# Bringing Out Inherent Strength

Annual Report 2013

TSUMURA & CO.

## CORPORATE PHILOSOPHY

The Best of Nature and Science

## CORPORATE MISSION

To contribute to the unparalleled medical therapeutic power of the combination of Kampo medicine and Western medicine.

## TSUMURA'S BUSINESS

Tsumura's core business is the manufacture and sale of prescription Kampo products. As a leading company in the field of Kampo medicine, Tsumura aims to achieve sustainable growth and build its corporate value through the provision of a stable supply of high-quality Kampo products.

## CONTENTS

## GLOSSARY

**Kampo Medicine**
The medicine traditionally practiced in Japan, based on ancient Chinese medicine.

**Western Medicine**
Originating with the practice of medicine in Greece, Western medicine is used as the counterpart to Eastern medicine.

**Kampo Medicines**
Kampo medicines are used in the practice of Kampo medicine.

**Crude Drugs**
Crude drugs are the main raw materials for Kampo products and primarily indicate the portion of plants and minerals used for medicinal purposes.

**Kampo Business**
A business model including not only the production and sale of Kampo products, but also encompassing the cultivation, processing, and storage of crude drugs.

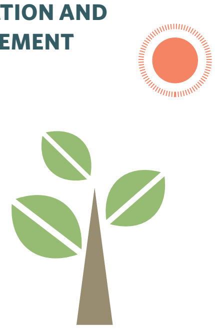
**"Drug Fostering" Program**
A program that aims to build a body of scientific evidence on the efficacy of Kampo products.



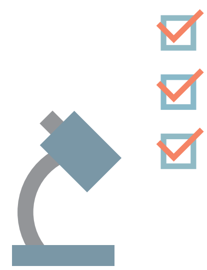
**Forward-looking Statements**
In this annual report, all statements that contain the words "believe," "anticipate," "estimate," "expect," or other similar words, and all numbers related to future performance, are considered forward-looking statements that are not historical facts but rather reflect management's best judgment and the most information available at the time this annual report was prepared. The actual results that Tsumura will achieve in the future may differ greatly from these estimates and forecasts due to various uncertain factors in the business environment and various risks that are discussed later in this annual report. The forward-looking statements contained herein were deemed reasonable by management at the time that we prepared this annual report, but it is important to exercise ample caution when making investment decisions based on these statements.

# TSUMURA AND KAMPO

**CULTIVATION AND PROCUREMENT**



**QUALITY INSPECTION**



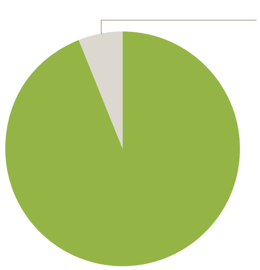
**STORAGE**

## TSUMURA'S BUSINESS

Tsumura is the only listed company in Japan manufacturing and selling prescription Kampo products—prescribed by physicians and covered under the national health insurance (NHI) plan. Almost all Kampo products are granulated extract formulations of crude drugs, primarily of plant origin. They are produced by blending different mixes of more than 100 varieties of crude drugs in the form of specific varieties of plants and other ingredients, extracting the active ingredients, and processing them into granulated extracts. In Japan, of the 148 formulations of Kampo products covered under the NHI plan, Tsumura manufactures 129 formulations.

The Kampo business encompasses an extremely wide range of activities. Beginning with the procurement of the crude drugs, the business extends to quality screening, manufacturing, sales, providing information on Kampo medicine and products, and conducting educational activities. Activities involving the procurement of raw material crude drugs cover a particularly wide range and timeframe in both geographic and temporal terms. As a result of Tsumura's across-the-board activities, the Company has built a high-performance Kampo value chain, allowing it to comprehensively manage all processes in the Kampo business. This system ensures the production of high-quality Kampo products. At the same time, it gives Tsumura an overwhelming competitive advantage and acts as a source of sustainable growth.

**Tsumura's Net Sales**

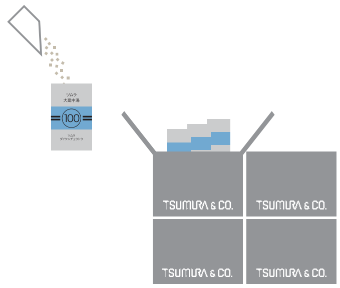



**94.1%**

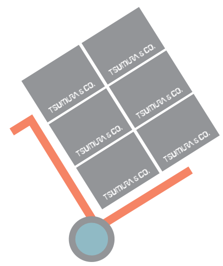
Tsumura is a company that specializes in the manufacture of Kampo products; prescription Kampo products generated 94.1% of Tsumura's net sales in fiscal 2013.

## POWDERED EXTRACT MANUFACTURING

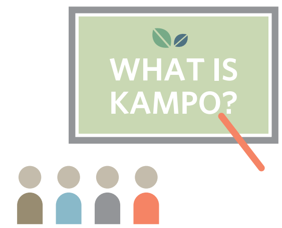
## MANUFACTURING




## SALES



## EDUCATION AND POPULARIZATION




## KAMPO VALUE CHAIN

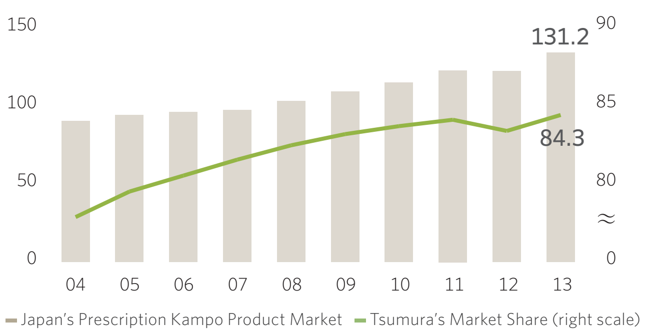
Tsumura's Kampo value chain begins with the procurement of raw material crude drugs. The Company maintains a stable supply of high-quality raw material crude drugs principally by signing cultivation contracts with farmers. At the same time, we are working to develop artificial cultivation technologies for key crude drugs that are currently derived from wild plants. Moreover, to ensure the safety of the raw material crude drugs procured, we have established a traceability system.

The manufacturing process technology and know-how that Tsumura has accumulated over the years support an unparalleled scale of manufacturing operations that mass produce a diverse variety of prescription Kampo products. Up until now, Tsumura has independently developed its large-scale manufacturing equipment, making capital investments for manufacturing expansion in stages in accordance with growing demand for Kampo products. As a result, our manufacturing facilities are on a level that cannot be compared with any other companies.

Furthermore, as a market leader in the Kampo business, Tsumura is creating a massive basic research database on Kampo products as well as a clinical testing database. Collaborating with research institutes and medical institutions, we are taking steps to establish a body of scientific evidence on the efficacy of Kampo products based on such databases. Through these efforts, we are endeavoring to instill a high degree of confidence in Kampo products among the public and the medical community.

**Size of Japan's Prescription Kampo Product Market and Tsumura's Market Share***

¥ billion/%




# 84.3%

In fiscal 2013, the size of Japan's prescription Kampo market was ¥131.2 billion.* Tsumura held a 84.3% share of the market.

# FINANCIAL HIGHLIGHTS

TSUMURA & CO. and subsidiaries
Years ended March 31

### Growth

Consolidated net sales rose 10.7% from a year earlier, supported by firm growth in prescription Kampo product sales. Although the average decrease in prescription Kampo products prices under the official drug price revision was 3.8%, stepped-up sales activities and promotional activities under the "drug fostering" program drove overall earnings growth.

### Profitability

Although the increase in cost of sales caused by the decrease in official drug prices and a rise in raw material expenses was mitigated by efforts to reduce the SG&A expense margin through more efficient use of expenses, the operating income margin fell 0.3 percentage point, to 21.9%.

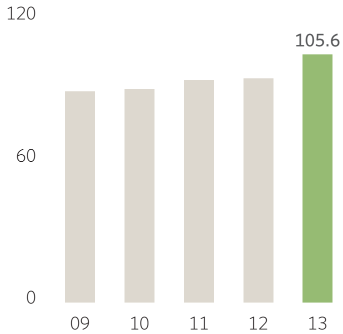
### Operating Efficiency and Stability

Consolidated net income increased 14.5% year on year with shareholders' equity also rising. As a result, return on earnings (ROE) remained the same as in the previous fiscal year, at 14.1%. The shareholders' equity ratio improved 2.1 percentage points, to 68.6%.

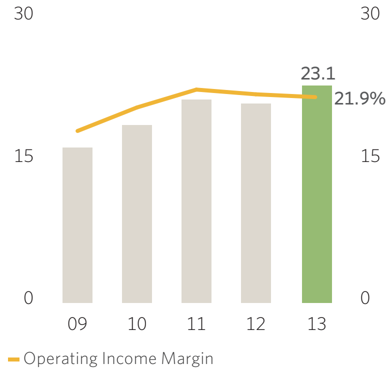
| | ¥ in millions | | | | | US$ in thousands* |
|---|---|---|---|---|---|---|
| | 2013 | 2012 | 2011 | 2010 | 2009 | 2013 |
| **For the year** | | | | | | |
| Net sales | ¥105,638 | ¥95,450 | ¥94,778 | ¥90,933 | ¥90,016 | $1,123,221 |
| Sales of prescription Kampo products | 99,457 | 89,964 | 89,247 | 83,782 | 79,013 | |
| Operating income | 23,124 | 21,233 | 21,553 | 18,938 | 16,483 | 245,879 |
| Net income | 15,373 | 13,431 | 12,945 | 10,704 | 10,777 | 163,456 |
| Selling, general and administrative expenses | 46,586 | 44,271 | 43,789 | 43,475 | 44,504 | 495,340 |
| R&D expenses | 4,904 | 4,565 | 4,123 | 3,770 | 3,958 | 52,149 |
| Depreciation | 4,049 | 3,850 | 3,453 | 3,225 | 3,298 | 43,055 |
| Capital expenditures for property, plant and equipment | 9,328 | 6,425 | 5,264 | 5,237 | 5,479 | |
| **At year-end** | | | | | | |
| Total assets | ¥170,466 | ¥151,874 | ¥141,549 | ¥134,697 | ¥126,824 | $1,812,513 |
| Total net assets | 118,537 | 102,240 | 91,154 | 83,752 | 73,968 | 1,260,364 |
| Interest-bearing debt | 22,059 | 22,070 | 23,086 | 23,204 | 25,412 | 234,545 |
| **Per share data** (yen/dollars) | | | | | | |
| Net income | ¥ 217.98 | ¥ 190.45 | ¥ 183.55 | ¥ 151.77 | ¥ 152.80 | $ 2.31 |
| Dividends | 62.00 | 60.00 | 58.00 | 46.00 | 34.00 | |
| Net assets | 1,658.88 | 1,430.94 | 1,274.06 | 1,175.04 | 1,037.76 | 17.63 |
| **Financial ratios** (%) | | | | | | |
| Operating income margin | 21.9 | 22.2 | 22.7 | 20.8 | 18.3 | |
| ROE | 14.1 | 14.1 | 15.0 | 13.7 | 14.9 | |
| ROA | 14.4 | 14.5 | 15.6 | 14.5 | 12.6 | |

* U.S. dollar amounts have been translated from yen, for convenience only, at the rate of ¥94.05=U.S.$1, the prevailing Tokyo foreign exchange market rate as of March 31, 2013.

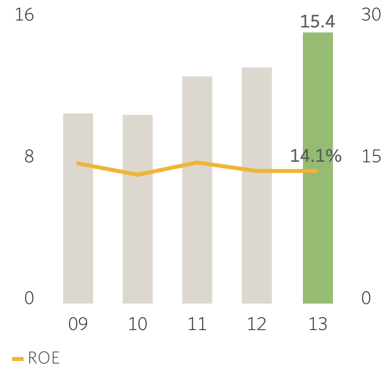
Net Sales
¥ billion



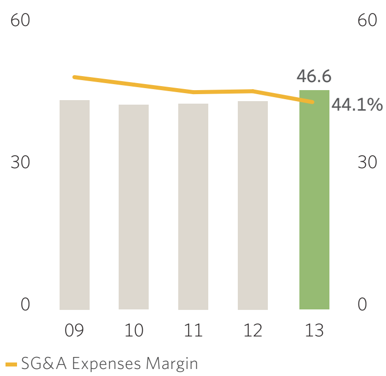

Operating Income/
Operating Income Margin
¥ billion/%



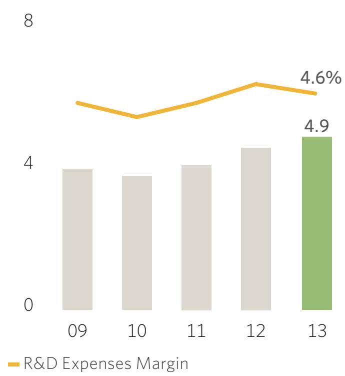

Net Income/ROE
¥ billion/%



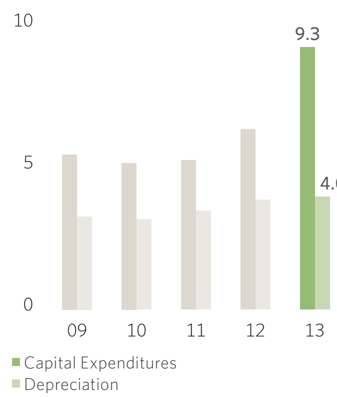

SG&A Expenses/
SG&A Expenses Margin
¥ billion/%



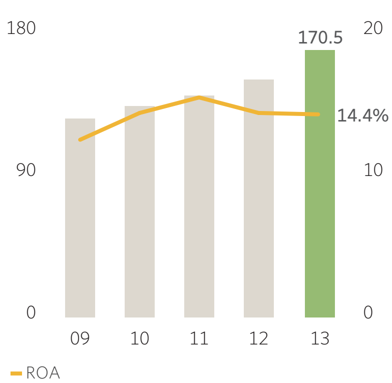

R&D Expenses/
R&D Expenses Margin
¥ billion/%



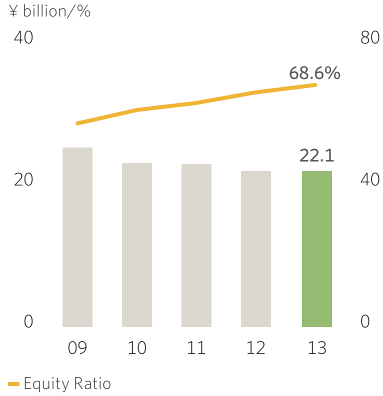

Capital Expenditures/
Depreciation
¥ billion



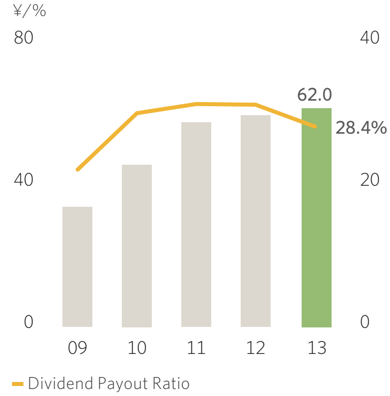

Total Assets/ROA
¥ billion/%




Interest-Bearing Debt/
Equity Ratio
¥ billion/%




Dividends per Share/
Dividend Payout Ratio
¥/%



# OPENING STORY—
# BRINGING OUT INHERENT STRENGTH


The raw materials for Kampo products are crude drugs, primarily of plant origin, two or more of which are blended together in formulations—some of which were determined more than 1,400 years ago. One of the special features of Kampo products is that they contain multiple ingredients—formulations contain several crude drugs, each with multiple ingredients. Kampo medicine's effect of stimulating our natural healing power and resistance to disease and balancing our overall bodies is thought to be linked to this special feature. The efficacy of Kampo medicine has been recognized within our modern medical system, and in Japan, prescription Kampo products are dispensed under the public healthcare insurance system.

## The combination of Kampo medicine and Western medicine opens up new medical treatment possibilities

Kampo products are widely used in the healthcare workplace in today's Japan.
The background to this acceptance of Kampo medicine is a national licensing system for physicians that does not differentiate between Western and Kampo medicine. The system allows physicians to prescribe both Western drugs and Kampo products. According to a recent survey, about 90% of Japan's physicians have prescribed Kampo products for their patients.* Moreover, Kampo medicine is included in the curriculums of all medical schools in Japan. These conditions have created a unique environment in which Kampo medicine has been integrated into a healthcare system based on Western medicine. This in turn has led to the use of Kampo products in such advanced medical treatment areas as oncology and surgery.

* Japan Kampo Medicines Manufacturers Association (JKMA), "2011 Survey on Prescribing Kampo Products."

# Developing crude drug cultivation in pursuit of a sustainable Kampo business

In the Kampo business, the quality and quantity of raw material crude drugs are extremely important aspects of operations. Accordingly, Tsumura includes farming as one of its business operations and is working to achieve a sustainable supply of safe and high-quality crude drugs through its cultivation and procurement programs. Specifically, the Company is providing guidance to farmers in China and Japan on cultivation technology and managing their use of pesticides under purchasing contracts. Tsumura procures 80% of its raw material crude drugs from China and another 15% from Japan. On the other hand, in Japan's Hokkaido and in Laos, which provides 5% of Tsumura's raw material crude drugs, we are operating our own farms. Among other related activities, we contribute to sustainable use of natural resources by taking steps to preserve the growing environment of wild plants that are harvested for crude drugs and to develop artificial cultivation technologies for those wild plants.

## Eliciting the growth power of the Kampo market using a scientific approach

Tsumura is endeavoring to establish a body of scientific evidence on the efficacy of Kampo products. This process involves conducting research on Kampo products that are deemed to be effective based on the amassing of empirical evidence. Our research aims to scientifically determine the chemical structures of their ingredients, elucidate their mechanisms, confirm that they can be safely used, and look at other aspects. Utilizing an abundant clinical database accumulated over our many years of Kampo operations and the underpinning basic research data, we are currently working to establish a body of scientific evidence for primarily five formulations. These efforts have already yielded a certain degree of success with the many scientific papers published on these formulations as a result of our program attracting attention both at home and abroad. That has led to the stimulation of new interest in and demand for Kampo products.

# MESSAGE FROM THE PRESIDENT

## DRAWING OUT TSUMURA'S STRENGTHS THROUGH MEDIUM-TERM BUSINESS PLAN EXECUTION AND INCREASING CORPORATE VALUE

One year has passed since I was appointed president in June 2012. During that time, I have traveled to our bases in Japan and China to explain our business strategies to employees. At the same time, I have kept up a dialogue with employees in our crude drug procurement, manufacturing, research and development, sales, and administration operations. Through this process, I have once again been reminded of two things about our company. First, I am leading a group of wonderful people filled with great pride and confidence in matters concerning Kampo medicine and a sense of mission in helping patients through their work. Second, I am managing a company of huge potential power.

Compared with Western drugs, manufacturing Kampo products can be said to require a lot more hands. Quickly running over the value chain, we have raw material crude drug producing farmers and the people responsible for transporting and storing the crude drugs and carrying out quality testing. Even in the technology and manufacturing processes, we need a much larger workforce compared with synthesizing drugs. Moreover, the extended timeframe of our value chain is characteristic of our business. It is not rare for the crude drugs used as raw materials for Kampo products to require several years to grow before harvesting. Therefore, our business requires a substantial amount of time from production of crude drugs to delivery of Kampo products into the hands of patients. I believe that the single greatest special feature of the Kampo business lies in this manufacturing of products over a long time span involving a large workforce.

We have in place a long-term business vision covering the 10-year period up to fiscal 2022. The medium-term management plan covering fiscal 2013 to 2016 that we announced in November 2012 is predicated on this long-term vision. Keeping in mind the previously mentioned special feature of the Kampo business, it is necessary for management of our company to be carried out from a long-term perspective and furthermore under the guidance of a long-term vision. Heading toward our long-term vision of "Aim to be a value-creation company that contributes to people's health through its Kampo medicine business," I intend to pursue management strategies that will draw out Tsumura's inner strengths.

### Fiscal 2013 Business Results

Fiscal 2013 was the first year of our first stage medium-term management plan aimed at realizing the goals of our long-term business vision. In my estimation, we made a good start toward those goals in fiscal 2013.

Looking at performance, consolidated net sales climbed 10.7% from a year earlier, to ¥105,638 million. In terms of profits, operating income increased 8.9%, to ¥23,124 million, while net income rose 14.5%, to ¥15,373 million. In fiscal 2012, we ended up recording a small increase in sales and profits because sales activities were hampered by the impact of the Great East Japan Earthquake. However, in fiscal 2013, growth in sales and profits returned to the same pace as before the major earthquake. Consolidated net sales achieved particularly strong results considering the average 3.8% reduction in official drug prices imposed by implementation of another of the two-year rounds of revisions. Of the Company's 129 formulations, 125 formulations posted year-on-year growth in the fiscal year under review.

The theme of the first stage medium-term management plan is "Strengthening the growth base to achieve greater value creation." The achievement of our performance goals can be attributed to the contributions of employees who believe in the value of Kampo medicine and redoubled their efforts to reach those goals. To attain growth in the Kampo business, an industry in which we have no companies to compare ourselves with, we have to have people who can pave a path forward on their own. I believe the fact that sales of our combined prescription Kampo and OTC products exceeded ¥100 billion for the first time in 20 years, is evidence of such people performing to their full potential.

**Fiscal 2013 Business Results**

¥ million

| | Plan (Revised November 8, 2012) | FY2013 | Vs. Planned | | YoY | |
|---|---|---|---|---|---|---|
| | | | Amount | Difference | Amount | Growth |
| Net sales | 104,500 | 105,638 | 1,138 | 1.1% | 10,188 | 10.7% |
| Operating income | 22,800 | 23,124 | 324 | 1.4% | 1,891 | 8.9% |
| Net income | 14,400 | 15,373 | 973 | 6.8% | 1,941 | 14.5% |
| Operating income margin | 21.8% | 21.9% | | +0.1 pts | | −0.3 pts |

**Price Revisions of the NHI Drug Price List**

% change

| | 4/2000 | 4/2002 | 4/2004 | 4/2006 | 4/2008 | 4/2010 | 4/2012 |
|---|---|---|---|---|---|---|---|
| All pharmaceuticals | −7.0 | −6.3 | −4.2 | −6.7 | −5.2 | −5.75 | −6.0 |
| All Kampo medicines | −5.6 | −5.2 | −3.8 | −4.7 | −3.6 | — | — |
| **Tsumura Kampo medicines** | **−3.4** | **−3.6** | **−2.8** | **−4.2** | **−3.3** | **−4.5** | **−3.8** |

### Factors Contributing to Sales Growth

Analyzing in detail the forces that drove sales growth in fiscal 2013, we can say that there were two main factors involved—a full-scale exertion of sales power and the reaping of the fruits of our "drug fostering" program.

During the fiscal year under review, we took several steps to achieve a full-scale exertion of sales power. We expanded our medical representative (MR) sales visits programs to include physicians who do not already prescribe Kampo products and had never been visited before. At the same time, we actively held Kampo seminars, lectures and study groups, and information meetings at medical institutions. As a result, we greatly increased the number of sales visits and information meetings held for medical departments by MRs in comparison with a year earlier. In fiscal 2012, our sales activities were substantially affected by self-imposed restraint policies following the major earthquake.

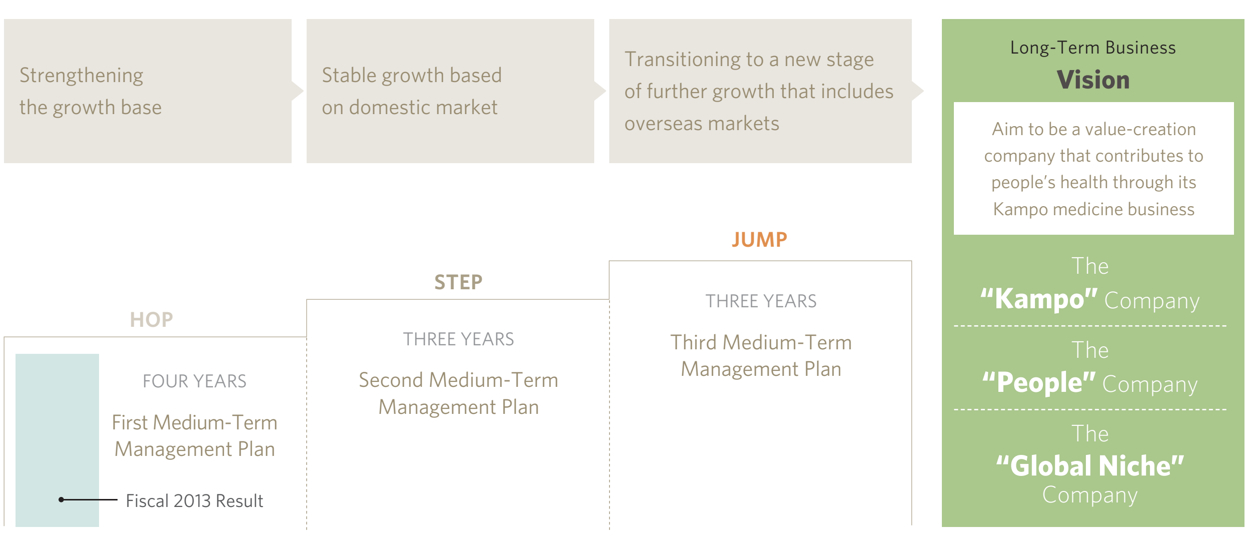
The second factor was progress with our "drug fostering" program to establish a body of scientific evidence for the efficacy of Kampo medicine. "Drug fostering" is a term coined by Tsumura to represent our efforts to build a body of scientific evidence on the efficacy of Kampo products. To do so, the Company has looked at the recent structure of disease and selected fields where medical treatment needs are high and prescription Kampo products demonstrate special efficacy for disorders that are difficult to treat with Western drugs. In recent years, our research efforts have been yielding a steady stream of results. While the details of our research efforts are mentioned elsewhere in this message, those results have had a significant impact in raising recognition of the efficacy of Kampo medicine among physicians. Synergies with our MR activities have led to an increase in the number of physicians prescribing Kampo products.

### Long-Term Business Vision and Medium-Term Management Plans

Guided by our corporate mission of "contributing to the unparalleled medical therapeutic power of the combination of Kampo medicine and Western medicine," in November 2012, we announced our long-term business vision. In that business vision, we established the following three goals for Tsumura.

**Strategic Positioning of Fiscal 2013**

**First Year of Long-Term Business Vision**



• The "Kampo" Company
We shall contribute to creating a healthcare environment in Japan where all patients can receive treatment that includes Kampo medicine where appropriate in any healthcare institution or medical specialty.

• The "People" Company
Kampo medicine is a pioneering field with no previous examples to build on worldwide. Therefore, we shall evolve into a corporate group comprised of people with professional skills that can independently pave the way forward for our Kampo business and is trusted by all.

• The "Global Niche" Company
Leveraging the technology and know-how of the Tsumura Group to the maximum, we will make efforts to develop new business, such as launching TU-100 (Daikenchuto) in the U.S. pharmaceutical market.

As mentioned before our long-term business vision was formulated based on the belief that a long-term value-creation perspective is essential to success in the Kampo business. We are pursuing value-creation with the goal of enabling Kampo medicine to demonstrate its maximum power wherever healthcare is practiced.

## Summary of 1st Medium-Term Management Plan

As a roadmap for realizing our long-term business vision, we formulated three medium-term management plans, rolling out the four-year 1st plan in fiscal 2013. The theme of the plan is "Strengthening the growth base to achieve greater value creation." Under that theme, we are pursuing the three strategic issues of expanding the Kampo medicine market, enhancing earning power, and increasing corporate value by executing effective financial and capital policies.

### Expanding the Kampo Medicine Market

Tsumura holds a greater than 80% share of the Kampo product market in Japan. At the same time we continue to make efforts to expand the market itself to fulfill our corporate mission of "contributing to the unparalleled medical therapeutic power of the combination of Kampo medicine and Western medicine." As can be seen in our performance record, our top line growth has not been at the expense of the market shares of other companies, but reflects the expansion of the market in Japan.

To expand the Kampo market, we are implementing sales promotions aligned with the usage of Kampo products by individual physicians. At the same time, we are pursuing measures to promote increased prescribing of strategic Kampo products based on a consideration of the needs of each type of medical institution. On top of those efforts, we are continuing our Kampo education activities. We are supporting expanded and enhanced Kampo education activities at university hospitals and designated hospitals for clinical training. We are also continuing our different types of Kampo seminars, lectures and study groups, and information meetings for medical specialty departments.

