

Financial Section

Management's Discussion and Analysis

BUSINESS OVERVIEW

The Alfresa Group mainly consists of Alfresa Corporation and Alfresa Pharma Corporation, as well as 11 consolidated subsidiaries, 41 non-consolidated affiliates not accounted for by the equity method, and 5 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. 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 ethical pharmaceuticals industry, the market grew around 4.5% due to factors such as expansion of the market for medications for lifestyle-related diseases, including cardiovascular pharmaceuticals. Meanwhile, on the profit side, the Alfresa Group worked to sell at appropriate prices while constructing a marketing system capable of accurately responding to diversifying customer needs, including moves toward joint and volume purchasing by the National Hospital Organization, and progress on the separation of drug dispensing from medical practice.

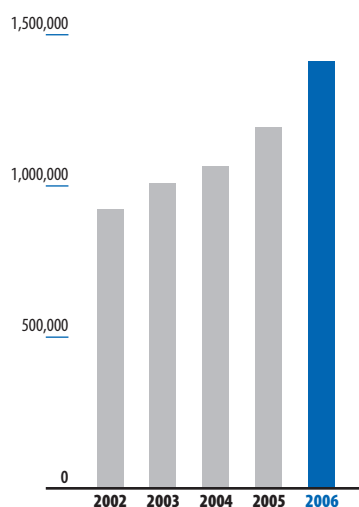
MAIN INITIATIVES IN THE FISCAL YEAR ENDED MARCH 31, 2006

The Alfresa Group is targeting a net income margin of 1% and ROE of 10% based on its fundamental goal of achieving Group-wide net sales of ¥2 trillion in the final year of its current medium-term management plan, which will end March 31, 2008. Additionally, the Group undertook business activities directed at key issues: "strengthen the corporate governance structure," "promote CSR," and "construct a new backbone information system."

As part of efforts to expand its sales network, in April 2005, the Alfresa Group carried out stock exchanges with OKAUCHI KANKODO, Ltd. (Kagawa Prefecture), Kowa Yakuhin Co., Ltd. (Tokushima Prefecture), and DAIWA Pharmaceutical Wholesalers Co., Ltd. (Ehime Prefecture), making them wholly owned subsidiaries. These three companies merged to form Shikoku Alfresa Corporation. Additionally, the Group carried out a stock exchange with SEIWA SANGYO CO., LTD. (Hiroshima Prefecture) in October 2005, and Meisho Co., Ltd. (Ishikawa Prefecture) in April 2006, making them both wholly owned subsidiaries. Furthermore, Alfresa Holdings and Alfresa Corporation concluded a business alliance with CS YAKUHIN CO., LTD. (Aichi Prefecture). Regarding business domain expansion, in April 2005, Alfresa Pip-Tokyo Corporation started operations, engaging in the Supply, Processing & Distribution (SPD) business (in-hospital product management services).

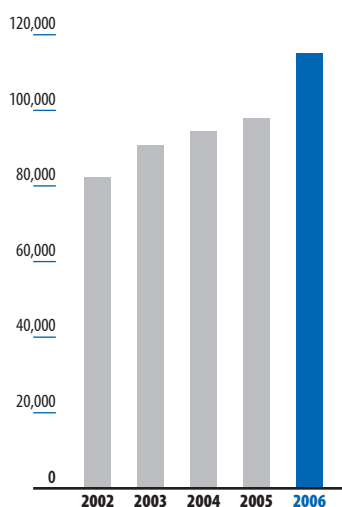
Net Sales

(Fiscal years ended March 31)
(¥ millions)



Gross Profit

(Fiscal years ended March 31)
(¥ millions)



* Figures for 2002 and 2003 represent the sum of results for AZWELL and Fukujin.

RESULTS OF OPERATIONS

Net Sales

For the fiscal year ended March 31, 2006, consolidated net sales were ¥1,411,639 million, an increase of ¥216,325 million, or 18.1%, year on year.

