ANNUAL REPORT 2006

Nippon Shinyaku

NIPPON SHINYAKU CO., LTD.

Profile


Kyoto Headquarters

Founded in the ancient capital Kyoto in 1919, Nippon Shinyaku is an R&D-oriented pharmaceutical company specializing in the development, manufacture, and sale of ethical drugs, particularly for the treatment of “contemporary diseases” such as cardiovascular, gastrointestinal, urological, and inflammatory and allergic diseases and for hematologic malignancies. Making good use of its technological know-how accumulated in the field of ethical drugs, the Company began the production of food additives in 1961, later expanding into fields such as functional food ingredients, and since then there has been steady growth in these business areas.

Since its establishment, Nippon Shinyaku has constantly pursued the creation of new top-quality pharmaceutical products and aggressively expanded its R&D activities. Basic research is conducted at our Discovery Research Laboratories in Kyoto and Tsukuba. Our office in Düsseldorf, Germany, and our U.S. subsidiary NS Pharma, Inc., in New Jersey, are engaged in the promotion of clinical studies and the collection of pharmaceutical and medical information in Europe and the United States, respectively.

The pharmaceuticals formulation plant at our Odawara Central Factory, which has one of the largest floor areas and one of the highest production capacities at the pharmaceutical industry in Japan, received the Nikkei Superior Trend-Setting Factories and Offices Awards (sponsored by the Nihon Keizai Shimbun) in 2002. The plant employs cutting-edge technology and sophisticated and highly efficient manufacturing systems.

Contents

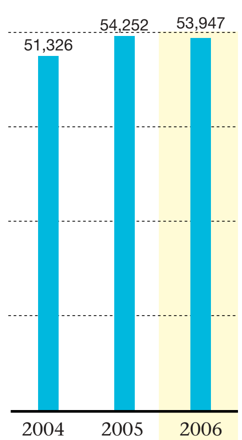
Forward-Looking Statements:
Statements contained in this report concerning plans, predictions, and strategies to improve future performance (“forward-looking statements”) are based on information currently available to the Company’s management, and inevitably involve a certain element of risk and uncertainties. Actual results may therefore differ from those in the forward-looking statements.

Consolidated Financial Highlights

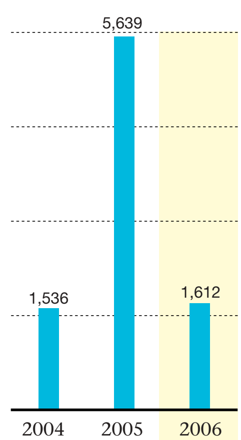
Years ended March 31, 2006 and 2005	Millions of yen 2006	Millions of yen 2005	Thousands of U.S. dollars (Note 2) 2006
Net sales	**¥ 53,947**	¥ 54,252	**$461,086**
Income before income taxes and minority interests	**3,285**	9,630	**28,077**
Net income	**1,612**	5,639	**13,778**
Amounts per share (in yen and U.S. dollars):			
Net income	**¥ 22.84**	¥ 81.22	**$ 0.20**
Shareholders' equity (Note 1)	**1,068.50**	1,025.26	**9,128**
Total assets	**¥ 104,899**	¥ 98,910	**$896,573**
Shareholders' equity	**75,412**	70,010	**644,547**
Investments in plant and equipment	**1,828**	1,745	**15,624**
R&D expenses	**10,071**	8,479	**86,077**

Notes: 1. Calculated on the basis of the average of the balances at the beginning and at the end of the term.
2. U.S. dollar amounts are converted from yen amounts at the rate of U.S.$1=¥117, the approximate exchange rate on March 31, 2006.

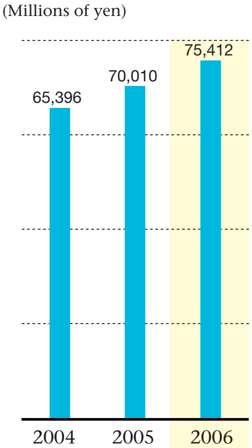
Consolidated Net Sales
(Millions of yen)



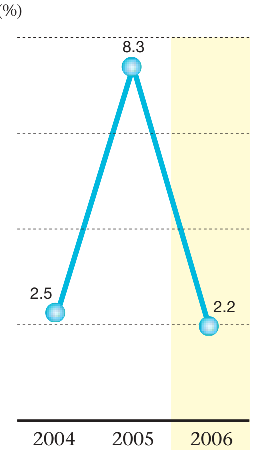
Consolidated Net Income
(Millions of yen)



Consolidated Shareholders' Equity
(Millions of yen)



Consolidated Return on Average Equity
(%)

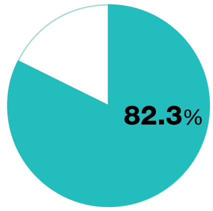


At a Glance

Sales breakdown

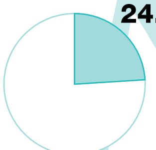
Net sales ¥53,946 million

Pharmaceuticals



¥44,406 million

Urological Drugs



¥12,925 million

◆Main Products

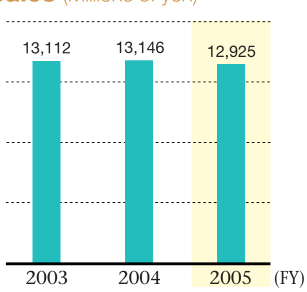
Eviprostat®(herbal extracts)
Remedy for Prostatic Hypertrophy

Bladderon®(flavoxate hydrochloride)
Remedy for Pollakisuria

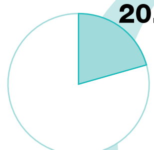
Estracyt®(estramustine sodium phosphate)
Remedy for Prostatic Cancer

Urocalun®(quercus salicina extract)
Remedy for Urinary Calculus

◆Sales (Millions of yen)



Drugs for Inflammation and Allergy



¥11,105 million

◆Main Products

Hypen®(etodolac)
Non-Steroidal Analgesic and Anti-inflammatory Agent

Livostin® Eye Drops
(levocabastine hydrochloride)
Remedy for Allergic Conjunctivitis

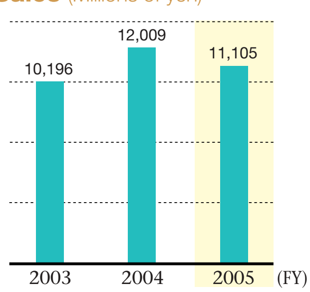
Livostin® Nasal Spray
(levocabastine hydrochloride)
Remedy for Allergic Rhinitis

Azunol® Gargle 4%
A Gargle Liquid which Contains Azulene

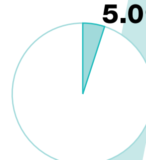
Leftose®(lysozyme hydrochloride preparation)

Orcl®(actarit)
Antirheumatic Agent

◆Sales (Millions of yen)



Drugs for Hematologic Malignancies



¥2,680 million

◆Main Products

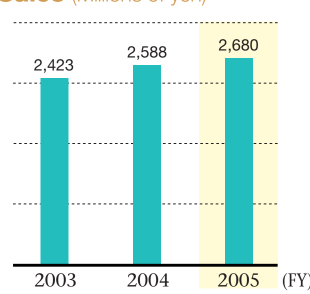
Cylocide®(cytarabine)
Remedy for Acute Leukemia and Solid Cancer

Cylocide®N(cytarabine)
Remedy for relapsed and refractory acute leukemia and Malignant Lymphoma

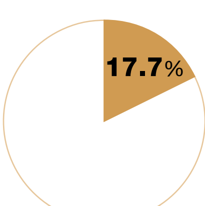
Trisenox®
Remedy for relapsed and refractory acute promyelocytic leukemia

Amnolake®
Remedy for relapsed and refractory acute promyelocytic leukemia

◆Sales (Millions of yen)



Functional Food

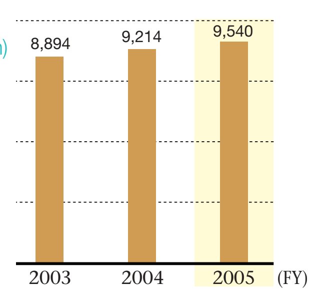


¥9,540 million

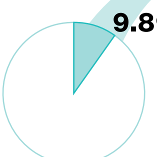
◆Main Products

Protein preparations
Preservatives
Seasonings & spices
Health food materials

◆Sales (Millions of yen)



Drugs for Cardiovascular and Metabolic Diseases



¥5,332 million

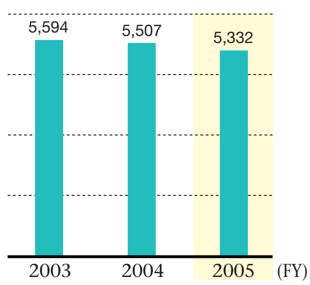
◆Main Products

Selectol®(celiprolol hydrochloride)
Remedy for Hypertension and Angina Pectoris

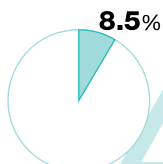
Glycoran®(metformin hydrochloride)
Remedy for Diabetes

Odric®(ACE inhibitor)
Anti-hypertensive Agent

◆Sales (Millions of yen)



Gastrointestinal Drugs



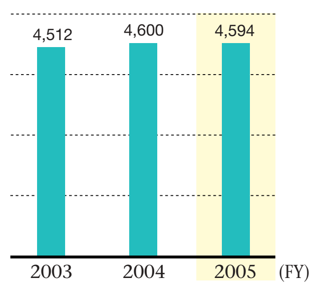
¥4,594 million

◆Main Products

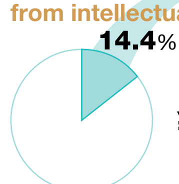
Gaslon N®(irsogladine maleate)
Remedy for Gastric Ulcer and Gastritis

Portolac®(lactitol hydrate)
Antihyperammonemia Agent

◆Sales (Millions of yen)



Others (Including the proceeds from intellectual property rights)



¥7,770 million

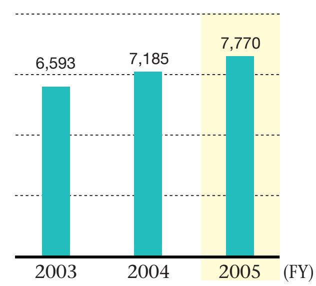
◆Main Products

Cephadol®(difenidol hydrochloride)
Antivertigo Agent

Iodocoat®
Agent for decubital ulcer and skin ulcer

Prulifloxacin®
Synthetic Antibacterial Agent

◆Sales (Millions of yen)



Urajirogashi (Quercus salicina)

Akamegashiwa (Mallotus Japonicus)

Product names followed by ® represent trademarks registered in Japan.

Message from the President

Japan is facing the prospect of a severe impact from its declining birthrate, as well a population that is aging with a momentum unprecedented in the world. The future course of its social security system, including pensions, national health insurance, and social welfare and nursing care, is the subject of intense debate. Above all, there is a high degree of interest among the citizens of Japan about the greatest concern of the aging population — health and the medical care system that supports it. The question of how to design a sustainable medical care system backed by sound finances is becoming a major political issue.

Measures are being taken to curtail the costs of medical care arising from the Japanese government's need to reduce its budgetary expenditures. These measures include pharmaceutical price reductions under the National Health Insurance System and the promotion of the use of generic pharmaceuticals. This is an equally pressing issue for the pharmaceutical manufacturing industry.

Under these circumstances, Nippon Shinyaku is working to enrich its drug pipeline and constantly bring innovative new products to market to meet the needs of healthcare professionals. We consider the achievement of a steady and sustained sales trend and profit growth through these activities to be the overarching management theme tied to our future progress and expansion.

