</b>

See notes to consolidated financial statements.

## Consolidated Statements of Shareholders' Equity

Toyama Chemical Co., Ltd. and Consolidated Subsidiaries  
Years Ended March 31, 2004 and 2003

	Millions of Yen						
	Issued Number of Shares of Common Stock	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Land Revaluation Surplus (Difference)	Net Unrealized Gain (Loss) on Available-for-sale Securities	Treasury Stock
<b>BALANCE, APRIL 1, 2002</b>	153,766,182	¥12,976	¥12,110	¥ (1,932)	¥ 526	¥ (58)	¥ (54)
Net loss				(5,166)			
Increase in treasury stock (339,306 shares)							(132)
Issuance of common stock	43,000,000	9,331	9,331				
Conversion of convertible bonds	381,355	90	90				
Net increase in unrealized gain on available-for-sale securities						42	
Net increase in land revaluation surplus due to change in statutory effective tax rate					12		
<b>BALANCE, MARCH 31, 2003</b>	197,147,537	22,397	21,531	(7,098)	538	(16)	(186)
Net loss				(4,900)			
Increase in treasury stock (84,560 shares)							(32)
Net increase in unrealized gain on available-for-sale securities						900	
Net decrease in land revaluation surplus due to amendment of accounting regulation					(2,103)		
<b>BALANCE, MARCH 31, 2004</b>	197,147,537	¥22,397	¥21,531	¥(11,998)	¥(1,565)	¥884	¥(218)

	Thousands of U.S. Dollars (Note 1)						
	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Land Revaluation Surplus (Difference)	Net Unrealized Gain (Loss) on Available-for-sale Securities	Treasury Stock	
<b>BALANCE, MARCH 31, 2003</b>	\$211,294	\$203,122	\$ (66,967)	\$ 5,075	\$ (153)	\$(1,753)	
Net loss			(46,220)				
Increase in treasury stock (84,560 shares)						(303)	
Net increase in unrealized gain on available-for-sale securities					8,490		
Net decrease in land revaluation surplus due to amendment of accounting regulation				(19,842)			
<b>BALANCE, MARCH 31, 2004</b>	\$211,294	\$203,122	\$(113,187)	\$(14,767)	\$8,337	\$(2,056)	

See notes to consolidated financial statements.

## Consolidated Statements of Cash Flows

Toyama Chemical Co., Ltd. and Consolidated Subsidiaries  
Years Ended March 31, 2004 and 2003

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2004	2003	2004
<b>OPERATING ACTIVITIES:</b>			
Income (loss) before income taxes and minority interests	¥ (5,550)	¥ 81	\$ (52,360)
Adjustments for:			
Income taxes—paid	(129)	(82)	(1,213)
Depreciation and amortization	1,685	2,130	15,897
Loss on disposal of property, plant and equipment	44	31	413
Loss on devaluation of investment securities	112	845	1,060
Loss on devaluation of golf club memberships	20	22	189
Equity in losses of associated company	301	7	2,839
Changes in assets and liabilities:			
Decrease (increase) in trade receivables	12,800	(78)	120,754
Increase in inventories	(1,669)	(1,202)	(15,745)
Decrease in trade payables	(430)	(666)	(4,058)
(Increase) decrease in interest and dividends receivable	(2)	1	(18)
Increase in interest payable	73	55	693
Decrease in liability for retirement benefits	(301)	(182)	(2,836)
(Decrease) increase in other payables	(2,292)	767	(21,625)
Other—net	312	(609)	2,932
Total adjustments	10,524	1,039	99,282
Net cash provided by operating activities	4,974	1,120	46,922
<b>INVESTING ACTIVITIES:</b>			
Purchases of short-term investments	(14,360)	(2,597)	(135,469)
Proceeds from sales of short-term investments	9,381	4,167	88,497
Purchases of property, plant and equipment	(189)	(237)	(1,781)
Proceeds from sales of investment securities	271	2,053	2,554
Purchase of investment securities	(871)	(596)	(8,217)
Decrease (increase) in other assets	156	(83)	1,475
Net cash provided by (used in) investing activities	(5,612)	2,707	(52,941)
<b>FINANCING ACTIVITIES:</b>			
Decrease in short-term bank loans—net	(15,879)	(4,213)	(149,801)
Proceeds from long-term debt	8,000	721	75,472
Repayments of long-term debt	(591)	(5,563)	(5,573)
Dividends paid		(1)	(1)
Proceeds from issuance of common stock		18,563	
Increase in other assets	(32)	(144)	(303)
Net cash provided by (used in) financing activities	(8,502)	9,363	(80,206)
<b>FOREIGN CURRENCY TRANSLATION ADJUSTMENTS ON CASH AND CASH EQUIVALENTS</b>			
	(2)		(17)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(9,142)	13,190	(86,242)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	26,080	12,890	246,034
CASH AND CASH EQUIVALENTS, END OF YEAR	¥16,938	¥26,080	\$159,792
<b>NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>			
Increase in capital stock from conversion of convertible bonds into common stock		¥ 90	
Increase in additional paid-in capital from conversion of convertible bonds into common stock		90	
Decrease in convertible bonds from conversion of convertible bonds into common stock		¥ 180	

See notes to consolidated financial statements.

## Notes to Consolidated Financial Statements

Toyama Chemical Co., Ltd. and Consolidated Subsidiaries  
Years Ended March 31, 2004 and 2003

### Note 1

#### Basis of Presenting Consolidated Financial Statements

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

In preparing these consolidated financial statements, certain reclassifications and rearrangements 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. Certain reclassifications and rearrangements have been made to the 2003 consolidated financial statements to conform to the classifications and presentations used in 2004. In addition, the notes to the consolidated financial statements include information which is not required under accounting principles generally accepted in Japan but is presented herein as additional information.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which Toyama Chemical Co., Ltd. (the "Company") is incorporated and operates. The translation of Japanese yen amounts into U.S. dollar amounts is included solely for the convenience of readers outside Japan and has been made at the rate of ¥106 to \$1, the approximate rate of exchange at March 31, 2004. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

### Note 2

#### Summary of Significant Accounting Policies

**a. Consolidation**—The accompanying consolidated financial statements include the accounts of the Company and its five (five in 2003) significant subsidiaries (collectively the "Group"). Consolidation of the remaining subsidiaries would not have a material effect on the accompanying consolidated financial statements.

