

## Letter to Stakeholders

Leveraging its **OPEN PLATFORM**, integrated business model, the **ALFRESA GROUP** has gotten off to a solid start amid a wave of realignment in the pharmaceuticals industry.

### *Operating Environment in the Wholesale Pharmaceuticals Industry*

#### Japan's Aging Population and Declining Birthrate

Japan has the longest life expectancy in the world, thanks to its National Health Insurance system and advances in medicine. According to data compiled by the National Institute of Population and Social Security Research, in 2003, the number of people aged 65 or older reached 19% of the total population, and is expected to increase to 26% in 2015. On the other hand, the birthrate is falling, with the average number of live births per woman at approximately 1.29. This means that in the near future Japan's population will decline. In terms of demographics, Japan is on the threshold of becoming an aging society with a falling birthrate, and therefore faces an imbalance between younger and older citizens.

#### Medical System Reforms

According to Ministry of Health, Labour and Welfare statistics, medical costs in Japan amounted to approximately ¥31 trillion in fiscal 2001. It is projected that national healthcare expenditures will continue to increase along with the aging of society. Also, partly because of the increase in corporate bankruptcies due to the nation's prolonged economic slump, the National Health Insurance system is expected to experience a financial crunch. Against the backdrop of these two scenarios, the government is drastically reforming the nation's medical system, including the medical insurance system and the medical service fee system.

#### Industry Realignment in the Wholesale Pharmaceuticals Sector

In this climate, Japan's ¥7 trillion wholesale pharmaceuticals industry, the Group's primary business domain, is projected to achieve moderate growth due to the effects of

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the nation's aging society. However, in Japan's wholesale pharmaceuticals market, the separation of drug dispensing from medical practices and policies aimed at constraining medical expenses are proceeding apace. Set against this background, the wholesale pharmaceuticals industry is facing lower National Health Insurance drug prices, joint purchasing by medical facilities and the emergence of drugstore chains. Due to these factors, the industry has entered an era of intense competition. This situation has triggered a shakeout and realignment in the industry, reducing the number of firms by half over the past several years. Much of the realignment has taken place in the form of M&As among major drug wholesalers. As a result, the market is starting to be dominated by a small number of firms. Currently, five major groups account for about 80% of the drug wholesale market in Japan, and we think this trend will strengthen going forward.

### [Market Remains Attractive for Surviving Firms](#)

Although reforms to the nation's medical system have prompted measures to reduce medical expenses, we think the wholesale drug market will continue to demonstrate stable growth, supported by the increasing population of senior citizens, rising incidences of lifestyle diseases, and the development of novel genomic drugs.

In short, although structural reforms are causing a shakeout, the market remains attractive for the surviving firms. When there were 300 to 400 drug wholesalers, customers did business with several firms. With realignment, however, customers have begun to narrow down their suppliers to two or three wholesalers, and this is translating into greater business efficiency. Also, the surviving wholesalers have grown larger as a result of industry realignment, giving them more buying power in respect to suppliers (i.e., drug manufacturers), and this is benefiting wholesaler earnings.

### *Alfresa Group Established*

#### Alfresa Group Created, Businesses Integrated

Faced with this business climate, in September 2003, AZWELL Inc. and Fukujin Co., Ltd., who had common business objectives, established Alfresa Holdings Corporation as a joint holding company through a transfer of shares, and consolidated their businesses to respond promptly to the changing circumstances, to enhance their corporate value, and further expand their scope of business. Subsequently, in April 2004, DAIWA Pharmaceutical Wholesalers Co., Ltd. (based in Matsuyama, Ehime Prefecture) and Odashima Limited (based in Hanamaki, Iwate Prefecture) were brought into the Alfresa Group, followed by Taishodo Co., Ltd. (based in Kumagaya, Saitama Prefecture), in July of the same year. With the integration of these businesses, the Alfresa Group expects consolidated sales to exceed ¥1.2 trillion yen in the fiscal year ending March 31, 2005. In the United States, where the drug wholesale system is more advanced, three major firms account for 90% of the market, clearly indicating that the focus for the survivors of realignment in Japan has to be an expansion in scale. We will continue to press ahead with integration, a trend that is reshaping the entire drug wholesaling industry, while fully exercising the economies of scale created by the merger and leveraging group resources efficiently and effectively.