As we are required to demonstrate the safety and effectiveness of our drug candidates based on global standards, it is inevitable that research and development costs will increase. Such increasing costs place pressure on the management of pharmaceutical manufacturers and constitute a management risk. To keep that risk to the minimum, we must efficiently manage the direction of our research and development. Nippon Shinyaku plans to diversify these risks through development partnerships with other companies in the same industry and with companies outside the industry, as well as through joint research conducted by industry, government, and academia. Last year, as part of our research on nucleic acid drugs, we decided to participate in the Functional RNA Project, a national project commissioned by NEDO (the New Energy and Industrial Technology Development Organization), an organization under the control of the Ministry of Economy, Trade, and Industry.

At Nippon Shinyaku, we have followed an R&D policy featuring five themes, as described below:

1. *Development of innovative new drugs through in-house drug discovery*
2. *Development of new drugs through in-licensing*
3. *Development of improved new drugs through the modification of existing active ingredients*
4. *Additional indications to the Company's own products*
5. *Improvement of the formulations of the Company's own products*

We are not only a developer of innovative medicines: we respond to the needs of healthcare professionals and use our ingenuity to raise the value of our pharmaceutical products in any little way we can, such as making dosages easier, or reducing side effects. In these ways, we are constantly exerting effort to extend our products' life cycles, and to increase demand for the Company's products.

While we focus on the areas of urology and inflammatory/allergic diseases in our in-house new drug research, we are also developing new agents for treating alcoholism, which has a potential social impact reaching well beyond the affected individual, and for intractable hematologic malignancies.

Furthermore, as one of our internationally strategic products, we have granted a license to F. Hoffmann-La Roche Ltd. of Switzerland, which has begun the full-fledged development of a treatment for dyslipidemia, for which we have considerable expectations. Another licensee, the American company, Innovive Pharmaceuticals, Inc., is aiming for the early development of an agent for chronic myelogenous leukemia. In terms of new formulation of our products, we have in recent years increased revenues by launching a smaller size tablet formulation for diabetes, as well as a portable gargle liquid and an easy-to-use gel ointment for the treatment of skin ulcers.

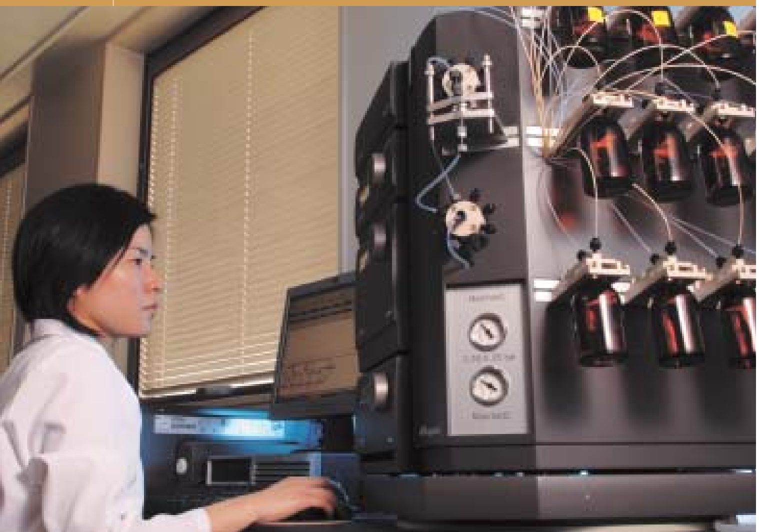
In the functional food business, we are steadily expanding our sales in the fields of health food materials and additives used for food processing. In addition, we plan to expand our sales channels through the establishment of a health food mail-order company, Laplus Pharma Co., Ltd. We also have great expectations of expanding our functional food business.

Our goal is the development of innovative, unique pharmaceuticals. Since the inauguration of our business, we have proceeded in an enterprising spirit that does not shy away from any challenge, as we continually make advances in cutting-edge research that meet the demands of the times. At Nippon Shinyaku, we hope to achieve innovative management that can respond to the expectations of our investors with a high-profile reputation among society at large. This reputation will rest on our contribution to health care through the provision of superior and unique pharmaceuticals.

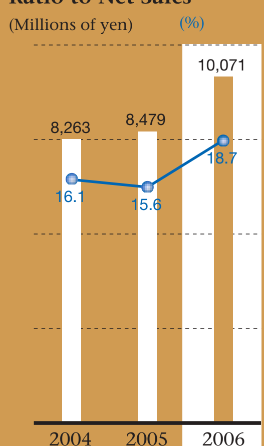
K. Hatsuyama

Kazuto Hatsuyama
President

Research and Development



Consolidated R&D Expenses
Ratio to Net Sales



DRUG DEVELOPMENT POLICY

In line with the global trend, mergers and reorganizations of leading pharmaceutical companies are proceeding in Japan, too. Certain medium-sized Japanese pharmaceutical companies have recently turned the focus of their attention to generic drugs. Their appearance suggests future market expansions of generic drugs, which will lead to increasingly severe market competition for pharmaceutical manufacturers. Nippon Shinyaku has over long years acquired its own in-house technologies for drug discovery, and is using these technologies as a basis for adopting cutting-edge techniques that move forward research and development for the discovery of entirely new drugs.

As a medium-sized company, Nippon Shinyaku aims to be a specialty pharmaceutical maker focusing on the development of new drugs for a characteristic niche market. Regarding our in-house development, we are focusing on urology and allergic/inflammatory disorders to maximize the efficiency of financial and human resources investments.

In addition to these two areas, we are making efforts to develop licensed drugs for urological and immunological disorders, allergies, and hematological malignancies, among other applications. All R&D activities are carried out with the purpose of discovering, developing, and providing characteristic new pharmaceuticals to patients as early as possible. As for our original products, we establish development strategies, which include overseas business development plans. At the same time, when we discover drug candidates that lie outside the scope of our own focus areas, we will look for the possibility of jointly developing these drugs with other companies or licensing them out, in order to maximize their value.

We have established a dedicated section for the early commercialization of our research pertaining to nucleic acid drugs based on mass synthesis technologies of nucleic acids established in our research laboratories.

RESULTS OF ACTIVITIES

In June of 2005, we launched Amnolake, a remedy for refractory/relapsed acute promyelocytic leukemia. With our products Trisenox, which is indicated for the same use, as well as Cylocide and Cylocide N, used in the treatment of leukemia and malignant lymphoma already on the market, our product lineup in the area of hematologic malignancies has been expanded. In December of 2005, we licensed out NS-187, a drug we developed in-house for the treatment of chronic myelogenous leukemia, to the U.S. company INNOVIVE Pharmaceuticals Inc. INNOVIVE has begun preparations for the commencement of a Phase I trial in the U.S. we have acquired the marketing rights from Bayer Yakuhin, Ltd. for Baynas® tablets, which have PGD2 and TXA2 receptor antagonistic properties and are used in the treatment of allergic rhinitis, and we began sales in July of 2006.

In fiscal 2005, as a result of our aggressive promotion of clinical trials for R&D compounds in the latter phase of clinical development, our R&D costs reached approximately ¥10 billion (18.6% of total sales). Our NS-126 (novel steroid), used in the treatment of allergic rhinitis, has completed its Phase III trial, and we are currently preparing for application for approval. Our centrally acting analgesic NS-315 is currently undergoing a Phase III trial. Our NS-11 (acamprosate), an agent used in the treatment of alcohol dependency, has completed the Phase I trial and has begun the Phase II trial.

In clinical trials being carried out overseas, NS-9, an agent for treating metastatic liver cancer, has completed the Phase I trial by NS Pharma, Inc. in the U.S. with regard to our licensed-out compounds, the Phase II trial of NS-8, an agent for overactive bladders, and the Phase I trial for NS-220, a therapeutic agent for dyslipidemia, have both made progress. In addition, Angelini ACRAF S.p.A. is preparing to launch our quinolone antibacterial agent, prulifloxacin, in several European countries outside Italy. The Phase III trial of prulifloxacin has been started in the U.S. by Optimer Pharmaceuticals, Inc., and our licensee in South Korea, Yuhan Corp., has completed clinical trials and is preparing to apply for approval.

DRUG DEVELOPMENT ORGANIZATION AND FUNCTION

Domestic

Nippon Shinyaku employs about 450 R&D staff. Collaborative efforts by our Kyoto and Tsukuba Research Laboratories for the rapid development of in-house compounds and the promotion of the in-licensing activities have enabled us to build up our pipeline. We are also strengthening our genomics-based drug discovery research, including investigations into protein structure and function. At the Discovery Research Laboratories in Kyoto, which are Nippon Shinyaku's main R&D facilities, we are exploring and synthesizing novel compounds in line with our drug discovery strategy, and conducting pharmacological and toxicological studies to generate compounds ready for clinical studies. We are working to improve existing formulations by applying our proprietary drug formulation technologies to new drug development so that we can better meet the needs of healthcare professionals.

We are also striving to improve our drug formulation technologies. By utilizing our proprietary apparatus, such as a twin-screw extruder and a rotary disk extruder, we have established formulation technologies for solid dispersion that do not require organic solvents, wax matrixes and inclusion compounds, and the further application of such formulation technologies has been investigated.

At our Tsukuba-based Discovery Research Laboratories, we are conducting cutting-edge drug discovery research focused on both genomics research and novel nucleic acid drugs which use our proprietary cationic liposomes. We have established the RNA Drug and Technology Business Dept. aimed at early commercialization of our nucleic acid drugs, and are coordinating our efforts with outside companies and research institutes. We are actively promoting coordination efforts with external organizations, and through joint investment with 21 major pharmaceutical enterprises, we have constructed a specialized beamline in the synchrotron radiation facility, Spring-8, for the establishment of a system for protein structure analysis. We are also investing and participating in the Reverse Proteomics Research Institute, an organization made up of eleven pharmaceutical companies. We intend to further our genomics-based drug discovery by utilizing the results of this institute's research, which is aimed at investigating and evaluating the interactions between carefully selected proteins derived from human full-length cDNA and commonly used low molecular weight pharmaceuticals for the purpose of drug discovery research.

Discovery Research Laboratories in Kyoto (Bldg. No.2)

Discovery Research Laboratories in Kyoto (Bldg. No.1)

Discovery Research Laboratories in Tsukuba

International

Nippon Shinyaku established an overseas office in Düsseldorf, Germany in 1991, and opened a New York office in 1997. In 1999, we upgraded the New York office to a subsidiary, NS Pharma, Inc. (We later moved its base of operations to Parsippany, New Jersey.) These overseas operations focus their efforts on the collection of the latest information on new drug development technologies and newly developed drug candidates from the major pharmaceutical companies in Europe and America, venture firms, and research institutions. The office and the subsidiary, which also act as bases of operation for the Company's clinical development efforts in Europe and America, have played important roles in our conduct of clinical trials by using CROs. NS Pharma, Inc. has recently completed the U.S. Phase I trial of NS-9, an agent for the treatment of metastatic liver cancer, by using CROs.

NS Pharma, Inc. in New Jersey

The Düsseldorf Office

Research & Development

Junichi Yano, Ph.D.

Director: General Manager, Research & Development Division

Our target for the current term are to speed up the drug R&D process right up to application for approval and to enrich our current R&D pipelines. In the field of new drug discovery, we are investing management resources in a particularly focused manner in the therapeutic areas of urology, and inflammation/allergies. In addition, we are working to license-in new drugs from other companies in the aforementioned two therapeutic areas as well as in blood malignancies. Regarding in-house-developed drugs that are competitive in overseas markets, we will be making efforts to market such drugs in various countries through the licensing-out as well as joint development.

To realize these goals, we will selectively focus management resources on the most promising drug candidates and target areas, and will work to appropriately and efficiently allocate management resources on a priority basis. We will also adopt a more rigorous approach than hitherto to the evaluation of R&D candidates, as well as risk management and schedule management.

We are planning to set up a nucleic acid-based pharmaceutical business utilizing our own technology, based on our recent successes in RNA interference (RNAi) drug discovery research. During the current business term, we will be offering our services to other pharmaceuticals companies on a consignment basis in the production of RNA synthesis and the production of bulk RNA synthetic materials as well as drug delivery system. With these activities at the core, we hope to develop a commercially feasible nucleic acid-based pharmaceutical business.