Furthermore, we are ramping up our activities for our program to establish a body of scientific evidence, which is already yielding strong results, and our promotional activities based on that scientific evidence. Overseas, we are pressing forward with development of TU-100 (Daikenchuto) in the United States.

### Enhancing Earning Power

While pursuing sales growth, we are also aiming to strengthen our profitability. We are proceeding with reform of the Company's cost structure by introducing innovative new manufacturing technology for Kampo products and improving crude drug production efficiency. Through this process, we are building a manufacturing base that will contribute to reducing manufacturing costs. Moreover, we are accelerating our drive to reduce the selling, general and administrative (SG&A) expenses ratio. Specifically, we will continuously test and implement measures to cut manufacturing costs, building new manufacturing systems and strengthening our operating system. We will also improve production efficiency for raw materials crude drugs by expanding Cultivated Land under Own Management and developing cultivation technology.

Furthermore, we will strive to improve our marketing efficiency through such measures as our scientific evidence based promotional activities.

### Increasing Corporate Value by Executing Effective Financial and Capital Policies

We are targeting increased profit through sustained growth in prescription Kampo product sales and reform of our cost structure. In addition, we are aiming to increase asset efficiency by controlling raw material crude drug inventories, improving cash management, and reviewing our holdings of non-operational assets, such as some of our marketable securities. Based on these measures, we plan to maintain our current return on earnings (ROE) level of 14%, even after capital investment and official drug price revisions, aiming to continuously build Tsumura's corporate value.

### Kampo Medicine Market Expansion Strategies and Progress

According to a survey by the Ministry of Health, Labour and Welfare, there were a total of about 295,000 physicians in Japan as of the end of 2010. If half of those physicians prescribed multiple Kampo products, we believe that Tsumura would be close to its goal of "creating a healthcare environment in Japan where all patients can receive treatment that includes Kampo medicine where appropriate in any healthcare institution or medical specialty." With that in mind, we are targeting expansion of the Kampo medicine market through the three approaches of supporting Kampo medicine education, establishing a body of scientific evidence, and internationalizing Kampo medicine.

• Supporting Kampo Medicine Education

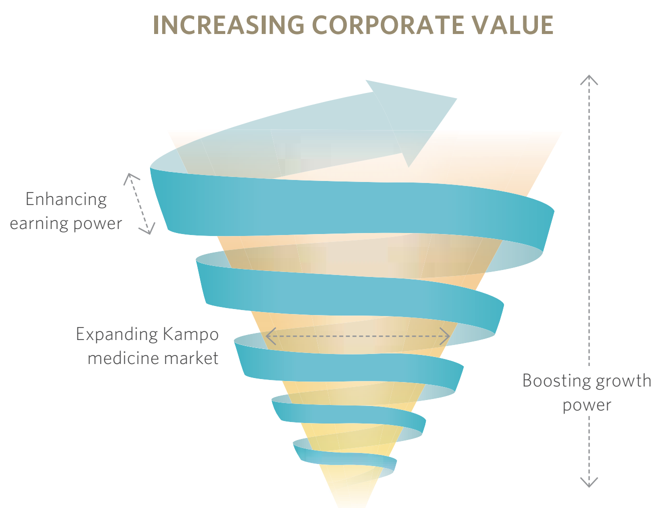
In Japan, no distinction is made between physicians practicing Western or Kampo medicine and their services are provided under the same national licensing system for physicians. Logically then, all physicians can prescribe Kampo products.

**Reaching Cruising Speed for Boosting Growth and Corporate Value**

## Aim for Sustained Growth at Optimum Speed by Pursuing Our Strategic Issues

**Strengthening the growth base to achieve greater value creation**

- Expand the prescription Kampo product market in Japan
- Reform the Company's cost structure through the introduction of new technology and other measures
- Increase corporate value by executing effective financial and capital policies



However, as symbolized by the national examination for medical practitioners' exclusive focus on Western medicine, in the past the opportunities to take courses specializing in Kampo medicine have been extremely limited for a great many physicians.

We believe that for Kampo medicine to become more mainstream, it is essential that physicians first become familiar with it. Based on this conviction, we have been promoting Kampo medicine education at medical schools. Moreover, we have been providing similar comprehensive and continuous support for physicians at all stages of their careers, from their student days, to physician-in-training, to practicing physician.

Currently, Kampo medicine courses are taught at all 80 medical schools in Japan. Of this total, 78 medical schools include at least eight Kampo medicine courses in their required curriculum. In 2011, the Ministry of Education, Culture, Sports, Science and Technology revised its guideline for medical education, the "medical education model core curriculum." In the revision, the Ministry upgraded the objective for Kampo medicine to "a general understanding of Japanese Kampo (Kampo products) and their current uses."

Tsumura also provides practicing physicians with a platform for learning about Kampo medicine through its Kampo medicine introductory and step-up seminars and other formats. Moreover, physicians maintain quite close contact with each other through formal and informal networks. It seems that there is an active exchange of information about the efficacy of Kampo products within these networks.

• Establishing a Body of Scientific Evidence

In the past, a negative view of Kampo products existed among physicians, who thought that there was no basis for believing in their efficacy. However, that situation has changed dramatically in recent years. The backdrop to this sudden reversal in opinion is Tsumura's activities under its "drug fostering" program. In other words, we changed the target of our R&D activities from new drug discovery to building a body of scientific evidence on the efficacy of Kampo products. The results of that change in R&D direction have materialized in a clearly visible form.

We are making steady progress with building a body of scientific evidence for the five Kampo formulations in the "drug fostering" program. As the evidence emerges, physicians who were hesitant about using Kampo products because they thought there was no scientific basis for it have begun to take an interest. In fact, multiple medical institutions are now carrying out basic and clinical research on Kampo products. In addition, in recent years there has been a marked increase in requests by medical institutions for Tsumura to hold information meetings for their medical departments.

We recognize this as a process. First, we create an interest in Kampo medicine among physicians. Then, we suggest to them to prescribe a high success rate formulation, which convinces almost all physicians of the efficacy of Kampo medicine. Following that experience, they form a positive attitude toward Kampo medicine. The building of a body of scientific evidence on the efficacy of Kampo medicine provides the breakthrough that evokes this positive change in perspective. In terms of expanding the Kampo medicine market, it can be said to be an extremely effective tool.

• Internationalizing Kampo Medicine

Since 2009, with the cooperation of U.S. medical institutions, we have been conducting U.S. clinical trials on TJ-100 (Daikenchuto)—we use the code number TU-100 in the United States. Our goal is to seek approval for Daikenchuto as a prescription drug and launch it in the U.S. market. We are now at the Phase II clinical testing stage. We plan to reach an agreement on a quality evaluation method for Kampo products with the U.S. Food and Drug Administration (FDA) agency by the end of fiscal 2016, and start Phase III clinical trials in fiscal 2017.

If TU-100 (Daikenchuto) is approved in the United States based on the body of evidence we have established there, we expect it will increase the degree of trust in Kampo products not only in the United States, but among physicians in Japan as well.

**Enhancing Earning Power Strategies and Progress**

During the period covered by our medium-term management plan, we plan to make capital investments at several of our manufacturing bases. Through an overall revision of our manufacturing system and the introduction of new manufacturing technology, we expect to improve productivity.

• Introducing New Manufacturing Technology

Compared with Western drugs, the manufacture of Kampo products requires large-scale facilities for each process. The raw materials crude drugs must be blended according to specific mix proportions, then the blended crude drug must be extracted, flash dried using spray dryers, and go through further processing. Furthermore, the manufacturing lines require many workers. As a result, any manpower savings achieved by renewing our manufacturing facilities will have a large impact on profitability.

During our current medium-term management plan, we will be making capital investments of about ¥55.0 billion, with the intent of strengthening the capabilities of our powdered extract, granulation, and packaging systems for each of our production lines. Our aim is for more than just improvements and repair—these are bold capital investments to optimize our entire manufacturing system. They will produce a dramatic improvement in labor productivity and reform our cost structure.

To determine whether reforming our cost structure was possible, I held discussions with the engineering staff of our production technology center. These experts are extremely familiar with the conditions in our manufacturing facilities. I received adequate assurances that we can be confident in pushing ahead with the capital investment plan. I mentioned at the beginning of this message that I travelled to our bases in Japan and China to speak with employees. I feel that in creating a well-grounded medium-term management plan, conducting these hearings on site was very important to the decision-making process.

• Improving Productivity

In addition to new manufacturing technology, we are raising shipment volume to improve productivity. The reason behind this action is that production loss occurs on Kampo product manufacturing lines when changeovers are made to switch to another product. The production line has to be stopped, cleaned, and restarted. This process requires a certain amount of time and labor, and the greater the number of changeovers, the greater the decline in productivity. If shipment volume increases, the production lines run longer for each product, changeover frequency declines, and productivity increases. In addition to this tactic, we are also looking at methods of automating the changeovers for each of our processes as well as other innovations, working to further improve our manufacturing productivity.

• Expanding Cultivated Land under Own Management

Terming it Cultivated Land under Own Management, we are concentrating on increasing the amount of farmland for which we can directly provide cultivation instruction and monitor the cultivation costs. Based on this control, we can determine the purchasing price for crude drugs. This Cultivated Land under Own Management includes not only directly managed farms in Laos and our farmland in Yubari in Japan, but also farms managed through partner companies.

The crude drugs produced by our Cultivated Land under Own Management still represent only a fraction of our total procurement of raw material crude drugs. However, if we continue to steadily expand this type of farmland and are able to manufacture under the three favorable conditions of stable quality, procurement, and price, we can expect great benefits from achieving low and stable raw material costs. Furthermore, as is typical in the agricultural industry, once our operations become well established, we should be able to reap the benefits for years to come. In that sense, establishing Cultivated Land under Own Management as the foundation of our business resources is strategically important. For the future, I want to use expansion of our Cultivated Land under Own Management as a way to control our raw material crude drug costs and inventory levels.

• Increasing Crude Drug Cultivation Bases in Japan

Tsumura is also stepping up its crude drug cultivation activities in Japan. Until now our efforts have been concentrated mainly on Hokkaido. However, we have also signed cultivation contracts with producers in Iwate, Gunma, Kochi, and Wakayama prefectures, working to accumulate crude drug cultivation and quality control know-how in Japan. In fiscal 2014, Tsumura set up a new base in southern Kumamoto Prefecture, aiming to steadily increase the amount of cultivation farmland in Japan.

**Medium-Term Management Plan Strategic Issues and Goals**

| Strategic issue | Activity | Goals |
|---|---|---|
| Expanding the Kampo medicine market | Supporting Kampo medicine education | Enhancing, firmly establishing, and developing comprehensive Kampo medicine education for physicians before, directly after, and post graduation |
| | Establishing a body of scientific evidence | Establishing basic and clinical scientific evidence, primarily for five “drug fostering” program formulations |
| | | Creating safety database using frequency of occurrence of adverse reactions surveys and drug interaction and other data |
| | | Discovery of ADME (Pharmacokinetics) for main ingredients of five “drug fostering” program formulations |
| | Internationalizing Kampo medicine | Developing and launching TU-100 (Daikenchuto) in U.S. market sometime in FY2020–FY2021 |
| Enhancing earning power | Increasing labor productivity | More than 20% improvement by FY2016 compared with FY2012 |
| | Restricting growth in the cost of sales ratio | Ratio expected to go up by 3.3 points by FY2016 compared with FY2012 |
| | Reducing SG&A expenses ratio | 5.1 point improvement by FY2016 compared with FY2012 |
| | Increasing operating margin | 1.8 point improvement by FY2016 compared with FY2012 |
| | Realizing stable procurement of crude drugs | Increasing crude drug cultivation bases in Japan |
| | | Expanding Cultivated Land under Own Management |
| Executing effective financial and capital policies | Increasing corporate value | ROE 14% |
| | | EPS ¥269 |

• Increasing Efficiency of MR Activities

Although a link was revealed between strengthening MR activities and sales growth in our fiscal 2013 business performance, we have no plans to sharply increase the number of MRs. Rather than using more people, I want to boost the quality of our MR activities to increase the sales per MR figure. In more concrete terms, we will aim to improve the efficiency of our activities by effectively utilizing the results of our "drug fostering" program.

**Fiscal 2016 Performance Targets**

¥ million/%

| | |
|---|---|
| Net sales | 123,000 |
| Operating income | 29,500 |
| Net income | 19,000 |
| Operating income margin | 24.0% |

Note: The performance targets above are established based on the information available at the time of the development of the medium-term management plan and are also subject to certain assumptions. Therefore, our actual financial performance may differ.

### Returning Profits to Shareholders

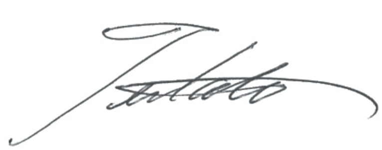
Since December 2012, the original sharp depreciation of the yen and following corrections have made it difficult to determine the impact of foreign exchange rate fluctuations on performance. Under these conditions, we plan to maintain stable dividend payouts while taking into consideration our earnings levels over the medium to long term. In addition, we will look at implementing buybacks of our shares while keeping a close eye on our capital investment and cash flows needs. Placing our top priority on strengthening our business base in preparation for long-term growth, I intend to respond to the expectations of investors by increasing corporate value over the medium to long term.

### Company Activities and Shared Values with Society

Nowadays, people have begun to question the significance of the value generated by companies to society. At Tsumura, we have also for some time debated how to create social value through our business. Among other activities, we have made efforts to recycle the waste generated by our manufacturing and participated in protection of the environment in the regions where raw material crude drugs grow. However, the social contribution that is closest to my heart is just how much our Kampo products are contributing to a better life for people.

TJ-54 (Yokukansan), one of our five "drug fostering" program formulations, is effective in treating nervous disorders associated with dementia, such as agitation, frustration, and insomnia. Naturally, Yokukansan improves the symptoms of the patients, but it also improves the lives of many other people involved. I am frequently told how Yokukansan alleviates the burden of the family and the healthcare staff caring for the patient as well as improving their relationship with the patient. Whenever I hear about such cases of the effectiveness of Kampo medicine, I am inspired by the power of Kampo medicine and am proud to be contributing to the growth of the Kampo business. I hope that this annual report will provide investors with an opportunity to gain a deeper understanding of Tsumura's value-creation process.

August 2013



Terukazu Kato
President, Representative Director

## SPECIAL FEATURE

# Tsumura's Growth Strategy

The theme of the first stage of Tsumura's medium-term business plan is "Strengthening Our Growth Base." Guided by that theme, the Company is building the Kampo market, progressing toward its goal of creating a healthcare environment where all patients can receive treatment that includes Kampo medicine where appropriate in any healthcare institution or medical specialty. In this section, we look at Tsumura's three approaches to expanding the prescription Kampo market and growing its Kampo business, considering their effectiveness and future directions.

## GROWTH INITIATIVE 1:
## PURSUING DRUG FOSTERING AND EVOLUTION OF KAMPO

# The "drug fostering" program is essential to building trust in Kampo medicine and the key to growth in demand

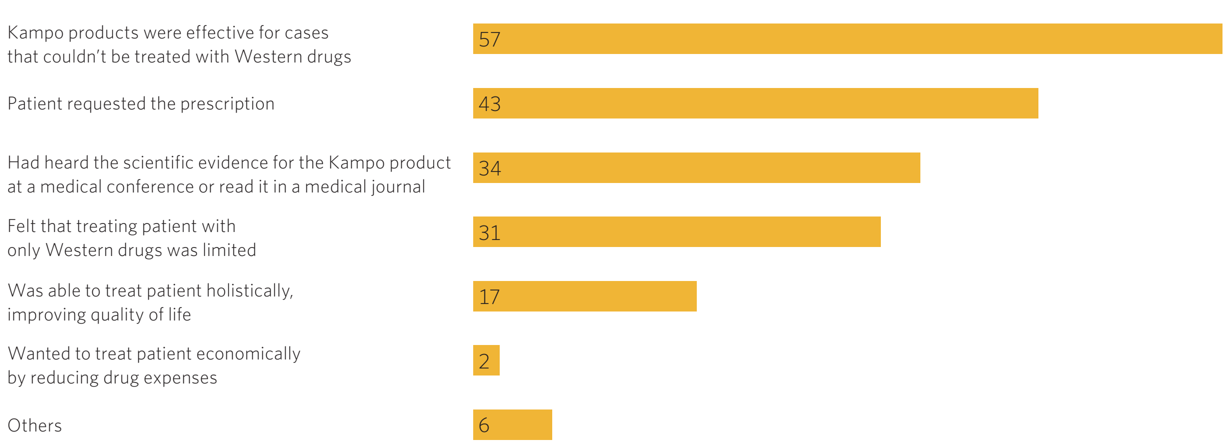
"Drug fostering" is a term coined by Tsumura to represent its efforts to build a body of scientific evidence on the efficacy of Kampo products. To do so, the Company has selected fields where medical treatment needs are high and Kampo products demonstrate special efficacy. Currently, Tsumura is focusing its program on five formulations—TJ-100 (Daikenchuto), TJ-43 (Rikkunshito), TJ-54 (Yokukansan), TJ-107 (Goshajinkigan), and TJ-14 (Hangeshashinto).

According to a 2011 survey* on the prescribing of Kampo products by physicians, "Had heard the scientific evidence for the Kampo product at a medical conference or read it in a medical journal" was among the top reasons for prescribing Kampo products. Moreover, in the same survey, physicians already using Kampo medicine in their practices were asked how they got started. "It was recommended by another physician" was the top response (45%) ahead of "Because of information provided by medical representatives" and "Because I heard it at a medical conference or read it in a medical journal." Combining this type of data with feedback from physicians gathered through our MR activities, it is clear that establishing a body of scientific evidence has important significance to physicians as a reason for prescribing Kampo products. It also proves that the use of Kampo products is spreading because of recommendations passed "by word of mouth" among physicians.

* Survey conducted by the Japan Kampo Medicines Manufacturers Association (JKMA)

**Reasons for Prescribing Kampo Products**

Proportion of times (%) included in responses with multiple choices possible (Valid number of responses = 558)




Source: 2011 Survey on Prescribing Kampo Products, the Japan Kampo Medicines Manufacturers Association

### Five "Drug Fostering" Program Formulations

| Name | Expected efficacy | Significance to program |
|---|---|---|
| TJ-100 (Daikenchuto) | Improves abdominal bloating from post-operative ileus (intestinal paralysis). Because it has been proven to stimulate or regulate enterokinesis and to increase intestinal blood flow, it is expected to also have application in treating patients with disorders thought to be caused by reduced intestinal blood flow. | Establishing scientific evidence of efficacy of prescription Kampo products in the surgical field. |
| TJ-43 (Rikkunshito) | Alleviates upper abdominal indefinite complaints arising from functional dyspepsia (FD), gastro-esophageal reflux disease (GERD), and others. Besides helping gastric emptying, it has been reported that TJ-43 (Rikkunshito) improves stomach content retention and helps stimulate the appetite. It is drawing considerable attention for its multiple mechanisms of action (MOA) in sharp contrast to modern drugs. | Elucidating special characteristics of multiple ingredient based Kampo medicine and correlation to MOA. |
| TJ-54 (Yokukansan) | Improves behavioral and psychological symptoms of dementia (delusions, hallucinations, anxiety, insomnia, and other disorders). | Researching the medical and economic contribution of Kampo medicine to medicine and medical treatment in an aged society. |
| TJ-107 (Goshajinkigan) | Alleviates neurotoxicity (numbness) adverse reactions of anticancer drugs and other treatments used in chemotherapy. | Establishing a body of scientific evidence on the efficacy of Kampo medicine in oncology and other advanced medical treatment fields. |
| TJ-14 (Hangeshashinto) | Mitigates mucosal damage (diarrhea and oral inflammation) resulting from anticancer drugs and other causes. | |

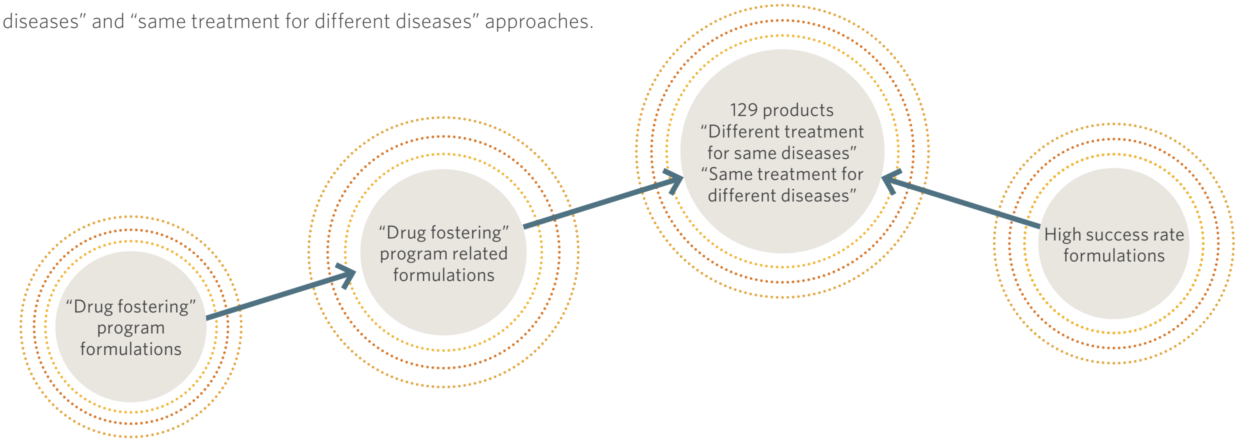
Since beginning the "drug fostering" program in fiscal 2005, Tsumura has been steadily building its body of scientific evidence. In addition to the cumulative body of basic and clinical research evidence, in September 2012, the results from a frequency of occurrence of adverse reactions survey on TJ-100 (Daikenchuto) were reported in a scientific journal, with the package insert revised in October. A similar survey is under way for TJ-54 (Yokukansan), with the collection of patient cases expected to be completed in fiscal 2014. The building of a database on the safety of Kampo products through such surveys or detailing adverse reactions is highly evaluated by people in the healthcare community.

Results of clinical trials for the three formulations where research has progressed the most—TJ-100 (Daikenchuto), TJ-43 (Rikkunshito), and TJ-54 (Yokukansan)—have been reported in authoritative scientific journals and at medical conferences. In turn, the scientific evidence has been recognized by physicians, acting as a driver for our sales growth. This process is an effective method of increasing the prescribing of Kampo products. First, there is an increase in the number of physicians taking an interest in Kampo medicine after deciding to prescribe one of the "drug fostering" program formulations increases. Then, the use of other Kampo products spreads among physicians, with this practice traveling out through physicians' information networks. Consequently, we intend to vigorously pursue our "drug fostering" program, working to strategically and effectively expand the prescribing of Kampo products.

**Strategic Expansion in Use of Different Kampo Formulations**

Aim for efficient increase in popularity of Kampo treatments

Starting with the "drug fostering" program or high success rate formulations, physicians progress to using more other Kampo products, ultimately resulting in the increase in the number of physicians who can use traditional Kampo medicine using "different treatment for same diseases" and "same treatment for different diseases" approaches.



## GROWTH INITIATIVE 2: STRENGTHENING MR ACTIVITIES

# Promoting the power of Kampo products by providing each physician and medical institution with information to suit their needs

Multiple surveys done in recent years have shown that approximately 90% of Japanese physicians have some experience in prescribing Kampo medicine. Given the public's heightened interest in Kampo medicine, we can probably say that Kampo products have become a common option for treatment among physicians.

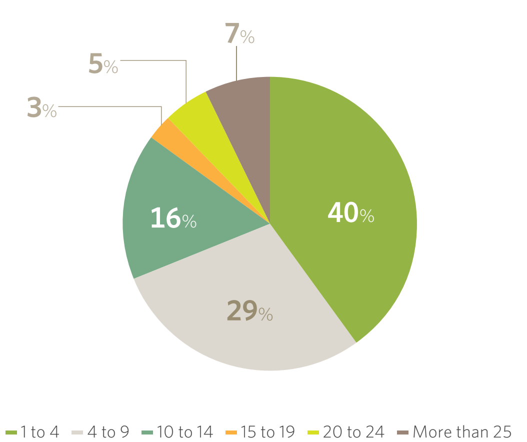
More-detailed surveys make it clear that the number of physicians prescribing Kampo products is not the only thing that is increasing. In fact, the number of types of Kampo products they prescribe is also growing. According to the JKMA's 2011 Survey on Prescribing Kampo Products, the average number of different Kampo products prescribed by the 558 respondent physicians who actually prescribe Kampo products was 8.5 products. The figure compares with 7.8 products in a previous survey done in 2008.

Nevertheless, the data collected through our MR activities tells us that this trend is still restricted to a fraction of Japan's physicians. Most physicians only use a limited number of Kampo products in their practices. Actually, the 2011 survey indicates that 40% of the respondents prescribed from 1 to 4 different Kampo products, with this number rising to 69% of the respondents when physicians using 5 to 9 different Kampo products were added. In contrast, only 31% of the respondents were using 10 or more different Kampo products, suggesting that these physicians are still a minority.

In consideration of these circumstances, Tsumura is increasing its market activities for all medical institutions, including medical clinics, hospitals, designated hospitals for clinical training, and university hospitals. In conjunction with those marketing activities, we are offering information support customized to physicians' level of interest in Kampo medicine as shown in the table on the next page.

Tsumura has for some time been supporting Kampo medicine education in medical colleges and universities. Evidence of these activities has shown up clearly in our MR activities. Whereas in the past we had to begin our visits to physicians with an explanation of "Just what is Kampo medicine," we now find there is a growing group of, mainly young, physicians that already have a basic understanding of and no resistance to the concept of Kampo medicine. To enable such physicians who already know about Kampo medicine from their student days to make use of that knowledge in a clinical setting, we are actively planning study groups for physicians-in-training working at designated hospitals for clinical training and university hospitals.

**Number of Types of Kampo Products Prescribed by Physicians**
Physicians who actually prescribe Kampo products
(Valid number of responses = 558)



## Information Support for Physicians

| Tsumura's approach | Details |
|---|---|
| Sales visits and meetings | Visit physicians individually, supplying them with information according to their needs.<br>If they show an interest in Kampo medicine, explain formulations that have the highest success rates. |
| Medical department information meetings | Explain the body of scientific evidence on Kampo medicine gathered by the "drug fostering" program to individual groups of research and diagnostic physicians in specialty departments at university hospitals and hospitals. |
| Kampo medicine seminars<br>(Introductory seminars) | Seminars are held all-year-round targeting physicians already working in the clinical field, but have never had the opportunity to study Kampo medicine. |
| Kampo medicine seminars<br>(Step-up seminars) | These seminars target physicians that have previously taken the introductory course and provide other physicians with an opportunity to increase their knowledge of Kampo medicine and products. |
| Kampo medicine seminars for designated hospitals for clinical training<br><br>Kampo medicine seminars for Kampo medicine lecturers<br>Kampo Medical Symposium | In this category, Tsumura targets providing information on Kampo medicine to physicians and lecturers in Kampo medicine at medical colleges and universities. In addition, Tsumura holds its Kampo Medical Symposium annually, bringing education-related people together under one roof to discuss Kampo medicine education issues and best practices. |

### Expansion Strategy for Kampo Medicine Market

Pursue marketing strategies that respond to the needs of physicians (institutions)

Physicians at clinics, hospitals, designated hospitals for clinical traning, university hospitals, and in all medical specialties

| Kampo non-users | Kampo users | Specialists |
|---|---|---|
| Visit/meeting | Kampo medicine seminars | Medical institution information meetings |
| Discover interest in Kampo medicine<br>→ Provide information according to needs | Kampo medicine style customized treatment<br>"Different treatment for same diseases"<br>"Same treatment for different diseases" | Obtain opportunities to make presentations on Kampo use in medical specialty fields<br>→ Explanation based on scientific evidence |
| Start with<br>**high success rate formulations** | Promote use of<br>**more that 10/20 formulations** | Promote use with many patients focused on<br>**"drug fostering" formulations** |

**Kampo products used in daily medical practice in all medical institutions and specialty fields**

## GROWTH INITIATIVE 3: ACHIEVING STABLE PROCUREMENT OF CRUDE DRUGS

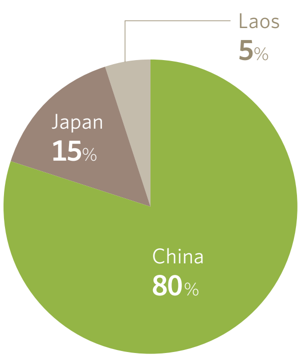
# Tsumura's sustainable growth depends on stable procurement of safe, high-quality raw material crude drugs based on an advanced value chain

One of the special characteristics of the Kampo medicine business is that its main raw material crude drugs are agricultural products. The concentrations of ingredients and other quality factors for raw material crude drugs change according to growing region and climate. Therefore, achieving stable procurement and quality control requires know-how that cannot be learned overnight. Depending on the variety of crude drug, the wild or cultivated plant may require several years before it can be harvested. Consequently, it is extremely important to procure supplies from a long-term perspective while carefully monitoring movement in Kampo product demand.