In the Wholesaling business, we configured our sales system so that various Group companies can accurately respond to customer needs in each region, while striving to capture synergies across the Group through such means as joint purchasing. Efforts were also made to construct a logistics system matched to customer needs by increasing the number of areas staffed by delivery professionals. This was aimed at responding to the higher delivery frequencies associated with progress on the nationwide separation of drug dispensing from medical practice. The number of consolidated subsidiaries was also increased and measures such as joint Group-wide sales promotion activities were implemented. As a result, net sales in the Wholesaling business steadily climbed ¥216,478 million, or 18.4%, to ¥1,394,969 million, including intersegment sales of ¥4 million.

In the Manufacturing business, the Group launched CHECK Flu A-B, a point-of-care-testing (POCT) reagent to detect influenza virus antigens, in November 2005. The Group also took over the manufacturing and marketing rights for the antidepressant agent Anafranil in January 2006. As a result, net sales in the Manufacturing business climbed ¥1,143 million, or 5.5%, to ¥22,024 million, including intersegment sales of ¥5,848 million.

In the Other segment, which comprises transportation services and other businesses, net sales fell ¥396 million, or 11.1%, to ¥3,166 million, including intersegment sales of ¥2,668 million.

Cost of Sales and Gross Profit (Gross Profit Margin)

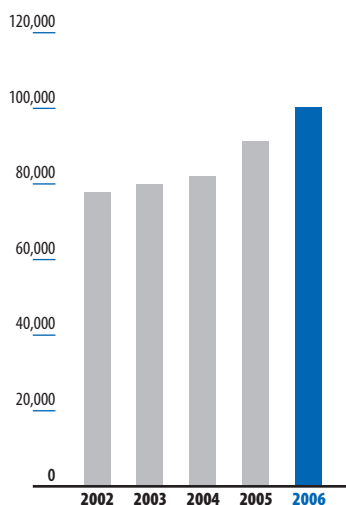
Cost of sales increased ¥199,027 million, or 18.1%, to ¥1,296,392 million, tracking higher net sales due to the addition of new consolidated subsidiaries. Gross profit climbed ¥17,298 million, or 17.7%, to ¥115,247 million, also reflecting the larger scope of consolidation. The gross profit margin remained unchanged from the previous fiscal year at 8.2%, reflecting efforts to sell at adequate prices.

Selling, General and Administrative (SG&A) Expenses

SG&A expenses climbed ¥8,985 million, or 9.8%, to ¥100,400 million, mainly due to newly consolidated subsidiaries. However, due to ongoing efforts to reduce costs, the SG&A expenses ratio improved 0.5 of a percentage point from the previous fiscal year, to 7.1%.

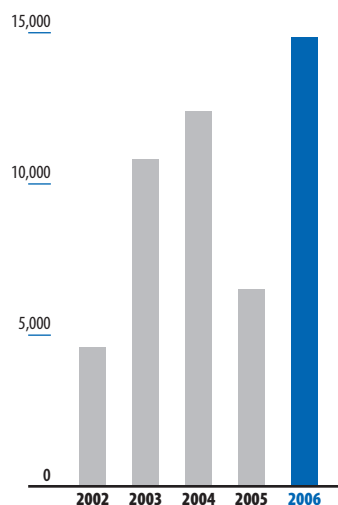
Selling, General and Administrative Expenses

(Fiscal years ended March 31)
(¥ millions)



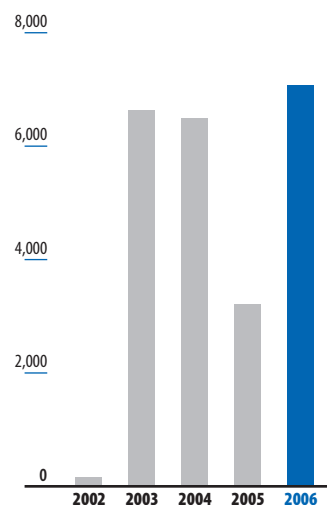
Operating Income

(Fiscal years ended March 31)
(¥ millions)