Developments in the Functional Food Business

In key protein products for our processed food business, we began selling soy protein concentrate and soy protein isolate in 2004 to reinforce our existing product lineup of egg white powder, whey protein concentrate and wheat gluten. Growth in sales of soy proteins has been buoyed by the technical support we provide to users.

In the health foods segment, we continue to develop evidence-based health foods by verifying effectiveness in human clinical trials. With Gekkeikan Sake Co., Ltd. , we jointly developed Sakekasu (Sake Lees) Peptide R for its hypotensive properties. In March 2006 we launched and exhibited this product together with Morus Leaves extract and Akamegashiwa extract at the Natural Products Expo West 2006 in Anaheim, California. We are also planning to carry out R&D on whey peptides. In addition we are seeking approval of Garcinia extract as a "Food for Specified Health Use" (FOSHU).Further, in April 2006 we established Laplus Pharma Co., Ltd., a mail-order health food subsidiary.

Regarding agents for improving food shelf life, in January

2006 we launched an agent that improves the shelf life of egg products called NewRestol Tamagoyaki-yoh S, which is effective in the preservation of foods with pH factors ranging from neutral to alkaline. Moreover, we are engaged in developing a fungicide for steamed bread products. In response to demand from the convenience store sector, we are also devoting efforts to developing agents that preserve the freshness of vegetables.

DRUGS UNDER DEVELOPMENT

Nippon Shinyaku aims to place at least one compound per year as a new product on the market. At present, we have four Phase III, four Phase II (including those in preparation stage), and three Phase I products (including one in the preparation stage) in development. Of these, six are products that were discovered in-house. Provided the development proceeds smoothly, we can anticipate they will become the next generation of Nippon Shinyaku's core products. The following table shows our pipeline compounds, including details of their development stage and expected indications.

◆R&D compounds

(As of July 2006)

< Domestic >

Stage	Product name	Generic name	Therapeutic field	Indications	Development
Pre-registration (Withdrawal planned)	Urespan	temiverine hydrochloride	urological	overactive bladder	original

Stage	Code No.	Generic name	Therapeutic field	Indications	Development
Phase III	NS-315	tramadol hydrochloride	inflammation/allergy	non-narcotic analgesic (cancer pain)	licensed-in from Grünenthal GmbH
Phase III Phase II	NS-126		inflammation/allergy	allergic rhinitis bronchial asthma	co-developed with Hisamitsu Pharmaceutical Co., Inc.
Phase III	HFT-290	fentanyl citrate	inflammation/allergy	narcotic analgesic (cancer pain)	co-developed with Hisamitsu Pharmaceutical Co., Inc.
Phase II	TRK-091	tramadol hydrochloride SR	inflammation/allergy	non-narcotic analgesic (low back pain)	co-developed with Toray Industries, Inc.
Phase II	NS-11	acamprosate	Others	alcohol dependence	licensed-in from Merck Santé S.A.S.
Phase I	NS-8		urological	overactive bladder	original

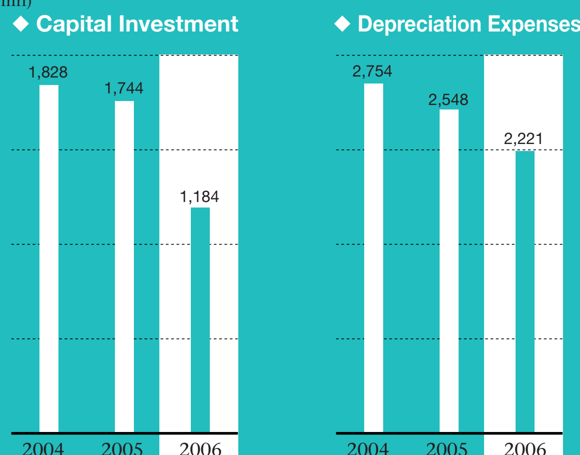
< Overseas >

Stage	Code No.	Generic name	Therapeutic field	Indications	Licensee
Phase III	NM441	prulifloxacin	chemotherapeutics	bacterial infections	Yuhan Corporation
Phase III					Optimer Pharmaceuticals, Inc.
Phase II	NS-8		urological	overactive bladder	APOGEPHA Arzneimittel GmbH
Preparation for Phase II	HMN-214		chemotherapeutics	solid tumor	TEVA Pharmaceutical Industries Ltd.
Phase I	NS-9		chemotherapeutics	hepatic cancer	
Phase I	NS-220		cardiovascular	dyslipidemia	F.Hoffmann-La Roche Ltd.
Preparation for Phase I	NS-187		chemotherapeutics	chronic myelogenous leukemia	INNOVIVE Pharmaceuticals, Inc.

Manufacturing

Odawara Central Factory

Capital Investment and Depreciation in Last 3 Years
(consolidated)
(¥mn)



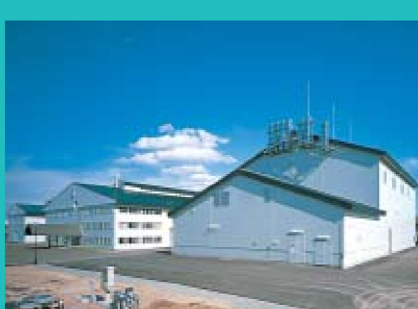
Nippon Shinyaku has four manufacturing plants: two pharmaceutical plants — the Chitose Synthesis Plant for the production of drug substances and the Odawara Central Factory for solid formulations and injections — and two plants for production of extracts and other food ingredients — the Chitose Functional Food Plant and the Morioka Factory.

The mainstay Odawara Central Factory is located in the city of Odawara in Kanagawa Prefecture, near such sightseeing spots as Mount Fuji, Hakone, and Izu. The Factory began operating in 1964 and has been refurbished through several generations of new technology to enable higher production volumes and compliance with the increasingly strict GMP regulations. The Factory is currently located on a 54,000-square meter site and boasts a total floor space of 28,000 square meters.

The Factory is equipped with integrated manufacturing facilities for various processes, ranging from raw material weighing to final packaging, for injectable formulations as well as tablet, capsule, granule, powder, and other solid formulations. A wide range of products is manufactured in compliance with international-level hygiene and cleanliness standards. The entire production system is computer-controlled, ensuring efficient manufacturing management and advanced quality control systems for the timely and reliable supply of product to the market. From March 2004, we began contract manufacturing of other companies' products. We are continually striving to improve our production processes, as they also contribute to improved Company earnings.

We obtained ISO14001 accreditation for the Factory's environmental management systems in August 2004. We aim to reduce our environmental impact, procure environmentally friendly supplies, and improve our local environment, and are building risk-management systems to address issues related to earthquakes and other risks.

Our other pharmaceuticals plant, the Chitose Synthesis Plant, is relatively new, having been completed in 1999 within the Chitose Airport Industrial Complex near the New Chitose International Airport. The Plant was established for the manufacture of drug substance for in-house development compounds from the clinical trial stage, and it meets the standards required for audits by overseas regulatory authorities. The Plant produces some drug substances used at the Odawara Central Factory and has also begun manufacturing drug



Chitose Synthesis Plant / Chitose Functional Food Plant

Morioka Factory

substances for sale to other companies.

Synthesis plants generally have a greater environmental impact than formulation plants, so we emphasized environmental conservation at the Chitose Synthesis Plant from the design stages. We are running our operations with a view to protecting the environment, for example by obtaining ISO14001 accreditation in 2002.

The Chitose Functional Food Plant is adjacent to the Chitose Synthesis Plant and began operating in 1990, mainly producing extracts from onions and red pepper. Recently, the Plant has begun production of concentrated fruit juices using fruit grown locally in Hokkaido, as well as various health food ingredients.

Our other plant involved in functional food-related products — the Morioka Factory, in Iwate Prefecture, northern Japan — began operating in 1966 for the manufacture of extracts from various spices and food additives, including agents to improve food shelf lives. The plant has recently diversified into the production of health food ingredients.

We therefore have in place a highly efficient production system through the operation of these four plants, as well as the plant operated by our pharmaceuticals manufacturing subsidiary Sioe Pharmaceutical Co., Ltd. at Amagasaki in Hyogo Prefecture and the foodstuffs plant operated by our subsidiary Tajima Syokuhin Kogyo Co., Ltd., also in Hyogo Prefecture.

Production

Dr. Nobuyoshi Sumi

Director: General Manager, International Business Division, Resource Procurement Division & Production Division

Every day, the staff of Nippon Shinyaku's Production Division devote their efforts to the manufacture of products of a guaranteed high quality level, to minimize the adverse impact of the Company's production operations on the natural environment, and to contribute to the economic and cultural development of regional community in which we operate.

To ensure high product quality, we observe current good manufacturing practices (cGMP), and continually invest management resources toward introducing leading-edge equipment and facilities, as well as training employees. We are also constantly mindful of the need for effort to preserve the global environment, to which end we have already obtained ISO 14001 environmental management systems certification for our flagship Odawara Central Factory. In addition, we regularly apply for updating of this certification.

We encourage our employees to volunteer for neighborhood cleanup initiatives, which has the additional positive effect of strengthening ties with the communities in which our plants and offices are located, which leads to the contribution to the economic and cultural development of each regional community in which we operate.

To ensure that Nippon Shinyaku never loses its reputation for trustworthiness among the wider community, all the staff of the Production Division are working and studying to improve themselves as employees and as responsible members of society with pride in the community in which they work.

Medical Representative Activity

We have 21 branches throughout Japan. We have adopted a flat organizational framework, and there are only three ranks in the branch organizations: branch manager, section head, and medical representative. The branch managers attend business meetings, the section heads attend nationwide section head meetings, and the medical representatives attend product promotion meetings as well as rank-based training sessions. Our marketing staff at the head office use these meetings and training sessions as opportunities to communicate directly with front-line staff (i.e. staff who work at our branches).

With our focus on the relatively small areas of urology, inflammation and allergy prevention, and hematological malignancies, we are able to make effective visits to medical institutions throughout Japan. We have designated these areas based on analysis of the distribution of physicians who are currently prescribing our existing medicines, and on an analysis of the compounds that are scheduled for launching and their projected marketability. As part of our goal of strengthening our allergic rhinitis and allergy prevention area, we will begin the sale in July of this year of the allergic rhinitis medication Baynas Tablets.

Our medical representatives attend monthly product explanation sessions at their offices, allowing them to acquire a high degree of knowledge in the aforementioned areas regarding both diseases and our products.

From here on, we intend to improve the efficiency of the detailed explanation of our products provided by our medical representatives on their visits to doctors by enabling them to more effectively utilize market analyses regarding our specialty areas. In this way, we aim to raise our medical representatives' reputation for reliability among the nation's doctors.

Marketing

Toshihiko Sago

Director: General Manager, Marketing Division

Nippon Shinyaku's marketing is highly dependent on the professional skills of its medical representatives, all of whom are very capable of thinking for themselves and take a proactive approach to developing the Company's business in the territories for which each of them are solely responsible, based on our marketing policies. We constantly urge them to further deepen their background knowledge regarding the pharmaceutical products they market to healthcare professionals, and to visit all the doctors on their lists more frequently. The training of medical representatives is an important part of the duties of our marketing managers, and they are required to accompany each medical representative under their authority on visits to doctors, so as to demonstrate directly how to effectively communicate with the Company's primary customers.

Our particular strategy during the current term is to raise profitability by focusing our marketing efforts on drugs with high profit margins that are also expected to sell strongly. We have drawn up action plans covering our principal products, and made exhaustive and detailed presentations of important points to the doctors they visit, which are used as guidelines for medical representatives.

The Japanese authorities are constantly tightening their rules and guidelines to curtail medical expenses under the national health insurance system, but there is no magic formula that we in the marketing division can use to bypass this problem. All our staff must maintain a sense of urgency and unity in their work, and continue to faithfully observe the fundamentals of marketing.