Investment in one (one in 2003) associated company is accounted for by the equity method.

Investments in the remaining unconsolidated subsidiaries and associated company are stated at cost. If the equity method of accounting had been applied to the investments in these companies, the effect on the accompanying consolidated financial statements would not be material.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from intercompany transactions is 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, certificates of deposit, commercial paper and mutual funds investing in bonds that represent short-term investments, all of which mature or become due within three months of the date of acquisition.

**c. Inventories**—Finished goods, merchandise inventories, semi-finished goods, work in process and raw materials are stated at cost as computed by the average method. Supplies are stated at the most recent purchase price which approximates cost determined by the first-in, first-out method.

**d. Marketable and Investment Securities**—Marketable and investment securities are classified and accounted for, depending on management's intent, as follows: (1) Held-to-maturity debt securities, which are expected to be held to maturity with the positive intent and ability to hold to maturity, are reported at amortized cost; and (2) Available-for-sale securities, which are not classified as the aforementioned securities, are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity. Non-marketable available-for-sale securities are stated at cost determined by the moving-average method.

For other than temporary declines in fair value, investment securities are reduced to net realizable value by a charge to income.

**e. Allowance for Doubtful Accounts**—The allowance for doubtful accounts is stated in amounts considered to be appropriate based on the companies' past credit loss experience and an evaluation of potential losses in the receivables outstanding.

**f. Property, Plant and Equipment**—Property, plant and equipment are stated at cost. Depreciation is computed by the declining-balance method at rates based on the estimated useful lives of the assets while the straight-line method is applied to buildings acquired after April 1, 1998. The range of useful lives is principally from 3 to 60 years for buildings and structures, from 2 to 15 years for machinery and equipment and from 2 to 20 years for other property, plant and equipment.

**g. Stock and Bond Issue Costs**—Stock and bond issue costs are amortized by the straight-line method over 3 years under the Japanese Commercial Code (the “Code”).

**h. Allowance for Loss on Sales Returns**—The allowance for loss on sales returns is calculated by multiplying the balance of trade receivables by the rate of gross margin for the current year and the actual average rate of sales returns in the previous 2 years.

**i. Retirement and Pension Plans**—The Group has unfunded retirement plans for all eligible employees. The Company and its certain subsidiaries have a contributory funded pension plan in addition to the above unfunded plans.

The Company and its certain subsidiaries accounted for the liability for retirement benefits based on projected benefit obligations and plan assets at the balance sheet date.

Retirement allowances for directors and operating officers (directors and corporate auditors in 2003) are recorded to state the liability at the amount that would be required if directors and operating officers (directors and corporate auditors in 2003) of the Company retired at each balance sheet date. Duties rendered by the directors and operating officers for the year ended March 31, 2004 are excluded from computation period in providing retirement allowances by the reward committee.

Retirement allowances for directors and corporate auditors are recorded to state the liability at the amount that would be required if directors and corporate auditors of subsidiaries and associated company retired at each balance sheet date.

**j. Research and Development Expenses**—Research and development expenses are charged to income as incurred.

**k. Leases**—All leases are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that deem to transfer ownership of the leased property to the lessee are to be 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.

**l. Income Taxes**—The provision for income taxes is computed based on the pretax income included in the consolidated statements of operations. 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.

**m. Appropriations of Retained Earnings**—Appropriations of retained earnings at each year end are reflected in the financial statements for the following year upon shareholders’ approval.

**n. Derivative Financial Instruments**—The Group enters into derivative financial instruments, including interest rate swaps and caps as a means of hedging interest rate exposures of floating-rate bank loans. The Group does not enter into derivatives for trading or speculative purposes.

Derivative financial instruments are classified and accounted for as follows: (a) all derivatives are recognized as either assets or liabilities and measured at fair value, and gains or losses on derivative transactions are recognized in the consolidated statements of operations; and (b) for derivatives used for hedging purposes, if derivatives qualify for hedge accounting because of high correlation and effectiveness between the hedging instruments and the hedged items, gains or losses on derivatives are deferred until maturity of the hedged transactions.

The interest rate swaps which qualify for hedge accounting and meet specific matching criteria are not remeasured at market value but the differential paid or received under the swap agreements are recognized and included in interest expense or income.

**o. Per Share Information**—The computation of net loss per share is based on the weighted-average number of shares of common stock outstanding during each year. The weighted-average number of common shares used in the computation was 196,658 thousand and 175,897 thousand for the years ended March 31, 2004 and 2003, respectively.

Diluted net income per share is not disclosed because of the Company’s net loss position.

**p. New Accounting Pronouncements**—In August 2002, the Business Accounting Council issued a Statement of Opinion, “Accounting for Impairment of Fixed Assets,” and in October 2003 the Accounting Standards Board of Japan (“ASB”) issued ASB Guidance No. 6, “Guidance for Accounting Standard for Impairment of Fixed Assets.” These new pronouncements are effective for fiscal years beginning on or after April 1, 2005 with early adoption permitted for fiscal years ending on or after March 31, 2004.

The new accounting standard requires an entity to review its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.

The Company is currently in the process of assessing the effect of adoption of these pronouncements.

