

Management's Discussion and Analysis

The Alfresa Group mainly consists of 2 wholly owned subsidiaries, Alfresa Corporation and Alfresa Pharma Corporation, as well as 10 consolidated subsidiaries, 35 non-consolidated affiliates not accounted for by the equity method and 4 affiliates not accounted for by the equity method. The Group's main businesses are the wholesale, manufacture and sales of pharmaceuticals, diagnostic reagents, and medical devices and equipment. Alfresa Holdings Corporation was established on September 29, 2003 as a holding company through the transfer of stock of AZWELL Inc. and Fukujin Co., Ltd., which became wholly owned subsidiaries. The fundamental role of Alfresa Holdings is to formulate a management vision for the entire Group and lay out business plans based on this vision, while promoting sustainable growth in corporate value through the effective use of the Group's resources.

BUSINESS ENVIRONMENT

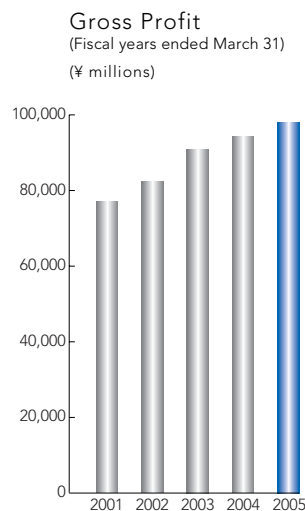
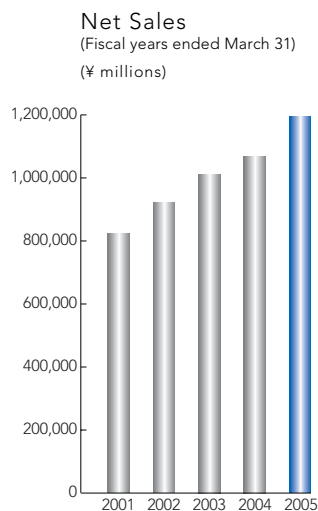
In the pharmaceuticals industry, despite a reduction of 4.2% in drug price standards through an NHI drug price revision in April 2004, the market grew around 2% owing to an outbreak of influenza in the winter, high airborne pollen counts, and other factors. On the other hand, the industry faced a difficult earnings environment due to moves toward joint purchasing at hospitals, tough pricing demands by dispensing pharmacy chains, as well as intensified competition between drug wholesalers and other factors.

MAIN INITIATIVES IN THE FISCAL YEAR ENDED MARCH 31, 2005

The Alfresa Group has been carrying out business activities in line with its basic strategies of "network expansion", "pursuit of synergies", "greater selectivity and concentration", and "promotion of low-cost management." In July 2004, Taishodo Co., Ltd. became a wholly owned subsidiary of Alfresa Holdings through a stock exchange. Furthermore, in October 2004, Alfresa Holdings used the corporate separation method to reorganize the operations of wholly owned subsidiaries AZWELL, Fukujin and Taishodo into Alfresa Corporation, which conducts the Wholesaling business, and Alfresa Pharma Corporation, which conducts the Manufacturing business. Thereafter, the Alfresa Group has worked to unify its marketing systems in order to bolster sales capabilities, while taking steps to optimize its organization by integrating and closing offices in overlapping regions.

Aiming to become No. 1 in the wholesale pharmaceuticals industry, the Alfresa Group has also been taking proactive steps to expand its marketing network. In April 2004, Alfresa Corporation converted DAIWA Pharmaceutical Wholesalers Co., Ltd. and Odashima Limited into consolidated subsidiaries, followed in February 2005 by NIKKEN SANGYO CO., LTD. Furthermore, the Alfresa Group formed business alliances with SEIWA SANGYO CO., LTD. in September 2004 and Meisho Co., Ltd. in October 2004. In January 2005, Alfresa Holdings concluded stock exchange agreements with OKAUCHI KANKODO, Ltd., Kowa Yakuhin Co., Ltd. and DAIWA Pharmaceutical Wholesalers Co., Ltd. on making these companies wholly owned subsidiaries.