Recent Developments at Nippon Shinyaku

The signing of the marketing agreement with Bayer Yakuhin, Ltd.

The packaging for the urinary calculus medication "Urocalun Tablets 225 mg"

The packaging for the refractory/relapsed acute promyelocytic leukemia medication "Amnolake Tablets 2 mg"

New Products and Additional Indications

April, 2006

➜ Entered into a partnership with Bayer Yakuhin, Ltd. to sell the allergic rhinitis medication "Baynas® Tablets" in Japan

August, 2005

➜ Began sale of the decubital ulcer and skin ulcer medication "Iodocoat ointment 0.9%"

July, 2005

➜ Began sale of the urinary calculus medication "Urocalun Tablets 225 mg"

June, 2005

➜ Began sale of the refractory/relapsed acute promyelocytic leukemia medication "Amnolake Tablets 2 mg"

Licensing and Joint Developments

December, 2005

➜ Concluded the license agreement with the American company INNOVIVE Pharmaceuticals, Inc. for the chronic myelogenous leukemia medication "NS-187"

Functional Food Company News

April, 2006

➜ Established an affiliated health food sales company "Laplus Pharma, Co., Ltd."

March, 2006

➜ Began sale of the product "Sakekasu (Sake Lees) Peptide R," jointly developed with Gekkeikan Sake Co., Ltd.

Corporate Governance: Basic Policy and Implementation

At Nippon Shinyaku, we recognize corporate governance as one of the most important issues facing management. We are working to improve our internal control systems to ensure transparent business administration and effective business functions.

The Company's Board of Directors comprises seven members: the President, two Managing Directors, and four Directors, all of whom play a role as members of the supreme decision-making body. In principle, the Board convenes once per month to decide on matters of primary business as defined in the Board Regulations, and to supervise the state of affairs of our business operations. With regard to any issues that are to be proposed to a Board meeting, all directors and statutory auditors attend an explanatory session for important cases beforehand. Staff members of the department that originated the proposal deliver presentations on the cases, giving relevant details, and a question and answer session is conducted.

Currently, the term of office of directors of the Company is one year. Aiming at further clarifying the management responsibilities of the Board of Directors and creating an optimal management structure that can respond flexibly to changes in the operating environment, we have adopted the executive officer system.

Instead of introducing a committee-based auditing system, we maintain the conventional statutory auditor system. Our Board of Auditors is composed of four statutory auditors, two of whom are full-time auditors, the other two being part-time external auditors. Corporate Auditors attend all Board meetings, where they fulfill their management oversight function as the Board of Auditors as a whole. Corporate Auditors observe proceedings at meetings of the Board of Directors so that the independence of the accounting auditors(certified public accountants) is secured, and through regular meetings with the accounting auditors, they receive from accounting auditors the outlines of the audit plans and information on the current status of the interim audits. In addition, they keep in close contact via their attendance during on-site audit sessions, and make efforts to mutually improve the effectiveness of the audits and overall audit efficiency. Corporate Auditors also maintain close contact with the Company's internal auditing staff so as to exchange opinions on their audit plans and the results of audits.

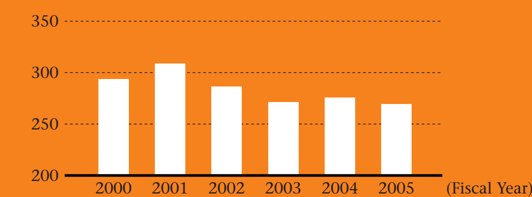
In addition to supervision by the Corporate Auditors, we also have an auditing function that reports directly to the President and conducts operational audits for internal controls in accordance with internal auditing guidelines.

Nippon Shinyaku's overriding principle is respect for human dignity, and we strive to conduct ourselves according to high ethical standards, always keeping our contribution to society in mind. We recognize that such conduct is closely associated with the improvement of our enterprise value. An internal control system is one of our means to that end, and it is a process implemented by all Company staff. We do all we can to ensure full compliance with laws and regulations, and seek effectiveness and efficiency in our business affairs. We consider that it is our duty to provide reasonable assurance that we will reach our objective of securing the reliability of the financial reports derived therein. On May 12, 2006, our Board of Directors resolved on an "Agenda for the Establishment of an Internal Control System."

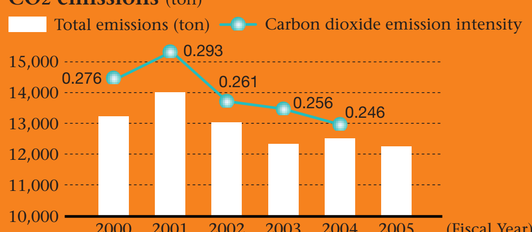
In the past, we have also drafted a "Charter of Business Conduct," a "Compliance Program Standards," and more, and we are making efforts to enlighten our employees on the subject of corporate ethics, and to ensure that they all maintain high ethical standards. We are furthering our internal control framework by adding internal auditing functions and functions for the promotion of corporate ethics, and we are active as a center for the promotion of internal controls.

Environmental Technology Section

Total energy consumption (1,000 GJ)

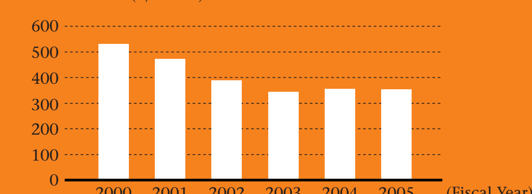


CO_2 emissions (ton)

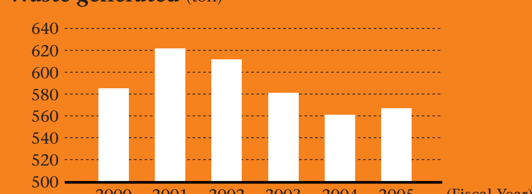


Carbon dioxide emission intensity
= Total CO_2 emissions / sales (tons/millions of yen)

Water used (1,000m³)



Waste generated (ton)



Under the Board of Directors, Nippon Shinyaku has established a corporate-level Environment Committee to deal with key environmental issues across the Company. We have also set up an environmental committee at each branch office.

To protect the environment, we seek to minimize the impact of our business activities in accordance with our Basic Environmental Policy. We have voluntarily set environmental preservation targets to ensure the systematic promotion of our environmental initiatives.

We have chosen eight items in our drive to protect the environment, including cutting CO_2 emissions, reducing waste generated, more effective management of chemical substances appropriately, and increasing our procurement of “green” supplies.

As a company based in the city that where the Kyoto Protocol was signed, we are actively working to cut our carbon dioxide emissions in accordance with the Kyoto City Global Warming Provisions, which went into effect in April 2005 and the Kyoto Prefecture Global Warming Provisions, which came into effect in April 2006.

We remain ISO14001 accredited for our environmental management systems after having our certificate renewed on first-time inspection at the Chitose Plant in November 2005. At the Odawara Central Factory, we had already received an approval through mid-term inspection in August 2005.

We are considering applying for inspection for accreditation of our head office, our Discovery Research Laboratories in Tsukuba, and our consolidated subsidiaries in fiscal 2006 and subsequent years.

Our environmental impact is shown in the graphs left.

Board of Directors and Corporate Auditors

As of June 29, 2006

(Front from left) *Managing Director* Yoshihisa Shibata
President Kazuto Hatsuyama
Managing Director Shigenobu Maekawa

(Back from left) *Director* Toshihiko Sago
Director Nobuyoshi Sumi
Director Junichi Yano
Director Hiroshi Adachi

President

Kazuto Hatsuyama

Managing Directors

Yoshihisa Shibata, Ph. D.
(General Manager, Human Resources Division & Regulatory Division)

Shigenobu Maekawa
(General Manager, Corporate Planning Division, Finance & Accounting Division, Information Systems Division)

Directors

Nobuyoshi Sumi, Dr. med. vet.
(General Manager, International Business Division, Resource Procurement Division & Production Division)

Junichi Yano, Ph. D.
(General Manager, Research & Development Division)

Toshihiko Sago
(General Manager, Marketing Division)

Hiroshi Adachi
(General Manager, Functional Food Division)

Corporate Auditors

Youichi Toriyama
Sadayasu Nagai
Kenji Ohishi
Yasuo Tanabe

Corporate Officers

Taro Sakurai
(General Manager, Finance & Accounting Dept.)

Akira Miura
(General Manager, Human Resources Dept.)

Tetsuya Yonekawa
(General Manager, Regulatory Affairs Supervision & Assurance Division)

Kouichi Nakamichi, Ph. D.
(General Manager, Odawara Central Factory)

Yojiro Ukai, Ph. D.
(General Manager, Research & Development Division)

Kichiro Inoue, Ph. D.
(General Manager, Discovery Research Laboratories)

Kazushige Itabashi
(General Manager, Licensing & Business Development Dept.)

Toru Sakata
(General Manager, Tokyo Business Office)

Hideo Arai
(General Manager, Nagoya Business Office)

Takeshi Nomura
(General Manager, Osaka Business Office)

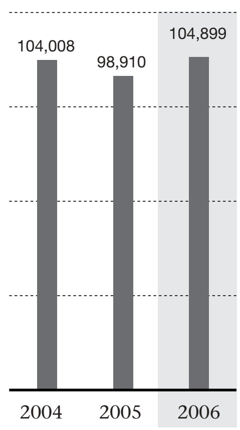
Financial Section Six-Year Summary (Consolidated)

	Millions of yen					
Years ended March 31	**2006**	2005	2004	2003	2002	2001
Net sales	**¥53,947**	¥54,252	¥51,326	¥52,942	¥50,587	¥50,949
Income before income taxes and minority interests	**3,285**	9,630	3,262	4,474	4,534	6,245
Net income	**1,612**	5,639	1,536	2,095	2,155	3,117
Amounts per share (in yen):						
Basic net income	**¥22.84**	¥81.22	¥21.50	¥29.20	¥30.68	¥44.37
Cash dividends applicable to the year	**10.00**	15.00	10.00	10.00	10.00	10.00
Total assets	**¥104,899**	¥98,910	¥104,008	¥109,549	¥103,871	¥110,143
Shareholders' equity	**75,412**	70,010	65,396	61,614	61,770	61,788
Investments in plant and equipment	**1,184**	1,745	1,829	4,370	2,959	8,886
R&D expenses	**10,071**	8,479	8,263	7,885	7,023	6,618

Contents

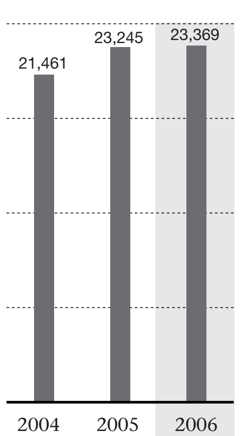
Management's Discussion and Analysis

Consolidated Total Assets
(Millions of yen)



Consolidated Stockholders' Equity Ratio
(%)

Consolidated Cost of Sales
(Millions of yen)



Financial Strategy

The Company maintains a sufficient level of retained earnings to reinforce its financial position while channeling management resources into commercially promising fields to improve competitiveness in the fast-evolving arena of pharmaceutical research and development. At the same time, we remain committed to adequate return of profit to our shareholders as a priority, under a basic policy of continuous and stable dividend payment.

Liquidity and Capital Resources

Total assets of the Company at the end of the reporting term stood at ¥104,899 million (US$xx million), an increase of ¥5,989 million year-on-year. Declines in cash and cash equivalents, trade receivables, other current assets, and plant property and equipment were outweighed by increases in the value of investment securities due to rising stock prices.

Total liabilities increased ¥579 million year-on-year to ¥29,350 million (US$xx million). Short-term borrowings and accrued retirement benefits both posted declines, which were more than offset by an increase in deferred tax liabilities caused by rising stock prices.