## Note 3

### Short-term Investments and Investment Securities

Short-term investments and investment securities at March 31, 2004 and 2003, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
<b>Current:</b>			
Time deposits	¥ 903	¥1,029	\$ 8,519
Government and corporate bonds	4,898	300	46,208
<b>Total</b>	<b>¥5,801</b>	<b>¥1,329</b>	<b>\$54,727</b>
<b>Non-current:</b>			
Marketable equity securities	¥3,272	¥1,875	\$30,868
Non-marketable equity securities	476	503	4,485
Trust fund investments and other	1,070	815	10,097
<b>Total</b>	<b>¥4,818</b>	<b>¥3,193</b>	<b>\$45,450</b>

The carrying amounts and aggregate fair values of marketable and investment securities at March 31, 2004 and 2003 were as follows:

	Millions of Yen			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>March 31, 2004</b>				
Securities classified as:				
Available-for-sale:				
Equity securities	¥1,801	¥1,552	¥ 81	¥3,272
Other	855	22	7	870
Held-to-maturity	400	5		405
March 31, 2003				
Securities classified as:				
Available-for-sale:				
Equity securities	¥1,850	¥ 249	¥224	¥1,875
Other	755		40	715
Held-to-maturity	400	6		406
Thousands of U.S. Dollars				
<b>March 31, 2004</b>				
Securities classified as:				
Available-for-sale:				
Equity securities	\$16,994	\$14,642	\$768	\$30,868
Other	8,064	211	65	8,210
Held-to-maturity	3,773	52	1	3,824

Available-for-sale securities whose fair value is not readily determinable as of March 31, 2004 and 2003 were as follows:

	Carrying Amount		
	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Available-for-sale—Equity securities	¥ 476	¥503	\$ 4,485
Available-for-sale—Others	4,698		44,322
<b>Total</b>	<b>¥5,174</b>	<b>¥503</b>	<b>\$48,807</b>

The carrying values of debt securities by contractual maturities for securities classified as available-for-sale and held-to-maturity at March 31, 2004 are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	Held-to-maturity		Held-to-maturity
	2004	2003	2004
Due in one year or less	¥200		\$1,886
Due after five years through ten years	200		1,887
<b>Total</b>	<b>¥400</b>		<b>\$3,773</b>

## Note 4

### Inventories

Inventories at March 31, 2004 and 2003 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	Held-to-maturity		Held-to-maturity
	2004	2003	2004
Finished goods and merchandise	¥ 3,949	¥3,222	\$37,257
Semi-finished goods and work in process	4,241	3,354	40,010
Raw materials and supplies	2,296	2,241	21,661
<b>Total</b>	<b>¥10,486</b>	<b>¥8,817</b>	<b>\$98,928</b>

## Note 5

### Land Revaluation

Under the “Law of Land Revaluation,” promulgated on March 31, 1998 and revised on March 31, 2001, the Company elected a one-time revaluation of its own-use land to a value based on real estate appraisal information as of March 31, 2001.

The resulting land revaluation excess represents unrealized appreciation of land and is stated as revaluation surplus as a component of shareholders’ equity. There is no effect on the statement of operations. Continuous readjustment is not permitted unless the land value subsequently declines significantly such that the amount of the decline in value should be removed from the net land revaluation excess account and net related deferred tax liabilities. The details of the one-time revaluation as of March 31, 2001 were as follows:

Land before revaluation:	¥11,700 million
Land after revaluation:	¥12,603 million
Land revaluation excess:	¥526 million (net of deferred tax liabilities of ¥377 million)

In 2004, the land revaluation excess and differences were recognized on a gross basis, and the related deferred tax assets and liabilities were recognized on an individual basis due to the amendment of the accounting regulations.

As of March 31, 2004, the carrying amount of the land after the above one-time revaluation exceeded the market value by ¥2,299 million.

## Note 6

### Investments in Unconsolidated Subsidiaries and Associated Companies

Investments in unconsolidated subsidiaries and associated companies at March 31, 2004 and 2003 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Investments in:			
Unconsolidated subsidiaries	¥ 69	¥ 69	\$ 648
Associated companies	604	468	5,703
<b>Total</b>	<b>¥673</b>	<b>¥537</b>	<b>\$6,351</b>

## Note 7

### Short-term Bank Loans and Long-term Debt

Short-term bank loans are principally notes to banks and bank overdrafts. The average annual interest rates for such items are 1.681% and 1.763% at March 31, 2004 and 2003, respectively.

Long-term debt at March 31, 2004 and 2003, consists of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Unsecured 1.00% yen convertible bonds, due March 2005	¥ 7,942	¥ 7,942	\$ 74,925
Unsecured 1.13% yen bonds, due June 2007	50	50	472
1.47% to 3.15% secured loans from banks and other financial institutions, due serially to 2010, payable in yen	8,585	1,170	80,989
0.00% to 1.75% loans without collateral from a bank and other institution due serially to 2005, payable in yen	1,325	1,330	12,492
<b>Total</b>	<b>17,902</b>	<b>10,492</b>	<b>168,878</b>
Less current portion	(8,270)	(344)	(78,014)
<b>Long-term debt, less current portion</b>	<b>¥ 9,632</b>	<b>¥10,148</b>	<b>\$ 90,864</b>

Annual maturities of long-term debt at March 31, 2004, were as follows:

Year Ending March 31	Millions of Yen	Thousands of U.S. Dollars
2005	¥ 8,270	\$ 78,014
2006	233	2,194
2007	23	221
2008	59	553
2009	5,000	47,170
2010 and thereafter	3,000	28,302
<b>Total</b>	<b>¥16,585</b>	<b>\$156,454</b>

The Company has non-interest bearing loans of ¥1,317 million (\$12,424 thousand) from Japan Science and Technology Corporation, a government-affiliated institution, to aid in the development of new medicines. The repayment date is to be determined subsequent to certification of success in developing the new medicines. Maturity information regarding such loans is excluded from the above table since the development is currently underway and therefore the repayment date is not yet determined.

The carrying amounts of assets pledged as collateral for short-term bank loans of ¥3,200 million (\$30,189 thousand) and the above collateralized long-term debt at March 31, 2004, were as follows:

	Millions of Yen	Thousands of U.S. Dollars
Investment securities	¥ 180	\$ 1,700
Property, plant and equipment—net of accumulated depreciation	6,472	61,052
<b>Total</b>	<b>¥6,652</b>	<b>\$62,752</b>

As is customary in Japan, the Company maintains deposit balances with banks with which it has borrowings. Such deposit balances are not legally or contractually restricted as to withdrawal.