Aiming to expand and reinforce business domains, in December 2004, Alfresa Holdings and PIP-Tokyo Co., Ltd. established Alfresa Pip-Tokyo Corporation, a joint venture to conduct the SPD business and wholesaling of medical materials. The SPD business supports medical institutions' efforts to increase efficiency by offering integrated in-hospital product management services ranging from the procurement to logistics and consumption of supplies.



* Figures for 2001 to 2003 represent the sum of results for AZWELL and Fukujin.

RESULTS OF OPERATIONS

Net Sales

For the fiscal year ended March 31, 2005, consolidated net sales were ¥1,195,314 million, an increase of ¥128,736 million, or 12.1% year on year.

By operating segment, net sales in the Wholesaling business steadily climbed ¥128,957 million, or 12.3%, to ¥1,178,491 million, including intersegment sales of ¥1 million. This was mainly the result of measures to expand sales, such as joint sales promotion activities carried out since before the reorganization of operations so that integration benefits could be reaped as early as possible. Also contributing to sales growth were appropriate actions targeting rising demand triggered by an influenza outbreak and high airborne pollen counts.

Meanwhile, net sales in the Manufacturing business were ¥20,881 million, an increase of ¥130 million, or 0.6%, year on year, including intersegment sales of ¥4,468 million. The main contributing factors were higher sales of Nipolazin, an antihistamine, due to an unusually severe pollen season; 5 drugs for which marketing rights were transferred from other companies in the fiscal year ended March 31, 2004; and Check Ad, a diagnostic reagent for measuring adenoviruses. Efforts to expand marketing channels through Alfresa Group's wholesaling network also contributed to net sales in this segment.

In the Other segment, which comprises transportation services and other businesses, net sales rose ¥108 million, or 3.1%, to ¥3,562 million, including intersegment sales of ¥3,151 million.

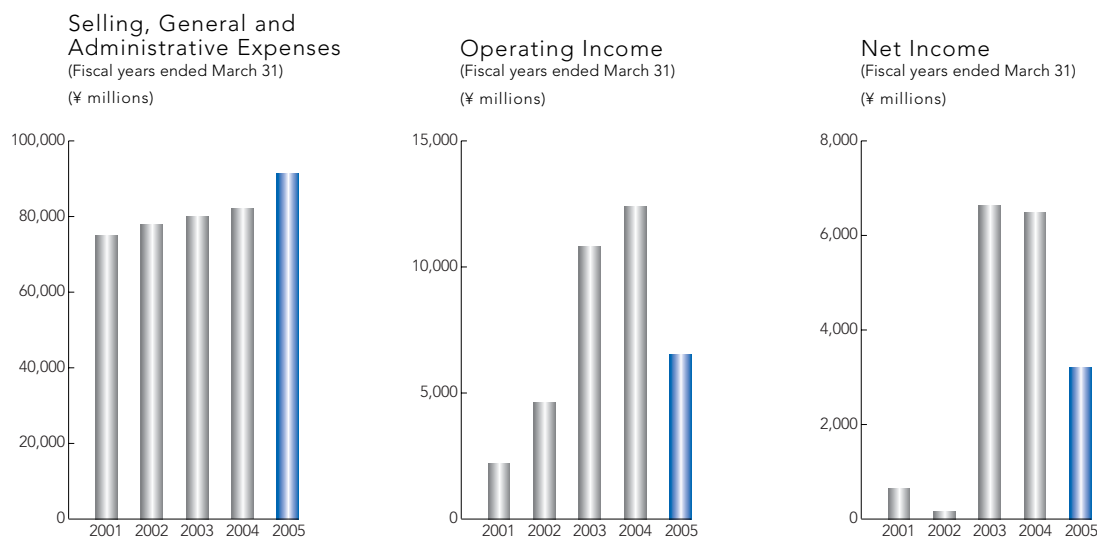
Cost of Sales and Gross Profit (Gross Profit Margin)

Cost of sales increased ¥125,222 million, or 12.9%, to ¥1,097,365 million, tracking higher net sales due to the addition of new consolidated subsidiaries. Gross profit climbed ¥3,513 million, or 3.7%, to ¥97,949 million, also reflecting the larger scope of consolidation. The gross profit margin decreased from 8.9% in the previous fiscal year to 8.2%, primarily due to tougher negotiations on prices with customers and intensified competition with drug wholesalers in the wholesaling business.