Shareholders' equity rose ¥5,402 million year-on-year to ¥75,412 million (US$xx million), from increases in retained earnings and unrealized gains on available-for-sale securities. The shareholders' equity ratio rose 1.1 percentage point year-on-year to 71.9%.

Turning to cash flows, net cash provided by operating activities rose ¥595 million year-on-year to ¥3,403 million (US$xx million). An increase in inventory and a decline in other current liabilities was more than offset by declines in trade receivables and other current assets.

Net cash used in investing activities rose by ¥2,821 million year-on-year to ¥3,330 million (US$xx million), due to declines in proceeds from redemption of marketable securities and proceeds from sales of plant, property and equipment.

Net cash used in financing activities shrank ¥4,002 million to ¥2,392 million (US$xx million) due to a decline in expenditures for repayment of short-term borrowings, which more than offset an increase in dividend payments.

As a result of the foregoing, cash and cash equivalents at the term-end decreased by ¥2,198 million to ¥13,753 million (US$xx million).

The Company is committed to maintaining the soundness of its financial position, while ensuring sufficient cash liquidity and funding for business operations.

Consolidated Cash Flows (Millions of yen)

	2004	2005	2006
Net cash provided by operating activities	4,068	2,808	3,403
Net cash used in investing activities	(2,273)	(509)	(3,330)
Net cash used in financing activities	(7,630)	(6,394)	(2,392)
Cash and cash equivalents, end of year	20,032	15,951	13,753

Results of Operations (consolidated)

The business environment facing the pharmaceutical industry in Japan remained difficult during the term under review. An unavoidable drag on our performance was strengthened government measures to curb medical costs into the long term, amid debate over the need to reform the national health insurance system in Japan in the face of increasing social welfare funding problems as the population grows older and the birth rate declines.

The food sector also continues to face a difficult operating environment, with consumption anemic and raw-material prices rising, but one bright spot is growth in ingredients for functional foods amid rising health-awareness among the Japanese people.

Against this backdrop, and despite the best efforts of the Company, sales declined 0.6% year-on-year to ¥53,947 million (US$xx million), reflecting a decrease in sales of anti-allergy agents after the pollen count in Japan fell well short of the previous term's level. Operating income declined 44.1% year-on-year to ¥2,586 million (US$xx million), as efforts to reduce selling, general and administrative expenses were outweighed by a substantial increase in research and development costs. Net income declined a 71.4% year-on-year to ¥1,612 million (US$xx million), due to a steep fall in extraordinary gains: in the previous term, extraordinary gains totaled ¥5,151 million deriving from the settlement of pension fund operations on behalf of the government, and proceeds mainly from the sale land, but in the reporting term, they only totaled ¥292 million, in proceeds from the sale of land.

Earnings by Segment

Pharmaceutical business

In the pharmaceutical business, growth was recorded in mainstay products, such as the overactive bladder agent Bladderon®, the nonsteroidal anti-inflammatory analgesic Hypen®, the acute promyelocytic leukemia treatment Trisenox®, the azulene gargle Azunol Gargle® and Gaslon N®, a remedy for gastric ulcer and gastritis. But sales were anemic for antiallergy Livostin® eye-drops and nose-drops, the benign prostatic hyperplasia agent Eviprostat™, the antirheumatic agent Orcl®, and the hypertension and angina agent Selectol®. Against this backdrop, we launched the new products Iodinecort ointment for treatment of decubital ulcers and Amnolake®, a treatment for refractory/relapsed acute promyelocytic leukemia.

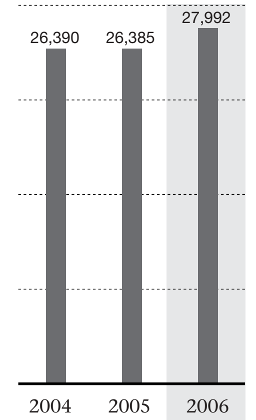
In other businesses, although revenue from intellectual property-rights declined substantially, we recorded strong growth in sales of the synthetic antibacterial Prulifloxacin®. As a result of the above, sales declined 1.4% year-on-year to ¥44,406 million.

Food business

Sales in the food business rose 3.5% year-on-year to ¥9,541 million. Health food ingredients posted lackluster sales amid ongoing weakness in consumption and rising raw-material costs, but effective marketing campaigns and a strengthened lineup boosted sales of protein products.

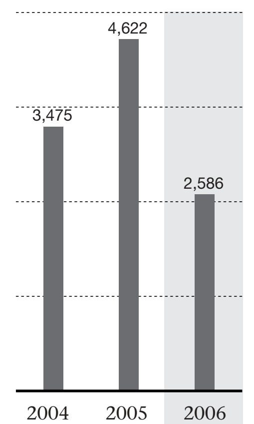
Consolidated Selling, general and administrative expenses

(Millions of yen)



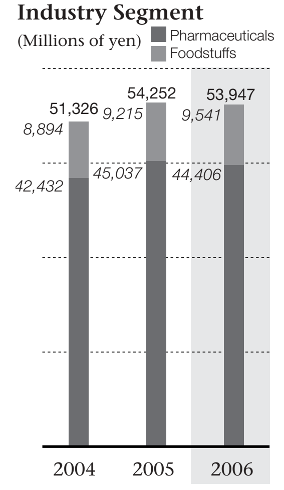
Consolidated Operating Income

(Millions of yen)



Consolidated Sales by Industry Segment

(Millions of yen)



Consolidated Balance Sheets

March 31, 2006 and 2005	Millions of yen 2006	Millions of yen 2005	Thousands of U.S. dollars (Note 1) 2006
Assets			
Current assets:			
Cash and cash equivalents	**¥ 13,753**	¥15,951	**$117,547**
Time deposits	**120**	100	**1,026**
Marketable securities (Note 3)	**500**	800	**4,274**
Notes and accounts receivable:			
Trade notes	**280**	1,088	**2,393**
Trade accounts	**24,566**	24,693	**209,966**
Other	**306**	133	**2,615**
Total notes and accounts receivable	**25,152**	25,914	**214,974**
Inventories (Note 4)	**9,211**	8,496	**78,726**
Deferred tax assets (Note 10)	**1,620**	1,646	**13,846**
Other current assets	**1,074**	2,116	**9,180**
Total current assets	**51,430**	55,023	**439,573**
Property, plant and equipment (Note 5):			
Land	**8,237**	8,351	**70,402**
Buildings and structures	**25,094**	25,290	**214,479**
Machinery and equipment	**11,454**	11,414	**97,897**
Tools, furniture and fixtures	**9,106**	9,541	**77,829**
Construction in progress	**39**	7	**333**
Total	**53,930**	54,603	**460,940**
Accumulated depreciation	**(32,515)**	(32,272)	**(277,906)**
Net property, plant and equipment	**21,415**	22,331	**183,034**
Investments and other assets:			
Investment securities (Note 3)	**26,406**	15,316	**225,692**
Long-term prepaid expenses	**2,825**	3,041	**24,145**
Deferred tax assets (Note 10)	**45**	61	**385**
Other assets	**2,778**	3,138	**23,744**
Total investments and other assets	**32,054**	21,556	**273,966**
Total	**¥104,899**	¥98,910	**$896,573**

See notes to consolidated financial statements.

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Liabilities and Shareholders' Equity			
Current liabilities:			
Short-term borrowings (Note 5)	**¥ 30**	¥ 50	**$ 256**
Current portion of long-term debt (Note 5)	**1,247**	1,299	**10,658**
Notes and accounts payable:			
Trade notes	**735**	446	**6,282**
Trade accounts	**3,341**	3,252	**28,555**
Other payables	**661**	3,045	**5,650**
Total notes and accounts payable	**4,737**	6,743	**40,487**
Income taxes payable	**404**	1,174	**3,453**
Accrued expenses	**5,429**	3,455	**46,402**
Deposits from customers	**272**	270	**2,325**
Other current liabilities	**558**	551	**4,769**
Total current liabilities	**12,677**	13,542	**108,350**
Long-term liabilities:			
Long-term debt (Note 5)	**2,424**	3,671	**20,718**
Liability for retirement benefits (Note 6)	**9,980**	11,199	**85,299**
Negative goodwill	**3**	3	**26**
Deferred tax liability (Note 10)	**3,950**	182	**33,761**
Other long-term liabilities	**316**	174	**2,701**
Total long-term liabilities	**16,673**	15,229	**142,505**
Minority interests	**137**	129	**1,171**
Contingent liabilities (Note 11)			
Shareholders' equity (Notes 7 and 14):			
Common stock, authorized, 200,000,000 shares; issued 70,251,484 shares	**5,174**	5,174	**44,222**
Capital surplus	**4,440**	4,439	**37,949**
Retained earnings	**57,027**	56,515	**487,410**
Unrealized gain on available-for-sale securities	**10,148**	5,218	**86,735**
Foreign currency translation adjustments	**(1)**	(11)	**(9)**
Treasury stock – at cost, 2,088,792 shares in 2006 and 2,034,407 shares in 2005	**(1,376)**	(1,325)	**(11,760)**
Total shareholders' equity	**75,412**	70,010	**644,547**
Total	**¥104,899**	¥98,910	**$896,573**

Consolidated Statements of Income

Years ended March 31, 2006 and 2005	Millions of yen 2006	Millions of yen 2005	Thousands of U.S. dollars (Note 1) 2006
Net sales (Note 15)	**¥53,947**	¥54,252	**$461,086**
Cost and expenses (Note 15):			
Cost of sales	**23,369**	23,245	**199,735**
Selling, general and administrative expenses (Note 8)	**27,992**	26,385	**239,248**
Total	**51,361**	49,630	**438,983**
Operating income (Note 15)	**2,586**	4,622	**22,103**
Other income (expenses):			
Interest and dividend income	**235**	200	**2,008**
Interest expenses	**(57)**	(90)	**(487)**
Gain on sales of property, plant and equipment	**292**	1,370	**2,496**
Gain on transfer of the substitutional portion of the governmental pension program		3,781	
Other – net	**229**	(253)	**1,957**
Other income – net	**699**	5,008	**5,974**
Income before income taxes and minority interests	**3,285**	9,630	**28,077**
Income taxes (Note 10):			
Current	**1,279**	2,013	**10,932**
Deferred	**386**	1,990	**3,299**
Total	**1,665**	4,003	**14,231**
Minority interests in net income (loss)	**8**	(12)	**68**
Net income	**¥ 1,612**	¥ 5,639	**$ 13,778**

	Yen 2006	Yen 2005	U.S. dollars 2006
Amounts per common share (Notes 2.o and 13):			
Basic net income	**¥22.84**	¥81.22	**$0.20**
Cash dividends applicable to the year	**10.00**	15.00	**0.09**

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

	Thousands	Millions of yen					
Years ended March 31, 2006 and 2005	Outstanding number of shares of common stock	Common stock	Capital surplus	Retained earnings	Unrealized gain on available-for-sale securities	Foreign currency translation adjustments	Treasury stock
Balance at April 1, 2004	68,793	¥5,174	¥4,439	¥51,621	¥ 5,049	¥ (9)	¥ (878)
Net income				5,639			
Cash dividends, ¥15.00 per share				(687)			
Bonuses to directors and corporate auditors				(58)			
Net increase in unrealized gain on available-for-sale securities					169		
Net decrease in foreign currency translation adjustments						(2)	
Repurchase of treasury stock	(579)						(450)
Disposal of treasury stock	3						3
Balance at March 31, 2005	68,217	5,174	4,439	56,515	5,218	(11)	(1,325)
Net income				**1,612**			
Cash dividends, ¥10.00 per share				**(1,023)**			
Bonuses to directors and corporate auditors				**(77)**			
Net increase in unrealized gain on available-for-sale securities					**4,930**		
Net increase in foreign currency translation adjustments						**10**	
Repurchase of treasury stock	**(59)**						**(54)**
Disposal of treasury stock	**5**		**1**				**3**
Balance at March 31, 2006	**68,163**	**¥5,174**	**¥4,440**	**¥57,027**	**¥10,148**	**¥ (1)**	**¥(1,376)**