General agreements with respective banks provide, as is customary in Japan, that additional collateral must be provided under certain circumstances if requested by such banks and that certain banks have the right to offset cash deposited with them against any long-term or short-term debt or obligation that becomes due and, in case of default and certain other specified events, against all other debt payable to the banks. The Company has never been requested to provide any additional collateral.

The conversion price of the unsecured 1.00% yen convertible bonds was ¥464 per share at March 31, 2004. Under certain conditions, the unsecured yen convertible bonds may be redeemed prior to maturity in whole, from May 1, 2000 to March 30, 2005.

The conversion prices of the convertible bonds are subject to adjustments to reflect stock splits and certain other events.

## Note 8

### Retirement and Pension Plans

The Group has retirement payment plans for employees, directors and operating officers.

Under most circumstances, employees terminating their employment are entitled to retirement benefits determined based on the rate of pay at the time of termination, years of service and certain other factors. The plan provides the payment to terminated (excluding death or job transferring under same employer) employees with more than ten years of participation in the plan, or to employees with more than ten years of participation and upon reaching the age of 65. Such retirement benefits are made in the form of a lump-sum severance payment from the Company or from certain subsidiaries and annuity payments from a trustee.

The liability for retirement benefits at March 31, 2004, includes retirement benefits for directors and operating officers of ¥697 million (\$6,574 thousand). The retirement benefits for the Company's directors and operating officers are paid subject to the reward committee.

The liability for employees' retirement benefits at March 31, 2004 and 2003 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Projected benefit obligation	<b>¥12,777</b>	¥13,226	<b>\$120,535</b>
Fair value of plan assets	<b>(70)</b>	(92)	<b>(662)</b>
Unrecognized actuarial gain	<b>(806)</b>	(945)	<b>(7,596)</b>
Net liability	<b>¥11,901</b>	¥12,189	<b>\$112,277</b>

The components of net periodic benefit costs for the years ended March 31, 2004 and 2003 are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Service cost	<b>¥351</b>	¥ 544	<b>\$3,316</b>
Interest cost	<b>169</b>	265	<b>1,594</b>
Recognition of actuarial loss (gain)	<b>77</b>	(13)	<b>729</b>
Contribution for trusted pension fund	<b>147</b>	292	<b>1,384</b>
Net periodic benefit costs	<b>¥744</b>	¥1,088	<b>\$7,023</b>

Assumptions used for the years ended March 31, 2004 and 2003 are set forth as follows:

	2004	2003
Discount rate	<b>2.2%</b>	2.2%
Recognition period of actuarial gain/loss	<b>12 years</b>	12 years

Unrecognized actuarial gain/loss is charged to income in the fiscal year following the fiscal year during which the unrecognized actuarial gain/loss was incurred, computed by the straight-line method over constant years not exceeding the expected remaining service period.

## Note 9

### Shareholders' Equity

Japanese companies are subject to the Code to which certain amendments became effective from October 1, 2001.

The Code was revised whereby common stock par value was eliminated resulting in all shares being recorded with no par value and at least 50% of the issue price of new shares is required to be recorded as common stock and the remaining net proceeds as additional paid-in capital. The Code permits Japanese companies, upon approval of the Board of Directors, to issue shares to existing shareholders without consideration as a stock split. Such issuance of shares generally does not give rise to changes within the shareholders' accounts.

The revised Code also provides that an amount at least equal to 10% of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period shall be appropriated as a legal reserve (a component of retained earnings) until such reserve and additional paid-in capital equals 25% of the balance of common stock. The amount of total additional paid-in capital and legal reserve that exceeds 25% of the balance of common stock may be available for dividends by resolution of the shareholders. In addition, the Code permits the transfer of a portion of additional paid-in capital and legal reserve to common stock by a resolution of the Board of Directors.

The revised Code eliminated restrictions on the repurchase and use of treasury stock allowing Japanese companies to repurchase treasury stock by a resolution of the shareholders at the general shareholders meeting and dispose of such treasury stock by a resolution of the Board of Directors beginning April 1, 2002. The repurchased amount of treasury stock cannot exceed the amount available for future dividends plus the amount of common stock, additional paid-in capital or legal reserve to be reduced in the case where such reduction was resolved at the general shareholders meeting.

Dividends are approved by the Board of Directors at a meeting held subsequent to the fiscal year to which the dividends are applicable. Semiannual interim dividends may also be paid upon resolution of the Board of Directors, subject to certain limitations imposed by the Code.

## Note 10

### 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 41.7% for the years ended March 31, 2004 and 2003.

On March 31, 2003, a tax reform law concerning enterprise tax was enacted in Japan which changed the normal effective statutory tax rate from 41.7% to 40.4%, effective for years beginning on or after April 1, 2004. The deferred tax assets and liabilities which will be realized on or after April 1, 2004 are measured at the effective tax rate of 40.4% as at March 31, 2004 and 2003.

The tax effects of significant temporary differences and tax loss carryforwards which resulted in deferred tax assets and liabilities at March 31, 2004 and 2003, are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
<b>Deferred tax assets:</b>			
Accrued retirement benefits	¥ 4,570	¥ 4,307	\$ 43,113
Tax loss carryforwards	3,596	1,628	33,923
Loss on devaluation of investment securities	468	421	4,420
Write-down of golf club membership	118	164	1,110
Other	377	582	3,557
Less valuation allowance	(6,472)	(4,790)	(61,057)
Total	2,657	2,312	25,066
<b>Deferred tax liabilities:</b>			
Special reserve for land for tax purposes	192	192	1,808
Net unrealized gain on available-for-sale securities	601		5,671
Other			5
Total	793	192	7,484
Net deferred tax assets	¥ 1,864	¥ 2,120	\$ 17,582

A reconciliation between the normal effective statutory tax rate and the actual effective tax rates reflected in the accompanying consolidated statements of operations for the years ended March 31, 2004 and 2003 is as follows:

	2004	2003
Normal effective statutory tax rate	(41.7)%	41.7%
Expenses not deductible for income tax purposes	0.3	253.1
Minimum inhabitant taxes	0.6	96.7
Valuation allowance	116.6	5,857.9
Effect of change in normal effective statutory tax rate		218.4
Prior period valuation allowance	(86.0)	
Equity in losses of associated companies	2.3	
Other	2.3	(6.2)
Actual effective tax rate	(5.6)%	6,461.6%

At March 31, 2004, the Company and its certain subsidiaries have tax loss carryforwards aggregating approximately ¥9,174 million (\$86,549 thousand) which are available to be offset against taxable income in future years. These tax loss carryforwards, if not utilized, will expire as follows:

Year Ending March 31	Millions of Yen	Thousands of U.S. Dollars
2006	¥ 695	\$ 6,552
2007	3,126	29,496
2008	12	110
2009	5,341	50,391
Total	¥9,174	\$86,549

## Note 11

### Royalty Income

Royalty income represents consideration prescribed on agreements for granting the license of patent rights and sales rights to domestic and overseas pharmaceutical companies.

## Note 12

### Depreciation of Property, Plant and Equipment

Depreciation of property, plant and equipment was ¥1,167 million (\$11,013 thousand) and ¥1,325 million for the years ended March 31, 2004 and 2003, respectively.

## Note 13

### Research and Development Expenses

Research and development expenses charged to the consolidated statements of operations were ¥5,161 million (\$48,686 thousand) and ¥5,088 million for the years ended March 31, 2004 and 2003, respectively.

## Note 14

### Leases

The Group leases certain machinery, equipment, software, furniture and fixtures, both as lessee and lessor.

**a. Lessee** Total rental expenses for the years ended March 31, 2004 and 2003 were ¥1,244 million (\$11,732 thousand) and ¥1,779 million, respectively, including ¥1,124 million (\$10,602 thousand) and ¥1,137 million of lease payments under finance leases.

Pro forma information of leased property such as acquisition cost, accumulated depreciation, obligations under finance leases, depreciation expense and interest expense under 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, 2004 and 2003 was as follows:

	Millions of Yen		
	Machinery and Equipment	Other	Total
<b>March 31, 2004</b>			
Acquisition cost	¥5,966	¥ 340	¥6,306
Accumulated depreciation	2,887	243	3,130
Net leased property	¥3,079	¥ 97	¥3,176
March 31, 2003			
Acquisition cost	¥6,055	¥1,291	¥7,346
Accumulated depreciation	2,408	982	3,390
Net leased property	¥3,647	¥ 309	¥3,956

	Thousands of U.S. Dollars		
	Machinery and Equipment	Other	Total
<b>March 31, 2004</b>			
Acquisition cost	\$56,286	\$3,204	\$59,490
Accumulated depreciation	27,242	2,290	29,532
Net leased property	\$29,044	\$ 914	\$29,958

Obligations under finance leases:

	Millions of Yen		Thousands of U.S. Dollars
	March 31		March 31
	2004	2003	2004
Due within one year	¥ 835	¥ 980	\$ 7,879
Due after one year	2,529	3,169	23,852
Total	¥3,364	¥4,149	\$31,731

Depreciation expense and interest expense under finance leases:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Depreciation expense	¥ 988	¥1,034	\$ 9,320
Interest expense	150	124	1,415
Total	¥1,138	¥1,158	\$10,735

Depreciation expense and interest expense, which are not reflected in the accompanying consolidated statements of operations, are computed by the straight-line method and the interest method, respectively.

**b. Lessor** Total rental income for the years ended March 31, 2004 and 2003 was ¥226 million (\$2,135 thousand) and ¥113 million, respectively, including ¥226 million (\$2,135 thousand) and ¥113 million of lease income under finance leases.

Information of leased property such as acquisition cost, accumulated depreciation, obligations under finance leases, depreciation expense and interest revenue under finance leases that do not transfer ownership of the leased property to the lessee for the years ended March 31, 2004 and 2003, was as follows:

	Millions of Yen		
	Machinery and Equipment	Other	Total
<b>March 31, 2004</b>			
Acquisition cost	¥1,109	¥ 5	¥1,114
Accumulated depreciation	412	3	415
Net leased property	¥ 697	¥ 2	¥ 699
March 31, 2003			
Acquisition cost	¥ 672	¥29	¥ 701
Accumulated depreciation	228	21	249
Net leased property	¥ 444	¥ 8	¥ 452

March 31, 2004	Thousands of U.S. Dollars		
	Machinery and Equipment	Other	Total
Acquisition cost	\$10,465	\$42	\$10,507
Accumulated depreciation	3,892	25	3,917
Net leased property	\$ 6,573	\$17	\$ 6,590

Obligations under finance leases:

	Millions of Yen		Thousands of U.S. Dollars
	March 31		March 31
	2004	2003	2004
Due within one year	¥204	¥105	\$1,929
Due after one year	517	358	4,875
Total	¥721	¥463	\$6,804

Depreciation expense and interest revenue under finance leases:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Depreciation expense	¥197	¥105	\$1,861
Interest revenue	43	11	399
Total	¥240	¥116	\$2,260

Depreciation expense and interest revenue, which are not reflected in the accompanying consolidated statements of operations, are computed by the straight-line method and the interest method, respectively.

## Note 15

### Contingent Liabilities

Contingent liabilities at March 31, 2004, were as follows:

	Millions of Yen	Thousands of U.S. Dollars
Trade notes discounted	¥122	\$1,148
Loan guarantee	122	1,153

## Note 16

### Derivatives

The Group has purchased interest rate caps to limit the unfavorable impact from increases in interest rates on floating-rate bank loans. The Group also enters into interest rate swaps as a means of managing its interest rate exposures on certain liabilities. Derivative transactions mentioned above are not executed for speculation purposes under the Group's policy.