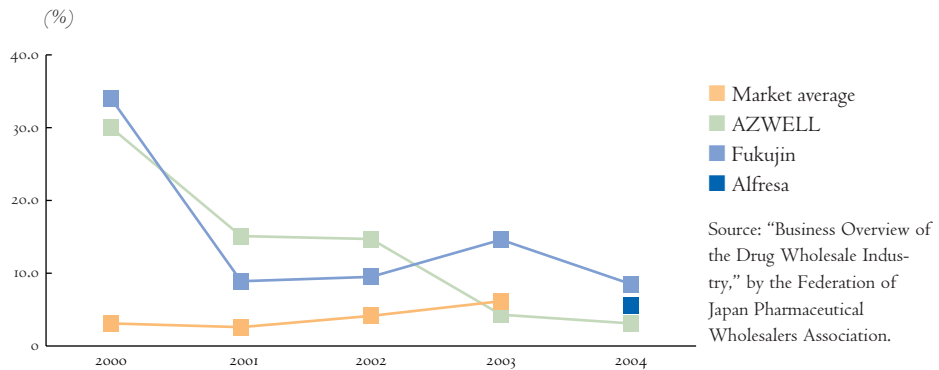
#### Aiming to be the No. 1 Drug Wholesaler in Japan

One of our goals is to be the No. 1 drug wholesaler in Japan. Toward this end, we are aggressively pursuing an M&A strategy with the objective of achieving our consolidated sales target of ¥2 trillion by the fiscal year ending March 31, 2008. In addition to business expansion, our vision for drug wholesaling involves the construction of a solid supply chain and stepping out of our current role as a sales agent for drug manufacturers and positioning ourselves as a procurement representative for customers. In doing so, we aim to build a value chain that adds value to downstream information and offers superior prescription solutions to patients.

Average Sales Growth for the Drug Wholesale Market and Alfresa Group

(Fiscal years ended March 31)

- AZWELL merged with three companies in 2000.
- Fukujin began reporting consolidated results in 2000.
- The market average for 2004 has yet to be announced as of the printing of this report.



Advantages of an Open Platform

Amid difficult industry conditions, we feel that our own resources alone are insufficient to achieve nationwide expansion and gain the No. 1 position in the domestic drug wholesaling industry. As such, our approach is to integrate under a holding company rather than relying on conventional M&As. We employ an industry-first open platform integration model centered on a holding company system that makes it easy for other drug wholesalers to join the Alfresa Group. This group structure will help us to assemble a network of firms with similar ambitions while allowing them to maximize their unique capabilities and individual strengths, and to evolve into an attractive corporate group for pharmaceuticals manufacturers and customers. We view this approach as the key to realizing our "Healthcare Consortium" scheme. In simple terms, this concept involves aligning with other firms to provide what customers need when existing Group resources are insufficient, with the ultimate objective of creating value for patients.

Performance Review for the Fiscal Year Ended March 31, 2004

Growth Exceeds Industry Average

Alfresa Holdings Corporation's consolidated results for the fiscal year ended March 31, 2004 comprise the results of the Company from its establishment date to the end of the term under review, plus the consolidated results of AZWELL Inc. and Fukujin Co., Ltd. During the fiscal year under review, AZWELL and Fukujin achieved sales growth of 3.2% and 8.7% in pharmaceuticals, respectively, relative to average market growth of 1.3% (Source: CRECON RESEARCH & CONSULTING INC.). AZWELL made greater use of knowledge management in its wholesale business and strengthened its marketing capabilities by upgrading its customer support and proposal functions, including Internet-based customer assistance ideas and promotions. In the manufacturing business, AZWELL focused on products transferred from other companies while

bolstering its marketing capabilities by increasing its number of medical representatives (MRs). Fukujin utilized its full lineup of products and logistics system, which enables periodic, high-frequency deliveries by specialists, to achieve strong results, especially in the pharmacy market. Fukujin also expanded its customer base through proactive marketing activities and stepped up sales of new products. In addition, Fukujin sought to generate profits through tighter price management while boosting operational efficiency through the use of contract workers and part-time employees and other measures. As a result, Alfresa Holdings Corporation recorded consolidated net sales of ¥1,066,578 million, operating income of ¥12,403 million, and net income of ¥6,490 million.