	Thousands of U.S. dollars (Note 1)					
	Common stock	Capital surplus	Retained earnings	Unrealized gain on available-for-sale securities	Foreign currency translation adjustments	Treasury stock
Balance at March 31, 2005	$44,222	$37,940	$483,034	$44,598	$(94)	$(11,325)
Net income			**13,778**			
Cash dividends, $0.09 per share			**(8,744)**			
Bonuses to directors and corporate auditors			**(658)**			
Net increase in unrealized gain on available-for-sale securities				**42,137**		
Net increase in foreign currency translation adjustments					**85**	
Repurchase of treasury stock						**(461)**
Disposal of treasury stock		**9**				**26**
Balance at March 31, 2006	**$44,222**	**$37,949**	**$487,410**	**$86,735**	**$ (9)**	**$(11,760)**

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

	Millions of yen		Thousands of U.S. dollars (Note 1)
Years ended March 31, 2006 and 2005	**2006**	2005	**2006**
Operating activities:			
Income before income taxes and minority interests	**¥ 3,285**	¥ 9,630	**$ 28,077**
Adjustments for:			
Income taxes – paid	**(2,001)**	(2,243)	**(17,103)**
Depreciation and amortization	**2,692**	3,016	**23,009**
Gain on sales of property, plant and equipment	**(292)**	(1,370)	**(2,496)**
Changes in assets and liabilities:			
Decrease (increase) in notes and accounts receivable	**762**	(2,126)	**6,513**
(Increase) decrease in inventories	**(715)**	428	**(6,111)**
Decrease (increase) in other current assets	**1,039**	(799)	**8,880**
Increase in notes and accounts payable	**378**	292	**3,231**
Increase (decrease) in other current liabilities	**7**	(46)	**60**
Decrease in liability for retirement benefits	**(1,219)**	(5,159)	**(10,419)**
Other – net	**(533)**	1,185	**(4,556)**
Total adjustments	**118**	(6,822)	**1,008**
Net cash provided by operating activities	**3,403**	2,808	**29,085**
Investing activities:			
Proceeds from sales of property, plant and equipment	**344**	1,569	**2,940**
Proceeds from redemption of marketable securities	**800**	2,300	**6,838**
Capital expenditures	**(885)**	(2,384)	**(7,564)**
Purchases of investment securities	**(3,434)**	(1,710)	**(29,350)**
Purchases of software	**(64)**	(110)	**(547)**
Acquisition of the license rights	**(242)**	(265)	**(2,068)**
Other – net	**151**	91	**1,290**
Net cash used in investing activities	**(3,330)**	(509)	**(28,461)**
Financing activities:			
Net decrease in short-term bank loans	**(20)**	(3,980)	**(171)**
Proceeds from long-term bank loans		20	
Repayments of long-term debt	**(1,298)**	(1,297)	**(11,094)**
Cash dividends paid	**(1,023)**	(689)	**(8,744)**
Increase of treasury stock	**(50)**	(448)	**(427)**
Other – net	**(1)**		**(8)**
Net cash used in financing activities	**(2,392)**	(6,394)	**(20,444)**
Foreign currency translation adjustments on cash and cash equivalents	**121**	14	**1,034**
Net decrease in cash and cash equivalents	**(2,198)**	(4,081)	**(18,786)**
Cash and cash equivalents, beginning of year	**15,951**	20,032	**136,333**
Cash and cash equivalents, end of year	**¥13,753**	¥15,951	**$117,547**

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1. BASIS OF PRESENTING THE CONSOLIDATED FINANCIAL STATEMENTS

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

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which Nippon Shinyaku Co., Ltd. (the "Company") is incorporated and operates. The translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥117 to $1, the approximate rate of exchange at March 31, 2006. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Consolidation — The consolidated financial statements include the accounts of the Company and its significant two domestic and one overseas subsidiaries (together, the "Companies"). Consolidation of the remaining subsidiary would not have a material effect on the accompanying consolidated financial statements.

Under the control or influence concept, those companies in which the Company, directly or indirectly, is able to exercise control over operations are fully consolidated, and those companies over which the Companies have the ability to exercise significant influence are accounted for by the equity method.

Investment in one unconsolidated subsidiary is stated at cost. If the equity method of accounting had been applied to the investment in this company, the effect on the accompanying consolidated financial statements would not be material.

The difference between the cost of an acquisition and the fair value of the net assets of the acquired subsidiary at the date of acquisition is reported as negative goodwill in the accompanying consolidated balance sheets and is being amortized over a period of five years.

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

b. Cash Equivalents — Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value. Cash equivalents include time deposits and short-term investments, all of which mature or become due within three months of the date of acquisition.

c. Marketable and Investment Securities — Marketable and investment securities are classified and accounted for, depending on management's intent, as follows:

i) held-to-maturity debt securities, which management has the positive intent and ability to hold to maturity, are reported at amortized cost; and ii) available-for-sale securities, which are not classified as held-to-maturity securities and are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported as a separate component of shareholders' equity. Realized gains and losses on available-for-sale securities are included in earnings and are calculated by using the moving-average method to determine the cost of securities sold. All other securities are stated at cost, cost being determined principally by the moving-average method. Write-downs are recorded in earnings for securities with a significant decline in value that is considered to be other than temporary.

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

e. Property, Plant and Equipment — Property, plant and equipment are stated at cost. Depreciation is principally computed by the declining-balance method while the straight-line method is applied to buildings acquired after April 1, 1998. The range of useful lives is principally from 15 to 50 years for buildings and structures, from seven to nine years for machinery and equipment, and from four to six years for tools, furniture and fixtures.

f. Long-lived Assets — In August 2002, the Business Accounting Council (BAC) issued a Statement of Opinion, *Accounting for Impairment of Fixed Assets*, and in October 2003 the Accounting Standards Board of Japan (ASBJ) issued ASBJ Guidance No.6, *Guidance for Accounting Standard for Impairment of Fixed Assets*. These new pronouncements were effective for fiscal years beginning on or after April 1, 2005 with early adoption permitted for fiscal years ending on or after March 31, 2004.

The Companies adopted the new accounting standard for impairment of fixed assets as of April 1, 2005.

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

The adoption of this new accounting standard for impairment of fix assets had no impact on the financial position or results of operations of the Companies.

g. **Retirement and Pension Plans** — The Company has a cash balance pension plan, under which each participant has an account on which a fixed amount is contributed and interest added which is calculated yearly based on a market-related interest rate with a certain minimum interest rate secured. The Company also has an unfunded retirement benefit plan for employees and a defined contribution pension plan to allow qualified persons aged from 60 to 64 to receive post retirement benefits at their discretion. Consolidated domestic subsidiaries have unfunded retirement benefit plans.

The transitional credit of ¥845 million determined as of April 1, 2000 was amortized over five years.

Previously, retirement benefits for directors and corporate auditors were introduced and were provided at the amount which would be required if such individuals were to retire at the balance sheet date. The Company and a consolidated subsidiary abolished the above retirement benefits plan. Resolution to pay the amount accumulated until the termination of the plan upon retirement of each individual was approved at the general shareholders' meetings. The total amount payable of ¥142 million ($1,214 thousand) is recorded as other long-term liabilities at March 31, 2006.

The liability for retirement benefits at March 31, 2005 included ¥304 million for directors' and corporate auditors' retirement benefits.

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

i. **Leases** — All leases, except those of the overseas subsidiary, are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the lessee's consolidated financial statements.

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

k. **Appropriations of Retained Earnings** — Appropriations of retained earnings are reflected in the consolidated financial statements for the following year upon shareholders' approval.

l. **Foreign Currency Transactions** — All short-term and long-term monetary receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rates at the balance sheet date. The foreign exchange gains and losses from translation are recognized in the statement of income to the extent that they are not hedged by forward exchange contracts.

m. **Foreign Currency Financial Statements** — The balance sheet accounts and revenue and expense accounts of the consolidated overseas subsidiary are translated into Japanese yen at the current exchange rates as of the balance sheet date except for shareholders' equity, which is translated at historical rates. Differences arising from such translation were shown as "Foreign currency translation adjustments" as a separate component of shareholders' equity.

n. **Derivative Financial Instruments** — The Company uses foreign currency forward contracts as a means of hedging exposure to foreign currency risks related to the procurement of merchandise from overseas suppliers. The Company does not enter into derivatives for trading or speculative purposes. All derivative financial instruments are used for hedging purposes that qualify for hedge accounting because of high correlation and effectiveness between the hedging instruments and the hedged items, which are deferred until maturity of the hedged transactions.

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

Cash dividends per share presented in the accompanying consolidated statements of income are dividends applicable to the respective years including dividends to be paid after the end of the year.

p. New Accounting Pronouncements —

Business Combination and Business Separation

In October 2003, the Business Accounting Council (BAC) issued a Statement of Opinion, *Accounting for Business Combinations*, and on December 27, 2005 the Accounting Standards Board of Japan (ASBJ) issued *Accounting Standard for Business Separations* and ASBJ Guidance No. 10, *Guidance for Accounting Standard for Business Combinations and Business Separations*. These new accounting pronouncements are effective for fiscal years beginning on or after April 1, 2006.

The accounting standard for business combinations allows companies to apply the pooling of interests method of accounting only when certain specific criteria are met such that the business combination is essentially regarded as a uniting-of-interests. These specific criteria are as follows:

(a) the consideration for the business combination consists solely of common shares with voting rights,

(b) the ratio of voting rights of each predecessor shareholder group after the business combination is nearly equal, and

(c) there are no other factors that would indicate any control exerted by any shareholder group other than voting rights.

For business combinations that do not meet the uniting-of-interests criteria, the business combination is considered to be an acquisition and the purchase method of accounting is required. This standard also prescribes the accounting for combinations of entities under common control and for joint ventures. Goodwill, including negative goodwill, is to be systematically amortized over 20 years or less, but is also subject to an impairment test.

Under the accounting standard for business separations, in a business separation where the interests of the investor no longer continue and the investment is settled, the difference between the fair value of the consideration received for the transferred business and the book value of net assets transferred to the separated business is recognized as a gain or loss on business separation in the statement of income. In a business separation where the interests of the investor continue and the investment is not settled, no such gain or loss on business separation is recognized.

Stock options

On December 27, 2005, the ASBJ issued *Accounting Standard for Stock Options and related guidance*. The new standard and guidance are applicable to stock options newly granted on and after May 1, 2006.

This standard requires companies to recognize compensation expense for employee stock options based on the fair value at the date of grant and over the vesting period as consideration for receiving goods or services. The standard also requires companies to account for stock options granted to non-employees based on the fair value of either the stock option or the goods or services received. In the balance sheet, the stock option is presented as a stock acquisition right as a separate component of shareholders' equity until exercised. The standard covers equity-settled, share-based payment transactions, but does not cover cash-settled, share-based payment transactions. In addition, the standard allows unlisted companies to measure options at their intrinsic value if they cannot reliably estimate fair value.

Bonuses to directors and corporate auditors

Prior to the fiscal year ended March 31, 2005, bonuses to directors and corporate auditors were accounted for as a reduction of retained earnings in the fiscal year following approval at the general shareholders meeting. The ASBJ issued ASBJ Practical Issues Task Force (PITF) No. 13, "*Accounting Treatment for Bonuses to Directors and Corporate Auditors*," which encouraged companies to record bonuses to directors and corporate auditors on the accrual basis with a related charge to income, but still permitted the direct reduction of such bonuses from retained earnings after approval of the appropriation of retained earnings.

The ASBJ replaced the above accounting pronouncement by issuing a new accounting standard for bonuses to directors and corporate auditors on November 29, 2005. Under the new accounting standard, bonuses to directors and corporate auditors must be expensed and are no longer allowed to be directly charged to retained earnings. This accounting standard is effective for fiscal years ending on or after May 1, 2006.