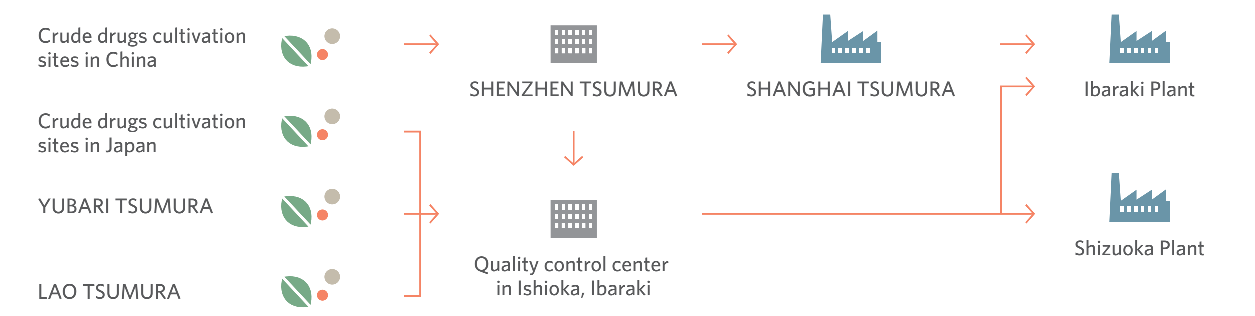
The Company procures approximately 80% of its raw material crude drugs from China, about 5% from Laos, and the remaining 15% from Japan. Our base in China, the origin of most crude drugs and our major procurement source, is SHENZHEN TSUMURA MEDICINE CO., LTD. Established in 1991, the local subsidiary purchases raw material crude drugs grown in China through their local production companies. The local subsidiary selects and processes the raw material crude drugs and provides quality control and storage functions as well as acting as a traceability base by gathering local production area information, providing farming guidance, and other activities.

In 2010, Tsumura established LAO TSUMURA CO., LTD., in Laos, to complete the traceability system for its crude drug procurement network. The local subsidiary is cultivating crude drugs on its Cultivated Land under Own Management. In recent years, the Company has also set up cultivation bases for crude drugs in Japan.


**Origin of Raw Material Crude Drugs**
(%)



### Sharing Traceability Information




Tsumura's raw material procurement is based on cultivation contracts. In China, we provide farmers with technological guidance and share our quality control know-how, including the use of agricultural chemicals, with the aim of increasing procurement amounts and achieving more-efficient production. Furthermore, through joint research with local partners, we are working at developing cultivation technology for rare raw material crude drugs. In 2011, after 10 years of research, we succeeded in developing such technology for licorice. Currently, we are proceeding with efforts to establish large-scale cultivation technology for licorice.

Our goal is to achieve stable procurement of crude drugs that meet the strict quality standards of the Company. Consequently, constant upgrading of our procurement, logistics, and traceability systems in China, the main production area for raw material crude drugs, is critical to our business model. Reflecting its strategic importance, Tsumura newly established a China Coordination Department in April 2013. Through this office, the Company will pursue strategies to achieve stable procurement of crude drugs in China.

Stable procurement of crude drugs is an essential condition for Tsumura's success with its growth strategy. It can be said that procurement determines the optimum speed or so-called cruising speed at which the Company can grow and build its corporate value. In recognition of this fact, we are taking steps to expand our Cultivated Land under Own Management. In other words, in China and Japan, we are increasing the amount of farmland with a certain scale of cultivable land where we can manage conditions. This oversight allows us to monitor actual cultivation costs, which in turn enables the calculation of crude drug prices. These farmlands not only serve as a hedge against extreme fluctuations in market prices, but also as a tactic in our strategy to control our future procurement costs.

# REVIEW OF OPERATIONS

## TRENDS IN PHARMACEUTICAL KAMPO PRODUCTS SALES AND PROFITS

### Pharmaceutical Kampo Products Sales and Market Share

In fiscal 2013, the year ended March 31, 2013, the Company posted solid growth in prescription Kampo products sales, reversing the weak performance in the previous fiscal year under the impact of the Great East Japan Earthquake. Net sales increased 10.7% year on year, to ¥105,638 million. Similarly, the overall prescription Kampo products market grew 9.6%, to an estimated ¥131.2 billion.[*1] As a result, Tsumura's share of the overall market rose 1.0 percentage point, to 84.3%.[*1] On a sales basis, prescription Kampo products are estimated to have accounted for approximately 1.4% of the total pharmaceutical drug market.[*1]

### Prescription Kampo Products Sales

Sales of the 129 formulations of prescription Kampo products manufactured by Tsumura increased 10.6% from a year earlier, to ¥99,457 million. Compared with the slight increase of 0.8% in the previous fiscal year, the Company registered substantial sales growth. The increase could be attributed to sales increases for 125 of the 129 formulations.

On a unit sales basis, actual sales by pharmaceutical wholesalers to medical institutions rose 15.1%, to 17.18 million units. Despite the decrease in the official drug price[*2], on a monetary basis, sales also increased 11.2% year on year.

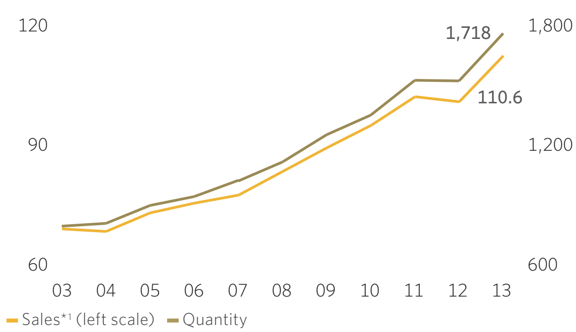
### Impact of the Official Drug Price Revision

In fiscal 2013, the government implemented a revision of the official drug price list for drugs eligible for coverage under the national health insurance system. The official drug prices of Tsumura's 129 formulations of prescription Kampo products were reviewed, with the average price decline amounting to 3.8%.

1. Copyright 2013 IMS Japan. All rights reserved. Estimated base on "IMS JPM Mar. 2013 MAT." Reprinted with permission.
2. Official drug price: This refers to the NHI-listed drug price for prescription Kampo products determined by the Ministry of Health, Labour and Welfare. The drug price list is revised in principle once every two years to close the gap between official and market prices (the prices at which pharmaceutical wholesalers sell to medical institutions).

**Sales and Quantity of Tsumura Prescription Kampo Products[*3]**

¥ billion/Ten thousands of units




3. Actual sales and quantity: Represent sales and quantity from pharmaceutical distributors to medical institutions

**Top 10 Kampo Products by Sales Amount**

¥ million

| | Product name | Main effectively treatable disorders | FY2013 | FY2012 | YoY change | |
|---|---|---|---|---|---|---|
| 1 | TJ-100 (Daikenchuto) | Abdominal pain / abdominal flatulence | 9,094 | 8,383 | 710 | 8.5% |
| 2 | TJ-41 (Hochuekkito) | Reinforcement of physical strength after illness / anorexia | 6,567 | 5,885 | 681 | 11.6% |
| 3 | TJ-43 (Rikkunshito) | Gastritis / maldigestion / anorexia | 6,163 | 5,314 | 849 | 16.0% |
| 4 | TJ-54 (Yokukansan) | Neurosis / insomnia | 6,041 | 4,748 | 1,293 | 27.2% |
| 5 | TJ-24 (Kamishoyosan) | Oversensitivity to cold / climacteric disturbance / menstrual irregularity | 4,102 | 3,700 | 402 | 10.9% |
| 6 | TJ-29 (Bakumondoto) | Coughing / bronchitis / bronchial asthma | 3,879 | 3,453 | 426 | 12.3% |
| 7 | TJ-68 (Shakuyakukanzoto) | Pain accompanied by muscle spasms | 3,803 | 3,456 | 346 | 10.0% |
| 8 | TJ-107 (Goshajinkigan) | Low back pain / leg pain / numbness / dysuria | 3,783 | 3,564 | 218 | 6.1% |
| 9 | TJ-114 (Saireito) | Swelling (edema) / acute gastroenteritis | 3,358 | 3,228 | 129 | 4.0% |
| 10 | TJ-19 (Shoseiryuto) | Rhinitis / allergic rhinitis / allergic conjunctivitis | 2,949 | 2,608 | 341 | 13.1% |
| — | TJ-14 (Hangeshashinto) | Stomatitis / neurotic gastritis / fermentative diarrhea | 1,120 | 902 | 217 | 24.0% |
| Total sales of 129 prescription Kampo products | | | 99,457 | 89,964 | 9,492 | 10.6% |

# SPECIALIST MEDICAL REPRESENTATIVE ACTIVITIES AND PHYSICIAN NETWORK

### MR Activities

One of the reasons behind the firm growth in prescription Kampo products sales in fiscal 2013 was a strengthening of our specialist medical representative (MR) activities. Commencing in the second half of fiscal 2012, we worked to get our MR visitation program back up to speed after unavoidably restricting these activities in response to the impact of the Great East Japan Earthquake in the first half of the previous fiscal year. During the fiscal year under review, we continued our visits to physicians who already used Kampo products. At the same time, we redoubled our efforts to approach physicians who have not used Kampo products in the past.

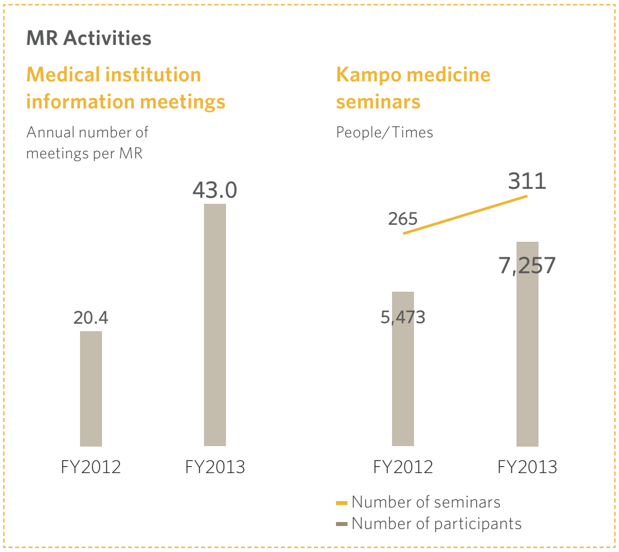
At university hospitals and other large-scale medical institutions, we concentrated on holding information meetings for specialists and other specific groups at the medical department level. Through this strategy, we endeavored to carry out sales activities based on scientific evidence of the efficacy of Kampo products in each specialist field. In fiscal 2013, the quantitative data clearly reflected our efforts to strengthen MR activities. MRs conducted medical department information meetings an average of 43.0 times during the year, up 2.1 times compared with the period where MR activities were curtailed after the major earthquake.

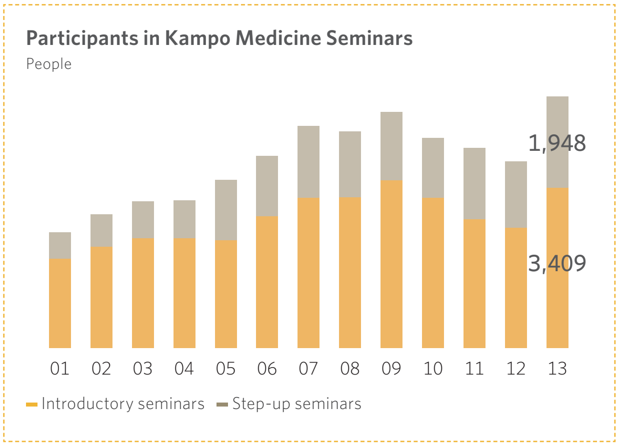
### Kampo Medicine Seminars for Clinical Physicians

Tsumura's goal of Kampo medicine courses being taught at all 80 medical schools in Japan became a reality in 2004. For clinical physicians in medicine today who did not have the occasion to learn about Kampo medicine when they initially studied medicine, Tsumura's seminars represent their main learning opportunities. We provide introductory seminars for physicians learning about Kampo medicine for the first time and step-up seminars for those physicians wanting to learn more after previously taking the introductory course. To date, approximately 37,000 physicians have taken the introductory course, while about 16,000 have taken the step-up course.

### Holding More Specific Kampo Seminars

Besides the previously mentioned seminars, Tsumura conducts additional seminars to meet the specific needs of physicians. In particular, since fiscal 2010, we have increased the proportion of lectures on our "drug fostering" formulations and our Kampo medicine seminars for designated hospitals for clinical training. Today, because Kampo medicine education is included in the curriculums of medical schools, we believe that Tsumura needs to reinforce its approach to educating physicians-in-training in order to help them put their Kampo medicine knowledge to good use in a clinical setting. For that reason, we plan to actively hold study groups for physicians-in-training at designated hospitals for clinical training and university hospitals.



# DRUG FOSTERING AND EVOLUTION OF KAMPO PROGRAM PROGRESS

**Expanding Sales of "Drug Fostering" Program Formulations**

In fiscal 2013, another engine of sales growth was the further development of Tsumura's drug fostering and evolution of Kampo program. The Company made progress with establishing a body of scientific evidence for the five prescription Kampo formulations in the program—TJ-100 (Daikenchuto), TJ-43 (Rikkunshito), TJ-54 (Yokukansan), TJ-107 (Goshajinkigan), and TJ-14 (Hangeshashinto)—heightening interest in Kampo medicine in the healthcare community. It is also possible that increasing the number of information meetings on the five "drug fostering" program formulations in response to requests from medical institutions naturally resulted in greater sales of Kampo products.

In comparison with the 10.6% increase in the total sales of Tsumura's 129 prescription Kampo products, sales of the five "drug fostering" program formulations grew 14.4%, acting as the growth engine for Tsumura's prescription Kampo products. Sales of three of the five "drug fostering" program formulations achieved particularly strong year-on-year growth: TJ-54 (Yokukansan), 27.2%; TJ-14 (Hangeshashinto), 24.0%; and TJ-43 (Rikkunshito), 16.0%. TJ-100 (Daikenchuto) and TJ-107 (Goshajinkigan) also recorded sales growth compared with the previous fiscal year. TJ-100 (Daikenchuto) posted sales of ¥9,094 million, generating 9% of Tsumura's total prescription Kampo products sales. Consequently, the proportion of total sales of Tsumura's 129 prescription Kampo products accounted for by the five "drug fostering" program formulations increased to 26.3%.

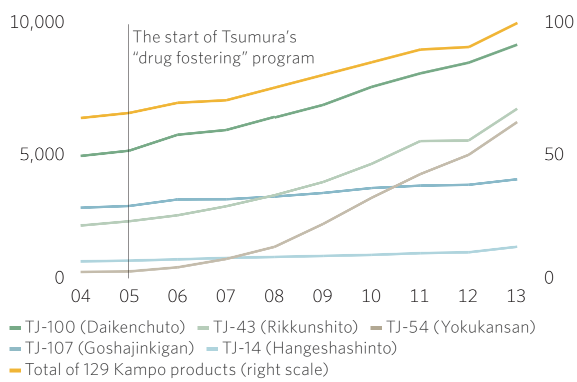
**Increase in Physicians Prescribing Kampo Products**

Supported by the heightened assessment of the efficacy of the five "drug fostering" program formulations and the previously mentioned step up in MR activities, the number of physicians prescribing Kampo products is steadily increasing. In fiscal 2013, a total of 18,049 physicians started prescribing Kampo products for the first time as a result of Tsumura sales activities, an increase of 1.9 times from the 9,409 physicians recorded a year earlier. Moreover, as a result of their enhanced understanding and interest in Kampo products generated by participation in Kampo medicine seminars or medical department information meetings, the number of physicians prescribing 10 or more different Kampo products rose more than 2.2 times, to 3,498 physicians.

While data indicates that more than 90% of physicians in Japan have some experience in prescribing Kampo products, the number of physicians prescribing 10 or more types of Kampo products is still small. Tsumura will strive to offer physicians more scientific-evidence-based information to stimulate interest in more Kampo products.

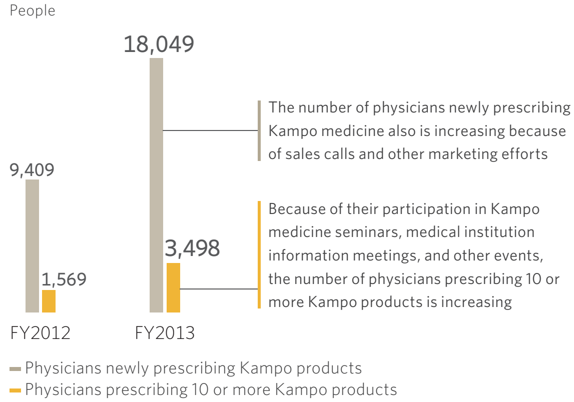
**Sales of "Drug Fostering" Program Formulations**

¥ million/¥ billion




**Growth in Physicians Prescribing Kampo Medicine**

People



## Informing the World about Kampo as a New Concept in Medicine, Broadening Medical Treatment Capabilities

Daikenchuto is a Kampo product that was perfected as a formulation about 1,800 years ago. Throughout its extremely long history of usage, Daikenchuto has mainly been used to treat abdominal pains. However, during the last approximately 20 years, its use in modern medical treatment—and what's more in surgery—has spread rapidly. The reason behind this sudden popularity was the discovery that Daikenchuto demonstrates efficacy in relieving pain from intestinal adhesion and paralysis and the feeling of bloating following major surgery. Today, it is said that 80% of Japanese surgeons have administered Daikenchuto in their practices.

I myself conduct over 100 surgeries annually in the clinical field, and took an interest in the post-surgery efficacy of Daikenchuto. To clarify the evidence in a more scientific manner, I conducted experimental trials using rats. About one week after performing surgery on the rats, I observed positive results. I wrote a report on the results showing improved intestinal motility and increased blood flow to the intestines that was published in a U.S. research journal and attracted a great deal of interest from overseas researchers. Recently, placebo-controlled clinical trials have been conducted that indicate evidence of a significant difference in patient results.

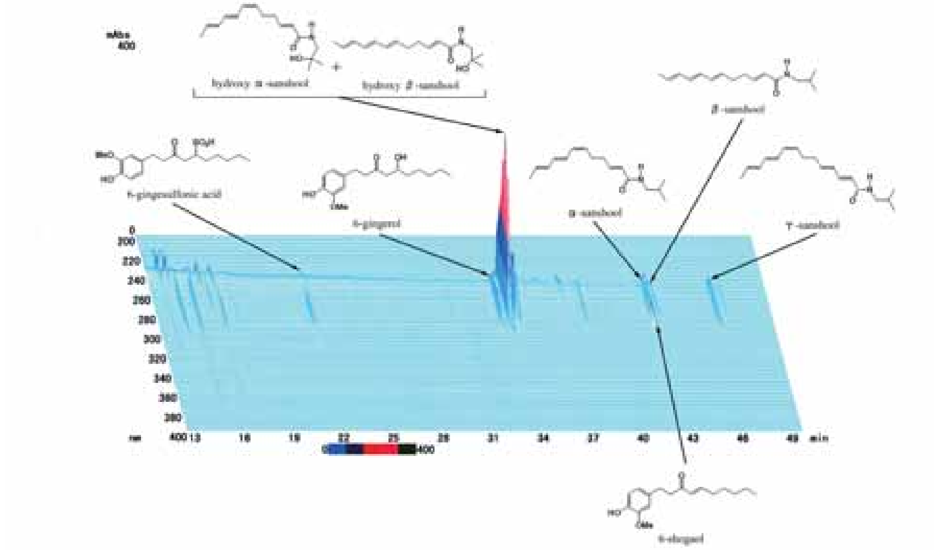
I believe that accumulating scientific evidence on Kampo medicine in this way will provide a foundation for Kampo medicine to be accepted not only in Japan, but also overseas as a medical treatment method involving a new concept distinct from traditional Western medicine. I also have high hopes that medical treatment capabilities can be further broadened if Kampo and Western medicine are combined.

**Toru Kono** M.D., Ph.D.

Director, Advanced Surgery Center
Center for Clinical and Biomedical Research
Sapporo Higashi Tokushukai Hospital

Invited Teacher, Visiting Associate Professor
Faculty of Pharmaceutical Sciences
Hokkaido University

**TJ-100 3D HPLC Pattern**



# ESTABLISHING KAMPO MEDICINE

### National Medical Examination as a Symbol of Establishment of Kampo Medicine

Since modern times, Western medicine has been the mainstream form of medicine in Japan. During the emergence of Western medicine at the end of the 19th century, Kampo medicine went through a period of disavowal and decline. However, due to the unwavering commitment of a group of Kampo medicine related people, the practice of Kampo medicine was preserved in Japan. Recently, based on new scientific research results, there has been a change in people's perception of Kampo medicine that has led to heightened interest among the Japanese public and within the healthcare community. Taking this background into consideration, Tsumura is expending efforts to support Kampo medicine education with the aim of getting questions on Kampo medicine included in the national examination for medical practitioners.*4 The goal of the Company's education activities is the establishment of Kampo medicine as a mainstream form of medical treatment.

### Current State of Kampo Medicine Education

Tsumura's support activities for Kampo medicine education include setting up and supporting Kampo-related lectures at medical schools throughout Japan. We also implement programs to develop medical lecturers able to teach Kampo medicine and provide advice on the curriculums at Kampo medicine outpatient clinics*5 set up by medical schools to give students clinical training.

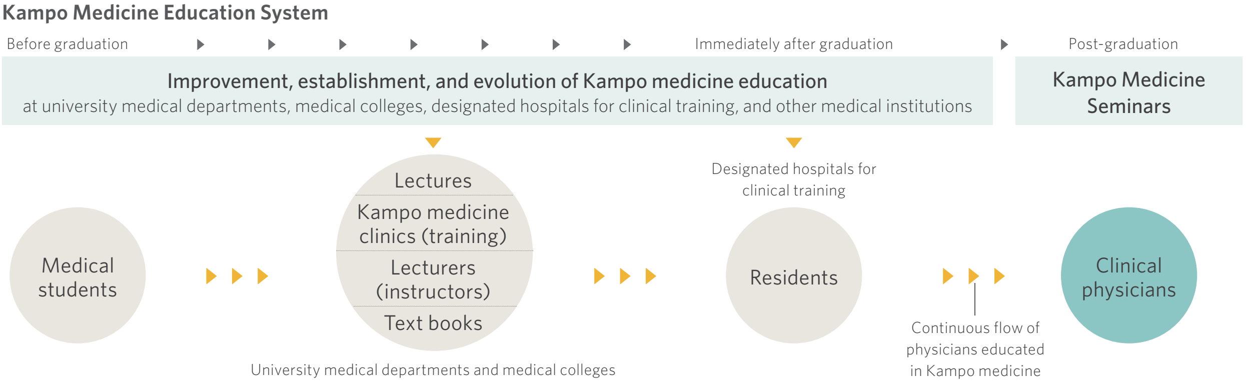
According to research by Tsumura, the number of medical schools requiring at least eight Kampo medicine courses in their required curriculum stands at 78 of the 80 medical schools in Japan. The number of medical schools with a faculty development (FD) program for Kampo medicine lecturers is 79 medical schools. Moreover, 79 medical schools have established Kampo medicine outpatient clinics. We see these figures as evidence of our steady progress toward establishing Kampo medicine.

### Kampo Medical Symposium

To provide a venue where Kampo medicine education at Japan's medical schools can be discussed, Tsumura has been holding an annual Kampo Medical Symposium since 2001. Many people participate in the symposium, particularly people in the field of medical education, such as the heads of medical schools and medical departments and members of medical school curriculum committees. The main theme of the 2013 symposium was "Comprehensive Kampo Medicine Education Before and After Graduation." Approximately 760 people attended the symposium in 2013, participating in lively discussions about various issues and success stories regarding Kampo medicine education.

4. Inclusion of Kampo medicine questions on the national examination for medical practitioners: Since 1870, the questions on the national examination for medical practitioners have been only about Western medicine. In practical terms, this situation had resulted in Kampo medicine being rejected as a form of medicine in Japan, leading to a decline in its practice. Today, there is no differentiation between Western and Kampo medicine in terms of medical licenses and the national examination for medical practitioners has only one class. However, no section for Kampo medicine questions has been established for the examination.
5. Kampo medicine outpatient clinic: A clinic specializing in Kampo medicine based diagnosis and treatment.

**Kampo Medicine Education System**



# INTERNATIONALIZING KAMPO MEDICINE

### TU-100 (Daikenchuto) Clinical Trials in the United States

While enlarging the body of scientific evidence on the efficacy of Kampo medicine, Tsumura is also developing Kampo products for the U.S. market. Specifically, we are conducting clinical trials on TU-100 (Daikenchuto), the product in our "drug fostering" program for which our body of scientific evidence is most advanced.

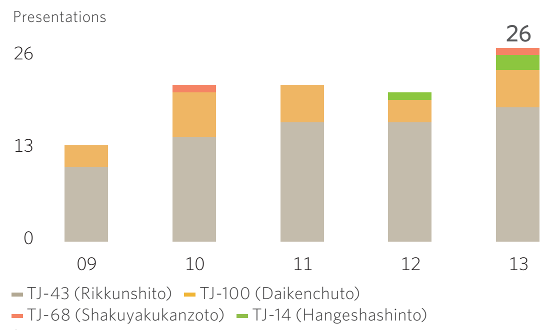
We have already made significant progress. We have completed Early Phase II clinical pharmacological trials on healthy subjects as well as clinical pharmacological trials using subjects suffering from functional constipation. The results of those trials have been announced at conferences or published in journals. As of July 2013, we were pursuing further clinical pharmacological trials on subjects with functional constipation, clinical trials on subjects with irritable bowel syndrome (IBS), and responder/non-responder based clinical trials on subjects with Crohn's disease.

As the next step, in cooperation with the U.S. Food and Drug Administration (FDA) agency, we plan to reach an agreement on a quality evaluation method for Kampo products (Kampo product bioassay method) by March 31, 2016. Following agreement on an evaluation method, we will aim to start Phase III clinical trials during fiscal 2017. The submission of the FDA drug approval request and market launch is scheduled for sometime during fiscal 2020 to fiscal 2021.

### Kampo Medicine Related Research Growing

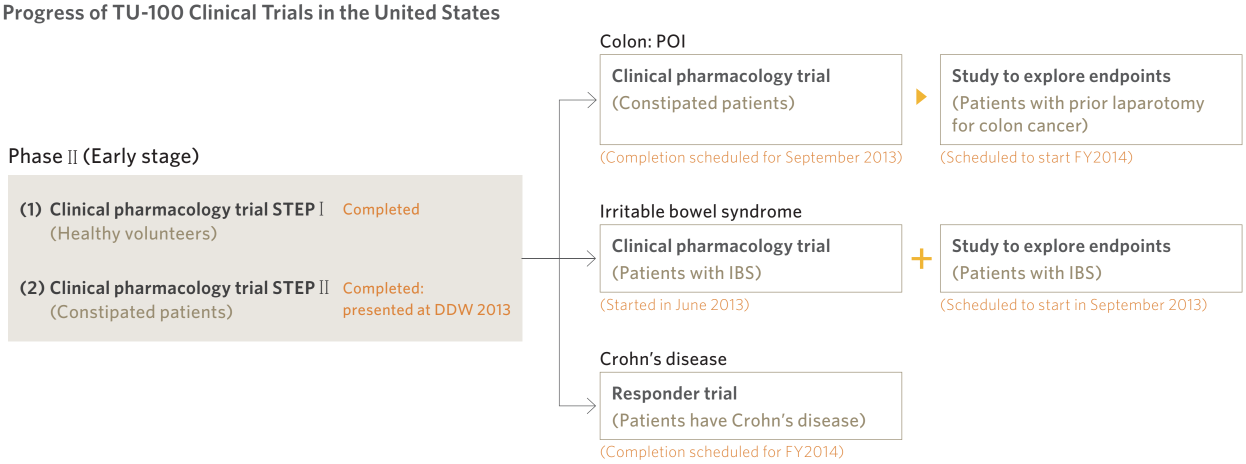
Along with the progress in building a body of scientific evidence on the efficacy of Kampo medicine, there has been a continuous increase in research papers, overseas conferences, and publications in scientific journals on Kampo medicine. For example in 2013, at the highly regarded Digestive Disease Week (DDW) conference, there were a record number of 26 Kampo medicine related presentations made. A total of 15,000 clinical physicians and researchers from around the world attended the conference. Among the presentations, two research studies were done in the United States. A Mayo Clinic research team presented a paper on TU-100 (Daikenchuto) and a University of California Los Angeles (UCLA) research team presented a paper on TJ-43 (Rikkunshito).