Selling, General and Administrative (SG&A) Expenses

SG&A expenses climbed ¥9,383 million, or 11.4%, to ¥91,415 million mainly due to newly consolidated subsidiaries. As for measures to reduce SG&A expenses, Alfresa Corporation, the core company of the Group, formed the Low Cost Operation Promotion Committee in October 2004 to carry out two projects. The first project, the Operating Expenses Improvement Project, aims to lower operating expenses by examining ways to reduce vehicle, delivery and other costs, and sell idle assets. The second project, the Workforce Optimization Project, is targeting a reduction of approximately ¥2.0 billion in personnel expenses in the fiscal year ending March 31, 2006. This will be accomplished through a total reduction of 312 full-time employees, including 265 applicants for an early retirement program instituted in December 2004 and 47 employees through attrition. The goal of these projects is to achieve an SG&A expense ratio on the order of 6% on a non-consolidated basis as soon as possible.

The promotion of low-cost operations is positioned as a key management issue for the Alfresa Group as a whole, and will continue to be pursued hereafter. As an example of these initiatives, the Alfresa Group expects the reduction of personnel expenses through a review of employment formats to yield cost savings of approximately ¥4.7 billion by the fiscal year ending March 31, 2008.



Operating Income (Operating Income Margin)

Operating income decreased ¥5,869 million, or 47.3% to ¥6,534 million, due to the impact of lower selling prices in the mainstay Wholesaling business. The operating margin was 0.5%.

Operating income in the Wholesaling business was ¥5,760 million, down ¥5,622 million, or 49.4% from the previous fiscal year. This represented an operating income margin of 0.5%.

Meanwhile, operating income in the Manufacturing business decreased ¥406 million, or 46.9%, to ¥460 million, representing an operating income margin of 2.2%.

Other Income (Expenses) and Net Income

Due to a voluntary early retirement program implemented by Alfresa Corporation in December 2004, the Alfresa Group booked an extraordinary loss of ¥2,962 million on additional retirement benefits. This and other factors led to a decrease of 50.6% in net income to ¥3,208 million.

Total Assets

As of March 31, 2005, total assets were ¥609,352 million, an increase of ¥96,164 million, or 18.7%, from a year earlier. This mainly reflected an increase in consolidated subsidiaries.

Current Assets

Total current assets climbed ¥77,729 million, or 18.2% from a year ago, to ¥505,006 million. This was mainly attributable to increases in trade notes and accounts receivable of ¥48,183 million, and in inventories of ¥16,859 million in line with the increase in sales, which was partly negated by a decline of ¥11,354 million in marketable securities due to a decrease in bonds and other invested assets.

Fixed Assets

Total fixed assets rose ¥18,435 million, or 21.5%, from a year earlier to ¥104,346 million. The main components of the increase in tangible fixed assets were increases of ¥4,307 million in land and ¥1,081 million in construction in progress due to a down payment for the purchase of land for a new distribution center. Intangible fixed assets increased ¥1,835 million from a year ago, mainly due to system development expenses.

Investments and other assets were ¥44,753 million, up ¥7,970 million, or 21.7%, from a year earlier, chiefly due to an increase of ¥3,122 million in investments in securities.