The companies must accrue bonuses to directors and corporate auditors at the year end to which such bonuses are attributable.

3. MARKETABLE AND INVESTMENT SECURITIES

Marketable and investment securities as of March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
March 31	**2006**	2005	**2006**
Current:			
Government and corporate bonds	**¥ 500**	¥ 800	**$ 4,274**
Non-current:			
Equity securities	**¥22,913**	¥12,517	**$195,837**
Government and corporate bonds	**2,696**	2,700	**23,043**
Trust fund investments	**797**	99	**6,812**
Total	**¥26,406**	¥15,316	**$225,692**

Information regarding each category of securities classified as available-for-sale and held-to-maturity at March 31, 2006 and 2005 were as follows:

	Millions of yen			
March 31, 2006	Cost	Unrealized gain	Unrealized loss	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	**¥5,318**	**¥17,207**		**¥22,525**
Government and corporate bonds	**100**		**¥ 3**	**97**
Trust fund investments	**801**		**4**	**797**
Held-to-maturity	**3,099**		**35**	**3,064**

	Millions of yen			
March 31, 2005	Cost	Unrealized gain	Unrealized loss	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	¥3,290	¥8,845		¥12,135
Trust fund investments	100		¥1	99
Held-to-maturity	3,500	7		3,507

	Thousands of U.S. dollars			
March 31, 2006	Cost	Unrealized gain	Unrealized loss	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	**$45,453**	**$147,068**		**$192,521**
Government and corporate bonds	**855**		**$ 26**	**849**
Trust fund investments	**6,846**		**34**	**6,812**
Held-to-maturity	**26,487**		**299**	**26,188**

Available-for-sale securities whose fair value is not readily determinable as of March 31, 2006 and 2005 were as follows:

	Carrying amount		
	Millions of yen		Thousands of U.S. dollars
March 31	**2006**	2005	**2006**
Available-for-sale:			
Equity securities	**¥388**	¥382	**$3,316**

Proceeds from sales of available-for-sale securities for the year ended March 31, 2006 was ¥13 million ($111 thousand). Gross realized gains on these sales, computed on the moving average cost basis, was ¥5 million ($43 thousand) for the year ended March 31, 2006.

The Companies disposed of corporate bonds which were classified as held-to-maturity for the year ended March 31, 2006. The management decided to dispose of these corporate bonds because the rating of the bond issuer was lowered.

Proceeds from this sale of held-to-maturity debt securities and realized loss on this sale were ¥188 million ($1,607 thousand) and ¥12 million ($103 thousand) for the year ended March 31, 2006, respectively.

The carrying values of debt securities by contractual maturities for securities classified as available-for-sale and held-to-maturity at March 31, 2006 are as follows:

	Millions of yen		Thousands of U.S. dollars	
March 31, 2006	Available for Sale	Held to Maturity	Available for Sale	Held to Maturity
Due in one year or less		**¥ 500**		**$ 4,274**
Due after one year through five years	**¥296**	**2,600**	**$2,530**	**22,222**
Total	**¥296**	**¥3,100**	**$2,530**	**$26,496**

4. INVENTORIES

Inventories at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
March 31	**2006**	2005	**2006**
Finished products and merchandise	**¥4,850**	¥4,081	**$41,453**
Work in process	**1,533**	1,951	**13,102**
Raw materials	**2,828**	2,464	**24,171**
Total	**¥9,211**	¥8,496	**$78,726**

5. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

Short-term borrowings consisted of bank overdrafts, due within one year.

The weighted average annual interest rate for short-term bank loans at March 31, 2006 and 2005 was 0.8%.

Short-term borrowings at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
March 31	**2006**	2005	**2006**
Loans from banks, 0.8% (2006 and 2005)	**¥30**	¥50	**$256**

Long-term debt at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
March 31	**2006**	2005	**2006**
Loan from financial institutions, 0.86% to 2.3% (2006 and 2005), due November 2012	**¥3,670**	¥4,968	**$31,368**
Capital lease obligations	**1**	2	**8**
Total	**3,671**	4,970	**31,376**
Less current portion	**(1,247)**	(1,299)	**(10,658)**
Long-term debt, less current portion	**¥2,424**	¥3,671	**$20,718**

Annual maturities of long-term debt at March 31, 2006 were as follows:

Year ending March 31	Millions of yen	Thousands of U.S. dollars
2007	¥1,247	$10,658
2008	1,202	10,274
2009	1,163	9,940
2010	31	265
2011	10	85
2012 and thereafter	18	154
Total	¥3,671	$31,376

At March 31, 2006, the following assets were pledged as collateral for certain short-term borrowings and long-term debt (including current portion):

	Millions of yen	Thousands of U.S. dollars
Property, plant and equipment, net of accumulated depreciation	¥5,619	$48,026
Related liabilities:		
Short-term borrowings	¥ 30	$ 256
Current portion of long-term debt	¥1,088	$ 9,299
Long-term debt (excluding current portion)	¥2,127	$18,179

6. RETIREMENT BENEFITS

Employees of the Company and domestic subsidiaries terminating their employment are entitled to lump-sum severance payments based on the rate of pay at the time of termination, length of service and certain other factors. If the termination is involuntary or caused by death, the employees are entitled to greater payments than in the case of voluntary termination.

The Company had contributory trusteed pension plan which funds a portion of the Company's retirement benefits. The contributory funded defined benefit pension plan, which was established under the Japanese Welfare Pension Insurance Law, covered a substitutional portion of the governmental pension program managed by the Company on behalf of the government and a corporate portion established at the discretion of the Company.

In accordance with the Defined Benefit Pension Plan Law enacted in April 2002, the Company applied for transfer of the substitutional portion of past pension obligations to the government and obtained approval by the Ministry of Health, Labor and Welfare on April 1, 2004. Based upon the above approval in April 2004, the Company recognized a gain on transfer of the substitutional portion of the governmental pension program in the amount of ¥3,769 million for the year ended March 31, 2005.

The Company thereafter transferred the substitutional portion of the pension obligations and related assets to the government on August 27, 2004 and recognized ¥12 million as income for the difference between the balance of the retirement benefit liabilities brought forward and the amount actually transferred for the year ended March 31, 2005.

The liability for employees' retirement benefits at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
March 31	**2006**	2005	**2006**
Projected benefit obligation	**¥25,524**	¥25,867	**$218,154**
Fair value of plan assets	**(10,238)**	(8,196)	**(87,504)**
Unrecognized actuarial loss	**(4,743)**	(6,168)	**(40,539)**
Unrecognized prior service cost	**(563)**	(608)	**(4,812)**
Net liability	**¥ 9,980**	¥10,895	**$ 85,299**

The components of net periodic benefit costs for the years ended March 31, 2006 and 2005 are as follows:

	Millions of yen		Thousands of U.S. dollars
March 31	**2006**	2005	**2006**
Service cost	**¥ 938**	¥ 932	**$ 8,017**
Interest cost	**514**	504	**4,393**
Expected return on plan assets	**(326)**	(356)	**(2,786)**
Amortization of transitional credit		(525)	
Recognized actuarial loss	**482**	436	**4,119**
Amortization of prior service cost	**45**	45	**385**
Premiums for defined contribution pension plan and other	**54**	165	**462**
Net periodic benefit costs	**1,707**	1,201	**14,590**
Gain on transfer of the substitutional portion of the governmental pension program		(3,781)	
Total	**¥1,707**	¥(2,580)	**$14,590**

Assumptions used for the years ended March 31, 2006 and 2005 are set forth as follows:

	2006	2005
Discount rate	**2.0%**	2.0%
Expected rate of return on plan assets	**4.0%**	4.0%
Recognition period of actuarial gain / loss	**15 years**	15 years
Amortization period of transitional credit		5 years
Amortization period of prior service cost	**15 years**	15 years

7. SHAREHOLDERS' EQUITY

Through May 1, 2006, Japanese companies are subject to the Commercial Code of Japan (the "Code").

The Code requires that all shares of common stock be issued with no par value and at least 50% of the issue price of new shares is required to be recorded as common stock and the remaining net proceeds are required to be presented as additional paid-in capital, which is included in capital surplus. The Code permits Japanese companies, upon approval of the Board of Directors, to issue shares to existing shareholders without consideration by way of a stock split. Such issuance of shares generally does not give rise to changes within the shareholders' accounts.

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

The Code allows Japanese companies to purchase treasury stock and dispose of such treasury stock upon resolution of the Board of Directors. The aggregate purchased amount of treasury stock cannot exceed the amount available for future dividends plus the amount of common stock, additional paid-in capital or legal reserve that could be transferred to retained earnings or other capital surplus other than additional paid-in capital upon approval of such transfer at the annual general meeting of shareholders.

In addition to the provision that requires an appropriation for a legal reserve in connection with the cash outlays, the Code also imposes certain limitations on the amount of capital surplus and retained earnings available for dividends. The amount of capital surplus and retained earnings available for dividends under the Code was ¥52,428 million ($448,103 thousand) as of March 31, 2006, based on the amount recorded in the parent company's general books of account.

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

On May 1, 2006, a new corporate law (the "Corporate Law") became effective, which reformed and replaced the Code with various revisions that would, for the most part, be applicable to events or transactions which occur on or after May 1, 2006 and for the fiscal years ending on or after May 1, 2006. The significant changes in the Corporate Law that affect financial and accounting matters are summarized below;

(a) Dividends

Under the Corporate Law, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the shareholders meeting. For companies that meet certain criteria such as;
(1) having the Board of Directors, (2) having independent auditors, (3) having the Board of Corporate Auditors, and (4) the term of service of the directors is prescribed as one year rather than two years of normal term by its articles of incorporation, the Board of Directors may declare dividends (except for dividends in kind) if the company has prescribed so in its articles of incorporation.

The Corporate Law permits companies to distribute dividends-in-kind (non-cash assets) to shareholders subject to a certain limitation and additional requirements.

Semiannual interim dividends may also be paid once a year upon resolution by the Board of Directors if the articles of incorporation of the company so stipulate. Under the Code, certain limitations were imposed on the amount of capital surplus and retained earnings available for dividends. The Corporate Law also provides certain limitations on the amounts available for dividends or the purchase of treasury stock. The limitation is defined as the amount available for distribution to the shareholders, but the amount of net assets after dividends must be maintained at no less than ¥3 million.

(b) Increases / decreases and transfer of common stock, reserve and surplus

The Corporate Law requires that an amount equal to 10% of dividends must be appropriated as a legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus) depending on the equity account charged upon the payment of such dividends until the total of aggregate amount of legal reserve and additional paid-in capital equals 25% of the common stock. Under the Code, the aggregate amount of additional paid-in capital and legal reserve that exceeds 25% of the common stock may be made available for dividends by resolution of the shareholders. Under the Corporate Law, the total amount of additional paid-in capital and legal reserve may be reversed without limitation of such threshold. The Corporate Law also provides that common stock, legal reserve, additional paid-in capital, other capital surplus and retained earnings can be transferred among the accounts under certain conditions upon resolution of the shareholders.

(c) Treasury stock and treasury stock acquisition rights

The Corporate Law also provides for companies to purchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The amount of treasury stock purchased cannot exceed the amount available for distribution to the shareholders which is determined by specific formula.

Under the Corporate Law, stock acquisition rights, which were previously presented as a liability, are now presented as a separate component of shareholders' equity.

The Corporate Law also provides that companies can purchase both treasury stock acquisition rights and treasury stock. Such treasury stock acquisition rights are presented as a separate component of shareholders' equity or deducted directly from stock acquisition rights.

On December 9, 2005, the Accounting Standards Board of Japan (ASBJ) published a new accounting standard for presentation of shareholders' equity. Under this accounting standard, certain items which were previously presented as liabilities are now presented as components of shareholders' equity. Such items include stock acquisition rights, minority interest, and any deferred gain or loss on derivatives accounted for under hedge accounting. This standard is effective for fiscal years ending on or after May 1, 2006.