**Kampo Medicine Related Presentations at Annual DDW Conference**




Source: Tsumura

**Progress of TU-100 Clinical Trials in the United States**



# STABLE PROCUREMENT OF CRUDE DRUGS AND INCREASING PRODUCTION EFFICIENCY

### Stable Procurement of Crude Drugs

The Company obtains approximately 80% of its raw material crude drugs for the manufacture of its 129 formulations from China. In 2011, the prices for these raw materials spiked in China because of a combination of factors, including growth in crude drug demand, speculative investment targeting that demand growth, and poor weather conditions in the production regions. Raw material crude drug prices later retreated but remained at a relatively high level compared with 2010 and earlier. Since then, prices have stabilized, remaining at almost the same level.

Because higher crude drug prices cause an increase in our manufacturing cost rate, stabilizing these prices is an extremely high priority issue. We are also taking steps at the same time to expand our procurement of raw material crude drugs in anticipation of the medium- to long-term growth in demand for Kampo products.

### Expanding Cultivated Land under Own Management

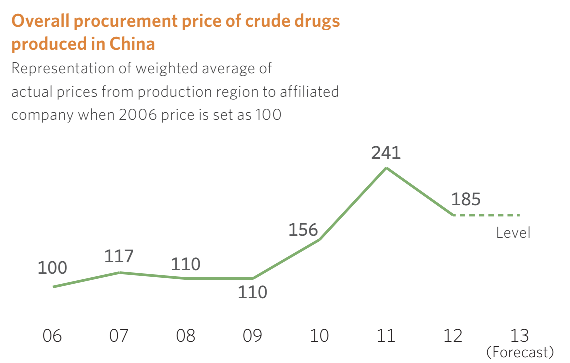
Tsumura defines farmland for which it can provide cultivation instruction, monitor the cultivation costs, and determine the purchasing price for crude drugs as Cultivated Land under Own Management. The Company is striving to expand such land to stabilize its procurement of raw materials. This Cultivated Land under Own Management includes not only directly managed farms in Laos and its own farmland in Yubari, Hokkaido in Japan, but also farms managed through partner companies. Currently, we are particularly focusing on expanding Cultivated Land under Own Management in China.

In more concrete terms, we are considering converting our licorice cultivation operations on Cultivated Land under Own Management to large-scale operations. Tsumura successfully developed an artificial licorice cultivation method in 2011. Among other activities, we established a ginseng cultivation base in Baishan, China in fall 2012 and expect to begin harvesting ginseng in 2015. We are also working to expand the production of crude drugs from Cultivated Land under Own Management in China through SHENZHEN TSUMURA MEDICINE CO., LTD., giving preference to the highest priority crude drugs. Our goal is to increase our procurement of raw material crude drugs from Cultivated Land under Own Management to levels that will contribute to stabilizing crude drug prices and to the more efficient inventory management of raw material crude drugs.

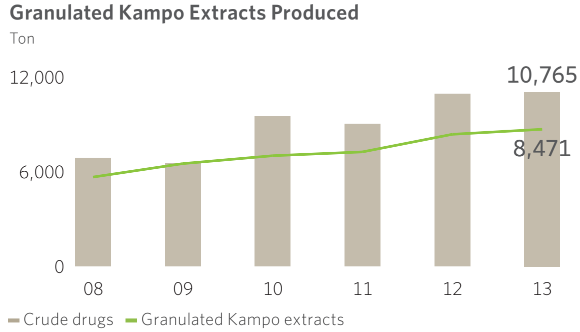
### Expanding Domestic Cultivation Bases

Tsumura is also expanding its cultivation operations in Japan, where it acquires approximately 15% of its raw material crude drugs. In 2009, the Company established YUBARI TSUMURA CO., LTD., a wholly owned subsidiary in Hokkaido. It has also collaborated with regional agricultural and producers' cooperatives to expand production in Iwate, Gunma, Wakayama, and Kochi prefectures. During the fiscal year under review, Tsumura set up a new base in Kumamoto Prefecture in cooperation with a local producers' cooperative. Until now, Tsumura had only cultivation research operations in the prefecture.

**Stability of Crude Drug Prices**




**Amount of Crude Used and Granulated Kampo Extracts Produced**



# INTRODUCTION OF NEW MANUFACTURING SYSTEMS

### Special Features of Kampo Product Manufacturing Systems

Because Kampo medicine is a highly unique product, no general-purpose manufacturing equipment is available. Consequently, Tsumura is involved with the development and design of its manufacturing equipment and builds systems that utilize its proprietary manufacturing technology and know-how. Another special feature of the manufacturing system is the large-scale facilities required compared with Western drugs because of the complex nature of a product like Kampo medicine. Underpinned by our technology and know-how, these advanced and large-scale facilities represent a de facto barrier to market entry and ensure Tsumura's dominance in the market.

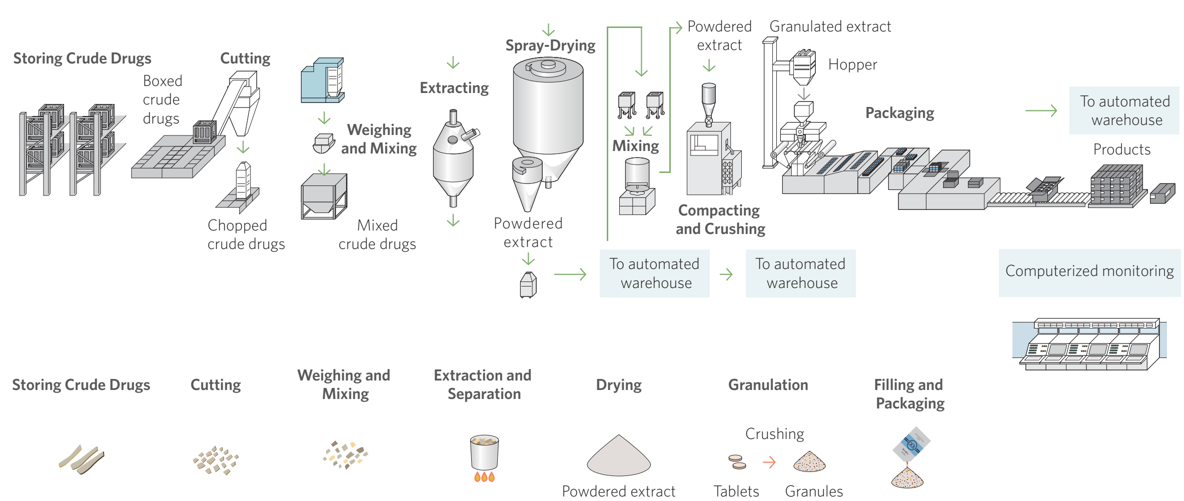
### Manufacturing System Innovations

Tsumura is taking steps to reduce manufacturing costs by introducing new manufacturing technology and running tests to ensure its system is operating optimally. In the next stage, we will introduce new manufacturing technology by making capital investments on an unprecedented scale, primarily in the fiscal year ending March 2014. We are proceeding with the construction of new manufacturing systems at home and abroad. Already, we have installed a new facility at SHANGHAI TSUMURA PHARMACEUTICALS CO., LTD., that uses a new powdered extract production method (SD). The SD line is scheduled to commence operations in October 2013. We will also introduce new manufacturing equipment at the Shizuoka and Ibaraki plants, our principal plants in Japan. In addition, we have plans to rebuild the Ishioka Processing & Quality Control Center, which is responsible for crude drug quality control.

### Capital Investment Plan for Fiscal 2014

| Production facility | Capital investment project | Start of operations |
|---|---|---|
| Shizuoka Plant | New crude drug warehouse | 5/2013 |
| Ibaraki Plant | New granulation facility | 7/2013 |
| SHANGHAI TSUMURA PHARMACEUTICALS | Spray dryer facility | 10/2013 |

### Typical Production Flow for Kampo Products



# FREQUENTLY ASKED QUESTIONS

Tsumura places high priority on communicating with shareholders and investors, and strives to provide information disclosure that will dispel as much as possible their concerns about the Company and its operations. This FAQ section provides answers to the most commonly asked questions from shareholders and investors received through our investor relations (IR) activities.

**Q**

**As Japan becomes an increasingly aged society, there is talk about heightened interest in Kampo medicine and Kampo products. What is the relationship between an aged society and Kampo?**

**A**

**Discussions surrounding the concern about mounting healthcare expenses and medical treatment conditions for the elderly lie behind this connection.**

Ahead of other countries, Japan is rapidly becoming an aged society. According to a survey by the Ministry of Internal Affairs and Communications, Japan's population as of October 1, 2012, was 127.52 million. Of that number, the proportion of the population 65 years old or over was 24.1%. Considering that in 2010, the average proportion of elderly people was 15.9% in advanced economies and 5.8% in industrializing nations, this is an extremely high figure. In fact, a growing number of researchers around the world are closely following Japan's system as a test case for aging societies.

Two issues are commonly raised regarding healthcare in aged societies. The first is the growth in public healthcare insurance expenses, and its control. In Japan, which has a universal public healthcare system, the aging of the population is seen to have the inevitable consequence of increasing public healthcare expenses. Therefore, the control of those rising costs has become a priority issue for the government. The second issue is providing care for the numerous illnesses of the aged. Elderly people are prone to chronic diseases and often have multiple infirmities. As a result, it has been pointed out that using a Western medicine approach alone raises the issue of how elderly patients will bear the cost and time burden as well as the other inconveniences caused by the large volume and increased number of medications they will need.

There are hopes that Kampo medicine and Kampo products can provide solutions to both of these issues. To control public healthcare expenses, government policy makers are looking interestedly at Kampo medicine's concept of rebalancing wellness in the body before people actually become sick. They are considering Kampo medicine from the perspective of controlling healthcare costs through so-called preventative medical treatment. Kampo medicine has also been pointed out as a more appropriate method of treating elderly people—the second issue. Because Kampo products have multiple ingredients, enabling single formulations to be used in treating several conditions, an increasing number of physicians have growing expectations for Kampo medicine's role in providing healthcare for the elderly.

**Q**

**It is said that there are no patents for prescription Kampo products. Doesn't this situation create the potential for fierce competition?**

**A**

**Manufacturing and supplying high-quality Kampo products requires a high-quality value chain. Consequently, the barrier to market entry is extremely high, and almost no new companies have entered the market.**

Despite the lack of patents for prescription Kampo products, there have been almost no new market entrances by companies over our history, including herbal medicine manufacturers. This can be attributed to the establishment and management of an advanced value chain being a prerequisite for the manufacture of high-quality Kampo products.

Being able to offer not only a stable supply, but also a variety of high-quality Kampo products requires the strict management of a series of value chain processes, from the procurement of raw material crude drugs to the production of extract products, quality assurance, and logistics. For example, in procuring raw material crude drugs, it is indispensable to have a broad ranging procurement network and quality management capabilities. Since many raw material crude drugs are harvested from nature, such assets are necessary to ensure the continuous procurement of crude drugs of a specific quality over many years. In addition, the manufacture of Kampo products necessitates large-scale storage and manufacturing facilities compared with Western drugs. Furthermore, the installation of such large-scale facilities and equipment necessitate special technology and know-how. These requirements form a strong barrier to market entry in the Kampo product manufacturing business.

Tsumura has built its value chain over many years, accumulating highly sophisticated value chain management know-how. We believe that it would be difficult for another company to build a similar value chain from scratch. Our proprietary Kampo value chain is the source of the medical community and their patients' high degree of trust in and strong evaluation of Tsumura. The overpowering value of this asset is more than enough to make up for the lack of patents for our products.

## Q

**Tsumura obtains approximately 80% of its raw material crude drugs from China. How does the Company view the risks related to its operations in China?**

## A

**Our operations in China are highly evaluated by local communities and the Chinese government. We believe that the risk of a situation that could significantly impact our crude drug procurement is minimal.**

In China, Tsumura has concluded long-term contracts with farmers cultivating crude drugs through companies in the growing areas. Moreover, we provide farmers with guidance in using cultivation technology for the purpose of raising the quality of the crude drugs while ensuring a good growing environment. Through our efforts to form networks with farmers and to provide technology transfers, we have built a good relationship with China's local administrative bodies and government institutions. In addition, consolidated subsidiaries SHENZHEN TSUMURA MEDICINE CO., LTD., and SHANGHAI TSUMURA PHARMACEUTICALS CO., LTD., have earned reputations as excellent companies in their regions, maintaining high employee retention rates. For these reasons, the Company believes that the possibility of a situation occurring in the short term that could substantially affect its operations is minimal.

China is our most important production region in terms of acquiring crude drugs that meet our requirement for active ingredient concentrations and other Tsumura quality standards. Even though the plants look the same on the outside, because crude drug ingredients differ depending on such factors as growing region and variety, it is difficult to substitute much of the Chinese produced crude drugs with products from other countries. For that reason, Tsumura carefully monitors China's agricultural and export policies. At the same time, the Company has implemented a measure to prevent any major short-term impact on its operations if for some reason imports of raw material crude drugs from China should be halted. That measure is to maintain a two-year manufacturing supply of raw material crude drugs in Japan.

We do anticipate that domestic demand for raw material crude drugs in China will increase in future along with the growth of its economy. With the goal of further stabilizing our raw material crude drug procurement in China, we are currently working to expand our Cultivated Land under Own Management in China. These controlled farming areas allow us to manage the cultivation technology as well as the farming expenses. Going forward, we plan to increase the stability of our raw material procurement by expanding the proportion of Cultivated Land under Own Management. We believe this measure also will contribute to improving the quality of raw material crude drugs being distributed in China's domestic market.

# RESEARCH AND DEVELOPMENT

Through its R&D activities, Tsumura is actively seeking to elucidate the mechanisms of Kampo products that have a history of use reaching back 1,400 years. The Company's purpose is to establish Kampo medicine as a useful contributor to modern medicine.

**Basic R&D Policy**

The most important area being addressed by Tsumura R&D programs is the establishment of a body of scientific evidence for the efficacy of pharmaceutical Kampo products. Previously, the Company's drug discovery programs focused on Western drugs similar to other pharmaceutical companies. However, in 2004, Tsumura halted these programs and shifted the direction of its R&D policy to concentrate its resources on the accumulation of a body of evidence for existing Kampo products. The backdrop to this action was a determination by management that for the Company to achieve its mission of "contributing to the unparalleled medical therapeutic power of the combination of Kampo medicine and Western medicine," it had to put Kampo products on the same playing field as Western drugs. In other words, Tsumura recognized that Kampo medicine would only truly be accepted as a Japanese form of medicine when its efficacy could be demonstrated using the same logic as applied to Western medicine—a scientific body of evidence.

**Establishing a Body of Evidence**

Guided by the new R&D policy, Tsumura is endeavoring to establish a body of scientific evidence for the efficacy of Kampo products. However, the Company is not attempting to cover all of its 129 formulations. Instead, taking into consideration the recent structure of disease, Tsumura is targeting prescription Kampo products that demonstrate special efficacy in patients with disorders for which the use of new drugs is difficult or for which there are strong medical needs. Currently, the Company is concentrating its research efforts on five formulations. In addition to gathering basic data through its own research, Tsumura is building a collaborative R&D network by supporting the work of medical research specialists that gather and analyze basic and clinical data.

For one of the five formulations mentioned previously, Tsumura has implemented a program to develop the formulation as a prescription drug for the U.S. market and launch it. The Company has linked its efforts to achieve efficient R&D programs in both markets. It has incorporated the results of its efforts to build a body of scientific evidence on the efficacy of Kampo medicine in Japan with its development drive in the United States. And it is utilizing the progress made in the U.S development program in its R&D activities in Japan. For information about the progress being made in preparation for the drug approval process for Kampo products in the United States, please refer to page 31.

**Contributing to the Kampo Value Chain**

One of the research areas of Tsumura's R&D program is solving issues related to the Kampo value chain. These activities directly contribute to advancing the sophistication of the Kampo value chain and to increasing Tsumura's corporate value.
The three main research themes in this area are (1) researching cultivation technology to secure stable supplies of raw material crude drugs, (2) enhancing the quality of raw material crude drugs, and (3) improving Kampo product quality control and manufacturing technology.

Of these themes, cultivation is the field where Tsumura has achieved the most innovation. The Company and its research partners have successfully developed cultivation technology for licorice, one of the most common ingredients of Kampo formulations. In conjunction with that development, Tsumura is also considering how to mechanize the process to achieve large-scale cultivation, and is prepared to introduce mechanization into its future cultivation of licorice. Even before taking that step, the Company developed cultivation technology for ephedra herb, a raw material crude drug that the Chinese government has restricted exports of, and had already converted its source of ephedra herb to cultivated products.

Moreover, the Company has successfully developed technology to improve the quality of certain crude drugs by increasing the harvested amount of crude drug and

**Evidence Building for "Drug Fostering" Program Products (DB-RCT & Safety)**

| Formulation | Targeted disorder/researchers | Trial group/institution in-charge | Case collection period | Public announcements, etc. | Note |
|---|---|---|---|---|---|
| **TJ-100 Daikenchuto** | Postoperative ileus after colon cancer surgery | Kitasato University, others (DKT Forum, Colon Team) | Jan. 2009–June 2011 | Japan Surgical Society Annual Congress (Apr. 2013: Fukuoka) | |
| | Postoperative ileus after colon cancer surgery (Additional study) | Fujita Health University, others (DKT Forum, Clinical Pharmacology Team) | Jan. 2009–June 2011 | Japan Surgical Society Annual Congress (Apr. 2013: Fukuoka) | |
| | Postoperative ileus after liver cancer surgery | Kushiro Rosai Hospital, others (DKT Forum, Hepatic Surgery Team) | Feb. 2010–May 2011 | JDDW[1] 2012 (Oct. 2012: Kobe) The American Association for the Study of Liver Diseases (Nov. 2012: Boston) | |
| | Postoperative ileus after gastric cancer surgery | Oita University, others (DKT Forum, Stomach and Esophagus Team) | Jan. 2011–Dec. 2012 | Case collection completed, preparing for analysis | |
| | JAPAN-PD STUDY (Postoperative ileus after pancreatic cancer surgery) | Wakayama Medical University, others (ECRIN) | Aug. 2012–Aug. 2014 | Case collection ongoing | |
| | Crohn's disease | Keio University, others | June 2012–May 2014 | Case collection ongoing | |
| **TJ-43 Rikkunshito** | Functional dyspepsia | Keio University, others | Feb. 2011–Feb. 2013 | Analysis proceeding | * |
| | G-PRIDE STUDY (PPI resistent GERD) | Osaka City University, others (Waksman Foundation) | Aug. 2011–Sept. 2012 | DDW[2] 2013 (May 2013: Orlando) | |
| **TJ-54 Yokukansan** | Schizophrenia | Shimane University, others | Mar. 2011–Sept. 2012 | U.S. Society of Biological Psychiatry Annual Meeting (May 2013: San Francisco) | * |
| | BPSD | Tohoku University, others | Feb. 2011–Jan. 2013 | Analysis proceeding | * |
| **TJ-107 Goshajinkigan** | GENIUS STUDY (FOLFOX treatment peripheral neuropathy) | Kyushu University, others | Oct. 2011–May 2012 | Trial halted | * |
| **TJ-14 Hangeshashinto** | HANGESHA-C STUDY (Oral inflammation from chemotherapy for colon cancer) | National Hospital Organization Osaka National Hospital, others (ECRIN) | Oct. 2010–May 2012 | ESMO[3] (Oct. 2012: Vienna) Japan Society of Clinical Oncology (JSCO) (Oct. 2012: Yokohama) | |
| | HANGESHA-G STUDY (Oral inflammation from chemotherapy for stomach cancer) | Kanagawa Cancer Center, others (ECRIN) | Oct. 2010–Sept. 2012 | Analysis proceeding | |
| **TJ-100 Daikenchuto** | Frequency investigation of adverse drug reactions | — | Apr. 2010–Mar. 2012 | Published in Progress in Medicine journal (Sept. 2012) Revision of package insert (Oct. 2012) | |
| **TJ-54 Yokukansan** | Frequency investigation of adverse drug reactions | — | Oct. 2012–Mar. 2014 | Ongoing | |

1 Japan Digestive Disease Week 2 Digestive Disease Week 3 European Society for Medical Oncology
* Grants-in-Aid for Scientific Research

the concentration of active ingredient in each plant. It utilizes tissue-culture technology to grow roots with high concentrations of active ingredient and combines that technology with cultivation and harvesting technologies.

Quality control for Kampo products is an important issue throughout the Kampo value chain. Accordingly, Tsumura implements various measures at each stage of the chain. At the cultivation and procurement stage, the Company provides guidance to farmers on cultivation technology. In addition, Tsumura has developed technology to differentiate all crude drugs on a DNA level.

The procured raw material crude drugs are tested for residual agricultural chemicals, microorganisms, and heavy metals at SHENZHEN TSUMURA MEDICINE in China and at the Analytical Technology Center in Japan. The Company has developed new analytical methods that cover all of the agricultural chemicals that are used in the cultivation of crude drugs in Japan and China. Using analytical results, the Company manages the quality of its raw materials.

Quality remains an important focus at the manufacturing stage as well, with Tsumura complying with GMP* and Kampo GMP standards for manufacturing and quality control. The Company constantly endeavors to improve its manufacturing technology.

* Good Manufacturing Practice. Manufacturing standards set by the Minister of Health, Labour and Welfare as stipulated in the Pharmaceutical Affairs Act.

# CORPORATE SOCIAL RESPONSIBILITY

### Basic CSR Policy

Tsumura's mission is to contribute to the unparalleled medical therapeutic power of the combination of Kampo medicine and Western medicine through the production and distribution of Kampo products. The Company has established a medium-term business vision of "Aim to be a value-creation company that contributes to people's health through its Kampo medicine business." Based on this vision, Tsumura is continuing to seek growth in all its fields of operations. Moreover, the Company does not just pursue its own interests. Through its operations, Tsumura wants to "become a people-friendly company that contributes to society and humanity."

### Body of Evidence Program Uncovering the Possibilities of Kampo Medicine

Tsumura aims to improve the quality of life of patients by providing stable supplies of effective, safe, and superior-quality Kampo medicine. In addition to manufacturing and selling Kampo products, the Company places special emphasis on building a body of scientific evidence for the efficacy of Kampo medicine, seeking to foster and strengthen the confidence of the medical community and their patients in Kampo medical treatment. At the same time, through these research activities, we are contributing to uncovering new possibilities in medical treatment. We are doing so by elucidating the efficacy of Kampo medicine in cases that are difficult to treat with Western medicine and other possibilities.

### Sustainable Harvesting of Crude Drugs

From the perspective of the procurement of the crude drugs that are the raw materials for Kampo products, Tsumura's business only exists because of the crude drugs that we derive from nature. Based on that recognition, it is essential that we preserve the biodiversity of their production regions and achieve renewable resources. Therefore, Tsumura includes farming as one of its fields of operations and is shifting to cultivated plants for almost all its raw material crude drugs. However, Tsumura still has to depend on crude drugs derived from wild plants for some of the formulations it manufactures.

Overharvesting of wild plants can result in the depletion of these resources. Depending on the variety of wild plant involved, overharvesting can also lead to desertification of the production region. For that reason, we systematically harvest these wild plants within the scope of their natural regenerative capacity. Not only that, but we are also developing wild plant cultivation methods through joint research with research institutions in China, where the main growing regions of the wild plants are situated.

For more information on the procurement of crude drugs, please refer to pages 24 to 25 and 40 to 42.

### Activities as a Recycling-Oriented Company

Tsumura's operations produce crude drug botanical residues*[1] from the manufacturing of Kampo products. These botanical residues account for over 90% of the industrial waste produced by the Company in its operations. We recycle all of these crude drug botanical residues not only from our plants in Shizuoka and Ibaraki prefectures in Japan, but also our SHANGHAI TSUMURA PHARMACEUTICALS plant into fertilizer and other materials.

1. Residues left over after the Kampo extracts are removed from the crude drugs.

**Tsumura's Business Cycle and Four Core Components**

We have also conducted research on processing methods for recycling crude drug botanical residues that place even less of a burden on the environment. Consequently, some of our botanical residues are being used as biomass fuel by thermal power stations to fuel electric power generation on a full-scale basis. We are also investigating methods of converting the botanical residues to marketable goods, such as raw materials for fertilizer.

**Crude Drug Cultivation and Regional Social Contribution**

In February 2010, Tsumura established a local subsidiary in the Lao People's Democratic Republic (Laos) to achieve better traceability of its crude drugs. The local subsidiary has begun cultivating crude drugs on its Cultivated Land under Own Management. Moreover, Tsumura intends to meet the high expectations that the government of Laos has for the Company to contribute to the development of the region. Our operations represent primary industry as set out in their 2+3 local government policy*2 and will contribute to the local economy in terms of creating jobs and building infrastructure, such as roads, bridges, wells, and irrigation facilities.

Tsumura also has set up procurement bases for crude drugs in Japan, purchasing crude drugs from regions in Iwate, Gunma, Kochi, Wakayama, and Kumamoto prefectures. In addition, we established the subsidiary YUBARI TSUMURA CO., LTD., in the town of Yubari, Hokkaido to pursue cultivation of crude drugs. In Yubari, we commissioned farmland that had been abandoned because of the shrinking size and aging of the population to be used for cultivating crude drugs. While pursuing a stable supply of high-quality crude drugs, we will at the same time be seeking to revitalize the agricultural industry in the region.

**Targeting Employment Diversity**

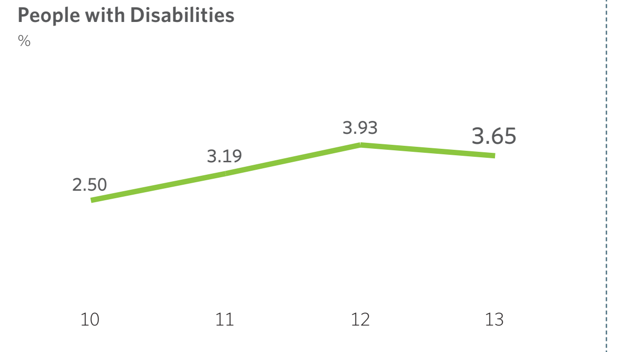
In fiscal 2010, Tsumura established a three-year employment plan to create job opportunities for people with disabilities on a Groupwide basis. As a result of that plan, the percentage of people with disabilities in our workforce has surged, going from 1.97% in fiscal 2009 to 3.65% at the end of fiscal 2013. As of April 1, 2013, the legal employment percentage for people with disabilities set by Japan's government is 2.0% of the workforce.

Our goal is not just an employment rate, we have also taken steps to create environments where people with disabilities can easily work. Specifically, at YUBARI TSUMURA's crude drugs processing plant, we have made the workplace barrier free and designed it to accommodate people in wheelchairs working on such production lines as crude drugs sorting.

In April 2010, our subsidiary YUBARI TSUMURA signed a contract with Temiru Farm*3 commissioning them to cultivate crude drugs. Through this agreement, we are providing an opportunity to get involved with cultivating crude drugs to people with disabilities.

2. The 2+3 system: A government policy that enables investors to set up projects in which the farmers provide the land and labor required (2) and the investors provide funding, materials, and technical support (+3).
3. An agricultural production corporation established in April 2010 by Harunire No Sato, a social welfare corporation based in Hokkaido with 50 offices and facilities in Sapporo and Ishikari, for the purpose of helping people with mental disabilities to become more independent.