Net Income

(Fiscal years ended March 31)
(¥ millions)



Operating Income (Operating Income Margin)

Operating income jumped ¥8,313 million, or 127.2%, to ¥14,847 million, representing an operating income margin of 1.1%. This mainly reflected efforts in the core Wholesaling business to further reduce costs, and develop a sales system that emphasizes profitability by ensuring sales at adequate prices through such means as strictly enforcing compliance with the authorized price limit. Operating income in the Wholesaling business rose ¥7,906 million, or 137.3%, to ¥13,666 million. The operating income margin was 1.0%. Operating income in the Manufacturing business decreased ¥55 million, or 12.0%, to ¥405 million. The operating income margin was 1.8%.

Other Income (Expenses) and Net Income

Due to the withdrawal from and sale of unprofitable operations, the Group recorded an extraordinary loss of ¥2,238 million on the loss on transfer of business. However, net income rose 120.5%, to ¥7,074 million.

FINANCIAL CONDITION

Total Assets

As of March 31, 2006, total assets were ¥687,774 million, an increase of ¥78,422 million, or 12.9%, from a year earlier. This mainly reflected an increase in consolidated subsidiaries.

Current Assets

Total current assets climbed ¥59,391 million, or 11.8% from a year ago, to ¥564,397 million. This was mainly attributable to increases in trade notes and accounts receivable of ¥42,541 million, in line with the increase in sales, and a ¥10,056 million increase in cash and cash equivalents.

Fixed Assets

Total fixed assets rose ¥19,031 million, or 18.2%, from a year earlier to ¥123,377 million. The main component of the increase in tangible fixed assets was an increase of ¥4,700 million in land acquired for a new pharmaceuticals center. In intangible fixed assets, the Alfresa Group booked goodwill of ¥2,310 million.

In investments and other assets, investments in securities rose ¥8,876 million, mainly due to increases in unrealized gains on listed shares held by the Group.

Liabilities

As of March 31, 2006, total liabilities were ¥551,710 million, an increase of ¥58,104 million, or 11.8%, from a year earlier. Total current liabilities were ¥524,948 million, an increase of ¥55,747 million, or 11.9%, from a year ago. The main reason was an increase of ¥50,614 million in trade notes and accounts payable due to an increase in products purchased from pharmaceutical manufacturers in line with higher sales. Total long-term liabilities rose ¥2,357 million, or 9.7%, to ¥26,762 million, chiefly the result of an increase of ¥1,613 million in employees' severance and retirement benefits.

Shareholders' Equity

Total shareholders' equity rose ¥20,408 million, or 18.4%, to ¥131,484 million. The main contributing factors were increases of ¥18,314 million in the capital surplus and ¥5,007 million in retained earnings, which were partly offset by a decrease of ¥4,591 million attributable to the purchase of treasury stock. The shareholders' equity ratio was 19.1% and ROE was 5.8%.

Cash Flows

Net cash provided by operating activities was ¥24,665 million. The main cash inflow was income before income taxes of ¥16,495 million. This was partly offset by a ¥12,898 million increase in trade notes and accounts receivable and a ¥2,857 million increase in other receivables.

Net cash used in investing activities was ¥9,992 million. The main cash outflows were payments of ¥5,284 million for acquisition of long-term prepaid expense and ¥3,628 million for the purchase of property, plant and equipment.

Net cash used in financing activities was ¥8,555 million. This was primarily due to payments of ¥3,532 million for the purchase of treasury stock, a net decrease of ¥2,844 million in short-term debt, and cash dividends paid of ¥2,053 million.

Cash and cash equivalents as of March 31, 2006 were ¥67,436 million, ¥10,056 million more than at the end of the previous fiscal year. This mainly reflected a ¥3,907 million increase in cash and cash equivalents due to stock exchange.