8. RESEARCH AND DEVELOPMENT COSTS

Research and development costs for the years ended March 31, 2006 and 2005 were ¥10,071 million ($86,077 thousand) and ¥8,479 million, respectively.

9. LEASES

The Companies lease certain vehicles, computer equipment, office space and other assets.

Total rental expenses for the years ended March 31, 2006 and 2005 were ¥1,065 million ($9,103 thousand) and ¥1,195 million, respectively, including ¥196 million ($1,675 thousand) and ¥201 million of lease payments under finance leases, respectively.

Pro forma information of leased property under finance leases that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2006 and 2005 was as follows:

Machinery and equipment, and tools, furniture and fixtures:

	Millions of yen		Thousands of U.S. dollars
March 31	**2006**	2005	**2006**
Acquisition cost	**¥121**	¥139	**$1,034**
Accumulated depreciation	**106**	101	**906**
Net leased property	**¥ 15**	¥ 38	**$ 128**

Obligations under finance leases:

	Millions of yen		Thousands of U.S. dollars
March 31	**2006**	2005	**2006**
Due within one year	**¥ 9**	¥23	**$ 77**
Due after one year	**6**	15	**51**
Total	**¥15**	¥38	**$128**

Depreciation expense, which is not reflected in the accompanying consolidated statements of income, computed by the straight-line method was ¥23 million ($197 thousand) and ¥24 million for the years ended March 31, 2006 and 2005, respectively.

The minimum rental commitments under non-cancelable operating leases at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
March 31	**2006**	2005	**2006**
Due within one year	**¥11**	¥10	**$ 94**
Due after one year	**4**	13	**34**
Total	**¥15**	¥23	**$128**

10. INCOME TAXES

The Company and its domestic subsidiaries are subject to Japanese national and local income taxes which, in aggregate, resulted in a normal effective statutory tax rate of approximately 41% for the years ended March 31, 2006 and 2005. The overseas subsidiary is subject to income tax of the country in which it operates.

The tax effects of significant temporary differences which resulted in deferred tax assets and liabilities at March 31, 2006 and 2005 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Deferred Tax Assets:			
Retirement benefits	**¥4,086**	¥4,266	**$34,923**
Accrued expenses	**1,107**	1,149	**9,461**
Property, plant and equipment	**119**	139	**1,017**
Other	**1,098**	960	**9,385**
Less valuation allowance	**(154)**		**(1,316)**
Deferred tax assets	**6,256**	6,514	**53,470**
Deferred Tax Liabilities:			
Unrealized gain on available-for-sale securities	**7,052**	3,626	**60,274**
Deferred gains on sales of property	**1,254**	1,263	**10,718**
Other	**235**	100	**2,008**
Deferred tax liabilities	**8,541**	4,989	**73,000**
Net deferred tax (liabilities) assets	**¥(2,285)**	¥1,525	**$(19,530)**

A reconciliation between the normal effective statutory tax rate for the year ended March 31, 2006 and the actual effective tax rates reflected in the accompanying consolidated statements of income is as follows:

	Year ended March 31,
	2006
Normal effective statutory tax rate	**41.0%**
Expenses not deductible for income tax purposes	**11.0**
Income not taxable for income tax purposes	**(0.9)**
Increase in valuation allowance	**4.7**
Tax credits for research and development costs	**(5.8)**
Other – net	**0.7**
Actual effective tax rate	**50.7%**

As the difference between the normal effective statutory tax rate and the actual effective tax rate reflected in the accompanying consolidated statement of income for the year ended March 31, 2005 is not more than 5% of the normal effective statutory tax rate, a reconciliation has not been disclosed.

11. CONTINGENT LIABILITIES

At March 31, 2006, contingent liabilities were ¥679 million ($5,803 thousand) representing loans guaranteed (jointly guaranteed with six unrelated companies). There is an agreement between the seven companies to equally share liability.

In addition to above, ¥7 million ($60 thousand) of export bill receivables were discounted with a financial institution for which the Company is contingently liable at March 31, 2006.

12. DERIVATIVES

The Company has no internal policies which regulate derivative transactions, since the Company's derivative transactions are specific foreign exchange forward contracts. However, it is the Company's basic practice not to use derivatives for trading or speculative purposes. The Company has entered into foreign exchange forward contracts to hedge foreign exchange risk specifically associated with imported merchandise, as requested by customers. Such derivative transactions are entered into to hedge foreign currency exposures incorporated within the Company's business.

Because the counterparties to these derivatives are limited to major financial institutions, the Company does not anticipate any losses arising from credit risk.

Forward exchange contracted amounts which are assigned to associated liabilities and are reflected in the consolidated balance sheets at year-end are not subject to the disclosure of market value information.

13. NET INCOME PER SHARE

Net income per share ("EPS") for the years ended March 31, 2006 and 2005 is as follows:

	Yen in millions	Thousands of shares	Yen	Dollars
	Net income	Weighted average shares	EPS	
For the year ended March 31, 2006:				
Basic EPS				
Net income available to common shareholders	**¥1,558**	**68,193**	**¥22.84**	**$0.20**
For the year ended March 31, 2005:				
Basic EPS				
Net income available to common shareholders	¥5,570	68,583	¥81.22	

Diluted net income per share is not disclosed because there are no dilutive securities outstanding.

14. SUBSEQUENT EVENTS

At the general shareholders' meeting held on June 29, 2006, the Company's shareholders approved the following:

1) Payment of a year-end cash dividend of ¥5.00 ($0.04) per share to holders of record at March 31, 2006 for a total of ¥341 million ($2,915 thousand).
2) Payment of bonuses to directors and corporate auditors of ¥54 million ($462 thousand).

15. SEGMENT INFORMATION

Information about industry segments of the Companies for the years ended March 31, 2006 and 2005 is as follows:

Industry Segments

a. Sales and Operating Income

	Millions of yen				Thousands of U.S. dollars			
	2006				2006			
	Pharmaceuticals	Functional food	Eliminations/ Corporate	Consolidated	Pharmaceuticals	Functional food	Eliminations/ Corporate	Consolidated
Sales to customers	**¥44,406**	**¥9,541**		**¥53,947**	**$379,539**	**$81,547**		**$461,086**
Intersegment sales	**4**		**¥ (4)**		**34**		**$ (34)**	
Total sales	**44,410**	**9,541**	**(4)**	**53,947**	**379,573**	**81,547**	**(34)**	**461,086**
Operating expenses	**41,969**	**9,396**	**(4)**	**51,361**	**358,709**	**80,308**	**(34)**	**438,983**
Operating income	**¥ 2,441**	**¥ 145**	**¥Nil**	**¥ 2,586**	**$ 20,864**	**$ 1,239**	**$ Nil**	**$ 22,103**

b. Assets, Depreciation and Capital Expenditures

	Millions of yen				Thousands of U.S. dollars			
	2006				2006			
	Pharmaceuticals	Functional food	Eliminations/ Corporate	Consolidated	Pharmaceuticals	Functional food	Eliminations/ Corporate	Consolidated
Assets	**¥57,845**	**¥7,162**	**¥39,892**	**¥104,899**	**$494,402**	**$61,214**	**$340,957**	**$896,573**
Depreciation	**2,487**	**161**	**44**	**2,692**	**21,257**	**1,376**	**376**	**23,009**
Capital expenditures	**938**	**246**		**1,184**	**8,017**	**2,103**		**10,120**

a. Sales and Operating Income

	Millions of yen			
	2005			
	Pharmaceuticals	Functional food	Eliminations/ Corporate	Consolidated
Sales to customers	¥45,037	¥9,215		¥54,252
Intersegment sales	4		¥ (4)	
Total sales	45,041	9,215	(4)	54,252
Operating expenses	40,475	9,159	(4)	49,630
Operating income	¥ 4,566	¥ 56	¥ Nil	¥ 4,622

b. Assets, Depreciation and Capital Expenditures

	Millions of yen			
	2005			
	Pharmaceuticals	Functional food	Eliminations/ Corporate	Consolidated
Assets	¥59,587	¥7,103	¥32,220	¥98,910
Depreciation	2,773	201	42	3,016
Capital expenditures	928	84	733	1,745

Independent Auditors' Report

Deloitte.

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To the Board of Directors and Shareholders of
Nippon Shinyaku Co., Ltd.:

We have audited the accompanying consolidated balance sheets of Nippon Shinyaku Co., Ltd. and consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Nippon Shinyaku Co., Ltd. and consolidated subsidiaries as of March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

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

Deloitte Touche Tohmatsu

June 29, 2006

Member of
Deloitte Touche Tohmatsu

Corporate Directory

Founded
October 1919

Date of Incorporation
September 1919

Paid-in Capital
¥5,174 million

Issued and Outstanding Number of Shares
70,251,484

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The Bank of Tokyo-Mitsubishi UFJ, Ltd.
The Kyoto Bank, Limited
Japan Trustee Services Bank, Limited
Societe Generale Bank & Trust
Tokio Marine & Nichido Fire Insurance Co., Ltd.
The Master Trust Bank of Japan, Limited
Mitsubishi Corporation
The Daiichi Mutual Life Insurance Company

(As of March 31, 2006)

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(As of July 2006)

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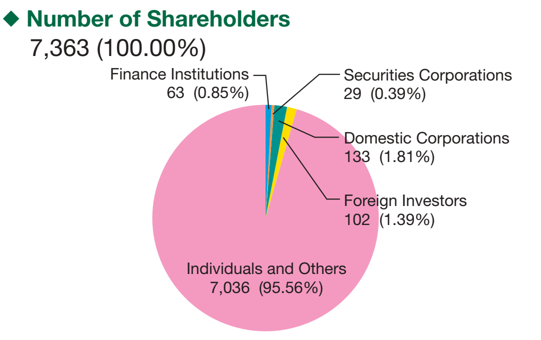
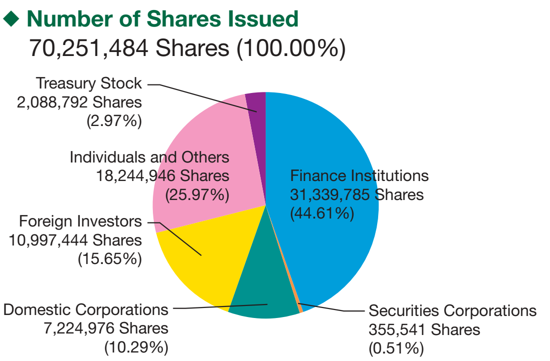
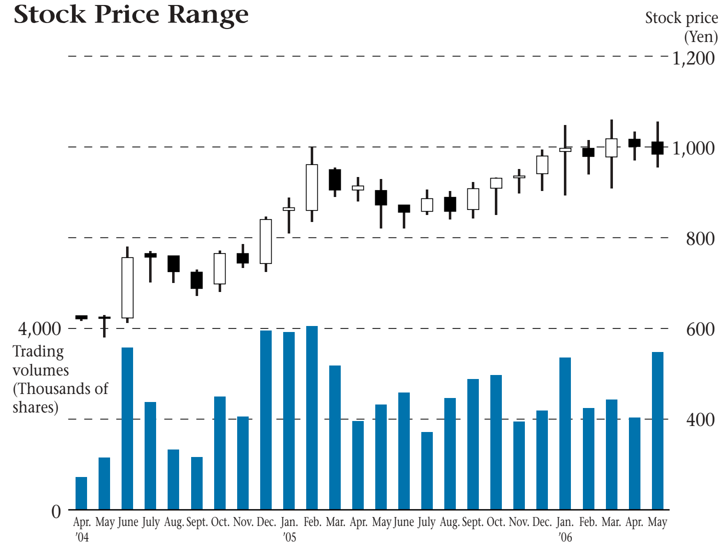
Investor Information

Distribution of Shareholders and Shares





Stock Price Range



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