Liabilities

As of March 31, 2005, total liabilities were ¥493,606 million, an increase of ¥92,359 million, or 23.0%, from a year earlier. Total current liabilities were ¥469,201 million, an increase of ¥87,122 million, or 22.8%, from a year ago. The main reason was an increase of ¥84,380 million in trade notes and accounts payable in line with higher net sales. Total long-term liabilities rose ¥5,237 million, or 27.3%, to ¥24,405 million, chiefly the result of an increase of ¥2,004 million in employees' severance and retirement benefits.

Shareholders' Equity

Total shareholders' equity rose ¥2,667 million, or 2.5%, to ¥111,076 million. The main contributing factors were increases of ¥2,733 million in the capital surplus and ¥1,228 million in retained earnings, which were partly offset by a decrease of ¥2,467 million attributable to the purchase of treasury stock. The shareholders' equity ratio was 18.2% and ROE was 2.9%.

Cash Flows

Net cash provided by operating activities was ¥10,170 million. The main cash inflows were income before income taxes of ¥5,571 million, and an increase in trade notes and accounts payable of ¥36,003 million. These were partly offset by increases in trade notes and accounts receivable, inventories, and other receivables of ¥13,035 million, ¥8,877 million, and ¥8,161 million, respectively.

Net cash used in investing activities was ¥4,039 million. The main cash outflows were payments of ¥2,227 million for the purchase of property, plant and equipment, chiefly for a down payment for the purchase of land for a new distribution center, and ¥2,194 million for the purchase of intangible assets, mainly representing system development expenses.

Net cash used in financing activities was ¥7,567 million, primarily due to repayments of debt of ¥3,095 million, payments of ¥2,097 million for the purchase of treasury stock, and cash dividends paid of ¥2,547 million.

As a result, cash and cash equivalents as of March 31, 2005 were ¥57,380 million, ¥521 million less than a year ago.

Capital Expenditures

Capital expenditures for the Alfresa Group totaled ¥4,956 million. The main components were system development expenses and a down payment for the acquisition of the site for a new distribution center at Alfresa Corporation.

Research and Development (R&D)

R&D expenses for the Alfresa Group were ¥1,354 million. On March 31, 2005, Alfresa Pharma Corporation, which is responsible for the Group's manufacturing business for pharmaceuticals and other products, filed an application for manufacturing approval of CN-801, a therapeutic agent for narcolepsy, a form of chronic sleep disorder, with the Ministry of Health, Labour and Welfare. The goal is to obtain approval of this application as early as possible. R&D activities will also be focused on expanding possible indications of CN-801 for obstructive sleep apnea syndrome and attention deficit hyperactivity disorder (ADHD).

(1) Business Environment

Japan's ethical pharmaceuticals market, where the Alfresa Group mainly conducts business, is significantly influenced by Japan's National Health Insurance system and medical policies. The Group's results may be thus directly affected by official actions such as NHI drug price revisions. Furthermore, in the event that drastic reforms are made to Japan's medical system, there could be a material effect on the Group's results.

Presently, Japan's national medical expenditures are rising due to an aging population and increasing incidences of lifestyle-related diseases. However, because of declining funding sources for payments made by the medical insurance system, medical system reforms aimed at reducing expenditures are being implemented. These reforms include the introduction of comprehensive payments of medical service fees, as well as reviews of co-payment percentages and NHI drug price scheme. Furthermore, the separation of drug dispensing from medical practice has been changing the mix of customers to whom the Group sells products, replacing clinics and hospitals with a growing percentage of dispensing pharmacies. Moreover, the possible decline in selling prices in step with the transformation of national hospitals into independent administrative institutions and changing purchasing methods used by medical institutions are also our concern. These trends could affect the Group's results. The Group will be responding to these trends by molding its chain of operations ranging from procurement to the collection of trade receivables into a form that better fits present circumstances.

(2) NHI Drug Price Revisions

Official prices of ethical pharmaceuticals, the Group's core products, are set by the Japanese government by notification of the Minister of Health, Labour and Welfare.