The Group is exposed to interest rate risk due to future fluctuations of interest rates, which may arise from interest rate-related derivatives. Because the counterparties to those derivatives are limited to major international financial institutions, the Group does not anticipate any losses arising from credit risk.

The management planning section of the Group enters into derivative transactions upon approval of transaction type and position limit by the management council (the Board of Directors at subsidiary), and monitors and controls risks associated with these derivatives. Also, a director responsible for derivatives reports financial results on a monthly basis, including derivatives, at the meeting of full-time officers. The Group prevents derivative transactions being executed for speculative purposes through the above-mentioned internal control and risk management procedures.

The contract or notional amounts of derivatives which are shown in the following table do not represent the amounts exchanged by the parties and do not measure the Group's exposure to credit or market risk.

**Fair Value of Derivative Financial Instruments** The fair value of the Group's derivative financial instruments at March 31, 2004 and 2003, is as follows:

	Millions of Yen		
	Contract Amount	Fair Value	Unrealized Gain/Loss
<b>March 31, 2004</b>			
Interest Rate Transaction			
Not through market:			
Interest rate swaps—fixed rate payment, floating rate receipt	¥ 1,200	¥(108)	¥62
Interest rate options—caps purchased	6,700		
<b>Total</b>	<b>¥ 7,900</b>	<b>¥(108)</b>	<b>¥62</b>
<b>March 31, 2003</b>			
Interest Rate Transaction			
Not through market:			
Interest rate swaps—fixed rate payment, floating rate receipt	¥ 2,200	¥(170)	¥ 9
Interest rate options—caps purchased	11,200		(4)
<b>Total</b>	<b>¥13,400</b>	<b>¥(170)</b>	<b>¥ 5</b>

	Thousands of U.S. Dollars		
	Contract Amount	Fair Value	Unrealized Gain/Loss
<b>March 31, 2004</b>			
Interest Rate Transaction			
Not through market:			
Interest rate swaps—fixed rate payment, floating rate receipt	\$11,321	\$(1,017)	\$588
Interest rate options—caps purchased	63,207	3	(2)
<b>Total</b>	<b>\$74,528</b>	<b>\$(1,014)</b>	<b>\$586</b>

Interest rate swaps which qualify for hedge accounting for the years ended March 31, 2004 and 2003, are excluded from the disclosure of market value information.

## Note 17

### Related Party Transactions

Transactions with principal shareholder, unconsolidated subsidiaries and associated companies for the years ended March 31, 2004 and 2003, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2004	2003	2004
Sales	¥12,537	¥ 85	\$118,270
Royalty income		7,300	
Commission expenses	312	130	2,943

The balance of trade accounts receivable from the principal shareholder amounted to ¥124 million (\$1,169 thousand) and ¥2,625 million as of March 31, 2004 and 2003.

## Note 18

### SUBSEQUENT EVENT

**Significant Contract** On March 31, 2004, the Company agreed to grant global development, usage and sales rights to Schering-Plough Corporation for T-3811 (generic name: garenoxacin), a new-type quinolone synthetic antibacterial agent under development by the Company.

On June 22, 2004 (Japanese standard time), the Company and two subsidiaries of Schering-Plough Corporation entered into a definitive license agreement for T-3811.

An overview of the contract is as follows:

**(1) Purpose or reason**

T-3811 is a new-type quinolone synthetic antibacterial agent originated by the Company. The drug was initially licensed out to U.S. firm Bristol-Myers Squibb and global clinical development was conducted by them. The clinical trials showed excellent results mainly in respiratory and surgical infections. The Company reacquired all rights to T-3811 from Bristol-Myers Squibb in October 2003, for their commercial reasons. Since then, the Company has been investigating the selection of a new partner.

**(2) The party to the contract**

Company names: Schering Corporation (USA)  
Schering-Plough Limited (Switzerland)

**(3) Overview of the party to the contract**

Schering Corporation (USA) and Schering-Plough Limited (Switzerland) are the subsidiaries wholly owned by Schering-Plough Corporation.

Profile of Schering-Plough Corporation

Company name: Schering-Plough Corporation  
Representative: Fred Hassan (Chairman and CEO)  
Number of employees: Approximately 30,500  
Net sales: U.S.\$8.3 billion in 2003  
Business: Manufacture and sales of OTC and ethical drugs for human health.  
Headquarters: 2000 Galloping Hill Road, Kenilworth, NJ 07033-0530, U.S.A.

**(4) Time limit of the contract**

June 22, 2004 (Japanese standard time)

**(5) Content of agreement**

1. The Company will grant exclusive rights to develop, use and sell garenoxacin worldwide, excluding Japan, South Korea and China.
2. The Company has exclusive rights to develop, use and sell garenoxacin in Japan, South Korea and China.
3. The Company will supply with bulk product.
4. The Company will receive a payment of U.S.\$80 million for the signing of this license agreement.
5. The Company will also receive additional milestone payments totaling up to U.S.\$245 million based on certain development and commercial milestones being reached.
6. In addition, the Company will receive royalties based on the net sales of garenoxacin by Schering Corporation (USA) and Schering-Plough Limited (Switzerland).

## Note 19

### Segment Information

The Group operates principally in two business segments: pharmaceutical and other businesses. Information by business segment is not disclosed in accordance with the applicable regulations because net sales, operating income and assets of the pharmaceutical business are more than 90% of consolidated net sales, operating income and assets, respectively. Export sales are not disclosed because they are less than 10% of consolidated net sales. Geographic segments are not disclosed because the Company does not have any consolidated subsidiaries or branches overseas.

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of  
Toyama Chemical Co., Ltd.:

We have audited the accompanying consolidated balance sheets of Toyama Chemical Co., Ltd. (the "Company") and consolidated subsidiaries as of March 31, 2004 and 2003, and the related consolidated statements of operations, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Toyama Chemical Co., Ltd. and consolidated subsidiaries as of March 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

As discussed in Note 18 to the consolidated financial statements, the Company and Schering Corporation (USA) and Schering-Plough Limited (Switzerland) which are the subsidiaries wholly owned by Schering-Plough Corporation entered into a license agreement with respect to T-3811, a new-type quinolone synthetic antibacterial agent on June 22, 2004.