**Tsumura's Employment Percentage for People with Disabilities**



CSR Feature:

# VALUE OF RAW MATERIAL CRUDE DRUG PROCUREMENT OPERATIONS TO TSUMURA'S BUSINESS AND TO SOCIETY

KEIKO YOSHIZAWA
Associate Manager
Botanical Raw Materials Division
Botanical Raw Materials
Procurement Dept.

YOSHIAKI NOSE
Assistant Manager
Botanical Raw Materials Division
Botanical Raw Materials
Procurement Dept.

**Tsumura's Kampo business could not operate without the input of raw material crude drugs. Consequently, the stable procurement of crude drugs is a key issue to achieving sustainable business growth as well as being a critical element of the Kampo value chain. In the following section, two Tsumura employees involved in crude drug procurement share their experiences with conditions in the field in China and Japan and talk about the value of Tsumura's procurement activities.**

### Technology Guidance Contributes to Sustainable Farming that Protects the Environment

**Ms. Yoshizawa:** China is where Kampo medicine originally got started, and some of the important raw material crude drugs grow in environments that cannot be replicated in Japan. Mr. Nose, while you travel to China about once every two months, my responsibilities are focused on our production bases in Japan. Therefore, I think our jobs are quite different even though we are both involved with drug procurement.

**Mr. Nose:** The areas I am responsible for in China are in the north region—Jilin and Heilongjiang provinces and Inner Mongolia. The term desert region aptly describes conditions in Inner Mongolia, with summers being extremely hot and winter extremely cold. On top of the harsh climate in the region, most of the territory exists in a tenuous balance with nature.

"To achieve stable procurement of crude drugs, it is essential to establish an environment that supports such a goal."

"Commissioned cultivation promotes more-stable income generation for farmers and enables planning for the future."

**Ms. Yoshizawa:** In such areas, the procurement of raw material crude drugs must be affected strongly by the growing conditions for crude drugs. Because a variety of changes in the growing conditions will also affect the wild crude drugs. Changes in the growing environment will also impact on cultivated crude drugs, causing reduced harvests or variations in quality.

**Mr. Nose:** Actually, over the last few years local people have begun to pay attention to changes in conditions related to crude drug procurement. Thoroughly following technology guidance provided by Tsumura and complying with the rules regarding the use of pesticides have done more than just increase and maintain the quality of crude drugs. Another aspect of our operations, I believe, has been to cause people to preserve conditions necessary for crude drug procurement and think in terms of environmentally conscious sustainable farming.

The speed of development in farming villages in China has been amazing. I am often surprised by how much village conditions have improved compared with two or three years ago. The thought that part of Tsumura's contribution to the region is providing people with an understanding of sustainable farming and a sense of shared values in the procurement process motivates me in my work.

### Commissioning Cultivation Promotes Stable Farming Operations

**Ms. Yoshizawa:** In terms of sustainable farming, crude drug procurement activities have ramped up considerably in Japan. Tsumura started commissioning cultivation domestically in the 1960s, but that fact was not widely known up to now. I feel that an awful lot has changed over the past few years.

**Mr. Nose:** Right from the start, Kampo medicine has never been very familiar to people in Japan. They have the strong impression that all the raw materials are imported from China. Therefore, up until only very recently, farmers and public administrators of the agricultural industry alike for the most part did not show very much interest in crude drug cultivation.

**Ms. Yoshizawa:** Previously, even if we notified agricultural co-ops and other production associations that "we're holding an information meeting on crude drug cultivation and we'd like you to attend," we didn't receive a very positive reaction. But recently, even if we don't go to the trouble of notifying them, many people come to hear our talks—and we receive requests to hold information meetings from various regions. I get the sense that local communities are now supporting crude drug cultivation as a new business.

**Tsumura's Procurement Regions in Northern China**


**Tsumura's Domestic Procurement Bases**

"Our crude drug procurement operations contribute to stimulating farming as an industry."

**Mr. Nose:** That phenomenon is probably related to the heightened interest in Kampo medicine. It is also possible that, because we are actually commissioning more cultivation, Tsumura's policy of building a relationship of trust with production bodies and farmers themselves is beginning to take hold in the industry.

**Ms. Yoshizawa:** Prices for vegetables can fluctuate greatly depending on market movement, causing farmers to be constantly anxious about their businesses. When our Company signs a cultivation contract with them and regularly purchases their harvested crops, it becomes easy for farmers to predict their income. I often hear it said that if you can predict income, then you can invest as well.

**Mr. Nose:** Recently, Japan's local governments are also being positive about crude drug cultivation. After crude drugs are cultivated, they have to be dried in the production area, which requires a significant investment. However, if you can create a business plan based on a cultivation contract, in some cases farmers are able to make use of government subsidy systems.

**Ms. Yoshizawa:** Quite some time has passed since the aging of Japan's farming community, depopulation of the countryside, and the flow of people into urban areas were pointed out as problems in Japan. However, recently we have begun to see young farmers at our crude drug cultivation information meetings. Commissioning cultivation of crude drugs carries a great deal of significance beyond the aspect of achieving stable procurement of crude drugs. It is also important from the point of vitalizing Japan's agricultural industry and creating a link to the next generation of farmers.

### Building a System that Controls Crude Drug Prices and is Advantageous for Farmers

**Ms. Yoshizawa:** Demand for crude drugs has also risen in China, hasn't it? Poor weather conditions in 2011, resulted in speculative investment in certain crude drugs, driving up prices sharply.

**Mr. Nose:** But by the end of 2011, the prices for those crude drugs affected by speculation had peaked, and crude drug prices were on the decline in 2012. Still, an environment where market prices can be easily affected is extremely unsettling for producers from a business standpoint. The key to solving this problem is commissioned cultivation. By encouraging the widespread use of a system that ensures stable income, the people in the agricultural region see it as an advantage—and Tsumura also benefits by being able to control crude drug prices. We are working to build such a system by particularly increasing our Cultivated Land under Own Management.

**Ms. Yoshizawa:** While it's not likely to happen soon, it would be nice to get the regional farmers, production companies that contract them, and local governments collaborating together to build a system that enables more fruitful procurement of crude drugs for all.

# CORPORATE GOVERNANCE

### Basic Policy

Tsumura positions corporate governance as one of its most important management issues. We do so in recognition that further strengthening our corporate governance organization is essential to achieving sustained growth and development as well as fulfilling our social responsibilities based on our corporate philosophy of "the Best of Nature and Science."

The Company has introduced a corporate officer system to clearly separate the oversight role of directors and the operational execution role of corporate officers as well as to establish a management organization that can respond quickly to changes in the business environment. Aiming to achieve further enhancements in the transparency, efficiency, and soundness of its management, Tsumura has also appointed a chairman that is independent of the corporate officer system and added an outside director to the Board of Directors for the first time as of June 2012.

### Board of Directors and Auditors

| Name | Title | Appointed director | Shareholdings (thousands of shares) |
|---|---|---|---|
| Junichi Yoshii | Chairman of the Board | June 1995 | 25.0 |
| Terukazu Kato | President & Representative Director | June 2011 | 6.7 |
| Norihiro Tanaka | Senior Managing Director, Executive Officer | June 2007 | 11.0 |
| Toru Sugita | Managing Director, Executive Officer | June 2007 | 12.4 |
| Shuichi Takeda | Director, Executive Officer | June 2010 | 5.5 |
| Terunari Nakayama | Director, Executive Officer | June 2011 | 8.6 |
| Yasunori Fuji | Director, Executive Officer | June 2011 | 13.1 |
| Tsuyoshi Iwasawa | Director, Executive Officer | June 2012 | 8.1 |
| Ryuji Takasaki | Director, Executive Officer | June 2012 | 3.9 |
| Shigeru Sugimoto | Outside Director<br>Certified Public Accountant/Certified Real Estate Appraiser/Certified Tax Accountant<br>Representative, Sakura Horwath Audit Corporation | June 2012 | 0.1 |

| Name | Title | Appointed auditor | Shareholdings (thousands of shares) |
|---|---|---|---|
| Yoshiki Mori | Auditor | June 2011 | 12.4 |
| Yukio Minato | Auditor | June 2011 | 4.8 |
| Tomiji Yusa | Outside Auditor<br>Certified Public Accountant (Japan and New York)<br>Chief Executive Officer, Mercury Financial Brain Co., Ltd.<br>Corporate Auditor, Aoi Advertising Promotion Inc. | June 2007 | 2.2 |
| Seiko Noda | Outside Auditor<br>Lawyer<br>Partner, Nagasawa Law Offices | June 2007 | 1.8 |

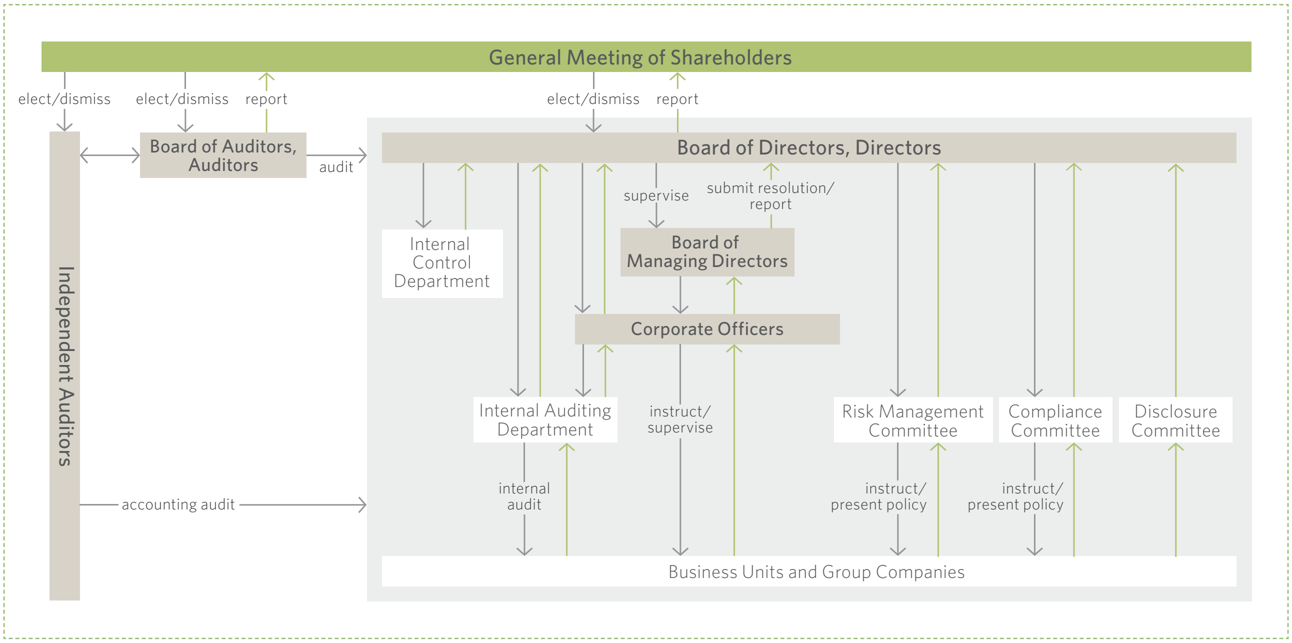
### Director Compensation

| Category | Total compensation (¥ in millions) | Breakdown of total compensation | | | | Number of directors compensated |
|---|---|---|---|---|---|---|
| | | Basic | Stock options | Incentive | Severance | |
| Directors (excluding outside directors) | 482 | 482 | – | – | – | 11 |
| Auditors (excluding outside auditors) | 47 | 47 | – | – | – | 2 |
| Outside directors and outside auditors | 22 | 22 | – | – | – | 3 |

The above figures include those for two directors who resigned their positions as of the conclusion of the regular general meeting of shareholders held on June 28, 2012.
In addition to the above amounts, a total of ¥5 million was paid to the two directors who resigned their positions as of the conclusion of the regular general meeting of shareholders held on June 28, 2012. These amounts were severance payments in accordance with a resolution passed at the regular general meeting of shareholders held on June 29, 2005.

## Overview of Corporate Governance System

- Board of Directors
  As management's top decision-making body, the Board of Directors makes decisions related to law, the articles of incorporation, and other important matters regarding Tsumura's business as well as overseeing business execution.
  Number of directors: 10 (including one outside director)
- Board of Managing Directors
  The Board of Managing Directors discusses important issues to determine general operational policies based on the fundamental policies set by the Board of Directors. Also, the Board of Managing Directors exercises overall control of business operations.
  Number of board members: 4
- Corporate Officers
  Appointed by the Board of Directors, corporate officers manage and execute the operations they are given responsibility for.
  Number of corporate officers: 7
  Officers who are also directors: 7
- Board of Auditors
  The Board of Auditors, comprising all appointed auditors, determines auditing policies based on the Board of Auditors' regulations, pertinent laws, and Tsumura's articles of incorporation. Also, the Board of Auditors forms its audit opinion by integrating all auditor reports.
  Number of auditors: 4 (including two outside auditors)
- Auditors
  Auditors monitor the decision-making processes of the Board of Directors and the Board of Directors' execution of business operations by attending Board of Directors meetings and other important meetings, holding periodic meetings with the members of the Board of Managing Directors, reviewing documents related to important decisions, and, as necessary, conducting hearings with directors and corporate officers on business operations. Auditors periodically receive reports from the Internal Auditing Department and meet with them to exchange opinions. As necessary, the auditors are present during the internal audits or take other collaborative measures.
- Independent Auditors
  The independent auditors and the Board of Auditors meet periodically to exchange opinions and to share information regarding relevant issues.



## Strengthening Corporate Governance

### Appointment of Outside Director

Commencing with the fiscal year ended March 2013, Tsumura decided to place an outside director on the Board of Directors for the first time. The Company took this action in order to strengthen its board of directors' oversight function to increase its competitiveness and corporate value. Tsumura judged that the new outside director, Mr. Shigeru Sugimoto, would adequately fulfill his role in making decisions about the important business matters of the Company and in providing oversight of the execution of operations. Tsumura made that decision based on the fact that Mr. Sugimoto has acquired a wealth of experience and knowledge in his careers as a certified public accountant (CPA), certified real estate appraiser, and certified tax accountant as well as being involved with business management as the representative of several companies. By having a person knowledgeable about management of a business other than Tsumura's business participate in the Company's management from an independent perspective, Tsumura is aiming to further vitalize the discussion of the Board of Directors and strengthen the management oversight function. Going forward, the Company will endeavor to constantly reinforce its corporate governance, maintain management transparency, and increase corporate value.

### Appointment of Outside Auditors

As a firm that has chosen to be a company with auditors under Japanese law, Tsumura has four corporate auditors to provide business auditing and management oversight. The Company has chosen a lawyer and a CPA as its two outside auditors.

Mr. Tomiji Yusa is a CPA and has a considerable amount of knowledge of finance and accounting. He has been asked by the Company to serve as an outside auditor to lend his abundant experience and insight as a CPA to Tsumura's auditing operations.

Ms. Seiko Noda has been asked by the Company to serve as an outside auditor to lend her expertise as an attorney to Tsumura's auditing operations.

As highly independent specialists, Tsumura feels that its two outside auditors ensure the objectivity and neutrality of its management oversight function.

## Message from the Outside Director

Since being appointed as the outside director of the Company in June 2012, I have had several revelations. I have attained a real sense of just how necessary prescription Kampo products are in today's society and the extent of Tsumura's high reputation. I am deeply aware that, as the outside director, I have an extremely important role in protecting that reputation and building it even further.

Following my appointment, I have attended all Board of Directors meetings. I can with great confidence report that the other directors and the two outside auditors have expressed their opinions freely at these meetings. I myself have spoken at these meetings from the viewpoint of a certified public accountant and tax accountant. When there have been matters concerning the Kampo business that I did not understand or had doubts about, I proactively questioned them. At times, my questions as a newcomer to the business seemed obvious to directors involved with operations. However, in many cases, my view as an outsider brought new stimulus to the discussions. Every meeting of the Board of Directors has been spirited.

Because I had taken TJ-100 (Daikenchuto) in the past, I felt a connection with Kampo medicine even before my appointment. Now that I have actually participated in the Company's management, I have discovered another aspect of Tsumura. In terms of profit structure, management issues, and other business matters, it has unique qualities and strengths inherent to the Kampo business. While there is a shared awareness of the issues Tsumura faces, I believe that the atmosphere at the Company is overwhelmingly cheerful—and that we can expect Tsumura to achieve great things in the future.

## Corporate Governance Activities

| Item | Details |
|---|---|
| Corporate structure | Company with auditors under Japanese law |
| Chairman of board of directors | Director without an executive position |
| Annual number of board of directors meetings | 19 times (13 times after June 28, 2012) |
| Board of directors meetings attended by outside director | 13 times |
| Annual number of board of auditors meetings | 22 times |
| Board of auditors meetings attended by outside auditors | Mr. Tomiji Yusa (22 times)<br>Ms. Seiko Noda (22 times) |
| Board of directors meetings attended by outside auditors | Mr. Tomiji Yusa (19 times)<br>Ms. Seiko Noda (19 times) |
| Audit corporation | Ernst & Young ShinNihon LLC |
| Audit corporation compensation | ¥43 million |

## Other Management Systems

| Item | Details |
|---|---|
| **Compliance** | The Company formulated the Tsumura Compliance Program, including the Tsumura Code of Conduct, as the basic business practice rules for compliance in its business activities. Based on this program, the Company is carrying out continuous and systematic compliance activities, including educating relevant stakeholders. |
| | The director in charge of compliance (director in charge of the Compliance Advancement Department) keeps track of Companywide efforts and regularly reports on them to the Board of Directors. Group compliance polices are determined by the Board of Directors. |
| | To promote compliance, the Company has established a hierarchy of compliance staff—the Chief Compliance Officer, a director in charge of compliance, compliance officers, compliance supervisors as well as the compliance office (Compliance Advancement Department). These compliance-related employees and sections are responsible for establishing the Group's overall compliance system, educating employees about it, and spreading its use. In addition, they implement activities to promote the observance of corporate ethics. |
| **Internal Control** | On April 1, 2013, the Company established an Internal Control Department for the purpose of strengthening the overall Group internal control system. |
| | The Company has established the Disclosure Committee to boost its information disclosure efforts based on strengthening its internal control system for information disclosure. The purpose of the committee is to consider appropriate information disclosure based on relevant laws and regulations and to increase the quality and transparency of information disclosure by clarifying the responsibility of those involved. |
| **Risk Management** | The Company has decided basic guidelines regarding risk management by the Group and created the Risk Management Rules to support their effective implementation. |
| | The Company has built an organization to promote risk management, including a Chief Risk Management Officer, a director in charge of risk management, a Chief Risk Compliance Officer, risk compliance officers, and the risk management office (General Affairs Department). The Company has also established systems for setting up internal risk management systems, for determining and evaluating business risks, for taking measures to avoid the occurrence of risk events, and for minimizing damages and losses should a risk event occur. |
| | If an emergency situation occurs that threatens to have a serious impact on the business operations of the Group, the Chief Risk Management Officer has the authority to establish an emergency crisis management office with himself as senior manager and implement measures to resolve the crisis. |
| | The Board of Directors is kept informed of the overall status of risk management within the Tsumura Group through regular reports by the director in charge of risk management (director in charge of the General Affairs Department). |

# FINANCIAL SECTION

# ELEVEN-YEAR SELECTED FINANCIAL DATA (UNAUDITED)

TSUMURA & CO. and subsidiaries
Years ended March 31

| ¥ in million | 2013 | 2012 | 2011 |
|---|---|---|---|
| **For the year** | | | |
| Net sales | ¥ 105,638 | ¥ 95,450 | ¥ 94,778 |
| Cost of sales*1 | 35,928 | 29,946 | 29,435 |
| Gross profit | 69,711 | 65,505 | 65,342 |
| Selling, general and administrative expenses | 46,586 | 44,271 | 43,789 |
| Operating income | 23,124 | 21,233 | 21,553 |
| Income before income taxes and minority interests | 24,062 | 22,448 | 21,058 |
| Net income | 15,373 | 13,431 | 12,945 |
| **At year-end** | | | |
| Inventories | ¥ 35,565 | ¥ 30,570 | ¥ 22,057 |
| Property, plant and equipment, net | 50,657 | 44,869 | 42,154 |
| Long-term liabilities | 9,448 | 8,093 | 8,587 |
| Total liabilities | 51,929 | 49,633 | 50,394 |
| Total net assets*2 | 118,537 | 102,240 | 91,154 |
| Total assets | 170,466 | 151,874 | 141,549 |
| **Other selected data** | | | |
| Capital expenditures for property, plant and equipment | ¥ 9,328 | ¥ 6,425 | ¥ 5,264 |
| R&D expenses | 4,904 | 4,565 | 4,123 |
| Depreciation | 4,049 | 3,850 | 3,453 |
| Free cash flow | 3,989 | 1,972 | 5,232 |
| **Per share data** (yen) | | | |
| Net income | ¥ 217.98 | ¥ 190.45 | ¥ 183.55 |
| Dividends | 62.00 | 60.00 | 58.00 |
| Net assets*2 | 1,658.88 | 1,430.94 | 1,274.06 |
| **Financial ratios** (%) | | | |
| As a percentage of net sales: | | | |
| Gross profit | 66.0% | 68.6% | 68.9% |
| Selling, general and administrative expenses | 44.1 | 46.4 | 46.2 |
| Operating income | 21.9 | 22.2 | 22.7 |
| Income before income taxes and minority interests | 22.8 | 23.5 | 22.2 |
| Net income | 14.6 | 14.1 | 13.7 |
| ROE | 14.1 | 14.1 | 15.0 |
| ROA | 14.4 | 14.5 | 15.6 |
| Current ratio | 222.5 | 207.8 | 189.1 |

*1 Including credit (debit) for allowance for sales returns.
*2 Due to a change in accounting standards, figures for the fiscal year ended March 2006 and prior years are net shareholders' equity.

| | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|---|---|---|---|---|---|---|---|
| | ¥ 90,933 | ¥ 90,016 | ¥ 94,799 | ¥ 91,227 | ¥ 90,419 | ¥ 84,837 | ¥ 82,155 | ¥ 81,411 |
| | 28,518 | 29,028 | 31,609 | 29,438 | 28,000 | 26,522 | 25,635 | 25,529 |
| | 62,414 | 60,987 | 63,190 | 61,788 | 62,419 | 58,314 | 56,520 | 55,882 |
| | 43,475 | 44,504 | 47,369 | 46,282 | 45,951 | 46,351 | 45,298 | 44,239 |
| | 18,938 | 16,483 | 15,820 | 15,505 | 16,467 | 11,962 | 11,221 | 11,642 |
| | 18,710 | 17,940 | 14,605 | 21,261 | 14,726 | 8,548 | 9,132 | 7,485 |
| | 10,704 | 10,777 | 9,139 | 13,152 | 12,380 | 10,401 | 8,479 | 8,035 |
| | ¥ 22,335 | ¥ 19,810 | ¥ 19,651 | ¥ 17,073 | ¥ 16,468 | ¥ 15,655 | ¥ 15,842 | ¥ 15,278 |
| | 40,857 | 38,754 | 40,251 | 41,289 | 48,497 | 47,702 | 49,219 | 48,778 |
| | 8,773 | 8,970 | 14,440 | 21,400 | 26,287 | 32,354 | 39,836 | 41,972 |
| | 50,944 | 52,855 | 62,734 | 73,760 | 79,482 | 83,040 | 94,129 | 99,066 |
| | 83,752 | 73,968 | 72,411 | 69,618 | 54,625 | 38,824 | 28,933 | 15,994 |
| | 134,697 | 126,824 | 135,146 | 143,378 | 135,158 | 122,674 | 124,011 | 116,101 |
| | ¥ 5,237 | ¥ 5,479 | ¥ 3,124 | ¥ 3,906 | ¥ 4,090 | ¥ 2,441 | ¥ 3,631 | ¥ 6,131 |
| | 3,770 | 3,958 | 4,368 | 4,829 | 4,856 | 5,372 | 5,423 | 5,315 |
| | 3,225 | 3,298 | 3,396 | 2,777 | 2,761 | 2,782 | 2,517 | 2,868 |
| | 5,864 | 7,293 | 1,309 | 23,521 | 12,145 | 3,311 | 7,931 | (11,006) |
| | ¥ 151.77 | ¥ 152.80 | ¥ 129.57 | ¥ 186.43 | ¥ 173.62 | ¥ 145.81 | ¥ 118.97 | ¥ 113.61 |
| | 46.00 | 34.00 | 23.00 | 17.00 | 14.00 | 12.00 | 13.00 | - |
| | 1,175.04 | 1,037.76 | 1,015.46 | 970.50 | 772.34 | 548.39 | 408.54 | 226.38 |
| | 68.6% | 67.8% | 66.7% | 67.7% | 69.0% | 68.7% | 68.8% | 68.6% |
| | 47.8 | 49.4 | 50.0 | 50.7 | 50.8 | 54.6 | 55.1 | 54.3 |
| | 20.8 | 18.3 | 16.7 | 17.0 | 18.2 | 14.1 | 13.7 | 14.3 |
| | 20.6 | 19.9 | 15.4 | 23.3 | 16.3 | 10.1 | 11.1 | 9.2 |
| | 11.8 | 12.0 | 9.6 | 14.4 | 13.7 | 12.3 | 10.3 | 9.9 |
| | 13.7 | 14.9 | 13.1 | 21.3 | 26.5 | 30.7 | 37.8 | 59.0 |
| | 14.5 | 12.6 | 11.4 | 11.1 | 12.8 | 9.7 | 9.4 | 9.6 |
| | 173.8 | 157.2 | 142.3 | 133.7 | 107.7 | 106.9 | 99.1 | 91.5 |

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Tsumura's Financial History

### Favorable Growth for Kampo Products Following NHI Listing

In 1976, 33 of Tsumura's pharmaceutical Kampo products were approved under the National Health Insurance (NHI) plan. Tsumura's Kampo product sales were only ¥1.87 billion in the fiscal year ended March 1977, but grew steadily starting in the following year. Three years later, in the fiscal year ended March 1980, Tsumura's Kampo product sales surged to ¥10 billion. In 1987, the Company had a total of 129 prescription Kampo products approved under the NHI plan. Later, clinical data was announced demonstrating the efficacy of TJ-9 (Shosaikoto), a Kampo medicine for colds, in treating chronic hepatitis. Consequently, Tsumura's sales of prescription Kampo products rose substantially to approximately ¥100 billion in the fiscal year ended March 1992. Of this amount, about one-third was sales of TJ-9 (Shosaikoto).

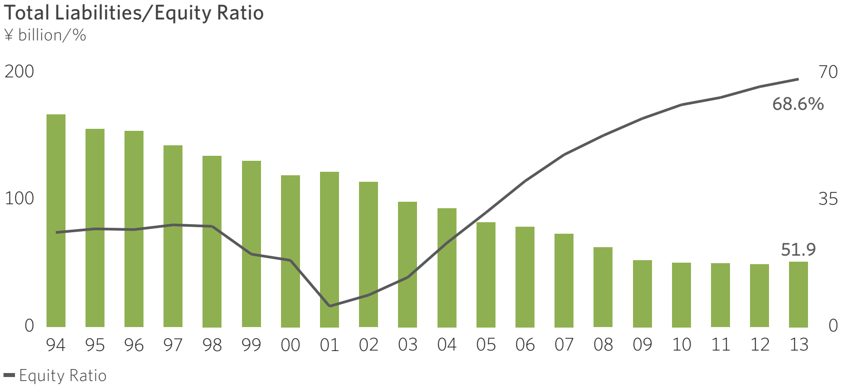
### Adverse Reactions Problem Causes Sales to Stagnate

Prescription Kampo product sales continued to record favorable growth, but then news of an unexpected adverse reaction from treatment with TJ-9 (Shosaikoto) emerged. This news was followed by the announcement of a warning about using the product in 1991. Although the frequency of occurrence of interstitial pneumonia caused by treatment with TJ-9 (Shosaikoto) was low compared with Western drugs, the public's confidence was shaken because it was commonly believed that Kampo medicines did not have any adverse reactions. This news had a negative impact on the public's image of Kampo products and consequently sales slumped. Moreover, we pursued a business diversification strategy at that time, and many of those businesses began to produce red ink, resulting in a deterioration in our financial position.