These official prices set by the Japanese government thus represent "NHI drug prices." Functioning effectively as an upper limit on selling prices, these drug prices are revised down roughly once every two years to reflect actual prices determined in the marketplace and trends in demand. Therefore, NHI drug price revisions could have an effect on the Group's results.

(3) Changes in Laws and Other Regulations

The Group's main business is the wholesale, manufacture, and sales of ethical pharmaceuticals. In accordance with Japan's Pharmaceutical Affairs Law and other regulations, the Group is required to register licenses and permits and obtain relevant designations as well as various other approvals and permits concerning the development, manufacturing and import of ethical pharmaceuticals.

(4) Credit Management

The Group's primary customers are medical institutions and dispensing pharmacies. Medical system reforms, such as those aimed at reducing medical expenditures, could affect the businesses of these customers. Therefore, the Group's results could be affected by unforeseeable circumstances that hamper the collection of trade receivables. Moving forward, the Group's policy is to further reinforce credit management mainly by promoting the exchange of formal sales contracts with customers, as well as requiring that the Credit Management Department and relevant personnel in charge fully perform credit administration.

(5) Risks Associated With the Manufacturing Business

The Manufacturing business, a core business of the Group, is exposed to the risk of product recalls, the cancellation of sales and other consequences of unforeseen side effects of its products, the contamination of product contents, and other risks. These risks could be accompanied by lawsuits brought against the Group. In the event that these risks materialize, there could be a material effect on the Group's results. The Group allocates significant resources to processes ranging from product development to sales to make every effort to ensure the safety and reliability of its products.

(6) System Integration

The Group is presently integrating its systems with the aim of making its operations more efficient. If systems fail to function normally when integrated, there could be a disruption in business operations, primarily involving sales activities such as order entry and the shipment of products. This could have an impact on the Group's results. Presently, the Group is taking every precaution to ensure that the new backbone information system gets up and running smoothly as part of preparations for its scheduled launch in May 2007.

(7) Overseas Transactions

Part of the production network of the Group's manufacturing business is in China, while export and import-based product transactions can be affected by political tensions and sharp exchange rate movements. These factors could have an impact on the Group's results.

The Company has positioned the distribution of profits to shareholders as a key management policy. The Company determines the amount of profits distributed to shareholders based on consolidated financial results, while taking into consideration the need to strengthen its operating structure and drive future business expansion. In doing so, the Company targets an annual dividend on equity of at least 2%.

FUNDAMENTAL POLICY ON THE DISTRIBUTION OF PROFITS

REMUNERATION

Remuneration for directors and corporate auditors

Remuneration for directors	¥112 million
Remuneration for auditors	¥ 31 million
Total	¥143 million

Remuneration for independent auditors

Remuneration related to audit certification	¥ 12 million
Other fees	¥ 12 million
Total	¥ 24 million

OUTLOOK FOR THE FISCAL YEAR ENDING MARCH 31, 2006

In the fiscal year ending March 31, 2006, the Alfresa Group expects to continue to face a difficult business environment. The pharmaceuticals market is likely to remain challenging due to ongoing measures to reduce medical expenditures, the rise in joint purchasing at national hospitals, and other factors.

In this environment, the Wholesaling business will work to ensure that it sells products at optimal prices, while arresting the decline in its gross profit margin and paring back SG&A expenses to secure earnings. With respect to the expansion of marketing areas, OKAUCHI KANKODO and Kowa Yakuhin were brought into the Alfresa Group in April 2005, with plans calling for the consolidation of SEIWA SANGYO in October 2005.

Furthermore, the Manufacturing business will work to expand sales of products transferred from other companies, while continuing to take actions to broaden sales channels by strengthening partnerships with Group wholesaling companies.

Established in December 2004, Alfresa Pip-Tokyo commenced operations on a full scale in April 2005.

In the fiscal year ending March 31, 2006, the Company forecasts consolidated net sales of ¥1,340,000 million, up 12.1% from the previous fiscal year, operating income of ¥10,660 million, up 63.1%, and net income of ¥7,500 million, up 133.8%.