Our audits also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 1. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

*Deloitte Touche Tohmatsu*

June 25, 2004

## Business Risks

The following is a summary of the main items that could become risk factors for Group business.

### **Transfer of Sales Functions to Taisho Toyama Pharmaceutical:**

Intensifying competition and slowing growth rates are making conditions even more unfavorable in the market for antibiotics and antibacterials, which are Toyama Chemical's mainstay products. In order to respond to such changes in the operating environment, the Company formed a capital alliance with Taisho Pharmaceutical in September 2002 and began a business partnership in ethical drug research and development and marketing.

As part of this business alliance, the joint venture Taisho Toyama Pharmaceutical (in which Toyama Chemical holds a 45% share) began full-scale operations in April 2003 to market ethical drugs produced by Toyama Chemical and Taisho Pharmaceutical. Accordingly, Toyama Chemical Group staff involved in sales, such as MRs, have been assigned to Taisho Toyama Pharmaceutical.

Selling costs, including employee costs for the assigned staff, have been transferred to Taisho Toyama Pharmaceutical. Toyama Chemical now supplies products to Taisho Toyama Pharmaceutical at prices that less than make up for the amount transferred in selling expenses. The Company's net sales and selling, general and administrative expenses have both declined substantially.

Sales to Taisho Toyama Pharmaceutical account for at least 80% of Toyama Chemical's sales. Therefore, any fluctuation in Toyama Chemical Group product revenues from Taisho Toyama Pharmaceutical could impact the Group's overall profitability and financial health.

**Seasonal Fluctuations in Operating Results:** Antibiotics and synthetic antibacterials account for at least 70% of Toyama Chemical Group's ethical drug sales. Demand for these products generally peaks in the winter, so net sales tend to rise in the second half of the fiscal year.

**Repayment of Convertible Bonds:** The balance of convertible bonds issued in April 2000 (amount issued: ¥10,000 million; due date: March 31, 2005) was ¥7,942 million as of March 31, 2004, as bonds valued at ¥2,058 million were converted at the end of fiscal 2004.

If the bonds are not converted by the due date, the Company will record the balance as a decrease in cash equivalents.

**Legal Regulations:** The ethical drugs business is subject to various regulations, including the Pharmaceutical Affairs Law (PAL) and guidelines on Good Laboratory Practice (GLP), Good Clinical Practice (GCP), Good Manufacturing Practice (GMP) and Good Post-Marketing Surveillance Practice (GPMS), which covers post-marketing surveys conducted for applications for the re-evaluation of new drugs. With the amendments to the PAL, the regulatory authorities plan to introduce a new manufacturing and marketing approval system and implement new guidelines, including Good Vigilance Practice (GVP), which covers safety management after manufacturing and marketing, Good Post-marketing Surveillance Practice (GPSP), which covers study implementation and surveys

conducted after manufacturing and marketing, and Good Quality Practice (GQP), which covers quality control of manufactured and marketed products. Toyama Chemical Group revenues could be affected if there is any change in the duration of the regulatory review process as a result of changes in such legal regulations.

**New Product Research and Development:** The Toyama Chemical Group's business mainly involves the research and development, manufacture and sale of ethical drugs (with Taisho Toyama Pharmaceutical responsible for sales to the market).

Research and development into new products involves identifying candidate compounds from numerous substances, establishing the compound's efficacy and safety through rigorous animal studies and clinical trials, and submitting these study data for strict regulatory review. Only compounds that have passed this regulatory review are approved as new drugs.

Usually, the process from the discovery of a new chemical entity to sale as a pharmaceutical takes many years and requires significant investment in research and development. Moreover, drug development projects can run into delays or be discontinued, so the Toyama Chemical Group's financial position or operating results could be affected by delays in the process compared with the drug development plan.

**Royalty Income:** The Toyama Chemical Group is building the following revenue platforms in line with its medium-term management plan:

- 1) Revenue from ethical drug sales through Taisho Toyama Pharmaceutical
- 2) Royalty income from the out-licensing of compounds developed in-house
- 3) Revenue from the bulk supplying of drugs and drug products to partner companies

Royalty income from out-licensed compounds may be categorized as follows:

- Initial royalties: One-off income received when the contract is made
- Milestone royalties: One-off income received, for example, when the compound is filed for approval, approved, launched or achieves certain sales targets
- Running royalties: Sales-linked income commensurate with sales performance by the licensing partner

Initial royalties and milestone royalties represent one-off income and often involve large sums, so the Company's revenues can vary substantially if the royalties are received in accounting periods other than expected.

**Changes in Recent Out-Licensing Contracts and Foreign Exchange Rates:** The US\$80 million payment from Schering-Plough, due on the signing of the licensing agreement for T-3811, and subsequent royalty income under this agreement will be payable in full in U.S. dollars, so any fluctuation in the yen-U.S. dollar exchange rate will have an impact on future revenue at the Toyama Chemical Group.

## Corporate Information

### HEAD OFFICE

2-5, Nishi-Shinjuku 3-chome,  
Shinjuku-ku, Tokyo 160-0023, Japan  
Telephone: (03) 3348-6611  
Facsimile: (03) 3348-6638  
Web site: <http://www.toyama-chemical.co.jp>

### TOYAMA WORKS

*(Toyama Chemical's main factory  
and research laboratories)*

4-1, Shimo-Okui 2-chome,  
Toyama-shi, Toyama 930-8508, Japan  
Telephone: (076) 432-3136  
Facsimile: (076) 431-8203

### TOYAMA USA INC.

114 West 47th Street, 23rd Floor,  
New York, NY 10036, U.S.A.  
Telephone: (212) 704-2373  
Facsimile: (212) 704-2372

### TOYAMA EUROPE LTD.

8th Floor, Dashwood House,  
69 Old Broad Street,  
London EC2M 1QU, U.K.  
Telephone: (020) 7256-2046  
Facsimile: (020) 7256-2047