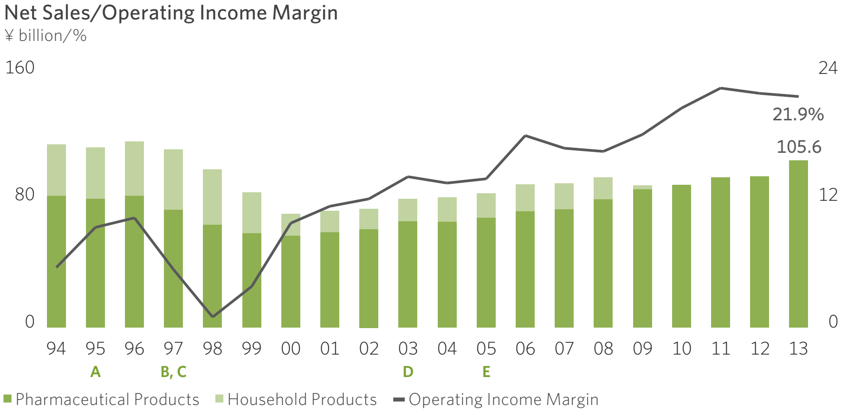
### Specialization in Kampo Business

To overcome its business crisis, Tsumura changed its business policy drastically, switching to one specializing in the development of the Kampo medicines business. Under the revised business policy, the Company focused its efforts on patiently promoting the popularization of Kampo medicine through actions aimed at disseminating a proper understanding and awareness of Kampo medicine among students at

Total Liabilities/Equity Ratio




Net Sales/Operating Income Margin




**A** In 1991, Interferon was indicated for the treatment of hepatitis C and a warning was issued about a possible adverse reaction (interstitial pneumonia) of TJ-9 (Shosaikoto). In 1994, the combined use of TJ-9 (Shosaikoto) and Interferon was prohibited.
**B** Extensive media coverage of possible adverse reactions of TJ-9 (Shosaikoto)
**C** First reported TJ-9 (Shosaikoto) related deaths
**D** Education ministry introduces model core curriculum—Outline of Kampo drugs approved
**E** Kampo education available at all 80 Japanese medical schools

medical schools and universities, clinical physicians, and general consumers. Specifically, the Company began activities to support Kampo medicine education at medical schools and universities, implemented Kampo medicine seminars for clinical physicians, and held public lectures on Kampo medicine for general consumers. As a result of these efforts, sales bottomed out in the fiscal year ended March 2000 and have continued to rebound since then—as has Tsumura's financial position. Moreover, in fiscal 2009, the Company divested its household products business in order to further specialize in its Kampo medicine business.

## Tsumura's Business

Our principal business is the manufacture and sale of pharmaceutical products, including primarily prescription Kampo products covered under the NHI plan as well as OTC Kampo products. We also used to have a household products business that manufactured and marketed household products, mainly bath additives and hair-growth agents. However, with the sale of all the shares of Tsumura Lifescience Co., Ltd., on August 29, 2008, we now focus only on pharmaceutical products.

## Income Statement

Overview of Results

| ¥ in millions, except ratios | 2013 | 2012 |
|---|---|---|
| Net sales | ¥105,638 | ¥95,450 |
| Gross profit | 69,711 | 65,505 |
| Gross profit margin | 66.0% | 68.6% |
| Operating income | ¥ 23,124 | ¥21,233 |
| Operating income margin | 21.9% | 22.2% |
| Net income | ¥ 15,373 | ¥13,431 |

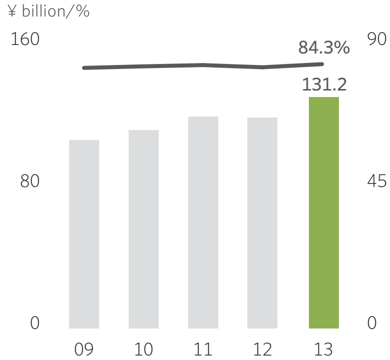
### Net Sales

During the fiscal year under review, the business environment in the prescription Kampo product market remained difficult. There was no change in the Japanese government's policy of curtailing medical care expenses, as it implemented another revision of official drug prices in April 2012, among other measures.

Notwithstanding these circumstances, Tsumura's consolidated net sales rose 10.7% from a year earlier, to ¥105,638 million. A firm increase in the sales of prescription Kampo products despite the impact of a decline in official drug prices supported overall sales growth. Against the backdrop of the steady growth in the popularity of Kampo medicine, use of Kampo products has spread to the treatment of a variety of diseases. As a result, of the Company's 129 formulations, 125 formulations posted growth in the fiscal year under review. Prescription Kampo product sales climbed 10.6% year on year, to ¥99,457 million.

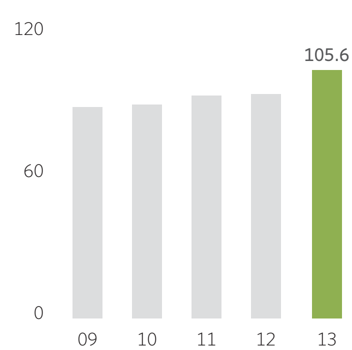
One of the reasons behind the steady growth in prescription Kampo product sales was Tsumura's adjustment of sales activities to fit the different usage of Kampo products by physicians and medical institutions. Specifically, in addition to our regular physician sales visits, we strengthened our sales visits and consultation activities for physicians that do not use Kampo products in their practices. Moreover, we sought to expand and improve the dissemination of Kampo medicine and Kampo products information by actively conducting Kampo medicine seminars, lectures, study groups, and medical institution information meetings. Regarding the five Kampo products featured in Tsumura's drug fostering and evolution of Kampo program—TJ-100 (Daikenchuto), TJ-43 (Rikkunshito), TJ-54 (Yokukansan), TJ-107 (Goshajinkigan), and TJ-14 (Hangeshashinto)—we took advantage of the emerging

Japanese Market Size for Prescription Kampo Products*
¥ billion/%

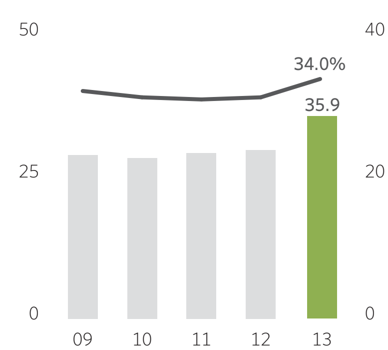



▬ Tsumura's Share * NHI Listed Price


Net Sales
¥ billion




Cost of Sales/Cost of Sales Ratio
¥ billion/%




▬ Cost of Sales Ratio

high-quality scientific evidence to carry out promotional activities based on it through our MRs. As a result, our Kampo products began to steadily gain a good reputation in various medical specialty fields. Reflecting this progress, sales of the five "drug fostering" program prescription Kampo products increased 14.4% from a year earlier, continuing to drive growth in overall prescription Kampo products.

### Cost of Sales

Along with the 14.0% growth in sales of prescription Kampo products on a unit sales basis, cost of sales increased 20.0% from last year, to ¥35,928 million. The cost of sales ratio rose 2.6 percentage points year on year, to 34.0%, worsening mainly because of the impact of the 3.8% average decline in official drug prices and higher prices for raw material crude drugs. Since the weakening of the yen happened after the beginning of 2013, the prices of imported raw material crude drugs and powdered extracts did not have a material impact on the Company's profits because of significant inventory levels.

### Selling, General and Administrative (SG&A) Expenses

Selling, general and administrative (SG&A) expenses increased 5.2%, to ¥46,586 million, with cost efficiency efforts mitigating the greater costs resulting from increased sales. Reflecting this increase, the SG&A expenses margin improved 2.3 percentage points, to 44.1%.

Among major SG&A expenses, sales promotion expenses rose 10.8%, to ¥4,213 million, while sales rebate expenses increased 14.2%, to ¥7,688 million, and salaries and allowances rose 1.7%, to ¥16,866 million. In contrast, provision for employees' retirement and severance benefits contracted 1.6%, to ¥1,186 million.

Among other SG&A expenses, advertising cost fell 14.1%, to ¥889 million, while research and development expenses increased 7.4% from a year earlier, to ¥4,904 million. The higher R&D expenses can be attributed to ongoing efforts to internationalize Kampo medicine and to establish a body of scientific evidence on its efficacy.

**Major Expenses**

| ¥ in millions | 2013 | 2012 |
|---|---|---|
| Personnel expenses | ¥27,663 | ¥26,950 |
| Sales promotion expenses | 4,213 | 3,801 |
| Advertising cost | 889 | 1,036 |
| R&D expenses | 4,904 | 4,565 |

### Operating Income

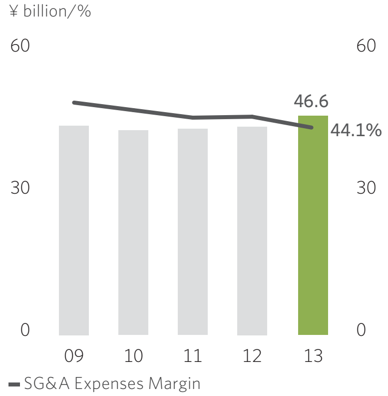
Operating income increased 8.9%, to ¥23,124 million. The operating income margin declined 0.3 percentage point, to 21.9%.

### Net Income

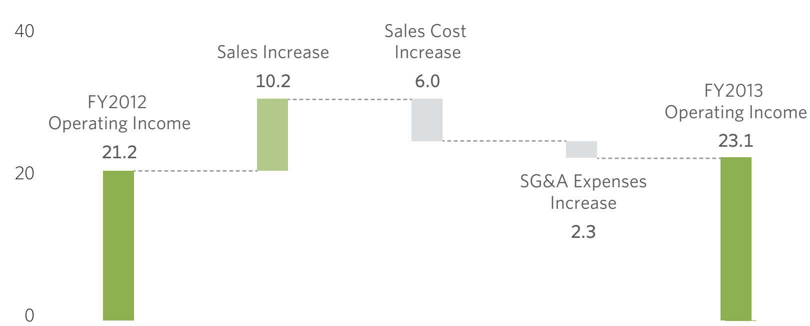
Consolidated net income climbed ¥1,941 million, or 14.5% year on year, to ¥15,373 million. Profit growth can be attributed to operating income increasing ¥1,891 million compared with the previous fiscal year as well as the lack of the extraordinary items booked last year—loss on devaluation of investment securities, gain on sale of stock of a subsidiary, and the extraordinary loss from the Great East Japan Earthquake disaster.

Net income per share increased to ¥217.98 per share, compared with ¥190.45 per share a year earlier.

**SG&A Expenses/ SG&A Expenses Margin**
¥ billion/%




**Factors in Increase/Decrease of Operating Income**
¥ billion



## Liquidity and Capital Resources

### Cash Flows

**Cash Flows**
¥ in millions

| | 2013 | 2012 |
|---|---|---|
| Cash flows from operating activities | ¥12,011 | ¥7,314 |
| Cash flows from investing activities | (8,022) | (5,342) |
| Cash flows from financing activities | (4,275) | (5,272) |

Net cash provided by operating activities amounted to ¥12,011 million during the fiscal year, increasing ¥4,697 million year on year. Although there were negative factors—inventories and receivables increased and payables and accrued expenses decreased—they were offset by the growth in income before income taxes and minority interests.

Net cash used in investing activities amounted to ¥8,022 million, increasing ¥2,680 million from a year earlier. While cash outflows expanded because of the increase in purchase of property, plant and equipment, cash inflows decreased because of declines in proceeds from sales and redemption of investment securities.

Net cash used in financing activities amounted to ¥4,275 million, falling ¥997 million from last year. The decrease can be attributed to no repayments of bank loans.

As a result of the above activities, the balance of cash and cash equivalents at the end of the fiscal year was ¥13,762 million, a decrease of ¥144 million from the beginning of the fiscal year.

### Balance Sheet

**Balance Sheet Data**
¥ in millions

| | 2013 | 2012 |
|---|---|---|
| Total assets | ¥170,466 | ¥151,874 |
| Total liabilities | 51,929 | 49,633 |
| Interest-bearing debt | 22,059 | 22,070 |
| Total net assets | 118,537 | 102,240 |

#### Assets

Compared with the end of the previous fiscal year, current assets grew ¥8,197 million, to ¥94,527 million. Although cash and time deposits remained at almost the same level, current assets rose in several other categories. In addition to the growth in inventories because of the increase in raw material crude drug inventories and the impact of the weaker yen, trade notes and accounts receivable increased.

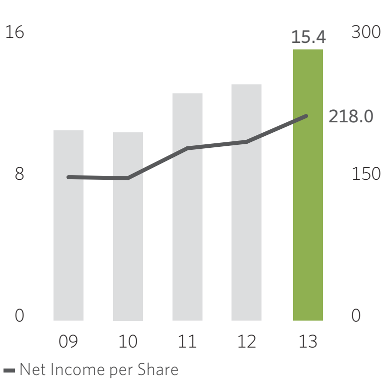
Fixed assets increased ¥10,395 million, to ¥75,939 million. Besides the increase in property, plant and equipment because of the expansion of manufacturing facilities at the Ibaraki Plant, the Shizuoka Plant, and SHANGHAI TSUMURA PHARMACEUTICALS CO., LTD., investment securities expanded.

Overall, total assets amounted to ¥170,466 million, rising ¥18,592 million from the previous fiscal year.

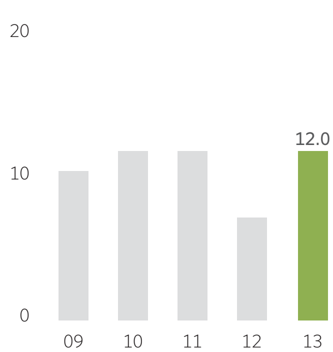
#### Liabilities

Current liabilities increased ¥941 million year on year, to ¥42,480 million. Although accounts payable—other rose, income taxes payable decreased, resulting in an overall increase. Long-term liabilities expanded ¥1,355 million, to ¥9,448 million because of an increase in deferred tax liabilities. Interest-bearing debt edged down ¥11 million, to ¥22,059 million.

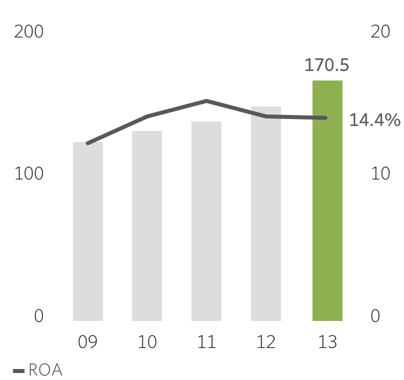
**Net Income/Net Income per Share**
¥ billion/¥




**Cash Flows from Operating Activities**
¥ billion




**Total Assets/ROA**
¥ billion/%



Consequently, total liabilities at the end of the fiscal year increased ¥2,296 million from the prior year, to ¥51,929 million.

**Net Assets**

At fiscal year-end, net assets amounted to ¥118,537 million, increasing ¥16,297 million from a year earlier. The increase can be attributed to the growth in retained earnings and in the unrealized holding gain on other securities, net of taxes.

## Financial Policy

To increase profitability, the Company is working to build free cash flow and optimize its capital structure. Seeking to improve capital efficiency and further enhance profitability, Tsumura's management has positioned ROE as an important performance indicator. In the fiscal year under review, ROE was the same as last year, at 14.1%. The figure remained unchanged because although net income increased, shareholders' equity also expanded because of growth in retained earnings and in unrealized holding gain on other securities, net of taxes. ROA declined 0.1 percentage point, to 14.4%. The equity ratio improved 2.1 percentage points year on year, to 68.6%, while the debt-to-equity ratio declined to 0.44 times from 0.49 times the previous year. Tsumura is committed to continuing its efforts to implement thoroughly efficient operations and strengthen its financial structure.

Currently, the Company is progressing with manufacturing cost structure reforms, planning to allocate the cash earned from operating activities to capital and other investment in growth, such as the improvement of the productivity of existing facilities and the introduction of new manufacturing technologies.

At the same time, Tsumura places great importance on returning profits to shareholders. For that reason, the Company's policy is to achieve stable dividend payouts and consider systematic buybacks of its own shares after taking into consideration capital investment, consolidated performance, and the dividend payout ratio. For the fiscal year under review, Tsumura increased total annual dividends by ¥2.0 per share, to ¥62.0 per share, resulting in the dividend payout ratio declining 3.1 percentage points, to 28.4%.

Financial Policy and Dividend Policy

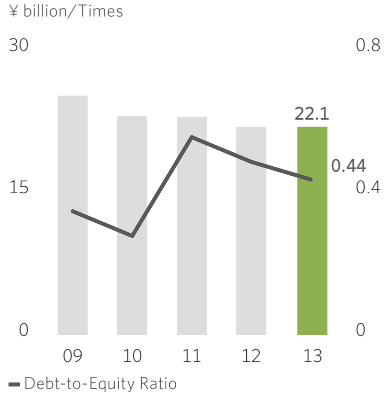
| % | 2013 | 2012 |
|---|---|---|
| ROE | 14.1% | 14.1% |
| ROA | 14.4 | 14.5 |
| Equity ratio | 68.6 | 66.5 |
| Debt-to-equity ratio (times) | 0.44 | 0.49 |

## Risk Factors

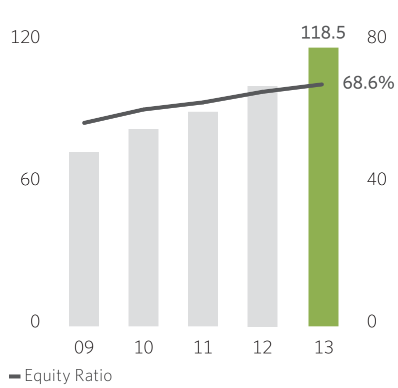
In the following discussion of risk factors, major risks related to the Group's businesses that may exert a significant influence on investors' judgment are outlined. From the standpoint of proactive information disclosure, we have included references to matters that do not necessarily constitute risk factors but we believe are important for investors to consider. The Tsumura Group will strive to avoid the materialization of such risks; however, should such risks materialize, we will endeavor to minimize their impact.

This discussion includes issues that are not yet pertinent to the Group's performance. However, they have been included as management has deemed them important as of 27 June, 2013.

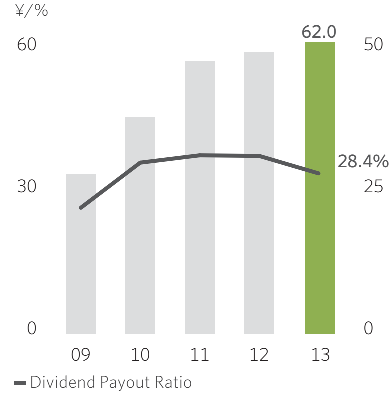
Interest-Bearing Debt/
Debt-to-Equity Ratio
¥ billion/Times




Net Assets/Equity Ratio
¥ billion/%




Dividends per Share/
Dividend Payout Ratio
¥/%



**(1) Medical system**

In the pharmaceutical industry, changes to medical care systems exert a major influence on the market environment. Depending on the direction of change, a negative effect on the industry as a whole and on the Tsumura Group could result.

**(2) Competition**

In Japan, we have long maintained a dominant position in the field of prescription Kampo products, which is the mainstay of the Group. However, if a major domestic or foreign pharmaceuticals company entered the Kampo medicines market, competition would intensify further, and the Group's performance could suffer.

**(3) Product supply**

Approximately 80% of the crude drug medicinal plants that constitute the main ingredients of Tsumura's Kampo formulations are imported from China, and some processes in the production of Kampo products are commissioned to subsidiaries situated in China. Because most of the medicinal plants grow wild, we are researching the cultivation of major medicinal plants for the future. However, in the event of unforeseeable changes in legal regulations or political or economic conditions, it could become difficult to secure or import sufficient quantities. In addition, bad weather, natural disasters, or wars could destabilize social conditions, creating instability in the circulation of demand of the raw materials and supply of them procured domestically and internationally for the manufacture of products, which could have a negative impact on the supply of products due to hikes in the market prices of the raw materials or scarcity of their supply.

Likewise, while we have incorporated earthquake-resistant features in construction and conduct regular inspections of equipment and facilities within Japan, we cannot completely guarantee that the functioning of our facilities will not be hampered or lost in the event of a massive earthquake, fire, power outage, or other disaster. The Group's social standing or performance could be negatively affected should the supply of products be interrupted or delayed due to the above.

**(4) Product safety and adverse reactions**

In the manufacturing of the Group's products, we strictly adhere to the quality control standards of the countries in which we operate and our own original standard for crude drugs. However, we cannot completely guarantee that there will not be a defect or safety problem, including undetected pesticide residue on a medicinal plant used in a Kampo product. In addition, should consumers experience unexpected adverse reactions from a pharmaceutical product marketed by the Tsumura Group, the existing methods of use may be restricted, and a loss of confidence in the Group and its pharmaceutical products may result in a drop in the dispensation of our medicines or in patients' refusal to take them. The Tsumura Group's performance may suffer if a situation such as the above results in a decline in sales volume, demand for large amounts of damage compensation, or a large-scale recall, among other possibilities.

**(5) R&D**

In the interest of future growth and better corporate performance, the Tsumura Group conducts R&D activities related to new products and new technologies both in Japan and abroad. However, we cannot guarantee that all of these activities will be successful. The Group's performance could suffer if for some reason R&D activities were canceled or delayed or if costs increased significantly.

**(6) International business**

The Tsumura Group engages in the manufacture and sale of pharmaceuticals in China, South Korea, and other foreign countries. Because of this involvement in international business, it is possible for the Group to be negatively affected by unforeseeable changes in legal regulations or in political, economic, or other conditions.

**(7) Financial condition**

The Group's performance and financial condition could be negatively affected by such conditions as sharp increases in declining share prices or increased retirement liabilities arising from a drop in the discount rate.

**(8) Intellectual property**

We cannot guarantee the full protection of the intellectual property owned by the Group in relation to Kampo products, and others. The Group's performance may be negatively affected if there were leakage of such information, leading to a decline in competitiveness.

**(9) Exchange rate fluctuations**

The Group imports from China most of the crude drugs used in the Kampo products that it markets. Therefore, sharp movements in exchange rates could impact negatively on the Group's business results and financial position.

# CONSOLIDATED BALANCE SHEETS

TSUMURA & CO. and consolidated subsidiaries
March 31, 2013 and 2012

| | ¥ in millions | | US$ in thousands (Note 2) |
|---|---|---|---|
| ASSETS | 2013 | 2012 | 2013 |
| **Current assets:** | | | |
| Cash and time deposits (Notes 4 and 13) | ¥ 13,793 | ¥ 13,939 | $ 146,661 |
| Trade notes and accounts receivable (Note 4) | 37,199 | 34,532 | 395,524 |
| Less allowance for doubtful receivables | (3) | (6) | (39) |
| Inventories (Note 5) | 35,565 | 30,570 | 378,150 |
| Deferred tax assets (Note 8) | 1,123 | 1,497 | 11,943 |
| Other current assets | 6,850 | 5,796 | 72,840 |
| Total current assets | 94,527 | 86,330 | 1,005,080 |
| **Investments and other assets:** | | | |
| Investments in non-consolidated subsidiaries and affiliates (Note 4) | 2,249 | 2,165 | 23,920 |
| Investment securities (Notes 3 and 4) | 19,741 | 14,201 | 209,903 |
| Deferred tax assets (Note 8) | 35 | 720 | 378 |
| Other assets | 3,023 | 3,389 | 32,143 |
| Less allowance for doubtful accounts | (4) | (30) | (44) |
| Total investments and other assets | 25,045 | 20,446 | 266,301 |
| **Property, plant and equipment, at cost:** | | | |
| Land (Note 6) | 9,897 | 9,897 | 105,232 |
| Buildings and structures | 47,944 | 45,783 | 509,779 |
| Machinery and equipment | 34,955 | 31,446 | 371,674 |
| Tools, furniture and fixtures | 7,387 | 7,246 | 78,551 |
| Construction in progress | 7,407 | 4,427 | 78,762 |
| Others | 206 | 186 | 2,199 |
| Less accumulated depreciation | (57,142) | (54,118) | (607,571) |
| Property, plant and equipment, net | 50,657 | 44,869 | 538,627 |
| **Intangible assets, net of accumulated amortization** | 235 | 227 | 2,502 |
| **Total assets** | ¥170,466 | ¥151,874 | $1,812,513 |

| LIABILITIES AND NET ASSETS | ¥ in millions 2013 | 2012 | US$ in thousands (Note 2) 2013 |
|---|---|---|---|
| **Current liabilities:** | | | |
| Short-term bank loans (Notes 4 and 7) | ¥ 21,957 | ¥ 21,957 | $ 233,460 |
| Current portion of long-term debt (Note 7) | 26 | 28 | 277 |
| Trade notes and accounts payable (Note 4) | 2,954 | 3,033 | 31,411 |
| Income taxes payable (Notes 4 and 8) | 4,222 | 5,425 | 44,893 |
| Accounts payable—other (Note 4) | 8,649 | 6,978 | 91,966 |
| Allowance for sales returns | 9 | 10 | 96 |
| Other current liabilities | 4,662 | 4,106 | 49,575 |
| Total current liabilities | 42,480 | 41,539 | 451,682 |
| **Long-term liabilities:** | | | |
| Long-term debt, less current portion (Note 7) | 76 | 84 | 815 |
| Deferred tax liabilities other than unrealized revaluation gain on land (Note 8) | 997 | 0 | 10,602 |
| Deferred tax liability—unrealized revaluation gain on land (Note 6) | 1,559 | 1,559 | 16,578 |
| Accrued employees' retirement and severance benefits (Note 9) | 2,055 | 1,933 | 21,859 |
| Other long-term liabilities | 4,759 | 4,515 | 50,610 |
| Total long-term liabilities | 9,448 | 8,093 | 100,466 |
| **Net assets: (Note 10)** | | | |
| **Shareholders' equity:** | | | |
| Common stock | 19,487 | 19,487 | 207,206 |
| Authorized—250,000,000 shares in 2013 and 2012 | | | |
| Issued—70,771,662 shares in 2013 and 2012 | | | |
| Capital surplus | 1,940 | 1,940 | 20,634 |
| Retained earnings | 90,397 | 79,255 | 961,163 |
| Treasury stock, at cost | (385) | (384) | (4,102) |
| Total shareholders' equity | 111,440 | 100,300 | 1,184,902 |
| **Accumulated other comprehensive income:** | | | |
| Unrealized holding gain (loss) on other securities, net of taxes | 3,394 | (63) | 36,092 |
| Deferred gain on hedges, net of taxes | 987 | 387 | 10,501 |
| Unrealized revaluation gain on land, net of taxes (Note 6) | 1,984 | 1,984 | 21,099 |
| Translation adjustments | (812) | (1,687) | (8,635) |
| Total accumulated other comprehensive income | 5,554 | 619 | 59,058 |
| Minority interests in consolidated subsidiaries: | 1,542 | 1,321 | 16,403 |
| Total net assets | 118,537 | 102,240 | 1,260,364 |
| **Total liabilities and net assets** | ¥170,466 | ¥151,874 | $1,812,513 |

See notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF INCOME

TSUMURA & CO. and consolidated subsidiaries
For the years ended March 31, 2013 and 2012

| | ¥ in millions | | US$ in thousands (Note 2) |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| **Net sales** | ¥105,638 | ¥95,450 | $1,123,221 |
| Cost of sales (Note 5) | 35,928 | 29,946 | 382,020 |
| **Gross profit before allowance for sales returns** | 69,709 | 65,503 | 741,201 |
| Reversal of allowance for sales returns | 1 | 1 | 19 |
| **Gross profit** | 69,711 | 65,505 | 741,220 |
| Selling, general and administrative expenses (Note 12) | 46,586 | 44,271 | 495,340 |
| **Operating income** | 23,124 | 21,233 | 245,879 |
| **Other income (expenses):** | | | |
| Interest and dividends received | 365 | 455 | 3,884 |
| Interest expenses | (216) | (234) | (2,296) |
| Equity in income of affiliates | 15 | 18 | 160 |
| Foreign exchange gain | 672 | 110 | 7,151 |
| Gain on sales of property, plant and equipment | 1 | – | 14 |
| Loss on sales and disposition of property, plant and equipment | (142) | (187) | (1,512) |
| Impairment losses (Note 18) | (184) | – | (1,960) |
| Gain on sales of investment securities (Note 3) | 2 | 1,381 | 23 |
| Loss on sales of investment securities (Note 3) | – | (1) | – |
| Gain on sales of investments in subsidiaries and affiliates | 75 | – | 797 |
| Loss on sales of investments in subsidiaries and affiliates | – | (71) | – |
| Loss on devaluation of investment securities (Note 3) | – | (134) | – |
| Loss on disaster (Note 19) | – | (320) | – |
| Other, net | 348 | 200 | 3,709 |
| Total other income (expenses) | 937 | 1,215 | 9,971 |
| **Income before income taxes and minority interests** | 24,062 | 22,448 | 255,851 |
| **Income taxes (Note 8):** | | | |
| Current | 8,761 | 9,162 | 93,160 |
| Deferred | (174) | (211) | (1,855) |
| Subtotal | 8,587 | 8,951 | 91,305 |
| **Net income before minority interests** | 15,475 | 13,497 | 164,545 |
| **Minority interests** | (102) | (65) | (1,088) |
| **Net income** | ¥ 15,373 | ¥13,431 | $ 163,456 |

See notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

TSUMURA & CO. and consolidated subsidiaries
For the years ended March 31, 2013 and 2012

| | ¥ in millions | | US$ in thousands (Note 2) |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Net income before minority interests | ¥15,475 | ¥13,497 | $164,545 |
| Other comprehensive income (Note 16): | | | |
| Unrealized holding gain on other securities, net of taxes | 3,458 | 995 | 36,772 |
| Deferred gain on hedges, net of taxes | 600 | 738 | 6,385 |
| Unrealized revaluation gain on land, net of taxes | – | 212 | – |
| Translation adjustments | 983 | (74) | 10,451 |
| Share of other comprehensive income of affiliates accounted for using equity method | 38 | 1 | 408 |
| Total other comprehensive income | 5,080 | 1,873 | 54,018 |
| Comprehensive income | ¥20,555 | ¥15,371 | $218,563 |
| Total comprehensive income attributable to: | | | |
| Interests of the parent | ¥20,307 | ¥15,315 | $215,923 |
| Minority interests | 248 | 55 | 2,639 |

See notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

TSUMURA & CO. and consolidated subsidiaries
For the years ended March 31, 2013 and 2012

¥ in millions

| | | Shareholders' equity | | | | |
|---|---|---|---|---|---|---|
| | Number of shares of common stock | Common stock | Capital surplus | Retained earnings | Treasury stock | Total shareholders' equity |
| **Balance at April 1, 2012** | 70,771,662 | ¥19,487 | ¥1,940 | ¥79,255 | ¥(384) | ¥100,300 |
| Cash dividends paid | – | – | – | (4,231) | – | (4,231) |
| Net income | – | – | – | 15,373 | – | 15,373 |
| Purchase of treasury stock | – | – | – | – | (1) | (1) |
| Net changes in items other than those in shareholders' equity | – | – | – | – | – | – |
| Total changes during the year | – | – | – | 11,141 | (1) | 11,140 |
| **Balance at March 31, 2013** | **70,771,662** | **¥19,487** | **¥1,940** | **¥90,397** | **¥(385)** | **¥111,440** |

¥ in millions

| | Accumulated other comprehensive income | | | | | | |
|---|---|---|---|---|---|---|---|
| | Unrealized holding gain (loss) on other securities, net of taxes | Deferred gain on hedges, net of taxes | Unrealized revaluation gain on land, net of taxes (Note 6) | Translation adjustments | Total accumulated other comprehensive income | Minority interests in consolidated subsidiaries | Total net assets |
| **Balance at April 1, 2012** | ¥ (63) | ¥387 | ¥1,984 | ¥(1,687) | ¥ 619 | ¥1,321 | ¥102,240 |
| Cash dividends paid | – | – | – | – | – | – | (4,231) |
| Net income | – | – | – | – | – | – | 15,373 |
| Purchase of treasury stock | – | – | – | – | – | – | (1) |
| Net changes in items other than those in shareholders' equity | 3,458 | 600 | – | 875 | 4,934 | 221 | 5,156 |
| Total changes during the year | 3,458 | 600 | – | 875 | 4,934 | 221 | 16,296 |
| **Balance at March 31, 2013** | **¥3,394** | **¥987** | **¥1,984** | **¥ (812)** | **¥5,554** | **¥1,542** | **¥118,537** |

US$ in thousands (Note 2)

| | | Shareholders' equity | | | | |
|---|---|---|---|---|---|---|
| | Number of shares of common stock | Common stock | Capital surplus | Retained earnings | Treasury stock | Total shareholders' equity |
| **Balance at April 1, 2012** | 70,771,662 | $207,206 | $20,634 | $842,700 | $(4,086) | $1,066,454 |
| Cash dividends paid | – | – | – | (44,993) | – | (44,993) |
| Net income | – | – | – | 163,456 | – | 163,456 |
| Purchase of treasury stock | – | – | – | – | (15) | (15) |
| Net changes in items other than those in shareholders' equity | – | – | – | – | – | – |
| Total changes during the year | – | – | – | 118,463 | (15) | 118,448 |
| **Balance at March 31, 2013** | **70,771,662** | **$207,206** | **$20,634** | **$961,163** | **$(4,102)** | **$1,184,902** |

US$ in thousands (Note 2)

| | Accumulated other comprehensive income | | | | | | |
|---|---|---|---|---|---|---|---|
| | Unrealized holding gain (loss) on other securities, net of taxes | Deferred gain on hedges, net of taxes | Unrealized revaluation gain on land, net of taxes (Note 6) | Translation adjustments | Total accumulated other comprehensive income | Minority interests in consolidated subsidiaries | Total net assets |
| **Balance at April 1, 2012** | $ (679) | $ 4,116 | $21,099 | $(17,945) | $ 6,591 | $14,046 | $1,087,091 |
| Cash dividends paid | – | – | – | – | – | – | (44,993) |
| Net income | – | – | – | – | – | – | 163,456 |
| Purchase of treasury stock | – | – | – | – | – | – | (15) |
| Net changes in items other than those in shareholders' equity | 36,772 | 6,385 | – | 9,309 | 52,467 | 2,357 | 54,824 |
| Total changes during the year | 36,772 | 6,385 | – | 9,309 | 52,467 | 2,357 | 173,272 |
| **Balance at March 31, 2013** | **$36,092** | **$10,501** | **$21,099** | **$ (8,635)** | **$59,058** | **$16,403** | **$1,260,364** |

See notes to consolidated financial statements.

| | Number of shares of common stock | Common stock | Capital surplus | Retained earnings | Treasury stock | Total shareholders' equity |
|---|---|---|---|---|---|---|
| | | ¥ in millions | | | | |
| | | Shareholders' equity | | | | |
| **Balance at April 1, 2011** | 70,771,662 | ¥19,487 | ¥1,940 | ¥70,075 | ¥(383) | ¥ 91,120 |
| Cash dividends paid | – | – | – | (4,231) | – | (4,231) |
| Net income | – | – | – | 13,431 | – | 13,431 |
| Purchase of treasury stock | – | – | – | – | (0) | (0) |
| Other | – | – | – | (19) | – | (19) |
| Net changes in items other than those in shareholders' equity | – | – | – | – | – | – |
| Total changes during the year | – | – | – | 9,180 | (0) | 9,179 |
| **Balance at March 31, 2012** | 70,771,662 | ¥19,487 | ¥1,940 | ¥79,255 | ¥(384) | ¥100,300 |

| | Unrealized holding gain (loss) on other securities, net of taxes | Deferred gain (loss) on hedges, net of taxes | Unrealized revaluation gain on land, net of taxes (Note 6) | Translation adjustments | Total accumulated other comprehensive income | Minority interests in consolidated subsidiaries | Total net assets |
|---|---|---|---|---|---|---|---|
| | ¥ in millions | | | | | | |
| | Accumulated other comprehensive income | | | | | | |
| **Balance at April 1, 2011** | ¥(1,059) | ¥(351) | ¥1,772 | ¥(1,624) | ¥(1,263) | ¥1,298 | ¥ 91,154 |
| Cash dividends paid | – | – | – | – | – | – | (4,231) |
| Net income | – | – | – | – | – | – | 13,431 |
| Purchase of treasury stock | – | – | – | – | – | – | (0) |
| Other | – | – | – | – | – | – | (19) |
| Net changes in items other than those in shareholders' equity | 995 | 738 | 212 | (62) | 1,883 | 22 | 1,906 |
| Total changes during the year | 995 | 738 | 212 | (62) | 1,883 | 22 | 11,086 |
| **Balance at March 31, 2012** | ¥ (63) | ¥ 387 | ¥1,984 | ¥(1,687) | ¥ 619 | ¥1,321 | ¥102,240 |

See notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

TSUMURA & CO. and consolidated subsidiaries
For the years ended March 31, 2013 and 2012

| | ¥ in millions | | US$ in thousands (Note 2) |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| **Cash flows from operating activities:** | | | |
| Income before income taxes and minority interests | ¥24,062 | ¥22,448 | $ 255,851 |
| Adjustments to reconcile income before income taxes and minority interests to net cash provided by operating activities: | | | |
| Depreciation | 4,049 | 3,850 | 43,055 |
| Impairment losses (Note 18) | 184 | – | 1,960 |
| Interest and dividends received | (365) | (455) | (3,884) |
| Interest expenses | 216 | 234 | 2,296 |
| Equity in (income) of affiliates | (15) | (18) | (160) |
| Loss on sales and disposition of property, plant and equipment | 124 | 188 | 1,322 |
| (Gain) on sales of investment securities | (2) | (1,379) | (23) |
| Loss on devaluation of investment securities | – | 134 | – |
| (Gain) loss on sales of investments in subsidiaries and affiliates | (75) | 71 | (797) |
| (Increase) decrease in receivables | (2,626) | 94 | (27,922) |
| (Increase) in inventories | (4,262) | (8,508) | (45,317) |
| (Decrease) increase in allowance for doubtful receivables | (29) | 1 | (308) |
| (Decrease) increase in payables and accrued expenses | (426) | 1,359 | (4,536) |
| Increase in accrued employees' retirement and severance benefits | 122 | 108 | 1,300 |
| Others, net | 847 | (2,898) | 9,009 |
| Subtotal | 21,805 | 15,232 | 231,845 |
| Interest and dividends received | 385 | 473 | 4,099 |
| Interest paid | (216) | (233) | (2,301) |
| Income taxes paid | (9,963) | (8,158) | (105,934) |
| Net cash provided by operating activities | 12,011 | 7,314 | 127,708 |
| **Cash flows from investing activities:** | | | |
| Purchase of property, plant and equipment | (7,991) | (7,321) | (84,973) |
| Proceeds from sales of property, plant and equipment | 4 | 16 | 48 |
| Purchase of intangible assets | (60) | (49) | (647) |
| Purchase of investment securities | (209) | (9) | (2,229) |
| Proceeds from sales and redemption of investment securities | 4 | 1,609 | 47 |
| Purchase of investments in subsidiaries and affiliates | (100) | – | (1,071) |
| Payments of loans receivable | (249) | (9) | (2,655) |
| Collection of loans receivable | 10 | 309 | 116 |
| Deposits of time deposits with maturity of more than three months | (43) | (35) | (457) |
| Refunds of time deposits with maturity of more than three months | 45 | 23 | 478 |
| Others, net | 568 | 124 | 6,046 |
| Net cash used in investing activities | (8,022) | (5,342) | (85,297) |
| **Cash flows from financing activities:** | | | |
| Repayments of bank loans | – | (1,000) | – |
| Repayments of long-term debt | (29) | (27) | (316) |
| Purchase of treasury stock | (1) | (0) | (15) |
| Cash dividends | (4,229) | (4,225) | (44,971) |
| Cash dividends paid to minority shareholders | (14) | (18) | (156) |
| Net cash used in financing activities | (4,275) | (5,272) | (45,460) |
| **Effect of exchange rate changes on cash and cash equivalents** | 142 | 8 | 1,514 |
| **Net (decrease) in cash and cash equivalents** | (144) | (3,291) | (1,534) |
| **Cash and cash equivalents at beginning of year** | 13,906 | 17,198 | 147,866 |
| **Cash and cash equivalents at end of year (Note 13)** | ¥13,762 | ¥13,906 | $ 146,331 |

See notes to consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

TSUMURA & CO. and consolidated subsidiaries
For the year ended March 31, 2013

## 1 Summary of Significant Accounting Policies

**(a) Basis of presentation**

The accompanying consolidated financial statements of TSUMURA & CO. (the "Company") and its consolidated subsidiaries are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company as required by the Financial Instruments and Exchange Act of Japan (the "FIEA").

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

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year's presentation.

**(b) Principles of consolidation and accounting for investments in unconsolidated subsidiaries and affiliates**

The accompanying consolidated financial statements include the accounts of the Company and any significant companies controlled directly or indirectly by the Company. Companies over which the Company exercises significant influence in terms of their operating and financial policies have been accounted for by the equity method.

The consolidated financial statements include the accounts of the Company and its five significant subsidiaries for the years ended March 31, 2013 and 2012. All significant inter-company balances and transactions have been eliminated in consolidation.

The equity method is applied to investments in significant affiliates in accordance with the provisions of the Regulation for Consolidated Financial Statements.

Investments in non-consolidated subsidiaries and other affiliates are stated at cost. If the equity method had been applied to the investments in these companies, there would have been no material effect in the accompanying consolidated financial statements.

**(c) Accounting period**

The accounting period of the Company begins on April 1 and ends on March 31 of the following year. The three overseas consolidated subsidiaries have fiscal years ending on December 31. The necessary adjustments for significant transactions, if any, during the intervening period are made on consolidation.

**(d) Translation of foreign currencies**

Monetary assets and liabilities denominated in foreign currencies are translated into yen at the rates in effect at the balance sheet date and the accounts of the overseas consolidated subsidiaries, etc., except for the components of shareholders' equity, which are translated into yen at the rates of exchange in effect at the balance sheet date. Foreign exchange gains and losses are credited or charged to operations and translation differences are included in net assets.

**(e) Cash and cash equivalents**

Cash and cash equivalents in the cash flows statement consist of cash on hand, demand deposits and liquid short-term investments with a maturity of three months or less from acquisition date.

**(f) Marketable securities and investment securities**

Trading securities are carried at market value and held-to-maturity securities are amortized or accumulated to face value. Money in trust with a market value is carried at market value.

Other securities with determinable market value are carried at market value with any changes in unrealized holding gain or loss in net assets. Other securities without determinable market value are stated at cost determined principally by the moving average method. The cost of other securities sold is principally computed based on the moving average method. The Company and its consolidated subsidiaries do not have any trading securities and held-to-maturity securities.

**(g) Inventories**

Inventories of the Company and its consolidated subsidiaries are mainly stated at cost determined by the average cost method of reducing book value when the contribution of inventories to profitability declines.

**(h) Property, plant and equipment (except for leased assets)**

Property, plant and equipment are stated at cost and depreciation of property, plant and equipment is computed by the straight-line method.

The estimated useful lives of the major depreciable assets are as follows:

| | |
|---|---|
| Buildings and structures | 3 to 65 years |
| Machinery and equipment | 3 to 8 years |

**(i) Intangible assets (except for leased assets)**

Intangible assets are amortized by the straight-line method. Cost of software purchased for internal use is amortized by the straight-line method over five years, the useful life applicable to commercially available software.

**(j) Allowance for doubtful receivables**

The Company and its consolidated subsidiaries provide allowances for losses on bad debts at the amounts estimated specifically on each doubtful receivable and the amounts calculated based on past experience for receivables other than specific doubtful receivables.

(k) Allowance for sales returns

Allowance for sales returns is provided for estimated losses on sales returns subsequent to the balance sheet date.

(l) Employees' retirement and severance benefits

Employees of the Company and domestic subsidiaries who terminate their employment are entitled to lump-sum or retirement pension or severance benefits based on length of service and level of compensation at the time of termination of employment.

The Company maintains a combination plan of cash-balanced plan, defined contribution plan and employees' pension fund plan (multiple employer plan).

The Company's domestic subsidiaries maintain employees' pension fund (multi-employer plan) and a defined benefit plan.

Accrued retirement and severance benefits are provided based on the estimated retirement and severance benefits obligation and the pension fund assets.

Actuarial gains and losses and past service obligations are amortized using the straight-line method over 10 years, which is within the estimated average of remaining service years of employees.

(m) Leased assets

Leased assets under finance lease transactions that do not transfer ownership to the lessee are depreciated under the straight-line method over the lease term with no residual value.

Among finance lease transactions that do not transfer ownership to the lessee, those lease transactions that commenced on or before March 31, 2008, are accounted for in the similar manner as operating lease transactions in accordance with generally accepted accounting standards.

(n) Income taxes

Deferred tax assets and liabilities are determined based on the differences between financial reporting and the tax bases of the assets and liabilities and are measured using the enacted tax rates and laws which will be in effect when the differences are expected to reverse.

(o) Accounting for consumption taxes

Transactions subject to consumption taxes are recorded at amounts exclusive of consumption taxes. Consumption taxes paid by the Company and its consolidated subsidiaries on the purchases of goods and services that are not deductible under the Consumption Tax Law of Japan are expensed as incurred.

(p) Reclassifications

Certain prior year amounts have been reclassified to conform to the 2013 presentation. These changes had no impact on previously reported results of operations or net assets.

(q) Accounting standards issued but not yet applied

On May 17, 2012, the Accounting Standards Board of Japan ("ASBJ") issued "Accounting Standard for Retirement Benefits" (ASBJ Statement No. 26) and "Guidance on Accounting Standard for Retirement Benefits" (ASBJ Guidance No. 25), which replaced the Accounting Standard for Retirement Benefits that had been issued by the Business Accounting Council in 1998 with an effective date of April 1, 2000 and the other related practical guidance, being followed by partial amendments from time to time through 2009.

The accounting standard for retirement benefits has been revised from the viewpoint of improvements to financial reporting and international convergence, mainly focusing on how unrecognized actuarial gains and losses and prior service costs should be accounted for, how retirement and severance benefit obligations and service costs should be determined, and enhancement of disclosures.

The Company will adopt this standard and the guidance from the end of year ending March 31, 2014 and from the beginning of year ending March 31, 2015 with regard to the revisions relating to determination of retirement and severance benefit obligations and service costs.

The Company is currently evaluating the effect that these modifications will have on its consolidated results of operations and financial position.

(r) Additional information

The Company and certain consolidated subsidiaries requested for approval to apply the consolidated tax payment system from the year ending March 31, 2014. Accordingly, from the year ended March 31, 2013, the income tax accounting treatment is premised on applying the consolidated tax payment system, in accordance with "Practical Solution on Tentative Treatment of Tax Effect Accounting Under Consolidated Taxation System (Part 1)" (Practical Issues Task Force (PITF) No. 5, March 18, 2011) and "Practical Solution on Tentative Treatment of Tax Effect Accounting Under Consolidated Taxation System (Part 2)" (PITF No. 7, June 30, 2010).

## 2 Basis of Translation

The consolidated financial statements presented herein are expressed in yen and, solely for the convenience of the reader, have been translated into U.S. dollars at ¥94.05=US$1.00, the approximate exchange rate prevailing on the Tokyo Foreign Exchange Market on March 31, 2013. This translation should not be construed as a representation that the amounts shown could have been, or could in the future be, converted into U.S. dollars at that or any other rate.

## 3 Investment Securities

The cost and related aggregate market values of securities, other than those held for trading and held-to-maturity purposes, with a readily available market value at March 31, 2013 and 2012 are summarized as follows:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Cost | ¥14,448 | ¥14,240 | $153,622 |
| Market value | 19,642 | 14,112 | 208,853 |
| Total unrealized gain | 5,870 | 2,067 | 62,421 |
| Total unrealized loss | (676) | (2,195) | (7,190) |

Securities as of March 31, 2013 and 2012, which are excluded from the above table are summarized at their book values as follows:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Non-current assets: | | | |
| Unlisted stocks other than those on the over-the-counter market | ¥98 | ¥88 | $1,049 |

Securities, other than those held for trading and held-to-maturity purposes, which were sold during the years ended March 31, 2013, and 2012 are summarized as follows:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Proceeds received | ¥4 | ¥1,609 | $47 |
| Total gain | 2 | 1,381 | 23 |
| Total loss | – | 1 | – |

The Company recognized impairment losses on all securities whose market value had declined by 50% or more of book value and on some securities whose market value had declined by 30% or more of book value. Impairment losses were, if any, recognized at the amount of the difference between book value and market value. Impairment losses on securities for the years ended March 31, 2013 and 2012 were nil and ¥134 million on securities other than those held for trading and held-to-maturity purposes with a readily available market value, respectively.

## 4 Financial Instruments

The Company and its consolidated subsidiaries finance short term operating capital through bank loans although capital investments for the pharmaceutical production and selling business are financed mainly by our own funds. Temporary excesses funds are operated by highly rated financial institutions. Derivative transactions are only utilized to hedge the following risks, and it is our policy not to enter into derivative transactions for speculative purposes.

Operating receivables such as trade notes and accounts receivables are exposed to credit risk. The Company and its consolidated subsidiaries manage the due date and balance for each customer following internal rules and asking for deposits depending on the customers credit conditions.

Investment securities mainly consist of securities of counterparties and are exposed to market fluctuation risk. The fair value of the investment securities is regularly reported to the responsible board of directors.

Operating payables such as trade notes and accounts payables are due within one year. Some of the operating payables relating to imports of raw materials are denominated in foreign currencies and are exposed to foreign currency fluctuation risk. The Company and its consolidated subsidiaries utilize foreign currency forward contracts to hedge the risk.

Short-term bank loans are used to finance operating capital and are exposed to interest fluctuation risk.

Accounts payable—other and Income taxes payable are each due within one year.

The Company and its consolidated subsidiaries utilize derivative financial instruments, such as foreign exchange forward contracts to hedge their foreign currency risk. Please refer to Note 15: Derivatives for hedge accounting.

Implementation and management of derivative transactions are based on the internal rules. The Company and its consolidated subsidiaries only enter into derivative transactions with highly rated financial institutions to mitigate credit risk.

Operating payables and loans are exposed to liquidity risk. The Company and its consolidated subsidiaries manage the risk by preparing the cash management plans monthly.

The contract amount and others regarding derivative transactions described in Note 15: Derivatives does not indicate market risk related to derivative transactions.

Carrying value on the consolidated balance sheets, fair values and differences of financial instruments as of March 31, 2013 and 2012 are as follows:

| | ¥ in millions | | |
|---|---|---|---|
| | | | 2013 |
| | Carrying value reported in the balance sheets | Fair value | Difference |
| Cash and time deposits | ¥13,793 | ¥13,793 | ¥– |
| Trade notes and accounts receivable | 37,199 | 37,199 | – |
| Investment securities: | | | |
| Other securities | 19,642 | 19,642 | – |
| Total | ¥70,635 | ¥70,635 | ¥– |
| Trade notes and accounts payable | ¥2,954 | ¥ 2,954 | ¥– |
| Short-term bank loans | 21,957 | 21,957 | – |
| Accounts payable—other | 8,649 | 8,649 | – |
| Income taxes payable | 4,222 | 4,222 | – |
| Total | ¥37,782 | ¥37,782 | ¥– |
| Derivative transactions | ¥ 1,593 | ¥ 1,593 | ¥– |

| | ¥ in millions | | |
|---|---|---|---|
| | | | 2012 |
| | Carrying value reported in the balance sheets | Fair value | Difference |
| Cash and time deposits | ¥13,939 | ¥13,939 | ¥– |
| Trade notes and accounts receivable | 34,532 | 34,532 | – |
| Investment securities: | | | |
| Other securities | 14,112 | 14,112 | – |
| Total | ¥62,584 | ¥62,584 | ¥– |
| Trade notes and accounts payable | ¥ 3,033 | ¥ 3,033 | ¥– |
| Short-term bank loans | 21,957 | 21,957 | – |
| Accounts payable—other | 6,978 | 6,978 | – |
| Income taxes payable | 5,425 | 5,425 | – |
| Total | ¥37,393 | ¥37,393 | ¥– |
| Derivative transactions | ¥ 624 | ¥ 624 | ¥– |

| | | | US$ in thousands |
|---|---|---|---|
| | | | 2013 |
| | Carrying value reported in the balance sheets | Fair value | Difference |
| Cash and time deposits | $146,661 | $146,661 | $– |
| Trade notes and accounts receivable | 395,524 | 395,524 | – |
| Investment securities: | | | |
| Other securities | 208,853 | 208,853 | – |
| Total | $751,039 | $751,039 | $– |
| Trade notes and accounts payable | $ 31,411 | $ 31,411 | $– |
| Short-term bank loans | 233,460 | 233,460 | – |
| Accounts payable—other | 91,966 | 91,966 | – |
| Income taxes payable | 44,893 | 44,893 | – |
| Total | $401,732 | $401,732 | $– |
| Derivative transactions | $ 16,940 | $ 16,940 | $– |

Unlisted stocks of ¥98 million (U.S.$1,049 thousand) and ¥88 million as of March 31, 2013 and 2012, respectively, whose fair value is extremely difficult to determine were not included in the above table.

Furthermore, unlisted stocks of ¥1,620 million (U.S.$17,224 thousand) and ¥1,620 million included in "Investments in non-consolidated subsidiaries and affiliates" as of March 31, 2013 and 2012, respectively, whose fair value is extremely difficult to determine were not included in the above table.

Valuation method of fair value of financial instruments and information regarding marketable and investment securities and derivative transactions is summarized as follows.

Cash and time deposits and trade notes and accounts receivable:

The carrying value is deemed as the fair value since these items are scheduled to be settled in a short period of time.

Investment securities:

Fair value of stocks is based on the quoted market prices. The fair value of bonds is based on the price provided by the counter-party financial institutions. Please refer to Note 3: Investment Securities for the notes regarding the securities by classification.

Trade notes and accounts payable, short-term bank loans, account payable—other and income taxes payable:

The carrying value is deemed as the fair value since these items are scheduled to be settled in a short period of time.

Derivative transactions:

Please refer to Note 15: Derivatives.

The redemption schedule of monetary assets and securities with maturity dates at March 31, 2013 and 2012 is summarized as follows:

| | | | | ¥ in millions |
|---|---|---|---|---|
| | | | | 2013 |
| | Within one year | Over one year within five years | Over five years within ten years | Over ten years |
| Cash and time deposits | ¥13,765 | ¥– | ¥ – | ¥– |
| Trade notes and accounts receivable | 37,199 | – | – | – |
| Investment securities | | | | |
| Other securities with maturity dates (corporate bonds) | – | – | 1,000 | – |
| Total | ¥50,964 | ¥– | ¥1,000 | ¥– |

| | ¥ in millions | | | |
|---|---|---|---|---|
| | 2012 | | | |
| | Within one year | Over one year within five years | Over five years within ten years | Over ten years |
| Cash and time deposits | ¥13,916 | ¥– | ¥ – | ¥– |
| Trade notes and accounts receivable | 34,532 | – | – | – |
| Investment securities | | | | |
| Other securities with maturity dates (corporate bonds) | – | – | 1,000 | – |
| Total | ¥48,449 | ¥– | ¥1,000 | ¥– |

| | US$ in thousands | | | |
|---|---|---|---|---|
| | 2013 | | | |
| | Within one year | Over one year within five years | Over five years within ten years | Over ten years |
| Cash and time deposits | $146,361 | $– | $ – | $– |
| Trade notes and accounts receivable | 395,524 | – | – | – |
| Investment securities | | | | |
| Other securities with maturity dates (corporate bonds) | – | – | 10,632 | – |
| Total | $541,886 | $– | $10,632 | $– |

The repayment schedule of bonds payable and long-term loans payable after the fiscal year-end: Please refer to Note 7: Debt.

## 5 Inventories

Inventories at March 31, 2013 and 2012 consisted of the following:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Merchandise and finished goods | ¥ 6,862 | ¥ 6,102 | $ 72,965 |
| Work in process | 8,351 | 7,806 | 88,795 |
| Raw materials and supplies | 20,351 | 16,661 | 216,389 |
| Total | ¥35,565 | ¥30,570 | $378,150 |

Inventories at March 31, 2013 and 2012 are stated at net selling value. Inventories valuation loss included in cost of sales was ¥127 million (U.S.$1,350 thousand) and ¥26 million for the years ended March 31, 2013 and 2012, respectively.

## 6 Land Revaluation

In accordance with the Land Revaluation Law (Proclamation No. 34, dated March 31, 1998), land used for business activities was revalued at March 31, 2002. Unrealized revaluation gain on land, net of related deferred taxes, has been presented as a component of net assets.

The market value of the land as of March 31, 2013 and 2012 decreased by ¥2,363 million (U.S.$25,130 thousand) and by ¥2,176 million after the revaluation, respectively.