#### Medium-term Business Plan: Basic Strategies

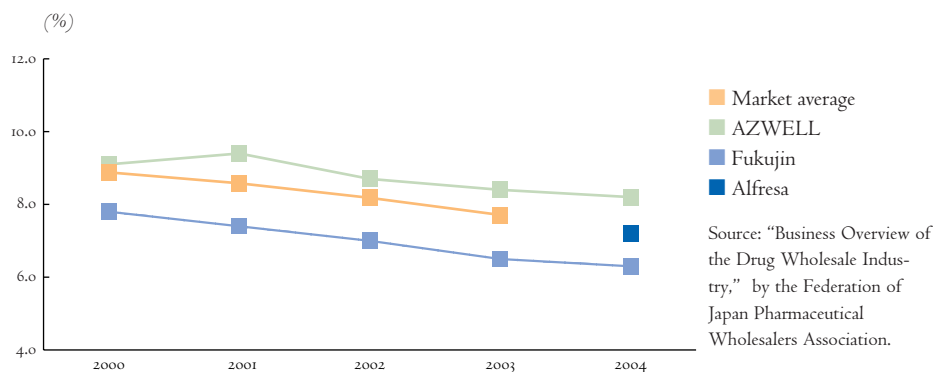
The Alfresa Group has formulated a medium-term business plan that runs from October 1, 2003 to March 31, 2006. The objectives of the plan are to make the Alfresa Group a leading pharmaceuticals wholesaler in Japan, realize a net income margin of 1.1% and ROE of 9.7%, and increase sales and production efficiency. The basic strategies of the plan are to expand the Alfresa network, pursue synergies, achieve greater selectivity and concentration in the business portfolio, and promote low-cost management.

**NETWORK EXPANSION**—Not only will we work to strengthen our bases in the Tokyo metropolitan area, and the Tokai and Kinki regions, we will take steps to extend our marketing reach nationwide by pursuing an open platform-oriented M&A strategy, all with the objective of achieving our sales target of ¥2 trillion. As part of this strategy, we intend to expand our relationships with many domestic and overseas firms, primarily drug manufacturers, and construct a “Healthcare Consortium” while enlarging our business.

### Average SG&A Ratio for the Drug Wholesale Market and Alfresa Group

(Fiscal years ended March 31)

· The market average for 2004 has yet to be announced as of the printing of this report.



**PURSUIT OF SYNERGIES**—This will entail cost reductions through joint purchasing. However, this fundamental policy also encompasses efforts to assess customer needs from a nationwide perspective. By consolidating our various product lines, information and services, we aim to leverage our full capabilities while quickly and accurately addressing customer needs. Regarding our manufacturing business, one key advantage is that AZWELL's products can be marketed using Alfresa's ¥1 trillion wholesaling channels. We also intend to make our distribution and marketing systems more efficient while strengthening alliances with our wholesale partners.

**GREATER SELECTIVITY AND CONCENTRATION**—Our goal here is to gain the ability to respond more flexibly to changes in the operating environment and to deploy corporate resources more effectively and efficiently, thereby maximizing corporate value and satisfying the expectations of society and our stakeholders. We will strengthen our core wholesale pharmaceuticals business and upgrade our drug manufacturing capabilities, with the objective of growing our business through more effective allocation of corporate resources to R&D.

**PROMOTION OF LOW-COST MANAGEMENT**—We intend to consolidate or close AZWELL and Fukujin branches and offices in overlapping areas and more effectively utilize distribution centers, with the aim of reducing costs and increasing productivity. While reducing their number, staff members made redundant as a result will be reassigned to regions and business domains we are focusing on, so as to make strategic and effective use of the workforce and reinforce individual business domains. We had planned to integrate our information systems to gain additional efficiencies in conjunction with the integration of operations scheduled for October 2004. However, we have decided to postpone this process to ensure that all systems operate smoothly following integration.

In the lead-up to the integration of operations scheduled for October 2004, we will work to sustain high ratings from our customers and maintain the trust of our shareholders by continuing to pursue our customer-oriented business model and providing solutions focused on frontline operations. We also look forward to working and growing with participants in the Alfresa Group. Our hope is for all participants to share the rewards of developing the Alfresa Group, while aligning the interests of all participants in a common direction in order to mold a unified corporate culture. We also invite other like-minded drug wholesalers throughout Japan to join the Alfresa Group. We aspire to be a group that creates new value and earns the trust of society by contributing, mainly through the medical field, to the health of many people. We are confident that our best years still lie ahead.

August 2004



Kunio Fukujin

*Chairman and CEO*



Futoshi Yokoi

*President*