### BOARD OF DIRECTORS

**Director, President and Chief Executive Officer**  
Katsuhiko Nakano

**Directors and Senior Executive Officers**  
Takeo Abe

*Toyama Works and Production*

Hideo Sanada  
*Research and Development*

**Director and Operating Officer**  
Masayuki Yamashita  
*Environment, Compliance and Administration*

### Directors

Toshiharu Hagiwara

Yukio Yanagida\*

Hiroichi Yoshida\*

Shinichiro Inushima\*

Shozo Kakimoto\*

\* Outside Directors

(As of June 25, 2004)

## SUBSIDIARIES

	Paid-In Capital (Thousands)	The Company's Equity Ownership (%)	Principal Business
Toyama Kouei Co., Ltd.*	¥20,000	100.0	Design, production, and maintenance of manufacturing plants
Tomix Co., Ltd.*	¥41,250	100.0	General leasing
HOKURIKU MEDICAL SERVICE CO., LTD.*	¥80,000	100.0	Provision of medical equipment and instrument sterilization and home care services
Taiyo Sangyo Co., Ltd.*	¥42,000	100.0	Contracting business
White Public Relations Co., Ltd.*	¥20,000	100.0	Advertising
TOYAMA USA INC.	\$300	100.0	Development and clinical trials of pharmaceuticals Gathering of medical and pharmaceutical information
TOYAMA EUROPE LTD.	£150	100.0	Development and clinical trials of pharmaceuticals Gathering of medical and pharmaceutical information
Taisho Toyama Pharmaceutical Co., Ltd.	¥1,000,000	45.0	Sales and promotion of ethical drugs

\* Consolidated subsidiaries

## HISTORY

1936	Toyama Chemical Co., Ltd., established around the business of Toyama Chemical Research Laboratory	1990	TOMIRON fine granules and OZEX introduced
1961	Listed on the Second Section of the Tokyo Stock Exchange	1992	SELECAL introduced
1970	General Research Laboratory completed	1994	FLUCAM introduced Consumer Health Care Department established
1971	Factory for the manufacture of injectable products completed ESPERAN introduced	1997	TOYAMA USA INC. established
1972	Listed on the First Section of the Tokyo Stock Exchange	1998	HOKURIKU MEDICAL SERVICE CO., LTD. and TOYAMA EUROPE LTD. established
1975	No. 2 Research Laboratory completed	1999	LUPRAC introduced
1980	PENTCILLIN introduced No. 3 Research Laboratory completed	2000	Toyama Works and the 2nd Toyama Factory acquired ISO 14001 certification
1981	ABOVIS and CEFOPERAZIN introduced	2001	TAZOCIN introduced
1982	BAXO capsules introduced	2002	HALOSPOR and PASIL introduced Agreed a strategic capital and business alliance with Taisho Pharmaceutical Co., Ltd.
1985	TOMIPORAN introduced		Taisho Toyama Pharmaceutical Co., Ltd., established
1986	BAXO balm introduced	2003	Transferred OTC business to Taisho Pharmaceutical and Kyorin Pharmaceutical Co., Ltd.
1987	TOMIRON introduced		
1988	BAXO suppositories introduced		
1989	No. 1 Research Laboratory completed		

## Main Products

### ETHICAL DRUGS

- Broad-spectrum injectable quinolone antibacterial agent PASIL
- Broad-spectrum oral quinolone antibacterial agent OZEX
- Broad-spectrum injectable 2nd generation cephalosporin HALOSPOR
- Broad-spectrum oral 3rd generation cephalosporin TOMIRON
- Broad-spectrum oral 3rd generation cephalosporin TOMIRON fine granules
- Broad-spectrum oral 3rd generation cephalosporin CEFOPERAZIN
- Penicillin formulation, combining PENTCILLIN and a  $\beta$ -lactamase inhibitor TAZOCIN
- Broad-spectrum penicillin PENTCILLIN
- Loop diuretic LUPRAC
- Long-lasting nonsteroidal anti-inflammatory drug FLUCAM
- Long-lasting nonsteroidal anti-inflammatory drug BAXO
- Percutaneous nonsteroidal anti-inflammatory drug BAXO ointment
- Long-lasting nonsteroidal anti-inflammatory drug BAXO suppository
- Gastro-selective muscarinic M1 agonist ABOVIS

### CONSUMER HEALTH CARE PRODUCTS

- Health tea YANRONCHA
- Alkaline ionized water SHINKAIYUMU



PASIL



OZEX



PENTCILLIN



TOMIRON



TAZOCIN



LUPRAC

## Investor Information

### ESTABLISHED

November 15, 1936

### CAPITAL STOCK

¥22,397 million

### NUMBER OF EMPLOYEES

911

### MAJOR SHAREHOLDERS

Taisho Pharmaceutical Co., Ltd.  
The Hokuriku Bank, Ltd.  
Sumitomo Mitsui Banking Corporation  
Taisei Corporation  
The Master Trust Bank of Japan, Ltd.  
(Trust Account)  
Kanematsu Corporation  
Japan Trustee Services Bank, Ltd.  
(Trust Account)  
Nippon Life Insurance Company  
Nakano Kosan Co., Ltd.  
The Tokyo Marine and Fire Insurance Co., Ltd.

### ORDINARY GENERAL MEETING

The Ordinary General Meeting of Shareholders is held annually in June.

### TRANSFER AGENT

The Chuo Mitsui Trust and Banking Co., Ltd.  
33-1, Shiba 3-chome,  
Minato-ku, Tokyo 105-8574, Japan

### STOCK LISTING (TICKER CODE: 4518)

Tokyo Stock Exchange, First Section

### FOR FURTHER INFORMATION, PLEASE CONTACT:

Licensing Dept.  
Telephone: (03) 5381-3889  
Facsimile: (03) 3348-6460

(As of March 31, 2004)

 **TOYAMA CHEMICAL CO., LTD.**

<http://www.toyama-chemical.co.jp>