## 7 Debt

Short-term bank loans at average interest rates of 1.0% and 1.1% amounted to ¥21,957 million (U.S.$233,460 thousand) and ¥21,957 million at March 31, 2013 and April 1, 2012, respectively.

Long-term debt at March 31, 2013 and April 1, 2012 consisted of the following:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Lease obligations, maturing through 2019 | ¥102 | ¥113 | $1,093 |
| Less: current portion | (26) | (28) | (277) |
| | ¥ 76 | ¥ 84 | $ 815 |

The aggregate annual maturities of lease obligations subsequent to March 31, 2013 are summarized as follows:

| Years ending March 31 | ¥ in millions | US$ in thousands |
|---|---|---|
| 2014 | ¥ 26 | $ 277 |
| 2015 | 24 | 258 |
| 2016 | 23 | 244 |
| 2017 and thereafter | 29 | 312 |
| Total | ¥102 | $1,093 |

No assets were pledged as collateral for short-term bank loans and long-term debt at March 31, 2013 and 2012.

The Company and its consolidated subsidiaries had no credit commitments with a bank at March 31, 2013 and 2012.

## 8 Income Taxes

At March 31, 2013 and 2012, the significant components of deferred tax assets and liabilities are summarized as follows:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Deferred tax assets: | | | |
| Employees' retirement and severance benefits | ¥ 737 | ¥ 692 | $ 7,843 |
| Accrued bonuses | 952 | 935 | 10,123 |
| Accrued enterprise tax | 375 | 407 | 3,992 |
| Unrealized holding loss on other securities | – | 64 | – |
| Other | 753 | 640 | 8,008 |
| Total deferred tax assets | 2,818 | 2,740 | 29,968 |
| Valuation allowance | (188) | (259) | (2,001) |
| Deferred tax assets recognized | 2,630 | 2,480 | 27,966 |
| Deferred tax liabilities: | | | |
| Unrealized holding gain on other securities | (1,800) | – | (19,138) |
| Deferred gain on hedges | (605) | (237) | (6,439) |
| Other | (62) | (25) | (668) |
| Total deferred tax liabilities | (2,468) | (262) | (26,246) |
| Net deferred tax assets | ¥ 161 | ¥2,218 | $ 1,719 |

The Company and its consolidated subsidiaries are subject to a number of taxes based on income which, in the aggregate, resulted in statutory tax rates of approximately 38.0% and 40.5% for the years ended March 31, 2013 and 2012, respectively. The statutory tax rates reflected in the accompanying consolidated statements of income for the years ended March 31, 2013 and 2012 differ from the effective tax rates for the following reasons:

| | 2013 | 2012 |
|---|---|---|
| Statutory tax rates | 38.0% | 40.5% |
| Effect of: | | |
| Inhabitants per capita taxes | 0.4 | 0.4 |
| Permanent differences such as entertainment and donation expenses | 0.7 | 1.2 |
| Nontaxable dividend income | (0.4) | (0.6) |
| Tax credit for research and development expense | (1.9) | (1.8) |
| Increase (decrease) in valuation allowance | (0.2) | 0.0 |
| Reduction of deferred tax assets due to income tax rates change | – | 0.9 |
| Other | (0.9) | (0.7) |
| Effective tax rates | 35.7% | 39.9% |

## 9 Employees' Retirement and Severance Benefits

The Company maintains a combination plan of cash-balanced, defined contribution plan and employees' pension fund plan (multi-employer plan).

The Company's domestic subsidiaries maintain employees' pension fund (multi-employer plan) and a defined benefit plan.

Under these plans, employees who terminate their employment are entitled to lump-sum or retirement pension or severance benefits based on their length of service and level of compensation at the time of the termination.

In addition, the Company and its domestic subsidiaries pay meritorious service awards to employees in excess of the prescribed formula which are charged to income as paid as it is not practicable to compute the liability for such future payments since the amounts vary depending on the circumstances.

(Multi-employer plan)

Required contributions for the multi-employer plan as stated above are included in retirement benefit expenses.

(Fiscal 2013)

(1) Overall funding status as of March 31, 2013 is as follows:

| | ¥ in millions | US$ in thousands |
|---|---|---|
| Plan assets | ¥ 414,218 | $ 4,404,234 |
| Benefit obligations, calculated based on assumptions for the entire plans | (459,016) | (4,880,555) |
| Difference | ¥ (44,797) | $ (476,320) |

The amounts in the above table are provided based on the most recent available information (as of March 31, 2012 for fiscal 2013).

(2) Contributions ratio of the Company to the entire plans during the year ended March 31, 2013 is 3.68%.

(3) Supplemental information

The difference described in (1) above was calculated by the sum of balance of the unamortized prior service costs of ¥38,602 million (U.S.$410,448 thousand), accumulated deficit of the fund at end of the prior year of ¥3,215 million (U.S.$34,191 thousand) and deficit of the fund this year of ¥2,979 million (U.S.$31,680 thousand).

The balance of unamortized prior service costs represents the present value of special premium income and is amortized using the equal payment method with a 15.5‰ premium ratio burdened by the employer. The remaining amortization period is 6 years and 10 months as of March 31, 2012.

The ratio in (2) above is not equal to the actual share ratio.

(Fiscal 2012)

(1) Overall funding status as of March 31, 2012 is as follows:

| | ¥ in millions |
|---|---|
| Plan assets | ¥ 408,248 |
| Benefit obligations, calculated based on assumptions for the entire plans | (454,863) |
| Difference | ¥ (46,614) |

The amounts in the above table are provided based on the most recent available information (as of March 31, 2011 for fiscal 2012).

(2) Contributions ratio of the Company to the entire plans during the year ended March 31, 2012 is 3.69%.

(3) Supplemental information

The difference described in (1) above was calculated by the sum of balance of the unamortized prior service costs of ¥43,398 million and accumulated deficit of the fund at end of the prior year of ¥3,215 million.

The balance of unamortized prior service costs represents the present value of special premium income and is amortized using the equal payment method with a 15.5‰ premium ratio burdened by the employer. The remaining amortization period is 7 years and 10 months as of March 31, 2011.

The ratio in (2) above is not equal to the actual share ratio.

The following table summarizes the funded status and amounts recognized in the consolidated balance sheets at March 31, 2013 and 2012:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | **2013** | 2012 | **2013** |
| Retirement and severance benefit obligations | **¥(15,181)** | ¥(13,537) | **$(161,417)** |
| Plan assets | **11,524** | 10,049 | **122,536** |
| Unfunded benefit obligation | **(3,656)** | (3,487) | **(38,881)** |
| Unrecognized actuarial gain and loss | **1,779** | 1,794 | **18,916** |
| Unrecognized prior service cost | **(178)** | (240) | **(1,894)** |
| Accrued employees' retirement and severance benefits | **¥ (2,055)** | ¥ (1,933) | **$ (21,859)** |

The following table summarizes the components of the net retirement benefit expenses for the years ended March 31, 2013 and 2012:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | **2013** | 2012 | **2013** |
| Service cost | **¥1,288** | ¥1,270 | **$13,700** |
| Interest cost on benefit obligation | **306** | 295 | **3,256** |
| Expected return on plan assets | **(346)** | (328) | **(3,683)** |
| Amortization of unrecognized actuarial gain and loss | **304** | 312 | **3,237** |
| Amortization of unrecognized prior service cost | **(62)** | (66) | **(666)** |
| Other | **342** | 345 | **3,642** |
| Net retirement benefit expenses | **¥1,832** | ¥1,829 | **$19,487** |

The assumptions used in determining pension benefit obligation are shown below:

| | **2013** | 2012 |
|---|---|---|
| Method of periodic allocation of estimated retirement benefits | **Straight-line method** | Straight-line method |
| Discount rate | **1.5%** | 2.3% |
| Expected rate of return on assets | **3.5%** | 3.5% |
| Amortization period of prior service cost | **10 years** | 10 years |
| Amortization period of actuarial gain and loss | **10 years** | 10 years |

## 10 Net Assets

The Companies Act of Japan (the "Act"), which superseded most of the provisions of the Commercial Code of Japan, went into effect on May 1, 2006. The Act provides that an amount equal to 10% of the amount to be disbursed as distributions of capital surplus (other than the capital reserve) and retained earnings (other than the legal reserve) be transferred to the capital reserve and the legal reserve, respectively, until the sum of the capital reserve and the legal reserve equals 25% of the capital stock account. Such distributions can be made at any time by resolution of the shareholders, or by the Board of Directors if certain conditions are met. The legal reserve amounted to ¥2,198 million (U.S.$23,372 thousand) and ¥1,775 million as of March 31, 2013 and 2012, respectively.

## 11 Amounts per Share

Net assets per share as of March 31, 2013 and 2012 are ¥1,658.88 (U.S.$17.63) and ¥1,430.94, respectively.

Net income per share for the years ended March 31, 2013 and 2012 is ¥217.98 (U.S.$2.31) and ¥190.45, respectively.

The basis for calculation of basic total net assets per share as of March 31, 2013 and 2012 is as follows:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Basic total net assets per share: | | | |
| Total net assets | ¥118,537 | ¥102,240 | $1,260,364 |
| Less: Minority interests in consolidated subsidiaries | 1,542 | 1,321 | 16,403 |
| Amounts attributable to shareholders of common stock | ¥116,994 | ¥100,919 | $1,243,961 |
| Number of shares outstanding at the end of the periods | 70,526,265 | 70,526,815 | 70,526,265 |

The basis for calculation of basic net income per share for the years ended March 31, 2013 and 2012 is as follows:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Basic net income per share: | | | |
| Net income | ¥15,373 | ¥13,431 | $163,456 |
| Less: Amounts not attributable to shareholders of common stock | – | – | – |
| Amounts attributable to shareholders of common stock | ¥15,373 | ¥13,431 | $163,456 |
| Weighted-average number of shares outstanding | 70,526,550 | 70,526,998 | 70,526,550 |

Basic net income per share is computed based on the net income and the weighted-average number of shares of common stock outstanding during each year. Diluted net income per share is computed based on the net income and the weighted-average number of shares of common stock outstanding during each year after giving effect to the dilutive potential of shares of common stock to be issued. Diluted net income per share for the years ended March 31, 2013 and 2012 has not been presented because there were no potentially dilutive securities at March 31, 2013 and 2012, respectively.

Net assets per share are based on the number of shares of common stock outstanding at each balance sheet date.

The Company and its consolidated subsidiaries and non-consolidated subsidiaries and other affiliates to which the equity method had been applied had 245,397 and 244,847 shares of treasury stock at March 31, 2013 and 2012, respectively.

## 12 Major Expenses

Major expenses included in selling, general and administrative expenses for the years ended March 31, 2013 and 2012 are as follows:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Sales promotion expenses | ¥ 4,213 | ¥ 3,801 | $ 44,799 |
| Sales rebate | 7,688 | 6,730 | 81,748 |
| Salaries and allowances | 16,866 | 16,587 | 179,331 |
| Research and development expenses | 4,904 | 4,565 | 52,149 |
| Provision for employees' retirement and severance benefits | 1,186 | 1,205 | 12,620 |
| Provision for doubtful accounts | 0 | 0 | 0 |

Research and development expenses included in general and administrative expenses and cost of sales for the years ended March 31, 2013 and 2012 amounted to ¥4,904 million (U.S.$52,149 thousand) and ¥4,565 million, respectively.

## 13 Cash and Cash Equivalents

A reconciliation of cash and cash equivalents at March 31, 2013 and 2012 to the accounts and amounts in the accompanying balance sheets is summarized as follows:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Cash and time deposits | ¥13,793 | ¥13,939 | $146,661 |
| Less: Time deposits with a maturity in excess of three months | (31) | (33) | (329) |
| Cash and cash equivalents | ¥13,762 | ¥13,906 | $146,331 |

## 14 Leases

Finance lease transactions that do not transfer ownership

Leased assets consisted of test facilities in the laboratory, etc.

Finance lease transactions that do not transfer ownership commenced on or before March 31, 2008 are still accounted for in the same manner as operating lease transactions.

Pro-forma information of leased assets such as acquisition cost, accumulated depreciation, obligations under finance leases, depreciation expense, interest expense and other information of finance leases that do not transfer ownership of the leased assets to the lessee on an "as if capitalized" basis for the years ended March 31, 2013 and 2012 are as follows:

1) A summary of the pro-forma amounts for acquisition cost, accumulated depreciation and net book value relating primarily to tools, furniture and fixtures at March 31, 2013 and 2012 are as follows:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Acquisition cost | ¥61 | ¥193 | $650 |
| Accumulated depreciation | 46 | 159 | 491 |
| Net book value | ¥14 | ¥ 34 | $159 |

2) Future minimum lease payments at March 31, 2013 and 2012 are summarized as follows:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Payments in one year or less | ¥ 8 | ¥19 | $ 92 |
| Payments after one year | 6 | 14 | 67 |
| Total | ¥14 | ¥34 | $159 |

3) Lease payments and pro-forma depreciation charges for the years ended March 31, 2013 and 2012 are analyzed as follows:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Lease payments | ¥18 | ¥44 | $200 |
| Pro-forma depreciation charges | 18 | 44 | 200 |

4) Depreciation and interest allocation policy

The pro-forma effects of depreciation are computed using the straight-line method over lease terms with no residual value.

Operating leases

Future minimum lease payments for non-cancellable operating leases subsequent to March 31, 2013 and 2012 are as follows:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Payable in one year or less | ¥46 | ¥40 | $498 |
| Payable after one year | 18 | 17 | 199 |
| Total | ¥65 | ¥58 | $698 |

## 15 Derivatives

The Company and its consolidated subsidiaries have entered into foreign exchange forward contracts to reduce its exposure to the risk of future adverse fluctuations in foreign exchange rates related to assets and liabilities denominated in foreign currencies.

An unrealized gain or loss on a hedge instrument is deferred until the Company recognizes a gain or loss on the hedged item.

It is the Company's policy not to enter into any speculative derivatives transactions. The Company and its consolidated subsidiaries have entered into derivative transactions to hedge foreign exchange risk of normal foreign currency transactions based on past import activities, etc.

The management of the Company considers that the Company would not be significantly impacted by market risk related to derivative transactions because their effects on income would be opposite to the effects of the underlying hedged transactions. As the Company enters into contracts with domestic banks with high credit ratings, the Company does not anticipate any risk of non-performance by these counterparties.

The Company and its consolidated subsidiaries enter into and monitor derivative transactions in accordance with internal execution and control regulations relating to derivative transactions which stipulate control policies, purpose, scope and reporting system of derivative transactions.

Derivative transactions for which hedge accounting has been applied at March 31, 2013 and 2012 are as follows:

Currency related

| | | | ¥ in millions | | | US$ in thousands | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | | 2013 |
| Hedge accounting method | Transaction | Hedged items | Contract amount | Contract amount over one year | Fair value | Contract amount | Contract amount over one year | Fair value |
| Allocation method | Foreign exchange forward contracts USD (Buying) | Forecast transactions denominated in foreign currency | ¥10,949 | ¥– | ¥1,593 | $116,424 | $– | $16,940 |

| | | | ¥ in millions | | |
|---|---|---|---|---|---|
| | | | | | 2012 |
| Hedge accounting method | Transaction | Hedged items | Contract amount | Contract amount over one year | Fair value |
| Allocation method | Foreign exchange forward contracts USD (Buying) | Forecast transactions denominated in foreign currency | ¥14,784 | ¥6,527 | ¥624 |

Fair value is principally based on obtaining quotes from counterparty financial institutions.

Information on derivative transactions for which hedge accounting does not apply is omitted since all outstanding derivative positions qualified for hedge accounting.

## 16 Comprehensive Income

Reclassifications and adjustments and income tax effects attributable to other comprehensive income for the years ended March 31, 2013 and 2012 are as follows:

| | ¥ in millions | | US$ in thousands |
|---|---|---|---|
| | 2013 | 2012 | 2013 |
| Unrealized holding gain (loss) on other securities, net of taxes: | | | |
| Gains (losses) arising during the year | ¥ 5,325 | ¥1,438 | $ 56,619 |
| Reclassifications and adjustments | (2) | 136 | (23) |
| Before income tax effects | 5,322 | 1,574 | 56,595 |
| Income tax effects | (1,864) | (579) | (19,823) |
| Unrealized holding gain (loss) on other securities, net of taxes | ¥ 3,458 | ¥ 995 | $ 36,772 |
| Deferred gain (loss) on hedges, net of taxes: | | | |
| Gains (losses) arising during the year | ¥ 968 | ¥1,215 | $ 10,300 |
| Income tax effects | (368) | (476) | (3,915) |
| Deferred gain (loss) on hedges, net of taxes | ¥ 600 | ¥ 738 | $ 6,385 |
| Unrealized revaluation gain on land, net of taxes: | | | |
| Income tax effects | ¥ – | ¥ 212 | $ – |
| Unrealized revaluation gain on land, net of taxes | ¥ – | ¥ 212 | $ – |
| Translation adjustments: | | | |
| Adjustments arising during the year | ¥ 983 | ¥ (74) | $ 10,451 |
| Translation adjustments | ¥ 983 | ¥ (74) | $ 10,451 |
| Share of other comprehensive income of affiliates accounted for using equity method: | | | |
| Gains (losses) arising during the year | ¥ 38 | ¥ 1 | $ 408 |
| Share of other comprehensive income of affiliates accounted for using equity method | ¥ 38 | ¥ 1 | $ 408 |
| Total other comprehensive income | ¥ 5,080 | ¥1,873 | $ 54,018 |

## 17 Segment Information

Information about reportable segment is not disclosed since the Company and its consolidated subsidiaries have categorized its reportable segment into a single segment, pharmaceutical products operation.

(Related information)

(1) Information about products and services

Information about products and services is not disclosed since sales amount of single product or service classification to external customers exceeded 90% of net sales on the consolidated statements of income.

(2) Information about geographical areas

(a) Sales

Information about sales by geographical areas is not disclosed since sales to external customers in Japan exceeded 90% of net sales on the consolidated statements of income.

(b) Property, plant and equipment

Information about property, plant and equipment by geographical areas for the years ended March 31, 2013 and 2012 is as follows:

| | | | ¥ in millions |
|---|---|---|---|
| | | | 2013 |
| Japan | China | Other | Total |
| ¥41,176 | ¥9,480 | ¥0 | ¥50,657 |

| | | | ¥ in millions |
|---|---|---|---|
| | | | 2012 |
| Japan | China | Other | Total |
| ¥39,019 | ¥5,849 | ¥0 | ¥44,869 |

| | | | US$ in thousands |
|---|---|---|---|
| | | | 2013 |
| Japan | China | Other | Total |
| $437,817 | $100,801 | $8 | $538,627 |

(3) Information about major customers for the years ended March 31, 2013 and 2012 is as follows:

| | Sales | | |
|---|---|---|---|
| | ¥ in millions | US$ in thousands | |
| Name of major customers | | 2013 | Segment |
| Alfresa Holdings Corporation | ¥27,043 | $287,543 | Pharmaceutical products |
| MEDIPAL HOLDINGS CORPORATION | 21,262 | 226,079 | Pharmaceutical products |
| Suzuken Co., Ltd. | 16,222 | 172,486 | Pharmaceutical products |
| TOHO HOLDINGS CO., LTD. | 13,054 | 138,802 | Pharmaceutical products |

| | Sales | |
|---|---|---|
| | ¥ in millions | |
| Name of major customers | 2012 | Segment |
| Alfresa Holdings Corporation | ¥23,791 | Pharmaceutical products |
| MEDIPAL HOLDINGS CORPORATION | 18,952 | Pharmaceutical products |
| Suzuken Co., Ltd. | 14,675 | Pharmaceutical products |
| TOHO HOLDINGS CO., LTD. | 12,130 | Pharmaceutical products |

Since the Company and its consolidated subsidiaries have categorized its reportable segment into a single segment, pharmaceutical products operation, information regarding impairment losses on fixed assets by reportable segment for the years ended March 31, 2013 and 2012 was omitted.

## 18 Impairment Losses

(Fiscal 2013)

For the year ended March 31, 2013, the Company and its consolidated subsidiaries recognized ¥184 million (U.S.$1,960 thousand) of impairment losses on fixed assets used for business, which consisted of the following:

| Location | Description | Classification |
|---|---|---|
| Gyoda-shi, Saitama, Japan | Distribution facilities | Buildings, etc. |

The Company and its consolidated subsidiaries group their assets used for business on the basis of business segments, considering the characteristics of the products and similarity of markets. Idle assets and assets to be disposed of are grouped individually. The recoverable amount utilized in the calculation was value in use. Discount rates are considered to be immaterial and are not taken into account since the assets are scheduled to be disposed of in a short period of time.

The Company disposed of assets related to distribution facilities and their carrying values have been reduced to their recoverable amounts and recognized in other income (expenses) as impairment losses.

Impairment losses of ¥184 million (U.S.$1,960 thousand) consist of ¥182 million (U.S.$1,944 thousand) for buildings and structures etc. for the year ended March 31, 2013.

(Fiscal 2012)

For the year ended March 31, 2012, no impairment losses on fixed assets were recognized.

## 19 Loss on Disaster

Loss on disaster for the years ended March 31, 2013 and 2012 consists mainly of fixed costs (nil) and (¥272 million), respectively, during the shutdown period due to the Great East Japan Earthquake, which struck on March 11, 2011.

Damages to facilities and inventories, etc, in main locations such as manufacturing plants, were covered by insurance. The losses on damages to facilities and inventories etc. were immaterial.

## 20 Note to Consolidated Statements of Changes in Net Assets

Issued stock and treasury stock as of March 31, 2013 are as follows:

Number of issued shares

Common stock 70,771,662 shares

The number of treasury stock is as follows:

| | At April 1, 2012 | Increase | Decrease | At March 31, 2013 |
|---|---|---|---|---|
| | | | | Shares |
| Common stock | 244,847 | 550 | – | 245,397 |

Dividends from surplus as of March 31, 2013 are as follows:

(1) Dividend payments

| Scheduled resolution | Category | Total amount of dividends (¥ in millions) | Dividend per share (¥) | Total amount of dividends (US$ in thousands) | Dividend per share (US$) | Record date | Effective date |
|---|---|---|---|---|---|---|---|
| Ordinary general meeting of shareholders held on June 28, 2012 | Common Stock | ¥2,115 | ¥30 | $22,496 | $0.31 | March 31, 2012 | June 29, 2012 |
| Board of directors' meeting held on November 8, 2012 | Common Stock | 2,115 | 30 | 22,496 | 0.31 | September 30, 2012 | December 4, 2012 |

(2) Dividends whose effective date is subsequent to March 31, 2013

| Scheduled resolution | Category | Source of dividend | Total amount of dividends (¥ in millions) | Dividend per share (¥) | Total amount of dividends (US$ in thousands) | Dividend per share (US$) | Record date | Effective date |
|---|---|---|---|---|---|---|---|---|
| Ordinary general meeting of shareholders held on June 27, 2013 | Common Stock | Retained earnings | ¥2,256 | ¥32 | $23,996 | $0.34 | March 31, 2013 | June 28, 2013 |

## 21 Subsequent Event

At the shareholders' meeting held on June 27, 2013, the following appropriation from unappropriated retained earnings of the Company was approved by the shareholders:

| | ¥ in millions | US$ in thousands |
|---|---|---|
| Cash dividends, ¥32.00 (U.S.$0.34) per share | ¥2,256 | $23,996 |

# REPORT OF INDEPENDENT AUDITORS

ERNST & YOUNG

Ernst & Young ShinNihon LLC
Hibiya Kokusai Bldg.
2-2-3 Uchisaiwai-cho
Chiyoda-ku, Tokyo, Japan 100-0011

Tel : +81 3 3503 1100
Fax: +81 3 3503 1197

## Independent Auditor's Report

The Board of Directors
TSUMURA & CO.

We have audited the accompanying consolidated financial statements of TSUMURA & CO. and its consolidated subsidiaries, which comprise the consolidated balance sheet as at March 31, 2013, and the consolidated statements of income, comprehensive income, changes in net assets, and cash flows for the year then ended and a summary of significant accounting policies and other explanatory information, all expressed in Japanese yen.

*Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in Japan, and for designing and operating such internal control as management determines is necessary to enable the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. The purpose of an audit of the consolidated financial statements is not to express an opinion on the effectiveness of the entity's internal control, but in making these risk assessments the auditor considers internal controls relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of TSUMURA & CO. and its consolidated subsidiaries as at March 31, 2013, and their consolidated financial performance and cash flows for the year then ended in conformity with accounting principles generally accepted in Japan.

*Convenience Translation*

We have reviewed the translation of these consolidated financial statements into U.S. dollars, presented for the convenience of readers, and, in our opinion, the accompanying consolidated financial statements have been properly translated on the basis described in Note 2.

Ernst & Young ShinNihon LLC

June 27, 2013
Tokyo, Japan

# CORPORATE DATA

As of March 31, 2013

**Head Office:** 17-11, Akasaka 2-chome,
Minato-ku, Tokyo 107-8521, Japan
Corporate Communications Department
Phone: 81-3-6361-7101
Fax: 81-3-5574-6630
URL: http://www.tsumura.co.jp/english/

**Founded:** April 10, 1893
**Incorporated:** April 25, 1936
**Number of Employees:** 2,831 (Consolidated)
**Plants:** Shizuoka, Ibaraki, Shanghai
**Research Laboratory:** Ibaraki

**Subsidiaries and Affiliates:**

| Country | Company | Business |
|---|---|---|
| Japan | LOGITEM TSUMURA CO., LTD. | Logistics, storage, distribution, and materials handling services |
| | CREATIVE SERVICE, INC. | Sales of Kampo products |
| United States | TSUMURA USA, INC. | Development of pharmaceutical products in the United States |
| China | SHENZHEN TSUMURA MEDICINE CO., LTD. | Procurement, sorting, processing, and storage of botanical raw materials |
| | SHANGHAI TSUMURA PHARMACEUTICALS CO., LTD. | Production and sale of Kampo extract intermediates |
| | SICHUAN CHUANCUN TRADITIONAL CHINESE MEDICINES CO., LTD. | Procurement and sorting of botanical raw materials |

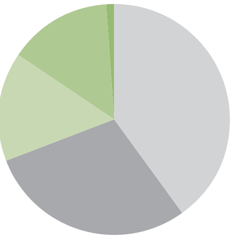
# INVESTOR INFORMATION

As of March 31, 2013

**Stock Exchange Listing:** Tokyo
**Stock Code:** 4540
**Paid-in Capital:** ¥19,487 million
**Net Assets:** ¥118,537 million
**Common Stock:**
Authorized: 250,000,000
Issued: 70,771,662
**Closing Date of Accounts:** March 31
**Independent Auditor:**
Ernst & Young ShinNihon LLC
Hibiya Kokusai Bldg.,
2-3, Uchisaiwai-cho 2-chome,
Chiyoda-ku, Tokyo 100-0011, Japan
**Shareholder Register Agent for Common Stock in Japan:**
Mitsubishi UFJ Trust and
Banking Corporation
4-5, Marunouchi 1-chome,
Chiyoda-ku, Tokyo 100-8212, Japan
**Number of Shareholders:** 10,520

| Major Shareholders | % of equity |
|---|---|
| Japan Trustee Services Bank, Ltd. (Trust Account) | 9.39 |
| The Master Trust Bank of Japan, Ltd. (Trust Account) | 6.79 |
| The Bank of Tokyo-Mitsubishi UFJ, Ltd. | 3.12 |
| Employees' Stockholding | 2.70 |
| SAJAP | 2.20 |
| DAIICHI SANKYO COMPANY, LIMITED | 2.16 |
| SSBT OD05 OMNIBUS ACCOUNT-TREATY CLIENTS | 2.09 |
| National Mutual Insurance Federation of Agricultural Cooperatives | 1.81 |
| Japan Trustee Services Bank, Ltd. (Trust Account 9) | 1.73 |
| Dainippon Sumitomo Pharma Co., Ltd. | 1.55 |

**Ownership and Distribution of Shares**
%



| | |
|---|---|
| Japanese Financial Institutions | 40.00% |
| Foreign Institutions | 29.31% |
| Other Japanese Corporations | 15.33% |
| Japanese Individuals and Others | 14.30% |
| Japanese Securities Firms | 1.06% |

**TSUMURA & CO.**
2-17-11, Akasaka, Minato-ku, Tokyo 107-8521, Japan

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