Capital Expenditure

Capital expenditure for the Alfresa Group totaled ¥10,746 million. The main components were ¥2,266 million for the construction of a new pharmaceuticals center and ¥4,640 million to acquire drug manufacturing and marketing rights.

Research and Development (R&D)

R&D expenses for the Alfresa Group were ¥1,351 million. Alfresa Pharma Corporation, which is responsible for the Group's Manufacturing business, has filed an application for manufacturing approval of CN-801, a therapeutic agent for narcolepsy, a form of sleep disorder, with the Ministry of Health, Labour and Welfare. The goal is to obtain approval of this application as early as possible. Plans call for conducting Phase II clinical trials of NFκB decoy oligo, a therapy for the treatment of atopic dermatitis for which Alfresa Pharma has concluded a joint development agreement with AnGes MG, Inc.

RISK INFORMATION

(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 the 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 within the Group handles products that have a direct bearing on patients' lives. Accordingly, the Group allocates significant resources to processes ranging from product development to sales to ensure the safety and reliability of its products. However, the business is exposed to the risk of product recalls, the suspension of sales and accompanying lawsuits that may be caused by unforeseen side effects of products, the contamination of product contents, and other risks. Therefore, these risks could have an effect on the Group's results.

(6) Systems Integration

The Group is presently integrating its information systems to raise the efficiency of business activities. Currently, the Group is making preparations to ensure that the integrated system operates smoothly. However, 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 shipment of products. This could have an effect on the Group's results.

(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.

(8) Impairment of Fixed Assets

The Alfresa Group has adopted asset impairment accounting standards. Further impairment of the fixed assets, including the Group-wide asset holdings and business sites with low profitability, may be required due to further declines in actual asset value. This could have an effect on the Group's results and financial condition.

(9) Risks Associated with Leakage of Personal Information

The Group holds and manages personal information obtained from various clients. To prevent the leakage of personal information, the Group has enacted a "Personal Information Management Policy." Guided by this policy, the Group pays close attention to holding and using personal information carefully, while safeguarding this information with care. However, the leakage of personal information due to unforeseen incidents, accidents, etc., could have an effect on the Group's results and financial condition.

FUNDAMENTAL POLICY ON THE DISTRIBUTION OF PROFITS

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%.

REMUNERATION**Remuneration for directors and corporate auditors**

Remuneration for directors	¥159 million
Remuneration for auditors	¥ 31 million
Total	¥191 million

Remuneration for independent auditors

Remuneration related to audit certification	¥16 million
Other fees	¥ 4 million
Total	¥20 million

OUTLOOK FOR THE FISCAL YEAR ENDING MARCH 31, 2007

In the fiscal year ending March 31, 2007, the Alfresa Group expects to continue to face a difficult business environment. The ethical pharmaceuticals market is likely to remain challenging due to ongoing policies to curb national medical expenditures, including an average 6.7% downward revision of NHI drug prices carried out on April 1, 2006.

In this environment, the Alfresa Group will work to expand businesses by capturing Group-wide synergies. With the addition of Meisho Co., Ltd. (Ishikawa Prefecture) to the Group in April 2006, the Wholesaling business has taken a step closer to establishing a nationwide distribution system. In parallel, the Wholesaling business aims to increase sales through effective expansion of sales promotion functions for the Group as a whole. Another goal is to generate an adequate level of earnings by taking the initiative in price negotiations and properly managing progress toward earnings targets.

The Manufacturing business will work to expand its product lineup, centering on generic drugs and POCT reagents (rapid testing reagents) through such means as promoting sales and business alliances with other companies.

Consequently, in the fiscal year ending March 31, 2007, the Company forecasts consolidated net sales of ¥1,533,000 million, up 8.6% from the previous fiscal year, operating income of ¥18,200 million, up 22.6%, and net income of ¥10,000 million, up 41.3%.